

Submission to the World Bank on Guidance Note to Environmental and Social Standard 9 December, 2017

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ESS9 should contain considerably more guidance to help World Bank financial intermediaries establish effective environmental and social management systems (ESMS) and ensure that sub-projects apply the requirements of all relevant ESSs and do no harm. The application by financial institutions of environmental and social responsibilities is relatively new, and many financial institutions that will become World Bank intermediaries do not have even basic ESMSs or sufficient staff with expertise on environmental and social assessment. Many have little or no experience in applying environmental and social safeguards, even for the most straightforward of projects, let alone for more complex financial relationships. In the financial sector, the application of environmental and social requirements will depend on the type of FI (eg. private equity, commercial banks) and the type of transaction (equity or debt, including credit facilities, syndicated loans, bonds, etc.) and the role the FI plays in the transaction (arranger, manager, underwriter, holder, etc.). Because of this lack of experience and staff, on one hand, and the complexity of different relationships, on the other, there is a need for particularly strong and practical guidance for FIs on the application of ESS9.

This need is borne out by the evidence from other DFIs. The World Bank need look no further than research and analysis conducted in relation to the International Finance Corporation (IFC)'s financial sector investments to understand just how poorly many financial intermediaries have implemented environmental and social requirements. This includes the CAO's compliance audit of IFC's financial sector portfolio¹ and its monitoring reports. Although the CAO's mandate limits it to examining the IFC's own compliance, rather than its clients, the reports are nonetheless instructive for identifying areas for which strong guidance for FIs is necessary. For instance, among many problems, the 2017 monitoring report found that only 5% of IFC FIs has established an external communications and grievance mechanism to receive complaints of E&S harm in relation to the FI's portfolio.² This widespread failure of FIs to comply with a most basic requirement, suggests a widespread and systemic failure in ESMSs across the board. Indeed, the CAO has also found that IFC does not have assurance that the development of a client's ESMS is leading to implementation of the Performance Standards at the sub-project level," suggesting broad failures of compliance both by the IFC and its FI clients.

¹ http://www.cao-ombudsman.org/newsroom/documents/Audit_Report_C-I-R9-Y10-135.pdf

² http://www.cao-ombudsman.org/newsroom/documents/documents/CAOMonitoringReport_FIAudit_March2017.pdf

We also urge the World Bank to take heed of Inclusive Development International and Oxfam's [many publications](#) on the suffering caused to hundreds of thousands of people across the world by projects financed by IFC FIs when environmental and social standards have not been applied effectively.³

The CAO reports, its growing caseload of FI projects, and NGOs' many publications, should be given serious attention in the revision of these guidance notes to help ensure that the World Bank's financial sector investments do not repeat these consequential problems and failures.

It is worth noting in this context that ESS9 omits important aspects of due diligence that were in the previous Policy/Bank Procedures on Involuntary Resettlement, but are critical to include in these guidance notes to ensure that the new policy is not weaker than the previous policy *in practice*. For example, the previous policy required FI clients whose sub-projects involve involuntary resettlement to submit satisfactory resettlement plans for those sub-projects to the Bank for prior approval. Under the policy, implementation of resettlement plans was also subject to ex post review by the Bank.⁴ The submission of all high and substantial risks subprojects to the Bank for prior approval is a critical component for effective supervision and monitoring of FI client due diligence. The guidance notes for ESS9 should support clients to implement all the substantive requirements and objectives of the ESSs in the most effective way possible to avoid the same systemic problems observed at IFC.

The guidance notes should refer FIs to the increasing number of international standards that create an expectation that financial institutions respect human rights in their investment decisions, including by adopting human rights and environmental and social policies; conducting environmental and social due diligence across their products and services, using their leverage with clients to prevent, mitigate and remediate harms and human rights violations, and contributing to remedies themselves in some cases. The guidance should provide references to key documents, including the OECD Guidelines on Responsible Business Conduct for Institutional Investors, and others relating to the financial sector, many of which can be found [here](#).

We urge the World Bank to incorporate the following priority additions and changes to the final GN on ESS9:

1. The introduction to ESS9 states that the “way in which the FI will manage its portfolio will take various forms, depending on a number of considerations, including the capacity of the FI [...]” **Guidance should make clear that the level of capacity of the FI does not affect its responsibilities under ESS9, but may affect the resources, measures, and support needed to develop a fully functioning and effective ESMS.** Where the FI requires additional support, it should discuss these

³ All of these reports can be found here: <https://www.inclusivedevelopment.net/campaign/campaign-to-reform-development-lending-through-financial-intermediaries/>

⁴ World Bank Operational Policy on Involuntary Resettlement (OP 4.12), para 30. We note that the ADB also requires the submission of all sub-projects with significant impacts to the ADB for clearance prior to approval.

needs with the World Bank and develop a capacity building strategy.⁵ The FI should also consider its Environmental and social capacity as a key determining factor in considering its portfolio size and environmental and social risk.

2. **Guidance to the objectives of ESS9 should explain that underlying the general objectives relating to environmental and social risk management is the end goal of ensuring that World Bank sub-projects apply the relevant issue-specific ESSs on the ground, meet their objectives, and do no harm to people and the environment.**
3. GN4.1 explains that the scope of application of ESS9 depends on the project activities or commitments covered by Bank project financing. The GN should end with: **“However, even in cases in which the Bank’s investment is limited to a specific class of sub-projects, in line with UN Guiding Principles on Business and Human Rights and other international standards, World Bank FIs are encouraged to apply their environmental and social management systems across their entire portfolios and operations.”** A similar sentence should appear in guidance to paragraph 5.
4. GN4.3 mentions some of the financial products and services that FIs may provide. In addition to traditional financing products, such as loans, it mentions other more exotic products such as “dealing room products (for example hedging, swaps) and investment banking products (for example, bond underwriting, arranging of equity issuance)”. Yet, there is no guidance on how the ESSs apply to these types of products and services. **The GNs should provide detail on how the FI can meet its responsibilities with respect to a variety of types of transactions and roles.** For example, if an FI is considering joining a syndicated loan or participating in a bond issue, but is not the manager or arranger, it should nonetheless be required to use its leverage to push for relevant ESSs to be incorporated into contractual arrangements, and if such clauses are not included, the FI should be required to make a “no-go” decision where there is a risk of environmental or social harm. It should be made clear that as an arranger, manager, or underwriter of such transactions, including a bond issue, the FI needs to ensure that clauses reflecting the ESS requirements are incorporated into agreements and covenants. When considering acquiring equity or debt on secondary markets, where it cannot influence the sub-project directly, it should make a no-go decision if the sub-project is associated with environmental and social risk and has made no commensurate commitments to mitigate those risks. **The guidance should set out clearly the expectations that the FI is responsible for ensuring its client is committed to and prepared to implement the ESSs where applicable and it should not make the investment if this commitment has not been made explicitly upfront. As a general rule, the FI should ensure that this commitment is laid out clearly in contractual arrangements with the investee.**
5. GN14.1, which simply repeats the structural elements of an ESMS, does not effectively provide guidance on paragraph 14, which sets out requirements regarding

⁵ This should be considered part of the Bank’s objective of “building borrower systems”, and it should take the opportunity of investing in FIs to establish sustainable practices for the FI beyond the Bank’s immediate interest.

environmental and social policies of the FI. Paragraph 14 requires FIs to institute a policy that includes complex elements such as metrics with regard to the FI's ESMS. Guidance is needed given that many financial institutions that become World Bank intermediaries have little or no experience developing such environmental and social policies. **Such guidance should also encourage FIs to adopt a human rights policy that is in line with the United Nations Guiding Principles on Business and Human Rights.**

6. **GN to paragraph 16(e) should explain the systems of ongoing due diligence that FIs should undertake in order to monitor the sub-projects compliance with environmental and social requirements as set out in the contractual arrangements.** For example, it should require regular reporting by the sub-project to the FI and public review of these reports, including identification of gaps in reporting; it should conduct site visits to high and substantial risk sub-projects; and importantly it should routinely monitor for news alerts and reports of NGOs and ESG research firms regarding the sub-client and sub-project.
 7. Paragraph 23 requires the FI to submit to the Bank Annual Environmental and Social Reports on the implementation of its ESMS. **The GN should explain that the FI should hire a professional independent third party auditor to conduct the Annual E&S Reports, which should include a report on compliance by the FI and by a representative sample of high and substantial risk sub-projects with the World Bank's ESS requirements. The GN should clarify that the definition of "independent third party" excludes the use of parties involved in sub-project design or operation.**
 8. The guidance should explain that meeting the requirements of ESS9 and other ESSs, particularly those in relation to external communication and grievance mechanisms, specifically including the Inspection Panel, by implication necessitates the disclosure of sub-projects by the FI (and the World Bank). If communities are to avail themselves of these mechanisms, they must be made aware that the FI is financing the project and that the project is supposed to adhere to the World Bank's standards. As such, **the GN should urge FIs to systematically seek consent from sub-clients to disclose information about high and substantial risk subprojects and to avoid those subprojects for which such consent is not provided as it could be a red flag of potential risks down the road and could effectively bring the FI out of compliance as we describe below. FIs should, at a minimum, make public the name of the company and its subsidiaries, and the names, sectors, and locations of sub-projects along with draft and then final environmental and social risk assessments for such projects. The FI should regularly provide the World Bank with the information to make available through its online project database.** Guidance describing and encouraging⁶ disclosure should be inserted in relation to paragraph 9, which sets out the required elements of an FI's ESMS, including external communication mechanisms, and paragraph 25, which briefly elaborates on procedures for external communications. The need for disclosure should be referred to again in relation to paragraph 11, requiring sub-project compliance with relevant parts of the ESSs. **Guidance should be provided on paragraph 27 encouraging the**
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FI to obtain consent for all high and substantial risk sub-projects for the FI and the World Bank to disclose project-related documents, including draft assessments, required by the application of the ESSs.

Increasingly, disclosure is industry best practice; for instance the third version of the Equator Principles sets out a framework for disclosure by signatory banks of the names, locations and sectors of its project finance investments with the consent of its clients. The guidance notes provide an important opportunity for the World Bank to play a leadership role in pushing for greater disclosure in the financial sector, consistent with its development mandate and goals. Disclosure places a reputational incentive on the FI and the sub-project to: undertake more thorough due diligence; consult with communities and obtain free, prior, and informed consent when appropriate; conduct robust environmental and social impact assessments with specific attention to gender issues, the vulnerable and those without land title; and develop strong risk management plans. It also allows for communities to alert the FI and the World Bank early on if concerns arise. These benefits should be articulated in the GNs.

While in many jurisdictions, banks are subject to client confidentiality laws and regulations that restrict disclosure of individual and business financing relationships, the duty of confidentiality to clients can be overcome by agreement with the client. The World Bank itself provides the perfect model of enforcing disclosure rules: it requires its direct clients, both in the public and private sector, as a condition of financing, to agree to public disclosure of the investment. There is no good reason this could not be extended to the sub-projects of FI clients that meet appropriate criteria.

9. **The GN should address FI responsibilities in regards to the provision of effective remedy.** This includes the following:
 - a) **The GN should explain that FIs are expected to incorporate into all contractual arrangements with sub-projects clauses relating to remedial actions should E&S issues arise.** This should be included in GN7.4, GN11.3, which both refer to the FIs' responsibility to set out the requirements of the ESSs in contractual arrangements. These clauses should address the sub-project's responsibility to take remedial measures in line with the ESSs, including providing appropriate remedies to project affected people should the sub-project fail to apply the ESSs and where harms ensue as a result. The contractual arrangements should also set out the legal remedies available to the FI when sub-projects are found not to be in compliance with the ESSs and/or provide for substantive remedies for communities that have suffered harms as a result (for example through penalty fees or environmental performance bonds). These will create meaningful and enforceable legal imperatives on the sub-project to comprehensively apply the ESSs.
 - b) **Guidance should explain that the FI must require high and substantial risk sub-projects to ensure project-affected people are aware as early as possible and before project implementation begins, that they are entitled to access the Inspection Panel and describe how the Inspection Panel may be accessed by those affected. The FI should ensure this responsibility is discharged by**

- requiring the sub-project to provide a report to the FI** (ie. details of date, manner and form in which affected people were made aware of their entitlements to access the Inspection Panel). **The FI should report this information to the World Bank in its Annual Environmental and Social Reports, which should in turn be publicly disclosed by the Bank.**
- c) It is disappointing that ESS9 does not explicitly require FIs to establish grievance mechanisms themselves. **Guidance should be provided to urge FIs to ensure their external communications mechanisms are known and accessible to project-affected people and effective at addressing E&S issues that come to the FI's attention.** (See related recommendation on disclosure of sub-projects above.) **E&S issues brought to the FI's attention through the external communications mechanism should be reported to the World Bank.** In addition, ESS9 should contain guidance on **requiring high and substantial risk sub-projects to establish operational-level grievance mechanisms**, as required by ESS10 and other ESSs.
- d) The GN lacks sufficient guidance on the FI's responsibility should social and environmental issues arise in its sub-projects. GN21.2 says that the FI "works with the FI subproject to ensure corrective actions are implemented." The guidance note requires much more. **It should explain that if issues emerge after an investment has been made, the FI must use its leverage to the fullest extent possible to ensure those issues are addressed in line with the ESSs, including through measures to prevent, mitigate, and remediate harms. The guidance should also emphasize the expectation that the FI fully support remedial processes, including Inspection Panel investigations. Where, despite the FI's full and meaningful efforts to influence the sub-project, it refuses to address risks or remediate harms, the FI should exit the relationship and exclude the sub-project from future investments. It should inform the World Bank of these developments. In such cases, the World Bank and the FI should publicly disclose the reasons the FI ended the relationship.**
- e) **The GN should explain that in certain cases, the FI itself may have contributed to the harms and will therefore be responsible for contributing to remedy itself** as well as using its leverage with the sub-project to provide remedy. For example, in the case of project finance, where risks were known by the FI or should have been known, and the FI failed to ensure the sub-project put mitigation measures in place, it will have contributed to the harms by providing financing that enabled them to occur.
- f) **When an FI is considering an investment in a sub-project that has previously caused adverse impacts and these harms are ongoing, the FI should require the sub-project to remedy the harms.** For example, if a sub-project caused forced evictions and displaced people without adequate compensation, access to adequate housing and livelihood support and opportunities, and several years later the sub-project seeks financing from the FI in order to complete construction, operate, expand, or whatever the case may be, the FI must require the sub-project to remediate the harms in line with ESS5 as a condition of financing.