



APPRAISAL REPORT

CAO Appraisal for Audit of IFC

CAO Compliance

CAO Ref Code: C-I-R5-Y12-F165

October 02, 2012

IFC Investments in Mindoro Resources Limited

Philippines

Case of

Complaint from members of indigenous communities of Barangay San Pablo and Barangay Bunga, Agusan del Norte

Summary

This appraisal relates to an IFC equity investment in Mindoro Resources Limited (MRL or the company), a mining exploration company that holds a number of permits for mineral exploration and extraction in the Philippines.

The allegations that triggered CAO involvement in this project relate to MRL's principal nickel laterite resource in the Province of Agusan del Norte on Mindanao Island, and more specifically areas covered by its Tapan Extension Exploration Permit near the settlements of Dinarawan and Bunga.

As set out in their letters of complaint and the CAO Ombudsman Assessment Report, the issues raised by the Complainants (representatives of the Mamanwa tribes of Dinarawan and Bunga) can be summarized as follows:

- (a) concerns that IFC failed to acknowledge the complainants as indigenous people affected by the project;
- (b) concerns regarding the extent and quality of consultations with the indigenous communities of Bunga and Dinarawan prior to the conduct of exploration activities in areas to which they assert rights (the contested area);

- (c) allegations that exploration activities were conducted in the contested area without prior consent from the indigenous communities;
- (d) allegations that MRL exercised and are exercising undue influence on the Free Prior Informed Consent process as administered by the National Commission on Indigenous Peoples causing division within the communities;
- (e) concerns regarding the potential social environmental impacts of future mining activities in the contested area.

Having considered the complaint and conducted a review of documentation related to the investment, CAO finds indications of shortcomings with regard to IFC's Environmental and Social performance. In particular CAO has questions as to: (a) whether IFC ensured that the project's area of influence was appropriately defined at the time it conducted its Environmental and Social (E&S) review in 2010; (b) whether the project was assigned the appropriate IFC E&S risk category; and (c) whether the project was adequately supervised. More generally CAO finds that this case raises issues regarding the effectiveness of IFC's policies, procedures and standards in managing the necessarily undefined downstream risks of early stage investment in mining ventures. Further, having reviewed IFC's handling of the issues raised by the complainants, CAO questions whether IFC policies and procedures provide sufficient guidance to staff on how to respond to complaints from project affected communities in a balanced manner.

These concerns notwithstanding, CAO finds that the immediate impact of MRL's operations on the complainants was mitigated by MRL's decision to suspend exploration in the contested area. CAO also finds it positive that IFC negotiated covenants in its 2012 Subscription Agreement with MRL that, so long as IFC holds shares in the company, would require MRL to seek a waiver from IFC before recommencing operations in the contested area.

In these circumstances CAO finds limited value in conducting a compliance audit at present. Acknowledging the potential E&S risks that attach to extractive industries projects in indigenous communities, however, CAO reserves the right, in line with its Operational Guidelines, to reconsider this decision should development of MRL's nickel operations progress in a manner that raises significant concerns regarding impacts on communities or the environment.

Contents

1. Overview of the CAO Compliance Appraisal process
2. Background
3. Summary of the Issues
4. Discussion
5. CAO Decision

About CAO

The CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

The CAO (Office of the Compliance Advisor Ombudsman) is an independent post that reports directly to the president of the World Bank Group. The CAO reviews complaints from communities affected by development projects undertaken by the two private sector lending arms of the World Bank Group: the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

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

1. Overview of the CAO Compliance Appraisal process

When CAO receives a complaint about an IFC or MIGA project, the complaint is first referred to CAO's dispute resolution arm, CAO Ombudsman, which works to respond quickly and effectively to complaints through facilitated settlements, if appropriate. If CAO Ombudsman concludes that the parties are not willing or able to reach a facilitated solution, the case will be transferred to the compliance arm of CAO, CAO Compliance for appraisal and potential audit.

In the context of a CAO compliance audit, the issue is whether:

- The actual social or environmental outcomes of a project are consistent with or contrary to the desired effect of the IFC/MIGA social and environmental policy provisions; or
- A failure by IFC/MIGA to address social or environmental issues as part of the appraisal or supervision resulted in outcomes that are contrary to the desired effect of the policy provisions.

A compliance audit is concerned with assessing the application of relevant policy provisions and related guidelines and procedures to determine whether IFC and MIGA are in compliance. The primary focus of compliance auditing is on IFC and MIGA, but the role of the sponsor may also be considered.

In order to decide whether an audit is warranted, CAO Compliance first conducts a compliance appraisal.

To guide the appraisal process, the CAO applies several criteria. These are framed as a series of questions to test the value of undertaking a compliance audit.

- Is there evidence of significant adverse social and environmental outcome(s) as a result of the project now or in the future?
- Are there indications that a policy or other audit criteria has not been adhered to or properly applied?
- Is there evidence that indicates that IFC/MIGA's provisions, whether or not complied with, have failed to provide an adequate level of protection?
- Is there an argument for the value of a compliance audit, either because an audit is likely to support the realization of better social and environmental outcomes in the project under review, or because a compliance audit could yield information or findings that might better inform the application of policies (or other audit criteria) to future projects?

As part of the appraisal process for this case CAO Compliance reviewed relevant documentation and held discussions with the IFC project team to understand the validity of the concerns, which criteria IFC used to assure itself/themselves of project performance, how IFC assured itself/themselves of compliance with these criteria, and generally whether an audit is the appropriate response. In addition to providing access to project documentation the IFC team provided written responses to CAO's enquiries.

After a compliance appraisal has been completed, the CAO can choose one of two options: to close the case, or to initiate a compliance audit of IFC or MIGA.

The CAO will report and disclose the findings and decision of the CAO compliance appraisal in an appraisal report in order to inform the President of the World Bank Group, the Boards of the World Bank Group, senior management of IFC or MIGA, and the public in writing about its decision.

If the CAO decides to initiate a compliance audit as a result of the compliance appraisal, the CAO will draw up a Terms of Reference for the audit in accordance with CAO's Operational Guidelines.

2. Background

Mindoro Resources Ltd (MRL or the company) is a mining exploration company listed on the Toronto and Australian stock exchanges. MRL holds a number of permits for mineral exploration and extraction in various sites in the Philippines. Relevant to the current complaint, this includes the Agata Mineral Production Sharing Agreement (MPSA), the company's principal nickel laterite resource in the Province of Agusan del Norte on Mindanao Island. Additionally in October 2000, the company applied for an Exploration Permit (EP) that covered several areas north of the Agata MPSA to the West and Southeast of Lake Mainit (known as Tapian Extension). After being granted Certification Precondition by the National Commission on Indigenous Peoples (NCIP) in December 2008,¹ the EP for the Tapian Extension was issued by the Mines and Geoscience Bureau in November 2010. The complainants in this case live in the settlements of Dinarawan and Bunga (see figure 2 below) and their concerns relate to areas within the Tapian Extension EP.²

IFC's interest in the company dates to July 2010 when the World Bank Group Board approved an equity investment of up to 10 million Canadian dollars (CAD) in MRL. On this basis IFC purchased approximately CAD 4 million in MRL shares in July and November 2010. In addition IFC took part in a private placement, purchasing CAD 600,000 in MRL shares in January 2012.

3. Scope of Appraisal

As set out in their letters of complaint and the CAO Ombudsman Assessment Report,³ the issues raised by the Complainants can be summarized as follows:

- (a) concerns that IFC failed to acknowledge the complainants as indigenous people affected by the project;
- (b) concerns regarding the extent and quality of consultations with the indigenous communities of Bunga and Dinarawan prior to the conduct of exploration activities in areas to which they assert rights (the contested area);
- (c) allegations that exploration activities were conducted in the contested area without prior consent from the indigenous communities;
- (d) allegations that MRL exercised and are exercising undue influence on the Free Prior Informed Consent process as administered by the National Commission on Indigenous Peoples causing division within the communities;
- (e) concerns regarding the potential social environmental impacts of future mining activities in the contested area.

From the perspective of CAO's mandate, the general question raised is whether IFC exercised due diligence in its review and supervision of environmental and social (E&S) aspects of the Project, particularly as they relate to the above issues.

¹ CAO notes that the claimants may contest the legitimacy of the Certificate of Precondition.

² The maps below illustrating the project location were provided by MRL.

³ Available at http://www.cao-ombudsman.org/cases/case_detail.aspx?id=176

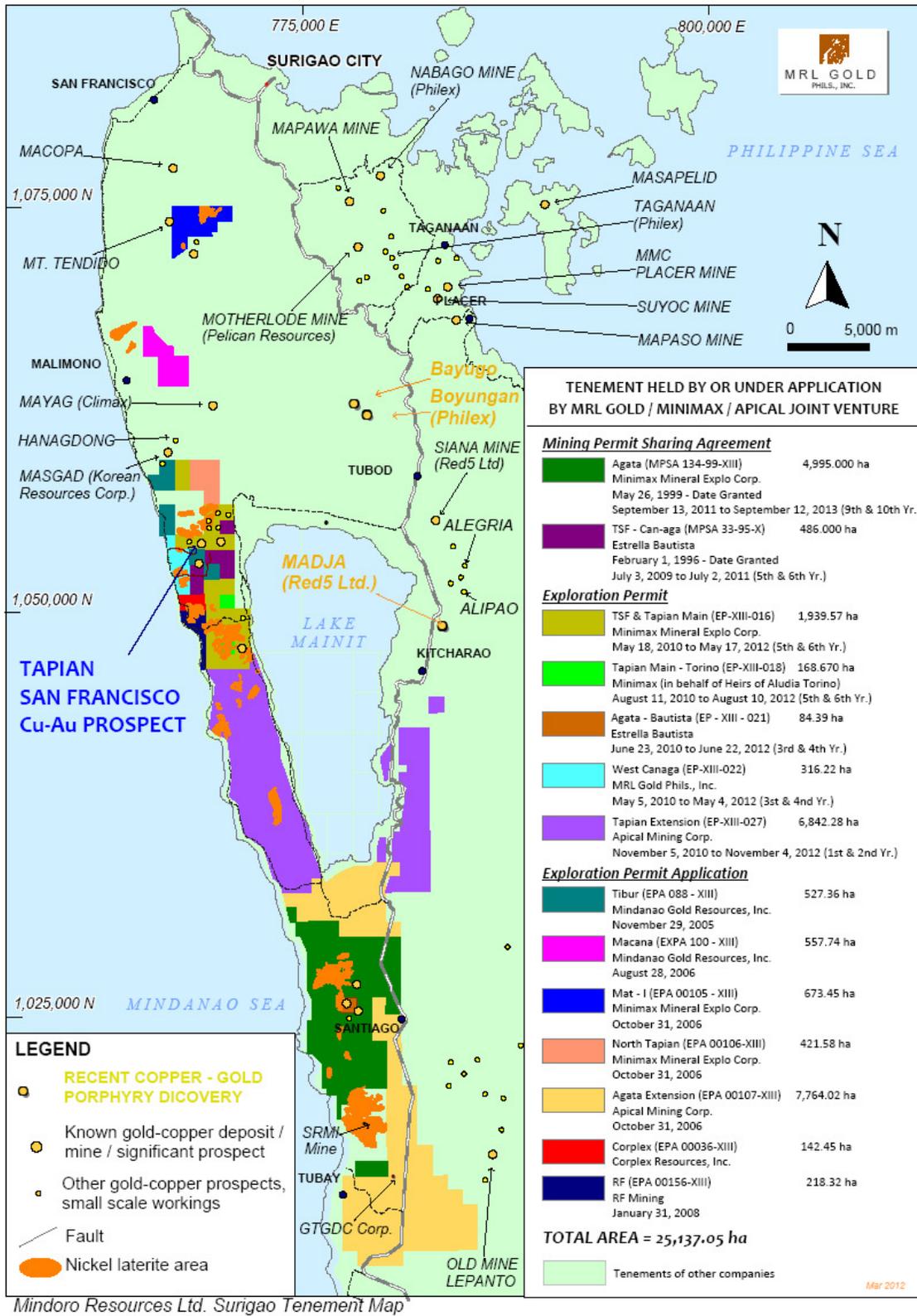


Fig. 1: MRL Tenement Map, Surigao Region

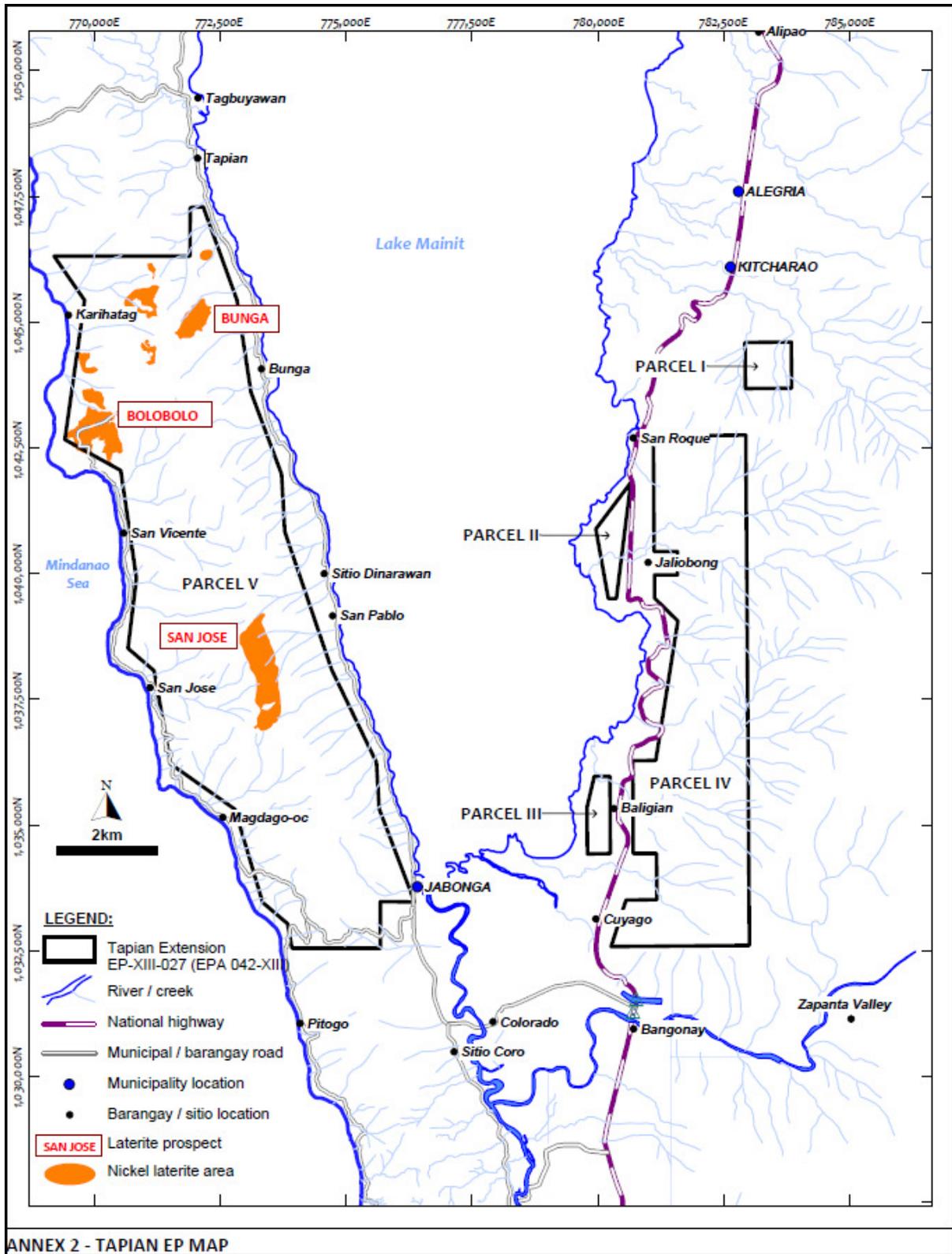


Fig. 2: MRL Tenement Map, Tapian Extension Exploration Permit

4. Discussion and Findings

The analysis that follows is organized chronologically following the IFC project cycle, dealing first with issues related to IFC due diligence in its preparation of the project.

Issues related to project preparation

In relation to the pre-commitment phase of the project cycle, the key question for CAO is whether IFC exercised due diligence in its review of and response to the client's assessment of the project's Environmental and Social (E&S) impacts. In this case specific questions arise relating to IFC's review of Broad Community Support (BCS) for the project and the classification of the project as E&S Category B (meaning that the project was expected to have limited adverse social or environmental impacts that were few in number, generally site specific, largely reversible and readily addressed through mitigation measures).

The IFC E&S early review process for this investment commenced in January 2008 and included visits to MRL field offices and exploration sites as well as a sponsor check which covered E&S issues. At this stage IFC Performance Standards (PS) 1 through 8 were expected to be applicable. In relation to PS1 (E&S Assessment and Management Systems) the scope of environmental impact from exploration was expected to be limited and manageable applying the company's existing practices for drilling. On the social side MRL is described as having a positive and proactive approach to engagement with affected communities and local government. In relation to PS7 (Indigenous Peoples) MRL, through its Community Relations and Development Officer, was found to coordinate closely with the National Commission on Indigenous People (NCIP) and local indigenous people (IP) and to respect national legislation requiring Free Prior Informed Consent for exploration activities on IP lands. In relation to PS8 (Cultural Heritage), while noting that no issues had been identified in the company's area of activities, IFC recommended that the company engage a local archeologist to assess whether any important cultural heritage sites exist in project areas prior to development. The IFC Early Review – Project Data Sheet dated March 2008 describes the company's E&S focus as exceptional for a junior exploration company and notes its strong local team and excellent track record in this respect.

An E&S peer review meeting on the project was convened in May 2008. By this stage IFC E&S staff had reviewed MRL's E&S documentation in more detail, including an Environmental and Social Impact Assessment (ESIA) for the proposed mining and direct shipping of ore (DSO) from the Agata MPSA area. A gap analysis by IFC E&S staff concluded that the ESIA would need upgrading to meet IFC standards. Relevant issues identified in the gap analysis and at peer review included: (a) that the ESIA potentially underestimated the zone of impact of the proposed operation; (b) that social impacts of the project were not articulated in terms that meet the IFC's Performance Standards; and (c) that environmental baseline data was insufficient. After weighing the pros and cons of giving the project an E&S classification of A or B, the peer review meeting concluded that the E&S Review Summary should be drafted on the basis of a B classification, with the possibility of re-categorization if necessary.

By the time the investment review meeting was held in June 2008, IFC's position on the company was that the DSO operation was unlikely in the immediate future. As such it was made explicit that the project would be an 'exploration deal' with the possibility of future mining. On this basis, it was proposed that the investment could go forward with the requirement for an upgraded ESIA to be agreed with IFC prior to any commencement of mining. Following the June 2008 investment review meeting, however, a decision was made to hold off on taking the investment to Board due to the impact of the global financial crisis on nickel prices and thus on MRL's operations.

The potential for an investment in MRL was revived as nickel prices rebounded and MRL announced positive drilling results in 2009/10. At this stage IFC updated its E&S Review Summary

(ESRS) and assessment of Broad Community Support (BCS) for the MRL project. Again the scope of the investment was defined in terms of “funding ongoing resource drilling, feasibility and other studies and exploration work” though the potential to develop the resource into a “large-scale mine” was recognized (ESRS, 2010, p.2). The ESRS thus proceeded on the assumption that: (a) an “ESIA would be required for any DSO operation and a further ESIA for any larger scale development;” (b) “documentation at each stage would be subject to a full Free Prior Informed Consultative Process;” and (c) “any future IFC investments will be categorized according to impacts generated by that project.”

In terms of the application of the PSs the ESRS noted the following:

At the exploration stage, IFC’s investment will not result in any involuntary resettlement or loss of livelihoods and therefore PS5 does not apply. Similarly, exploration activities are undertaken largely by teams on foot, exploration roads are minimized and there are no impacts on bio-diversity and thus PS 6 does not apply. Similarly, as disturbance of the ground is minimal and no sensitive ecological or cultural habitats have been identified, PS8 does not apply [but that] ... if a mining project is developed, in addition to the above standards, the project would likely have impacts which would have to be managed consistent with PS5, 6 and 8 and which would be addressed in the ESIA’s referred to above (ESRS, 2010, p.3)

The B categorization of the project was explained as follows:

This is a category B project according to IFC’s Environmental and Social Review Procedure because it is an exploration project, with very limited environmental and social impacts that are identified and mitigated. No communities are physically displaced and access to land is transitory and sporadic. The key social and environmental issues in relation to the exploration activities are: erosion and rehabilitation of drill roads, drill sites and trenches, waste materials, water and effluent management, occupational health and safety, compensation and management of local expectations (*Ibid.*)

In relation to PS7 the ESRS finds that “there is no IP community physically or economically displaced or otherwise directly impacted by exploration activities or by land access.” This comment in particular is the subject of concern from the complainants who assert that they are IPs and claim to be directly affected by the project. The one IP community expressly discussed in the ESRS is described as “indirectly and lightly affected by the development and the use of the existing access road to the exploration camp site” (ESRS, 2010, p.9). This village, named Coro, is situated near the Agata MPSA and was the subject of the IFC BCS review.

The updated IFC BCS review is documented in a note dated May 2010. While acknowledging the range of MRL’s tenements, including “Exploration Permits for Agata, Tapian San Francisco, and Tapian Main, as well as MPSAs and Exploration Permit applications for the remaining Surigao District properties” covering “over 26,000 hectares,” similarly to the ESRS, the BCS approval proceeds on the basis that only one indigenous community will be affected by the development. A review of the documentation suggests that this conclusion was drawn in 2008 and not altered when the E&S review was updated in 2010. In discussions with the IFC team, it was explained that only one IP community was identified as project affected as the concrete exploration plans MRL had in place at the time only affected one IP village. To the extent they may be impacted, the IFC team further explained that the villages from which the CAO complaint emerged, are covered by an exploration permit that was not granted until after IFC had committed to the project.

On the general question of the adequacy of IFC’s E&S due diligence, CAO questions whether IFC gave sufficient attention to ensuring that MRL had articulated an up to date definition of the project’s area of influence. Given the prospect in early 2008 that MRL would move quickly to a DSO operation under the Agata MPSA it may have made sense for IFC to focus its E&S review on this area. However, by 2010 when the prospect of IFC financing for the project was revived, MRL’s financial and press statements indicate that that the company was pursuing an “Exploration Target”

covering 900 hectares to the north of the Agata MPSA.⁴ This development is recognized in the IFC board paper which references both the new Exploration Target as well as MRL interests in the “Tapien San Francisco, Tapien Main and extension projects” in its description of the project.⁵ Further, according to material published on MRL’s website in December 2011, MRL had completed the most recent reported phase of its drilling activities in the Agata MPSA area (phase four) prior to the date of IFC’s commitment to invest in the company.⁶ In this context CAO finds that compliance with the Policy on Environmental and Social Sustainability (the Sustainability Policy) would have required IFC to review an updated articulation of the project’s likely area of influence as part of its 2010 E&S review. This having been done, IFC would have been required to reconsider the E&S impacts of the investment on this area, including asking such questions as: (a) whether the indigenous people of Caro (identified in 2008) would be the only affected group in the revised area of influence; and (b) whether the revised area of influence could be expected to house sites of cultural heritage that would require special consideration under PS8. A rearticulation of the project’s area of influence would also have had consequences for the scope of IFC’s BCS enquiries.

On the question of whether the project was correctly categorized, CAO notes that the wording of the Sustainability Policy requires the IFC to assess the “potential” impacts of projects when assigning an E&S category.⁷ In the case of early stage equity investments in the extractive industries, CAO notes that IFC holds itself out as a “long-term strategic partner” and a “cornerstone investor,” with an investment horizon of 6 to 8 years.⁸ Reflecting this position, CAO notes the following in IFC’s description of its value added or “additionality” for the project: “IFC’s role as a long-term strategic investor provides comfort to the company and other investors when additional funding is required for the company to develop the nickel mine and processing facility.” CAO also notes IFC’s articulation of its strategy with regard to investment for mineral exploration; namely that IFC is prepared to commit “early equity” investments to junior companies when there is “enough information for IFC to make a judgment that there is a strong possibility of a mine being developed.”⁹ On this question CAO finds it relevant that IFC’s 2010 Board Paper for the project sets 2011 as the target year for commencement of the DSO operation. Given the potentially significant, but necessarily undefined, medium to long term impacts of MRL’s ambitions to move from exploration to extraction, and IFC’s stated long term interest in the investment, CAO questions whether it was consistent with the Sustainability Policy to assign the project Category B on basis that the immediate focus of the company would be on exploration and other small footprint activities. While IFC attempted to ring fence these concerns by requiring various undertakings from MRL, as is discussed below, CAO has questions as to the robustness of these measures in circumstances where IFC’s ownership in MRL is likely to be diluted.

⁴ Although the Tapien Extension EP was not finally approved until November 2010, MRL reports that Certification Precondition was granted as early as December 2008 and at the time of E&S review in 2010 that the EP application was “advancing normally through the approval process.” See MRL *Interim Consolidated Financial Statements (Unaudited) For the Three Months Ended March 31, 2010*, available at <http://www.mindoro.com/i/pdf/2010Q1.pdf>

⁵ IFC (2010) *Mindoro Resources Limited (Project No. 26987) Project Summary*.

⁶ See Ausenco (2011) *Technical Report for the Agata Nickel Laterite Project*, available at: http://www.mindoro.com/i/pdf/NI_43_101_Technical_Report_20_12_2011.pdf

⁷ CAO notes that the Merriam Webster dictionary defines “potential” as “existing in possibility: capable of development into actuality” (see <http://www.merriam-webster.com/dictionary/potential>)

⁸ *Global Mining Overview*, available at:

<http://www1.ifc.org/wps/wcm/connect/434c0a0049a5f8cda3d0e3a8c6a8312a/IFC+Mining+Overview.pdf?MOD=AJPERES>

⁹ *IFC Mining Background Note*, available at:

[http://ifcnet.ifc.org/intranet/infrastructure.nsf/AttachmentsByTitle/IFC+Mining+%E2%80%93+Background+Note/\\$FILE/IFC+Mining+2010+-+Background+Note.docx](http://ifcnet.ifc.org/intranet/infrastructure.nsf/AttachmentsByTitle/IFC+Mining+%E2%80%93+Background+Note/$FILE/IFC+Mining+2010+-+Background+Note.docx)

Issues related to the Subscription Agreement

In line with the ESRS, IFC's July 2010 Subscription Agreement with MRL included provisions that required MRL to implement an E&S Action Plan (ESAP) and otherwise comply with the IFC Performance Standards. Of relevance to MRL's exploration activities, these include: (a) the requirement to develop a Health, Safety, Environment and Community (HSEC) Policy, and (b) complete Free, Prior, Informed Consultation (both of which steps were reported as completed prior to completion of the ESAP in June 2010).

In addition to the above E&S requirements, the subscription agreement and ESAP contain a number of provisions designed to ensure that future activities (including mining) would take place in accordance with the Performance Standards. These include requirements, prior to the start of any substantive mining operations, to:

- (a) conduct an ESIA which describes in detail how any future mining operation would meet IFC Performance Standards;
- (b) put in place a corresponding Environmental, Health and Social management system (both of which would be subject to public disclosure and IFC approval); and
- (c) carry out independent monitoring of any mining activities with respect to IFC Performance Standards.

Further, the subscription agreement extends the obligation to comply with the Performance Standards in the execution of any future project to joint venture partners requiring that:

- (a) prior to making an investment in any future project MRL will undertake due diligence in order to determine the project's compliance with the Performance Standards as such standards have been incorporated into the HSEC Policy; and
- (d) if the results of the due diligence determine that the proposed project can attain substantial compliance through reasonable corrective measures, that the Company will implement, and require any joint venture partners to implement an ESAP agreed to with IFC.

While at the time of writing, MRL had not commenced mining, it was actively seeking partners to pursue exploitation of both its gold and nickel assets in the Philippines.¹⁰ As of July 2012 MRL announced the sale of its gold assets to another junior miner, Red Mountain (RMX) (in which MRL will hold a 40 per cent stake). At the same time, negotiations were ongoing with regard to a joint venture with a Canadian listed junior, TVI Pacific, to exploit Mindoro's nickel assets in the Philippines. The TVI transaction, as announced on September 27, 2012 involves the purchase (in two tranches) of total of 63,115,559 units of Mindoro, at a price per Unit of C\$0.05. As at the time of writing the completion of this transaction was subject to a number of conditions, but it is anticipated to support a DSO operation commencing mid 2013, with the possibility of onshore processing of ore at a later stage. As indicated to IFC, MRL has proposed language in the joint venture agreement to the effect that MRL and TVI would be required to use their reasonable best efforts to comply with the IFC Performance Standards. In relation to the RMX deal, MRL has indicated to IFC that, in addition to E&S warranties contained in the existing purchase agreement, Red Mountain would consider issuing a separate letter indicating its commitment to the IFC Performance Standards. As explained by IFC to CAO, these assurances together with the ongoing involvement of MRL E&S staff give some comfort that future exploration and mining activities will be carried out in accordance with the Performance Standards. The IFC team acknowledges, however, that its leverage on the E&S performance of the joint ventures is likely to be weakened as its shareholding is diluted.

¹⁰ Details with regard to the transactions outlined below are available on MRL's website (www.mindoro.com).

Issues related to project supervision

Following commitment, IFC's obligation is to monitor the client's E&S performance in accordance with the Sustainability Policy and E&S Review Procedures (ESRP). Relevantly this includes the requirement to develop and retain the information needed to assess the status of compliance with the Performance Standards (ESRP 6) and review project performance on the basis of the client's commitments in the investment agreement and ESAP, as reported by the client's Annual Monitoring Reports (AMRs) (Sustainability Policy, 2006).

IFC received an AMR from MRL for financial year 2011 (January – December 2011) on time in March 2012. While the subscription agreement would have required MRL to prepare an AMR for 2010, the IFC team indicated to CAO that this was considered unnecessary given the anticipated low level impact of the activities that were being financed and the fact that funds were only committed in mid 2010. Neither documentation of IFC's review of the 2011 AMR nor its E&S Risk Rating were available to CAO at the time of writing. Thus according to ESRP 6 the project would not appear to meet the required standards for a "Supervised Project" and should have been classified as a "Knowledge Gap" project on the basis that no E&S Risk Rating had been completed within 15 months of disbursement.

MRL's 2011 AMR is prepared in accordance with the agreed format. According to the AMR all required ESAP actions had been completed. In relation to the PS7 requirements for Free Prior Informed Consultation, CAO notes that the 2011 AMR describes MRL's approach to community consultation in general terms, supplemented by pictures illustrating the process, and a list of meetings held with community groups. While this information is useful in understanding approach taken by MRL, it would generally not be sufficient to satisfy IFC's requirements under PS7 with respect to communities whose traditional or customary lands can be expected to be impacted by a project (para. 13).

In cases where adverse impact on lands of an indigenous community (including spiritual use) can be expected, PS7 requires that an IFC client will:

- (a) identify through a process of social and environmental assessment all communities of indigenous people who may be affected by the project within the project's area of influence as well as the nature and degree of the expected social, cultural (including cultural heritage) and environmental impacts on them (para. 7);
- (b) avoid adverse impacts where possible (para. 7);
- (c) develop a culturally appropriate process for Free, Prior, Informed Consultation with the affected communities (para. 7);
- (d) document its efforts to avoid or at least minimize the size of land proposed for the project (para. 13);
- (e) ensure that the indigenous peoples' land use is documented by experts in collaboration with the affected communities (para. 13);
- (f) ensure that affected communities are informed of their rights with respect to the lands in question (para. 13);
- (g) offer affected communities at least compensation as due process available to those with full legal title, together with culturally appropriate development opportunities; and
- (h) enter into and document good faith negotiations with the affected communities.

In addition under PS8, where cultural heritage is expected to be found, an IFC client should implement chance find procedures established through the E&S assessment.

While IFC ensured that MRL had in place the various E&S policies for exploration agreed in the ESAP and the subscription agreement, IFC did not document a review of the content of these policies to ensure that they met the requirements of IFC's Performance Standards, in particular the above mentioned aspects of PS7 and PS8. As explained by IFC, this sort of detailed review was not deemed necessary given the risk profile of the project at the exploration stage. Beyond the level of the client's policies, CAO questions whether IFC had at its disposal sufficient information to assess MRL's actual adherence to the Performance Standards as required by ESRP 6. Further, CAO notes that Free Prior Informed Consultation is described in the ESAP as having been "completed" by June 2010. In CAO's view this is potentially misleading with regard to the framework established under PS7 which would require MRL to undertake Free Prior Informed Consultation with any indigenous group adversely affected by its future exploration or mining activities. This point is of particular relevance as MRL's plans to start drilling in areas to the North of the Agata MPSA appear to have firmed prior to IFC's November 2010 purchase of MRL shares.¹¹ Given that IFC had not included these areas in its original E&S review, the occasion of the November 2010 share purchase should have provided IFC with the opportunity: (a) to appraise itself of the status of MRL's negotiations with communities in the project's expanded area of influence, and (b) in the context of a community that is contesting access, to recommend that its client engage external experts to document both the community's claims as well as the process and results of any consultations that were undertaken.

IFC's response to the specific issues raised in the complaint

IFC requested additional documentation in relation to MRL's interactions with the complainant communities from MRL after receipt of the CAO complaint. In this documentation MRL provides more detailed responses to the issues raised by the complainants.

Having reviewed this documentation, in January 2012, IFC decided that no barrier existed to purchasing additional shares in MRL. This decision, it appears, was made on the basis of: (a) a view that MRL had a good record on E&S matters; (b) the company's undertaking that it would not pursue further exploration activities in the contested area without agreement from the affected communities, and (c) the understanding that the project was not expected to significantly impact indigenous peoples.

The conditions of this purchase of shares were formalized in a new Subscription Agreement dated January 27, 2012. Relevant to the complaint this included covenants that would require a waiver from IFC (so long as IFC was a shareholder in MRL) should MRL wish to recommence operations in the contested area.

With regard to the adequacy of IFC's response to the specific issues raised in the complaint, CAO finds that IFC relied primarily on assertions of its client in assuring itself that the investment was being executed in compliance with the Performance Standards. CAO questions whether this provided an adequate basis on which to: (a) evaluate the status of its client's compliance with the Performance Standards in practice, and (b) decide if the client needed additional support to carrying out its work in accordance with the Standards. In these circumstances, CAO questions whether IFC policies and procedures provide sufficient guidance to staff on how to respond to complaints regarding clients' E&S performance in a balanced way.

These concerns notwithstanding, CAO finds it positive that IFC negotiated covenants responding to the issues raised by the complainants in its 2012 Subscription Agreement with MRL. While they may not fully satisfy the complainants, appropriately supervised, CAO finds that the 2012

¹¹ As referenced in "Update Presentation for ASX Cross-Listing" (IFC, October 2010).

covenants provide IFC with a basis to ensure that future operations in the contested area are conducted in accordance with the Performance Standards.

5. CAO Decision

Applying the framework it uses to test the value of conducting a compliance audit, CAO finds as follows:

- *Is there evidence of significant adverse social and environmental outcome(s) as a result of the project now or in the future?*

CAO acknowledges that extractive industry projects, even at the exploration stage, can have significant social impacts on indigenous communities, particularly when sites of religious or cultural importance are involved. While not in a position to make detailed findings as to the claimants' allegations vis-à-vis MRL, CAO finds that the immediate risk of adverse outcomes to the complainants was mitigated by MRL's decision to suspend exploration in the contested area. Regarding the longer term risk, CAO considers it positive that IFC negotiated covenants in its 2012 subscription agreement that prevent MRL from proceeding with operations in the contested area absent a waiver from IFC. Appropriately supervised, CAO finds that these covenants provide IFC with an improved basis to ensure that any future operations are conducted in accordance with the Performance Standards, in particular as they relate to indigenous people and cultural heritage.

- *Are there indications that a policy or other audit criteria has not been adhered to or properly applied?*

CAO finds indications of shortcomings with regard to the implementation of IFC's policies and procedures, in particular requirements to ensure that:

- (a) the project's area of influence was appropriately defined at the time of the E&S review;
 - (b) the project was assigned the appropriate IFC E&S category; and
 - (c) the project was adequately supervised.
- *Is there evidence that indicates that IFC/MIGA's provisions, whether or not complied with, have failed to provide an adequate level of protection?*

This case raises questions regarding the effectiveness of IFC's policies, procedures and standards in managing the necessarily undefined downstream risks that may emerge from early stage investment in mining ventures.

Further, having reviewed IFC's handling of the issues raised by the complainants, CAO questions whether IFC policies and procedures provide sufficient guidance to staff on how to respond to complaints from project affected communities in a balanced manner.

- *Is there an argument for the value of a compliance audit, either because an audit is likely to support the realization of better social and environmental outcomes in the project under review, or because a compliance audit could yield information or findings that might better inform the application of policies (or other audit criteria) to future projects?*

Having reviewed the available documentation, and recalling that the focus of CAO compliance auditing is IFC's performance, CAO finds that the conclusions set out in this appraisal are unlikely to be materially advanced by the conduct of a compliance audit at present. Acknowledging the potential E&S risks that attach to extractive industries projects in indigenous communities, however, CAO reserves the right in line with its Operational Guidelines, to reconsider this decision should MRL's nickel operations progress in a manner that raises significant concerns regarding

impacts on communities or the environment. In reaching these findings CAO acknowledges that the complainants are aggrieved by what they perceive as past wrongs and an ongoing lack of respect for their community by MRL, both of which they see as fuelling anger and conflict, and that these points of grievance remain unaddressed.