Norad

EVALUATION DEPARTMENT

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IFC's Performance Standards: A Global Norm for Responsible Business Conduct

INTRODUCTION AND OVERVIEW

Projects and investments in developing countries have the potential to generate economic growth and employment, and to contribute positively to countries' development. However, experience shows that there may also be adverse environmental or social impacts as results of projects. Projects may cause pollution, health and safety hazards, or make use of child labor. Such project impacts often disproportionately affect poor and vulnerable groups, such as local Indigenous communities dependent on natural resources; women; or people displaced by land acquisition.

Multilateral development banks (MDBs) have recognised these challenges for several decades. They have gradually established policies and standards to identify risks of potential adverse impacts in different areas, and to avoid or mitigate such impacts. Almost all MDBs have adopted such environmental and social (E&S) safeguards policies, which are sometimes referred to as 'do no harm' policies. [1]

While these standards were initially developed for investment projects where MDBs finance government agencies for public-sector projects in areas such as transport, energy, or health and education, environmental and social standards are also key to how the private sector does business in a responsible manner. The most recognised and widely used international framework for E&S risk identification and management is the set of eight Performance Standards developed by the private sector arm of the World Bank Group, the International Finance Corporation (IFC). These standards were established in 2006 and revised through a global consultation process from 2009 to 2011. The updated framework was approved by all 185 member countries of the IFC in 2011 and became effective in January 2012.

THE EIGHT PERFORMANCE STANDARDS ARE [2]

1. Assessment and Management of Environmental and Social Risks and Impacts. This is considered the 'umbrella policy', since it contains core principles and expected outcomes related to E&S risk management. The other seven Standards address more specific topics in greater detail:
2. Labor and Working Conditions
3. Resource Efficiency and Pollution Prevention
4. Community Health, Safety, and Security
5. Land Acquisition and Involuntary Resettlement
6. Biodiversity Conservation and Sustainable Management of Living Natural Resources
7. Indigenous Peoples
8. Cultural Heritage

USAGE AND UPTAKE

The Performance Standards require firms to undertake a comprehensive risk assessment of projects that they plan and implement. The emphasis is on risk of potential adverse impacts that a project may cause or contribute to on the natural environment or project-affected people. Such potential impacts should be identified and mitigated. In understanding these risks, it is not enough to just look at the 'footprint' or direct impact of a project. Broader contextual risks or pre-existing risks – such as operations in fragile or conflict affected areas, or projects affecting vulnerable groups – are also considered.

Since their adoption, the Performance Standards have become the de facto global norm for E&S risk management in projects. They have been adopted widely not just by IFC's direct clients, but other firms as well as financial institutions, both private and public. They are increasingly

1 MDBs with safeguards policies or environmental and social standards include the World Bank, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, and the recently established Asian Infrastructure Investment Bank, among several others.

2 It is beyond the scope of this short briefing note to go into detail about the content of all eight Standards. For more information on the content of the Standards, see for example IFC's web pages, including an overview webinar.

seen as representing best practice, and as the benchmark against which projects and investments should be measured. An example is the recently established Development Finance Institute Canada, a subsidiary of Canada's export credit agency. In their November 2019 draft Environmental & Social Policy, they refer to the IFC performance standards in their overview of good international practice that underpins their work:

- UN Guiding Principles on Business and Human Rights [3]
- ILO Declaration on Fundamental Principles and Rights at Work
- OECD Guidelines on Multinational Enterprises
- World Bank Group Environmental Health and Safety Guidelines
- IFC Performance Standards on Environmental and Social Sustainability

3 See a discussion later in this note about the relationship between the UNGP and the IFC Performance Standards.

Some other examples of usage and uptake of the Performance Standards include:

- More than 100 commercial banks and OECD export credit agencies in 38 countries are organised in an association called the Equator Principles Financial Institutions (EPFIs). These institutions have all committed themselves to applying the IFC Performance Standards in projects in so-called 'non-designated countries'.[4] The member institutions include banks as diverse as ABN Amro (Netherlands), Access Bank (Nigeria), Bank of America (USA), Citigroup (USA), IDFC (India), JP Morgan Chase (USA), Lloyds (United Kingdom), Nordea Bank (Sweden), Banco do Brasil (Brazil), Credit Suisse (Switzerland), and the Bank of Huzhou (China). In Norway, both DNB and Export Credit Norway are members of the EPFIs. Collectively, these financial institutions cover the majority of international project finance in developing countries.

4 Non-designated countries are most countries in emerging markets or developing countries. The EPFIs do not apply the Performance Standards when they finance projects in most OECD countries, since those countries are *'deemed to have robust environmental and social governance, legislation systems and institutional capacity designed to protect their people and the natural environment'*. (From the Equator Principles web page).

- Another institution which applies the IFC Performance Standards is Norfund In Norway, which invests to 'help build sustainable businesses in poor countries'. Norfund's web page states that it is a responsible investor, which adds value *'by helping the companies to achieve good standards of governance, along with strong environmental and social performance'*.
- Among multilateral development banks, there is general agreement that policies and standards should be harmonised to the extent possible. Increasingly, MDBs are adopting environmental and social frameworks based on or consistent with the IFC Performance Standards. This is the case with the World Bank, which in 2018 started applying its new Environmental and Social Framework, based largely on the Performance Standards. Similarly, the European Bank for Reconstruction and Development (EBRD) applies a set of Performance Requirements very similar to the Performance Standards. And most recently, the Inter-American Development Bank has announced that it intends to change its existing environmental and social safeguards polices and apply a new policy framework based on the Performance Standards.

This adoption of key principles and elements of the IFC Performance Standards among MDBs, commercial banks, and other institutions has important implications for support to developing countries' own environmental and social legislation and institutions. It is consistent with the 2005 Paris Declaration on Aid Effectiveness and the 2008 Accra Agenda for Action, which call for harmonisation and alignment among donor countries in moving towards strengthening and using local systems in developing countries.

The Performance Standards are relevant not just for investment projects, but also for other development initiatives, such as advisory services or technical assistance. IFC has a large program of advisory services, and its 2018 Policy on Environmental and Social Sustainability states that '.. *the advice provided to clients shall be consistent with the Performance Standards as a framework of good international industry practice in environmental and social risk management.*'[5]

ARCHITECTURE AND STRUCTURE

In some cases, the Performance Standards are used by firms or institutions on a voluntary basis, without being a contract requirement by a lending or financing institution such as IFC or Norfund. More often, the typical risk management architecture is based on two complementary systems through contractual arrangements:

Financial institution: The financial institution has its own environmental and social policies and procedures for risk assessment and due diligence for proposed loans and investments. The financial institution's overall set of policies, procedures, decision-making processes, and available financial and human resources to manage risk responsibly in this area is generally referred to as an Environmental and Social Management System, ESMS. As part of the financial institution's due diligence process, it evaluates potential clients' ability and commitment to meet the requirements of the Performance Standards. This system needs to be embedded in how the institution does its business, and it needs appropriate resourcing. IFC currently has around 100 E&S specialists undertaking due diligence and providing guidance and assistance to clients, while the World Bank, with its larger portfolio, has nearly 600 E&S specialists.

Clients: In IFC's case, application of these Standards is a legal requirement in contracts with clients. Clients are required to apply the Performance Standards. Norfund, for example states that '*We require that all investees comply with the environmental and social standards of the World Bank's International Finance Corporation (IFC)*'.

In this risk management architecture, there is a distinction between mandatory requirements, and guidance and good practice:

Requirements: The overall principle related to requirements and compliance is that there should be no net harm caused by the projects to people or the environment. This is expected to be achieved through assessment and management of E&S risks and impacts, where users of the Standards first '*identify and evaluate environmental and social risks and impacts of the project*', and then '*adopt a mitigation hierarchy to anticipate and avoid, or where avoidance is not possible, minimise, and, where residual impacts remain, compensate / offset for risks and impacts to workers, Affected Communities, and the environment*'. [6]

These requirements make it mandatory for firms using the Performance Standards to understand and address potential adverse E&S impacts that their projects may cause or contribute to. This includes consultation and

5 IFC Policy on Environmental and Social Sustainability, para 39.

6 Performance Standard 1, Assessment and Management of Environmental and Social Risks and Impacts: Objectives.

engagement with local communities and other stakeholders who may be affected by the project. This process should be based on '*relevant, transparent, objective, meaningful and easily accessible information which is in a culturally appropriate local language(s) and format*', through a process which is '*free of external manipulation, interference, coercion, or intimidation*'.[7]

Guidance and good practice: Each of the eight Performance Standards is accompanied by a Guidance Note. Unlike the Performance Standards, application of the Guidance Notes is not required. While the Performance Standards stipulate what should be done, the Guidance Notes have been developed to provide advice on how to interpret and implement the principles in the Performance Standards. In addition to the Guidance Notes, IFC also regularly produces good practice handbooks, interpretation notes, and other knowledge products to help users apply the Performance Standards. It also organises webinars and learning events, including convening an annual conference called the Community of Learning for the Equator Principles Financial Institutions and other users of the Performance Standards. In recent years, knowledge products have included:

- A series of webinars on environmental and social issues (2014–2019)
- Addressing Gender and Gender-Based Violence in IFC Projects (2018)
- Managing Risks Associated with Modern Slavery (2018, with EBRD and DFID)
- Environmental, Health and Safety Approaches for Hydropower Projects (2018)
- Good Practice Handbook: Use of Security Forces (2017)
- Managing Contractors' Environmental and Social Performance (2017)

THE BUSINESS CASE

Responsible businesses now see environmental and social risk management as a sound investment, rather than just as a cost. Being associated with damage to the environment or harm to people carries significant reputational risks for a firm, which can translate to credit risk or financial loss, while conducting business in a responsible manner can enhance a firm's reputation and attract investments and customers.

There are several reasons for the uptake and success of the IFC Performance Standards, and why they have become the global norm for E&S risk management. They are recognised as being comprehensive, in that they cover a broad range of issues and topics. At the same time, they are flexible in how they are applied, and can be adapted to many different settings and to different sectors and types of businesses. They can be applied to initiatives as diverse as building a hotel, constructing a power plant, and undertaking natural resource management. This flexibility is primarily in relation to procedural requirements: The Performance Standards do not contain detailed or prescriptive steps, checklists, or procedures. Instead, they focus on principles and expected outcomes in how firms and other users should identify and manage E&S risks. This makes them more flexible than much environmental legislation and earlier safeguards policy architectures, which tend to be more procedurally rigid and prescriptive.

The Standards are also more flexible in that they are less 'front-loaded' than most other approaches to E&S risk management. This means that projects may be approved more quickly. Relevant studies and mitigation plans will still need to be undertaken, but in many cases, they can be done during project implementation rather than as a precondition for project approval. This may

7 Performance Standard 1, para 30.

be described as a 'progressive realisation' of expected outcomes, where compliance with the requirements is seen more as an ongoing and incremental process than as a binary, either-or issue.

While more flexible at the outset of project financing, this approach does not mean that the E&S risk management can be taken lightly. On the contrary, the Standards require ongoing application of the principles throughout the project cycle, rather than just as an up-front licensing requirement. Firms applying the Performance Standards are required to have continuous engagement with stakeholders also during project implementation, and to provide regular feedback and updates to them of implementation progress. Performance Standard 1 states that *'The client will provide periodic reports to the Affected Communities that describe progress with implementation of the project Action Plans on issues that involve ongoing risk to or impacts on Affected Communities and on issues that the consultation process or grievance mechanism have identified as a concern to those Communities'*. [8] In order to verify that clients are addressing E&S considerations in accordance with the Performance Standards, IFC supervises projects actively throughout the project's lifetime.

8 Performance Standard 1, para 36.

CORPORATE SOCIAL RESPONSIBILITY

The Performance Standards are different from what is commonly known and practiced as Corporate Social Responsibility, CSR. In practice, CSR is often applied in a top-down, paternalistic manner. It is more akin to charity than to sustainable development. In many cases, it represents attempts to buy a 'social license' to operate, by providing some benefits to local communities. This is rarely based on systematic analysis and transparent stakeholder consultations, and it is rarely linked directly with project-induced adverse impacts. Firms applying CSR in developing countries sometimes think they can use local investments to offset negative impacts of their projects – but the financing of a local school does not compensate for a community's loss of land or access to water resources.

In contrast, the Performance Standards link mitigation measures directly with analysis and consultations around potential risks and adverse impacts, and should be understood more as a rights-based approach than charity: People have a right to be consulted, and they have a right to have firms minimise or mitigate adverse impacts.

This is not to say that CSR has no place in development projects. CSR approaches can complement responsible application of E&S safeguards and standards. Since the Performance Standards are oriented towards risk management and aim to ensure no net loss to people or the environment, more aspirational development goals – do good, rather than just doing no harm – can be financed and supported by CSR approaches. Such approaches function best when they are built on real needs and opportunities, and identified through systematic consultation processes rather than just presented to local communities as a gift or charity. The Performance Standards and CSR approaches can and often should coexist – but one should not be confused for the other.

HUMAN RIGHTS AND ACCOUNTABILITY MECHANISMS

As noted above, the Performance Standards reflect a rights-based approach to development. They are informed by, and intended to be consistent with, human rights principles. Performance Standard 1 states that *'Business should respect human rights, which means to avoid infringing on the human rights of others and address adverse human rights impacts business may cause or contribute to'*. [9] This language reflects the 2011 UN Guiding Principles on Business

9 Performance Standard 1, para 3.

and Human Rights, with its three pillars of the state duty to protect human rights; the corporate responsibility to respect human rights; and the right to remedy of those affected. The UN Guiding Principles emphasise that firms should avoid causing or contributing to adverse human rights impacts, and seek to prevent or mitigate adverse impacts that are linked to their operations, even if they have not contributed to those impacts. This is referred to as the 'cause, contribution, linkage' approach. The Performance Standards' language and guidance on risk analysis and management are consistent with this approach.

Applying the principle of the right to remedy, people affected by projects using the Performance Standards have a right to remedy when their rights are not respected: the Performance Standards state that *'the client will establish a grievance mechanism to receive and facilitate resolution of Affected Communities' concerns and grievances about the client's environmental and social performance'*.[10] In addition to project-level grievance mechanisms, IFC and other MDBs have also established their own independent accountability mechanisms. In the case of IFC this mechanism is called the Compliance Advisor Ombudsman, CAO. The World Bank's mechanism is called the Inspection Panel. These mechanisms contribute important correctives and institutional learning for the MDBs, and help draw attention to adverse impacts that need to be remedied.

10 Performance Standard 1, para 35.

COSTS AND CHALLENGES

Meeting the requirements in the Performance Standards is challenging and requires a serious commitment over time. It requires resources and commitment, and it means integration of E&S issues into firms' and financial institutions' decision-making processes. It also generally requires multi-disciplinary expertise in a broad range of environmental and social issues, from labor standards to resettlement, cultural dynamics when dealing with Indigenous Peoples, biodiversity and ecosystem services, energy efficiency and climate related risks, and tangible and intangible cultural heritage. Few firms or financial institutions have such expertise from the outset.

Another challenge in applying the Standards is that an individual firm may have limited control or leverage over third parties it is associated with. This may involve government agencies undertaking expropriation of land for a private sector concession; different parts of a complex supply chain; contextual risks such as conflict, fragility, and violence; or being perceived to be linked to human rights abuses committed by others. It takes experience and skills to understand and address both the issues a project is directly responsible for, and broader risks in the operating environment. The expectation when applying the Performance Standards is not that a firm should say 'I didn't cause the problem, so I am not going to deal with it.' Rather, responsible application of the Performance Standards means that the firm should (i) understand the risks it is associated with, and (ii) make good faith efforts to use or develop leverage to try to influence the situation or third parties, to minimise and mitigate risks.

For a financial institution, it is rarely sufficient to simply tell its clients to apply the Performance Standards and assume that business is conducted in a responsible manner. Systematic due diligence, follow-up, and in many cases technical assistance and ongoing engagement are needed, particularly in high-risk circumstances.

These challenges may lead some to conclude that this is too difficult, and that the transaction costs of dealing with such a broad set of issues around environmental and social risks and impacts, along with transparent and systematic stakeholder engagement, are too high. Some may argue that this makes firms less competitive against competitors who do not apply similar standards. But while this may be true from a narrow economic profit-loss perspective, the failure to apply responsible business standards carries high costs to affected people and to the environment. From a development perspective it is unacceptable to ignore such societal and environmental costs. Increasingly, financial institutions and firms are recognising this, and converging around common standards and approaches such as the Performance Standards. As the Equator Principles Financial Institutions have established, having a common approach also means a level playing field, where it becomes harder for clients who do not want to conduct business responsibly to shop around for the cheapest bargain.

Finally, it should be recognised that the Performance Standards require clients to understand and try to address many systemic issues that may affect projects, but where the root causes are not caused by the project, and cannot easily be addressed through individual transactions. At best, firms can deal with the symptoms rather than the causes of some of these issues, which may include fragility, conflict and violence in the operating environment, pervasive discrimination and gender-based violence, or marginalisation of Indigenous Peoples. There are often gaps between what the Performance Standards and similar frameworks require, and national laws and practices. In the case of land acquisition and involuntary resettlement, for example, the Performance Standards (along with safeguards policies of other MDBs) require more comprehensive support to physically or economically displaced people than what most countries' legislation provides. The greater this gap is between a country's legislation and practices, and what the Performance Standards require, the harder it is for individual firms to operate. Responsible private sector business conduct should therefore be complemented by public sector engagement in improving laws, policies, and institutions, including governance structures, people's access to justice, and their ability to hold both public and private institutions accountable. Development assistance and engagement in the public sector can therefore play a crucial role in creating a better authorising environment to support private sector firms in conducting their business in a responsible manner.

Evaluation Overview

This evaluation brief complements the 2020 evaluation *'Norwegian Development Assistance to Private Sector Development and Job Creation'*. The evaluation was commissioned by the Evaluation Department in Norad and conducted by the Chr. Michelsens Institute. The brief is written by Reidar Kvam, international expert on the use of safeguard policies, responsible business and stakeholder engagement, and former Senior Manager in the World Bank Group. He is not currently associated with IFC, and the views expressed in this brief are his own. Responsibility for the accuracy of data included in this brief rests with the author alone.

EVALUATION DEPARTMENT

Norwegian Agency for
Development Cooperation

www.norad.no
post-eval@norad.no

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