



AUDIT REPORT

CAO Audit of IFC
CAO Compliance

C-I-R6-Y08-F096
June 19, 2009

CAO Audit of IFC's investments in:

Wilmar Trading (IFC No. 20348)

Delta–Wilmar CIS (IFC No. 24644)

Wilmar WCap (IFC No. 25532)

Delta–Wilmar CIS Expansion (IFC No. 26271)

Office of the Compliance Advisor/Ombudsman (CAO)
for the
International Finance Corporation (IFC)
Multilateral Investment Guarantee Agency (MIGA)
Members of the World Bank Group



Executive Summary

Large-scale oil palm cultivation in Indonesia began in 1911. During the early years of the Suharto era (1967–98), state-owned agricultural enterprises were promoted - including large-scale oil palm plantations. In the 1970s and 1980s, smallholder involvement in oil palm cultivation was strongly promoted and was supported through World Bank/IDA loans that also supported plantations, crude palm oil (CPO) mills and related infrastructure. From the late 1980s, private estates played an increasingly important role in oil palm expansion, with and without associated smallholders. IFC financed one of its first oil palm projects in 1988 and, between 1990 and 2002, it concluded several investments with various palm oil producers.

Between 2003 and 2008, IFC made four different investments in the Wilmar Group: Wilmar Trading (IFC No. 20348); Delta–Wilmar CIS (IFC No. 24644); Wilmar WCap (IFC No. 25532); and Delta–Wilmar CIS Expansion (IFC No. 26271).

The Wilmar Group is one of the world's largest processors and merchandisers of palm and lauric oils, and one of the largest plantation companies in Indonesia and Malaysia. IFC's Wilmar Group investments included two investments in a trade facility to facilitate CPO trading and two investments in a refinery within the Group to produce higher value end products.

In July 2007, non-governmental organizations (NGO), smallholders and indigenous peoples' organizations living and working in Indonesia, or in support of people in Indonesia, filed a complaint with the CAO. The signatories claimed that the Wilmar Group's activities in Indonesia violated a number of IFC standards and requirements.

For more than twenty years, IFC had information at its disposal on significant governance as well as environmental and social risks inherent in the Indonesian oil palm sector. This came from World Bank experience; from the various IFC projects appraised in the sector and the country from the 1980s and onwards; and from monitoring and reporting on ongoing IFC oil palm investments in Indonesia. Despite awareness of the significant issues facing it, IFC did not develop a strategy for engaging in the oil palm sector. In the absence of a tailored strategy, deal making prevailed.

With regard to its Wilmar Group investments, IFC applied a *de minimis* approach towards assessing each project's supply chain. For each investment, commercial pressures were allowed to prevail and overly influence the categorization and scope and scale of environmental and social due diligence. As a result, IFC's development mandate and mission were not robustly represented in the decision-making processes. This had the effect of insulating IFC from obtaining key information as to how each project would impact the palm oil supply chain. Because commercial pressures dominated IFC's assessment process, the result was that environmental and social due diligence reviews did not occur as required.

Therefore, the CAO concludes that IFC did not meet the intent or requirements of its own Performance Standards for its assessment of the Wilmar trade facility investment.



Incorrect assumptions were made about the impact of certain types of financial products (trade facilities) without proper consideration of the sector and country context of the investment. As for the Wilmar refinery investment, IFC failed to assess the supply chain plantations or other companies and suppliers linked through the Wilmar Group, as required by its Performance Standards.

Finally the CAO concludes that the adoption of a narrow interpretation of the investment impacts—in full knowledge of the broader implications—is inconsistent with IFC's asserted role, mandate of reducing poverty and improving lives, and a commitment to sustainable development.



Contents

About the CAO

Acronyms and Definitions

Overview of the CAO Compliance Audit Process

Background and Scope of the CAO Compliance Audit of IFC

1. Overview and Background Relevant to IFC's Investments

2. CAO Findings

3. CAO Conclusions



About the CAO

The CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

The CAO (Office of the Compliance Advisor/Ombudsman) is an independent post that reports directly to the President of the World Bank Group. The CAO reviews complaints from communities affected by development projects undertaken by the private sector lending and insurance members of the World Bank Group, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

For more information about the CAO, please visit www.cao-ombudsman.org

Acronyms

AMR	Annual Monitoring Review
AMRR	Annual Monitoring Review Report
BACP	Biodiversity and Agricultural Commodities Program
BTO	Back-to-Office Report
CAO	Office of the Compliance Advisor/Ombudsman
CAP	Corrective Action Plan
CES	IFC's Environmental and Social Department
CIC	IFC's Corporate Investment Committee
CPO	Crude palm oil
CSO	Civil society organizations
EIA	Environmental Impact Assessment
ERS	Environmental Review Summary
ESRP	Environmental and Social Review Procedure
FFB	Fresh fruit bunches
FWI	Forest Watch Indonesia
GEF	Global Environment Facility
GFW	Global Forest Watch
ha	Hectares
IEG	Independent Evaluation Group
IFC	International Finance Corporation
MAM	Management Approval Memorandum
MIGA	Multilateral Investment Guarantee Agency
NES	Nucleus Estate and Smallholder program
NGO	Non-governmental organization
OED	Operations Evaluation Department (World Bank)
PKO	Palm kernel oil
PS	Performance Standards
PTP	Perseoran Terbatas Perkebunan (state-owned agricultural enterprises)
RSPO	Roundtable on Sustainable Palm Oil
SPI	Summary of Proposed Investment
WBG	World Bank Group

Definitions

Inti	nucleus estate
Plasma	participating farm household



Overview of the CAO Compliance Audit Process

When the CAO receives a complaint about an IFC or MIGA project, it first refers it to the *CAO Ombudsman*, which works to respond quickly and effectively to complaints through facilitated settlements, if appropriate. If the CAO Ombudsman concludes that the parties are not willing or able to reach a facilitated solution, the case is transferred to the compliance arm of CAO, *CAO Compliance*, to appraise the concerns raised in the complaint for a compliance audit of IFC or MIGA. A *compliance audit* may also be initiated by request from the President of the World Bank Group or senior management of IFC or MIGA.

A CAO Compliance Appraisal is a preliminary investigation to determine whether the CAO should proceed to a compliance audit of IFC or MIGA. Through CAO Compliance appraisals, the CAO ensures that compliance audits of IFC or MIGA are initiated only for those cases with substantial concerns regarding social or environmental outcomes.

The purposes of CAO auditing are to ensure compliance with policies, standards, guidelines, procedures, and conditions for IFC/MIGA involvement and thereby improve the social and environmental performance of investments and activities backed by IFC/MIGA.

CAO Compliance auditing focuses on IFC and MIGA, and how IFC/MIGA assured itself/themselves of project performance. In many cases, however, in assessing the performance of the project and implementation of measures to meet relevant requirements, it is necessary to review the actions of the project sponsor and verify outcomes in the field.

A compliance audit must remain within scope of the original complaint or request. It cannot go beyond the confines of the complaint or request other issues to be addressed. In such cases, the complainant or requestor should consider a new complaint or request.

CAO Compliance appraisals and audits consider how IFC/MIGA assured itself/themselves of compliance with national law, reflecting international legal commitments, along with other audit criteria. The CAO has no authority with respect to judicial processes. The CAO is neither a court of appeal nor a legal enforcement mechanism, nor is the CAO a substitute for international court systems or court systems in host countries.



Background and Scope of the CAO Compliance Audit of IFC

IFC has undertaken four investments in the Wilmar Group: Wilmar Trading (IFC No. 20348); Delta–Wilmar CIS (IFC No. 24644); Wilmar WCap (IFC No. 25532); and Delta–Wilmar CIS Expansion (IFC No. 26271).

IFC's involvement with the Wilmar Group started in 2003 with its first investment, followed by two further investments in 2006. In October 2008, IFC approved a fourth investment, the Delta–Wilmar CIS Expansion.

In July 2007, non-governmental organizations (NGOs), smallholders and indigenous peoples' organizations living and working in Indonesia, or in support of people in Indonesia, filed a complaint with the CAO. Besides representing themselves, the organizations filed on behalf of affected groups in the oil palm sector, including indigenous peoples and smallholders. The nineteen signatories, under the lead of Forest Peoples Programme, Sawit Watch and Serikat Petani Kelapa Sawit, claimed that the Wilmar Group's activities in Indonesia violated a number of IFC standards and requirements.

In November 2007, CAO Ombudsman disclosed a "Preliminary Stakeholder Assessment" report. Based on the division of topics made in the CAO Ombudsman report, CAO Ombudsman transferred IFC-related allegations to CAO Compliance for a compliance appraisal on two separate occasions. In March 2008, CAO Ombudsman transferred what was defined as "Topic 3: Issues related to the IFC". In December 2008, CAO Ombudsman transferred what was defined as "Topic 2: Issues related to Wilmar's compliance with national laws and procedures – particularly with respect to environmental permits and burning". For details on how CAO Ombudsman divided the complaint into three different topic areas, see the November 2007 CAO Ombudsman "Preliminary Stakeholder Assessment" report, available at www.cao-ombudsman.org.

On September 4, 2008, CAO Compliance concluded that the issues transferred from CAO Ombudsman in March 2008 merited an audit (see the CAO Compliance appraisal report at www.cao-ombudsman.org for details). CAO Compliance disclosed Terms of Reference for the audit on December 3, 2008.

CAO Compliance concluded on March 11, 2009 that the issues transferred from CAO Ombudsman in December 2008 merited an audit (see the CAO Compliance appraisal report at www.cao-ombudsman.org for details).

In late December 2008, the CAO Vice President initiated a compliance appraisal of IFC's fourth investment in Wilmar, the Delta–Wilmar CIS Expansion. CAO Compliance disclosed an appraisal report on March 11, 2009 that concluded that an audit was merited. As a result, the scope of the ongoing audit was expanded to include the fourth investment, but was limited to the issues transferred by CAO Ombudsman and originating from the July 2007 complaint to the CAO.



The overall objective of the compliance audit is to assess the reasonableness of IFC's approach to these investments based on its mission, policies, standards, experience, and guidance. This includes an assessment of:

- Whether the current procedures and established practices provide sufficient and correct guidance to IFC staff in assessing upstream supply chain issues to ensure that the outcomes of the investments made meet the intent of applicable policies, as well as IFC's mission and mandate.
- How IFC assured itself that these investments would achieve an outcome consistent with IFC's development mission, and how, during its review process, IFC considered earlier experiences of achieving sustainable development outcomes within the region, country, sector, and with the client.
- Whether the allocation of Category 'B' and 'C'¹ to these investments was reasonable, taking into account the specifics of the sector, the region, and earlier experiences.
- Whether the allocated categorization was consistent with IFC's environmental and social policies and standards at the time of the different investments.
- Whether IFC's rationale for defining the upstream supply chain as not associated with, and outside the area of influence of their investments was reasonable and correct, taking into account IFC's policies, mandate, and mission.

The scope of the audit also includes developing an understanding of the immediate and underlying causes for any non-compliance identified by the CAO.

The scope of CAO Compliance appraisals and audits is limited to the issues raised in the request, and related to the complaint. The CAO cannot accept an expansion of the scope defined in the request, or expand beyond issues related to the complaint.

A major underlying issue of concern for the CAO is how sustainable livelihoods are achieved, or secured, for the people impacted by IFC's investments.

Specific complainant concerns

The complainants further specified their concerns with respect to alleged violations of IFC Performance Standards and Safeguard Policies² in several particular contexts: compliance with applicable national laws, including host country obligations under international law; analysis of social and environmental risks and impacts in a Social and

¹ Categorization as defined in IFC's "Environmental and Social Review Procedures", <http://www.ifc.org/>
CATEGORY 'A': Projects expected to have significant adverse social and/or environmental impacts that are diverse, irreversible, or unprecedented. **CATEGORY 'B'**: Projects expected to have limited adverse social and/or environmental impacts that can be readily addressed through mitigation measures. **CATEGORY 'C'**: Projects expected to have minimal or no adverse impacts, including certain financial intermediary projects.

² <http://www.ifc.org/>

Environmental Assessment, and related action plans to address potential impacts; and assessments and actions related to provisions given for land acquisition and involuntary resettlement, for biodiversity conservation and sustainable natural resource management, and for indigenous peoples and cultural heritage.

The complainants raised the following specific issues in their complaint:

Incorrect categorization of the investments: IFC's involvement in Delta-Wilmar was classified as Category B. The other two IFC investments were classified as Category C. The complainants claim that the categorizations are incorrect because of supply chain issues, among other matters (*Addressed by the CAO in Findings 2.1.7, 2.1.8, 2.2.10, 2.2.11, 2.2.12, 2.5.7, 2.5.8, 2.5.9, 2.6.6, and 2.6.7*).

Violations of IFC policies and standards: The complainants claim that:

- The Wilmar subsidiaries are not complying with applicable national law, as required by IFC policies and standards (*Addressed by the CAO in Finding 2.8*).
- There are no social and environmental impact assessments or action plans publicly available for Wilmar subsidiaries, as required by IFC's standards (*Addressed by the CAO in Finding 2.8*).
- IFC gave no attention to Performance Standard 5, or to the prior policy on involuntary resettlement, when assessing the projects (*Addressed by the CAO in Findings 2.5.7, 2.5.8, 2.5.9, 2.6.6, and 2.6.7*).
- IFC gave no attention to Performance Standard 6, or to the prior policies and guidelines concerned with preserving biodiversity, when assessing the projects (*Addressed by the CAO in Findings 2.5.7, 2.5.8, 2.5.9, 2.6.6, and 2.6.7*).
- IFC gave no attention to Performance Standard 7, or to the prior policy on indigenous people, when assessing the projects (*Addressed by the CAO in Findings 2.5.7, 2.5.8, 2.5.9, 2.6.6, and 2.6.7*).

The complainants further state that the adverse impacts on the ground include (*Addressed the by CAO on a sector basis in Chapter 1*):

- Illegal use of fire to clear lands
- Clearance of primary forests
- Clearance of areas of high conservation value
- Seizing of indigenous peoples' customary lands without due process
- Failure to carry out free, prior, and informed consultations with indigenous peoples leading to broad community support
- Failure to negotiate with communities or abide by negotiated agreements
- Failure to establish agreed areas of smallholdings
- Social conflicts that triggered repressive actions by companies and security forces
- Failure to carry out or wait for approval of legally required environmental impact assessments
- Clearance of tropical peat and forests without legally required permits.



For this audit, as with all CAO audits of IFC, the objective is to provide greater clarity in relation to the steps that IFC took, or did not take, to assure itself of the performance and impacts of its investments. The overall scope is to assess IFC from a perspective of compliance with audit criteria related to the allegations put forward in the complaint. As part of the audit, the CAO seeks to develop an understanding of the causes for any non-compliance identified, which includes both the immediate causes and any underlying causes.

1. Overview and Background Relevant to IFC's Investments

The four IFC loans to Wilmar that are the focus of the CAO audit and this audit report have their roots in the development pattern of the oil palm industry in Indonesia. This brief background section introduces these topics, starting with a description of palm oil and its production in Indonesia (see box 1).

Box 1. Palm Oil and Products

Palm oil is derived from the fruit of the tropical oil palm tree, which originated in West Africa. Oil palms are grown for their multiple clusters of fruit, called fresh fruit bunches (FFB), which can weigh 40–50 kg each. Yields, which are highly dependent on sound agronomic practices and soil fertility, commence about 3 years after planting and peak after 5–10 years. The palms require replanting after approximately 25–30 years. In Indonesia, Malaysia, Papua New Guinea, and other countries, oil palms are cultivated by small farmers and by plantations. Fresh fruit bunches are harvested throughout the year and are processed within 24 hours into crude palm oil (CPO) and palm kernel oil (PKO) at mills located near cultivated areas.

Typically, plantation companies own these mills and process their own fruit, and fruit from smallholders under contract. CPO/PKO is used to produce a range of products including edible oils, cooking fats and soaps, and biofuels. Further refining and fractionation of CPO/PKO yields a wide range of higher value products (for industrial products and cosmetics, for example), and may take place in the producing country or be shipped for processing closer to end-product markets.

Global demand for CPO/PKO and derivative products is currently strong, and is expected to remain so, especially for cooking oil in major emerging markets, and for biofuels in developed markets. Indonesia and Malaysia have a strong comparative advantage and dominate world production and trade due to suitable growing conditions and cost factors.

1.1 Oil palm in Indonesia

Despite being introduced in Indonesia in 1848, oil palm was first cultivated in North Sumatra in 1875. Oil palm was grown only on plantations—unlike rubber, which developed strong support from small farmers in the early years. Large-scale cultivation began in 1911 in North Sumatra and Aceh, and by 1938 the area cultivated was close to 100,000 hectares (ha). Stagnation occurred in the 1940s and the Indonesian government nationalized all foreign-owned estates between 1958 and 1960. A decade later, the policy of nationalization was reversed.

In the 1960s and 1970s, Indonesia relied heavily on agriculture and to a lesser extent on forestry and fishing. With 80 percent of the country's 135 million people living in rural areas, the sector dominated the life and welfare of the Indonesian people. Rice contributed 30 percent of agricultural GDP and supply was growing slowly, as was the supply of other food crops. The main rural problems related to overpopulation, small farm size, and low productivity. The best soils are in Java, Madura, and Bali, all of which had intensive cultivation, and even marginal land was cultivated. On Java, one-third of the agricultural labor force was landless, and 40 percent of farm incomes were derived off-farm. With a rising population, the future looked bleak.

To address rural problems, the government's Second Five Year Plan (1974–9) listed its priorities as employment creation, balanced regional growth, social development, increased food crop production, and increased export crop production—especially rubber, to maintain Indonesia's market share. Strategies to support this accelerated land settlement included transmigration to bring some of an estimated 40 million hectares of "unutilized land", mostly on the outer islands, into smallholder food crop and tree crop production, plus a replanting program for rubber and coconut. The establishment of rural livelihoods based on oil palm development and other industrial tree crops was an important part of the government's strategy.

The early years of the Suharto era (1967–98) strengthened the role of the state and promoted state-owned agricultural enterprises (*Perseroan Terbatas Perkebunan*, or PTPs). These companies and private plantations were encouraged to plant large-scale oil palm as well as other industrial tree crops such as rubber, coconut, and tea. For oil palm, the government's intention was to ensure adequate supplies of affordable cooking oil for domestic consumers, promote industrial development, and boost non-oil exports.

In view of scarce technical and managerial capabilities, one of the main approaches selected by the government was to use the PTP corporations to plant tree crops on land to be settled by local landless families and transmigrants. The companies provided a range of services, including planting material, land clearing and planting, and procurement of inputs, and provided processing and marketing facilities to the smallholders. The World Bank and other major donors such as the Asian Development Bank (ADB) were invited by the government to assist in financing Nucleus Estate Smallholder (NES) projects and other projects that were based on the development of industrial tree crops.

1.2 WBG and NES programs

Smallholder involvement in oil palm cultivation was strongly promoted in the 1970s, which included support through seven World Bank/IDA loans under the Nucleus Estate and Smallholder (NES) program. Under the NES concept in Indonesia, a state-run or private-run company became the nucleus estate (*Inti*) of the system, and each smallholder (*plasma*, or participating farm household) was allocated 2 hectares per household for cultivation and 1 hectare for housing. Smallholders came from the area or were resettled from other areas.

The NES projects were implemented through a contractual arrangement between financial capital and technical expertise (for example, through a PTP's financial and technical resources, external loans, and government funds), human resources (for example, by settling landless people or villagers whose living conditions and skills were anticipated to be significantly improved), and available ("unutilized") land for perennial crop and food crop cultivation. The NES projects were expected to generate productive employment at relatively low cost and raise farm incomes of landless and near-landless families. The tree crops under the World Bank NES program were oil palm, rubber, and coconut, which accounted for significant shares of agricultural GDP and non-oil exports, as well as food crops. Other development agencies, including the ADB, Commonwealth Development Corporation, Gesellschaft Technische Zusammenarbeit (GTZ), and the International Fund for Agricultural Development, also supported projects under the NES program.

The World Bank-financed NES projects are well documented and have been the subject of analysis. Hundreds of thousands of rural jobs were created through the expansion of tree crops, especially in the eastern part of Indonesia, where poverty was of high concern. Tree crops grown on NES projects played an important role in poverty reduction, particularly where soils were not suitable for annual crops. However, the World Bank Group's overall assessment in the 1992 Operations Evaluation Department (OED) Report and the Project Completion Reports of various loans was that the NES style of investment through the PTPs in the 1970s and 1980s had not met its goals. For instance, an OED evaluation of three projects —NES IV, V, and VI—notes that "a more gradual approach, on a smaller scale, might have left more sustainable benefits. The projects overstretched the management capacity of the public sector estate companies that were responsible for implementation. Most of the public sector estate companies lacked financial flexibility and were vulnerable to delays and reductions in the funds released for the projects from the government budget".³

The 1989 World Bank strategy that replaced the earlier approach called for greater private sector involvement, gave greater emphasis to the legal and policy framework, governance, and building institutional capacity. At that time, concerns over deforestation were emerging and rights over forest resources were becoming a major issue of social dispute. Burning of vegetation to facilitate the conversion of forests, grasslands and peat soil areas into oil palm plantations, as well as the resulting loss of habitat and biodiversity, led to international concerns. The oil palm and timber plantation companies were found to be mainly responsible for the massive forest fires in Indonesia in 1997 that contributed to regional smog and health risks in neighboring countries (see box 2).

Box 2. Forest Losses in Indonesia and the Role of and Impact on Smallholders

International comparisons show that Indonesia's rate of forest loss is among the highest in the world. Several World Bank reports argue that in the last two decades in Indonesia, at a national scale, industrial/large-scale impacts on forests have outweighed the effects of smallholders and communities.

³ "Nucleus Estates and Smallholders Projects in Indonesia – Performance Audit Report", OED, World Bank, September 1992.

A joint World Bank and IFC report⁴ cites⁵ data supporting the conclusion that smallholder expansion of cultivated areas for non-food crops and cash crops does “not appear to be a primary mover behind encroachment into forested areas”.⁶ Of the crops examined (clove, coconut, coffee, oil palm, rubber, sugar cane, tea, and tobacco) only oil palm has seen a major expansion since the early 1990s⁷. Although forest degradation and loss involves many actors and many causes, and smallholders certainly play a role, the report concludes that commercial expansion of oil palm estates has been more serious than smallholder incursions in recent times. In terms of the underlying causes of deforestation, Global Forest Watch (GFW)/ Forest Watch Indonesia (FWI)⁸ mentions governance issues, including unclear legal status of land, inappropriate land use allocations, weak enforcement, land conflict, industrial overcapacity, poverty and landlessness, and regional government revenue needs.

The World Bank report also highlighted weak incentives for sound and sustainable forest management and noted that licenses have been granted for timber harvesting and conversion of forested lands into plantation crops. Acts of short-term opportunism had also occurred, with some licensees focusing on harvesting timber, rather than on long-term plantation development. “The land claims of commercial operations, usually granted from the centre, may also displace local communities or constrain their livelihood opportunities on traditionally used areas,” the World Bank report notes. Overall, the existing incentives favor continued plantation development over smallholders, the World Bank report concluded.

1.3 Private sector development of oil palm

Since the late 1980s, private estates have played an increasingly important role in oil palm expansion. By the late 1980s, the World Bank and most other donors that supported the NES schemes had reached the conclusion that investments via public sector tree crop corporations (PTPs) were not suitable for further smallholder developments. By 1989, the World Bank was advising that “The public sector estates companies (PTPs) succeeded in planting large areas for smallholders, but now face major debt servicing obligations and operational inefficiencies....the PTPs will need to return to their role as commercial enterprises...”⁹

As outlined in the 1989 strategy, the World Bank then saw the private sector as the major driver for growth. Private sector oil palm development accelerated rapidly in the 1990s and by 2002, over half the planted area of 4.1 million hectares was owned by private companies, 30 percent by smallholders, and 13 percent by state-owned companies. By 2005, the area planted had expanded to over 6 million hectares. Many private companies used forestry exploitation to help defray the cost of plantation development or as a primary objective to earn revenue.

⁴ “Sustaining Economic Growth, Rural Livelihoods and Environmental Benefits”, World Bank, 2006.

⁵ World Bank report cites Minister of Agriculture, Area and Production of Estate Crops, 1993 to 2002.

⁶ “Sustaining Economic Growth, Rural Livelihoods and Environmental Benefits”, World Bank, 2006.

⁷ Cocoa, if included, would have had an impact.

⁸ “The State of the Forest: Indonesia”, Forest Watch Indonesia and Global Forest Watch, Washington DC, USA, 2002.

⁹ “Indonesia: Strategies for Sustained Development of Tree Crops”, World Bank, 1989 and “Indonesia: Strategies for Sustained Development of Tree Crops, World Bank, 1989, Volume II”.

The Asian financial crisis hit Indonesia in 1997–98, resulting in a massive devaluation of the rupiah. The combination of the growing attraction of export earnings, the high international price for CPO, the low cost of production, and vast available forest/grassland areas caused the Center for International Forestry Research to conclude “Oil palm is seen to emerge as the winner on all counts, just as the IMF has endorsed further development of tree-based cash crops”.¹⁰ Rural oil palm producers were far better placed financially than their counterparts in other agricultural sectors.

However, achieving the potential livelihood benefits for small oil palm producers in the longer term has been undermined by the productivity gap between smallholder yields and plantation yields due to low quality planting material, poor husbandry, lack of knowledge, and lack of fertilizers. For instance, Zen et al, 2005¹¹ notes, “over half the individual smallholder plantings in the 2000s are still being made with inferior low-yielding trees, and it is crucial to check this practice which almost halves subsequent oil palm outputs for over 25 years.” Based on survey data from one province in Indonesia, an IFC report from 2006¹² showed that average smallholders achieved only 24 percent of the value added per unit of crop (gross margin/kg of fresh fruit bunches) earned by average plantations, and only 12 percent of the amount earned by best practice plantations. A best practice plantation’s value added per unit crop was only 44 percent of that earned by a best practice CPO mill, illustrating the value of the product captured in the downstream processing, as in many other agribusiness value chains. The higher oil content of FFB from plantations “explains the current reluctance of large palm oil companies to expand their supply from smallholders”.¹³ Employment is far lower on oil palm plantations than on smallholdings on a per hectare basis.

World Bank monitoring reports on the oil palm industry have become less frequent since the World Bank ended its lending for tree crop development. Forestry, on the other hand, has become more regularly monitored as activities in that sector have expanded. Yet the two sectors are closely related, as confirmed by the World Bank in 2006. The continued expansion of oil palm planting means increasingly marginal areas are used for production, with mounting environmental risk.

1.4 IFC’s earlier engagements in oil palm

Against the backdrop of World Bank experience in the Indonesian oil palm sector, including the challenges and pitfalls it had encountered, IFC embarked on one of its first oil palm projects in 1988. In 1990, this project turned into an investment. Between 1990 and 2002, IFC concluded several investments with different palm oil producers.

¹⁰ Potter L. and Lee J., “Tree Planting in Indonesia: Trends, Impacts and Directions”, Center for International Forestry Research, December 1998.

¹¹ Zen Z., Barlow C. and Gondowarsito R., “Oil Palm in Indonesian Socio- Economic Improvement – A Review of Options”, The Australian National University, 2005.

¹² “Value Chain Analysis for Aceh Palm Oil Sector”, IFC, 2006. The CAO notes that data from one province is not representative of other provinces due to many differences between them. However, this report was an IFC report that provided an in-depth analysis of the palm oil value chain.

¹³ “Value Chain Analysis for Aceh Palm Oil Sector”, IFC, 2006.



The records confirm that IFC's experience in the Indonesian oil palm sector was consistent with the experience of the World Bank. The results of due diligence reviews for each project assessed, including some that did not materialize as investments, listed issues of concern to IFC. These concerns remained a challenge for IFC management for the duration of these investments. Among other things, IFC routinely noted its concerns about non-compliance with environmental and social standards and guidance, ongoing security issues, and unresolved land disputes. Several of these investments were still active at the time when the initial Wilmar investment was appraised and approved.

In a Board paper dated March 2002, IFC noted that it had placed all its activities in Indonesia under review since April 2001 due to the difficult business and legal environment. However, in recognition of recent modest improvements in the business environment, IFC agreed in 2002 to proceed with the trading facilities investments, which had been approved by the Board in January 2001, but had been suspended since then. The investment proposed to the Board in 2002 would allow for the completion of plantation development, which is labor-intensive, thereby providing permanent jobs to local populations.

These earlier investments involved development of land for the establishment of oil palm plantations; the construction and commissioning of associated CPO mills; and in one case, additional support infrastructure. In 2001, the IFC Board took particular interest in the environmental risks associated with one of these investments and was satisfied by management that this project served as a model for oil palm development in Kalimantan. This followed a special site visit to the project to assess land use issues and relationships with local communities. For this investment, IFC management also promised the Board that IFC was in the process of updating its knowledge of the environmental and social problems associated with the sector and country and gave an assurance that all IFC policy provisions were being met. IFC was working with the company to formalize and expand its existing community development programs, a relatively new approach that was meant to serve as a model for improving other existing oil palm plantations with similar issues.

With the exception of an early first investment, which was done prior to the IFC procedure of categorization, all these investments were categorized either 'A' or 'B'.

In various reports—the Annual Monitoring Report Reviews (AMRR), Back-to-Office (BTO) reports, Corrective Action Plans (CAP), and Environmental Review Summaries (ERS)—management assessed and reported non-compliance with IFC's policy provisions and guidelines and identified how infringements were being addressed, if at all. For one project, a co-investor with IFC independently commissioned an environmental review in 2002 to see whether that particular project complied with World Bank and IFC environmental, health and safety, and social policy provisions and guidelines. The following year, IFC itself raised concerns about the same issues and considered withdrawing from this particular investment due to the increased reputational risk it presented, noting that the issues were similar to those in other Indonesian oil palm investments. For another Indonesian palm oil project, contemporaneous with Wilmar,



IFC debated the social and environmental issues involved and agreed to pay extra attention to these in the AMRRs.

Overall, AMRRs, BTOs, CAPs, and the ERS record numerous problems and slowness in alleviating or mitigating the concerns at the project level. A 2006 IFC study of the palm oil value chain in Aceh identified the following issues of concern: poor returns to smallholders, lack of access to services, and the need for improved industry environmental management and better interaction with local communities.

1.5 Development of the Wilmar Group

Wilmar International Limited was founded in 1991 as a joint partnership between a Malaysian national, Mr. Kuok Khoon Hong, and an Indonesian national, Mr. Martua Sitorus. It commenced operations as a palm oil trading company.

Besides his engagement and ownership in Wilmar, Mr. Kuok has interests and close relationships with the Kuok Group, a Malaysian-based agribusiness conglomerate. In 2007, Wilmar bought the Kuok Group's palm plantation business, increasing Wilmar's planted oil palm acreage and land bank. In addition to his engagement and ownership in Wilmar, Mr. Martua Sitorus has interests in and a close relationship with Ganda Group Indonesia, an Indonesian plantation-operating group. The CEO and President of Ganda Group, Mr. Ganda and Mr. Sitorus, respectively, were involved in the establishment and management of PT Karya Prajona Nalayan (PT KPN), which became part of Wilmar International Limited.

Wilmar explains on its public web site and in its annual reports: "Over the years, we have established a resilient integrated agribusiness model that captures the entire value chain of the agricultural commodity processing business, from origination and processing to the branding, merchandising and distribution of a wide range of agricultural products. Through scale, integration and the logistical advantages of our business model, we are able to extract margins at every step of the value chain, resulting in significant operational synergies and cost efficiencies".

In 1991, when Wilmar started engaging in the merchandising of palm oil in Indonesia, it acquired a land bank of approximately 7,100 hectares in Western Sumatra. By 2002, the plantation area was stated to have reached 80,000 hectares.

In 2006, Wilmar announced a proposed merger with the Kuok Group's palm plantation, edible oils, grains, and related businesses (PGEO Group Sdn Bhd and PPB Oil Palms Berhad) in a deal worth up to US\$2.7 billion. In a separate transaction, Wilmar announced a restructuring exercise to acquire the edible oils, grains, and related businesses of parent company Wilmar Holdings Pte Ltd, including interests held by Archer Daniels Midland Asia Pacific and its subsidiaries in these businesses, for US\$1.6 billion. The company was renamed Wilmar International Limited on July 14, 2006, upon completion of the reverse takeover of Ezyhealth Asia Pacific Ltd. In 2006, Wilmar also concluded a major production capacity expansion drive through the completion of three refineries, three fractionation plants, four palm kernel crushing plants, and four palm oil



milling plants. In parallel, Wilmar expanded its oil palm plantation acreage through the acquisition of five plantation companies (with a combined land bank of 85,000 hectares in Kalimantan, Indonesia), the acquisition of 25,000 hectares of land bank by two existing subsidiaries, and the acquisition of a plantation company with a land bank of 30,000 hectares in Jambi, Sumatra.

As of 2008, Wilmar was one of the world's largest processors and merchandisers of palm and lauric oils, and one of the largest plantation companies in Indonesia/Malaysia. The assets of the Wilmar Group were valued at US\$17 billion. A net profit of US\$1.53 billion was reported (Wilmar 2008 Annual Report). In Indonesia, its plantations are located in Sumatra, West Kalimantan, and Central Kalimantan (southern region), while in Malaysia, they are located in the states of Sabah and Sarawak. As of December 31, 2008, Wilmar owned approximately 570,000 hectares of plantation land, of which 223,000 hectares were planted, according to its 2007 and 2008 Annual Reports.

Wilmar states that it intends to grow its plantation business through greenfield projects and acquisitions. Total planted area is expected to triple within a decade through new plantings of about 40,000 hectares per year.¹⁴

1.6 Development of RSPO

In 2001, the World Wildlife Fund (WWF) initiated an exploration of the possibilities of forming a voluntary international organization to establish sustainable practices in the palm oil sector. In 2004, the Roundtable on Sustainable Palm Oil (RSPO) was formally established.

RSPO is composed of Ordinary Members in seven different sectors—oil palm growers, palm oil processors and/or traders, consumer goods manufacturers, retailers, banks and investors, environmental/nature conservation NGOs, social/developmental NGOs—as well as Affiliate Members. It currently has over 250 Ordinary Members and close to 100 Affiliate Members.

The objective of the RSPO is to become the central body for allowing certification of sustainable palm oil. To this end, it has adopted eight principles:

- Principle 1. Commitment to transparency
- Principle 2. Compliance with applicable laws and regulations
- Principle 3. Commitment to long-term economic and financial viability
- Principle 4. Use of appropriate best practices by growers and millers
- Principle 5. Environmental responsibility and conservation of natural resources and biodiversity
- Principle 6. Responsible consideration of employees and of individuals and communities affected by growers and mills
- Principle 7. Responsible development of new plantings
- Principle 8. Commitment to continuous improvement in key areas of activity.

¹⁴ Wilmar International Ltd., 2007 Annual Report, page 2.



Each principle also has a supporting range of criteria that provides guidance on how to perform to meet the intent of the principles. The criteria address both plantation operators and smallholders.

In June 2007, RSPO approved a certification protocol with recommendations for a complete scheme for certifying palm oil production using the RSPO Principles and Criteria. In October 2008, RSPO finalized the Supply Chain Certification System, which establishes procedures to guarantee that all facilities that are part of the supply chain of RSPO-certified palm oil production comply with relevant requirements.

Wilmar joined RSPO in August 2005. IFC joined in November 2005.

1.7 Growth and development of civil society in Indonesia

In the 1970s and 1980s, while oil palm planting by state-owned PTPs and smallholders was rapidly expanding, the role of civil society was negligible. Land development decisions in the NES era, for example, followed a top-down process where the PTPs, the Directorate General of Estates, and local government coordinated the steps for the required approvals. Local leaders were consulted, but the systematic participation of local people in decision making was not common. As a result, local knowledge on land and water quality, traditional foods and medicines, forest and grassland management, and biodiversity and its economic and social contribution were not adequately considered. Mapping and environmental considerations overall were inadequate. Accordingly, the value of land and natural resources to local people and their customary practices and belief systems was underestimated prior to oil palm plantation development.

This situation continued in the 1990s, when private sector oil palm growth started to boom. In the last ten years, however, greater expression of local peoples' interests has emerged through the growth of community-based organizations and NGOs. These groups, which have developed partnerships with international NGOs, have increasingly developed the capacity to monitor and report on the local situation, to exchange information among different provinces, and to articulate the views of local people. The virtual absence of tree crop sector reviews by the World Bank Group in the last 20 years has left an information gap that is partially being filled by the NGOs. World Bank forestry sector work has shown the link between commercial oil palm development and deforestation. A World Bank sector report highlighted that "large plantation investments tend to have the support of national and provincial governments in terms of permitting and licensing, as well as access to land. In contrast...smallholders, during recent decades, have not had important pathways for acquiring land, nor the security to warrant conversion into agricultural uses on a large scale".¹⁵

1.8 Current and future situation and the concerns of CAO complainants

¹⁵ "Sustaining Economic Growth, Rural Livelihoods and Environmental Benefits, World Bank, 2006.

The area planted with oil palm has approximately doubled in the past decade and is estimated to exceed 7 million hectares as of 2009. Private plantation owners occupy the largest area, exceeding smallholders and public sector plantation owners. Oil palm national planting targets, as expressed in various sources, are upwards of 20 million hectares, or a tripling of the current area.

The complainants have drawn attention to claimed violations of IFC's procedures and policies provisions, as well as other general concerns.

The evidence put forward in reports compiled by international NGOs is consistent with the experiences of IFC in its pre-Wilmar engagements, and with many of the issues faced in the earlier WBG/NES era. At the CAO audit team meeting in Jakarta in March 2009, these complaints were confirmed. In addition, complainants raised issues that, according to them, will impact them in the future. They noted that continued oil palm development, without corrective actions to ensure that their key concerns are addressed, would likely lead to further losses of land by indigenous people, failure to achieve sustainable livelihoods for small farmers, and that this may lead to future poverty. They raised concerns about low smallholder productivity and the large gap in per hectare profitability compared to plantations; lack of access to financial and technical services; and lack of adequate representation in planning and decision making at the plantation company and palm oil industry levels.

2. CAO Findings

2.1 IFC No. 20348–Wilmar Trading (2004)

CIC review, August 13, 2003; Investment Review Meeting, November 10, 2003; Board approval, April 27, 2004; Commitment, June 23, 2004; Renewed (2005); MAM, May 23, 2005; Commitment, November 17, 2005.

IFC states: “Wilmar Trading is the merchandising and trading arm of Wilmar Holdings,... IFC's support would facilitate Wilmar Trading to finance its 2003/2005 export program and allow continued sustainable long-term growth in a sector where Indonesia has a strong comparative advantage. The project is intended to enable Wilmar Trading to scale up its off take of crude palm oil (CPO) from palm oil plantations in Indonesia and process them into refined oil”.¹⁶

The investment in Wilmar Trading was reviewed according to the 1998 Environmental and Social Review Procedure (ESRP) and the 1998 Safeguard Policies.

- 2.1.1 IFC recognized, in its initial contacts with Wilmar, that:
- possibilities for further business opportunities in Wilmar existed
 - a successful first investment would set a precedent for likely future investments in Wilmar
 - a Category ‘C’ rating would, according to IFC, greatly improve the chance of successfully closing this first deal.

2.1.2 IFC stated, in the Summary of Proposed Investment (SPI) document and the Board presentation papers, that this investment would be perceived as an endorsement by IFC of the Indonesian oil palm sector. In these same documents, IFC recognized the high sensitivity of social issues within the sector.

2.1.3 IFC identified the development outcome of this project as including a positive effect on other players in the supply chain, such as farmers who would benefit from increased demand, as well as local businesses providing services. However, the development indicators selected by IFC for monitoring progress in these key areas ignored these projected development outcomes. In particular, IFC did not address the livelihood and economic issues faced by smallholders or plantation workers in the supply chain.

2.1.4 The 1998 Environmental and Social Review Procedure requires that categorization depends upon the type, location, sensitivity, and scale of the project, as well as the nature and magnitude of its potential social and environmental impacts. IFC project documentation makes it clear that the funds were intended to maintain or increase crude palm oil (CPO) off-take and that positive outcome for farmers and local businesses were anticipated in the crude palm oil supply chain.

¹⁶ “Summary of Proposed Investment (SPI)” for IFC No. 20348.

However, IFC categorized this investment as a Category 'C' project, based on the argument that as a trade facility, the project would have limited, or no, environmental or social impacts. It therefore excluded the supply chain from its investment decision making process.

2.1.5 The CAO finds that the direct effect of IFC's category 'C' decision was that it excluded the assessment and monitoring of the development outcomes and impacts in the supply chain.

2.1.6 The CAO notes that IFC's environmental and social department (CES) initially assigned a Category 'B' to this investment. The CAO also notes that differences in opinion existed between CES and the Investment Department on the required scope of the assessment of project impacts and on the categorization. The position of the Investment Department that the investment be categorized a Category 'C' project prevailed.

2.1.7 The CAO finds that IFC's categorization and approach to environmental and social due diligence was inconsistent with IFC's own analysis of this project's identified projected outcomes, including the sensitivity of the environmental and social issues inherent in the sector and country.

2.1.8 The CAO finds that IFC therefore failed to meet the intent of its policies and its project specific promises to the Board. The CAO therefore finds that this investment was incorrectly categorized as a Category 'C' project.

2.2 IFC No. 24644–Delta Wilmar CIS (2006)

CIC Review, February 13, 2006; Investment Review Meeting, June 7, 2006; Board approval, June 27, 2006; Commitment, July 5, 2006.

IFC states: "Delta-Wilmar CIS will construct, equip and place into operation a 1,500 metric ton per day crude palm oil (CPO) refinery in Ukraine. IFC's expected contribution to the project would include:

- promoting a "South-South" investment from an existing IFC client specialized in the trade of agricultural commodities (Wilmar) to a manufacturing plant in Ukraine; and
- providing long-term finance which is not otherwise available in Ukraine."¹⁷

The investment in Delta Wilmar was reviewed according to the 1998 Environmental and Social Review Procedure (ESRP) and the 1998 Safeguard Policies.

2.2.1 IFC's environmental and social department (CES), upon initial consideration of this investment in November 2005, proposed that an 'A' categorization be assigned and a comprehensive environmental and social

¹⁷ Summary of Proposed Investment (SPI) for IFC No. 24644.

assessment be undertaken of both the Ukrainian refinery operation and its Indonesian palm oil supply chain.

2.2.2 IFC, in November 2005, expressed concerns about Wilmar's response to social and environmental issues and concerns raised related to its supply chain in Indonesia.

2.2.3 IFC stated in January 2006 that it observed significant improvements in the environmental and social performance of Wilmar.

2.2.4 IFC noted in January 2006 that its analysis indicated a significant improvement in the management of environmental and social issues within the Wilmar Group.

2.2.5 IFC also noted that Wilmar did not have a fully functioning environmental and social management system in place at the time of this project investment decision.

2.2.6 IFC subsequently revisited the extent of the scope of the assessment and concluded that the refinery operation should remain within the scope, but that the supply chain should be excluded.

2.2.7 IFC had internal differences of opinion about the appropriate scope of the assessment of the project's impact, and specifically whether the supply chain to the refinery should or should not be included. As previously, the position of the Investment Department prevailed. The supply chain was excluded on the basis that crude palm oil would be purchased on the open market, and therefore was not traceable to areas of plantations; and that IFC was satisfied that Wilmar had improved its ability to manage reputational risk connected to the supply chain.

2.2.8 Taking into consideration the refinery alone - and excluding its supply chain - IFC categorized the investment as a Category 'B' project.

2.2.9 The CAO notes that IFC argues that the palm oil is not traceable due to Wilmar's procurement process. Yet, at the same time, IFC states that the refinery is not engaging in commodity type of purchasing since the origin of most of the palm oil is known.

2.2.10 The CAO finds that IFC's analyses in 2005 and 2006 should have considered the extent to which Wilmar was establishing control over its CPO suppliers, especially as Wilmar's 2006 Annual Report stated that its strategy was to develop a vertically integrated business, that captured value and controlled costs at all points of the supply chain. The same annual report disclosed that an independent third party was able to verify that Wilmar's palm oil was traceable throughout the entire supply chain.



2.2.11 The CAO finds that IFC's decision to exclude the palm oil supply chain contradicts Wilmar's stated business strategy.

2.2.12 The CAO finds that IFC's stated inability to trace CPO to specific plantation areas in Indonesia is incorrect and is therefore not a valid argument for excluding a supply chain with social and environmental concerns that are well documented. The CAO finds this inconsistent with the intent of IFC's policies and mandate.

2.3 RSPO

2.3.1 In 2005, RSPO was a newly formed, member-regulated industry association. IFC notes that the establishment of the RSPO was an important consumer-driven development, and that Wilmar became a member and supported the RSPO principles.

2.3.2 The CAO finds that Wilmar's stated support of the RSPO principles cannot substitute the application of IFC's policies, procedures, and standards. The IFC's Performance Standards are more comprehensive, and provide safeguards in areas that the RSPO principles do not address. RSPO had no established independent verification process in operation to verify performance on the ground at the time of the investments.

2.4 Technical assistance

2.4.1 IFC recognized that poor management practices in the palm oil supply chain were a reputational risk. In response, in 2006, IFC proposed and started to develop a technical advisory program intended to promote sustainable practices along the supply chain and to mitigate in part the reputational risk of the proposed investments in Wilmar. IFC stated that this program would provide tools to improve traceability, address supply chain issues, and introduce incentives related to those smallholders from which Wilmar obtained CPO.

2.4.2 The CAO finds that as of 2009, only one limited scope technical advisory project had been approved. A small grant (US\$ 211,000) to the London Zoological Society, in association with Wilmar and financed by the Global Environment Fund (GEF) under the Biodiversity and Agricultural Commodities Program (BACP), seeks to address biodiversity concerns.

2.5 IFC No. 25532–Wilmar WCap (2006)

CIC Review, October 26, 2006; Investment Review Meeting, November 30, 2006; Board approval, December 20, 2006; Commitment, February 9, 2007.

IFC states: "The project is intended to enable Wilmar Trading Pte Limited..., to meet its working capital needs to purchase crude palm oil (CPO) from palm oil plantations in Indonesia and process them into refined oil for export. IFC's support is essential to

enable the company to finance its export program and allow continued sustainable long-term growth in a sector where Indonesia has a strong comparative advantage and will be a good illustration of IFC's support for good sponsors in a socially sensitive sector. The project will ensure the continuous operation of the CPO supply chain and the preservation of all economic interests and employment associated with that chain such as plantation, transportation, storage, processing and shipping."¹⁸

The investment in the Wilmar trade facility (Wilmar WCap, IFC No. 25532) was reviewed according to the 2006 Environmental and Social Review Procedure (ESRP) and the 2006 IFC Performance Standards.

2.5.1 IFC assessed the performance of a small sample of Wilmar plantations in some detail as part of its due diligence review.

2.5.2 IFC attached significance to Wilmar's membership of the RSPO with regard to social and environmental issues.

2.5.3 IFC was aware of well-documented civil society concerns about the sustainability of plantation development and operations in West Kalimantan.

2.5.4 IFC's Summary of Proposed Investment (SPI) focuses on Wilmar's ability to manage the palm oil supply chain and to extract value from it.

2.5.5 IFC Performance Standards state that adverse impacts associated with supply chains shall be considered where low cost labor is a factor, or where the resource utilized is ecologically sensitive.

2.5.6 IFC Performance Standards state that where the client has commercial leverage over its suppliers, IFC will expect the client to work with its suppliers to propose mitigation measures to increase their performance.

2.5.7 IFC categorized this second investment in the trade facility as a Category 'C' project, the same as its categorization of the first Wilmar trading investment. The decision was again based on IFC's argument that as a trade facility, the project would have limited, or no, environmental or social impacts. It therefore excluded the supply chain from its investment decision making process.

2.5.8 The CAO finds that both impacts on low cost labor and ecologically sensitive resources are directly relevant to the palm oil sector.

2.5.9 The CAO again finds this categorization inconsistent with IFC's policy and procedural provisions.

¹⁸ Summary of Proposed Investment (SPI) for IFC No. 25532.

2.5.10 The CAO finds that the exemption of “financing aimed at improving the efficiency of capital” under the 2006 procedure was not applicable for this investment.

2.5.11 The CAO finds that IFC’s decision to categorize the investment as a Category ‘C’ project minimized the environmental and social impact assessment of the investment. The effect was that applicable Performance Standards were not triggered.

2.6 IFC No. 26271–Delta Wilmar CIS Expansion (2008)

CIC Review, June 11, 2008; Investment Review Meeting, August 25, 2008; Board approval, October 22, 2008; Commitment, November 13, 2008.

IFC states: “Delta-Wilmar CIS, a palm oil refinery and shortening manufacturer and current IFC client in Ukraine, will increase its capacity and invest in related infrastructure at its plant near the Yuzhny port in Odessa region. IFC’s expected contribution to the project would include:

- promoting a “South-South” investment from an existing IFC client specialized in the trade of agricultural commodities (Wilmar) to a manufacturing plant in Ukraine; and
- providing long-term finance which is not otherwise available in Ukraine.”¹⁹

Project 26271, Delta Wilmar CIS expansion, was reviewed under the 2006 Performance Standards and the 2007 ESRP.

2.6.1 IFC categorized this second investment in the refinery as a Category ‘B’ project, the same as its categorization of the first Delta Wilmar investment.

2.6.2 IFC Performance Standards state that adverse impacts associated with supply chains will be considered where low cost labor is a factor, or where the resource utilized is ecologically sensitive.

2.6.3 IFC Performance Standards state that where the client has commercial leverage over its suppliers, IFC will expect the client to work with its suppliers to propose mitigation measures to increase their performance.

2.6.4 IFC reviewed a limited number of Wilmar plantations, on the basis of protecting IFC’s reputation.

2.6.5 IFC again argued that it was unable to trace the origin of the crude palm oil procured, and that an estimated 4 percent of the CPO processed originates from Wilmar owned plantations. This estimate is identical to the one made by IFC in 2006.

¹⁹ Summary of Proposed Investment (SPI) for IFC No. 26271.

However, IFC had information that Wilmar's oil palm plantation acreage as well as its land bank for future oil palm development had grown significantly between 2006 and 2008.

2.6.6 The CAO finds that IFC's focus on whether CPO is traceable back to Wilmar-owned plantations is inconsistent with IFC's Performance Standards, which require a broader assessment of suppliers and supply chains.

2.6.7 The CAO finds that IFC failed to correctly assess the supply chains related to its investment in Delta Wilmar Expansion, thereby limiting the scope of IFC's environmental and social impact assessment of the investment. The effect of this was that applicable Performance Standards were not triggered.

2.7 Findings relevant for all four investments

2.7.1 The CAO finds that IFC was aware for more than twenty years that there were significant environmental and social issues and risks inherent in the oil palm sector in Indonesia. This awareness was gained through World Bank experience that was well documented, from numerous IFC projects appraised in the sector and country from the 1980s and onwards, and monitoring and reporting from ongoing IFC investments in the oil palm sector in Indonesia.

2.7.2 The CAO finds that IFC had no specific strategy for engaging in the Indonesian oil palm sector, even though it recognized the sensitive social, environmental, and governance issues inherent in the sector in Indonesia. In the absence of a specific strategy, the prevailing IFC business strategy that favored deal-making applied.

2.7.3 The CAO finds that, although IFC's policy provisions became more stringent in April 2006, IFC approved two Wilmar investments after 2006 without any significant change in the scope of its due diligence compared to its Wilmar investments prior to 2006.

2.7.4 The CAO finds that, despite extensive documentation of social and environmental issues in the oil palm sector in Indonesia, as well as IFC's own experiences with several other investments in the sector in Indonesia, IFC took a *de minimis* approach so as to exclude assessments of the supply chains.

2.7.5 The CAO finds that the overall approach taken by IFC in this series of investments with the Wilmar Group has sought to insulate IFC from the real impacts of its investments through its approach to categorization. The approach set the boundaries of the areas of influence of the projects so that the palm oil supply chain was excluded.

2.7.6 The CAO finds this approach counter-productive to IFC's mission of reducing poverty and improving lives, when it was clear from the earliest project documentation that IFC was fully aware of the significance of its engagement with



the Wilmar Group, and the challenges that existed within the Indonesian palm oil sector.

2.8 Compliance with National Laws

2.8.1 IFC did not assess the Wilmar plantation operations compliance with national laws in its due diligence of its Wilmar projects, since IFC decided to exclude the plantation operations from the scope of the due diligence

2.8.2 The CAO finds that in November 2007 and January 2008, IFC and Wilmar acknowledged shortcomings in how its policies were applied on the ground. This included acknowledgment of failure by the plantation operations to comply with national legal requirements related to permits and standards, and disclosure of environmental impact assessments (EIA).

2.8.3 Because IFC excluded legal compliance of the plantation operations from its due diligence reviews, IFC failed to identify legal non-compliance issues.

3. CAO Conclusions

3.1 Observation

3.1.1 The CAO concludes that IFC had no specific strategy that provided guidance for engagement in the Indonesian palm oil sector, despite the recognized social, environmental, and governance sensitivity of the sector, prior IFC and WBG experience, and IFC's own recognition of the significance of its engagement in the sector.

3.1.2 The CAO concludes that, from a due diligence perspective, IFC's environmental and social review procedures do not adequately address the particular characteristics of trade financing, or other similar kinds of investments. At present, there is no procedure implemented for such investments that addresses the sector, country and commodity based risks.

3.1.3 The CAO concludes that the difference in scope of environmental and social reviews for a category 'A' or 'B' project, versus a category 'C' project is considerable. As a result, IFC is exposed to the possibility that significant internal and external commercial pressure is placed on IFC's categorization process to decide a Category 'C' result.

3.2 Non-compliance Issues

3.2.1 The CAO concludes that IFC did not meet the intent or the requirements of the Performance Standards in its assessment of the Wilmar trade facility investment (Wilmar WCAP, IFC No. 25532), and that the project should not have been categorized as 'C'. The 'C' categorization led to an assessment that was too narrow in its scope and too limited in its execution, and that in turn failed to trigger assessment of applicable Performance Standards.

3.2.2 The CAO concludes that the IFC assessment of Delta Wilmar CIS Expansion (IFC No. 26271) failed to take into account the supply chain plantations and other companies and suppliers linked to the Wilmar Group, as required in the Performance Standards. This led to a scope of IFC's due diligence that was too narrow and limited, and that in turn failed to trigger assessment of applicable Performance Standards.

3.2.3 The CAO concludes that this narrow interpretation of the investment impacts—in full knowledge of the broader implications—was inconsistent with IFC's asserted role, mandate and commitment to sustainable development.

3.3 Underlying Causes for Non-compliances Identified

3.3.1 Commercial pressures were allowed to prevail and overly influence the categorization and scope and scale of environmental and social due diligence in the Wilmar Group investments. As a result, IFC's development mandate and mission were not robustly represented in the decision-making processes.

3.3.2 The significant differences between the social and environmental due diligence approaches for a Category 'A' and 'B' project versus a Category 'C' project create pressure on IFC both internally and externally to structure an investment so that it falls within the Category 'C' range.

3.3.3 Incorrect assumptions were made about the impact of certain types of financial products (trade facilities) without proper consideration of the sector and country context of the investment. IFC should not have assumed that a trade facility project would be a Category 'C' without appropriate screening of the full context of the investment. IFC should have considered the impacts of its investment, rather than a narrow interpretation of specific financial flows.

3.3.4 IFC paid inadequate attention to civil society monitoring reports and concerns about continuing social, environmental, and economic problems in the oil palm industry in Indonesia.