

Environmental and Social Strategy (ESS)¹

I. Overview

- 1.1 The objective of the proposed loan (the “Loan”) is to support financing for sustainable municipal infrastructure and basic services projects and equipment in the state of Minas Gerais (“MG”), through a partnership with Banco de Desenvolvimento de Minas Gerais (“BDMG”). The proposed Sustainable Infrastructure Line will promote and expand access to financing for projects that will result in direct socio-economic returns to the population of MG. The project complements several IDB initiatives in Brazil to support public services.
- 1.2 IDB’s proposed due diligence activities, presented below, will confirm the nature of the works to be financed and the adequacy of the respective norms, and where necessary agree with BDMG on additional measures to screen out projects with higher risk or to complement the respective ESHSL requirements

II. Environmental and Social Impacts and Risks

- 2.1 BDMG’s projects are likely to have low to medium impacts and important value added to local users. The projects financed could include projects such as street lighting, water and drainage, paving, urban development, improvement of municipal buildings, support to tourism and restoration of historical and cultural heritage, and equipment and machinery that may require specialized risk management know-how.
- 2.2 Based upon the nature of this operation, there may be minimal to moderate ² direct environmental, social or health and safety and labor (ESHSL) risks and impacts. The potential key ESHSL risks and impacts associated with this operation are those related to transactions financed by BDMG, and could include: (i) financial, legal and reputational credit risks associated with BDMG’s existing portfolio; and (ii) direct ESHSL risks and impacts related to future investments in sectors with IDB’s funds. Specific environmental due diligence will be completed to confirm the extent of the risks and impacts and the adequacy of the mitigation measures proposed.
- 2.3 Financial, legal and reputational credit risks: Financial and legal credit risks refer to potential negative effects on BDMG’s ability to collect on sub-loans due to environmental and social issues (e.g. liabilities, law suits, fines, health and safety problems due to working conditions.) associated with its loans and its clients operations. Based on early indication, these risks are considered minimal since the sub-borrowers are municipal entities. Reputational risks are associated with BDMG’s involvement in projects, companies or activities considered unacceptable to the IDB. At this stage, such risks are expected to be minimal as well.

¹ This ESS will be made available to the public in accordance with the Bank’s policy on information disclosure. The ESS does not represent either the Bank’s approval of the Project or verification of the ESS completeness or accuracy. The Bank, as part of its due-diligence on the feasibility of the Project, will assess the environmental and social aspects. This assessment will be presented in the Project Environmental and Social Management Report that will be prepared by the Bank, and will be made available to public prior to consideration of the Project by the Bank’s Board of Executive Directors.

² Minimal, moderate, significant

- 2.4 Direct ESHSL impacts associated with projects financed by BDMG: The proposed operation may generate ESHSL impacts associated with the financed loans in specific sectors. These will vary depending on the loan amount, activity, and location. Based on sector concentration's in BDMG's portfolio proposed for IDB support, the impacts and risks could include: **Urban Infrastructure:** habitat alteration and fragmentation, emissions to air, fuel management, wastewater, solid waste, noise and vibration, workers accidents, fatigue, electrical hazards, traffic disturbances, affectation of properties and buildings, business interruption. **Water and Sanitation:** Solid waste, wastewater, hazardous chemical, air emissions and odor, ecological impacts, domestic or industrial wastewater discharges, leaks and overflows, accidents and injuries, chemical exposure, exposure to pathogens and vectors, and noise. The scope of urban development and tourism support projects will be better defined during the ESDD, but preliminary information indicates that the magnitude and scope of the works would not be likely to generate significant impacts.
- 2.5 E&S Risk management capacity of BDMG is estimated to be limited but adequate. In initial conversations, IDB understands that E&S risk management for BDMG includes verification that the municipal works it finances have all licenses and permits required by local laws and regulations.

III. Status and Compliance

- 3.1. Given that this is a financial intermediary and based on Directive B.13 of the Environment and Safeguards Compliance Policy (OP-703), this transaction is not categorized. Given the magnitude and nature of the projects proposed for financing (described by BDMG as minor urban infrastructure, primarily focused on road paving and rehabilitation and in the average range of US\$1,000,000), this FI transaction would be classified as a moderate risk FI.

IV. Strategy for Environmental and Social Due Diligence

- 4.1 As per the IDB Environment and Safeguards Compliance Policy and Guidelines, and as part of its due diligence process, the Bank will assess BDMG's capacity for environmental and social risk management. During this process the Bank will establish whether appropriate procedures are in place to assess and manage the potential environmental risks and impacts associated with sub-loans. The IDB will ensure that appropriate and feasible ESHSL requirements, including capacity building, in the form of an Environmental and Social Management System (ESMS), tailored to the particular characteristics of the transaction, are included in the legal agreements.
- 4.2 The environmental and social due diligence required for this operation will comprise of the following steps:
- a. An identification of any environmental and occupational safety liabilities in BDMG's facilities and operations and, if required, an assessment of the adequacy of action plans to properly resolve them.
 - b. An assessment of BDMG's compliance status with the applicable country environmental, social, health and safety, and labor regulatory requirements as well as with any relevant conventions and treaties which have been ratified by Brazil;

- c. An assessment of BDMG's actual and pipeline portfolio, to establish potential reputational risks associated with BDMG's involvement in projects or activities considered unacceptable to the IDB;
 - d. An assessment of specific ESHSL impacts and risks related to investment in the sectors and type and magnitude of works likely to be financed under the proposed operation,.
 - e. An evaluation of the current credit appraisal, approval and monitoring procedures in place to manage environmental and social liabilities, impacts and risks associated with BDMG's portfolio as well as an assessment of BDMG's capacity in terms of environmental and social risk management, including:
 - An assessment of BDMG's existing ESHSL requirements and procedures, and of the adequacy of local norms to address the ESHSL aspects and requirements applicable to this operation considering the amount of the loans and potential financed sectors
 - An assessment of current capacity and capacity building plans that should, at a minimum provide for: (i) loan officers to be trained and qualified to identify ESHSL issues/liabilities; and (ii) include the consideration of environmental and social issues in the loan analysis that:
 - eliminate projects which are on the IDB exclusion list;
 - screen out any high-risk projects that may involve potential impacts on protected areas, indigenous peoples, physical or economic displacement of vulnerable groups, possible effects that may result from natural disasters, or other significant social and environmental impacts (i.e. pollution, overexploitation of resources, impacts to health and safety of neighboring communities, etc.);
 - verify compliance of the ESHSL laws applicable to sub-loans;
 - verify compliance with sector specific complementary requirements where necessary to comply with IDB policies
 - Verify that local stakeholders are provided with adequate opportunity to express any concerns regarding projects with potential environmental and social impacts or risks in a timely manner.
- 4.3 The results of the due diligence will be presented in an Environmental and Social Management Report and summarized in the Financing Proposal to establish the environmental, social, health and safety, and labor requirements for the operation which will be included in the Loan Agreement. Such results will include the Bank's definition and agreement with BDMG on: (i) sub-loan eligibility criteria that clearly establish the scope of the use of proceeds; (ii) the conditions for the scope, depth and content of an ESMS (or ESHSL Procedure) adequate to the proposed use of proceeds to be implemented by BDMG; and (iii) ESHSL capacity building activities, if any.