

Friends of the Earth US Comments on the “External Review of IFC/MIGA E&S Accountability, including CAO’s Role and Effectiveness”

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Submitted by Friends of the Earth US

Friends of the Earth US (FOE US) appreciates the opportunity to provide feedback on the External Review to the Board of Executive Directors. Due to the short window for public comments, we provide initial observations and recommendations below¹.

On “Recommendation 1: IFC/MIGA Need to Take the Lead on Private Sector Sustainability”²

Friends of the Earth US agrees that the IFC/MIGA should seek leadership status in setting high, international environmental and social standards in private sector sustainability. We agree with the view that in regards to working with clients, “IFC/MIGA should be leading with the most ambitious E&S principles and commitments; experimenting with innovating practices and instruments; and delivering world-class economic, environmental, and social results”³. We appreciate there is additional recognition of the need for IFC/MIGA to support clients during the “front end during project design, preparation, and implementation”, particularly in IDA-eligible and fragile countries⁴.

This recommendation implicitly acknowledges that the IFC Performance Standards (PS) should be revised and updated so as to reflect the most cutting edge and pioneering environmental and social standards. These standards should in turn reflect current global crises such as biodiversity loss and climate change. Currently, the PS can certainly be further evolved and improved to better address these global challenges.

For instance, considerably expanding the IFC’s Exclusionary List could be one means of improving the PS while also pioneering new ground in sustainable finance policies. By expanding the Exclusionary List, or adopting a “No Go” policy which categorically prohibits financing activities in key areas, IFC/MIGA can prevent major environmental and social risks and controversies. Based on FOE US’ experience, **many**

¹ All footnote references are based on the Report: Mr. Peter Woicke, et al, “External Review of IFC/ MIGA Environmental & Social (E&S) Accountability, including CAO’s Role and Effectiveness”, World Bank Group, June 2020. <http://pubdocs.worldbank.org/en/578881597160949764/External-Review-of-IFC-MIGA-ES-Accountability-disclosure.pdf>

² Page ix

³ Paragraph 22, Page ix

⁴ Paragraph 21, page ix

controversies or problems commonly arise due to the project's location, which as a result are extremely difficult if not impossible to fully resolve. As such, we strongly encourage the Board to consider adapting their Exclusionary List to prohibit direct and indirect financing to harmful, large-scale, or extractive activities in and/or nearby the following areas:

- 1. Areas recognized by international conventions such as the Bonn Convention, Ramsar Convention, World Heritage Convention and Convention on Biological Diversity, or other international bodies such as UNESCO (Biosphere Reserves, UNESCO Global Geoparks, etc) or Food and Agricultural Organization (vulnerable marine ecosystems), International Maritime Organization (particularly sensitive areas), IUCN Designated Areas (Categories IA – VI)*
- 2. Nationally or legally protected or recognized nature areas*
- 3. Habitats with endangered species categorized as “Vulnerable”, “Endangered”, or “Critically Endangered” per the IUCN Red List*
- 4. Old-growth forests, defined as primary forest or jungle which has not undergone any major unnatural, human-induced changes for the last 100 years*
- 5. Free-flowing rivers, defined as bodies of water whose flow and connectivity remain unaffected by human activities*
- 6. Protected marine or coastland areas*
- 7. Areas having archaeological, paleontological, or irreplaceable cultural values, including land with sacred, and ancestral significance to traditional and indigenous communities*
- 8. Iconic Ecosystems, defined as ecosystems with unique, superlative natural, biodiversity, and/or cultural value which may sprawl across state boundaries, and thus may not be wholly or officially recognized or protected by host countries or international bodies. Examples include transboundary ecosystems, such as the Amazon, the Arctic, and at-risk ecosystems, such as mangrove forests, wetlands, reef systems, among others*

Currently, the IFC's Exclusionary List does not include these areas, and the PS instead allow activities to occur in these areas with or without certain conditions or processes. However, there are numerous examples which indicate the value of including such exclusionary areas. For instance, proposed coal development in the Great Barrier Reef triggered an international campaign against financiers involved in the project; oil exploration in the Democratic Republic of Congo's Virunga National Park cost the project developer, SOCO International, \$68 million USD in losses after failing to consider biodiversity and environmental concern, in which SOCO ultimately decided to withdraw; Chinese banks and project developers involved in the \$3 billion USD Mes Aynak copper mine underestimated, if not ignored, the well-known fact that the area was an active archaeological site for many years, and as a result, ten years since the contract was signed, the project continues to languish.

Although the PS allows for project activities to continue if certain requirements are met, such as biodiversity offsets, **we strongly recommend that the use of biodiversity offsets be discontinued due to their impact in creating perverse incentives, normalizing continued destruction of natural places and habitats (which in turn places more strain on the ecosystem, particularly if located in a critical**

ecosystem or conservation area), merely displacing pollution or harmful impacts into “non-offset areas”, and ignoring or devaluing indigenous or traditional community rights in designated offset areasⁱ. There are also numerous examples of how biodiversity offsets are ineffective and in fact contribute to creating perverse development incentives (please see Endnote 1).

There is also no guarantee that an area designated as a biodiversity offset area will remain a protected area. For instance, the Moyon-Bafing National Park in Guinea was designated as a wild chimpanzee “offset” as part of a mining development project. The mining project was supported by IFC. Today, however, the proposed Koukoutamba Dam threatens to destroy the chimpanzee sanctuary, and has received signs of financial support from China Export Import Bank. Despite the destruction of chimpanzee sanctuary, the Guinean government nonetheless supports the dam. It should be noted that the dam’s feasibility studies were funded by the World Bankⁱⁱ.

The lack of a stronger Exclusionary List, in addition to the PS’ allowance for the use of biodiversity offsets, significantly contributes to a situation where projects are “set up to fail”. This is because the inherent location of a project creates a scenario in which environmental, social, or indigenous peoples risks and problems are extremely difficult if not impossible to fully resolve. Surprisingly, even internationally recognized places of outstanding natural beauty or cultural heritage, such as World Heritage or IUCN recognized sites, are vulnerable to harmful development activities. Even iconic ecosystems such as the Amazon, Arctic, and others are vulnerable to extractive activities. Even with offset or “no net loss” schemes, it is highly likely that the natural or cultural integrity of such places would inherently suffer.

It should be noted that although PS 6 states that projects with negative biodiversity impacts should only be “considered only after appropriate avoidance, minimization, and restoration measures have been applied”, in practice project proponents and investment officers do not follow such procedures. Instead, biodiversity offsets are strategically used to justify and enable projects with negative biodiversity impacts. Furthermore, in light of the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES) global assessment report on biodiversity and ecosystem services, the world has reached a critical threshold where biodiversity is disappearing at a disturbingly accelerated pace – according to the report, “An average of around 25 per cent of species in assessed animal and plant groups are threatened..., suggesting that around 1 million species already face extinction, many within decades, unless action is taken to reduce the intensity of drivers of biodiversity loss”. At the same time, the report asserts that the efficacy of biodiversity schemes are “mixed”, suggesting that they should not be considered a tool of first resort, let alone a common approach to addressing biodiversity risksⁱⁱⁱ.

The IPBES report points out that nature and biodiversity “underpins” human health and wellbeing, as well as our ability to choose alternatives in an uncertain world. Given the grim reality of rapidly deteriorating nature and biodiversity, **both IFC/MIGA and CAO should consider expanding its Exclusionary List to account these new environmental challenges in a rapidly changing world.** The IPBES Report further identifies the unique role and responsibility that global financial and economic systems play in fostering unhealthy and unsustainable economic growth paradigms. **It is clear that financial institutions play an important part in preventing and slowing down biodiversity loss. Unfortunately, however, the current PS and environmental and social risk management system does not reflect this responsibility and the current reality.** PS 6 approaches biodiversity offsets as rooted in “no net loss” and “like-for-like or better” principles, but frankly the window of opportunity for such schemes has closed – the scientific evidence of rapidly declining biodiversity, mass deforestation, and

the ability of critical ecosystems (such as those listed in our proposed No Go policy) to support human life in the age of climate change suggests we are urgently running out of time.

We agree that the IFC/MIGA has lost its edge as a leader in sustainable finance, **and in order to again become a leader in environmental and social standards, IFC/MIGA would benefit by expanding its Exclusionary List to reflect “No Go” areas given the world’s current climate and biodiversity crisis.** The CAO report calls for “proactive E&S support” for clients, but this also entails that such support should also attempt to preempt environmental and social risks that a client may face. **Expanding the Exclusionary List to include key, critical ecosystems would also be aligned with the Report recommendation that “IFC/MIGA should review the PS and identify all requirements that need to be complied with before a project can be approved” and that PS “Need to Met at the Commitment Stage of a Project”⁵.** Having a strong screening process which is in part based on IFC’s Exclusionary List at the outset can thus help IFC/MIGA to regain its status as a leader in E&S standards by preemptively preventing a wide array of environmental and social issues across industrial sectors.

We believe that a newly revised Exclusionary List should also apply to financial activities carried out by financial intermediaries. If IFC/MIGA is able to expand its Exclusionary List based on the above areas, it would certainly demonstrate the institution’s commitment to be a leader in environmental and social standards.

On “Recommendation 8: Efforts to Seek Early Resolution of Complaints Need to Be Strengthened” and “Recommendation 9: An IFC/MIGA Framework Needs to be Established for Remedial Action in Cases in which Non-compliance Contributes to Harm”⁶

We agree with these recommendations, as well as the finding that there is a need to shorten the timeframe for complaint handling⁷. **In regards to Recommendation 8, we note that it should be considered that a long timeline for complaints handling can in fact inflict its own kind of harm, as the failure to effectively resolve grievances can prevent affected persons from moving on both physically or emotionally.** Waiting an average of three years for redress may thus serve to re-traumatize a complainant who may have already been wronged. The loss of land, livelihood, or even injuries or death can have a devastating impact in the complainant’s ability to simply survive.

As a result, in addition to significantly cutting down wait times in general (which perhaps can be alleviated in part by IFC staff/investment officers taking a more proactive role in preempting E&S risks), we encourage the CAO to also consider significantly modifying timelines to reflect the urgency or severity of the complaint. In other words, complaints regarding significant, debilitating grievances or injustices, such as loss of land, livelihood, and health/wellbeing, should be considered on an accelerated timeline to ensure speedy compensation and corrective actions.

In regards to Recommendation 9, a framework for remedial action in “cases in which non-compliance contributes to harm” should indeed be established. In particular, **we recommend the use of legal covenants to enshrine Client environmental and social obligations should be better utilized.** The use of

⁵ Paragraph 97, page 7

⁶ Page xvi-xvii

⁷ Paragraph 202, page 34

E&S loan covenants to ensure better Client performance is already being encouraged by other actors, such as the Chinese Banking Regulatory and Insurance Commission. For instance, Chinese bank regulators published suggested loan clauses for environmental and social risk management control. Examples include making a “commitment that it establish internal management system of environmental and social risk and well define the responsibilities, duties, penalty of borrowers' related people”, and stipulating specific measures lenders can take if clients fail to implement environmental and social risks, such as revoking loan commitments, suspending loans, recalling loans, or other punitive measures^{iv}. Interestingly, these kinds of new policies and guidance documents reflect Chinese bank regulators surpassing international peers in becoming a new international leader of sustainable finance.

Because loan covenants are legally binding and are signed early on in the loan process, they should be better utilized to clarify the role of Client and Lender in cases of environmental and social failures, and ensure a clear road map for how to deal with potential, future issues. “Frontloading” E&S issues in loan contracts is also opportune timing, as this is when a lender has the most leverage over a Client. Notably, doing so also insulates IFC as a lender if the Client should willfully not implement key environmental and social measures. Publicly disclosing the E&S loan covenants can also further help prevent liability on the lender as the Client’s E&S roles and responsibilities are public information and thus subject to public monitoring.

Lastly, we provide suggestions on the discussion of E&S contingent funding requirements. We agree with the report’s finding that “IFC/MIGA contribution to harm triggers an obligation for their contribution to remedy”⁸. We believe that an E&S contingent funding should come from both the Client and IFC, and propose some thoughts in developing such a fund (or funds).

For the Client

- IFC Management or CAO reserve the right to use Client’s collateral to cover environmental and social harms caused by the Client
- IFC Management requires Clients to submit an “E&S Deposit”, which will be returned to the Client two years after the project is completed and Client did not cause any harm
- IFC Management requires the Client to commit to potential environmental and social redress and compensation in loan covenants, if it can be shown the Client negligently or willfully ignored environmental and social risks

For IFC

- IFC Management should allocate a small percentage of interest earned off loans across its portfolio towards E&S contingent funds (similar to the Robin Hood Tax^v)
- The rights to administer the E&S contingent fund should reside with the CAO, and administration of the funds should be transparent to the public

On IFC and CAO Governance

We agree with the recommendation that a Sustainability Committee at the Board level should be created.

⁸ Paragraph 60, page xviii

We also agree that “investment officers should pay more attention to environmental risks and particularly social risks potentially inherent in projects when they look at investments”⁹. We take particular note to the report’s acknowledgement that a system of “incentives” which facilitate “action or inaction by a client” can lead to the bank directly contributing to harm, which in turn should require that the “bank has a responsibility to contribute to remedy, along with its client”¹⁰.

Based on the report and our own observations, it is clear that IFC/MIGA staff are not properly incentivized to prudently and seriously consider environmental and social issues with clients. In order to correct these unbalanced incentive systems, we suggest that the Board consider integrating environmental and social performance indicators across departments. This could include the Legal and Compliance Risk Department, the Risk and Finance Department, Economics and Private Sector Development Department, and Regional Departments (assuming E&S Policy and Risk Department already have performance indicators related to their role in properly identifying, escalating, and resolving environmental and social issues).

Examples of performance indicators across teams can include the following:

- Staff/investment officers are rewarded for actively and properly contributing to in identifying, escalating, or resolving environmental and social issues
- Staff/investment officers are not penalized but are rewarded for flagging or rejecting loan proposals with significant environmental and social risks.
- Staff/investment officers bonuses are reduced if their managed Clients/projects are found to have serious environmental and social issues up to two years after a project has been completed
- Staff/investment officers are penalized if the Client can prove they were not adequately informed of proper environmental and social requirements by IFC staff, according to the PS or other environmental and social conditions
- Staff/investment officers performance is in part assessed based on the success of the Client in addressing and resolving environmental and social issues
- Staff in the E&S Policy and Risk Department and CAO staff can recognize other IFC staff/investment officers for recognizing or escalating environmental and social issues properly by providing peer to peer “bonuses” on a quarterly or other timely basis. This fund would be provided from IFC.
- Staff promotions should also consider if the environmental and social performance of the IFC staff person’s portfolio was positive and led to few or no longstanding issues.
- If Staff/investment officers can be shown to be grossly negligent in failing to consider environmental and social problems in a timely and responsible manner, management reserves the right to re-adjust staff base salary
- If Staff/investment officers are shown to continuously fail in informing Clients of E&S risks, or fail to make reasonable and honest efforts in ensuring Clients “succeed” in meeting E&S requirements, IFC management reserves the right to place the staff member in question on probation

These indicators can be used in assessing staff promotion, as well as institutional bonuses.

⁹ Paragraph 163, page 22

¹⁰ Paragraph 324-325, page 75

We also note that the consideration and resolving of environmental and social issues should be included in performance reviews of the Board of Executive Directors, in order to align environmental and social issues with improved incentive structures.

Furthermore, we believe that by more closely tying staff performance expectations and compensation packages to environmental and social performance can significantly address the “systemic disconnect” between the compliance review and IFC staff/management, as there is currently no common, meaningful incentive structure to ensure IFC staff and investment officers fully address E&S concerns¹¹. Doing so may thus help alleviate and address the “systemic disconnect”, as IFC staff and investment officers will be more motivated to ensure stronger due diligence, and take more steps to make sure Clients do in fact take corrective actions.

¹¹ Paragraph 314, page 72

Endnotes

ⁱ “Regulated Destruction”, Friends of the Earth International, October 2018. <https://www.foei.org/wp-content/uploads/2019/11/foe-FoN2-regulated-destruction-EN-WEB.pdf>

ⁱⁱ Jonathan Watts, “Chimp sanctuary created by World Bank threatened by World Bank-backed dam”, Guardian, August 3, 2018. <https://www.theguardian.com/environment/2018/aug/03/chimp-sanctuary-created-by-world-bank-threatened-by-world-bank-backed-dam>

ⁱⁱⁱ IPBES (2019): Global assessment report on biodiversity and ecosystem services of the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services. E. S. Brondizio, J. Settele, S. Díaz, and H. T. Ngo (editors). IPBES secretariat, Bonn, Germany.

^{iv} “Appendix V, Green Credit Guidelines Key Performance Indicators”, China Banking and Regulatory Commission June 2014. <http://www.cbrc.gov.cn/EngdocView.do?docID=C5EAF470E0B34E56B2546476132CCC56>

^v “Robin Hood Tax”, <https://www.robinhoodtax.org/>