

Environmental and Social Management Report
Banco Nacional de Costa Rica (Costa Rica), SME Finance Partnership
(CR-L1069)

I. Project Description and Background

- 1.1 The proposed subordinated financing (the “Loan”) establishes a long-term strategic partnership with Banco Nacional de Costa Rica (“Banco Nacional” or “BNCR”) focused on addressing the financing gap of SMEs by expanding their Banca de Desarrollo program, and in particular, the loan will support Banco Nacional’s women-led SMEs program Banca Mujer, one of the few banks financing programs targeting women businesses in the region. The Loan consists of a subordinated A-loan for up to US\$75 million, with a tenor of up to ten years. Potentially, the China Co-Financing Fund could accompany IDB with a US\$25 million subordinated co-loan on the same terms and conditions as the IDB A-Loan. The Loan will be complemented with two technical assistances (“TA”) that will be led by FOMIN.

II. Project Status and Compliance

- 2.1 The Environmental and Social Strategy (ESS) for CR-L1069 was presented to the Environmental Safeguards review team and no special actions were required. Based on Directive B.13 of the Environment and Safeguards Compliance Policy (OP-703), this Project is classified as a financial intermediary and as such is not categorized according to its potential environment and social (E&S) impacts and risks.
- 2.2 BNCR has confirmed that it is in compliance with Directive B.2 (country laws and regulations) of IDB Environmental and Safeguards Compliance Policy, complying with all applicable legal and regulatory environmental, social, health and safety, and labor (ESHS&L) laws and regulations.
- 2.3 As a national bank, BNCR is required to ensure that any client applying for a loan is in compliance with the environmental and social requirements of the *Secretaria Tecnica Nacional Ambiental* (SETENA) and has received the corresponding permits and authorization. These requirements are consistent with IDB’s Environmental and Social Policy. The average outstanding loan amount for micro enterprises is US\$19,000, for small companies US\$26,000, and for medium size companies US\$70,000¹, and BNCR’s financing limit will be up to US\$500,000. Its dominant portfolio concentration is in commerce and services with more limited exposure in industry, construction, and agriculture. Lending to certain productive sectors in its portfolio may present moderate and higher risk. Based on management capacity and portfolio composition, this operation is classified as low risk (FI-3).

III. Environmental and Social Risks and Impacts

¹ SME are defined as having fewer than 100 employees, and annual sales of less than US\$1.5 million.

A. Potential risks and impacts associated with BNCR's portfolio

- 3.1 Within their total portfolio, BNCR has the following sector concentrations as of July 2013: Commerce (25%), Services (37%), Agriculture (9%), Construction (15%), and Industry (9%).
- 3.2 The ESHS impacts and risks associated with loans to SMEs in BNCR's portfolio are likely to be low to moderate in nature in light of the dominance of low risk sectors. Any likely significant environmental and social impacts would relate to lending in agriculture, industry and construction. The ESHS risks and impacts could include, for example: i) habitat conversion and degradation (agriculture, livestock); ii) poor land use/contaminated land (agriculture, livestock, construction), iii) stress/contamination of water resources (agriculture, livestock, construction), iv) inadequate waste management and disposal (livestock, agriculture), v) use of migratory or informal labor (agriculture, livestock), vi) transport, traffic noise and dust management and natural disaster risks (construction).

IV. Environmental and Social Management

A. BNCR's Management of Environmental and Social Risks

- 4.1 BNCR does not have an environmental and social management system in place, but instead relies on the permits and authorization granted by SETENA prior to offering finance to any project or operation. SETENA categorizes projects on the basis of sector and activity. Environmental categorization includes A, B1, B2, B3, and C each of which has corresponding conditions required in order for permits and authorization to be granted. As part of the application for a BNCR loan a client is required to present evidence of having completed this process. In evaluating a project's environmental and social issues, SETENA bases its categorization on the project's sector, site location, water/energy use, projected air and land impacts, as well as related social impacts (including resettlement, landscape, and cultural heritage). Based on the associated categorization, the client is required as applicable to detail prevention, correction, mitigation, and compensation measures as part of the ESIA. In high risk projects, an independent evaluation of the ESIA is required. After having granted permits on the basis of the proposed project management, SETENA provides periodic monitoring as appropriate. These requirements will apply when and as necessary for IDB's loans below the US\$500,000 limit.

V. Environmental and Social Requirements

- 5.1 For this operation which involves SME lending of on average US\$50,000 and up to US\$500,000, the Bank will require BNCR as part of the Loan Agreement to:
 - (i) Comply with all applicable Costa Rican legal and regulatory requirements, and in relation to the financing of each SME loan require and obtain satisfactory assurance that all customers/use of proceeds comply with: (a) at a minimum host country environmental, social, health and safety, and labor (ESHS) regulations and standards, in accordance with SETENA procedures and requirements as outlined in paragraph 4.1 above; (b) BNCR's own policies on environmental,

social, health and safety and labor matters for sub-loans (b) the IDB List of Excluded Activities for Non-Sovereign-Guaranteed (NSG) operations; and (c) the Fundamental Principles of the Rights at Work;

- (ii) Assign staff responsibility to screen for environmental and social issues, and ensure that the designated staff member take part in the IIC/IDB Environmental Risk Management training course, or a similar workshop by other organizations such as UNEP-FI, to be agreed upon by the IDB.
- (iii) Present an Annual Environmental and Social Compliance Report (ESCR) with information on the SME portfolio, and any particular risk issues identified during screening, mitigation measures agreed with clients, and compliance status.

5.1 The IDB will supervise the environmental and social aspects related to the use of the proceeds of the IDB loan either by an in-house specialist or with external consultants, and if necessary, will require measures to address the management of impacts and risks. To this end BNCR will provide and facilitate access by IDB to all relevant documentation, personnel and project facilities.