



The Independent Accountability Mechanism for IFC & MIGA

JULY 2025

Compliance Monitoring Report

Fourth Monitoring Report on IFC's Response to CAO
Audit of Sample IFC Investments in Third-Party
Financial Intermediaries

About CAO

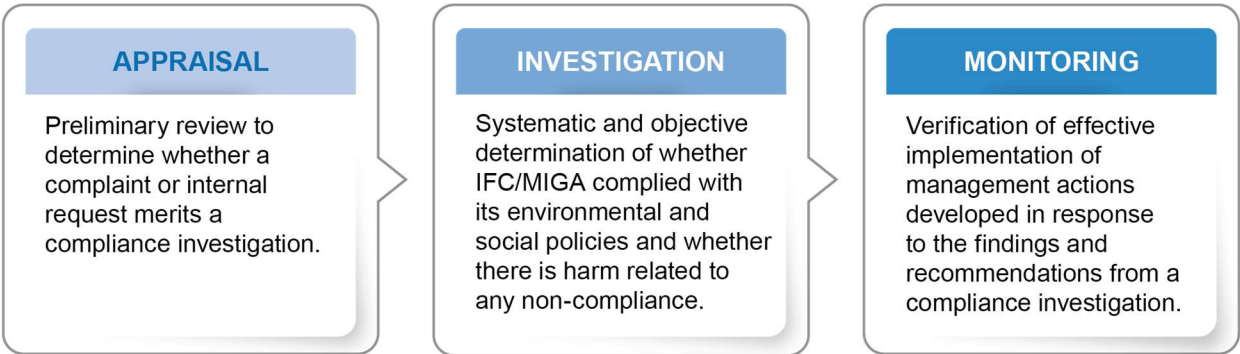
The Office of the Compliance Advisor Ombudsman (CAO) is the independent accountability mechanism of the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA), members of the World Bank Group. We work to facilitate the resolution of complaints from people affected 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:



Acronyms

CAO	Office of the Compliance Advisor Ombudsman (IFC and MIGA)
DG	Director General
E&S	Environmental and Social
ERR	External Review Report (2020 External Review of IFC's / MIGA's E&S Accountability including CAO's Role and Effectiveness)
ESAP	Environmental and Social Action Plan
ESDD	Environmental and Social Due Diligence
ESMS	Environmental and Social Management System
ESRP	Environmental and Social Review Procedures
ESRS	Environmental and Social Review Summary
FI	Financial Intermediary
FY	Fiscal Year
IFC	International Finance Corporation
MSME	Micro, small, medium-sized enterprise
MIGA	Multilateral Investment Guarantee Agency
PS	IFC Performance Standards
SME	Small, medium-sized enterprise

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Executive Summary

About this Report

This monitoring report covers actions taken by IFC to enhance its E&S risk management in its FI portfolio. Monitoring is the last phase in CAO's compliance process, providing a critical opportunity for CAO to assess whether its compliance findings have translated into IFC improvements.

This monitoring report is the fourth addressing actions taken by IFC in response to CAO's [2012 compliance review](#) of IFC's financial support to financial intermediaries (FIs) such as commercial banks, non-banking financial institutions, insurance companies, and private equity funds.¹ CAO initiated this review on the basis that IFC's FI investments (a) represented over 40% of IFC's total investment portfolio in 2011 and (b) were less known to and less understood by affected communities, and therefore less likely to be the subject of a community-submitted complaint.

CAO's 2012 FI Report was based on a sample review of 63 active FI investments. It concluded that IFC lacked a methodology for determining whether FI clients' implementation of an Environmental and Social Management System (ESMS) achieved IFC's core objectives of doing no harm or improving E&S outcomes at the sub-project level. In addition, CAO found that IFC's E&S procedures were not designed to support broader E&S outcomes and that, to accomplish this, IFC needed to facilitate a self-sustaining cultural change within its FI clients' organizations.

In response, in 2013 IFC committed to (a) formalize a continual improvement framework for managing the E&S performance of its FI business; (b) conduct formal outreach, consultation, and dialogue with key stakeholders; and (c) strengthen IFC's advisory services to support regulatory, market, and client capacity for E&S risk management in emerging market financial sectors.

In 2014, 2015, and 2017, CAO published monitoring reports covering IFC's actions in response to CAO's 2012 report (see Section 2 for details). In 2020, the World Bank Board's *External Review of IFC's / MIGA's E&S Accountability including CAO's Role and Effectiveness* recommended that CAO determine an endpoint to monitoring of this case and create a CAO advisory product on IFC application of its E&S policies to FIs.²

Methodology: For this fourth and final monitoring report, CAO reviewed a sample of 25 IFC FI investments committed between FY17-FY22. Given that over 14 years have passed since CAO selected its initial sample of 63 IFC investments, it was not practical to review those same investments again as many had been completed (i.e., the loans were repaid or IFC equity was sold). Further, these investments would not reflect IFC's ongoing commitment in response to the 2012 CAO FI Report to continually improve its management of E&S risks and impacts of FI investments as well as more recent efforts to

¹ IFC only make equity investments in private equity funds.

² As a combined response to the 2020 *External Review* request, CAO Advisory has engaged with IFC in preparing a baseline report to explore IFC's differentiated approach to FIs and highlight the issues and challenges that may arise from its application relation to FIs. The baseline report will provide considerations for IFC in updating its Sustainability Framework in relation to FIs.

revise its approach to E&S management of FI operations. The conclusions of this monitoring report are based on a sample of more recent investments that more accurately reflect IFC's current practices.

In order to effectively monitor IFC's ongoing actions to enhance its E&S review and supervision of FI investments, this sample focuses on high E&S risk FI investments and those that reflect risk reduction changes in IFC's approach such as ringfenced investments. CAO emphasizes that the sample is not statistically representative of IFC's entire FI portfolio.

IFC Financial Intermediary Investment Growth and E&S Risk Exposure

IFC makes investments in financial intermediaries because of the potential to expand IFC's development impact and reach. Between FY13 (July 2012-June 2013) and FY24 (July 2023-June 2024), IFC's annual long-term investments in FIs doubled in value from US\$4.5bn/year to over US\$10bn/year. Since FY17, IFC's annual long-term commitments to FIs make up the majority of IFC's new annual investment commitments.

Through its FI investments, IFC is indirectly exposed to the E&S risks and impacts of the sub-projects financed by its FI clients. IFC manages this risk by requiring its FI clients to implement an ESMS to assess and mitigate sub-project E&S risks and impacts. Depending on the level of E&S risk, IFC may require the FI to apply IFC's Performance Standards to a sub-project.

IFC makes FI investments in over 100 countries, each with different E&S risk factors, market perspectives, and legal frameworks. Accordingly, ensuring the consistent application of IFC E&S Requirements across its regions is both a complex and diverse challenge. In order to address this challenge, IFC has implemented global E&S Review Procedures (IFC staff procedures for assessing and managing E&S risks), embedded E&S staff in investment teams, implemented an E&S oversight function, and placed E&S staff in regional offices.

Since 2017, IFC has actively sought to reduce its exposure to E&S risks by being more selective in its FI equity investments and ringfencing loans to commercial banks with a focus on lower risk asset classes such as women-owned small and medium businesses or climate finance. As a result, IFC investment in high E&S risk (FI-1) clients fell from 80 FI-1 investments between FY13 and FY18 to 20 FI-1 investments between FY19 and FY24.

CAO Monitoring Conclusion

For this fourth monitoring report of IFC's actions in response to the 2012 CAO FI Report, CAO notes continued improvements in transparency, access to, and knowledge of accountability mechanisms such as CAO, and IFC FI E&S resource allocation. In particular:

- IFC has improved its disclosure of FI sub-projects. IFC now discloses sub-projects financed by private equity fund clients and, while implementation to date has been poor, IFC has rolled out a process for sub-project disclosure of Category A sub-projects and select Category B sub-projects financed by commercial banks.

- From FY 2012 to FY 2024, CAO has received and determined eligible 31 complaints from affected people related to FI-financed sub-projects.³ Prior to 2012, CAO had received one complaint related to an FI-financed sub-project. This suggests that communities potentially impacted by IFC supported sub-projects may have improved knowledge of and access to CAO.
- IFC now allocates significant E&S staff resources to its FI portfolio. When it began implementing the Sustainability Framework in 2006, IFC employed 2.5 Full-Time Equivalent (FTE) E&S staff devoted to FIs; this rose to 14 dedicated FTE E&S staff by 2011. As of 2025, this team has grown to 30 FTE E&S staff. Taken together with IFC structural changes (E&S staff in investment teams and E&S oversight function), these measures provide IFC with a significant and materially more robust approach to oversee its FI portfolio.
- CAO monitoring of this case has documented material improvements in IFC's pre-investment E&S review and supervision of FI investments.

CAO has therefore decided to close its monitoring of this case.

This CAO monitoring report also documents areas where IFC should focus its continual improvement efforts related to implementation of its Sustainability Policy commitments regarding financial intermediaries. Based on its review of 25 active FI investments, CAO observed the following points:

- **IFC Pre-Investment Review:** IFC appropriately categorized the E&S risk of all FI sample investments. In 23 of 25 cases in the sample, IFC required the FI client to apply the appropriate IFC E&S Requirements. However, an FI's application of IFC's E&S Requirements is a significant endeavor. While IFC's Sustainability Policy recognizes the importance of FI capacity building, CAO's review concludes that IFC's approach in preparing the FI for this task rarely addresses the fundamental changes necessary to adequately mitigate E&S risks and impacts at the sub-project level. Moreover, an FI client's effective application of the Performance Standards can have implications for its business strategy, and requires significant enhancement to FI systems, processes, staff capacity, and management commitment (relevant to 2012 CAO Finding 4.6, 4.8, and 4.9 (see Annex A)).
- **IFC Supervision:** The quality and depth of IFC supervision of FI investments has continued to improve. IFC conducts site visits to its FI clients in accordance with its procedures, and positively, in some instances where IFC was able to negotiate sub-project access rights, also conducts visits to FI sub-projects, enhancing its understanding of FI client and sub-project E&S outcomes on the ground. However, as in previous CAO monitoring reports, CAO notes that in the majority of sample cases where the Performance Standards applied, IFC did not consistently document and retain sufficient information about actual E&S performance at sub-project level (with the exception of private equity funds). As a result, for FI investments with exposure to higher E&S risks, IFC supervision often does not provide sufficient evidence that FI clients' E&S Management Systems are resulting in effective implementation of relevant Performance Standards, and achieving the core objectives of the IFC Sustainability Policy 2012 (paras. 1 and 9) which include doing no harm and attaining positive development outcomes (relevant to 2012 CAO Finding 4.1, 4.3, and 4.6 (see Annex A)). CAO notes, however, that IFC supervision of private equity funds is more robust

³ Out of the 31 complaints, 2 cases closed at CAO's Assessment stage, 11 proceeded to CAO's Dispute Resolution function (4 completed and 7 ongoing), and 18 proceeded to CAO's Compliance function (of which 4 closed at appraisal and 14 went to investigation).

than other IFC FI investments. IFC frequently conducts E&S reviews of client sub-projects before a fund finances them and fund reporting on E&S sub-project performance is more comprehensive.

- The result of the above is that **FI clients' implementation of IFC E&S Requirements is inconsistent**: Based on CAO's review of the sample of investments, available evidence retained by IFC indicates that IFC-financed FIs are not consistently applying IFC's Performance Standards to sub-projects, where applicable. CAO observed poor FI prepared due diligence reports (ESDDs), poor E&S Action Plans, and limited FI supervision of sub-projects, resulting in inadequate demonstration of Performance Standard implementation in sub-projects (relevant to 2012 CAO Finding 4.1 and 4.6, (see Annex A)). At the same time, CAO observed examples where IFC's investment, and excellent IFC staff engagement, resulted in significant improvements in FI E&S risk management and E&S capabilities.
- **IFC's ringfencing approach⁴ is not working as intended**: Based on the investment sample, CAO concludes that there is room for improvement in IFC's monitoring of the Use of Proceeds by relevant clients. In most cases, in CAO's view, FI client reporting obligations are insufficient for IFC to adequately monitor and IFC monitoring does not adequately demonstrate that its funds were used for their intended purpose (relevant to 2012 CAO Finding 4.1 and 4.2 (see Annex A)). However, CAO did not observe any instances where an FI client explicitly used IFC funds for an activity outside the Use of Proceeds conditions.

IFC has also included Use of Proceeds conditions in the majority of recent IFC Tier II subordinated loans. When IFC provides a Tier II Use of Proceeds loan to an FI client, IFC follows Sustainability Policy para. 36 in applying its E&S Requirements to the targeted asset class. As a result, the FI is required to apply IFC's E&S Requirements to a specific asset class (e.g., SMEs), and IFC focuses supervision upon that asset class. However, a key objective of a Tier II Use of Proceeds loan is to provide regulatory capital loss-absorption on a gone-concern basis, as per Basel II and Basel III capital framework.⁵ Effectively, this loan provides financial support of a general purpose that supports the capital base of the FI client. Tier II loans usually do not permit IFC to include legal provisions to accelerate loan repayment if an FI does not use IFC's funds for the intended purpose or E&S non-compliance. There is, therefore, an inherent tension of IFC's Tier II Use of Proceeds loans both seeking to support the entire capital base of an FI client while simultaneously narrowing the scope of E&S risk to be managed to a targeted asset class, which IFC has limited leverage to enforce. This could be a significant unmanaged risk for IFC.

Further, CAO notes that (i) before 2018, IFC Tier II loans did not include Use of Proceeds conditions and, thus, FI clients in receipt of this financial product were required to apply IFC's E&S Requirements to their entire portfolio and (ii) some jurisdictions prohibit Use of Proceeds

⁴ IFC ringfences an investment by including Use of Proceeds conditions in the loan agreement to target its funds to support a specific asset class the FI client finances (e.g., FI client loans to small and medium sized enterprises). As per the IFC Sustainability Policy (2012), where IFC targets its funds to a specific asset class, the FI client is required to apply IFC's E&S Requirements to that specific asset class. IFC then supervises the implementation of its E&S Requirements to that specific asset class. IFC is not required to supervise the application of its E&S Requirements to the entire portfolio of the FI, as would be the case for an IFC equity investment or general-purpose loan to an FI.

⁵ The Basel Committee on Banking Supervision have published four accords on global banking regulation. These accords set minimum capital requirements for banks to meet, and defined the types of different capital that can be considered as part of a bank's capital base. For more information, see <https://officecao.org/4kq17pm>.

A gone concern is a business that is either already in such a liquidation state or is likely to enter in the near future

conditions in subordinated loans on the basis that these financial instruments should be entirely unrestricted in their use and not tied to a specific asset class.

More broadly, CAO notes that the widespread use of Use of Proceeds conditions in IFC loans to commercial banks (Tier II and non-Tier II loans), while reducing IFC's exposure to FI E&S risks, can have unintended consequences. These include: (i) client commercial banks with weak ESMSs devoting scarce E&S resources to manage risk in lower risk IFC-funded asset classes compared to higher E&S risk sub-projects the FI finances; and (ii) IFC not using its investment role and leverage, where available, to achieve a broader positive development outcome through E&S risk management across the FI's entire portfolio.

In its 2017 response to CAO's monitoring report, IFC noted that CAO's report lacked specific proposals to enable a constructive conversation about possible actions IFC could take to address key concerns. Annex B includes suggestions following this fourth monitoring report.

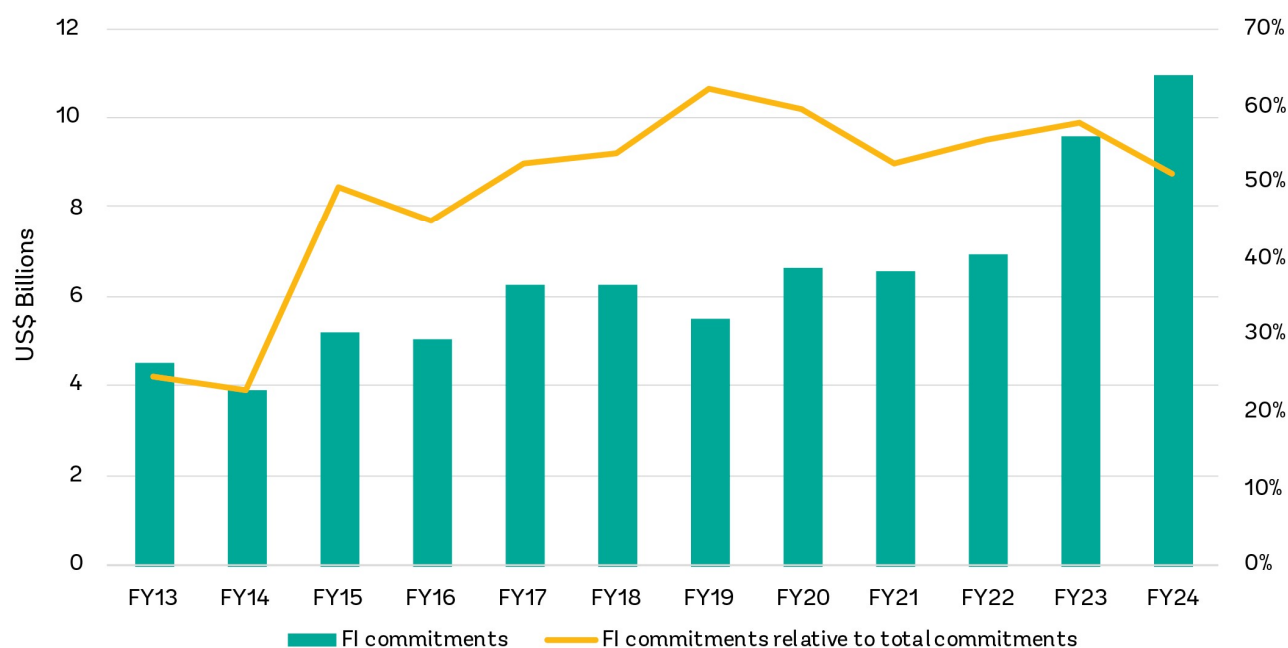
1 IFC's Financial Intermediary Business: Impact, Growth, and E&S Risk

IFC makes investments in financial intermediaries because of the potential to expand IFC's development impact and reach.⁶ Through such investments, IFC seeks to support economic development by strengthening domestic capital and financial markets on a smaller scale of activity than is possible through IFC's direct investments.⁷ FI recipients of IFC funds include commercial banks, non-banking financial institutions, insurance companies, leasing companies, and private equity funds. These investments support the general investment and lending operations of an FI or are directed toward the FI client's specific financing operations such as MSME finance, trade finance, or renewable energy and climate resilient projects.

Growth in IFC Financial Intermediary Investments

IFC's long-term FI commitments⁸ more than doubled in value between IFC fiscal year (FY) 2013 and 2024,⁹ from US\$4.5bn/year to over US\$10bn/year¹⁰ (see Figure 1). Since FY17, IFC's FI long-term investments have represented over 50% of all its total long-term commitments by value. As of January 2025, IFC had over 1,000 active FI investments,¹¹ of which 340 are private equity clients.

Figure 1: IFC Long-term Annual FI Commitments



⁶ IFC Official Response to CAO FI Audit (January 31, 2013).

⁷ IFC Sustainability Policy (2012), paras. 32-36.

⁸ Long-term are IFC commitments with a tenure of 12 months or more. These commitments do not include IFC trade finance commitments, which have a tenure or less than 12 months.

⁹ IFC's fiscal year runs from July-June. For example, FY24 runs from July 2023 to June 2024.

¹⁰ FI commitments are IFC long-term commitments to financial market and funds, as reported in IFC annual reports.

¹¹ This includes trade finance clients.

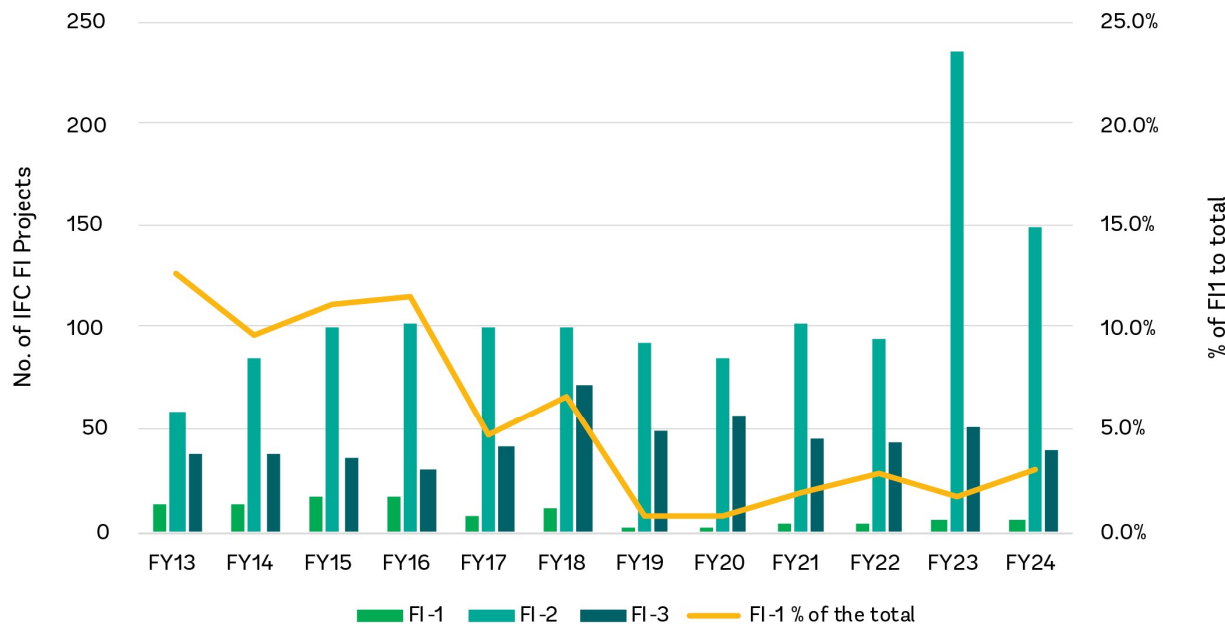
IFC Exposure to E&S Risk in its FI Portfolio

FI investments carry particular environmental and social risks for IFC because they involve primary clients such as banks, private equity, and insurance institutions that then invest in companies or projects. These IFC sub-projects can be large in number, geographically dispersed and difficult to track with IFC relying on the FI client to assess, mitigate and report any sub-project related E&S risks and impacts.

From FY13-24, IFC reported that its exposure to high E&S risk FI investments (categorized as F1-1) declined.¹²

Between FY13 and FY18 (the six years from July 2012 to June 2018), IFC made 80 FI-1 investments (see Figure 2). IFC then took steps to significantly reduce its exposure to high E&S risks in its FI portfolio, leading to only 20 F1-1 investments between FY19 and FY24 (the six years from July 2018 to June 2024).¹³ However, FY25 saw an uptick in IFC financing to high E&S risk FI investments, with IFC disclosing 11 new FI-1 investments, five of which will support FIs to finance multiple infrastructure sub-projects.¹⁴ IFC has also stated its intention to make more equity investments as it aims to broaden its development impact,¹⁵ thus creating exposure to an FI's entire portfolio and its related E&S risks.

Figure 2: IFC Annual FI Projects by E&S Risk Category



¹² IFC Sustainability Policy (2012), para. 40. IFC categorizes the E&S risk of an investment as:
FI-1 (high risk): when an FI's existing or proposed portfolio includes, or is expected to include, substantial financial exposure to business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented.
FI-2 (medium risk): when an FI's existing or proposed portfolio is comprised of, or is expected to be comprised of, business activities that have potential limited adverse environmental or social risks or impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures; or includes a very limited number of business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented.
FI-3 (low risk): when an FI's existing or proposed portfolio includes financial exposure to business activities that predominantly have minimal or no adverse environmental or social impacts.

¹³ Data gathered from IFC annual reports.

¹⁴ As per IFC Disclosure.

¹⁵ Semafor (April 2025) *World Bank's investment arm targets rise in African equity investments*, available at <https://officecao.org/43gPqb0>.

IFC Approach to E&S Risk Management in its FI Portfolio

IFC's mission is to achieve positive development outcomes from its investment activities, including investments in financial intermediaries. An important component of this objective is the environmental and social sustainability of the clients and projects it finances, and IFC is committed to the principle to “do no harm” to people and the environment in its investment activities.¹⁶

IFC's sustainability commitments and obligations, established under its Sustainability Framework, include meeting Sustainability Policy (2012) requirements and ensuring that clients comply with the IFC E&S Requirements. To meet these commitments, IFC requires its FI clients to apply the following IFC E&S Requirements to the business activities¹⁷ (also known as “sub-projects”) the FI finances: (a) IFC's Exclusion List;¹⁸ (b) applicable E&S requirements under national law; and (c) IFC's Performance Standards¹⁹ in cases where an FI finances higher risk business activities with IFC funds.²⁰ Collectively, (a) (b) and (c) are referred to as IFC E&S Requirements in this report (see Figure 3).

IFC requires all FI clients to establish and implement an E&S Management System (ESMS)^{21, 22} in order to assess and supervise the E&S risks and impacts of their sub-clients/sub-projects in accordance with the IFC E&S Requirements.²³ More details on FI ESMS are presented in section 4.3.

¹⁶ IFC Sustainability Policy (2012), para. 9.

¹⁷ IFC requires an FI apply IFC's E&S Requirements to the FI's business activities it supports. The term Business Activities can encompass a wide range of activities an FI supports (depending on the FI's operations) – including lending, investment, trade finance, deposits, insurance, risk management products and advisory services (this list is not exhaustive). For the purpose of this monitoring report and as it is more commonly used in IFC and other FI publications, CAO will use the term sub-project rather than business activities (unless referencing a specific IFC policy or procedure requirement).

¹⁸ The IFC Exclusion List defines the type of project, business activities and E&S risks that IFC does not finance. Available at <https://bit.ly/3ihL8sW>.

¹⁹ The IFC Performance Standards (2012) are best-in-class E&S requirements which include PS 1: Assessment and Management of Environmental and Social Risks and Impacts; PS 2: Labor and Working Conditions; PS3: Resource Efficiency and Pollution Prevention; PS4: Community Health, Safety, and Security; PS5: Land Acquisition and Involuntary Resettlement; PS 6: Biodiversity Conservation and Sustainable Management of Living Natural Resources; PS7: Indigenous Peoples; and PS8: Cultural Heritage.

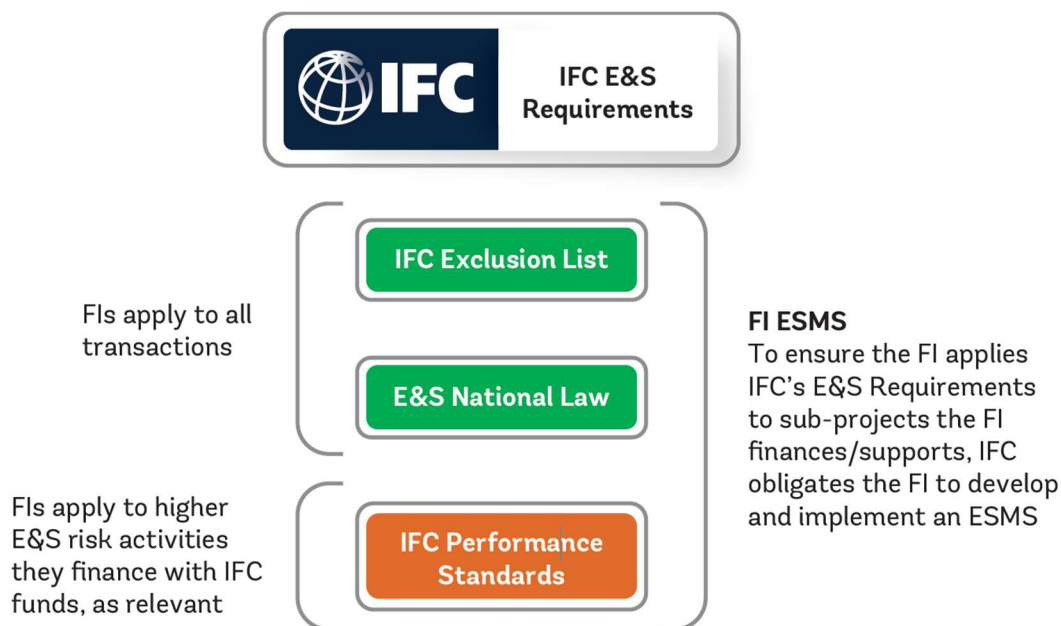
²⁰ IFC Sustainability Policy (2012), para. 35.

²¹ IFC Sustainability Policy (2012), para. 33.

²² For further details, see IFC FIRST for Sustainability. Available at <https://bit.ly/3FZJRbw>.

²³ IFC Sustainability Policy (2012), para. 33.

Figure 3: IFC E&S Requirements



In 2017, following the 2017 CAO FI Monitoring report (see Section 2 below) and increasing concern from stakeholders, IFC acknowledged that equity investments and general-purpose loans to commercial banks were creating high E&S risk in its FI portfolio and took additional steps to address this.

IFC committed to being more selective in its equity investments and to reducing the number of general-purpose loans. In addition, IFC noted that it would increase the number of targeted loans which can be “ringfenced” – designating funds to specifically support FI clients’ lower risk asset classes rather than their entire portfolio.^{24,25} By 2018, about 95% of IFC loans to FIs were ringfenced, and in June 2020, IFC noted that it ringfenced all new loans to FIs “to ensure that IFC financing only supports key targeted sectors such as micro, small and medium enterprises, women-owned businesses, housing finance and climate-related projects.”²⁶

With regard to the challenges of overseeing FI clients’ business activities, IFC’s position is that while it cannot apply the same level of oversight to the sub-projects supported by its FI clients, it is committed to supporting FI clients through appraisal, supervision, and capacity-building.²⁷

IFC has also acknowledged that disclosing subprojects is not standard practice by FI clients, and IFC committed to greater transparency beyond its existing Access to Information Policy. This included demonstrating that targeted loans to banks are being used for their express purpose.²⁸ Further, in 2018,

²⁴ 2017 IFC Statement. Available here: <https://officecao.org/3FbQfwe>.

²⁵ An IFC ringfenced investment is where IFC includes conditions in the legal agreement on the use of proceeds of IFC’s investment. The intention is for IFC’s funds to support a specified portfolio of the FI (e.g., FI financing of Small Medium Enterprises (SME)), and not the entire FI portfolio. See section 4.4 for further details. While in 2017 IFC noted that it would increasingly ringfence loans to FI clients to reduce its exposure to E&S risk, the longstanding objective of ringfencing is to ensure the allocation of funds to specific purposes to maximize development impact, i.e., MSME financing.

²⁶ IFC Statement, October 2018. Available here: <https://officecao.org/4mmRlkd>. IFC 2020 statement regarding ringfence is available in IFC Green Equity Approach, document page 3. Available at <https://bit.ly/3YglfR6>

²⁷ 2017 IFC Statement. Available at <https://officecao.org/3FbQfwe>.

²⁸ 2017 IFC Statement. Available at <https://officecao.org/3FbQfwe>.

IFC stated that it would “*pilot a voluntary initiative with our FI clients exposed to high-risk [sub-]projects for the next two years to promote disclosure of such high-risk sub-projects initiated from IFC lending, including the name, sector, and host country of the project.*” In addition, IFC committed to require new FIs with exposure to high-risk sub-projects to disclose a summary of their ESMS.²⁹ In 2020, for IFC investments in commercial banks, IFC further committed to disclose the name, location, and sector for Category A sub-projects and for loans of US\$20 million or more for Category B sub-projects supporting climate-related activities.³⁰

Finally, to limit its exposure to coal-related activities through FI investments, IFC published its Approach to Greening Equity Investments in Financial Institutions in September 2020.³¹ This affirmed that IFC would no longer make equity investments in FIs that lacked a plan to phase out investments in coal-related activities. In 2023, IFC required a commitment from FI clients not to originate and finance any new coal-related sub-projects from the time IFC becomes a shareholder.³²

²⁹ IFC Statement, October 2018. Available here: <https://officecao.org/4mmRlkd>. IFC made further commitments in relation to FI sub-project disclosure in March 2020. Further details available at <https://bit.ly/3EP2yyi>.

³⁰ In 2020, IFC made a commitment that new equity investments in commercial banks, including with existing clients (excluding rights issues arising from existing equity commitments previously approved by IFC’s Board of Directors), to which IFC commits funds from July 1, 2020, onward, such banks are required to disclose annually the name, location by city, and sector for Category A sub-projects committed after IFC’s investment. With respect to any new senior bonds issued by commercial banks, where IFC is the sole investor, and senior loans to commercial banks to which, in each case, IFC commits funds from July 1, 2020 onward, such banks will disclose annually the sub-project name, location by city, and sector for (i) Category A sub-projects, and (ii) Category B sub-projects consisting of a corporate loan or a project finance loan of US\$20 million equivalent or more that would be considered as financing “climate-related activities” and is funded by the proceeds from IFC’s senior bond or senior loan. Commercial banks will follow these disclosure requirements unless prohibited by domestic law, in which case IFC will require and disclose the client’s explanation for non-disclosure with the specific legal reference. Additional information available at <https://officecao.org/4mpzoac>.

³¹ September 2020, IFC’s Approach to Greening Equity Investments in Financial Institutions. Available here: <https://bit.ly/3YglfR6>.

³² 2023 IFC’s Green Equity Approach (GEA) Update. Available here: <https://bit.ly/3Y0tuFf>.

2 CAO Monitoring of Financial Intermediary Investments and IFC Responses

CAO's involvement in providing oversight of the environmental and social implications of IFC's FI portfolio began in 2011 as a result of CAO's concerns about the size and related E&S risk of the growing portfolio and the fact that IFC's FI sub-project investments lacked transparency. CAO conducted a compliance review that audited IFC's approach to applying its sustainability requirements to FI projects (2012 CAO FI Report), and, thereafter, published three monitoring reports that analyze IFC's subsequent actions to address CAO's 2012 findings. This section summarizes CAO's compliance activity over the past 13 years, along with IFC's responses.

2012: CAO FI Report and IFC Response

In June 2011, CAO initiated a compliance review of IFC's application of E&S Requirements to its financial sector investments. CAO acted based on concerns about the E&S risks of such investments (as outlined in Section 1 above). In addition, CAO had noted that 40% of IFC long-term commitments at the time were to financial institutions but CAO had only received one eligible complaint related to a sub-project financed by an IFC-supported financial intermediary. In triggering the review, CAO noted that access for project-affected communities to grievance redress through CAO was inhibited because:

*...financial sector projects are less known to and less understood by affected communities because disclosure provisions required in the financial markets in which IFC operate are less transparent, and the structures and instruments used by IFC to support private sector development through financial intermediaries and other instruments are very complex.*³³

In conducting the compliance review, CAO reviewed IFC's performance in appraising and supervising 63 FI clients committed between 2006-2011 – which represented 10% of IFC's FI portfolio at the time. As IFC had multiple investments with some of these clients, CAO's review covered 188 investments. CAO hired three expert consultants who reviewed IFC's documentation, interviewed IFC staff in relation to 50 FI clients, and met with 37 FI client staff in-country.

In September 2012, CAO finalized its report, *Audit of a Sample of IFC Investments in Third-Party Financial Intermediaries* ("the 2012 CAO FI Report").³⁴ CAO's report and IFC's response were published in February 2013.

From its review of the 63 FI client sample, CAO's report made the following key findings:³⁵

- IFC processed the majority of its investments in the sample in compliance with the applicable E&S policy and procedural requirements.

³³ CAO Compliance Appraisal Report: IFC's Investment Projects in the Financial Sector, June 2011. Available at <https://bit.ly/4l554kA>.

³⁴ CAO, *Audit of a Sample of IFC Investments in Third Party Financial Intermediaries* (2012 CAO FI Report). For further details, see <https://bit.ly/3B2XWCP>. The CAO FI Report was finalized in October 2012, and published in February 2013, after finalization of IFC's Official Response. CAO updated its Operational Guidelines in March 2013 and the CAO Policy in 2021. Through these updates, the term 'compliance audit' was changed to 'compliance investigation'. This report uses these terms interchangeably.

³⁵ See Annex A for a list of CAO's key findings.

- However, IFC did not have a methodology for determining whether its principal requirement for FIs – the implementation of an ESMS – achieved the core objective of doing no harm or improving E&S outcomes at the sub-project level.
- Further, IFC's E&S procedures were not designed to support the broader E&S outcomes commensurate with IFC's prominent leadership role as a promoter of E&S responsibility. To achieve these outcomes, CAO concluded that IFC needed to focus on facilitating a self-sustaining cultural change within its FI clients' organizations.

After discussion with the IFC Board, IFC committed to an action plan. The plan committed IFC to (i) formalize a continual improvement framework for managing the E&S performance of its FI business; (ii) establish a formal ongoing process of outreach, consultation, and dialogue with key stakeholders; and (iii) strengthen IFC's Advisory Services to support regulatory, market, and client level capacity to help raise the standard of E&S risk management in the financial sector in emerging markets.³⁶

2014-2015: CAO FI Compliance Monitoring Reports

In October 2014 and 2015, CAO published its first and second monitoring report summarizing the actions taken by IFC in response to the 2012 CAO FI Report. CAO noted that the actions proposed by IFC, if well implemented, had the potential to improve the quality of E&S outcomes from FI investments over time. However, based on data available at the time, CAO had questions as to whether IFC's response to date had led to either improved E&S outcomes on the ground, or improvements in compliance with the 2012 Sustainability Framework. CAO therefore decided to prepare a third report based on the performance of a sample of active FI investments in meeting the requirements of the Sustainability Framework. CAO noted that this would provide an enhanced measure of the effectiveness of IFC's response to the 2012 CAO FI Report.³⁷

2017: CAO FI Compliance Monitoring Report

In 2017, CAO published its third monitoring report ("the 2017 CAO FI Monitoring Report"),³⁸ with monitoring conclusions based on a review of IFC E&S performance in 38 active investments. This sample was not designed to be statistically representative of IFC's FI portfolio. CAO selected the projects on the basis of i) random selection; ii) IFC recommendations; and iii) selective additions for the purpose of achieving regional balance and coverage of IFC ESMS Diagnostic Service³⁹ clients. In conducting this monitoring report, CAO reviewed IFC's investment documentation in relation to the 38 sample FI clients, and CAO staff held discussions with a sub-set of IFC investment teams and IFC FI clients in the sample.

³⁶ IFC, 2013, E&S Risk Management of Financial Institutions at the IFC. Available at <https://bit.ly/4I5iCfW>.

³⁷ CAO, 2015, Monitoring IFC's Response to: CAO Audit of a Sample of IFC Investments in Third-Party Financial Intermediaries. Second Monitoring Report. Available at <https://bit.ly/4hKSf9>.

³⁸ CAO, 2017, Third Monitoring Report of IFC's Response to: CAO Audit of a Sample of IFC Investments in Third-Party Financial Intermediaries. Available at <https://bit.ly/4I2zluM>.

³⁹ As noted in CAO's 2017 monitoring report, IFC piloted an ESMS Diagnostic Service with 20 FI clients to identify E&S risk areas and enable benchmarking of the client's performance. The tool reviews an FI's approach to E&S risk management in terms of its policies, procedures and processes, and capacity for implementation IFC's requirements. The objective of the diagnostic is to identify risks and areas for improvement, and provide recommendations for improvement. IFC staff compile the diagnostic based on a review of the client's ESMS documentation, on-site interviews with FI management and staff, and in some instances, where IFC was able to negotiate sub-project access rights, site visits to sub-projects. The performance gaps identified during the diagnostic are addressed by a set of recommendations that prioritizes areas for improvement with deliverables specified.

From this monitoring exercise, CAO concluded:

- The quality and depth of IFC's pre-investment review and supervision of FI investments had improved. CAO noted good practice examples of IFC's use of its E&S Diagnostic Service and ESMS Implementation Review.
- However, IFC did not in general have a basis to assess FI clients' compliance with its E&S Requirements. CAO found this to be of particular concern in relation to FI clients that supported projects with high E&S risks, and in cases where IFC did not have assurance that an FI client's ESMS was resulting in implementation of IFC's Performance Standards at the sub-project level.
- Gaps remained in IFC's approach to ensuring that people affected by the business activities of its FI clients had ready access to external communication and grievance mechanisms.

2017: IFC Response

In response to CAO's monitoring report, IFC stated that:⁴⁰

- It was committed to addressing relevant findings of CAO's monitoring report and striving to improve FI clients' E&S risk management practices. IFC detailed actions it had taken to enhance performance, including assessing country-specific risks, developing tailored E&S Action Plans (ESAPs), engaging with high-risk clients, improving E&S assessment tools, focusing on external communication, and ensuring consistency in appraisal and supervision of FI investments.
- It disagreed with many of CAO's observations, arguing they did not align with IFC policies, procedures, mitigation measures, or market practices and did not accurately reflect the broader FI portfolio performance. Specific IFC concerns related to: (i) the representativeness and accuracy of the CAO sample; (ii) the benchmarks used by CAO, which IFC considered inconsistent with IFC policies; and (iii) lack of actionable conclusions in CAO's report.⁴¹

2020: External Review of IFC/MIGA E&S Accountability

In August 2020, the World Bank Board of Directors published the *External Review of IFC's/MIGA's E&S Accountability including CAO's Role and Effectiveness: Report and Recommendations* (ERR).⁴² Prepared by six independent experts, the wide-ranging report including commentary on CAO's FI monitoring. It recommended that CAO: (i) determine an endpoint to its ongoing monitoring of this case and ensure that it maintains a clear distinction between the compliance focus of monitoring and advice to IFC and/or the Board on the overall application of the Performance Standards to FI clients; and (ii) create a new CAO advisory product to enable IFC to clarify the application of the Performance Standards to FIs.⁴³

⁴⁰ IFC, 2017, IFC Response to Third Monitoring Report of IFC's Response to: CAO Audit of a Sample of IFC Investments in Third-Party Financial Intermediaries. Available at <https://bit.ly/4cmhJf3>.

⁴¹ In its response to the 2017 CAO FI Monitoring Report, IFC states that CAO's assessments are based on inaccurate benchmarks, often ignoring IFC's updated procedures and Board-approved policies. IFC disputed CAO's conclusions on appraisal quality, stating that missing details and lack of project-specific feedback make the findings unsubstantiated. IFC defended its use of Performance Standards thresholds, noting they were Board-reviewed and exceed market norms. IFC also challenged CAO's interpretation of mitigation measures, asserting that ESAPs are designed to include key milestones, not exhaustive steps. Lastly, IFC criticized the CAO report's findings on supervision, claiming they contradict internal evaluations and fail to reflect recent improvements in tools, training, and client engagement. Available at <https://bit.ly/4cmhJf3>.

⁴² World Bank, 2020., *The External Review Report of IFC's/MIGA's Environmental and Social Accountability* Available at: <https://officecao.org/4I03eR6>

⁴³ As a combined response to the 2020 *External Review* request, CAO Advisory has engaged with IFC in preparing a baseline report to explore IFC's differentiated approach to FI's and highlight the issues and challenges that may arise from its application relation to FI's. The baseline report will provide considerations for IFC in updating its Sustainability Framework in relation to FI's.

3 Methodology for CAO's Fourth FI Monitoring Report

For this current monitoring report, CAO reviewed a sample of 25 active FI investments made by IFC under the 2012 Sustainability Framework. In keeping with the findings of the 2012 CAO FI Report, CAO's review of these projects sought to identify the effectiveness of IFC's investment approach to assess and manage E&S risks and impacts in its FI portfolio.

The sample was therefore not designed to be statistically representative of IFC's overall FI portfolio. Instead, CAO used a stratified sampling approach⁴⁴ to select:

- 10 high E&S risk FI investments (FI-1)
- 8 IFC FI investments in commercial banks that include Use of Proceeds conditions⁴⁵
- 7 randomly selected investments.⁴⁶

Selected from IFC FI investments made from FY17-FY22, and active in March 2024, the sample reflects the most recent IFC approaches to E&S risk management in its global FI portfolio. CAO did not include IFC FI investments made after FY22 in order to ensure that the sample projects had undergone at least one year of supervision. Similar to its 2017 CAO FI Monitoring Report approach, CAO invited IFC to recommend up to three FI investments to include in the sample.⁴⁷

In line with both the 2012 CAO FI Report and the 2017 CAO monitoring report, the names of the IFC FI clients selected in the sample will remain confidential as the investments are not part of a specific CAO complaint process.

This report was prepared in accordance with CAO's Operational Guidelines (2013). In 2021, the IFC and MIGA Boards approved the IFC/MIGA Independent Accountability Mechanism (CAO) Policy (the "CAO Policy"), effective July 1, 2021. In accordance with CAO's Transitional Arrangements from the CAO Operational Guidelines to the CAO Policy, cases under CAO's monitoring function prior to July 1, 2021 are handled in accordance with the CAO Operational Guidelines.⁴⁸

⁴⁴ "Stratified sampling can be considered similar to the concept of importance sampling. The idea is to divide the system into different subpopulations referred to as strata and to draw more samples into subintervals that give greater contributions to the final results." as defined by ScienceDirect, available here: <https://officecao.org/4ja4fET>.

⁴⁵ These investments represent IFC's strategic decision in 2018-2020, described in Section 1, to reduce its exposure to E&S risk through ringfencing loans.

⁴⁶ Similar to the 2017 CAO monitoring report, CAO did not select a sample representative of the population. CAO decided on this approach to: (i) focus on IFC FI-1 (high risk) investments (a noted concern from the 2017 CAO FI Monitoring Report); (ii) include a material number of IFC Use of Proceeds investments, as this was a decision of IFC following CAO's 2017 FI monitoring report; (iii) minimize resources as a sample of the population would have necessitated a larger sample size and more CAO resources and staff time to conduct the analysis reflected in this monitoring report. As was the case in the 2012 CAO FI Report and 2017 CAO FI Monitoring Report, the CAO sample did not include any IFC FI clients that had an active or closed CAO case.

⁴⁷ IFC decided not to suggest any FI investments to be included in the sample.

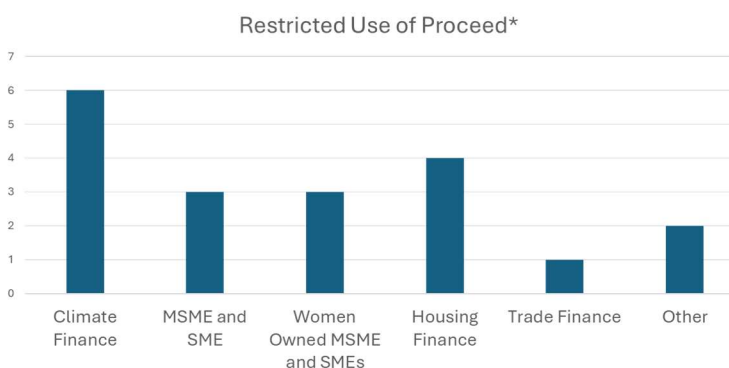
⁴⁸ CAO's Operational Guidelines (2013), CAO Policy and Transitional Arrangements are available at <https://bit.ly/3JecGQC>.

Sample Investment Characteristics:

FI Type	No.
Commercial Banking	15
Private Equity Fund	3
Fund – Debt Investments	2
Other (Insurance, Microfinance Institution, Distressed Assets, etc.)	5

E&S Risk Category ⁴⁹	No.
FI-1	10
FI-2	12
FI-3	3

Use of Proceeds	No.
General Purpose Finance (equity or unrestricted loans)	10
Restricted Use of Proceeds	15



* Multiple Restricted Use of Proceeds investment supported more than one activity (e.g. Climate Finance and SMEs)

As part of its methodology, CAO undertakes documentary review and interviews with IFC staff to verify information received. To this end, CAO requested IFC documentation in relation to the selected FI investments in January 2024. CAO received IFC documentation between March and August 2024, which CAO conducted a desk review of. In September 2024, CAO staff had a general discussion with IFC staff

⁴⁹ FI-1 investments make up 40 percent of CAO's sample. However, during the period of FY17-22 period, new IFC FI-1 investments accounted for approximately 3 percent of IFC annual FI commitments. CAO's sample includes a higher proportion of FI-1 investments in order to provide more oversight of investments which IFC considered to be high E&S risk.

on IFC's approach to E&S risk management in its FI portfolio. In mid-January 2025, CAO requested interviews with five IFC FI project teams to discuss how IFC assessed and supervised the application of IFC E&S Requirements with those FI clients. However, IFC declined interviews with CAO in relation to the five selected FI investments; instead, IFC provided written responses to CAO's questions.⁵⁰ Subsequently, CAO shared additional questions with IFC specific to its approach to ringfencing, to which IFC provided written responses.⁵¹

Monitoring Report Key Questions:

In this fourth and final FI Monitoring Report, CAO seeks to answer the questions below in relation to the E&S implications of IFC's still-growing portfolio of global financial intermediary clients and their sub-projects. These questions reflect the objective of this report to consider IFC's ongoing commitment in response to the 2012 CAO FI Report to continually improve its management of E&S risks and impacts of FI investments as well as more recent efforts to revise its approach to E&S management of FI operations.

- Do IFC's FI pre-investment reviews in the sample cases evidence an adequate assessment of E&S risk and, where relevant, include appropriate mitigation measures to close gaps between the FI's E&S risk management practices and IFC's E&S Requirements?
- Do IFC's FI supervision activities evidence an adequate assessment of FI client implementation of IFC's E&S Requirements and, as relevant, application of IFC's Performance Standards at the sub-project level?
- Has IFC reduced its E&S risk exposure in its FI portfolio?
- Do project-affected people have access to adequate accountability mechanisms in business activities funded by FI clients? To answer this question, CAO will consider access to information, external communication mechanisms, and grievance mechanisms.

⁵⁰ In the absence of an opportunity to speak with the relevant IFC investment and E&S staff, CAO's analysis related to those investments was limited to documentation provided by IFC.

⁵¹ IFC noted to CAO that it declined the meetings as in IFC's view this exercise is not aligned with the CAO Policy and the scope of CAO's compliance monitoring mandate, and that it continues to engage with CAO Advisory on products related to FIs. CAO notes that the Advisory product and the current monitoring report are distinct exercises, both recommended by the 2020 *External Review* request.

4 CAO Analysis of Sample Investments for Fourth Monitoring Report

The following section presents CAO's analysis of the sample IFC investments described above, through the lens of IFC's response to CAO's 2012 report, previous monitoring report conclusions, and actions IFC has taken since 2013 to strengthen its approach to E&S risk management in its FI portfolio. As noted in Section 2, in response to CAO's 2012 FI Report, IFC committed to an action plan that included the following: (i) formalize a continual improvement framework for managing the E&S performance of its FI business; (ii) establish a formal ongoing process of outreach, consultation, and dialogue with key stakeholders; and (iii) strengthen IFC's advisory services to support regulatory, market, and client level capacity to help raise the standard of E&S risk management in the financial sector in emerging markets. Since IFC published this action plan in 2013, its approach to E&S risk management has continued to evolve. IFC has (i) updated its E&S Review Procedures; (ii) enhanced its FI E&S capacity, including adding staff to regional offices; (iii) embedded E&S staff in IFC investment teams; and (iv) established an E&S Policy and Risk Department with responsibility for independent E&S expertise, advice, guidance, and review of E&S risk management across IFC as well as support to IFC investment teams.

Below, CAO considers the effectiveness of IFC's actions to address some of the core findings of the 2012 CAO FI Report (Findings 4.1, 4.2 4.3, 4.6, 4.7, 4.8, and 4.9 (see Annex A for details)). These 2012 findings noted that IFC's emphasis on an FI client's E&S Management System was not generating information on actual E&S results and outcomes at the sub-project level, and therefore not achieving IFC's central objective of doing no harm. The report also noted that this approach risks reducing the ESMS to a compliance exercise, rather than facilitating a self-sustaining cultural change within its FI clients' organizations.

This section discusses the effectiveness of IFC's actions according to: (i) IFC pre-investment review; (ii) IFC supervision; (iii) IFC review of FI E&S risk management of sub-projects; and (iv) IFC's ringfence approach. Each sub-section summarizes IFC's E&S requirements followed by CAO's monitoring observations.

CAO reiterates that the sample used for this analysis is skewed toward FI investments with higher E&S risks and ringfenced investments. Accordingly, CAO observations are not representative of IFC's entire FI portfolio.

4.1 IFC Pre-Investment Review

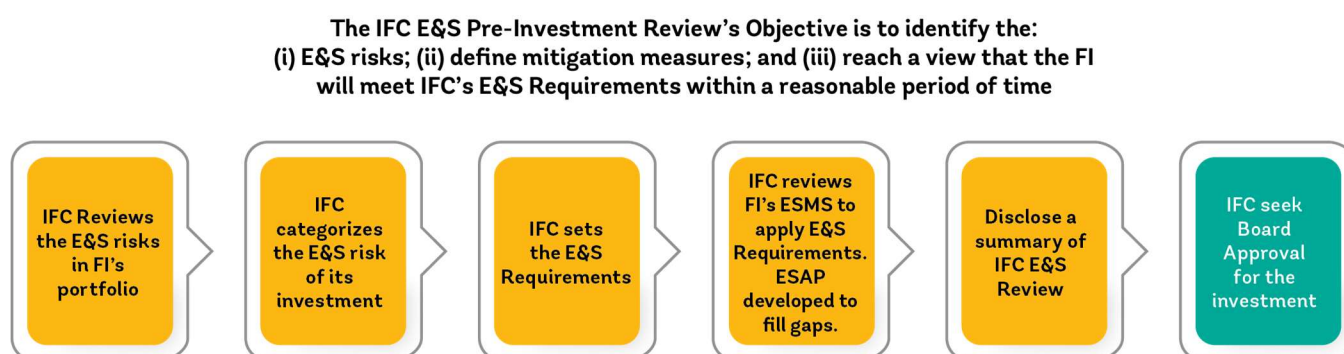
This section considers improvements in IFC's approach to pre-investment E&S review since CAO's 2012 FI Report. Relevant findings from CAO's 2012 FI Report for the forthcoming discussion include Finding 4.6, 4.8, and 4.9 (see Annex A).

Requirements

When IFC conducts E&S due diligence in a prospective FI client such as a commercial bank, microfinance lender or private equity firm, it has two objectives. These are: (i) to identify and assign a risk category⁵² to the E&S risks of the FI business activities that IFC funds will support; and (ii) to establish any gaps between the client's E&S Management System to implement IFC E&S Requirements and agree client mitigation measures to fill these gaps, generally through an E&S Action Plan.⁵³ In making an investment in a financial intermediary, IFC seeks to support the client in managing E&S risks. This is achieved in part through the development and implementation of an ESMS, and by enhancing FIs' in-house capacity for day-to-day management of portfolio risks, including environmental and social risk.⁵⁴

The Sustainability Policy also requires IFC to assure itself that the FI will implement IFC's E&S Requirements within a reasonable period of time, before presenting the investment to the IFC Board for approval.⁵⁵

Figure 4: Steps in IFC Pre-Investment E&S Review of FI Investments



CAO Monitoring Observations

- **IFC review of E&S risk of portfolio it is financing:** IFC's pre-investment review documentation accurately presents the E&S risks in the sample FI portfolios. Positively, in some instances, IFC's description of FI portfolio risks also included contextual risks such as geographical and sector E&S risks.

⁵² IFC Sustainability Policy (2012), para. 40. IFC categorizes the E&S risk of its investment as FI1 (high risk), FI2 (medium risk), or FI3 (low risk).

⁵³ IFC reviews the FI's ESMS with a view to the FI applying IFC's E&S Requirements. Where IFC identifies gaps in the FI's ESMS, IFC requires the FI to address these gaps either prior to IFC legal commitments or as an ESAP with implementation linked to IFC disbursements or defined dates.

⁵⁴ IFC's 2012 Sustainability Policy (para. 33) establishes that "[T]hrough its engagement with FIs, IFC supports the capacity development of the banking and financial sector to manage environmental and social risks. This is achieved in part through the development and implementation of an ESMS, and by enhancing FIs' in-house capacity for the day-to-day management of portfolio risks, including environmental and social risk."

⁵⁵ IFC Sustainability Policy (2012), para. 22.

- **IFC E&S risk categorization:** IFC followed its FI risk categorization framework and accurately categorized the E&S risk of all investments in the CAO sample.
- **IFC E&S Requirements:** Based on the intended use proceeds of IFC's financing for each case,⁵⁶ in almost all instances (23 of 25), IFC correctly established the IFC E&S Requirements the FI needed to apply to its business activities. However, in two instances, IFC financed FI-1 (high risk) clients without adequately applying the IFC Performance Standards to the IFC-client investment agreement.
- **IFC assessment of FI client commitment:** Before making an investment, IFC reviews an FI's ESMS to assess the client's readiness to adjust its E&S risk management practices, build in-house capacity and training, and make a formal commitment to implement IFC's E&S Requirements (as codified in legal covenants and the ESAP). FI implementation of the IFC Performance Standards can impact an FI's business strategy as these standards usually exceed local market practices.⁵⁷ It is therefore important that IFC discuss with its FI client the risks and opportunities for the FI's business strategy from applying the Performance Standards to its sub-projects. However, from its review of 10 sample cases where IFC provided general purpose financing, in six instances CAO did not observe evidence that IFC adequately discussed application of the Performance Standards with the FI client and ensured it understood the implications for its business and was fully committed to applying the E&S requirements.
- **IFC investment presentation to the IFC Board of Directors:** In 10 cases (most of which were categorized as FI-1 – high risk), CAO observed that IFC presented an overly-optimistic assessment to the Board of the E&S risks of the proposed FI investment. For example, IFC did not adequately present to the Board key issues such as: E&S risk management challenges from converting an IFC loan to equity, post-disbursement risk of failure to implement a technical assistance program by an FI-1 client with no prior E&S risk management program, and known E&S risks of financing renewable energy infrastructure projects in an FI-2 investment.
- **IFC E&S Action Plans for FI clients:**
 - **Quality of ESAPs:** CAO observed ESAPs agreed between IFC and its clients that differed materially in terms of detail and quality. Often ESAP items focused on outputs rather than outcomes. For example, ESAPs required the client to “*Develop an ESMS*” or “*Develop Staff Training Plan*”. Such activities are not explicitly linked to an intended outcome—such as using training and coaching programs to ensure that FI E&S staff can adequately perform their duties as per the FI's ESMS or evidence of implementation through the production of five FI prepared E&S due diligence reports and supervision reports. In a few cases, CAO did observe detailed ESAP action items that enhanced the robustness of IFC's supervision.
 - **Loss of leverage:** CAO observed multiple instances where key ESAP action items for managing E&S risks in FI-1 investments (such as implementation of an ESMS) were only required after IFC disbursement. This is particularly concerning in cases where key ESAP

⁵⁶ For example, where the IFC investment or loan was general purpose or was targeted to a specific end use.

⁵⁷ The Performance Standards frequently exceed national E&S standards and there can be a perception that their implementation has additional costs for sub-projects, if value add is not adequately explained. Thus, sub-projects may be less inclined to seek financing from an IFC FI client where it is requiring Performance Standards application – as this is seen beyond market practice in the national financial sector. As an example, the Performance Standards sometimes have more stringent environmental emission standards than national law. This can result in additional upfront costs to implement more efficient/high-cost technology to reduce the E&S impact of its operations (and reduced operation costs), beyond what is expected by national law in some jurisdictions.

actions are also not tied to time-bound IFC supervision activity.⁵⁸ Unless linked to a financial incentive or disincentive schedule, IFC leverage generally decreases post-disbursement, making it more difficult for IFC to ensure the completion of critical ESAP items which may be designed to avoid risks to and impacts on project-affected people.

- **Application of Performance Standard requirements:** Positively, CAO observed one instance where IFC required the FI to apply relevant Performances Standards (PS) to its sub-projects on a time-defined graduated basis – concentrating on high-risk sectors immediately, medium risk within one year, and low risk with two years. Such an approach can support the change management often needed to implement IFC's E&S Requirements on a realistic timeline.
- **Use of technical assistance programs:** In a number of instances, IFC's investment was combined with either an IFC technical assistance program or a requirement for the FI to hire a consultant to implement such a program. PS application by an FI usually requires a significant allocation of FI resources, a strong commitment from its management, and possible implications for the types of investment the FI can make in the future (see footnote 54). CAO observed that the proposed technical assistance programs included in IFC's sample investments were usually broadly defined. In general, they did not adequately address the typical barriers to adequate FI ESMS implementation: governance improvements, FI investment team support for E&S risk management, adequate E&S capacity, and use of external E&S experts. In some instances, the improvements needed for an FI to meet IFC's E&S Requirements went beyond the client preparing an E&S/Sustainability Policy and Procedures to involve significant change to aspects of the FI's investment operations. CAO observes that for some IFC FI clients, technical assistance programs may therefore also necessitate a change management approach.⁵⁹

4.2 IFC Supervision

This section considers improvements in IFC's approach to E&S supervision since CAO's 2012 FI Report. Relevant findings from CAO's 2012 FI Report for the forthcoming discussion include Finding 4.1, 4.3, and 4.6 (see Annex A).

Requirements

IFC's objective during supervision is to assess the FI client's implementation of IFC's E&S Requirements throughout the life of the investment.⁶⁰ In turn, IFC expects the FI, through its own pre-approval due diligence and supervision, to require the sub-clients/sub-projects it finances to operate in accordance with IFC's E&S Requirements.

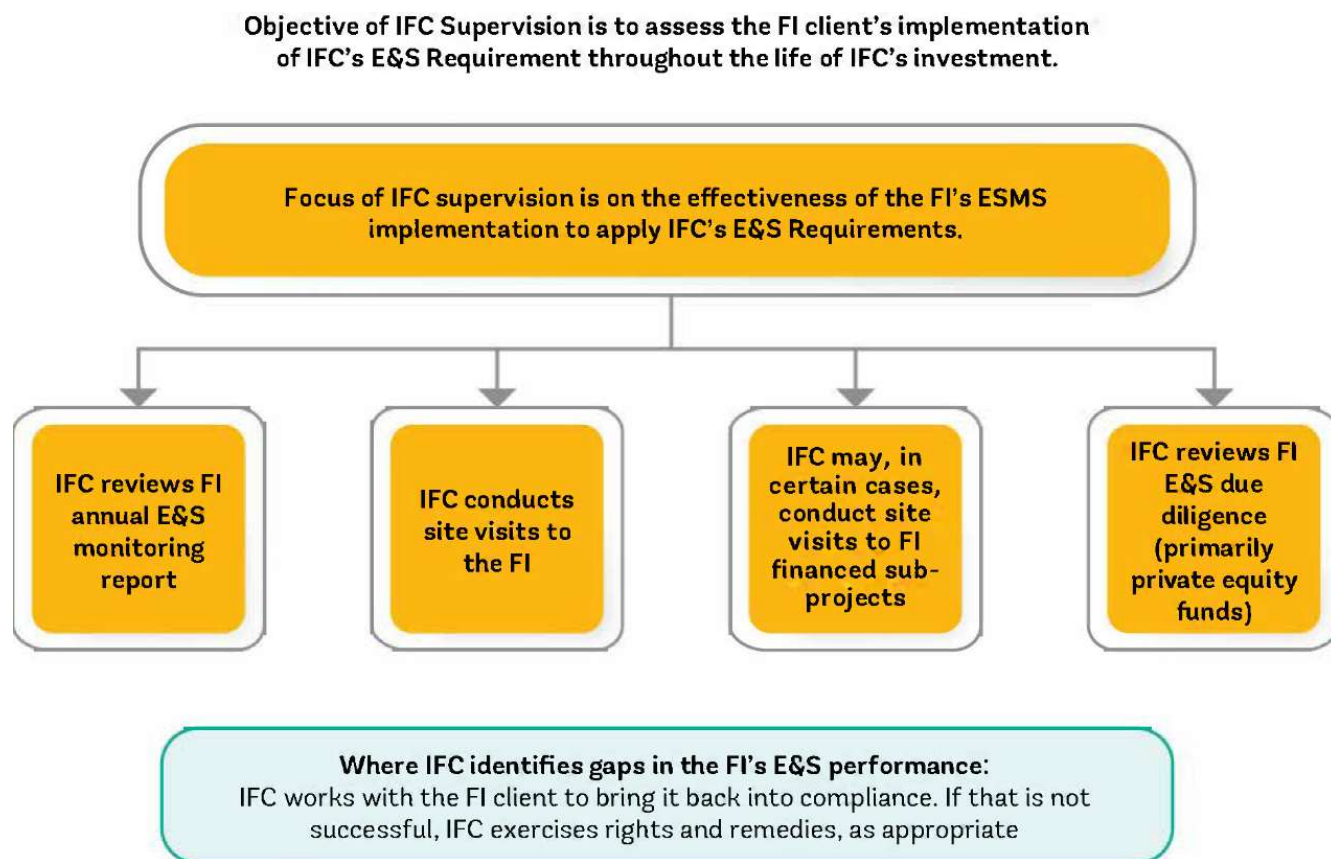
To meet this objective, IFC undertakes the below activities to assess the effectiveness of the FI's ESMS implementation and compliance.

⁵⁸ Where an ESAP action is not linked to an IFC disbursement event, CAO observed that IFC generally supervised implementation of a post-disbursement action during its annual E&S review of the FI client. As an example, IFC could disburse funds to an FI on March 15. The FI may have an ESAP action due for June 30. The FI's annual E&S reporting obligation is not until March of the next calendar year. CAO observed instances where IFC's documentation indicated IFC supervised the FI following submission of its annual E&S report.

⁵⁹ See Annex C for ESMS Implementation as a change management challenge.

⁶⁰ IFC Sustainability Policy (2012), para. 45.

Figure 5: IFC E&S Supervision Activity



For FI investments that are private equity funds, IFC has also committed to disclose the name, sector, and location of all sub-projects, subject to regulatory constraints and market sensitivities.⁶¹ For IFC investments in commercial banks, IFC committed in 2020 to disclose the above information for Category A sub-projects and for loans of US\$20 million or more for Category B sub-projects supporting climate-related activities.

CAO Monitoring Observations

- **Improved supervision:** The quality and depth of IFC's supervision of FI investments continues to improve since the release of the 2012 CAO FI Report. In the CAO sample for the current monitoring report, CAO notes that IFC conducts site visits to FI-1 and FI-2 clients in accordance with its procedures and, in some cases, where IFC was able to negotiate sub-project access rights, also visits sub-projects financed by the FI client. The frequency of these visits is commensurate with IFC's assessment of E&S risk,⁶² which CAO observes is appropriate.

⁶¹ IFC Access to information Policy, 2012. Footnote 16. This policy commits IFC to such disclosure for high E&S risk sub-projects. In response to the 2012 CAO FI Report, IFC agreed to expand this disclosure for all private equity fund sub-projects. In 2020, for IFC investments in commercial banks, the World Bank Group President announced that new IFC (i) equity investments, (ii) senior loans and (iii) senior bonds where IFC is the sole investor, will provide for IFC disclosure of Category A and some Category B sub-projects. Additional information available at <https://officecao.org/4mpzoac>.

⁶² Both in terms of IFC E&S risk categorization (e.g. FI-1, FI-2, and FI-3), and in response to challenges IFC identifies during its supervision.

- **Progress on FI E&S risk management but inconsistent demonstration of compliance:** With the exception of private equity funds, IFC's supervision of FIs exposed to higher E&S risk sub-projects (FI-1 and some FI-2) in most instances did not consistently document and retain sufficient information about E&S performance at the sub-project level. Accordingly, IFC does not have sufficient assurance that FI clients are adequately applying the Performance Standards in their financing of higher risk sub-projects. At the same time, CAO observed multiple cases in its sample where IFC's investment combined with excellent IFC staff engagement with clients resulted in significant improvements in FI E&S risk management and E&S capabilities.
- **Limited information regarding FI client investment in Category A sub-projects:** CAO observed limited evidence of IFC FI clients that are financing higher E&S risk sub-projects routinely informing IFC promptly when they have or intend to finance a Category A sub-project, in line with IFC requirements.⁶³
- **Limited analysis of FI E&S Management Systems:** IFC review of FI clients' E&S performance during supervision tends to describe the client's ESMS but lacks critical analysis. Key factors such as client commitment, ESMS implementation barriers, quality of clients' E&S due diligence of their investments including legal covenants and ESAP status, consistent use of experts for high-risk sub-projects, and the FI's ESMS budget are either not assessed or described without sufficient analysis.
- **Lack of specificity in FI reporting to IFC:** CAO observed limited customization of IFC's requirement that FI clients submit an Annual E&S report to IFC. IFC operates in a diverse range of markets with unique E&S risks and frequently targets funds for FI clients to specific end uses. Yet, IFC's FI reporting format lacks sufficient specificity for IFC to adequately assess a particular client's implementation of IFC's E&S Requirements and its overall E&S risk management performance.
- **Inadequate supervision of FI external communication mechanisms⁶⁴:** Most IFC FIs in the CAO sample that finance higher E&S risk sub-projects have developed procedures to receive and handle external queries and complaints. This is a material improvement on the findings of CAO's 2012 compliance report and 2017 monitoring report. However, the sample investments suggest that IFC supervision focuses on whether a complaints mechanism exists but not its adequate implementation. In particular, IFC supervision does not demonstrate that FIs are promoting the use of these mechanisms to stakeholders, or receiving and addressing external concerns related to sub-projects they finance.
- **Limited IFC sub-project disclosure:** IFC committed to disclose sub-project name, sector, and location for private equity fund and some commercial bank clients. IFC disclosed this information for two of the three private equity funds in the sample. For four additional clients (commercial banks) in the sample, IFC included conditions in the investment agreement to allow disclosure of sub-project information (in accordance with IFC's 2020 commitment on sub-project disclosure). IFC has subsequently only disclosed sub-project information for one of these four

⁶³ IFC require its FI clients to promptly inform IFC in writing when it intends to finance a Category A sub-project, or an existing sub-project engages in activities classified as Category A. From the sample, CAO observed that IFC private equity funds and 1 commercial bank informed IFC in advance of financing Category A sub-projects. (Category A sub-project involves activities with potential significant adverse environmental or social risks and/or impacts that are diverse, irreversible, or unprecedented).

⁶⁴ IFC's Sustainability Policy requires FI-1 and FI-2 clients to operate an ESMS incorporating relevant principles of PS1. As part of the ESMS, the FI needs to implement and maintain an External Communication Mechanism (ECM). This is a procedure for external communications that includes methods to receive, register, screen, and assess, track, respond to, and act upon external inquiries and complaints from the public regarding their operations.

FI clients. IFC noted to CAO that this is due to the fact that only one bank reported sub-projects that triggered this requirement for IFC sub-project disclosure.

- **Robust private equity fund supervision:** CAO considers IFC supervision of the three private equity funds in the sample to be more robust than its supervision of other FI investments. In advance of a private equity fund client's investment in a sub-project, IFC usually has the right to review the fund's E&S due diligence report.⁶⁵ Private equity fund quarterly or annual reporting to IFC includes a summary of the fund's ESMS performance, sub-project E&S performance, and updates via fund E&S investor sub-committees. IFC's supervision of private equity funds⁶⁶ therefore provides a higher degree of assurance that such FI clients are implementing IFC's E&S Requirements and that IFC adequately assesses sub-project E&S performance.
- **Limited sector expertise in IFC supervision of fund sub-projects:** IFC's reviews of FI sub-projects is generally conducted by IFC E&S staff who specialize in supervising FIs. CAO observed limited documented instances where IFC E&S sector experts were included in the review of sub-projects with medium-high E&S risks that an FI proposed to or already had invested in. This represents a missed opportunity for IFC E&S experts with deep knowledge of sectors that carry E&S risk such as energy and infrastructure, to provide input to medium-high E&S sub-projects financed by IFC private equity funds.
- **Improved IFC E&S staff resources:** IFC has enhanced its E&S staffing for its FI portfolio. When IFC commenced implementation of the Sustainability Framework in 2006, IFC had 2.5 Full-Time Equivalent (FTE) E&S staff devoted to FIs. When CAO initiated this compliance review in 2011, IFC had 14 FTE E&S staff devoted to FIs. As of 2025, this has grown to 30 FTE E&S staff.⁶⁷

Box 1: IFC E&S Staff Responsibilities

- IFC E&S staff face a complex layering of issues during supervision of FI operations.
 - For sub-projects an FI may finance, IFC E&S staff may encounter issues related to all Performance Standards across multiple diverse sectors with differing contextual risks, many of which require specialized knowledge.
 - IFC E&S staff are required to assess an FI's ESMS and its implementation including adequate policies and procedures, and the client's actual capacity to effectively implement. Further, IFC E&S staff are often called upon to support the capacity development of the FI's ESMS.
 - In addition, IFC E&S staff must assess soft factors such as FI client commitment and the application of E&S requirements in complex financial transactions.
- As a result, in cases where IFC is financing an FI-1 or FI-2 client required to apply the Performance Standards, the IFC staff time, specialized knowledge of E&S issues, and knowledge of financial structure and transactions to adequately review and follow up with an FI on the application of the Performance Standards is immense.

⁶⁵ IFC usually has the right to review a fund's E&S due diligence for the funds first three sub-project investments and all Category A sub-project investments.

⁶⁶ As reviewed from the PE Funds in the sample.

⁶⁷ CAO, Audit of a Sample of IFC Investments in Third Party Financial Intermediaries (2012 CAO FI Report). For further details, see <https://bit.ly/3B2XWCP>. 2025 data based on IFC response to CAO questions.

4.3 IFC Approach to Reviewing FI E&S Risk Management of Sub-Projects

Sections 4.1 and 4.2 covered IFC's own actions to assess and supervise FI clients, drawing on the 25-investment sample. These sections primarily considered IFC's project E&S risk categorization, IFC's mitigation plans, timing of IFC supervision, IFC disclosure, and IFC E&S staffing. The current section focuses on the FI level – specifically, IFC's review of FI clients' performance in applying IFC's E&S Requirements to the sub-projects and sub-clients they invest in. Fundamentally, this is where E&S risks and impacts to communities are primarily assessed and managed in IFC's FI portfolio. Relevant findings from CAO's 2012 FI Report for the forthcoming discussion include Finding 4.1 and 4.6 (see Annex A).

Requirements

IFC's approach to E&S risk management in its FI portfolio is reliant on the financial intermediary implementing an adequate ESMS (see Figure 6)⁶⁸ that assesses and manages the E&S risks and impacts of its sub-projects in accordance with IFC's E&S Requirements.

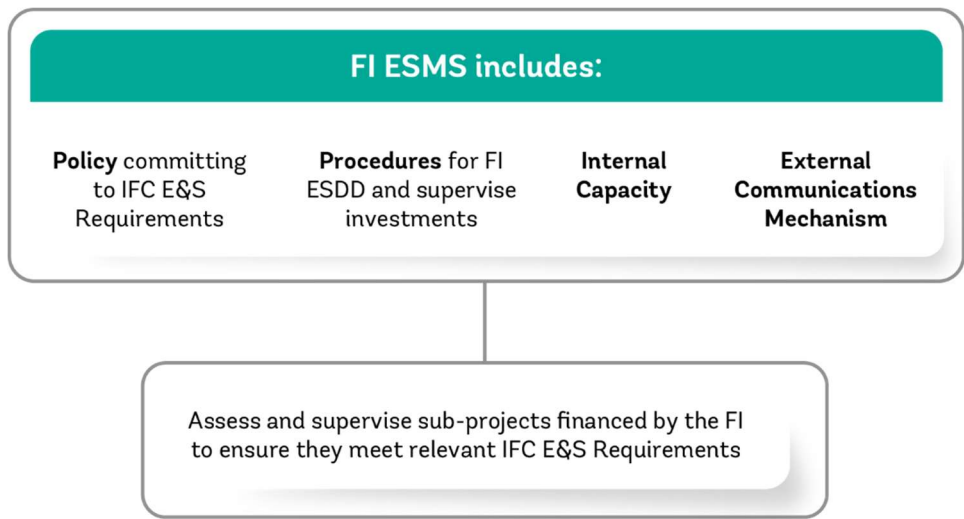
IFC is required to determine and monitor the effectiveness of this system during both pre-investment review and supervision.⁶⁹ This includes assessing: (i) whether the ESMS has adequate policy, procedures, capacity, and an external communication mechanism in place⁷⁰; and (ii) whether the FI is adequately implementing the ESMS to generate information about sub-project E&S risks and impacts, develop appropriate mitigation measures, and monitor results. IFC supervision seeks to ascertain that the FI clients maintain a robust ESMS for screening sub-projects and long-term corporate finance transactions against the Performance Standards and adequately identify higher risk transactions. As part of the supervision process, IFC assesses the quality of the FI's E&S due diligence process, E&S Action Plans for sub-projects, and internal capacity of the FI clients. In certain situations, IFC also conducts sample supervision at the sub-project level to confirm the implementation of sub-project level ESAPs and the FI client's ESMS. The monitoring is done with a risk-based approach and based on targeted samples as the size of a typical FI client's portfolio is too large to be monitored otherwise.

⁶⁸ IFC requires its FI clients to develop and operate an ESMS that is commensurate with the level of E&S risks in their portfolios to be financed by IFC. IFC specifically requires FI clients to put in place appropriate arrangements for higher risk activities financed by IFC to bring such activities into compliance with applicable E&S Requirements. At a minimum, IFC requires that a FI client's ESMS provide that ESAPs be developed for higher risk sub-projects based on the risks identified by the FI's E&S due diligence. This ESAP is expected to be included as part of the legal agreement between the FI client and its sub-borrower.

⁶⁹ IFC Sustainability Policy, 2012, para. 45.

⁷⁰ The ESMS should incorporate relevant principles of Performance Standard 1. For FI clients that IFC has categorized as FI-3, the FI will screen business activities they support against IFC Exclusion List and national law.

Figure 6: FI ESMS Components



CAO Monitoring Observations

As discussed in the previous section, CAO observed a material difference between IFC’s pre-investment review and supervision of private equity funds versus other types of FIs such as commercial banks, non-deposit institutions, and insurance companies. IFC private equity funds, in turn, demonstrated a more robust approach to E&S due diligence of their sub-projects (such as using external consultants and reporting to E&S investor sub-committees) and ongoing E&S supervision by external consultants and/or their own E&S staff. These FI clients also generally provided more comprehensive E&S reporting to IFC on sub-project performance.

The following observations therefore relate to the 15 IFC-financed financial intermediaries (not including private equity funds) in the sample that IFC required to apply the Performance Standards.

- **FI E&S capacity:** IFC’s pre-investment reviews place considerable emphasis on requiring an FI to have an ESMS officer, often with limited consideration of whether additional FI E&S staff are needed commensurate to E&S risk in the FI’s portfolio. IFC’s supervision documentation for these cases does not frequently provide analysis that the FIs retain an adequate level of E&S capacity (expertise and staff numbers/external consultants) to conduct sub-project reviews and supervision. Further, IFC does not typically fully consider the degree to which the FI ESMS officer has sufficient authority to influence investment decisions based on their E&S assessments. CAO notes that, in some markets, the availability of qualified E&S expertise may be limited and thus the cost to an FI of hiring/retaining such staff may be higher than initial expectations. However, IFC’s documentation for FI investments in these markets, does not consider the in-country availability of E&S expertise.
- **Inadequate FI and sub-client engagement:** CAO observed instances in IFC’s documentation where FI investment staff, rather than E&S staff, led discussions with the sub-client financial team on IFC Performance Standards requirements. As FI investment staff are likely not best positioned to assess and explain Performance Standard requirements for sub-projects, this can result in

poor understanding and implementation of IFC E&S Requirements to the sub-project, exposing IFC and its FI client to E&S risk.⁷¹

- **IFC E&S requirements in sub-borrower contracts are not consistently reflected:** Available evidence indicates that IFC's E&S Requirements are not appropriately and consistently translated into contracts between FI clients and sub-borrowers/sub-projects.⁷² IFC does not systematically review the quality/robustness of the E&S provisions of FI sub-project loan agreements.
- **Limited leverage:** In instances where an FI has limited leverage over a sub-project it is considering to finance,⁷³ there is limited evidence of an FI conducting an adequate screening of the sub-project against the Performance Standards. As a result, IFC is exposed to a sub-project which could operate outside the IFC Performance Standard requirements on which IFC and its FI client have very limited leverage.
- **Low quality of FI E&S due diligence:** CAO observed many instances of poor quality among the pre-investment E&S due diligence (ESDD) efforts conducted by FIs on sub-projects in the sample. There is a tendency for FI ESDDs to be a checklist rather than a detailed analysis of E&S risks and impacts, and related IFC Performance Standard requirements. CAO also observed few examples of adequate FI-prepared ESAPs for their sub-projects. This is a crucial point because if an FI client is not conducting adequate ESDD for sub-projects with medium to high E&S risks and including ESAPs as part of its sub-project investment, then IFC can have limited confidence that its E&S Requirements are being adequately applied to the sub-project level. This may ultimately undermine the achievement of IFC's Sustainability Policy commitments of doing no harm and positive development outcomes.
- **Shortcomings in FI supervision of higher risk sub-projects:** Of the sample reviewed, there is limited evidence that IFC-financed FIs are implementing adequate supervision of higher E&S risk sub-projects.⁷⁴ Of particular concern, CAO notes limited evidence of FI supervision of sub-client implementation of ESAPs, which contain binding provisions.

Regarding the seven sample cases where IFC is financing an FI that was not required to apply the Performance Standards, CAO notes the following:

- **FI supervision of lower risk sub-projects:** In cases where IFC has targeted its lending to an FI to support lower E&S risk sub-projects, there is no indication of regular FI E&S supervision of its own clients. This is in line with IFC's expectation of client E&S supervision commensurate to risk.

⁷¹ In some instances, FI clients requested guidance from IFC on the gaps between IFC Performance Standard requirements and relevant national law. Such guidance was not available.

⁷² For example, for higher risk sub-projects -the FI should include covenant requiring compliance with the IFC Performance Standards in the investment/loan agreement between the FI and the sub-project.

⁷³ As example, where an FI invests in publicly listed bonds or is a junior partner in a syndicated loan – the FI may be unable to conduct its own ESDD at the project level, is unable to include specific E&S policy provisions in the legal agreement. Where an FI has limited leverage over a proposed sub-project investment, IFC guides the FI to screen the sub-project against the PS requirements on the basis of information received from the sub-project, lead syndicated arranger and other publicly available information. Further details available at <https://officecao.org/4lci1J3>.

⁷⁴ Sub-projects that should apply the IFC Performance Standards.

4.4 IFC Ringfencing Approach

IFC has a longstanding history of providing targeted loans to FIs. The objective of these loans is to ensure the allocation of funds to specific purposes to maximize development impact, i.e., MSME financing.⁷⁵

Following CAO's 2017 FI Monitoring Report, as well as concerns raised by several civil society organizations regarding the E&S risks involved in FI operations,⁷⁶ IFC stated that it would target more FI loans to commercial banks to a specific end use such as MSME financing.⁷⁷ IFC noted that this approach, known as ringfencing, would reduce IFC's exposure to E&S risk in its FI portfolio.

Today, the vast majority of IFC's loans to financial intermediaries (primarily commercial banks) are targeted to support a specific asset class or sector.⁷⁸ Through this approach, IFC seeks to support sub-projects that have a measurable positive development impact.⁷⁹ However, as discussed below, ringfencing also reduces the scope of IFC's assessment and supervision of E&S risks in its FI investments. Relevant findings from CAO's 2012 FI Report for the forthcoming discussion include Finding 4.1 and 4.2 (see Annex A).

Requirements

Under the Sustainability Policy, in cases where IFC targets its investments to a specific end use, IFC's E&S Requirements cover the specific end use asset class only.⁸⁰ For example, an FI may have a lending portfolio composed of (a) corporate, (b) small or medium enterprise (SME), and (c) retail clients. If IFC's investment in this client is limited to financing women-owned MSMEs (a subset of (b)), the FI is only required to implement IFC's E&S Requirements for its lending to women-owned MSMEs.

IFC Actions Relevant to Ringfencing:

E&S risk categorization: IFC defines the E&S risk category (FI-1, FI-2, or FI-3) for FI investments where IFC funds are traceable and intended for a specific end use based on the E&S risks in the asset class being financed.⁸¹ For example, if an FI client has exposure to some high E&S risk sub-projects, but IFC targets its funds to support FI investments in women-owned MSMEs, then IFC may categorize the E&S risk as lower based on E&S risks in the women-owned MSMEs portfolio.⁸²

IFC pre-investment review: IFC assesses how the FI will apply IFC's E&S Requirements to the asset class that IFC's funds support.

⁷⁵ In 1976, IFC made its first credit line to an FI to support local SME's. Further details available at <https://officecao.org/4nlGabG>.

⁷⁶ See following links for examples of CSO concerns regarding IFC FI portfolio. Oxfam (2015) <https://officecao.org/4lqwhqY> and Inclusive Development International (2017) available at <https://officecao.org/3Ta3lO3> and Bretton Woods Project coverage (2017) available at <https://officecao.org/4lm9GC3>.

⁷⁷ 2017 IFC Statement. Available here: <https://officecao.org/3FbQfwe>.

⁷⁸ IFC noted that as of June 2020, all debt investments were ringfenced. September 2020, IFC's Approach to Greening Equity Investments in Financial Institutions. Available here: <https://bit.ly/3YglfR6>.

⁷⁹ As described by IFC, "working with local financial intermediaries allows IFC to support far more micro, small, and medium enterprises than we would on our own. We work with financial intermediaries to support: banking on women, capital markets, climate finance, digital finance, trade and supply chain finance, housing finance, MSME finance, credit infrastructure, and distressed asset resolution." IFC Financial Institutions. Available here: <https://officecao.org/43Hjxw9>.

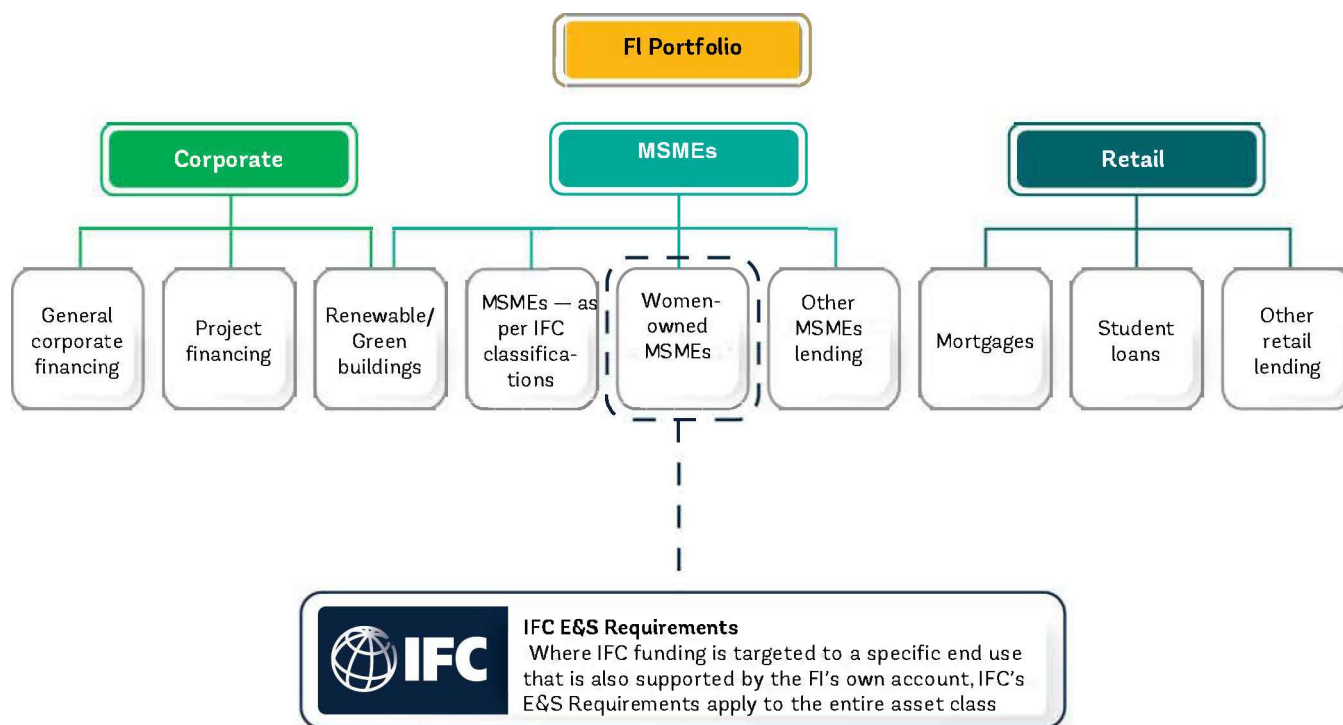
⁸⁰ IFC Sustainability Policy (2012), para. 36.

⁸¹ IFC Sustainability Policy (2012), para. 44.

⁸² Consequently, a general purpose IFC investment in FI with exposure to high E&S risk subprojects would likely be categorized as FI-1 (high risk). However, an IFC's investment in the same FI whereby IFC target its funds to an asset class with lower E&S risks, would likely be categorized as FI-2 (medium risk).

IFC's E&S supervision of the investment is focused on FI's E&S performance in assessing and managing E&S risks in the asset class that IFC funds support. IFC does not have a responsibility to supervise the FI's E&S performance for asset classes IFC does not support.

Figure 7: Illustrative Sample of Application of IFC E&S Requirements in Use of Proceeds investments



IFC Use of Proceeds Conditions and Supervision:

IFC ringfences its lending to commercial banks by including Use of Proceeds conditions in its legal agreement with the client. This requires the bank to use IFC funds for a specific asset class (see Box 2 for typical legal conditions) and requires IFC supervision on this Use of Proceeds.

IFC investment staff have primary responsibility for supervising Use of Proceeds. IFC noted to CAO that in supervising Use of Proceeds it takes the following approaches:

- When an FI client requests a financial disbursement, the FI commits to IFC that it will meet defined Use of Proceed within the set time period.
- Where IFC is processing a subsequent disbursement to the FI, IFC will get evidence that the previous disbursement has been utilized for the intended purpose.
- IFC investment staff will review periodic client reports on Use of Proceeds, and review the same during their site visits.
- Where an FI does not meet its Use of Proceeds commitments, IFC seeks to engage with the FI on why the targeted lending was not achieved and determine whether IFC could support lending to the specified asset class, for example by providing advisory support. In the case of senior (non-Tier II capital) loans, IFC also retains the option to request early repayment as appropriate.

Box 2: IFC Legal Conditions for Ringfencing⁸³

Typically, IFC includes these provisions in its legal agreement to ringfence an investment:

Purpose Statement: Affirms the purpose of IFC's loan to the FI (e.g., to support MSME financing).

Definition: Detailed definitions outline the eligibility criteria for the Use of Proceeds. IFC has published general definitions for micro, small and medium-sized enterprises (MSME), Women-Owned Enterprises, Housing Finance, and Climate-Related Financing.⁸⁴

Disbursement Period: In making a disbursement request to IFC, the FI states that it needs the proceeds at the time of the request or within a defined period (e.g., six months).

Covenant on Use of Proceeds: FI makes a legal commitment to use IFC funds for the intended purpose, as defined (e.g., to support the FI's financing of MSMEs).

Reporting to IFC: FI commits to report to IFC on an annual basis on the Use of Proceeds. A reporting form in the legal agreement requires the FI to report on aggregate portfolio exposure (e.g., Retail Loans, Mortgage Loans, Student Loans and Commercial loans at different loan amounts intervals – less than \$10,000, between \$10,000 and \$100,000, etc.). For loans targeted to climate finance sub-projects or green/social bonds, reporting to IFC includes individual sub-project details. IFC requires the FI to certify to IFC in its annual reports that it has met IFC's Use of Proceeds conditions.

Events of Default: Failure to use IFC's funds for the intended purpose is considered an event of default. IFC can take action to seek escalated repayment of the loan, where appropriate (and after other IFC actions have not resolved the issue). Note: For regulatory reasons, such loan acceleration covenants are usually not permitted in the case of Tier II capital loans (further discussion below).

⁸³ An example of some of these conditions is available here: <https://officecao.org/3H5JsVH>.

⁸⁴ For further details see, IFC Definitions of Targeted Sectors, available at <https://bit.ly/3F52PNO>.

CAO Monitoring Observations

- **Clear designation of Use of Proceeds:**

CAO reviewed eight loans to commercial banks to which IFC attached legal Use of Proceeds conditions. These require the banks to utilize IFC's funds for a specific asset class.⁸⁵ IFC's agreements included clear definitions on the Use of Proceeds and requirements to direct clients to utilize these proceeds for the purpose within a defined period of time.

- **Appropriate E&S risk categorization:** IFC categorized the E&S risk of its investments on the basis of the asset class it financed. In most instances in the sample, the IFC-financed asset class had a lower E&S risk profile than other aspects of the commercial bank's portfolio.

- **Lack of confirmation of timely Use of Proceeds:** In requesting IFC to disburse a loan, a commercial bank must represent⁸⁶

that it will use IFC's funds within a defined period of time⁸⁷ to finance on-lending to a specific asset class. When the defined time period has passed, IFC is required to seek assurance that its funds were used for the intended purposes. Documentation reviewed by CAO for the relevant sample investments did not demonstrate any specific IFC supervision activity to ensure the banks fully utilized IFC's funds for the specified asset class after the disbursement utilization timeframe lapsed. Rather, IFC noted to CAO that it verifies Use of Proceeds on the basis of subsequent disbursements to the client,⁸⁸ client submitted periodic reports, and during site visits.

- **Reporting requirements:** FI client reporting requirements on Use of Proceeds varied:

- For climate finance and thematic use of proceeds bonds such as Green Bonds, FI clients are required to report individual transaction data. Such information permits IFC to trace the use of IFC funds (Sustainability Policy para. 44).

E&S Risk Categorization Example:

Over several years, IFC made several investments in a commercial bank. The bank has a large corporate, SME and retail portfolio. In its corporate portfolio, the bank has exposure to sub-project with high E&S risks such as oil and gas, mining, energy generation and distribution, infrastructure, construction and agribusiness. Earlier IFC investments in the bank were general purpose. Accordingly, IFC categorized the E&S risk as FI-1 (high-risk). A more recent IFC investment was targeted to women-owned SMEs which IFC considered to have lower E&S risks. Accordingly, IFC categorized the E&S risk as FI-2 (medium-risk). This is in accordance with IFC's Sustainability Policy.

⁸⁵ The sample included 15 IFC FI investments that included use of proceeds conditions. CAO excluded 7 investments from this ringfence analysis as these loans were not to commercial banks.

⁸⁶ IFC does not require the FI to demonstrate to what degree it is achievable for the FI to use IFC's funds for the specific asset class within the defined timeframe.

⁸⁷ From the sample reviewed, CAO observed 3, 6, 12 months, and in one instance 4 years. In relation to the latter example (4 years), documentation reviewed demonstrated IFC-FI negotiation on the term which (i) provided the FI with realistic timeframe to grow a new asset class and (ii) ensured that the FI could not use the funds for other higher E&S risk activities in the interim.

⁸⁸ Of the sample loans reviewed, IFC either made one disbursement or subsequent disbursements were within the defined time period for the FI to utilize IFC's funds. Accordingly, in none of the sample loans reviewed did a subsequent disbursement create an IFC supervision activity to assure itself on the Use of Proceeds.

- Six of the eight relevant sample loans were targeted to MSMEs/Women-owned MSMEs.⁸⁹ For MSME finance, the IFC annual reporting requirement for Use of Proceeds requires a commercial bank to report aggregate data (e.g., number of MSME sub-clients and MSME total portfolio), and loans based on value. This approach comingles sub-projects considered corporate level and sub-projects that meet IFC's MSME definition. IFC does not request individual transaction level data or a sample of transaction level data for the purpose of verifying FI sub-projects meet defined IFC asset class criteria. CAO observes that this means that IFC's reporting requirements on Use of Proceeds for MSME investments do not provide it with a basis to adequately assess and trace the use of its funds.⁹⁰
- **Monitoring Use of Proceeds:**
 - For climate finance sub-projects, IFC requested and received individual transaction level data. This provides sufficient information for IFC to trace Use of Proceeds as required under the Sustainability Policy (para. 44).
 - In other cases, such as for MSME-targeted loans, IFC received aggregate data on Use of Proceeds. Based on the documents CAO reviewed for these investments, IFC did not document an adequate review of FI reporting on Use of Proceeds⁹¹ or verify the accuracy of FI reported data. This is significant as: i) FI reporting on Use of Proceeds for a specific asset class may be new for an FI client; ii) IFC's definition of a specific asset class may differ from national usage or the FI's definition⁹²; and iii) FI's may experience challenges in gathering accurate data to demonstrate each sub-project meets the defined asset class criteria.
- **Limited remedies for default:** In three of the eight relevant cases in the sample, IFC's agreement did not include conditions that would permit IFC to accelerate repayment of a loan in instances where the FI client did not meet the Use of Proceeds obligations.⁹³

IFC Ringfencing Approach for Subordinated Tier II Capital Loans

CAO's investment sample for this monitoring period included three subordinated Tier II loans with Use of Proceeds conditions.⁹⁴ The primary function of Tier II loans extended to FIs by IFC is to provide regulatory capital for loss-absorption on a gone-concern basis, as per Basel II and Basel III.⁹⁵ For many years, IFC has also included Use of Proceeds covenants in such loan agreements where possible, in order to target its financing towards a portfolio of eligible sub-borrowers and sub-projects and thus create a more focused basis for development impact attribution and measurement. The use of such ringfencing covenants in Tier II loans is done only where the national regulator clearly permits their inclusion or does not prohibit their use, and following IFC local counsel view on their use in the national jurisdiction.

⁸⁹ In some cases, IFC's loan also included other targets such as housing finance, etc.

⁹⁰ If an FI client used IFC's funds for purpose not within the ringfenced activity, or IFC is unable to determine with an adequate degree of confidence that its funds were used for the intended purpose, IFC is potentially exposed to the FI's entire portfolio – which may include sub-projects with higher E&S risks and impacts.

⁹¹ Based on documentation provided, CAO's review did not identify instances of an FI in the sample misallocating IFC's funds.

⁹² For example, IFC has a global definition for SME based on number of employees, total assets and annual sales. However, in Brazil, SME is defined solely based on annual sales/revenue, and in Colombia, SME is defined based on number of employees and a multiple of the minimum legal monthly wage. For more information see <https://officecao.org/43mKeoB> and <https://officecao.org/43qPqb0>.

⁹³ For two of the three investments that did not include Event of Default conditions, IFC's agreement did include conditions for IFC to raise the loan interest rate where the FI did not meet the Use of Proceeds conditions.

⁹⁴ CAO's sample also included one subordinated Tier II loan that did not include Use of Proceed conditions.

⁹⁵ These are the Basel Accords issued by the Basel Committee on Banking Supervision.

Through its Tier II loans with Use of Proceeds conditions, IFC is seeking to achieve two objectives: capital support to a commercial bank and targeted development impact via funding specific asset classes. As these types of loans have an additional objective (capital support) to other IFC Use of Proceeds loans, CAO analyzed them further in reviewing IFC documentation for this monitoring report. See Box 3 for further explanation of this product.

Box 3: Subordinated Tier II Capital Loans

These debt instruments are loans and bonds structured to be compliant with the Basel accords⁹⁶ and qualify as part of a commercial bank’s regulatory capital. Tier II capital loans have the following characteristics: (i) subordinated debt; (ii) longer-term financing⁹⁷; (iii) possess an essential characteristic of capital (i.e., can be used to absorb general portfolio-wide losses of a bank at a point of non-viability)⁹⁸; and (iv) as decided by the national regulator and/or provisions within the investment agreement, when a commercial bank is considered non-viable these subordinated Tier II loans can be converted into equity or written off.⁹⁹ Tier II capital instruments typically do not contain restrictive covenants or default clauses that would allow the holder to trigger acceleration of repayment in circumstances other than the insolvency, bankruptcy, or winding-up of the issuer.

- As per IFC’s Investment Disclosure website, IFC’s earliest Tier II loan was made to a commercial bank in 2006.¹⁰⁰ From then until 2017, these types of loan were structured to provide general purpose financing support with IFC requiring commercial bank recipients to apply IFC’s E&S Requirements across their entire portfolio.
- Since 2018, IFC has made 26 Tier II loans to commercial banks with Use of Proceeds conditions¹⁰¹. For such loans, IFC requires the commercial bank to apply IFC E&S Requirements only to the specific asset class being financed. Accordingly, IFC categorized the E&S risk of 25 of these 26 loans as FI-2 (medium risk). Where IFC did not include Use of Proceeds conditions, four of the six relevant loans were categorized as FI-1 (high-risk) since their broader application exposes IFC to higher E&S risks across the FI’s portfolio.
- Prior to IFC making such investments, IFC obtains external legal counsel confirmation that Tier II loans with Use of Proceeds conditions are permitted by the national regulator. If they are not, IFC

IFC Tier II loans with Use of Proceeds conditions		
	FI-1	FI-2
2018-2024	1	25

IFC Tier 2 Loans with no Use of Proceeds conditions		
	FI-1	FI-2
2018-2024	4	2

⁹⁶ The Basel Committee on Banking Supervision have published four accords on global banking regulation. These accords set minimum capital requirements for banks to meet, and defined the types of different capital that can be considered as part of a bank’s capital base. For more information, see <https://officecao.org/4kq17pm>.

⁹⁷ BIS – Minimum Capital Requirements, para 49 (xii) available at <https://officecao.org/3H2Ujzy>. At least five year maturity

⁹⁸ BIS – Minimum Capital Requirements, para 49 (vii) available at <https://officecao.org/3H2Ujzy>

⁹⁹ BIS – Definition of capital Basel III – Executive Summary. Available at <https://officecao.org/3Fac7ly>

¹⁰⁰ As per IFC Disclosure. For further details see <https://officecao.org/3ZvFxYm>. IFC did provide subordinated convertible loans (similar to Tier II loans) as early as 1996, with the FI required to apply IFC’s E&S requirements across its entire portfolio.

¹⁰¹ CAO analysis based on IFC Disclosure.

can still offer subordinated debt but the FI client must apply IFC's E&S Requirements across its entire portfolio.

CAO Monitoring Observations

- **Inherent tension of loan product simultaneously used to support capital base and a specific asset class:** When IFC provides a Tier II Use of Proceeds loan, IFC follows Sustainability Policy para. 36 in applying its E&S Requirements to the targeted asset class.¹⁰² However, the primary purpose of a sub-ordinated Tier II loans is to provide regulatory capital for loss-absorption on a gone-concern basis, as per Basel II and Basel III capital requirements. For IFC's investment to be considered Basel compliant, it needs to possess an essential characteristic of capital, i.e., used to support a bank's general portfolio-wide losses and possible conversion to equity in a situation of financial stress. This type of IFC loan provides financial support of a general purpose that supports the capital base of the FI client. Prior to 2018, IFC Tier II loans did not include Use of Proceeds conditions, and thus, FI clients in receipt of this financial product were required to apply IFC's E&S Requirements to their entire portfolio.¹⁰³ Due to the Basel rulebook on Tier II capital, other legal conditions were weaker in these IFC Tier II loans compared to non-Tier II capital ringfenced investments. Two of the three relevant loans in CAO's sample did not include Event of Default conditions on Use of Proceeds and, in all instances, the national regulator had oversight of such investments.¹⁰⁴ As a result, if one of these banks did not meet its Use of Proceeds conditions, IFC had limited formal leverage to enforce them. Accordingly, where IFC elects to provide a Tier II loan with Use of Proceeds conditions to target the development impact to defined asset classes, this additional feature (Use of Proceeds) confers upon IFC additional responsibility due to IFC's limited leverage in instances of FI non-compliance.¹⁰⁵
- **National regulator's acceptance of Tier II Use of Proceeds loans:** IFC Tier II loans are not permitted in some jurisdictions on the basis that subordinated loans must be entirely unrestricted in their use and provide "gone concern"¹⁰⁶ loss-absorbing capacity for the bank in the event of non-viability rather than being tied to specific asset classes. In such circumstances, IFC applies its E&S Requirements to the FI clients' entire portfolio.
- **National regulator's role on IFC E&S Requirements:** The decision on whether to include Use of Proceeds conditions in Tier II loans appears to be dependent upon whether the national regulator will permit the inclusion of such conditions. As a consequence, the decision of the national regulator has a material effect on the scope of IFC's E&S Requirements in its FI investment. National regulators are basing their assessment on whether the Use of Proceeds conditions could create uncertainty over Tier II eligibility under the Basel framework.

¹⁰² "In cases where IFC's investment is targeted to a specified end use (e.g., credit lines for microfinance), IFC's requirements regarding environmental and social risk management ... will cover the specified end use only. However, if the FI supports similar activities from its own account, then IFC's requirements will apply to the entire asset class. IFC will also encourage its clients to manage environmental and social risks throughout their entire portfolio." (IFC Sustainability Policy para. 36).

¹⁰³ In these instances, IFC applied para. 37 of the Sustainability Policy which states that "In cases where IFC provides equity or financial support of a general purpose, without a specified end use, IFC requirements regarding environmental and social risk management ... will apply to the entire portfolio of the FI that is originated from the time IFC became a shareholder or investor".

¹⁰⁴ For example, the national regulator could intervene over the treatment of subordinated Tier II capital debt in certain circumstances and/or its approval was needed for IFC to take action to accelerate loan repayment. Regulator's oversight and limited leverage in the case of non-compliance is a characteristic of sub-ordinated loans regardless of whether the Tier II loan is general purpose or targeted.

¹⁰⁵ If the FI client did not use the IFC funds for the targeted asset class, IFC would have limited formal leverage to ensure compliance.

¹⁰⁶ A gone concern is a business that is either already in such a liquidation state or is likely to enter in the near future.

- **Illustrative example (Table 1):** CAO has observed similar IFC Tier II loans to similar FIs with similar IFC development impact objectives. However, these loans have materially different FI E&S Requirements and IFC supervision responsibilities due to the fact that in different countries the national regulators took divergent views on whether Use of Proceeds conditions could be included in the Tier II loan.

Table 1: Illustrative example of E&S Requirements applied in Tier II Use of Proceeds and Tier II General Purpose loans

	FI client in Middle East, Central Asia, Türkiye, Afghanistan, and Pakistan region	FI client in Africa region
Total assets	Approx USD \$15-25 billion	Approx USD \$20-30 billion
IFC's investment	Excess USD \$75 million	Excess USD \$75 million
Nature of investment	Basel Tier II	Basel Tier II
IFC Development Impact Use of Proceeds/ Beneficiaries	Loans to SME Borrowers	Loans to MSME and Woman-Owned SMEs
Regulator permits targeted use of proceeds	Yes	No
Scope of IFC E&S Requirements applied	<p>In scope: Asset class (SME lending)</p> <p>Out of scope: Corporate lending with significant exposures to construction, textiles, food and beverage, metal products, autos, and chemical products</p>	<p>In scope: All SME and Corporate lending with significant exposures to petroleum, power, construction, real estate, tourism, and food and beverage.</p> <p>Out of scope: Nothing</p>

5 Conclusion

In 2011, CAO initiated its compliance review of IFC's growing portfolio of FI investments. It did so on the basis that these investments in banks and other financial intermediaries, and the sub-projects they support around the world, were not well known or understood by affected communities because disclosure requirements for the financial markets in which IFC operates lack transparency. At the time, CAO had received only one eligible complaint in relation to an IFC FI sub-project.

For this fourth monitoring report of IFC's actions in response to the 2012 CAO FI Report, CAO notes continued improvements in transparency, access to and knowledge of accountability mechanisms such as CAO, and IFC FI E&S resource allocations. In particular:

- IFC has improved its disclosure of FI sub-projects. IFC now discloses sub-projects financed by private equity fund clients and, while implementation to date has been poor, IFC has rolled out a process for sub-project disclosure of Category A sub-projects and select Category B sub-projects financed by commercial banks.
- Since 2012, CAO has received and determined eligible 31 complaints from affected people related to FI-financed sub-projects. This suggests that communities potentially impacted by IFC supported sub-projects may have improved knowledge of and access to CAO.
- IFC now allocates significant E&S staff resources to its FI portfolio. IFC employed 2.5 FTE E&S staff devoted to FIs when it began implementing the Sustainability Framework in 2006, which rose to 14 dedicated FTE E&S staff by 2011. As of 2025, this team has grown to 30 FTE E&S staff.
- CAO monitoring of this case has documented material improvements in IFC's pre-investment E&S review and supervision of FI investments.

CAO has therefore decided to close its monitoring of this case.

At the same time, this CAO monitoring report documents ongoing weaknesses and challenges in IFC's implementation of its Sustainability Policy commitments regarding financial intermediaries. These are areas where IFC's continual improvements could be focused going forward. Based on the review of 25 sample FI investments, CAO observed the following points:

- **IFC Pre-Investment Review:** IFC appropriately categorized the E&S risk of all FI investments in the sample and in most cases (23 of 25) required the FI client to apply the appropriate IFC E&S Requirements. However, an FI's application of IFC's E&S Requirements is a significant endeavor, particularly where the FI is required to apply the Performance Standards. IFC's approach in preparing the FI client for this task rarely addresses the fundamental changes necessary to adequately mitigate environmental and social risks and impacts at the sub-project level. An FI client's effective application of the Performance Standards can have implications for its business strategy, and requires significant enhancement to FI systems, processes, staff capacity, and management commitment (relevant to 2012 CAO Finding 4.6, 4.8 and 4.9 (see Annex A)).
- **IFC Supervision:** The quality and depth of IFC supervision of FI investments has continued to improve. IFC conducts site visits to its FI clients in accordance with its procedures, and positively,

in some instances, where IFC was able to negotiate sub-project access rights, also visits to FI sub-projects, enhancing its understanding of client E&S outcomes on the ground. However, in the majority of sample cases where the Performance Standards applied, IFC did not consistently document and retain sufficient information about actual E&S performance at sub-project level (with the exception of private equity funds). As a result, for FI investments with exposure to higher E&S risks in particular, CAO observes that IFC supervision often does not provide sufficient evidence that FI client implementation of E&S Management Systems achieves IFC's core objectives of doing no harm or improving E&S outcomes at the sub-project level (relevant to 2012 CAO Finding 4.1, 4.3, and 4.6 (see Annex A)).

IFC supervision of private equity funds is more robust than other IFC FI investments. IFC frequently conducts E&S reviews of client sub-projects before a fund finances them and fund reporting on E&S sub-project performance is more comprehensive. This same level of attention is not provided to other FI operations.

- **FI Level Implementation of IFC E&S Requirements:** Based on CAO's review of its sample investments, available evidence retained by IFC indicates that IFC-financed FIs are not consistently applying IFC's Performance Standards to sub-projects, where applicable. CAO observed poor FI prepared ESDDs, poor ESAPs, and limited ongoing FI supervision of sub-projects, resulting in an inadequate demonstration of Performance Standard implementation in sub-projects (relevant to 2012 CAO Finding 4.1 and 4.6, (see Annex A)). At the same time, CAO observed examples where IFC's investment, and excellent IFC staff engagement, resulted in significant improvements in FI E&S risk management and E&S capabilities.
- **IFC Ringfencing Approach:** Based on the investment sample, there is room for improvement in IFC's monitoring of the Use of Proceeds by relevant clients. In most cases, FI client reporting obligations for Use of Proceeds are insufficient for IFC to adequately monitor. Further, IFC's monitoring of Use of Proceeds in most cases does not adequately demonstrate that its funds were used for their intended purpose (relevant to 2012 CAO Finding 4.1 and 4.2 (see Annex A)). However, CAO did not observe any instances where an FI client explicitly used IFC funds for an activity outside the Use of Proceeds conditions.

At the same time, since 2018, there has been a growth in IFC including Use of Proceeds conditions in its Tier II loans. As a result, the FI is required to apply IFC's E&S Requirements to a specific asset class (e.g., SMEs), and IFC focuses supervision upon that asset class. However, there is an inherent tension in IFC's Tier II Use of Proceeds loans both seeking to support the entire capital base of an FI client while simultaneously narrowing the scope of E&S risk to be managed to a targeted asset class, which IFC has limited leverage to enforce. This could be a significant unmanaged risk for IFC.

CAO notes that (i) before 2018 IFC Tier II loans did not include Use of Proceeds conditions and (ii) some jurisdictions prohibit Use of Proceeds conditions in subordinated loans on the basis that

these financial instruments should be entirely unrestricted in their use and not tied to specific asset classes.

Furthermore, CAO notes that the widespread use of Use of Proceed conditions in IFC loans to commercial banks (Tier II and non-Tier II loans), while reducing IFC's exposure to E&S risks in the FIs it finances, can have the unintended consequences. These include: (i) client commercial banks with weak ESMSs devoting scarce E&S resources to manage risk in lower risk IFC funded asset classes compared to higher E&S risk sub-projects that the FI finances; and (ii) IFC not using its investment role and leverage to achieve a broader positive development outcome through E&S risk management across the FI's entire portfolio.

In its 2017 response to CAO's monitoring report, IFC noted that CAO's report lacked specific proposals to enable a constructive conversation about possible actions IFC could take to address key concerns. Annex B includes suggestions following this fourth monitoring report.

Annex A: Key Findings from CAO Audit of a Sample of IFC Investments in Third-Party Financial Intermediaries (2012 CAO FI Report)

CAO Finding No.	Findings of CAO's Audit of a Sample of IFC Investments in Third-Party Financial Intermediaries
4.1	IFC's E&S processes and results do not fully correspond to IFC's overall corporate message. The IFC approach, which is based on achieving change through the application of a management system, does not generate information about actual E&S results at the sub-client level.
4.2	There is a lack of clarity about when IFC's two different concepts of E&S risk [do no harm and credit risk] apply, thus creating the possibility that IFC's systems do not effectively minimize environmental or social harm that may result from the action of clients or sub-clients.
4.3	There is a lack of clarity about IFC's actual E&S objectives. In addition, there is not a systematic approach to assessing whether the two broader objectives [do no harm and have a positive impact] are being achieved. The current approach is focused on confirming that clients have implemented an ESMS.
4.4	Differing E&S requirements among various development finance institutions places a burden on IFC's clients and fails to take advantage of potential opportunities to increase the efficiency and leverage of the DFIs, individually and collectively.
4.5	There are potential opportunities for IFC to encourage the adoption of a widely shared vision of industry standards for acceptable E&S practices, behavior, and results. Requiring clients to report and disclose E&S performance and to engage third-party assurers to provide an independent check would further contribute to the propagation of global norms, while improving disclosure.
4.6	IFC's focus on establishing an ESMS as a legally required product—instead of as part of a more fundamental change management process—creates the risk of a reporting and compliance orientation on the part of the client. This focus, in turn, means that the ESMS can become an end in itself, rather than a means of enhancing E&S performance outcomes on the ground.
4.7	IFC's E&S requirements have not been adequately adapted for FI clients and are thus not optimally designed to assist FM clients in improving the E&S performance of their sub-clients.

4.8	IFC does not have a structured approach to assess and address two key elements of a successful E&S program: client commitment and client capacity to implement an effective E&S management system.
4.9	IFC's current approach to the application of E&S issues to financial markets transactions does not adequately reflect the significant differences in client capacity and the business, institutional, and cultural setting in which they operate.
4.10	The deployment of high quality E&S staff to work on FM investments in recent years has had a material impact on the quality of support provided to clients. However, this has yet to address the underlying limitations of the ESMS-based approach to E&S management.
4.11	IFC's allocation of E&S resources is not cost based. IFC does not have an adequate system in place to determine whether E&S resources are being used efficiently, or whether certain functions should be outsourced.

Annex B: CAO Proposals

In its 2017 response to CAO's monitoring report, IFC noted that CAO's report lacked specific proposals to enable a constructive conversation about possible actions IFC could take to address key concerns. CAO makes the following suggestions following this fourth monitoring report.¹⁰⁷

1. For FI's with high E&S risks in their portfolio, consider **change management measures** when seeking the FI to establish and/or enhance their ESMS. This would include FI management having a comprehensive understanding that the adoption of IFC's E&S Requirements may have material implications to some aspects of their business strategy. For further details, see Annex C.
2. For FIs that propose to finance Category A sub-projects, IFC should ensure that the **FI has in place robust measures prior to IFC's first disbursement**. This would include the FI having sufficient seniority of E&S staff and retaining of E&S consultants with expertise on the Category A sectors the FI is targeting. IFC should also consider a formal IFC E&S staff review of proposed Category A investments prior to FI – sub-project commitment (similar to IFC private equity funds).
3. IFC could **enhance its KPIs to assess and monitor the effectiveness of FI client ESMS**. Examples include: (a) costed ESMS implementation; (b) seniority of FI E&S staff; (c) number of FI E&S staff vis-à-vis number of Cat A and Cat B sub-projects; (d) % of new high risk projects entering into the portfolio that have undergone a risk adequate ESDD; (e) % of high risk subprojects adequately presented at the FI clients decision making level, as evidenced through board papers / credit committee meetings; (f) 100% of projects categorized adequately; (g) % of high risk subprojects that have a legally binding and acceptable ESAP in place for projects that so far do not comply with E&S requirements, which is also monitored by the FI client
4. IFC could create a **dedicated program** with sufficient budget **to support FI technical assistance programs**.
5. In some FI investments, IFC FI E&S staff are required to review Category A sub-project prior to the FI investments. There are opportunities for **IFC E&S sectoral experts** (e.g., power, roads, agribusiness) dedicated to direct investments to provide support to IFC FI E&S staff on **review of Category A sub-projects** (IFC E&S staff renting to IFC FI activities).
6. **For Use of Proceeds investments, IFC could enhance its reporting form and its monitoring procedures**, in order for IFC to meet its Sustainability Policy commitments to ensure IFC's funds are traceable and used for the intended specified end use. For IFC funds targeted to asset classes with a large number of sub-projects (e.g., MSMEs), IFC should request a sample of sub-projects delineated by the eligibility criteria for that asset class. IFC should consider actions it could take to give it confidence that an FI can utilize IFC's funds within the prescribed timeframe, and IFC should take prompt supervisory action to verify utilization of Use of Proceeds once the timeframe has lapsed.

¹⁰⁷ CAO's monitoring process does not explicitly provide for CAO to make recommendations during this phase. However, in light of CAO's decision to close this case and IFC's prior request for actionable conclusions, CAO has included Annex B.

Annex C: ESMS Implementation as a Change Management Approach

Vision	Consensus	Skills	Incentives	Resources	Action Plan	Result
✓	+	✓	+	✓	+	✓ = Success
✗	+	✓	+	✓	+	✓ = Confusion
✓	+	✗	+	✓	+	✓ = Sabotage
✓	+	✓	+	✗	+	✓ = Anxiety
✓	+	✓	+	✓	+	✗ = Resistance
✓	+	✓	+	✓	+	✗ = Frustration
✓	+	✓	+	✓	+	✗ = False Starts

Lippit-Knoster Model for Managing Complex Change

In some instances, an FI's application of an ESMS to apply IFC's E&S Requirements may present significant FI strategy opportunities and impacts to its investment and lending operations. A change management approach to ESMS implementation would consider the above components in the graph¹⁰⁸ and each resulting failure where those components are not addressed.

For an FI, these components are:

Vision: A clear and compelling vision typically formulated in the E&S policy provides direction and purpose, helping relevant banking functions understand the goals and importance of the change.

Consensus: Widespread agreement and support from all relevant banking functions (risk, credit, legal, HR, E&S) are crucial for minimizing resistance and fostering cooperation.

Skills: All staff members involved in the E&S risk management process need to have the necessary skills and competencies to execute the change plan and their respective activities as defined in the E&S procedures effectively.

Incentives: Incentives are the rewards or motivations provided to encourage individuals and teams to support and participate in the change effort. These can be recognition through better projects, management highlight of staff performance, financial benefits (bonuses).

Resources: Allocate adequate resources, including time, budget, technology, and tools, to support and sustain the change process.

Action Plan: A well-defined action plan outlines the steps, timelines, and responsibilities, providing a clear roadmap for the changes and the new E&S risk management process. This may be very different than the one agreed with IFC.

¹⁰⁸ Lippit-Knoster Model for Managing Complex Change