

Understanding the IFC Performance Standards on environmental and social sustainability

Introduction

Environmental and social (E&S) risks can have a material impact on a company's operations, financial performance and reputation. The IFC Performance Standards provide a widely recognised framework for identifying and managing these risks, covering areas ranging from labour practices and resource efficiency to community impacts, biodiversity and cultural heritage. Understanding the standards can therefore help institutions strengthen their E&S risk management practices, while giving investors a practical framework for assessing how effectively these risks are identified and managed.

For most companies, **Performance Standards 1 and 2 are the most broadly relevant**. PS1 establishes the overall framework for identifying, assessing and managing environmental and social risks and impacts, while PS2 focuses on labour and working conditions, which are relevant to virtually every business regardless of sector. Together, they provide a foundation for a company's broader E&S management approach.

Performance Standards 3-8 address more specific environmental and social risks, including pollution, community health and safety, land acquisition, biodiversity, Indigenous Peoples and cultural heritage. Their applicability is highly dependent on the sector, location, scale and nature of a company's activities. Nevertheless, even where a particular standard does not directly apply, understanding its requirements can help institutions identify potential risks early, particularly when expanding into new activities, developing projects or operating in environmentally or socially sensitive areas.

For investors, understanding the Performance Standards can also strengthen **E&S due diligence** by providing a structured framework for assessing a company's policies, risk management systems and exposure to material environmental and social risks. The standards can be used not only to identify existing gaps, but also to understand whether an institution has appropriate systems in place to manage risks as its operations evolve.

Performance Standard 1: Assessment and management of environmental and social risks and impacts

Performance Standard 1 (PS1) establishes the overall approach to identifying and managing environmental and social risks. It requires institutions to establish an Environmental and Social Management System (ESMS) that is appropriate to the project's nature, scale and level of risk.

The ESMS is built around seven core elements:

- **E&S policy:** Establishes an institutions' overall commitment to managing environmental and social risks and impacts.
- **Identification of risks and impacts:** Procedures to identify and assesses E&S risks based on the nature of a business project, its scale, location and potential impacts.
- **Management programmes:** Sets out the actions, responsibilities and resources needed to avoid, minimise or mitigate identified risks.
- **Organisational capacity and competency:** Ensures appropriate roles, responsibilities, staff capacity and expertise are in place to implement the ESMS effectively.
- **Emergency preparedness and response:** Establishes processes to identify potential emergencies and prepare for and respond to them effectively.
- **Stakeholder engagement:** Ensures the institution's clients, investors, affected communities and other relevant stakeholders are appropriately informed, consulted and able to raise concerns.
- **Monitoring and review:** Tracks E&S performance and the effectiveness of mitigation measures, allowing the ESMS to be updated as risks or circumstances change.

For an investor, the ESMS provides a useful lens for assessing whether an institution can identify E&S risks, allocate responsibility, implement mitigation measures and monitor performance over time.

Performance Standard 2: Labour and working conditions

PS2 covers employment practices, worker-management relationships, non-discrimination, child and forced labour, occupational health and safety, retrenchment and worker grievance mechanisms.

Under PS2, an institution is expected to:

- Have **Human Resources policies and procedures** appropriate to its size and workforce that establish its approach to managing workers.
- Provide **reasonable working conditions and terms of employment**, including clear information on workers' rights and responsibilities.
- Respect workers' rights to **freedom of association and collective bargaining**, and not discriminate against or interfere with workers' organisations or alternative mechanisms for expressing workplace concerns.
- Maintain policies and practices that promote **non-discrimination and equal opportunity** in employment.
- Establish a **grievance mechanism** that enables workers, and their organisations where they exist, to raise workplace concerns without fear of retaliation.
- Prohibit **child labour and forced labour** in accordance with applicable requirements.
- Provide a **safe and healthy working environment**, taking into account the inherent risks associated with the institution's sector and operations.

From an investment perspective, weak labour practices can create operational disruption, legal exposure, reputational risk and difficulties attracting or retaining employees. Investors can therefore assess whether a company has appropriate employment policies, health and safety controls, worker grievance mechanisms and oversight of contractors and key suppliers.

Performance Standard 3: Resource efficiency and pollution prevention

PS3 covers resource efficiency, energy and water use, greenhouse gas emissions, waste management and the prevention and control of pollution.

Under PS3, an institution is expected to:

- Identify opportunities to improve **resource efficiency**, particularly in the use of energy and water.
- Implement measures to reduce **energy consumption and greenhouse gas emissions**, where technically and financially feasible.
- Avoid, minimise and control **pollution** arising from its operations, including emissions to air, water and soil.
- Manage **waste and hazardous materials** safely throughout their lifecycle.
- Consider the potential **environmental and social impacts** associated with the use of significant quantities of water and other natural resources.

From an investment perspective, poor resource efficiency and pollution controls can increase operating costs, create regulatory and environmental liabilities and expose an institution to reputational risk. Investors can therefore assess resource consumption, emissions, waste management practices, environmental permits and the institution's processes for identifying and managing pollution risks.

Performance Standard 4: Community health, safety and security

PS4 covers the health, safety and security risks that business activities can create for affected communities, including risks from accidents, hazardous materials, disease transmission and security arrangements.

Under PS4, an institution is expected to:

- Identify and assess **health and safety risks to affected communities** arising from its operations and infrastructure.
- Avoid or minimise risks associated with **worksite accidents, hazardous materials, disease transmission and other operational hazards**.
- Establish appropriate measures for **emergency preparedness and response**, particularly where incidents could affect surrounding communities.
- **Engage with affected communities** where necessary to understand and address significant health, safety and security concerns.

For Investors, weak practices can result in accidents, operational disruption, legal liabilities, and reputational damage. Investors can therefore assess whether an institution has appropriate risk assessments and response mechanisms for addressing community concerns.

Performance Standard 5: Land acquisition and involuntary resettlement

PS5 covers the physical and economic displacement that can result from land acquisition or restrictions on land use. It aims to avoid involuntary resettlement where possible and minimise its impacts where avoidance is not feasible.

Under PS5, an institution is expected to:

- Consider **alternative project designs and locations** to avoid or minimise physical and economic displacement.
- Provide **fair compensation at full replacement cost** for assets where displacement cannot be avoided and provide appropriate assistance to displaced people.
- Engage with affected communities and individuals throughout the **planning, implementation, monitoring and evaluation** of resettlement and compensation activities.

From an investment perspective, poorly managed land acquisition and resettlement can lead to legal disputes, project delays, community opposition, additional costs and reputational damage. Investors can therefore assess land ownership and acquisition processes, compensation arrangements, community consultation and any existing or potential physical or economic displacement.

Performance Standard 6: Biodiversity conservation and sustainable management of living natural resources

PS6 covers the protection and conservation of biodiversity, maintenance of ecosystem services and sustainable management of living natural resources.

Under PS6, an institution is expected to:

- Identify and assess potential **risks and impacts on biodiversity and ecosystems** arising from its activities.
- Avoid impacts on **biodiversity and critical natural habitats** where possible and minimise impacts where avoidance is not feasible.
- **Apply appropriate mitigation measures** to address residual impacts on **natural habitats and ecosystem services**.
- **Promote the sustainable management of living natural resources**, including agriculture, forestry, fisheries and other natural resource-based activities.
- Apply appropriate measures to address risks to biodiversity associated with **supply chains**, where relevant.

From an investment perspective, biodiversity-related risks can affect access to land and natural resources, operating continuity, regulatory approvals and relationships with local communities. Investors can therefore assess the institution's exposure to sensitive ecosystems as well as the adequacy of its mitigation measures.

Performance Standard 7: Indigenous peoples

PS7 covers the protection of the rights, dignity, culture, livelihoods and development interests of Indigenous Peoples affected by business activities. It recognises that Indigenous Peoples may be particularly vulnerable to adverse project impacts.

Under PS7, an institution is expected to:

- Identify whether **Indigenous Peoples** may be affected by its activities and assess the associated environmental and social risks.
- Seek to **avoid and minimise adverse impacts** on Indigenous Peoples, particularly impacts on their lands, natural resources, livelihoods, culture and identity.
- Respect the **rights, dignity, aspirations, culture and livelihoods** of Indigenous Peoples.
- Obtain **free, prior and informed consent (FPIC)** and engage in **informed consultation and participation** with affected Indigenous Peoples throughout the project lifecycle.

From an investment perspective, inadequate engagement with Indigenous Peoples can create community conflict, legal disputes, project delays, reputational damage and restrictions on access to land or natural resources. Investors can therefore assess whether an institution has identified potentially affected Indigenous Peoples, conducted appropriate consultation and established measures to avoid, minimise and manage impacts.

Performance Standard 8: Cultural heritage

PS8 covers the protection of cultural heritage, including archaeological, historical, cultural, artistic and religious sites, as well as intangible cultural heritage and traditional cultural knowledge.

Under PS8, an institution is expected to:

- Identify and assess potential impacts of its activities on **cultural heritage**.
- Take measures to **avoid or minimise adverse impacts** on cultural heritage where possible.
- Protect and preserve **archaeological, historical, cultural, artistic and religious sites and objects** that may be affected by its activities.
- **Engage with affected communities** and relevant authorities where cultural heritage may be impacted.
- Where cultural heritage is used for commercial purposes, promote the **equitable sharing of benefits** arising from its use.

From an investment perspective, damage to cultural heritage can result in project delays, regulatory action, community opposition, legal liabilities and reputational damage. Investors can therefore assess whether the institution has identified relevant cultural heritage risks, undertaken appropriate assessments and established procedures for protecting cultural heritage.

Conclusion

The IFC Performance Standards provide a practical framework for understanding and managing the environmental and social risks associated with business activities. While the relevance of individual standards will vary depending on a company's sector, activities and operating environment, the underlying principles are broadly useful for institutions seeking to strengthen their E&S practices.

For most companies, **PS1 and PS2 provide the core foundation**, covering the systems used to identify and manage E&S risks and the way workers are treated. **PS3-PS8 address more specialised risks** and may become particularly relevant as an institution's activities, geographic footprint or project exposure changes. Keeping these standards in mind can help institutions identify emerging risks early and incorporate appropriate safeguards into business and investment decisions.

For investors, the Performance Standards provide a consistent framework for E&S due diligence and ongoing monitoring. They can help investors assess whether an institution has appropriate policies, governance structures and risk management processes in place, while highlighting areas that may require further investigation or improvement. Used in this way, the standards are not simply a compliance checklist, but a practical tool for understanding how environmental and social risks can translate into operational, financial and reputational risks.