IFC International Finance Corporation World Bank Group

Interpretation Note on Financial Intermediaries

January 1, 2012

Introduction

IN1. IFC is committed to developing the financial sector in emerging markets through institution building, use of innovative financial products and mobilization, with a special focus on medium and small scale enterprises. To deliver on this commitment in a manner consistent with its strategic focus on sustainable development, IFC has adopted environmental and social (E&S) risk management policies and procedures. This includes a risk based approach to the categorization of the portfolio of its financial intermediary (FIs)[IN1] clients and the determination of the associated E&S requirements. Whereas IFC's direct investment operations in other industry sectors includes a significant volume of project finance and long-term corporate finance, there is limited volume of such products provided through FIs. Nonetheless, a key aspect of IFC's approach to the E&S risk management in the FI sector is to ensure that FIs providing project or long-term corporate finance are identified and the E&S risks from such activities are assessed and appropriately mitigated.

IN2. The objectives of this Interpretation Note (IN) are to (i) clarify how IFC's Policy on Environmental and Social Sustainability (Sustainability Policy) applies to FIs; (ii) explain how IFC's E&S requirements that flow from the Sustainability Policy and Performance Standards apply to the activities and operations of FIs; (iii) guide FIs in making necessary adjustments and enhancements in their operations to help them meet these requirements; and (iv) provide guidance to FI clients on reporting to IFC.

IN3. This IN includes four sections. Section I provides a brief overview of the E&S risks associated with the lending/investment[IN2] activities of FIs. Section II explains how IFC's Sustainability Framework[IN3] is applicable to FIs. Section III addresses the FI's role and responsibilities in managing the E&S risks associated with its lending/investment activities in accordance with Performance Standard 1. Section IV addresses the labor policy requirements of Performance Standard 2 that are directly applicable to an FI's management of its human resources.

IN4. References to additional resources and guidance are provided as footnotes throughout the IN. Users of this IN should also refer to other reference, guidance, and good practice materials made available by IFC through its website and FI client support portal.[IN4]

I. E&S Risk in FI Lending/Investment Activities

IN5. All FIs are exposed to some level of E&S risk through the activities of their borrowers/investees, which can represent a financial, legal, and/or reputational risk to the FI. The E&S risks associated with the internal operations of an FI are typically limited to managing aspects related to labor and working conditions of employees, as well as ensuring the safety of employees and visitors within its premises.

IN6. The E&S risk associated with an FI's lending/investment activities depends on factors such as the specific E&S circumstances associated with a borrower's/investee's[IN5] operations, the sector, and the

[IN1] For the purpose of this IN, the term "financial intermediary," or FI, refers to a variety of financial institutions such as universal banks, investment banks, private equity funds, venture capital funds, microfinance institutions, and leasing and insurance companies, among others.

[IN2] The terms "lending" and "investment" refer to the transactions between the FI and its clients (sub-project level for IFC). The terms are used interchangeably throughout this document.

[IN3] IFC's Sustainability Framework includes Policy and Performance Standards on Environmental and Social Sustainability, and Access to Information Policy.

[IN4] FIRST (Financial Institutions: Resources, Solutions and Tools) for Sustainability provides information for financial institutions to learn about the benefits of E&S risk management, and how to identify and take advantage of environmental business opportunities (http://firstforsustainability.ifc.org).

[IN5] The terms "borrower" and "investee" refer to the FI's clients (sub-project level for IFC). The terms are used interchangeably throughout this document.

geographic context, among others. How an FI addresses these risks will depend on the level of perceived risk, the type of financing undertaken and the amount of leverage that the FI has in obtaining mitigation measures from its borrowers/investees. When an FI provides project or long-term corporate finance, it is more exposed to the underlying E&S risks of the borrowers'/investees' operations but also has the opportunity to manage these risks at the transaction level.

IN7. Considering E&S risk in the transaction review and due diligence process contributes to an FI's overall risk management efforts.[IN6] Doing so requires undertaking individual transaction screening and, where necessary, due diligence and monitoring, and overall E&S risk management in accordance with the resulting E&S risk profile of the portfolio. This also requires the need to develop and maintain the requisite capacity for E&S risk management and allocate appropriate resources for this function.

II. Application of IFC's Sustainability Framework to FIs

IN8. As IFC clients, FIs are expected to manage the E&S risks associated with the lending/investment activities associated with IFC finance. IFC's FI clients are engaged in a diverse range of financial activities including, but not limited to, corporate finance; project finance; lending to micro, small, and medium enterprises; trade finance; and housing finance, among others, each with different E&S risk. Consistent with its Sustainability Policy, IFC reviews the business activities of prospective FI clients to identify areas where the FI could be exposed to potential E&S risk as a result of the borrowers/investees in its portfolio and/or prospective business. The FI is then required to undertake lending/investment-level actions commensurate with the level of E&S risk related to the FI activities supported by IFC, ranging from a simple review against IFC's Exclusion List[IN7] to application of the Performance Standards.

IN9. In accordance with IFC's Sustainability Policy, IFC categorizes investments using a system based on the relative magnitude of E&S risks and impacts. Investments involving FIs or delivery mechanisms involving financial intermediation are classified as Category FI. This category is further divided into FI-1, FI-2, and FI-3 to capture the E&S risk profile of the existing or proposed portfolio of investments/financing activities. IFC considers the tenor, type, size, and sector exposure of the FI's existing or proposed portfolio in determining the categorization. The three sub-categories are defined as follows:

- **Category FI-1**: when an FI's existing or proposed portfolio includes, or is expected to include, substantial financial exposure to business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented.

- **Category FI-2**: when an FI's existing or proposed portfolio comprises, or is expected to comprise, business activities that have potential limited adverse environmental or social risks or impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures; or includes a very limited number of business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented.

- **Category FI-3**: when an FI's existing or proposed portfolio includes financial exposure to business activities that predominantly have minimal or no adverse environmental or social impacts.

[IN6] Additional guidance for FIs on managing E&S risk in transactions is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/managing-environmental-and-social-risk-2_2.php).

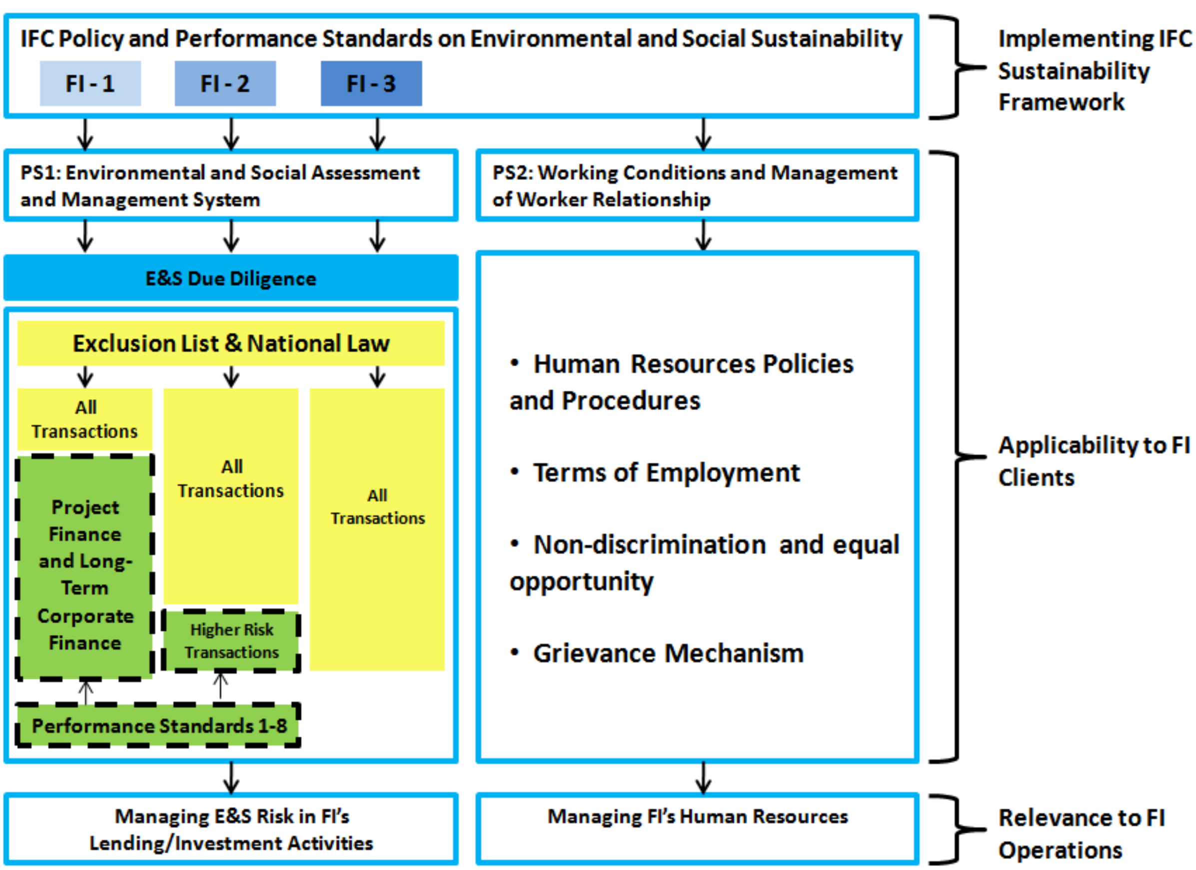
[IN7] The IFC Exclusion List defines the types of projects that IFC does **not** finance (http://www1.ifc.org/wps/wcm/connect/Topics_ext_content/ifc_external_corporate_site/IFC+Sustainability/Risk+Management/Sustainability+Framework/Sustainability+Framework+-+2006/IFC+Exclusion+List/).

IN10. IFC requires all FI clients to develop and operate an Environmental and Social Management System (ESMS) commensurate with the level of E&S risk in their portfolio and prospective business activities. The ESMS should incorporate relevant principles of Performance Standard 1 on Assessment and Management of Environmental and Social Risks and Impacts (see Section III of this IN). The scope and complexity of the ESMS will depend on the E&S risk of the FI's lending/investment activities. Typically, project finance and long-term corporate finance transactions carry increased E&S risk compared to microfinance, mortgage finance, insurance and short-term finance products. Under IFC's Sustainability Policy, higher risk FI subprojects must apply the Performance Standards when they are receiving project finance or long-term corporate finance from an FI. In effect, these higher risk subprojects are those that would be considered Category A or B projects if financed directly by IFC.

IN11. All FI clients must also manage the working conditions of their workforce in accordance with relevant aspects of Performance Standard 2 on Labor and Working Conditions (see Section IV of this IN). In the case of the financial sector this typically relates to employment practices and conditions.

IN12. Figure 1 illustrates the general E&S requirements that apply to IFC's FI clients, the specific E&S risk management requirements[IN8] that are associated with the E&S categorization determined by IFC during its E&S review process, and how these requirements apply to internal and external aspects of an FI's operations.

Figure 1. Overview of IFC Requirements for FI Clients



IN8 Additional guidance for FIs on IFC's E&S risk management requirements is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/ifc-environmental-and-social-performance-requirements.php).

IN13. All FI clients must avoid supporting activities on the IFC Exclusion List and must review the operations of borrowers/investees, where they present E&S risks, for compliance with national E&S laws and regulations where they exist and are applicable.

IN14. IFC's FI clients categorized as FI-1 and FI-2 (as illustrated in Figure 1) are required to apply the Performance Standards[IN9] to transactions involving project finance and long-term corporate finance.[IN10] Project and corporate finance activities are more likely to involve some E&S risk for the FI, as they are typically medium-/long-term transactions and will typically have negotiated transaction documents that incorporate relevant covenants. The FI will assess E&S risks of transactions according to Performance Standards 1 through 8 and will require its borrowers/investees to comply with these Performance Standards in their operations.

III. Applying Performance Standard 1 on Assessment and Management of E&S Risks and Impacts to FI Lending/Investment Activities

IN15. For FIs, application of Performance Standard 1[IN11] requires the development of an ESMS to identify and manage the E&S risks associated with their portfolio on an ongoing basis. The complexity of the ESMS will vary according to the risk exposure that the FI is expected to manage; for instance for FI categorized as FI-3, which constitute the majority of IFC's investments through FIs, the ESMS will consist of a simple review mechanism.

IN16. The scope of application of the ESMS is in part determined by the use of funds from IFC financing. In cases where funds provided by IFC are targeted to a specified end use (e.g., a credit line for a specific sector), the requirements for E&S risk management will cover only the specified end use. However, if the FI supports similar activities from its own account, the E&S risk management approach will apply to the entire asset class. For example, if IFC finances a credit line for small and medium enterprises (SME), then the FI's entire SME operations should also apply the agreed E&S requirements. The FI may choose to expand the application of its E&S risk management practices to manage such risk across its operations.

IN17. In cases where IFC's investment consists of equity or general purpose financial support with no specified end use, the approach to E&S risk management will apply to the entire portfolio that the FI originates from the time IFC becomes a shareholder or lender.

IN18. If changes in the FI business result in different E&S risks than those identified at the time of IFC's investment, the FI will need to adjust its ESMS in a manner consistent with the E&S risk profile resulting from the new business activities.

IN19. The ESMS should be tailored to fit the needs of the FI and can be integrated into its existing risk management systems for credit, operational risk, finance, legal, compliance, or any other relevant system operating within the FI, which may already consider some E&S risk.[IN12] These processes should be used as a foundation on which to build the additional E&S risk management elements of the ESMS. Where the FI already has an ESMS, its elements may meet, or may need to be modified to meet, the requirements of IFC's Sustainability Framework.[IN13]

[IN9] IFC may require the application of the Performance Standards to other transactions in accordance with the E&S risk management requirements determined at the time of IFC's E&S review process.

[IN10] For the purpose of this document, project finance and long-term corporate finance includes private equity funds.

[IN11] See paragraph 5 of Performance Standard 1.

[IN12] Examples of existing E&S risk management practices are verification of valid E&S permits and authorizations in compliance with national E&S regulations.

[IN13] Additional guidance for FIs on how to establish and maintain an ESMS is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/establish-and-maintain-an-esms.php).

IN20. An FI's ESMS should typically consist of the following elements: (i) E&S policy; (ii) internal organizational capacity and competency; (iii) E&S due diligence (ESDD) processes/procedures to identify risks and impacts of borrowers/investees; (iv) monitoring and review of portfolio; (v) external communications and grievance mechanisms; and (vi) emergency preparedness and response.[IN14] Each ESMS element is discussed in more detail below.

E&S Policy[IN15]

IN21. The E&S policy should state the E&S requirements and standards that apply to the FIs lending/investment activities and that will be used to manage the E&S risk associated with the FI's portfolio of borrowers/investees.[IN16]

IN22. The E&S requirements and standards for FIs categorized as FI-3 and most FIs categorized as FI-2 that do not provide project or long-term corporate finance should include a list of excluded or restricted activities that the FI will not support, including, at a minimum, the IFC Exclusion List, and where their operations present E&S risks, applicable relevant national E&S laws and regulations of the host country/countries where the FI operates. In addition, FIs categorized as FI-1 and FI-2 that support project and long-term corporate finance transactions should reference the requirements of Performance Standards 1 through 8 and any other relevant standards, such as international protocols, industry-specific codes of practice, and other voluntary standards (e.g., Equator Principles, UNEP-FI, Global Compact, UN-PRI, etc.), where applicable. The policy should also specify the E&S requirements for different business lines.

IN23. The E&S policy should be endorsed by the FI's senior management and include a commitment to develop and maintain the necessary internal capacity and structure to implement it. The policy should be actively communicated to employees at all levels and functions. Good practice also recommends external communication of the policy through public disclosure, presenting it in corporate statements and reports, and publishing it on the FI's website.

Internal Organizational Capacity and Competency[IN17]

IN24. Performance Standard 1 outlines the need for IFC clients to establish and maintain an organizational structure that defines roles, responsibilities, and authority to implement the ESMS.

IN25. For FIs, this means designating personnel with E&S responsibilities and ensuring that resources are available for the effective implementation of the ESMS across the organization.[IN18]

IN26. An FI's organizational capacity needs will vary depending on the E&S risk profile of its portfolio. The FI may use qualified in-house staff or retain external experts to conduct the necessary ESDD for transactions (as described in IN33–IN39) with the intent of meeting all applicable requirements of national E&S laws and regulations and, where applicable, the Performance Standards.

[IN14] Additional guidance for FIs on how to develop an ESMS is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/ifc-environmental-and-social-requirements.php).

[IN15] See paragraph 6 of Performance Standard 1.

[IN16] Additional guidance for FIs on how to develop an E&S policy and examples of E&S Policies are available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/environmental-and-social-policy.php).

[IN17] See paragraphs 17–19 of Performance Standard 1.

[IN18] Additional guidance for FIs on the roles and responsibilities of E&S personnel is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/responsibilities-and-decision-making.php.

IN27. While day-to-day operations of the ESMS can be delegated,[IN19] the FI's senior management is ultimately responsible for E&S risk management and should allocate sufficient resources to implement the ESMS. This requires designating and communicating E&S responsibilities to relevant personnel to conduct the necessary ESDD and to monitor at the transaction and portfolio levels, and providing appropriate incentives for doing so.

IN28. The FI should ensure that applicable staff has sufficient knowledge for managing the E&S risks, as well as implementing and maintaining the ESMS. Training programs are an important component to ensure that all relevant personnel understand their E&S responsibilities.[IN20]

E&S Due Diligence Processes to Identify E&S Risks of Borrowers/Investees[IN21]

IN29. Performance Standard 1 requires IFC clients to establish and maintain a process to identify the E&S risks and impacts of their operations, as well as to develop Environmental and Social Action Plans (ESAPs),[IN22] which detail mitigation and performance improvement measures that are necessary to address identified E&S risks and impacts.

IN30. For an FI, this requires identifying the E&S risks and impacts associated with their lending/investment activities. This means conducting an ESDD at the transaction level to identify the risks and impacts associated with environmental, social, labor, occupational health and safety, and security of the business operation considered for financing. As an outcome of the ESDD process, the FI can identify necessary mitigation or corrective measures (as described in IN36–IN41) for borrower/investee operations.

IN31. All IFC FI clients must review proposed transactions against the IFC Exclusion List and national E&S laws and regulations where they exist and are applicable, requiring at a minimum that FIs check if borrowers/investees have all necessary permits where required and that their operations are not unlawful. For FI clients categorized as FI-3, this review process represents the only ESDD requirement. FI clients that have been categorized as FI-1 or FI-2 (as illustrated in Figure 1) are also required to assess E&S risks and impacts as part of their ESDD process. This will include a more in-depth review against the relevant national laws and regulations, and, where applicable, against the Performance Standards (as described in IN33).

IN32. FI clients categorized as FI-1 and FI-2 should develop a categorization system[IN23] based on the level of E&S risk of the transaction to guide them on the scope of the ESDD. A typical system includes three E&S risk categories, designated as high,[IN24] medium,[IN25] and low risk[IN26] (or other categories such

[IN19] Additional guidance for FIs on designating an ESMS Officer is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/designate-an-esms-officer.php).

[IN20] Additional guidance for FIs on E&S training is available at FIRST for Sustainability (http://firstforsustainability.org/resources/training.php). IFC offers two free online training courses: E-Learning Course on Managing Environmental and Social Performance and Sustainability Training and E-Learning Program (STEP) (http://www.ifc.org/step).

[IN21] See paragraphs 7–16 of Performance Standard 1.

[IN 22] While FIs more commonly use the term "corrective action plan," the term "action plan" is used in this IN to keep it consistent with the language of Performance Standard 1.

[IN23] Additional guidance for FIs on E&S risk categorization is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/risk-categorization-and-managing-portfolio.php).

[IN24] High: projects with potential significant adverse environmental or social risks and/or impacts that are diverse, irreversible, or unprecedented.

[IN25] Medium risk: projects with potential limited adverse environmental or social risks and/or impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures.

[IN26] Low risk: projects with minimal or no adverse environmental or social risks and/or impacts.

as 1, 2, and 3, or A, B, and C) reflecting different risk levels. Categorization also allows FIs to aggregate E&S risks of transactions at the portfolio level.

IN33. For transactions within the scope of category FI-1 and FI-2 institutions, the ESDD process[IN27] typically consists of (i) reviewing all relevant documents and information provided by the borrower/investee, including information on risks related to the particular industry[IN28] sector and technical aspects of the borrower's/investee's operation; (ii) reviewing against pre-determined criteria such as the IFC Exclusion List, national E&S laws and regulations, and where applicable, the Performance Standards; (iii) conducting site visits to facilities and meetings/interviews with relevant stakeholders; and (iv) reviewing the borrower's/investee's track record on E&S issues in terms of potential non-compliance with national regulations or negative publicity. As part of an FI's ESMS, responsibilities for conducting the ESDD are integrated at various stages of the FI's lending/investment cycle.

IN34. If the initial review or the ESDD concludes that a proposed lending/investment activity will have minimal or no potential E&S risks or adverse impacts, the FI should document this conclusion as part of its transaction decision.

IN35. Additional in-depth due diligence will be required should the ESDD process indicate the existence of E&S risks or potential impacts. In such cases, the FI may consider outsourcing the ESDD to an external expert. The ESDD should also identify corrective actions to be taken by the borrower/investee to comply with the FI's E&S policy.

IN36. The FI should document the findings of the ESDD in a report, including recommendations to proceed with financing and any conditions of investment, such as ESAPs agreed with the borrower/investee to mitigate identified E&S risks and impacts within their operations.

IN37. The ESAP[IN29] should outline key E&S performance gaps in a borrower's/investee's operations identified during the ESDD or monitoring (as described in IN44–IN48), as well as proposed mitigation measures and a timeline to ensure compliance with applicable national E&S laws and regulations and the Performance Standards (where required). ESAPs may range from basic mitigation measures to detailed management plans, with actions that can be measured quantitatively or qualitatively.

IN38. If at the time of the FI's transaction with a borrower/investee the physical assets to be developed, acquired, or financed have yet to be defined, the ESAP should require the borrower/investee to develop an E&S risk management process at the operations level to ensure that E&S risks and impacts will be adequately identified in the future when the physical assets are defined.

IN39. The FI should discuss the ESAP with the borrower/investee and agree on its scope and timeframe for completion. If the ESAP is developed as part of the transaction review process, it should be referenced in the legal agreement (as described in IN41). The timeframe for implementing specific mitigation measures will vary according to the E&S risk and may range from being a condition of transaction approval to a condition of disbursement or post investment condition.

IN40. The FI should require its borrowers/investees to submit regular E&S performance reports to provide an update on progress made with respect to the ESAP (if there is one), overall E&S performance,

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[IN 27] Additional guidance for FIs on the ESDD process is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/environmental-and-social-due-diligence.php).

[IN28] See World Bank Group EHS Guidelines (http://www1.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/risk+management/sustainability+framework/sustainability+framework+-+2006/environmental%2C+health%2C+and+safety+guidelines/ehsguidelines) and the E&S Tool for private equity funds (https://www.estoolkit.com/).

[IN29] Additional guidance for FIs on preparing E&S action plans is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/corrective-action-plan.php).

and any changes in its operations that may result in additional E&S risks and impacts. Though the scope and frequency of reporting will vary according to the E&S risk and potential impacts of each transaction, reporting should be done at least annually.

IN41. To ensure that borrowers/investees comply with the FI's E&S policy, the FI should incorporate E&S provisions and investment conditions into legal agreements. Standard E&S terms are typically represented as general E&S definitions, representations and warranties, disbursement conditions, and/or covenants regarding compliance with the requirements as defined by the FI's E&S policy. ESAPs including mitigation measures to address performance gaps as well as annual reporting on E&S performance should also be included in the legal agreement.[IN30]

IN42. To support the ESDD process, the FI should develop the necessary supporting guidance documents and checklists[IN31] for use by its staff. This should reflect E&S issues that will be reviewed, as well as other factors that will be considered to review compliance with the FI's E&S policy. A good starting point is a review of the E&S issues associated with those industry sectors to which the FI is the most exposed in its portfolio. Also, the FI should appoint or hire personnel to develop a comprehensive understanding of relevant national E&S laws and regulations of the countries in which it operates. If an FI client is required to apply the Performance Standards to project and long-term corporate finance, the FI may want to review the requirements of the Performance Standards against those of applicable national E&S laws and regulations to identify requirement gaps.

Monitoring and Review of Portfolio[IN32]

IN43. Performance Standard 1 requires IFC clients to establish monitoring procedures to review progress with ESAPs and compliance of operations with any legal and/or contractual obligations and regulatory requirements. This should include periodic review of the effectiveness of the ESMS in managing the E&S risks.

IN44. For an FI, this requires monitoring the borrower's/investee's E&S performance against the FI's E&S policy, the ESDD findings, and the ESAP (if required). The extent and frequency of monitoring should be commensurate with the E&S risk and potential impacts of the transaction as identified through the ESDD. Depending on the monitoring outcome, the mitigation measures in the ESAP may need to be revised.

IN45. For FI clients involved with project and long-term corporate finance, the monitoring process should (i) focus on the key risks and impacts of the borrower's/investee's operations on their workers, communities, and the natural environment as identified during the FI's ESDD process (as described in IN33); and (ii) review progress with regard to implementing the agreed ESAP.

IN46. The monitoring[IN33] process is conducted as part of the FI's ESMS, and typically involves the use of internal resources to review E&S reports received from borrowers/investees review of relevant activities of respective national authorities such as factory inspections (where available) and conducting periodic site visits. Support from external experts may be necessary. Monitoring outcomes and identified corrective

[IN30] Additional guidance for FIs on inserting E&S provisions into legal agreements is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/environmental-and-social-covenants-in-legal-agreements.php). As an example, also see Guidance to EPFIs on Incorporating Environmental and Social Considerations into Loan Documentation (http://www.equator-principles.com/documents/EPLoanDocumentGuidance.pdf).

[IN31] Additional guidance for FIs on developing ESDD guidance documents is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/guidance-for-managing-environmental-and-social-risk.php).

[IN32] See paragraphs 22–24 of Performance Standard 1.

[IN33] Additional guidance for FIs on the monitoring process is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/monitoring-client-investee-se-performance.php).

actions should be documented, and the FI should work with borrowers/investees to ensure that corrective actions are implemented.

IN47. FI senior management should be informed regularly of the E&S risks at the portfolio level[IN34] and of individual borrowers/investees, if necessary. This information gives an FI a better understanding of its overall exposure to E&S risk, and allows the FI to focus on transactions and borrowers/investees that may require additional resources to manage E&S impacts.

IN48. FIs should periodically review[IN35] the implementation effectiveness of their ESMS, and adjust or update procedures, as needed, to enhance practices and efficiency, address potential changes in the E&S risk profile of their portfolio, and respond to changes in the E&S regulatory environment.

External Communications and Grievance Mechanisms[IN36]

IN49. Performance Standard 1 requires IFC clients to implement and maintain a procedure for external communications and a grievance mechanism to receive external complaints from the public regarding any aspects of operations.

IN50. For an FI, this requires implementing a process for receiving and responding to concerns from third parties—for example, concerns related to the FI's investment activities and/or a borrower/investee in its portfolio. The process should provide publicly available and easily accessible channels (e.g., phone number, website, e-mail address, etc.) to receive communications and requests from the public for information regarding E&S issues. The FI will assess the relevance of the external communication received and determine the level of response required, if any.

IN51. Most FI clients will be required to submit annual E&S performance reports to IFC. An FI may have additional reporting requirements to additional stakeholders (internal and external) regarding E&S risks and impacts associated with its activities. For an FI, E&S performance reports[IN37] should include:

- Portfolio breakdown by industry sector, high-risk transactions and ESDD process prior to transaction approval where relevant;[IN38]
- Cases of non-compliance and significant E&S accidents or incidents related to a transaction;
- Information on the implementation of and changes to the FI's ESMS; and
- Information on DOTS[IN39] indicators as agreed with the client.

Emergency Preparedness and Response[IN40]

IN52. Where an IFC client's operations involve activities and facilities that are likely to generate impacts, Performance Standard 1 requires clients to establish and maintain an emergency preparedness and response system to respond to accidental and emergency situations.

[IN34] Additional guidance for FIs on managing portfolio risk is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/risk-categorization-and-managing-portfolio.php).

[IN35] Additional guidance for FIs on reviewing the effectiveness of ESMS implementation is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/esms-review-and-continuous-improvement.php).

[IN36] See paragraphs 34 and 35 of Performance Standard 1.

[IN37] Additional guidance for FIs on preparing annual E&S performance report for IFC is available at FIRST for Sustainability (http://firstforsustainability.org/risk-management/report-annually.php).

[IN38] Private Equity Funds will provide names, locations and sectors of high-risk subprojects that have been supported with IFC funding, subject to regulatory constraints and market sensitivities.

[IN39] Development Outcomes Tracking System—for investments made with and through FIs, IFC reports annually on the development outcomes of its FI portfolio. Information gathered from FI clients is presented in an aggregate form.

[IN40] See paragraph 20 of Performance Standard 1.

IN53. For an FI client, this means ensuring that the necessary emergency preparedness and response plans are in place within its premises to protect the health and safety of its employees as well as that of visitors. Effective emergency preparedness and response plans should identify responsibilities and procedures for communicating different types of emergencies (e.g., fire, earthquake or robbery) to the appropriate authorities and for safe evacuation. Plans should also include specific training and practice requirements (i.e., simulations and drills).

IN54. Buildings that are owned or rented/leased by the FI that are accessible to the public should be designed, constructed, and operated in full compliance with local building codes, local fire department regulations, local legal/insurance requirements, and in accordance with internationally accepted life and fire safety standards.

IV. Applying Performance Standard 2 on Labor and Working Conditions to the FI's Workforce

IN55. Performance Standard 2[IN41] requires IFC clients to commit to the fair treatment, non-discrimination and equal opportunity of employees, to maintain or improve employee-management relationships, and to promote compliance with national employment and labor laws. Performance Standard 2 also requires IFC clients to extend the same rights to certain third-party (contracted) employees.

IN56. For FIs, this means (i) maintaining good working conditions and employee relationships through the adoption and implementation of clear and transparent human resources policies and procedures; (ii) reasonable conditions of employment (including non-discrimination); (iii) allowing freedom of association among employees; (iv) managing a grievance process to learn about employees' concerns and suggestions; and (v) in cases when collective dismissal of employees is unavoidable, having a fair retrenchment plan.

Human Resources Policies and Procedures[IN42]

IN57. Performance Standard 2 requires IFC clients to adopt and implement human resources policies and procedures appropriate to the size of their operations and workforce. These policies and procedures should state the approach for managing employees and be consistent with the requirements of Performance Standard 2 and national law.

IN58. For an FI, this means documenting human resources policies and procedures and clearly communicating such policies and procedures to all employees. The scope and complexity of the human resources policies and procedures should be tailored to the size and nature of the FI's workforce. The FI should communicate employment terms to employees upon and throughout the duration of employment.

IN59. All employees should have a contract or letter of employment[IN43] outlining the working relationship with the FI, stating the employment conditions and referring to the FI's applicable policies, procedures, and labor regulations. Employees should also have access to their employment records in accordance with national law.

IN60. The FI's human resources policy should address employees' rights to privacy. For reasons relevant to the hiring process, an FI may need to collect personal employee data, including medical data;

[IN41] Detailed guidance on overall compliance with Performance Standard 2 is available in the Guidance Note to Performance Standard 2. (http://www1.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability+framework/2012+edition/guidancenote2)

[IN42] See paragraphs 8 and 9 of Performance Standard 2.

[IN43] While FIs more commonly use the term "letter of employment," the term "contract" is used in this IN to keep it consistent with the language of Performance Standard 2.

this information should be kept confidential. If employees are under camera or other surveillance methods, the FI should inform them and explain the reasons for doing so.

IN61. An FI should not tolerate any kind of harassment of its employees, including sexual harassment or mistreatment within the workplace. The FI's human resources policy and procedures should outline the necessary measures for preventing this type of behavior and provide a mechanism for reporting and addressing inappropriate behavior (as described in IN74–IN76).

Working Conditions and Terms of Employment[IN44]

IN62. Performance Standard 2 requires IFC clients to provide reasonable working conditions for all employees.

IN63. For FIs, this means providing conditions and terms of employment that, at a minimum, comply with national law and Performance Standard 2. In addition to salary, this should include a safe work environment free of discrimination or harassment; maximum working hours and payment for overtime work for applicable employees/job types; health insurance; pension; and leave time for holidays, illnesses/injuries, and maternity.

IN64. Where collective bargaining agreements are in place, the FI should verify that these meet the requirements of national law and Performance Standard 2, and provide conditions and terms of employment in line with these agreements. Where some employees are covered by collective bargaining agreements and others are not, the terms and conditions of employment as well as benefits of all employees in similar positions should be substantially equivalent.

IN65. When the FI provides fee-based services (e.g., training) to employees, these services should be provided in a non-discriminatory manner and should comply with national and international standards for quality, security, safety, and professional competency. Employee participation should not be mandatory and service fees should be at the market rate, transparent, and fair.

Employees' Organizations[IN45]

IN66. Performance Standard 2 requires IFC clients to recognize the rights of their employees to form and join employees' organizations where permitted by law. These organizations should be freely chosen by employees and should not be under the direct influence or control of the employer or the government.

IN67. For an FI, this means not discouraging employees from forming or joining an employees' organization, or discriminating or retaliating against employees who attempt to form or join these organizations. Refusing to hire employees who have been members or leaders of employees' organizations for reasons unrelated to qualifications or job performance constitutes discrimination. The FI should not favor one employees' organization over another or unreasonably restrict access to employees by representatives of such organizations. Employees should be free to meet and discuss employment issues with representatives of employees' organizations and should be allowed to request participation of representatives from these organizations in disciplinary proceedings.

IN68. Where freedom of association and/or collective bargaining is substantially restricted by law, the FI should engage directly with employees to address issues relating to their conditions and terms of employment and recognize alternative means of employee representation.[IN46]

[IN44] See paragraphs 10–12 of Performance Standard 2.

[IN45] See paragraphs 13 and 14 of Performance Standard 2.

[IN46] Alternatives include recognizing employee committees and allowing employees to choose their own representatives for dialogue with management in a manner that does not contravene national law.

Non-Discrimination and Equal Opportunity[IN47]

IN69. Performance Standard 2 requires IFC clients not to make employment decisions on the basis of personal characteristics unrelated to job requirements. In certain situations, protection or assistance designed to increase employment of underrepresented groups in the workforce or in particular occupations are acceptable under Performance Standard 2. Such affirmative actions are not deemed to constitute discrimination and may be used where permitted by law.

IN70. For an FI, this requires applying the principles of equal opportunity and non-discrimination by basing all employment decisions (such as recruitment, hiring, working conditions, and terms of employment) on the ability of a person to perform their job duties.

Retrenchment[IN48]

IN71. Performance Standard 2 states that in the absence of alternatives to eliminating a significant number of work positions at one time, IFC clients are required to develop and implement retrenchment plans to reduce the adverse impacts on affected employees. This does not apply to isolated cases of termination of employment for cause or voluntary departure. In addition to complying with regulatory requirements to notify or consult public authorities and others, the retrenchment plan should be based on the principle of non-discrimination and consider the outcomes of consultations with employees, their organizations, and, where appropriate, the government as well as any specific requirements stipulated in collective bargaining agreements, if these exist.

IN72. For an FI, this requires developing a retrenchment plan[IN49] that includes an analysis of potential alternatives (options considered, number of positions saved, and a cost analysis). This process[IN50] should (i) include consultations with employees to consider their concerns and ideas on adopting other measures (such as collective reductions in hours and salary) to avoid or minimize layoffs; (ii) communicate criteria for selection (which should be objective, fair, and transparent, and not based on personal characteristics unrelated to job requirements); and (iii) present compensation payments. The FI should also establish a grievance mechanism to address potential claims that the retrenchment plan was not followed appropriately.

IN73. In cases where retrenchment cannot be avoided, the FI should pay any outstanding back pay and benefits, as well as severance payments mandated by national law and/or collective agreements. If the FI is required to make payments for the employees' benefit to specific third-party institutions such as pension funds or health funds, it should provide evidence of such payments to employees. Where payments can be made either to third-party institutions or as a direct cash payment to employees, the FI should defer to the employee's preference.

[IN47] See paragraphs 15–17 of Performance Standard 2.

[IN48] See paragraphs 18 and 19 of Performance Standard 2.

[IN49] See Good Practice Note on Managing Retrenchment at: http://www1.ifc.org/wps/wcm/connect/Topics_ext_content/ifc_external_corporate_site/IFC%20Sustainability/Publications/Publications_GPN_Retrenchment__WCI__1319579072627

[IN50] Useful guidance on retrenchment is included in the Guidelines for Multinational Enterprises of the Organization for Economic Co-operation and Development (http://www.oecd.org/topic/0,2686,en_2649_34889_1_1_1_1_37439,00.html) and the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy of the ILO (http://www.ilo.org/public/english/employment/multi/index.htm).

Grievance Mechanism for Employees[IN51]

IN74. Performance Standard 2 requires IFC clients to provide a mechanism for employees to raise workplace concerns and provide feedback. This mechanism should be clearly communicated to employees and allow for anonymous complaints to be raised and addressed.

IN75. For FIs, this requires developing a process whereby employees can state their concerns directly to human resources or management, bypassing their immediate supervisors if needed, and ensuring that matters are brought to management's attention and addressed in a timely manner. The mechanism should protect confidentiality and ensure that there is no retribution for filing grievances. The FI should document all grievances and provide feedback to those who file complaints.

IN76. Where a grievance mechanism is provided through a collective bargaining agreement, the FI should follow this process for those employees covered by the agreement, provided that the mechanism meets the requirements of Performance Standard 2.

Workers Engaged by Third Parties[IN52]

IN77. Performance Standard 2 also applies to contracted workers and requires IFC clients to take reasonable efforts to ensure that third parties that hire these workers are reputable and legitimate enterprises and have appropriate labor practices.

IN78. For an FI, this requires contractors hired for core functions[IN53] to have the same rights and benefits as regular employees. For non-core functions,[IN54] the FI should establish policies and procedures for selecting and managing third-party employers to ensure that their labor practices are consistent with the requirements of Performance Standard 2.

IN79. If an FI requires armed security during the course of its operations, the FI should follow safety standards and guidelines when hiring security companies. Standards and guidelines should include appropriate training; a code of conduct for the use of force with or without firearms; ways to prevent and resolve conflicts without using force; grievance mechanisms related to possible abuses in the use of force; and audit and internal assessment systems to review the performance of private security companies.

[IN51] See paragraph 20 of Performance Standard 2.

[IN52] See paragraphs 24–26 of Performance Standard 2.

[IN53] Examples of core functions for an FI include tellers and secretaries.

[IN54] Examples of non-core functions for an FI include cleaning and security.