

**IFC's Policy and Performance Standards on  
Social and Environmental Sustainability  
and Disclosure Policy:**

**Progress Report on the First 18 Months  
of Application**

**International Finance Corporation**

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**INTERNATIONAL FINANCE CORPORATION’S  
POLICY AND PERFORMANCE STANDARDS ON  
SOCIAL AND ENVIRONMENTAL SUSTAINABILITY AND  
DISCLOSURE POLICY:**

**PROGRESS REPORT ON THE FIRST 18 MONTHS OF APPLICATION**

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## GLOSSARY OF TERMS

<b>AMR</b>	Annual Monitoring Report
<b>AS</b>	Advisory Services
<b>BCS</b>	Broad Community Support
<b>BRIC</b>	Brazil, China, India and Russia
<b>CAO</b>	Compliance Advisor Ombudsman
<b>CES</b>	Environment and Social Development Department
<b>CESES</b>	CES Policy & Standards Unit
<b>CESIG</b>	CES Investment Support Group
<b>DOTS</b>	Development Outcomes Tracking System
<b>E&amp;S</b>	Environment and Social
<b>EHS Guidelines</b>	Environmental, Health and Safety Guidelines
<b>EIR</b>	Extractive Industries Review
<b>EP</b>	Equator Principles
<b>EPFI</b>	Equator Principles Financial Institutions
<b>ESG</b>	environmental social and governance
<b>ESRD</b>	Environmental and Social Review Document
<b>ESRP</b>	Environmental and Social Review Procedure
<b>ESRR</b>	Environmental and Social Risk Rating
<b>ESSD</b>	Environmentally and Socially Sustainable Development Network of the World Bank
<b>FI</b>	financial intermediaries
<b>FMTAAS</b>	Funding Mechanism for Technical Assistance and Advisory Services
<b>GHG</b>	greenhouse gases
<b>HQ</b>	IFC Headquarters
<b>IFI</b>	International Financial Institution
<b>ILO</b>	International Labour Organization
<b>MIGA</b>	Multilateral Investment Guarantee Agency
<b>NGO</b>	Non-Governmental Organization
<b>OECD</b>	Organization for Economic Co-operation and Development
<b>PEP</b>	Private Enterprise Partnership
<b>PPAH</b>	Pollution Prevention and Abatement Handbook
<b>PS</b>	Performance Standards
<b>QA</b>	CES Quality Assurance Team
<b>SEMS</b>	Social and Environmental Management System
<b>SPI</b>	Summary of Proposed Investment
<b>SRSG</b>	UN Secretary-General's Special Representative for Business and Human Rights
<b>UN</b>	United Nations
<b>WHO</b>	World Health Organization

# **IFC's Policy and Performance Standards on Social and Environmental Sustainability and Policy on Disclosure of Information: Progress Report on the first 18 Months of Application**

## **EXECUTIVE SUMMARY**

1. This paper updates IFC's Board of Directors on IFC's implementation of the Policy and Performance Standards on Social and Environmental Sustainability (the Sustainability Policy and Performance Standards), and the Policy on Disclosure of Information (the Disclosure Policy), both of which became effective on April 30, 2006.
2. Based on data on projects approved by the Board between May 1, 2006, and September 30, 2007 (out of 450 projects approved during this period, 250 applied the Performance Standards), management believes that IFC's implementation of the new policy framework is sound and that the new approach is working to strengthen projects.
3. IFC has made significant efforts to ensure sound implementation. The Environment and Social Development Department (CES) made organizational adjustments, and set up its new management system with two important elements, the Environmental and Social Review Procedure, and the Quality Assurance (QA) System. This management system addresses the IFC investment cycle from pre-appraisal to supervision, and is administered by a new quality assurance team. An IFC-wide training program for investment and advisory staff and in-depth training for CES specialists ensure an appropriate knowledge base for the institution. The new Disclosure Portals allow tracking of information by internal and external stakeholders, and a new internal procedure for addressing external requests for information allows orderly responses.
4. The new policy framework has had an impact on IFC's leadership and operational activities in three areas: on IFC's business and clients, on IFC's projects, and on market practices worldwide. Despite concerns that the policy framework would be costly for IFC to implement, direct costs have been modest and spread over three fiscal years. Costs of project processing did not increase significantly, except for Category B projects; and this is consistent with the increase in IFC's overall cost of processing such projects. Among clients IFC has surveyed, 72 percent feel that the cost in meeting the Performance Standards would not impact their decision to return to IFC for financing.
5. The new Standards' tailored approach to risk management lets clients and IFC specify appropriate and relevant requirements in the Standards without the constraint of categorization. In return, clients have to implement specific procedure or mitigation measures, previously reserved only for Category A projects, in order to meet the requirements under the Performance Standards. IFC's implementation data shows that new requirements, such as free, prior, and informed consultation and broad community support, are being applied based on potential impacts and risks (as opposed to flowing from a categorization decision). This new approach is working to strengthen projects, rather than to weaken them.

6. In the financial markets worldwide, the Performance Standards catalyzed the swift convergence of standards for cross-border project finance and this has leveled the playing field. To date, 56 banks and financial institutions use the Equator Principles, which have been updated to refer to the new Performance Standards. In addition, 32 export credit agencies of the OECD countries also benchmark private sector projects against the Performance Standards, and MIGA has also recently adopted the Performance Standards for its operations. IFC is sharing its experience and lessons learned in applying the Standards with these institutions, using its convening power to establish and maintain a Community of Learning.

7. IFC will continue to apply the Standards with diligence and will return to the Board at the end of FY09 to present a comprehensive three-year implementation report. Management will also present a review process proposal that outlines the next update round for the Performance Standards, to begin in FY10. At the same time, IFC is directing ongoing efforts to external outreach programs on the Standards and the Equator Principles, with emphasis on financial institutions in middle-income countries, and to the Community of Learning.

8. The new policy framework enables IFC to continue to expand its policy instruments for new policy areas and audiences as risks and challenges for private sector investors continue to be better understood. IFC is well equipped to addressing new policy challenges, such as climate change. In connection with the forthcoming World Bank Group's Climate Change Strategy, IFC will offer tools and methodologies for use during project appraisal and portfolio management for financial institutions using the Standards and Equator Principles.

9. Finally, time is right for IFC to explore ways to create value from its Performance Standards, using them not only for risk management, but as a proxy for environmental and social sustainability considerations in investing. As a first step in this direction, IFC is planning a more tailored application of the Standards to listed equity vehicles as well as exploring developing niche financial products for the market that exploit the quality of IFC's own portfolio as a result of rigorously applying these Standards.

## **PART I. BACKGROUND**

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1. On February 21, 2006, IFC's Board of Directors approved management's proposal to adopt the new Policy and Performance Standards on Social and Environmental Sustainability (the Sustainability Policy and Performance Standards), and Policy on Disclosure of Information (the Disclosure Policy) with an effective date of April 30, 2006. The internal and external processes leading to the approval was unprecedented for IFC. The formal consultation period lasted for more than a year, in two phases, and included four regional multistakeholder consultation workshops, and numerous thematic, geographic, and sectoral meetings. During the period, IFC released two drafts in the public domain for comments, as well as a compilation of all comments received and IFC's responses to the common questions and comments. The process also involved extensive internal consultation within the World Bank Group. Of particular note, the process built upon the constructive input of both IEG-IFC and the CAO. Approximately \$4,500,000 and 20 staff years were expended in the effort. The result is a comprehensive set of Standards for the key social and environmental risk factors in private sector projects in emerging markets.

2. At the February 2006 Board meeting, some members of the Board, while supporting the management proposal, expressed concerns about potential weakening of policy requirements, internal and external cost implications of policy implementation, and impacts on IFC's competitiveness and attractiveness, particularly to smaller companies. They also expressed their strong desire for IFC to consistently apply the Performance Standards, and asked IFC to monitor and report on its implementation frequently. It was agreed that the policy documents would be formally reviewed three years after their introduction, with an eighteen-month implementation report to the Board. This paper summarizes IFC's first year and a half of policy application, and looks ahead on a landscape that has been altered by the Standards and the implications and opportunities for IFC.

3. In order to share IFC's experience with external stakeholders, including the growing number of private and public international and domestic financial institutions that apply or refer to the IFC Performance Standards in their operations, management requests the consent of the Board of Directors to post this Board paper on IFC's website. Dissemination of this paper will also enable IFC to receive feedback from external stakeholders on their reactions to the findings in this paper.

## **PART II. IMPLEMENTATION**

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### ***a. Overview of Implementation***

4. Significant institutional effort has gone into the implementation of the new policy framework. Work began in advance of the effective date of the policy framework, and virtually all of it was performed within IFC, using its internal expertise and resources, in order to ensure fit to IFC and internal ownership. As of today, management considers IFC's implementation of the new policy framework to be sound. The organization, systems and processes established for compliance, monitoring, and data generation are innovative and effective. The direct cost of implementation is relatively modest, and increased processing costs incurred by the institution in processing Category B projects are appropriate and welcome. Based on data available to date, the new approach created under the policy framework is helping to strengthen projects, rather than weakening them.

### ***b. Organization***

5. Differentiating through sustainability is one of the five strategic pillars of IFC for FY08. Sound implementation of the Performance Standards and continued support for the Equator Principles are two priority components of this strategic pillar. IFC's own application of the Performance Standards is led by the Investment Support Group (CESIG) within the Environment and Social Development Department (CES). The group consists of 45 specialists and two managers, who are dedicated to project review and supervision, and play an essential role in identifying opportunities for additionality and value addition. They also form an integral part of IFC's business development efforts in high risk/high reward sectors. CESIG is funded from IFC's administrative budget.

6. IFC's work on the Performance Standards and its activities with the community of other institutions that use them, including the Equator Principles Financial Institutions, is spearheaded by a small Policy and Standards Unit (CESES) within the Environment and Social Development Department (CES). CESES's role is to assist in policy coherence and consistent interpretation, to conduct outreach activities directed to external stakeholder groups, and to advise IFC on relevant policy development in the global arena. Funding for part of CESES's work is from the administrative budget, and more recently, given the global relevance of the Standards and Equator Principles for IFC and its global external stakeholders, programs related to the Performance Standards and Equator Principles are eligible for IFC Global FMTAAS funding (funded out of IFC's net income).

### ***c. Management System***

7. As many members of the Board stressed last year, consistent policy application to projects is key in any new policy initiative. From IFC management's perspective, it is critical to our ability to manage risk for IFC, its clients, the natural environment, and affected communities. With this in mind, CES has established a new management system to ensure that CES management can effectively manage resources to ensure consistent and high quality implementation. The management system allows CES management to track the state of policy

application and compliance, as a basis of data reporting to IFC management, to Development Outcomes Tracking System (DOTS), and to the Board as well as external stakeholders. The data produced by the management system is also designed to provide IFC with the basis for understanding the impact of the Performance Standards on clients, as well as the relationship between meeting Standards and positive development outcomes. We expect that such information will create a solid baseline for our future review and revision of the policy. Two important elements of the CES's management system are the Environmental and Social Review Procedure (ESRP), and the QA System, described below.

8. Simultaneously with the implementation of the Performance Standards, IFC began applying the new ESRP. The first version of the ESRP introduced in April 2006 was updated in July 2007, reflecting the first 15 months of application. The ESRP articulates IFC's day to day project processing requirements that will enable IFC to operationalize its sustainability policy framework. Integral to the ESRP is the new Environmental and Social Review Document (ESRD), which is an electronic interface that links ESRP requirements with projects, allowing CES to document due diligence and track project attributes (set of compliance and performance indicators) throughout IFC's involvement in the project. A subset of the project attributes also consists of CES's direct input into the DOTS process. The project attributes continue to be refined to capture the most relevant parameters under the Performance Standards. The ESRP is publicly available through the IFC web space.

9. More recently, CES undertook a rapid review of the portfolio of advisory services (AS) activities to assess whether the ESRP on Advisory Services (ESRP 11) is effectively applied. This rapid review screened the AS portfolio, and identified AS activities with elements that should have triggered requirements under ESRP 11, which were then subjected to a rapid desk review. This review demonstrated that the system is effective in managing environmental and social risk from AS projects. The system will be strengthened through additional training and mentoring of AS champions to increase their ability to recognize Performance Standards issues.

10. CES's QA Team operates a system of quality assurance to support the implementation of the ESRP and the ESRD. The QA Team comprises of three CES staff members reporting to Manager, CESIG. The QA Team creates document templates to generate reports that inform management on appraisal and supervision performance, conducts spot reviews on the ESRDs, organizes and identifies follow up action from formal peer reviews<sup>1</sup>, and collates data on Standards implementation. Much of the data reported in this Board report was obtained primarily from reports drawn from the ESRDs. Over time, the system will track additional data and parameters for analysis by the QA staff, CES and IFC management and going forward issues of environmental and social risk will be reviewed by IFC's Financial Risk Committee.

#### ***d. People & Capacity***

11. As part of IFC's evolution of continued decentralization, an initiative known as Global / Local, more CES specialists were located in field offices in order to be close to IFC clients and operational staff in the field. This local capacity, combined with sustainability champions in key

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<sup>1</sup> In addition to the formal peer reviews that cover a full spectrum of project issues, mini peer reviews are organized on specific topics on an ad hoc basis.

regional advisory facilities, enables IFC to engage more effectively with prospective and portfolio clients and other private sector companies. With these relocations, CESIG's expertise is now spread around the world more than ever. Care is taken to balance the location of specialist and generalist skills in the headquarters and field offices, and specialists' skills are being kept up to date and new expertise added in order to meet the demands of IFC investments and requests from clients for advice. Many specialists are being retrained in areas in addition to their current scope of responsibility. In addition, in-depth training and tools have been made available under several Performance Standards (see more details in paragraphs 19-21 below). CES's knowledge management function helps the specialists to learn from one another and keep their skills current in both formal and informal ways, and encourages knowledge networks inside and outside the department. This internal basis of knowledge can then be translated in public goods for sharing with the Community of Learning (see paragraph 61 below) and other external stakeholders as good practice.

12. To equip HQ and field staff with information to engage with and advise clients, CES organized training on the Performance Standards. Out of about 3,000 staff members, 1228 have been trained, including 532 investment staff through 42 sessions to the end of the last fiscal year. In the current fiscal year, the training will be repeated quarterly, and will be supplemented by a new e-learning course on the Performance Standards, which was launched in September. This simple but effective program helps new staff get acquainted with the function of the Standards in IFC projects, and will provide basic operational knowledge until such time staff member can access live training.

*e. Project Appraisal and Approval*

13. For the 17 months beginning on May 1, 2006 and ending on September 30, 2007, 250 projects applying the Performance Standards were approved by IFC's Board of Directors. This is a smaller number of projects in comparison to the total of 450 projects approved by the Board during this period, reflecting the fact that projects already in the appraisal stage by the time of the adoption of the Performance Standards were grandfathered. This ensured a fair and predictable transition to the new Standards, enabling projects that had already expended time and money to conform to the safeguard policies to proceed. Nine projects that would have been grandfathered elected to apply the new Standards. Although the number of grandfathered projects steadily declined over the last few months to almost zero, it was higher in the first twelve months of implementation. As a result, the data in this report should be considered as representing a transition period. The next report to the Board on three year's implementation should provide a fuller picture of policy implementation based on a larger number of projects applying the Performance Standards.

14. All 250 projects applied the Performance Standards as an initial screen, of which 125 projects in the real sector were deemed to involve potential significant adverse impacts, or limited impacts, resulting in the in-depth application of some or all of the Performance Standards during appraisal by CES specialists. An additional 38 projects were deemed to involve minimal or no impacts. Projects with financial intermediaries (FIs) totaled 87. All these FI projects were processed under the new procedure designed to enable IFC to determine the appropriate standard, local law, or exclusion requirements in their operations, depending on the riskiness of

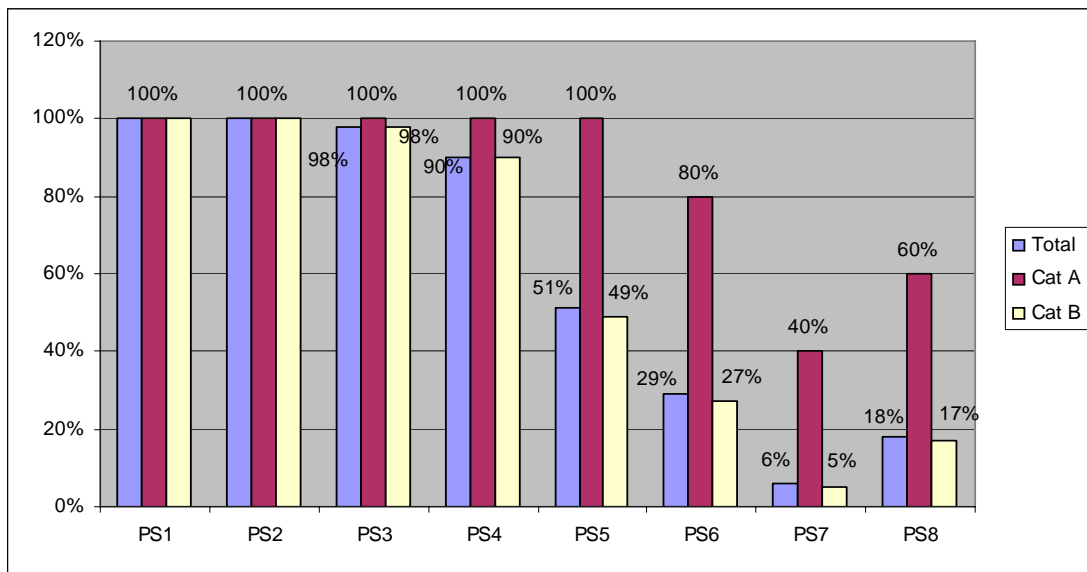
the FI's portfolio (see paragraphs 26-29 below on FI projects). The breakdown of these projects by categorization and disbursement can be found in Box 1 below.

**Box 1**

<b>Board Approved Projects Applying the PPS</b>		
	<b>Application of the PPS</b>	<b>Disbursed</b>
Category A	5 (2%)	2 (40%)
Category B	120 (48%)	64 (53%)
Category C	38 (15%)	17 (45%)
Category FI	87 (35%)	43 (49%)
<b>Total</b>	<b>250 (100%)</b>	<b>126 (50%)</b>

15. Box 2 below indicates the frequency of application of each of the Performance Standards. The data confirms our assumption from the outset that the core standards that are applied consistently across all sectors and regions are Performance Standards 1 through 4 (PS 1: Social and Environmental Assessment and Management Systems; PS 2: Labor and Working Conditions; PS 3: Pollution Prevention and Abatement; and PS 4: Community Health, Safety and Security). Performance Standard 1 is the key business process standard applicable to any client. Performance Standards 2 through 4 address social and environmental impacts from the project's immediate physical operation, such as impacts to the project's most immediate stakeholders and their natural surroundings, so that they make a compelling case for risk avoidance and management for projects. Since some of the issues addressed in these Standards are new to IFC, IFC focused on internal capacity building in a number of key areas.

**Box 2**



16. Specific performance data on social and environmental assessment and management systems is summarized in Tables 3 through 8 of Annex A. IFC's observations on the current system of project categorization appears in paragraphs 50-53 below. Implementation on requirements related to Action Plans can be found in paragraphs 30 and 34, and Tables 6 and 7 of Annex A. Data on project level disclosure of information is described in paragraphs 34 and 35.

17. One of the most important commitments made under Performance Standard 1 was to require clients to carry out free, prior and informed consultation with communities expected to be significantly affected by the project. This requirement goes hand in hand with IFC's responsibility to ensure broad community support for the proposed projects. To date, 9 projects applied these requirements. The sectors of these projects were diverse: three in oil & gas; two in mining; two in power; one each in road and general manufacturing. Five were Category A projects and 4 were B projects. Each project presented its own unique circumstances and challenges. For example, one project involved an analysis of a community engagement process that stretched over several years, while another had to be analyzed carefully to separate the affected community's expression of appreciation for ongoing corporate social responsibility programs from expression of broad community support. CES currently uses a number of indicators to ascertain the quality of the client's free, prior, and informed consultation, and IFC's examination of broad community support. We will monitor these projects in order to refine the indicators, and plan to produce a more detailed diagnostic on implementation effectiveness. In a few months' time, clients will also have access to an additional tool on community engagement in the form of a concrete guidance document on how to establish and maintain project level grievance mechanisms. Additional data on community engagement requirements can be found in Table 8 of Annex A.

18. Social assessment, labor assessment, health assessment, risk assessment, community engagement, and grievance mechanisms – these are processes to assess impacts that are also relevant in an overall assessment and management of human rights impacts of project activities. In an attempt to create a coherent business process framework for addressing these issues, CES has released a draft Human Rights Impact Assessment tool, developed jointly with the International Business Leaders Forum, in response to a call for such tools by the UN Secretary-General's Special Representative for Business and Human Rights (SRSG). This tool will be road tested by IFC projects and other volunteer companies in the coming months. IFC looks forward to learning from the road testing experience, and to reporting back to interested members of the Board on the outcomes and findings.

19. On Labor and Working Conditions, CES has developed for IFC and introduced a draft Labor Toolkit, a practical screening and due diligence tool for project review, and delivered in-depth training designed to enable the CES specialists to apply the Toolkit to projects with labor issues. When faced with country issues and potentially problematic sectors, a comprehensive labor audit is called for. To date, 5 projects have undergone internal (CES) or external labor audits. 15 projects carried out a supply chain assessment, which is a challenging area for both labor and materials supply chain (see Table 10 of Annex A).

20. To promote good practice under PS 2, CES published two Good Practice Notes (one on retrenchment and another on discrimination) and is working on the third on employment relations. In addition, CES established the Labor Advisory Group, consisting of practitioners from institutions, enterprises, and labor unions, who provide advice to IFC on specific labor issues. To date, CES specialists and industry staff met with the Group twice. The most recent meeting with the Group solicited the Group's feedback on the draft Labor Toolkit. Based on this feedback and after further revisions, CES expects to make the Toolkit available publicly to solicit feedback from external stakeholders. Additional performance data on PS 2 can be found in Tables 9 and 10 of Annex A.

21. In the area of pollution prevention and abatement, IFC completed a major overhaul of that part of the Pollution Prevention and Abatement Handbook (PPAH) providing emissions and discharge measures for major industrial sectors. On April 30, 2007, IFC published 56 guidelines as the new World Bank Group Environmental, Health and Safety Guidelines, after a two and a half year review process. Six more guidelines are expected to be finalized by the end of this fiscal year. The Guidelines are intended to promote the use of good international industry best practice in pollution prevention and abatement. As 'living documents,' they will be updated on a regular basis. Multilateral and bilateral financial institutions, the Equator Principles Financial Institutions (EPFIs), and private sector companies and consultants already refer to the Guidelines as de facto industry standards for emerging markets projects. To maximize the impacts of this important product, work is underway to translate these into Spanish, Chinese and Russian, as a matter of priority. In addition to the Guidelines, CES is planning to update an outdated GHG quantification tool in order to address the needs of multiple sectors that must quantify its GHG emissions under Performance Standard 3. This tool will be part of a climate change tool kit under development by CES under IFC's climate change strategy (see discussion in paragraph 69 below). Additional performance data on PS 3 can be found in Tables 11 and 12 of Annex A.

22. On community health, safety and security, CES designed and delivered training on the use of security forces, and carried out a significant update of Guidance Note 4 to reflect the importance of health issues in communities, in discussion with the World Health Organization (WHO). CES is currently in the process of creating an impact assessment tool to address the human health needs of the local community, which will be tested in the coming months, and an indepth training in this area is expected in the spring. Additional performance data on PS 4 can be found in Table 13 of Annex A.

23. Performance Standards 5 through 8 (PS 5: Land Acquisition and Involuntary Resettlement; PS 6: Biodiversity Conservation and Sustainable Natural Resource Management; PS 7: Indigenous Peoples; and PS 8: Cultural Heritage) are specialized standards that apply only in specific circumstances, but entail potentially serious risks for IFC and projects when they do. As a result, these areas demand narrow but deep expertise within CES, currently located mostly in headquarters.

24. Data on implementation of Performance Standard 5 on Land Acquisition and Involuntary Resettlement indicates that the private sector is actively getting involved in managing resettlement necessitated by its project, even where the government is primarily responsible for arranging the resettlement (see Table 15 of Annex A). Whether private sector companies will

willingly and actively support a government-managed resettlement process was a point of contention during consultation on this Standard. This finding is consistent with IFC's belief that private sector companies get involved in order to ensure good resettlement outcomes on the ground. Nonetheless, at times, meeting all the requirements under PS 5 is a challenge, particularly in countries that legally specify compensation levels that are below market. When resettlement is unavoidable in congested urban areas in these countries (e.g., road projects), and the borrower is not the project proponent (e.g., a construction company with a fixed price contract), or the borrower's project budget is fixed in a project agreement, such as a concession agreement, achieving the outcomes contemplated by PS 5 will be difficult, unless IFC is working with a proactive borrower. IFC is considering working at the sector level to ease this systemic problem.

25. On biodiversity, Performance Standard 6 requires projects to proceed in critical natural habitat, only if there are no measurable adverse impacts on the habitat. Collection of, or access to, biodiversity baseline information is difficult and time consuming, at times requiring months or years of field study by experts. Of the 17 projects that went through a full process of peer review, 24% specifically raised the problem of lack of data on biodiversity at the outset in an area deemed to be sensitive (critical habitat or legally protected area) (see Table 21 of Annex A). Where base line information does not exist, the discrepancy between the project timeline and baseline information timeline becomes more acute. In most of these projects reviewed, CES worked out a rapid assessment process that will make additional information available to the project team and relevant stakeholders. CES is working to establish standard methodologies for information gathering and rapid measurement of impacts, and identification of partner institutions that can help with access to technical information quickly and objectively.

*f. Financial Intermediary (FI) Projects*

26. IFC's Sustainability Policy established a new, risk based approach to IFC's FI projects. This approach entails an analysis of the risk level of the FI's portfolio, carried out during appraisal. Depending on the risk level, different compliance requirements apply. FIs with a high risk portfolio (e.g., project financing or large corporate loans) will apply the Performance Standards, whereas FIs with medium risk (e.g., small corporate loans) will apply national law, and those with low risks (e.g., student loans or housing finance) will apply the FI Exclusion List (see Box 3 below). IFC actively engages with the FI upfront and during the appraisal stage in order to agree on an Action Plan for the FI to create or enhance its environment and social management system that will enable the FI to comply with the IFC requirements. The Action Plan is included in the covenants of the investment agreement between the FI and IFC. Annex B outlines the process followed in greater detail as well as an overview of the changes between the old policy framework and the new one.

27. Box 3 below shows the total FI projects approved by the Board between May 1, 2006 and September 30, 2007 and applying this new approach, broken down by the industry department and categorization. These projects are reviewed by a CES team of four specialists (a quadrupling of capacity).

**Box 3**

	Applicable Requirements			
	Exclusion List	National Law	IFC PS	Total
Private Equity Funds	0	3	9	12
Financial Markets	15	46	9	70
Health and Education	0	2	1	3
Infrastructure	0	0	1	1
Subnational Finance	0	0	1	1
<b>Total</b>	<b>15</b>	<b>51</b>	<b>21</b>	<b>87</b>

28. As anticipated, most private equity funds projects are likely to apply the Performance Standards while about 10% of the Financial Markets projects apply the Performance Standards. At the time of this report, the first few FI projects applying the Standards are nearing the first supervision cycle. The focus of the environmental and social supervision will be on implementation of the requirements and client follow up as required. While complete data on the impacts of IFC requirements are not yet known, the fact that the new approach is focused on outcomes encourages FIs to integrate the environmental and social risk management function into the credit and appraisal processes. The new approach has shown results even in complex markets, such as India and China, where clients have developed sound approaches to social and environmental risk management through management systems tailored to their business.

29. The enhancement of the FI specialist capacity means that IFC is able to systematically confirm client commitment to the new approach during appraisal. However an important driver of the success of this approach will be the ongoing follow up with clients. For this CES now makes available one-on-one guidance to high risk clients, while moving the standardized FI training to an e-learning platform for greater efficiency and reach for clients whose needs are for the basic program. Project and portfolio level compliance tracking and management and client follow up across the portfolio will be a increased focus in the ESRD for FI projects. IFC is exploring how to make more regional capacity available to support and guide FI clients on social and environmental challenges. With these improvements, it is expected that the outcomes envisaged in the new policy framework will be consistently realized across IFC's new FI portfolio.

***g. Supervision***

30. The process of social and environmental assessment, together with IFC's engagement with clients, results in an Action Plan, which the client is required to covenant in the loan

agreement (or other relevant legal agreements). Of the 125 projects that applied the Performance Standards (Category A and B projects), 110 projects either proposed satisfactory Action Plans from the outset (26), or produced Action Plans with IFC’s engagement (84) (see Table 6 in Annex A). The remaining projects (15) have covenants related to environmental and social matters in loan or other legal agreements. Data indicates that 27 projects have or will engage external experts to verify the client’s monitoring data (4 Category As and 23 Category Bs). The Policy on Social and Environmental Sustainability requires IFC to monitor the client's social and environmental performance throughout the life of the IFC investment.

31. Meanwhile, as part of the overhaul in management systems, CES has made significant improvements on its environmental and social supervision process. In January, 2007, CES adopted a clearer, risk-based framework of supervision. All projects that have Annual Monitoring Report (AMR) requirements (all Category A and B projects and some C projects with environmental or social conditions, but excluding a few projects with equity only) will have an annual AMR desk review by a CESIG specialist. In addition, every project that has potential environmental and/or social impacts and risks will be visited by a CESIG specialist on a frequency determined by the amount of risk and the environmental and social performance of the project. CES uses a tool to estimate the potential environmental and social risk of investments called the Environmental and Social Risk Rating (ESRR). Its computation includes elements of both risk and performance, and a score of between 1 (good) to 4 (substandard) is assigned to each project in supervision and updated when new information is received. The ESRR score in combination with the categorization of A or B determines the visit frequency by a specialist. For example, projects that are low risk and are performing well may be physically visited once every three years. If a project is higher risk or is not performing well, it will be visited more frequently. FI projects will be visited more selectively based on a process of selection determined by their risk profile and performance (see Box 4 below).

**Box 4**

CATEGORY	SUPERVISION FREQUENCY		
	Yearly	Every 2 years	Every 3 years
A in construction*	√		
A with ESRR 3&4	√		
B with ESRR 3&4	√		
A with ESRR 1&2		√	
B with ESRR 1&2			√
FI	Based on: 1) risk profile, and 2) identified deficiencies in EMS		

\*Possibly as frequently as quarterly visits

Potential impact:

A = Projects with potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented  
 B = Projects with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures  
 FI = All financial intermediary projects excluding those that are category C projects.

Risk:

- 1= Good
- 2= Satisfactory
- 3= Watch
- 4= Substandard

32. An important piece of feedback received in the process of overhauling the safeguards was that the AMR reporting format was cumbersome to clients. We have therefore focused efforts on making environment and social reporting easier. Under the 1998 Environmental and Social Review Procedure, the AMR template was at times onerous. In the new ESRP, we specify the information we require from clients in an AMR template focusing on the most important risk issues. Since the first generation of projects that applied the Performance Standards are only now starting to submit their first AMRs, it is too early to draw any observations on our new practice; however, we anticipate that this should increase the quality and quantity of AMRs submitted by clients over time.

#### ***h. Local and Institutional Disclosure***

33. Since the introduction of the new sustainability policy framework, responsibilities for information disclosure have been clearly allocated to the client for project level information pursuant to Performance Standard 1 and the Sustainability Policy (with respect to extractive industry and infrastructure projects), and to IFC for its institutional responsibility pursuant to the Disclosure Policy.

34. Regarding project level disclosure, 91% of projects with social and/or environmental impacts disclosed their social and environmental information as part of their community engagement. The rest of the projects did not do so, either because no local community existed around the project, or because the “project” involves a facility that has not identified the details of projects to be implemented under the facility. Of the projects disclosing such information, 83% disclosed their Action Plans to affected communities. The rest of the projects did not do so, primarily because the actions agreed with IFC relate to actions that do not involve any local communities (e.g., actions on the management system). It is too early to determine the number of projects that disclosed implementation under the Action Plan.

35. In addition to client disclosure provisions in Performance Standard 1, IFC also committed to have sector specific information related to extractive industry projects made public, and agreed to encourage disclosure of information for certain infrastructure projects. This commitment stemmed from the Extractive Industries Review and was included in the Sustainability Policy (see paragraphs 21-23 of the Sustainability Policy). Since January 1, 2007, IFC has been requiring all new extractive industry projects it supports to publicly disclose their material payments from those projects to the host government. In early 2008, IFC will review investors’ performance through 2007 and will make available a summary of findings with a readily accessible record of where investors have made disclosures. IFC continues to carefully review the governance risks to its projects and notes this review in its Summary of Project Information (SPI). In the infrastructure sector, IFC financed only one relevant project (power distribution) within the period under review. The bid price of that project was disclosed by the privatization agency at the time of the privatization, and the regulator publicly disclosed tariff adjustments as well as service standards. Similar practices are being implemented in the water sector.

36. Simultaneously with the implementation of the Sustainability Policy and Performance Standards, IFC, through its Corporate Relations department also began implementing its new Disclosure Policy, which articulates IFC's institutional commitment to transparency and responsibility for disclosure of institutional and project level information. Staff training on key policy requirements was carried out alongside training on the Sustainability Policy and Performance Standards. Separate Disclosure Portals were set up for internal and external stakeholders, supported by a new disclosure database that allows information tracking and monitoring. In addition, 40 disclosure champions have been designated in regional and investment departments to act as first responders to requests for information directed to these departments. More complex requests are handled by the individual departments with the support of Corporate Relations.

37. During the period from September 2006 to September 2007, IFC received a total of 66 requests for information from the general public. It is important to note that these requests were not complaints, but requests for various types of information. The requests were for project level information (28), specific information on environmental and social issues (22), IFC corporate information (10) and others (6). NGOs led the number of requesters (26), followed by the private sector (12), individuals (8), academics (7), government (2) and others (11). 36 of the requests resulted in full disclosure, 5 in partial disclosure, 16 in no disclosure, and 9 requests are pending. In accordance with the Disclosure Policy, IFC advised the requesters of the reasons for any partial or non-disclosure. Of the responses made by IFC, only one was referred to the Disclosure Policy Advisor as provided for in the Disclosure Policy.<sup>2</sup>

38. Under the Disclosure Policy, IFC is committed to disclose data on development effectiveness on an aggregated basis. A number of Board members as well as the CAO stated in the February 2006 Board meeting that IFC should go further and commit to disclose project level development effectiveness information. At the time of the Board meeting, IFC did not make this disclosure commitment on the basis of its need to balance transparency with an obligation to protect business confidential information of the client, but agreed to seek ways to have clients disclose more project level information. IFC will observe MIGA's implementation of its recent commitment to its Board to disclose, for a small number of high impact projects, project level development effectiveness information, and consider whether their experience is relevant for IFC projects and address this in the context of the next review of the Disclosure Policy. Meanwhile, IFC will continue to encourage clients to disclose project level information through comprehensive client reporting to the affected communities, and through sustainability reports and other avenues of disclosure. Currently, one out of five Category A and B projects already publishes sustainability reports.

39. The recent IFC Annual Report for FY07 for the first time combined in one report its financial, sustainability, and development results reporting, as well as its report to the donor community. It contains record of IFC's implementation of the Performance Standards during FY07. And as promised, it discloses IFC's first aggregated DOTS scores. As reported in the Annual Report, 75% of portfolio projects had satisfactory or excellent environmental and social performance.

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<sup>2</sup> The request related to the language of an environmental and social impact assessment document. The Disclosure Policy Advisor determined that IFC had a reasonable basis for non-disclosure of the requested information.

## **PART III. IMPACTS**

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### ***a. Impacts on IFC's Business and Clients***

40. As the Board is well aware, IFC's FY07 results exceeded estimates, and IFC is in both a growth mode and decentralizing. Our market share among multilateral and international financial institutions stands at around 30% as of the end of FY07, compared to 29% in FY06. For the time being, there appears to be no obvious cause for concern that the new policy framework is negatively impacting IFC's business or putting IFC at a competitive disadvantage. In fact, there is evidence from IFC's client survey that the strong environmental and social risk framework provides a reason for clients to approach IFC, and in certain markets provides IFC with a clear competitive advantage.

41. While these are welcome signs, CES gathered information from various sources in an effort to determine whether there are negative impacts on IFC and its clients, in response to specific questions from the Board on our need to measure the impact on clients. Specifically, CES looked at the cost to IFC and cost to its clients in applying the Performance Standards.

42. In terms of costs to IFC, the direct cost of implementation is relatively modest. The cost factors include one labor specialist in CES (who complements other specialists with labor expertise), the cost of establishing the management system and the ESRP (internal staff time only, plus the cost of the QA team), the direct cost of training (staff time in training design and execution, travel to field offices, and staff time attending the training), and the cost of creating an e-learning program (outsourced). These costs were mostly incurred between FY06 and 07, with additional costs expected in FY08.

43. In order to identify any increase in project processing costs from applying the Performance Standards, CES identified a representative sample of portfolio projects from FY06 and FY07, matching project category, sector, country, and total project value, and compared the labor and non-labor costs borne by IFC in the environmental and social review of such projects. There was no significant change in processing costs associated the environmental and social review of Category A, B or C projects, as a fraction of the total IFC processing cost for these projects between FY06 and FY07. However, in real terms the cost of CES due diligence increased by almost 35% for Category B projects. For Category A and C projects, the proportion of CES processing cost to total IFC processing cost remained largely unchanged between the two years. The proportion of CES due diligence cost to IFC overall due diligence cost for Category A projects is about 25%. It is assumed that the environmental and social processing cost for Category A projects remained unchanged as these projects usually require maximum resources from IFC, often requiring the project to exceed requirements under the Safeguard Policies or Performance Standards. For a detailed description of the methodology and conclusions of this study, please see the first half of Annex C.

44. The increase in the CES due diligence costs for Category B projects is not only the result of implementing requirements under the Performance Standards, which now apply regardless of categorization (see paragraphs 50-53 below). The increase is also likely a reflection of

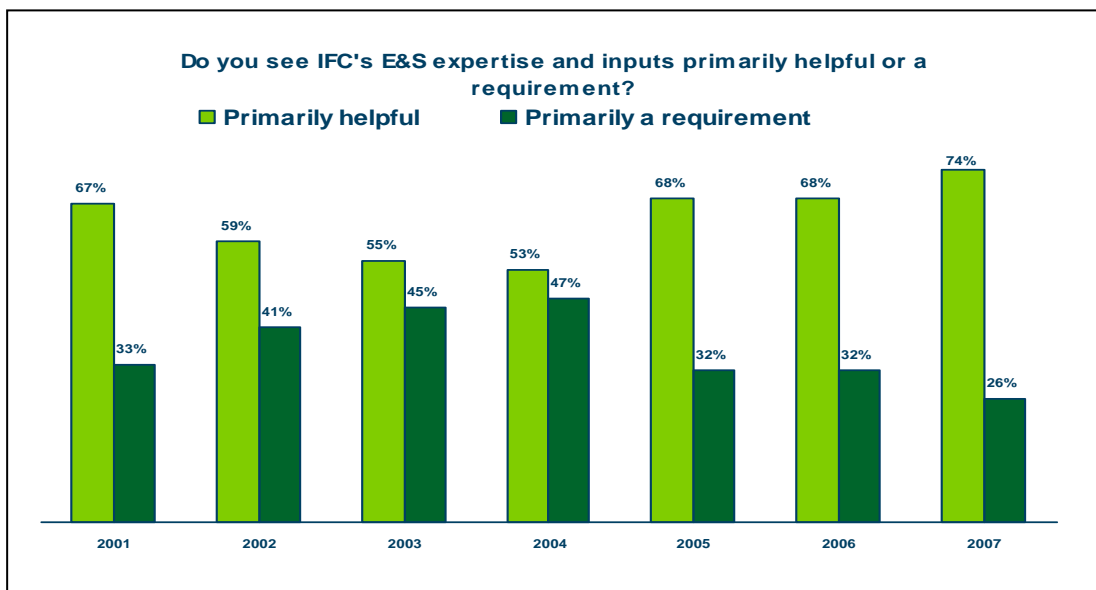
additional time spent by specialists to conform to the demands of the QA system. It is also possible that some Category B projects involve increasingly complex project structures, which in turn affects the level of CES due diligence. In any event, this is a welcome development for IFC, as management's concern was that some Category B projects in the past may not have received appropriate scrutiny. The additional effort needed to process a Category B project does hold implications for staffing levels in CES as IFC grows.

45. Unlike costs to IFC, which can be ascertained through a number of business indicators that IFC already collects, pinpointing costs borne by clients in meeting IFC Performance Standards is a far more complex task. Clients incur costs of environmental compliance and mitigation under local law; furthermore, many of their environmental or social actions with cost consequences are driven by a number of considerations extraneous to IFC, such as market or strategic considerations, or a function of a management system. As a result, CES determined that it was not possible to obtain a precise figure for compliance costs incurred by clients. Instead, CES designed a specific client survey in order to hear directly from its current clients about their perceptions of the new Standards. The details of the design and outcomes of this specific survey can be found in the second half of Annex C. 45 companies from the real sector, including 22 repeat clients, and 19 from the financial sector responded to the survey.

46. The outcome of the survey indicates that costs associated with meeting the Performance Standards are broadly acceptable to real sector clients, even though 57% of respondents feel that the cost is higher than an average cost of meeting social and environmental requirements for their sector. For some of the returning clients, the costs are higher today than when they sought financing from IFC under the Safeguard Policies. 72% of the clients indicated that the cost in meeting the Performance Standards would not impact their decision to return to IFC for financing. Among the financial sector clients, almost 95 percent think that establishing a Social and Environmental Management System (SEMS) in their institutions would help in better understanding risks in their portfolio; 83 percent consider SEMS as a useful element that enables better access to international finance; and almost 70 percent see a positive impact on their brand as a result of having an SEMS. Prior to the next implementation report to the Board, CES will carry out a similar client survey with a larger client sample, and will include more projects for which funds have been disbursed, in order to monitor client perceptions on an ongoing basis. We will also look into ways to assess cost savings by clients through their application of the Performance Standards.

47. The results of the client survey carried out by CES are broadly consistent with the results of the IFC client survey (see Box 5 below). In the most recent IFC client survey for 2007, 76% of clients indicated that IFC's environmental and social expertise and inputs are primarily helpful, whereas 26% see these primarily as a requirement. The 2007 results can be contrasted with the results from 2004 (when IFC began to update the Safeguard Policies), in which 47% of the clients perceived environmental and social expertise and inputs as primarily a requirement. These indications lead us to believe that the impacts on client costs are not and will not be detrimental to IFC's business.

## Box 5



48. Notwithstanding these reassuring findings on costs and processing time, there have been instances in which projects did not proceed for reasons related to the Performance Standards. For example, one client in the agribusiness sector in Latin America terminated a mandate agreement with IFC on account of IFC's labor requirements, which they preferred not to meet. We are also aware of a number of instances in which Board approved projects did not proceed to commitment due to specific environmental or social reasons. For example, an African school project was requested to put together an Action Plan on life and fire safety matters but refused to do so, resulting in IFC dropping the project. While projects are lost at times for reasons related to the Standards, IFC's corporate data suggests that projects do not proceed for multiple reasons beyond environmental and social considerations. From these findings, it appears that negative impacts on IFC's business are negligible at this time.

49. IFC's regional and investment departments will now be able to look at data showing application of a specific Standard to projects in a particular country/region and sector. While the data on frequency of application of a particular Standard for the time being is directly influenced by the project volume in a country/region/sector, over time, CES will be able to identify issues addressed under the relevant Standards, and identify recurrent issues (e.g., resettlement in road projects in country X). This in turn will enable CES to predict typical issues to be anticipated and expertise needed in a given project, and mobilize people accordingly. We also expect new information will enable CES to engage with colleagues in the regional and industry departments in the context of their regional or sectoral strategies.

### ***b. Impacts on Projects***

50. Under the former Safeguard Policy system, IFC's environmental and social requirements were determined by project categorization system. For example, Category A projects had to produce a certain kind of an assessment document and had to consult with the stakeholders at

specified points in the assessment process. These requirements did not apply to Category B projects. Categorization was required early in the appraisal process based on limited project information (though recategorization based on information obtained during appraisal was possible), and judgment had to be made on superficial information, such as project size and sector. The mechanical nature of categorization, as opposed to a risk based system, did assure a degree of predictability for IFC staff and clients. Nonetheless, it meant that unnecessary procedural or substantive requirements were imposed on Category A projects, while specific issues in Category B projects had been left unaddressed as no relevant requirements were specified for them.

51. Under the new policy framework, IFC proposed that project requirements flow from impacts and risks, i.e., assessment of potential impacts and likelihood of harm, rather than from categorization. While maintaining categories, categorization would follow impacts assessment - only at the end of the project appraisal based on full information, IFC would announce its project category. Its main function would be to specify 30- or 60 day periods of disclosure of project information before IFC presented projects for approval to its Board. Some NGOs criticized this proposal, and a few Board members also expressed concerns about the potential weakening of IFC safeguards.

52. Today, data indicates that the policy and Standards are allowing IFC to specify requirements that are appropriate to the particular project under review, based on impacts and risks. For example:

- In peer reviews (for both eventual A and B projects), discussions focus on the relevant project information and ways to address information gap, and appropriate tools and measures to ensure project compliance. Only 1 out of 4 peer reviews specifically discusses categorization;
- The requirement for a comprehensive social and environmental assessment is specific to projects with potential significant impacts that are diverse, irreversible, or unprecedented. 5 A projects and 34 B projects applied this requirement (Annex A, Table 3);
- 5 A and 50 B projects used external experts for assessment (Annex A, Table 4)
- 4 A and 23 B projects will use external experts to verify monitoring data (Annex A, Table 4)
- The need for the project to conduct free, prior, and informed consultation (and for IFC to ascertain that broad community support exists) is not specific to categorization but instead to the level of potential impacts on affected communities. 5 A and 4 B projects applied these requirements (Annex A, Table 8)
- While community development plans are not a policy requirement, 3 A projects and 30 B projects are implementing these plans
- Labor audits and inspections were used in 8 B projects (Annex A, Table 9)
- One A project and 14 B projects quantified GHG emissions (Annex A, Table 12)
- The good faith negotiation process specified in Performance Standard 7 – to date 2 A projects and 1 B project underwent such a process with affected Indigenous Peoples (Annex A, Table 18)

53. Based on the aforementioned data, IFC is of the view that the new approach is working well to strengthen projects, rather than weaken them. The obvious result of this shift is improvement in the quality of assessment information and process in Category B projects. IFC does not consider that the former system of categorization could achieve the same result, due to the rigidity in the system that imposes generic requirements regardless of issues and risks. More flexibility in the assessment process, coupled with rigorous management where it is warranted, can assure better engagement with the affected communities, better mitigation and management of project risks, and better decision making by the project.

54. While the early indicators are helpful, they do not yet allow us to draw conclusions about how Standards implementation on the ground is positively impacting the project, the surrounding communities and their natural environment. By the end of September 2007, just under half of the 250 approved projects have disbursed some funds, including two Category A projects. This means that most of the projects applying the Performance Standards are not yet fully operational, and that the effectiveness of all aspects of the Action Plans cannot be measured yet. Some programs, such as livelihood restoration programs, will take several years before effectiveness can be measured. As mentioned already, more rigorous assessment process and community engagement is expected to result in better outcomes, and early anecdotes confirm these expectations. IFC plans to present data in the next progress update to the Board on policy effectiveness on the ground. Meanwhile, as noted above, 75% of FY07 portfolio projects had satisfactory or excellent environmental and social performance.

*c. Impacts on Market Practices*

55. In the February 2006 Board meeting, board members discussed the potential uptake of the new standards by other institutions, including through the Equator Principles. IFC is concerned to create a level playing field for project sponsors and within the financial sector on environment and social standards. A year and a half later, 56 financial institutions around the world adhere to the updated Equator Principles that reflect the Performance Standards, including banks from Argentina, Brazil, Chile, Costa Rica, Oman, and South Africa (the current list of the EPFIs appears in Annex D). It is now reported that over 85% of cross-border project finance in emerging markets is carried out in reference to the Principles.

56. In June of this year, 32 export credit agencies from 28 OECD countries announced their intent to benchmark projects against the Performance Standards in the case of private sector limited recourse projects. More recently, the Board of Directors of MIGA approved MIGA's adoption of the Performance Standards in August of this year.

57. While not adopting the Standards in their entirety, some multilateral institutions are looking to achieve "Equator equivalence" in their latest policy updates, and many bilateral institutions express their interest in better understanding IFC's implementation of the Standards, particularly the social Standards. In addition, some government agencies are exploring the possibility of referring to the IFC Standards in a regulatory context or encouraging industries to apply them voluntarily for domestic or outbound investments. In the words of a government official of an OECD country, the IFC Performance Standards have become "a standard that

businesses and NGOs can agree on”. Moreover, support for the Performance Standards and the Equator Principles was mentioned in the 2007 G8 Summit communique.<sup>3</sup>

58. These events point to a swift convergence of standards that is taking place within private and public international financial institutions engaged in the finance of private sector projects in emerging markets – leveling of playing field that was elusive only until recently. And beyond the practice of project finance, there is a sea change involving other key players in the financial sector, including corporate bankers, trade and commodity financiers, asset managers, institutional investors, rating agencies, and stock exchanges, each embracing the concept of sustainability in their own business. Many of these institutions look to IFC to share its experience and lessons learned in applying environmental and social requirements to various aspects of the business of finance. External demand for IFC’s services and collaboration in this area has never been greater.

59. Direct feedback from civil society organizations on the new policy framework has been relatively light to date. Several comments have been received on the Performance Standards and Guidance Notes, and specific comments and critiques have been issued on some of the draft EHS Guidelines. Civil society organizations did critique a few IFC projects and projects financed by other international financial institutions, alleging violation of the Performance Standards or the Equator Principles, and requesting the respective institution to cease such projects. While there is by no means a consensus view among external stakeholders, many businesses, including financial institutions, as well as governmental and non-governmental organizations continue to express their expectations that the Performance Standards can help businesses address environmental and social issues in operations in emerging markets.

***d. Maximizing Impacts through Training and Outreach***

60. In order to meet the market demand for training products, IFC publicly solicited and procured four consulting firms to deliver training on the Performance Standards. Currently, three firms continue to deliver such services on a fee-basis to Equator banks, companies, and civil society organizations that provide services to projects. Around 30 EPFIs have been trained to date, some of them engaging consultants to train staff in multiple locations, or organizing training that is open to other EPFIs. In response to requests from governmental agencies, IFC staff has carried out several training sessions designed for such agencies. More recently, IFC began experimenting with other training models, including a training session specifically for environmental and social consultants (one was organized in Moscow in October 2007), and an exploration of a potential “academy” of labor consultants who are equipped to review projects against Performance Standard 2. Later in the fiscal year, IFC will release its Performance Standards e-learning program, based on the successful internal e-learning course for new staff. As a complement to training, and to provide in-depth and practical guidance, CES published new guidance materials on specific topics under the Performance Standards. The list of CES guidance materials published during the last 17 months can be found in Annex E.

61. To promote deeper knowledge sharing on Standards implementation, IFC convened the first meeting of the Community of Learning for 40 international financial institutions, including

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<sup>3</sup> See *Growth and Responsibility in the World Economy*, pp 31-33.

Equator banks, multilateral and bilateral institutions, and export credit agencies. The three day agenda included raining on labor and working conditions and use of security personnel, case studies, and discussions on challenges and dilemmas.

62. While many of the institutions in the Community of Learning are from Part I countries, increasingly institutions in Part II countries are expressing interest in adhering to the Equator Principles or to learn about the benefits of applying the Performance Standards to their business. In order to respond to these requests for information and engagement, IFC is implementing an outreach program in emerging markets with an emphasis on Brazil, China, India, and Russia. To date, CES in collaboration with regional departments organized seminars and discussions in these four countries, in addition to Chile, Columbia, Mexico, and South Africa. In response to request for information and technical assistance, CES, Syndications Department, and Global Financial Markets Department have been working with 30 banks from all regions, of which eight so far announced their decision to adopt the Principles.

63. Partnership opportunities have flowed from the new Performance Standards and the attention they have received and many other international agencies, business associations, organizations, and professional groupings have approached IFC to discuss how the standards can form the basis for new collaborative work in interpreting standards, developing more guidance or extending the standards. Notable among these partnerships are the relationships with UN agencies, such as the Global Compact, International Labour Organization (ILO), World Health Organization, United Nation Environment Programme Finance Initiative (UNEP FI), and UN SRSG. These can be characterized as efforts to learn from these specialized agencies and to collaborate in challenging areas. ILO and IFC enjoy close collaboration in several areas, including a joint program called the Better Work, which promotes good labor practices at the enterprise level. At the same time, CES is working with other private sector voluntary standard setting organizations and initiatives to either help set standards in new areas (e.g., the Commodity Roundtable initiative) or identify areas where IFC Standards and those of other organizations potentially overlap (e.g., SA8000, Voluntary Principles on Security and Human Rights). Identification of areas of overlap will help ease the compliance burden on private sector companies wishing to adhere to international standards in their operations.

## **PART IV. STRATEGIC OUTLOOK**

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64. IFC's internal focus for the next 18 months will continue to be on implementation of the Standards, data generation, and creation and testing of tools and guidance materials, with particular attention to challenging areas. IFC will also create case studies based on the new generation of projects implemented under the Performance Standards. CES will be directing a significant amount of resources to ensure that the Community of Learning serves as an effective learning network among international financial institutions applying the Standards, so that good practices, dilemmas, and lessons learned can be shared, and policy gaps identified.

65. We will also continue our external outreach, engagement and technical assistance program on the Standards and Equator Principles for emerging markets financial institutions, companies, and governmental agencies. We plan to work closely with Equator banks to explore how the Principles can be broadened out to maintain their leadership in sustainable banking. In terms of outreach, our focus is on the BRIC countries (Brazil, China, India and Russia), and we plan a variety of tailored programs in each country based on consultation with key stakeholders. For example, in China, a series of public seminars and direct technical assistance to targeted banks will be underway. In addition, CES is working with China Export-Import Bank to promote social and environmental sustainability pursuant to the Memorandum of Understanding signed with the China Export-Import Bank in May 2007. In Brazil, we plan to work with the existing financial institutions and stakeholders to examine the relevance of the Performance Standards in the context of the Amazon. Our program in India and Russia consist of public seminar and private meetings.

66. In keeping with the commitment to review the policy framework in three years' time from its adoption, CES will make a review process proposal to IFC management in early FY09. After consultation with management, the proposal will be circulated to the Board for comment, along with a three year policy implementation update to the Board. It is currently envisaged that the process of review will start in early FY10. IFC is aware of a number of studies on aspects of the World Bank Group's activities in environment, including the safeguard policies, planned by IEG over the next years. IFC management will consult with IEG and CAO in determining the nature of the external review.

67. Through our network of Equator banks, the Multilateral Financial Institutions' Working Group on the Environment, the OECD, the Community of Learning, the SRSG multistakeholder consultations on business and human rights, and through interactions with the NGO community, we have been receiving ongoing feedback on the IFC sustainability policy framework. NGOs are also commenting on the adequacy of the Performance Standards in the context of specific projects, which provides us with insights on how the Standards work on the ground. In addition, CES maintains a "Stakeholder Portal" where anyone interested in commenting on the Policy and Performance Standards, the Disclosure Policy, the Guidance Notes, and the EHS Guidelines is able to do so electronically. CES is tracking these comments on an ongoing basis, in an effort to have a comprehensive set of comments for the next update the policy framework. While these comments will not alleviate the need for IFC to consult at the time of the next review, they provide first hand knowledge of how stakeholders have been reacting to the policy framework in real time.

68. In parallel with our internal implementation and mapping of the next review process, we will continue to develop and refine the sustainability policy framework. The framework was designed with modular elements, so that additional policies, standards, guidelines, guidance, and tools can be bolted on as necessary. CES is discussing ways to take advantage of this framework to address emerging global issues, such as climate change.

69. IFC is currently working on its climate change strategy and business plan, as an integral part of the World Bank Group strategy on climate change. We will adopt a portfolio approach to aggressively pursue immediate opportunities while developing tools, products and mechanisms to bring opportunities to the private sector in our client countries. As part of CES's contribution, we are in the process of developing a toolkit that will help with our projects and portfolio: (i) a GHG assessment tool to help with the quantification of GHGs under Performance Standard 3; (ii) a climate adaptation methodology that will help us and our clients look at the climate change risks to projects and to mitigate them; and (iii) a methodology to quantify portfolio footprint, which will help us understand the carbon risks to our own portfolio. These will be additional components of the sustainability policy framework. With these tools and methodologies, CES anticipates that there will be a solid foundation to enable the EPFIs and others to address climate issues more fully than the limited coverage of the issue currently presented in Performance Standard 3.

70. While the convergence of standards within the project finance world is a new and welcome development, project finance in proportion to total global lending remains small. Other forms of financing are currently outside the scope of the Equator Principles, even though some EPFIs claim to apply Equator to corporate finance and other activities. For some of the interested banks in emerging markets, the Equator Principles present a challenge since the \$10 million total project cost threshold means that their small projects do not come under Equator. External stakeholders question whether Equator should continue to have such a narrow focus on project finance and advisory services only. Others have argued that more investment banks should join the Equator Principles, without recognizing that some investment banks are already part of the current Equator banks, and others that are not nonetheless refer to the Equator Principles in their environmental policies. These developments point to the potential for Equator evolve to yet another phase, and IFC is interested in facilitating discussions around these issues.

71. Updated standards and principles must go hand in hand with continual improvement in implementation. Even though IFC is not an enforcing agency of the Principles, IFC's reputation will be at risk if the Equator Principles do not offer means for IFC or any other stakeholder to ascertain the level of diligence applied by the banks in implementing the Principles, and appropriate incentives and disincentives for the best in class banks and the laggards, respectively. A process of evaluation and engagement with the Equator banks is needed in order for IFC to protect its reputation and leadership.

72. While the drivers for both the Performance Standards and Equator Principles were risk management, including reputational risk, IFC has always encouraged its clients to consider both risks and opportunities when they are integrating sustainability into their operations. In the same vein, time is right for IFC to consider how it can create value from its Performance Standards for itself and for others. Asset owners and managers interested in socially responsible investment

(SRI), or integrating environmental, social and governance (ESG) considerations in investing are asking whether they can consider projects that meet the Performance Standards as proxy for environmental and social sustainability. As a first step in this direction, IFC is planning to develop and evaluate the feasibility of a more tailored application of the Performance Standards to listed equity vehicles.

**Annex A**  
**Data on Performance Standards**  
**Application**

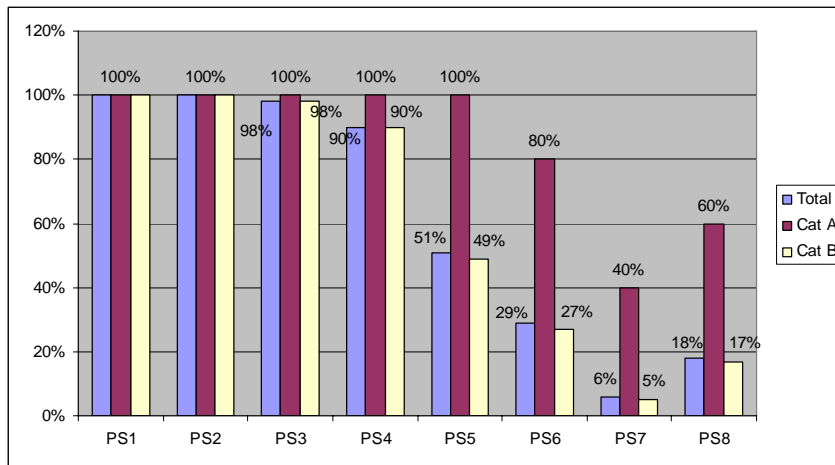
**Table 1**  
**Screening Projects Against Policy & Performance Standards (PPS)**

PPS screened Projects		
	Screened against PPS*	Disbursed
Category A	5 (2%)	2 (40%)
Category B	120 (48%)	64 (53%)
Category C	38 (15%)	17 (45%)
Category FI	87 (35%)	43 (49%)
<b>Total</b>	<b>250 (100%)</b>	<b>126 (50%)</b>

\* Projects approved by the Board between May 1, 2006 and September 30, 2007

\* 9 projects applied PPS prior to April 30, 2006  
 (Category B: 6 projects, Category FI: 3 projects)

**Table 2**  
**Which Performance Standards Applied?\***



\*Out of 125 projects applying the Performance Standards (Category A and B projects only)

\*For data on FI projects applying the Performance Standards, see Table 20

**Table 3**  
**PS 1 S & E Assessment and Management Systems**

**Comprehensive Env & Social Impact Assessment (required for projects with potential significant adverse impacts):**

	<b>Project #*</b>	<b>% wtihin category</b>
Cat A	5	100%
Cat B	34	28%
<b>Total</b>	<b>39</b>	<b>31%</b>

\*Out of 125 projects applying PS 1

**Table 4**  
**PS 1 S & E Assessment and Management Systems**

**Assessments/Monitoring Verification carried out by External Experts:**

	<b>Cat A</b>	<b>Cat B</b>	<b>Total</b>
E&S Assessment	5 (100%)	50 (42%)	55 (44%)
Monitoring Verificaton	4 (80%)	23 (20%)	27 (22%)

- Out of 125 projects applying PS 1

## Table 5 PS 1 S & E Assessment and Management Systems

Disclosure of E&S Information Locally:

	Disclosed	Not Applicable*	Not yet disclosed	Total
Cat A	5	0	0	5
Cat B	109	9	2	120
<b>Total</b>	<b>114</b>	<b>9</b>	<b>2 **</b>	<b>125</b>
<b>Total (%)</b>	<b>(91%)</b>	<b>(7%)</b>	<b>(2%)</b>	<b>(100%)</b>

\*Disclosure is not applicable where specific investments have not yet been identified (e.g., project facility), or there is no affected community nearby

\*\*2 transportation privatization projects will disclose E&S information in the future.

- Out of 125 projects applying PS 1

## Table 6 PS 1 S & E Assessment and Management Systems

	Project #*	%
<b>Action Plan</b>	110	88%
<b>No Action Plan</b>	15	12%

- Action Plans are either client's own plan or a supplemental plan required by IFC after review of client's plan. Includes specific plans required under various Performance Standards
- 12% of projects (15) have no action plans either the plan will be developed in the future or it is part of the Environmental Social Review Summary

\*Out of 125 projects applying PS 1

## Table 7 PS 1 S & E Assessment and Management Systems

Disclosure of Action Plans Locally:

	Disclosed	Not Applicable*	Total**
Cat A	4	0	4
Cat B	87	19	106
<b>Total</b>	<b>91</b>	<b>19</b>	<b>110</b>
<b>Total (%)</b>	<b>(83%)</b>	<b>(17%)</b>	<b>(100%)</b>

\*19 projects have not disclosed Action Plans, because the actions agreed with IFC are actions that do not relate to local communities (e.g., actions specific to the project management)

\*\*Out of 110 projects with Action Plans

## Table 8 PS 1 S & E Assessment and Management Systems

- Instances of Free Prior Informed Consultation/Broad Community Support application

	Project #	% within category
Cat A	5	100 %
Cat B	4	3 %
<b>Total</b>	<b>9</b>	<b>--</b>

- Grievance Mechanism

	Project#	% within category
Cat A	4	80%
Cat B	44	37%
<b>Total</b>	<b>48</b>	<b>--</b>

**Table 9**  
**PS 2**  
**Labor and Working Conditions**

		Total
<b>Labor Audit</b>	By Buyer of Clients	4*
	By IFC Specialist	0
	By Independent Auditor	1
Inspection by Labor Inspectorate		4*
<b>Total</b>		<b>8**</b>

\* One project audited by both buyer of client & labor inspectorate.

\*\*Out of 125 projects applying PS 2

**Table 10**  
**PS 2**  
**Labor and Working Conditions**

	Total**
<b>Supplemental Action Plan*</b>	<b>56 (45 %)</b>
<b>Collective Bargaining</b>	<b>35 (28%)</b>
<b>Supply Chain Screening</b>	<b>15 (12%)</b>
<b>Grievance Mechanism</b>	<b>55 (44 %)</b>

\* A Supplemental Action Plan by IFC supplements the client's Action Plan

\*\*Out of 125 projects applying PS 2

**Table 11**  
**PS 3 Pollution Prevention and Abatement**

	Project #*
Project with a component of energy efficiency, renewable energy, or/and reduce the waste stream	46
Applied less stringent guidelines	5
Integrated Pest Management Strategy	11

\*Out of 122 projects applying PS 3

**Table 12**  
**PS 3 Pollution Prevention and Abatement**

- GHG Emissions quantification over 100,000 tons/year
  - One Category A project and 14 Category B projects

	Project #
GHG emissions > 100,000 tons/year	15
Total GHG quantification (million tons)	24.397*
Evaluated Options to Reduce GHG	3**
Evaluated Options to Offset GHG	2**

\*11 out of 15 projects

\* \*Out of 15 projects with GHG>100,000 tons

**Table 13**  
**PS 4 Community Health, Safety and Security**

	Project #	%
Supplemental Action Plan	43	34%*
External Experts conducting Safety Reviews	31	28%*
Health Impact Assessment	3	3%*
Use of Security Personnel	50	45%*
Security Personnel Management Plan	27	54%**

\* Out of 112 projects applying PS 4

\*\*Out of 50 projects that engaged security personnel

**Table 14**  
**PS 5 Land Acquisition and Involuntary Resettlement**

**Physical and Economic Displacement:**

	Project #*	Cat A	Cat B
Physical Displacement	8 (13%)	3	5
Economic Displacement	13 (20%)	3	10
Both	5 (7%)	3	2
Resettlement Action Plans	17 (27%)	3	14

\* Out of 64 projects applying PS 5

**Table 15**  
**PS 5 Land Acquisition and Involuntary Resettlement**

Resettlement handled by	Project #*	%
Government	4	24%
Client	3	18%
Both	10	59%
Financial Supplement by Client	4	24%

\* Out of 17 projects with resettlement

**Table 16**  
**PS 6 Biodiversity Conservation**

Project location	Project #*	%
Modified Habitat	11	31%
Natural Habitat	3	8%
Critical Habitat	0	0%
Legally Protected Habitat	2	6%

\* Out of 36 projects applying PS 6

**Table 17**  
**PS 6 Biodiversity Conservation**

	<b>Project #</b>	<b>%</b>
<b>Biodiversity Action Plan</b>	2	6%*
<b>Biodiversity Offset</b>	6	17%*
<b>External Experts on Biodiversity Assessment</b>	2	6%*

\* Out of 36 projects applying PS 6

**Table 18**  
**PS 7 Indigenous Peoples**

	<b>%</b>	<b>Project #</b>
<b>Good Faith Negotiation</b>	3	38%*
<b>Indigenous Peoples Development Plan</b>	2**	25%*
<b>External Experts on IP Assessment</b>	1	13%*

\*Out of 8 projects applying PS 7

\*\*IPDP as part of the CDP or Action Plan.

**Table 19**  
**PS 8 Cultural Heritage**

	Project #	%
<b>Supplemental Action Plan</b>	9	7%
<b>May Affect Critical Cultural Heritage</b>	4	17 %*
<b>May Affect Cultural Heritage</b>	8	35 %*
<b>Commercial use of Cultural Heritage</b>	1**	4 %*
<b>Cultural Heritage Removed</b>	4***	17 %*
<b>External Experts on Cultural Heritage Assessment</b>	7	30 %*

\*Out of 23 projects applying PS 8

\*\*Project is not located directly in Cultural heritage, but has certain restriction related to cultural heritage.

\*\*\*E.g., removal of graves; projects with potential to affect cultural heritage area in the future

**Table 20**  
**IFC's FI Investments**

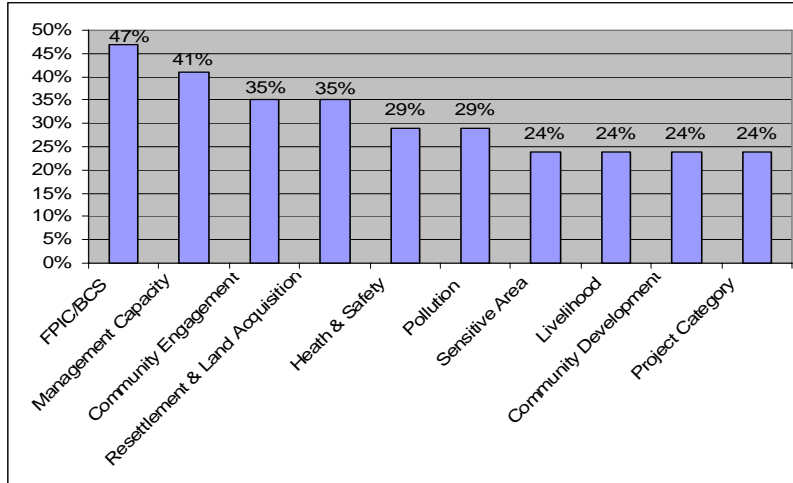
- FI Project and Performance Standards**

		Project #	%
<b>High-risk</b>	<b>Apply PS</b>	21	24%*
<b>Moderate-risk</b>	Apply Exclusion List and Host Country Laws	51	59%*
<b>Low-risk</b>	Apply Exclusion List only	15	17%*
<b>Total</b>		87	100%*

\* Out of 87 FI projects

## Table 21 Top 10 Peer Review Meeting Discussion Topics

- 17 Formal Peer Review Meetings



## Annex B: Features of the new approach to Financial intermediary projects

### Key changes and comparisons

The 2006 Sustainability policy framework as applied to Financial Intermediaries has made a number of refinements from the 1998 policy with the specific objective of improving performance and outcomes. The key changes are summarized below.

	Old	New
At the IFC level	IFC Safeguard Policies  IFC Environmental & Social Review Procedure (ESRP)	IFC Sustainability Policy & Performance Standards & Disclosure Policy Revised IFC ESRP
Categorization:	C, FI-1, FI-2, FI-3	C or FI
Categorization based on:	Nature of IFC investment and some project risk	FI portfolio risks and end use of IFC financing
Requirements	<ul style="list-style-type: none"> <li>▪ SEMS required (after IFC training)</li> <li>▪ IFC FI training a requirement</li> <li>▪ Applicable Requirements include                             <ul style="list-style-type: none"> <li>— No requirements (Category C)</li> <li>— Exclusion list (FI Type 1)</li> <li>— National laws (FI Type 1)</li> <li>— Safeguard policies (FI Type 2 &amp; 3)</li> </ul> </li> <li>▪ IFC clears individual Category A projects for FI-2 &amp; FI-3</li> </ul>	<ul style="list-style-type: none"> <li>▪ SEMS or other evidence of E&amp;S process is now a COD</li> <li>▪ IFC FI training is not a requirement. Client is encouraged to participate where IFC training is provided but client is responsible for establishing capacity</li> <li>▪ Applicable Requirements include                             <ul style="list-style-type: none"> <li>— No requirements (C)</li> <li>— Exclusion list (FI)</li> <li>— National laws (FI)</li> <li>— Performance Standards(FI)</li> </ul> </li> <li>▪ IFC clearance and client obligations on Category A projects rationalized with increased focus on client's SEMS</li> </ul>
Operational outcomes	<ul style="list-style-type: none"> <li>▪ E&amp;S performance of FIs has been variable due to capacity and clarity of requirements</li> <li>▪ IFC Training was a requirement and a proxy for the SEMS</li> <li>▪ Many low risk FIs have been expected to set up an SEMS, attend training and report to IFC when not required</li> </ul>	<ul style="list-style-type: none"> <li>▪ Expected to yield better and more consistent E&amp;S performance and outcomes.</li> <li>▪ Expected to simplify requirements for less risky FIs and enable a focus on those FIs that have high risk portfolios.</li> </ul>

A major change has been the approach to training for FI clients. There is a significant change over the 1998 policy where the client was required to establish an Environmental Management System after attending a training conducted by IFC. While IFC training program, operated under the SFMF Donor funded facility was very successful and established the benchmark for FI training globally, IFC's ability to conduct training for clients in all regions/countries was limited due to staffing and

geographical constraints. The steps already taken to create an online training experience and making available one-on-one discussions during appraisal with clients have resulted in the acceptance of the new policy framework by clients.

### **Upgrade of the E&S risk scoring system for FIs**

As part of the systems upgrade IFC has enhanced its Environmental and Social Risk Rating methodology (ESRR). The new approach separates the intrinsic risk of the FIs portfolio, the management of the risk by the FI, and the residual risk and tracks these separately. The ESRR is computed at appraisal and during supervision to enable a tracking of change over time. The above steps are particularly useful as they enable tracking projects on compliance while also prioritizing the supervision and follow up strategy based on intrinsic risk based on the FIs portfolio and the residual risk considering the effectiveness of the FIs SEMs.

The review of the client's capacity is also based on reviewing the clients SEMs against a number of dimensions including management commitment, implementation, capacity and quality, internal review and reporting as well as reporting to IFC. The approach is non prescriptive providing flexibility to customize the systems to each FI's internal operational processes, while focusing on the outcomes.

### **Client Supervision and follow up**

There is a formal supervision based on the ESRR covering both the intrinsic risk of the FI's portfolio as well as the implementation of the SEMs. The key features of the supervision plan covers 100% annual supervision of high risk FIs as well as poorly performing ones. This would be a staged approach of portfolio officer follow up for information deficiencies, CES specialist follow up on technical deficiencies, sample validation and field visits as required.

Additionally a program of regional field visits is already in place. The regional field visits cover the following issues:

- Meeting with regional portfolio teams to discuss and reinforce the FI approach, supervision and follow up strategy
- Select client meetings for follow up on
  - Gaps
  - High risk projects (including those projects where clients have actively sought IFC guidance)
  - Problem projects
  - Opportunities for value add beyond compliance

### **Portfolio management and rationalization**

For FI projects, the volume of transactions poses requirements for an effective MIS and compliance tracking system. Such a system, integrated with the ESRD for FIs is currently under development. The objective is to ensure that there is close monitoring of performance and risk at the portfolio level to enable continuous prioritization of FIs where performance or risk has changed requiring IFC attention.

Another key step being taken to rationalize the portfolio is the planned migration of all projects processed under the old policy framework to the new over one supervision cycle. While covenants and existing agreements with clients will not be changed, the adoption of the new ESRR and new approach for client follow up will be implemented.

To ensure that the active management of the portfolio, a formal mechanism of periodic meetings with the central and regional portfolio teams has been established. All regional portfolio teams have been trained on the new policy framework and the roles and responsibilities and the approach will be reinforced continually.

### **Decentralization and client support**

A major determinant of the success of the new approach will be IFC's ability to actively follow up with clients and provide guidance as required to create effective E&S risk management systems. This is going require IFC to be able to provide more supervision stage guidance and follow up close to the client. In this connection with the larger IFC initiative of Local Global , a decentralization and local capacity creation plan is being developed. IFC will look at building field capacity to support FI clients on sustainability covering risk management as well as opportunities. The model will consider both relocation of specialists and local hires as appropriate and seek to leverage local available capacity with the knowledge and quality function being played by the Global team.

### **Exploring opportunities with FI clients**

Going beyond compliance IFC will also leverage the client relationship to promote sustainable finance opportunities through FIs through the Financial Markets Sustainability Unit set up in the Global Financial Markets department. The opportunity to closely review the FI portfolio for the risk management requirements, offers an excellent opportunity to help clients move beyond this to create business opportunities in sustainability. The sectoral areas of focus include

- Renewable Energy
- Cleaner Production and Energy Efficiency
- Sustainable Supply Chains
- Corporate Governance credit lines

The objective will be to leverage IFC's FI clients to promote IFC's priority areas of Sustainability and Climate Change.

## **Annex C: Cost of Performance Standards Implementation**

### Summary of Findings

The Environment and Social Development Department of IFC (CES) assessed the costs to IFC of carrying out environmental and social (E&S) due diligence on investments and associated costs to clients under the new Performance Standards Performance Standards. Initial results indicate that

- Applying the new Performance Standards has not adversely impacted IFC’s cost of doing business
- The CES processing cost as percentage of total IFC processing cost for all project categories remained largely at the same level as before the application of the new Performance Standards
- The real cost of applying new E&S due diligence in category “B” projects increased, while for categories “A” and “C” the costs remained almost unchanged
- Evidence indicates that costs associated with meeting the Performance Standards are acceptable to clients

### **Background**

During the consultation period to update IFC’s Social and Environmental Performance Standards, Board members requested that IFC present an estimate of the costs of applying the Performance Standards both at the IFC and the client levels. The main reason for this was to assess if the implementation of the Performance Standards could erode IFC’s competitive edge in the market through increased cost of doing business, and whether it may have an adverse impact on its clients through a significant increase of project costs related to meeting the Performance Standards requirements.

The Environment and Social Development Department (CES) made a commitment to the Board to track financial costs associated with Performance Standards implementation by IFC and by its clients. In an effort to fulfill this commitment, CES undertook an analysis to calculate the difference in environmental and social (E&S) due diligence costs between FY07 (when the Performance Standards entered into force) and FY06 (during which the Safeguards regime applied)<sup>1</sup>. In order to ascertain implementation costs to clients, IFC carried out a client survey consisting of eight questions for category A and B, and 4 questions for category FI projects associated with the client’s perception of cost of environmental and social mitigation.

### **Cost to IFC**

#### **Methodology**

CES identified a representative sample of portfolio projects. To limit the impact of different variables, a target sample (41 pairs of projects)<sup>2</sup> was selected according to a) project category, b) sector, c) country, and d) total value.

<sup>1</sup> The period from April 30, 2006 until June 30, 2007 should be considered as a transition phase which still includes both the old and new behavior patterns in conducting E&S due diligence. The results for FY08 could vary. It is the first exercise of this kind for CES. Traditionally, CES did not gather data for due diligence cost comparison. There was no historical baseline in place. For the purposes of this exercise, CES tried to reconstruct the baseline. Starting from FY08, CES will have a proper basis for comparison purposes.

<sup>2</sup> See Box 1 below

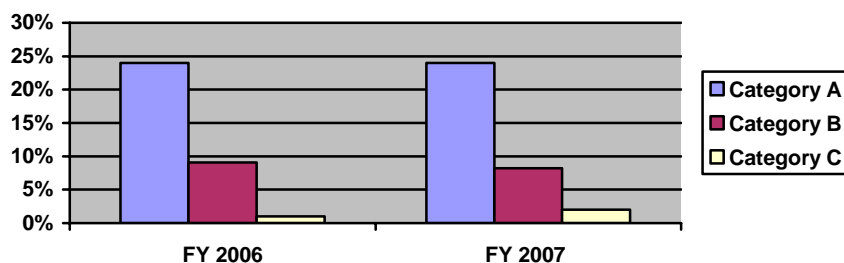
The sample was drawn from a list of the 182 projects screened through the Performance Standards that were approved between May 1, 2006 and June 30, 2007, and the 264 projects in which IFC made commitments during FY06.

The cost of E&S due diligence (or CES processing cost) was defined as the following: labor and non-labor<sup>3</sup> costs borne by IFC to ensure that the projects it financed were developed in compliance with the requirements of IFC/World Bank Safeguards for projects approved before April 30, 2006, and with the new IFC Performance Standards for projects approved after April 30, 2006<sup>4</sup>.

### Initial Results

Category “A” projects<sup>5</sup>: Initial results indicate that there were no significant increases in the processing costs associated with category “A” projects<sup>6</sup>. Although some of the category “A” projects approved during FY06 and FY07 did not go through the whole project cycle by June 30, 2007, comparison of costs at each stage of the project suggests that the costs are similar, and constitute about 23-25 percent of the total IFC processing cost for category “A” projects.

**Chart 1 Social and Environmental Due Diligence cost as % of total IFC processing cost by project category FY2006-FY2007**



*Based on data received from the Corporate Accounting Department*

Category “B” projects: Initial results suggest that there is a minor decrease of approximately 1 percentage point in CES processing costs compared to total IFC processing costs for category “B” projects. In FY06, the average CES processing cost constituted 9.1 percent of the total IFC processing cost, while in FY07 this cost decreased to 8.2 percent. However, in real terms the cost

<sup>3</sup> Labor cost – time of E&S specialists GE level and above dedicated to particular project and charged against BB budget  
 Non-labor cost – travel of E&S specialists GE level and above related to due diligence work on particular project and charged to BB budget

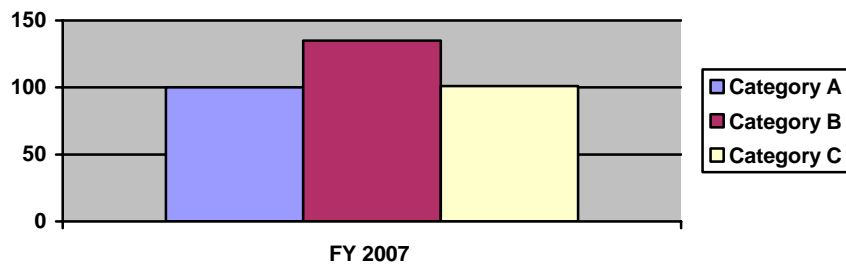
<sup>4</sup> More specifically, the labor and non-labor costs included CES support in the following stages of the project cycle: “pending appraisal”, “pending approval”, “pending commitment”, and “pending disbursement”. The costs related to supervision were not included. The results of this analysis provide enough data to initially assess the PS impact on the cost of environmental and social due diligence.

<sup>5</sup> A sample for category A due to limited number of projects included also pairs from different countries.

<sup>6</sup> An environmental and social (E&S) category is assigned after the completion of the E&S review; the category serves as an indication of the nature and extent of potential E&S impacts that the project is expected to have. The category reflects the magnitude of the potential impacts posed as follows: Category A Projects: Projects with potential significant adverse environmental or social impacts that are diverse, irreversible or unprecedented; Category B Projects: Projects with potential limited adverse environmental or social impacts that are few in number, site-specific, largely reversible, and readily addressed through mitigation measures; or Category C Projects: Projects with minimal or no adverse environmental or social impacts.

of CES due diligence increased by almost 35 percent. This increase is not only the result of implementing requirements under the Performance Standards that now apply to Category B projects (which in the past only applied to Category A projects, most notably consultation with affected communities) but also reflects additional time spent to conform with the demands of a new quality assurance system (Q&A) and Environmental and Social Review Document (ESRD). It also displays a general increase in cost of travel and includes specialists' salaries adjustments. The increase in due diligence cost in real terms for Category B projects is encouraging, as it shows that IFC is spending more on due diligence on these projects, which in the past did not necessarily receive adequate resources in comparison to Category A projects.

**Chart 2. Cost of IFC' Environmental and Social Due Diligence in 2007 (real terms - year 2006=100)**



Category "C" projects: The impact of the new standards on due diligence costs in category "C" projects has been estimated to be a very small increase of approximately 1 percent. In FY06, average due diligence costs represented 1 percentage point of the total IFC processing cost for category "C" projects. In FY07, this rose to 2 percent, still constituting a small fraction of the total processing cost.

### **Cost to IFC's clients**

IFC-supported projects are being financed under different host country social and environmental legal regulation, in different sectors, and at different stages of the client's project cycle. In addition, each firm has its own characteristics, such as differing social and environmental systems, which make comparisons between companies problematic. These variables make it difficult to accurately calculate the impact of the Performance Standards in terms of costs to clients.

To further assess the impact of the Performance Standards on clients' costs, CES conducted a client survey in September 2007. The survey was addressed to 107 companies whose projects were a) screened through performance standards between May 1, 2006 and June 30, 2007 and categorized as A (1 project), B (65 projects) or FI (41 projects), and b) either committed, pending first disbursement, or in supervision stage. The interviewed companies were located in various regions and represented different sectors. The survey included eight questions for category A and B projects and four questions for category FI (financial intermediary) projects. Questions were predominantly close-ended, but space for written comments was provided where appropriate<sup>7</sup>.

The overall level of response was 60 percent: 100 percent for category A, 68 percent for category B, and 39 percent for category FI respectively. Although the survey includes a statistical error

<sup>7</sup> See Box 2 below

bigger than 3% the data gathered allows for the identification of general trends. The survey was open between August 13 and September 30, 2007 for a period of 49 days.

#### Category A and B projects

The clients in the survey were asked to compare an average cost of meeting social and environmental requirements for their sector of operations to the cost of meeting IFC's Performance Standards requirements. Almost 57 percent of respondents indicated that costs related to meeting the Performance Standards is higher or much higher. For 32 percent of respondents, these costs are about the same, while only 7 percent consider these costs lower than average for their sector of operations<sup>8</sup>.

Bringing a project to compliance with the national environmental requirements constitutes the biggest cost to almost 26 percent of respondents. Meeting requirements of Performance Standard 1 was recognized by over 16 percent as the main cost, followed by PS 2, PS 3, and PS5. Each of them was indicated by over 9 percent of companies. This was partially confirmed by additional desk analysis of Corrective Action Plans, which suggested that meeting requirements of PS1 constitutes the main cost, followed by PS5, PS2, PS3, and PS4.

More than 37 percent of interviewed companies, for which a Corrective Action Plan was prepared, estimate their costs (capital cost and operating cost) associated with meeting the requirements of Performance Standards indicated in the Action Plan at between 1 and 3 percent of the total cost of the project; 31 percent estimated this at below 1 percent; almost 12 percent of firms between 3 and 5 percent; while, for almost 5 percent of firms, this cost went above 5 percent of the total project cost<sup>9</sup>.

22 out of 45 companies were identified as returning clients. For almost 27 percent of returning clients, the cost of meeting requirements of the Performance Standards is about the same when compared to the cost related to the previous Safeguards. 21 percent of companies think that this cost is higher and 2 percent that this cost is lower.

Given companies' general experience with implementation of the Performance Standards, 72 percent of them indicated that the cost factor related to Performance Standards implementation would not impact their decision to consider applying for IFC's financial support in the future. 16 percent think that Performance Standards cost might negatively influence their decision, while for 5 percent this factor will have a positive influence on their decision<sup>10</sup>.

#### Category FI projects

Clients were asked to rate the constraints of establishing social and environmental management systems (SEMSs) in their institutions. Additional cost to their institution and additional cost to their clients were identified as the main constraints. At the same time, almost 95 percent think that establishing an SEMS in their institutions would help in better understanding risks in their portfolio; 83 percent consider SEMS as a useful element that enables better access to international finance; and almost 70 percent see a positive impact on their brand as a result of having an SEMS.

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<sup>8</sup> 4 percent did not know.

<sup>9</sup> 16 percent did not provide an answer.

<sup>10</sup> 7 percent did not know.

Given companies' general experience with implementation of an SEMS, 43 percent of them indicated that the cost factor related to it would not impact their decision to consider applying for IFC's financial support in the future. Over 6 percent think that costs related to the requirement to implement an SEMS might negatively influence their decision, while 50 percent did not know if it might impact their decision in the future. For half of them it is most likely too early to assess impacts of SEMS on their clients and their business.

**Box 1. IFC's Due Diligence Cost - Project Sample**

Region (2007)	Department	Cat. (same for 2006 and 2007)	Region (2006)	Department
<b>Category A</b>				
CAF	COC	A	CAF	COC
CEU	COC	A	CEU	COC
CSA	CIN	A	CSA	CIN
CLA	CAG	B	CLA	CAG
CAF	COC	B	CAF	COC
CSA	CGM	B	CSA	CGM
CEA	CGM	B	CEA	CGM
CLA	CHE	B	CLA	CHE
CSA	CIN	B	CSA	CIN
CEA	CGM	B	CEA	CGM
CLA	CGM	B	CLA	CGM
CLA	CIN	B	CLA	CIN
CME	COC	B	CME	COC
CSE	CGM	B	CSE	CGM
CSE	CIN	B	CSE	CIN
CLA	CIN	B	CLA	CIN
CSA	CGM	B	CSA	CGM
CME	CAG	B	CME	CAG
CEA	CAG	B	CEA	CAG
CEA	CGM	B	CEA	CGM
CEU	CAG	B	CEU	CAG
CLA	CAG	B	CLA	CAG
CLA	CAG	B	CLA	CAG
CSA	CHE	B	CSA	CHE
CLA	COC	B	CLA	COC
CAF	CIN	B	CAF	CIN
CLA	CIN	B	CLA	CIN

CSE	CHE	B	CSE	CHE
CSA	CIN	B	CSA	CIN
CSA	COC	B	CSA	COC
CSA	CIN	B	CSA	CIN
CEU	CAG	B	CEU	CAG
CEA	CIT	C	CEA	CIT
CEU	CGF	C	CEU	CGF
CEA	CIT	C	CEA	CIT
CEU	CGM	C	CEU	CGM
CEA	CIT	C	CEA	CIT
CME	CGF	C	CME	CGF
CLA	CIT	C	CLA	CIT
CEA	CIT	C	CEA	CIT
CEU	CIT	C	CEU	CIT

**Box 2. Questionnaire used to identify IFC's clients perception toward cost associated with the Performance Standards**

1. What was the Environmental and Social category assigned to your project by IFC?

A	B	C	FI	Don't know
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

If you selected "FI" in question #1 please go directly to question 8

2. Listed below are a number of potential benefits that might result from meeting Performance Standards. On a scale of 1-6, 1 meaning not beneficial at all, 6 meaning very beneficial, please rate the benefit of meeting Performance Standards for your company.

	1	2	3	4	5	6
Better access to finance	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Competitive advantage	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Alignment with industry trends	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Cost savings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improved management of risk	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Compliance with legislation	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improved internal management systems	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Enhanced shareholder value	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improved employee relations	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Sustainable operations	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Enhanced brand	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Better relations with local community	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Other, please indicate.....	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

3. Please indicate if compared to an average implementation cost of social and environmental requirements for your sector of operations the cost of meeting requirements of Performance Standards is:

Much higher	Higher	About the same	Lower	Much lower	Don't know
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

4. If IFC required your company to prepare an Action Plan, which one of the below constituted the main cost to your company to implement? (Chose only 1 answer)

<input type="radio"/> bringing project to compliance with national environmental standards required by law
<input type="radio"/> bringing project to compliance with national social standards required by law
<input type="radio"/> meeting requirements of PS 1 S&E Assessment and Management Systems
<input type="radio"/> meeting requirements of PS 2 Labor and Working Conditions
<input type="radio"/> meeting requirements of PS 3 Pollution Prevention and Abatement
<input type="radio"/> meeting requirements of PS 4 Community Health, Safety and Security
<input type="radio"/> meeting requirements of PS 5 Land Acquisition and Involuntary Resettlement

- meeting requirements of PS 6 Biodiversity Conservation and Sustainable Natural Resources Management
- meeting requirements of PS 7 Indigenous Peoples
- meeting requirements of PS 8 Cultural Heritage
- N/A

5. To the best of your knowledge, how much did it cost your company (capital cost and operating cost) to meet requirements of Performance Standards indicated in the Action Plan?

- less than 1% of the total cost of the project
- between 1% and 3% of the total cost of the project
- between 3% and 5% of the total cost of the project
- more than 5% of the total cost of the project
- not applicable

7. Given your general experience with implementation of the Performance Standards, please indicate if the cost factor related to it would impact your decision to consider applying for IFC's financial support in the future.

- |                                      |                       |                                      |                       |                                |                       |            |                       |
|--------------------------------------|-----------------------|--------------------------------------|-----------------------|--------------------------------|-----------------------|------------|-----------------------|
| Yes, it would have a positive impact | <input type="radio"/> | Yes, it would have a negative impact | <input type="radio"/> | No, it would't have any impact | <input type="radio"/> | Don't know | <input type="radio"/> |
|                                      | <input type="radio"/> |                                      | <input type="radio"/> |                                | <input type="radio"/> |            | <input type="radio"/> |

6. If you are IFC's returning client, please indicate whether compared to the previous Social and Environmental Safeguards, implementation of Performance Standards has been:

- |                       |                       |                       |                       |                       |                       |                       |                       |                       |                       |                       |                       |
|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Much more expensive   | <input type="radio"/> | More expensive        | <input type="radio"/> | About the same        | <input type="radio"/> | Less expensive        | <input type="radio"/> | Much less expensive   | <input type="radio"/> | Don't know            | <input type="radio"/> |
| <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input type="radio"/> |

8. (For "FI" " projects only) Listed below are a number of potential constraints related to establishing a Social and Environmental Management System (SEMS). On a scale of 1-6, 1 meaning not a constraint at all, 6 meaning a major constraint, please rate the constraints of establishing SEMS in your institution.

	1	2	3	4	5	6
Additional cost to your institution	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Additional cost to your clients	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Lack of internal capacity to run SEMS	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
No qualified environmental/social consultants to advise your institution	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
It is not a standard practice in the financial sector	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Concerns on how shareholders will view SEMS	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

9. (For "FI" " projects only) . Listed below are a number of potential benefits for your clients in meeting the Performance Standards. Based on your knowledge of

10. (For "FI" " projects only) On a scale of 1-6, 1 meaning not beneficial at all, 6 meaning very beneficial, what is your perception about below listed benefits of the Social and Environmental

**your clients, using a scale of 1-6, 1 meaning not beneficial at all, 6 meaning very beneficial, please rate the benefit of meeting Performance Standards for your clients.**

	1	2	3	4	5	6
Better access to finance	0	0	0	0	0	0
Competitive advantage	0	0	0	0	0	0
Alignment with industry trends	0	0	0	0	0	0
Cost savings	0	0	0	0	0	0
Improved management of risk	0	0	0	0	0	0
Compliance with legislation	0	0	0	0	0	0
Improved internal management systems	0	0	0	0	0	0
Enhanced shareholder value	0	0	0	0	0	0
Improved employee relations	0	0	0	0	0	0
Survival of business in long term	0	0	0	0	0	0
Better reputation	0	0	0	0	0	0
Better relations with local community	0	0	0	0	0	0
Other, please indicate.....	0	0	0	0	0	0

**Management System your institution.**

	1	2	3	4	5	6
Better understanding of an important risk in your portfolio	0	0	0	0	0	0
Access to International finance	0	0	0	0	0	0
Branding and Market differentiation	0	0	0	0	0	0
Developed sustainability products	0	0	0	0	0	0
Value added to your clients	0	0	0	0	0	0
Other (please specify).....	0	0	0	0	0	0

**11. Given your general experience with implementation of SEMS, please indicate if the cost factor related to it would impact your decision to consider applying for IFC's financial support in the future.**

	Yes, it would have a positive impact	Yes, it would have a negative impact	No, it would't have any impact	Don't know
	0	0	0	0

**OBSERVATIONS**

**We would welcome your other observations on the topics covered in this survey; please feel free to add your comments below or on a separate note.**

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**Thank you very much for your time in completing this survey.**

**D1. Please indicate respondent's position in the company:** \_\_\_\_\_

**D2. Please indicate country where the project supported by the IFC was implemented:** \_\_\_\_\_

**D3. Please indicate the sector of your company operations:** \_\_\_\_\_

## Annex D: Banks Adopting the Revised Equator Principles

56 Banks as of October 2007

ABN AMRO Bank	<i>(Netherlands)</i>	Dexia Group	<i>(France, Belgium)</i>	National Australia Bank	<i>(Australia)</i>
ANZ	<i>(Australia)</i>	Dresdner Bank	<i>(Germany)</i>	Nedbank Group	<i>(South Africa)</i>
Banco Bradesco	<i>(Brazil)</i>	Export Kredit Fonden	<i>(Denmark)</i>	Nordea	<i>(Denmark, Finland, Norway &amp; Sweden)</i>
Banco do Brasil	<i>(Brazil)</i>	E+Co	<i>(US)</i>	Rabobank Group	<i>(Netherlands)</i>
Banco Galicia	<i>(Argentina)</i>	Export Development Canada	<i>(Canada)</i>	Royal Bank of Canada	<i>(Canada)</i>
Banco Itau	<i>(Brazil)</i>	FMO	<i>(Netherlands)</i>	Scotiabank	<i>(Canada)</i>
BankMuscat	<i>(Oman)</i>	Fortis	<i>(Belgium)</i>	SEB	<i>(Sweden)</i>
Bank of America	<i>(US)</i>	HBOS	<i>(UK)</i>	SMBC	<i>(Japan)</i>
BMO Financial Group	<i>(Canada)</i>	HSBC Group	<i>(UK)</i>	Société General	<i>(France)</i>
BTMU	<i>(Japan)</i>	HypoVereinsbank	<i>(Germany)</i>	Standard Chartered Bank	<i>(UK)</i>
Barclays plc	<i>(UK)</i>	ING Group	<i>(Netherlands)</i>	TD Bank Financial Group	<i>(Canada)</i>
BBVA	<i>(Spain)</i>	Intesa Sanpaolo	<i>(Italy)</i>	The Royal Bank of Scotland	<i>(Scotland)</i>
BES Group	<i>(Portugal)</i>	JP Morgan Chase	<i>(US)</i>	Unibanco	<i>(Brazil)</i>
Caja Navarra	<i>(Spain)</i>	KBC	<i>(Belgium)</i>	Wachovia	<i>(US)</i>
Calyon	<i>(France)</i>	la Caixa	<i>(Spain)</i>	Wells Fargo	<i>(US)</i>
CIBC	<i>(Canada)</i>	Manulife	<i>(Canada)</i>	WestLB AG	<i>(Germany)</i>
CIFI	<i>(Costa Rica)</i>	MCC	<i>(Italy)</i>	Westpac Banking Corporation	<i>(Australia)</i>
Citigroup Inc.	<i>(US)</i>	Millennium bcp	<i>(Portugal)</i>		
CorpBanca	<i>(Chile)</i>	Mizuho Corporate Bank	<i>(Japan)</i>		
Credit Suisse Group	<i>(Switzerland)</i>				

## Annex E: New Publications

- PS 1:
  - Stakeholder Engagement: *A Good Practice Handbook for Companies Doing Business in Emerging Markets* (May 2007)
  - *Human Rights Impact Assessment Guidance* for road testing (September 2007)
- PS 2:
  - *Good Practice Note* on Employee Relations (Forthcoming - February 2008)
- PS7:
  - *ILO 169 and the Private Sector: Questions & Answers for IFC Clients* (March 2007)
- Others:
  - *Good Practice Note on Animal Welfare* (Oct 2006)
  - *BTC Lessons of Experience* (Sept 2006)
  - *External Monitoring of the Chad Cameroon Pipeline* (Sept 2006)
  - *Banking on Sustainability* (Jan 2007)
- **New Environmental, Health and Safety Guidelines**
  - 56 EHS Guidelines finalized on April 30, 2007
    - Technical reference documents for good international industry practice for EHS performance
    - Establish IFC's expectations for managing industrial EHS impacts in support of aspects of PS2, PS3, PS4, and PS6.
    - They form part of the Equator Principles, specifically Principle 3
    - 6 more to be published shortly
- **Updates of E&S Procedure and Guidance Notes**
  - Updated Guidance Notes (July 2007)
  - Updated Environmental and Social Review Procedure (ESRP) (July 2007)