



---

## **COMPLIANCE MONITORING REPORT**

*IFC Investment in Quellaveco, Peru*

*Project #3823*

*Complaint 01*

---

### **Monitoring of IFC's Response to: CAO Investigation of IFC's Investment in Minera Quellaveco S.A., Peru**

**March 21, 2017**

*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 development 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](http://www.cao-ombudsman.org)

# Table of Contents

- Introduction ..... 4
- Background..... 4
- IFC’s Response to the Investigation..... 5
- Observations from CAO Monitoring (Sep. 2015 – Feb. 2017) ..... 5
  - Project level actions..... 5
  - Actions at the level of IFC policies, procedures, practice or knowledge ..... 5
- Conclusion ..... 8
- Annex 1 – Summary of Key Investigation Findings ..... 9

## 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 IFC/MIGA's response to a compliance investigation at two levels:

- Firstly, CAO considers actions taken or proposed by IFC/MIGA that respond to CAO findings at the project level.
- Secondly, CAO considers actions taken or proposed by IFC/MIGA that respond to CAO findings at the level of IFC/MIGA policies, procedures, practice or knowledge.

The first level of analysis is designed to ensure that project level concerns identified by CAO are addressed. The second level is designed to document progress in the IFC/MIGA's approach to the identification and management of E&S risk.

This is CAO's second monitoring report documenting CAO's assessment of IFC's response to its investigation of IFC's investment in Minera Quellaveco S.A. ("the compliance investigation").<sup>1</sup> A first monitoring report was published in October 2015, and covered IFC's response in the period August 2014 – August 2015.<sup>2</sup>

This report documents IFC's response to the compliance investigation in the period September 2015 – February 2017.

## Background

The compliance investigation relates to IFC's investment in Minera Quellaveco S.A. ("the client"), a mining concession located in Peru in the Region of Moquegua. In April 1993, the IFC Board approved a US\$ 6 million investment to acquire a 20 percent equity investment in the client. Between 1996 and 2011, IFC participated in a number of rights issues providing US\$ 54 million in additional capital to the company to continue its development activities. In February 2012, IFC sold all of its shares in the Company.

The compliance process was triggered by a complaint received in November 2011 from *Asociación Civil Labor*, a local environmental NGO in Peru, raising concerns about the Quellaveco project's actual and anticipated impacts on local people and the environment. The issues raised in the complaint can be summarized as concerns regarding water resources, pollution, land claims, and the adequacy of community engagement in relation to the preparation of an Environmental Impact Assessment (EIA).

The compliance investigation was released in August 2014. A summary of findings as presented in the August 2014 report is set out in Annex 1.

---

<sup>1</sup> The CAO investigation, IFC's response to the investigation and related materials are available on the CAO website. See <http://goo.gl/QCyeiB>.

<sup>2</sup> CAO Monitoring Report of IFC's Response to CAO's Investigation of IFC's Investment in Minera Quellaveco S.A., Peru, October 2015. See <https://goo.gl/UfDJow>.

## IFC's Response to the Investigation

A management response from IFC was released together with the investigation report in August 2014.<sup>3</sup>

At project level, IFC's response notes that IFC has divested from Quellaveco after 19 years in which IFC supported the project's exploration activities, feasibility studies, and environmental and social management initiatives. IFC underscores that during its involvement in the project, IFC's E&S activities focused on: (a) the actual on the ground impacts of exploration and feasibility work; and (b) the potential impacts of the project if it were to, one day, be built. According to IFC, Quellaveco was compliant in its day-to-day activities.

IFC notes that it had no active investment in the project, and considers that the project ownership has transitioned to two reputable sponsors, providing confidence to IFC that the project would be carried out with sound E&S management.

IFC's response notes that CAO's comments relating to broader IFC investment practices would be taken on board by IFC management as the institution continues to enhance its investment practices. IFC's response acknowledges CAO's findings regarding broader operational policies relating to, among others, early equity investments, E&S categorization, rights issuances, and divestment policies. Through its response, IFC committed to continuing the dialogue with CAO in this regard.

## Observations from CAO Monitoring (Sep. 2015 – Feb. 2017)

### Project level actions

Similarly to CAO's October 2015 monitoring, IFC has not reported any action that addresses CAO's project level findings during the period covered by this monitoring report.

In 2015, IFC reported to CAO that the main explanation for this decision not to take up the findings with its client is that it disagrees with CAO's project level findings, and that IFC has concluded its engagement with the project in 2012. IFC reported that, in this case, it did not believe trying to re-engage with the project owners on these issues would be productive.

### Actions at the level of IFC policies, procedures, practice or knowledge

IFC reported to CAO steps that are being taken to address the investigation findings at the level of policy, procedures, practice or knowledge.

These include findings in relation to:

- IFC's approach to the **categorization** of early equity mining projects.
- IFC's procedures for providing **additional financing**.
- IFC's decision making process around **divestment** and E&S considerations.

In July 2016, IFC reported to CAO that it had incorporated a new procedure within its Environmental and Social Review Procedures (ESRP), setting out processes for E&S appraisal

---

<sup>3</sup> IFC's Response to CAO Compliance Investigation Report in respect of IFC's investment in Minera Quellaveco, Peru. See <http://goo.gl/TetWDL>.

and supervision of IFC investments in phased development investment projects ('ESRP 13'). CAO acknowledges the development of this procedure, which was finalized and published on IFC's website in October 2016.<sup>4</sup> CAO's monitoring observations with regard to ESRP 13 are developed below in relation to the Quellaveco investigation findings.

### ***IFC's approach to the categorization of early equity mining investments***

#### **CAO Investigation Finding**

IFC assigns a project a categorization of A, B or C depending on its potential E&S risk. The CAO investigation found IFC's Quellaveco investment would properly have been categorized A at the outset, given: (a) the magnitude of the potential impacts of the proposed mine; (b) IFC's view that it had a high likelihood of moving forward to development; and (c) the potential E&S risks and impacts of the Project in the pre-development phase, in particular potential impacts on Indigenous People.

#### **IFC's Actions in Response to the Finding**

In 2015, IFC reported to CAO that it had ongoing internal conversations around categorization and re-categorization of projects.

The issue of categorization is addressed in IFC's ESRP 13, as disclosed in October 2016. ESRP 13 notes that at pre-investment stage, IFC staff should be mindful of potential prospective impacts should the project be developed, and that categorization should consider the potential speed of likely development (para. 2.1). ESRP 13 also references IFC's Policy on Environmental and Social Sustainability (2012) which provides that where "IFC invests in a pre-development phase of a business activity, IFC will determine the category based on risks inherent to the particular sector and the context of the business activity's setting" (para. 43).

At the same time, however, ESRP 13 states that inherent uncertainties over whether any later-stage development will result, the form it will take, and the nature of any related impacts, mean that potential impacts of project development should not be reviewed or discussed in detail. ESRP 13 also states that risks and impacts of early stage investments are typically limited and readily mitigated or reversible and that these are therefore category B investments (para. 2.1). Finally, ESRP 13 provides that Project recategorization may be considered if E&S risks and impacts change in a material manner as the project evolves (para. 2.3).

### ***IFC's procedures for providing additional financing***

#### **CAO Investigation Finding**

In addition to an initial investment of \$6 million in 1993, IFC contributed an additional \$54 million to the project through rights issues between 1996 and 2011. The CAO investigation found that IFC complied with existing procedures for participating in rights issues in the Company. At the same time, CAO noted that the procedures lacked a requirement for IFC to review E&S risks before participating in a rights issue. In this context, CAO noted that to harmonize the procedures for participating in rights issues with the higher level goals of the Sustainability Policy, IFC would need to ensure that appropriate consideration of the current status of a client's E&S obligations and compliance is required before rights issues are processed.

---

<sup>4</sup> IFC (2016) Environmental and Social Review Procedures. See <https://goo.gl/suULxG>.

### IFC's Actions in Response to the Findings

In 2015, IFC reported to CAO that a proposed approach to dealing with rights issues and similar follow-on equity investments had been drafted. This issue is again flagged in ESRP 13, which states that “guidance for specialists on such financial mechanisms will be issued in due course” (para. 2.3).

At the time of writing, IFC had reported to CAO that internal approvals have been received for updates to IFC's operational procedures, systems, and ESRP in relation to E&S review when processing additional financing.

### ***IFC's decision-making process and E&S considerations around divestment***

#### CAO Investigation Finding

The CAO investigation found no indication that IFC's investment staff discussed divestment with IFC's E&S staff prior to divestment, or otherwise considered E&S issues when making the decision to divest. In this context, CAO noted that it would be consistent with IFC's Operational Procedures and IFC's broader commitments to E&S sustainability for E&S considerations to be structured into IFC's decision making process for equity sales.

#### IFC's Actions in Response to the Findings

IFC has not reported actions that address CAO's findings on divestment. This issue is not dealt with by ESRP 13.

## Conclusion

At the level of policies and procedures, CAO recognizes that ESRP 13 provides relevant guidance to IFC staff in relation to E&S processes for phased development projects. ESRP 13 is relevant to the type of investment considered in the Quellaveco investigation, however, it does not represent a response that addresses all the CAO's policies, procedural and knowledge findings.

CAO's investigation indicated three areas where policy guidance was needed:

- (a) E&S categorization;
- (b) consideration of E&S issues around rights issues; and
- (c) consideration of E&S issues around divestment.

Of these issues, (a) is partially addressed by ESRP13. In particular CAO welcomes the acknowledgement in ESRP 13 that E&S categorization of a phased development project should consider potential prospective impacts should the project be developed, as well as the speed of likely development. CAO also welcomes the provision that project recategorization may be considered if E&S risks and impacts change in a material manner as the project evolves.

Generalizations that development phase investments will generally be category B, however, risk understating the potential for significant E&S impacts both during the development phase and in operation, particularly in locations where sensitive ecosystems or social structures are present. CAO further notes that ESRP 13 may narrow the application of the existing ESRP 2 (2013) regarding project categorization. ESRP 2 states that "where the physical assets have yet to be identified, but the sponsor's business plans and investment strategy indicate strong likelihood that high risk projects ... will be developed or acquired, the project is categorized as A." ESRP 2 further indicates that "it is ... expected that investments in sectors that are of inherent high risk and are likely to be located in geographically sensitive areas will be categorized as A."

In this context, CAO notes examples of good international industry practice that require case by case assessment and mitigation of the E&S impacts of mining exploration activities.<sup>5</sup>

While IFC has reported internal approvals and discussions in relation to its procedures for providing additional financing, a policy or procedure addressing issue (b) above had not been issued at the time of writing this report.

Issue (c) above remains substantively unaddressed.

IFC has not reported any project level actions in response CAO's findings, nor has it reported any consultation with the Quellaveco complainants.

Overall, CAO finds that IFC's response has not substantially addressed the investigation findings. Nevertheless, CAO has decided to close its monitoring of this investigation considering the time that has passed since IFC's divestment from the project, and IFC's decision not to engage in a project level response with its former client or the affected communities. Findings from CAO's investigation that require a response at the level of IFC's policies, procedures and practices may be addressed through CAO's ongoing compliance and advisory work.

---

<sup>5</sup> Eg: Prospectors & Developers Association of Canada (PDAC), e3 Plus: A Framework for Responsible Exploration, Excellence in Environmental Stewardship Toolkit (EES), March 2009. <https://goo.gl/yzgmoY>.



## Annex 1 – Summary of Key Investigation Findings

<b>General</b>
The absence of E&S requirements in IFC's Shareholders Agreement for Quellaveco meant that there was a significant gap in terms of the Company's E&S obligations. This made effective E&S supervision difficult.
Nevertheless, IFC supervised the Project with reference to IFC's evolving E&S standards and policies. This represented good practice.
While the Complainants' concerns had not been resolved as at the time of IFC's divestment, CAO finds that IFC's engagement with the Company around E&S issues was generally appropriate to the stage of development of the Project.
Key E&S issues identified by IFC in project supervision were, however, not translated into corrective action plans. Agreeing on corrective action plans would have been of particular relevance in relation to: (a) resettlement activities (which IFC noted were proceeding in advance of the development of studies and plans required by IFC E&S standards); (b) the impact of land acquisition on Indigenous people; (c) issues of stakeholder engagement; and (d) the more technical elements of project design and environmental impact assessment that are discussed in IFC's 2007 and 2010 supervision documentation.
Information presented by IFC to its Board regarding this Project was incomplete, particularly with relation to the E&S standards which applied to the Project and its level of E&S compliance.
<b>E&amp;S Categorization</b>
IFC's Quellaveco investment would properly have been categorized A at the outset given: (a) the magnitude of the potential impacts of the proposed mine; (b) IFC's view that it had a high likelihood of moving forward to development within a relatively short period of time; and (c) the potential E&S risks and impacts of the Project in the pre-development phase, in particular potential impacts on Indigenous People.
The decision as to whether an early equity mining project should be categorized as A or B needs to be determined on a case-by-case basis, taking into account the potential E&S impacts of the Project (both immediate and long term), as well as its likelihood of development.
<b>E&amp;S Considerations around Participation in Rights Issues</b>
IFC complied with existing procedures for participating in rights issues in Quellaveco
IFC's procedures as applied in the processing of rights issues in Quellaveco are inconsistent with IFC's commitment to having clients manage E&S risks in accordance with the Performance Standards as set out in the Sustainability Policy (2006).
IFC's procedures regarding the processing of rights issues are inconsistent with para. 17 of the Sustainability Policy (2006), which implies a requirement to analyze any additional financing in terms of whether it involves "new business activity", and if so to apply the Performance Standards to that investment.
<b>E&amp;S Considerations around Divestment</b>
IFC did not adequately consider whether the investment's purpose has been "substantially fulfilled" in the context of its divestment decision. In circumstances where IFC's additionality is framed in terms of E&S issues (as was the case in relation to Quellaveco), this requires an analysis of E&S achievements and future risks.
IFC's Operational Procedures on Equity Sales do not adequately support IFC's commitments to E&S sustainability in its investments.
It would be consistent with both the Operational Procedures on Equity Sales and IFC's broader commitments to E&S sustainability for E&S considerations to be structured into IFC's decision making around divestment.