

The IFC's Investment Policies and Legal Structure: Reconciling Social, Environmental and Human Rights Objectives with Commercial and Financial Markets Realities

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Abstract

Many believe that the International Finance Corporation (IFC) portfolio as a member of the World Bank Group, could make positive difference based on its standards in order to eliminate the extreme poverty and promote shared prosperity. However, a close examination of the evidences on this matter indicates otherwise. In this paper, the question whether the IFC is on the right track with regard to its investment policies and legal structure will be examined. In order to answer to this question, reference will be made to issues such as, IFC standards, IFC and human rights, legal constrains and limitations and project financing in the light of some specific projects carried out by the IFC. Since the IFC in fact, acts as a bridge and actually a hybrid

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place for financing between the private and public sectors, its performance in the private sector usually creates a profitable policy, this not only makes the corporation far from its intended goals but also creates tension in the financing path in order to generate revenue instead of achieving its goals. This issue turns away the IFC from the nature of an international organization and instead makes it act as a private investment bank. The article concludes that with regard to the IFC's actual performance, it becomes clear that, the IFC has not fully and accurately complied with its required standards while this diverts the corporation from its original purpose, which must be reformed and monitored.

Keywords: Private sector, private finance, human rights, performance standards, project finance.

Introduction

The International Finance Corporation (“IFC” or “Corporation”) is a sister organization of the International Bank for Reconstruction and Development (commonly referred to as the “World Bank”, and a part of the World Bank Group. It established by an international treaty, the Articles of Agreement of the International Finance Corporation (“Articles of Agreement”), in effect since 1956. The Corporation is headquartered in Washington, D.C.¹

As the World Bank lends primarily to the government sectors, the IFC intended to supplement the activities of the World Bank, seeking to “further economic development by encouraging the growth of productive private enterprise in member countries, particularly in the less developed areas.”² This is supposed to be achieved by lending to,

¹ Scott L. HOFFMAN, *The Law and Business of International Project Finance: A resource for Governments, sponsors, lawyers and project participants*, 2nd ed, (Cambridge University Press, 2001) at 402.

² Articles of Agreement of the Int'l Fin. Corp, 25 May 1955 (entered into force 20 July 1950), art. I.

or investing in, private sector projects in the member states. Also, many of the projects in which IFC participates receive funding from other International Financial Institutions (IFIs), unilateral or multilateral development institutions, export-import banks, export credit insurance agencies and major international banks such as the Inter-American Development Bank and its Inter-American Investment Corporation, the African Development Bank, the Asian Development Bank, and the European Bank for Reconstruction and Development.

The IFC promotes private sector investment, both foreign and domestic, in developing member countries. Its investment and advisory activities are designed to reduce poverty and improve people's lives in an environmentally and socially responsible manner. Its work includes activities in some of the riskiest sectors and countries. IFC serves as an investor and an honest broker to balance each party's interest in a transaction, reassuring foreign investors, local partners, other creditors, and government authorities. IFC also advises businesses entering new markets and governments trying to provide a more hospitable business environment, to create effective and stable financial markets, or to privatize inefficient state enterprises.³

this paper will examine the question whether the IFC is on the right track with regard to its declared investment policies and legal structure. To this end, we will, firstly explore the question whether the IFC complied with its own standards, secondly, we will explore the IFC actions in line with the relevant human rights standards. As an international organization, the IFC must adhere to international human rights standards. Next, we will discuss two types of gaps and, legal obstacles, those related to the IFC's own legal structure and those

³ Francis CHERUNILAM, *International Business, Text and Cases*, (PHI Learning Private Limited 2010) at 309.

related to the country's legal system in which investment is going to be made. Finally, we will review the IFC's activities according to the sustainable development obligations. We consider the significance of the IFC commitments in line with the global sustainable goals.

I. IFC's Investment Policies: Does it comply with its own standards?

The IFC plays a critical role in International financing mainly by private sector. This means that measures, taken by the IFC will affect people and the environment in many ways. Instead, the IFC evaluates the relevant conditions according to its own policies when seeking to invest in a project.

In order to be eligible for the IFC financing, a project must meet the following criteria:

1. located in a developing country that is a member of IFC
2. In the private sector
3. Technically sound
4. Have good prospects of being profitable
5. Benefit the local economy
6. And be environmentally and socially sound, satisfying our environmental and social standards as well as those of the host country.⁴

The IFC considers the criteria when forming a contract with its clients, but the question we address in this regard is whether the IFC, in practice, overlooks some of the criteria in its project financing, If so, what are the reasons and how extensive was the scope of this deviation? It is also questionable whether the IFC has failed in its work?

⁴ How to work with IFC, Creating Markets, Creating Opportunities, available at <http://www.ifc.org/wps/wcm/connect/bec2f5804f6134099820fe0098cb14b9/How+to+work+with+IFC+-+English.pdf?MOD=AJPERES>.

Before answering these questions, it is necessary to investigate the work of the IFC in different places. Based on this, we argue that, it is not fully compliant with its own declared policies and criteria, because every business is completed by time as more experiences are gathered. Indeed, every organization (regional or international) adheres to a set of standards defined to guide their way to achieve their goals. However, some of Theas organizations occasionally have failed to comply with their own standards, they have failed to access the relevant conditions carefully (so as to escape or prevent the negative consequences), or to implement their standards fully.

One of the most prominent cases in which the IFC failed to comply with its own standards occurred in 2016.⁵ The project was located in Eco Oro Minerals' Angostura mine in the high-altitude wetlands of Santurbán, Colombia. The Ombudsman reported that IFC's investment policies in the Angostura mine had an impact on the environment. This means that the IFC did not meet all the standards required of its investments, including an assessment of potential impacts on biodiversity..., which is critical to ensuring our water supply. Therefore, any threat to its biodiversity affects the water resources of the entire metropolitan area of Bucaramanga."⁶

The IFC should have assessed the above-mentioned projects in every aspect. In other words, it should have considered all direct and indirect impacts as well as side effects of the project on the environment. Yet, according to the Ombudsman's report, the IFC failed to assess the impacts of the entire mining project, and instead only concentrated on the impacts of the exploration stage, despite the

⁵ New Ombudsman Finds IFC failed comply with Investment Standards Colombia, available at <http://www.ciel.org/news/ombudsman-finds-ifc-failed-comply-investment-standards-colombia/>.

⁶ Ibid.

fact that it justifies its investment on the basis of the supposed benefits that the eventual mine would bring.”⁷

Probably, it might be argued that the IFC is only the financing party to the project, so it cannot be held legally responsible. In response we can say that, although the IFC is not the operational party, but the supervising role that it plays, leaves some rooms for criticism. In other words, the IFC shall as per its own standard, evaluate and supervise the project to ensure it operates within the defined framework or not. Failing to do that, the IFC should be considered as responsible. The office of the Compliance Advisor Ombudsman (CAO) stated, that one of the required “purposes of IFC’s investment was to develop the studies necessary to determine whether the project could comply with IFC’s [performance standards]”, while the IFC’s client did not complete the required studies. However, when the IFC realizes, the client failed to comply with its standards, it must intervene or resort to the sanctions it envisaged for the fulfillment of commitments. Despite this, the IFC continued to make subsequent investments in the company although the borrower repeatedly failed to comply with the required standards.

According to IFC’s standards, it shall assess all the potential risks to the environment and if the assessment is positive, then it can finance the project. So, the case of Angostura mine suggests that in practice the IFC has not met its own standards according to which IFIs are obliged to show they are working based on a legal and operational framework. When an IFI fails to comply with its own standards and policies it will unsecure its position in the global market on the one hand, and on the other hand, the host states will not trust their work guaranteeing the requirements in various dimensions.

⁷ Ibid.

In this regard it is appropriate to refer to Performance Standard 3⁸ which concerns the issue of Pollution and the Environment. The IFC presented more demanding requirements in its 2012 Performance Standards as a result of the increasing danger posed by climate change. The 2012 Performance Standards is couched in such a way that commercial feasibility of a project is to be less of a consideration when preventing negative impacts of a project. It further requires the use of less hazardous substitutes where environmentally hazardous materials are used. In the area of waste disposal, the 2012 Performance Standards provides that where waste cannot be recycled, it ought to be disposed of in an environmentally responsible manner.

According to IFC's contracts we can point out that in the process of assessment IFC's environmental and social staff will categorize the Project based on its potential social and environmental impacts. For category A and B projects, the IFC will make publicly available an Environmental and Social Review Summary ("ESRS") no later than 60 days, for category A projects and 30 days, for category B projects, prior to any consideration of the project by IFC's board of directors. For all projects, IFC will make publicly available a Summary of Proposed Investment ("SPI") no later than 60 days for category A projects, and 30 days for other projects, prior to any consideration of the project by IFC's board of directors.

However, as noted previously, the IFC on the paper is more rational and acceptable than the IFC in practice: it is doing a great paper job, but fails to comply with them in practice. One can say that the IFC is going to be a merely profit-gaining corporation. This is an alarm to environments which have been advocating environment friendly projects. Looking at the Angostura mining project, in spite of

⁸ IFC Performance Standard 3 available at https://www.ifc.org/wps/wcm/connect/topic_ext_content/ifc_external_corporate_site/sustainability-ar-ifc/policies-standards/performance-standards/ps3

failures in the risk assessment, the IFC still continued with the investments. This suggests that the IFC was solely concerned about monetary aspects of the project.

When a project fails to comply with the IFC standards, the IFC should attempt to make it to comply with, otherwise it should withdraw its investment and terminate the project. Nonetheless, it is obvious that the IFC continues to make investment in profitable projects regardless of the assessment results.

The Angostura report reveals that the IFC has an explicit policy of investing in junior mining companies with limited capacity to manage environmental and social issues, in countries where the regulatory framework (Environmental regulations) is weak or not enforced.

One of the most common criticisms levelled at the IFC is that, it provides capital at favorable terms to large companies (including subsidiaries of multinationals with dubious human rights records like Shell). In other words, “rather than promote development and alleviate poverty, the IFC uses taxpayer dollars to subsidize multinational corporations and businesses connected to local elites.”⁹

A brief scan of many IFC funded projects lends some credence to this claim, especially in natural resource areas like mining. This includes a loan of \$125 million to Newmont Mining Corporation in Ghana, a project that came under strong criticism from the civil sector for environmental concerns for matters such as water contamination and the estimated displacement of 9,500 subsistence farmers.¹⁰

Another common critique of the IFC's lending policies is that as a for-profit entity its lending tends to focus on the most profitable projects, which may not always be the most beneficial for poverty

⁹Charlie CRAY, *Dubious Development: The World Bank's Foray into Private Sector Investment*, (2001), Vol 22, *Multinational Monitor*, at 20.

¹⁰ Radhika SARIN, *World Bank Backs Controversial Gold Mine*, (2006), *World Watch*, at 20.

reduction. For example, a quick glance at the IFC's website shows projects like a 2003 loan for the "Astana Tower" project in Kazakhstan, which provided \$5 million of a total \$22 million for a "business and shopping center that will generate commercial development and boost related support services as commerce and business activity grows in Astana."¹¹

While they have been other instances of the IFC failing to comply with its own standards, but we believe that they can more accurately be seen as a violation of human right. thus, in the next section we discuss a number of cases where it appears that the IFC has breached or complied with human rights.

II. The IFC and Human Rights

Human rights are the most fundamental and primary rights which every person can enjoy inherently. It goes without saying that human rights involve different legal, social, political and economic elements. Thus, every measure taken by any international organization will have different effects and the the IFC is not an exception.

The Compliance Advisor Ombudsman (CAO) reported on a case regarding IFC's investment in Honduras 20, in December 2013. The IFC invested \$30 million in Honduran palm oil project under the management of Corporation Dinant. The CAO reported that Dinant corporation was involved in human rights abuses.¹² The report showed a variety of abuses such as killing, kidnapping and forced eviction of farmers in the Bajo Aguán region where the corporation's palm oil

¹¹ Norlen DOUG, *The Kumtor Gold Mine: Spewing Toxics From On High* (2000), available at https://bankwatch.org/wp-content/uploads/2000/09/kumtor_toxics_09_02.pdf.

¹² CAO report on a case regarding IFC's investment in Honduras, available at <http://ifcext.ifc.org/ifcext/spiwebsite1.nsf/c9aba76ed1df1938852571c400727d66/2f9b9d3afcf1f894852576ba000e2cd0?>

plantations are located and land rights are heavily disputed. An estimated 92 people have been killed between 2009 and 2012, the majority of them were local farmers, according to figures from the Honduran National Commission for Human Rights.

Key Allegations made regarding the project were that:

1. IFC's client (Dinant) conducted, facilitated or supported forced evictions of farmers in the lower Aguán Valley (or Bajo Aguán);
2. Violence against farmers on and around Dinant plantations in the Bajo Aguán (including multiple deaths) occurred because of inappropriate use of private and public security forces under Dinant's control or influence; and
3. The IFC failed to identify early enough and/or respond appropriately to the situation of Dinant in the context of the declining political and security situation in Honduras, and specifically in the Bajo Aguán, following the ouster of President Zelaya in June 2009.

In addition to the above-mentioned points, the most eminent points in the report are as follow:¹³

1. The IFC was aware of the importance of access to land free from conflicts and disputes as crucial to the success of agribusiness projects, its staff underestimated risks related to security and land conflict associated with the Dinant investment.
2. IFC's E&S (Environmental and Social Performance) review "was not 'commensurate to risk', and thus did not meet a key

¹³ For more information, including an overview of CAO's compliance and dispute resolution work see <https://www.cao-ombudsman.org>.

requirement of the sustainability policy. In particular IFC accepted an overly narrow definition of project E&S risk, without adequate consideration of project context or contemporaneously available sources of information regarding land conflict and insecurity in the Bajo Aguán.”

3. The IFC’s environmental and social (E&S) “review failed to ensure that adequate consideration was given to relevant risks and impacts around” security personnel and indigenous peoples.
4. The CAO found “no indication that IFC supervised its client’s obligations to investigate credible allegations of abusive acts of security personnel” and its obligation not to “sanction the use of force by security personal “other than for preventative and defensive purposes in proportion to the nature and extent of the threat.”
5. The “IFC did not give due consideration to the requirement that IFC exercise remedies where appropriate in a situation where a client does not or is not able to re-establish environmental and social compliance” and that the “IFC did not have a reasonable basis on which to conclude that the project could be expected to meet the performance standards over a reasonable period of time. The decision to invest was thus not in compliance with the Sustainability Policy”.
6. The CAO found “no evidence that the communities living closest to Dinant’s properties were consulted during the preparation of the environment and social assessment” which is a breach of the IFC’s policies. The IFC’s “failure to disclose the Dinant E&S assessment was not compliant with its policy on disclosure of information. IFC remains non-compliant on this point.”

The IFC responded to these allegations and expressed its disagreement with some of them. This indicates that at least to some extent, the non-compliance of the IFC has failed to comply with human rights principles, affirming our view that the IFC is becoming a merely profit-gaining corporation.

In addition, the IFC recognizes that indigenous peoples are amongst the most vulnerable segments of the population. They usually feel the effects of development activities more than other groups. They are especially limited in their capacity to defend their economic, social and legal rights.¹⁴ The 2012 Performance Standards require the design and implementation of a Livelihood Restoration Plan for communities affected by involuntary resettlement. This plan should be implemented in a transparent and consistent manner. Also, it requires the Free Prior Informed Consent (FPIC) of the affected indigenous peoples to the project design, implementation and effects. The Performance Standards does not contain a definition for FPIC but it provides that the client should engage with indigenous groups in good faith. The client is also expected to hire competent professionals to determine impacts on Indigenous Peoples.

Also, the 2012 Performance Standards goes further than the 2006 Performance Standards by providing for gender inclusion. Performance Standard 7 provides that the assessment of land and natural resource use should take into account gender differences making provision for women's role in the management and use of resources.¹⁵ IFC clients are expected to assess the extent to which resettlement may likely impact on women's economic and social development. Clients are also expected to ensure that development

¹⁴ IFC (2012) Performance Standards 7, available at https://www.ifc.org/wps/wcm/connect/3274df05-7597-4cd3-83d9-2aca293e69ab/PS7_English_2012.pdf?MOD=AJPERES&CVID=jiVQI.D. at 47.

¹⁵ Ibid, at 49.

projects do not negatively impact women's property rights, working condition and economic development.¹⁶ The IFC cannot fulfill its mandate without considering the structural causes of poverty that human rights instruments protect against, such as discrimination, exclusion, lack of accountability, and abuses of state power. We come to this end that the IFC needs to adopt a more systematic approach to human rights.

III. IFC's Legal Constrains and Limitations

In this section we will discuss the relevant gaps and legal obstacles those related to the IFC's own legal structure and those related to the host country's legal system in which investment is going to be made.

Concerning IFC's own legal structure, it must be noted that when it enters into contract with a party (borrower or partner), it shall follow its own internal rules and regulations providing the party with a pre-drafted contract. In other words, the IFC imposes the terms and conditions to the parties and leave them no choice. In doing so, the IFC pursues two goals: being the superior actor in the economic relation; and obtaining the financial interest according to the Corporation's policies.

It is thus clear that the IFC provides the clients with an international policy and ask them to accept it as offered. However, this appears as an impediment to IFC's global admissibility. It is true that the IFC invests in and lends to many countries, but it is not pervasive. To become an "every-person's favorite" it shall reconcile its policies with a trustworthy way that each and every private sector can rely on.

The fact that there is no room for negotiation between the IFC and borrowers may be viewed as a legal weakness in its legal structure. In a business every party should be afforded the opportunity to express

¹⁶ Ibid, at 49.

its options, since it helps confidence building and makes a secure atmosphere for both parties involved. Thus, it seems that the approach taken by the IFC will hamper its overall success as an international financial institution.

Regarding the host country's legal system in case of investment, it shall be noted that IFIs are interested in investing where it is attractive to them. In other words, they are reluctant to invest in countries where the economic environment does not attract them. Accordingly, the IFIs are cautious about states whose legal systems put obstacles in their way.

“Laws of under-developed countries will constitute deterrents to foreign investment if they fail to maintain an adequate and reasonable balance between the interests of foreign investors and the investee state.”¹⁷ We understand that a reasonable balance shall be made between parties' interests so that both investor and investee will be willing to bear the conditions of the investment. A win-win situation is made by good legislation. If there are rules which hamper a successful operation, IFIs will normally be reluctant to proceed with investment.

One of the most important obstacles or deterrents to IFIs' investment will be discriminatory tax legislations: for example, when a government decides to levy taxes on foreign corporations on a discriminate basis according to which domestic financial corporations will be exempted from or are less charged. Accordingly, the obstacles related to IFC's own legal structure and the host country's legal system in which investment is going to be made, affect IFC's successful operation in real practice.

IV. The IFC and Project Financing

¹⁷ E. I. NWOGUGU, *the Legal Problems of Foreign Investment in Developing*, (New York, Manchester University. Press, 1965), at 9.

Project Finance is generally described as a lending method adopted by financiers whereby the lender relies primarily on the revenues generated by a single project as the source of repayment for both the original loan, as well as the security for the initial capital exposure. This project is usually run by a Special Purpose Entity (SPE) or Special Purpose Vehicle (SPV) i.e., a project company established by the borrowing company, usually a Multinational corporation (MNC).¹⁸ Under this sought of arrangement, the SPE is not permitted to perform any function other than developing, owning, and operating the installation. The consequence of this type of financing is that repayment of the project finance loan depends primarily on the SPE's cash flow and on the collateral value of its assets, and not the assets of the investing MNC that established the SPE. This type of financing is usually utilized for large, technical and expensive installations, for example, oil and gas installations, construction of power plants, mines, dams, transportation and telecommunications infrastructure.¹⁹

According to this financing structure is that the project documentation, including loan documents, must be carefully formulated and designed to ensure that lenders may take possession of the assets, including all contracts, if the borrower fails to repay the loan. Such projects usually require significant and rigorous due diligence exercise to determine the technical and economic feasibility of the project, as well as the contractual allocations of the risks of

¹⁸ See Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards (Basel II), November 2005, available at www.bis.org/publ/bcbs118.pdf.

¹⁹ Graham VINTER, Project Finance: A Legal Guide, Sweet and Maxwell: London, 2nd Edition (1998), at 56.

construction and operation.²⁰ Because project financing is often used outside of the world's developed economies and legal systems, it is not uncommon for the project documentation to form the principal legal framework for the transaction.²¹

Employing project finance is critical to the promotion of sustainable development by financiers having in mind the peculiar financing and political risk which financiers may face in Africa. Lenders under a project financing arrangement have a more significant stake in the borrowers' financial performance, owing to the limited recourse nature of the loan.²² This stake provides the financing institution with the incentive, financial and reputational, to ensure that social and environmental risk of the proposed project is considered and lessened where appropriate. The increased use of project finance in Africa is allowing for the penetration of industry best practices, through the employment of policies and guidelines of financiers, in jurisdictions whose domestic law are silent on social and environmental responsibility or in jurisdictions that pay lip service to social and environmental responsibility.²³ For example, Nigeria has laws on environmental protection and an environmental impact assessment Act, but environmental enforcement rate is still quite low.²⁴

²⁰ Robert F LAWRENCE, William L THOMAS, *The Equator Principles and Project Finance: Sustainability in Practice?* 19 *Natural Resources and Environment* (2004) at 20, 21.

²¹ *Ibid* at 20, 21.

²² Vinter, *supra* note 26 at 111.

²³ Benjamin J. RICHARDSON, 'Financing Sustainability: The New Transnational Governance of Socially Responsible Investment', in K. Fauchald, and J. Werksman, (eds.) *Yearbook of International Environmental Law*, (Oxford: Oxford University Press, 2007) at 73, 87.

²⁴ Yinka OMOROGBE, 'The Legal Framework for Public Participation in Decision Making on Mining and energy Development in Nigeria: Giving Voices to the Voiceless in Human rights', in Donald Zillman, Alastair Lucas and George Pring (eds) *Natural Resource Development: Public Participation in the Sustainable*

Therefore, the significance of the policies and guidelines of MDBs is illustrated by the fact that there exists no effective legal framework, resulting the environmental and social impacts arising from financing activities is almost absent. These policies and guidelines have evolved from a need to promote sustainable development, with development banks seeing themselves as morally obliged to improve the behavior of their clients, by imposing certain requirements on clients wishing to access funds to finance a project.

Also, commercial banks have become important players arranging project finance in Africa. These banks provide the requisite funds, either jointly with other commercial banks or in conjunction with the IFC. Initially, these banks failed to take into consideration the social and environmental impacts of their financing activities. For example, starting in the late 1990s a number of well-publicized civil society campaigns against a number of large commercial banks accused them of financing projects that were violating the rights of local communities and harming the environment. In some of these cases, a number of commercial banks which were alleged to have financed a project though an MDB (Multilateral Development Bank) had refused to provide funding because the project was in violation of its environmental and social policies.²⁵

One of such projects was the financing of the large-scale conversion of forests into oil palm plantations in Indonesia by ABN AMRO. As financier, ABN AMRO was targeted by the Dutch Chapter of Friends of the Earth for financing the conversion of Indonesian forests without carrying out substantive social and

Development of Mining and Energy Resources (Oxford: Oxford University Press, 2002), at 580.

²⁵ Andreas MISSBACH, The Equator Principles: Drawing, The Line for Socially Responsible Banks? An Interim Review from an NGO Perspective, *Development*, 2004, Vol 47(3), at 78-84.

environmental impact assessment.²⁶ Also, Barclays was criticized for its involvement in the large-scale forestry projects of Asia Pulp and Paper.²⁷ In these and other numerous cases, the public campaigners alleged that commercial banks bore some responsibility for the adverse impacts of their financing activities, and demanded that commercial banks directly confront irresponsible or negligent borrowers to ensure that funds are not used to execute projects with adverse social and environmental impacts.²⁸ Along similar lines, Richardson (2007) noted that the financing arrangements of the Chad-Cameroon Oil Pipeline Project were the specific catalyst for the development of the EPs. He stated that the fear of reputational damage and the possibility of losing business to unscrupulous lenders if they insisted on strict environmental safeguards led a group of commercial banks to seek a level playing field for project financing.²⁹

Thus in October 2002, a meeting of project finance banks was arranged by ABN AMRO and the IFC to discuss the negative impacts of social and environmental aspects in project finance.³⁰ Commercial

²⁶ Friends of the Earth (2005) Greasy palms: The social and ecological impacts of large-scale oil palm plantation development in Southeast Asia, available at http://www.foe.co.uk/resource/reports/greasy_palms_impacts.pdf.

²⁷ Friends of the Earth, Briefing Note: Barclays Finance of Rainforest Destruction, available at http://www.foe.co.uk/resource/briefings/barclays_finance_destruct.pdf.

²⁸ Christopher WRIGHT, Setting Standards for Responsible Banking: Examining the Role of the International Finance Corporation in the Emergence of the Equator Principles, in Biermann, F, Siebenhüner, B., and Schreyrogg, A. (eds.) (2007), *International Organizations and Global Environmental Governance*, London: Routledge, at 7.

²⁹ Richardson, *supra* note 30 at 89.

³⁰ IFC, Environmental and Social Leadership through the Equator Principles, available at www.ifc.org/ifcext/environment/epbroc1.pdf, In a parallel development, a group of NGOs sponsored the Collevocchio Declaration in 2003, which called for financial institutions to observe principles of sustainability, responsibility, accountability, transparency, sustainable markets and governance and the principle

banks, including Citigroup, ABN AMRO, Barclays Bank, West LB together with the IFC, presented case studies on past projects which had attracted controversy because of negative social and environmental impacts. Citigroup went ahead to propose that the banks ought to develop a self-regulatory instrument to ensure that lenders ensure their borrowers consider the social and environmental impacts of executed projects.³¹ Subsequently, these commercial banks agreed to constitute a task force to draft a framework document for consideration by other banks. These four banks assumed the burden of drafting what were to become the Equator Principles with the IFC acting as technical advisor.³² The commercial banks then went ahead to employ the normative framework of the IFC's performance standards as the basis for the EPs owing to its experience, financial clout and operational mandate.³³ Thus, it is safe to state that the IFC played a standard setting role in the development of the EPs as its performance standards constitute the blueprint for the EPs. Essentially, the performance standards aim to protect people and the environment from the adverse effects of Bank-financed operations and are based on international agreements, even if these protections are not explicitly provided for in the jurisdiction of the borrower or under the domestic law of the country where the project is to be executed.³⁴

Firstly, the primary reason for basing the Equator Principles, on the IFC's Performance standards is that the principles would

that they should 'do no harm', available at www.banktrack.org/download/colleveciodeclaration_with_signatories.pdf.

³¹ Malcolm FORSTER, Paul WATCHMAM and Charles JULY, *The Equator Principles - Towards Sustainable Banking?* Part 1, *Journal of International Banking & Financial Law*, 2005 Volume 20/Issue 6, 217, at 2.

³² *Ibid.*

³³ Wright, *supra* note 28 at 12.

³⁴ See Bretton Woods Projects, *Safeguard Policies and Performance Standards*, available at <http://www.brettonwoodsproject.org/art-565324>.

immediately gain recognition and legitimacy from private financing institutions. This is as a result of the IFCs relationship with commercial banks and its unparalleled expertise in project financing activities. It was also important from the point of view of obtaining the support of environmental NGOs campaigning for improved environmental protection as the Performance Standards already recognized issues such as human rights, protection of ecosystems and public access to decision making.³⁵ It is worth noting that, environmental NGOs frequently criticized the scope of the performance standard and the way it was applied to projects. These policies, however, had come to define responsible lending symbolizing the influence of the IFC on project financing.

The depth of Banks' commitment to the Equator Principles is evidenced by their willingness to lose potential profits by withdrawing from projects that fail to meet the requirements established by the Equator Principles. The Preamble to the Equator Principles provides that signatories to the Principles "will not provide loans directly to projects where the borrower will not or is unable to comply with [their] environmental and social policies and processes".³⁶ The Principles have become widely accepted and applied in project finance globally. From the institutional standpoint, a report by the

³⁵ Shannon LAWRENCE, *Retreat from the Safeguard Policies – Recent Trends Undermining Social and Environmental Accountability at the World Bank*, prepared by Lawrence, S. in collaboration with Bosshard, P., Jenkins B, Kalafut J., Perrault, A., Durbin, A., and Hunt, S.; Wright, C., *Setting Standards for Responsible Banking: Examining the Role of the International Finance Corporation in the Emergence of the Equator Principles*, in Biermann, F, Siebenhüner, B., and Schreyrogg, A. (eds.) (2007), *International Organizations and Global Environmental Governance*, London: Routledge, at 12.

³⁶ See Equator Principles (2006), "The Equator Principles - A Financial Industry Benchmark for Determining, Assessing and Managing Social and Environmental Risk in Project Financing", available at http://www.equator-principles.com/resources/equator_principles.pdf.

international law firm, Freshfields Bruckhaus Deringer, revealed that several signatories to the Equator Principles have entered into structured dialogues with stakeholders and NGOs about the social and environmental aspects of their lending. It concludes that the Equator Principles have positively influenced financial markets generally and redefined project lending in particular.³⁷ Further, around seventy one per cent of total project finance debts in emerging market economies were subjected to the Equator Principles (52.9 billion USD out of a total of 74.6 billion USD) with the Equator Principles further promoting good environmental practices in the other parts of the financial sector.³⁸ Despite their voluntary nature, a large majority of signatory banks are now able to show a significant level of internalization of the EPs within their lending criteria and practice.³⁹

Although the Equator Principles could be classified as process standards, they also include a normative framework through their incorporation of the IFC's Performance standards on social and environmental sustainability. The Equator Principles were formulated primarily by the banking industry in collaboration with the IFC. The Equator Principles target private, commercial lending in developing countries and emerging economies where environmental regulation may be weak and difficult to enforce.⁴⁰ The benefit to people and planet arises because the financier relies on the provisions of the Equator Principles, which are based on the IFC performance

³⁷ Freshfields B. DERINGER, *Banking on Responsibility: Part 1 of Equator Principles Survey 2005: The Banks*, London.

³⁸ Richard MACVE and Chen XIAOLI, *The Equator Principles: A success for voluntary codes*, *Accounting, Auditing and Accountability Journal*, 2010, Vol 23, no 7, 890-919, at 898.

³⁹ D ONG, *From 'International' to 'Transnational' Environmental Law? A Legal Assessment of the Contribution of the 'Equator Principles' to International Environmental Law*, *Nordic Journal of International Law* 2010, 79, 35-74, at 47.

⁴⁰ Richardson, *supra* note 30 at 89.

standards, instead of local legislation which may be silent on social and environmental aspects. By basing the equator principles on the performance standards, commercial banks are helping to further promote sustainable development.

The IFC occupies an important position in the global project finance market. Through its participation in financing arrangements with the private sector, the IFC has developed invaluable operational relationships with private financial institutions in developing countries. Its financing schemes continue to benefit private institutions and the locality where projects are sited. For instance, the IFC arranges debt or equity financing to a private institution or investment fund operating in a developing country, which in turn provides financing to multiple private companies. These financing schemes may include staff training and corporate restructuring programmers aimed at improving corporate governance and commercializing risk management practices in private financial institutions.⁴¹ The IFC also organizes participants meeting for private financial institutions, investment funds and development agencies to showcase its loan syndication program providing the opportunity to discuss opportunities and share experiences about investing in developing countries.⁴² These activities help in promoting the policies and guidelines of the IFC through its clients.

The IFC also has other stringent methods of securing client compliance. It is also capable of attaching conditions or incorporating legal obligations into loan documentations. The use of loan covenants to support compliance with environmental and social requirements is a standing practice regularly employed by the institution.⁴³ For instance,

⁴¹ Wright, *supra* note 28 at 11.

⁴² *Ibid.*

⁴³ Independent Evaluation Group Study Series, *Safeguards and Sustainability Policies in a Changing World: An Independent Evaluation of World Bank Group*

it could link disbursement of funds to the attainment of certain milestones or specific acts of the clients. Also, the IFC could include a policy-put in the loan documentation enabling it to sell its shares for noncompliance of policy provisions. These activities allow the IFC consolidate its hold on private institutions, enabling greater penetration of its policies and guidelines.

The IFC has been able to seamlessly integrate the use of its loan documentation and the provisions of the Performance standards to ensure client compliance with its sustainability objectives. The IFC has attained this position owing to its operational mandate, its financial muscle and the expertise of its staff who have been involved in major financing projects. Owing to the pervasive influence of the IFC on private sector financing in developing countries, the institution is able to influence standard setting largely by the use of its sustainability framework, thereby promoting the penetration of sustainable development practices in developing countries. Over time, the underlining sustainability objective of the IFC has shifted from a “do-no harm”⁴⁴ approach towards a policy of “doing good” evidencing an improved concern on sustainability and the management of associated risks.⁴⁵ The approach adopted has now shifted to increased engagement with clients with the institution

Experience (2010) The World Bank, Washington DC, available at <http://www.worldbank.org/ieg>.

⁴⁴ This approach was contained in the former IFC, Policy on Social and Environmental Responsibility (30 April 2006), available at www.ifc.org/sustainability.

⁴⁵ See Independent Evaluation Group Study Series, Safeguards and Sustainability Policies in a Changing World: An Independent Evaluation of World Bank Group Experience (2010) The World Bank, Washington DC, available at <http://www.worldbank.org/ieg>, at 3.

playing a more supervisory role in order to achieve its overall development objectives.⁴⁶

Conclusion

As an international organization with international goals, the IFC must, according to its creation charter, strive to eradicate poverty and improve the progress of underdeveloped and developing countries, rather than pursue its own corporate business interests as a private investment bank. The purpose of establishing an international financial institution under the auspices of the World Bank is to benefit the others from the tasks and standards by which it was created. If it is not supervised and monitored properly and deviates from its original purpose, it loses its international and universal dimension and becomes a for-profit institution.

Moreover, the IFC must support, advise and lead the formulation and implementation of the organization's goals and initiatives, effectively and efficiently manage human, financial and technological resources, and assess internal and external environment in line with international human rights norm and instruments as well as international sustainable development goals.

Unfortunately, in most cases, it has been impossible to access to the details of the IFC financing projects. Likewise, it has been difficult to ascertain instance in which the IFC failed to comply with its own statutory obligations and commitments: thus, it would be extremely difficult to clearly monitor its performance. The details of the IFC financing projects should be made available to ensure transparency in all areas, especially environmental and human rights issues. The failure to do so, must be considered on IFC red line and in case of a

⁴⁶ IFC Performance Standards on Social and Environmental Sustainability (2012), at 1.

breach, it eventually could be compensated. it is recommended that, an official independent international monitoring unit with required expertise, should be set up to closely monitor and inspect IFC's operations and activities. This makes it more likely that the IFC will not turn away from its goals and principles as well as the standards by which it was created.