

Environmental and Social Management Report
Banco BAC San Jose (Costa Rica) MSME Finance Partnership
(CR-L1074)

I. Project Description and Background

- 1.1 The Project consists of a Senior Unsecured Loan (“the Senior Loan”) for up to US\$50 million to support the expansion of MSME lending at Banco BAC San Jose (“BAC”); specially, assisting the bank in formally establishing financial products targeted at women-led MSME. The transaction will be structured as a US\$40 million Senior Loan funded by IDB; and a B-Loan of up to US\$10 million. In addition, the Project will also include a technical cooperation (“TC”) with MIF, through the women entrepreneurshipBanking (weB) initiative, with the objective of creating new products and services that are better suited to meet women-led MSME needs and support BAC’s objective of formally establishing a new women-banking business lines.
- 1.2 Banco BAC is part of BAC Credomatic, which is wholly-owned by Banco de Bogota, which is in turn majority-owned by Grupo Aval (65%) from Colombia. Minority shareholders own the remaining shares (35%), none of whom holds more than 10% of the shares of Banco de Bogota. IDB provided BAC with an MSME and mortgage loan in 2012 with the aim to downscale into these segments. Based on the portfolio composition and E&S management with a sub-loan cap of US\$500,000, this operation is classified as low risk (FI-3).

II. Project Status and Compliance

- 2.1 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. BAC 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 BAC’s portfolio

- 3.1 As of December 2013, BAC’s credit portfolio amounted to approximately US\$2.8 billion, ranking as the largest private bank in Costa Rica. BAC’s portfolio is primarily concentrated in retail lending (at just over 60%). BAC has continued expanding their participation in the MSME segment, usually by approaching their suppliers and value chain producers. This effort has resulted in about a quarter of the bank’s total commercial loans made to MSMEs, which is broken down as follows: commerce (49%); services (39%); industry (9%); and agriculture (3%). Loans to the MSME segment have been, and will likely continue to be, on average US\$42,000.

- 3.2 The ESHS impacts and risks associated with loans to SMEs in BAC'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 and industry. The ESHS risks and impacts could include, for example: i) habitat conversion and degradation (agriculture,); ii) poor land use/contaminated land (agriculture, industry), iii) stress/contamination of water resources (agriculture, industry), iv) inadequate waste management and disposal (industry, agriculture), v) use of migratory or informal labor (agriculture), vi) transport, traffic noise and dust management and natural disaster risks (construction), vii) occupational health and safety (industry, agriculture).

IV. Environmental and Social Management

A. BAC's Management of Environmental and Social Risks

- 4.1 BAC has received support from other development institutions such as the Netherlands Development Finance Company (FMO) and the Inter-American Investment Corporation (IIC), which required BAC to develop an Environmental and Social Management System (ESMS). In 2006, BAC developed the Manual of Procedure for the Environmental and Social Risk Analysis System (SARAS acronym in Spanish), to identify evaluate and manage E&S risks that may result from projects or activities to be financed. In November 2011, the SARAS was re-launched and applied to all eligible projects financed by BAC for loans above US\$1,000,000. For these sub-loans, the SARAS includes a categorization checklist, due diligence questionnaires, definition of roles and responsibilities, site visits, sector specific guidance, and BAC-defined procedures depending on the categorization of the operation.
- 4.2 For sub-loans below US\$1 million, the SARAS relies on application of the exclusion list and local law, specifically as defined by Costa Rica's Ministry of Environment (SETENA). SETENA categorizes projects on the basis of sector and activity. Environmental categorization includes A, B1, B2, and C each of which has corresponding conditions required in order for permits and authorization to be granted.¹

V. Environmental and Social Requirements

- 5.1 For this operation which involves MSME on-lending, with a focus in women-led MSMEs, for loans averaging US\$42,000 and not to exceed US\$500,000, the Bank will require BAC 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 MSME 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 4.2 above; (b) BAC's own policies on environmental,

¹ A full list of sectors, activities and corresponding categorization can be found in Anexo No. 2, p. 82, Reglamento General sobre los procedimientos de Evaluación de Impacto Ambiental (EIA). A high risk checklist applies for activities categorized as A, and B1, and a medium risk checklist applies for activities categorized as B2, and C.

social, health and safety and labor matters for sub-loans (c) the IDB List of Excluded Activities for Non-Sovereign-Guaranteed (NSG) operations; and (d) 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 MSME portfolio, and any particular risk issues identified during screening, mitigation measures agreed with clients, and compliance status.

5.2 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 BAC will provide and facilitate access by IDB to all relevant documentation, personnel and project facilities.