

# **Setting Standards for Responsible Banking: Examining the Role of the International Finance Corporation in the Emergence of the Equator Principles**

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## *Introduction*

Voluntary business regulation is becoming an increasingly prominent feature of global environmental governance. (Falkner 2003; Levy and Newell 2005; Pattberg 2006) Underpinning this trend is a deepening institutional relationship between international organizations, transnational corporations and civil society groups, which has placed the private sector at the centre of global responses to environmental problems. (Ruggie 2004) In this policy space, international organizations are playing a leading role in directly facilitating the creation and administration of voluntary codes of conduct that aim to integrate environmental and social norms into business practices, particularly in developing countries. (Utting 2005) Through such institutional arrangements, they seek to contribute to defining and diffusing international best practices for private companies.

Most international organizations facilitate the emergence of voluntary initiatives in their capacity as international bureaucracies governing particular issue areas. As a result, voluntary initiatives, such as the U.N Global Compact, the *OECD Guidelines on Multinational Enterprises*, and the statements of United Nations Environment Program's Finance Initiative, most often take the form of 'principled codes' that primarily contain aspirational principles affirming the moral responsibilities of private companies, yet often lack specific guidelines on how individual commitments will be put into practice. (Bondy, Matten and Moon 2004) Changes to corporate behaviour are expected to result from a process of social learning, in which private companies are provided with a forum for sharing and gaining knowledge and information about incorporating various aspirational environmental and social goals into their business operations. (Ruggie 2002)

In stark contrast to the U.N and the OECD, several multilateral development banks are mandated to provide financing directly to private sector companies or projects in developing countries. As participants in financial markets, these international organizations enjoy strong operational relationships with commercial banks and private companies, which allows them to directly shape corporate practices in their countries of operations. Therefore, while other international organizations' interaction with the private sector is limited to facilitating interactions between businesses and harmonizing practices around specific

ethical principles, multilateral development banks can leverage their commercial relationships and internal business expertise to influence corporate practices in much more fundamental ways.

This chapter will discuss the role of the International Finance Corporation (IFC), the private sector lending arm of the World Bank Group, in facilitating the emergence of the Equator Principles, a voluntary code of conduct that stipulate how financial institutions should incorporate environmental and social concerns into project lending. (Equator Principles 2003, 2006) Launched in June 2003, the framework is based on the internal operational policies and procedures of the IFC, and has to date been adopted by over forty private financial institutions, whose combined market share exceeds 80 percent of the global project finance market. (Amalric 2005; Wright and Rwabizambuga 2006) The analysis will consider how and on what basis the IFC influenced the drafting of the framework, and in particular, why its operational standards and procedures was chosen by leading commercial banks as a blueprint for devising common environmental and social standards for the project finance industry.

Even though compliance with the Equator Principles is not formally enshrined in law, the framework may significantly inform the future development of lender liability in developing countries by exhibiting ‘law-like’ characteristics and setting a global benchmark for acceptable or responsible financing practices. (Boisson de Chazournes 2000; FBD 2005) Already, some adopting banks are using the Equator Principles to inform the integration of environmental and social considerations into investment practices other than project financing, and there is evidence that some transnational corporations in environmentally-sensitive industries are recognizing that compliance with the Equator Principles may in the future be a condition for accessing long-term capital. (see FBD 2005: 118-121; Lazarus 2004) As a result, a new industry of consulting, training and legal advisory services is emerging to meet demands from commercial banks and transnational corporations for support in applying and interpreting the framework.

The chapter will be divided into four sections. The first section will briefly introduce the IFC and the unique organizational features of multilateral development banks that provide direct financing to private sector companies and projects in developing countries. The second section will discuss the recent growth of the project finance market in developing countries, and the emergence of environmental and social norms in multilateral project financing. The third section will consider the rise of environmental advocacy campaigns against commercial project finance banks and the emergence of the Equator Principles. And finally, the fourth section will consider why the IFC’s environmental and social standards became recognized as the global standard in the project finance market.

### *The IFC and the Promotion of Globalization*

In 1951, a U.S development policy advisory panel first endorsed the idea of establishing a public financial institution affiliated with the World Bank mandated to encourage private sector growth and investment in developing countries. In 1956, separate Articles of Agreement were drafted for an International Finance Corporation (IFC), mandating it to promote private sector development by ‘encouraging the growth of productive private enterprise in member countries, particularly in the less developed areas.’ While a formal member of the World Bank Group, alongside the International Bank for Reconstruction and

Development (IBRD), the International Development Agency (IDA) and the Multilateral Investment Guarantee Agency (MIGA), the IFC operates as a separate legal entity, with its own operational mandate, professional staff and financial resources. As with the World Bank, voting power on its Board of Directors is weighted according to the amount of paid-in-capital from each country, with the United States enjoying a voting share of 23.66 percent in 2005. (IFC 2005) At present, it has a staff of 2,400, just over half of which are located in its Washington D.C headquarters, the remainder divided among its 70 international field offices. And its relative autonomy is secured by the financing of the organization, which relies extensively on public borrowing and private placements in international capital markets for financing its lending operations, and total capital and retained earnings for equity investments.

As a corporation, the IFC has experienced tremendous growth in recent years, in parallel with many commercial banks in OECD countries. Since its inception in 1956, the IFC has committed US\$49 billion in loan and equity investments to 3,319 private companies, with a six-fold increase in annual commitments since the late 1970s. During the 1990s, the IFC accounted for nearly one-quarter of the total multilateral- and bilateral financing to private sector entities in developing countries. (IFC 2002) In 2005 alone, it financed 236 projects across 67 developing countries, amounting to \$5.4 billion in financing of IFC's own account. (IFC 2005) Its financing to developing countries is provided in various forms; long-term project loans typically ranging from 7-20 years in maturity, equity stakes in financial institutions and other private companies, partial credit guarantees to help clients access additional long-term capital and diversify their funding sources, and technical assistance in the form of staff training, organizational capacity building and restructuring. (IFC 2005) In addition to its direct financing, the IFC mobilizes private investment through its loan syndications program, in which commercial banks are invited to provide debt financing alongside IFC loans, thereby benefiting from the IFC's preferred creditor status as a multilateral lender.

Underlying its private sector financing is an unwavering commitment to promoting a neo-liberal economic order through its investments and advisory services. The combination of its governance structure and operational mandate produced an international organization that was 'owned by governments but acted as a corporation', taking on the full commercial risks of its investments, accepting no government guarantees, and earning profits from its financing operations. (IFC 1996) By focusing on transaction-based financing to private sector projects, its operations were meant to supplement those of the World Bank, which lends exclusively to member state governments. In this context, its financing activities are intimately tied to establishing and maintaining a neo-liberal economic order conducive to accelerating transnational private capital flows and private sector growth. Symptomatically, on its 40th anniversary in 1996, the IFC proclaimed with content that its investments had collectively promoted 'an economic model based on privatization, liberalization of trade and investment regimes, establishment of domestic capital markets, and encouragement of a dynamic, competitive local private sector with a growing export base.' (IFC 1996:10)

## UNDERSTANDING MULTILATERAL FINANCING TO THE PRIVATE SECTOR

Spanning more than a half-century, the IFC has a long history that predates all other multilateral development banks, or programs within them, providing financing directly to the

private sector. This underscores the fact that multilateral financing to the private sector at a significant scale is a relatively recent phenomenon. Indeed, the IFC's annual commitments did not exceed \$ 1 billion until the mid-1980s, when there was a notable shift in multilateral financing towards private sector investments and economic reforms programs designed to encourage private sector growth. In 1989, the Inter-American Development Bank (IDC Group) established the Inter-American Investment Corporation (IIC) to primarily finance small business growth through financial intermediaries, and in 1994, it created the Private Sector Development Department (PRI) to financially support the privatization of large-scale infrastructure in Latin America. In 1991, the European Bank for Reconstruction and Development (EBRD) was established to promote market reforms and private sector growth in the former planned economies of Eastern Europe and the republics of the former Soviet Union. During this time, the Asian Development Bank (ADB) and the African Development Bank (AfDB) also obtained authorisation to lend for non-guaranteed private investments.

Whether lending to the public or the private sector, multilateral development banks are amongst the most formally institutionalized features of the international economic regime. As international bureaucracies, they comprise of large bodies of professional staff that work within an array of operational procedures and bureaucratic routines, managing the transfer of vast financial resources to developing countries. In this context, decision-making follows a distinctly technocratic logic, as it is rooted in professional expertise and management practices that aim to produce measurable results, quickly and efficiently. (Gulrajani 2006) The focus on quantitative analysis means they engage in the collection, production, manipulation and dissemination of vast amounts of information, that provides the basis for developing and demonstrating specialized competency in particular professional fields. In turn, by being large depositories of technical knowledge that informs policy-making and investment decisions, they significantly influence the development and diffusion of international best practices in both the public and private sectors.

While all multilateral development banks generally share these organizational characteristics, those that predominately finance private sector entities have a distinctly commercial orientation to their operational mandate and organizational structure. Their financing operations are overwhelmingly transaction-based and revolve around the identification, assessment and approval of profitable investment projects. While they do offer advisory services to government entities in support of regulatory reforms that further private sector development, they generally do not provide policy- or sector loans that address the broader institutional context of development. By implication, lending and equity financing is provided under a narrower mandate, carried out in sector-based banking divisions run by finance professionals that are trained in investment and risk management practices.

Furthermore, while they do operate within a broader mission to promote sustainable development, commercial viability is the overarching criterion for selecting projects and negotiating financing terms, as projects do not benefit from host government guarantees. When financing development projects, they often take on the same commercial risks as private lenders do, and seek to operate within the constraints and opportunities of the market place in order to demonstrate the commercial viability of developing country investment. Under these circumstances, managing and mitigating investment risk by carefully structuring the transaction and involving a multitude of different financial institutions becomes central to realizing individual projects. By implication, they are therefore more 'bank-like' than public sector lenders, with an organizational culture, operational

structure and professional staff more narrowly attuned to identifying and assessing commercial investment opportunities. (Gutner 2002)

### *Project Finance and Sustainable Development*

Since the early 1990s, market reforms in developing countries have resulted in the widespread privatization of traditional public sector industries, harmonization of tax regimes, and lower restrictions on foreign capital all contributed to the growth in long-term private capital flows to infrastructure projects, including power plants, roads, ports and telecommunication. (World Bank 2004) By implication, transnational corporations and their financial bankers increasingly presided over the construction and implementation of projects that not only contributed to the economic transformation of entire sub-national regions and industry sectors, but also had a profound impact on the environment and local communities. Between 1990 and 1997, commercial bank financing for infrastructure in developing countries increased nine-fold, and the annual volume of project finance deals exploded from less than \$5 billion to over \$50 billion. (Esty 2004; World Bank 2004) The growth was led by commercial banks from OECD countries - principally Japan, the United States, France, Germany, the Netherlands, and the United Kingdom -which accounted for roughly three-quarters of all commercial infrastructure finance in developing countries. In addition, local capital markets in the fastest growing economies, led by regional and public development agencies, became a significant source of long-term financing for capital-intensive projects.

The growth in financing to the private sector in developing countries also manifested itself in the composition of aid and financing from official sources. Between 1991 and 1997, long-term official capital flows to developing countries declined nearly 40 percent and the World Bank withdrew almost entirely from large-scale public infrastructure lending. Meanwhile, during the same period, multilateral- and bilateral financing to private entities in developing countries nearly tripled, growing from US\$ 9 billion to US\$25 billion. (IFC 2002) This underscores how multilateral lenders and official export credit agencies were critical to mobilizing commercial bank lending to the private sector in so-called high-risk sectors and regions by way of loan syndications. (World Bank 2004) As an example, the recently completed Baku-Tblisi-Ceyhan oil pipeline project, which included an oil field and a pipeline stretching 1760 kilometers from Azerbaijan to Turkey, had a total project cost of \$3.6 billion and was financed by syndications which included the IFC and the EBRD, seven export credit agencies, and fifteen commercial banks. In this case and other large projects, commercial banks took comfort in the participation of a multilateral lender, as they enjoyed a 'preferred creditor status' and were in position to secure a political commitment from host governments not to introduce policies or regulations that would adversely affect the borrowers' future capacity to service loan payments.

### THE IFC'S ENVIRONMENTAL AND SOCIAL POLICY REFORMS

Not surprisingly, the systematic consideration of environmental and social issues in private sector financing arrived much later than in public sector lending. As an indication, whereas the World Bank hired its first environmental specialist as early as 1971, the IFC did not do so until 1989. In general terms, the notion that the consideration of environ-

mental and social issues is political territory and falls outside of the commercial mandate of private sector financing was for long the prevailing view, and remains contested. Among multilateral development banks that predominately finance the private sector, the EBRD is the only one officially mandated to promote sustainable development. Yet, all multilateral development banks have made a commitment to protect the environment and reduce poverty in some form, primarily by institutionalizing environmental and social review procedures in their project cycles, aimed at detecting and mitigating any adverse environmental and social impacts that may arise as a result of their investment projects (for overviews, see IFC 2002; Gutner 2002; Kennedy 1999; Park 2006).

Relative to its half-century long history, the IFC only recently established an internal environmental and social policy framework. Until the late 1980s, the selection of projects was overwhelmingly based on a combination of technical criteria and internal rates of return. It was not until the early 1990s that the IFC began using environmental review procedures similar to those of the World Bank on an ad-hoc basis, and started adding a number of environmental specialists to oversee the due diligence process. Its own explanation for introducing environmental review of projects pointed to five developments; the growth in scientific knowledge about environmental issues, regulatory developments in the United States and the European Union, an internal learning process, a strategic desire to manage economic transitions in a sustainable manner; and the influence of the NGO community. (IFC 2002)

While all of these factors contributed to raising awareness and mobilizing political will, the timing of the environmental and social reforms was undoubtedly in large part due to external calls for greater accountability and transparency. In 1995, it came under immense pressure from civil society groups alleging that the IFC was violating the World Bank's environmental and social policies in a Chilean hydropower project (Park 2006). The controversy resulted in a scathing independent report criticizing the IFC's conduct, triggering an internal re-examination of its policies and procedures (Hair et.al 1997; IFC 2002). It emerged on the heels of two independent reports on the World Bank's compliance with its own operational policies – the *Morse Report* and the *Wapenhaus Report* – which highlighted the importance of strengthening internal quality controls at the World Bank to ensure that projects contribute to the broader objectives of the organization. (See Boisson de Chazournes 2000)

In 1998, the IFC formally adopted most of the World Bank's *Environmental and Social Safeguard Policies*, an umbrella term used for the set of nice thematic policies that provide internal staff with guidance on how to manage a variety of adverse environmental and social impacts associated with projects. (Boisson de Chazournes 2000) Its main element was the *Operational Policy on Environmental Assessment* (OP 4.01), which listed environmental screening, public consultation, information disclosure and implementation requirements, and identified the *World Bank's Pollution Prevention and Abatement Handbook* and *Occupational Health and Safety Guidelines* as benchmarks for IFC's private sector projects. Furthermore, it introduced the *Procedures for Environmental and Social Review*, which outlined the internal procedures by which environmental specialists would assess environmental assessments provided by borrowers.

The main component of these reforms was an environmental screening process whereby each project proposal would be assigned a category – A, B, C or FI - according to its level of expected environmental impact, and the financing modality ('FI' was assigned to projects involving a financial intermediary). In turn, the category assigned to each project would

determine the scale and scope of environmental assessment and public consultation. Finally, the set of nine operational policies laid out the minimum environmental and social standards that all projects would be subjected to. As examples, it included the *Operational Policy on Natural Habitats* (OP 4.04) barred the IFC from financing projects that involved the significant conversion or degradation of critical natural habitats, as defined by the World Conservation Union (IUCN), and the *Operational Policy on Dam Safety* (OP 4.37) required the technical aspects of hydropower construction to be overseen by an independent panel of experts, amongst other things.

### *The Rise of NGO Campaigns Against Commercial Banks*

Given that many of the projects with the most widespread adverse environmental and social impacts also happen to generate the most revenue, it is not surprising that the management of environmental and social issues remains a very controversial issue. Yet, until recently, most of the public scrutiny of the environmental and social impacts of project finance deals was directed towards multilateral development banks, and to a lesser extent bilateral export credit agencies. (Gutner 2002; Wade 1997) Since they held strong positions in the market and had certain obligations as publicly mandated institutions to ensure that investments did not negatively impact local communities and the environment, they became natural targets for critics. But the expansion of the project finance market in the early 1990s, and the growing public visibility of commercial banks as arrangers and financiers of large projects, revealed the extent to which the decisions regarding the management of environmental and social impacts of large projects were often taken by commercial banks and private borrowers.

Starting in the late 1990s, a series of well-publicized civil society campaigns against a number of large commercial banks accused them of financing projects that were violating the rights of local communities and harming the environment. In numerous cases, commercial banks were alleged to have financed a project even though a multilateral development bank had refused to do because they were in violation of their environmental and social policies. (Missbach 2004) Milieudefensie, the Dutch chapter of Friends of the Earth, together with other NGOs, targeted ABN Amro for its lengthy involvement as a co-financier of mines in Papua New Guinea operated by Freeport-McMoRan, and alongside other Dutch commercial lenders, for financing the conversion of Indonesian forests to oil palm plantations. (FOE 2001)

In 2000, the Rainforest Action Network (RAN) launched a public advocacy campaign against industry leader Citigroup for its involvement in numerous projects, including the Chad-Cameroon pipeline, and the Oleoducto de Crudos Pesados (OCP) pipeline and Camisea gas fields in Peru, which over a three year period included consumer boycotts and targeted media campaigns. Similarly, German NGOs and parliamentarians criticized West Deutsche Landesbank, the quasi-public German bank, for arranging the highly controversial Peruvian pipeline, whereas Barclays's reputation was adversely affected by its financial involvement with the large-scale forestry projects of Asia Pulp and Paper, the conglomerate that financially collapsed in 2001. In these and other cases, NGOs alleged that the commercial banks bore some responsibility for the adverse impacts of their project financing, and demanded that they directly confront irresponsible or negligent borrowers.

In 2002, a senior executive at ABN Amro met with IFC's executive vice-president and discussed the growing criticism levied against commercial banks for financing projects in developing countries with significant adverse environmental and social impacts. In many cases, civil society groups had attempted to mobilize bank customers to support their advocacy campaigns, adversely affecting retail banking operations. In October 2002, following additional discussions, the IFC and ABN Amro decided to convene a meeting of leading project finance banks in London to discuss the management of environmental and social issues in projects. Co-chaired by the IFC and ABN Amro, the meeting gathered project finance and risk management executives of numerous commercial banks to share their experiences with 'problem projects'. In turn, the four banks that gave presentations – ABN Amro, Barclays, Citigroup and West LB – formed a working group to explore the formulation of a common set of environmental and social review procedures for commercial project finance banks. (Lazarus 2004)

During the ensuing four months, the working group collaborated with a technical advisor from the IFC to consider a set of environmental and social standards for project finance investments that would be suitable for commercial banks. Through meetings with the working group and in bilateral talks with individual banks, IFC presented and discussed how it applied the *Safeguard Policies* to high-risk projects. Initially, the working group briefly considered devising an entirely new set of standards, but over time, the impracticality of starting from scratch, and the objective to maximize the appeal and utility of the framework, led them to base a draft framework on the IFC's *Safeguard Policies*.

In February 2003, a second meeting was hosted by Citigroup to discuss a set of draft standards named the 'Greenwich Principles', in reference to the meeting location's proximity to Greenwich, near Central London. (Lazarus 2004) The representatives of commercial banks were presented the draft standards, and most of them gave their tentative support, subject to discussions with internal corporate relations and legal departments, senior management, and clients. Subsequently, the draft standards were circulated to a select group of NGOs for consultation. While generally positive of the standards themselves, the NGOs highlighted several shortcomings regarding implementation and governance, including the lack of a reporting requirement or compliance mechanism to ensure transparency and accountability, and the absence of a secretariat to facilitate communication between the banks and stakeholders. These concerns had been previously articulated in the *Collevocchio Declaration on Financial Institutions and Sustainability*, a policy statement issued jointly by over 100 civil society groups at the World Economic Forum in Davos, January 2003. (see Missbach 2004)

In April 2003, the four commercial banks of the working group formally endorsed announced they would adopt the framework, and hosted a consultation meeting with a selection of NGOs in London. A month later, a fourth meeting was held in Dusseldorf at the headquarters of WestLB. In the meeting, the IFC gave a series of presentations on the process of environmental screening and the application of its *Safeguard Policies* to individual projects.. It also affirmed its interest in providing environmental management training to adopting banks, in order to increase their capacity to implement their new commitments. (Lazarus 2004) By then, the standards had been renamed the Equator Principles so as to reflect the joint intention among adopting banks to produce a global framework applicable to all industry sectors. Less than one month later, senior executives of ten commercial banks gathered at the IFC's headquarters in Washington D.C alongside its chief executive to officially launch the Equator Principles.

Since June 2003, an additional thirty-two financial institutions have pledged their commitment to adhering to the Equator Principles in their project finance operations. To date, 45 financial institutions have adopted the Equator Principles, representing over 85 percent of the global project finance market. In October 2005, leading Equator banks began revising the framework, in anticipation of the IFC's release of new *Policy and Performance Standards on Social and Environmental Sustainability*, replacing the *Safeguard Policies* upon which the original Equator Principles were based. In July 2006, the new Equator Principles were released and readopted by the vast majority of the commercial banks that had pledged their commitment to the original framework.

## THE EQUATOR PRINCIPLES

In actuality, the formal existence of the Equator Principles is limited to a publicly available document that spells out the normative and business rationale for undertaking environmental risk management, and specific operational standards that adopting banks commit to using in their project finance activities. It has no formal organization or secretariat, and communication with stakeholders is done through a website ([www.equator-principles.com](http://www.equator-principles.com)), hosted on by one of the adopting banks on a rotating basis. It is a strictly non-binding framework in which '[financial] institutions are adopting and implementing [the] Principles voluntarily and independently, without reliance on or recourse to IFC or the World Bank.' (Equator Principles 2003:4, 2006:5) Furthermore, it has no independent monitoring mechanism mandated to verify that projects have been prepared according to the relevant provisions. As is stated, compliance with host country laws and regulations and relevant World Bank and IFC guidelines will be addressed to the satisfaction of the financier.

By and large, the differences between the original and the revised version of the Equator Principles reflect the changes that the IFC made to its own environmental and social policy framework. (see Watchman and Baines 2007:6-7) Under both versions of the framework, adopting banks pledge to apply the environmental screening process to their project financing, and require operators of category A and B projects to complete an environmental assessment report which identifies requirements under host country laws and regulations and international treaties and agreements, as well as a wide range of other concerns not necessarily covered in national jurisdictions. In turn, operators are required to complete an environmental management plan which addresses mitigation, actions plans, monitoring, and the management of risk and schedules. The Equator Principles also identify the World Bank and the IFC's industry guidelines as appropriate reference points for minimum environmental standards, and for projects in developing countries, the IFC's *Safeguard Policies* – or the *Performance Standards* in the revised framework - would also be applied.

### *The IFC and the Equator Principles: Exploring the Links*

This section will make an argument as to why the IFC's environmental and social policies and procedures became recognized as 'best practice standards' in the global project finance market, manifested in the widespread adoption of the Equator Principles among leading project finance banks. It identifies two developments that were crucial to this outcome, the IFC's involvement as a meeting facilitator and a technical advisor during the drafting

stages of the Equator Principles, and the eventual decision among commercial banks to base a set of common environmental and social standards for commercial project lenders on the IFC's internal operational policies. Both developments speak to rising influence of the IFC in the global economy during a time of globalization.

#### THE COMMERCIAL ORIENTATION OF THE IFC'S FINANCING OPERATIONS

As the largest provider of multilateral finance to the private sector in developing countries, the IFC is a significant market actor in its own right. The IFC's involvement as a technical advisor in the drafting stages of the Equator Principles reflects the extent to which leading commercial banks identified with its operational experiences as a project lender in developing countries, and considered it as a valuable source of expertise for managing environmental and social risks in developing country projects. These perceptions were grounded in several characteristics of the IFC as an international organization.

First, the IFC's organizational structure and professional practices centre on identifying, evaluating, negotiating and closing financially viable investment projects, which broadly resembles that of commercial banks. Given this transactional orientation, the IFC's operational staff primarily consists of business professionals with advanced degrees in corporate finance or business management. Its financing operations are organized in nine industry departments, each charged with identifying and completing investment projects in particular industries, such as agribusiness, infrastructure and global financial markets. Tasks associated with identifying and mitigating the environmental and social impacts of project proposals are primarily handled by environmental specialists working in a separate support department.

Secondly, apart from an organizational structure that focuses on project transactions, the IFC's investment decisions are primarily made on the basis of financial viability. While its mission to foster sustainable development is much broader than that of commercial banks, it remains firmly wedded to its original purpose of mobilizing financial resources in support of financially viable private sector projects in developing countries. Indeed, profitability is considered a prerequisite for a project to make a positive contribution to development. (Jaabre 2002) This emphasis effectively means that IFC financing and commercial bank lending is broadly driven by the same organizing principle, which in turn guaranteed that the IFC's technical advice to commercial banks would not directly conflict with their profit motive.

Third, given its focus on identifying financially viable transactions, the IFC engages with the environmental and social dimension of private sector development on a project-by-project basis, and increasingly, with business profitability in mind. While a significant purpose of its environmental and social policy framework is for minimum standards to increase the development impact and accountability of its financing operations, the IFC is increasingly arguing for the existence of a 'business case' for managing environmental and social issues in project investments. (IFC 2002a; Wright 2006) By having adopted this distinctly corporate perspective on environmental and social issues, the IFC is not only aligning its environmental and social mission with the concept of corporate social responsibility, but also reinforcing the notion that private sector growth and investment is a prerequisite for reversing environmental degradation and reducing poverty.

And finally, the commercial orientation of the IFC's financing activities means its operational knowledge and experiences are directly relevant to commercial banks. During the last decade in particular, the IFC has amassed considerable expertise in environmental and social risk management by increasing the number of in-house environmental specialists from under 10 to over 100.(IFC 2002; Park 2006) In doing so, it frequently promoted its specialized expertise in environmental and social risk management, and positioned itself as 'a partner of choice' for private borrowers in developing countries. (IFC 2003:2; Wright 2006). And in the context of its financial sector investments, it has provided environmental risk management training to financial institutions, produced guidance material diffusing its own operational experiences and made the case for considering environmental and social issues in investments. More recently, the IFC has exploited its enhanced leverage and expertise to form a partnership with the U.N Global Compact and the UNEP FI to further the integration of environmental and social issues in financial markets.

#### FINANCIAL PARTNERSHIPS IN A GLOBAL MARKETPLACE

By virtue of its financing operations, the IFC has long had operational relationships with private financial institutions, as a provider of debt or equity financing, or as a co-financier in large development projects. Since the mid-1990s, the financial sector has been a strategic priority sector for the IFC, and has received between two-thirds and one-half of its annual financing. These investments often take the form of intermediary financing schemes, in which the IFC provides debt or equity financing to a financial institution or investment fund operating in a developing country, which in turn provides financing to multiple private companies. Such intermediary financing schemes sometimes include staff training and corporate restructuring programs aimed at improving corporate governance and commercializing risk management practices in private financial institutions.

Apart from providing financing or technical assistance to private financial institutions operating in domestic markets, it also enjoys close, operational relationships with many of the world's largest commercial banks with significant global investment portfolios. These interactions are in large part a product of the IFC's long-standing loan syndications program – also referred to as its B-Loan program -, through which it co-finances development projects with commercial banks. The program necessitates frequent interactions between project finance executives in commercial banks and operational staff at the IFC, which provided the backdrop for the initial discussions that eventually led to the drafting of the Equator Principles.

In fact, among the ten commercial banks that adopted the framework at its inception in June 2003, six had participated in IFC syndications signed that year, including all four of the banks that constituted the working group in charge of the drafting process. As frequent participants of the program, commercial banks had regularly been in communication with the IFC's internal B Loan Management division that disseminates progress reports on syndicated loans and keeps participating banks informed of potential syndications opportunities. It also organizes an annual participants meeting for private financial institutions, investment funds and development agencies to showcase its loan syndication program and provide a forum for discussing opportunities and obstacles to investing in developing countries. Not coincidentally, the Equator Principles were launched at the Annual Participants Meeting in June 2003.

## GLOBAL STANDARDS FOR A GLOBAL INDUSTRY

While the IFC's operational mandate, financial strength, and risk management expertise may explain why the IFC became involved as a technical advisor in the drafting stages, this does not by itself reveal why commercial banks chose the IFC's environmental and social policy framework as the blueprint for the Equator Principles. To understand their appeal among leading commercial banks, it is necessary to consider the characteristics of the IFC's *Safeguard Policies* from the commercial vantage point of financial institutions in position to decide whether or not to apply them to their project finance lending.

First, choosing to base the common industry standards on the IFC's environmental and social policy framework guaranteed that they would draw a certain amount of immediate and unconditional recognition and legitimacy. As the IFC's Board of Directors, representing over 170 governments, formally approves changes or additions to the IFC's operational policies and procedures, the *Safeguard Policies* enjoyed a multilateral endorsement, albeit perhaps not equally supported by all governments. And as they give affirmation to well-recognized norms and rules in the international system, such as human rights, protection of sensitive ecosystems and public access to decision-making, they also enjoy relatively strong support among environmental NGOs campaigning for better protections for the environment and local communities. (EDF 2005)

While environmental NGOs frequently criticized the scope of *Safeguard Policies*, and particularly the way the World Bank and the IFC applied them to projects, they nevertheless had come to define responsible lending and symbolized the influence of environmental NGOs on development financing. Thus, when leading commercial banks were first confronted by public advocacy campaigns over their involvement in projects that adversely affected the environment and local communities, they were often criticized for failing to abide by the environmental and social policies of the World Bank and the IFC. (see Missbach 2004) Given that preventing damages to their corporate reputation was a primary concern for commercial banks, the legitimacy that the *Safeguard Policies* enjoyed among their chief critics was a significant factor in deciding to use them as a blueprint for developing an industry standard for commercial project lending. (Amalric 2005; Wright and Rwabizambuga 2006)

Secondly, the fact that many commercial banks were quite familiar with the IFC's environmental and social policy framework provided a strong rationale for aligning industry standards with it. Although the IFC has less financial strength than many commercial banks, it enjoys unique privileges as a multilateral institution that allow it to significantly influence how environmental and social issues are managed in large-scale infrastructure projects in developing countries. By determining the financing conditions attached to its own loans, and in the context of syndications, to commercial bank loans as well, the IFC can influence the standardization of contracting practices and commercial legal obligations in developing countries, particularly those that lack access to private financing. By implication, frequent borrowers in environmentally-sensitive industries, such as oil, gas, mining and infrastructure, and commercial banks participating in loan syndications, have become familiar with the IFC's environmental and social policies and the World Bank's environmental standards and guidelines.

And finally, given the global reach of the project finance market, there was a purely functional argument for commercial banks to choose a policy framework that could be applied to project investments in all industry sectors globally. In fact, gaining the support of a significant share of market participants was as important for the working group as the selection of standards. In contrast to those of regional development banks, the IFC's operational policies and procedures were not designed to respond to the institutional conditions of particular geographic regions, but meant to be applicable and equally effective in all of its countries of operation. In turn, this universal logic was well suited for a globally integrated industry, in which the project finance portfolios of commercial banks differed widely in their geographic and sectoral concentrations. In this context, drawing on the IFC's framework would be meant to ensure the widest possible participation in the Equator Principles, as it would not in principle discriminate against financial institutions from any region.

### *Conclusion*

By being based on the IFC's environmental and social policy framework, the widespread support for the Equator Principles has effectively made the IFC a *de facto* standard-setter in the global project finance market. Overall, the Equator Principles reflects the growing discursive and structural influence of the IFC in the global economy, and has undoubtedly raised its public profile as an international organization. In a lead editorial, the Washington Post went so far as proclaiming that the Equator Principles 'demonstrate that the [World Bank Group] can remain relevant in a world awash in private capital.' (Washington Post 2006)

However, notwithstanding such media report, the influence of the IFC should not be overestimated. Once commercial project financing was negatively affected by a growing reputational risk, commercial banks drove the cooperative and deliberative process that eventually led to the launch of the Equator Principles. Without commercial banks voluntarily committing to a common industry standard and offering their widespread endorsement of the framework, it would not have materialized. Yet, despite being industry-driven, the Equator Principles do have a significant public dimension, as the standards themselves were originally developed within multilateral institutions and were designed under a public mandate to ensure that project loans would not harm the environment and local communities.

In attaining its influential position in the global project finance market, the IFC draws on three main sources of power. First, the IFC exerts discursive influence over corporate practices, by collecting, organizing and manipulating knowledge and information about the relationship between private sector investment, environmental degradation and poverty, and advocating certain kinds of corporate interventions. (see IFC 2002a) Secondly, the IFC's discursive influence is reinforced by its operational mandate and financing operations, which allow it to exert structural power in the global economy by arranging project financing and placing environmental and social conditions on the disbursement of project loans, thereby diffusing its own operational policies and procedures in the marketplace. And third, by virtue of its public mandate, technical expertise and market influence, the IFC enjoys significant convening power in the global project finance market, manifested in attendance figures for its Annual Participants Meeting for syndicating banks, gathering leading financial institutions operating in developing countries.

In the context of the Equator Principles, the IFC's convening power proved instrumental to bring together otherwise fiercely competitive financial institutions to share their experiences with project finance investments in developing countries. Yet, far from playing an entirely neutral role, IFC was in a privileged position relative to other international organizations, able to directly influence finance executives in an operational setting. The subsequent participation of the IFC in the drafting stages influenced the eventual decision among leading commercial banks to make the *Safeguard Policies* the blueprint for a common industry framework, as it convinced them that the IFC's framework was the most effective in mitigating the environmental and social risks associated with project financing globally, across all industry sectors.

As the Equator Principles have been widely embraced by financial institutions, project sponsors and third parties such as international law firms and environmental consultancies, the framework has significantly influenced the environmental and social risk management in the project finance market and enjoys legitimacy as a voluntary initiative. However, environmental NGOs have argued that the lack of the accountability and transparency makes it near impossible for external observers to pass judgement on the effectiveness of the framework. (see Banktrack 2006) To respond to such criticisms, an additional principle was inserted in the latest revision of the framework that requires financial institutions to report, at least annually, on "Equator Principles implementation processes and experience", which should at a minimum include the number of transactions screened, and their environmental screening category. (Equator Principles 2006:5) However, this requirement falls short of disclosure practices at multilateral lenders, which notify the public of projects that are under consideration for financing. The weakness of the reporting requirement in the Equator Principles reflects the fact that commercial banks remain reluctant to publicly disclose which projects they are financing, much less how they apply the Equator Principles to particular projects. In support of their stance, there is evidence that the disclosure of project-level information would be considered illegal or highly unprofessional in most jurisdictions. (FBD 2005) Yet, notwithstanding this obstacle, to instill public confidence in the voluntary framework, it is necessary for commercial banks to disclose how the standards and procedures are applied to the most controversial projects.

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