

ENVIRONMENTAL AND SOCIAL STRATEGY

Banco Continental PE-L1065

Introduction

The present operation represents an additional step in the partnership established in 2006 between the Bank and Banco Continental (“Continental”), when the Bank approved a Financing Facility (of up to US\$120 million) to provide long term senior and subordinated financing. Since then, Continental has been successfully growing its mortgage origination business and has significantly grown its mortgage portfolio, demonstrating a strong market response and an important accomplishment for both financial institutions. Moreover, it demonstrates Continental’s commitment to position itself as one of the primary mortgage lenders in Peru by increasing its market share and expanding the availability and affordability of housing in Peru through product innovation.

Going forward, Continental is now requesting another financing facility to yet expand its long term loan portfolio (i.e., mortgage portfolio), and enter into more sustainable lending practices, through an expansion of its lending program to micro, small and medium enterprises (MSMEs).

While the previous experience provide good indicators about Continental’s environmental and social performance, the present environmental and social strategy will further investigate and evaluate current or future environmental and social issues related to the Facility’s investments, especially considering potential impacts associated with the funded operations.

Project Description

The proposed project involves a financing facility to Banco Continental (Continental), one of Peru’s leading financial institutions. The project would consist of:

- 1.) A **subordinated loan**, structured as an A/B loan where the IDB would fund up to US\$15 million. This Subordinated Tranche will provide additional support to Continental’s capital position (Tier II Capital), and will expand its long term loan portfolio, specially mortgage financing, while strengthening Continental’s funding, liquidity and capital position.
- 2) A **senior loan** (Senior Tranche) of up to \$30 million to enable Continental to expand its sustainable lending for micro, small and medium enterprises. particularly those adopting measures related to energy efficiency, sustainable forestry, clean energy, integrated waste management, water and wastewater treatment, clean industrial technology and industrial environmental certificates.

Considered a “green” credit line, the Senior Tranche will allow Continental to engage in sustainable lending practices, and, depending on the characteristics of the eligible projects, could count with the technical cooperation of the IADB’s Sustainable Energy and Climate Change Initiative (SECCI) through which Continental would channel technical assistance to its clients, compounding the environmental impact of the projects as well as the expected financial results to the beneficiaries.

The amounts earmarked for the abovementioned environmental initiatives, associated with the Technical Assistance funds, are all part of IDB’s support to sustainable finance, and are especially well suited for Continental, as an Equator Principle adhered Bank..

This proposed operation is innovative, in the sense that this would be the first time the Bank uses the A/B loan mechanism to bring international investors as subordinated lenders. This mobilization of an international investor to provide subordinated debt that qualifies as Tier II Capital should have an important demonstration effect in the region, especially under current market conditions of tight liquidity.

IDB’s participation in the project is consistent with the strategy to enhance competitiveness and the efficient development of the private sector. The project provides the funding and comprehensive support for mortgage origination and sustainable financing, while strengthening the funding, liquidity and capital position of a key financial institution in the Peruvian financial system.

Environmental and Social Impacts and Risks

Given the nature of this Facility, (i.e., credit finance for mortgages and MSME`s), the potential environmental and social impacts and risks are expected to be minimal. Moreover, because the Senior Tranche will support companies that will engage in positive environmental activities, such as: use of energy efficiency alternatives, generation of carbon bonds, it is generally expected that investment activities will result in favorable environmental and social impacts.

While potential impacts are said to be minimal, some activities, like their individual residential loan program, could present some environmental, social, or health and safety concerns to *Banco Continental*. These potential environmental risks could arise from properties located in areas susceptible to natural hazards (floods, seismic events, fires or hurricanes); or, properties built on land which may be contaminated due to previous land use activities, such as illegal dumping.

Additionally, other potential credit risks to the IDB could be associated to:

- (i) mortgages or other assets provided as collateral which due to environmental liabilities or risks may have a lower than estimated value,

- (ii) environmental, social, health and safety and/or labor issues in *Banco Continental* Corporate Loans, that may result on material impacts to *Banco Continental* (e.g. clean-up costs, fines, etc) thus affecting its cash flow and its ability to repay the IDB, and
- (iii) to a lesser extent environmental, social, or health and safety risks associated with *Banco Continental* facilities (e.g. poor emergency preparedness practices in cases of fires, and/or earthquakes, etc).

There are also potential reputation risks that could be transferred to the IDB in the case *Banco Continental* inappropriate manages environmental, social, health and safety, or labor matters.

Since this Facility is an expansion of a previous loan and complements the financing already provided to Continental, the environmental and social due diligence will consist of an evaluation of: (i) the progress made on Continental's development and implementation of its Environmental Management System; and, (ii) the criteria to be developed by Continental for the operation of the "green line" of credit (Senior Tranche), in particular an evaluation of criteria that establishes eligibility and environmental and social requirements for the MSMEs; (iii) an update of existing ESMR with specific attention to ensuring current environmental and social capacity .

Regarding a review of the existing ESMR for Banco Continental, specific attention will be given to ensuring current capacity to manage and mitigate environmental and social impacts and risks, as well as Banco Continental's action plans to implement its Environmental Management System.

Based on IDB Environment and Safeguards Compliance Policy, OP-703, Directive B.13 that deals with financial intermediation operations, this operation does not need to be categorized.