

RE: FMO's Position Statement on Impact and ESG for Financial Intermediaries

This document was realized through the cooperation of Both ENDS, Oxfam Novib, Recourse and SOMO and is a response to the public consultation of FMO's Position Statement on Impact and ESG for Financial Intermediaries, submitted on the 10th of June 2022.

Our previous inputs, dated April 2021, have not been addressed in the current version of the position statement. We strongly advise FMO to take on these foundational principles as the starting point of the position statement for it to meet its purpose, namely, the protection of human rights and the environment also for its indirect investments. They are included in the Annex for FMO's reference.

The current position statement does not address ESG risks and impact. Instead, the position statement describes in detail how FMO distances itself from the outcomes of its financial intermediary (FI) investments. The position statement lacks a framework of rules for FMO's clients, and a spirit of what FIs must uphold. It remains vague on what is required from clients, how impact is measured and what FMO's role and responsibility are to ensure its Sustainability policy and other environmental and social (E&S) safeguards are implemented and negative impacts for people and environment are prevented or taken care of. Nearly 40 percent of FMO's portfolio – corresponding to €3.7 billion out of the €9.7 billion of total committed portfolio in 2021 – is channeled through financial intermediaries. This time we chose not to respond with textual suggestions, as we did last time. In Table 1 we have highlighted areas of particular concern of our first submission that FMO has not addressed.

Table 1: Examples of our inputs that have not been addressed in the current PS:

- The PS should explicitly state the supervisory responsibilities that FMO adopts and the specific steps that it takes to ensure that effective ESG risk management systems are in place that comply with FMO's Sustainability Policy and the standards it commits to.
- As AIIB and EBRD do, require clients to flag higher risk sub projects for enhanced supervision and monitoring (Referral list)
- Require approval from bank for A and B+ projects
- Adopt a requirement for all existing FI clients to track and disclose coal and other fossil fuel investments
- Ensure that none of its new investments results in an increase in coal use
- Exclude coal, oil and gas.
- Invest only in FI clients who commit to develop a portfolio decarbonization plan to achieve Paris.
- Require time-bound disclosure of projects information in advance of approval.
- Disclosure of name, sector and location of higher risk sub-projects financed via FIs on FMO website and client website.
- Disclosure of FMO's involvement in sub-projects at the project's sites, ensuring that it is clearly visible and understandable to affected communities.
- FMO should ensure information about the ICM is disclosed at project sites, including how affected communities can contact the mechanism, and supervise client's adherence to this requirement.

Our joint comments, concerns and suggestions for FMO's drafted Position Statement on Financial Intermediaries are:

- (1) What we expect from a position statement (PS) on financial intermediary (FI) lending is the acknowledgement that this form of third-party lending comes with significant risks for human rights and the environment. Despite our recommendations and input over the past 4 years, this is not adequately reflected in the new version of the PS.

- a. This is in contradiction of the EDFI Principles to which FMO adheres, which calls on its members to: *“Recognize that our decisions and activities may be associated with negative environmental, social and human rights impacts for local communities”*.
 - b. From publicly available materials we do not know whether FMO has done a human rights impact assessment of the FI portfolio. In 2018, FMO published its first (and until now only) [Human Rights Report](#). At the time, the FI portfolio was not part of the human rights report. We were told it would take more time and would follow in due course which to date has – to our knowledge – not happened. It is important to understand what the salient E&S issues are in the FI investment chain, and these should be addressed in the PS.
 - c. The PS does not address the findings from FMO’s own [FI evaluation](#), where it has been observed that FI clients have ESG policies in place, but there is a serious lack of capacity among its clients to implement the policies.
- (2) It is unclear from the PS what role FMO will take to make sure investments do not cause human rights violations and environmental harm at the least, and at best take into account the ideas and needs of those that development is meant for. Much of the language on FMO’s role remains unclear. If there are negative impacts, increased engagement cannot be the only answer of FMO. The PS needs to specify what tools FMO has. These tools need to include site visits and dialogues with stakeholders independent of the client, audits, and financial consequences for the client.
- (3) The PS recognizes FMO’s role in using leverage to stop adverse impacts and support with access to remedy. The problem is that FMO often doesn’t know if there is malpractice on the ground, as it relies on its client for reporting without a mandatory timeline for clients’ communication. The information often doesn’t reach FMO. Human rights and environmental risks do not have to be reflected by material impacts. The PS reads *“The destination of on-lending or sub-investment is not known”*. This lack of information has multiple negative consequences. First, if the outcome is unknown, development impact cannot be measured. Second, the implementation of robust ESG and human rights practices cannot be monitored if there is no information where funds end up. Third, there is no basis to measure performance and progress.
- a. The PS should explicitly state the supervisory responsibilities that FMO adopts and the specific steps that it takes to ensure that effective ESG risk management systems are in place that comply with FMO’s Sustainability Policy and the standards it commits to. For example, in the absence of knowledge about the end beneficiaries of general portfolio investments and without clarifying how asset class investments enable increased transparency, *“reporting requirements in contract and fund documentation”* cannot be considered an effective monitoring system that avoids and reduces negative impacts by FI clients and its investees.
 - b. From our own experience, we cannot tell whether FMO has supported project affected people related to FI clients. For example, in 2021 a [complaint](#) was submitted related to one of FMO’s FI clients – FirstRand Bank in South Africa – in support of project affected communities in Liberia. FMO has not shown any intention or interest to use its leverage or position to support these communities. Instead, FMO distanced itself from taking any action on the case complaint by saying that its [newest loan](#) to FirstRand, dated 2020 was via a B-construct, with IFC being the A lender. This is yet a financial intermediary in this case complaint. FMO therefore argued not to have any leverage, meanwhile, FMO’s funds end up with FirstRand, the bank with a high-risk portfolio and with a client that significantly harmed Liberian communities. How does this reconcile with the statement that *“we will strive for a proportionate, risk-based response to the situation”*? Given that it takes time (and funds) for international NGOs and local CSOs to find links, write complaints, and support affected communities to find remedy, FMO should have encouraged FirstRand to engage in the complaint process in good faith at the very least.
 - c. FMO’s PS delegates too much power and responsibility to the FI client, *“The Financial Intermediaries in which we invest are responsible for, and make decisions on how FMO’s funding is used, within the boundaries established by its contract with FMO.”* This statement

downplays FMO's own responsibility and accountability for the outcomes of its FI investing. It is FMO's money - and therefore the public's - that FI clients are using to support sub-projects, and therefore FMO bears a degree of responsibility for the outcomes of how that FI invests. In this statement, FMO describes that it has no responsibility and accountability for where its funds end up. As we have outlined in our previous submissions and discussions with FMO, other DFIs take a more pro-active role (see Annex).

- (4) In the PS, FMO is referring to the UN OHCHR's letter to BankTrack ([here](#)), but only references the letter partially arguing for FIs limited accountability, which is a misinterpretation. *"We consider our responsibilities in alignment with the principle laid out by the UNGP that the mere existence of a business relationship does not automatically mean that there is a direct link between an adverse impact and a bank's financial product or service, and that for UNGP 13(b) to apply the link between the financial product or service provided and the adverse impact need to be direct."*
- a. The full paragraph reads: *"In practice, many of the impacts associated with a bank's financial products and services may fall into the 'direct linkage' category. 'Direct linkage' refers to situations where a bank has not caused or contributed to an adverse human rights impact, but there is nevertheless a direct link between the operations, products or services of the bank and an adverse human rights impact, through the bank's business relationships. A situation of 'direct linkage' may occur where a bank has provided finance to a client and the client, in the context of using this finance, acts in such a way that it causes (or is at risk of causing) an adverse impact. Providing a financial product or service creates a business relationship between the bank and the client for the purposes of the UNGPs. However, the mere existence of such a business relationship does not automatically mean that there is a direct link between an adverse impact and the bank's financial product or service. For UNGP 13(b) to apply, the link needs to be between the financial product or service provided by the bank and the adverse impact itself."*
 - b. On general purpose lending specifically, there was no intention that this kind of lending should be excluded from the scope of application of the UNGPs. As ever, the question is context specific. The point about the "direct" link was just to make clear that in the UNGPs the opposite of a "direct" link is not an "indirect" link which some FIs tried to argue – there is either a link between the FI and the adverse impact or there is no link. Depending on the circumstances, an equity investment and even a general service loan can be reasonably considered to facilitate human rights abuse by the FI client.
- (5) In the PS it reads that investing in medium enterprises is low risk – which is not the case, especially not if these companies operate in forestry or agriculture – where risks for human rights are well-known and documented. For example, related to land conflicts and water pollution. We see issues related to land conflicts and biodiversity loss happening in FMO's own FI portfolio – with its investment in the Arbaro Fund for example where local CSOs have reported [land conflicts](#). We have informed FMO about this.
- (6) In December 2021, we published a [database](#) with FMO's exposure to high-risk sub-projects through its FI clients. The information is publicly available. In 2020, IFC has committed to disclose this kind of information. FMO has not and indicated that it will not do so in the foreseeable future. The PS does not include what would be a minimum requirement of transparency obligations for FI clients, it describes that FMO's approach to specific assets "enable increased transparency" but without substantiation.
- a. Without transparency it is not possible to "look-through" the FI's investment portfolio and understand its contribution to each of the three core SDGs, neither the impact on potential project affected people or the environment. FMO argues that its clients should disclose information and does not see a role for its own organization to do so, which does not align with its [disclosure policy](#) which reads "FMO believes that transparency on our financing and investments are fundamental to fulfilling our development mandate".

- b. Without transparency about which sub projects are supported by FMO via its FI clients, FMO effectively is denying Complainants their right to be heard and access to information. For civil society to hold FMO accountable and to ensure affected communities know who is financing the project affecting them and therefore have the ability to complain to the Independent Complaints Mechanism (ICM), it is vital that FMO improves transparency around its FI lending to both debt and equity clients.
 - c. FMO's position on transparency in FI lending is lagging behind other DFIs. For example, the IFC has disclosed all private equity client investments since 2013, and now also discloses all Category A (high risk) and higher risk Category B sub-projects funded via FIs. The China-led Asian Infrastructure Investment Bank has recently undertaken fundamental reforms to its standards relating to FI investments, including improving disclosure for both equity and debt clients.
- (7) SDG 13 on Climate Action: It is clear that the current FI portfolio cannot be assessed in terms of its contribution to SDG13. To address this, enhanced transparency – including the name, sector and location of high-risk sub-projects – is required. Moreover, there is no role for FMO and development finance to further finance fossil fuels. They should lead on the transition to a clean energy future including in indirect investments. It is therefore of critical importance that this FI position statement is clear and addresses issues related to comprehensive climate requirements for FI investees, in line with FMO's commitment to align with the Paris Climate Agreement and without delegating such key aspects to a new policy to be developed sometime in the future. Clarifications on climate requirements for FI clients who represent nearly half of its portfolio cannot indeed wait any longer if FMO is serious about advancing its climate agenda. Moreover, these would enable FMO to measure more accurately its contribution to SDG13, since mitigation efforts would be more effectively assured.
- a. *“EDFIs will exclude new coal and fuel oil financing and will limit other fossil fuel financing to Paris-aligned projects until generally excluding them by 2030 at the latest.”* EDFI explicitly includes FIs: *“EDFIs will exclude new fossil fuel financing, directly or indirectly through new commitments to investment funds and dedicated lending via financial institutions.”*¹
 - b. FMO's fossil fuel statement is limited to direct investments, leaving out 40 percent of its portfolio. The current draft statement does not adequately exclude indirect fossil fuels investments. We therefore question how FMO can be truly championing SDG13 while supporting banks with high portfolio's shares in gas & oil and admitting that it doesn't know where its funds end up.
 - c. FMO should know and report its exposure to fossil fuels also through indirect investments and take this into account in realizing its climate goals. The PS does not mention any exclusion of fossil fuels or exposure to fossil fuels. The PS only mentions to restrict exposure to coal, which is not enough. The whole coal industry needs to be excluded (along with other fossil fuel sectors).
- (8) We do not see how FMO measures its impacts of FI investing in reducing inequalities. With regards to investments in big funds, resulting in large agriculture or forestry projects (for example &Green fund or Arbaro), or big banks with a large market share, it is not known how these result in reducing inequalities or potentially contributing to inequalities.
- (9) What the PS states FI clients are contractually required to do is concerningly below minimum standards. First of all, FMO cannot adhere to a vision for which new projects, including FIs, are *de facto* in breach of its Sustainability Policy and E&S standards. At the very minimum, it should disclose timebound ESAP to bring such projects into compliance with FMO's safeguards. In addition, FMO's Sustainability Policy states that *“For investments in financial institutions (FI), FMO requires FI-A and FI-B clients to apply the IFC Performance Standards framework to IFC PS-triggered*

¹ EDFI Statement on Climate and Energy Finance, adopted 5 November 2020

transactions". Therefore, the FIs PS must improve clarity on the fact that compliance with FMO's Sustainability Policy and the IFC PS is contractually mandatory for all high-risk FIs clients.

Furthermore, FMO should contractually require FIs:

- a. to include compliance with FMO E&S safeguards, international law and national law in contracts with sub-clients
- b. for FMO's approval of high-risk sub-projects as well as supervision of these through, for example, site visits
- c. to include in its own monitoring reports to FMO adequate information about stakeholder consultation conducted by sub-clients
- d. to refer E&S incidents by sub-clients, including human rights abuses, within a strict timeframe
- e. to establish effective grievance mechanisms in accordance with UNGP 31
- f. to disclose information at the project site about FMO involvement in sub-projects
- g. to disclose information at the project site about the existence of both the FIs' grievance mechanism and FMO's ICM, ensuring that such information is clearly visible and understandable to affected communities

Annex: Input previous FI PS consultation, April 2021

Why developing clear and mandatory requirements for FI investing matters

In 2020, 40 percent of FMO's total portfolio (\$3.7 billion out of \$9.3 billion) was invested in financial institutions². About 87% of FMOs FI portfolio is debt financing, with the rest in equity investments. There are currently 341 investments in FMO's FI portfolio.³

While investing in FIs can help to mobilise funds and attract private capital for economic development, this form of third-party or 'hands-off' lending also comes with significant risks - in particular around clients' adherence to environmental and social (E&S) safeguards. In recent years, the International Finance Corporation (IFC) - over 50 per cent of whose investment portfolio is to FIs - has been forced to acknowledge these risks and has taken some steps to address them. Following critical findings from both the IFC's Compliance Advisor Ombudsman (CAO)⁴ and from civil society groups⁵, IFC has reduced high-risk lending through FIs, no longer provides general-purpose loans, and has developed a 'Green Equity Approach' to help to transform not only its own lending but that of its FI equity clients, phasing out coal to zero by 2030.

It is therefore disappointing that FMO does not recognise this increased risk profile in the FI Position Statement, and instead highlights only the advantages of FI investing. This is in contradiction of the EDFI Principles to which FMO adheres, which calls on its members to: "Recognize that our decisions and activities may be associated with negative environmental, social and human rights impacts for local communities"⁶

Furthermore, FMO's own internal evaluation of its FI investments in 2020 found a worrying lack of capacity among FMO's FI clients to establish and implement adequate E&S standards.⁷ The evaluation found, "Some 60% of FI-A and B+ clients have red or amber scores on proper E&S due diligence, establishing external E&S agreements and E&S monitoring and follow-up."

The evaluation further noted that even when E&S systems are set up, clients struggle to implement them. "FMO's E&S experts confirm that the current challenges are with actual implementation, not so much with developing proper systems and E&S templates anymore (which was the case five years ago)."

Given these A and B+ clients are those judged the highest risk, it should be of overwhelming concern to FMO and the Dutch government that the majority do not to establish or implement sufficient E&S protections in the projects they finance⁸.

Therefore, in recognition of this increased risk in FI investing and in common with other development banks, we would expect to see the FMO Position Statement address the following crucial issues:

- Improving monitoring and supervision of high risk clients and sub projects
- Improving development outcomes, including climate action
- Transparency

² Annual Report FMO, 2020

³ <https://www.fmo.nl/worldmap?search=®ion=&year=&projects=allProjects§or%5B%5D=4>

⁴ <http://www.cao-ombudsman.org/newsroom/documents/FIAUDIT.htm>

⁵ <https://www.oxfam.org/en/research/suffering-others>; <https://www.inclusivedevelopment.net/policy-advocacy/financial-intermediary-lending/>

⁶ https://www.edfi.eu/wp/wp-content/uploads/2017/09/EDFI-Responsible-Financing-SDG_Principles_final_190515-1.pdf

⁷ https://reporting.fmo.nl/FbContent.ashx/pub_1000/downloads/v201103155523/200701%20Final%20report%20FI%20Evaluation_ext.pdf

⁸ Problematic examples of FMO FI investing; [Santa Rita](https://rightsinddevelopment.org/wp-content/uploads/2019/05/CASE-3-Santa-Rita-ENG-2.pdf) (<https://rightsinddevelopment.org/wp-content/uploads/2019/05/CASE-3-Santa-Rita-ENG-2.pdf>), [Barillas](https://www.re-course.org/wp-content/uploads/2020/07/Letter-to-Philippe-Le-Houerou-Barillas-8-July-2020.pdf) (<https://www.re-course.org/wp-content/uploads/2020/07/Letter-to-Philippe-Le-Houerou-Barillas-8-July-2020.pdf>), [Ficohsa](https://www.ficohsa.org/).

- Access to remedy

It is deeply disappointing that the Position Statement makes little or no attempt to address these fundamental concerns. If such detail were provided in the FMO's Sustainability Policy (SP) this could be a reason for not spelling out requirements in the Position Statement, but in the absence of clarity on these vital issues in the SP, we would expect FMO to develop a mandatory FI policy, to help investment officers, clients and civil society better understand FMO's E&S commitments and responsibilities.

1. Improving monitoring and supervision of high risk clients and sub projects

Current FMO position: "Although the operations of a Bank or any other Financial Institution itself are unlikely to cause major E&S impacts, the customers they finance might be exposed to E&S risks." "The Financial Intermediaries that we invest in make decisions on how FMO's funding is used, within the boundaries established by their contract with FMO"

The internal review of FMO's FI portfolio in 2020 clearly identified that high risk clients (A and B+) were struggling both to establish and to implement E&S standards. However, instead of this being a priority to address in the Position Statement, FMO continues to delegate all responsibility to its FI clients. This is out of step with current practice as numerous peer institutions and threatens to undermine FMO's success at delivering development impact. For example, unlike other institutions, FMO does not commit to third party audits, to site visits, or to enhanced monitoring and supervision for defined high risk projects using 'referral lists' or other mechanisms used by other banks. Instead, FMO relies on its client for information about compliance with E&S requirements – which leaves the door wide open to mistakes.⁹ A key part of FMO's additionality lies in supporting FI clients to develop and implement effective ESG systems. This Position Statement should explicitly state the supervisory responsibilities that FMO adopts and the specific steps that it takes to ensure that effective ESG systems are in place that comply with FMO's Sustainability Policy and the standards it commits to.

Best practice at peer institutions:

Given the documented problems with FI mis-categorisation of projects (the incentive is to categorise the projects at a lower risk level to avoid costly due diligence), other peer institutions have developed measures to spot, identify and provide extra capacity and attention to higher risk sub projects funded via FIs.

The European Bank for Reconstruction and Development (EBRD) has developed a 'referral list'¹⁰ for higher risk projects, to ensure it both assesses risk categorisation and monitors E&S standards implementation itself in

⁹ FMO's position statement says "FMO monitors these investments through the reporting it receives, regular on- and offsite dialogue with Fund Managers, as well as active participation in the Advisory Committee meetings. Furthermore, FMO exercises its influence by defining ESG requirements in the Limited Partnership Agreement; reviewing the due diligence reports, typically for the first few investments, participating in ESG Advisory Panels⁷ and Limited Partner Advisory Committees (LPAC) and giving feedback and advice based on ESG monitoring reports." Seeking external input and sources for E&S information, including from affected communities themselves, is vital for adequate due diligence, monitoring and supervision of E&S risk.

¹⁰ The EBRD referral list is as follows: **PR9 Annex 2 The FI Referral List**

The financing by FIs of the following environmentally or socially sensitive business activities financed with EBRD funds is subject to referral to EBRD: *The principal Performance Requirement that proposed transactions will be expected to meet is indicated in italics.*

(i) Activities involving involuntary resettlement- *EBRD Performance Requirement 5*

(ii) Activities that occur within or have the potential to adversely affect an area that is protected through legal or other effective means, and/or is internationally recognised, or proposed for such status by national governments, sites of scientific interest, habitats of rare/endangered species, fisheries of economic importance, and primary/old growth forests of ecological significance- *EBRD Performance Requirement 6*

(iii) Activities within, adjacent to, or upstream of land occupied by indigenous peoples and/or vulnerable groups including lands and watercourses used for subsistence activities such as livestock grazing, hunting, or fishing- *EBRD Performance Requirement 7*

higher risk sub-projects. The China-led Asian Infrastructure Investment Bank has revised its Environmental and Social Framework¹¹ to include increased AIIB staff responsibility for monitoring and supervision of ‘Higher Risk Activities’ funded via FIs. There is also a new requirement for AIIB to have prior approval of high risk sub projects “**Prior Approval of Higher Risk Activities**. The Bank requires the FI to furnish to the Bank for the Bank’s prior approval the FI’s detailed environmental and social due diligence assessment and instruments for all Higher Risk Activities.” These include “(a) all Category A activities; and (b) selected Category B activities, as determined by the Bank, that may potentially result in: (i) Land Acquisition or Involuntary Resettlement, (ii) risk of adverse impacts on Indigenous Peoples and/or vulnerable groups, (iii) significant risks to or impacts on the environment, community health and safety, biodiversity, and cultural resources, (iv) significant retrenchment of more than 20% of direct employees and recurrent contractors, and/or (iv) significant occupational health and safety risks.”

Proposal for reforms:

- ⇒ Adopt a ‘referral list’ approach, where higher risk sub-projects are automatically flagged and given higher attention, including by FMO staff. This should include sub projects which among other, have human rights implications, affect indigenous or vulnerable communities, involve displacement of affected communities, support fossil fuels, or impact protected areas. Higher attention can include FMO being required to carry out site visits, to engage with affected communities and third party audits.
- ⇒ EBRD language **requires direct engagement in E&S management for high risk projects**, rather than delegating that responsibility to the FI client as FMO currently does. “EBRD will assist FIs with the appraisal of these [referral list] subprojects. EBRD environmental/social specialists will review the due diligence information collected by the FI, determine any additional information needed, assist with determining appropriate mitigation measures and, if necessary, specify conditions under which the subprojects may proceed.” Given the findings of the internal evaluation, FMO should adopt a similar approach.

2. Improving development outcomes, including for climate action

Current FMO position: “The end beneficiaries of our investments in Financial Intermediaries are debt clients and equity investees ranging from micro enterprises to larger businesses. We generally do not have **direct** influence on the customers of the Banks in which we invest, nor on the investee companies in a PE Fund’s portfolio.”

FMO’s July 2020 internal evaluation, *FMO FI investing from 2014-19 – ESG effectiveness and development impact*, recommended: “Sharpening project objectives towards results-based indicators and evaluating the success of projects.”

(iv) Activities which may affect adversely sites of cultural or archaeological significance-*EBRD Performance Requirement 8*

(v) Activities in the nuclear fuel production cycle (uranium mining, production, enrichment, storage or transport of nuclear fuels)¹⁰¹

(vi) Energy generation using nuclear fuels (excluding electricity import/export)¹⁰²

(vii) Activities involving the release of GMOs into the natural environment – *EBRD Performance Requirement 6*

(viii) Any micro, small or medium-sized HPPs that do not trigger Category A requirements – *EBRD Eligibility Criteria for Small Hydropower Plant Projects*

(ix) Any Category A projects included as Appendix 2 to the EBRD Environmental and Social Policy

¹¹ https://www.aiib.org/en/policies-strategies/_download/environment-framework/AIIB-Review-Draft-Environmental-and-Social-Framework_Sept-7-2020.pdf

Assessing the development impact of FMO's FI investing is a focus of the internal evaluation, given its importance to reviewing whether FMO is contributing to the three SDGs prioritised by FMO: "Development impact is a societal concept and each of these core SDGs [SDG8: Decent work, SDG10: reduce inequality and SDG13: climate action] show that it is important to understand **what impact FMO support with its investments, beyond the development of the local private sector, on local populations and the environment.** In the case of the FI sector, it is therefore important to "look-through" the FI's investment portfolio and understand its contribution to each of the three core SDGs."

To this end, for example, the evaluation notes that, in terms of a contribution towards meeting SDG8, "FMO measures and reports direct jobs supported with its investments, and estimates the number of jobs indirectly supported by means of economy-wide knock-on effects. For the FI sector this implies collecting data on the number of jobs at the FI level and estimating the level of the indirect employment created at sub-client level."

"Indeed, the FMO FI sector supported a significant number of jobs through its clients across the evaluation years, ranging between 211,000 and 353,000 per year that can be attributed to FMO."

It is clear from the above that FMO is measuring and claiming credit for the *positive* development impacts of the sub projects supported by its FI clients, being able to count the number of jobs created. This is at odds with the claim in the Position Statement that FMO's end beneficiary is the FI client – here FMO is claiming responsibility for beneficiaries of its FI clients' investments.

If FMO can claim the positive development impacts of its FI portfolio, citing the development outcomes at the sub project level, it stands to reason that it is also responsible for any *negative* impacts at the sub project level- and that these should be assessed and counted. In this context, FMO's assertion in the Position Statement that its end beneficiaries are FMO's FI clients makes no sense and should be removed.

Climate is a priority for FMO: one of the three 'headline' Sustainable Development Goals (SDGs) FMO focuses on in its work is SGD13 on Climate Action. In practice, "this means pursuing a portfolio that delivers positive outcomes on climate mitigation and adaptation;" and includes striving "to align our portfolio with a 1.5°C pathway."¹² It is therefore surprising and deeply disappointing to find that FMO's Fossil Fuel Position Statement does not apply to its entire portfolio, but only to FMO's direct investments.¹³

This makes it all the more important that the development impact of FMO's FI portfolio in terms of climate outcomes is covered in the FI Position Statement. The EDFI Principles, to which FMO is a signatory, says: "EDFIs will exclude new coal and fuel oil financing, and will limit other fossil fuel financing to Paris-aligned projects until generally excluding them by 2030 at the latest." EDFI explicitly includes FIs: "EDFIs will exclude new fossil fuel financing, directly or indirectly through new commitments to investment funds and dedicated lending via financial institutions."

A first step is to ensure that FMO is transparent about which of its FI investments are exposed to fossil fuel projects. This is particularly important given the findings of the recent internal review of the FMO's FI business, which assessed its contribution to SDG13 on climate action as follows:

¹² <https://www.fmo.nl/news-detail/04e58852-2d73-44a9-8b93-79b6d33262ee/fmo-opens-consultation-on-next-step-in-climate-action-commitment>

¹³ https://www.fmo.nl/l/en/library/download/urn:uuid:a33fb062-2f52-44e0-9e1e-c0992fe6cd45/201006+final+draft+fossil+fuel+position+statement_for+consultation.pdf

“SDG13 (Climate Action): FMO also increased its contribution to SDG13 through its financial institutions investments in the past five years, although the growth of its green portfolio slowed down in 2019 (due to increased competition). By design, FMO’s green investments create a positive impact on SDG13. However, *the precise contribution could not be established at portfolio level.*” [emphasis added]

It is clear from the review that the current FI portfolio cannot be assessed in terms of its contribution to SDG13. To address this, enhanced transparency – including the name, sector and location of high-risk projects – is required. Additionally, if the FI Position Statement clarified climate requirements, FMO would be able to measure more accurately its contribution to SDG13, since mitigation efforts would be more effectively assured.

FMO’s peers are already implementing progressive policies with regard to fossil fuel exposure, which FMO would do well to emulate. *See Annex 1: Best practice at peer institutions: Climate action*

Proposal for reforms: FMO has the opportunity to join the leaders in ensuring the transformation necessary to avert catastrophic climate change. To do so, FMO should:

- ⇒ Adopt a requirement for all existing FI clients to **track and disclose coal and other fossil fuel investments**;
- ⇒ Ensure that none of its new investments results in an **increase in coal use**: whether for power generation or industrial uses, or for associated facilities such as transmission lines and railways or ports primarily meant for the transportation of coal;
- ⇒ **Exclude coal, oil and gas** from private equity fund investments including debt investments;
- ⇒ Invest only in FI clients who commit to develop a **portfolio decarbonisation plan** to achieve emissions reductions in line with targets set under the Paris Climate Agreement.

3. Transparency

Current FMO position: FMO does not disclose any information about where money ends up when it is invested through FIs. FMO does disclose basic information about its FI clients, but not on the sub projects supported via its investment in those clients.

International financial institutions recognise the importance of transparency not only in improving accountability to shareholders and citizens, but in helping to avoid and manage risk. *See Annex 2: Best practice at peer institutions: Transparency*

According to FMO, “FMO believes that transparency on our financing and investments are fundamental to fulfilling our development mandate.”[...] “It will disclose information about its investments and financing.”¹⁴ Transparency has been a particular challenge in financial intermediary lending, given the longer chain from investor to project; conversely, transparency is all the more important in this type of lending given its higher risk profile. When risks are spotted early on, they are more easily avoided or mitigated, leading to better project outcomes and lower reputational risk.

¹⁴ https://www.fmo.nl//library/download/urn:uuid:f75e4ebb-f48f-41a4-a779-c0c7f63a3a17/disclosure.pdf?format=save_to_disk&ext=.pdf

Proposal for reforms: FMO should commit to principles of disclosure and transparency and enshrine best practice, as at other peer institutions, including:

- ⇒ Requiring **time-bound disclosure** of project information in advance of approval, in line with best practice;
- ⇒ Disclosure of the **name, sector and location of higher risk sub-projects** financed via FIs on FMO’s website and on the FI client’s website;
- ⇒ Disclosure of FMO’s involvement in sub-projects at the **project sites**, ensuring that it is clearly visible and understandable to affected communities.

4. Access to remedy

Current FMO position: The FMO’s FI Position Statement sets out its requirement from its FI client as follows: an external communications mechanism which it describes as, “A procedure for external communications that includes methods to receive, register, screen and assess, track, respond to, and act upon external inquiries and complaints from the public regarding the Financial Intermediary’s (and its clients’/investees’) operations.” An external communications mechanism is not the same as a grievance redress mechanism and does not substitute for accurate communication about communities’ right to access redress.

FMO describes the purpose of its Independent Complaints Mechanism as follows: “The Mechanism ensures the right to be heard for Complainants who feel affected by an FMO-Financed Operation in order to enable resolution of disputes and assist FMO in drawing lessons learned for current and future operations. FMO strives to implement a robust and independent procedure and to communicate transparently about it to stakeholders.”¹⁵ However, without transparency about which sub projects are supported by FMO via its FI clients, FMO effectively is denying Complainants their right to be heard. In order for civil society to hold FMO accountable and to ensure any affected communities know who is financing the project affecting them and therefore have the ability to complain to the Independent Complaints Mechanism (ICM), it is vital that FMO improves transparency around its FI lending to both debt and equity clients.

The 2020 External Review of IFC/MIGA Accountability¹⁶ recommended enhanced disclosure to promote accountability. The review recommended that IFC/MIGA should ensure its client “provide information to affected communities both about the client’s grievance mechanism and about the CAO [Compliance Advisor/Ombudsman IFC’s accountability mechanism]” *including for “FI sub-projects.”* We strongly agree with the review’s recommendation 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 the CAO.”

Proposal for reforms:

- ⇒ FMO should disclose its involvement in sub-projects at the **project sites**, ensuring that it is clearly visible and understandable to affected communities.
- ⇒ Additionally, FMO should ensure **information about the ICM** is disclosed at project sites, including how affected communities can contact the mechanism; and supervise clients’ adherence to this requirement.

¹⁵ <https://www.fmo.nl/independent-complaints-mechanism>

¹⁶ <https://www.worldbank.org/en/about/leadership/brief/external-review-of-ifc-miga-es-accountability>

Annex 1: Best practice at peer institutions: Climate action

The International Finance Corporation

The IFC has instituted a number of significant reforms aimed at reducing its fossil fuel exposure, including in its FI business.

In its [Interpretation Note](#) for FIs from November 2018, the IFC states: “The Exclusion List can be extended by adding more excluded activities, as part of the E&S risk management efforts. For instance, in case of any targeted products IFC will **exclude coal related sub-projects including coal mining, coal transportation or coal-fired power plants**, as well as infrastructure services exclusively dedicated to support any of these activities. In case of projects involving collective investment vehicles such as PE Funds, the coal related investments will be either excluded up front or when this is not feasible IFC will opt out from such investments.”

The IFC also committed in the Interpretation Note to improve disclosure around coal exposure, including by requiring FI clients to report annually to the IFC: “For an FI, E&S performance reports to IFC should typically include: ... Where relevant, the FI clients’ exposures to high risk activities (e.g. coal related activities, palm oil, etc.)”

The IFC also commits to make this information on coal exposure public: “We will require new equity financial intermediary clients exposed to coal projects to publicly disclose their total exposure in this sector.”¹⁷

IFC’s September 2020 **Green Equity Strategy**¹⁸ includes:

- an aim to reduce coal exposure to zero;
- not to invest in FI clients that do not have a plan to phase out investments in coal;
- a new strategy for equity clients that includes specific targets on phasing out coal in clients’ entire portfolios – by 50% by 2025 and to zero by 2030.

Annex 2: Best practice at peer institutions: Transparency

The Green Climate Fund

The Green Climate Fund (GCF) is a highly relevant institution for the purposes of comparison with the FMO’s FI lending, since 100 per cent of its lending is carried out through intermediaries (or as the GCF calls them ‘Accredited Entities’). The GCF has adopted a high degree of disclosure in line with international best practice, including time-bound disclosure of crucial project information – such as environmental and social impact assessments – ahead of approval. The degree and timing of disclosure is calibrated according to the risk profile of the investment: with more and better disclosure for the highest risk (Category A). The following excerpts from its 2016 Information Disclosure Policy describe the degree of disclosure:

“Environmental and social reports. With respect to project and programme funding proposals that have an environmental or social impact, the Accredited Entities (AE’s) shall disclose and announce to the public and, via the Secretariat, to the Board and Active Observers:

(a) in case of Category A projects, the Environmental and Social Impacts Assessment (ESIA) and an Environmental and Social Management Plan (ESMP) at least 120 days in advance of the AE’s or GCF’s Board decision, whichever is earlier;

¹⁷ Le Houérou, P (2018) [A new IFC vision for greening banks in emerging markets](#), in *Devex* 8 October 2018.

¹⁸ <https://www.ifc.org/wps/wcm/connect/05541643-0001-467d-883c-5d7a127ffd57/IFC+Greening+Report+Sept+2020.pdf?MOD=AJPERES&CVID=niscDfR&ContentCache=NONE&CACHE=NONE>

“(b) in the case of Category I-1 programmes, the Environmental and Social Management System (ESMS)² at least 120 days in advance of the AE’s or GCF’s Board decision, whichever is earlier;

“(c) in the case of Category B projects, the ESIA³ and an Environmental and Social Management Plan (ESMP)⁴ at least 30 days in advance of the AE’s or GCF’s Board decision, whichever is earlier; and

“(d) in the case of Category I-2 programmes, the ESMS at least 30 days in advance of the AE’s or GCF’s Board decision, whichever is earlier.”

The GCF expects its conditions to be met when working with other multilaterals, raising the possibility of FMO being obliged to improve disclosure if it works with the GCF. For example, in the case of the GCF’s involvement with the EBRD’s Green Cities Project, the GCF’s Board stipulated additional conditions:

“In relation to each Category A public sector sub-project to be funded under the Facility, the Accredited Entity shall disclose the Project Summary Document, Environmental and Social Impacts Assessment (ESIA) and Environmental and Social Action Plan (ESAP), and, as appropriate, inclusive of the Resettlement Policy Framework (RPF) and/or Land Acquisition and/or Resettlement Action Plan (LARAP or RAP), and any other associated information required to be disclosed in accordance with the Accredited Entity’s Public Information Policy (“Project Disclosure Package”). The Accredited Entity, 120 calendar days in advance of its Board meeting, shall disclose, in English and the local language (if not English), the Project Disclosure Package on its website and shall require that the Borrower does so in locations convenient to affected peoples, and provide the Project Disclosure Package to the GCF Secretariat for further distribution to the Board and Active Observers and for posting on the GCF website.”¹⁹

The World Bank

The World Bank invests in FIs and requires and practices a high degree of disclosure, including of sub-projects supported through commercial banks. Under the disclosure clause of the World Bank’s 2013 Operational Procedure BP 4.03, the World Bank requires its FI clients to disclose as well as permit, in writing, the World Bank to disclose the summary of the Environmental and Social Impact Assessment (ESIA) of any sub-project considered high risk (Category FI-1 and FI-2). In practice, however, the World Bank seems to go beyond summaries by disclosing full reports of impact assessments, mitigation, and resettlement plans.²⁰

Examples include the World Bank’s investments in Turkish banks, TKB and TSKB, for which the World Bank disclosed 208 documents relating to the investments and their sub projects.

The International Finance Corporation

The International Finance Corporation (IFC) discloses different information depending on the type of FI client. It has made several significant reforms over the past five years, largely in response to civil society pressure and a number of highly damaging cases.²¹

For **private equity fund clients**: in its 2012 Performance Standards, IFC committed to “periodically disclose a listing of the names, locations and sectors of high-risk sub-projects that have been supported by IFC

¹⁹ Green Climate Fund GCF/B.21/34 p 71 Annex XV List of conditions and recommendations.

²⁰ Oxfam (2018) Open Books See <https://oxfamlibrary.openrepository.com/bitstream/handle/10546/620559/bp-financial-institutions-disclosure-161018-en.pdf>

²¹ See for example: AgriVie case in Uganda (http://www.cao-ombudsman.org/cases/case_detail.aspx?id=180); GMR Kamalanga case in India (http://www.cao-ombudsman.org/cases/case_detail.aspx?id=165); RCBC bank in the Philippines (http://www.cao-ombudsman.org/cases/case_detail.aspx?id=1266); Ficohsa Honduras (http://www.cao-ombudsman.org/cases/case_detail.aspx?id=209) and Dragon Capital Cambodia (http://www.cao-ombudsman.org/cases/case_detail.aspx?id=212).

investments through private equity funds, subject to regulatory constraints and market sensitivities.” This was updated in 2015 when in response to pressure from civil society, IFC started to disclose all sub projects supported via its private equity fund clients, stating: “with input from CSOs and other stakeholders, we have improved transparency by now disclosing all private equity fund sub-projects.”²² In 2017, the IFC applied this new rule retrospectively to all PE fund clients since 2012: “We publish the name, sector and location of every investment of our funds’ portfolio companies. In 2017, IFC fulfilled 100 percent of this requirement for the 63 fund investments initiated since 2012, and published information on more than 387 funds’ portfolio companies.”²³

In a letter from Bank President David Malpass in March 2020, the IFC committed to **further disclosure of its financial intermediary portfolio**.²⁴ High-risk and selected medium-risk IFC financial intermediary clients must now annually ‘report the name, sector. Location by city, and sector for sub projects funded by the proceeds from IFC’s [investments].’

The European Bank for Reconstruction and Development (EBRD)

In 2019, the EBRD took steps to improve disclosure in FI lending.²⁵ PR 9 of the Bank’s Environmental and Social Policy states that:

“PR 9.16: The FI will put in place a system for dealing with external communication on environmental and social matters. The FI will respond to such enquiries and concerns in a timely manner. FIs are also encouraged to publish their corporate environmental and social policy or a summary of their ESMS on their website, if available. FIs will list on their website the link to any publicly available environmental and social impact assessment (ESIA) reports for Category A sub-projects which they finance. FIs will also publicly disclose information on the environmental and social risks of any sub-project referred to EBRD in accordance with paragraph 15 of this PR and the proposed mitigation measures to address such risks, subject to applicable regulatory constraints, market sensitivities or consent of the sponsor of the sub-project.”

Also, in the EBRD’s Access to Information Directive, it requires further environmental and social information about FI subprojects to be made publicly available:

“1.4.7. For Category A Projects and Category B Projects associated with significant environmental and social risks and impacts, the environmental and social sections of the PSD (Project Summary Document) will be reviewed annually and updated as appropriate. For financial intermediary (Category FI) Projects, the environmental and social sections of the PSD will be reviewed and updated as appropriate, including by way of hyperlinks to the information disclosed by financial intermediary on its website on sub-projects referred to the EBRD in accordance with the ESP.”

²² IFC (2015) IFC’s Work with Financial Intermediaries; see:

https://www.ifc.org/wps/wcm/connect/1c3013804a260251bf70bfe54d141794/IFC_FI_FactSheet_April2015.pdf?MOD=AJPERES

²³ IFC (2017) Sustainable Practices for Private Equity Funds Business see: <https://ifc-org.medium.com/sustainable-practices-for-private-equity-funds-business-5d841850f7c5>

²⁴ Letter from the World Bank President to the US Treasury, 20 March 2020.

²⁵ European Bank for Reconstruction and Development, Environmental and Social Policy 2019.

