

CSO response to the CAO investigation into IFC investment in Corporación Dinant, Honduras

Summary

International and Honduran CSOs, including Movement of Unified Campesinos in Aguan (Honduras), Movimiento Madre Tierra (Honduras), CIFCA, FIAN, Plataforma Interamericana de Derechos Humanos, Democracia y Desarrollo, Oxfam, ActionAid International, Rights Action, Asociación Interamericana para la Defensa del Ambiente, the Centre for Research on Multinational Corporations (SOMO), Global Witness, Urgewald, the Bretton Woods Project, the Center for International Environmental Law, Forest Peoples Programme, COFADEH (Honduras), Accountability Counsel, GRAIN, Rel-UITA, Latindadd, BankTrack, Inclusive Development International, The Corner House, Re:Common, Habitat International Coalition, Latin America Office (HIC-AL), Carbon Market Watch, Rettet den Regenwald, Yayasan SETARA Jambi, erlassjahr.de/Jubilee Germany, Eurodad, Centre national de coopération au développement, CNCD-11.11.11, International Human Rights Clinic, Indigenous Peoples Links, GMB, Honduras-Forum Switzerland, Ecologistas en Acción, Robin Wood, Both ENDS, Biofuelwatch UK/US, the Norwegian Coalition for Debt Cancellation, the Social Justice Committee of Montreal Canada, KOSID and Mani Tese, condemn the response of the International Finance Corporation (IFC) to the highly critical findings of the Compliance Adviser/Ombudsman regarding the IFC's investment in Corporación Dinant in Honduras¹, which has been associated with extensive human rights abuses, including the killing, kidnapping and forced eviction of farmers.

The investigation is one of the most damning ever issued by the internal watchdog and concludes that the Bank's private sector lending arm, the International Finance Corporation:

- Failed to adhere to its own policies meant to protect local communities, and continued to allow the company to breach those safeguards over the past five years to the present;
- Either failed to spot or deliberately ignored the serious social, political and human rights context in which this company is operating or where it did, failed to act effectively on the information;
- Failed to disclose vital project information, consult with local communities, or to identify the project as a high-risk investment, despite public information that was widely available at the time the investment was made.

The CAO found that these failures arose, in part, from staff incentives "to overlook, fail to articulate, or even conceal potential environmental, social and conflict risk"², and that staff felt pressured to "get money out the door"³ and discouraged from "making waves"⁴.

The CAO investigation reveals one of the most egregious investments in the IFC's history. Such findings should rightly provoke shockwaves at the institution, and an admission of fault, a commitment to root and branch investigation and reform, and apology and remedy to affected communities who have suffered at the hands of IFC's client.

However, despite the CAO's evidence of serious and sustained failures in IFC's handling of the case, the IFC's official response is superficial and its proposed actions totally inadequate. In the face of CAO-compiled

¹ See the CAO investigation here: http://www.cao-ombudsman.org/cases/document-links/documents/DinantAuditCAORef-I-R9-Y12-F161_ENG.pdf, and the IFC's response here: http://www.cao-ombudsman.org/cases/document-links/documents/IFCResponsetoCAOAuditofDinant_Jan32014.pdf

² CAO investigation p. 59.

³ CAO investigation p. 26.

⁴ CAO investigation p. 57.

evidence which points to systemic problems and could indicate malpractice on its part, the IFC not only refuses to address these systemic issues, but compounds them with further attempts to cover up its wrongdoings. In its response, the IFC rejected some of the CAO's findings, without specifying which ones or providing evidence to support this rejection. IFC also states that the Action Plan is contingent on Dinant's agreement.⁵ Of grave concern is that the IFC continues to deny that human rights abuses may have been committed by its client in the Aguán Valley, and to deny that the root cause of these abuses is a long standing conflict over land.

CSOs are now calling for:

- An admission by IFC CEO Jin Yong Cai of the many failures documented in the CAO investigation;
- The immediate withdrawal of the Action Plan and IFC response. In its place, set up a **consultation mechanism** that involves the farmers' organizations in the development and implementation of a much stronger and more comprehensive action plan to correct the deficiencies highlighted by the CAO;
- **The suspension of any further disbursements** to Corporación Dinant, including the pending second \$15 million tranche, and abstain from resuming funding until a) the material and intellectual authors of the crimes and human rights violations committed against organised farmers and their supporters in the Aguán Valley have been brought to justice. If Dinant is found to be responsible for any of these crimes and human rights violations, then the IFC should terminate its relationship with Dinant immediately; and b) a comprehensive, just, peaceful and sustainable resolution is provided to the conflicts over land between the Corporación Dinant, the state of Honduras and the local farmers' movements;
- **President Kim to commission an independent investigation of the underlying systemic reasons** identified by the CAO for the repeated and serious failures to adhere to standards by IFC staff. This investigation should also propose measures to address and rectify these systemic failures, which are not limited to this case alone.⁶ It should also propose measures that incentivise IFC staff to work towards the two corporate goals of ending extreme poverty and promoting shared prosperity and not just getting money out of the door. In particular it should address what the CAO calls the 'risk averse' culture at the IFC, where "accountability for results defined primarily in financial terms may incentivize staff to overlook, fail to articulate, or even conceal potential environmental, social and conflict related risks";⁷
- A commitment to **carry out human rights impact assessments** in high risk countries and those with a documented culture of impunity, and a commitment to consider in these assessments the findings of UN human rights monitoring bodies as well as regional human rights systems.

A full list of NGO demands can be seen at the end of this document.

⁵ The IFC response states, "In addition, we will seek Dinant's agreement to undertake that the following actions are undertaken in the next 12 months..." p. 4.

⁶ See also the recent Tata Mundra case, http://www.cao-ombudsman.org/cases/document-links/documents/TermsOfReference_CGPLAudit_October242012.pdf and the appraisal for the Ficohsa case: http://www.cao-ombudsman.org/cases/document-links/documents/CAO_Appraisal_Ficohsa_C-I-R9-Y13-F190.pdf

⁷ CAO investigation p. 10.

The CAO findings and IFC response – a summary and reaction from CSOs

The CAO investigation exhaustively documents failures at every stage of the investment process at IFC: assessment, supervision and evaluation.

1. Assessment Phase Failures

At the **assessment phase**, the CAO catalogues failures by the IFC in all its formal procedures: environmental and social due diligence, the Integrity Due Diligence review, project categorisation, and processes of consultation and information disclosure. The more serious failures include:

- **Ignoring available evidence:** CAO's own investigators conducted news searches using the same parameters mandated by the World Bank's rules; these revealed allegations about the company available at the time the investment was made including: "(a) misuse of political influence; (b) involvement in the murder of an environmental activist; (c) [the company CEO] having been the subject of warrant for arrest in relation to environmental crimes; (d) involvement in multiple land disputes, and (e) the use of his properties as a staging post for drug trafficking."⁸ CAO concludes that "IFC staff either knew about these allegations and perceptions and failed to deal with them" or did not conduct required news searches.⁹
- **Breaching policies on disclosure and consultation:** The CAO finds that the IFC was and continues to be in breach of its policy on information disclosure.¹⁰ In addition, "CAO found no evidence that the communities living most proximate to Dinant's properties were consulted during the preparation of the E&S Assessment"¹¹, again in breach of its policies.

The IFC's response:

In the face of clear evidence to the contrary presented by the CAO, the IFC's response last week continues to claim that in 2008 there was 'no evidence of land claims'. More worryingly, in an initial response to the draft CAO investigation in summer last year, the IFC attempted to pressure CAO into covering up its own findings:

"In making these findings CAO notes IFC's request that "discussion of IFC's integrity due diligence as it was applied to Dinant" be "removed from the report."¹²

Such denial in the face of clear evidence to the contrary is then compounded by an attempt by the IFC to force CAO to conceal its own findings. This verges on malpractice.

The IFC does not respond to the CAO's finding that it continues to be in breach of its own information disclosure requirements. The IFC's response is that Dinant will carry out a "comprehensive stakeholder mapping and socio-economic baseline survey" in January 2014.

It is unacceptable that the IFC fails to admit or correct its wrong-doing on information disclosure, especially considering the CAO's discovery that the client's translation of the Environmental and Social Review Summary was "modified"¹³. It is unacceptable that despite the CAO's findings that community consultation

⁸ CAO investigation p. 6.

⁹ CAO investigation pp. 6-7.

¹⁰ "IFC's failure to disclose the Dinant E&S Assessment was not compliant with its Policy on Disclosure of Information (para. 13). IFC remains non-compliant on this point." See p. 7: http://www.cao-ombudsman.org/cases/document-links/documents/DinantAuditCAORefC-I-R9-Y12-F161_ENG.pdf

¹¹ CAO investigation p. 7.

¹² CAO investigation p. 32.

¹³ CAO investigation p. 33.

should have occurred back in 2008, the IFC does not acknowledge the fact that Dinant's plans to consult communities come six years too late. The information gathered from the consultation was to have been used to determine if IFC would invest in the project.

The IFC's response also refers to "other international financial institutions" which "also conducted their own due diligence prior to IFC and subsequently obtained approval from their respective Boards of Directors".

The IFC's reference to other banks in this way is disingenuous as it then fails to mention that both the Deutsche Entwicklungsgesellschaft (DEG) and the Inter-American Development Bank decided not go ahead with their investments in Dinant because of concerns around human rights and land conflicts.¹⁴¹⁵ Further, the IFC promotes its Performance Standards as a "global benchmark"¹⁶ in the field of development finance. If that were true, then the IFC should not rely on the due diligence of other institutions.

2. Supervision phase failures

At the **supervision** phase, the CAO again finds significant flaws in the IFC's actions at all phases: including sustained failure to enforce its own loan agreement Conditions of Disbursement; failure to supervise Dinant's compliance with key Performance Standards such as that relating to the use of force by security guards; and failure to "exercise remedies" when non-compliance continued. These include:

- **Breach of Performance Standard 4 (PS4) on Security:** The CAO writes that as Dinant employed a security force of more than 300 persons, it was a requirement under PS4 that the client "assess the risks (...) posed by its security arrangements," and consider issues such as "good international practice in terms of hiring, rules of conduct, training, equipping and monitoring such personnel." However, the CAO "finds no indication that IFC supervised its client's PS4 obligations: (a) to investigate credible allegations of abusive acts of security personnel; or (b) that the use of force by security personnel would not be sanctioned other than for "preventative and defensive purposes in proportion to the nature and extent of the threat."¹⁷
- **Sustained failure to bring the project into compliance:** An IFC site visit post-disbursement in March 2011 found Dinant's Environmental and Social (E&S) management system to be "poorly developed" with Dinant being given an "unsatisfactory" Environmental and Social Risk Rating. The same unsatisfactory rating is maintained in the next visit in April 2012 with the additional note that Dinant "has significant gaps with Honduran E&S legal requirements and little progress has been made on the social aspects including stakeholder engagement and security forces practices." The next visit in January 2013 finds that only eight of the 28 outstanding commitments are completed and the IFC is forced to ask Dinant to "move faster on ESAP [Environmental and Social Action Plan] implementation".¹⁸ At no point does this non-compliance trigger any kind of consequence regardless of the fact that it is in violation of Dinant's contractual obligations with IFC.

The IFC's response:

¹⁴ A IDB spokesman told the Financial Times, "In the case of Dinant, there was a significant shift in a number of matters surrounding the project that led us to reconsider. The political turmoil Honduras experienced in 2009 was one of the aspects affecting this decision. Other considerations included changes in Dinant's credit profile and its involvement in a controversy over real estate ownership." See: <http://blogs.ft.com/beyond-brics/2014/01/10/honduras-claims-worst-is-yet-to-come/?catid=677&SID=google#axzz2qMf5Ve3H>

¹⁵ See:

http://www.fian.org/news/article/detail/german_development_bank_withdraws_dinant_finance_in_response_to_human_rights_violations_in_bajo_agu/

¹⁶ President Kim Responds to Civil Society's Concerns on Private Sector Investments, Dec. 9, 2013, available at: <http://www.worldbank.org/en/news/press-release/2013/12/09/statement-world-bank-group-jim-yong-kim-civil-society-private-sector-investments>.

¹⁷ CAO investigation p. 20.

¹⁸ CAO investigation pp. 48-54.

In its response to the CAO's findings on its failure to supervise compliance with PS4, the IFC prescribes more of the same in its Action Plan: more training of staff, screening of security guards, more corporate social responsibility projects, and the setting up of a grievance mechanism. For example, the Action Plan says that "Dinant will continue to collaborate with proper authorities to investigate any credible allegations of unlawful or abusive acts of its security personnel". This is in a context of total impunity – where not one of the deaths associated with the land conflict in the Aguán Valley has resulted in a successful prosecution. As Human Rights Watch¹⁹ has put it, "the IFC is leaving the job to the fox that raided the chicken coop in the first place".²⁰

The Action Plan merely re-states what the IFC is anyway obliged to require by Performance Standard 4, but has failed to meet to date: PS4 also provides that the "client will investigate any credible allegations or abusive acts of security personnel, take action (or urge appropriate parties to take action) to prevent recurrence, and report unlawful and abusive acts to public authorities where appropriate."

Nor does the IFC acknowledge the documented issues with Dinant's contracted security company. The report from the UN Working Group on Mercenaries²¹ states that one of the firms hired by Dinant is Orion. As per paragraphs 38 and 39 of the report, Orion's security guards are allegedly those responsible for the murders of five farmers at El Tumbador in November 2010, and that witness accounts state that they were using prohibited weapons (AK47s and M60s).

An Action Plan which proposes more of the same engagement with Dinant on security issues that has been proven to fail to date is not acceptable in such a volatile and sensitive context. Human lives are at stake, yet the IFC is refusing to take its human rights obligations seriously.

In its response to the CAO's overwhelming evidence of IFC's sustained negligence over Dinant's failure to comply with its standards, the IFC merely proposes to increase the number of monitoring and supervision discussions rather than committing to enforce the company's compliance. Furthermore, the response's mention of "intensified supervision" with visits in 2011, 2012 and 2013 sidesteps the issue as to how it took the IFC over a year and a half to react to a crisis that had been worsening significantly since 2009. The response also omits mention of the highly unsatisfactory findings from these visits in terms of Dinant's non-compliance with its obligations. To say that Dinant had taken "significant strides forward" is contradicted by its own supervision reports, cited by the CAO²², which show Dinant failing again and again to comply.

The IFC's response to its repeated failures to bring Dinant into compliance is at best disingenuous and at worst deliberately misleading. More frequent monitoring and supervision will achieve nothing if the IFC does not enforce compliance with its own standards.

3. Systemic issues uncovered in the CAO investigation

The CAO finds that the problems at IFC which led to the failures it documents stem not from deficiencies in its policies, but from a lack of their implementation.

The CAO states that while "the overall approach outlined in the Sustainability Framework is one which CAO finds to be applicable in conflict and non-conflict scenarios"²³, "IFC non compliance identified in the report are due in large part to problems with the interpretation and application of existing policies and procedures"²⁴.

¹⁹ <http://www.hrw.org/news/2014/01/10/world-bank-group-inadequate-response-killings-land-grabs>

²⁰ The CAO notes that the "IFC failed to require an adequate root cause analysis in relation to the serious incidents that were occurring around the project (ESRP 6. v.5, para 2.2.)." At a minimum, the IFC should commit to conduct such an analysis.

²¹ http://reliefweb.int/sites/reliefweb.int/files/resources/A-HRC-24-45-Add1_en.pdf

²² See CAO investigation pp. 48-54.

²³ CAO investigation p. 10.

These problems arise because:

“The combination of client relationship, operational and compliance functions within project teams can generate conflicts of interest and conflicting incentives for staff and management.”²⁵

The CAO finds “a culture of risk aversion at the Bank”:

“In a risk averse setting, accountability for results defined primarily in financial terms may incentivize staff to overlook, fail to articulate, or even conceal potential environmental, social and conflict related risks.”²⁶

Staff at the IFC recounted to CAO an institutional culture that encouraged lending at the expense of social and environmental impacts:

‘there was pressure to grow the agribusiness portfolio at the time the Dinant investment was processed and that the investment department was thus highly motivated to “get money out of the door” with little regard for E&S concerns. The same interviewee noted that this was leading to investments in clients who were very weak from an E&S perspective.’²⁷

Anonymous interviews carried out by CAO with IFC staff revealed they (rightly) feared for their jobs if they raised concerns:

“E&S staff who “make waves” are disadvantaged when it comes to decisions around promotions and pay increases.”²⁸

Indeed the lead social and environmental specialist on the Dinant case was replaced for raising compliance concerns:

“When a more “compliance based” approach to the supervision of the Dinant investment was thus raised, CAO finds that this elicited push back from the IFC portfolio manager as a result of which the lead environmental specialist working on the project was replaced.”²⁹

Crucially, CAO found that although staff knew about problems they did not feel able to raise them:

One interviewee said that IFC knew from experience that “land is the number one issue in most palm oil investments”; and that “they all [oil palm investments] have unresolved land issues, it is just a matter of looking.” But that “staff did not feel as though they could rely on support from their management in addressing contentious issues”³⁰

The IFC’s Response:

The IFC’s response does not acknowledge or address these issues of systemic failure and instead claims that under the new 2012 Performance Standards, many of the findings of the CAO are addressed.

The IFC’s claim that recent policy changes could address many of the failures identified by the CAO is without basis in fact. The CAO’s findings are clear in concluding that it is not policy failures but rather

²⁴ CAO investigation p. 10.

²⁵ CAO investigation p. 10.

²⁶ CAO investigation p. 10.

²⁷ CAO investigation p. 26.

²⁸ CAO investigation p. 57.

²⁹ CAO investigation p. 54.

³⁰ CAO investigation p. 26.

failures in their implementation that is at fault – so further policy changes would make little to no difference if staff will not implement them. On the contrary, the IFC's response fails to address even one of the 15 systemic underlying causes for the failures identified by the CAO.³¹ Without acknowledging what went wrong, the IFC cannot hope to avoid repeating the same mistakes in the future.

4. Failures not limited to this case

The CAO investigation also uncovered further IFC support to Dinant, and triggered the announcement on 4 December 2013 of a second investigation into IFC's conduct. Despite IFC's knowledge of the land conflicts and human rights violations and abuses in the Aguán Valley, it went ahead with a further loan to one of Dinant's main investors, Banco Ficohsa. The CAO's appraisal of the case found that IFC documentation around this investment "does not reveal reference to violent conflict around Dinant properties, of which IFC was aware at the time."³²

IFC began its investment in Ficohsa in 2008 and directly in Dinant in 2009. By 2010, the conflict and allegations surrounding Dinant's involvement in the Aguán Valley were in the public eye, and in early 2011, the head of IFC sent a letter to Honduran President Lobo regarding the situation with Dinant. Five months later, however, in May 2011, IFC made a \$70 million investment in Ficohsa, despite knowing Dinant's role as its third largest client and the deteriorating situation surrounding Dinant on the ground.

IFC investment in financial intermediaries – like Ficohsa – has come under recent scrutiny. In February 2013, the CAO published an audit³³ showing that IFC "knows very little" about the environmental and social impacts of its lending to financial intermediaries such as private equity funds and commercial banks, which amount to around half of IFC's total lending.

The CAO investigation on financial intermediaries demonstrated that IFC doesn't know where its money is going. But this latest revelation about Ficohsa shows that even when the IFC does know the risks, it turns a blind eye to the impacts of its lending. The IFC knew that Ficohsa was financing Dinant, it knew that Dinant was caught up in a land conflict and yet it continued to invest in Ficohsa.

CSO demands

In the light of CAO's findings, international and Honduran CSOs, including Movement of Unified Campesinos in Aguan (Honduras), Movimiento Madre Tierra (Honduras), CIFCA, FIAN, Plataforma Interamericana de Derechos Humanos, Democracia y Desarrollo, Oxfam, ActionAid International, Rights Action, Asociación Interamericana para la Defensa del Ambiente, the Centre for Research on Multinational Corporations (SOMO), Global Witness, Urgewald, the Bretton Woods Project, the Center for International Environmental Law, Forest Peoples Programme, COFADEH (Honduras), Accountability Counsel, GRAIN, Rel-UITA, Latindadd, BankTrack, Inclusive Development International, The Corner House, Re:Common, Habitat International Coalition, Latin America Office (HIC-AL), Carbon Market Watch, Rettet den Regenwald, Yayasan SETARA Jambi, erlassjahr.de/Jubilee Germany, Eurodad, Centre national de coopération au développement, CNCD-11.11.11, International Human Rights Clinic, Indigenous Peoples Links, GMB, Honduras-Forum Switzerland, Ecologistas en Acción, Robin Wood, Both ENDS, Biofuelwatch UK/US, the Norwegian Coalition for Debt Cancellation, the Social Justice Committee of Montreal Canada, KOSID and Mani Tese, call on the IFC to:

1. **Halt any further disbursements** to Corporación Dinant, including the pending second \$15 million tranche, and abstain from resuming it until a) the material and intellectual authors of the crimes and

³¹ For a full list of these underlying causes, see CAO investigation pp. 56-57.

³² http://www.cao-ombudsman.org/cases/document-links/documents/CAO_Appraisal_Ficohsa_C-I-R9-Y13-F190.pdf

³³ See http://www.cao-ombudsman.org/documents/Audit_Report_C-I-R9-Y10-135.pdf

human rights violations committed against organised farmers and their supporters in the Aguán Valley have been brought to justice. If Dinant is found to be responsible for any of these crimes and human rights violations, then the IFC should terminate its relationship with Dinant immediately; and b) a comprehensive, just, peaceful and sustainable resolution is provided to the conflicts over land between the Corporación Dinant, the state of Honduras and the local farmers' movements;

2. Commit to **address affected communities' concerns**, including by requiring its client, Dinant, to halt all violence directed at local farmers and to find a peaceful and sustainable resolution to conflict over land;
3. Implement a **consultation mechanism** that involves the farmers' organizations in the development and implementation of a much stronger and more comprehensive action plan to correct the deficiencies highlighted by the audit;

Commission an independent investigation **on the security firm which is** contracted by Dinant and being trained under the IFC action plan, as it has allegedly been involved in human rights abuses in other areas of Honduras. In addition, the farmers' organisations from the Aguan Valley demand that the World Bank does not continue to fund corporations and projects that result in the monopolisation of natural resources and the displacement of communities and indigenous peoples.

We regard this as a **test case for President Kim's commitment to learn from past mistakes**. While we welcome Kim's assurance that he will personally monitor the IFC's action plan³⁴ and commitments in this case, the IFC's proposed action plan is totally inadequate in relation to systemic failures identified in the CAO investigation.

In response to a similar CAO investigation in 2009³⁵ also about IFC's investment in a palm oil company, which revealed systemic failures at the IFC, then-President Robert Zoellick reacted swiftly and decisively to enact reforms. Announcing a World Bank Group-wide moratorium on palm oil investments, Zoellick told CSOs:

*"I share your concerns about the detrimental effects of palm oil development when sound environmental and social practices are not followed...I agree that the CAO audit highlighted important deficiencies in IFC's past approach. I have directed IFC management to take all necessary steps to ensure that the problems identified in the CAO audit are not repeated."*³⁶

We therefore call on President Kim to ensure the **IFC learns lessons from the systemic failures** identified in the investigation and enacts specific systemic reforms so that future IFC investments do not result in breaches of this gravity. In particular:

This action plan should immediately be withdrawn and re-written to address the serious failures in IFC's due diligence processes highlighted in this investigation, and include:

1. **Commissioning an independent investigation of the underlying systemic reasons** identified by the CAO for the repeated and serious failures to adhere to standards by IFC staff. In particular this would address what the CAO calls the 'risk averse' culture at the IFC, where "accountability for results defined primarily in financial terms may incentivize staff to overlook, fail to articulate, or even conceal potential environmental, social and conflict related risks."³⁷ This investigation should also propose measures to address and rectify these systemic failures;

³⁴ <http://www.worldbank.org/en/news/press-release/2013/12/09/statement-world-bank-group-iim-yong-kim-civil-society-private-sector-investments>

³⁵ http://www.cao-ombudsman.org/uploads/case_documents/Combined%20Document%201_2_3_4_5_6_7.pdf

³⁶ http://news.mongabay.com/2009/0909-palm_oil_ifc.html

³⁷ CAO investigation p. 10.

2. An admission from IFC CEO Jin Yong Cai of the multiple failures identified by the CAO;
3. Staff responsible for these failures, the continuing breaches of IFC policies, and the malpractice identified by the CAO should be held to account;
4. A commitment to **carry out human rights impact assessments** in high risk countries and those with a documented culture of impunity;
5. A commitment to consider in their assessments, the findings of UN human rights monitoring bodies as well as regional human rights systems;
6. Credible consultation with affected communities, including Free, Prior and Informed Consent where applicable for projects taking place on or with impacts on their lands;
7. A commitment to conflict-sensitive investments that promote long-term peace and reconciliation.