



APPRAISAL REPORT

CAO Appraisal for Compliance
Investigation of IFC

CAO Compliance

CAO Compliance Ref: C-I-R6-Y13-F180

June 26, 2013

**India Infrastructure Fund
India**

Case of

Odisha Chas Parivesh Surekhsa Parishad and the Delhi Forum

Summary

In April 2011, CAO received a complaint from the Odisha Chas Parivesh Surekhsa Parishad and the Delhi Forum, raising concerns about the environmental and social impact of a proposed coal-based power plant in Odisha State, India.

GMR Kamalanga Energy Limited (GKEL) is a special purpose vehicle set up by GMR Energy Limited to develop and operate a 1400MW coal-based power plant near Kamalanga village in Dhenkanal, a district of Odisha State. It is a portfolio investment of the India Infrastructure Fund (the Fund), a project equity fund that makes equity and equity-related investments in the infrastructure sector in India.

In September 2007, the IFC Board approved a commitment to the Fund, which was ultimately negotiated to US\$50m. Various capital calls have been made on IFC's commitment since Board approval.

The issues raised in the complaint relate to:

- IFC's disclosure policy in relation to Financial Intermediary investments;
- Performance Standard 1 (System of Social and Environmental Management and Assessment) – adequacy of consultation and assessment of cumulative impact;
- Performance Standard 3 (Pollution Prevention and Abatement) – exacerbation of existing pollution;
- Performance Standard 4 (Community Health, Safety and Security) – impact on local buildings, use of private security guards, waste disposal and groundwater use;

- Performance Standard 5 (Land Acquisition and Involuntary Resettlement) – adequacy of compensation;
- Performance Standard 7 (Indigenous Peoples) – adequacy of consultation.

CAO has conducted a Compliance Appraisal in accordance with its Operational Guidelines.

CAO acknowledges the positive steps taken by IFC to assess and address E&S risks and impacts around its investment in the Fund. For example, IFC put in place additional E&S requirements in relation to the Fund, on the basis that the Fund's portfolio was likely to have significant E&S risks and impacts. These included a requirement that E&S due diligence undertaken for the first few Fund projects be sent to IFC; that the Fund provide IFC with advance notice of all Category A projects; and that an independent E&S audit be provided to Advisory Board members at least once per year. Further, CAO recognizes that IFC CES was heavily involved in the appraisal of the Fund's investment in GKEL. The Fund provided the EIA and SIA for GKEL, as well as the ESDD and Action Plan to IFC for review. IFC provided extensive comments and recommendations, to which the Fund appeared to be receptive.

However, CAO has a number of outstanding questions in relation to this investment. These questions relate to:

1. The extent to which legal arrangements between IFC and the Fund provided an adequate structure for managing E&S risk in the case of non-compliance with relevant E&S obligations, either by the client or its sub-clients;
2. The adequacy of supervision of the GKEL Project with regard to the Performance Standards;
3. Whether IFC's supervision of its investment in the Fund met the requirements of the Sustainability Policy and ESRP;
4. Whether IFC's E&S policies and standards as applied to this Project are adequate in relation to disclosure requirements; and
5. Whether IFC's approach the management of E&S risks around its investment in the Fund was adequate in the context of its broader commitments to sustainable development and 'do no harm' principles.

Based on the Compliance Appraisal, CAO will conduct a Compliance Investigation into IFC's investment in the Fund. The Compliance Investigation will focus on whether IFC's investment in the Fund (in the context of the Fund's investment in GKEL) was appraised, structured and supervised in accordance with applicable IFC policies, procedures and standards. It will also consider whether IFC's Policy and Performance Standards on Environmental and Social Sustainability and Policy on Disclosure of Information provide adequate levels of protection in relation to the issues raised in the complaint.

The objectives and scope of the investigation will be further defined in terms of reference which will be disclosed in accordance with the CAO Operational Guidelines.



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About the CAO

The 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.

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

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



1. Overview of the CAO Compliance Appraisal process

When CAO receives a complaint about an IFC or MIGA project, the complaint is referred to CAO's dispute resolution arm, CAO Ombudsman, which works to respond quickly and effectively to complaints through facilitated settlements, if appropriate. If CAO Ombudsman concludes that the parties are not willing or able to reach a facilitated solution, the case is transferred to CAO Compliance for Appraisal and potential Compliance Investigation.

The focus of CAO Compliance is on IFC and MIGA, not their client. This applies to all IFC's business activities including the real sector, financial markets, and advisory. CAO assesses how IFC/MIGA assured itself/themselves of the performance of its business activity or advice, as well as whether the outcomes of the business activity or advice are consistent with the intent of the relevant policy provisions. In many cases, however, in assessing the performance of the project and IFC's/MIGA's implementation of measures to meet the relevant requirements, it will be necessary for CAO to review the actions of the client and verify outcomes in the field.

In order to decide whether a Compliance Investigation is warranted, CAO Compliance first conducts a Compliance Appraisal. The purpose of the appraisal process is to ensure that Compliance Investigations are initiated only for those projects that raise substantial concerns regarding environmental and/or social outcomes, and/or issues of systemic importance to IFC/MIGA.

To guide the appraisal process, the CAO applies several basic criteria. These criteria test the value of undertaking a Compliance Investigation, as CAO seeks to determine whether:

- There is evidence of potentially significant adverse environmental and/or social outcome(s) now, or in the future.
- There are indications that a policy or other appraisal criteria may not have been adhered to or properly applied by IFC/MIGA.
- There is evidence that indicates that IFC's/MIGA's provisions, whether or not complied with, have failed to provide an adequate level of protection.

In conducting the Appraisal, CAO will hold discussions with the IFC/MIGA team working with the specific project and other stakeholders to understand which criteria IFC/MIGA used to assure itself/themselves of the performance of the project, how IFC/MIGA assured itself/themselves of compliance with these criteria, how IFC/MIGA assured itself/themselves that these provisions provided an adequate level of protection, and, generally, whether a Compliance Investigation is the appropriate response. After a Compliance Appraisal has been completed, the CAO can close the case or initiate a Compliance Investigation of IFC or MIGA.

Once CAO concludes an Appraisal, it will advise IFC/MIGA, the President, and the Board in writing. If an Appraisal results from a case transferred from CAO's Dispute Resolution role, the complainant will also be advised in writing. A summary of all appraisal results will be made public. If CAO decides to initiate a Compliance Investigation as a result of the Compliance Appraisal, CAO will draw up Terms of Reference for the Compliance Investigation in accordance with CAO's Operational Guidelines.

2. Background

IFC investments in financial intermediaries

IFC channels a large portion of its financing to private sector projects in developing countries through financial intermediaries (FIs). IFC provides finance to a wide variety of FIs. The rationale provided for FI investments is that it allows IFC to extend long-term finance to more companies, in particular to small and medium enterprises and microfinance entrepreneurs. As part of its FI investments, IFC has built up a portfolio in emerging market private equity funds.

IFC requires its FI clients to manage the E&S risks associated with the lending/investment activities undertaken with IFC finance. IFC reviews the business activities of prospective FI clients to identify areas of possible exposure to E&S risk. The FI is required to undertake actions commensurate with the level of E&S risk, ranging from review against IFC's Exclusion List to application of the Performance Standards.

Investment

The India Infrastructure Fund (the Fund) is a project equity fund that makes equity and equity-related investments in the infrastructure sector in India. This is one of the first funds of its kind in India, focusing on project-level investments. The Fund is managed by IDFC Project Equity Company Limited (the Investment Manager), which is wholly owned by the Infrastructure Development and Finance Company Limited, an existing IFC client.

In September 2007, the IFC Board approved a commitment to the Fund of US\$100m, on the understanding that this would allow IFC to nominate a member to the Investment Committee of the Fund. IFC's investment was subsequently negotiated to US\$50m. With this commitment, IFC was able to nominate a member to the Advisory Board, but was not able to nominate a member to the Investment Committee of the Fund. Various capital calls have been made on IFC's commitment since Board approval.

One of the Fund's portfolio investments is GMR Kamalanga Energy Limited (GKEL). GKEL is a special purpose vehicle set up by GMR Energy Limited to develop and operate a 1400MW coal-based power plant near Kamalanga village in Dhenkanal, a district of Odisha State. Capital calls specifically relating to GKEL were met by IFC in January 2009, March 2011, May 2011, September 2011, December 2011, March 2012, May 2012, October 2012 and February 2013.

Complaint

In April 2011, CAO received a complaint from the Odisha Chas Parivesh Surekhsa Parishad and the Delhi Forum. Odisha Chas Parivesh Surekhsa Parishad (Odisha Agriculture and Environment Protection Council) is a grassroots organization dealing with social and environmental issues in relation to people affected by industrial projects in the Dhenkanal and Angul districts of Odisha State. Delhi Forum is an advocacy, research, media, networking and documentation support organization based in New Delhi.

The complaint raises concerns about the environmental and social impact of the proposed coal-based power plant near Kamalanga village. It also raises general concerns about IFC's

investments in financial intermediaries. A more detailed summary of concerns is set out under 'Scope of Appraisal' below. CAO concluded that the complaint meets its eligibility criteria.

Ombudsman assessment report

The Ombudsman Assessment Report was published in February 2013.¹ It records that after receiving the complaint in April 2011, the CAO Ombudsman team undertook site visits, concluding in March 2012 that the parties were willing to participate in a voluntary dispute resolution process. The Ombudsman team worked with the parties to develop acceptable parameters and ground rules for dialogue and carried out capacity building and training exercises.

In March 2013, the CAO published a Conclusion Report,² reporting that at a joint meeting in January 2013 between the Fund, Complainants and community representatives, it was evident that relations between the parties had broken down to the point where the dispute resolution process could no longer continue. The case was transferred to CAO's Compliance function.

3. Scope of the Appraisal for a Compliance Investigation of IFC

In cases referred by CAO Ombudsman, the scope of the appraisal is defined by issues raised in the complaint and identified during the CAO assessment phase.

In relation to IFC's Policy on Social and Environmental Sustainability, the letter of complaint focuses on IFC's approach to Financial Intermediary (FI) projects. The Complainants claim that the Performance Standards and disclosure requirements applied to IFC's direct investments (including disclosure of categorization) should also apply to its FI sub-projects. The Complainants claim this would enhance community engagement in relation to such projects.

The letter of complaint raises the following issues in relation to IFC's Performance Standards on Social and Environmental Sustainability and the GKEL sub-project:

- Performance Standard 1 (System of Social and Environmental Management and Assessment) – the Complainants claim that community consultation (including with Indigenous peoples) has been inadequate and that the cumulative impacts of the project together with other industries in the area have not been considered.
- Performance Standard 3 (Pollution Prevention and Abatement) – the Complainants raise concerns that the sub-project will exacerbate existing pollution (particularly in the Bhramani River), stating that there is no information available on proposed pollution mitigation.
- Performance Standard 4 (Community Health, Safety and Security) – the Complainants raise concerns about the impact of dynamiting on buildings; the role of private security guards and dogs; waste disposal from the sub-project; and use of groundwater affecting community access to water.
- Performance Standard 5 (Land Acquisition and Involuntary Resettlement) – the Complainants raise extensive concerns about failure to provide adequate compensation for land, crops, trees and water sources acquired, and failure to address loss of

¹ <http://www.cao-ombudsman.org/cases/document-links/documents/FinalCAOAssessmentReportIIF-GMRcomplaintFebruary2013.pdf>

² http://www.cao-ombudsman.org/cases/document-links/documents/CAOConclusionReportIIF_March2013.pdf

livelihoods. Further claims relate to arrests of community members protesting at the sub-project site.

- Performance Standard 7 (Indigenous Peoples) – the Complainants state that some of the land acquired belongs to members of a scheduled tribe, and that appropriate consultation has not been undertaken.

To these issues, the CAO Ombudsman’s assessment identifies a number of additional issues including access to health and education facilities, public safety and roads, lack of benefits for people with special needs, the impact of laying a water pipeline and the valuation of an existing canal system.

CAO received an update letter from the Complainants on 16 May 2013. This letter noted further concerns regarding acquisition of land, employment, investigations undertaken by Indian authorities into the Fund, Homestead lands, grazing land and damage to roads.

From the perspective of the CAO compliance mandate, the general question raised is whether IFC exercised due diligence in its review and supervision of environmental and social (E&S) aspects of the project, particularly as they relate to the issues identified above. CAO will also consider whether there is evidence indicating that IFC’s E&S policies and standards provide an adequate level of protection.

4. CAO Findings

IFC guidelines and standards

IFC’s investments in the Project were made in the context of the 2006 Policy and Performance Standards on Social and Environmental Sustainability. The Environmental and Social Review Procedure relevant to the initial investment was that issued in July 2007.

IFC Policy

IFC’s 2006 Policy on Social and Environmental Sustainability sets out IFC’s roles and responsibilities in relation to managing social and environmental risks in IFC projects. The 2006 Policy states that ‘[c]entral to IFC’s development mission are its efforts to carry out its investment operations and advisory services in a manner that “do no harm” to people or the environment’.

IFC’s 2006 Policy on Disclosure of Information reflects the view that transparency and accountability are fundamental to fulfilling IFC’s development mandate and strengthening public trust in IFC and its clients.

The Complainants contend that IFC’s disclosure policy does not facilitate access to information about the Fund’s sub-projects, including GKEL. They contend that IFC should apply the same policy regarding disclosure of FI sub-projects as it applies to direct investments, including disclosure of the category applied to each sub-project. The Complainants state that they sourced the information linking the Fund and GKEL from various publicly available documents. The Complainants are concerned that the lack of transparency about financial intermediary projects such as GKEL ‘runs the risks of causing more harm than good to communities’.

IFC Policy and FI Investments

The 2006 Policy makes specific provision in relation to FI projects, stating that

IFC reviews the business of its FI clients to identify activities where the FI could be exposed to social and environmental risk as a result of its investments. IFC's requirements for the FI client will be proportional to the level of potential risk.

According to the 2006 Policy, 'FIs with business activities that have minimal or no adverse social or environmental risks' are considered Category C and do not need to apply specific E&S requirements. All other FIs must apply IFC's Exclusion List. In addition, 'FIs providing long-term corporate finance or project finance' will require the recipient of finance to i) follow national laws where the financed activity presents limited social or environmental risks; and ii) apply the Performance Standards where the financed activity presents significant social or environmental risks. FIs are required to 'establish and maintain a Social and Environmental Management System' (SEMS) and IFC monitors performance on the basis of the SEMS. Under the 2006 Policy, all FI projects excluding those that are Category C projects are 'Category FI Projects'.

IFC's 2006 Policy on Disclosure of Information exempts investments in FI projects from the general requirement to issue a brief summary of findings and recommendations (the Environmental and Social Review Summary or ESRS). Instead, for investments in FI projects, the summary of any recommendation in relation to the SEMS is found in the Summary of Proposed Investment (SPI). The SPI provides a factual summary of the main elements of the project and includes IFC's categorization of the project for social and environmental purposes and reference to the social and environmental information available for the project. In the case of an FI project, a brief summary of key enhancements to be made to the FI's SEMS must be included.

IFC's Investment in the Fund

IFC's SPI in relation to its proposed investment in the Fund was disclosed publicly on 24 August 2007. The SPI noted that 'IFC will work with the Fund to develop its Social and Environmental Management System (SEMS), through which the Fund will oversee the social and environmental risks of all Fund investments'. The Project was categorized as Category FI. The applicable requirements were expected to be the IFC Exclusion List; the applicable Indian social and environmental laws and regulations; and the IFC Performance Standards (in other words, the full extent of requirements that can be applied to an FI). IFC would review the capacity of the Fund to manage social and environmental risks and to establish and maintain a SEMS. Additionally, 'given the potential E&S issues associated with the sectors of the Fund investment, IFC [would] also review the implementation and performance of the Fund's SEMS for the first few [sub-]projects, prior to investment [in the Fund], to ensure that the IIF SEMS is robust'. In relation to all Category A sub-projects undertaken by the client, '[the Fund] will need to provide IFC, prior to investing, information relating to the Fund's assessment and management of social and environmental risks'.

The IFC Board approved the proposal to invest in the Fund on 27 September 2007. In relation to IFC's role and additionality, the Board documentation noted that IFC's reputation, particularly in relation to good governance and E&S issues, would be an important means of attracting other investors to this new type of fund. The documentation noted that given the types of infrastructure projects in which the Fund would invest (including ports, roads, hydro power and railways), the environmental and social impacts were likely to be significant. It noted that the Investment



Manager had a strong SEMS, and was in the process of updating it to ensure compliance with the 2006 Performance Standards. The Investment Manager would provide IFC with documentation of recent E&S due diligence carried out for large projects; would require that E&S due diligence carried out for the first few Fund projects be sent to IFC; and would advise IFC of all Category A projects in advance of review by the Fund Investment Committee. An independent E&S audit for new and existing projects would be provided to Advisory Board members at least once per year. The documentation also indicated that there appeared to be gaps in the Fund's approach with respect to IFC expectations; remedying those gaps would be part of the Fund's obligations under the respective legal agreements.

The Fund's investment in GKEL

In July 2008, the Fund notified IFC CES that it was considering an investment in GKEL, for a thermal coal-based power plant. IFC CES noted that the project would be Category A and would require detailed due diligence. IFC CES provided a checklist of considerations for the client's Environmental and Social Due Diligence (ESDD) Report.

In August 2008, the Fund corresponded extensively with IFC CES regarding an Environmental Impact Assessment, a Social Impact Assessment, a draft ESDD Report and an Environment, Health, Safety and Social Action Plan for GKEL. IFC CES provided detailed suggestions to which the Fund's SEMS Officer responded. The ESDD Report categorized the Project as A and addressed Performance Standards 1-6. It was clear that the Project might have significant implications in relation to air pollution, water pollution, noise, solid and hazardous waste, ecological impacts, socio-economic issues, resources (including water), and greenhouse gasses. Many of these issues correspond with the concerns raised in the Complaint. IFC CES successfully sought the Fund's commitment to include in its agreement with GKEL a post-disbursement condition requiring that

The Project shall, at all times during the currency of the investment, comply with the environmental, health, safety and social ... requirements of the Fund, undertake necessary social and environmental assessments to meet the Fund's Performance Standard requirements, and comply with the recommendations of the assessment findings / results by implementing mitigation measures, as required, to achieve outcomes consistent with the provisions of Fund's Performance Standards, all applicable legislation, clearances issued thereunder and maintenance of documents to be able to demonstrate compliance with the same.

While IFC reviewed and commented on the E&S conditions and covenants that were proposed to be included by the Fund in its agreements with GKEL, CAO understands that IFC has not reviewed the agreements themselves.

The Action Plan for GKEL prepared by the Fund set out specific obligations including to establish Environment and Social Management Systems; to submit monthly reporting of air quality monitoring; to submit a note on greenhouse gas reduction potential; to develop and implement a labor influx management plan; and to develop a Stakeholder Consultation and Information Disclosure Plan.

In an email in September 2008 to the Fund, IFC noted its understanding that the agreements between the Fund and GKEL would include covenants requiring GKEL to ensure compliance with the Fund's Performance Standards (which were identical to IFC's Performance Standards),



undertake necessary social and environmental assessments to meet Performance Standard requirements, and implement any necessary mitigation measures to meet the Performance Standard requirements.

In December 2008, IFC received an initial capital call for the GKEL project. Funds were disbursed in response to the capital call in January 2009. Subsequent capital calls specifically relating to GKEL were met by IFC in March 2011, May 2011, September 2011, December 2011, March 2012, May 2012, October 2012 and February 2013.

CAO Findings

It was clear that the types of projects in which the Fund would invest, including roads, ports, railways, power and urban infrastructure, were likely to have significant E&S impacts. CAO acknowledges that a number of steps were taken by IFC to address E&S contingencies, including procedures to allow for IFC review of Category A projects and reporting by the Fund. The Project was correctly categorized under the 2006 Policy, and E&S standards applicable to the Fund were defined by IFC as including the Exclusion List, relevant laws, and the Performance Standards.

For reasons outlined above, CAO has questions as to the adequacy of the disclosure requirements for FI investments as applied in this case. The 2006 Disclosure Policy does not provide for disclosure in relation to FI sub-projects. The 2012 Access to Information Policy states, in a footnote, that 'IFC will also periodically disclose a listing of the names, locations and sectors of high risk sub-projects that have been supported by IFC investments through private equity funds, subject to regulatory constraints and market sensitivities'. While this new provision may capture investments similar to IFC's investment in the Fund, CAO is unclear as to whether the development of IFC's disclosure framework responds adequately to the issues raised in this complaint.

The Board documentation for the initial investment in the Fund indicated that an independent E&S audit for new and existing projects would be provided to Advisory Board members at least once per year. However, CAO understands that such audits have not been undertaken.

CAO is also unclear as to whether the legal arrangements in place provided IFC with adequate recourse in the event of non-compliance with the Performance Standards by the Fund's sub-clients.

IFC Performance Standards

IFC applies the Performance Standards to manage social and environmental risks and impacts and to enhance development opportunities. IFC is required to supervise an FI client's E&S obligations and ensure that these are fulfilled. This includes assessing whether there is sufficient evidence that the client has applied the applicable (E&S) performance requirements to their sub-projects, and that the client is operating the SEMS as envisaged at the time of appraisal (ESRP 9.2.6).

The Complainants raise specific concerns regarding GKEL's compliance with the Performance Standards. Under PS1, these include claims that community consultation, including with Indigenous peoples, has been inadequate; and that the cumulative impacts of the Project together with other industries in the area have not been considered. Under PS3, the Complainants raise



concerns that the sub-project will exacerbate existing pollution (particularly in the Bhramani River), stating that there is no information available on proposed pollution mitigation.

Under PS4, the Complainants raise concerns about the impact of dynamiting on buildings; the role of private security guards and dogs; waste disposal from the sub-project; and use of groundwater affecting community access to water. Under PS5, the Complainants raise extensive concerns about failure to provide adequate compensation for land, crops, trees and water sources acquired and failure to address loss of livelihoods. Further claims relate to arrests of community members protesting at the sub-project site, and failure to provide promised employment to local families. Under PS7, the Complainants state that some of the land acquired belongs to members of a scheduled tribe, and that appropriate consultation has not been undertaken.

IFC Supervision of Financial Intermediary Clients

In accordance with the relevant ESRP (July 2007), IFC clients are required to provide IFC with an Annual Monitoring Report. Specifically, FI clients are required to provide IFC with a Social and Environmental Performance Report at the end of the client's calendar year. CES provides feedback to the client and the IFC investment officer about any shortcomings in the report; requests additional information when relevant; and follows up as relevant, either directly with the client or through the IFC Investment Officer. The requirement for IFC supervision of annual reports prepared by clients has not changed substantively over time.

Each client is assigned an annual Environmental and Social Risk Rating (ESRR), based on its Social and Environmental Performance Report and experience with the client during the year, including on-site visits when relevant. The ESRR is used to manage the portfolio as a whole and to focus on clients that are having difficulties with compliance.

CAO's Audit of a Sample of IFC Investments in Third-Party Financial Intermediaries recorded that FI clients were visited on-site at least every two years, but that clients with the two weakest categories of ESRR scores were visited at least annually. IFC CES has recently advised CAO that under the 2012 Policy, FI clients categorized as F1 (highest E&S risk) are visited every year while FI clients categorized as F2 and F3 are visited once every 3 years. IFC CES has also recently advised that to date, it has undertaken 150 site visits to sub-clients of its FI clients.

IFC Supervision of the Fund's Compliance with the Performance Standards

In May 2008 (approved September 2008), the Fund finalized an Environment Management System and Procedures (EMSP) document. This document sets out procedures for E&S due diligence, for undertaking E&S monitoring and review, for identifying non-compliance and undertaking corrective action as well as EMSP audits. It refers throughout to 'the Fund's Performance Standards'. The Fund's Investment Policy includes an 'Environmental and Social Policy Statement' to the effect that the Fund 'shall adopt and comply with the IFC Performance Standards on Social & Environmental Sustainability dated April 30, 2006'. The IFC Performance Standards are scheduled to the Investment Policy. In substance, the Fund's Performance Standards are identical to IFC's Performance Standards. IFC CES provided comments on the draft EMSP.

In mid-2008, IFC Advisory Services funded external consultants to carry out environmental capacity building in the Infrastructure Development and Finance Company Limited, the parent company of the Investment Manager and Trustee of the Fund. The objectives of the capacity



building were to align processes and management systems with IFC's Performance Standards, and to build capacity to undertake Environmental and Social Due Diligence.

CAO has reviewed various Social and Environmental Performance Report provided by the Company, together with reviews of these documents by IFC CES and a Back to Office Report (BTOR) prepared by IFC CES on 11 July 2012. The picture that emerges is one of a significant risk profile for the Fund, with at least half of its projects at any one time categorized as A. The high risk projects undertaken by the Fund included a number of coal-based power projects. IFC CES's reviews indicate that efforts to secure a visit to the coal-based power projects were unsuccessful.

The Fund's Supervision of GKEL's compliance with the Performance Standards

CAO is able to ascertain some information about the Fund's supervision of GKEL's compliance with the Performance Standards in relation to the issues raised by the Complainants from the material reviewed by IFC in relation to the GKEL Project.

The Fund's ESDD Report in relation to GKEL was shared with IFC. The ESDD Report categorized the Project as A and addressed Performance Standards 1-6. As noted above, it was clear that the Project could have significant implications in relation to air pollution, water pollution, noise, solid and hazardous waste, ecological impacts, socio-economic issues, resources (including water), and greenhouse gasses. IFC CES also reviewed the EIA and SIA for the GKEL Project and identified gaps in relation to the Performance Standards. While the Fund was receptive to IFC CES's recommendations, it is not possible on the information available for CAO to determine the extent to which IFC CES's suggestions were conveyed to GKEL by the Fund, or the extent to which they were implemented.

CAO is also able to ascertain some information about GKEL's compliance with the Performance Standards from the Social and Environmental Performance Reports (SEPRs) prepared by the Fund and reviewed by IFC, and the E&S supervision reports prepared by IFC CES. The SEPRs recorded regular site visits undertaken by the Fund to GKEL and indicated that GKEL was in compliance with the Fund's ESAP and was reporting to the Fund in accordance with the schedule.

IFC's supervision review identify a number of gaps regarding application of the Performance Standards to GKEL, including gaps in the ESAP implementation, and weaknesses in E&S documentation. As a result, IFC recommended corrective actions

Ultimately, it is not possible on the basis of the documentation available to form a judgment about the extent to which GKEL has complied with IFC's Performance Standards. The structure of FI investments is such that the establishment of a SEMS and regular reporting form the basis for assuring IFC that the client's sub-projects are (to the extent required) complying with the Performance Standards.

CAO Findings

IFC's approach to FI investments such as the Fund focuses on achieving change through the application of a management system. As found in CAO's recent CAO's Audit of a Sample of IFC Investments in Third-Party Financial Intermediaries, this approach may not generate comprehensive and structured information about E&S results at the sub-client level.

In this case, the Fund prepared an SEMS satisfactory to IFC and complied with its reporting obligations. However, CAO does not have sufficient information to make an assessment about implementation of the SEMS generally, or about GKEL's compliance with the Performance Standards in particular. On the basis of available information, CAO is unclear as to the extent of adverse environmental and/or social outcomes now, or in the future.

Further, CAO notes that E&S concerns emerged about another investment of the Fund in a coal fired power station. CAO finds that evidence of non-compliance in the other sub-project may be relevant to the adequacy of the Fund's supervision in relation to GKEL. In addition, based on the information that was available, CES had identified gaps between the Performance Standards and the way in which the GKEL Project was progressing. In these circumstances CAO is unclear whether IFC's supervision of its investment met the requirements of the Sustainability Policy and ESRP. CAO also has questions as to whether IFC's approach to supervision was adequate in the context of its broader commitments to sustainable development and 'do no harm' principles.

5. CAO Decision

The decision about whether CAO should initiate a compliance investigation requires the weighing of a number of factors including the likely social and environmental impact of a project, a preliminary appraisal of IFC's E&S performance, as well as a more general assessment of whether there is an argument for the value of a compliance investigation for project-related or systemic reasons.

CAO acknowledges the positive steps taken by IFC to assess and address E&S risks and impacts around its investment in the Fund. For example, IFC put in place additional E&S requirements in relation to the Fund, on the basis that the Fund's portfolio was likely to have significant E&S risks and impacts. These included a requirement that E&S due diligence undertaken for the first few Fund projects be sent to IFC; that the Fund provide IFC with advance notice of all Category A projects; and that an independent E&S audit be provided to Advisory Board members at least once per year. Further, CAO recognizes that IFC CES was heavily involved in the appraisal of the Fund's investment in GKEL. The Fund provided the EIA and SIA for GKEL, as well as the ESDD and Action Plan to IFC for review. IFC provided extensive comments and recommendations, to which the Fund appeared to be receptive.

However, CAO has a number of outstanding questions in relation to this investment. These questions relate to:

1. The extent to which legal arrangements between IFC and the Fund provided an adequate structure for managing E&S risk in the case of non-compliance with relevant E&S obligations, either by the client or its sub-clients;
2. The adequacy of supervision of the GKEL Project with regard to the Performance Standards;
3. Whether IFC's supervision of its investment in the Fund met the requirements of the Sustainability Policy and ESRP;
4. Whether IFC's E&S policies and standards as applied to this Project are adequate in relation to disclosure requirements; and
5. Whether IFC's approach the management of E&S risks around its investment in the Fund was adequate in the context of its broader commitment to sustainable development and 'do no harm' principles.



On the basis of the above analysis, CAO will conduct a Compliance Investigation into IFC's investment in the Fund. The Compliance Investigation will focus on whether IFC's investment in the Fund (in the context of the Fund's investment in GKEL) was appraised, structured and supervised in accordance with applicable IFC policies, procedures and standards. It will also consider whether IFC's Policy and Performance Standards on Environmental and Social Sustainability as well as its Policy on Disclosure of Information provide adequate levels of protection in relation to the issues raised in the complaint.

The objectives and scope of the investigation will be further defined in terms of reference which will be disclosed in accordance with the CAO Operational Guidelines.