BRETTON WOODS project

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Dr Jim Yong Kim, President
World Bank
1818 H St NW
Washington, DC 20433
United States

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RE: IFC investment in the financial sector

Dear Dr Kim:

We, the undersigned organisations, welcome the audit by the Compliance Advisor/Ombudsman (CAO) on the International Finance Corporation's lending to the financial sector. The IFC's response to the audit fails to acknowledge the gravity of the findings and is notable for its lack of commitment to addressing them. In advance of the IFC's planned consultation with civil society this month, **we urge you to commit to revise the IFC's strategy for investment in this sector**.

The CAO audit findings serve as an indictment of the entire premise on which development outcome assessment and social and environmental safeguards are applied to the IFC's large investments in the financial sector. The audit finds that the IFC has no way to determine whether these investments are causing harm, regardless of the IFC requirement of its financial sector clients to maintain an environmental and social management system (ESMS). What matters is results – positive development outcomes and prevention of harm to communities and the environment – but the IFC does not measure these results. This is not acceptable to us, nor should it be to the World Bank Group.

The CAO audit also found significant irregularities and compliance issues within the existing policies, which have been criticised for their inadequacy. Ten per cent of financial sector projects were failing to meet the IFC's standards, and the compliance of a further 25 per cent is in doubt. Additionally, IFC sub-clients are, in some cases, allowed to invest up to 5 per cent of their portfolios in activities covered by the IFC exclusion list (such as tobacco production, the arms industry, and gambling). This should not be allowed.

The audit also highlights the fact that inadequate transparency (in part due to excessive invocation of client confidentiality) prevents the IFC itself knowing about the end use of funds. The near-total absence of public access to information about end use of IFC funds is a significant barrier to accountability, including for communities which may not even be able to discern IFC involvement in a project that affects them.

The IFC's approach to financial intermediary support is based on the mistaken premise that the development of any part of the financial sector is likely to be beneficial for developing countries. In reality, as the recent global financial crisis has demonstrated, it matters enormously what kinds of banks, private investment funds, and other investment funds are supported by public institutions like the IFC. The sub-projects and investments made by those financial intermediaries which, *de facto*, act on behalf of the IFC, are very important; many can potentially have significant adverse impacts on poor communities and the environment. In 2009, a CAO audit of a single palm oil project caused the IFC to stop and rethink its strategy and safeguards for the palm oil sector. The CAO's deep examination of the issues in investment in the financial sector and conclusion that the IFC's policies are not adequate indicates that the IFC should take a step back and fundamentally reconsider its strategy in this area.

To remedy this situation we urge you to **begin with a revised IFC response to the CAO audit that acknowledges the fundamental flaws found in financial sector investment and makes a commitment to develop a new strategy for investments in this sector**. As we have stated, the IFC should fundamentally rethink the nature, purpose and modalities of IFC investment in the financial sector**. In the development of a new strategy for investment in the financial sector, the IFC should formulate a process for independent input, participatory consultation with affected communities, and broader stakeholder engagement.**

While a new strategy is being developed, the IFC can take immediate measures to remedy some of the past harms. We urge minimum immediate actions in the following areas:

- **Transparency/disclosure:** in all new financial sector contracts specify that 'commercial confidentiality' may only be applied as is strictly necessary and not to block full and transparent reporting including related to environmental and social impacts; publish the details of financial intermediaries where the IFC and/or the CAO know that IFC clients or subclients are out of compliance with IFC policies;
- **Accountability:** suspend all investment in and urgently address the environmental damage or social harm that has been done by financial sector investments and make good any losses communities have suffered;
- **Financing procedures:** in all new IFC contracts include language requiring suspension of investment, without prejudice or fee, in the event of breach of environmental and social requirements; also include a provision that requires clients to include the IFC's social and environmental standards in contracts with all subclients; renegotiate old contracts to include these stipulations where they are absent.

In addition, given the failure of the IFC's self-reporting and client-dependent approach, we urge you to avoid utilising the IFC as a model for the World Bank safeguard review process.

While we welcome the opportunity to consult with IFC staff on these issues, we request a meeting with you to discuss our call for a new strategy for IFC lending to the financial sector. We look forward to your response and would be delighted to work with you to take forward institutional changes at the IFC in response to the CAO's findings, which we believe will bring better outcomes for people living in poverty.

Yours sincerely,

Peter Chowla, Coordinator, Bretton Woods Project, United Kingdom

On behalf of:
Jorge Daniel Taillant, Executive Director, Centro de Derechos Humanos y Ambiente, Argentina

Alberto Croce, Executive Director, Fundación SES, Argentina

Heinz Hödl, Director, Co-ordination Office of the Austrian Bishops Conference on Development and Mission, Austria

Eva Filzmoser, President, Nature Code, Austria

Hasan Mehedi, General Secretary, Humanitywatch, Bangladesh

Bogdan Vanden Berghe, Director, 11.11.11 – The Coalition of the Flemish North-South movement, Belgium

Arnaud Zacharie, Secretary General, CNCD-11.11.11, Belgium

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Janet Redman, Co-director, Sustainable Energy & Economy Network, United States

Stephanie Fried, Executive Director, ‘Ulu Foundation, United States

Cc: Jin-Yong Cai, executive vice president IFC
IFC Board of Directors and alternates