

October 6, 2017

Mr. Osvaldo L. Gratacós
Compliance Advisor Ombudsman
International Finance Corporation
2121 Pennsylvania Avenue, N.W.
Washington DC 20433

Subject: IFC Management’s Response to the CAO Investigation Report on Latin Renewables Infrastructure Fund, as related to the Hidroeléctrica Santa Rita complaint (project #31458)

Dear Mr. Gratacós:

Thank you for the opportunity to respond to the CAO Compliance Investigation Report (the “Report”) with respect to IFC's equity investment in the Latin Renewables Infrastructure Fund (the “Fund” or the “Client”) and the Fund's investment in sub-project Hidroeléctrica Santa Rita (“HSR” or the “Project”).

IFC believes that a CAO-mediated dispute resolution process could have produced a better outcome in this case. As noted by CAO, the Complainants chose not to pursue this option, despite the willingness of the Fund, HSR, and a large number of the communities in the area to engage.

We appreciate CAO’s affirmation that IFC correctly identified the Fund as high E&S risk and classified it appropriately. IFC strives to learn and constantly improve its processes on the basis of lessons learned. We acknowledge the CAO’s findings relating to the complex contextual environment in this area of Guatemala at the time of the investment, and have since strengthened our internal procedures for contextual risk analysis. IFC has also taken a number of actions over the last several years that have advanced our framework for managing E&S risks in private equity fund investments and promoting greater transparency. These are outlined in the attached Annexes along with IFC’s more detailed responses to CAO’s findings.

There are a few key issues related to the Report that we would like to highlight, as follows:

First, it is important to clarify that this Project was stopped early in the process and was never constructed. As a result, most of the potential E&S impacts discussed in the Report never materialized. Rather, the Client, through its ongoing E&S assessment process, identified key social risks that merited further consideration and sought to address these through ongoing stakeholder engagement. When these efforts proved unsuccessful, the Client subsequently made the decision not to proceed with the Project, thereby limiting the potential for any future adverse impacts.

Second, the Report seems to imply that the E&S assessment for the Project had been completed and was deficient. In fact, the process was ongoing and there were many additional studies, community programs, and mitigation measures envisioned as part of the Environmental and Social Action Plan (ESAP) that were designed to ensure compliance with the Performance Standards, *had the Project progressed*.

Third, IFC's performance should be assessed through the E&S framework applicable for Financial Intermediaries ("FIs"), which in this case involves IFC investing as a Limited Partner ("LP") investor in a fund. While we appreciate CAO's observations, it is worth noting that the Environmental and Social Due Diligence (ESDD) review framework applied to this Project is the most rigorous under IFC's procedures and is considered best practice in the investor community – going well beyond any existing market approach today.

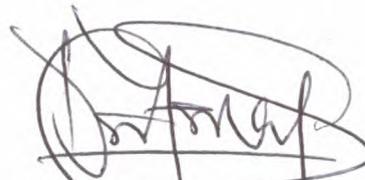
IFC recognizes the challenges associated with doing business in difficult markets. We remain committed to pursuing investments in challenging frontier regions with underserved populations, while promoting the adoption of strong environmental and social sustainability standards by our clients.

We thank the CAO for its Report and look forward to continuing our dialogue.

Sincerely,



Ethiopis Tafara
Vice President and General Counsel



Dimitris Tsitsiragos
Vice President

Annex 1: IFC Tabulated Management Response

	CAO Finding	IFC's Response	Actions Taken or Proposed
1.	IFC appropriately categorized the investment as F11 (high E&S risk) and required the Fund to ensure that projects it supported were operated in accordance with the Performance Standards.	IFC appreciates CAO's acknowledgement of IFC's appropriate categorization.	N/A
2.	IFC's E&S review of its investment in the Fund was not commensurate to risk.	To the contrary, IFC applied the most rigorous requirements for high E&S risk projects contemplated by our policies and procedures. IFC engaged with the Fund on an ongoing basis, reviewing the Fund's E&S due diligence (ESDD) and remaining engaged post ESDD. IFC consulted with internal and external Social Specialists to assure itself of appropriate consideration of social risks. Where gaps were identified, the Fund conducted additional studies. The Fund's ESMS was such that they identified E&S issues as they arose and took active measures to address these. They ultimately stopped the Project, which was never resumed.	While the E&S review in this case was commensurate with risks and IFC procedures, in 2015, IFC made a decision to employ even greater selectivity in its fund selection. Funds are rigorously segmented according to their underlying E&S risk, and new investments in high risk funds are intentionally limited.
3.	Given the high E&S risk profile of the Fund's prospective investments and the client's limited capacity, the framework which IFC negotiated for review of the Fund's projects limited the ability of the E&S specialist "to determine whether the client's ESMS implementation [was]	The framework applied to this Project is the most rigorous contemplated under IFC's E&S procedures for FIs. IFC reviews whether the procedures and capacity of the client are adequate to manage the risks of the fund, by reviewing the policies, procedures, tools, and other supporting documents of the ESMS, as well as the expertise and experience of fund staff.	In addition to the various measures IFC already had in place with respect to funds, IFC's legal requirements now include specific remedies to address E&S non-compliance issues. A fund manager is given opportunities to bring a sub-project back into compliance through remedial plans and actions; if ultimately unsuccessful, the fund is typically required to use all reasonable efforts to

	<p>robust” as required by ESRP 7.2.10.</p>	<p>Currently, IFC’s approach to its funds investments exceeds the E&S oversight and requirements of other investors, including DFIs. For example, fund clients are required to have an E&S Management System established <u>before</u> IFC finalizes its commitment to the fund. IFC also generally retains the rights to review the Fund’s ESDD of its first three investments, and those of all its Category A investments. This is completed <u>prior</u> to the fund making a sub-project investment, so that IFC can comment on the quality of the ESDD and recommend additional actions as part of the E&S Action Plan. The LRIF project followed this approach – before investing, IFC reviewed the ESDD for Santa Rita and provided feedback to the Fund, which incorporated this perspective into their ESDD, and also required additional studies.</p>	<p>dispose of the investment or terminate its financing of the sub-project. IFC also now generally has the right not to fund a capital call for an investment that remained in breach regarding E&S and was not moving into compliance.</p>
<p>4.</p>	<p>IFC did not assure itself that the Fund had adequately assessed potential impacts on water and dam safety risk associated with the project particularly given the change in the size of the plant and the dam.</p>	<p>IFC confirmed with the Fund that appropriate studies were underway or completed. There is no evidence that dam safety was an issue for this Project. Many of these studies were still ongoing and contemplated in the E&S Action Plan, which was to be completed before the construction of the dam started. IFC remained engaged post ESDD, and was prepared to adapt to changing circumstances, should the Project have advanced.</p>	<p>N/A</p>
<p>5.</p>	<p>IFC did not take adequate steps to assure itself that the Project met IFC’s requirements for consultation and disclosure.</p>	<p>IFC’s role is distinct from the Fund’s role in the ESDD process. IFC’s review of the Fund’s ESDD resulted in specific discussions and clarifications regarding consultation and disclosure and recommendations of additional measures, which the Fund readily accepted, including a review by</p>	<p>In addition to several initiatives designed to strengthen IFC’s oversight of fund investments and support to IFC clients to better manage E&S risks, IFC has also gone beyond its own policies in promoting transparency. As per the</p>

		<p>an independent consultant that was concluded and available to the CAO. IFC also discussed the Project with its own Social Specialists to confirm the adequacy of consultation and disclosure processes at the time.</p>	<p>Access to Information Policy, IFC publishes the name, sector, and location of every investment of its funds' sub-projects. In 2017, IFC fulfilled 100% of its requirement for the 63 fund investments initiated since 2012, and published information on more than 387 fund sub-projects.</p>
6.	<p>IFC's review was not sufficient to ensure that the Fund had correctly assessed the application of Performance Standard 7 to the Project, in particular the requirement for Free Prior Informed Consent ("FPIC") for projects impacting land and natural resources under traditional ownership or customary use.</p>	<p>IFC took several steps to assure itself that Performance Standard 7 was appropriately considered. Two different IFC Social Specialists were consulted during the ESDD review; they concluded that FPIC was not applicable because the impacts were limited and did not meet the Performance Standard criteria for FPIC. IFC also reached out to Social Specialists of another investor directly involved in the Project, who independently concurred that FPIC was not applicable to this Project based on the information available at the time predicting limited adverse impacts. Additionally, the conclusion of the independent consultant, whose findings the CAO otherwise uses throughout its Report, supports the view that FPIC did not apply to the Project.</p>	<p>IFC is satisfied with the Fund's management of its ESDD, and responded to areas indicated for improvement or further studies. IFC has also developed new E&S procedural requirements to systematically screen projects for contextual risks and to factor these risks into decision-making, categorization, and overall risk management. IFC is also making efforts to better capture and present contextual risks, and to be clear about the limitations of private sector clients to address these, namely done through project documentation and Board discussion.</p>
7.	<p>IFC did not assure itself that the Fund had adequately assessed potential economic displacement as a result of the Project.</p>	<p>Both IFC and the Fund took all applicable measures in this regard. No economic displacement was expected, given the flood area and due to the construction of the transmission line.</p>	<p>N/A</p>
8.	<p>IFC's ESDD review was not sufficient to ensure that the Fund</p>	<p>Most of the gaps highlighted by the CAO in the original ESDD were actually identified in</p>	<p>N/A, the ESDD review framework applied to this project is already the most</p>

	had correctly applied its E&S requirements to the Project	additional reviews conducted by the Fund itself. The ESDD review was not a static, one-time process and IFC remained engaged with the Client post-ESDD review. IFC had a team of two E&S Specialists reviewing the ESDD and consulted with two additional social experts to discuss the findings. In addition, multiple communications took place with the Fund to confirm that the document covered all applicable aspects of the Performance Standards. Where gaps were identified, the Fund conducted additional studies.	rigorous version contemplated by IFC and considered best practice in the investor community, well beyond any existing market approach.
9.	IFC's supervision did not provide sufficient evidence to conclude that the Fund was correctly applying IFC's E&S requirements to the Project.	<p>The Fund was taking active measures to address E&S issues as they arose, including full stoppage of the Project at significant financial cost. In that time the Fund tried to find ways to engage with the community. Issues that are central to this investigation were identified and reported by the Fund itself well before the CAO complaint and investigation – as a consequence the Project was stopped, and never resumed.</p> <p>Impacts were duly reported, and IFC's supervision indicated that the Fund was dealing appropriately with the situation, especially in light of its decision to stop the Project at significant financial cost. IFC also consulted with other investors and outside E&S Specialists on the adequacy of the mitigation measures in place.</p>	IFC's E&S supervision complied with the applicable policies for FI investments, and exceeded that of any other investors in the Fund. Nonetheless, IFC continues to enhance its E&S supervision of FI clients. For example, IFC's approach to supervision includes visits from IFC's E&S staff to a sample of fund sub-projects to assess E&S risks and help fund clients in managing those risks. IFC is also offering regular E&S risk management training for clients, which has resulted in better implementation of IFC's E&S requirements and increased compliance by fund managers.
10.	Given the ongoing conflict around the Project, and persistent concerns about local impacts, additional supervision	IFC's role is distinct from the Fund's. IFC applied the most rigorous requirements for high risk E&S projects contemplated by our policies and procedures, and went beyond them in areas	N/A

<p>was required by IFC, in particular in relation to: (i) the adequacy of additional E&S assessments required by the Project ESAP, (ii) the decision not to apply FPIC to the Project; and, (iii) the client's security management plan.</p>	<p>such as: consultation with internal and external Social Specialists; review of several other documents, in addition to the ESDD; and confirmation of the Fund's findings by outside sources. IFC worked with the Fund on all the items mentioned by the CAO in this report.</p>	
--	--	--

Annex 2: Improvements in IFC's Approach to E&S Risk Management for Private Equity Funds

IFC strives to learn and constantly improve its processes. Some specific actions taken over the last few years that have advanced IFC's framework for managing E&S risks in investments and promoting transparency in private equity funds are as follows.

1. Legal protections: IFC's legal requirements now include specific remedies to address E&S non-compliance issues. A fund manager will be given opportunities to bring a sub-project back into compliance through remedial plans and actions, and if ultimately unsuccessful, the fund is usually required to use all reasonable efforts to dispose of the investment or terminate its financing of the sub-project. IFC also now generally has the right not to fund a capital call for an investment that remained in breach of E&S and was not moving into compliance. The legal templates on E&S terms for generalist growth equity funds were developed in consultation with, and adopted by, major DFI partners. These revised templates incorporate the lessons of previous CAO cases, such as ensuring that the CAO obtains access rights to underlying investee companies.
2. Interaction preceding investment: IFC currently applies an E&S approach to its funds investments that exceeds the oversight and requirements of other investors, including DFIs. For example, fund clients are required to have an E&S Management System established before IFC finalizes its commitment to the fund. An additional generally applicable requirement is for IFC to have rights to review the E&S due diligence conducted by the fund of its first three investments and those of all Category A investments. This is completed prior to the fund making an investment in a sub-project so that IFC can give feedback on the potential E&S risks and begin an iterative process of providing guidance for an E&S action plan if necessary.
3. Supervision: IFC's approach to supervision now includes visits from IFC's E&S department to a sample of fund sub-projects to assess E&S risks and help fund clients in managing those risks. IFC has dedicated E&S experts who engage with funds and sub-projects for supervision post-investment. Since the 2012 Sustainability Framework was implemented, IFC funds clients are developing External Communications Mechanisms to receive inquiries or complaints from external parties. IFC has also significantly scaled up the support it gives to clients, not just providing in-depth support during appraisal and supervision, but also by offering regular E&S risk management trainings across regions. Over the past two years, IFC has provided advanced E&S training to over 100 clients in Asia, EMENA, Africa and Latin America. The capacity building through regional training programs and enhanced supervision have resulted in better implementation of IFC's E&S requirements and increased compliance by our fund managers.
4. Selectivity: IFC has implemented greater selectivity in fund selection, as funds are segmented rigorously per their underlying E&S risk. Since 2015, a conscious decision has been made to limit new investments in high risk funds, with an increased focus on growth equity, venture capital and SME funds, all of which invest in sub-projects with lower E&S risks.
5. Access to information policy ("AIP"): In addition to these initiatives designed to strengthen IFC's oversight of fund investments and support to IFC clients to better manage E&S risks, IFC has also gone beyond its own policies in promoting transparency. As per Access to Information Policy, IFC publishes the name, sector and location of every investment of its funds' sub-projects. In 2017, IFC fulfilled 100% of its requirement for the 63 fund investments initiated since 2012, and published information on more than 387 fund sub-projects.