

Environmental and Social Management Report (ESMR) Bayport Colombia

I. Project Description

- 1.1. The objective of the Project is to increase financial access for Base of the Pyramid (BOP) public employees in Colombia by scaling up the innovative loan origination program repayable via payroll deductions (*libranzas*) developed by Bayport Colombia S.A.S (“BC”). BC is a non-bank financial institution focused particularly in rural areas and regions with low levels of financial inclusion and high levels of Unsatisfied Basic Needs. The use of funds will support the company’s loan origination activity and allow it to scale its existing portfolio, specifically to provide financing for home improvements, education, health, micro and small enterprises (MSEs) and agricultural activities. In order to achieve this objective, the Opportunities for the Majority Sector is proposing to provide Bayport Colombia an A/B loan of up to US\$50 MM (equivalent in Colombian Pesos) composed of an A Loan of up to US\$15 MM (equivalent in Colombian Pesos) and a B Loan of up to US\$35 MM (equivalent in Colombian Pesos).
- 1.2. BC’S business model allows it to mitigate credit risk as its loan repayments are received via payroll deductions through the commercial agreements entered into with 430 municipal, departmental and national entities, as well as pension funds. This allows BC to quickly identify potential clients, assess their credit risk level, process approved loans, and receive repayments on time through its partner public entities. Commission-based agents are able to actively serve large rural areas with low population densities where clients are located. Once an agent has identified a client (through visits at their place of work and homes to better assess the client profile, including use of resources), the closest local office is in charge of completing the loan application package and of submitting it to one of the large regional hubs for review, credit analysis and final approval. This approach allows the regional hubs to leverage economies of scale, centralize all information and reduce both operational/credit risk and administrative costs.
- 1.3. In each local office, Team Leaders act as mentors and coaches for the agents under their supervision, complemented by a training officer in charge of guiding agents through the Bayport Academy courses. The latter are a mix of hands-on training and an online training platform in sales, personal finance, marketing, and all Bayport policies, values and products. Basic courses in the different subjects are mandatory in order to become a Bayport agent, and around 30% of agents pursue a Technical Degree in Sales in partnership with the *Politecnico Grancolombiano*.
- 1.4. BML, BC’s parent company, has a formal strategy to transfer knowledge and know-how through a Technical Assistance agreement with BC, which includes among others the transferring of best practices in lending through BML’s “Client Protection Principles”. This has led BC to endorse the Smart Campaign Principles¹, ensuring respectful collection practices and adopting high ethical standards in the treatment of its clients. In 2014, BC expects to receive the “Client Protection Certification”², which will make it the sixth FI to be certified in LAC out of only 14 FIs currently certified across the world.

¹ The Smart campaign is based on 3 Client Protection Principles: (i) appropriate financial products to clients’ needs; (ii) FI seeks client feedback for product design and delivery; (iii) FI does not use aggressive sales techniques. www.smartcampaign.org

² The Certification process involves assessing policies, procedures, training, marketing and operations against the Client Protection Principles. The Certification process consists of offsite and onsite verification by trained, third party certifiers.

- 1.5. By law, payroll deductions cannot exceed 50% of the salary/pension after deducting all mandatory contributions (taxes, health, social and pension benefits, as applicable). Additionally, if an individual changes employment to an employer without an agreement with the client's payroll lender, by law the employer is obliged to accept the lender and allow it to continue discounting from the employee's payroll. The lender can request information of a client's new employer from a national list that is updated on a monthly basis with the social security contributions system.
- 1.6. BC average loan amounts are COP\$9 MM (US\$4,400) with tenors between 6-60 months (average is 52 months) and an average annual interest rate of 23.88%³. Through agreements with insurance providers, loans include a mandatory life insurance⁴. 80% of BC's financing is allocated to housing (home improvements and new housing), education (technical education), MSEs (productive assets/working capital), agriculture (inputs and equipment), and health expenses⁵.
- 1.7. In 2014, BC will offer several new products: (i) new education insurance product to be contracted with a third party, covering education costs for dependents in case of unemployment, death or disability; (ii) a dedicated home improvement program in alliance with specialized home improvement retailers to provide additional value added to its clients, including top quality construction materials, as well as basic technical assistance; (iii) alliance with other retailers, which offer productive assets for BC's MSE line; and (iv) technical education providers. Subsequently, BC will launch additional alliances with other service/goods providers in accordance with its geographical presence and client needs across the country.
- 1.8. Beneficiaries that wish to become eligible for the loans must meet the following requirements:
 - a) Be formally employed by any public institution or be pensioned from one
 - b) Comply with credit risk requirements, including verification of over-indebtedness
 - c) Earn more than one monthly Minimum Wage (MW)⁶
 - d) Have a valid ID (cedula de ciudadanía)
 - e) Be no more than 55 and 60 years for women and men respectively for active employees
 - f) Be no more than 85 years for both women and men for pensioners
- 1.9. The main terms and conditions for the loans are as follows:
 - a) Tenor between 6-60 months
 - b) Minimum Loan amount: COP\$1,000,000 (US\$500)
 - c) By law, payroll deductions cannot exceed 50% of salary after deducting other financial and non-financial obligations, such as taxes, health, social and pension benefits
 - d) Competitive market rates
 - e) Loans include a mandatory life and surety insurance

II. Project Status and Compliance

- 1.10. The Environmental and Social Strategy for the Project was presented and approved on March 7, 2014 to facilitate financial inclusion for public employees at the Base of the Pyramid by the Environmental Safeguards Review team. Based on Directive B.13 of the Environmental Safeguards

³ The maximum interest rate allowed by law for consumer lending as of February 2014 is 29.48%. *SuperFinanciera de Colombia*.

⁴ Life insurance covers the outstanding loan amount in case of death, disability, and it also provides 6-month unemployment insurance.

⁵ The remaining 20% are used for debt repayments/restructuring to both formal and informal lenders.

⁶ As of January 2014, the Minimum Wage in Colombia was COP\$616,000 (US\$306)

Compliance Policy (“Environmental Policy”), and given that this is a financial intermediary, this operation was not categorized.

- 1.11. Bayport Colombia has confirmed that it is in compliance with the Directive B.2 (country, laws and regulations) of the Environmental Policy, complying with all applicable legal and regulatory, environmental, social, health and safety, and labor laws and regulations.

Environmental and Social Impacts and Risks

A. Environmental and Social Impacts and Risks associated with Bayport Colombia’s portfolio

- 1.12. Due to the nature of this operation, which consists of providing consumer financing directed at housing (home improvements), education (tuition fees and school supplies), MSEs (productive assets/working capital), agriculture (inputs and equipment), and health expenses, this operation is considered as a low risk financial intermediaries operation. The operation is expected to generate positive social impacts as it will provide access to financial inclusion and basic goods and services to BOP (Base of the Pyramid) public-sector employees that are based in rural areas or areas with low financial inclusion.
- 1.13. There may be specific ESHS and labor risks and impacts related to the financing of housing (home improvements) and agriculture (inputs and equipment), however, those are considered minimal, in particular due not only to BC’s environmental policies in place, but also due to the strong regulatory framework in place in Colombia and the proactive supervision coming from the various regulatory entities, such as the *Superintendencia de Sociedades*, which supervises Bayport’s operations. Moreover, the legal due diligence confirmed that the company is in compliance and has the appropriate environmental and social policies, labor contracts, and procedures to mitigate these risks as stipulated under Colombian legislation.
- 1.14. The home improvements may be exposed to certain indirect lesser ESHS risks and impacts related to the sites where the home improvement takes place, the design of the housing improvements, the housing improvement works themselves, and the materials that will be used in construction (e.g. materials damaging to human health such as unbounded asbestos, lead paint, formaldehyde, and radon). Agricultural financing might have indirect impacts on water resources, soil erosion, health problems due to pesticide use, eutrophication of aquatic environments, biodiversity impacts, crop residues and other solid waste, atmospheric emissions, physical and chemical hazards and confined space entry.
- 1.15. Bayport has stated and the legal and business due diligence confirmed that BC has neither financial liabilities in its existing portfolio related to ESHS issues nor outstanding ESHS concerns, through involvement in projects, companies or activities considered unacceptable to the IDB that could potentially generate significant public opposition or concerns. BC has also stated, and the team has confirmed in its analysis of exiting origination, collection, credit risk procedures, marketing and communication materials, that its finance application and analysis process is equitable, fair and unbiased in terms of social factors (e.g. gender, age, ethnicity, or cultural heritage).

B. Environmental and social risks associated with BC’s facilities and Human Resources practices.

- 1.16. BC’s head office is located in Bogota, Colombia. The risks associated with BC’s facilities and operations, such as environmental liabilities in their offices or employees having occupational health and safety problems due to the working conditions are considered minimal. BC stated, and

the legal due diligence confirmed that it is in compliance with Colombia's labor law and regulations. BC, and the legal due diligence also confirmed that there is no material employee or labor disputes or any material health issues (including legal claims). Furthermore, BC has not faced any fine or non-monetary sanction for noncompliance of its operations with environmental regulations. Bayport is an equal opportunity employer, unbiased in terms of social factors (.e.g gender, age, ethnicity, or cultural heritage).

IV. Environmental and Social Management

- 1.17. BC requires that all of its financed loans comply with relevant Colombian laws and regulations. Additionally, BC has a comprehensive environmental policy coming from BML, its parent company. This screening process is in line with Colombian regulations and international best practices for financial intermediaries focused on consumer financing.
- 1.18. Other risks related to the location and the technical aspects of the home improvements works are mitigated by the alliances with construction material retailers, which are providing quality construction materials and technical assistance.
- 1.19. Risks associated to agricultural financing are mitigated by the fact that average loan sizes are small (US\$4,400) and this financing line represents around 6% of the outstanding portfolio. The objective is to help clients improve productivity better use of land resources by having access to working capital, quality productive assets, and better quality inputs, such as seeds and fertilizers. The main constraint BOP small farmers face is lack of capital to improve their production capacity, as well as the quality of their inputs and fixed assets. The latter must comply with all Colombian environmental and social regulations, including adequate use of land resources.

V. Environmental and Social Requirements

- 1.20. As part of the IDB- Bayport Colombia Loan Agreement, the IDB will require that BC comply with: (i) all applicable Colombian ESHS, and labor regulatory requirements; (ii) IDB List of Excluded Activities for Non-Sovereign Guaranteed (NSG) Operations; (iii) the Fundamental Principles of Rights at Work; and (iv) BC's comprehensive environmental and social policies and guidelines.

VI. Supervision

- 1.21. The IDB will supervise the environmental and social aspects of the Loan Agreement either by an in-house specialist or with external consultants, and require BC to present environmental and social compliance reports in form, content, and frequency satisfactory to the IDB.