

Priorities for new leadership at FMO

SOMO / Both ENDS / Oxfam Novib

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Introduction

In the past years SOMO, Both ENDS and Oxfam Novib have been actively engaging with FMO on a range of issues to improve FMO's sustainability and human rights policies and practices. These topics have been discussed through different channels. In addition to our quarterly dialogues with the bank, we have engaged individually, jointly or through multi-stakeholder engagement, including: the Dutch banking agreement, research publications¹, the Dutch LANDdialogue, monitoring specific cases,² and submissions with partners in the Global South on proposed investments. We believe this engagement has contributed to welcome reforms at FMO, including the strengthening of its human rights commitments, through a human rights defenders early warning screening, human rights context analysis, and a position statement on land governance.

Despite these positive changes, there is much more to be done, especially in the areas of transparency and accountability, vital to sustainable development. FMO's disclosure policy, especially as it relates to lending through financial intermediaries, lags behind its peers. FMO's responses to concerns raised about non-compliance – either through the Independent Complaints Mechanism or other channels – often do not demonstrate a true commitment to ensuring that the costs of development are not borne by poor and marginalized communities. And those are perhaps the easiest changes to make, as they involve policy fixes. More difficult are the changes in culture needed for FMO to adopt a people-centered approach to development – to ensure development is no longer about people, but with people. FMO needs a change in mindset. The recent change in leadership at FMO creates an opportunity for a new direction.

Below we provide a more in-depth analysis of our priorities for a changed mindset and improved responsible investment performance at FMO. In brief, we recommend that FMO:

1. Establish its own, credible and direct lines of communication with project-affected people and CSOs;
2. Launch and consult publicly on a review of its Disclosure Policy;
3. Commit to prepare management action plans in response to complaints and establish remedy funds;
4. Launch and consult publicly on a mandatory Position Statement on Financial Intermediaries;
5. Develop a clear climate vision across all its operations, including public reporting on and targets to reduce emissions.

For each of these priority areas, we propose specific actions, along with timeframes, that FMO should take in order to demonstrate progress.

¹ Including: [Consent is everybody's business](#) on the application of FPIC by banks (Oxfam), and the [Glass half full? On The State of Accountability in Development Finance \(SOMO\)](#) and [Open Books](#), on transparency and financial intermediaries (Oxfam)

² Including: Barro Blanco, Aqua Zarca, Azito and Ciprel, Nachtigal, Salima

A change in mindset

FMO's mandate is to promote economic development. The private sector is simply the tool through which it strives to achieve this goal. FMO's interests and objectives will not always be aligned with its clients' interests and objectives. Instead, the interests and well-being of the people who are intended to benefit from FMO's investments should be its anchor. When viewed this way, local communities become invaluable partners in the development process, providing critical information about the investment context, the perceived risks of the project, whether and how benefits have been received. Concerns raised by local communities should cease to be an inconvenient distraction to be addressed solely by FMO clients, rather they are warning flags that are central to the development outcome of the investment. Information about how the project will affect the lives of local communities will no longer be considered the property of FMO's clients to be disclosed or not at their discretion, but rather FMO must proactively ensure that this information is shared with communities. This should be seen as part of the meaningful fulfilment of communities' rights throughout the development process.

The signal to change the culture of FMO must come from the top. The new CEO must acknowledge that FMO does not have all the information or all the answers. He or she must reward, not discourage, staff from engaging openly with communities and CSOs, especially in difficult times. The CEO must allocate sufficient budget for local stakeholder engagement. He or she must welcome criticism as an opportunity for learning and improving outcomes.

1. *Communities as partners*

One lesson FMO learned from the COVID-19 pandemic was that it is overly reliant on its network of consultants to provide it with information about potential risks and benefits of its investments. Without them, FMO is essentially flying blind without the ability to verify what its clients say. To address this gap, FMO must have its own, direct lines of communication with project-affected people and CSOs. It is not, as FMO has previously asserted, solely within the clients' purview to communicate with those affected by its investments. It is a necessary part of fulfilling its own responsibilities to ensure stakeholder engagement is undertaken in a robust way, especially in contexts where there is limited civic space. During the due diligence phase, FMO should ensure it has a diverse network of sources of information, including local, regional and national civil society organizations. Additionally, it should be clear how the information collected during this phase influences the decision making. Similar sentiments are expressed in the recent FMO-A Evaluation: *"Engaging with a wider set of stakeholders rather than relying on clients for information is crucial to identifying and managing E&S risks. Before, during and after investments are made, FMO could engage more proactively with a wider set of stakeholders than is currently the case."*³⁴ We ask of FMO to have established credible and direct lines of communication with project-affected people and CSOs by the end of 2021.

³ Evaluation of FMO, November 2020, p. x-xi

⁴ A recent external review of the International Finance Corporation's accountability framework made a finding that is equally applicable to FMO: "IFC/MIGA also need to recognize that interacting directly with affected people, including complainants, is often a necessary and effective means to (1) understand issues and options; (2) help solve the issues of concern by providing well-informed advice to the client; and (3) demonstrate IFC/MIGA commitment to affected people."

Proposed actions:

- Create an action plan, including timeframe, for establishing credible and direct lines of communication with project-affected communities and CSOs as part of FMO's due diligence before, during and after investments by end of Q4 2021.
 - Consult CSOs on the action plan
 - Ensure that precautionary protective measures are developed for vulnerable communities/CSOs.
 - Publicly launch the action plan by the end of Q4 2021.
- Organize credible and direct dialogues with project-affected communities/CSOs during Q4 2021. In the coming period, the signatory organizations offer their support in identifying project-affected communities and local CSOs for FMO to establish meaningful dialogue with by the end of Q4 2021.

2. Transparency

The information disclosed by FMO and its clients is not sufficient for the purposes of accountability to its stakeholders and respect for the rights of affected communities to information about activities that will affect them. FMO should provide more detailed information about its investments on its website both to demonstrate it has implemented its commitments and as a backstop in the event its client fails to provide information to project-affected communities directly. FMO should also require and more closely supervise its clients in proactively publicly sharing information relevant to community livelihoods and well-being.

Reporting on investment risks provides stakeholders the assurance that FMO has done its due diligence. As research done by International Accountability Project has demonstrated,⁵ FMO shares only minimal information about the specific risks of the investment and the steps to be taken to address those risks. In addition to elaborating more on the environmental and social risks, which are typically disclosed at other DFIs, FMO should also share the outcome of its analyses on human rights impacts and risks to human rights defenders. When an investment triggers the requirement for broad community support or free, prior, and informed consent, FMO should share a summary of the process undertaken to obtain and monitor it. FMO already shares a fairly generic description of the development outcome of the investment, but it should also provide detailed information about the benefits that the project-affected community will receive as a result of FMO's investment.

Project-affected communities must have access to any and all information produced by FMO or its client about how the investment may affect them, in a manner and language accessible to them. That includes all environmental and social assessments that have been conducted and the environmental and social action plan (ESAP) developed to address those risks. By design, the IFC Performance Standards, on which FMO bases its approach, leave a lot of room for discretion in their interpretation. The Performance Standards also allow the client to come into compliance over the life of the investment. The ESAP and the contract are the only documents containing the specific requirements applied to the project and by when the client must meet them, but neither are publicly disclosed by FMO or its client despite the fact that Performance Standard 1 requires that the client disclose all action plans to project-affected communities. Clients should also be required to disclose the availability of FMO's Independent Complaints Mechanism. There is little point

⁵ https://accountabilityproject.org/wp-content/uploads/2021/02/FINAL-In-Practice_-Information-Disclosure-at-FMO-1.pdf

maintaining a complaints mechanism if no one knows about it. FMO's Evaluation⁶ recommends the following: *"FMO's Independent Complaints Mechanism is a valuable innovation that is unusual among bilateral DFIs, but could have more visibility among local stakeholders and more could be done to ensure that initial recommendations are followed up on and documented"* and on E&S and non-financial additionality also recommends to *"Publicise widely, and require investees to publicise widely, the existence of the Independent Complaints Mechanism in the local language of the countries of operation."*⁷

Proposed actions:

- Clarify the envisioned steps involved in the roadmap on the review of FMO's Disclosure Policy, including timeframes. As part of this FMO should:
 - Develop an Access to Information policy to replace the outdated Disclosure Policy
 - Initiate public consultation on the new policy.
- For each of FMO's investments, the new policy should require disclosure of the following:
 - Copies of ESIA's
 - Copies of ESAPs, showing how risks have been avoided and/or mitigated
 - Information on how BCS and FPIC have been obtained and are monitored throughout the project lifecycle
 - Details related to benefits brought by FMO's investment to local communities
 - Investments of its private equity clients as well as name, sector and location of higher risk sub-projects of its commercial bank clients.
- Require clients to disclose, by contract, references to the ICM in the local language of the client's countries of operations.
- For all of the above, create a credible and ambitious timeline, with all results visible by the end of 2022.

3. Accountability

Things are going to go wrong. When they do, FMO should be open and willing to hear criticism. It must not regurgitate the assertions of its clients, marginalize those with grievances, or unilaterally impose solutions. And it must play a role in providing for remedy when its client is unwilling or unable to do so.

As is the case with all independent accountability mechanisms (IAMs), FMO's Independent Complaints Mechanism (ICM) does not have the authority to order remedy if it finds that harm occurred as a result of an FMO-financed activity. That responsibility rests with FMO management. And yet, as with other DFIs, management often fails to respond adequately to ICM's findings. FMO's Evaluation report, Annex C p. 87 states that *"In conclusion, for each of the four admissible complaints, there is either insufficient progress or insufficient documentation of progress made since the complaint has been made."* As the IFC/MIGA External Review described it: *"All IAMs face difficulties in supporting effective remedial actions, albeit to differing extents. The frustration of*

⁶ Evaluation of FMO, November 2020

⁷ Also: The IFC/MIGA Review's recommendation is clear on this point, that IFC must ensure clients "provide information to affected communities both about the client's grievance mechanism and about CAO" including for "FI sub-projects." It goes on, "IFC/MIGA supervision should ensure that clients are meeting this responsibility, in part by surveying diverse community members regarding their awareness of the client's grievance mechanism and the existence and work of CAO."

complainants who may wait years to benefit from remedial actions after a long compliance process is generally described as ‘the last mile problem.’ Complainants’ claims might have been substantiated as the compliance process recognizes non-compliance and related harm, but in many cases (during “the last mile”), their harm is addressed only partially, or not at all.”⁸ We ask FMO to adopt two reforms to address this gap.

- Prepare Management Action Plans (MAP) that lay out a detailed, operational, time-bound set of actions to correct non-compliance and address harm. IFC/MIGA’s External Review noted the absence of such a requirement at FMO: “All IAMs of the IFIs, other than CAO and ICM (DEG-FMO-Proparco), require Management to present a Management Action Plan after (or concurrently while) their respective Boards have received a compliance investigation report.”⁹ Complainants should be consulted in the preparation of the MAP, as is standard practice at other institutions.
- Ensure that sufficient resources are available to remedy the harm. Applying the analysis done by the Dutch Bank Sector Agreement, IFC/MIGA’s External review determined that a finding of non-compliance would be sufficient to establish some degree of contribution by the IFC.¹⁰ The review made the following recommendation that is equally applicable to FMO: “Two mechanisms should be established to fund remedial actions: (1) contingent liability funds from the client that can be tapped in the event that E&S harm materializes and is linked to the client’s failure to meet the Performance Standards; and (2) funds that the IFC/MIGA can contribute in the event that IFC/MIGA has/have contributed to E&S harm.”¹¹

Proposed actions:

- Introduce a formal requirement to prepare a Management Action Plan in instances of non-compliance or harm.
- Create mechanisms and allocate sufficient funding that enables adequate remedial action.
- Create a credible and ambitious timeline for the above, with all results visible by the end of 2022.

4. Financial Intermediaries

Financial institutions (FIs) is FMO’s largest sector. Yet it is also the most opaque both in terms of what standards apply to those investments and the destination of those funds beyond the FI¹² FMO

⁸ External Review of IFC/MIGA E&S Accountability, including CAO’s Role and Effectiveness Report and Recommendations, June 2020. Para. 313

⁹ Para. 315 (emphasis added).

¹⁰ Para. 324

¹¹ Para. 333

¹² External Review of IFC/MIGA E&S Accountability, para. 27 (“[T]he complexity, diversity, and limited transparency of IFC’s instruments for FI investments create challenges for affected stakeholders to raise concerns with IFC/MIGA and with CAO...To address these challenges, IFC should enhance the transparency of IFC-funded portfolios and sub-projects. The Review Team supports the recent commitments made by the World Bank President to disclose FIs’ Category A sub-projects (those with potential for significant adverse E&S risks/impact) and climate finance Category B sub-projects (those with potential for limited adverse E&S risks/impacts) on IFC’s website, where legally permissible. IFC should seek ways to extend further the scope of FI disclosure of sub-projects.”).

should immediately disclose all investments of its private equity clients, as IFC has done since 2015, and the name, sector and location of all high risk investments of its commercial bank clients.

We have engaged FMO in a dialogue on its approach to FIs for many years, and yet it remains unclear exactly how FMO applies its human rights and environmental standards to this form of investment. FIs were explicitly excluded from FMO's first Human Rights Report and its new Position Statement on Fossil Fuel Lending, despite making up over a third of FMO's total portfolio. The draft Position Statement on Environmental, Social & Governance Standards for Financial Intermediaries still fails to make this clear. Meanwhile, an internal evaluation by FMO shows that 60% of FI-A and B+ clients have red or amber scores on E&S due diligence, establishing external E&S agreements and E&S monitoring and follow-up. In other words, a majority of FMO's FI portfolio does not seem to meet FMO's own standards. FMO's E&S experts confirm that the current challenges are with actual implementation.¹³ It is well past time that FMO is transparent about how it assesses and mitigates human rights and environmental risks of its FI investments.

In the consultation call on 4th May 2021 on the draft Position Statement, FMO expressed that the document is seen as a reflection of current practices rather than a review of the current approach to FIs. In this case, FMO should formulate a far stronger FI Position Statement based on feedback provided on the draft. In addition to this, FMO should urgently prioritize initiating a revision of its FI approach based on the feedback provided as part of the current consultation, and include disclosure and human rights due diligence as priorities.

Proposed actions:

- Revise the draft Position Statement on Financial Intermediaries based on the inputs provided to FMO by the CSOs' joint submission dated 16 April. In particular, ensure that the revised Position Statement includes detailed information on:
 - Improved monitoring and supervision of high risk clients and sub projects
 - Improved development outcomes, including climate action
 - Transparency
 - Access to remedy
- Ensure that a revised draft of the Position Statement on Financial Intermediaries is open to new public consultations
- Create a credible and ambitious timeline for the above, with all results visible by the end of 2022.

5. Climate

The climate is changing fast and the world needs urgent action. FMO has the opportunity to take a leading role in climate action and to put forward a vision that ensures that its investments across all sectors contribute to tackling the climate crisis. FMO has already recognized the climate emergency and made it central to its strategy. In order to put these words into policy and practice, we encourage FMO to be bolder in its climate action commitments.

In October 2020, FMO disclosed a long overdue statement on Phasing Out Fossil Fuels for consultation, showing the Bank's willingness to increase its climate action commitments. However,

¹³ EVALUATING FMO INVESTMENTS IN FINANCIAL INSTITUTIONS, FMO Evaluations, July 2020

the draft statement makes allowances for fossil gas as a transition fuel¹⁴, meaning investments in the fossil gas sector remain possible in exceptional cases where it is considered that there are no viable alternatives. Yet FMO is not transparent on its definition of exceptional cases and the methodology that will define the viability of available alternatives and situations in which fossil gas investments are considered necessary. Furthermore, the statement does not apply to indirect investments, which form over a third of FMO's portfolio. This simply leaves too much room for FMO to continue to invest across the fossil fuel supply chain. The position statement on coal even leaves room for FMO to continue to invest indirectly in the coal sector. FMO needs to rapidly raise the bar on ruling out fossil fuel investments. It would do well to consider the new position of the UK government which is excluding fossil fuels from all forms of public support¹⁵.

Additionally, FMO has developed two technical papers on how to align its strategy with the Paris agreement.¹⁶ Although these papers mark a beginning of FMO's ambitions to improve its climate impact reporting, discussions with CSOs on the accounting approach and steps towards implementation are still absent. As set out in the *Priorities for Public Climate Finance in the Year Ahead*, which sets out the priorities for Public Climate Finance leading up to COP26,¹⁷ clear methodologies, timelines and action plans on how alignment with the Paris Agreement will take place need to be published. FMO's strategy on this needs to be strengthened.

The potential climate impacts of FMO's investments extend beyond the energy sector, of course. Agribusiness, Food and Water represents another key investment sector for FMO, with its portfolio including investments in large-scale agricultural monocultures and forestry plantations. This is particularly concerning given that this industrial production model has had a significant impact on the global climate: the global agricultural sector has the second highest emissions after the energy sector.¹⁸ Such investments in large-scale plantations do not fit within a strategy that works towards Paris alignment. FMO needs urgently to develop a methodology to structurally report on the impacts of its agribusiness, food and water portfolio on climate change. As a consequence, FMO should develop a vision on how to ensure investments in this sector contribute to complying with the Paris Agreement.

In sum, the new CEO has the opportunity to show that FMO will be a frontrunner in meaningful and effective climate change action. We ask FMO to develop and implement a vision and strategy that integrate a holistic understanding of the entire portfolio's impacts on climate change.

Proposed actions:

- Revise the draft position statement to exclude gas from direct investments or clearly define the exceptional circumstances in which investments in gas are considered acceptable.
- Incorporate financial intermediary investments into the draft Position Statement on Phasing out Fossil Fuels.

¹⁴ At page 78, the FMO Evaluation A report recommends "Expand the FMO position statement on coal power to cover other fossil fuels (oil and gas) as part of FMO's broader climate change commitments."

¹⁵ <https://www.gov.uk/government/news/pm-announces-the-uk-will-end-support-for-fossil-fuel-sector-overseas>

¹⁶ <https://www.fmo.nl/climate-action>

¹⁷ <https://2nsbg1gn1rl23zol93eyrccj-wpengine.netdna-ssl.com/wp-content/uploads/2021/01/PRIORITIES-FOR-PUBLIC-CLIMATE-FINANCE-IN-THE-YEAR-AHEAD.pdf>

¹⁸ <https://www.wri.org/blog/2014/05/everything-you-need-know-about-agricultural-emissions>

- Develop and publish a timebound action plan on how FMO envisions its alignment with the Paris Agreement, including reports on the impacts of its agribusiness, food and water portfolio.
- Create a credible and ambitious timeline for the above, with all results visible by the end of 2022.

We welcome the opportunity to engage with you and your staff on these issues and we would like to jointly explore how we can strengthen the engagements on the management level, to ensure an effective added value to the existing quarterly dialogues. We wish you much success in your new position.

Sincerely,

Both ENDS
Oxfam Novib
SOMO