COMPLIANCE ADVISOR OMBUDSMAN

October 2, 2019
Office of the Compliance Advisor Ombudsman (CAO)

COMPLIANCE APPRAISAL: SUMMARY OF RESULTS

IFC Investments in Rizal Commercial Banking Corporation (RCBC)
(IFC Project #30235, #32853, #34115, #37489)
Philippines

Rizal Commercial Banking Corporation (RCBC or "the client") is a large universal bank in the Philippines, providing a wide range of banking and other financial products and services, including commercial and retail banking, credit cards, asset management, and treasury and investment banking products and services. IFC has made multiple investments to support RCBC. In March 2011, IFC made its first equity investment in RCBC. In March 2013, IFC provided equity and loan investments to establish a special purpose vehicle to acquire and service RCBC's non-performing assets. In April 2013, IFC's Asset Management Company made an equity investment in the client. In November 2014, IFC provided the client with a loan to support growth in its small medium enterprise (SME) portfolio. In November 2015, IFC participated in a RCBC bond issue through a US$75 million investment.

In October 2017, a national NGO, the Philippine Movement for Climate Justice (PMCJ) submitted a complaint to CAO on behalf of several communities living in the proximity of 19 active or proposed coal-fired power plants located in different parts of the Philippines, and on their own behalf as an alliance of organizations of concerned citizens of the Philippines fighting climate change. Two international NGOs, Inclusive Development International (IDI) and Bank Information Center Europe (BIC Europe), also supported the complaint.

The complaint asserts that RCBC has provided financial support to 19 coal-fired power plants and raises environmental and social concerns related to the development and operation of the plants, including impacts on biodiversity, health impacts caused by air pollution, inadequate compensation for physical displacement, loss of livelihoods, and violation of Indigenous Peoples' rights. The complaint also raises issues about climate change impacts on the Philippines and its residents, including the complaint signatories, identifying the RCBC funded coal projects as contributing to climate change. Further, the complaint raises issues related to RCBC's environmental and social risk management system, lack of consultation and information about the named coal plants and their impacts, and the absence of effective grievance mechanisms for the affected communities. Finally, the complaint raises issues about IFC, asserting that there is a lack of transparency regarding IFC's financial intermediary portfolio, and IFC's monitoring and supervision of RCBC's environmental and social performance.

CAO determined the complaint eligible in relation to RCBC's support to 11 coal-fired power plants. Between November 2017 and April 2019, CAO conducted an assessment of the complaint to further understand the issues raised, the client's response, and whether there was interest between the parties for a CAO facilitated dispute resolution process. None of the complainant groups reached agreement to engage in a dispute resolution process with the owners of the respective affected coal-fired power plants. Therefore, in accordance with CAO's Operational Guidelines, the complaint was transferred to CAO's compliance function.

IFC's Sustainability Policy sets out IFC's E&S commitments and its approach to implementing these commitments through its investments in banks and other financial intermediaries (FIs). IFC commits to only finance clients that are expected to meet IFC's Performance Standards requirements within a reasonable period of time. Persistent delays in meeting these requirements can lead to loss of financial support from IFC. Through its Sustainability Policy, IFC recognizes that climate change is a serious global challenge and IFC affirms that addressing climate change with the private sector and other parties is a strategic priority for IFC.

Specifically, in regard to FI investments, IFC requires the client to implement an environmental and social management system (ESMS) to apply IFC's Performance Standards to their higher risk business activities. IFC supervises the FI through a review of its ESMS implementation. IFC supervision may include visits to the FI, as well as to recipients of funds from the FI to provide assurance that IFC's requirements are being followed. However, it is the FI client and not IFC that has the responsibility to review and supervise the E&S risks associated with projects funded by the FI.

Complaints in relation to multiple projects that an IFC FI client is supporting raise questions regarding the (a) the effectiveness of the client's ESMS, and (b) the extent to which the client is applying IFC's Performance Standards to its investments. Accordingly, this compliance appraisal considers IFC's pre-investment E&S review and supervision of the client prior to the submission of the complaint to CAO. Once IFC became aware of the complaint, CAO also considers actions taken by IFC to assure itself that the client adequately assessed and supervised the application of IFC's Performance Standards to the projects of concern, as relevant to the client's agreed E&S requirements.

In advance of its 2011 equity investment, IFC analyzed the client's portfolio and identified that the client had exposure to higher risk business activities. Accordingly, IFC required the client to implement an ESMS to apply IFC's Exclusion List, applicable national law and IFC's Performance Standards to its investments. IFC processed its first disbursement to the client in March 2011. The client was expected to implement an ESMS to apply IFC's E&S requirements within a defined period following the date of IFC's investment agreement. Subsequently, IFC completed further equity and loan investments with the client. These included a revised ESAP updating client commitments to implement an ESMS in line with IFC's E&S requirements. In 2015, IFC prepared an in-depth review of the client's ESMS, and in 2017 IFC provided enhanced client support to improve its ESMS implementation. While IFC's recent supervision documentation suggests progress in the development of the client's E&S systems, it does not provide assurance of implementation of the ESMS as agreed.

Following the filing of the CAO complaint and as noted during the CAO assessment, the client reports that it conducted enhanced due diligence of 10 of the coal fired power plants named in the complaint. As reported by the client to CAO, the enhanced due diligence exercise identified higher level E&S risk at one of the ten power plants reviewed while the remaining plants had more limited levels of E&S risk. According to the client these observations do not indicate an immediate threat to the environment, project staff or the communities.

The purpose of a CAO compliance appraisal is to ensure that compliance investigations are initiated only in relation to IFC investments that raise substantial concerns regarding E&S outcomes and/or issues of systemic importance to IFC. In determining whether to initiate an investigation, CAO weighs a number of factors including the magnitude of the E&S concerns raised in a complaint, results of a preliminary review of IFC's E&S performance in relation to these issues, the existence of questions concerning the adequacy of IFC's requirements, and a more general assessment of whether a compliance investigation is the appropriate response in the circumstances.

The complainants raise a range of local environmental and social issues in relation to the multiple coal fired power plants that the client is financing. They also allege that IFC, in not ensuring that the client is following its E&S requirements and funding coal fired power plants, is contributing to climate change impacts in the Philippines. In particular, they are concerned that carbon emissions from coal-fired power plants funded by the client will worsen global climate change impacts, to which the Philippines is particularly vulnerable.

It is beyond the scope of a CAO compliance appraisal to reach a conclusion on whether the coal fired power projects listed in the complaint have in fact had significant adverse E&S impacts. The question at this point is whether, on a preliminary review of available evidence, the complaint raises substantial concerns regarding E&S outcomes of IFC's investment. CAO notes RCBC's positive assessment of the E&S performance of the coal fired power plants. However, CAO concludes that there are substantial concerns regarding the E&S outcomes of IFC's investment in RCBC considering: (a) the specific allegations of adverse impacts raised in the complaints; (b) the number of coal fired power plants being financed, (c) the E&S risk profile of the construction and operation of such plants; and (d) questions regarding the capacity of the client to implement an ESMS which applies IFC's Performance Standards to higher risk business activities.

CAO has also identified questions related to application of IFC's E&S standards to this investment, in particular: (a) whether IFC's pre-investment E&S review of the client was commensurate to risk and established a realistic expectation that the client would meet IFC's E&S requirements within agreed timeframes; (b) whether IFC's supervision of the client, including IFC's processing of additional investments, included adequate consideration of client implementation of IFC's E&S requirements and the developing E&S risk profile of the client's lending; (c) whether IFC responded adequately to project level E&S concerns raised in the complaint to CAO; and, (d) whether IFC's approach to its investment was consistent with Sustainability Policy commitments to work with the private sector to address climate change.

Considering the potential adverse E&S impacts of the projects listed in the complaint, the concerns regarding impact raised by the complainants, and the above questions regarding IFC's review and supervision of its investment in the client, CAO has decided to conduct a compliance investigation in response to this complaint. The scope of the investigation will be further defined in terms of reference developed in accordance with the CAO Operational Guidelines.

About the CAO

CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

CAO (Office of the Compliance Advisor/Ombudsman) is an independent post that reports directly to the president of the World Bank Group. The CAO reviews complaints from communities affected by development projects undertaken by the two private sector lending arms of the World Bank Group: the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

For more information about the CAO, please visit www.cao-ombudsman.org

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Acronyms

AEPR	Annual Environmental Performance Report
AMC	IFC Asset Management Company
ASEAN	Association of Southeast Asian Nations
CAO	Office of the Compliance Advisor Ombudsman (IFC and MIGA)
E&S	Environmental and Social
ESMS	Environmental and Social Management System (synonymous with the pre-2012 term - Social and Environmental Management System (SEMS))
ESRP	Environmental and Social Review Procedures
ESRR	Environmental and Social Risk Rating
FI	Financial Intermediary
GHG	greenhouse gas
IFC	International Finance Corporation
NGO	Non-Governmental Organization
PS	Performance Standards (IFC)
PS1	Performance Standard 1: Assessment and Management of Environmental and Social Risks and Impacts
PS2	Performance Standard 2: Labor and Working Conditions
RCBC	Rizal Commercial Banking Corporation ("the client")
SII	Summary of Investment Information
SPI	Summary of Proposed Investment

Overview of the Compliance Appraisal Process

When CAO receives a complaint about an IFC or MIGA project, the complaint is referred for assessment. If CAO concludes that the parties are not willing or able to reach a facilitated solution, the case is transferred to CAO's compliance function for appraisal and potential investigation.

A compliance appraisal also can be triggered by the CAO Vice President, IFC/MIGA management, or the President of the World Bank Group.

The focus of CAO's compliance function is on IFC and MIGA, not their client. This applies to all IFC's business activities, including the real sector, financial markets and advisory. CAO assesses how IFC/MIGA assured itself/themselves of the performance of its business activity or advice, as well as whether the outcomes of the business activity or advice are consistent with the intent of the relevant policy provisions. In many cases, however, in assessing the performance of the project and IFC's/MIGA's implementation of measures to meet the relevant requirements, it will be necessary for CAO to review the actions of the client and verify outcomes in the field.

In order to decide whether a compliance investigation is warranted, CAO first conducts a compliance appraisal. The purpose of the compliance appraisal process is to ensure that compliance investigations are initiated only for those projects that raise substantial concerns regarding environmental and/or social outcomes, and/or issues of systemic importance to IFC/MIGA.

To guide the compliance appraisal process, CAO applies several basic criteria. These criteria test the value of undertaking a compliance investigation, as CAO seeks to determine whether:

- There is evidence of potentially significant adverse environmental and/or social outcome(s) now, or in the future.
- There are indications that a policy or other appraisal criteria may not have been adhered to or properly applied by IFC/MIGA.
- There is evidence that indicates that IFC's/MIGA's provisions, whether or not complied with, have failed to provide an adequate level of protection.

In conducting the appraisal, CAO will engage with the IFC/MIGA team working with the specific project and other stakeholders to understand which criteria IFC/MIGA used to assure itself/themselves of the performance of the project, how IFC/MIGA assured itself/themselves of compliance with these criteria, how IFC/MIGA assured itself/themselves that these provisions provided an adequate level of protection, and, generally, whether a compliance investigation is the appropriate response. After a compliance appraisal has been completed, CAO can close the case or initiate a compliance investigation of IFC or MIGA.

Once CAO concludes a compliance appraisal, it will advise IFC/MIGA, the World Bank Group President, and the Board in writing. If a compliance appraisal results from a case transferred from CAO's dispute resolution, the complainant will also be advised in writing. A summary of all appraisal results will be made public. If CAO decides to initiate a compliance investigation as a result of the compliance appraisal, CAO will draw up terms of reference for the compliance investigation in accordance with CAO's Operational Guidelines.

I. Background

Investment

Rizal Commercial Banking Corporation (RCBC or "the client") is a large universal bank in the Philippines, providing a wide range of banking and other financial products and services, including commercial and retail banking, credit cards, asset management, and treasury and investment banking products and services. IFC has made multiple investments to support RCBC.

In March 2011, IFC acquired 6.7 percent equity stake in RCBC for US$48.3m.[1] The purpose of the investment was to support the client's growth in the areas of microfinance, SME and retail banking.[2] As part of this investment, the client was required to establish and implement an Environmental and Social Management System (ESMS) to apply IFC's Environmental & Social (E&S) requirements to its investments. As IFC had an equity exposure to the client, these requirements applied to all new lending by the client.

In March 2013, IFC provided equity and loan investments to establish a special purpose vehicle to acquire and service RCBC non-performing assets.[3] While this investment did not increase IFC's exposure to the client, it did have the effect of improving the client's capital base in advance of more stringent capital adequacy requirements of the Basel III framework.[4]

In April 2013, IFC's Asset Management Company (AMC) acquired 5.6 percent equity stake in the client for US$100m.[5] The purpose of the investment was to strengthen the client's capital base.

In November 2014, IFC provided the client with a US$30m loan to support the client's capacity to lend to small medium enterprises (SMEs).[6] This loan was fully repaid by July 2018.

In April 2015, IFC sold part of its equity stake to another shareholder.[7] Post-transaction, IFC and AMC collectively held 8 percent equity in the client.[8]

In November 2015, IFC participated in a RCBC bond issue through a US$75 million investment.[9] The expected development impact of this IFC investment included (a) broadening and deepening the bond market; (b) supporting the client to expand lending to infrastructure projects; and (c) continuing support of the client's strategy to increase inclusion in underserved sectors such as SMEs and rural population.[10]

Complaint and CAO Assessment

In October 2017, a complaint was lodged with CAO by national NGO Philippine Movement for Climate Justice (PMCJ), on its own behalf as an alliance of organizations of concerned citizens of

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[1] Philstar, March 9, 2011, *IFC acquires 6.7% stake in RCBC*. Available at http://bit.ly/2FoZyHj.
[2] IFC Disclosure, Summary of Proposed Investment (SPI): project number 30235. Available at http://bit.ly/2J0EsQa.
[3] IFC Disclosure, Summary of Proposed Investment (SPI): project number 31184. Available at http://bit.ly/2WXq7cm.
[4] Business World Online, February 26, 2013, *RCBC bad asset, share sale 'credit positive'*, available at http://bit.ly/2Iu6lkB.
[5] IFC Disclosure, Summary of Investment Information (SII): project number 32853. Available at http://bit.ly/2WXbJkq; Philstar, April 30, 2013, *IFC completes equity investment n RCBC*. Available at http://bit.ly/2N1x1gU.
[6] IFC Disclosure, Summary of Investment Information (SII): project number 34115. Available at http://bit.ly/2MWrx75.
[7] RCBC, April 20, 2015, *RCBC and Cathay Life close equity investment deal.* Available at http://bit.ly/2IvPoq3.
[8] Reuters, August 8, 2016, *Philippines bank used in Bangladesh heist wins shareholder support.* Available at https://reut.rs/2x9yEyw.
[9] IFC Disclosure, Summary of Investment Information (SII): project number 37489. Available at http://bit.ly/2RrC0WQ.
[10] IFC Disclosure, Summary of Investment Information (SII): project number 37489. Available at http://bit.ly/2RrC0WQ.

the Philippines fighting climate change.[11] The complaint, which was supported by two international NGOs, was also filed on behalf of several communities living in the proximity of 19 active or proposed coal-fired power plants in different parts of the Philippines. The complaint alleges that RCBC, a client of IFC, provided financial support to the coal-fired power plants and cites serious E&S impacts on the communities arising from the plants.

In November 2017, CAO determined the complaint eligible in relation to 8 of the 19 communities alleging impact by existing/proposed power plants. In March 2018, CAO determined the complaint eligible in relation to a further 3 power plants. Combined, the total number of communities with an eligible complaint is 11 ('the complainants'). CAO determined the remaining 8 plants did not meet the eligibility criteria.[12] See Annex A for a full list of the power plant projects and eligibility decisions.

Complainants' Perspective

The complaint alleges that RCBC has provided financial support to the power plants and raises several concerns related to (a) community level E&S risks and impacts of the power plants; (b) the power plants' impact on climate change; (c) the client's approach to managing E&S risk; and, (d) IFC's monitoring of the client and transparency in its FI portfolio.

Community representatives raised a series of concerns about the environmental and social impacts of the coal-fired power plants in question. Not all impacts were reported to be simultaneously present in all locations, but they asserted that there was significant repetition from site to site. Specifically, they outlined the following concerns regarding the coal-fired power plants: (a) impacts on public health; (b) adverse impacts from fly ash; (c) water, air and noise pollution; (d) impacts on fishermen; (e) inadequate resettlement; (f) cumulative impacts; (g) workers' concerns; (h) legacy of adverse impacts; (i) flawed construction process; (j) concerns about government-run processes; (k) history of repression of concerns and opposition; and, (l) carbon emissions. Annex A presents complainant allegations in relation to each eligible complaint.

The complaint also links the development of these coal fired power plants to broader issues about climate change impacts on the Philippines and its residents, including the complaint signatories. The complainants are concerned that carbon emissions from coal-fired power plants will worsen global climate change impacts, to which the Philippines is particularly vulnerable. The complaint raises issues related to RCBC's E&S risk management system, lack of consultation and information about the supported power plants and their impacts, and absence of grievance mechanisms for the affected communities.

The complaint also raises issues about IFC, namely a lack of transparency regarding IFC's financial intermediary portfolio; IFC's monitoring and supervision of RCBC's E&S performance, especially given its investments in "business activities with potential significant adverse environmental and social risks or impacts that are diverse, irreversible, and unprecedented,"[13] such as the coal sector; and compliance with its own policies and procedures in relation to its investments in RCBC.

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[11] Complaint to CAO is available at http://bit.ly/2N23fsr.
[12] See CAO's Assessment Report, April 2019, for a full list of the coal-fired power plant projects and eligibility decisions. Available at - https://bit.ly/30BV5ZS.
[13] IFC Sustainability Policy, 2012, para. 40.

Client Perspective

RCBC explained that its relationship with IFC focuses primarily on providing access to finance to SME lending, supporting women entrepreneurs, and rural lending.

The client described its approach to E&S risk management and noted that it has established and implements an ESMS to support its due diligence, E&S risk categorization and supervision. The client asserts that its ESMS is robust and complies with IFC's Performance Standards. The client affirmed that it follows IFC's Performance Standards and industry best practice to screen and categorize all investments and loan applications. The client also asserted that it carefully chooses its investments and engages with project sponsors[14] willing to implement IFC's Performance Standards. Where an investment is classified as high E&S risk, the client noted that it conducts an enhanced due diligence which includes RCBC staff visiting the project, meeting with community members and local officials to assess the potential E&S impact(s). For project finance deals, the client stated that it requires an independent technical advisor to advise for the entire duration of the loan on non-financial and technical aspects of the project.

With regards to the CAO complaint, RCBC noted that it has outstanding loans to 10 of the 11 projects for which CAO determined the complaint eligible. RCBC noted that its financial relationship is through syndication structures (involving multiple banks), with exposures ranging between 2-29 percent of project cost, with a maximum tenor of up to 15 years. RCBC noted that it did not have a current exposure to one project, and thus, it is not supervising its E&S performance.[15]

In April 2019 RCBC reported that enhanced due diligence has been conducted and reports issued on 9 out of the 10 power plants, with a report on the remaining power plant being prepared.[16] Based on these reports, the client made observations of high E&S risk at one power plant. According to RCBC, these observations do not indicate an immediate threat to the environment, project staff or the communities.[17]

RCBC also pointed out that it is an active financier of renewable energy projects in the Philippines and southeast Asia, with an eligible sustainable portfolio that is materially larger than its loans to coal fired power plants. Further, RCBC noted that in 2018 it issued the first green bond from the Philippines, raising US$290m. The bond was three times over subscribed and was issued under the ASEAN Green Bond Standards and is also aligned with the International Capital Market Association's Green Bond Principles 2018.

As the Philippines has suffered serious energy shortages in the past, RCBC noted that government policy has been to prioritize ensuring the energy sector is able to cover the country's base load requirements, which includes the use of coal power.[18]

II. Analysis

This compliance appraisal outlines IFC's pre-investment review and supervision of its investments in the client. It considers how IFC has assured itself that its client is reviewing and supervising

[14] In this compliance appraisal the term project refers to the business activities at the ground level.
[15] CAO Assessment Report, April 2019.
[16] CAO Assessment Report, April 2019.
[17] CAO Assessment Report, April 2019.
[18] CAO Assessment Report, April 2019.

moderate to high risk investments in accordance with IFC's E&S requirements. Following submission of the complaint, this appraisal considers actions taken by IFC to assure itself that its client appropriately applied IFC's E&S requirements to the projects subject to the complaint.

IFC Policy Framework and E&S Requirements

IFC's 2011 equity investment was made in the context of the 2006 Policy on Environmental and Social Sustainability ("the Sustainability Policy"), the 2006 Performance Standards (PS) and 2006 Policy on Disclosure of Information ("Disclosure Policy") - together referred to as the Sustainability Framework. In 2012, the Sustainability Framework was updated. Accordingly, IFC's post-2012 investments and general supervision of the client was conducted in reference to the updated framework. As revised from time to time, the Environmental and Social Review Procedures (ESRP) provide guidance to IFC staff in implementing the Sustainability Framework.

Through the Sustainability Policy, "IFC seeks to ensure, through its due diligence, monitoring and supervision efforts, that the business activities it financed are implemented in accordance with the requirements of the Performance Standards." IFC affirms that it will "only finance investment activities that are expected to meet the requirements of the Performance Standards within a reasonable period of time. Persistent delays in meeting these requirements can lead to loss of financial support from IFC."[19]

When IFC invests in a financial intermediary, IFC seeks to support its capacity to manage E&S risks. This is achieved in part through establishing and implementing an ESMS, and by enhancing an FIs in-house capacity to carry out individual transaction appraisal and monitoring as well as overall portfolio management.[20]

During its pre-investment review, IFC reviews an FI's "existing portfolio and prospective business activities of its FI clients to identify activities where the FIs and IFC could be exposed to risks as a result of their investments and defines requirements for managing these risks." IFC's FI requirements depend on the type of investment IFC is making, use of proceeds and E&S risk of the FI's portfolio which IFC will be exposed to through its investment.

IFC requirements for its FI clients include development of an ESMS to apply IFC's Exclusion List and applicable national law to its investments. Where the FI supports business activities with moderate to high E&S risks, IFC requires the FI to apply IFC's Performance Standards to its higher risk business activities. Where IFC provides equity or financial support of a general purpose, IFC requirements are applied to the FI entire portfolio from the time IFC became a shareholder or investor.[21]

IFC supervises its FI clients through a review of ESMS implementation. This includes a periodic review of the process and results of the FI's E&S due diligence. "The frequency and focus of supervision visits is commensurate with the identified risks. IFC works with its FI clients to help them address any shortcomings in their ESMS."[22]

[19] IFC Sustainability Policy, 2012, para 7 and 22.
[20] IFC Sustainability Policy, 2012, para 33.
[21] IFC Sustainability Policy, 2012, para 37.
[22] IFC Sustainability Policy, 2012, para 45.

Climate Change: IFC's commitments and requirements

Through its Sustainability Policy, IFC "recognizes that climate change is a serious global challenge and that climate-related impacts may impede economic and social well-being and development efforts. Working with the private sector and other parties to address climate change is therefore a strategic priority for IFC."[23]

The Sustainability Policy further provides that IFC, "in its efforts to support its climate-related commitments, … will produce instruments and develop practices that allow its clients to consider climate-related risks and opportunities in their investment decisions." IFC also commits to require its clients to include greenhouse gas (GHG) emissions in their regular reporting in accordance with the Performance Standard 3 quantification threshold.[24]

In 2008, the World Bank Group set targets for financing renewable energy projects and outlined additional criteria that it would consider before financing coal fired power plants through traditional financing instruments. In July 2013 the World Bank Group announced that it would only provide financial support for greenfield coal power generation project in rare circumstances.[25] With regard to existing coal plants, the World Bank Group affirmed that it would support interventions that reduce GHG emissions. the 2013 paper was approved by the Board, and applies to IFC, but it makes no reference to IFC's exposure to coal fired power through financial intermediary investments.

In October 2018, the IFC CEO announced a new approach to FI clients exposed to coal. IFC affirmed that it would support financial intermediaries that formally commit upfront to reduce or, in some cases, exit all coal investments over a defined period. IFC noted that it would "require new equity financial intermediary clients exposed to coal projects to publicly disclose their total exposure in this sector."[26]

In summary, IFC's policy framework commits the institution to work with the private sector to address climate change as a strategic priority, without expressly excluding the financing of coal fired power stations by financial intermediaries.

IFC's Pre-Investment Due Diligence

A key question for CAO is whether IFC exercised due diligence in its review of the E&S risks of the investment and design of mitigation measures. As per the ESRPs, IFC reviews the client's capacity to implement IFC's requirements and its track record to date in ESMS implementation. Where gaps are identified, these are captured in an action plan agreed with the client and incorporated into IFC's legal agreement with the client.[27]

IFC's 2011 equity investment exposed IFC to the full business of client. Accordingly, IFC pre-investment review required an assessment of all aspects of the client's approach to E&S risk management.

In disclosing a summary of its pre-investment review, IFC noted that it analyzed the client's portfolio and determined that the client would be required to apply to its investments IFC's Exclusion List,

[23] IFC Sustainability Policy, 2012, para 10.
[24] IFC Sustainability Policy, 2012, para 10 and 11.
[25] World Bank Group, 2013, Toward a Sustainable Energy Future for All: Directions for the World Bank Group's Energy Sector.
[26] IFC CEO, October 2018, Opinion: A new IFC vision for greening banks in emerging markets. Available at http://bit.ly/2GiAmCv.
[27] ESRP, 2007, para. 7.2.16–17.

applicable national law and regulations and IFC's Performance Standards (combined the Applicable Performance Requirements). In order to implement these standards, IFC required the client to (a) develop an ESMS to IFC's satisfaction prior to disbursement; (b) identify responsible, qualified persons to manage and implement the ESMS; (c) commit to implement the ESMS to ensure that the investments/activities supported by IFC's financing are in compliance with the Applicable Performance Requirements; (d) demonstrate a commitment to applying IFC's PS2: Labor and Working Conditions requirements to RCBC's own operations; and, (e) submit a periodic report to IFC detailing implementation of IFC's requirements.[28] IFC's legal agreement required the client to implement these actions between IFC's commitment and several months post commitment.

In the context of the client's size and significant corporate lending portfolio, CAO's initial review of IFC's 2011 pre-investment review raises questions as to whether IFC adequately reviewed the client's capacity to implement IFC's E&S requirements. Further, CAO has questions as to whether the material available to IFC during the pre-investment review supported a conclusion that the client could operate in accordance with IFC's Performance Standards in a reasonable period of time, the threshold test for IFC investment.

Supervision

During supervision, IFC monitors an "FI's performance on the basis of the Management System [ESMS]."[29] Specifically, IFC is required to determine whether "there is sufficient evidence that the client is operating the [ESMS] as envisaged at the time of appraisal" and "there is sufficient evidence that the client has applied the applicable [IFC E&S requirements] to their … projects."[30]

IFC processed its first disbursement to the client in March 2011.[31] Since then, IFC has reviewed the client's AEPRs, annual client site supervision visits, visited three client projects and reviewed sample project E&S due diligence prepared by the client.

The client was expected to implement an ESMS to apply IFC's E&S requirements shortly after first commitment. Subsequently, IFC completed further equity and loan investments with the client. These included a revised ESAP updating client commitments to implement an ESMS in line with IFC's E&S requirements. In 2015, IFC prepared an in-depth review of the client's ESMS, and in 2017 IFC provided enhanced client support to improve its ESMS implementation. While IFC's recent supervision documentation suggests progress in the development of the client's E&S systems, it does not provide assurance of implementation of the ESMS as agreed.

As of April 2019, the client affirmed that it had active exposure to 10 of the 11 coal-fired power plants listed in the complaint. The client noted that enhanced E&S due diligence has been conducted and reports issued on 9 out of the 10 power plants, with a report on the remaining power plant being prepared. Based on these reports, the client made observations of high E&S risk at one power plant. According to RCBC, these observations do not indicate an immediate threat to the environment, project staff or the communities.[32]

IFC advised CAO that the client had shared the enhanced E&S due diligence reports for the coal fired power stations, and other high-risk projects the client financed, with IFC. IFC reviewed and

[28] IFC Disclosure, SPI, project number 30235
[29] IFC Sustainability Policy, 2006, para. 29.
[30] ESRP 2007, para. 10.2.7.
[31] IFC Disclosure, SPI, project number 30235.
[32] CAO Assessment Report, April 2019.

provided comments to the client on three of these reports. As part of IFC's enhanced client support in 2017, an IFC consultant visited one of the coal-fired power plants subject to the complaint.[i]

While recent project documentation suggests increased IFC attention to the client's ESMS implementation in general, and management of the E&S risk associated with exposure to the coal fired power stations listed in the CAO complaint in particular, available information leaves questions as to IFC supervision of the client, particularly with respect to: (a) ESMS implementation capacity, (b) processes to ensure that IFC's Performance Standards are being applied to the higher risk business activities the client is supporting; and (c) monitoring of high risk projects against the requirements of the Performance Standards.

III. CAO Decision

The purpose of a CAO compliance appraisal is to ensure that compliance investigations are initiated only in relation IFC investments that raise substantial concerns regarding E&S outcomes and/or issues of systemic importance to IFC. In determining whether to initiate an investigation, CAO weighs a number of factors including the magnitude of the E&S concerns raised in a complaint, results of a preliminary review of IFC's E&S performance in relation to these issues, the existence of questions concerning the adequacy of IFC's requirements, and a more general assessment of whether a compliance investigation is the appropriate response in the circumstances.

The complainants raise a range of environmental and social issues in relation to the multiple coal fired power plants the client is financing. They also allege that IFC, by not ensuring that the client is following its E&S requirements and funding coal fired power plants, is contributing to climate change impacts in the Philippines. In particular, they are concerned that carbon emissions from coal-fired power plants funded by the client will worsen global climate change impacts, to which the Philippines is particularly vulnerable.

It is beyond the scope of a CAO compliance appraisal to reach a conclusion on whether the coal fired power projects listed in the complaint have in fact had significant adverse E&S impacts. The question is whether, on a preliminary review of available evidence, the complaint raises substantial concerns regarding E&S outcomes of IFC's investment. CAO notes RCBC's positive assessment of the E&S performance of the coal fired power plants. However, CAO concludes that there are substantial concerns regarding the E&S outcomes of IFC's investment in RCBC considering: (a) the specific allegations of adverse impacts raised in the complaints; (b) the number of coal fired power plants being financed; (c) the E&S risk profile of the construction and operation of such plants; and, (d) questions regarding the capacity of the client to implement an ESMS which applies IFC's Performance Standards to higher risk business activities.

Accordingly, CAO has identified questions pertaining to IFC's performance, in particular: (a) whether IFC's pre-investment E&S review of the client was commensurate to risk and established a realistic expectation that the client would meet IFC's E&S requirements within agreed timeframes; (b) whether IFC's supervision of the client, including IFC's processing of additional investments, included adequate consideration of client implementation of IFC's E&S requirements and the developing E&S risk profile of the client's lending; (c) whether IFC responded adequately to project level E&S concerns raised in the complaint to CAO; and, (d) whether IFC's approach to its investment was consistent with Sustainability Policy commitments to work with the private sector to address climate change.

Considering the potential adverse E&S impacts of the projects listed in the complaint, the concerns regarding impact raised by the complainants, and the above questions regarding IFC's review and supervision of its investment in the client, CAO has decided to conduct a compliance investigation in response to this complaint. The scope of the investigation will be further defined in terms of reference developed in accordance with the CAO Operational Guidelines.

ANNEX A – Eligible Sub-Projects and alleged E&S impacts[33]

	Sub-project name	CAO Eligibility Decision	Project Status	Alleged E&S impacts
1	Masinloc Power Plant Expansion Project	Eligible	Expansion	The plant has affected fisheries. There is less catch for fisherfolk, who now must go farther out to sea to fish, which has increased their expenses. Their daily income is now not enough to sustain their families. There has also been destruction of seaweed, also a livelihood resource. Seaweed farmers have had to leave the area in order to earn a living elsewhere. There have also been impacts on crops and fruit trees.
2	GNPower Dinginin Power Station Expansion	Eligible	Expansion	Local communities have not been properly informed or meaningfully consulted and some groups have been excluded altogether. The operating plant has emitted a foul odor. There has been a lot of respiratory disease in the community since the coal plant began operation. There have also been skin irritations. Some domesticated animals have died, believed to have been caused by the plant. Fisherfolk are no longer allowed to fish in the area, despite this being the main source of livelihood. Fences were built to protect the vicinity of the coal plant and block fishers' access. When fisherfolk try to get close to the area, private guards fire warning shots. In addition, fishing areas have been gradually affected as waters are contaminated. Local residents have been evicted with minimal compensation (according to one resident, ranging from 50 to 100 pesos). Part of the land that was fenced off belonged to an indigenous community.
3	South Luzon Thermal Energy Corp.	Eligible	Operational	Farmers are complaining about dying crops and plants surrounding the facility because of coal ash. Water sources are have been impacted, with artesian pump wells in the community drying up. The construction of the coal plant eroded the shoreline, which has affected livelihoods, as in the case of a resident's rest house business
4	San Buenaventura Power Ltd. Co. Project	Eligible	Expansion	A study by the Health Care Ministry in Quezon has shown Power Ltd. Co. Project, Mauban, Quezon that the incidence of tuberculosis has increased since the operation of the existing 511MW Quezon Power Plant in Mauban, Quezon. According to a study by Greenpeace, the operational coal plant in Mauban, Quezon revealed "insidious presence of heavy metals: mercury, arsenic, carcinogen, as well as the hazardous substances lead and chromium." Heavy metals are proven to have serious impacts on water biodiversity, which is one of the main sources of livelihood of residents in Mauban. The community fears further incidences of respiratory disease and other negative impacts to their health and the environment due to the expansion.
5	Panay Power Station Expansion Project	Eligible	Expansion	Residents from Brgy. Nipa, Concepcion, Iloilo complained of lung problems and skin diseases.

[33] As presented in the CAO complaint http://bit.ly/2N23fsr

6	Southern Mindanao Coal Fired Power Plant	Eligible	Expansion	Some members of the B'laan tribe have been displaced from their ancestral lands, without any process of FPIC. Residents have been experiencing severe stomach aches, which according to the municipal health office, are caused by water contamination. The coal plant threatens the Tino-Tampuan coral reef, a protected area
7	Lanao Kauswagan Power Plant	Eligible	Construction underway	In August 2016, 321 families were evicted and resettled to an unfinished site, with no security of tenure. Residents were asked to relocate to unfinished housing units with unsafe electrical wiring and poor construction, muddy roads, and no water for the housing units
8	Toledo Power Corp. Plant	Eligible	Operational	All the coal ash generated is being dumped indiscriminately around the open spaces in Toledo City and its immediate environs. This has caused serious harms, including pollution of seawaters surrounding the plant. The company has not put any prevention and mitigation measures in place.
9	Atimonan One Energy Power Plant	Eligible	Proposed	A public consultation was held in May 2015. Attendees observed that it was "overly biased in favor of the proponent" and "lacked important details that would explain its calculated impacts." According to some community members, they were not aware of the change from Liquefied Natural Gas (LNG), as initially proposed by AOE, to coal. The community is concerned that they will be economically displaced and not provided with any job opportunities by the company. They are also concerned of negative health impacts. The proposed plant is located in the periphery of Lamon Bay causing a direct threat to the bay.
10	Limay Power Plant	Eligible	Phase 1 Operational Phase 2 Construction underway	Local communities have not been properly informed or meaningfully consulted. Only some people were invited to a public scoping. A public hearing was only conducted after the plant was already constructed. The company broke its promise to some residents to provide job opportunities (importing workers from Manila instead). Fly ash from the plant scatters all over the communities – no prevention measures are in place. Fly ash has caused severe skin and lung disease. The company denied this, saying skin rashes were caused by dogs and refuses to remedy harms. Plants, crops, and rivers have been polluted by continuous scattering of fly ash. Fruit bearing tress are not as productive as before the coal plant was built. Residents have been evicted. Some were relocated, but to areas without livelihood opportunities. Some received 30,000 to 60,000 pesos and had to promise not to return to Limay.
11	**SMC Global Power Coal Plant** Malita, Davao	Eligible	Proposed	Local communities have not been properly informed or meaningfully consulted and fear negative impacts as experienced by other communities living near operational plants.