

July 19, 2017

Mr. Osvaldo L. Gratacós  
Compliance Advisor Ombudsman  
International Finance Corporation  
2121 Pennsylvania Avenue, N.W.  
Washington D.C., 20433

**Subject: IFC Management Response to the CAO Investigation Report on IFC's Investments in Lydian International, Armenia (Projects #25924 and #27657)**

Dear Mr. Gratacós:

We appreciate the opportunity to review and respond to CAO's investigation report regarding IFC's performance in relation to our equity investments in Lydian International ("Lydian"). We regret that the complainants withdrew from the mediation process and that the mediation attempts were ultimately unsuccessful. But we are pleased to note the report's findings regarding IFC's compliance with applicable Environmental and Social (E&S) policies and procedures in the majority of the areas assessed. We also note the concerns set out in the report and wish to respond here and via detailed comments to key findings in the attached Annex.

The concerns set forth in the report broadly relate to IFC's performance during the pre-investment E&S review of Lydian's Amulsar project. While we appreciate CAO's observations, CAO's assessment does not sufficiently take into account the nature of IFC's investment at that time. IFC's initial investment in Lydian in 2007 was used to fund Lydian's exploration works in several countries, with a focus on its most advanced exploration project in Kosovo. The Amulsar project in Armenia was at an early stage of exploration with limited works ongoing on-site, consisting only of initial prospecting activities (e.g., rock-chip sampling and geochemical testing). It represented less than 15 percent of the expected use of proceeds of IFC's investment and the work in Armenia did not include any drilling and, as a consequence, had a limited E&S impact. IFC's initial assessment and early supervision of the Amulsar project reflected the early stage exploration nature of the project.

We agree with CAO's observation on the usefulness of guidance to IFC staff in such situations. To clarify our approach, IFC has recently formalized existing practice into documented procedural guidance for the E&S appraisal and supervision of phased development projects (IFC Environmental and Social Review Procedure #13). This provides more explicit guidance on the appraisal and supervision of early-stage projects. The guidance makes clear that IFC's appraisal of early stage projects should consider the actual on-the-ground risks and impacts of the preliminary IFC financing. This is consistent with the risk-based approach taken in Lydian in 2007. The guidance also informs the scope of the E&S action plan and how to support early stage clients in developing management systems. We believe the improvements to our procedural guidance

address CAO's observations regarding clarity of the scope of IFC's pre-investment review and early supervision of projects.

While we agree with CAO's observation about the importance of staff guidance, we disagree with CAO's assessment that early expert scoping of E&S risks was required at the time of IFC's initial investment in Lydian. While scoping is an important part of impact identification, it would have been premature in 2007 and would not have revealed the risks later identified. No economically viable mineral resource had yet been identified, and hence the project footprint and area of influence were still unknown. Such scoping was undertaken by a reputable environmental consultancy in 2010, after a mineral resource was defined and Amulsar became Lydian's primary focus and before Lydian commenced a full Environmental & Social Impact Assessment (ESIA) for the project.

IFC made a number of investments in Lydian between 2007 and 2015. IFC's investments initially funded exploration works in a number of countries, and from 2010 onwards, continued exploration and feasibility studies for Lydian's flagship Amulsar project, while supporting the company in improving its E&S management practices. We are pleased to note that in its report, CAO recognizes IFC's contributions to the project in preparing an ESIA in line with IFC's Performance Standards and good international industry practice. This is a significant achievement and standard setting for Armenia's mining sector.

Given that Lydian has succeeded in attracting funding for mine development from private sector sources, IFC has divested its investment in Lydian, as we seek to deploy our capital where it is needed most to foster sustainable economic development. IFC is therefore no longer overseeing mine development. Nevertheless, we believe that the sustainable development of the Amulsar project has the potential to contribute to economic growth in Armenia.

We thank you for your report and look forward to continuing our dialogue with CAO. Please find in the Annex our more detailed responses to the key findings raised in the CAO Report.

Sincerely,



Ethiopis Tafara  
Vice President and General Counsel  
Legal, Risk Compliance & Sustainability



Dimitris Tsitsiragos  
Vice President

**Annex. IFC Tabulated Management Response: Lydian International**

	CAO Findings	IFC's Response	Actions Taken <sup>1</sup> or Proposed
<b>Findings Related to IFC's Environmental and Social Pre-Investment Review (2007–2009)</b>			
1.	<p><b>Finding:</b> CAO finds shortcomings in IFC's 2007 pre-investment Environmental and Social (E&amp;S) review of the Amulsar project. In particular, CAO notes the absence of E&amp;S information from the client and lack of a site visit by an IFC E&amp;S specialist.</p>	<p>In line with our procedures, IFC's pre-investment review and E&amp;S specialist site visit focused on Lydian's most advanced exploration project at the time, which was outside of Armenia. The Amulsar project in Armenia was at an early stage of exploration with limited work ongoing on-site (e.g., rock-chip sampling and geochemical testing) and no drilling taking place. For the same reason, Lydian's E&amp;S assessments at this early stage were also limited.</p> <p>Lydian began increasing its attention on Amulsar in 2008, when drilling started on site. At that point, an IFC Environmental Specialist visited Amulsar twice (June and October 2008) and regularly through the remaining time of IFC's investment.</p>	N/A
2.	<p><b>Finding:</b> CAO notes a lack of early expert scoping of E&amp;S risks with regards to IFC's pre-investment review of the Amulsar project in 2007. Such E&amp;S scoping would have identified key risks and provided a framework for the development of the Environment and Social Impact Assessment (ESIA) and baseline studies.</p> <ul style="list-style-type: none"> <li>• <u>Early risk scoping (Biodiversity):</u> In particular, CAO finds that neither IFC's initial appraisal nor its early supervision of the project identified</li> </ul>	<p>In 2007, Amulsar was at an early exploration stage. Any future mine development was inherently uncertain, and the potential footprint of such development was not yet known. Accordingly, even though IFC agrees that early scoping is an important part of impact identification, we believe that a scoping exercise in 2007 was not warranted given the early nature of the project and low level of activities/risks at the Amulsar site at the time.</p> <p>Even if an expert scoping exercise had been carried out, IFC does not believe that it would have revealed the risks later identified. Specifically, the identification of the plant species <i>Potentilla porphyrantha</i> was only possible through detailed in-field surveys carried out by</p>	<p>Since 2007, IFC's due diligence processes have evolved. IFC's specialists now have access to tools they can use to augment their initial project assessment.</p> <p>In 2009, IFC introduced the use of the Integrated Biodiversity Assessment Tool (IBAT). IBAT provides access to geospatial information related to international recognized biodiversity sensitive areas to help IFC identify sensitive species/habitats early on and focus any additional efforts during</p>

<sup>1</sup> Listed hereunder are actions IFC has taken as part of its supervision of the project to address certain CAO findings, both project specific, and/or changes in IFC's corporate policies and procedures, which have been triggered by IFC's wider experience in the sector, including this project. Since IFC is no longer a shareholder in Lydian, we are no longer able to request project-specific actions from Lydian. Proposed actions are therefore limited to IFC actions.

	<p>biodiversity as an important issue, and IFC did not trigger the application of Performance Standard (PS) 6 to the project. As a consequence, IFC's appraisal and early supervision did not provide assurance that the client was in a position to meet the requirements of PS6 in relation to critical habitats.</p> <ul style="list-style-type: none"> <li>• <u>Early risk scoping (socio-economic)</u>: CAO finds that the area of influence of the project was not expressly considered during the E&amp;S review for IFC's 2007 and 2009 investments. As a consequence, no early socioeconomic risk scoping was conducted. Risks posed by the development of a mine to the tourist economy, as well as potential community concerns, were thus not identified and relevant requirements in relation to these issues were not triggered.</li> </ul>	<p>highly trained international specialists. This was requested by IFC as part of the ESIA baseline data collection process, once the project footprint was defined. In fact, it was IFC's requirements and their implementation that revealed the presence of this population of species previously unknown.</p> <p>A scoping exercise was carried out by Wardell Armstrong in 2010 (<i>Amulsar Open Pit Gold Project Scoping Report-Armenia</i>), once a technical project footprint was defined and prior to Lydian embarking on the development of the ESIA for mine development. That scoping study also identified tourism activities in Jermuk as a key economic activity. Accordingly, potential project impacts to tourism activities in Jermuk were therefore addressed as part of the ESIA.</p>	<p>appraisal and supervision on these aspects of the project.</p> <p>While IBAT has enhanced staff's ability to undertake early screening of biodiversity as part of the initial appraisal, in the case of Lydian, IBAT would not have identified the Amulsar mountain, where initial prospecting activities were carried out, as an area of high biodiversity value because it was not within any national or international recognized biodiversity areas at the time. Hence, we believe PS6 would not have been triggered during the initial appraisal. As noted, the presence of the population of <i>Potentilla porphyrantha</i> was only revealed later as part of specialized baseline data collection, which was undertaken as part of the ESIA process once the project footprint had been defined.</p>
3.	<p><b>Finding:</b> CAO notes an overreliance by IFC on statements of commitment by the client's management. Given the complexity of the project, acknowledged gaps in client capacity, and its lack of E&amp;S track record, a more detailed and structured Environmental and Social Action Plan (ESAP) would have been appropriate at the pre-investment stage.</p>	<p>We agree that the capacity of junior mining companies is often limited and needs to be developed over time as the project progresses to development. Supporting clients in such iterative capacity development and developing an improved understanding of Good International Industry Practice (GIIP), such as IFC's Performance Standards, is a clear value that IFC can bring to its investee companies and is part of our development role.</p> <p>Lydian's management capacity was assessed at the appraisal stage and deemed sufficient for exploration-stage activities, with the ESAP requirement to build-up</p>	<p>IFC has formalized its long practice of assessing early project risks into documented procedural guidance for the E&amp;S appraisal and supervision of phased development projects (IFC Environmental and Social Review Procedure #13). This provides more explicit guidance to manage the appraisal and supervision of early-stage projects, including guidance on the scope of the ESAP which should be aligned with the preliminary activities financed by IFC.</p>

		management capacity as the project progressed. In addition, Lydian's management showed solid commitment to E&S responsibility. This was initially demonstrated in discussions with the company's management and by Lydian signing up to the ESAP requirements and implemented in practice over time (albeit at times requiring interventions by IFC to ensure adherence to the ESAP).	
4.	<b>Finding:</b> CAO finds that IFC's pre-investment review of issues related to consultation was not commensurate to the risk, thus being noncompliant with the requirements of the 2006 Sustainability Policy. CAO finds that IFC did not include in the E&S Action Plan sufficient requirements (deadlines, need for adequate expertise, documentation, and reporting) to ensure that implementation of the client's Public Consultation and Disclosure Plan (PCDP) would be consistent with the objectives of PS1.	<p>As per our procedures, IFC assessed the client's policies and procedures on stakeholder engagement. In IFC's opinion, the corporate-level Public Consultation and Disclosure Strategy, as well as the project-level PCDP were appropriate for the activities ongoing on site. The ESAP included a requirement for Lydian to report on implementation of these procedures on an annual basis. IFC therefore considers the ESAP requirements to be adequate in that regard.</p> <p>IFC, however, acknowledges shortcomings in the documentation of IFC's ongoing review of Lydian's plans and procedures for community engagement in the early years of supervision. The supervision documentation was improved in the later years of supervision, as recognized by CAO.</p>	N/A
5.	<b>Finding:</b> CAO notes that IFC's initial determination that the project had broad community support (BCS) was not supported by social analysis or expert opinion.	IFC acknowledges that the practices around conducting and documenting BCS in 2007 were still evolving. At the time of IFC's initial appraisal, the BCS determination of Amulsar did not include social analysis or the opinion of a Social Development Specialist. As highlighted, the Amulsar project was in the early exploration phase. After the focus shifted to Armenia, IFC Social Development Specialists later completed a BCS assessment for the Amulsar project, which was documented.	IFC has since strengthened internal practices and guidance for assessing and documenting BCS prior to presenting projects to IFC's Board of Directors, where appropriate.

Findings related to early years of supervision (2007–2013)			
6.	<p><b>Finding:</b> CAO finds that IFC did not effectively supervise the client’s delivery of agreed E&amp;S mitigation measures, in particular, to develop an Environmental and Social Management System (ESMS) for the exploration phase and to carry out independent Health Safety Environment and Community audits; hence in CAO’s opinion, IFC lacked assurance that exploration activities were carried out in line with its E&amp;S requirements, and that the client’s E&amp;S assessment work was conducted to IFC standards.</p> <p>In this context, CAO notes that, as a result of what it believes to be IFC’s insufficient supervision and the delay in developing the ESMS for the exploration, the client’s exploration-phase activities had negatively impacted tier-one critical habitat for the population of a critically-endangered plant, <i>Potentilla porphyrantha</i>.</p>	<p>In phased development projects, IFC must allow for appropriate flexibility in the timing of ESAP items, given the constraints of early stage development companies with continuously evolving project schedules and timelines. However, prioritization is given to ESAP actions required to mitigate actual or imminent impacts.</p> <p>IFC’s supervision process during the early years highlighted the delay in developing a detailed ESMS for the exploration phase and the need to strengthen the implementation of the ESMS to manage impacts on the ground. These issues were noted by IFC and raised with the company’s senior management and Board of Directors. The company and IFC proceeded to work together to address the issues.</p> <p>Regarding the impacts on the <i>Potentilla porphyrantha</i> during the exploration phase, it was during IFC supervision in 2013 that the existence of, and impacts on, this critically endangered plant were identified. Subsequently, the company engaged with IFC to develop related monitoring and management plans. IFC ultimately concluded the impact was not irreversible and consequently did not jeopardize long-term compliance with PS6.</p>	<p>In response to IFC bringing the issues regarding the delay in developing a detailed ESMS for the exploration to management’s attention, Lydian agreed to hire an E&amp;S Manager who had experience with GIIP in the mining sector. This was instrumental in ensuring implementation of IFC’s Performance Standards and GIIP as the project progressed through the exploration phase.</p> <p>In response to the identification of impacts on <i>Potentilla porphyrantha</i>, IFC requested Lydian to develop a Footprint Management Plan and put in place tangible controls on Amulsar to avoid any subsequent impacts on the species or other environmental sensitivities, including physical barriers and signage, and the development of an “environmental sensitivities map” for the area. As a further follow-up action, Lydian carried out further baseline studies in coordination with an international biodiversity expert to map (and hence protect) this species on the mountain. These baseline studies were included as part of the data for the ESIA and the Biodiversity Management Plan.</p>

Findings related to later years of supervision and development of ESIA (2013–2016)			
7.	<p><b>Finding:</b> CAO finds that IFC’s supervision of the ESIA process in relation to potential impacts of the project on Jermuk’s brand as a resort town was not commensurate with the risk.</p>	<p>The ESIA concluded that there were no significant project-related impacts on Jermuk. It did include an assessment of the impacts on the town related to the company workers’ accommodation plans and foresaw that the majority of the workers would be housed at the mine site, while a smaller portion of Lydian’s employees would be housed in a refurbished hotel in Jermuk.</p> <p>IFC agrees that the potential impact of the mine on Jermuk’s “brand” as a resort town had not been fully considered as part of the ESIA. IFC does not believe that the potential impact on a “brand” based on a potential change in public perceptions can be fully quantified in an ESIA. However, IFC engaged with Lydian on this topic, as described in the next column.</p>	<p>To assess potential impacts of the project on Jermuk’s “brand” as a resort town, IFC engaged with Lydian to ensure adequate attention was brought to supporting the tourism sector through their communication strategy, engagement with local authorities and community investment strategy. The focus was on supporting tourism at the municipal level, accompanied by an independent third-party participatory monitoring program of potential impacts on water.</p>
8.	<p><b>Finding:</b> CAO finds that IFC lacks assurance that project impacts on the community of Gndevaz have been subject to an integrated assessment that considers “all relevant E&amp;S risks and impacts” as required by PS1 (para. 7). This is a prerequisite for the development of mitigation plans as required by PS1 (para 15).</p>	<p>IFC disagrees with CAO’s assessment, which appears to depart from a review of the adequacy of IFC’s procedural and policy compliance and instead questions IFC’s professional judgement.</p> <p>The ESIA for the project was developed by a reputable international consultancy company and reviewed by an independent consultant and by IFC. The review concluded that the ESIA was in compliance with IFC’s Performance Standards. We note that CAO also acknowledges this in the report in the Executive Summary.</p> <p>It is IFC’s professional judgement that the ESIA sufficiently considered impacts on Gndevaz through an integrated assessment considering the different types of impacts from the point of view of the community. This is reflected in several of the management plans, including the Community Health Safety and Security Management Plan, which addresses health, safety and security from a community perspective. This is complementary to other</p>	N/A

		<p>Management Plans such as: Emergency Preparedness Response Plan (EPRP); Occupational Health and Safety Management Plan (OHSMP); Transport Management Plan (TP); Cyanide Management Plan (CMP); Worker Accommodation Management Plan (WAMP); and Stakeholder Engagement Plan (SEP).</p> <p>The ESMS includes a monitoring program which will evaluate the effectiveness of the mitigation measures of all management plans through regular monitoring. The results will be shared with the community and progress of implementation will be reported to company senior management on a quarterly basis.</p>	
<b>Findings related to IFC Policy and Guidance</b>			
9.	<p><b>Finding:</b> CAO finds gaps in IFC guidance associated with the PSs in that it does not elaborate on how to ensure that a full and integrated assessment of the combined or cumulative social effects of a project is undertaken.</p>	<p>As part of our normal E&amp;S assessment, IFC E&amp;S specialists do look at the combination of impacts on affected communities. This was done in this case as well.</p> <p>The particular requirement for a Cumulative Impact Assessment in IFC's PSs relates to the impacts of multiple distinct projects on a single environmental or social issue/community resource. That consideration is not relevant in this case.</p>	N/A