

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**MANAGEMENT RESPONSE TO THE FINAL
REPORT OF THE INDEPENDENT ADVISORY
GROUP ON SUSTAINABILITY**

FROM MANAGING RISKS TO EMBRACING NEW OPPORTUNITIES

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ABBREVIATIONS

ADB	Asian Development Bank
ESG	Environmental and Social Safeguards Unit
GEF	Global Environmental Facility
IAG	Independent Advisory Group on Sustainability
IDB	Inter-American Development Bank
IDB-9	Ninth General Increase in the Resources of the Inter-American Development Bank
IDB-SWG	IDB Sustainability Working Group
INE	Infrastructure and Environment Department
KNL	Knowledge and Learning
MDB	Multilateral Development Bank
SCF	Structured and Corporate Finance Department

I. INTRODUCTION

“In Latin America and Caribbean, the path to sustainable development will be built on each country’s ability to respond to increasing demands for economic growth and social progress with development strategies that ensure the protection of terrestrial and marine ecosystems goods and services, reverse the degradation of the natural resource base, and provide for mitigation and effective adaptation to the consequences of climate change.”¹

- 1.1 The Inter American Development Bank (IDB) Environment and Safeguard Compliance Policy (GN-2208-20, OP703) was approved by the Board of Executive Directors in 2006. The policy required the Bank to conduct an independent assessment of its implementation no later than 3 years after coming into effect.
- 1.2 Concurrent with this, the Bank had initiated a request to its Members for an increase of capital, which resulted in the agreements set out in the Cancun Declaration and reflected in the Report on Ninth General Increase in the Resources of the Inter-American Development Bank (AB-2764, IDB-9) approved by the Board of Governors at the Annual meeting in Cancun, México in April 2010.
- 1.3 IDB-9 provides the Bank with an institutional strategy that recognizes *“protecting the environment , responding to climate change, promoting renewable energy and ensuring food security”* as one of the Bank’s five strategic priorities. Governors, in the Better Bank Agenda, laid out a series of goals to maximize the effectiveness and impact of IDB’s interventions in the context of IDB-9, including the Bank’s commitment to expanding its *“focus on environmental and social sustainability directed to sustaining the underpinnings of development, ensuring accountability and transparency, and continuously working to strengthen its safeguards system”*.
- 1.4 In August 2009 the Bank engaged the assistance of an Independent Advisory Group on Sustainability (IAG) to provide advice and recommendations to the IDB on sustainability issues and concerns, both in response to the mandate of the Environment Policy and as part of the Bank’s preparation for the requested capital increase.
- 1.5 The Report on the Ninth General Increase in the Resources of the Bank outlines the objectives of the IAG, who will seek to provide an independent review and make recommendations to: (i) increase the effectiveness of the Environment and Safeguard Compliance Policy approved in 2006, (ii) updates to the policy; (iii) how the Bank can continue to provide leadership on emerging sustainability issues in the Region.
- 1.6 The IAG presented its Final Report to the Committee of the Whole and to the Management in February 2011. The report concluded that the environmental and social

¹ IAG Sustainability Report

safeguards provided for in the Environment and Safeguard Compliance Policy were adequate. However the report recommended a number of additional measures in order to strengthen the Bank's capacity to meet the commitments of IDB-9 and maintain a leadership role in the region. These recommendations mainly seek to mainstream sustainability considerations in the Bank's work and ensure better effectiveness in the implementation of the safeguards.

- 1.7 In response to the recommendations included in the report, Management created an internal working group to determine, with the benefit of independent expertise, the best way to incorporate appropriate activities for this purpose. This document presents the working group's response to the recommendations of the report.
- 1.8 Following a summary of the IAG Sustainability report, this document describes the mandate and work of the IDB Working Group on Sustainability and presents the action plan and implementation strategy developed by the Working Group.

II. THE IAG SUSTAINABILITY REPORT

- 2.1 The IAG was created to provide advice and recommendations to the IADB about critical sustainability issues affecting Latin America and the Caribbean and about improvements that might be made to the Bank's Environment and Safeguards Compliance Policy (OP703) to better address these issues.
- 2.2 The purpose of the IAG, as spelled out in the terms of reference issued when the group was established, is to provide advice on four main subjects:
 - i. The IDB's efforts and performance in addressing the critical environmental issues affecting the Region;
 - ii. The improvements and/or amendments to the Environment Policy and the IDB's processes that may be necessary to better enable the IDB to address these critical environmental issues;
 - iii. The emerging sustainability issues in the region and how the Bank could effectively address them in the context of its Better Bank agenda; and
 - iv. How the Bank can play a sustainability leadership role in the Region as indicated in the IAG report
- 2.3 The IAG report provided an analysis of the IDB's response to the critical environmental and sustainability issues facing the Region and the implementation of the Environment and Safeguards Compliance Policy by the IDB. Following that analysis the report proposed a strategic direction and an action plan to strengthen the implementation of the Bank's Environment and Safeguards Compliance Policy and provide the Bank with the necessary tools to meet the commitments of IDB-9.

IDB's response to the critical environmental and sustainability issues facing the region

- 2.4 The report recognized the progress made by the Bank in addressing environmental and sustainability issues in the region, with significant increases in its lending and non-lending volume towards environmental improvement, as well as its noteworthy initiatives and activities such as the disaster risk management initiative, the groundbreaking work of the MIF in promoting sustainable approaches for small and medium enterprises, and its increasingly active involvement with the Global Environment Facility (GEF). The report also highlighted the exemplary job done by the Sustainable Energy and Climate Change Initiative (SECCI) in mainstreaming climate change solutions in country dialogue and sector operations.
- 2.5 From an institutional point of view, the report pointed out the significant contribution that the Infrastructure and Environment Department (INE) brought after the Realignment. By encompassing climate change, environment and natural resources sector work with infrastructure operations, INE created synergies that fostered interdisciplinary collaboration among its sector divisions, facilitated the “greening” of the Department’s loan operations for transport, energy, water and sanitation as well as productive sectors (e.g., agriculture and tourism), and paved the way for mainstreaming environment and climate change issues across sectors under a unique strategy.
- 2.6 However, the report raised questions about the scope of the Bank’s environmental portfolio and its direct relationship to underlying issues of sustainability in member countries, and noted several emerging issues in the region, areas of opportunity which, while recognized by the Bank, will require greater attention in the future. A major point made by the report was that **the Bank’s mainstreaming aspects of the policy have not received the priority and leadership required**, and as a result, the compliance sections of the policy have come to be considered the policy’s primary aim.
- 2.7 In terms of aligning the Bank’s portfolio with the Countries’ needs, the report noted the need to systematically include sustainability as part of the Bank’s dialogue with its member countries and include sustainability considerations in the Bank’s country strategies and programs in a substantial way.
- 2.8 A main area of opportunity according to the report is **Biodiversity and Ecosystems Services**. As indicated by the IAG, and the recent UNDP Report “Latin America and the Caribbean: a Biodiversity Superpower”, the LAC region’s natural resources provide a great competitive advantage and can play a key role in the social and economic development of the region. The report suggests that this area should be given equal weight with climate change mitigation and adaptation within the Bank.
- 2.9 Other areas noted by the report included (i) the Bank’s agenda on poverty reduction and social equity, where it was suggested that the Bank should maintain its leadership in promoting equal access to services and jobs, income distribution and social inclusion; and (ii) promoting environmental governance among the public and private sector.

Review of the implementation of the Environment and Safeguards Policy

- 2.10 As indicated in the IAG report, the IDB Environment and Safeguards Policy is divided into two sets of Policy Directives. The first set covers the Bank's objectives and actions with regard to mainstreaming sustainability considerations in the Bank's work and the second set spells out the scope of the Bank's environmental and social safeguard requirements and the procedures for applying them.
- 2.11 The report found the Policies to be adequate and recognized the progress achieved by the Bank in their implementation, but nevertheless found several critical distortions and deficiencies in the implementation of the Policies. In particular, the report noted that, despite various initiatives in the different Vice Presidencies, the responsibilities for the implementation of the mainstreaming aspects of the Bank's policy were unclear and diffuse. In particular the report noted two major issues: (i) **the need to include sustainability considerations in country strategies** through a better alignment of Country Environmental Assessments with Country Strategies; and (ii) **the need for increased efforts in supporting environmental governance in public and private institutions in the region.**
- 2.12 The report recognizes the Bank's progress in implementing the safeguards compliance policy requirements and pointed out that ESG has developed a strong core staff and has become increasingly effective in the last few years. However, the report noted that the workload for ESG has also increased significantly and that in response to that, the Bank should undertake a detailed review of the numbers and distribution of its environmental staff.
- 2.13 The report indicated that no professionals or managers within the Bank questioned the primary function that ESG performs, managing the Safeguards Compliance process, but noted that the manner in which ESG discharges its responsibility may lead to adversarial relationships between ESG and project operations staff that may work against the timely and innovative resolution of environmental issues. This relationship is even more problematic in the case of private sector operations because it appears that some potential borrowers may be shying away from the Bank because of what they perceive to be the unpredictable application of excessively rigid safeguards compliance requirements. While there is a natural tension in the relation between compliance reviewers determined to uphold the highest standards and operations staff seeking to move a project to approval and implementation, a great danger is that the situation may lead to a compliance culture that places risk avoidance on a higher plane than the search for solutions to sustainability problems.
- 2.14 The report also noted the **challenges associated to ESG's dual role as compliance reviewer and provider of environmental technical support.** It stressed the need to place a premium on designing sustainable solutions to compliance issues and offer incentives and training..
- 2.15 In addition, the report noted (i) the growing needs for environmental training and capacity across the organization, particularly in Country Offices; (ii) the usefulness of

Strategic Environmental Assessments to assess cumulative impact from complex and regional operations; (iii) the potential of strengthening and leveraging country safeguards systems and harmonizing safeguard requirements with other MDBs and International Finance Institutions.

A new strategic direction for Sustainability at the IDB

2.16 The report concludes its analysis with a strong message to encourage the Bank to continue in its leadership path by evolving from a compliance culture that is able to anticipate and manage risks to a mainstreaming culture that proactively leverages the opportunities to foster sustainable development in the region and makes the most of the richness and competitive advantages of our region's biodiversity and ecosystems.

Recommendations

2.17 In response to the diagnostic and strategic direction described above, the IAG report proposes a series of recommendations:

- i. Provide leadership in the mainstreaming of sustainability considerations in the Bank's strategies, programs and operations through a figure like a Chief Sustainability Officer
- ii. Develop a Sustainable Development Framework to guide and monitor the implementation of the Environment and Safeguards Policy
- iii. Allocation of Environmental Staff Resources to effectively implement the mainstreaming aspects of the policy. In particular more environmental staff should be allocated to SCF and in the COFs
- iv. Streamline the focus of ESG to rationalize the dual role of compliance reviewer and provider of technical support in project design. ESG should focus primarily on safeguards compliance, strengthening country systems, ensure coordination with other IFIs and developing Bank wide indicators on project impacts.
- v. Strengthening the Bank's training offering in environmental issues
- vi. Devoting financial resources to emerging sustainability issues and exploring new areas of intervention to transform the traditional model of development into a new paradigm that recognizes the value of the environment as a source of economic growth.

III. THE IDB WORKING GROUP ON SUSTAINABILITY

3.1 The IDB Sustainability Working Group (IDB-SWG) was convened by the Executive Vice President (EVP) and chaired by the Principal Advisor to the EVP. The IDB-SWG

included a representation of the four bank Vice Presidencies as well as the Managers of the Strategic Planning Department (SPD), the Legal Department (LEG), the Infrastructure and Environment Sector (INE), the Social Sector (SCL), the Structured and Corporate Finance Department (SCF), the Knowledge and Learning Department (KNL), the Multilateral Investment Fund (MIF), the Inter American Investment Corporation (IIC) and the Division and Unit Chiefs of the Environment and Rural Development Division (RND), the Environment and Safeguards Unit (ESG), and the Gender and Diversity Unit (GDI).

- 3.2 The IDB-SWG met during Q2 and Q3 2011 to review and discuss the recommendations of the AIG Report.
- 3.3 In response to the emphasis placed by the report on the need to focus on the mainstreaming aspect of the Bank’s Environment and Safeguards Policy, the group structured its work around two main tracks:
 - i. Mainstream environmental and sustainability considerations
 - ii. Addressing sustainability considerations in the Bank’s private sector operations
- 3.4 The Working Group combined plenary discussions with break-out sessions to address specific issues within each of the two main tracks. The IDB-SWG also received support from various members of the IAG, including Tom Lovejoy (IAG Chair), Emma Torres, Francis Sullivan and Walter Arensberg.
- 3.5 The following chapter presents the IDB-SWG response to the recommendations from the IAG report and an associated action plan.

IV. FROM MANAGING RISKS TO EMBRACING NEW OPPORTUNITIES

“The Latin American and Caribbean region is a biodiversity superpower. It has one of the greatest endowments of natural capital in the world, which is a source of economic growth and has the potential to become the world leader in offering the services its ecosystems and biodiversity provide, and in return receive new benefits from this conservation and sustainable management.”²

- 4.1 The major conclusion from the IDB-SWG’s interpretation of the IAG report was that the Bank has made significant progress in managing the risks associated to environmental and sustainability considerations in its operations and is now in a position to build on this capacity and move to a new approach focused on helping the LAC region leverage the comparative advantage the lies on its natural resources. In other words, **expanding from managing risks to embracing new opportunities.**

² Latin America and the Caribbean: a Biodiversity Superpower, UNDP. Quoted in IAG Sustainability Report

- 4.2 For purposes of implementation, OP-703 is organized into two sets of Policy Directives. The first set - Policy Directives A1 to A7-covers the Bank’s objectives and actions with regard to “mainstreaming” environment through a set of “do good” and proactive sustainability directives. The second set of Policy Directives (B1-B17) focuses on safeguard and “do no-harm” measures to ensure that Bank financed operations comply with the right set of risk management and mitigation measures.
- 4.3 The IAG report concluded that the Bank’s Environmental and Social Safeguards policies are adequate and noted that, while efficiencies should be introduced in the application of the safeguards compliance policy directives, the main priority for the Bank should be to focus on improving the application of the mainstreaming policy directives and in strengthening the Bank’s efforts in addressing emerging sustainability issues in the region. The IDB-SWG structured its work around two tracks in order to respond to the priorities established in the IAG report. The IDB-SWG will work to address the recommendations aimed at improving efficiency in the application of the safeguard compliance directives.
- 4.4 The following action plan describes the proposed actions each track.

Mainstream environmental and sustainability considerations

- 4.5 In response to the challenges and recommendations outlined in the IAG report as it relates to mainstreaming environmental and sustainability considerations, the IDB-SWG proposed the following initiatives.
- i. **Improve the integration and mainstreaming of environmental sustainability considerations into Bank Country Strategy and Programming exercises.** VPS/INE will work with VPC and SPD to develop a pilot experience to incorporate the environmental dimension into the Country Strategy and Programming exercises and products. As a first step, environmental sector notes will be carried out as part of the Country Strategy and Programming exercises in four (4) countries. The environmental sector notes will be prepared in accordance with SPD guidelines and should meet the following principles, and should specifically be: (i) an integral part of the Country Dialogue and Country Strategy development process, led by VPC; (ii) focused on the critical sustainability issues for the country and their relation with the areas that the country has prioritized for work with the Bank; (iii) carried out in a timely manner; (iv) coordinated or integrated with the development of Climate Change Sector Notes and the environmental risk assessment notes produced as per Directive A.6.

Once the pilot has been completed, VPC and VPS/INE will proceed to extend the practice to new Country Strategies.
 - ii. **Review Bank’s experiences in promoting environmental and sustainability governance.** The IDB-SWG recognized the challenges indicated in the IAG report in terms of promoting environmental and sustainability governance. The Bank and other institutions have placed significant efforts but the needs remain

high. Improved environmental and sustainability governance in LAC would bring a broad range of benefits to the region and would pave the road for the Bank to increasingly rely on Country Systems. The IDB-SWG recommends an analysis of the Bank's interventions in this area and, based on this analysis, will promote environmental and sustainability governance as an enabler to implement its Country Strategies through greater reliance on country systems.

- iii. **Increase Bank's focus on Biodiversity and evaluate the possibility to develop a Biodiversity initiative with similar characteristics as the Climate Change initiative.** VPS/INE will increase its focus on Biodiversity with a view of designing an initiative that would support the development of cost effective solutions that rely on maximizing the region's natural resource assets, making it a powerful center of economic benefits for local communities – many of which are indigenous – by furthering environmentally sound practices such as sustainable agriculture, eco-tourism and forestry conservation activities tied to biodiversity, carbon, water and other ecosystem services.

This approach requires raising awareness and taking into consideration and attributing value to the biodiversity and natural ecosystems, as part of a country or a region's capital stock. The LAC region faces a great opportunity to recognize the value of its natural resources and use this value to promote sustainable development and poverty reduction.

- iv. **Prepare a Bank wide approach towards the 2012 Earth Summit (Rio+20) covering environmental and social sustainability.** In 1992, governments, development organizations and civil society met at the Earth Summit in Rio de Janeiro and brought the relationship between economic development and the environment into the global and public agenda. In June 2012, 20 years later, the challenge is even more ambitious - with a growing population, increasing demands for food and energy, and the world's ecosystems degrading at a faster pace than ever before, Rio+20 will attempt to establish new approaches to economic growth that not only draw upon, but also sustain our planet's biodiversity.

There is also a growing expectation that Rio+20 will be considering the development of Sustainable Development Goals (SDGs). Such goals could help marshal political support and means of implementation to inform the MDG post 2015 framework.

In that context, the IDB, as a key player in the LAC region, should prepare a comprehensive approach to this conference and help raise the profile of LAC and its unique opportunities. The IDB-SWG will be working on a comprehensive Bank wide approach that would include the presentation of the Bank's biodiversity platform, a communication campaign with a documentary on LAC's biodiversity and an IDB position paper on Green Economy.

- v. **Transform the Sustainable Energy and Climate Change Unit (ECC) into a Climate Change and Sustainability Division.** The IDB-SWG agrees with the view that, given the importance set out in IDB-9 to climate change and sustainability through a lending program target and the implementation of the Bank's Strategy for Climate Change, and based on the IAG recognition of the SECCI model, it would make sense to give ECC an organizational position aligned to its functions to articulate climate change with sustainability issues.
- vi. **Knowledge Management initiatives to facilitate mainstreaming of environmental and sustainability considerations.** The IDB-SWG will work with VPS/KNL to expand the knowledge base among Bank staff and regional stakeholders about the economic and environmental value of biodiversity through training, knowledge sharing, documenting Bank's experience and creating strategic partnerships with regional and non-regional academic and research institutions.

Addressing sustainability considerations in the Bank's private sector operations

- 4.6 IDB-9 establishes two strategic goals that build on the Bank's comparative advantages and are essential to achieve its corporate mission: *address the special needs of the less developed and smaller countries and foster development through the private sector*. In line with this, the Bank will gradually move from the 10 percent statutory ceiling on NSG lending to an amount such that risk capital requirements for NSG operations will not exceed 20 percent of total Bank equity calculated in the context of the Bank's capital adequacy policy.
- 4.7 With a Private Sector operations pipeline and portfolio in a growth track, and in response to the challenges and recommendations outlined in the IAG report as it relates to improving the efficiency of the implementation of the policy in the Bank's private sector operations, the IDB-SWG proposed the following initiatives.
 - i. **Greater reliance and strengthening of country systems.** The Bank will increase emphasis on strengthening country systems for operations, including NSG and SG operations. The IDB-SWG proposes to establish dedicated resources for strengthening country systems, which will include not only undertaking equivalency analysis, but also to support the borrower's capacity to facilitate reliance on country systems.
 - ii. **Seek consistency with other MDBs.** Given their use by several co-financing institutions the group identified the IFC's Performance Standards (PS), as the point of reference for private sector operations. A comparative analysis of the IFC's performance standards is underway and will include in 2012 a review of the IFC guidelines, as well as the proposed approach being considered for updating the World Bank safeguard policies. The group will review the results of the analysis and propose to the Board any changes required to the IDB's Environment and safeguard Policy to ensure harmonization of IDB's safeguards with international benchmarks, including IFC's PS and World Bank policies.

iii. **Mainstreaming sustainability considerations in private sector operations.**

The group identified a number of opportunities to improve mainstreaming and increase efficiency in the application of safeguards compliance policies in the growing pipeline and portfolio of private sector operations. These include fostering cross relations, standardizing requirements (FI manual/scorecard) and continuing to enhance teamwork between SCF and ESG by strengthening incentives. The group will continue to look at the practices at the IDB in order to continue to have a close dialogue between SCF and ESG to ensure efficiency and effectiveness in the application of safeguards to private sector operations.

SCF will increase its efforts to integrate sustainability considerations and leverage new opportunities in new sectors related to sustainability through dedicated sustainability/environment specialists. This will allow a more sophisticated dialogue and the development of more innovative operations with a greater added value and additionality. In addition, ESG will embed dedicated officers to SCF's divisions to strengthen collaboration and priorities and streamline the focus of safeguards.

The MIF has continued its work in energy efficiency, sustainability, and conservation, in complement to the Bank. In the last year, through adoption of the Access Framework, the MIF consolidated these activities into a new Climate Change team. This team, which has staffed-up in 2011, continues to develop operations, knowledge products, and action plans for sustainable MSME development.

V. CONTINUED OVERSIGHT OF SUSTAINABILITY CONSIDERATIONS

- 5.1 The IAG report recommended that the Bank to continue providing leadership in the mainstreaming of sustainability considerations in the Bank's strategies, programs and operations. It explicitly recommended creating a role to lead this process and guide and monitor the implementation of the Environment and Safeguards Policy.
- 5.2 The IDB-SWG, under the leadership of the Principal Advisor to the Executive Vice President, will oversee the implementation of the action plan described above and will lead the discussions related to sustainability and environmental considerations at the Bank.
- 5.3 The IDB-SWG will also continue to address other recommendations from the IAG report, in particular as it relates to improving the efficiency and effectiveness in the application of the safeguards policy directives. This will require developing improvements in the application of the safeguard functions in a way that ensures effective compliance and enhanced competitiveness.
- 5.4 In order to continue to strengthen the Safeguards Compliance process to ensure that Bank operations achieve the aims of OP 703, ESG will work with the IDB-SWG will increase its efforts in raising awareness and increasing the understanding of the Bank's safeguards

policies' requirements and processes among SG and NSG operations staff. The IDB-SWG will also review the experience of comparable organizations, including MDBs such as the Asian Development Bank, IFC, and World Bank, as well as other bilateral financial institutions, and commercial banks with which the IDB co-finances operations.

- 5.5 One of the first lessons from the ADB experience is the clear benefit of a consolidated community of practice with a similar mandate to the IDB-SWG, which convenes and discusses sustainability considerations regularly.
- 5.6 The IDB-SWG will transition into a community of practice that will convene at least four times a year, with the members described above. It will also keep the members of the IAG in an advisory role as needed.
- 5.7 The following will be the main functions of the IDB-SWG
 - i. Monitor the implementation of the IDB Sustainability action plan
 - ii. Support for dialogue on sustainable development across sectors within the Bank
 - iii. Advocate sustainability and the opportunities associated to the transition towards the Green Economy among Bank employees
 - iv. Development and promotion of innovative sustainable approaches through Bank lending and non-lending operations