



Forest Peoples Programme

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Robert B. Zoellick
President
International Finance Corporation
2121 Pennsylvania Avenue NW
Washington DC 20433, USA

14th August 2009

Dear Mr Zoellick and members of the IFC Board,

IFC Compliance Failures in Oil Palm Sector must be followed by Effective Action

We are writing to you following the public release on 7th August 2009 of the CAO audit report dated 19th June 2009 on IFC's investments in the Wilmar Group together with the Management Response dated 4th August 2009. These reports constitute the main response to date to the compliance failures by the IFC which we brought to your attention at the time of our complaint to the CAO of July 2007.

The audit report reveals shocking and systematic compliance failures by IFC staff in making loans and investment guarantees to one of the world's largest transnational palm oil trading companies, Wilmar International. The audit report confirms that:

- From previous projects, IFC staff knew of the environmental and social risks in the palm oil sector, including unresolved land disputes and non-compliance with its social and environmental standards, but chose to ignore the risks (see pages 11-20, 27)
- IFC investment staff overrode IFC procedures and the warnings of environment staff in order to speed investments (page 23)
- IFC staff mis-categorised investments as 'low risk' (Category 'C') to avoid safeguards and to avoid applying their own performance standards (page 22, 25, 26)
- IFC staff implied reliance on the procedures of the newly formed Roundtable on Sustainable Palm Oil, when they knew these procedures were not yet in place (page 24)
- IFC staff persuaded the IFC Board in 2001 to lift a halt on lending to the sector, aware of its problems, by making promises that they would develop a strategy for engagement, yet eight years later they have still not done so (page 24, 27)
- IFC staff failed to assess the impact of its investments in terms of the supply chain (page 27) and skimmed procedures to avoid applying its standards (page 27)
- In later investments, IFC staff failed to apply its performance standards even after they had been tightened (page 27)
- IFC failed to assess the Wilmar Group's operations in terms of compliance with national laws, although such a lack of compliance has since been admitted by Wilmar (page 28)
- These actions are found to have been 'counter-productive to IFC's mission of reducing poverty and improving lives' (page 27)
- Underlying these failures was a determination by staff to allow commercial pressures to override the application of IFC's standards (page 30).

These violations are even more egregious given that IFC staff already knew about the serious problems in the oil palm sector and had already been directly warned by us of the problems besetting the Wilmar group of companies, which was aggressively expanding its 'land bank' in Borneo and Sumatra. Furthermore, even while IFC was subject to an IFC Compliance Advisory Ombudsman procedure and the Ombudsman team had clearly identified, and was seeking to mediate in, serious land conflicts between communities and Wilmar group companies in Sambas district, IFC staff persisted in ignoring the situation and prepared a further loan to the Wilmar Group. It saddens us to note that the IFC Board agreed to this further loan (23rd October 2008), even though IFC staff were again in violation of procedures, and even though we had appealed directly to you and all the members of the Board not to approve it.

We have also taken care to review the 'Final IFC Management Group Response' to the audit. We note that IFC management now belatedly accepts that there were errors in the way its procedures were applied and accepts that IFC did lack a strategy for engagement in the

sector. IFC Management partially agrees that investments in palm oil should be categorised as higher risk (Category 'A' or 'B'), should trigger application of its Performance Standards and that it should examine implications in the supply chain - an area of work that it finds challenging and says requires greater rigour. It agrees that it needs to develop a strategy over 'the next three months' for its future engagement in the sector and that it looks to the RSPO to help guide this. It promises to be more selective in the future and to work 'only with clients who recognise the environmental and social sensitivity of their operations' (something that the Performance Standards require anyway). It also promises to take account of the audit report in its own review, and possible revision, of its Performance Standards.

We find this response inadequate.

In the first place, it is clear to us, and the audit confirms this, that IFC suffers a systemic problem whereby the pressure to lend and to support business interests overcomes prudence, due diligence and concern for social and environmental outcomes. No actions are proposed to address this problem.

Secondly, the Management Response provides no contextual analysis of the wider problems within the palm oil sector in Indonesia, instead an Annex to the management response only puffs the potential benefits. As our own documentation has detailed and as the audit report confirms, the palm oil sector in Indonesia suffers endemic problems which are not limited to one company or group of companies. These include:

- Host country failure to bring its laws and procedures into compliance with international laws ratified by Indonesia, (and see Annex 1)
- Failure to recognise the customary rights of local communities,
- Widespread land grabbing by companies with the connivance of local and national State agencies,
- Serious human rights abuses when communities object to the takeover of their lands,
- Extensive clearance of forests and peatlands,
- Illegal practices such as use of fire to clear lands,
- Massive CO₂ / GHG emissions from fires, forest clearance and peat drainage,
- Absence of compliance with environmental impact assessments,
- Abusive labour relations on estates,
- Exploitative relations between companies and smallholders.

We note in particular that in the Management Response:

- No actions are suggested to discipline IFC staff for systematic policy violations.
- No actions are recommended to stop IFC staff misleading the Board when controversial projects are presented for the Board's approval.
- No actions are proposed to remedy the wider problems still besetting the Wilmar group's operations in which IFC has so heavily invested.
- No actions are proposed to address the fundamental problem that the current land tenure laws and land acquisition procedures in Indonesia deny customary rights and encourage companies to take over communities' lands without their free, prior and informed consent.
- No actions are proposed to address the problems raised in our complaint that companies are planting on peatlands and burning forests, despite global concern about climate change being exacerbated by deforestation and land use change,

- Indeed no comprehensive action plan is presented to clarify what IFC staff will actually do to ensure future compliance with standards.

In the absence of a clear action plan and strategy, we call on IFC to suspend its support for the palm oil sector in Indonesia until these deficiencies are addressed.

Many private sector banks, such as the 'Equator Banks', look to the IFC for leadership in their lending procedures and use the Performance Standards to guide them. It is therefore all the more imperative that the IFC demonstrates responsible practice.

We ask that the Board give this matter detailed attention at its next meeting. We suggest that, in preparation for that meeting, the President and Board request from Management a credible and comprehensive action plan that sets out what IFC will do to:

- Discipline staff for non-compliance,
- Create a clear incentive structure that will discourage further poor staff performance and due diligence violations,
- Openly assess through a participatory review the fundamental problems in the sector which are beyond the control of any single company,
- Based on this review, develop an effective strategy for investment in line with the IFC's mission and its Performance Standards, open to input from the public, civil society organisations and indigenous peoples.

We look forward to learning how you plan to deal with this matter.

Yours sincerely



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