

June 4, 2012

**PROPOSED ADOPTION AND APPLICATION OF WORLD BANK PERFORMANCE STANDARDS FOR  
PRIVATE SECTOR PROJECTS SUPPORTED BY IBRD/IDA**

1. The purpose of this memorandum is to seek Board approval of the proposed application of the IFC Performance Standards, to be called *World Bank Performance Standards*, to private sector projects supported by IBRD/IDA. The IFC Performance Standards have been approved by the Board as the environmental and social policy standards for private sector projects following extensive external and internal consultations. The Board approved the revised Performance Standards during 2011 and they went into effect on January 1, 2012. The final version of the IFC Performance Standards can be found on the IFC website at [www.ifc.org/enviro](http://www.ifc.org/enviro). The aim of this proposal is to facilitate Bank support for private sector led projects by applying environmental and social policy standards that are better suited to the private sector, while enhancing greater policy coherence and cooperation across the World Bank Group (WBG). To this end Executive Directors had already considered and approved MIGA's adoption of the IFC Performance Standards in 2007.

***Background***

2. Infrastructure development is critical to delivering growth, reducing poverty and creating broader development impacts. The WBG has been making sustained efforts to support this important sector over the last decade. In 2011, aiming to scale up its engagement in this sector, the WBG updated its infrastructure strategy for FY12-15,<sup>1</sup> and made Public-Private Partnerships (PPPs) a key pillar of the WBG's infrastructure business. Mobilizing private sector finance is an important element for the WBG to realize infrastructure projects, such as those with interconnected infrastructure or infrastructure needed for green growth. Commercial banks remain risk averse and Basel III implementation is increasing the cost of long-term funding; as for the Bank, it has its own capital constraints. To realize the type of scaling up envisaged in the updated infrastructure strategy, and to meet the expectations of its shareholders, the WBG must not only increase its efforts but also conduct its business differently.

3. Accordingly, this paper proposes to address one of the greater constraints to PPP, which is the dual system of World Bank environmental and social safeguard policies and IFC/MIGA Performance Standards that the WBG currently uses in PPP projects. This constraint has been repeatedly identified and questioned by internal surveys and studies, by Executive Directors of the institutions in the WBG, and by external stakeholders. Considering such feedback, and also

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<sup>1</sup> *Transformation through Infrastructure: World Bank Group Infrastructure Strategy Update FY2012-2015*, March 2012.

taking into account the Bank's strong commitment to efficiency and effectiveness of projects it supports, as well as the development impacts of its limited financial resources, Bank Management submits this proposal.

### ***Constraints to Collaboration across WBG***

4. Increased collaboration across the members of the WBG, particularly in IDA countries, is an institutional priority. Increased demand for IBRD/IDA financial resources has emphasized the need to leverage the Bank's financial resources as well as the range of WBG products and services.

5. In low income countries in particular, the success of IFC's and MIGA's private sector clients depends in part on the success of Bank efforts to support sector reform and policy dialogue, and to invest in public and institutional infrastructure. At the same time, these reform efforts are more likely to be realized with IFC and MIGA's help in opening new markets for private sponsors. Both theory and practice support the notion that harmonized support for private sector investment using existing or new instruments and resources can leverage the WBG's actions in member countries, contribute to growth, and lead to better development outcomes.<sup>2</sup>

6. In this context, the Bank has recently seen a significant increase in the number of Partial Risk Guarantees (PRGs) sought by private sector investors, especially in IDA countries. This reflects the growing interest in PPPs led by private sector investors that are designed to meet critical infrastructure or public service needs. In addition, the Bank has recently expanded its support for private sector activity through innovative financing tools such as IDA-IFC Risk Sharing Facilities to encourage commercial bank lending to SMEs, and IDA support for government participation/membership in trade facilitation agencies and guarantors that effectively operate commercially (e.g., the Africa Trade Insurance Agency).

7. Although the desirability of collaboration between different arms of the WBG in support of private sector investment is obvious and growing, these collaborative efforts require additional support and resources. Prior to its self-imposed sunset, the IDA/IFC Secretariat reported in its 2009 Progress Report (SecM2009-0173) that the application of two different environmental and social safeguards systems is perceived by staff as a serious constraint that creates confusion and adds transaction costs, time and complexity to joint projects, reducing their appeal to country and private sector clients alike. Before its term expired, the IDA/IFC Secretariat also recommended consideration of a pilot under which the Board would authorize a subset of privately managed but jointly financed projects to apply the Performance Standards. The proposal in this paper takes up that challenge, responding to the renewed emphasis the WBG is placing on PPPs today.

8. The Bank has taken note that private sector entities seeking Bank support through PRGs or other instruments are keen to use the Performance Standards as benchmarks for environmental and social risks and impacts assessment and management. This is because they are generally familiar with the Performance Standards in their business dealings, and because they feel that the Standards, which benefited from a rigorous process of consultation with relevant stakeholder

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<sup>2</sup> World Bank–International Finance Corporation Collaboration in IDA Countries: A Progress Report, February 16, 2009.

groups, will in turn give them credibility with their own stakeholders. As a result, the Performance Standards are increasingly seen as legitimate WBG Standards for private sector operations in developing countries.

### ***Background for Use of the Performance Standards by the Private Sector***

9. First introduced in 2006, IFC's Performance Standards on Environmental and Social Sustainability quickly became the international benchmark for managing environmental and social risks in project and development finance. Today, the Performance Standards are in use by over 70 international banks worldwide under the Equator Principles, a voluntary environmental and social risk management framework. In addition, more than 30 Export Credit Agencies of the member countries in the Organization for Economic Co-operation and Development (OECD) refer to the Performance Standards. European Development Finance Institutions (EDFIs) also use the Performance Standards in their operations, and, in 2008 the European Bank for Reconstruction and Development (EBRD) updated its safeguard systems as Performance Requirements, based on IFC's Performance Standards. In addition, a significant number of private sector companies and business associations use IFC's Performance Standards as a global benchmark for environmental and social risk management. Within the WBG, IFC and MIGA both refer to this common framework for private sector projects they finance or support. The Performance Standards have become de facto prerequisites for companies to raise funds from international markets.

10. Based on IFC's learning from the application of the 2006 Performance Standards, and informed by the CAO and IEG studies and external feedback, IFC updated the Performance Standards in 2011, with an effective date of January 1, 2012. Bank Management chose to defer action on the proposal of the IDA-IFC Secretariat until the Board had considered the proposed update of the Performance Standards by the IFC.

### ***Proposed Adoption of World Bank Performance Standards for Private Sector Projects***

11. In carrying out the recent process of updating the Performance Standards, IFC, with the approval of CODE, engaged in an extensive, collaborative, and transparent consultation process with stakeholders. Although the consultations covered the entire IFC Policy and Performance Standards on Social and Environmental Sustainability, the update of the Performance Standards is a key component of this process, and is particularly relevant to this proposal. These extensive consultations occurred in three phases. The first phase focused on identifying key issues and challenges in the use of the Performance Standards. The second phase involved consultation on draft policy changes, and the third phase invited comments on the final draft policy reflecting feedback received during the second phase. IFC sought input from diverse stakeholder groups, including businesses, international financial institutions, UN agencies, some government agencies, civil society organizations, and communities directly affected by IFC projects. IFC also engaged extensively with World Bank and MIGA staff and management. IFC used a combination of web-based consultations, face-to-face consultations in Washington DC and in different regions, including communities affected by IFC projects. Management, therefore, believes that the proposed adoption of World Bank Performance Standards soon after the completion of IFC's consultation and updating process is timely.

12. In light of the above, Management proposes to adopt the IFC Performance Standards as the World Bank Performance Standards for Private Sector Projects (World Bank Performance Standards) and the application of such World Bank Performance Standards to Bank financing or support which is destined to projects (or components thereof) that are owned, constructed and/or operated by the private sector, in place of the World Bank environmental and social safeguard policies.<sup>3</sup> Bank Management proposes to adopt the IFC Performance Standards in their entirety with no change other than the names of the institutions (changing “IFC” to “The World Bank”).

13. The majority of projects that fall within the scope of this proposal are generally expected to be PPPs, especially those in infrastructure sectors such as water, energy, information and communications technology, and transport. Generally, a PPP is any contractual arrangement between a public entity or authority and a private company whereby risks from construction, and/or operations, and/or financing are fully or partially transferred to the private company. Civil works contracts and turnkey contracts, which are more typically treated as public works contracts, would not be eligible for consideration under this proposal. For the purpose of this paper, technical assistance for preparatory work for private sector engagement in PPPs would be eligible, as well as investment operations that include medium- or long-term management contracts, affermage/leases, privatizations, concessions, and projects within the Build-Own-Transfer (BOT) family.<sup>4</sup> Typically, these are projects that are owned, constructed and/or operated by a private sector entity. Financial intermediary lending also is a candidate for this proposal, provided the Bank lending or guarantee to the financial intermediary is designated for subprojects implemented by the private sector or private parties. In exceptional cases, Management expects to provide the option to borrowers (including financial intermediaries) to apply the World Bank Performance Standards to projects implemented by state-owned entities, or sub-sovereign entities, provided that they operate on a commercial basis,<sup>5</sup> and have a recognized capacity to manage environmental and social issues (for itself, and in the case of FI operations, for the subprojects).<sup>6</sup> It is further expected that the private sector, financial intermediary, or commercially operated entity will be responsible for identifying, assessing and managing environmental and social risks and impacts associated with the project, consistent with the Performance Standards. Financial intermediaries will have to develop an acceptable Environmental and Social Management System (ESMS) that guides the intermediary in assessing and managing environmental and social risks in its Bank-financed lending portfolio of subprojects.

14. Examples of the types of projects that would apply the World Bank Performance Standards include the following:

- (a) Bank projects jointly financed with IFC and/or MIGA;

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<sup>3</sup> OP/BP 4.01, OP/BP 4.04, OP/BP 4.09, OP/BP 4.10, OP/BP 4.11, OP/BP 4.12, OP/BP 4.36, OP/BP 4.37, OP/BP 7.50, OP/BP 7.60.

<sup>4</sup> These would include build-own-transfer (BOT), build-own-operate-transfer (BOOT), build-own-operate (BOO), and other similar structuring variations.

<sup>5</sup> It is likely though not necessarily conclusive that a corporate structure and existence of an independent board of directors are indications of a commercial operation.

<sup>6</sup> Ability to raise commercial funds in the market under the Equator Principles, or existence of a satisfactory management system may indicate such capacity.

- (b) Stand-alone Bank guarantee operations for a specific private project/s, such as PRG projects including PRG Series, and PCG projects for private projects (when available);
- (c) Bank guarantee operations with an associated loan/credit/grant to the same specific private project(s);
- (d) Bank loans/credits/grants to the government/public entities to on-lend or provide other financial support to specific private project(s), or Bank loans/credits/grants directly to private projects;
- (e) Bank Guarantee or loan/credit/grant operation in support of government-sponsored or backed guarantee and other risk mitigation facilities for benefiting private financiers;
- (f) Bank FI operations through public entities/private entities to multiple private projects or private firms to be identified; and
- (g) Bank loan/credit/grant to commercially-operated SOEs.

15. In all cases that apply the World Bank Performance Standards, those government obligations that are not covered by the Performance Standards but covered by the World Bank safeguard policies will be managed according to the relevant Bank safeguard policies. This will avoid duplication of safeguard/standard systems.

16. As noted by the IDA-IFC Secretariat, the differences between IFC Performance Standards and the World Bank safeguard policies are not significant, except in a small number of issues in which the World Bank safeguard policies contain obligations that are better suited to the public sector, including, for example, the obligation to carry out a no-project alternative analysis or strategic, sectoral or regional assessment, or obligation to establish a high level advisory panel to advise government borrowers. On the other hand, the IFC Performance Standards cover additional environmental and social areas that could pose risks to private sector projects, including labor, security, and business and human rights issues. This proposal avoids application of dual safeguards systems where these differences need to be resolved; instead, this proposal applies a single system across the World Bank Group that is appropriate for application to projects or project components implemented by the private sector.

17. Management advises that this approach would provide the same degree of protection as currently applied under the World Bank safeguard policies, and in some cases enhance the responsibility of the commercial entity that is operating the project. In the event that the borrower in a stand-alone Bank project (i.e., there is no participation by IFC or MIGA) prefers to use the World Bank safeguard policies (including the use of Country Systems – OP 4.00), the Bank will apply its safeguard policies (or OP4.00) to the entire project.

18. To clarify the division of responsibilities, the private sector entity applying the World Bank Performance Standards will assess and manage all environmental and social risks arising from its own operations that are its responsibility under the Performance Standards. Among

others, the private sector will pay specific attention to business and human rights, labor and safety issues. To the extent there are additional or remaining issues that must be addressed by the public sector, those will be assessed and managed under the World Bank safeguard policies. In addition to strategic, sectoral or regional assessments, examples of such issues to be managed by the public sector include land use designation or acquisition; management of environmental or social impacts over an airshed or watershed; implementation of a regional development or influx management plan; regional biodiversity management plan; and transboundary riparian notifications (provided that such obligations are not explicitly allocated to the private sector under license, concession or implementation contracts). The rationale for the allocation of responsibilities, and ensuing responsibility for implementing specific requirements will be clearly identified in documents prepared for Board approval.

19. Management notes that the IDA-IFC Secretariat did put out a Guideline for use by teams engaged in joint projects. The Guidelines were recently updated to reflect the 2012 IFC Performance Standards. Much of the procedural guidance in the Guidelines, such as anticipating policy and procedural issues, and good communication and coordination between the joint teams, will remain relevant for projects jointly prepared using the Performance Standards and Bank Safeguard Policies as might occur in circumstances outlined in paragraph 18. The Access to Information Policy of the Bank will continue to apply to the Bank-financed or supported projects under this proposal.

20. It is estimated that between 10 and 15 IBRD/IDA projects will come under this approach per year, a significant number of which will be private sector operations implemented jointly with IFC or MIGA.

### ***Staff Resources, Training in Performance Standards, Implementation***

21. At present, a limited number of Bank staff have knowledge of and experience in implementing projects subject to the IFC Performance Standards. To ensure effective application of the proposed World Bank Performance Standards, Management will roll out a dedicated training program for relevant staff, including supervision of projects. This would be done jointly with the IFC through mutually agreed arrangements. Where projects are processed jointly with IFC or MIGA, the Bank may rely on IFC or MIGA due diligence.

22. The Bank will also provide specific substantive and procedural guidance and tracking tools to staff to monitor private sector compliance with the Bank Performance Standards on an ongoing basis. In particular, the Bank will direct the IFC Guidance Notes for reference by the private sector project and World Bank staff; in addition, the Bank will also introduce the format of the Annual Monitoring Reports used by IFC clients to report on their compliance with applicable law and on progress with specific environmental or social actions listed in the action plans. The Bank recognizes ongoing supervision of projects that apply the Performance Standards will have to be rigorous, since this is an area in which the Bank needs strengthening. Supervision will be particularly important in cases where the Bank will not have a direct contractual relationship with the commercial entity that will be implementing the PPP project, as is already the case with financial intermediary projects, whether financed by the Bank or IFC. Procedural guidance will address required supervision steps.

### ***Accountability Mechanisms***

23. In accordance with the Resolution establishing the IBRD/IDA Inspection Panel and subsequent Clarifications, Management expects that the Inspection Panel will have jurisdiction over projects processed under the World Bank Performance Standards. In joint projects, the Inspection Panel and CAO will continue to carry out their responsibilities in same manner as current practice, in that the Inspection Panel will address potential requests for inspection of IBRD/IDA financing, and the CAO will do the same for IFC/MIGA financing.

### ***Conclusion and Recommendations***

24. This proposal is an administrative step to enable implementation of the Bank Group's strategy for the infrastructure sector in an effective and efficient manner. Management is committed to making such incremental changes to reduce overlaps and duplications. This proposal would apply to eligible projects with a concept note review date on or after July 1, 2012. Management will report back to the Board on the experiences with the implementation after a period of two years.

25. The lessons learned from this initiative will also feed into the process of Safeguard Policy Update and Consolidation. The Bank Group will clearly define the boundaries between the World Bank supported commercially operated projects to which private sector-oriented standards of the Bank Group should apply, and public sector projects to which the updated and consolidated safeguard policies will apply.

26. I recommend that the Executive Directors approve the following:

- (a) Adoption of the IFC Performance Standards as the World Bank Performance Standards for Private Sector Projects (*World Bank Performance Standards*) as described in paragraph 12 and 17; and
- (b) Application of such *World Bank Performance Standards* in place of the World Bank environmental and social safeguard policies and procedures to Bank financing or support for projects (or components thereof) that are owned, constructed and/or operated on a commercial basis as described in paragraph 13.