

Risky venture

The AIIB's hands off approach to funding infrastructure in India

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Cover Image: State police officials standing on guard at a project site, acquired from farmers for a factory in Singur, West Bengal.

Photo credits: Joe Athialy

Introduction

In June 2018, India is playing host to the third Annual Meeting of the world's newest multilateral development bank (MDB), the Asian Infrastructure Investment Bank (AIIB). India is the second largest shareholder in AIIB, after China and ahead of Russia, and holds substantial sway over decision-making. It is currently the largest recipient of AIIB investment, with over US\$1 billion in committed financing.ⁱ

Financing and building infrastructure - roads, ports, railways, power plants and more - is a cornerstone of Indian Prime Minister Narendra Modi's administration.ⁱⁱ Expanding infrastructure was a priority of his BJP election platform in 2014, which saw the party gain a landslide victory. At the AIIB's first Board of Governors meeting in June 2016, India's Finance Minister Arun Jaitley announced that the country suffers from an infrastructure financing 'gap' of up to US\$1.5 trillion.ⁱⁱⁱ The timing of the announcement was no coincidence - the Indian government hopes that the AIIB, in which India is both donor and recipient, will invest not only its own funds, but catalyse and attract other investors with its triple A credit rating.^{iv}

The AIIB prides itself on being 'lean, clean and green'. The bank's Energy Sector Strategy, approved in June 2017, explicitly commits AIIB to the Paris Climate Agreement and the United Nations' Sustainable Development Goals. However, the strategy does not specifically stop the AIIB from unsustainable practices, most significantly the financing of coal.^v In March 2017, 31 civil society organisations (CSOs) in India wrote to the AIIB saying, "We remain deeply concerned that the supposedly 'green' bank still may end up funding dirty fuels across Asia, including coal and gas thermal plants, as it does not exclude these. Other MDBs have renounced coal funding, and the AIIB should not undermine this broader position."^{vi}

Of particular concern is the increasing trend of lending through third parties - or 'financial intermediary' (FI) lending. In this model, a bank invests in an intermediary such as a commercial bank or an infrastructure fund, which then on-lends to a subproject or client. This 'hands-off' lending carries high risks because social and environmental standards become diluted, and there is little to no transparency about where the money ends up. The AIIB dipped its toe into FI lending in 2017, approving three FI investments: in Indonesia's Regional Infrastructure Development Fund; the India Infrastructure Fund (IIF); and the Emerging Asia Fund. Next up is a potential \$200 million commitment to India's National Investment and Infrastructure Fund (NIIF), which is coming before the Board at the June 2018 AGM.^{vii}

This briefing summarises some of the available information and concerns about the IIF and the NIIF, as well as recommendations on how the AIIB can close the loop-

holes that expose it to the risk of financing coal and other damaging projects through FIs.

APPROVED: AIIB and the India Infrastructure Fund

In June 2017, during its second Annual General Meeting in South Korea, the AIIB's Board approved a US\$150 million equity investment in the India Infrastructure Fund (IIF).^{viii} Leading up to the Board's decision, CSOs in India and internationally raised concerns about the investment, arguing that AIIB's standards were not adequate to prevent risky investments and that the IIF was potentially heavily exposed to the coal industry.^{ix} It transpired that the AIIB's investment was into a different fund with exactly the same name. The confusion arose from the fact that no information was publicly available about the AIIB's IIF, save a very vague project information document posted on AIIB's website.

Further information was not made available until March 2018, through an update to the AIIB's project document which revised the name of the fund to the North Haven Infrastructure Investment Fund, managed by Morgan Stanley, an American multinational investment bank and financial services company.

The AIIB investment

AIIB has invested up to US\$150 million into the IIF, representing 20 per cent of the total committed capital for the fund. The objective for the investment is "to benefit mid-cap infrastructure projects in India by creating a mechanism to mobilise private capital from global long-term investors such as pension funds, endowments and insurance companies." The fund aims to achieve this through investments in "infrastructure platforms and infrastructure service companies with high growth potential that derive their revenues principally from India." Targeted sectors include energy and utilities; transportation and logistics; urban public-private partnership projects; and healthcare and education.^x

The AIIB's rationale for using an FI as its investment vehicle is that it will enhance "its development impact by increasing the number of investments [it] can transact", as well as providing it with "an effective way to deploy capital by allowing [it] to make investments it would not have been able to execute on its own". The AIIB also spells out an expectation of long term income and capital gains for the bank through the investment.

According to India's Economic Times, the IIF was expected to close in March 2018 with a ten year life span.^{xi}

Concerns

Despite the AIIB's updating of the project documentation, there is no information publicly available about any investments the IIF has made or is considering. This is despite assurances to civil society by the AIIB's DJ Pandian in June 2017 that there was no obstacle to releasing that information.^{xii} Nor is other crucial information, such as environmental and social policies, about the North Haven Infrastructure



Women affected by the IFC-funded India Infrastructure Fund coal power project, GMR Kamalanga Energy. (Photo: Joe Athaly)

THE RISKS OF STALLED PROJECTS

While the National Investment and Infrastructure Fund is yet to name the projects that it is considering financing, it is worth taking a look at the types of stalled project that form part of the Indian government's plans and therefore could be eligible for NIIF support.

Power projects continue to dominate stalled projects: 39.04% of total stalled projects by value is in the electricity sector. One such project is the highly controversial Srikakulam Thermal Power Station in Andhra Pradesh. This project was originally proposed as a 2,400 MW coal plant by Andhra Pradesh Power Generation Corporation (APGENCO). However, in December 2014 it was reported that APGENCO had signed a Memorandum of Understanding with Japan-based Sumitomo Corporation for a 4,000 MW coal plant in Srikakulam district. In August 2015, after witnessing the growing protest by the farming community, the government of Andhra Pradesh told Sumitomo that the company would be limited to 1,650 acres of land, rather than the 3,000 acres that the company had sought. The government argued that the amount of land needed to store coal could be limited by bringing coal by conveyer belt, due to the project's seaside location. By limiting the acreage of the plant, the government was reportedly seeking to minimise the amount of land that would need to be acquired from local farmers.^{lxxxix}

Villagers in Thotada, Rallapalli and Susaram objected to the plant on the basis that the government did not actually possess the 1,300 acres that it claimed to have available for the project. Since the area comprised fertile agricultural land, local communities were not prepared to let the government acquire their land. Opposition parties also extended their support to the farmers, while representatives of farmers' associations accused the government of trying to intimidate opponents of the plant by deploying a heavy police presence to the area. In April 2017, the government of Andhra Pradesh took the decision to defer construction of the 4,000 MW plant until 2022.

At a summit organised by the Indo-American Chamber of Commerce the Minister for Road Transport and Highways explained how the stalled projects had been re-started: "Land acquisition, environment, forest clearance, etc., were the problems. Now, we have cleared all these things".^{lxxxix}

Investment Fund publicly available. It is therefore impossible for concerned Indian citizens, potentially affected communities, and civil society to assess whether the AIIB is ensuring that its social and environmental protections are being implemented in this investment.

IN THE PIPELINE: AIIB and the National Investment and Infrastructure Fund (NIIF)

The next FI up for approval by the AIIB is a US\$200 million investment in the NIIF - a mega-FI or “fund of funds” that will invest in several sub-funds. It is a showpiece of the Indian government, vital to its plan to attract investors such as sovereign wealth funds, insurance and pension funds, endowments and other private investors, to the country’s infrastructure sector. NIIF has been in the AIIB’s project pipeline since mid-August 2017 but, despite being scheduled for approval the first quarter of 2018, it is only now coming before the Board at the AGM in Mumbai.^{xiii}

NIIF has had a rocky time since its launch in 2015. Touted as a vehicle that would attract financing from Russia, United Arab Emirates (UAE), Singapore and other sovereign wealth funds, the corpus was proposed to be about US\$6 billion (Rs 40,000 crore) with the Indian government investing 49 per cent. However, NIIF failed to secure any investment in the first two years, resulting in scathing media reports.^{xiv} Moreover, rather than the “weeks” promised by Finance Minister Jaitley to recruit a CEO for the Fund, this key appointment was not made until June 2016 - a delay the UAE, one of India’s major potential partners in the Fund, said had deterred investment.^{xv} NIIF’s first investment platform, focusing on ports, transportation and logistics businesses, was not set up until January 2018, which was followed in April by NIIF’s first investment: £120 million into the Green Growth Equity Fund, a partnership with the UK Government to leverage private sector investments from the City of London towards green infrastructure projects, in particular renewable energy, in India.^{xvi}

The proposed AIIB investment

The AIIB states that it is considering investing in a fund created by NIIF “with an aggregate target corpus of US\$2.1 billion”, out of which the Indian government will contribute with US\$1 billion. The main aim of the fund is to maximise economic impact by being a catalyst for the mobilisation of “more private sector capital into infrastructure sectors, and increase infrastructure investment in India.” The fund’s main investment vehicle will be sector specific platform companies, created by the fund “in partnership with a limited number of financial investors”, which will target “infrastructure assets primarily in the following sectors: roads, ports, airports, power (generation, transmission, distribution), urban infrastructure, and logistics.”^{xvii}

There is no further information available on AIIB’s or NIIF’s websites on the fund regarding what sectors or specific projects will be prioritised through the AIIB investment,

nor an updated official timeline regarding the investment approval. In February, President Jin emphasised AIIB’s support for NIIF, expecting it to “take off soon.”^{xviii} In May, Indian newspaper Business Express indicated that AIIB was working with NIIF to identify an agreeable structure of the fund in time for approval during the Annual Meeting in June, with the AIIB being particularly interested in the Green Growth Equity Fund.^{xix}

Concerns

In mid-March, 31 Indian CSOs wrote to M.M. Kutty, the Executive Director representing India at the AIIB, to raise concerns about the proposed investment into NIIF and called for the Board not to approve it. The letter pointed specifically to the NIIF’s focus on high-risk sectors in India, which could lead to “serious impacts on local communities and natural resources. Given this, we are deeply concerned about the lack of transparency around NIIF’s sub-projects and clients, and serious concerns that social and environmental protections will not be applied to projects funded by NIIF.”

The letter highlighted the fact that no information is available regarding sub-projects or clients expected to be supported by the NIIF investment: “This total absence of transparency is not acceptable. How can the AIIB’s Board take a decision to invest in a fund when it does not know where that money will end up and therefore cannot guarantee that those projects will do no harm?” It called on the AIIB to demand that all FI clients disclose their investments publicly to help ensure “that affected communities are aware that the sub-projects must comply with environmental and social standards and can approach the AIIB and its Board at early stages if those standards are not being met.”^{xx}

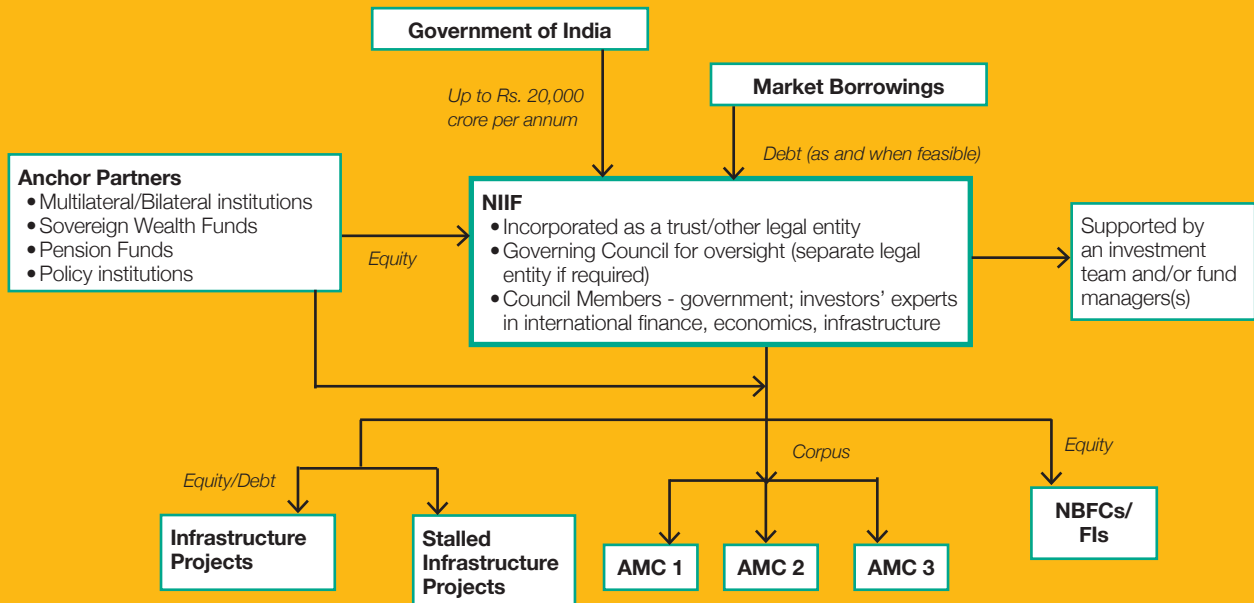
A significant risk associated with the NIIF is its mandate to re-start ‘stalled’ projects.^{xxi} This is in line with Prime Minister Modi’s vow to revive long-stalled infrastructure projects, especially in the coal, power, petroleum, railways and road sectors. Raising finance to re-start stalled projects brings with it high social and environmental risks. The reason many projects are stalled often relate to land, and environmental and social restrictions in place. In other words, local resistance has stalled projects - such as coal mines and power plants - because of their potential impacts: threatening to displace and impoverish communities, destroy forests or pollute rivers. A 2016 report by the Rights and Resources Institute and the Bharti Institute for Public Policy stresses the role that disputes over land and resources have played in delaying projects:

Restarting such projects brings with it a host of risks - not least the reputational risk to any financier involved. The question is whether these are risks potential investors such as the AIIB are willing to shoulder?

The structure of the NIIF

The Indian government has already approved its contribution of Rs 20,000 crore towards NIIF, but by mid 2017 - due to a lack of investors - had not yet disbursed those funds.

Structure and Composition of NIIF



Source: Arthapedia. Rs 1 crore = Rs 1 million = circa \$160,000

Analysts have seriously underestimated the role that land-related conflicts play in stalling investment projects, and the magnitude of the cost imposed by these conflicts on the Indian economy and society. Out of 80 high-value stalled projects, more than a quarter (21 projects) are stalled due to land disputes.^{lxxxiii}

At the same time, the Indian government has enacted reforms to over 100 policies and procedures including setting up an online land allotment system, creating a single window system for granting construction permits, and reforms to labour laws. While such changes have resulted in India leaping 30 points up the World Bank's 'Ease of Doing Business' scale, critics argue that the reforms have watered down many essential environmental and social protections to facilitate speedy investment.^{xxii}

The high risks of third-party lending

Social and environmental impacts of sub-projects:

There is a high risk of losing control of the outcomes of sub-projects when funding through FIs, threatening to result in harm to communities and natural resources. This risk is especially high with infrastructure projects. The World Bank's private sector arm and standard-setter for private finance globally, the International Finance Corporation (IFC), has learnt this lesson the hard way. After numerous cases filed to its complaint mechanism relating to harmful projects funded via FIs, the IFC has cut its high-risk FI lending significantly in the last year, from 18 to 5

investments.^{xxiii} The IFC has also reduced its exposure to harmful sub-projects by turning away from equity investments.^{xxiv}

In India, one such controversial IFC-funded FI project is the GMR Kamalanga thermal Power Project in the state of Odisha.^{xxv} The project has been marred by serious human rights violations and environmental and social concerns. With none of the social and environmental policies of the IFC applied to this FI sub-project, affected communities had no access to information as to who was the funder of the project and whom to approach with their demands. Eventually, supported by a local NGO, the communities were able to trace the fund back to the IFC, and filed a complaint to the Compliance Advisor Ombudsman (CAO), the IFC's accountability mechanism.^{xxvi} The CAO's resulting audit confirmed serious breaches of the IFC's environmental and social policies, however, little has changed for communities on the ground who continue to suffer the negative impacts of the project.

Lack of transparency. Similar to what we know about both IIF and NIIF, the IFC's India Infrastructure Fund also aimed to support equity investments in energy projects and utilities, transport infrastructure, telecommunications, and other infrastructure solely in India. The AIIB's Energy Sector Strategy states: "In the case of financial intermediaries, attention will be paid to their capacity for environmental and social management and careful screening of sub-projects."^{xxvii} However, it is unclear whether the AIIB

Board are aware of which sub-projects IIF has supported to date, nor is there much concrete information about the sub-projects the NIIF might fund.

In response to a January letter sent by the NGO Forum on ADB on behalf of 30 CSOs requesting a number of reforms to AIIB's FI lending, AIIB Vice-President von Amsberg committed to ensuring that both FI clients and the AIIB release information about FI sub-projects. This included the disclosure by FIs of "relevant social and environmental documentation" in a manner "proportionate to the associated environmental and social risks and impacts". He also wrote that "For its part, the Bank undertakes to ... disclose relevant environmental and social documentation on these sub-projects." To date, however, this information is simply not available. The commitment also falls short of defining exactly which subproject information will be made available (for example, environmental and social impacts assessments, resettlement actions plans, indigenous peoples plans etc.) and crucially when.

It is essential that project documents are made available to stakeholders before project approval and that high and substantial risk projects financed through infrastructure funds or FIs are disclosed publicly. Not only does such transparency ensure accountability to affected commu-

nities (and the opportunity of redress should things go wrong), but it is crucial in allowing risk identification, supervision and management. Spotting and managing risks up front is often cheaper and less time-consuming than having to rectify mistakes later. Allowing stakeholders to participate and contribute their views and knowledge is key to ensuring the full impacts of projects are known and addressed (or avoided) early-on in the project cycle.

AIIB's Environmental and Social Framework (ESF) is not sufficiently robust in its disclosure requirements. For example, it does not commit to disclose documents a specific number of days before project approval, nor does it mention information disclosure relating to financial intermediary investments. The AIIB's draft Public Information Policy released for public consultation at the beginning of 2018, is also not reassuring. It does not specifically mention information disclosure in financial intermediary lending, despite this being a high risk investment activity. Furthermore, the draft policy puts in place restrictions which could presume against information disclosure by FIs, such as: "the Bank shall not disclose information, if doing so would prejudice the financial worth or competitiveness of a natural individual person or the Bank or any other corporate entity, or their assets." Nor does the draft policy commit to time bound disclosure of project

Activists meeting to discuss the Delhi Mumbai Industrial Corridor. (Photo: Joe Athialy)





An old lady sitting dejected in front of the partly demolished structure which was once her home. Mumbai witnessed massive urban demolitions in the recent times, that has left many thousands homeless. (Photo: Joe Athialy)

information - an essential step in ensuring information is available early enough in the project cycle for risks to be spotted and managed or averted.

The coal loophole

Investments into the energy sector deserve particular attention in the era of the climate change crisis. Today, India is at an energy crossroads: with a burgeoning solar industry and massive untapped renewable potential, a big shift to clean energy is already underway. But at the same time, India is historically dependent on coal.^{xxviii} What happens next is crucial, given that energy demand - which has doubled since 2000 - will continue to rise as India's economy grows, contributing fully one quarter of the world's predicted rise in demand. The International Energy Agency predicts this growth will be fuelled by coal: "Surging consumption of coal in power generation and industry makes India, by a distance, the largest source of growth in global coal use."^{xxix}

AIIB President Jin was very clear when he told attendees of 2017's AGM in Jeju, South Korea, "there are no coal projects in our pipeline, and we will not consider any proposals if we are concerned about their environmental and reputational impact." Both IIF and NIIF have the potential to play a catalytic role in shaping India's energy future, if the right choices to back sustainable and clean energy options are made. However, a risk that comes with financing projects via intermediaries is that it is very difficult to track where the money actually ends up. The Bank's Envi-

ronmental and Social Framework is not sufficiently robust to stop coal and its safeguards applying to FIs are weak.

The AIIB should learn from the mistakes made by the World Bank in this regard. Despite commitments that it would only fund coal "in exceptional circumstances", in its indirect lending - through policy loans and through FIs - the World Bank remains, however inadvertently, steeped in coal. In just three countries, India, the Philippines and Vietnam, recent research uncovered over 40 coal mines and plants backed by the IFC through FIs since that 2013 pledge.^{xxx} This was not part of some deliberate strategy to back coal secretly - rather it happened because stringent protections and exclusions to ensure such damaging projects did not slip through the net were either absent or not enforced. The IFC has now begun "tracking FI clients' exposure to coal, and plans to incorporate a reporting requirement on coal exposures in legal documents with all new FI clients".^{xxxi}

Such loopholes can and should be closed, to ensure that the AIIB's lending through FIs does not end up financing harmful projects such as coal by the back door. In this context, it is crucial that the AIIB act to avoid social, environmental and reputational damage associated with its FI portfolio, especially as it moves to approve more and more FI investments, including the NIIF. The AIIB can do so by putting in place robust policies and systems around FIs to ensure transparency, accountability and efficient channels of communication with all stakeholders.

RISKY BUSINESS: The problems with hands-off lending through intermediaries

While investing in financial intermediaries can help to mobilise funds and attract private capital for economic development, this form of third-party or 'hands-off' lending also comes with significant risks, in particular around clients' adherence to environmental and social (E&S) safeguards. In recent years, the International Finance Corporation (IFC) - which has channelled more than half of its investment portfolio via FIs - has come to acknowledge these risks, and has taken some steps to address them. Following critical findings from both the IFC's own accountability mechanism, the Compliance Advisor Ombudsman (CAO) and from civil society, the IFC's CEO, Philippe Le Houérou, has committed to reduce high-risk lending through FIs, saying "we will reduce IFC's own exposure to higher risk FI activity, and apply greater selectivity to these type of investments."^{xxxiv}

In March 2017, the CAO released its third monitoring report on the IFC's financial sector portfolio.^{xxxv} The report examined actions taken by IFC to address the findings of the CAO's 2012 Audit of a Sample of IFC Investments in Third Party Financial Intermediaries, in which the CAO found, among other things, that the "result of [IFC's] lack of systematic measurement tools is that IFC knows very little about potential environmental or social impacts of its F[inancial] M[arkets] lending."^{xxxvi} In the 2017 update, the CAO found that the "IFC does not, in general, have a basis to assess FI clients' compliance with its E&S requirements." As the CAO states, this is highly problematic in relation to FI clients that are supporting high-risk projects, and "where IFC does not have assurance that the development of a client's ESMS [Environmental and Social Management System] is leading to implementation of the Performance Standards at the sub-project level."^{xxxvii}

Independent research carried out over the last year has supported these findings. Inclusive Development International (IDI) conducted a forensic investigation to track IFC's investments in financial intermediaries to their end use. This research examined the business of only a tiny segment of the 700 financial institutions and 220 private equity funds in the IFC's FI portfolio; however, IDI found more than 130 projects and companies funded by two dozen IFC intermediaries that are causing or are likely to cause serious environmental harms and human rights violations. The projects are located in 24 countries and come from a range of high-risk sectors, including energy, industrial agriculture, mining, transportation, infrastructure, and even private military contracting. In each of these cases it is apparent that IFC's environmental and social Performance Standards are not being applied. IDI has detailed these findings, in collaboration with Bank Information Center, Urgewald, 11.11.11, Ulu Foundation and Accountability Counsel, in a four-part investigative series, entitled Outsourcing Development: Lifting the Veil on the World Bank Group's Lending through Financial Intermediaries.^{xxxviii}

Even with regard to renewable energy projects, it is important that sub project information is disclosed. Unlike in the United States, Germany, Australia and other nations with large renewable programmes, the vast majority of solar power in India comes not from decentralised rooftop panels but from expansive parks. Indian authorities have enticed developers by acquiring land, building transmission links and offering up buyers for the new power, usually state-owned companies with low default risk.^{xxxii}

These mega-projects necessitate the acquisition of huge land areas. There are already signs of trouble with three recorded conflicts^{xxxiii} related to land acquisition for renewable energy projects. One of these involves an ultra-mega solar park with a capacity of 500 MW or more in Ananthapur district^{xxxiv} in western Andhra Pradesh, according to Land Conflict Watch, a mapped online repository of land conflicts across India. Hence, even with renewable energy projects, there are concerns around the scale of environmental and social impacts since they can resemble other mega projects and require greater transparency and risk management than smaller projects.^{xxxv}

Recommendations

The AIIB should put in place robust policies and systems around financial intermediary investments to ensure transparency, accountability and effective channels of communication with all stakeholders. This includes:

- Contractually requiring the FI client to disclose publicly all of its investments and permit the AIIB to disclose the information on its website. This will help to ensure that affected communities and other stakeholders are aware that the sub-projects must comply with environmental and social standards and can alert the client, the AIIB and its Board at early stages if those standards are not being met. A provision requiring this disclosure of FI sub-projects should be included in the AIIB's forthcoming Public Information Policy;
- Scrutinising the existing project portfolio and pipeline of proposed FI clients to ensure that all projects are in line with the bank's policies and strategies;
- Ensuring that the proposed FI client has in place a robust environmental and social management system before the investment is approved;
- Reviewing the track record of the FI client in applying the environmental and social framework and making



The GMR Kamalanga Energy coal power project in Odisha, funded by the IFC-backed India Infrastructure Fund. (Photo: Joe Athialy)

- this assessment public;
- Ensuring that FI clients require sub-projects to comply with all AIIB policies especially the Environmental and Social Framework (ESF), Complaints Handling Mechanism (CHM), Public Information Policy, and all relevant sectoral strategies and guidelines to enable FI sub-projects to be accountable to AIIB oversight and due diligence at all stages of the project cycle;
- Monitoring the proposed client's social and environmental due diligence and supervision of its investment; and
- Ensuring FI sub-project affected communities have access to redress, including through the AIIB's accountability mechanism.

Specifically with regard to the IIF and NIIF:

- No funds should be disbursed and no loans granted until there is clarity as to which particular project is being supported by the fund and there is public disclosure of that information.
- Until all environmental and social and transparency policies are approved after a thorough process of consultation with all stakeholders including CSOs and affected communities, and an adequate complaints and accountability mechanism is in place, no further projects should be approved, whether co-financed or through FIs.
- All policies which are applicable to AIIB projects financed directly should also be applicable to FI projects.
- Communities should be informed of the relevant AIIB policies and the availability of a complaints and accountability mechanism in a language and manner

they can understand and their consent should be sought before a project is approved.

With regard to energy sub-project investments:

- The AIIB should ensure none of its investments results in an increase in coal use: whether for power generation or industrial uses, or associated infrastructure dedicated to coal such as ports, railway lines or transmission lines. This includes tightening loopholes in financial intermediary lending to ensure AIIB does not inadvertently fund coal-related projects indirectly.
- Shifting from fossil fuels to sustainable renewable energy: The AIIB can send a strong signal to other development finance institutions and the financial sector by matching the World Bank's recent commitment to end financing for oil and gas extraction^{xxxvi}, establishing a plan to phase out remaining investment in fossil fuels by 2020, and shifting its investments to sustainable renewable energy. This should exclude large hydro-power projects which can cause extensive social and environmental harms.

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