

Estrategia Ambiental y Social (ESS)

I. Overview

- 1.1 The project's objective is to support the financing of small and medium producers of agricultural products ("SMPs") in Ecuador, with special focus on the agricultural sector, including both livestock and crops. Palm oil would be roughly 15% of the portfolio focus. SCF/FMK and OMJ/OMJ have identified Banco de Guayaquil (BG) as a strategic partner to achieve this goal, and will provide a senior unsecured loan of US\$75 million (US\$10 million from OMJ, US\$40 million from SCF, and US\$25 million from the China Co-Financing Fund).
- 1.2 Coordination between these two private sector windows will allow IDB to provide Ecuador's second largest commercial bank with a dedicated agribusiness line. The use of funds will be directed towards working capital loans. Coupled with this loan will be the possible provision of technical assistance through a number of specific local corporate partners with the aim to support producers in increasing productivity and accessing new markets. La Fabril S.A., a producer of refined vegetable oils, has been identified as one such partner in its capacity as a supply chain buyer of raw palm oil, and exporter of finished product.⁵

II. Environmental and Social Impacts and Risks

- 2.1 Based upon the nature of this operation to support SMPs with a focus on agriculture, and particularly palm oil, sub-loan supported activities are likely to have direct, indirect and potentially cumulative environmental, social, health and safety and labor (ESHS) impacts and risks are likely to be moderate to significant. To that end, specific environmental due diligence is required. The potential key ESHS and labor risks and impacts associated with this operation are those related to the specific ESHS and labor risks and impacts related to lending in the agricultural sector financed by BG with the proposed financing. These could entail (i) environmental credit and reputation risks to BG, (ii) risk associated with BG's facilities and practices, (iii) direct impacts associated with loans to SMPs, and (iv) IDB reputation risks associated with the impact of other operations and/or financing by BG and its strategic partners, particularly in the palm oil industry.
- 2.2 *Environmental credit risks:* Environmental credit risks refer to potential negative effects on BG because of: risk of an eventual non-repayment of sub-loan due to environmental and social issues (e.g. law suits, fines, etc) associated with its loans.
- 2.3 *Risks associated with BG Facilities and Practices.* Are the risks associated with BG's (i) facilities and operations, such as environmental liabilities in their offices due to asbestos, lead paint, etc. or employees having occupational health and safety problems due to working conditions (e.g. inadequate emergency preparedness, lack of fire exits, etc. (ii) BG's finance application and analysis process that is not equitable, fair, and unbiased in terms of social factors (e.g. gender, age, ethnicity, or cultural heritage, etc.); and (iii) significantly deficient labor practices.

⁵ La Fabril is an Ecuadorian company with a diversified production line of both consumer and industrial products for domestic and international markets. More information at http://www.lafabril.com.ec/alm_portada.php

- 2.4 *Direct impacts associated with loans to SMPs:* The Partnership may generate primarily moderate to significant negative social and environmental impacts associated with loans to SMPs in the agricultural sector.⁶ The type and extent of impacts will vary depending on the amount of loans to be extended and on the type of activities to be financed. Specific environmental, social, health and safety (ESHS) and labor impacts and risks related to SME loans in agriculture and palm oil can include i) habitat conversion and degradation; ii) poor land use/contaminated land; iii) stress/contamination of water resources; iv) waste management and disposal; v) use of migratory, informal or underage labor; vi) pesticide use and agrochemical management. The assessment of social and environmental impacts for each loan will be the responsibility of BG, and managed through the development and implementation of an Environmental and Social Management System. In the context of a corporate partner, such as La Fabril, these impacts may additionally be managed through La Fabril's ESMS. Early indication suggests La Fabril has worked with Ecuador's Ministry of Environment on a certification program that addresses environmental and social risk issues in the agroindustry sector. La Fabril is also a member of the Roundtable on Sustainable Palm Oil (RSPO) and the certification status of their facilities and supply chain will be the subject of due diligence.
- 2.5 *Reputational risks.* Reputational risks are associated with BG's involvement in projects, companies or activities considered unacceptable to the IDB and/or that will face significant public opposition or concerns, such as inappropriate development location or ESHS management practices. There may also be reputational risks associated with palm oil and other agribusiness industry in general, and with the activities or practices of strategic partners.
- 2.6 These risks may be minimal to significant and will be assessed during due diligence, which in this case will include a review of the strategic partners and the supply chain to the extent appropriate.

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 nature of the sub-loans the risk level is likely to be FI-3.

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 BG'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 in agriculture and palm oil. The IDB will ensure that appropriate and feasible ESHS and labor requirements, including capacity building, in the form of an Environmental and Social Management System (ESMS), tailored to the particular needs of the Partnership, are included in the legal agreements.

⁶ Sub-loans will not be in excess of US\$500K.

- 4.2 As IDB's proceeds will be used to support the portfolio in palm oil and agribusiness and the role to be played by strategic partners such as La Fabril in this operation, the ESDD will cover identified partners and supply chain and the ESMS may include special procedures for IDB ESDD of future partners and supply chains as they become known.
- 4.3 The environmental and social due diligence required for this partnership will comprise the following steps:
- a. An identification of any environmental, social and occupational safety and labor related liabilities in BG's facilities and operations and, if required, an assessment of the adequacy of action plans to properly resolve them.
 - b. An assessment of BG'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 Ecuador;
 - c. An assessment of BG's procedures to ensure that its loan, finance application and analysis process is equitable, fair, and unbiased in terms of social factors (e.g. age, gender, cultural heritage, etc).
 - d. An assessment of BG's actual and pipeline clients with primary focus in the agriculture and palm oil sectors, to establish potential reputational risks associated with BG's involvement in projects, companies or activities considered unacceptable to the IDB; and specific ESHS and labor impacts and risks related to investment in certain sectors, likely to be financed under the Partnership.
 - e. An evaluation of the current credit appraisal, approval and monitoring procedures in place to manage ESHS and labor liabilities, impacts and risks associated with BG's portfolio as well as an assessment of BG's capacity in terms of environmental and social risk management.
 - f. An evaluation of corporate partners' ESHS and labor practices including supply chain management and a review of an indicative sample of potential sub-borrower projects with respect to: (i) identifying potential direct, indirect and cumulative ESHS and labor impacts of typical projects; (ii) evaluating sample ESMPs and ESMS systems and certification programs, particularly those involved in the purchase, production and export of palm oil products, their adherence to national laws and regulations and internationally recognized good practice standards, such as the Roundtable on Sustainable Palm Oil (RSPO) and other industry standards as applicable .
 - g. A review of the characteristics and geographic location and concentration of targeted small producers to determine if there are cumulative impacts, vulnerabilities or other risks that require specific mitigation measures as part of the ESMS or otherwise.
- 4.4 The results of the due diligence will be presented in an Environmental and Social Management Report and summarized in the Loan Proposal to establish the environmental, social, health and safety, and labor requirements for the Partnership.