Guidelines Briefing Part 4: IFC Performance Standards - User-friendly standards under review

Posted by Oliver Balch [1] on Apr 30, 2010

While the International Finance Corporation's standards are a useful project finance benchmark, they are not immune to criticism

As the private sector lending arm of the World Bank, the International Finance Corporation has a mandate to aid development in its 182 member countries. It seeks to achieve this through financing large private sector projects.

Concerns over the social and environmental impacts of its project portfolio led the IFC to devise robust guidelines for its lending practices back in 1998. These initial safeguard policies were revised in 2006 to form the Policy and Performance Standards on Social and Environmental Sustainability.

The institution's motivation is financial as well as reputational. As with any private bank, the IFC has a vested interest in reducing its social and environmental liabilities. Poor management of non-financial risks damages clients' long-term profitability and increases the potential for default.

Between 2006 and 2009, the IFC board received financing requests for about 560 projects. The investments, which have a net value of more than $25bn, represent a quarter of the total number of projects in the IFC's portfolio.

The IFC's review process attributes a risk category to all potential projects. There are three in total. Category A projects have "potential significant adverse" impacts that are "diverse, irreversible or unprecedented". Category B projects have potential impacts that are limited and generally site-specific. Category C projects present minimal or no risk.

One of the main strengths of the standards is their community engagement requirement. IFC clients must demonstrate that they have disclosed all relevant project information to affected communities and meaningfully consulted them throughout the project development phase. Projects must also have a grievance mechanism in place through which local communities can submit their concerns.

Public disclosure forms another positive feature of IFC's standards. In accordance with its own rules, IFC discloses information relating to its own institutional and investment activities. Clients must also meet exacting disclosure norms, particularly in the extractive and infrastructure sectors.

A year-long revision of the standards is presently under way, with an updated version of the standards expected by January 2011. The revision aims to clarify language, improve implementation effectiveness and fill gaps in present coverage.

Environmental protection

Civil society groups have highlighted a range of additional challenges. "IFC currently has only a limited number of climate change-related requirements within the performance standards and no requirements for IFC in the sustainability policy," an 18-page open letter released in March by a group of nearly 100 non-profit groups alleges.

The letter highlights IFC's continued support for oil, coal and other fossil-fuel-intensive projects linked to climate change. The NGO critics would like to see IFC phase-out support for fossil fuels.

"In order to trigger a portfolio shift towards low carbon technologies, IFC should make clear commitments to reduce total emissions according to a set timetable," says Antonio Tricarico from the Italian-based Campaign to Reform the World Bank and a signatory to the letter.

Another key demand of the civil society group is to include specific reference to international human rights standards, particularly those reflected in the UN Declaration on the Rights of Indigenous Peoples.

Initial social and environmental assessments by IFC clients are “notably flawed”, the letter says, and assessment requirements should be tightened. Suggested steps include introducing a “no project” alternative within the impact assessment, reporting on impacts to all ecosystem services and more effectively considering the cumulative impacts of projects on regional development.

For its part, the IFC concedes that a number of process challenges exist. These include managing financial intermediary risks and differing stakeholder views on how IFC categorises projects.

Weaknesses related to supply chain issues have also been identified. The agribusiness sector, where environmental and social risks are becoming increasingly complex, is a particular area of concern.

As for climate change and biodiversity, the IFC acknowledges that these issues are “important” and “need attention”. The IFC will reveal proposed changes in early June, prompting a further 60-day consultation.

“Stakeholders will be able to see the changes we propose and provide their feedback on how issues such as climate change and biodiversity have been addressed,” says Greg Radford, director of environment and social development at the IFC.

The standards boast some significant successes, however. Arguably, the biggest strides have been witnessed outside the IFC itself. OECD export credit agencies and European development finance institutions, for example, feature among the public development financial institutions that reference the use of the standards.

The most traction to date has come from the private project finance community. Almost 70 private banks have so far committed to use the IFC’s standards in project assessment. The banks convene under the voluntary Equator Principles, launched in June 2003. This initiative commits participating banks to apply the IFC’s standards in all project financing deals worth more than $10m.

In the absence of an internationally recognised set of environmental risk guidelines, the IFC standards offer a “de facto threshold” for the finance sector, according to Chris Bray, head of environmental risk management at Barclays.

“From a banking risk perspective, the standards are relatively easily understood. In addition, they are well embedded as an industry norm for project finance,” he says.

Useful links
IFC Performance Standards: www.ifc.org/EnvSocStandards [2]
Equator Principles: www.equator-principles.com [3]
Civil Society Letter: www.accountabilityproject.org/jointsubmission [4]

Links:
[1] http://www.ethicalcorp.com/users/oliver-balch
[2] http://www.ifc.org/EnvSocStandards
[3] http://www.equator-principles.com
[4] http://www.accountabilityproject.org/jointsubmission