



COMPLIANCE MONITORING REPORT

India Infrastructure Fund (IFC Project # 26237)
India

**Monitoring of IFC's Response to:
CAO Investigation of IFC's Investment India Infrastructure Fund, India**

March 29, 2019
Office of the Compliance Advisor Ombudsman (CAO)

About CAO

CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

CAO (Office of the Compliance Advisor Ombudsman) is an independent post that reports directly to the President of the World Bank Group. CAO reviews complaints from communities affected by projects undertaken by the two private sector arms of the World Bank Group, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

For more information about CAO, please visit www.cao-ombudsman.org

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Introduction

CAO's compliance function oversees investigations of IFC/MIGA's environmental and social (E&S) performance with a view to ensuring compliance with relevant requirements and improving the E&S performance of the institutions.

Following a CAO compliance investigation, CAO monitors actions taken by IFC/MIGA until such actions assure CAO that its compliance findings are being addressed.

CAO's monitoring considers actions taken or proposed by IFC/MIGA that respond to CAO findings at the project level. This analysis is designed to ensure that project level concerns identified by CAO are addressed.

This is CAO's first monitoring report following CAO's investigation of IFC's investments in India Infrastructure Fund (IIF, "the Fund").¹ CAO's compliance investigation report was finalized in October 2015 and was released along with IFC's Official Response in January 2016. This report documents IFC's response to the compliance investigation from the period December 2015 – October 2018. In preparing this monitoring report, the CAO team (including an external expert): (a) reviewed IFC's project documentation; (b) reviewed documentation provided to CAO by the Fund; and (c) held meetings with IFC staff, the complainants and the Fund. A visit to the project site was not possible as CAO did not receive required mission clearance from the Government of India.

This report provides: i) a case background; ii) a summary of IFC's response to CAO investigation report, Fund and project actions and IFC's supervision; iii) CAO's compliance monitoring analysis; and iv) Conclusion.

Background

IFC's investment

In 2008, IFC committed to a US\$50m equity investment in India Infrastructure Fund ("the Fund"), a private equity fund established and managed by the Infrastructure Development Finance Company (IDFC) of India. The Fund was established to make investments in large infrastructure projects of a nature and scale that IFC recognized as having potential significant E&S impacts on local communities. Unless the Fund is listed, the Fund has a 12 year life term, extendable by a further 3 years by agreement.² As part of IFC's investment, the Fund agreed to i) upgrade its Environmental and Social Management System (ESMS) to implement IFC's Performance Standards in its portfolio companies;³ ii) provide IFC with a E&S summary of all category A investments for IFC to review and provide recommendations before the Fund proceeded with an investment; and, iii) provide IFC with an annual monitoring report detailing ESMS operation and E&S performance of portfolio companies.⁴

GMR Kamalanga

GMR Kamalanga Energy Limited (GKEL) is a special purpose company set up by GMR Energy Limited ("GMR Energy"). Its purpose is to develop and operate a large coal fired power plant near Kamalanga village, Dhenkanal district, Odisha State, India ("the Kamalanga project", "the project"). The Kamalanga project achieved financial closure in May 2009, raising a total of US\$953m (debt and equity).⁵ Phase one of the Kamalanga project, comprising three 350MW generation units, is

¹ The CAO investigation, IFC's Official Response to the investigation, and related materials are available on the CAO website. See <https://goo.gl/yXYAvW>.

² Livemint, April 27, 2009. *India Infrastructure Fund invests \$50m in two toll road projects*. Available at <https://goo.gl/6Vv3BR>.

³ The Fund describes projects the Fund invests in as "portfolio companies".

⁴ The term portfolio company is used for companies in which the Fund holds an investment.

⁵ Bombay Stock Exchange filing, May 27, 2009. See <http://goo.gl/48P2T3>.

operational.⁶ A planned second phase, an additional 350MW unit (Phase II), has not proceeded at the time of writing.

IFC is exposed to the Kamalanga project through the Fund's 15 percent equity stake in GKEL.⁷ Between January 2009 and June 2014, IFC made 10 disbursements to the Fund to finance the Fund's investment in the project.

The complaint

In 2011, CAO received a complaint in relation to the environmental and social (E&S) impacts of the Kamalanga project. The complaint came from project-affected communities with the support of two NGOs; Odisha Chas Parivesh Surekhsa Parishad (Odisha Agriculture and Environment Protection Council) and the Delhi Forum ("the complainants"). The complainants raise concerns about the project's impacts, which they state pose a threat to their health, livelihoods and human rights.

More specifically, the complainants raised the following issues regarding the application of IFC's Performance Standards to the project:

- Performance Standard 1 (Social and Environmental Assessment and Management Systems) — The complaint claims that community consultation (including with indigenous peoples) has not been adequate, and that the cumulative impact of the project together with other industries in the area has not been considered. The complaint also raises concerns regarding the project's use of a deep bore well to extract groundwater and the impact this has on the availability of ground water in surrounding villages.
- Performance Standard 3 (Pollution Prevention and Abatement) — The complaint raises concerns that the project will exacerbate existing pollution (particularly of the Bhramani River), stating that there is no information available on proposed pollution mitigation. The complaint also raises concerns regarding health-related impacts of air pollution from the project.
- Performance Standard 4 (Community Health, Safety and Security) — The complaint raises concerns about structural damage to buildings which they claim has been caused by dynamiting. The complaint also raises concerns regarding alleged intimidation by the project's security guards and arrests of community members who have opposed the project.
- Performance Standard 5 (Land Acquisition and Involuntary Resettlement) — The complaint raises concerns about the failure to provide adequate compensation for land, crops, trees, and water resources acquired, and failure to address loss of livelihoods due to the subproject.
- Performance Standard 7 (Indigenous Peoples) — The complaint alleges that land acquired for the project belongs to scheduled tribe members and was acquired without required consultation.

CAO's Investigation Report

In October 2015, CAO finalized its investigation report. CAO acknowledged that IFC's approach to support financial intermediaries to develop their own ESMSs has the potential to increase the reach and impact of IFC's E&S standards, and thus IFC's development impact.

At the same time, CAO made a series of non-compliance findings regarding IFC's investment in the Fund. These findings relate to: (a) IFC's pre-investment due diligence in the Fund; (b) the structure for management of E&S risks in the Fund; (c) IFC's supervision of the Fund and the Kamalanga project; and (d) IFC's disclosure obligations. These are summarized below.

a) IFC's pre-investment due diligence in the Fund:

- IFC appropriately categorized the investment as FI and noted that the Fund was planning to make high-risk investments. However, IFC's pre-investment due diligence did not adequately assess the client's ESMS track record or capacity to implement an ESMS to apply IFC's E&S requirements to high risk investments. Accordingly, CAO

⁶ The Hindu, March 25, 2014. *Third unit of GMR's Kamalanga thermal power plant operational*. See <https://goo.gl/u19EBF>.

⁷ VC Circle, October 8, 2009. See <http://goo.gl/sk7kdC>.

found that IFC lacked a basis to conclude that its investments through the Fund could meet the requirements of the IFC Performance Standards.

b) Structure for management of E&S risks in the Fund:

- The agreements that governed IFC's investment in the Fund provided IFC with inadequate leverage should E&S issues arise post disbursement. In particular, IFC risked considerable financial penalties if IFC refused to participate in any of the Fund's investments. If concerns arose regarding a portfolio company's E&S performance, IFC had limited leverage to influence implementation of corrective measures.
- In this context, CAO found that the agreements that governed IFC's investment in the Fund did not support IFC's stated objective of ensuring that the "projects it finances are operated in accordance with the requirements of the Performance Standards" (Sustainability Policy, para. 5).

c) IFC's supervision of the Fund and the Kamalanga project:

- CAO found IFC's supervision of the Fund to be inadequate. CAO made this finding on the basis that: (a) IFC disbursed to the Fund without assuring itself that Fund had a Performance Standard compliant ESMS; (b) IFC's initial supervision of the Fund's ESMS did not provide sufficient evidence that its ESMS was PS compliant; (c) when IFC did identify that the Fund's E&S performance was unsatisfactory, IFC was not in a position to resolve identified gaps.
- CAO found that IFC review of the Kamalanga project was insufficient to establish a reasonable expectation that the project would meet Performance Standard requirements. Once notified of concerns regarding the project, CAO found that IFC management did not adequately respond to serious, longstanding and well documented concerns regarding the E&S impacts of the project on local communities. Rather IFC continued to make disbursements to the Fund to support the project's development.

d) IFC disclosure obligations:

- IFC complied with its own disclosure obligations.
- CAO found that IFC did not adequately supervise the Fund's compliance with PS1 requirements to disclose E&S assessment documentation and ESAPs, either in relation to the operations of the Fund or those of the project.
- Further, CAO found that IFC did not assure itself that the Fund had established a grievance mechanism about which potentially affected communities were informed as required by Performance Standard 1.

IFC response, Fund and project actions and IFC supervision

IFC response

In its Official Response, IFC agreed with CAO's general conclusions regarding IFC's performance vis-à-vis the Fund and its experience supervising the investment in GKEL. IFC noted that since the investment in the Fund was approved, IFC has intensified its general approach to due diligence of a fund manager's track record, commitment and in-house E&S expertise. IFC also noted several measures it has implemented to strengthen private equity investment agreements and its approach to private equity supervision and disclosure of information.⁸

IFC's response includes actions committed to by the Fund in relation to enhancing its approach to E&S risk management generally (IFC-IIF ESAP). Specifically, the Fund committed to: (a) ensure all Category A portfolio companies conduct a third party audit to assess compliance with the

⁸ IFC Official Response to CAO Investigation Report: India Infrastructure Fund. October 2015. Compliance Monitoring Report – IFC Investment in IIF, India (March 2019)

Performance Standards by September 2016; (b) agree corrective action plans with portfolio companies to address any identified gaps from third party audits by December 2016; (c) implement and disclose any corrective action plan in accordance with Performance Standard requirements; and, (d) complete a third party action plan completion audit.⁹

IFC asserted that it remains committed to working with the Fund and GKEL to improve project performance and address outstanding issues. IFC affirmed that it has “taken a constructive and multi-pronged approach towards resolving the situation by engaging extensively with all parties at the highest levels in the respective organizations.”¹⁰ IFC noted that it engaged with GKEL and IIF to agree a GKEL-specific action plan. A draft action plan between the Fund and GKEL is included in IFC’s response (IIF-GKEL ESAP). Specifically, the action plan provides for GKEL to: (a) complete implementation of a July 2014 ERM action plan; (b) finalize a Livelihood Restoration Plan and Stakeholder Engagement Plan by March 2016; (c) complete implementation of the Stakeholder Engagement Plan by June 2016 and the Livelihood Restoration Plan by December 2018; (d) implement third party recommendations for the grievance redress mechanism in consultation with affected communities; (e) commission an independent audit to confirm completion of prescribed actions; and (f) disclose audits, assessments, action plans and periodic updates to affected communities in accordance with Performance Standard requirements.¹¹

IFC supervision of the Fund: general E&S performance

Since the release of CAO’s investigation report, IFC has received the Fund prepared Annual Environmental Performance Reports (AEPR) for fiscal year 2016 and 2017.¹² In March 2018, IFC documented: (a) a review of the Fund’s 2016 and 2017 AEPRs; (b) several meetings between IFC and the Fund; and, (c) IFC site visit to GKEL in May 2017 and two portfolio companies in December 2017.

For the reporting period, IFC noted that the Fund had not amended its ESMS procedures and had hired a social specialist. Regarding the IFC-IIF ESAP, IFC recorded that the Fund had commissioned independent E&S audits of all category A portfolio companies except one.¹³ In its review of the independent E&S audits, IFC found the audits (a) to be limited in scope; (b) did not comment on the adequacy of documents prepared as part of the original ESAP for each category A portfolio company; and, (c) did not confirm if the portfolio company was in compliance with IFC’s Performance Standards. IFC provided comments to the Fund and asked for the Fund to update its independent E&S audit reports. Following the independent E&S audits, IFC recorded that the Fund agreed ESAPs with each portfolio company to remedy gaps. IFC noted these ESAPs should be disclosed and consulted with affected communities in accordance with the Fund’s Performance Standards.¹⁴ IFC noted that the Fund would schedule receipt of ESAP completion reports from each portfolio company and, thereafter, a third-party action plan completion audit.

In December 2017, IFC completed a site visit to two portfolio companies. IFC noted that one portfolio company was operating to a satisfactory performance on E&S aspects, however, IFC did identify several improvement opportunities. IFC documented E&S concerns regarding the second portfolio company. Specifically, IFC was concerned the portfolio company’s infrastructure was not satisfactory and presented a major safety hazard. Further, IFC documented concerns that once operations of the portfolio company commenced, there could be pollution impacts to local communities.

Taken together, based on gaps in implementing the Performance Standards in some portfolio companies, IFC has rated the Fund’s performance as Unsatisfactory - indicating IFC’s view that the

⁹ IFC Official Response to CAO Investigation Report: India Infrastructure Fund. October 2015, Annex A.

¹⁰ IFC Official Response to CAO Investigation Report: India Infrastructure Fund. October 2015.

¹¹ IFC Official Response to CAO Investigation Report: India Infrastructure Fund. October 2015, Annex A.

¹² The Fund’s fiscal year is from April to March. Accordingly, fiscal year 2016 is from April 1 2015 to March 31, 2016.

¹³ The Fund did not complete an independent E&S audit for one portfolio company as that company was in a state of financial distress. This does not relate to GKEL.

¹⁴ As per IFC’s agreement with the Fund, the Fund’s Performance Standards are IFC’s Performance Standards.

Fund is materially non-compliant with IFC's E&S requirements. For future supervision, IFC noted that it would closely review implementation and disclosure of independent E&S audits for category A projects.

IFC monitoring of the Fund: Kamalanga project

GKEL Reporting

Following the release of CAO's investigation report, GKEL published on its website the executive summary of a project E&S Assessment prepared by ERM in July 2014.¹⁵ This assessment documents ERM review of the project in reference to IFC's Performance Standards and identifies performance gaps. The assessment included a 48 E&S action items and 32 OHS action items for GKEL to implement (ERM Action Plan). As related to issues raised in the complaint, this action plan proposed the development of a Livelihood Restoration Plan (LRP), a Grievance Redress Mechanism (GRM), a Stakeholder Engagement and Informational Disclosure Plan (SEP), and improvements in the project pollution controls. This action plan formed part of the IFC published IIF-GKEL ESAP.

In March 2016, ERM prepared for GKEL a project Livelihood Restoration Plan (LRP), a Grievance Redress Mechanism (GRM), a Stakeholder Engagement and Informational Disclosure Plan (SEP) and a Community Health Baseline (CHB). In October 2016, GKEL published a revised GRM and SEP.¹⁶

These documents outlined the following:

- **Livelihood Restoration Plan:** This plan summarized the results of a 2015 socio-economic study of project affected families (PAFs). To identify PAFs entitled to support, the plan categorized families on the basis of those who: (a) had previously received livelihood support; (b) had annual household incomes in excess of Rs60,000 (USD 840); and (c) lived within two kilometers of the project. The plan proposed three livelihood restoration options: i) farm and livestock support for income enhancement; ii) skill training and placement facilitation and iii) micro-enterprise support for income enhancement. Households with incomes in excess of Rs60,000 were classified as "privileged" and ineligible for three proposed livelihood restoration options. A process for disclosure and consultation with PAFs was outlined.
- **Grievance Redress Mechanism:** The document described how grievances are handled and proposed: (a) series of improvements; (b) a disclosure plan; and, (c) a monitoring and reporting framework.
- **Stakeholder Engagement and Informational Disclosure Plan:** This plan outlined each project stakeholder, how GKEL would communicate with each stakeholder and the frequency of communication.
- **Community Health Baseline:** This report summarized the lifestyle and health status of people in project area, outlined GKEL's community health interventions to date, and recommended improvements in GKEL's approach.

In April and October 2016, ERM completed monitoring reports of GKEL's implementation of the ERM Action Plan.¹⁷ The October 2016 report noted that all action items were completed. Further, ERM noted that GKEL had implemented additional air pollution controls and processes to manage wastewater disposal. Specifically, ERM recorded that GKEL had: (a) connected the coal plant's ash handling facility to the reclamation point to ensure that water was recycled into the plant rather than discharged outside the plant's boundary; (b) implemented additional water sampling monitoring

¹⁵ ERM, July 2014, *Executive Summary for the Environmental and Social Assessment of 140MW coal based thermal power plant at Kamalanga, Odisha, India*. Available at <https://goo.gl/Gbs9dK>.

¹⁶ These reports are available at <https://goo.gl/dgd4Bi>.

¹⁷ ERM, April and October 2016, *Environmental Occupational Health Safety and Social Action Plan Final Monitoring Report: Executive Summary*, available at <https://goo.gl/dgd4Bi>.

points to verify compliance with national requirements; and (c) implemented additional controls to manage fly ash and coal dust leakage.¹⁸

Between 2016 and 2017, GKEL published four quarterly reports on LRP implementation.¹⁹ These reports recorded GKEL's counseling of PAF to select livelihood options and number of PAFs who received benefits.

IFC Supervision

In July 2016, IFC staff meet with IIF, GKEL and ERM to discuss the LRP, GRM and SEP. Prior to the meeting IFC provided the Fund with its comments on these documents. IFC noted that the LRP categorized some PAFs as privileged and, thus, excluded these families from livelihood restoration options. IFC's key concern was that the LRP eligibility criteria did not meet PS5 requirements. IFC noted that all PAFs must be consistently offered and covered by the mitigation measures in the LRP. IFC also noted that the GRM needed to: (a) include a clear escalation structure; (b) ensure that affected communities were represented on the Grievance Redress Committee (GRC); and, (c) clarify the GRC's role. IFC advised that the SEP include ongoing E&S performance reporting to key stakeholders. Regarding the application of PS7, IFC observed that ERM's July 2014 report concluded that PS7 was not applicable on the basis that the project avoided land acquisition from Scheduled Tribes. IFC noted, however, that several project assessments list Schedule Tribe households as PAFs. Accordingly, IFC advised the Fund that the LRP needed to include a section on PS7 applicability, and specific measures (if required) to comply with PS7 requirements.

IFC met the Fund in September 2016 to discuss implementation of the IIF-GKEL action plan. IFC was informed that the LRP would be revised to incorporate IFC's July 2016 comments, and implementation would commence in the first quarter 2017. IFC was also informed that GKEL had commenced consultation with PAFs on their livelihood restoration preferences. IFC expressed concern regarding the delay in implementation. IFC advised that a detailed timeline for LRP implementation be developed with clear targets and monitored closely.

In November 2016 and January 2017, the Fund updated IFC on its GKEL investment. Specifically, the Fund reported that: (a) ERM certified GKEL's implementation of the ERM Action Plan; (b) the LRP was updated to include IFC's July 2016 comments and an addendum including a PS7 update would be published locally by March 2017; (c) the number of PAFs was amended to 2083 after subtracting non-land losers; (d) a consultant to monitor LRP implementation had been identified; and (e) the GRM and SEP were finalized and disseminated to all relevant stakeholders.

In May 2017, IFC joined the Fund on a site supervision visit to GKEL. During the visit IFC and the Fund reviewed GKEL implementation of the ERM Action Plan and visited nearby villages to meet PAFs in their homes. The Fund noted to IFC that it was satisfied with the visit to the villages and discussions with the PAFs.

In March 2018, IFC outlined its view of project in its supervision report. IFC summarized the project's GRM, LRP and SEP. IFC noted that GKEL had made progress in implementing the LRP and hired a third party to monitor implementation. In addition to the LRP, IFC noted that GKEL had provided: (a) medical insurance to all PAFs; (b) piped water to five villages; and (c) provided a mobile health van once a week to every village. IFC observed that the GRM and SEP could be improved by holding formal community level meetings in affected villages, opening complaint boxes once a week and providing an acknowledgment receipt to complainants after registering a grievance. IFC noted that a cumulative impact assessment study was conducted however it did not factor in other industries in the area or GKEL's proposed fourth 350MW power unit (Phase II). IFC requested that GKEL update its cumulative impact assessment.

¹⁸ ERM, April and October 2016, *Environmental Occupational Health Safety and Social Action Plan Final Monitoring Report: Executive Summary*, available at <https://goo.gl/wgXSe3>.

¹⁹ GKEL, Quarterly Report of Activities Accomplished Under Livelihood Restoration Plan available at <https://goo.gl/dgd4Bi>.
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From meeting with PAFs during its May 2017 site visit, IFC noted in its supervision report that all meetings with PAFs confirmed that they: (a) have been counseled and surveyed for the LRP, (b) receive regular support from GKEL during LRP implementation, and (c) are benefiting from the livelihood support received from GKEL. IFC staff also met with a complainant to CAO. IFC noted that the complainant acknowledged that the LRP implementation had commenced but asserted that the budget per family was inadequate and it may not result in significant income improvement for PAFs. IFC recorded that the complainant confirmed that PAFs do raise grievances with GKEL, and these grievances are addressed.

CAO compliance monitoring analysis

This section presents CAO's analysis of IFC's response to its non-compliance findings and adequacy of IFC's actions to date. The following sub-sections are organized in reference to CAO's compliance findings: IFC Pre-Investment Due Diligence; Structure of E&S Risk Management; Supervision; and, Disclosure.

IFC Pre-Investment Due Diligence

Summary of CAO Investigation Findings

IFC correctly identified that its client's planned investments in large scale infrastructure projects involved significant E&S risks.

IFC's pre-investment review of its client's capacity to manage the E&S risks associated with the Fund was not commensurate with the level of these risks.

As a result, IFC lacked a basis to conclude that its investment in the Fund could meet the requirements of the Performance Standards over a reasonable period of time.

IFC Response and Analysis: In response, IFC agreed with CAO that establishing client commitment and capacity to implement an ESMS is central to meeting IFC's Performance Standards. IFC noted that it has improved its approach to FI due diligence since 2008. Specifically, IFC affirmed that it now thoroughly reviews a fund manager's track record, commitment, and in-house E&S capacity.

As CAO's findings relate to IFC's due diligence in 2007, and IFC's approach has changed since then, a project level response to these findings is not expected. In CAO's audit and monitoring reports of IFC's FI portfolio,²⁰ CAO has acknowledged that IFC has improved its approach to FI due diligence. Specifically, in its March 2017 FI monitoring report, CAO observed that IFC (a) improved its guidance to E&S staff; (b) piloted tools for in-depth E&S due diligence; and (c) is considering sub-project risk at due diligence. Notwithstanding this, CAO noted that the quality of IFC's FI due diligence is highly variable and, in the majority of cases reviewed, IFC's FI due diligence was not commensurate to risk. CAO also raised concerns with IFC's review of FIs capacity to implement IFC E&S requirements.

Conclusion: A project level response regarding these findings is not expected. More broadly, IFC's FI pre-investment due diligence approach will continue to be considered as part of CAO's ongoing engagement with IFC regarding FI investments.

²⁰ IFC Compliance Audit and Monitoring reports of IFC's Financial Sector Investments are available at <https://goo.gl/tLzUWH>.

Summary of CAO Investigation Findings

The agreements that governed IFC's investment in the Fund provided IFC with limited leverage to ensure compliance with its E&S requirements

Key E&S requirements as agreed by IFC management were not incorporated into the agreements that governed IFC's investment in the Fund.

E&S requirements, as outlined in guidance available to IFC staff at the time, were not included in the agreements that governed IFC's investment in the Fund.

The agreements that governed IFC's investment in the Fund did not support IFC's objective of ensuring that the projects it finances are operated in accordance with the Performance Standards.

IFC Response and Analysis: In agreeing its investment agreements, IFC affirmed that its investment team followed an approach that provided meaningful protections, in a complex legal environment and at a time when E&S requirements were not well advanced in the market. IFC noted that since committing to this investment, and based on learning from other private equity investments, IFC has strengthened its investment agreements. Specifically, IFC noted that it now routinely requests the right to: (a) visit the premise of a fund's portfolio companies and have access to their books and records to monitor E&S compliance; (b) request the fund to implement corrective measures with non-performing sub-projects or exercise efforts to terminate financing; and (c) disclose information necessary to comply with its E&S obligations in accordance with the IFC Access to Information Policy.

In April 2018, it was announced that IDFC had agreed to sell its equity stake in IIF and its complete ownership of the IDFC Alternatives²¹ to Global Infrastructure Partners.²² As per IFC's legal agreement, consent from 75 percent of IIF's Limited Partners was required for the sale to proceed. In a memo to IFC management, the IFC team recommended that IFC provide consent to the sale on the condition that the new Investment Manager agree to assume all E&S obligations of the then existing Investment Manager. In addition, IFC sought additional conditions to be included in its investment agreements. Specifically, IFC requested that the new Investment Manager: (a) provide IFC access to the Fund's portfolio investment sites and E&S information as requested; (b) formally agree to implement the IFC-IIF ESAP and monitor implementation of the IIF-GKEL ESAP; (c) provide IFC with an annual third-party audit of compliance with IFC's Performance Standards on terms of reference and by agencies acceptable to IFC; and (d) provide IFC with quarterly process reports on implementation of the IFC-IIF ESAP and the IIF-GKEL ESAP. IFC recognized, however, that as it did not hold sufficient equity to reject the sale, IFC's ability to require inclusion of these additional conditions was limited.

In June 2018, IFC provided its consent to the sale. IFC noted that the revised investment agreements incorporated commitments from the new Investment Manager to implement (a) and (b), but it did not include specific commitments to implement (c) and (d). IFC noted, however, that the formal commitment to implement the IFC-IIF ESAP included a requirement for a one-time third-party audit of all portfolio investments. IFC noted that its agreed to the sale as it risked losing the additional rights it negotiated if it did not consent.

Conclusion: CAO's compliance investigation found that the agreements that governed IFC's investment did not provide IFC with sufficient leverage to ensure E&S compliance. Since the release of the investigation report, CAO acknowledges steps IFC has taken to negotiate additional E&S conditions which materially improve its ability to supervise the investment. At the same time, other

²¹ IDFC Alternatives is the Investment Manager for IIF. An Investment Manager's role is to actively manage the day to day operations of the fund.

²² VC Circle, April 30, 2018. *IDFC Alternatives inks pact to sell infrastructure funds to GIP*. Available at <https://goo.gl/n1FwNQ>.

gaps noted in CAO's investigation report remain unresolved. Specifically, CAO is concerned that in instances where a portfolio company is non-compliant with IFC's E&S requirements and is not taking steps to bring itself back into compliance, IFC is not in a position to require the Fund to either divest from the portfolio company or remove IFC's exposure to the portfolio company without a negative financial impact to IFC.

Supervision

Summary of CAO Investigation Findings

IFC's supervision was not sufficient to ensure that the high risk projects it was financing through the Fund were designed and operated in a manner consistent with the Performance Standards – a key objective of IFC's Sustainability Policy.

IFC made its first disbursement to the Fund without ensuring that E&S conditions of disbursement were met.

IFC's review of the Fund's E&S due diligence for the Kamalanga project did not provide a basis to conclude that the project could meet the requirements of the Performance Standards over a reasonable period of time.

IFC E&S staff correctly allocated an ESRR of 4 (unsatisfactory) to the Fund from October 2010, and the responsible IFC investment staff was informed of gaps in the client's E&S performance in line with the requirements of the ESRP.

IFC management did not adequately respond to serious, longstanding and well documented concerns regarding the E&S impacts of the Kamalanga project.

IFC made two new investments in IDFC subsidiaries over the period when the Fund was considered to be materially non-compliant with IFC's E&S requirements. This was inconsistent with the requirement under the Sustainability Policy that IFC consider remedies in response to ongoing non-compliance.

The Kamalanga project has completed construction and is fully operational while IFC maintains the view that key concerns regarding the impacts of the project as raised by the complainants have not been addressed in accordance with the Performance Standards.

IFC Response and Analysis: In response to the investigation report, IFC noted that it was working with IIF and GKEL to improve project performance and address outstanding issues. Included in its response was an action plan to enhance IIF's ESMS (IFC-IIF ESAP) and an action plan to address identified project compliance gaps (IIF-GKEL ESAP).

CAO's investigation report found that IFC supervision was not sufficient to ensure that the high-risk projects that it financed through the Fund were designed and operated in a manner consistent with the Performance Standards. This finding was made on the basis that IFC's: (a) AEPR format provided to the Fund did not provide sufficient detail to assess compliance; and (b) inability to assure itself of implemented of IFC's E&S requirements at the project level for all portfolio companies, either through third party audit or direct supervision visits. As acknowledged above, IFC has since improved its access rights to portfolio companies and required a third-party audit of Category A portfolio companies.

Since the release of IFC's response, IFC has supervised implementation of the IFC-IIF ESAP. IFC has reviewed third-party audits for all Category A portfolio companies with the exception one portfolio company in financial distress. Positively, IFC followed up its review with visits to three portfolio companies (GKEL included) and provided substantial feedback to the Fund. Based on gaps in implementing the Performance Standards in some portfolio companies, IFC has rated the Fund's performance as Unsatisfactory.

In regard to the Kamalanga project, IFC has reviewed and identified gaps in the GRM, LRP and SEP documentation. Specifically, IFC raised concern: (a) that the LRP categorized some PAFs as privileged and excluded them from livelihood restoration options; (b) with the design of the GRM; (c) that the SEP did not provide for ongoing E&S performance reporting to key stakeholders; and (d) that previous assessments identified some Scheduled Tribes as PAFs but the LRP did not consider the application of PS7 to these affected people.

Following a site visit in May 2017, IFC made further recommendations to the Fund to improve the project's E&S performance. Specifically, IFC recommended that: (a) the cumulative impact assessment consider the project's proposed expansion and other industries in the area; and, (b) GRM and SEP implementation be improved via formal meetings in affected communities, regular opening of complaint boxes and acknowledgement of registered complaints.

While CAO acknowledges IFC's supervision and advice to the Fund to improve project E&S performance, a number of shortcomings, as identified in CAO's investigation report, have yet to be fully addressed.²³ Items requiring further review to provide assurance of compliance include:

- i. The adequacy of the project's social impact assessment and livelihood restoration activities, considering for example the impact of inflation, and delays in implementation of livelihood restoration activities for households that lost land;
- ii. The adequacy of consultation with complainants in relation to the development of livelihood restoration options;
- iii. The methodology applied in determining that Scheduled Tribes living in the project's area of impact should not be considered indigenous peoples under for the purposes of PS7;
- iv. An assessment of project health impacts on communities and associated mitigation measures;
- v. An assessment of project compliance with IFC air quality requirements, including provisions under the 1998 IFC Thermal Power Guidelines that include offsets for new power stations in degraded airsheds.

Conclusion: Since the release of the investigation report, IFC has negotiated additional access provisions, reviewed third party audits required as part of the IFC-IIF ESAP and visited three portfolio companies. Taken together, this level of supervision provides IFC with a basis to supervise the fund's compliance with its E&S requirements. At the same time, CAO is concerned that IFC has not amended its AEPR reporting format, thus ensuring IFC receives sufficient information about portfolio company E&S performance on an ongoing basis.

CAO acknowledges that IFC has actively supervised the Kamalanga project, identified gaps in the GRM, LRP and SEP, and advised its client to takes steps to remedy identified gaps. At the same time, further supervision is required to provide assurance of compliance with IFC's Performance Standards.

²³ See Annex A for CAO Observations of IFC's Supervision of the Kamalanga project. Compliance Monitoring Report – IFC Investment in IIF, India (March 2019)

Summary of Findings

IFC complied with the requirements of its then applicable Disclosure Policy.

IFC did not adequately supervise the Fund's compliance with the disclosure requirements under the Performance Standards, either in relation to its own operations or those of the Kamalanga project.

IFC Response and Analysis: In response to CAO finding on IFC's supervision of IIF's PS1 disclosure obligations, IFC noted that responsibility to disclose E&S project information lies with the project, and not the Fund. The IFC-IIF Action Plan includes commitments for the disclosure to affected communities, at the local level and in the local language of third-party audits conducted for Category A projects. In addition to this disclosure, the IIF-GKEL Action Plan includes commitments for the disclosure of assessments, action plans and periodic updates on the status of action plan implementation. Further, ongoing disclosure and consultation with affected communities would be undertaken as per the SEP.

Following the release of CAO's report, GKEL published the following reports, in English language only, on its website: (a) ERM E&S Assessment, July 2014 – executive summary; (b) GRM, LRP and SEP, March 2016 - executive summaries; (c) revised GRM and SEP, October 2016 – executive summaries (d) details on how to file a complaint; (e) ERM E&S audits, April and October 2016, - executive summaries; (f) quarterly LRP implementation reports (June 2016-March 2017); (g) semiannual GKEL prepared Environmental Clearance reports to national authorities; and (h) ash utilization reports. In July 2016, ERM prepared a disclosure verification report for GKEL. ERM affirmed that executive summaries of the GRM, LRP, and SEP had been translated into Odia and provided to the head of the village council. While the report includes photographs of notice board disclose, it is unclear whether the notice of disclosure is in the local language, accessible to affected communities, and disclosed for a reasonable timeframe. Relevantly, after disclosure of these documents, IFC supervision documentation noted that no queries had been received from the community.

Conclusion: At the Fund level, CAO found that IFC had not assured itself that the Fund establish a grievance mechanism about which potentially affected communities were informed as required by PS1. Neither IFC's response nor actions since have responded to this finding.

At the project level, CAO found that IFC had not adequately supervised the Fund's implementation of disclosure requirements at the project level. Since the release of the investigation report, GKEL has published multiple reports, in English, on its website. ERM has confirmed that the GRM, LRP and SEP have been translated into the local language and provided to the head of the village council. Available project documentation does not indicate that earlier assessments (e.g. July 2014 ERM report) and the IIF-GKEL Action Plan have been published in the local language. As ERM's disclosure verification report does not clearly evidence whether project information was disclosed in an accessible manner to affected communities and IFC's observed the lack of community queries on published reports, CAO is concerned that project level disclosure to date is not accessible to affected communities. Further, it is unclear whether updated versions of the GRM, LRP and SEP and periodic reports on implementation of these plans and the IIF-GKEL action plan have been disclosed at the project level in a manner accessible to affected communities.

Conclusion

The Fund was established in 2008 with a 12-year life cycle to make investments in large infrastructure projects of a nature and scale that IFC recognized as having potential significant E&S impacts on local communities. As noted in CAO's investigation report, since 2012, IFC has consistently rated the Fund's E&S performance as unsatisfactory – indicating IFC's view that the Fund is materially non-compliant with IFC's E&S requirements.

In response to CAO's investigation report and supervision thereafter, IFC has actively monitored the Fund's implementation of the IFC-IIF ESAP. Positively, IFC has negotiated additional supervision access rights and has conducted site supervision visits to three portfolio companies to verify PS implementation. Notwithstanding IFC's active supervision of the Fund and noting IFC's view that the Fund's E&S performance is rated as unsatisfactory since 2012 – CAO is concerned that IFC's investments have potentially had adverse E&S project impacts which have yet to be resolved.

IFC made its first investment in the Fund for the purpose of supporting the Kamalanga project in January 2009 and the CAO complaint was submitted in April 2011. As a Category A investment, the Kamalanga project is acknowledged as having significant potential environmental and social risks and impacts. In response to CAO's investigation, IFC published a draft IIF-GKEL ESAP to assess and resolve project level compliance gaps. While this action plan has led to the development of additional assessments and plans to resolve project impacts, further supervision by IFC is necessary to assure itself of project level compliance in relation to issues identified in CAO's investigation report. Specifically, these include the adequacy of: (a) livelihood restoration measures for households impacted by land acquisition; (b) consultation around the livelihood restoration plan; (c) disclosure of project E&S documentation in local languages; (d) the methodology used to determine PS7 applicability; (e) community health impact assessment and risk mitigation framework; and (f) monitoring of project compliance with IFC air quality requirements.

CAO will keep the case open. CAO's Operational Guidelines require CAO staff to verify outcomes in the field. Accordingly, in order to verify outcomes in the field and to confirm satisfactory implementation of IFC's response, CAO intends to visit the Fund and the project site in advance of issuing a follow up monitoring report – contingent upon Government of India approval to conduct the visit.

Annex A: CAO Observations of IFC's Supervision of the Kamalanga project

IFC Requirement	IFC Response and Supervision	CAO Observation
<p>PS1 - Consultation and Disclosure ...the client will disclose the [Social and Environmental] Assessment ... the client will provide [affected] communities with access to information... disclosure should occur early in the Social and Environmental Assessment process and in any event before project construction commences... (PS1 para 20) ...the consultation process shall ensure free, prior, informed consultation and facilitate their [affected communities] informed participation. (PS1 para 22)</p>	<p><u>IIF-GKEL Action Plan</u></p> <ul style="list-style-type: none"> • Disclose to affected communities the audits, assessments, action plans and periodic updates on the status of implementation of action plans • Disclose findings and action plan of July 2014 ERM audit • Disclose documents in local language and make available at third-party location • Third party to verify disclosure and consultation • Ongoing disclosure and consultation with affected communities to be undertaken as per SEP. <p><u>GKEL Reporting</u> GKEL published on its website English language version of a) ERM E&S Assessment, July 2014 – executive summary; (b) GRM, LRP and SEP, March 2016 - executive summaries; (c) revised GRM and SEP, October 2016 – executive summaries (d) details on how to file a complaint; (e) ERM E&S audits, April and October 2016, - executive summaries; (f) quarterly LRP implementation reports (June 2016-March 2017); (g) semiannual GKEL prepared Environmental Clearance reports to national authorities; and (h) ash utilization reports. ERM prepared for GKEL a local disclosure verification report - July 2016.</p> <p><u>IFC Supervision</u> IFC observed that the company has not received any queries from community members on the published reports. IFC observed that the GRM and SEP could be improved by holding formal community level meetings in affected villages, opening complaint boxes once a week and providing an acknowledgment receipt to complainants after registering a grievance.</p>	<p>Further IFC supervision is required to provide assurance of PS1 compliance.</p> <p>Specifically:</p> <p>Available project documentation does not indicate that July 2014 ERM report, the IIF-GKEL Action Plan and periodic updates have been published in the local language and made accessible to affected communities.</p> <p>ERM prepared disclosure verification report does not clearly evidence whether project information was disclosed in an accessible manner to affected communities.</p>

PS1 – Verification of E&S Monitoring

For projects with significant impacts that are diverse, irreversible, or unprecedented, the client will retain qualified and experienced external experts to verify its monitoring information. The extent of monitoring should be commensurate with the project's risks, impacts and compliance requirements. (para 24)

IIF-GKEL Action Plan

- Complete implementation of ERM Action Plan by October 2016. ERM verify implementation
- Independent audit confirm completion of GRM, LRP and SEP.

In April and October 2016, GKEL published an ERM audit of its implementation of the ERM Action Plan.

Independent audit to confirm completion of GRM, LRP and SEP is pending.

PS3 – Pollution control – Technical Consideration

The client will refer to the current version of the EHS Guidelines when evaluating and selecting pollution prevention and control techniques for the project. These Guidelines contain the performance levels and measures that are normally acceptable and applicable to projects. When host country regulations differ from the levels and measures presented in the EHS Guidelines, clients will achieve whichever is more stringent (PS3: para. 8).

IFC Response

IFC affirmed that the 1998 EHS Guidelines were relied upon only for stack emission limits. For ambient air quality purposes, the more current EHS Guidelines of 2007 were relied upon, and the measures proposed by GKEL to minimize impacts on ambient air quality are in line with those provisions.

GKEL Reporting

GKEL published regular ash utilization reports and half yearly national compliance reports. In November 2018, GKEL asserted that it was in compliance with its national environmental clearance conditions.²⁴

GKEL also prepared a community health baseline (CBH) survey which summarized the lifestyle and health status of people in project area, outlined GKEL's community health interventions to date, and recommended improvements in GKEL's approach.

IFC Supervision

IFC advised the Fund that the Kamalanga project needed to prepare a cumulative impact assessment which factor in other industries in the area and GKEL's proposed fourth 350MW power unit.

Further IFC supervision is required to provide assurance of PS3 compliance.

Specifically:

The CBH did not outline potential project health impacts upon communities in the project area of influence nor mitigation measures the project would implement to eliminate any identified impacts. Rather, where community members were exposed to non-communicable diseases (e.g. cardiovascular, cancers, chronic respiratory diseases and diabetes) it was recommended that these can be prevented by life-style management such as healthy balanced diet and yoga or exercises.

Since the release of the investigation report, IFC's supervision has not commented on the environmental performance of the Kamalanga project nor its assessment of project related community health impacts.

²⁴ GKEL, November 2018, Half Yearly EC Compliance Status Report for EC-1 (3x250MW), available at <https://goo.gl/dgd4Bi>.

PS5 - Land Acquisition and Involuntary Resettlement

- Economic Displacement; In the case of economic displacement under Government-Managed Resettlement "the client will prepare a plan (or a framework) that together with the documents prepared by the responsible government agency, will address the relevant requirements of this Performance Standards.... The client may need to include in its plan (i) a description of the entitlements of displaced persons provided under applicable laws and regulations; (ii) the measures proposed to bridge any gaps between such entitlements and the requirements of this Performance Standard; and (iii) the financial and implementation responsibilities of the government agency and/or the client. (para 23)

IIF-GKEL Action Plan

- Complete development of Livelihood Restoration Plan (LRP) by March 2016
- Complete implementation of LRP by December 2018 subject to possible revision

GKEL Reporting

In March 2016, GKEL published an executive summary of its LRP. This document summarized the results of a 2015 socio-economic study of project affected families (PAFs). PAFs were categorized on the basis of those who: (a) had previously received livelihood support; (b) had annual household incomes in excess of Rs60,000 (USD 840); and (c) lived within two kilometers of the project. PAFs who met condition (b) were considered privileged and not eligible for livelihood restoration options.

The plan proposed three livelihood restoration options: i) farm and livestock support for income enhancement; ii) skill training and placement facilitation and iii) micro-enterprise support for income enhancement.

Subsequently, GKEL published four quarterly LRP implementation reports (2016-2017).

IFC Supervision

IFC reviewed the LRP (version March 2016) and advised the Fund that categorizing PAFs as privileged did not meet PS5 requirements. The LRP was updated in May 2017 (not published online). The updated version provided for livelihood restoration options for all PAFs.

After completing a site supervision visit where IFC meet some PAFs, IFC noted all meetings with PAFs confirmed that they: (a) have been counseled and surveyed for the LRP; (b) receive regular support from GKEL during LRP implementation; and (c) are benefiting from the livelihood support received from GKEL.

Further IFC supervision is required to provide assurance of PS5 compliance.

Specifically:

The project's social impact assessment (SIA) was conducted in 2007. When the ERM Audit was conducted in July 2014, additional project land was acquired in the interim. Evidence of a supplementary SIA for this additional land was not available.

It is unclear whether the project has adequately accounted for and maintains up to date records of total PAFs and PAF sub-categories. Further, it is unclear whether the project has maintained sufficient information regarding each PAF in order to assess their status before and after project implementation.

PS1 requires that mitigation measures needed to be implemented to comply with PS reflect the outcome of consultation with PAFs. The LRP does not evidence an adequate disclosure and consultation process with PAFs in order to develop livelihood restoration options. Consultation that occurred with PAFs during the LRPs implementation was limited to selection of pre-defined restitution options and not whether these options were acceptable to PAFs or if alternative options could be proposed.

There is limited analysis of whether the LRP options provided to PAFs will restore their earning potential to pre-land acquisition levels (e.g. 2007) as adjusted for inflation and their socio-economic status. The LRP does not consider loss of income from when community members lost access to their land and received LRP options.

PS7 - Indigenous People

The client will establish an ongoing relationship with the affected communities of Indigenous Peoples from as early as possible in the project planning and throughout the life of the project. In projects with adverse impacts on affected communities of Indigenous Peoples, the consultation process will ensure their free, prior, and informed consultation and facilitate their informed participation on matters that affect them directly, such as proposed mitigation measures, the sharing of development benefits and opportunities, and implementation issues. (para 9)

IFC Response

IFC's response did not comment on this issue.

IFC Supervision

IFC observed that ERM's July 2014 report concluded that PS7 was not applicable on the basis that the project avoided land acquisition from Scheduled Tribes. IFC noted, however, that several project assessments list Schedule Tribe households as PAFs. Accordingly, IFC advised the Fund that the LRP needed to include a section on PS7 applicability, and specific measures (if required) to comply with PS7 requirements.

The revised LRP (May 2017) reviews the PS7 applicability and concludes that socio-cultural characteristics of PAFs, who are part of a Schedule Tribe, do not fulfill PS7 criteria for identification of Indigenous People.

Further IFC supervision is required to provide assurance of PS7 compliance.

Specifically:

The LRP (May 2017) PS7 applicability assessment was made based on a rapid ethnography of the community via a transect walk within the community and interviews with village elders. Considering identified PAFs are designated as a Schedule Tribe, the LRP assessment methodology does not evidence a depth of review to support an assertion that the affected people are not Indigenous Peoples as per PS7.