



The Independent Accountability Mechanism for IFC & MIGA

11 SEPTEMBER 2024

Compliance Appraisal Report

**Complaints Regarding IFC's Exposure to the Lower Sesan
2 Hydropower Project in Cambodia through an
Investment in Postal Savings Bank of China**

IFC Project #35461

About CAO

The Office of the Compliance Advisor Ombudsman (CAO) is the independent accountability mechanism of the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA), members of the World Bank Group. We work to facilitate the resolution of complaints from people affected by IFC and MIGA projects in a fair, objective, and constructive manner, enhance environmental and social project outcomes, and foster public accountability and learning at IFC and MIGA.

CAO is an independent office that reports directly to the IFC and MIGA Boards of Executive Directors. For more information, see www.cao-ombudsman.org.

About the Compliance Function

CAO's compliance function reviews IFC and MIGA compliance with environmental and social policies, assesses related harm, and recommends remedial actions where appropriate.

CAO's compliance function follows a three-step approach:

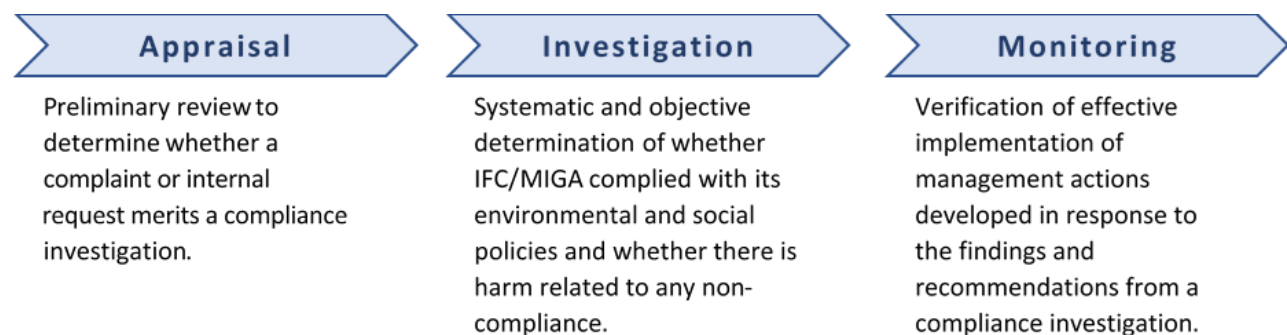


Table of Contents

Acronyms	iv
Executive Summary	v
1. Introduction	1
2. Concerns Raised by Complainants	4
3. Summary of IFC and Client Responses	6
4. IFC Environmental and Social Policy Framework	9
5. CAO Appraisal Analysis	9
6. CAO Decision	16
Appendix 1: IFC Management Response	18
Appendix 2: PSBC Response	30

Acronyms

Acronym	Definition
ABBank	An Binh Commercial Joint Stock Bank
CAO	Office of the Compliance Advisor Ombudsman (IFC and MIGA)
E&S	environmental and social
EIA	Environmental Impact Assessment
ESMS	Environmental and Social Management System
ESRP	Environmental and Social Review Procedures
FI	financial intermediary
HLRH	Huaneng Lancang River Hydropower Co., Ltd.
IFC	International Finance Corporation
LS2	Lower Sesan 2 (Hydropower Project)
MSME	micro-, small, and medium-sized enterprises
MIGA	Multilateral Investment Guarantee Agency
PS	Performance Standards (IFC)
PSBC	Postal Savings Bank of China
EVNI	Electricity Vietnam International Joint Stock Company

Executive Summary

In December 2015, the International Finance Corporation (IFC) made an equity investment in Postal Savings Bank of China (PSBC). This compliance appraisal documents the preliminary review conducted by the Office of the Compliance Advisor Ombudsman (CAO) of a complaint from local communities alleging adverse impacts from Cambodia's largest hydropower dam, the Lower Sesan 2 (LS2) Hydropower Project, including the claim that IFC is exposed to the LS2 hydropower project through its investment in PSBC. CAO concludes that, according to the CAO Policy, the LS2 project cannot be considered an IFC sub-project through its investment in PSBC.

Context and Investments

In December 2015, IFC made a US\$286 million investment to acquire a 0.69 percent equity stake in PSBC to promote access to finance for China's unbanked. In early 2019, IFC began selling its shares of PSBC, following a continuous preapproved sales plan. In August 2023, when this complaint was filed, IFC held 0.086 percent of shares in PSBC. In December 2023, IFC sold its remaining shares in PSBC, ending the financial relationship.

PSBC has financial relationships with the China Huaneng Group Co., Ltd. (China Huaneng Group Co.) and its subsidiary Huaneng Lancang River Hydropower Co., Ltd. (HLRH). The latter wholly owns HydroLancang International Energy, which became the majority shareholder of the LS2 hydropower project at the end of 2012. Construction of the LS2 project began in 2013, and in 2017, the gates of the largest hydropower dam in Cambodia began to close, flooding the reservoir and previously occupied settlements.

The Complaint

In August 2023, CAO received a complaint reiterating allegations of widespread negative environmental and social (E&S) impacts from the LS2 project. The same communities had raised these concerns in three earlier complaints submitted to CAO in June 2018 related to IFC's investment in the Vietnamese An Binh Commercial Joint Stock Bank (ABBank), which has financial links to the LS2 project. The merged 2018 complaints are currently in the final stage of a CAO compliance investigation.

The current complaint alleges that PSBC has provided loans to Huaneng Lancang River Hydropower and its ultimate parent company, the China Huaneng Group Co., representing significant, active, and material exposure of IFC's PSBC investment and the LS2 project.

The complaint alleges that three groups have been affected:

1. *Villagers who refused to resettle* claim their livelihoods and food security have been affected by a significant decline in local fish stock. Communities have allegedly found it difficult to access clean water since the start of LS2 project operations, leading to adverse health effects and economic burdens. Dam-related flooding has allegedly resulted in a lack of sufficient farmland. Some complainants identify as Indigenous Peoples seeking to protect their cultural identity and sacred sites.

2. *Resettled villagers* allege that their new living conditions are inadequate, that they did not receive livelihood restoration support, and were unable to participate in decisions about land allocation. They say that outsiders have built homes in their villages under the pretext of having bought the land.
3. *Upstream villagers* allege harm to their livelihoods due to changing water levels and fewer fish in the Sesan and Srepok rivers. They say they have been forced to temporarily relocate during floods, leading to health problems and physical hazards. They claim they were never informed or consulted about the LS2 project or its compensation policies.

Each of these three groups allege that the consultation of affected communities during the planning and development process of LS2 was inadequate, and they all fear the cumulative impact of the multiple dams planned for the Srepok and Sesan rivers. The complainants have requested their identities remain confidential for fear of threats and reprisals.

IFC and Client Responses

Responses from IFC and PSBC on June 27 and July 25, 2024, respectively, deny any financial link between IFC's investment in PSBC and the LS2 project. IFC argues that PSBC provided project loans to Huaneng Lancang River Hydropower that were restricted to its business activities in China, and the loans to the Huaneng Group must be invested in projects within China. PSBC argues that the LS2 project is outside the scope of the use of proceeds from IFC and PSBC funding and does not qualify as a sub-project under the CAO Policy.

CAO Analysis

A CAO compliance appraisal determines whether a complaint merits an investigation by applying the following criteria: a) whether there are preliminary indications of harm or potential harm; b) whether there are preliminary indications that IFC may not have complied with its E&S policies, and c) whether the alleged harm is plausibly linked to the potential noncompliance.

In this case, the CAO must first determine whether the LS2 dam can be considered an IFC sub-project through the PSBC investment.¹ Its preliminary review of available information does not find a sufficient basis to conclude that the LS2 hydropower project is an IFC sub-project through the PSBC investment. The CAO's view is based on the following reasoning:

- IFC's made an equity investment in PSBC that did not have use-of-proceeds limitations. All PSBC's clients during the life of IFC's investment were IFC sub-clients and business operations, for which IFC should have required PSBC to apply its Environmental and Social Management System.
- Huaneng Lancang River Hydropower and the China Huaneng Group Co. were both IFC sub-clients in that they were PSBC clients who received loans and investments during the time IFC held equity in PSBC.

¹ IFC/MIGA Independent Accountability Mechanism (CAO) Policy (June 28, 2021), glossary and para. 77.

- However, under the CAO Policy, only the business operations of a sub-client that fall under the investment's use of proceeds are considered sub-projects.
- Because the loans provided by PSBC to Huaneng Lancang River Hydropower between 2016 and 2023 were restricted to activities not involving HydroLancang International Energy or the LS2 project, the LS2 project cannot be considered a business operation within the use of proceeds of those loans.
- Some—but not all—of PSBC loans to the China Huaneng Group Co. were similarly restricted. PSBC also provided several working capital loans to the China Huaneng Group Co. that do not appear to have use-of-proceeds restrictions. The China Huaneng Group Co. has controlling interest in two subsidiaries that have business operations with the LS2 project: Huaneng Lancang River Hydropower and Huaneng Finance. These subsidiaries could be considered sub-projects of IFC's sub-client the China Huaneng Group Co.
- However, CAO has no basis to conclude that the LS2 project is a sub-project of the China Huaneng Group Co., within the meaning of the CAO Policy. CAO has seen no evidence to suggest that the China Huaneng Group Co. is directly involved in the operation of the LS2 project or that the project constitutes a significant part of its business activities.
- Available information indicates that the LS2 project might be considered a business operation of Huaneng Lancang River Hydropower, which owns 100 percent of LS2's majority shareholder and is specialized in hydropower construction and operations, but PSBC loans to Huaneng Lancang River Hydropower include use-of-funds restrictions that do not include HydroLancang International Energy or LS2 hydropower project activities.

CAO concludes that the LS2 hydropower project cannot be considered an IFC sub-project through its investment in PSBC according to the CAO Policy. There is therefore no basis for CAO to conduct a compliance investigation of IFC's investment in PSBC.

Next Steps

Because the compliance appraisal criteria are not met, CAO will not initiate a compliance investigation into IFC's equity investment in PSBC and this case will be closed.

This appraisal report will be published on the CAO website and shared with the Board, IFC management, the client, and the complainants.

1. Introduction

This section provides an overview of the Lower Sesan 2 (LS2) Hydropower Project in Cambodia, as well as the investment of the International Finance Corporation (IFC) in Postal Savings Bank of China (PSBC). It then describes the scope and methodology of the compliance appraisal conducted by the Office of the Compliance Advisor Ombudsman (CAO).

a) Overview of the IFC investments and the Lower Sesan 2 Hydropower Project

PSBC is the fifth largest commercial bank in the People's Republic of China, serving hundreds of millions of retail clients. Most borrowers are micro-, small, and medium-sized enterprises (MSMEs) and individuals, but PSBC also has a portfolio of corporate lending to larger businesses.² According to PSBC, as of December 31, 2023, it had a total of 39,364 business outlets covering all cities and 99 percent of counties in China with a retail client base of over 660 million.³

In December 2015, IFC made a US\$286 million equity investment in PSBC to acquire a 0.69 percent equity stake.⁴ The stated purpose of the investment was to help promote access to finance for China's unbanked—some 235 million people, many of whom live in rural areas.⁵ The investment was made as part of a PSBC offer to sell a 16.92 percent shareholding in a private placement of shares with strategic international and domestic investors ahead of listing on the stock exchange. At the time of IFC's investment, IFC and PSBC also signed a Strategic Cooperation Agreement under which IFC provided expert advice to PSBC on MSME and rural finance, corporate governance, and environmental and social (E&S) risk management.⁶

In early 2019, following a continuous preapproved sales plan, IFC started selling its shares of PSBC.⁷ In August 2023, when the CAO complaint was filed, IFC held 0.086 percent of PSBC shares.⁷ In December 2023, IFC sold its remaining shares in PSBC.

Since at least 2009, PSBC has had financial relationships with the China Huaneng Group Co., Ltd. (China Huaneng Group Co.) and its subsidiary Huaneng Lancang River Hydropower Co., Ltd. (HLRH), which wholly owns HydroLancang International Energy, the majority shareholder of the LS2 hydropower project.

The LS2 project is the largest hydropower dam in Cambodia, with an installed capacity of 400 MW. It is located in Stung Treng Province on the Sesan River in northern Cambodia, below the confluence of the major Sesan and Srepok tributaries and about 25 km from the Mekong

² IFC, *Summary of Investment Information (SII)*, Project 35461, Postal Savings Bank of China.

³ CAO, *Assessment Report Regarding Concerns in Relation to IFC's Investments in the Postal Savings Bank of China (IFC Project #35461) and Issues Raised in Cambodia* (May 2024), <https://bit.ly/3TkMmsR>.

⁴ The investment was approved by the Board in June 2015 and the legal agreements were signed in December 2015.

⁵ IFC, "IFC Invests in Postal Savings Bank of China to Promote Financial Inclusion for Underserved," press release (December 10, 2015), <https://bit.ly/3yVuVFZ>.

⁶ IFC, *Summary of Investment Information (SII)*, Project 35461, Postal Savings Bank of China.

⁷ *Management Response to the CAO Complaint Cambodia—Postal Savings Bank of China (PSBC-02)* (June 27, 2024), para. iv (see appendix 1).

River (see map 1.1). Construction of the dam began in 2013 and when the gates began to close in 2017, the reservoir and previously occupied settlements were flooded.⁸ The dam was built under a 45-year build-operate-transfer agreement. At the end of this period, ownership will be transferred to Cambodia's electricity utility, Electricite du Cambodge.

The LS2 hydropower project was originally a joint venture between Electricity Vietnam International Joint Stock Company⁹ (EVNI) and The Royal Group, a Cambodian conglomerate, which owned 51 and 49 percent of the project, respectively. In September 2012, HydroLancang International Energy bought 51 percent of the shares in the project and became its majority shareholder, while EVNI's stake was reduced to 10 percent and Royal Group to 39 percent. These equity holdings remain unchanged as of the writing of this report.

Completed in 2018, the LS2 hydropower dam ultimately resulted in the displacement of nearly 5,000 people and impacted upstream and downstream communities who depend on the fisheries of the Sesan and Srepok rivers for food and income.¹⁰ Relocation of households accepting the resettlement package occurred in 2015–16, but 136 families residing in the reservoir area refused to resettle and instead relocated to just outside the flood zone.¹¹

From 2008 through the dam's completion in 2018, there were ongoing protests by community members expressing opposition to the project, with media reports, studies, and civil society groups raising concerns about the dam's environmental and social impacts.¹²

⁸ Human Rights Watch, *Underwater: Human Rights Impacts of a China Belt and Road Project in Cambodia* (2021), <https://bit.ly/3XBzh1j>; Royal Group's Lower Sesan 2 website: <https://bit.ly/3UNcFX8>.

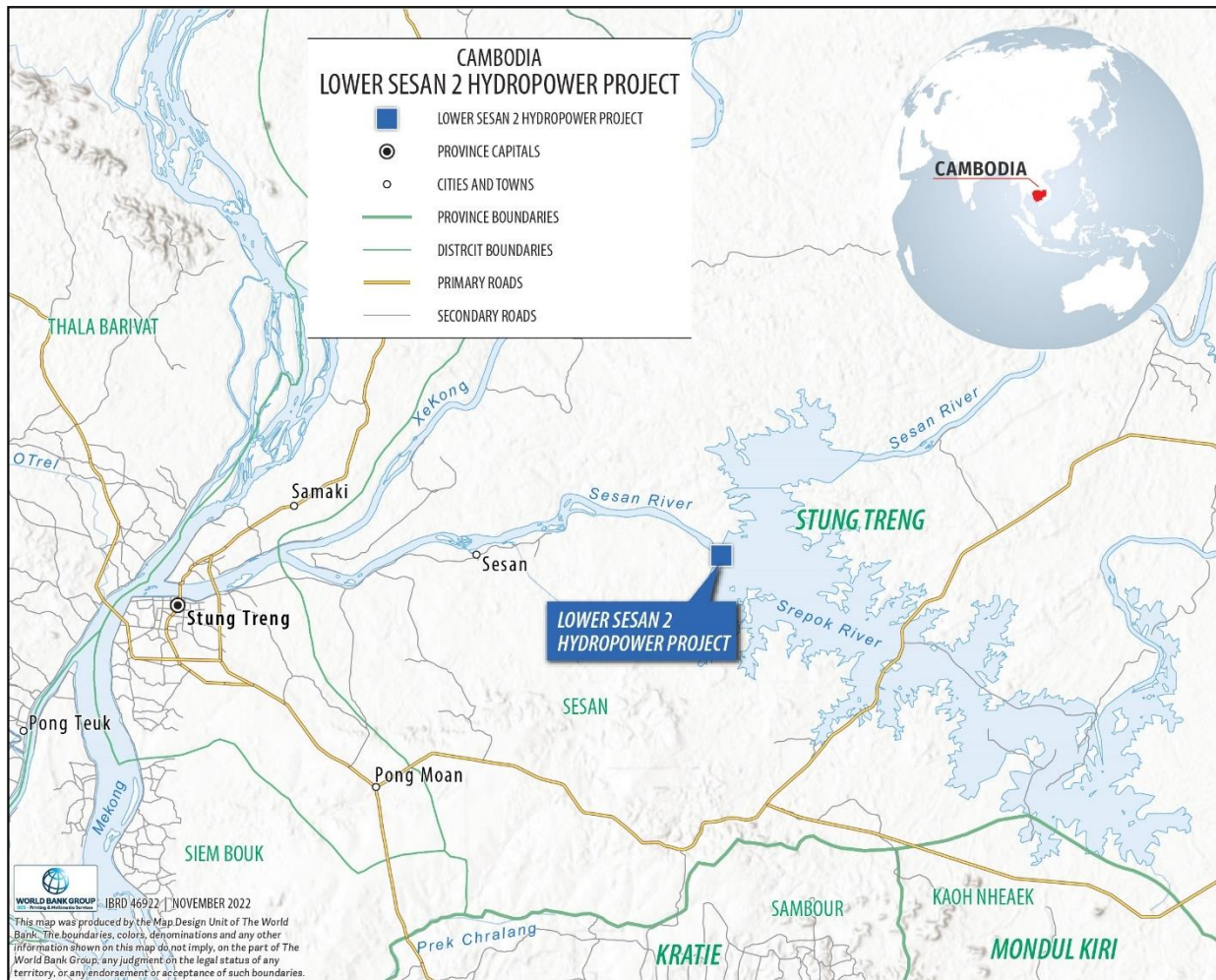
⁹ EVNI was originally created as EVN Cambodia Joint Stock Company, an EVN subsidiary tasked with investing in energy projects in Cambodia and Laos. See EVNI's website: <https://bit.ly/3EfStGE>.

¹⁰ See Human Rights Watch, *Underwater* (2021). According to a 2020 Corporate Social Responsibility Report of the LS2 project, 3,690 people from six villagers in the dam and its reservoir have been affected by the project. LS2 Sustainability Report, 2020, p. 8. The project's Environmental Impact Assessment (EIA) conducted in 2008, estimated that 1,059 households needed to be physically displaced. It did not identify the number of people to be potentially economically displaced but estimated that 300,000 people upstream and downstream of the project area would be indirectly affected by the project. EIA carried out by Key Consultants Cambodia (KCC), October 2008, p.121, available at: <https://bit.ly/3D5O9dm>. In 2009, a civil society study commissioned by the Rivers Coalition of Cambodia had found around 78,000 people would suffer impacts on food security and income losses from LS2. Best practices in compensation and resettlement for large dams: Rivers Coalition in Cambodia (RCC). The case of the planned Lower Sesan 2 Hydropower Project in northeastern Cambodia, Baird, Ian G., Phnom Penh, 2009, pp. 138

¹¹ In the context of the Cambodia FI 01-03 Compliance Investigation (<https://bit.ly/3XbByOE>), CAO conducted a mission in October 2023 and collected testimonies from communities and made its own observations, which substantiate the above situation.

¹² See, among others, Mean Meach, "The Lower Sesan 2 Dam: Potential Impacts of Relocation on Affected Communities," *EarthRight Mekong School, EarthRights International* (2008); Neou Vannarin and Paul Vrieze, "Dam Project a Dilemma for Stung Treng Villagers," *The Cambodian Daily* (August 2009), 22–23; David Boyle, "Damming the Future of Villages on the Banks of the Sesan River," *Phnom Penh Post* (April 30, 2010); May Tithara and Adam Miller, "Flood of Hydrodam Fears," *Phnom Penh Post* (May 20, 2011); "Little information on Lower Sesan Dam: Report," *Phnom Penh Post* (January 25, 2013); K. Ham, S. Hay, and T. Sok, "The Politics of the Lower Sesan 2 Dam in Cambodia," in *Hydropower Development in the Mekong Region: Political, Socio-Economic and Environmental Perspectives*, edited by N. Matthews and K. Geheb (2015), 153–172; Sithirith Mak, "Dams and State Security: Damming the 3S Rivers as a Threat to Cambodian State Security," *Asia Pacific Viewpoint* 57, no. 1 (2016): 60–75; Oliver Hensengerth, "Regionalism, Identity, and Hydropower Dams: The Chinese-Built Lower Sesan 2 Dam in Cambodia," *Journal of Current Chinese Affairs* 46, no. 33 (2017): 85–118; W. Nathan and Ian G. Baird, "The Contentious Politics of Hydropower Dam Impact Assessments in the Mekong River Basin, Green," *Political Geography* 83 (2020).

Map 1.1: Location of the Lower Sesan 2 Hydropower Project



Source: World Bank Group, IBRD 46922, November 2022.

b) CAO Process and Scope and Methodology of Compliance Appraisal

In August 2023, CAO received a complaint from three groups of villagers, alleging widespread negative environmental and social impacts from the LS2 hydropower project, which they argued was financially linked to PSBC, IFC's financial intermediary client. The complaint was submitted on behalf of these communities by three international NGOs—International Rivers, International Accountability Project, and Mekong Watch.

In November 2023, CAO found the complaints eligible for an assessment in relation to IFC's investment in PSBC. The complainants subsequently sought to engage in a dispute resolution process convened by CAO. However, no consensus was reached to enter into a CAO-supported

dispute resolution process.¹³ With the complainants' consent, the case was transferred to CAO's compliance function on May 24, 2024, for a compliance appraisal.¹⁴

The scope of this compliance appraisal is limited to issues raised in the complaint and CAO's assessment report.¹⁵ CAO has made the appraisal decision based on the appraisal criteria and other relevant considerations contained in the CAO Policy. The appraisal involved a preliminary review of the following information:

- Documentation related to three complaints received by CAO in 2018, the 2024 complaint related to the LS2 hydropower project, CAO's assessment report of the 2024 complaint, and the responses to the 2024 complaint from IFC Management and PSBC
- CAO's investigation of the Cambodia financial intermediary (FI) 01-03 case related to IFC's exposure to the LS2 hydropower project in Cambodia through its investment in the An Binh Commercial Joint Stock Bank (ABBank)¹⁶
- CAO's appraisal related to IFC's exposure to the Dairi Prima Mineral Mine in Indonesia through its investment in PSBC¹⁷
- IFC and client documentation on the implementation of the project's E&S requirements
- Information gathered through engagements with the IFC project team, client representatives, and the complainants' advisors
- Relevant media and other publicly available documentation, including academic literature.

CAO extends its appreciation to all parties mentioned in this report who shared their perspectives, knowledge, and time.

2. Concerns Raised by Complainants

Complainants allege that PSBC has provided loans to the dam's majority owner, Huaneng Lancang River Hydropower and its ultimate parent company, the China Huaneng Group Co., They indicate that two of PSBC's loans to Huaneng Lancang River Hydropower and the China Huaneng Group Co. are recent and appear to be active, and that, in turn, the China Huaneng Group Co. and its subsidiaries have made an equity investment in the dam and provided additional financing and guarantees for the project. They allege this represents significant, active, and material exposure of the IFC to the LS2 hydropower project.

¹³ CAO, *Assessment Report Regarding Concerns in Relation to IFC's Investments in the Postal Savings Bank of China* (May 2024), p.6. Available at: <https://bit.ly/3TkMmsR>

¹⁴ CAO, *Assessment Report Regarding Concerns in Relation to IFC's Investments in the Postal Savings Bank of China* (May 2024).

¹⁵ CAO Policy, para. 88.

¹⁶ See case page for "Cambodia: Financial Intermediaries 01-03" at <https://bit.ly/3XbByOE>; *Assessment Report Regarding Concerns in Relation to IFC's Investments in ABBank and VietinBank and Issues Raised in Cambodia*, June 2022, <https://bit.ly/3AYHSSr>; CAO, *Compliance Appraisal of Complaints Regarding IFC's Exposure to the Lower Sesan 2 Hydropower Project in Cambodia through ABBank and Vietinbank* (November 18, 2022, (Cambodia: FI 01-03 Appraisal Report), available at: <https://bit.ly/4gidUJa>.

¹⁷ CAO, *Compliance Appraisal of a Complaint Regarding IFC's Exposure to the Dairi Prima Mineral Mine in Indonesia through an Investment in Postal Savings Bank of China (PSBC)* (July 6, 2022, (PSBC-01 Appraisal Report), available at: <https://bit.ly/3MEVdSi>.

Additionally, the complaint refers to and reiterates allegations included in three complaints related to the LS2 hydropower project that were submitted to CAO by the same communities in June 2018.¹⁸ The merged 2018 complaints are currently in the final stages of a CAO compliance investigation.¹⁹ The complainants, who requested that CAO keep their identities confidential, include:

- Villagers permanently resettled from Old Kbal Romeas and Old Srekor villages due to the LS2 hydropower project
- Villagers from Old Kbal Romeas and Old Srekor who refused to resettle
- Villagers from Taveng, Lumpath, Kounmom, Angdong Meas, and Veun Sai Districts in Ratanakiri Province, located along the Sesan and Srepok rivers upstream of the dam.

The resettled villagers allege that living conditions and infrastructure at their relocation site are inadequate. Specifically, they claim:

- Living conditions are not in accordance with verbal promises made by local government officials. Their concerns include insufficient availability of clean well water, lack of capacity at health centers, low quality housing, the flooding of new farmlands, and the lack of a properly working sewage system.
- Compensation has been inadequate due to the lack of a comprehensive socioeconomic survey of pre-displacement assets. Complainants claim they were not provided with livelihood restoration programs and support, including for irrigation and to plow farmland, and that the available farmland does not include planted trees or space to raise animals.
- The resettlement site is several kilometers from the river, limiting fishing activity, and their substitute agricultural plots are not as productive as their former lands. These villagers have not received any compensation for impacts on their livelihoods.
- The complainants say they have been unable to meaningfully participate in resettlement decision-making processes and ongoing unaddressed issues with the resettlement site's layout, infrastructure, and quality. The project lacks a grievance mechanism, limiting the villagers' ability to raise issues with the dam operator. Complainants do not feel safe to express their concerns because some have been told they would lose their resettlement land and homes if they complained.

The villagers who refused to resettle, who total approximately 136 families who did not want to leave their homes and livelihoods in the reservoir area.

- The villagers from Old Kbal Romeas are members of government-recognized Indigenous communities. They say they refused to resettle to protect their cultural identity and sacred sites and emphasized the lack of consideration of their wish to be resettled within their customary land. These villagers indicate that they are willing to sacrifice their lives to protect their land and ancestral graves.

¹⁸ The three complaints claimed that IFC is exposed to the LS2 hydropower project through its investment in a Vietnamese bank, An Binh Commercial Joint Stock Bank (ABBank).

¹⁹ See case page for Cambodia: Financial Intermediaries 01-03: <https://bit.ly/3XbByOE>

- The reservoir has flooded their old village and rice fields, leading to the loss of sacred and ancestral lands and the culturally significant rituals tied to them.
- The dam has allegedly caused a significant decline in the local fish population, including migratory species, affecting diets and incomes.
- The communities complain that they lack basic infrastructure and sufficient land to farm due to flooding, which they attribute to the LS2 hydropower project. Poorer access to the river and fish insecurity not only threatens cash income but also communities' food security. Communities found it difficult to access clean water since the LS2 started its operations, leading to adverse health effects and economic burdens.
- Currently residing on customary lands, these communities continue to lack the security of land tenure and have received no compensation for physical and economic displacement.
- Complainants allege a lack of free, prior, and informed consultation, as most are Indigenous Peoples who suffered intimidation and retaliation in 2017–18 as the dam's construction ended and operations began.

The upstream complainants include ethnic Lao and Khmer and indigenous Tampuan, Jarai, Krajoh.

- These groups allege that they were not informed or consulted about the LS2 hydropower project or its compensation policies, and that their only source of information was a local nongovernmental organization.
- They claim that flooding forced communities to temporarily relocate in tents, leading to health problems and physical hazards.
- They claim adverse livelihood impacts due to declining migratory fish populations and changes in river flow, forcing them to buy food in the marketplace. They have received no compensation for these impacts, nor any acknowledgment that they are project-affected people.

Since at least 2008, local communities have consistently raised serious environmental and social concerns regarding the LS2 hydropower project, supported by a significant amount of publicly available information from civil society, academic, and media sources.²⁰

3. Summary of IFC and Client Responses

The IFC and PSBC responses to the complaint provided to CAO are summarized below and attached in full as appendixes 1 and 2. Both rejected the complainants' premise that IFC is exposed to the LS2 project in Cambodia through its investment in PSBC.

a) IFC Response

On June 27, 2024, IFC provided its Management Response to the complaint (see appendix 1). IFC contests the complainants' view about financial links between PSBC, Huaneng Lancang

²⁰ See Cambodia FI 01-03 *Appraisal Report*, pp. 25-29, footnotes 51-71, available at: <https://bit.ly/4gidUJa>.

River Hydropower, and the China Huaneng Group Co., and while acknowledging the seriousness of the harms being alleged, does not specifically or substantively address environmental and social concerns related to the LS2 hydropower project. IFC argues that:

1. PSBC provided two loans to Huaneng Lancang River Hydropower in 2016 and 2017, which were project loans and ringfenced for its business activities in China. According to PSBC, the loan agreements state that the loan proceeds were to be used for the construction of the Miaowei Hydropower Station Project and the Huangdeng Hydropower Station Project in Yunnan Province. The loan agreements also state that the borrower shall not change the purpose of the loans or use the proceeds for another purpose, such as equity investment.
2. PSBC confirmed that the China Huaneng Group Co. received two working capital loans from PSBC in 2018. IFC states that because PSBC is a commercial bank established under the laws of the People's Republic of China, its working capital loans are subject to the country's laws and regulatory framework, which restrict the use of such loans. Specifically, IFC points out that the borrower may not use the proceeds of a working capital loan on fixed assets, equity, or capital investment in another enterprise, or to invest in a project outside of China, such as the LS2 hydropower project.
3. All loans provided by PSBC to Huaneng Lancang River Hydropower and the China Huaneng Group Co. have been repaid, and PSBC has no current financial exposure to Huaneng Lancang River Hydropower or to the China Huaneng Group Co.

IFC further notes that it fully exited from PSBC in December 2023 following the continuous implementation of a preapproved sales plan and is therefore no longer exposed to PSBC or any of its sub-projects.

IFC also notes that CAO is already conducting a compliance investigation on the LS2 hydropower project regarding IFC's exposure through another financial intermediary client, with similar issues raised in the complaint.

b) Client Response

On July 25, 2024, CAO received a response from IFC's client, PSBC, in relation to the complaint, attached as appendix 2.

PSBC's alleges that it has no financial exposure to the LS2 hydropower project, that all historical transactions with the China Huaneng Group Co. and Huaneng Lancang River Hydropower have been settled, and that the use of proceeds was clearly defined according to mutual agreements and regulatory requirements that did not permit their use for the LS2 hydropower project in Cambodia.

PSBC requests that CAO close the case, arguing that the LS2 hydropower project is entirely outside the scope of the use of proceeds from IFC and PSBC funding and does not qualify as a

sub-project under the CAO Policy. According to PSBC, this case is not within the scope of CAO's accountability mechanism, nor are there any "preliminary indications that IFC may not have complied with its E&S Policies" based on the arguments below:

1. IFC's investment in PSBC was aimed at helping PSBC strengthen its business related to rural finance and MSME finance. China Huaneng Group Co., Huaneng Lancang River Hydropower, and Huaneng Finance do not qualify as clients of "MSME finance under the retail operations," and the financial products that PSBC provides them are not within the scope of IFC's investment in PSBC.
2. PSBC has conducted a comprehensive and systematic investigation of its historical business dealings with Huaneng Lancang River Hydropower and the China Huaneng Group Co. during the period of IFC's shareholding in PSBC. There are no financial products that could potentially be used for the LS2 hydropower project. All historical business transactions with Huaneng Lancang River Hydropower and the China Huaneng Group Co. have clearly defined uses, which were specifically designated for domestic projects in China. PSBC confirmed that the funds under these financial transactions, by laws and mutual contracts are not allowed, and indeed cannot be used for the LS2 hydropower project. PSBC provided further confidential explanations and evidence in support of these arguments.
3. PSBC claims that the use of proceeds for IFC's investment in PSBC and the use of proceeds of PSBC's financial products with Huaneng Lancang River Hydropower and the China Huaneng Group Co. are clear and explicit but that even if they were unclear, there would be no basis for determining that the LS2 hydropower project is a business operation of Huaneng Lancang River Hydropower and the China Huaneng Group Co., according to the "involvement, influence, and importance" criteria used by CAO in past cases that would qualify it as an IFC sub-project.
4. PSBC believes that IFC's Performance Standards do not apply to all PSBC business activities. It argues that the investment agreement between IFC and PSBC only stipulated that PSBC should "use all reasonable efforts to ensure the continuing operation of the E&S Management System to identify, assess and manage the social and environmental performance of the Company Operations in compliance with the S&E Requirements." PSBC alleges that its financing operations subject to IFC's Performance Standards involve long-term financing of over 36 months and equity investments, according to the *Interpretation Note on Financial Intermediaries*²¹ of January 2012, and the *Guidance Note on Financial Intermediaries*²² of September 2023. PSBC argues that liquidity loans/working capital loans should neither be considered significant equity investments nor high-risk transactions to which the Performance Standards should be applied. Thus, the transactions between PSBC and Huaneng Lancang River Hydropower and the China Huaneng Group Co. do not fall within the scope of IFC's Performance Standards.
5. Lastly, IFC no longer holds any shares in PSBC and there are no active loans or investments between PSBC and Huaneng Lancang River Hydropower or the China Huaneng Group Co. PSBC argues that opening a compliance investigation will not bring value in terms of "accountability, learning, or remedial action" because: (1) it will not facilitate the

²¹ IFC, *Interpretation Note on Financial Intermediaries* (January 1, 2012), available at: <https://bit.ly/4ecUluz>.

²² IFC, *Guidance Note on Financial Intermediaries* (September 29, 2023) available at: <https://bit.ly/3MDCgiX>.

implementation of remedial actions for any harm that CAO believes to exist; (2) any compliance shortcomings are already being addressed and supervised in the ongoing CAO Compliance Audit of IFC's Financial Sector Investments,²³ and (3) PSBC is extremely unlikely to continue cooperating on this case given that the legal agreement between IFC and PSBC has ceased to be effective.

4. IFC Environmental and Social Policy Framework

IFC's 2012 Sustainability Framework requirements are applicable to IFC's investments in financial intermediaries such as PSBC. The IFC Sustainability Framework includes the Sustainability Policy (binding on IFC) and the Performance Standards (client requirements).

The Sustainability Policy states that IFC seeks to ensure that it carries out investment and advisory activities with the intent to "do no harm" to people and the environment. To achieve this, IFC conducts a pre-investment review and supervision of its investments. IFC requires its clients to manage the E&S risks and impacts of their operations in accordance with IFC's Performance Standards.²⁴ For a financial intermediary, this means implementing an Environmental and Social Management System (ESMS)²⁵ to ensure that it applies IFC's exclusion list and follows relevant national laws; high-risk business activities are required to apply relevant requirements of the Performance Standards. The IFC Sustainability Policy does not differentiate between financial products (e.g., project, corporate, or working capital finance) in terms of the requirement to apply the Performance Standards but instead among the underlying E&S risks of the financed activity.²⁶ In cases where IFC provides a financial intermediary with equity or financial support of a general purpose without a specified end use, IFC requirements regarding environmental and social risk management apply to the entire portfolio of the FI that is originated from the time IFC became a shareholder or investor.²⁷

The IFC's Performance Standards define IFC clients' responsibilities for managing the environmental and social risks and impacts of their business operations.

5. CAO Appraisal Analysis

This section presents CAO's analysis of the complaint based on research; document review; and engagements with IFC, the client, and complainants. The CAO Policy establishes three appraisal criteria required to initiate a compliance investigation:

1. Whether there are preliminary indications of harm or potential harm;

²³ CAO Compliance Audit of IFC's Financial Sector Investments, available at: <https://bit.ly/3MBjaKv>.

²⁴ IFC Sustainability Policy (2012): para 7–9.

²⁵ An ESMS is a set of policies, procedures, tools, and internal capacity to identify and manage a financial institution's exposure to the environmental and social risks of its clients/investees. For further details on ESMS aspects, see IFC Performance Standard 1, *IFC Interpretation Note on Financial Intermediaries* (2018); and IFC's *First for Sustainability*, available at <https://bit.ly/3qFLsc7>.

²⁶ As per IFC Sustainability Policy 2012, para. 35, *FIs with portfolio and/or prospective business activities that present moderate to high environmental or social risks (i.e., Category FI-1 and FI-2) will require higher risk business activities they support to apply relevant requirements of the Performance Standards.*

²⁷ IFC Sustainability Policy (2012), para. 37.

2. Whether there are preliminary indications that IFC or MIGA may not have complied with its E&S Policies; and
3. Whether the alleged harm is plausibly linked to the potential non-compliance.²⁸

In this case, as it has done in previous cases,²⁹ CAO considers it necessary to first examine the alleged financial relationships between IFC's FI client PSBC and the LS2 hydropower project before analyzing the formal appraisal criteria.

Based on the analysis below, CAO finds that the complaint does not meet the criteria for a compliance investigation regarding IFC's 2015 equity investment in PSBC.

Relationships between PSBC and the Lower Sesan 2 Hydropower Project

Examining the relationship between IFC's FI client, PSBC, and the LS2 hydropower project is relevant because, according to the CAO Policy, the purpose of CAO's compliance function is to "assess, as relevant, IFC/MIGA's review and supervision of its E&S Requirements at the *project or sub-project-level* and consider *project or sub-project-level* E&S performance."³⁰ In addition, the CAO Policy defines "Harm" as "any material adverse environmental and social effect on people or the environment *resulting directly or indirectly from a project or sub-project*" (emphasis added).³¹ Thus, CAO must determine at the outset whether the LS2 hydropower dam is an IFC sub-project. If it is not, the complaint should close at appraisal, in accordance with the CAO Policy.

The CAO Policy defines a sub-project as "a business operation of a sub-client within the use of proceeds requirements in IFC's finance or investment documents or MIGA's contract of guarantee." The term sub-client is defined as "a business directly supported by an FI client that is within the use of proceeds requirements in IFC's finance or investment documents or MIGA's contract of guarantee."³²

In deciding whether the business activity subject to a CAO complaint qualifies as a "business operation" of an IFC sub-client, and thus a sub-project, CAO considers both the sub-client's involvement in and leverage over the operations of the business activity, as well as the importance of the business activity to the sub-client.³³

IFC and PSBC have indicated that there was no financial exposure to the LS2 hydropower project in Cambodia through IFC's investments in PSBC.

²⁸ CAO Policy, para. 91.

²⁹ CAO, *Compliance Appraisal of Complaints Regarding IFC's Exposure to the Lower Sesan 2 Hydropower Project Appraisal of Complaints* (November 18, 2022), pp.15-19, available at: <https://bit.ly/4gidUJa>

³⁰ CAO Policy, para. 77.

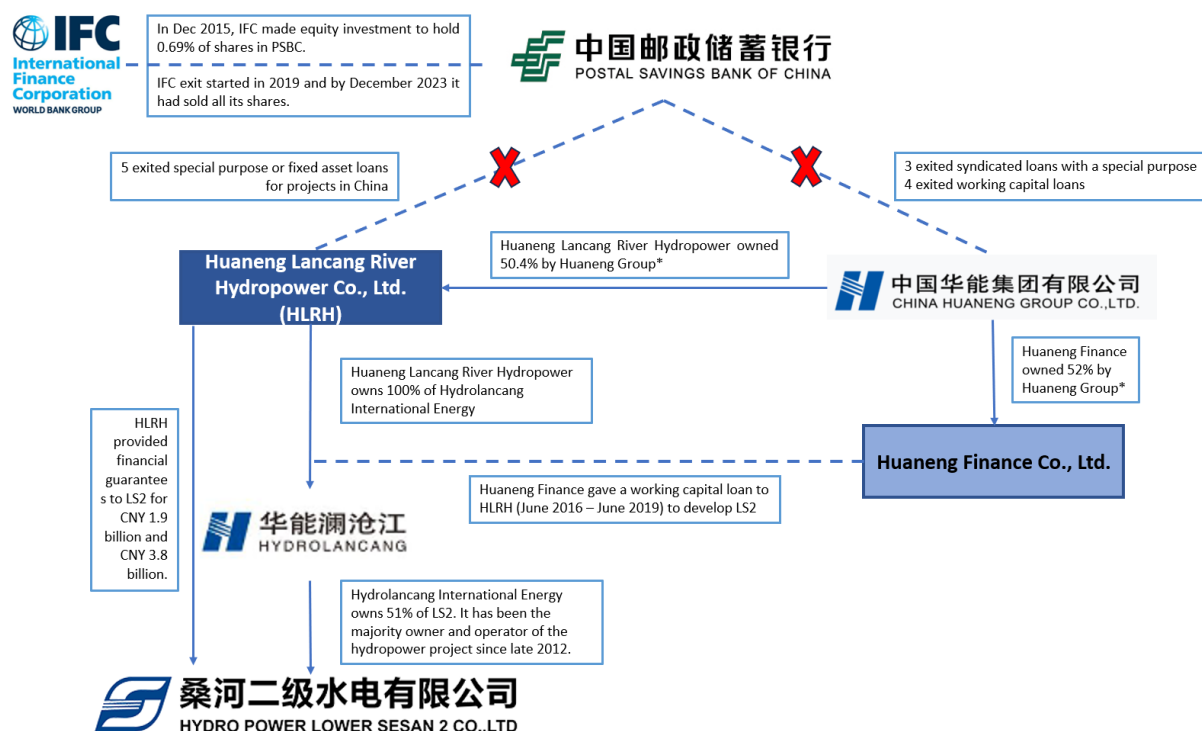
³¹ CAO Policy, glossary.

³² CAO Policy, glossary.

³³ CAO, *Compliance Appraisal of a Complaint Regarding IFC's Exposure to the Dairi Prima Mineral Mine in Indonesia* (July 6, 2022), p. 29, available at: <https://bit.ly/3MEVdSi>; CAO, *Compliance Appraisal of Complaints Regarding IFC's Exposure to the Lower Sesan 2 Hydropower Project Appraisal of Complaints* (November 18, 2022), p. 16, available at: <https://bit.ly/4gidUJa>.

To determine whether there are preliminary indications of IFC noncompliance with its E&S Policies and Harm, CAO first needs to determine whether the LS2 hydropower dam can be considered an IFC sub-project through PSBC. CAO's preliminary review of available information concludes that the LS2 hydropower dam is not an IFC sub-project through PSBC. The CAO's view is based on the following reasoning:

Figure 1.1: Alleged IFC exposure to the LS2 hydropower project through PSBC



Source: CAO Analysis

- *IFC's investment in PSBC was an equity investment and, as such, does not have use-of-proceeds limitations.*

IFC made an equity investment in PSBC, which exposed it to all of PSBC's operations and required that PSBC apply IFC's E&S requirements to the entire portfolio that originated after the IFC investment.³⁴ As explained above, such E&S requirements vary depending on the level of risk of the business activity being supported by the FI: IFC's exclusion list and national law for all operations and the Performance Standards for high-risk operations. This should be determined

³⁴ Sustainability Policy, para. 37; Environmental and Social Review Procedures (ESRP) (2014), section 3.2.4; *IFC Interpretation Note on Financial Intermediaries*, IN17.

and applied through an ESMS developed and operated by the FI commensurate with the level of E&S risks in its portfolio.³⁵

In the case of IFC's investment in PSBC, IFC went beyond the requirements of the Sustainability Policy and formally agreed with the client that PSBC would apply its ESMS to all existing and future financing operations, using all reasonable efforts to identify, assess and manage the bank's operations in compliance with E&S requirements.ⁱⁱ

Therefore, all PSBC's clients, including Huaneng Lancang River Hydropower and the China Huaneng Group Co., were IFC sub-clients for which IFC should have required PSBC to apply its ESMS, given the general nature of equity investments. The intended purpose of IFC's investment (to strengthen MSME lending) does not limit the potential use of a general equity investment.

- *Huaneng Lancang River Hydropower and the China Huaneng Group Co. were both IFC sub-clients, in that they were PSBC clients during the time IFC held equity in PSBC.*

Huaneng Lancang River Hydropower and the China Huaneng Group Co. both received loans from PSBC during the time IFC held equity in PSBC.

Complainants alleged that PSBC had provided loans and had active credit lines with Huaneng Lancang River Hydropower, according to its 2016, 2020, and 2023 bond prospectuses; and with the China Huaneng Group Co., according to its 2016, 2018, 2022, and 2023 bond prospectuses and the 2017 and 2018 annual reports on corporate bonds for the China Huaneng Group Co. PSBC explained that the amounts reflected as "utilized credits" in those bond prospectuses correspond to the amount actually contracted by the China Huaneng Group Co. or Huaneng Lancang River Hydropower and all of its controlled member units including subsidiaries with/from PSBC during the corresponding period.³⁶

Regarding Huaneng Lancang River Hydropower, PSBC indicated that the utilized credits correspond to five special purpose or fixed-asset loans that PSBC provided to Huaneng Lancang River Hydropower to construct and/or develop the Xiaowan Hydropower Station, Huangdeng Hydropower Station, and Miaowei Hydropower Station, or to cover specific expenses of the Manwan Hydropower Plant, Jinghong Hydropower Plant, Xiaowan Hydropower Plant, Nuozhadu Hydropower Plant, and the Miaowei-Gongguoqiao Hydropower Plant. The loans were restricted in their use, and PSBC verified such use with each disbursement and at settlement.

³⁵ Sustainability Policy, para. 35.

³⁶ PSBC explained that the "credit lines" or "credit limits" mentioned in the bond prospectuses represent the maximum credit amount authorized to be given by PSBC for that particular client in a particular period, on the basis of a comprehensive assessment of the risks and financial conditions of a client, determined by PSBC in accordance with the provisions of the *Guidance for Commercial Banks on Implementing the Unified Credit Granting System* issued by the People's Bank of China. PSBC indicated that the "credit line" or "credit limit" is not equivalent to a loan or investment for that amount. Clients need to follow the normal application procedures for any particular loan, and PSBC is not obligated to provide credit or extend all requested credits. Each transaction by every member unit of Huaneng Group must be approved in accordance with PSBC's relevant procedures and authority. The credit limit just means that the total business volume must not exceed the group limit approved for that period.

CAO reviewed redacted versions of the corresponding loan contracts, loan evaluation reports, loan certificates, credit drawdown requests, disbursement review opinions, disbursement notices, post-disbursement inspections, and settlement certificates, among other documents. CAO's preliminary review of such documentation finds that the five loans provided by PSBC to Huaneng Lancang River Hydropower that were active between 2016 and 2023 included use-of-proceeds restrictions and thus could not be used to finance the LS2 hydropower project.

Regarding the China Huaneng Group Co., PSBC indicated that the utilized credits in the public bond announcements correspond to three syndicated loans and four working capital loans during the period of IFC's investment in PSBC. The use of proceeds from the three syndicated loans was limited to a designated purpose unrelated to the LS2 hydropower project. In contrast, working capital loans are by their nature general purpose loans typically used to cover a company's short-term operational costs, such as payroll and rent, or to manage cash flow gaps during a business's slow season.³⁷ In this case, PSBC and the China Huaneng Group Co. assert and provided evidence that these working capital loans were short-term, one-year loans requested and used for the repayment of the China Huaneng Group Co.'s two super-short-term commercial papers from 2017 and one medium term note from 2014, as well as one loan from another bank used for daily operating expenses at the company's headquarters.

IFC argues that Chinese law states that working capital loans cannot be used for fixed assets, equity, or capital investment.³⁸ IFC holds the view that national legal and regulatory requirements prohibit the use of working capital loan proceeds for investment in an enterprise outside China. PSBC also asserts these working capital loans could not be used for any purpose outside of the headquarters of the China Huaneng Group Co. or its subsidiaries due to their loan terms and regulatory requirements of the publicly issued bonds.³⁹

A preliminary review of the financial regulation shared by IFC and PSBC does not reflect that the proceeds of working capital loans in China could not be used for overseas investments.⁴⁰ At the

³⁷ "Working capital loans are corporate debt borrowings that companies use to finance operating expenses. While they cannot be used to buy long-term assets or make investments, they can cover a company's short-term operational needs such as payroll, rent, and other operational costs and manage cash flow gaps during a business's slow season." CAO, *Compliance Appraisal of a Complaint Regarding IFC's Exposure to the Dairi Prima Mineral Mine in Indonesia* (July 6, 2022), p. 28, available at: <https://bit.ly/3MEVdSi>.

³⁸ IFC, *Management Response* (June 27, 2024), p. 9. See similar arguments in CAO, *Compliance Appraisal of a Complaint Regarding IFC's Exposure to the Dairi Prima Mineral Mine in Indonesia* (July 6, 2022), *Management and Client Responses*, pp. 14–15; IFC *Management Response to the CAO complaint on PSBC Equity*, February 11, 2022, pp.10–11, available at: <https://bit.ly/3MEVdSi>.

³⁹ *Client Response from PSBC to CAO Regarding Lower Sesan 2 Complaint*, p. 6. See similar arguments in CAO, *Compliance Appraisal of a Complaint Regarding IFC's Exposure to the Dairi Prima Mineral Mine in Indonesia* (July 6, 2022), *Management and Client Responses*, pp. 14–15; PSBC *Client Response regarding Concerns in Relation to IFC's Investment*, February 11, 2022, available at: <https://bit.ly/3MEVdSi>. CAO, *Compliance Appraisal of a Complaint Regarding IFC's Exposure to the Dairi Prima Mineral Mine in Indonesia* (July 6, 2022), pp. 6–7, available at: <https://bit.ly/3MEVdSi>.

⁴⁰ The Chinese regulation made available to CAO seems to limit the use of working capital loans for fixed assets, equity, or capital investments but does not refer to overseas restrictions. The *Interim Measures for the Administration of Working Capital Loans* itself provides in article 21 that "the lender shall stipulate in the loan contract that the borrower shall commit to the following matters: [...] (3) Obtain the lender's consent before making overseas investments, substantially increasing debt financing, and conducting mergers, divisions, equity transfers and other major matters. [...]" Such a provision reveals that working capital loans can be used for overseas investments unless the lender

same time, it is unclear to CAO why the restrictions on the use of funds raised through publicly issued bonds would restrict the use of proceeds of a working capital loan acquired by the bond issuer to repay said bonds. Even if the operations are related, they are different financial transactions and therefore it does not follow that the restrictions in the use of proceeds for one automatically apply to the other unless specified in the loan agreements—which it is not.

- *The LS2 hydropower project is outside the use of proceeds of the financial products provided by PSBC to Huaneng Lancang River Hydropower and thus is not a sub-project through that sub-client.*

HydroLancang International Energy, the majority owner of the LS2 hydropower project, is a business activity of Huaneng Lancang River Hydropower, one of the IFC sub-clients through PSBC. However, the loans provided by PSBC to Huaneng Lancang River Hydropower were restricted in their use to activities that did not involve HydroLancang International Energy or the Lower Sesan 2 Hydropower Project. Consequently, the LS2 project cannot be considered a business operation within the use of proceeds of these loans and a sub-project under the CAO Policy.

- *Lower Sesan 2 Hydropower Project is not a sub-project of the China Huaneng Group Co.*

The three syndicated loans provided by PSBC to the China Huaneng Group Co., the parent company of Huaneng Lancang River Hydropower and Huaneng Finance, were restricted in their use of proceeds. However, the working capital loans were not restricted, and as such could potentially have been used for any operational purpose.

As stated above, to determine whether a business activity subject to a CAO complaint (i.e., the LS2 project) qualifies as a “business operation” of an IFC sub-client (i.e., the China Huaneng Group Co.) and thus as a sub-project, CAO considers the sub-client’s involvement and leverage over the operations and the importance of the business activity to the sub-client.⁴¹ As CAO has previously indicated,⁴² the CAO Policy does not require a “direct link” between the client, the sub-client and the related E&S risks and impacts. A business can be directly linked to E&S risks and impacts through its business relationships, which can include businesses that are numerous tiers down a value chain.⁴³ In past cases, CAO has determined that a business activity several tiers

stipulates in the contract that their consent is needed in advance. CAO has not seen evidence of such provisions in the documentation shared by the client for the relevant loans in this case. See Interim Measures for the Administration of Working Capital Loans, China Banking Regulatory Commission (February 12, 2010).

⁴¹ CAO, *Compliance Appraisal of a Complaint Regarding IFC’s Exposure to the Dairi Prima Mineral Mine in Indonesia* through an Investment in Postal Savings Bank of China (PSBC), (July 6, 2022), p. 29; CAO, *Compliance Appraisal of Complaints Regarding IFC’s Exposure to the Lower Sesan 2 Hydropower Project in Cambodia* through an ABBank and Vietinbank, November 18, 2022, p. 16.

⁴² See CAO, *Compliance Appraisal of a Complaint Regarding IFC’s Exposure to the Dairi Prima Mineral Mine in Indonesia* through an Investment in Postal Savings Bank of China (PSBC) (July 6, 2022), p. 28, available at: <https://bit.ly/3MEVdSi>.

⁴³ Office of the United Nations High Commissioner for Human Rights (OHCHR), *The Corporate Responsibility to Respect: An Interpretive Guide* (2012): 5, <https://bit.ly/3zuLgSI>; *OECD Guidelines for Multinational Enterprises and the United Nations Guiding Principles on Business and Human Rights* (2011), <https://www.oecd.org/corporate/mne/> and <https://bit.ly/3S72BpP>; OHCHR response to request from BankTrack and OECD Watch for advice regarding the

removed from the sub-client can constitute a sub-client's business operation and an IFC sub-project under the CAO Policy based on the priority or share it had in the sub-client's portfolio; the sub-client's past or present level of involvement in the business activity; the sub-client's responsibilities and control over the business activity; and the sub-client level of involvement or forms of participation in the business activity.⁴⁴

The business operations of the China Huaneng Group Co. include the shareholding and operation of Huaneng Lancang River Hydropower (50.4 percent shareholder) and Huaneng Finance (52 percent shareholder). Both subsidiaries in which the China Huaneng Group Co. has a controlling interest have financial relationships or have offered financial products to the LS2 hydropower project. Huaneng Lancang River Hydropower and Huaneng Finance therefore could be considered sub-projects of IFC's sub-client, the China Huaneng Group Co. In addition to the China Huaneng Group Co.'s controlling interest, both companies are regularly listed as important subsidiaries of the sub-client.⁴⁵ However, despite this relationship, CAO has no basis to conclude that the LS2 hydropower project is at the level of a sub-project of the China Huaneng Group Co., according to the definition in the CAO Policy. Huaneng Lancang River Hydropower and the China Huaneng Group Co. are distinct and separate companies, with different structures, management and Board members.⁴⁶ CAO has seen no evidence to suggest that China Huaneng Group Co. is directly involved in the operations of the LS2 hydropower project or HydroLancang International Energy, the LS2 project's majority shareholder, or that LS2 constitutes a significant part of the business activities of the China Huaneng Group Co. Neither HydroLancang International Energy nor the Lower Sesan 2 hydropower project are listed in publicly available documents as subsidiaries of the China Huaneng Group Co.⁴⁷

On the other hand, the available evidence indicates that the LS2 hydropower project could be considered a business operation of Huaneng Lancang River Hydropower, which owns 100 percent of its majority shareholder (HydroLancang International Energy), is specialized in the construction and operation of hydropower plants, seems to be involved in the operation of the

application of the *United Nations Guiding Principles on Business and Human Rights* where private sector banks act as nominee shareholders (August 30, 2021): 4.

⁴⁴ For example, whether it was the main source of revenue or a significant portion; whether the sub-client was the majority shareholder, operator, or engineering, procurement, and construction (EPC) contractor of the business activity; and whether the sub-client provided staff, management personnel, consultants, or contractors for the business activity. CAO, *Compliance Appraisal of a Complaint Regarding IFC's Exposure to the Dairi Prima Mineral Mine in Indonesia* (July 6, 2022), p. 30, available at: <https://bit.ly/3MEVdSi>; CAO, *Compliance Appraisal of Complaints Regarding IFC's Exposure to the Lower Sesan 2 Hydropower Project* (November 18, 2021), pp. 16–17, available at: <https://bit.ly/4gidUJa>.

⁴⁵ Huaneng Lancang River Hydropower and Huaneng Finance are repeatedly listed as "important subsidiaries" of Huaneng Group Co. in the China Huaneng Group Co's 2016, 2022, and 2023 bond prospectuses and the 2017 annual report on corporate bonds, while neither HydroLancang or the Lower Sesan 2 project are listed. Available at: <https://bit.ly/4emdrEd> (2016 Bond prospectus); <https://bit.ly/3XEgxHo> (2022 Bond prospectus); <https://bit.ly/3XnmiOL> (2023 Bond Prospectus); <https://bit.ly/4d0EmUM> (2017 Annual Report). Annual Reports of China Huaneng Group Co., Ltd. (2015-2023), available at: www.sse.com.cn.

⁴⁶ Huaneng Lancang River Hydropower is a publicly listed company in the Shanghai Stock Exchange, while China Huaneng Group Co. is a state-owned company. Both companies have separate and distinct Chairpersons, Board Members, Supervisors and Management. See information at: <https://bit.ly/4ekTXj2>, and <https://bit.ly/4egm8Qc>.

⁴⁷ See the China Huaneng Group Co's 2016, 2022, and 2023 bond prospectuses and the 2017 annual report on corporate bonds of the Huaneng Group Co. Annual Reports of China Huaneng Group Co., Ltd. (2015-2023), available at: www.sse.com.cn.

LS2 project, and regularly reports it as part of its subsidiaries, assets and sources of revenue.⁴⁸ However, the loans provided by PSBC to Huaneng Lancang River Hydropower were restricted in their use of funds to activities that did not involve HydroLancang International Energy or the LS2 project.

CAO concludes that the Lower Sesan 2 hydropower project cannot be considered a business operation of the sub-client China Huaneng Group Co. within the use of proceeds of the investment made by IFC and PSBC. Further, while the LS2 project could be considered a business operation of IFC's sub-client Huaneng Lancang River Hydropower, the loans provided by PSBC were restricted in their use of funds so that it does not meet the definition of sub-project in the CAO Policy. Therefore, the LS2 hydropower project cannot be considered an IFC sub-project through its investment in PSBC according to the CAO Policy, and CAO does not have the basis for a compliance investigation of IFC's investment in PSBC.

CAO notes that the fact that the LS2 hydropower project cannot be considered a sub-project of IFC's PSBC investment through the sub-client China Huaneng Group Co., does not mean that the LS2 hydropower project is not part of the broader China Huaneng Group Co.'s business activities whose E&S risks and impacts should have been assessed, addressed, and monitored through a properly functioning ESMS of PSBC. Despite this broader application of the IFC Sustainability Framework, CAO's policy limits CAO's compliance function to the project and sub-project level, which is why CAO has made the above determination in this appraisal.

-0-

CAO's appraisal decision in this case does not preclude future complaints related to the PSBC project or the Lower Sesan 2 hydropower project based on new circumstances, knowledge, or alleged harms/potential harms not known at the time of this report's completion.

6. CAO Decision

CAO will not proceed with a compliance investigation of IFC's equity investment in PSBC and its alleged financial exposure to the LS2 hydropower project in Cambodia. CAO determines that the complaint does not meet the criteria for a compliance investigation because a preliminary review of the information provided by complainants, IFC, and the client does not indicate that the LS2 hydropower project is an IFC sub-project over which CAO can exercise its compliance function. Consequently, CAO finds it cannot be established that there are preliminary indications of

⁴⁸ In its 2023 bond prospectus, Huaneng Lancang River Hydropower indicated that it had developed the LS2 hydropower station, accumulating rich experience in overseas projects. The 2020 bond prospectus similarly announces that Huaneng Lancang River Hydropower had developed the LS 2 hydropower plant, reporting it among its plants in operation and including its power capacity in the company's total installed capacity (available at: <https://bit.ly/4dYwkgn> (2020 Bond Prospectus)). According to the 2022 and 2023 Annual Reports of Huaneng Lancang River Hydropower, Lower Sesan 2 generated revenue equivalent to 3.88% and 5.71% of the total of Huaneng Lancang River Hydropower's revenues those years, respectively. Huaneng Lancang River Hydropower Annual Report (2022 and 2023), available at: www.sse.com.cn.

noncompliance from IFC regarding the LS2 hydropower project through its investment in PSBC. The appraisal criteria are not met, and CAO will close the case.

This appraisal report will be shared with the Board, the World Bank Group President, IFC Management, the client, and the complainants. CAO will also publish this appraisal report, IFC's Management Response, and the client's response on its website.⁴⁹

⁴⁹ CAO Policy, para. 106.

Appendix 1: IFC Management Response

INTERNATIONAL FINANCE CORPORATION

**MANAGEMENT RESPONSE
TO THE CAO COMPLAINT
ON**

**CAMBODIA - POSTAL SAVINGS BANK OF CHINA
(PROJECT NO. 35461)**

JUNE 27, 2024

TABLE OF CONTENTS

ABBREVIATIONS AND ACRONYMS	2
EXECUTIVE SUMMARY	3
I. INTRODUCTION	5
II. PROJECT BACKGROUND.....	5
III. CAO COMPLAINT	6
IV. MANAGEMENT RESPONSE.....	8
V. CONCLUSION.....	9

ABBREVIATIONS AND ACRONYMS

CAO	Office of the Compliance Advisor Ombudsman
E&S	Environmental and Social
ESAP	Environmental and Social Action Plan
IFC	International Finance Corporation
NGO	Non-Governmental Organization
MSME	Micro-, Small-, and Medium-sized Enterprises
PSs	IFC's Environmental and Social Performance Standards
PSBC	Postal Savings Bank of China
US\$	United States Dollar
WBG	World Bank Group

EXECUTIVE SUMMARY

- i. This Management Response is in relation to the CAO complaint submitted in August 2023 concerning an alleged indirect exposure of IFC, through IFC's equity investment in Postal Savings Bank of China (PSBC), to a hydropower project in Cambodia - Lower Sesan 2.
- ii. The Complaint alleges that villagers and communities living near or upstream of the Lower Sesan 2 hydropower project, were not appropriately consulted during the planning and development process of the alleged sub-project and the communities have faced serious environmental, social and economic challenges stemming from the alleged sub-project.
- iii. The Complaint claimed that IFC is exposed to Lower Sesan 2 through IFC's exited equity investment in PSBC. PSBC allegedly provided loans to the sub-project's majority owner, Huaneng Lancang River Hydropower Co., Ltd. (Huaneng Lancang River Hydropower) and its ultimate parent company, China Huaneng Group Co., Ltd. (Huaneng Group). Huaneng Lancang River International Energy Co., Ltd., a fully owned subsidiary of Huaneng Lancang River Hydropower, is the 51% owner of the Lower Sesan 2 hydropower project in Cambodia.
- iv. IFC made an equity investment equivalent to US\$286 million in PSBC in December 2015, representing a 0.69% shareholding at that time. In December 2023, IFC completely exited from PSBC following continuous implementation of a pre-approved sales plan. IFC no longer has any exposure to the former client.
- v. IFC analyzed documents provided by the former client and highlights that PSBC's two loans to Huaneng Lancang River Hydropower in 2016 and 2017 were project loans and ringfenced for its business activities in China. PSBC's two loans to Huaneng Group in 2018 were working capital loans. Under the laws of the People's Republic of China (PRC) and applicable regulatory framework, such working capital loans are all short term in nature and must be used only for operating expenses and working capital purposes, and cannot be used for fixed assets, equity, or capital investment in any case, e.g. overseas projects in Cambodia. PSBC has further confirmed that the loans have been repaid and that it currently has no financial exposure at all to either Huaneng Lancang River Hydropower or Huaneng Group.
- vi. IFC thus believes there is no financial link between IFC and the Lower Sesan 2 hydropower plant through its former investment in PSBC. The alleged sub-project was not subject to IFC Environmental and Social (E&S) requirements. Therefore, any alleged harm in Cambodia resulting from the Lower Sesan 2 hydropower project cannot plausibly or realistically be linked to PSBC or IFC.
- vii. On June 1, 2024, and June 21, 2024 respectively, CAO informed IFC and PSBC, of additional alleged financial exposures by the former client to the sub-project. PSBC needs additional time to investigate and respond to these allegations. Should further information become available during the CAO appraisal phase, IFC will update this Management Response accordingly.

viii. Management also notes that CAO is already conducting a compliance investigation on the Lower Sesan 2 hydropower plant on IFC's exposure through another financial intermediation. The issues brought forward in this Complaint are similar.

I. INTRODUCTION

1. In August 2023, a complaint was lodged with CAO concerning IFC's now exited equity investment in Postal Savings Bank of China (PSBC) claiming the former client's exposure to a hydropower plant – Lower Sesan 2 in Cambodia. In November 2023, CAO determined the Complaint eligible based on the argument that insufficient evidence had been provided to CAO to indicate that there were no material financial links between PSBC and Lower Sesan 2.
2. IFC fully exited from PSBC in December 2023 following the continuous implementation of a pre-approved sales plan and is therefore no longer exposed to PSBC or any of its sub-projects.
3. PSBC, now a former client, has also confirmed that, it currently has no financial exposure to either Huaneng Lancang River Hydropower or Huaneng Group.
4. During the assessment phase, CAO declined to assess the alleged links between PSBC and the sub-project. CAO reportedly was not able to contact the alleged sub-project owners during the assessment phase. The case has been transferred to compliance appraisal.¹
5. This Management Response provides a brief description of IFC's former investment in PSBC, the Complaint, IFC's response to the alleged financial exposure, information available to IFC at this point in time and a reflection on criteria for a compliance investigation, followed by the conclusion and a caveat for a likely needed update to the Management Response.

II. PROJECT BACKGROUND

6. ***IFC Investment in PSBC.*** In 2015, IFC's Board of Directors approved an investment in PSBC, one of China's largest banks and the leading local bank for Micro-, Small-, and Medium-sized Enterprises (MSME) and rural finance (the "Project"). The Project entailed an equity investment by IFC through the subscription of 474,290,000 common shares of PSBC for a cash consideration equivalent to US\$286 million, which represented a 0.69% shareholding at that time.
7. PSBC was listed on the Hong Kong Exchange and Shanghai Stock Exchange in 2016 and 2020, respectively. IFC completely exited from PSBC in December 2023 following continuous implementation of a pre-approved sales plan. As of the date of this Management Response, IFC no longer hold any shares of PSBC and has no exposure to the former client.
8. ***Project Context.*** The Project aligned with the IFC Country Partnership Strategy for China (FY2013-2016) to contribute to the World Bank Group's Universal Financial Access goal and China's own efforts in expanding financial access and inclusion. It does so by focusing on balanced

¹ CAO Assessment Report, p. 1 footnote 1. <https://www.cao-ombudsman.org/sites/default/files/downloads/Cambodia%20PSBC-02%20-%20CAO%20Assessment%20Report%20-%20May%202024-ENG.pdf>

and inclusive rural-urban development to reduce the gap between living standards in urban and frontier areas, through investments and advisory work in MSME finance and rural finance.

9. ***Project Purpose.*** The Project provided a unique opportunity for IFC to support financial inclusion and poverty alleviation in China, given PSBC's alignment with this mandate, its extensive outreach in the frontier regions to underserved MSMEs, and its potential growth with the introduction of new products and channels.

10. ***Advisory Services.*** In addition to the equity investment, IFC also provided a comprehensive advisory services package to PSBC in four areas: (i) Agriculture, Rural, and Farmer Finance; (ii) MSME Finance; (iii) Corporate Governance; and (iv) Environmental & Social Risk Management and Sustainable Finance. IFC's advisory work with PSBC was completed by June 30, 2021. With IFC support, PSBC has developed an environmental and social management system (ESMS) to screen and monitor its lending activities consistent with national laws and regulations as well as IFC requirements. PSBC has won many recognitions for its achievements in green financing, including the recent Global Green Finance Award by the International Finance Forum in 2021.

III. CAO COMPLAINT

11. On August 18, 2023, a complaint was lodged with CAO by three Non-Governmental Organizations (NGOs) – International Rivers, Mekong Watch, and International Accountability Project – on behalf of a group of villagers and communities living near the Lower Sesan 2 hydropower plant (Lower Sesan 2), the alleged sub-project, in Cambodia. The Complainants allege that villagers and communities living near or upstream of the reservoir or in resettlement sites, were not appropriately consulted during the planning and development process of Lower Sesan 2 and the communities have faced serious environmental, social and economic challenges stemming from the project. These include difficulty in carrying out fishing activities, the frequency and severity of flooding affecting the community's health, livelihood and daily subsistence, poorer access to clean water, land issues, and access to water, electricity and land titles; additional concerns were identified in the CAO Assessment Report, such as concerns for the Complainants' safety.²

12. This is the second complaint in relation to Lower Sesan 2 submitted by the same group of NGOs. In 2018 the first complaint raised similar issues and alleged IFC's exposure to Lower Sesan 2 through its investment in An Binh Commercial Joint Stock Bank (ABBank) and VietinBank. In a compliance appraisal CAO did not find any IFC exposure through VietinBank, but decided a compliance investigation was warranted on ABBank. Since 2022 the case is under compliance investigation.

² CAO Assessment Report. <https://www.cao-ombudsman.org/sites/default/files/downloads/Cambodia%20PSBC-02%20-%20CAO%20Assessment%20Report%20-%20May%202024-ENG.pdf>

13. This new Complaint claims that PSBC has provided loans to Lower Sesan 2's majority owner, Huaneng Lancang River Hydropower Co., Ltd. (Huaneng Lancang River Hydropower) and its ultimate parent company, China Huaneng Group Co., Ltd. (Huaneng Group). Huaneng Lancang River International Energy Co., Ltd., a fully owned subsidiary of Huaneng Lancang River Hydropower, is the 51% owner of Lower Sesan 2.

14. PSBC and IFC informed CAO that PSBC's loans to Huaneng Lancang River Hydropower were all ringfenced for its business activities in China and that PSBC has no financial exposure to the alleged sub-project in Cambodia. However, despite the explanations PSBC provided to CAO through IFC, CAO found the Complaint eligible for assessment in November 2023 assuming a material link between IFC's former client and the alleged sub-project.³ In CAO's view "*there is insufficient information to indicate that all relevant financial arrangements between PSBC and Huaneng Lancang River are ringfenced or designated for a special purpose.*"

15. According to PSBC, PSBC granted two loans to Huaneng Lancang River Hydropower. On December 15, 2023, PSBC provided to CAO the loan agreements for the two loans, which clearly state that these two loans were classified as fixed assets / project loans and the loan proceeds were to be used towards the construction of the Miaowei Hydropower Station Project and the Huangdeng Hydropower Station Project in Yunnan, China respectively. Both Huangdeng and Miaowei are villages located in Yunnan Province of mainland China and have no connection with Lower Sesan 2 in Cambodia. The loan agreements also state that the borrower shall not change the purpose of the loans or use the proceeds for other purposes such as equity investment.

16. During the assessment phase of the Complaint, CAO declined to analyze such evidence provided by PSBC to confirm the ringfencing of use of proceeds of their loans Huaneng Lancang River Hydropower.

17. On June 1, 2024, and June 21, 2024, respectively, CAO informed IFC and PSBC, of additional alleged financial exposures by the former client to the Huaneng Group and its subsidiaries to Lower Sesan 2, through additional financing and guarantees for Lower Sesan 2. At the time of submission of this response, IFC has no information whether CAO considered these additional financial links as material in their eligibility determination of the case or how they will be considered during compliance appraisal. PSBC additional time to investigate and respond to these additional alleged financial exposures.

18. During the assessment phase, CAO reportedly was not able to engage directly with the sub-project owners, to convene the relevant parties to agree on engaging in a voluntary dispute resolution process. The Complaint was referred to CAO Compliance for appraisal at the request of the Complainants.

³ Paragraph 41(a) of the CAO Policy states that for Complaints pertaining to FI sub-projects there is consideration as to whether ... there is a material link between the FI client and its active sub-client that is the subject of the complaint (considering factors including the nature of the financing, the share, type, and tenor of the FI investment/debt exposure to the sub-project).

IV. MANAGEMENT RESPONSE

19. IFC takes seriously the allegations in the Complaint related to E&S harms and the concerns for safety expressed by the Complainants. IFC's Position Statement on Retaliation Against Civil Society and Project Stakeholders makes clear that IFC does not tolerate any action by an IFC client that amounts to retaliation – including threats, intimidation, harassment, or violence – against those who voice their opinion regarding the activities of IFC or its clients.

20. IFC has supplied information as available to support CAO in its eligibility determination and assessment and appraisal process and continues to engage with the former client to facilitate PSBC's participation in the CAO process. IFC shares the former client's concern that, the evidence provided by PSBC to confirm their non-exposure to the alleged sub-project was not analyzed during the CAO assessment phase.⁴ The CAO Assessment Report is silent on if and how the complainants were informed about the concerns about the eligibility of their complaint and the consequences thereof.

21. The CAO Policy para 91 sets out criteria for CAO to apply where a compliance investigation is necessary: a) Whether there are preliminary indications of Harm or potential Harm; b) Whether there are preliminary indications that IFC may not have complied with its E&S Policies; and c) Whether the alleged Harm is plausibly linked to the potential non-compliance.

22. Regarding para 91a IFC acknowledges that described environmental and social harms related to the alleged sub-project in Cambodia are serious and takes the concerns for safety expressed by the Complainants seriously.

23. In relation to para 91b, whether there are preliminary indications that IFC may not have complied with its E&S Policies, Management highlights that there is no link between IFC and the Lower Sesan 2 hydropower plant through its past investment in PSBC.

24. Loan agreements provided by PSBC to CAO on December 15, 2023 for the two outstanding loans granted by PSBC to Huaneng Lancang River Hydropower clearly showed that: (i) the two loans were fixed assets / project loans as defined by the National Financial Regulatory Authority where use of proceeds are strictly ringfenced; and (ii) in the section on "Use of Proceeds", it is specified that the borrower shall use the proceeds to implement the construction of the Huangdeng Hydropower Station Project and the Miaowei Hydropower Station Project respectively and shall not change the purpose of the loans or use the proceeds for other purposes

⁴ CAO Assessment Report, p. 1 footnote 1. <https://www.cao-ombudsman.org/sites/default/files/downloads/Cambodia%20PSBC-02%20-%20CAO%20Assessment%20Report%20-%20May%202024-ENG.pdf>

such as equity investment. Given that both Huangdeng and Miaowei are villages located in Yunnan Province of mainland China, the two loans granted to Huaneng Lancang River Hydropower could not have been used to support the alleged sub-project in Cambodia.

25. In addition, IFC was informed by PSBC in June 2024 that PSBC had extended two loans to Huaneng Group in 2018, and both loans were working capital loans. Under the laws of the People's Republic of China (PRC) and regulatory framework applicable to the type of financing, such working capital loans were all short term in nature and must be used only for operating expenses and working capital purposes, and cannot be used for fixed assets, equity, or capital investment in any case, e.g., overseas project in Cambodia.

26. Based on the foregoing, IFC's former client has not been exposed to the alleged sub-project. Any E&S requirements applicable to the former client during the life of the exited investment would not have applied to the alleged sub-project. There are no preliminary indications of IFC non-compliance.

27. Consequently, in relation to para 91c, the alleged harm cannot be plausibly linked to IFC's former client or any IFC non-compliance.

28. During a compliance appraisal, CAO also considers whether an investigation would provide particular value in terms of accountability, learning or remedial action despite an IFC exit.⁵ Management highlights that on December 13, 2023, IFC completely exited from PSBC following continuous implementation of a pre-approved sales plan. On April 26, 2024, IFC received an email from PSBC confirming that the loans granted by PSBC to Huaneng Lancang River Hydropower have already been fully repaid. IFC no longer has any exposure to the former client and given the lack of exposure to the alleged sub-project, no remedies can be reasonably expected through this exited IFC investment, and an investigation would not provide value in terms of remedial action.

29. In relation to particular value in terms of accountability and learning, IFC notes that CAO is already conducting a compliance investigation on the Lower Sesan 2 project in Cambodia, investigating potential IFC non-compliance through its investment in ABBank on similar issues brought forward by the same NGOs, i.e. community resettlement, impacts on livelihood, economic challenges due to impacts on fish population, and increased vulnerability to flooding.

30. Management highlights that CAO Policy para 93 defines that CAO shall initiate a new compliance investigation on a sub-project that has already been subject of a compliance investigation, only where the complaint raises new issues or new evidence is available.

V. CONCLUSION

31. IFC takes seriously allegations regarding the E&S risks and impacts of IFC investments and is concerned about the allegations raised by the Complainants related to the Lower Sesan 2

⁵ CAO Policy para 91a.

hydropower project in Cambodia. However, based on all information provided so far, there is not, nor could there have been, a financial link between PSBC and the alleged sub-project. Given the lack of PSBC financial exposure to Lower Sesan 2, PSBC was not required to apply IFC E&S requirements to the alleged sub-project during IFC's investment. Any alleged harm related to Lower Sesan 2 cannot be plausibly linked to PSBC or IFC. It is therefore IFC's view that this Complaint does not satisfy CAO's appraisal criteria for a compliance investigation.

32. IFC has fully exited its investment in PSBC and is no longer exposed to the former client. Furthermore, PSBC has no current financial exposure to either Huaneng Lancang River Hydropower or Huaneng Group.

33. Management notes that CAO is currently already conducting a compliance investigation on similar issues on the alleged sub-project.

34. IFC highlights that further details of allegations on financial exposure of IFC's former client to Lower Sesan 2 were made available to IFC on June 1st, 2024, and to PSBC on June 21, 2024. PSBC needs additional time to investigate and respond to these allegations. Should further information become available during the CAO appraisal phase, IFC will update this Management Response accordingly.

Disclaimer

This IFC Management Response is provided in response to the Assessment Report of the Office of the Compliance Advisor Ombudsman (CAO) finding a complaint to a project supported by IFC finance or investment eligible for compliance appraisal.

Nothing in this IFC Management Response or in the process provided for in the CAO Policy (“CAO Process”) (1) creates any legal duty, (2) asserts or waives any legal position, (3) determines any legal responsibility, liability, or wrongdoing, (4) constitutes an acknowledgment or acceptance of any factual circumstance or evidence of any mistake or wrongdoing, or (5) constitutes any waiver of any of IFC’s rights, privileges, or immunities under its Articles of Agreement, international conventions, or any other applicable law. IFC expressly reserves all rights, privileges, and immunities. IFC does not create, accept, or assume any legal obligation or duty, or identify or accept any allegation of breach of any legal obligation or duty by virtue of this IFC Management Response.

While reasonable efforts have been made to determine that the information contained in this IFC Management Response is accurate, no representation or warranty is given as to the accuracy or completeness of such information. CAO is not a judicial or legal enforcement mechanism. Its analyses, conclusions, and reports are not intended to be used in judicial or regulatory proceedings nor to attribute legal fault or liability and it does not engage in factfinding nor determine the weight that should be afforded to any evidence or information. No part of this IFC Management Response or the CAO Process may be used or referred to in any judicial, arbitral, regulatory, or other process without IFC’s express written consent.

Appendix 2: PSBC Response

Client Response from PSBC to CAO Regarding Lower Sesan 2 Complaint

Postal Saving Bank of China (“PSBC”) places great importance on environmental and social (“E&S”) performance. In response to the complaint regarding Lower Sesan 2 Hydropower Project in Cambodia (“**Lower Sesan 2**”), PSBC has made efforts to cooperate with CAO and IFC to clarify the relevant facts. Upon review, it has been confirmed that there are no existing loans or investments between PSBC and Huaneng Group, Huaneng Lancang River Hydropower, and Huaneng Finance (hereinafter referred to individually or collectively as “**the related borrowers**” unless specifically indicated otherwise). All historical transactions have been settled. Furthermore, all historical loans and investments were clearly designated for specific use of proceeds and corresponded to domestic projects. PSBC's investigation revealed that the funds under these financial transactions, according to the agreements between the parties and regulatory requirements, were neither allowed nor practically possible to be used for Lower Sesan 2.

According to paragraph 87 of CAO Policy and other rules, PSBC submits the following response:

- 1. Lower Sesan 2 is entirely outside the scope of the use of proceeds from IFC and PSBC funding, and does not qualify as an accountable “Sub-Project” under CAO Policy. This case itself is not within the scope of CAO's accountability mechanism, nor is there any “preliminary indications that IFC may not have complied with its E&S Policies”**

1.1 CAO has explicitly stipulated and elaborated in a series of policies and cases that the scope of its accountability is limited to IFC's “Sub-Project”

According to CAO Policy and CAO's discussions in past cases¹, the scope of CAO's compliance appraisal should be limited to IFC's “Project or Sub-Project.” This means “assessing

¹ CAO Policy, paras. 77. See also, Compliance Appraisal of Complaints Regarding IFC's Exposure to the Lower Sesan 2 Hydropower Project in Cambodia through ABBank and Vietinbank, pg 15.

IFC/MIGA's review and supervision of its E&S Requirements at the **Project or Sub-Project level**, and consider **Project- or Sub-Project-level** E&S Performance.”²

Therefore, the premise for CAO to initiate the accountability process for this case is whether Lower Sesan 2 constitutes an IFC Sub-Project based on IFC's investment in PSBC. This is the primary issue that needs to be clarified in this case.

1.2 To determine whether the project involved in the complaint is an IFC Sub-Project, it is essential to focus on whether the project “meets the use of proceeds requirements outlined in IFC's financing or investment documents”

According to CAO Policy, IFC Sub-Project refers to “A business operation of a Sub-Client within **the use of proceeds requirements** in IFC's finance or investment documents or MIGA's contracts of guarantee.”³ Therefore, CAO needs to determine whether, through the investment in PSBC, Lower Sesan 2 falls **within the use of proceeds** stipulated in IFC's investment documents.

When determining whether Lower Sesan 2 constitutes an IFC Sub-Project, **it is necessary to examine each potential financial link between IFC and Lower Sesan 2**. This involves identifying, one by one, the scope of use stipulated by the financial products associated with each link, and subsequently determining whether Lower Sesan 2 falls within the scope of these financial products, thereby constituting an IFC “Sub-Project.” In other words, for a project to be considered an IFC “Sub-Project” due to IFC's investment in a Financial Intermediary (FI), the following conditions must be simultaneously met:

- (1) The project must fall within the scope of the funds provided by IFC to the FI. For instance, in the 2018 CAO complaint case involving Lower Sesan 2, CAO determined that, based on the “IFC-ABBANK (where IFC provided a loan to ABBANK **specifically for supporting SMEs**)-EVNI-Lower Sesan 2 Co., Ltd” chain, Lower Sesan 2 did not constitute an IFC Sub-Project. The reason for CAO's decision was that under this chain, IFC's funds to ABBANK were only allowed to support small- and medium-sized enterprises (“SMEs”), particularly those with female shareholders. However, ABBANK's

² Compliance Appraisal of Complaints Regarding IFC's Exposure to the Lower Sesan 2 Hydropower Project in Cambodia through ABBank and Vietinbank (pg.17-18)

³ “GLOSSARY” of CAO Policy

equity investment in EVNI did not fall within the aforementioned scope. Therefore, EVNI did not constitute an IFC “Sub-Client” due to ABBANK's equity investment in it; and consequently, Lower Sesan 2, in which EVNI holds a 10% stake, does not constitute an IFC “Sub-Project”⁴ either.

- (2) The project must fall within the scope of the funds provided by the FI to the project's corresponding clients. For instance, in the 2018 CAO complaint case involving Lower Sesan 2, CAO determined that, based on the “IFC-Vietinbank-EVN (where Vietinbank provided several loans to EVN for other projects)-Lower Sesan 2 Co., Ltd” chain, Lower Sesan 2 also did not constitute an IFC Sub-Project. CAO determined this because under this chain, Vietinbank's funds to EVN were limited to the use for six projects located in Vietnam⁵. Therefore, CAO concluded that there was no material link between Vietinbank and Lower Sesan 2.

In this case, to determine whether Lower Sesan 2 can be considered an IFC Sub-Project based on the “IFC-PSBC- the related borrowers” chain, CAO should evaluate whether the following conditions are met:

- (1) Whether Lower Sesan 2 falls within the scope of use stipulated by the financial products that PSBC provides to the related borrowers;
- (2) Whether the financial products that PSBC provides to the related borrowers fall within the scope of use stipulated in the agreement and other documents between IFC and PSBC.

1.3 IFC's investment in PSBC aims to help PSBC strengthen its businesses relating to rural finance and SME finance. The financial products that PSBC provides to the related borrowers are not within the scope of IFC's investment in PSBC.

⁴ Compliance Appraisal of Complaints Regarding IFC's Exposure to the Lower Sesan 2 Hydropower Project in Cambodia through ABBank and Vietinbank , IFC Projects with ABBank and Vietinbank (29745, 40081, 28509, 31300, 34124),(pg.17-18)

⁵ Compliance Appraisal of Complaints Regarding IFC's Exposure to the Lower Sesan 2 Hydropower Project in Cambodia through ABBank and Vietinbank (pg.18) : "These six projects are: (i) the Lai Chau hydropower project - Lai Chau Province- in 2013; (ii) the Son La hydropower project -Son La Province- in 2007; (iii) the Sesan 3 hydropower project -Kon Tum Province- in 2005; (iv) the Sesan 4 hydropower project -Gia Lai Province- in 2007; (v) the Duyen Hai 3 thermal project -Tra Vinh Province- in 2013; and (vi) the expansion of the Duyen Hai 3 thermal project in 2015."

According to the *Strategic Cooperation Agreement* signed on September 9, 2015, between PSBC and IFC, the purpose of IFC's investment in PSBC is to “**enhance the micro, small and medium enterprises (‘MSME’) finance and rural finance** under the retail operations of Party A, as well as to improve the risk management, corporate governance and environment and social risk management capacity building of Party A (PSBC)” (WITNESSETH of the *Strategic Cooperation Agreement*).

In this case, based on publicly available information:

- ✧ The related borrowers do not qualify as clients of “MSME finance under the retail operations”. According to *the Provisions on Criteria for Classifying Small and Medium-sized Enterprises*⁶ issued by the Ministry of Industry and Information Technology, the National Bureau of Statistics, the National Development and Reform Commission, and the Ministry of Finance, of the People’s Republic of China, the criteria for industrial “MSMEs” are “fewer than 1,000 employees or **annual revenue less than 400 million RMB.**” Public information shows that Huaneng Group's revenue was 301.982 billion RMB in 2020⁷, 371.158 billion RMB in 2021⁸, 424.548 billion RMB in 2022⁹, and 254.4 billion RMB in 2023¹⁰; Huaneng Lancang River Hydropower's revenue was 19,253,374,954.83 RMB in 2020, 20,201,630,492.14 RMB in 2021¹¹, 21,141,718,314.66 RMB in 2022¹², and 23,461,331,621.17 RMB¹³ in 2023. As of June 30, 2023, the revenue of Huaneng Finance was 525 million RMB¹⁴.
- ✧ Apparently, based on publicly available information, during IFC's investment in PSBC, the related borrowers did not qualify as “MSME finance under the retail operations” supported by IFC investments. The financial products that PSBC provided to the related borrowers also did not fall under the category of “MSME finance and rural finance under the retail operations”.

⁶ https://www.gov.cn/gongbao/content/2012/content_2041870.htm

⁷ https://pdf.dfcfw.com/pdf/H2_AN202105011488831477_1.pdf?1648322866000.pdf

⁸ <https://static.cninfo.com.cn/finalpage/2022-04-29/1213238838.pdf>

⁹ <https://new.qq.com/rain/a/20230512A03HA300?no-redirect=1>

¹⁰ <https://www.hangyan.co/reports/3364048511715771962>

¹¹ http://www.sse.com.cn/disclosure/listedinfo/announcement/c/new/2023-04-22/600025_20230422_VGSC.pdf

¹² Ibid.

¹³ <https://static.cninfo.com.cn/finalpage/2024-04-27/1219874437.PDF>

¹⁴ http://www.sse.com.cn/disclosure/listedinfo/announcement/c/new/2023-07-26/600011_20230726_A22P.pdf

Therefore, solely based on the use of IFC's investment funds in PSBC, the related borrowers do not constitute IFC's "Sub-Clients". In this case, even if Lower Sesan 2 is associated with the related borrowers, it does not constitute an IFC "Sub-Project."

1.4 PSBC has conducted comprehensive and systematic investigation of its historical business dealings with the related borrowers during the period of IFC's shareholding in PSBC. The investigation shows that there are no financial products that could potentially be used for Lower Sesan 2.

PSBC believes that, as mentioned above, based on the purpose of IFC's investment in PSBC, and the size of the related borrowers, none of the borrowers can be considered a "Sub-Client" of IFC. From this perspective solely, Lower Sesan 2 cannot be considered a "Sub-Project" of IFC either. Furthermore, in accordance with CAO's requirements, PSBC has further reviewed the financial transactions between PSBC and the related borrowers during the period of IFC's investment in PSBC. According to the results of the review, all business transactions with the related borrowers have clearly defined the use of proceeds and cannot be used for Lower Sesan 2.

On June 7, 2024, CAO sent an email to PSBC requesting information on "loans or investments" with Huaneng Lancang River Hydropower, Huaneng Group, and Huaneng Finance. On June 21, 2024, CAO provided PSBC with a redacted version of the Complainant's complaint letter, revealing that the Complainant:

- (1) Based on several public announcements issued by Huaneng Group and Huaneng Lancang River Hydropower, alleged that Lower Sesan 2 might fall within the scope of financial products provided by PSBC to Huaneng Group and Huaneng Lancang River Hydropower;
- (2) The public information provided by the Complainant did not include any details regarding PSBC providing financial products to Huaneng Finance.

PSBC promptly organized a comprehensive internal investigation, systematically examining the "loan or investment situations" between PSBC and the related borrowers. PSBC fully verified and responded to the public information regarding financial exposures pointed out by the Complainant.

After a comprehensive investigation, PSBC concludes that all historical business transactions with the related borrowers have clearly defined uses, which were specifically designated for domestic projects in China such as Xiaowan Hydropower Station, Huangdeng Hydropower Station, Miaowei Hydropower Station, Manwan Hydropower Plant, Jinghong Hydropower Plant, Xiaowan Hydropower Plant, Nuozhadu Hydropower Plant, and Miaowei-Gongguoqiao Hydropower Plant. Given the nature of these financial transactions, PSBC also conducted a thorough investigation on the use of proceeds, including obtaining an explanation letter from Huaneng Group. PSBC's investigation confirmed that the funds under these financial transactions, by laws and mutual contracts, are not allowed and indeed cannot be used for Lower Sesan 2.

Based on the results of this thorough investigation, PSBC prepared an extensive *Explanation of PSBC Regarding the Complainant's Allegations of Financial Exposure* spanning more than 50 pages, accompanied by a total of 113 pieces of evidence. PSBC plans to submit these materials to CAO. **Since the materials contain client information and internal management information of PSBC, PSBC has required CAO not to disclose this information.**

Under these circumstances, there are no “preliminary indications that IFC/MIGA may not have complied with its E&S Policies” as stipulated in paragraph 91 of CAO Policy. Regardless of whether CAO determines that there are “preliminary indications that IFC/MIGA may not have complied with its E&S Policies”, it is unrelated to IFC's investment in PSBC.

2. Even solely referring to the “involvement, influence, and importance” criteria outlined by CAO in past cases, there is insufficient information to determine that Lower Sesan 2 constitutes a “business operation” of the related borrowers, and thus an IFC “Sub-Project”

Firstly, after systematically analyzing CAO cases, including the complaint cases involving IFC's investments in ABBank and Vietinbank (29745, 40081, 28509, 31300, 34124), PSBC believes that:

- ✧ When restrictions on the use of proceeds for FI providing funds to its clients are clear, it is only necessary to examine whether the project falls within the clearly restricted use. There

is no need to further examine the “involvement and influence” of the FI’s clients in the project, as well as the “importance” of the project to the FI’s clients.

- ✧ Only when the use of proceeds for IFC's investment in the FI is unclear, and the use of proceeds for FI's funding in Sub-Clients is also unclear (e.g., general equity investments with no specific use), is it necessary to further examine the client's “involvement, influence, and importance” regarding the project.

PSBC reiterates that, in this case, as mentioned above, the use of proceeds for IFC's investment in PSBC and the use of proceeds of PSBC's financial products to the related borrowers are both clear and explicit. Based on the clearly defined funding use at each stage, the related borrowers are not IFC's “Sub-Clients”. Moreover, any financial products provided by PSBC to the related borrowers have clearly defined uses and could not be used for Lower Sesan 2. Under these circumstances, it is sufficient to determine that Lower Sesan 2 is not an IFC “Sub-Project,” **and CAO does not need to discuss the “involvement, influence, and importance” of the related borrowers in relation to the project.**

However, considering that CAO has discussed the issues of “involvement, influence, and importance” in cases such as Indonesia: FI-01 and the ones involving IFC's investments in ABBank and Vietinbank (29745, 40081, 28509, 31300, 34124), PSBC also wishes to further clarify that, even based solely on the criteria of “involvement, influence, and importance,” it is sufficient to refute Lower Sesan 2 constituting an IFC “Sub-Project.”

2.1 According to CAO Policy, even if an FI's client is recognized as an IFC “Sub-Client,” and the client's project falls within the scope of the funds provided by the FI to the client, it is still necessary to determine the client's “involvement, influence, and importance” in the project to ascertain whether the project constitutes an IFC “Sub-Project”

CAO has made it clear that in determining whether a complaint project constitutes an IFC “Sub-Project,” it is necessary to consider the IFC Sub-Client’s “involvement and influence” to the project, and the project’s “importance” to the Sub-Client. Referring to CAO's opinion in the Indonesia: FI-01 case and ABBank and Vietinbank case (29745, 40081, 28509, 31300, 34124), “In deciding whether the business activity subject to a CAO complaint qualifies as a business

operation of a Sub-Client, CAO assesses both the Sub-Client's involvement in and/or leverage over the operations of the business activity and the importance of the business activity to the Sub-Client's operations."¹⁵

PSBC believes that, based on the publicly available information and the complainant materials provided by CAO, there is no basis to determine that Lower Sesan 2 meets the "involvement, influence, and importance" criteria with respect to the related borrowers.

2.2 Lower Sesan 2 or Lower Sesan 2 Co., Ltd is not listed among the "subsidiaries" on Huaneng Lancang River Hydropower's official website

Firstly, according to publicly available information, Huaneng Lancang River Hydropower "is based in Yunnan and Tibet, primarily engaged in the development, construction, and operation of hydropower, photovoltaic, wind power, and other energy sources in the Lancang River basin and surrounding areas."

The subsidiaries listed on Huaneng Lancang River Hydropower's official website include: **"Manwan Hydropower Station** - located in Lincang City, Yunnan Province; **Jinghong Hydropower Station** - located in Xishuangbanna Prefecture, Yunnan Province; **Xiaowan Hydropower Station** - located at the border of Nanjian County and Fengqing County, Yunnan Province; **Nuozhadu Hydropower Station** - located in Pu'er City, Yunnan Province; **Miaowei and Gongguoqiao Power Plant** - located in Dali Prefecture, Yunnan Province; **Huangdeng and Dahuaqiao Power Plant** - located in Nujiang Prefecture, Yunnan Province; **Wunonglong and Lidi Hydropower Plant** - located in Diqing Prefecture, Yunnan Province; **International Energy Company** - located in Kunming City, Yunnan Province; **New Energy Company** - located in Kunming City, Yunnan Province; **Energy Sales Company** - located in Kunming City, Yunnan Province; **Longkaikou Power Station** - located in Dali Prefecture, Yunnan Province; **Huaneng Lancang River Upper Hydropower Co., Ltd.** - located in Chamdo City, Tibet Autonomous Region." ¹⁶

PSBC has learned through publicly available information that Lower Sesan 2 is developed, operated, and managed by Lower Sesan 2 Co., Ltd. However, the list of subsidiaries published

¹⁵ Compliance Appraisal of a Complaint Regarding IFC's Exposure to the Dairi Prima Mineral Mine in Indonesia Through an Investment in Postal Savings Bank of China, (pg.29)

¹⁶ https://www.chng.com.cn/detail_qygs/-/article/uYZwaH5JfpgQ/v/774278.html

on Huaneng Lancang River Hydropower's official website does not include Lower Sesan 2 Co., Ltd. This suggests that Lower Sesan 2 may not be of high “importance” to Huaneng Lancang River Hydropower, and Huaneng Lancang River Hydropower's “involvement” and “influence” on Lower Sesan 2 may also be limited. Therefore, PSBC believes that, in this regard, CAO also lacks sufficient basis to determine that Lower Sesan 2 constitutes a “Sub-Project” of Huaneng Lancang River Hydropower.

2.3 Huaneng Group is a large and diversified state-owned enterprise with “57 secondary units, over 480 tertiary enterprises, and 5 listed companies.” According to the criteria of “involvement, influence, and importance ,” Lower Sesan 2 is clearly not a “Sub-Project” of Huaneng Group

Regarding Huaneng Group, according to its official website¹⁷, it is an ultra-large enterprise with “57 secondary units, over 480 tertiary enterprises, and 5 listed companies.” Its main businesses include “power source development, investment, construction, operation, and management; production and sales of electricity (thermal power); development, investment, construction, production, and sales of financial, coal, transportation, new energy, environmental protection-related industries and products; and industrial investment, operation, and management.”

Referring to the above description on Huaneng Group’s official website, the “importance” of Lower Sesan 2 to Huaneng Group is likely limited. Therefore, PSBC believes that, in this regard, CAO also lacks sufficient basis to determine that Lower Sesan 2 constitutes a “Sub-Project” of Huaneng Group.

Regarding Huaneng Finance, the complainant has not alleged any financial exposure between PSBC and Huaneng Finance. After verification, PSBC confirms that there are no active loans or investments with Huaneng Finance. Therefore, PSBC will not address whether Lower Sesan 2 meets the “involvement, influence, and importance” criteria with respect to Huaneng Finance in this discussion.

3. PSBC believes that IFC's Performance Standards do not apply to all of PSBC's business activities. From this perspective alone, this case clearly does not meet the requirements for initiating a compliance investigation based on “preliminary

¹⁷ <https://www.chng.com.cn/us-ent.html>

indications that IFC may not have complied with its E&S Policies” or “the alleged Harm is plausibly linked to the potential non-compliance”

According to paragraph 91 of CAO Policy, the criteria that must be met for CAO to decide to initiate a compliance investigation include “preliminary indications that IFC may not have complied with its E&S Policies” and “the alleged Harm is plausibly linked to the potential non-compliance”. In this case, the transactions between PSBC and the related borrowers themselves do not fall within the scope of IFC’s Performance Standards. Therefore, even if CAO, based on the Complainant’s allegations, considers that there are “preliminary indications of Harm or potential Harm”, this does not imply that IFC's Performance Standards should have been applied and were not, thereby indicating “preliminary indications that IFC may not have complied with its E&S Policies”.

3.1 Since Lower Sesan 2 is not an IFC Sub-Project, the Complainant's allegation that the project has caused them harm does not indicate any inadequacy in PSBC's implementation of IFC's E&S Policies

As mentioned above, PSBC reiterates that Lower Sesan 2 is not within the scope of financial transactions between PSBC and the related borrowers, and is not an IFC “Sub-Project”. Therefore, there is no basis to suggest that Lower Sesan 2 should be subject to IFC Performance Standards based on IFC's investment in PSBC¹⁸.

Even if CAO finds “preliminary indications of Harm or potential Harm” associated with Lower Sesan 2, this does not imply that there are “preliminary indications that IFC may not have complied with its E&S Policies” in this case.

3.2 PSBC does not accept the viewpoint put forward by CAO in previous cases that “PSBC should apply the IFC's Performance Standards to all of its business operations”

¹⁸ As for whether Lower Sesan 2 should be subject to IFC performance standards based on IFC's investment in ABBank, ABBank's equity holding in EVNI, and EVNI's equity holding in Lower Sesan 2 Hydropower Co., Ltd., it is irrelevant to this case.

We note that in the compliance assessment report of the Indonesia: FI-01 case, CAO stated: “IFC’s investment agreement required PSBC to apply the Performance Standards to all financing operations.”¹⁹

PSBC disagrees with this point. According to the investment agreement between IFC and PSBC, PSBC should “use all reasonable efforts to ensure the continuing operation of the E&S Management System to identify, assess and manage the social and environmental performance of the Company Operations in compliance with the E&S Requirements”²⁰ This provision does not explicitly stipulate which of PSBC's products should be subject to IFC Performance Standards and other E&S requirements.

PSBC believes that under these circumstances, the scope of the agreed IFC E&S responsibility requirements should be interpreted with reference to IFC’s corresponding policies:

- (1) *The Interpretation Note on Financial Intermediaries*²¹ issued by IFC on January 1, 2012, stipulates that “A key aspect of IFC’s approach to E&S risk management in the FI sector is to ensure that where FIs provide project or long-term (over 36 months) corporate finance to a borrower/investee to support a business activity”;
- (2) *The Guidance Note on Financial Intermediaries*²² released by IFC in September 2023 stipulates that the types of business for which FIs should be assessed against the IFC Performance Standards include “Project finance” “Long-term (over 36 months) corporate debt (loans and bonds) to support development of new, pre-defined assets or existing assets” “Long-term (over 36 months) corporate debt (loans and bonds) for undefined assets” “Long-term (over 36 months) project related asset-based financing” “Non-life insurance” “Equity investments –private equity funds, Distressed Asset Recovery Program funds, single assets” “Equity investments –venture capital funds”;
- (3) It is also explicitly stipulated in *The Guidance Note on Financial Intermediaries* that “FIs categorized as FI-1 and the FI-2 clients that support Higher Risk Transactions should

¹⁹ Compliance Appraisal of a Complaint Regarding IFC’s Exposure to the Dairi Prima Mineral Mine in Indonesia Through an Investment in Postal Savings Bank of China (pg.26)

²⁰ Policy Memorandum of Understanding 2.2 (b) (i)

²¹ <https://documents1.worldbank.org/curated/en/693651480673428389/pdf/110693-InterpretationNote-FIs-2012.pdf>

²² <https://www.ifc.org/en/insights-reports/2012/publications-policy-interpretationnote-fi>

reference the Performance Standards as part of their underlying E&S policies for addressing risks in **Higher Risk Transactions**". Therefore, PSBC, categorized as FI-1, is only obliged to apply Performance standards to its "Higher Risk Transactions". Subject to *The Guidance Note on Financial Intermediaries*, "Higher Risk Transactions typically consist of transactions that involve **the provision by FIs of equity, project finance, or long-term corporate finance (over 36 months) to a borrower/investee to support a business activity...**"

- (4) *The Guidance Note on Financial Intermediaries* also stipulates, "For products not listed above, IFC will define appropriate E&S risk management requirements and determine applicability of the Performance Standards **on a case-by-case basis** and will present its determination in project-specific papers when seeking the approval of IFC's Board of Directors for the proposed E&S risk management approach."

PSBC holds the view that in the case of Indonesia: FI-01, CAO's position is contradicted not only by the plain text of *The Guidance Note on Financial Intermediaries*, but also by logic. Following CAO's view from the previous case, if an FI client offers a liquidity loan/working capital loan to a client, this FI client is then obligated to ensure that **all** of the client's projects (as long as they meet the standards of "involvement, influence, and importance" , as mentioned above) comply with the performance standards. However, if a project loan is provided, the requirement for Performance Standards is limited only to that project.

In essence, CAO argues that FIs have a more stringent duty to enforce Performance Standards when providing liquidity loans/working capital loans compared to project loans, which even reaches the standards of equity investment. CAO's position is contradicted to the plain text of *The Guidance Note on Financial Intermediaries*. **If liquidity loans/working capital loans were truly as significant as equity investments, they would have been included in the definition of "Higher Risk Transactions",** yet they are not. Besides, it is unreasonable and unfair to require an FI that only provides liquidity loans/working capital loans to bear Performance Standards obligations that are, in essence, equivalent to those of equity investments, since FIs do not have the same level of leverage when offering liquidity loans/working capital loans as they do when making equity investments.

In summary, since the investment agreement between IFC and PSBC does not require “PSBC to apply the Performance Standards to all financing operations” and only stipulated that PSBC should “use all reasonable efforts to ensure the continuing operation of the E&S Management System to identify, assess and manage the social and environmental performance of the Company Operations in compliance with the S&E Requirements.”²³, the scope of PSBC's financing operations that should be subject to IFC Performance Standards should be defined with reference to the aforementioned IFC policy documents. PSBC does not agree with the viewpoint expressed in CAO's Compliance Appraisal Report on the Indonesia: FI-01 case that “IFC’s investment agreement required PSBC to apply the Performance Standards to all financing operations”.

3.3 Even if CAO, based on the Complainant's allegations, believes there are “preliminary indications of Harm or potential Harm” related to Lower Sesan 2, CAO cannot conclude that “IFC's Performance Standards should have been adhered to but were not ”, nor that there are “preliminary indications that IFC may not have complied with its E&S Policies” or “the alleged Harm is plausibly linked to the potential non-compliance”

Firstly, as previously mentioned, PSBC found out through investigation that all historical business transactions with the related borrowers have clearly defined use of proceeds, including certain loans explicitly corresponding to domestic projects. PSBC has confirmed that the funds under these financial transactions, according to mutual agreements and regulatory requirements, are not allowed to and indeed cannot be used for the Lower Sesan 2 Hydropower Project in Cambodia.

In other words, for the “loans and investments” reviewed by PSBC, none of the three criteria outlined in CAO Policy for initiating a compliance investigation— “preliminary indications of Harm or potential Harm”, “preliminary indications that IFC may not have complied with its E&S Policies”, and “the alleged Harm is plausibly linked to the potential non-compliance”— are met:

- (1) All project loans have clear, specific use of proceeds that are precisely linked to domestic projects, having no connection whatsoever to Lower Sesan 2 or the complaint. For these

²³Ibid.

loans and their corresponding projects, the Complainant has not made any allegations, and thus, there are no “preliminary indications” that IFC's Performance Standards should have been complied with but were not. PSBC has also verified that other loans are unrelated to Lower Sesan 2, and the Complainant has not alleged any “preliminary indications of Harm or potential Harm” related to the use of proceeds of these loans.

- (2) There are certain loans which fall outside the application scope of IFC's Performance Standards, as stipulated in the *Interpretive Note on Financial Intermediaries* and the *Guidance Note on Financial Institutions*. For these loans, there are naturally no “preliminary indications” that IFC’s Performance Standards should have been complied with but were not.
- (3) Based on the above points and given that there is no financial exposure to Lower Sesan 2, which would make the application of IFC Performance Standards irrelevant, it is impossible to conclude that the alleged harm related to Lower Sesan 2 “may be related to potential non-compliance.”

4. IFC no longer holds any shares in PSBC. There are no active “loans or investments” between PSBC and the related borrowers

4.1 There are no longer any loans or investments between IFC and PSBC, nor between PSBC and the related borrowers

According to CAO's “definitions,” an IFC Exit is defined as “With respect to any Project, the earlier of (i) the termination of the financing, investment, or advisory relationship with the Client for such Project pursuant to the applicable Project agreements; or (ii) when the Project ceases to exist, or the Project has been dropped by IFC after Board approval.” Additionally, referring to CAO's opinion in the Indonesia: FI-01 case²⁴, if PSBC has settled the loans with its clients, this also constitutes IFC's exit from the investment.

In this case, in December 2023, IFC completely exited from its investment in PSBC and no longer holds any shares in PSBC. Furthermore, following a comprehensive internal

²⁴ Compliance Appraisal of a Complaint Regarding IFC's Exposure to the Dairi Prima Mineral Mine in Indonesia Through an Investment in Postal Savings Bank of China, (pg.30)

investigation, PSBC has determined that there are no active “loans or investments” with the related borrowers. All historical “loans or investments” have been settled.

Therefore, even if CAO, despite PSBC’s comprehensive clarification of the facts, still considers Lower Sesan 2 to constitute an IFC “Sub-Project,” IFC has already exited from its investment in this “Sub-Project.”

4.2 Continuing to initiate a compliance investigation by CAO in this case will not bring value in terms of “accountability, learning, or remedial action”

According to paragraph 92 of CAO Policy, when considering whether to initiate a compliance investigation for a project from which IFC has withdrawn, CAO must consider whether “conducting a compliance investigation would provide particular value in terms of accountability, learning, or remedial action.” We believe that there is no value in this case regarding accountability, learning, or remedial action.

- (1) Similar to the Indonesia: FI-01 case²⁵, since there are no active loans or investments between PSBC and the related borrowers, initiating a compliance investigation by CAO will not facilitate the implementation of remedial actions for any harm or signs of harm that CAO believes to exist.
- (2) According to the agreement between IFC and PSBC, the original *Policy Memorandum of Understanding* on E&S Responsibility signed by both parties has ceased to be effective. Given that the effectiveness of the *Policy Memorandum of Understanding* on E&S Responsibility between IFC and PSBC has been terminated, PSBC is extremely unlikely to continue cooperating on this case, whether considering contractual obligations or domestic regulatory requirements in China.
- (3) CAO has already pointed out in the Indonesia: FI-01 case²⁶ that the shortcomings indicated in IFC’s E&S review and supervision of PSBC, leading to a lack of application of the Performance Standards to Sub-Projects, are similar to those CAO has found in other IFC investments. These shortcomings are being continuously addressed and supervised in the

²⁵ Compliance Appraisal of a Complaint Regarding IFC's Exposure to the Dairi Prima Mineral Mine in Indonesia Through an Investment in Postal Savings Bank of China, (pg.31)

²⁶ Ibid.

ongoing Multi-Regional: CAO Compliance Audit of IFC's Financial Sector Investments²⁷. Similarly, in this case, even if CAO believes there are preliminary indications of IFC's non-compliance²⁸, these shortcomings are already being addressed and supervised in the ongoing CAO compliance oversight process for IFC FI investments.

5. PSBC has always been perplexed by CAO's decision on the eligibility of this case

5.1 The new CAO policy has established eligibility criteria for complaints involving IFC FI clients

As PSBC emphasized during the complaint analysis phase, CAO's acceptance criteria for complaints involving financial intermediaries are too low, which is an issue that urgently needs to be addressed by CAO. In this regard, an external review report issued by an independent external review team for the CAO accountability mechanism in June 2020, clearly pointed out that CAO, when accepting complaints involving IFC's investments in FI, should examine “the share, type, and term of the financial intermediary's investment in sub-projects.”²⁹

CAO's new policy responds to the recommendations of this external review report. According to paragraph 37 and 41 of CAO policy, in determining whether a complaint meets the eligibility criteria, CAO should first ascertain:

- (1) Based on IFC's investment in PSBC, whether Lower Sesan 2 constitutes an IFC “Sub-Project” (Article 41a).
- (2) Whether the complaint falls “within the scope of the financial product being offered to an FI by IFC”; and whether the “Sub-Project” is “within any ringfence that IFC contractually established with the FI (Article 41a1).
- (3) Whether there is a material link between the FI Client and its active Sub-Client that is the subject of the complaint (considering factors including the nature of the financing, the

²⁷ <https://www.cao-ombudsman.org/cases/multi-regional-cao-compliance-audit-ifcs-financial-sector-investments>

²⁸ PSBC believes that, based on its agreements with IFC and IFC's E & S policies, there are no instances or indications that PSBC has failed to comply with IFC's E & S policies.

²⁹ <https://thedocs.worldbank.org/en/doc/578881597160949764-0330022020/original/ExternalReviewofIFCMIGAESAaccountabilitydisclosure.pdf> (pg.41)

share, type, and tenor of the FI investment/debt exposure to the Sub-Project).
(paragraph 41a2).

However, PSBC is very disappointed to find that in this case, CAO has evidently circumvented the requirements of paragraph 41 of the new Policy, resulting in this new regulation, which aims to address procedural issues within CAO, not being effectively implemented.

5.2 During the eligibility screening stage, CAO determined that Lower Sesan 2 constituted an IFC “Sub-Project” without sufficient basis

After accepting the complaint, CAO did not contact PSBC to clarify or provide feedback on the financial linkages between PSBC and the related borrowers as raised by the Complainant. It was not until June 21, 2024, that PSBC received the redacted complaint letter annex from CAO, revealing the Complainant's allegations about the financial exposure, which PSBC then verified and clarified during the current Compliance Appraisal stage.

As stated above, following a thorough investigation and clarification, it is evident that Lower Sesan 2 is not an IFC “Sub-Project” in this case. PSBC believes that during the eligibility stage, CAO should have adhered to the provisions of paragraph 41 of its new Policy by providing PSBC with the opportunity to submit materials and feedback on whether Lower Sesan 2 could be considered an IFC “Sub-Project” based on IFC’s investment in PSBC.

However, during the eligibility stage, CAO did not contact PSBC to seek clarification or feedback. PSBC remains puzzled and confused as to how CAO could determine that the complaint met the criterion of being a “Sub-Project of an FI” without contacting PSBC. It is unclear whether this determination was based on factual information or subjective assumptions. As a party that aims to cooperate actively in resolving this CAO accountability issue, PSBC believes that this situation is in serious contradiction with CAO's core principles outlined in paragraph 10 of the new Policy, which aim to “Making every effort to **keep Parties informed** about processes and the progress of a complaint, and ensuring transparency and disclosure of CAO reports” and to ensure that “all relevant stakeholders are able to participate and be heard”.

5.3 During the eligibility stage, CAO also lacked a basis for determining “whether there is a material link between the FI Client and its active Sub-Client that is the subject of the complaint”

As mentioned above, before making the decision to accept a complaint, CAO should consider factors such as **“the nature of the financing, the share, type, and tenor of the FI investment/debt exposure to the Sub-Project”** (paragraph 41a2), in order to determine “whether there is a material link between the FI Client and its active Sub-Client that is the subject of the complaint”.

However, it was not until June 7, 2024, that CAO requested PSBC to collect business information related to the related borrowers. This indicates that when CAO made the decision to accept the complaint, it lacked relevant evidence to prove the existence of **a material link** between the FI Client and its active Sub-Client that is the subject of the complaint in this case. Therefore, it did not have sufficient evidence to determine whether the acceptance criteria stipulated in paragraph 37 and 41 of CAO Policy were met.

At PSBC’s request, CAO did not provide the redacted complaint letter attachments from the Complainant until June 21, 2024, revealing the allegations of financial exposure based on publicly available information. Upon receiving the email, PSBC immediately initiated a comprehensive investigation to respond and clarify the relevant information, providing various materials regarding **“the nature of the financing, the share, type, and tenor of the FI investment/debt exposure to the Sub-Project.”** These materials can abundantly demonstrate that the subject of the complaint, Lower Sesan 2, does not constitute a “Sub-Project” through IFC’s investment in PSBC at all, not to say there exists any material link between the FI client and the “Sub-Project”. However, by this time, more than ten months had passed since CAO received the complaint, and **more than seven months had passed since CAO made the decision to accept the complaint.**

6. Conclusion

PSBC has always placed great importance on E&S responsibility management and will continue to strive to enhance performance in these areas. PSBC takes the complaint seriously and expresses great sympathy for the issues raised. In this case, despite IFC having exited its

equity investment in PSBC and the *Policy Memorandum of Understanding* between IFC and PSBC having become invalid, PSBC has made every effort to fully cooperate with CAO's various requests, clarify the issues involved, and submit relevant materials.

PSBC believes that CAO's accountability mechanism is a critical safeguard for the E&S outcomes of IFC's private sector investments. Full respect and adherence to CAO Policy by all parties are crucial for this mechanism to function effectively and achieve its intended outcomes. This is inherent in the core principles of “transparency” and “predictability” explicitly stated in CAO Policy.

PSBC hopes that CAO will thoroughly review the clarifications provided by PSBC and respect the opinions put forward by PSBC. As an FI that highly values E&S responsibility performance, PSBC sincerely hopes that CAO's valuable resources can be effectively utilized. For cases like this one, which do not meet the “Sub-Project” criteria and where IFC has already exited from its investment, CAO should close the case immediately, thereby conserving valuable working resources.

Annex

No.	Title
1.	Explanation of PSBC Regarding the Complainant's Allegations of Financial Exposure (including Supporting Evidence)

Disclaimer

This PSBC Client Response is provided in response to the Office of the Compliance Advisor Ombudsman (CAO)'s finding of a complaint eligible for compliance appraisal.

Nothing in this PSBC Client Response or in the process provided for in CAO Policy ("CAO Process") (1) creates any legal duty, (2) asserts or waives any legal position, (3) determines any legal responsibility, liability, or wrongdoing, (4) constitutes an acknowledgment or acceptance of any factual circumstance or evidence of any mistake or wrongdoing, or (5) constitutes any waiver of any of PSBC's rights, privileges, or immunities under its paragraphs of Agreement, international conventions, or any other applicable law. PSBC expressly reserves all rights, privileges, and immunities. PSBC does not create, accept, or assume any legal obligation or duty, or identify or accept any allegation of breach of any legal obligation or duty by virtue of this PSBC Client Response.

While reasonable efforts have been made to determine that the information contained in this PSBC Client Response is accurate, no representation or warranty is given as to the accuracy or completeness of such information.

According to paragraph 9 of CAO Policy, CAO is not a judicial or legal enforcement mechanism. Its analyses, conclusions, and reports are not intended to be used in judicial or regulatory proceedings nor to attribute legal fault or liability and it does not engage in fact finding nor determine the weight that should be afforded to any evidence or information.

No part of this PSBC Client Response or CAO Process may be used or referred to in any judicial, arbitral, regulatory, or other process without PSBC's express written consent.