1. Introduction
This paper sets out the CAO’s approach in its contribution to IFC’s Third Year Policy Review and Update of IFC’s Policy and Performance Standards on Social and Environmental Sustainability (PPS) and Disclosure Policy. This work will build on our commentary on IFC’s Progress Report on the first 18 months of application of the PPS (available at www.cao-ombudsman.org).

The CAO welcomes the opportunity to contribute to this process and to provide our perspective and insights on the effectiveness of the new policy framework and its implementation. We will focus on policy areas of most direct impact on project-affected communities, drawing on our experience as IFC’s independent recourse mechanism for social and environmental aspects. This work is undertaken under the advisory function of the CAO.

2. Approach Summary
In our contribution to IFC’s policy review, the CAO is drawing on experiences and lessons from the ombudsman and compliance functions, as well as our 2003 Safeguard Policy Review, to conduct a small portfolio review, a local stakeholder perceptions study of IFC projects processed under the PPS, client interviews and thematic group discussions with the aim to address the following questions about the effectiveness and impact of the new framework and IFC’s underlying management system:

- Has IFC’s application of the PPS throughout its portfolio supported the establishment of transparent client requirements and clear expectations and predictability for both clients and communities at the project level?
- Have IFC’s own environmental and social management system and supervision capacity been adequately strengthened to support the move from process compliance to accountability for outcomes, ensuring the effectiveness and impact of the PPS?
3. Background
The CAO has played a role in IFC’s update of its safeguard policies and disclosure policy from the outset. Following our January 2003 Safeguard Policy Review, we provided comments on subsequent drafts in the course of IFC’s Safeguards Update and Disclosure Policy Review. Most recently, we commented on IFC’s Progress Report on the first 18 month of application of the PPS (these inputs are available at www.cao-ombudsman.org).

In the CAO 2003 Safeguard Policy Review, we made a number of recommendations to strengthen the effectiveness and impact of IFC’s environmental and social policy framework and management system. IFC agreed with our findings and set out to implement many of the recommended changes in adopting the PPS and reforming the supporting systems and procedures. Among a number of recommendations, we emphasized:

- the important role of sponsor commitment in achieving positive outcomes;
- the need to move from a focus on process compliance to accountability for outcomes, establishing explicit goals and targets, reporting on them, and demonstrating accountability for achieving them or failing to do so;
- the importance of strengthening IFC’s own environmental and social management system and supervision capacity, arguing that IFC should empower specialists to use their judgment in how they apply IFC’s policies, while at the same time enhancing the openness and transparency of their decision-making;
- the urgency to strengthen IFC’s supervision of, and support to, its financial intermediary clients to help ensure environmental and social performance of this increasingly important part of IFC’s portfolio.

In adopting the Policy and Performance Standards on Social and Environmental Sustainability, IFC embraced an outcomes-based approach, moving away from the approach of the previous safeguard policies, which tended to tie procedural requirements to a project’s environmental and social risk rating. Throughout, the Performance Standards allow IFC and its clients flexibility to agree on the best means to achieve desired outcomes based on project specific risks.

The CAO has welcomed this approach, but we have also maintained that increased flexibility and discretion need to be accompanied by greater transparency around each project’s agreed processes and outcomes. Further, we have stressed the need for strong supervision efforts on IFC’s part to ensure the implementation of this new approach leads to positive outcomes on the ground.

IFC further set out in the PPS to encourage early and constructive engagement between companies and communities, and IFC clients are required to engage potentially impacted local communities in differing degrees depending on the nature and potential severity of anticipated impacts. Action Plans are of central importance in this context. Disclosure of Action Plans and consultation of affected communities are mandated whenever a project may negatively impact local communities adversely.
In its Sustainability Policy, IFC further commits to treat projects that yield potentially significant environmental and social impacts with additional care. Such projects will only be presented for Board approval where the project enjoys Broad Community Support, as determined by IFC management.

4. Context
With the launch of the Equator Principles (now adopted by 67 international financial institutions), IFC’s Performance Standards (PS) have evolved into a global standard for environmental and social risk management in emerging markets project finance, extending IFC’s influence beyond its own portfolio.

If IFC desires to maintain this leadership position, the Equator Principles financial institutions (EPFI) will be important stakeholders in the upcoming review process. IFC will have to balance its role as standard setter for the larger industry, with its inherent potential for achieving positive impacts, with the need to set standards that help IFC meet its development mandate (which the EPFIs do not share). Currently, any commitments by IFC that go beyond the requirements shared by the EPFIs are comprised in the Sustainability Policy.

Since the adoption of the PPS, the human rights responsibilities of the private sector have been further defined in the work of UN Special Representative on Business and Human Rights, John Ruggie. This development presents IFC with an opportunity to update the PPS in accordance with this new policy framework for business and human rights. His final Report to the Human Rights Council sets out a number of responsibilities of corporations, including the need to establish an effective grievance mechanism as part of the corporate responsibility to respect, as well as developing monitoring and auditing processes.

At the same time, IFC’s portfolio composition has been changing: investments in financial intermediaries and product types such as corporate loans, equity and semi-equity investments, and trade finance represent an increasing share of IFC investments alongside more traditional project finance loans. As an example, financial market investments made up 40% of new investments and 38% of IFC’s portfolio in fiscal year 2008.1 The global financial crisis is likely further to strengthen the impetus on products such as corporate loans or trade finance as companies are adapting to the changing economic environment.

IFC’s role and leverage differs depending on the nature of its investments. IFC’s environmental and social policy framework needs to be relevant and applicable to all its various types of intervention, setting out how IFC will ensure adequate management of environmental and social impact management by its clients.

5. The CAO’s advisory role
This review will be carried out under the advisory role of the CAO. In keeping with the CAO’s operational guidelines, this advisory work will not constitute an institutional or programmatic-level audit. Nor will any project specific advice be given. Rather, we will draw on our experience in the ombudsman and compliance functions to inform our

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approach in assessing the application of the current policy framework and its implementation. We aim to make concrete recommendations that contribute pragmatically to IFC’s evolving approach to managing environmental and social aspects of its investments.

Should we come across any evidence of incidents of non compliance in the course of the portfolio review or other work carried out in the CAO’s advisory function, we will inform the directors of both the relevant industry department and the Environment and Social Development Department (CES) of what we found, and give IFC the opportunity to address and rectify the situation.

6. Approach
In the CAO’s experience, differences between a company’s and the host communities’ understanding and expectations of a project’s anticipated impacts, benefits, and mitigation measures is at the source of many conflicts between companies and their host communities. Conversely, establishing a common understanding of impacts and benefits, and agreement about how these are to be mitigated and monitored, is often the solution to conflict, and the foundation of mutually beneficial relationships: companies benefit from a stable and predictable operating environment, and communities benefit when they participate in decisions and issues which directly affect them, helping to avoid negative impacts and enhance opportunities.

Three years after the adoption of IFC’s new policy framework, many of the projects that were processed under the PPS are only just starting to generate outcomes. The CAO’s review will therefore concentrate on IFC’s implementation of the PPS to date, focusing specifically on IFC commitments and client requirements with a direct impact on local communities, and the company-community relationship.

In the PPS framework, a project’s Action Plan constitutes the core means of ensuring transparency and predictability for clients and host communities. While IFC’s Performance Standards deliberately leave room for interpretation to allow for the adaptation of requirements to a project-specific context, Action Plans apply only to a particular project. Therefore, Action Plans help create clarity by translating the PS into concrete client requirements. Consequently, the review will assess whether Action Plans have been used effectively to create clarity around project level requirements for communities and clients alike.

In assessing IFC’s implementation of the PPS over the last three years, the CAO will attempt to answer the following questions:

- Has IFC’s application of the PPS supported the establishment of transparent client requirements and clear expectations and predictability for both clients and communities at the project level?
- Have IFC’s own environmental and social management system and supervision capacity been adequately strengthened to support the move from process compliance to accountability for outcomes, ensuring the effectiveness and impact of the PPS?

While drawing on the CAO’s experiences in guiding this review, we recognize that it will be important to assess the relevance of these experiences more broadly within IFC’s
Accordingly, we propose to collaborate with IFC and IEG in selecting our project sample, supporting our objectives through a limited portfolio review and local stakeholder perceptions study that reflect a broader range of projects that IFC handles.

7. Work Program
This Advisory Note will be completed in three phases within calendar year 2009.

Approach development
(Mar – May 2009)
The CAO’s approach to this Advisory Note will be developed, and input and comments sought from various stakeholders and peers: CAO’s Strategic Advisory Group, IFC’s Environment Department, the Independent Evaluation Group, IFC management, as well as civil society representatives in the context of the Spring Meetings. The approach will be finalized on the basis of feedback and comments received, and the final approach paper posted on the CAO’s website in May 2009.

Review activities

Portfolio Review
(May – Sep 2009)
The CAO review will assess relevant project documents of 30 projects processed under the PPS. The choice of project sample will balance the need for representativeness of IFC’s portfolio with the aim to assess projects which are likely to yield relevant insights to the questions posed: e.g. projects triggering the Broad Community Support commitment, projects applying Performance Standards 4, 5, 7, or 8.

Documents to be reviewed:
- **IFC documents**: Board Reports, Environmental and Social Review Summaries, Environmental and Social Review Documents, client legal requirements, DOTS entries, Project Supervision Reports, IFC’s documentation of Broad Community Support, and documentation of CES peer reviews.
- **Client documents**: Environmental and Social Impact Assessments, Action Plans (including, as relevant, Resettlement Action Plans, Indigenous Peoples Development Plans, etc), Annual Monitoring Reports, Sustainability Reports.

The Portfolio Review will be completed in September 2009, and findings will be made available in a Portfolio Review Summary Report.

Local stakeholder perceptions study
(Jul – Nov 2009)
A further 5 projects will be assessed in more depth through field work. Local stakeholder perceptions of the project will be ascertained through interviews, to round out the picture that the review of IFC and client documentation has produced. This will include clients’ views on their work with the community as well as their experiences working with IFC and the Performance Standards.
The local stakeholder perceptions study will be completed, and a summary report with findings made available, in November 2009.

Advisory Note

Dec 2009

A final Advisory Note will be completed by the end of December 2009, setting out the CAO’s findings and recommendations to IFC.

6.5 Work Program Calendar:

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8. Peer Review

CAO team will draw on peer reviewer input at relevant stages of the review. The peer review group will include:

- Viraf Mehta, Partners in Change, India
- Anne Perrault, CIEL, USA
- Shawn Miller, Citigroup
- Ramanie Kunanayagam, BG Group
- Clive Armstrong, Lead Economist, IFC
- Charles di Leva, Chief Counsel, World Bank
- Joui Eerikainen, IEG
- Representative of international academia/development agency
- Peer review input from the Environment and Social Development Department, IFC