RE: follow up to your letter of 10th April 2015

Dear Sirs,

7th July 2015,

As civil society organizations who remain concerned about the IFC’s management of its investments through financial intermediaries (FIs), we would like to thank you for your letter dated 10 April 2015 in which you provide the rationale for the IFC’s use of FIs and note the steps taken by the IFC to address some of our long-standing concerns about the potential negative impact of these investments. We also want to thank the IFC for participating in our panel on FIs during the Spring meetings.

We write in the hope that our response will be used as a point of departure for continued detailed discussions between the IFC and members of our community. With that end in mind we have included a series of questions within our response below and look forward to discussing your response to them in the near future, including in the meeting we are currently trying to set up with your staff.

We recognize that financial intermediaries can, under certain conditions, provide an important source of finance to individuals and small and medium-sized enterprises. However, we note that unlike the IFC, private banks and equity funds generally do not have a sustainable development mandate. They make their investment decisions based solely on a profit motive, leading some to finance projects that pose significant risks to people and the environment, and run counter to the World Bank Group’s goals of ending extreme poverty and building shared prosperity. We therefore continue to stress that client choice is of paramount importance if IFC investments are to have a positive development impact. The IFC should therefore ensure that it places developmental impact ahead of financial return when reviewing investment choices.

Experience has shown that many financial intermediaries currently lack the systems, resources, technical capacity and commitment to ensure that their investments comply with the Performance Standards. These shortcomings, as the cases detailed in our recent “The Suffering of Others” report demonstrate, heighten the risk of severe social and environmental impacts to unacceptable levels.

The consequences of the ineffective implementation of robust environmental and social safeguard systems (ESM) are clearly illustrated by the recent World Bank Group Involuntary Resettlement Portfolio Review, which noted substantial shortcomings in the World Bank’s own ability to ensure adherence to its standards. The World Bank’s failure to implement its safeguards in so crucial an area, despite its resources and decades of experience, casts severe doubt on the efficacy of approaches that rely on the environmental and social safeguard systems and capacities of financial intermediaries.
In your letter of 10 April you note that “Risk is inherent to our business and that of our FI clients.” While we of course understand that financial risk is indeed a central component of your business, it is imperative that we clarify that our concerns lie not with the financial risks that IFC and its FI clients assume, but with the very real risks to the rights of people impacted by FI investments.

**What do we mean by risk?**

In our joint report, “The Suffering of Others: The human cost of IFC lending through financial intermediaries”, we highlighted the impacts endured by communities when risk was not appropriately identified, addressed and managed by the IFC and its clients. The cases we wrote about, from Cambodia, Uganda, Guatemala, India and Honduras, showed a catalogue of suffering by some of the poorest and most vulnerable communities in the world. Instead of development benefits, local communities endured displacement, loss of livelihoods, fear, violence, criminalization and repression.

Such risks will only escalate in coming years, given the IFC’s plans to increase its lending in fragile and conflict-affected states by 50 per cent and the WBG’s strategy of investing more in “transformational projects” such as large infrastructure, which will presumably involve the use of the FI financing model.

The Board tells us that it wants the IFC to take more risk in riskier investment environments. We agree that the IFC should focus its support on underserved segments of the economy such as small and medium enterprises and LDCs, and that this implies additional financial risks. We stress however that this should not mean taking more unnecessary environmental and social risks.

**The IFC’s response to The Suffering of Others report**

The IFC’s response to our report and its presentation to the Board of 2 April 2015 include a number of positive steps to improve its approach to risk. We are particularly encouraged by stated commitments to improve client selection, base risk assessments on the client’s investment strategy and pipeline, improve capacity building for high-risk fund managers, implement a pilot on contextual risk, and develop measures to improve delivery of Performance Standard 4 relating to the use of security guards.

**I. Questions for further discussion**

1. **Ensuring E&S and financial risks have equal weight in investment selection.**

In response to our concerns about the incentive structure within the IFC, senior management has often highlighted the fact that IFC staff do not receive bonuses and that the IFC’s incentive structures do not encourage a focus on investment volume to the detriment of environmental and social concerns. However it is clear from discussions with Bank staff and the results of previous staff surveys that the pressure to generate income and lending volume remain important determinants in staff decision-making and perceptions of the opportunities of career advancement.

The IFC has recently mentioned that reforms to its institutional culture have resulted in the equal weighting of E&S and financial risk. We would be interested in discussing the specific details of how these have translated into actual processes and incentives, beyond senior-level messaging.
2. **Risk assessment to inform client selection.**

2.1 During our discussions at the Spring meetings, the IFC indicated that it did not know about high risk projects that its clients funded. However it now talks about assessing the client’s investment pipeline. Does this indicate that the IFC does access information about the sub-projects the client is supporting and intending to support?

2.2 Does this risk assessment apply to all FI clients or only funds?

2.3 If it applies to all FI clients, how can these be used to improve transparency? For example, will this information about high-risk sectors and sub-projects be made public? We feel that seeking external input into this appraisal, including gaining local knowledge, would better enable the IFC and other stakeholders to carry out more effective risk identification, avoidance, monitoring and remediation when harm occurs.

2.4 How is the pilot to provide research and analysis to support E&S teams on broader country or systemic risk linked with the wider WBG Systematic Country Diagnostic and Country Partnership Framework processes? What opportunity, if any, will civil society have to feed into this contextual analysis?

2.5 We are very interested in the IFC’s commitment to “a formal review of the top exposures of the FI's portfolio to determine its exposure to high-risk sectors” and “processes for identifying and managing risks related to distributional gender aspects and any potentially vulnerable groups” for sub-projects where the Performance Standards apply. We would appreciate details on the processes that will be used to undertake these reviews and to identify the distributional impacts of high risk projects. To what extent will these processes benefit from external input?

3. **Improved capacity building for high-risk fund managers.**

While efforts to build capacity of high-risk fund managers are welcome, we wonder about the plans to extend capacity strengthening to other clients beyond the relatively small fund portfolio and would appreciate additional information on the approach to be used by the proposed consultants.

4. **Delivery of Performance Standard 4 relating to the use of security guards.**

We note that the IFC’s 2 April update to the Board outlines steps taken to strengthen internal capacity on the use of security forces (PS 4). While we look forward to discussing issues related to PS4 in greater detail in the future, we take the opportunity here to note that a wealth of comprehensive guidance tools already exist, for instance the Implementation Guidance Tools (IGTs) developed by the IFC among others. We argue therefore that what is required rather than new tools is support for **consistent implementation** of the IGTs, and monitoring of that implementation.

II. **What appears to be missing**

In its response to our report, the IFC claims that only 3 per cent of sub-projects of funds are Category A. However, as noted before, funds only comprise around 10 per cent of the IFC’s total FI portfolio. We remain extremely concerned that the IFC has admitted it has no idea how many high risk
projects are in the portfolio of IFC-supported banks. On this point we would highlight the CAO’s finding that Banco Ficohsa alone has 64 Category A projects in its portfolio. This represents one bank in one country that IFC acknowledges lacks the capacity to manage E&S risk. This would equal more Category A projects on the books of one commercial bank client than in the entire IFC PE portfolio.

Given the often substantial environmental and social impacts of infrastructure investments, we also highlight significant IFC investment in opaque infrastructure financial intermediaries, such as PT Indonesia Infrastructure Finance, which provides scant information to the public about intended investments and no information regarding assessments of the potential impact of security forces on local communities in the context of these investments.

Very much linked to the transparency issue below, we continue to express our concern that without any public disclosure of the high risk sub-projects supported through non-PE fund financial intermediary clients, communities can have no idea that they have the right to redress through the IFC’s accountability mechanism, the CAO. We have yet to hear an adequate response from the IFC on this issue.

Transparency.

With respect to our demands for greater transparency, we appreciate that IFC has begun disclosing information on private equity fund sub-projects. However, we feel that you can and must go further. The arguments that IFC has been making for the past several years regarding regulatory restrictions on the disclosure of underlying investments within the Bank’s portfolio are unsubstantiated. Despite several requests over the past two years, and a commitment from IFC to provide this, the legal arguments for non-disclosure have still not been shared with civil society. We acknowledge that regulated banking institutions in many jurisdictions are subject to customer privacy standards, which restrict disclosure of investments within their portfolios. However, the presumption of banking client confidentiality can be overturned by agreement with the client.

We have not been able to find a single country in the world with laws that restrict banks from disclosing their corporate clients with the agreement of the client. It is certainly not prohibited anywhere for the clients themselves to disclose their relationship with the bank. In most jurisdictions, security regulations require publicly listed companies to disclose their debts. In other cases, banks disclose information about their investments for marketing purposes, which the CAO’s Ficohsa audit notes was indeed the case with Ficohsa. Additionally, this information is captured by financial database companies, such as Bloomberg and Thompson Reuters, and is disseminated to those who buy licenses for their products.

The IFC itself provides the perfect example of disclosure by agreement: it requires its direct clients, as a condition of financing, to agree to disclosure of the investment. There is no reason that this could not be extended to the sub-investments of financial intermediary clients. In fact, there is already an implicit requirement under the Performance Standards that IFC’s FI clients disclose their sub-projects, because they are required to establish grievance mechanisms that are known and accessible to people affected by their investments. If people affected by an FI’s sub-project do not know that the FI is financing the project, then they would also be unaware that they can lodge a grievance with the FI, rendering the FI grievance mechanism pointless.

Finally, we agree with the conclusion of CAO in its Ficohsa audit, that “It is unclear ... why IFC cannot require regular disclosure in relation to FI sub-projects.”
We propose a practical way forward to increase transparency, which would enable FI clients to meet their contractual obligations to comply with the Performance Standards: The IFC should require its FI clients to obtain the agreement of their corporate clients that meet a number of criteria such as, the size of company, sector and risk profile, to disclose their investments. IFC should then collect and help disseminate this information to the public through a dedicated website.

We look forward to continuing our exchanges on the important issues outlined above and hope that our questions and proposals will provide a good foundation for future detailed discussions.

Regards,

On behalf of the following organizations: Accountability Counsel, Bank Information Center, Bretton Woods Project, Eurodad, Center for International Environmental Law (CIEL), Inclusive Development International (IDI), International Alert, Oxfam, Ulu Foundation, Urgewald.