

**IFC Policy and Performance Standards on Social and Environmental Sustainability  
and Policy on Disclosure of Information:  
A Process Proposal for the Third Year Policy Review and Update**

1. This paper updates the Board of Directors on the process of reviewing and updating the IFC Policy and Performance Standards on Social and Environmental Sustainability (the Sustainability Policy and the Performance Standards), and the Policy on Disclosure of Information (the Disclosure Policy), all of which became effective on April 30, 2006.
2. When the Board of Directors approved the above policy documents in February of 2006, the Board asked management to convene a review of these policies in three years' time from their adoption. As promised in the Progress Report that reviewed IFC's policy implementation for the first year and a half (IFC/SecM2007-0052), management now makes the following proposal for the third year policy review and the subsequent policy update process.
3. The overriding and ongoing question for management is whether the Sustainability Policy and Performance Standards and the Disclosure Policy are effective ("do they meet the stated policy objectives?") and efficient ("are they being implemented efficiently and at reasonable cost?"). Through the third year review, management hopes to ascertain policy effectiveness and efficiency by understanding the impacts of the Sustainability Policy and Performance Standards and the Disclosure Policy on four areas: (i) impacts within IFC; (ii) impacts on the IFC financed projects and IFC clients; (iii) impacts on the natural environment and the communities affected by IFC projects; and (iv) impacts on market practices.
4. As indicated in the 18 month Progress Report, the Sustainability Policy and Performance Standards and the Disclosure Policy appear to have created positive impacts on IFC's business, without creating significant implementation costs. The impacts on IFC clients and the physical projects financed by IFC are only beginning to emerge. By the end of the three year cycle, IFC should have more complete information on how the policies are affecting IFC projects and clients, including effects on their management systems for managing environmental and social risks, their actual business practices, and their interaction with stakeholders. The review should also take stock of any effect on the natural environment (such as biodiversity) and the local communities affected by the IFC financed projects (such as through resettlement or through community development). Finally, the review will explore whether the Performance Standards have demonstrable impacts on the project finance and development finance markets. Through the review process, IFC will examine the policy impacts on all four areas described above, and provide data and observations to the Board. And as requested by the Board, IFC will convene an external advisory group to provide their views on the policy effectiveness in areas (i) to (iv) above. IEG and CAO are expected to carry out their own reviews (see paragraph 12).

5. Management expects that any update to the Sustainability Policy and Performance Standards and the Disclosure Policy following the third year review described above should achieve the following specific objectives:

- i. To enhance the effectiveness and efficiency of the Sustainability Policy, Performance Standards and the Disclosure Policy through engagement with internal and external stakeholders
- ii. To reflect lessons learned from three years of policy application, and emerging environmental and social risk areas, e.g., climate change, in order to maintain IFC leadership position in the environmental and social standards
- iii. To further explore and refine the boundaries of specific responsibilities of the private sector and the public sector under the Sustainability Policy, Performance Standards and the Disclosure Policy

The specific circumstances leading to these three objectives are described below in turn.

6. With over 60 adopting financial institutions, the Equator Principles, based on IFC Performance Standards and the World Bank Group Environmental, Health and Safety Guidelines, are a de facto industry code of conduct for project finance in emerging markets. The 32 export credit agencies from the OECD countries that provide export credit support for these projects also apply the Performance Standards for private sector limited recourse projects. Following such standards convergence in the project finance market, the standards used among development finance institutions began to converge over the last few months. The 15 European Development Finance Institutions now apply the Standards to their high risk projects through the Rome Declaration, announced last fall. The recently adopted Environmental and Social Policy of EBRD is modeled closely on the IFC Standards, and within the World Bank Group, MIGA is now applying the Performance Standards to its operations. Given this swift convergence of standards in the project finance and development finance markets, IFC has an additional responsibility to ensure that the established common market practices can continue to evolve step-wise and consistently. Consultation on policy effectiveness and efficiency with these institutions that apply the relevant policies to their day-to-day operations is key. In addition, IFC needs to involve all other stakeholder groups, including IFC staff and clients, partner organizations with whom IFC had interaction or collaboration over the Standards since adoption, stakeholders with new policy insights and expertise in emerging environmental and social risk areas, and civil society organizations tracking IFC's policy implementation.

7. Any policy update should incorporate lessons learned from policy implementation, as well as latest external developments in the policy areas addressed by the Performance Standards. Since the policy implementation date, IFC has diligently tracked its policy implementation through its systems, and recorded its observations on areas of challenge. Some areas covered by the Standards, such as climate change, have undergone a process

of rapid transformation since April of 2006. Today, businesses around the world have a much higher level of awareness of climate change and its consequences to them. This brings into question whether the existing standard on greenhouse gases in Performance Standard 3 needs adjustment to meet the climate change challenges. These areas will be addressed in the update process.

8. Management is aware of the question, raised from time to time by various Board members, on whether the current environmental and social Safeguard/Standards system within the World Bank Group should continue. The current system is a result of a two year process undertaken by IFC to create for itself and the Equator banks a set of environmental and social sustainability policy and performance standards tailored to the private sector. Throughout this process (2004-2006), IFC had continuous and open dialogues with a diverse group of stakeholders on how the IFC safeguard system should evolve for private sector operations. By the time the IFC proposal was submitted to the Board for approval, the Bank-IFC managements and the Board agreed that the needs of IFC and the private sector are suitably addressed by the IFC Standards. The forthcoming review will examine the specific departures IFC made from the former safeguard policies, the rationale and effectiveness of the new IFC requirements on private sector projects, the boundary of private and public sector responsibilities, and how these differences impact joint projects.

9. The question on joint projects is currently being addressed by the IDA-IFC Secretariat in an effort to create Procedural Guidelines for joint projects. Through this process, though still in early stages, it is becoming evident that the perceived difficulties in project processing stemming from apparent policy differences between IFC and the World Bank may be overcome through procedural clarity between the two institutions. IFC and the Bank colleagues are already involved in extensive discussions to promote procedural efficiency for environmental and social issues for joint projects. IFC expects that such collegial exchange of views will continue to address the question of the appropriate responsibilities of the public and private sectors in the forthcoming policy review and update.

10. With the foregoing considerations in mind, IFC proposes that the policy review and the subsequent policy update process be implemented in three phases:

- **Phase One:** internal stocktaking, data generation, and report to Board
- **Phase Two:** reviews by the external advisory group, the CAO and the IEG; and
- **Phase Three:** Board and external engagement on IFC's policy update proposal

11. Starting in the second quarter of FY09, IFC will gear up for the third year review. This first phase will involve an internal stocktaking, including an analysis of policy implementation data, IFC and client cost analysis, internal perception surveys, etc. This phase will generate data and internal observations that may be useful in the next two phases. At the end of FY09, management will issue its third year implementation report to the Board for its consideration.

12. In phase two, starting in the third quarter of FY09, IFC will convene an independent review of the Sustainability Policy and Performance Standards and the Disclosure Policy by an external advisory group, who will be asked to comment on the four areas described in paragraph 3 above ((i) impacts within IFC; (ii) impacts on the IFC financed projects and IFC clients; (iii) impacts on the natural environment and the communities affected by IFC projects; and (iv) impacts on market practices). Beginning in early FY10, management looks forward to the report on the comprehensive review of the Bank Group safeguard policies by IEG (expected to be reported to CODE by July 2009). The CAO is also expected to add their observations on the effectiveness of the Standards (though the scope and timing of their review is to be determined).

13. In the third phase of the review, starting around the second quarter of FY10, and taking stock of information and recommendations from the various review streams from the first and second phases, management will consider whether any policy update is necessary, and if so, would draft a paper to CODE for discussion. Following CODE discussion, public consultation on the paper will take place during the third quarter of FY10, with a final update proposal to the full Board during the fourth quarter of FY10. It is management's aim to start FY11 operations with the updated set of policies.