



January 8, 2016

Office of the Compliance Advisor Ombudsman (CAO)

TERMS OF REFERENCE

CAO Compliance Investigation of IFC's Investment in Lydian International Ltd., Armenia

Project #27657

Complaints 01 and 02 / Gndevaz & Jermuk

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).

If CAO concludes that the parties are not willing or able to reach a facilitated solution, the case is transferred to the compliance function of CAO, to appraise whether the concerns raised in the complaint merit a compliance investigation of IFC/MIGA.

The focus of the CAO compliance process is on IFC/MIGA's appraisal and supervision of an investment, and whether or not IFC/MIGA complied with its own policy provisions to assure itself of the environmental and social performance of its investments. CAO does not undertake a compliance investigation of IFC/MIGA's client.

CAO discloses the findings of its compliance investigation in an investigation report to inform the President and Board of the World Bank Group, senior management of IFC/MIGA, and the public about its decisions and reasoning.

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

Background to the investment

Lydian International Ltd. ("the client") is a junior mining company based in the UK and listed on the Toronto Stock Exchange (TSX). The company is focused on its Amulsar Gold Project in Armenia ("the project"). The Amulsar Gold Project is managed by Geoteam CJSC, a 100% owned Armenian subsidiary of Lydian. IFC made its first equity investment in the company in 2007 to finance exploration activities and feasibility studies in relation to Lydian's mineral resource properties in Kosovo, Armenia and Turkey. This initial investment was followed by additional investments and exercises of warrants. As a result, at the time of writing, IFC held a 7.9% equity share in the client, and had invested 17.3 million Canadian dollars (CAD).

The European Bank for Reconstruction and Development (EBRD) is also a shareholder in the company.

At the time of writing, the project was at an advanced feasibility stage. A bankable feasibility study and a national EIA were completed in July 2014, and a mining license was granted to the company in November 2014. An international ESIA was disclosed in May 2015. The project had signed agreements to finance construction and was targeting full gold production in 2017.

The complaints

A first complaint was submitted to CAO in April 2014 by residents of Gndevaz and Jermuk villages near the project site with support from nine NGOs. The complainants highlight concerns about the adequacy of stakeholder consultation around the project, as well as the project's potential future project impacts on the environment and surrounding communities. Issues raised include criticisms of the national EIA process conducted by the company, alleged violations of IFC's Performance Standards and national regulations. Further, during the CAO assessment phase the project stakeholders raised additional concerns related to cultural heritage and potential negative impacts on a World Bank project in Armenia.

A second complaint was lodged with CAO in July 2014 by 148 local residents of Gndevaz village in Vayots Dzor province raising concerns about project impacts on livelihoods, the environment and on community health. Specifically, the complaint alleges lack of adequate project information, including information about land acquisition and resettlement plans; potential environmental contamination from the project's cyanide leaching system; dust pollution affecting fields, livestock and farmland; employee and community health issues; and insufficient community engagement.

Scope of the compliance investigation

In its 2015 appraisal reports related to the Lydian-01¹ and Lydian-02² complaints, CAO found that a review of certain aspects of this project which relate to its nature as an early equity mining investment might better inform the application of policies to this project as well as future projects.

In this context, CAO has decided to consider the issues raised by both the Lydian-01 and Lydian-02 complaints together. The two cases were thus merged for the purpose of this compliance investigation.

Given CAO's mandate, the focus of the CAO compliance investigation is on IFC, and how IFC assured itself of the environmental and social performance of its investment at appraisal and during supervision.

The approach to the compliance investigation is described in the CAO Operational Guidelines (March 2013)³, and states that the working definition of compliance investigations adopted by CAO is as follows:

An investigation is a systematic, documented verification process of objectively obtaining and evaluating evidence to determine whether environmental and social activities,

¹ CAO Compliance Appraisal Report, Lydian-01, April 2015 - <http://goo.gl/GWpgZm>

² CAO Compliance Appraisal Report, Lydian-02, April 2015 - <http://goo.gl/ddr6fv>

³ CAO Operational Guidelines, 2013 - <http://goo.gl/Hc46c8>

conditions, management systems, or related information are in conformance with the compliance investigation criteria.

As set out in CAO's appraisal reports, CAO will conduct a compliance investigation of IFC's investment in the client in relation to the issues raised in the complaint. In reaching the decision to conduct a compliance investigation, CAO noted that IFC has, to date, only funded activities that are preparatory to the construction of the mine, and that no decision on whether to fund construction of the mine had been made. Nevertheless, CAO noted that IFC's investments in the company had the clear objective of enabling construction of the mine. Subsequent to release of the CAO compliance appraisals, agreements to finance construction of the mine have been reached.

In the context of IFC's E&S policies, Performance Standards and procedures, CAO has identified the following specific questions in relation to the investment include:

- Was IFC's definition of the project and its pre-investment review commensurate with the level of E&S risks and impacts of the project?
- Did the structure of this investment adequately consider the potential long-term E&S risks impacts of the project and the likely changing risk profile over time?
- Was IFC's supervision of the evolving risk profile of the project adequate?

The scope of the compliance investigation also includes developing an understanding of the immediate and underlying causes for any non-compliance identified by the CAO.

Compliance Investigation Process and Preliminary Timeline

The preliminary time schedule is for CAO to have a draft compliance investigation report ready by the end of May 2016.

A draft investigation report will be circulated to IFC senior management and all relevant IFC departments for factual review and comment. IFC comments should be submitted in writing to CAO within 20 working days of receipt by IFC.

Upon receiving comments from IFC on the consultation draft, CAO Compliance will finalize the report. The final report will be submitted to IFC senior management for official response. A notification will be posted on CAO's website. IFC has 20 working days to submit a written response to CAO. CAO will forward the investigation report and the IFC response to the President of the World Bank Group. The President has no editorial input as to the content of the compliance investigation report, but may take the opportunity to discuss the investigation findings with CAO.

Once the President is satisfied with the response by IFC senior management, the President will provide clearance for the investigation report and the response. The President retains discretion over clearance. After clearance, CAO will disclose the investigation report and the IFC response to the Board. CAO will also alert relevant stakeholders of the disclosure of both documents on CAO's website, and share the documents with the complainants.

External Panelists

As per its established practice, CAO will engage one or more external experts to work with it on this task. For this compliance investigation, CAO considers the following as necessary for the compliance investigation panel:

- Significant expertise in relation to issues of environmental and social risks and impacts in the context of international finance, in particular in relation to extractive industries.
- Knowledge of IFC's E&S policies, standards and procedures.
- Experience and knowledge relevant to the conduct of compliance investigations.
- Demonstrated ability to analyze policies and practices and develop proposals for reform in complex institutional contexts.
- Expertise in relation to stakeholder engagement and consultation.