

Environmental and Social Management Report
Banco Agrícola MSMEs Financing Program
(ES-L1084)
and
Financing Access for BOP Mom and Pop Shop Owners
(ES-L1069)

I. Project Description and Background

- 1.1 The proposed MSME Financing Program seeks to address the lack of access to finance to MSMEs in El Salvador. IDB will join efforts with Banco Agrícola (“BA”), the largest bank in the country, to provide financing to this sector.
- 1.2 The Program consists of two financial products: i) a senior unsecured A/B Loan (the “Loan”) of up to US\$100 million to provide BA with medium-term financing to support its SME loan portfolio. A portion of the loan will be earmarked to support women that owned or lead SMEs; and ii) a Risk Sharing Guarantee Facility (“RSF”) of up to US\$5 million to provide BA with credit-risk coverage for its downscaling efforts into the microenterprise segment.

II. Project Status and Compliance

- 1.3 The Environmental and Social Strategy (ESS) for the ES-L1084 was presented February 25, 2013 and ES-L-1069 on September 28, 2012 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.
- 1.4 BA implemented an environmental and social management system (ESMS) in 2009, and has indicated capacity to assess and manage environmental and social risks in MSME lending. As further described below, BA’s portfolio concentrations are in services and commerce. Based on client capacity and sector composition within their portfolio, along with the projected average loan size of roughly US\$5,000 (OMJ) and US\$79,000 (FMK), the operation is classified as low risk.
- 1.5 BA 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.

III. Environmental and Social Risks and Impacts

A. Potential risks and impacts associated with BA’s portfolio

- 3.1 As El Salvador’s largest bank, BA manages a portfolio valued at roughly US\$2.7billion, dominated by personal banking (51%), and corporate finance (34%). MSMEs represent a combined 9% of the portfolio allocation at US\$234 million. Dominant sector

concentrations within MSMEs include Commerce (~35%), Mortgages (~25%), Services (~14%), Industry (~12%), and Construction (~5%), with more minor holdings in Transport and Agriculture.

- 3.2 The ESHS impacts and risks associated with loans to MSMEs are small in light of the dollar size and focus on lower risk sectors. With regard to industry lending, this involves most small-scale manufacturing for which the ESHS risks and impacts could include, for example: i) air emissions; ii) effluent discharge, iii) soil and groundwater contamination, and iv) waste disposal.

B. Environmental and social risks associated with BA's facilities and human resources practices

- 3.3 BA has stated that they have no material health issues (including legal claims) and do not have any materials employee or labor disputes. BA has also indicated 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). BA's guidelines for employee compensation (salary, pay raise, benefits) and analysis (evaluations) are based on the local legislation, following also El Salvadorian labor regulations. This is defined in their HR labor policy.

IV. Environmental and Social Management

A. BA's Environmental and Social Management System (ESMS)

- 4.1 BA applies a *Sistema de Gestion Ambiental*,¹ developed in 2009, to loans greater than US \$500,000. At a general level this involves (1) review against both the IDB and IFC exclusion lists, (2) categorization of projects (A, B, C) based on sector, size, and potential environmental impact, and (3) compliance with local law. In the case of high risk projects (Category A), BA requests environmental permits, and an independent Environmental Impact Assessment, which includes Environmental Management Plan. Of its US\$2.7 billion portfolio, 65 clients are involved in Category A operations representing US\$400 million (18%). These clients are primarily in Agroindustrial, Chemical, Pulp and Paper, Oil and Gal, and Construction sectors, among others. BA provides financing only after the required permits are obtained and any action plans defined by the respective Ministry. With the associated Category A projects, BA has confirmed that there no associated environmental liabilities or public opposition.
- 4.2 Regarding its MSME portfolio, and loans below US\$ 500,000, BA applies the IDB and IFC exclusion lists and ensures compliance with local law. It does not, however, at present analyze or categorize environmental and social risk at these values though is planning to develop an applicable checklist that would permit additional evaluation and management of identified issues.
- 4.3 Implementation of the ESMS is managed by BA's risk department, and ensuring compliance with the bank's E&S policy is the responsibility of loan officers with each individual transaction.

B. Training on Environmental and Social Risk Management

¹ Political y Sistema de Gestion Ambiental, 15 enero 2009, Version 1.

4.4 There has not been a recent training event provided to BA staff.

C. Corporate Social Responsibility

4.5 BA engages in several corporate responsibility initiatives. The primary activity is ‘Manos Unidas por El Salvador’, which is focused on improving basic education and access in the country’s poorest areas. In 2012, this program benefited 18,000 young students across 23 communities with total investment of nearly US\$ 290,000. In a similar vein, BA also provides financial education training for its clients. Last year, nearly 2,600 clients participated in the two hour workshop, which introduced basic financial concepts, and personal finance.

V. Environmental and Social Requirements

5.1 For OMJ operation ES-L1069 for an average loan size of US\$5,000 (and not exceeding US\$10,000), the Bank will require BA as part of the Loan Agreement and in relation with IDB use of funds to:

- (i) Comply with all applicable Salvadorian environmental, social, health and safety, and labor regulatory requirements, and in relation to the financing of MSMEs to ensure that each loan complies with: (a) in-country regulations; (b) the IDB List of Excluded Activities for Non-Sovereign-Guaranteed (NSG) operations; and (c) the Fundamental Principles of the Rights at Work.

5.2 For FMK operation ES-L1084 for an average loan size of US\$79,000, the Bank will require BA as part of the Loan Agreement and in relation with IDB use of funds to:

- (ii) Comply with all applicable Salvadorian environmental, social, health and safety, and labor regulatory requirements, and in relation to the financing of SMEs to ensure that each loan complies with: (a) in-country regulations; (b) the IDB List of Excluded Activities for Non-Sovereign-Guaranteed (NSG) operations; and (c) the Fundamental Principles of the Rights at Work;
- (iii) Customize a checklist based on an IDB template for lending operations between US\$250,000 – US\$500,000 and applicable only to Agriculture, Industry, and Construction on-lending sectors with IDB’s proceeds to identify potential environmental and social risks, screen out high risks, and propose management responses within six months of disbursement.
- (iv) Train relevant staff on the application of the new SME checklist, and wider E&S risks, issues, and management.
- (v) Ensure that at least one staff member with responsibility for the ESMS implementation and maintenance 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, to ensure that BA continue to remain up to date with its environmental and social risk management expertise.

For both operation, BA will present an Annual Environmental and Social Compliance Report (ESCR) with information on the MSME portfolio, and any particular risk issues identified during screening and mitigation measures agreed with clients.

5.3 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 means of enhancing management of impacts and risks.