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APPRAISAL REPORT

CAO Compliance Appraisal

C-I-R9-Y13-F190

December 4, 2013

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**IFC Investment in Ficohsa, Honduras**  
***[IFC Projects #26394, 27341 and 29257]***

**Case of**

CAO Vice President initiated appraisal of IFC's investments in Banco Financiera Comercial Hondureña S.A.

**Summary**

Banco Financiera Comercial Hondureña (Ficohsa) is the third largest bank in Honduras. Following earlier investments to support trade finance, housing and SME loans, in May 2011 the IFC Board approved an equity and sub-ordinated debt investment in Ficohsa.

Corporación Dinant (Dinant) is an integrated palm oil and food company in Honduras which received a loan from IFC in 2009. CAO has an ongoing compliance process in relation to IFC's investment in Dinant.<sup>1</sup> CAO's compliance process in relation to Dinant was triggered by the CAO Vice President in response to allegations that violence against farmers on and around Dinant plantations in the Aguan Valley occurred because of inappropriate use of private and public security forces under Dinant's control or influence.

In the course of CAO's compliance process in relation to Dinant, CAO became aware that Dinant is one of Ficohsa's largest borrowers and as a result that IFC had a significant exposure to Dinant through its equity stake in Ficohsa. As a result, the CAO Vice President initiated a compliance appraisal of IFC's investment in Ficohsa addressing the following questions:

- a. how IFC has reviewed and supervised Environmental and Social (E&S) risks associated with Ficohsa's portfolio and client base;
- b. how IFC assessed the commitment and capacity of its client to manage these risks; and
- c. whether E&S issues associated with Corporación Dinant (Dinant) and known to IFC were adequately communicated within IFC.

After reviewing IFC's documentation, it is unclear to CAO whether IFC's review of its equity and subordinated debt investment (project #29257) in Ficohsa met the requirements of IFC's Policy on

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<sup>1</sup> See CAO website: [http://www.cao-ombudsman.org/cases/case\\_detail.aspx?id=188](http://www.cao-ombudsman.org/cases/case_detail.aspx?id=188)

Social and Environmental Sustainability (2006). While IFC's review of its client's investments at the portfolio level identified Ficohsa's exposure to various economic sectors, it is unclear if IFC's review was sufficient to identify activities where its client could be exposed to environmental and social (E&S) risks or determine whether Ficohsa was engaged in projects with potentially significant E&S risks. It is also unclear to CAO whether IFC gave proper consideration to the adequacy of Ficohsa's environmental and social management system to implement the agreed E&S requirements, or whether an action plan was established that was commensurate to the level of E&S risk that was present in Ficohsa's portfolio.

Following commitment, it is unclear to CAO whether IFC obtained adequate evidence of compliance with the agreed conditions of disbursement.

In relation to issues of general supervision, it is unclear to CAO whether IFC adequately assured itself that its client's E&S obligations including reporting obligations were being fulfilled.

In the context of Ficohsa's significant exposure to Dinant, and other potentially high risk sectors and projects, and recalling the E&S governance risks that are attached to operations in Honduras, CAO concludes that IFC's environmental and social performance with regard to its investments in Ficohsa merits further enquiry. Thus, in accordance with its Operational Guidelines, CAO will develop Terms of Reference for a compliance investigation.

Office of the Compliance Advisor Ombudsman (CAO)  
for the  
International Finance Corporation (IFC)  
Multilateral Investment Guarantee Agency (MIGA)  
Members of the World Bank Group

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## **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. 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 CAO, please visit [www.cao-ombudsman.org](http://www.cao-ombudsman.org)

## **1. Overview of the CAO Compliance Appraisal Process**

CAO Compliance receives cases for appraisal through two avenues: a transfer of a complaint after a CAO Assessment/CAO Dispute Resolution process or as triggered at the request of CAO Vice President, President of the World Bank Group or IFC/MIGA senior management.

The focus of CAO Compliance 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 compliance 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, the 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, the 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 President, and the Board in writing. If a compliance appraisal results from a case transferred from CAO's dispute resolution role, 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.

## 2. Scope of the Compliance Appraisal

On August 21, 2013 the CAO Vice President initiated a compliance appraisal of IFC's investment in Banco Financiera Comercial Hondureña S.A. (Ficohsa).

As requested by the CAO Vice President, this compliance appraisal will consider:

- a. how IFC has reviewed and supervised Environmental and Social (E&S) risks associated with Ficohsa's portfolio and client base;
- b. how IFC assessed the commitment and capacity of its client to manage these risks; and
- c. whether E&S issues associated with Corporación Dinant (Dinant) and known to IFC were adequately communicated within IFC.

The focus of this appraisal will be on IFC's 2011 equity and debt investment in Ficohsa as it is the transaction that has the highest level of potential E&S risks and impacts. This investment also increased IFC's exposure to Dinant. IFC's initial small and medium enterprise (SME), housing finance, and trade finance investments are, however, also considered.

## 3. Background

### Ficohsa

IFC made its first investment with Ficohsa in May 2008 (project # 26394). The initial loan of US\$20 million supported Ficohsa's small and medium sized enterprise (SME) and middle to low income mortgage portfolio. This investment was combined with an IFC Advisory Service project to support Ficohsa's credit risk management, market segmentation and management information systems, and improve the housing and SME business lines in areas such as product management, underwriting, monitoring and collections. In July 2008, IFC approved Ficohsa's inclusion in the Global Trade Finance Program (GTFP) with an initial credit line of US\$15 million which was subsequently increased to US\$35 million (project # 27341). IFC entered discussion with Ficohsa about a potential equity and subordinated debt investment in late 2009. In May 2011, IFC Board approved a 10 percent equity (US\$32.1m) and sub-ordinated debt (US\$38m) investment (project # 29257). This investment was financed by the IFC's Asset Management Company (AMC) through its Global Capitalization Fund.<sup>2</sup>

Ficohsa is the third largest bank in Honduras. At the time of IFC's equity and subordinated debt investment it had a significant exposure in the construction and real estate sector (23%), food and beverages (12%) and utilities (7%). Ficohsa provides financing to a number of Honduras' largest business conglomerates including Grupo Terra (owned by the Nasser family), Grupo Dinant (owned by the Facusse family) and other major economic groups. In the context of a discussion of E&S risks, CAO notes Ficohsa's exposure to hydropower projects, large scale agribusiness, large industrial estates, and Honduras' two main political parties.

### Corporación Dinant

Dinant is an integrated palm oil and food company with plantations totaling over 20,000ha in the north of Honduras. In 2009, the IFC committed to a US\$30 million loan to Dinant of which US\$15

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<sup>2</sup> AMC is a wholly owned subsidiary of IFC, and invests alongside IFC. AMC established the Global Capitalization Fund in 2009. The Japanese Bank for International Cooperation (JBIC) committed US\$2 billion to the fund with IFC committing US\$1 billion from its own account.

million was disbursed in November 2009. A second disbursement of US\$15 million has been delayed since mid-2010.

In April 2012, CAO triggered a compliance appraisal in relation to IFC's investment in Dinant. This process was triggered in response to allegations that violence against farmers on and around Dinant plantations on Honduras' north coast (including multiple deaths) was occurring because of inappropriate use of security forces under Dinant's control or influence. At the time of writing the CAO Audit Report had been finalized and was pending clearance for public release.

In the course of CAO's compliance audit of IFC's investment in Corporacion Dinant, CAO became aware that Dinant was a major client of Ficohsa. Over the period of IFC's relationship with Ficohsa from mid-2008 to mid-2010, Ficohsa's exposure to Dinant increased from US\$18 million to US\$30 million. At the time IFC's equity and subordinated debt investment was approved by the IFC Board (May 2011), Dinant was Ficohsa's third largest client.

A brief overview of IFC's interaction with Dinant around E&S issues is also required at this point. As noted in CAO's Compliance Appraisal of IFC's Investment in Dinant, "there were contemporaneous reports of violence and conflict, as well as allegations relating to illegal activities on and/or around properties belonging to Dinant and its owner, in the public domain before IFC committed to the Project" (in April 2009).<sup>3</sup> The CAO Appraisal also notes President Zelaya's intervention in the conflict in mid-2009, and an escalation of violence "following a series of peasant occupations [of Dinant and other palm plantations in the region] that commenced in December 2009."<sup>4</sup> In November 2010 NGOs alerted the World Bank Group President to allegations that private security forces employed by Dinant had killed five farmers in the course of an illegal eviction. In response, in December 2010, IFC management wrote to the owner of Dinant asking for restraint. Subsequently, in January 2011, the Executive Vice President of IFC sent a letter to President Lobo of Honduras regarding the conflict. In March 2011, IFC conducted a site supervision visit to Dinant. Due to ongoing conflict issues and non-completion of an agreed E&S action plan, IFC gave Dinant an Environmental and Social Risk Rating (ESRR) of 4: Unsatisfactory. This rating was reaffirmed after supervision visits in April 2012 and January 2013.

#### 4. CAO Discussion

##### ***Equity and Subordinated Debt Investment (Project #29257)***

In late 2009, IFC and Ficohsa initiated discussions regarding an equity and subordinated debt investment in addition to its earlier SME and trade finance loans.

##### ***Purpose of investment and pre-appraisal waiver***

A key purpose of the equity and subordinated debt investment, as disclosed by IFC, was to "enable the Bank [Ficohsa] to strengthen its balance sheet, by enhancing its capital ratios, and would support its strategic growth".<sup>5</sup> In this context, CAO notes that in July 2010 IFC provided Ficohsa with a waiver allowing exposure in excess of agreed ratios to three major Honduran company groups (one which was Dinant). A review of IFC's documentation in relation to this waiver request does not reveal reference to violent conflict around Dinant properties, of which IFC was aware of at the time. Rather, CAO notes the characterization of Dinant's owner (in correspondence from the IFC team in Honduras to the manager responsible for authorizing the waiver) as a "very respected businessman with whom IFC has relationship since 1999 through two CAG [IFC Agribusiness]

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<sup>3</sup> CAO (2012) *Appraisal Report of IFC Investment Report in Corporación Dinant S.A. de C.V.* available at: [http://www.cao-ombudsman.org/cases/case\\_detail.aspx?id=188](http://www.cao-ombudsman.org/cases/case_detail.aspx?id=188)

<sup>4</sup> *ibid.*

<sup>5</sup> IFC Summary of Proposed Investment [August 2010]

investments.”<sup>6</sup> In this context it is unclear whether E&S risks associated with Dinant and known to IFC were adequately communicated within IFC.

### Appraisal & commitment

In relation to the pre-commitment phase of the project cycle, the key question for CAO is whether IFC exercised due diligence in its review of the Environmental and Social (E&S) risks of the investment. As a general principle, IFC is committed to a pre-investment E&S review that is commensurate with the level of E&S risk and impacts.<sup>7</sup> In this case, questions arise in relation to the adequacy of: (a) IFC’s review of the E&S potential risk attached to the business of its Financial Intermediary (FI) client, (b) IFC’s approach to the assessment of the client’s capacity to manage and mitigate these risks; and, (c) the measures that IFC required of the client to ensure appropriate management of E&S risk.

At appraisal, IFC is required to review “the business of its FI clients to identify activities where the FI could be exposed to social and environmental risk as a result of its investments.”<sup>8</sup> IFC’s E&S requirements are expected to be “proportional to the level of potential risk.”<sup>9</sup> Based on the above, IFC requires its clients to “establish and maintain a social and environmental management system (SEMS or ESMS) to ensure that its investments meet IFC’s requirements.”<sup>10</sup> As part of the appraisal process, IFC is expected to “review the client’s ESMS, considering its adequacy to implement the Applicable Performance Requirements.”<sup>11</sup> The appraisal of the client ESMS is expected to consider the following relevant factors:

- a. [the client’s] E&S policies and procedures;
- b. The current organizational structure and staffing;
- c. Skills and competencies in E&S areas;
- d. Training and awareness of the client’s investment, legal, and credit officers on the organization’s E&S requirements and the ESMS;
- e. Performance monitoring procedure;
- f. Reporting of results to management; and
- g. Track record to date in ESMS implementation.<sup>12</sup>

Further, IFC is required to “identify any ESMS actions that the client would need to undertake to address gaps in these areas to ensure compliance with the Applicable Performance Requirements.”<sup>13</sup> Gaps in the ESMS of FIs which are engaged in projects with “potentially significant E&S risks,” the ESRP suggests “must be closed to ensure compliance with the

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<sup>6</sup> IFC internal memo, July 2010

<sup>7</sup> Sustainability Policy (2006), para. 13.

<sup>8</sup> IFC (April 2006) *Policy on Social and Environmental Sustainability*, para. 28.

<sup>9</sup> *ibid.*

<sup>10</sup> *ibid.* para 29.

<sup>11</sup> ESRP 2009, para. 7.2.17.

For Financial Intermediaries (FI) the Applicable Performance Requirements may be the combination of an exclusion list, the national laws and regulations, and the elements of the IFC Performance Standards in general, including specific elements of the IFC Performance Standards that are identified during the review, and that are applicable to sub-projects supported by the FI and implemented through the FI’s Environmental and Social Management System.

<sup>12</sup> *ibid.*

<sup>13</sup> ESRP 2009, para. 7.2.18.

Applicable Performance Requirements before IFC commitment or as a condition of IFC disbursement.”<sup>14</sup>

In early review documentation (in February 2010), the IFC team noted that Ficohsa had “implemented the SEMs [ESMS] and submitted an environmental and social report” as required under IFC’s earlier SME and housing finance investment.

The appraisal report prepared by IFC for the September 2010 Investment Review Meeting (IRM)<sup>15</sup> regarding the project contains no summary of IFC’s E&S review. Potential regulatory and political risks are discussed but these are not linked to E&S risk. A Summary of Project Information included in the material circulated prior to the IRM contains the only discussion of E&S issues in the decision book. This is dated October 2007 and appears to have been prepared in advance of IFC’s May 2008, mortgage and SME investment in Ficohsa.

The IFC Board approved the equity and subordinated debt investment in May 2011. In the Board Paper IFC noted that “under an existing project (#26394), the Bank has implemented a social and environmental management system (“SEMS”) to ensure that its sub-borrowers comply with the IFC exclusion list and the environmental and social laws of Honduras.” The report also notes that “during appraisal, IFC reviewed the Bank’s portfolio to identify environmental and social risks.” Due to exposure to energy, construction and agriculture sectors IFC noted that “Ficohsa will be required to apply the IFC’s Performance Standards to high-risk transactions” and “upgrade its existing SEMs.”<sup>16</sup> IFC explained the added value it brought noting that: “[w]ith IFC as a strategic partner, Ficohsa will gain a more diversified funding base and better manage risks, and a stronger financial base to seize opportunities such as those in energy efficiency/renewable energy lending, which are beginning to arise due to a 2010 law promoting energy efficiency.”<sup>17</sup>

These commitments were captured in the investment agreements between IFC, the client and the other equity investors. Specifically, Ficohsa was required to “use all reasonable efforts to ensure the continuing operation of the S&E Management System [ESMS] to identify, assess and manage the social and environmental performance of the Company Operations<sup>18</sup> in compliance with the S&E Requirements...”<sup>19</sup> In case of providing funding to a Category A Activity,<sup>20</sup> Ficohsa was required to promptly inform each investor. Further, an ESMS Plan was agreed, under which Ficohsa was required to: (a) upgrade its ESMS to include screening projects against the applicable Performance Standards within three months of disbursement, and (b) ensure that staff responsible for the ESMS is trained to ensure its effective implementation.<sup>21</sup> Ficohsa was required ensure that

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<sup>14</sup> *ibid.*

<sup>15</sup> The Investment Review Meeting is the final internal review of a proposed investment prior to seeking Board approval for an investment

<sup>16</sup> IFC Board Paper May 2011

<sup>17</sup> *ibid.*

<sup>18</sup> Company Operations mean all existing and future financing operations of the Company and its Subsidiaries. Shareholders Agreement 2011, section 1.01).

<sup>19</sup> Shareholders Agreement (2011) *Policy Covenants*, section 7.04 (b)

<sup>20</sup> Category A Activity means any activity of a Client which is likely to have significant adverse environmental impacts that are sensitive, diverse or unprecedented. Examples of Category A projects given include “large dams and reservoirs,” “agro-industries (large scale),” “large thermal or hydropower development,” “projects affecting indigenous and tribal populations” and “major new industrial estates” (Shareholders Agreement, Annex E).

<sup>21</sup> Shareholders Agreement (2011) Annex J



an E&S Manager that was “reasonably acceptable to the Investors is appointed at all times.”<sup>22</sup> Relevantly, Ficohsa was also required to enter into a warranty that “there was no material social or environmental risk or issue in respect of the Company Operations.”<sup>23</sup>

Based on a review of available documentation, it is unclear if IFC’s review of this investment met the requirements of the Sustainability Policy. While IFC’s review of its client’s investments at the portfolio level identified Ficohsa’s exposure to various economic sectors, and led to agreement on E&S Requirements (including the IFC Performance Standards), it is unclear if IFC’s review was sufficient to “identify activities where the FI could be exposed to social and environmental risk”<sup>24</sup> or determine whether Ficohsa was “engaged in projects with potentially significant E&S risks.”<sup>25</sup> It is also unclear whether IFC gave proper consideration to the adequacy of Ficohsa’s ESMS to implement the agreed E&S requirements, or whether an ESMS plan was established that was commensurate to the level of E&S risk present in the Ficohsa portfolio.<sup>26</sup>

Any analysis of IFC’s approach to the review of E&S risks attached to its investment in Ficohsa will be of particular note given concerns around the prevalence of violent conflict, the weakness of the rule of law, and the fragility of institutions of environmental governance that prevailed in Honduras at the time the investment was made.

#### Disbursement

Prior to disbursement, IFC is required to obtain and review information as required to evidence compliance with the agreed conditions of disbursement.<sup>27</sup> Conditions of disbursement are established by para. 4.03 of the Subscription Agreement between IFC and Ficohsa and include the ongoing validity of the representations and warranties made under para. 3.01 as well as specific E&S conditions.

IFC disbursed its equity and subordinated debt investment in October and November 2011. E&S conditions of disbursement are noted as having been met following review and clearance by relevant E&S staff.<sup>28</sup> Having reviewed relevant documentation, however, it is unclear to CAO whether IFC obtained adequate evidence of compliance with the agreed conditions of disbursement.

#### General Supervision

During general supervision, IFC monitors an “FI’s performance on the basis of the Management System.”<sup>29</sup> Project E&S performance is supervised based primarily on a review of client’s Annual Environmental and Social Performance Report (AEPR). According to the ESRP, IFC is also responsible for “ensuring that client E&S obligations [including reporting obligations] are fulfilled.”<sup>30</sup> In addition to reporting requirements, the Ficohsa Shareholders Agreement includes a range of E&S covenants under para. 7.04(b).<sup>31</sup>

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<sup>22</sup> *ibid*, section 7.04 (b)

<sup>23</sup> Subscription Agreement, para. 3.01(m)(i).

<sup>24</sup> IFC (April 2006) *Policy on Social and Environmental Sustainability*, para. 28.

<sup>25</sup> ESRP (2009) para. 7.2.18

<sup>26</sup> ESRP (2009) paras. 7.2.17 & 18

<sup>27</sup> ESRP (2009) 8 & 9

<sup>28</sup> PDS Disbursement (equity and disbursement)

<sup>29</sup> IFC (April 2006) *Policy on Social and Environmental Sustainability*, para. 29.

<sup>30</sup> ESRP (2009) 9.2.4

<sup>31</sup> Shareholders Agreement 2011

In reviewing an AEPR, IFC is required to determine whether the “information provided [in the AEPR] is adequate”.<sup>32</sup> Relevantly, the AEPR review is required to evaluate “the client’s performance against the Applicable Performance Requirements;” “the status of the client’s implementation of the Environmental and Social Management System (ESMS);” and “Key performance or information gaps relating to the client’s performance and SEMS [ESMS]”.<sup>33</sup>

IFC received Ficohsa’s AEPR for 2011 in May 2012. The AEPR summarizes Ficohsa’s exposure by sector, and lists over 80 clients to which Ficohsa has an exposure of more than US\$1 million. This includes significant loans to the Dinant group as well as other exposures to potentially high risk sectors and projects. No material environmental and social issues associated with borrowers are reported. An AEPR for 2012 was provide to IFC in November 2013. At the time of writing it is unclear if IFC have reviewed this AEPR.

In December 2012, IFC conducted a site supervision visit of Ficohsa. The purpose of the visit included confirming that updates to the ESMS incorporated the Performance Standards. At the time, IFC concluded that the current scope of Ficohsa’s ESMS did not assess investments against the Performance Standards. IFC’s 2012 site supervision report also noted that Ficohsa’s investment in Dinant was provided in 2008, when Ficohsa was not required to assess corporate loans per IFC’s requirements. Ficohsa affirmed to IFC that they started monitoring the E&S aspects of the Dinant loan in 2011. IFC noted that if another loan is provided to Dinant, Ficohsa will be required to assess this to the Performance Standards. As a result of the supervision visit IFC required Ficohsa to hire an E&S specialist to support the ESMS updates, and document the enhanced procedures. IFC affirmed to Ficohsa the need to agree a time bounded action plan to update the ESMS. At time of writing, it is unclear if an Action Plan has been agreed.

In relation to issues of general supervision, it is unclear to CAO whether IFC adequately assured itself that its client E&S obligations including reporting obligations were being fulfilled.

#### ***Initial investments (Project #26394 and #27341)***

IFC’s initial investments in Ficohsa were ring fenced for SMEs, housing and trade finance limiting longer term exposure to high risk sub-projects. They are thus dealt with in less detail in this appraisal. Importantly, however, these initial investments informed IFC’s relationship with the client and historical understanding of Ficohsa’s approach to E&S risk management and mitigation. As such they are thus relevant to an understanding of IFC’s approach to its later, higher risk, equity and subordinated debt investment, and are discussed here in that light.

IFC’s made its initial US\$20 million investment with Ficohsa in May, 2008 (project # 26394). At the time, IFC noted that based on a “review of the FI’s capacity to manage social and environmental risks” Ficohsa was required to develop an ESMS to ensure IFC’s financed investments were in compliance with IFC’s Exclusion List and applicable national E&S legislation.<sup>34</sup> Further, IFC noted “[a]s a long term partner, IFC could help the Group [Grupo Ficohsa] with best practices in environmental and social standards and corporate governance...”.<sup>35</sup>

At the same time, IFC agreed to include Ficohsa in the Global Trade Finance Program (GTFP) with an initial credit line of US\$25 million (project # 27341). Ficohsa was required to ensure that the

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<sup>32</sup> ESRP (2009) 9.2.6

<sup>33</sup> ESRP (2009), 9.2.9

<sup>34</sup> IFC Board Paper, January 2008

<sup>35</sup> IFC PSD Early Review (August 2007)

transactions it finances under the GTFP were in accordance with IFC's Exclusion List. This requirement was incorporated in the GTFP legal agreement between IFC and Ficohsa.

IFC had reviewed Ficohsa's AEPRs for 2008 and 2009 prior to committing to its equity and subordinated debt investment.<sup>36</sup> In reviewing Ficohsa's 2008 AEPR, IFC noted that the client's ESMS, which had been approved by Ficohsa's Board in December 2008, was "detailed and stringent", however it found that it was too early to effectively evaluate implementation of the system.<sup>37</sup> IFC's review of Ficohsa's 2009 AEPR noted that "Ficohsa has a SEMS [ESMS] that is applied to all operations."<sup>38</sup> The June 2010 review also provides a summary of how the SEMS [ESMS] applies to larger loans. At the same time, following a supervision visit, IFC noted that the ESMS was still in pilot stage following changes in the client's E&S policy.<sup>39</sup>

## 5. CAO Decision

The decision about whether CAO should initiate a Compliance Investigation requires the weighing of a number of factors including the likely environmental and social impact of an investment, a preliminary appraisal of IFC's E&S performance, as well as a more general assessment of whether there is an argument for the value of a compliance investigation for project-related or systemic reasons.

After reviewing IFC's documentation, it is unclear to CAO whether IFC's review of its equity and subordinated debt investment in Ficohsa met the requirements of the Sustainability Policy. While IFC's review of its client's investments at the portfolio level identified Ficohsa's exposure to various economic sectors, and led to agreement on E&S requirements (including the IFC Performance Standards), it is unclear if IFC's review was sufficient to identify activities where the FI could be exposed to environmental and social risk or determine whether Ficohsa was engaged in projects with potentially significant E&S risks. It is also unclear to CAO whether IFC gave proper consideration to the adequacy of Ficohsa's ESMS to implement the agreed E&S requirements, or whether an ESMS plan was established that was commensurate to the level of E&S risk that was present in the Ficohsa portfolio.

Following commitment, it is unclear to CAO whether IFC obtained adequate evidence of compliance with the agreed conditions of disbursement.

In relation to issues of general supervision, it is unclear to CAO whether IFC adequately assured itself that its client E&S obligations including reporting obligations were being fulfilled.

In the context of Ficohsa's significant exposure to Dinant, and other potentially high risk sectors and projects, and recalling the E&S governance risks that attach operations in Honduras, CAO concludes that IFC's environmental and social performance with regard to the Ficohsa investment merits further enquiry. Thus, in accordance with its Operational Guidelines, CAO will develop Terms of Reference for a compliance investigation.

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<sup>36</sup> Submission of the AEPR for 2010 was a condition of disbursement for project #29257 (Subscription Agreement, para. 4.01(f)(i)).

<sup>37</sup> IFC 2008 AEPR Review

<sup>38</sup> IFC's 2009 AEPR Review (June 2010)

<sup>39</sup> IFC Back to Office Report (June 2010)