MONITORING REPORT

CAO Audit of IFC

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October 13, 2015

Monitoring of IFC's Response to:

CAO Audit of a Sample of IFC Investments in Third-Party Financial Intermediaries

Second Monitoring Report

Office of the Compliance Advisor Ombudsman (CAO)
for the
International Finance Corporation (IFC)
Multilateral Investment Guarantee Agency (MIGA)
Members of the World Bank Group

About the CAO

The CAO's mission is
to serve as a fair, trusted, and effective independent recourse mechanism
and thus
to improve the environmental and social performance 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

Introduction

The CAO compliance function oversees investigations and audits of IFC and MIGA with a view to improving the environmental and social (E&S) performance of the institutions. Following a CAO compliance investigation or audit, CAO may determine that it is necessary to monitor actions taken by IFC or MIGA until such actions assure CAO that its compliance findings are being addressed.[1]

This report documents CAO's monitoring of its *Audit of a Sample of IFC Investments in Third Party Financial Intermediaries* (the FI Audit), published in February 2013.[2] CAO published the first monitoring report in relation to this case in October 2014.[3]

Background

A large portion of IFC financing is delivered through third-parties: so-called financial intermediaries (FIs) such as banks, insurance companies, leasing companies, and private equity funds. FIs provide finance to businesses (described by IFC as "sub-clients") through a range of financial products. IFC provides investments and expertise to about 700 financial institutions and 220 private equity funds in more than 120 countries. In FY15, IFC new commitments to FIs (excluding Trade Finance) amounted to US$5.2 billion with a committed FI portfolio at year end of US$20.2 billion.[4]

Investments in banks and funds have the potential to expand IFC's development impact and reach. In its public communication, IFC stresses the positive impact that its FI lending has on access to finance for Micro, Small and Medium sized enterprises (MSMEs), creating jobs and spurring economic growth.[5] CAO notes, however, that IFC's largest FI investments are focused on commercial banks, finance companies and private equity funds.[6] In turn, these FI clients support companies working in a range of sectors including those such as agribusiness, energy, infrastructure, chemicals and mining which may have significant adverse E&S impacts. CAO's recent caseload provides some examples of the types high risk sub-projects which IFC's FI clients are financing.[7,]

[1] CAO Operational Guidelines (2013) para. 4.4.6.

[2] CAO, Audit of a Sample of IFC Investments in Third Party Financial Intermediaries (FI Audit). For further details see: http://goo.gl/e368ha

[3] CAO, First Monitoring Report of FI Audit. For further details see http://goo.gl/b3F3qY

[4] IFC Annual Report 2015, see http://www.ifc.org/annualreport

[5] See IFC, Financial Institutions Group. http://goo.gl/25EZTO Note: According to IEG, targeted MSME lending represents approximately 25 percent of IFC's FI portfolio. IEG. The Big Business of Small Enterprises (2014) p.37. See http://goo.gl/UIv8BB

[6] More than 70% of IFC's 125 largest active FI investments (those with a committed value of $75 million +) are made with general commercial banks, funds, and finance companies (CAO Analysis of IFC disclosures, October 2015). This figure includes FI investments made by IFC subsidiary, Asset Management Company, and excludes lines of credit that may be provided to general commercial banks exclusively for the purpose of MSME or housing finance.

[7] Recent such examples from CAOs caseload include: the agribusiness conglomerate Dinant - financed through Banco Ficohsa in Honduras; a coal fired power plant in India, GKEL - financed through the India Infrastructure Fund; and the New Forest Company in Uganda - financed through another Fund, Agri Vie.

In June 2011, the CAO Vice-President triggered an audit of a sample of IFC's FI investments based on concerns that affected people may face difficulties in bringing the environmental and social impacts of FI investments to CAO's attention. Also relevant in the decision to conduct the audit was the growth of IFC investments through FIs which constituted over 40% percent of IFC's portfolio at the time.

CAO published the FI Audit and IFC's Official Response to the FI Audit in February 2013. CAO's FI Audit noted that IFC's approach to the management of E&S risk in its FI investments is focused on the requirement that clients implement an environmental and social management system (ESMS). The FI Audit concluded that while generally processing FI investments in compliance with applicable E&S policy and procedural requirements, IFC lacked a robust methodology for determining whether its FI clients were in fact implementing the ESMS as required. In this context, the FI Audit raised concerns that the end use of IFC funds by FI clients was opaque and as such that IFC knew little about potential adverse E&S impacts of its financial sector lending. While acknowledging recent improvements, the FI Audit noted that IFC's approach to the assessment of capacity and commitment of FI clients to implement its E&S requirements was insufficiently structured and did not engage with the extent of change required to achieve its intended results. See Annex A for a list of key findings from CAO's FI Audit.

In its February 2013 response, IFC welcomed the FI audit and noted that it provided an independent perspective on IFC's work. At the same time, IFC's response noted differences of opinion with regard to a number of CAO's key findings.[8]

In September 2013, IFC released an Action Plan in response to the FI Audit. IFC committed to actions around three headings; a) Formalize a Continual Improvement Framework for managing the E&S performance of the FI business; b) Establish a formal ongoing process of outreach, consultation and dialogue with key stakeholders on IFC's FI business; and c) Strengthen IFC's advisory services to support regulatory, market and client level capacity building to help raise the standard of E&S risk management in the Financial Sector in emerging markets.[9]

Separately, in August 2014 CAO released its investigation report into IFC's FI investment in Banco Ficohsa (the Ficohsa investigation).[10] CAO's Ficohsa investigation made a number of project level and systemic level findings (See Annex B). Relevantly, the findings of the Ficohsa investigation raised issues of concern regarding IFC's approach to the identification and management of E&S risk in its FI investments. In response to this investigation, IFC noted that the systemic findings from CAO's Ficohsa investigation would be addressed through the Action Plan developed in response to the FI audit.

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[8] In particular IFC noted disagreement with findings 4.2, 4.3, 4.7, 4.8, 4.9, and 4.11 (see Annex A)
[9] IFC's FI Action Plan. For further details see http://goo.gl/zf0WMJ
[10] CAO, Investigation of IFC's Investments in Banco Ficohsa. For further details see: http://goo.gl/2vkPn8

Summary of Actions of IFC actions included in CAO's First Monitoring Report, October 2014

Key actions taken by IFC and noted in CAO first monitoring report in October 2014 include;

- IFC noted that its was piloting a program which sought to enhance IFC's assessment of E&S risks (ESMS Diagnostic Tool) and it was developing a more structured approach for validating an FI's ESMS through sub-client level reviews.
- IFC updated its Environmental and Social Review Procedures (ESRPs) for appraising and supervising FI investments. Specifically, the revised procedures provided more detailed guidance to staff on appraising and supervising FI investments. Further, IFC outlined changes to the circumstances in which IFC requires its FIs to apply the Performance Standards to sub-clients.
- IFC noted progress in the development of a system to track E&S gaps and noted that this presented to management on a quarterly basis during their portfolio review meetings.
- IFC noted that it sought to create a strong understanding and ownership of E&S issues among its staff through increased messaging by senior management, development of a tip sheet and E&S training programs for Investment staff.
- IFC noted a progress in piloting a number of programs to support the development of a shared vision of E&S sustainably finance and support in the development of capacity in the E&S consultancy sector.

Update on Actions taken by IFC since CAO's First Monitoring Report

The most recent statement of IFC's response to the FI Audit is contained in a IFC's Action Plan Status Table (July 2015 – see Annex C). This monitoring report has been prepared on the basis of: (a) the Action Plan Status Table, (b) documentation provided to CAO in preparation of this monitoring report and (c) ongoing discussions between CAO and IFC regarding IFC's response to the FI Audit.

Key actions as presented by IFC are as follows

a. Continual improvement –portfolio management and supervision

- IFC has provided CAO with an updated template for commercial bank E&S reporting to IFC. The updated template requires a commercial bank to provide IFC with a sample E&S assessments prepared by the client, details on the client's portfolio referencing the E&S risk of the portfolio (top 25 exposures), the number of incidents reported at the sub-project level and the number of E&S field appraisal and monitoring field visits conducted by the client to its sub-project.
- IFC notes developments in its approach to ESMS validation. In this context IFC states that the number of FI supervision visits conducted has increased from 140 in FY13 to 176 in FY15 (covering 40% of the FI portfolio). Over the same period IFC notes that client E&S due diligence (ESDD) files reviewed increased from 491 in FY13 to 617 in FY15, but that the number of sub-projects visited by IFC E&S staff decreased from 86 to 79.
- IFC reports the development of new tools which may be used to guide investments in instances where IFC is investing in a country/sector with specific challenges. These include third-party country contextual risk briefing reports, media intelligence reports and research briefs.

- IFC also notes that it is being more selective in pursing higher-risk investments in private equity funds, particularly sector funds.[11]

b. Continual improvement – comprehensive review of IFC's existing FI portfolio

- IFC indicates it has conducted a comprehensive review of all FI clients (excluding Private Equity clients) with a negative E&S risk rating (ESRR 3 or 4). IFC notes that it has developed an action plan jointly with each client to bring the client back into compliance. From this review, IFC reports that 18 clients have improved performance and 43 clients are on track to improved performance. Further, IFC notes that it has closed/exited or is in the process of exiting its investments with 19 clients and there are open issues with a further 12 clients.

c. Continual improvement – enhanced disclosure

- IFC notes that the Access to Information Policy was updated in 2012 requires IFC to disclose the names, locations and sectors of high-risk projects have that have been supported by an IFC's investment in a Private Equity (PE) fund, subject to regulatory constraints and market sensitivities. As part of its Action Plan IFC proposed to disclose all investee companies of IFC supported PE funds. IFC reports that it revised its legal E&S covenants for PE funds in late 2013 and commenced disclosure in April 2015. IFC's practice is to disclose projects when available with the intention of disclosure on an annual basis. To date IFC reports that 16 IFC private equity fund clients have disclosed their sub-projects through the IFC website. Further, CAO notes that IFC has reported no instances where disclosure of a PE project was not possible due to regulatory constraints or market sensitivities.
- With regard to disclosure of sub-project information in relation to commercial banks, the majority of IFC's FI portfolio, CAO notes IFC's statement that "regulatory and privacy rules govern disclosure of much information regarding a banks underlying portfolio at the project or individual level. Regulated banking institutions the world over are subject to customer privacy standards, which restrict disclosure of investments within their portfolios".[12]

d. Continual improvement – FI Grievance and Complaints Mechanisms

- IFC has revised its ESRPs to include an assessment of an FI's internal and external grievance mechanisms at appraisal. IFC has also revised its client E&S reporting formats so that FI clients are guided to report on the status of their grievance mechanisms. See Box 1 for further analysis.
- In developing this area of work, IFC notes that its FI clients should develop mechanisms that allow them to receive complaints which in turn they will work with sub-clients to address. IFC thus emphasizes that the focus of grievance redress should always remain at the sub-client level.

[11] IFC Letter to CSOs, April 10, 2015. For further details see http://goo.gl/mm9IEY
[12] IFC Letter to CSOs, April 10, 2015. For further details see http://goo.gl/mm9IEY

Box 1 – Grievance Mechanisms at the PE fund and sub-project level

IFC notes that clients are required to establish a communication mechanism to receive and register external communication and complaints from the public. The FI client is required to screen and assess issues raised, track and document responses, and adjust its ESMS as appropriate. IFC proposed in its Action Plan to have FI-1 and FI-2 clients communicate the presence of this mechanism and the way the public can access the same in their annual reports, as part of their commitment to good corporate citizenship and openness to stakeholder engagement.

IFC notes that during appraisal it assesses a client's grievance mechanism in accordance with PS1 (2012). Where no existing mechanism for a client exists, IFC provides its clients with guidance to support them in establishing a mechanism. During supervision FI clients are required to report on the development of the mechanism and its effectiveness. The quality of the client's grievance mechanism, IFC notes, is considered in IFC's assessment of the FI client's E&S performance.

While the commitment to establish an operational grievance mechanism applies to all IFC FI clients as an indicator of the extent of implementation of this requirement under PS1, CAO reviewed the web sites and available annual reports of a sample of 24 private equity funds to which IFC had provided financing under the 2012 Sustainability Framework. From its review CAO found that none of these funds communicated the presence of a grievance mechanism on its website or in its annual report – where publicly available.

Through committing to the IFC Performance Standards, each IFC FI is required to ensure that the sub-projects the PE Fund's supports operate in accordance with the Performance Standards where relevant. Accordingly, each sub-project is also required to implement a grievance mechanism and publicly communicate the presence of this mechanism. In reviewing the available websites of the 81 sub-projects that IFC has supported through the sample 24 Private Equity Funds, CAO notes that 4 sub-projects detail the presence of a grievance mechanism on their website.

e. IFC Advisory Services – E&S Management Systems tools for FI clients

- IFC reports that its has initiated roll out of its ESMS diagnostic tool which is designed to support systematic and in depth assessment of an FI client's systems and capacity to manage E&S risk. IFC reports that the tool was utilized with 6 banks in 6 markets in FY15, with further clients scheduled in the Latin America and Caribbean region and Sub-Saharan Africa region in FY16.
- IFC provided CAO with a sample diagnostic report for three clients. In preparing an ESMS Diagnostic Report, IFC reviewed the client's ESMS in terms of the adequacy of the client's E&S policy, due diligence process, organizational structure, staff capacity, supervision process, escalation to client management process and external communication. The findings of the review and recommendations made by IFC in regard to identified issues are recorded in the ESMS Diagnostic Report.

f. IFC Advisory Services – Training of trainers pilot

- IFC reports that a training of trainers (TOT) program was successful launched in Nigeria and later expanded to China, Mongolia, Bangladesh and Vietnam. IFC reports to CAO that 85 trainers have been trained to date in Vietnam and China. Further, IFC notes that it conducted a pilot training for PE funds in the Asia and Pacific region in May 2015. IFC intends to roll out this training program to other regions in FY16.

g. Internal Capacity and Prioritization – Messaging, Training and Capacity

- IFC notes that senior management continues to stress the strong understanding and ownerships of E&S issues to its staff. Further, IFC reports that it has provided additional E&S training sessions to staff in Asia and Africa in FY15, with additional sessions planned in Central Europe and Latin America and the Caribbean in FY16.
- IFC notes significant increases in the budget for the IFC E&S Department (CRKES) in the period FY15-17 which has facilitated the increase in E&S staff dedicated to FIs.

Summary of Progress and Gaps

Actions taken by IFC following the preparation of the Action Plan go substantially beyond the initial IFC response to the FI Audit and actively engage with a number of CAO's key findings. In particular, CAO welcomes IFC's emphasis on continuous improvement around the implementation of IFC's Sustainability Policy. In light of the findings of the FI Audit, CAO welcomes IFC's development of an ESMS diagnostic tool. This tool, well implemented, should provide IFC with a better understanding of its FI clients' ESMS and ESMS implementation capacity. Better diagnostics should also provide opportunities for IFC to support its FI clients to improve ESMS implementation and thus E&S risk management at the sub-project level.

The FI Audit noted a lack of capacity in the market to support FI clients to develop and operate an ESMS as required by IFC. CAO thus welcomes initial steps which IFC has taken, primarily in the East Asia region, to develop of capacity in the E&S consultancy market through a training of trainer program.

As noted in CAO's first monitoring report of the FI Audit, IFC revised its ESRPs for FIs in July 2014. These revisions provide staff with more detailed guidance on the requirements for pre-investment E&S review as well as an increased focus on E&S issues at key decision points. While welcoming these measures, CAO notes changes in the ESRPs with respect to the circumstances in which IFC requires that FIs apply the Performance Standards to sub-clients. In CAO's analysis, these revisions to the ESRPs narrow the application of the Sustainability Policy as approved by the IFC Board, in that they restrict the application of the Performance Standards to FI sub-clients that meet certain loan type, size and tenor requirements.

Based on the FI audit and Fichosa investigation, CAO has identified concerns that "*IFC has, through its FI investments an unanalyzed and unquantified exposure to projects with potential significant adverse environmental and social impacts*." While IFC's Action Plan responds to a number of the findings from the FI Audit and Ficohsa Investigation, important findings remain unaddressed. A crucial message from the FI Audit was that IFC does not have a *"methodology for determining whether the implementation of [an ESMS] actually achieves the objective of doing no harm or the objective of improving E&S outcomes on the ground*" and that "*[i]n some cases, the creation and implementation of [an ESMS] and related reporting has become an end in itself, rather than means to improved E&S outcomes on the ground*."

In response to these findings, CAO welcomes IFC's acknowledgement of the importance of active E&S supervision, and in particular verification of its clients' ESMS implementation at the sub-client level. However, data presented by IFC raises questions as to whether IFC's capacity to supervise the E&S risks attached to its FI investments is commensurate to the growing size and risk profile of its FI portfolio. In this context, CAO notes that some metrics of IFC's FI supervision have increased since the completion of the FI audit – for example the number of desk reviews of FI sub-projects conducted by IFC – while others, such as the number of sub-project visits by IFC E&S staff, have decreased, particularly when the growth in IFC's FI portfolio is considered.

CAO understands IFC's position that its ESMS based approach will not be perfect and cannot guarantee the absence of E&S issues at the sub-project level. Based on information available to date, however, it is unclear whether progress is being made in terms of IFC's key compliance requirement, namely that FI clients "develop and operate an ESMS" which requires "higher risk business activities they support to apply relevant requirements of the Performance Standards." In this context, CAO notes IFC's openness to considering third party verification of client E&S performance as part of its FI supervision structure. As discussed in the FI audit, the development of a robust methodology for verification of client ESMS implementation would represent a significant step forward in this regard.

While welcoming IFC's commitment to disclosure of sub-projects by private equity clients, CAO notes that the end-use of the majority of IFC FI financing remains undisclosed, even where the business activity financed has significant potential E&S impacts. In this respect, CAO notes that commercial banks which subscribe to the Equator Principles, version 3 (EPIII) have, since January 2014, agreed to a framework for consent based disclosure of the name and location of their project finance investments.[13] CAO also notes that EPIII requires financial institutions to report transaction data annually: by E&S category, sector, country, and whether transactions were subject to independent (E&S) review.[14] IFC disclosure requirements for FI clients lag EPIII standards in these respects.

Finally, CAO notes that IFC has recently begun supporting its FI client's to develop grievance mechanisms to receive complaints from people affected by the E&S impacts of their client's operations. While the grievance mechanism requirement has been present in Performance Standard 1 since 2006, IFC's implementation of the requirement in relation to FI clients is in its early stages. As a result, IFC is expecting its first reports from clients on implementation and effectiveness of their grievance mechanisms in FY16. More fundamentally, CAO notes questions regarding the effectiveness of an FI grievance mechanism absent systematic disclosure of the higher risk business activities which FIs support.

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[13] The third version of the Equator Principles (EP3) provide for Equator Principles Financial Institutions (EPFIs) to report the name, sector and country information publically on project finance transactions that have reached financial close. This reporting requirement is subject to client consent and applicable local laws, however, CAO notes that a number of EPFIs have included project name data in their 2014 reports. See for eg. National Australia Bank. Equator Principles Report (2014) p.3. http://goo.gl/lQFWwS

[14] Annex B: Reporting Requirements http://www.equator-principles.com/resources/equator_principles_III.pdf

Conclusion

CAO has considered the measures IFC has taken to address the findings of its FI Audit to date. Well implemented, these measures have the potential improve the quality of E&S outcomes in relation to IFC FI investments over time. In its monitoring role, CAO will continue to follow the specifics of these changes and the effectiveness of their implementation.

Based on currently available data, however, CAO has questions as to whether IFC's response has led either to improved E&S outcomes on the ground, or improvements in compliance under IFC's Sustainability Framework. This is of particular concern in contexts where IFC FI clients are investing in countries with limited E&S governance capacity and/or in projects with significant potential adverse impacts on communities or the environment.

CAO plans to release its third monitoring report in relation to its FI Audit no later than September 2016. In preparing its third monitoring report, CAO plans to review a sample of active FI investments committed under the 2012 Sustainability Framework. This will provide an enhanced measure of the effectiveness of IFC's response to FI audit.

Annex A: Key Findings for CAO's FI Audit, released in February 2013.

CAO Finding No.	Findings of CAO's Audit of a Sample of IFC Investments in Third-Party Financial Intermediaries
4.1	IFC's E&S processes and results do not fully correspond to IFC's overall corporate message. The IFC approach, which is based on achieving change through the application of a management system, does not generate information about actual E&S results at the sub-client level.
4.2	There is a lack of clarity about when IFC's two different concepts of E&S risk [do no harm and credit risk] apply thus creating the possibility that IFC's systems do not effectively minimize environmental or social harm that may result from the action of clients or sub-clients.
4.3	There is a lack of clarity about IFC's actual E&S objectives. In addition, there is not a systematic approach to assessing whether the two broader objectives [do no harm and have a positive impact] are being achieved. The current approach is focused on confirming that clients have implemented a ESMS.
4.4	Differing E&S requirements of the various development finance institutions places a burden on IFC's clients and fails to take advantage of potential opportunities to increase the efficiency and leverage of the DFIs, individually and collectively.
4.5	There are potential opportunities for IFC to encourage the adoption of a widely shared vision of industry standards for acceptable E&S practices, behavior, and results. Requiring clients to report and disclose E&S performance and to engage third-party assurers to provide an independent check would further contribute to the propagation of global norms, while improving disclosure.
4.6	IFC's focus on establishing a ESMS as a legally required product—instead of as part of a more fundamental change management process—creates the risk of a reporting and compliance orientation on the part of the client. This focus, in turn, means that the ESMS can become an end in itself, rather than a means of enhancing E&S performance outcomes on the ground.
4.7	IFC's E&S requirements have not been adequately adapted for FM clients and are thus not optimally designed to assist FM clients in improving the E&S performance of their sub-clients.
4.8	IFC does not have a structured approach to assess and address two key elements of a successful E&S program: client commitment and client capacity to implement an effective E&S management system.
4.9	IFC's current approach to the application of E&S issues to financial markets transactions does not adequately reflect the significant differences in client capacity and the business, institutional, and cultural setting in which they operate.
4.10	The deployment of high quality E&S staff to work on FM investments in recent years has had a material impact on the quality of support provided to clients. However, this has yet to address the underlying limitations of the ESMS-based approach to E&S management.
4.11	IFC's allocation of E&S resources is not cost based. IFC does not have an adequate system in place to determine whether E&S resources are being used efficiently, or whether certain functions should be outsourced.

Annex B: Findings from CAO's investigation of IFC's Investment in Banco Ficohsa, released in August 2014.

Pre-Investment E&S Due Diligence
IFC properly determined that Ficohsa would be required to screen projects against the Performance Standards as a requirement of the equity investment.
IFC took insufficient measures "to identify activities" where Ficohsa "was exposed to social and environmental risk" prior to investing as required by the Sustainability Policy.
IFC did not conduct an adequate review of Ficohsa's SEMS or adequately identify actions that Ficohsa would need to undertake to address gaps in its SEMS.
IFC did not require that gaps in Ficohsa's SEMS were closed as a condition of disbursement;
IFC did not meet the requirements of the Disclosure Policy in that it did not ensure that material changes in client E&S requirements were made public at least 30 days prior to Board approval of the investment.
These shortcomings, taken together, represent a material failure of IFC's pre-investment E&S review process.
Disbursement
IFC's review of the CODs did not comply with the ESRP requirement that E&S staff clear any E&S CODs following a review of evidence of compliance with the CODs.
IFC-AMC disbursed against its subscription and sub-ordinated debt agreements, without assuring itself that Ficohsa had submitted the E&S information that was required as a condition of disbursement.
IFC E&S staff did not review the ongoing validity of Ficohsa's E&S representations and warranties prior to disbursement.
Supervision
IFC's requirement to ascertain whether or not "there is sufficient evidence that the client has applied the Applicable Performance Requirements to their sub-projects," necessitates a more robust review of client performance than IFC conducted in relation to Ficohsa.
In supervision, IFC did not assure itself in an adequate or timely manner that Ficohsa was "operating the SEMS as envisaged at the time of appraisal" or that Ficohsa had "applied the Applicable Performance Requirements to its sub-projects."
IFC's June 2012 supervision documentation was deficient in that it did not address the E&S requirements of the 2011 equity investment, instead focusing on those of the earlier SME loan. As a result, IFC was able to rate Ficohsa's E&S performance "Satisfactory" meaning that Ficohsa was found to be in "material compliance" at a time when it was out of compliance with IFC's E&S requirements.
IFC did not meet the requirement to review initial financing activities in relation to an FI client with potential significant E&S risks associated with its financing activities.
IFC did not adequately supervise the requirements of PS1 vis-à-vis Ficohsa itself; in particular the requirement to establish a grievance mechanism which is "readily accessible … to affected communities" and about which affected people are informed.
There is a disconnect between the client reporting templates IFC provided to Ficohsa and the E&S requirements that were written into the investment agreements.
The AEPR format as provided to Ficohsa was not fit for purpose in terms of the detail that it required regarding the environmental and social performance of borrowers, in particular those involving high environmental and social risks.
IFC's engagement with the client has improved since late 2012 when the IFC E&S team supervising the Ficohsa investment became aware of the gravity of the concerns regarding Dinant.
Despite steps forward, capacity and country governance challenges mean that supervising compliance with the E&S requirements of the 2011 investment agreements presents a significant long term challenge.

Annex C: IFC Action Plan Status Table (Provided to CAO by IFC, July 2015)

Action Plan Initiative and Key Steps proposed	Department with <u>Primary</u> Responsibility	Specific Actions to be taken	Timeline	Status Update
1. Continual Improvement Framework: IFC endeavors to continually strengthen implementation of its policies and procedures. Based on the CAO report, stakeholder engagement and given the recent changes in the 2012 framework, IFC proposes the following:				
1.1. **Capacity and Commitment Assessments:** Client capacity and commitment is an important factor to the overall management of the E&S risks and IFC proposes to accord greater attention to alignment of values with clients on E&S during appraisal	CRKES	1) SL to develop guidance for FI Specialists to assess capacity and commitment, and review by FI team 2) CES management approval of assessment criteria 3) ESRP revision to include capacity and commitment as key areas of appraisal and IRM input by CES 4) Coaching session for FI Specialists and distribution of best practice examples	Q2 FY14 Q2 FY14 Q1 FY15 Q3 FY14	1) Completed 2) Completed 3) Completed 4) Completed
1.2. **Increased Supervision:** There is scope for increasing coverage of FI level site visits given the success of the enhanced supervision that has been in place for FI-1 projects. IFC proposes to cover all FI-2 clients with PS requirements, which will entail about 30 additional clients to be visited annually.	CRKES	1) Increase supervision by 10-20 FI clients in FY14 and FY15 each and prepare and implement SVM Plan	FY14 and FY15	1) Completed. FI supervisions have been increased to approximately 190 annually (covering 40% of total portfolio), compared to 140 supervisions in FY13 and 174 in FY14.
1.3. **Enhanced Disclosure:** There has been a call for enhanced disclosure for IFC's FI portfolio and there were substantive changes made in the 2012 AIP within the constraints of host country regulations in the financial sector. Even as the results of these policy changes are expected in the				

coming year, IFC is proposing to adopt the following steps:				
1.3.1. To expand the disclosure of investee companies by PE funds to cover all investments, and not just Category A investments. This will be initially done on a best efforts basis to test operational feasibility and client implications, before formalizing the same	CRKES/ CLED/FIG	1) Revise E&S covenants for PE Funds to allow for disclosure of all sub-projects 2) Roll-out revised legal provisions 3) Start annual disclosure of all sub-projects for projects to which new covenants apply	Q2 FY14 Q2 FY14 Q3 FY15	1) Completed 2) Completed 3) On-going task. The following funds have disclosed subproject listings as of today: IBEF II, Infuse Capital, GC Credit, ADP II, Lereko Metier, CDH Fund V, Abraaj North Africa Fund. All listings are published as an update to the SII under the E&S tab.
1.3.2. With the 2012 Sustainability framework update, IFC requires its FI clients to establish a communication mechanism to receive and register external communications and complaints from the public at large. The FI is required to screen and assess any issues raised, track and document responses, and adjust the ESMS as appropriate. IFC proposes to have FI-1 and FI-2 clients communicate the presence of this mechanism and the way the public can access the same in their annual reports, as their commitment to good corporate citizenship and openness to stakeholder engagement.	CRKES	1) Revise guidance on auditable criteria for ESMS review utilized by FI Specialists and ESMS development guidance materials for clients 2) Revise AEPR format to include reporting by FIs on development of communication mechanism, complaints received and responses provided 3) Client FIs to start reporting on the development of communication mechanism, complaints received and responses provided per revised AEPR format	Q3 FY14 Q2 FY16 Q2 FY16	1) Completed 2) Completed. The new AEPR format has been finalized and will be rolled out starting August 2015. 3) On-going. Presence of the external grievance and communication mechanism has already been assessed at appraisal of all clients to whom 2012 Sustainability Framework applies. The new AEPR format will require clients to report on the implementation and effectiveness of this mechanism.
1.3.3 IFC will also continue to explore and promote other market best practices that are feasible in the financial sector	CRKES			On-going
1.4. **Sub-project Reviews:** As presented earlier, IFC has a practice of validating the FI's ESMS through reviews of sub-project level information and site visits, having covered over 1,200 sub-clients for higher and medium risk FIs. IFC proposes to document	CRKES	1) SL to prepare proposal for sub-project sample selection criteria, and review by FI team 2) CES management approval of sample selection criteria	Q2 FY14 Q2 FY14	1) Completed 2) Completed

this practice as a formalized and systematized protocol for sub-client reviews as a basis of the FI's ESMS validation. IFC will share this protocol as has been requested by many stakeholders.		3) ESRP revision to include sub-project review approach 4) Development of Guidance Note on sub-project review (that can be shared with the public)	Q2 FY15 Q1 FY15	3) Completed 4) Completed
1.5. Performance Tracking System Enhancements: The core of strengthening implementation requires ensuring that internal data and performance tracking systems remain efficient and appropriate to the growth of the business. IFC will seek to review and strengthen internal data tracking and MIS, and strengthen internal coordination mechanisms to ensure active portfolio management and client engagement for effective E&S risk management.	CRKES/ FIG	1) Prepare list of changes required to portfolio tracking sheets, ESRDII and iDesk to enable better data management, and request CIB to implement changes 2) Develop E&S Portfolio Performance Sheet summarizing key gaps in each region, and share and discuss these on a quarterly basis during Portfolio meetings with FM 3) Set up an ongoing communication between senior management and staff on E&S issues 4) Prepare a tip-sheet for IOs on E&S risk management at IFC 5) Develop a training on FI's E&S risk management for FIG staff and deliver in a form of BBL/webinar/face-to-face 6) Deliver four more training sessions on FIs E&S risk management in the regions	Q3 FY14 Q3 FY14 Q3 FY14 Q4 FY14 Q4 FY14	1) Completed 2) Completed 3) On-going task (several messages were delivered by FIG management team during department's meetings, knowledge week and through email communication) 4) Completed (available on SPARK) 5) Completed. First training was delivered in June 2014 6) On-going task. Two training sessions have been delivered for staff in Asia and Africa in FY15 with two more planned for CEU and LAC
2. Stakeholder Outreach and Dialogue: There is recognition for a need for more information sharing and engagement with IFC's stakeholders on the nature of the FI business and how we manage different aspects of the same. In this regard IFC is proposing to take the following steps:				
2.1. IFC will engage, at least annually, in a dialogue with civil society organizations	FIG	1) To hold a meeting with CSOs in Washington, DC during Spring Meetings	Q4 FY14	1) Completed (meeting took place in April 2014)

(CSOs), covering various aspects of IFC's FI business. IFC initiated this process in December 2012 with a meeting with CSOs in Brussels. Since then, IFC has held meetings in Washington, D.C. and most recently in London. IFC is also exploring a meeting in Asia later this year, as requested by some of the CSOs. Interest at these meetings has been on: o The development impact and objectives of IFC's FI program o Management of risks, including E&S risks o Transparency and governance o Opportunities and constraints o Other issues based on stakeholder expressions of interest		2) To hold a meeting with CSOs in Asia or Europe 3) To hold a meeting with CSOs in Washington, DC during Spring Meetings	Q2 FY15 Q4 FY15	2) Completed (meeting took place in September 2014 in Myanmar) 3) Completed (meeting took place in April 2015)
2.2. IFC will continue to work in partnership/leadership with DFIs and market players to refine and harmonize E&S frameworks and evolve and disseminate best practices in the market	CRKES	1) Draft a Concept Note for Analysis and Coordination of DFIs E&S Requirements for FI Clients 2) Consultation with DFIs to seek their participation and cooperation on the analysis 3) Desktop IFC and DFI standards/procedures benchmarking and interviews	Q3 FY14 Q2 FY16 Q2 FY16	1) Completed 2) In progress. This has been slower than planned given the differences in approach. IFC is working to influence this process more effectively over the coming months 3) In progress. See comment for item 2) above
3. ESRM for FIs – Advisory Services: In addition to direct guidance and support provided to higher and medium E&S risk investment clients by the IFC E&S Specialists, IFC believes that strengthening market drivers and capacity is essential to improve E&S risk management in emerging markets. With this in mind, IFC proposes to scale up its advisory services program with the following elements:				
3.1. Supporting the development of market and regulatory drivers (already underway). Key highlights include: • IFC has been actively working with a number of key banking regulators on E&S guideline implementation. This	FIGAS/ CRKES	1) Develop implementation guidelines, tools and M&E mechanism for Bangladesh, China and Nigeria 2) Develop E&S guidelines for Indonesia, Mongolia, Philippines, Vietnam and Nepal	Q3 FY14 FY14-FY15	1) In progress. Completed in China and Nigeria. On-going in Bangladesh (until August, 2015) 2) In progress. Indonesia launched the Sustainable Finance Roadplan and Mongolia launched the Sustainable Finance Principles in December 2014.

has included Bangladesh, Brazil, China, and Nigeria. Based on the progress, IFC is working with a number of other banking regulators on E&S guidelines development. This includes Indonesia, Mongolia, Philippines, Vietnam and Nepal • IFC has established the Sustainable Banking Network (SBN) for Regulators to make this a global initiative and to share knowledge and resources across markets.		3) Organize second International Sustainable Banking Forum together with Central Bank of Nigeria 4) Organize third Sustainable Banking Forum together with Central Bank of Peru 5) Expand SBN	Q3 FY14 Q1 FY16 FY14 going forward	Vietnam launched the ESRM Directive in March 2015. Due to the earthquake disaster in Nepal, development of the guidelines will be delayed 3) Completed. Event took place in Nigeria on March 2-4, 2014 4) In progress. Planned for September 2015 5) On-going task. The network is represented by 17 countries and 24 members as of today. Central Banks of Nepal and Morocco joined the network in FY14. Central Bank of Pakistan, Kenya Banking Association and Honduras Banking Regulator/ and Association joined the network in FY15.
3.2. To support market capacity development, IFC proposes to build capacity in the markets, through third party providers, to support the financial sector with improvement of E&S practices (already initiated). The steps include: • Adapt and roll-out Train the Trainer modules for pilot testing in selected markets: Bangladesh, China, Mongolia and Vietnam • Develop partnerships and plan for rolling out in priority markets after pilot	FIGAS/ CRKES	1) Select a consulting firm to develop and deliver the TOT in select countries 2) Customize and translate training materials 3) Training partners' assessment and advice 4) TOT delivery and trainer development 5) Deliver of 4-5 trainings for multiple FIs in each market by consultant firms and trainers	Q4 FY14 Q4 FY14 Q2 FY16 FY15 going forward Q2 FY16	1) Completed. ERM was selected for Mongolia, Bangladesh and China and FI Konsult for Vietnam 2) Completed 3) In progress 4) In progress. TOT and FI training was completed in Vietnam. Two TOT rounds were delivered in China. Mongolia completed the first TOT series in Q3 FY15. TOT delivery for Bangladesh is planned for FY16 5) In progress. Delivery of FI training was completed in Vietnam. FI training (following TOTs) in China, Mongolia and Bangladesh will take place in FY16
3.3. IFC also plans to engage directly with leading FIs in the various markets to help build their capacity (new offering). It is expected that these FIs will be lighthouse	FIGAS/ CRKES	1) ESMS diagnostic services pilot	Q4 FY14	1) Completed. The diagnostics were conducted for 12 banks in 8 markets (Bangladesh, China, Georgia, Haiti, Honduras, Mexico, Turkey, and Vietnam)

institutions and will help shift market behavior. The steps include: • Developing a strong articulation of the business case for E&S risk management for FIs. This is proposed for FY14 • Developing FI ESMS diagnostic services that will enable FIs to identify E&S risk areas and also enable benchmarking. This will be launched as a pilot over FY14 and will be rolled-out thereafter • Pilot ESMS implementation support planned over CY14, and roll-out from CY15 • As the demand for this offering is as yet untested and as this initiative has strong value for reputation risk management for IFC and the FIs, IFC will explore pricing options during the pilot phase to arrive at a suitable approach to ensure success of the initiative.		2) ESMS diagnostic service roll out 3) Pilot ESMS implementation support	FY14 going forward FY15-onward	2) On-going task. Over FY15 we worked with 6 banks in Armenia, Bhutan, Morocco, Oman, Philippines and Turkey. In FY14 ESMS diagnostic pilot was conducted for 16 banks in 11 markets (Armenia, Bangladesh, Bhutan, China, Georgia, Haiti, Honduras, Mexico, Philippines, Turkey, and Vietnam). Additional diagnostics are planned for CAF and LAC 3) On-going task. ESMS development support is continued to be tested with clients focused on supporting ESMS development and capacity building.
3.4. In addition to the above, IFC proposes to integrate E&S risk management aspects into other relevant FI Advisory programs such as SME banking, Banking on Women, Agri-business financing and Risk Management.	FIGAS/ CRKES		FY15-onward	On-going task