

INTER-AMERICAN DEVELOPMENT BANK



REGIONAL

LATIN AMERICAN MEZZANINE FINANCE FUND

RG-0050

ENVIRONMENTAL AND SOCIAL IMPACT REPORT

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I. INTRODUCTION

- 1.1 The Bank has been requested to provide a direct loan of approximately US\$75 million to the Darby Latin American Mezzanine Fund (the "Fund"). The Fund is intended to address the shortfalls in the availability of long term subordinated or mezzanine debt financing in the region. The IDB and the Fund sponsors have identified the availability of this type of long term debt financing, which supplements sponsors' equity as a form of risk capital, as having significant potential for mobilizing private sector led infrastructure projects in Latin America.
- 1.2 The Fund will provide a new type of financing to private sector projects in Latin America and the Caribbean (the "Region"). Mezzanine finance consists of financial instruments that combine debt and equity features. Mezzanine loans are generally structured as long term subordinated loans with equity participation features such as conversion rights, warrants or other profit participating features. The Fund is expected to play a pioneering role in introducing mezzanine financing in the region, thereby offering both investors and borrowers a financing instrument with a risk/return profile that better meets their needs.
- 1.3 The Fund will seek to achieve substantial current returns and long-term capital appreciation through a diversified portfolio of mezzanine investments. The Fund will provide corporate finance to ongoing concerns, as well as limited recourse project finance, primarily in infrastructure sectors such as power, transportation, water supply and telecommunications.
- 1.4 The benefits of the Fund's product will be to allow sponsors to raise long term capital without giving up full equity control. Meanwhile, subordinated debt in a project's balance sheet will allow that company to still raise additional senior debt. While riskier than senior debt, the subordinated loans made by the Fund will typically be less risky than equity, thus representing a relatively lower risk to the Bank as a lender to the Fund. Also, given that debt instruments are amortized more rapidly and more predictably than equity, some early repayments to the Fund may be able to be recycled to additional projects throughout its life for more catalytic impact.
- 1.5 The size of the Fund is expected to be US\$500 million comprised of US\$250 million in equity and US\$250 million in senior debt, including US\$75 million from the Bank. Insurance companies, pension funds and other institutions are expected to have an interest in high yield emerging market paper. The Fund management will be the responsibility of Darby Overseas Investments, Ltd ("Darby") and the two sponsor investors, BBV and Dresdner. Darby is an emerging markets fund management company chaired by former U.S. Secretary of Treasury Nicholas F. Brady.

II. FUND DESCRIPTION

A. Purpose

- 2.1 The purpose of the fund is to catalyze funding from international investors and lenders, and to provide mezzanine financing to private sector projects in the Region. The Fund will provide corporate finance to ongoing concerns, as well as limited recourse project finance, primarily in infrastructure sectors such as power, transportation, water supply and telecommunications.

B. Investment Objective

- 2.2 The Fund will seek to realize substantial current income and long-term capital appreciation primarily by investing in a diversified portfolio of U.S. dollar-denominated long-term loans, secured or unsecured, but generally subordinated and containing equity participation features such as options, warrants, convertibility or equity participation rights), all to private sector borrowers located in the Region (mezzanine loans). The Fund may also make senior loans to private sector borrowers located in the Region on a secured or unsecured basis, in either case without equity-linked options. Finally, the Fund may make direct equity investments in private sector issuers located in the Region, although these investments will be limited to 15% of the aggregate Capitalization of the Fund (as defined below).

C. Capitalization

- 2.3 US\$500 million total capitalization of which US\$250 million (50%) will be equity and/or subordinated debt and US\$250 will be long term senior debt. IDB has been requested to provide the Fund with a direct loan of approximately US\$75 million. The balance of the US\$175 million in debt financing is expected to be raised through a private placement to institutional lenders after the Fund has begun operations.

D. Fund Management and Sponsor Investors

- 2.4 Darby Overseas Investments, Ltd. or an affiliate will serve as the General Partner but will share fund management with the other two Sponsor Investors: BBV and Dresdner. Other Sponsor Investors may be added to the Fund in the future. Each Sponsor Investor will be represented on the investment committee of the Fund and will have priority rights in the event of a co-investment opportunity. Sponsor Investors will also receive a portion of the carried interest paid to the general partner by the Fund, which amount shall not exceed 25% of the total amount of the carried interest, in the aggregate. Darby, BBV and Dresdner will all assign staff to the Fund in an effort coordinated by Darby. Staff of all three Sponsors will help to identify and recommend investments to the investment committee.

- 2.5 Darby, will be the primary manager and majority shareholder of the general partner of the Fund. The Fund will be managed by Darby senior management. While the senior management is responsible for overall policy and supervision of the firm's activities, actual day-to-day operations are the responsibility of its managing partner, who serves as chief operating officer. Actual operations will be controlled by two managing directors, supported by approximately ten investment professionals. The direct investment activity of the fund will be carried out by three principals, who will report to the two managing directors. Each will have a particular responsibility for an infrastructure sector: Power, Transport and Water, and Telecom.

E. Decision Making

- 2.6 The Fund's staff (partially provided by the Sponsors) will be responsible for negotiating and recommending individual investment decisions. The Investment Committee will review and recommend to the Board all investments, divestitures, exercise of options, conversions, and the like. The Committee will review investments at an early stage, and again for final approval. The Investment Committee will be chaired by the managing partner of Darby and which will include representatives of BBV and Dresdner. The interests of the Fund's other investors would be represented by a Board comprised of the representatives of the Fund's overall investor group.
- 2.7 The Fund Advisory Committee will review portfolio valuations, resolve conflicts of interest of the Fund manager, and offer general advice on the strategy and operations of the Fund. The advisory committee will review all quarterly valuations of Fund assets proposed by the Fund's management and meet at least annually to review the Fund's portfolio investments and render advice on general strategic issues. The Advisory Committee will be comprised of senior representatives from the Core Investors as well as independent representatives from both business and government.

F. Investment Period

- 2.8 The Fund expects to be fully invested within a five year period after launch

G. Diversification Policies

- 2.9 The Fund will operate on the basis of prudent diversification policies -as defined by international rating agencies- which would limit investments in various categories. Preliminary plans are to limit exposure in the following manner: to a single company or project, 8% of total capital base of the Fund; to a single country, 25% of total investments [(except in Brazil where the limit is 40%)]; to a single sector outside the infrastructure sector, 35% of total investments; not more than 15% of

the aggregate capital base of the Fund invested in direct equity investments; and not less than 65% of the aggregate capital base of the Fund invested in the infrastructure sector

H. Eligible Countries

- 2.10 The Fund will be developed to facilitate infrastructure development in IDB borrowing member countries throughout Latin America and the Caribbean

I. Scope of Investments

- 2.11 At least 65% of the Fund's total capital base (including committed capital plus senior debt and subordinated debt, if any) will be invested in infrastructure, in the following sub-sectors:

- Power, including power generation, transmission and distribution;
- Transportation, including toll roads, mass transit and rail systems, urban and interurban transport networks, shipping, toll bridges, tunnels and ports, gas and oil pipelines, airports, airlines and airport services;
- Water, sanitation and other utilities, including water and waste treatment, transmission and distribution, other treatment and processing facilities providing environmental services; and
- Telecommunications, including telephone systems (including cellular), cable TV, international cable links, satellite communications and other communication systems.

- 2.11 Given that the Fund will be quite specialized in terms of target Region and instrument (mezzanine finance) it is necessary to retain a limited degree of flexibility in terms of target sectors to ensure some diversification and a strong level of deal flow. Thus, up to 35% of the Fund's investments could be undertaken in companies engaged in other productive activities and sectors.

J. Investment Restrictions

- 2.12 The Fund will be subject to certain investment restrictions. These include, among others, (i) investing in other funds; (ii) investing in projects whose financial return is primarily determined by the availability of artificial tariffs or other forms of trade protection, or by the availability of subsidized local inputs; (iii) speculate in currency or commodity markets by trading in currencies or commodities; (iv) investing in firms or projects engaged in large-scale mining, oil or gas exploration or development; real estate development; or the production or distribution of tobacco or firearms; or (v) or investing in non-eligible activities based upon environmental and social criteria (see Table 4-1).

- 2.13 All investments must comply with the Fund's Environmental Management System (see section 4 for details).

III. ENVIRONMENTAL AND SOCIAL IMPACTS

- 3.1 The potential negative impacts associated with the Fund are attributable to those potential environmental and social impacts associated with a given project (Fund sub-projects which would be financed by the Fund). The type of impacts will depend upon the project characteristics (e.g., sector, type, location, etc.). These potential negative impacts will be mitigated both individually within the specific sub-projects and also globally over all projects by the implementation of an Environmental Management System.
- 3.2 The principal direct positive environmental and social impact from the Fund is that the participation of the Bank will result in more environmentally and socially sustainable projects financed by the Fund because of the Bank's environmental and social related requirements on the Fund (i.e., development and implementation of an Environmental Management System). By applying environmental and social standards to the Fund, the Bank has the opportunity to ensure that all US\$500 million of investments will be made in accordance to such standards, not just an amount equal to the US\$75 million loan provided by the Bank. This would, in effect, allow the Bank to leverage its environmental and social impact by 6.67 times the amount of its loan.
- 3.3 There are various other positive benefits associated with the Fund, including the following:
- providing financing for highly needed environmental (e.g., water supply, sanitation, etc.) and social sector projects;
 - providing unique financing (e.g., subordinated debt) to facilitate private capital investment in the needed infrastructure development, which in turn promotes economic and social growth of the country and its population;
 - providing a leadership role in supporting long-term direct investment in Latin America during difficult market conditions;
 - supporting the development of new and innovative financial instruments such as the various types of subordinated debt to be employed by this fund for mezzanine finance; and
 - providing a significant catalytic impact of the Bank's participation in mobilizing resources from other investors (A US\$75 million loan will help mobilize a total of US\$500 million, the Bank will act as a catalytic agent with a multiplying factor of 6.67 times IDB's direct loan. When multiplied by the total project costs of the Fund's underlying projects, the catalytic ratio of the Bank is expected to exceed 30 times the IDB loan. This impact would make the Fund

significantly more catalytic than would be possible with a single project even when employing the Bank's A/B loan umbrella.).

IV. ENVIRONMENTAL MANAGEMENT SYSTEM

- 4.1 The Bank's participation in the proposed Fund is not targeted to a specific project or specific sub-project to be financed by the Fund, but rather is to the Fund in general which may have some projects with environmental or social impacts. The Bank will not participate in the direct management or approval of individual Fund sub-projects. Thus, for this type of fund financing, the Bank will focus on the "process" of environmental management in the Fund rather than on the Bank's evaluation of specific sub-projects.
- 4.2 The Bank has required the Darby Fund to develop, subject to Bank approval, and implement an appropriate Environmental Management System (EMS) which will be applied to all sub-projects of the Fund. An initial version of the Fund's EMS has been developed by Darby. However, since the Fund will not be functional until after Bank approval of the project (loan), some of the specifics of the EMS can not be totally defined at this time; hence the final version of the EMS, subject to Bank approval, will be made a loan contract requirement for financial closure.
- 4.3 The EMS contains the following basic components (which are described further below):
- Policy and Requirements (section IV.A), which defines the basic principles and requirements for projects to be financed by the Fund;
 - Process (section IV.B), which defines the approach for the fund's environmental and social review and management of individual projects from initial sponsor contact through project (loan) supervision; and
 - Resources (section IV.C), which defines personnel and training aspects.

A. Policy and Requirements

- 4.4 The following are key premises in the Fund's environmental policy (see Table 4-1 for complete policy):
- "Darby Latin American Mezzanine Investments ("Darby"), as General Partner of the Darby Latin American Mezzanine Fund, L.P. (the "Fund"), will ensure that each and every investment of the Fund is made with due regard to environmental, occupational health and safety (EH&S), and social aspects."
 - "It is the Fund's desire to promote the positive EH&S and social aspects/components of projects in which it invests."
 - "Darby will not make an investment in any project unless the environmental, occupational health and safety, and social aspects have been addressed to the

satisfaction of the Investment Committee, and unless the appropriate host country governmental authority has initially approved the project. “

- “As Chair of the Investment Committee, the Managing Partner will assure conformance with this Policy, and the Managing Directors, the Chief Counsel, principals and consultants, as will be designated from time-to-time, will be responsible for its execution.”

4.5 In addition to the policy, the EMS incorporates other noteworthy premises which are listed below.

- All project legal commitment documents (e.g., loan contract) will incorporate environmental and social covenants, including both standard covenants (i.e., applicable to all projects), and, as necessary, project-specific requirements into legal documentation for the project.
- The Investment Committee cannot refer a project to the Board of Directors for approval unless all environmental and social issues have been addressed to the satisfaction of the Investment Committee.
- The prospective investee may be encouraged to operate an environmental management system to ensure compliance with the terms of the investment agreement and to ensure operational efficiency.

4.6 The Fund is prohibited from investing in any project involved in any activity listed in Table 4-1.

4.7 The basic requirements for all projects and project companies to be financed by the Fund are listed below.

1. The project and the project company must comply with all applicable environmental, health and safety host country regulatory requirements, including without limitation: all requirements associated with any environmental, health and safety related permits, authorizations or licenses that apply to Project; provisions of relevant international environmental treaties or conventions of which the host country is a signatory and for which ratification requirements, if any, have been fulfilled; and all environmental, health and safety, and social requirements in the project concession contract or other similar document, if applicable.
2. The project and the project company must comply applicable requirements in the World Bank Pollution Prevention and Abatement Handbook (sector guidelines in Part III)(dated August 1998 or subsequent versions), the International Finance Corporation (IFC) sector guidelines for which there are no parallel guidelines in Part III of the Handbook (note: this includes general health and safety guidelines for all projects), and any applicable Inter-American Development policy, including specifically guidelines for development of environmental impacts assessments and the Involuntary Resettlement Policy (OP-710, August 1998). Refer to Table 4-2 for list of World Bank and IFC

sector guidelines. For projects in host countries without applicable regulatory ambient criteria, the project must comply with recommended criteria in the World Bank Pollution Prevention Handbook (Part II).

3. The project and the project company must comply all environmental, social, and health and safety requirements (e.g., mitigation measure, monitoring program, actions, works, etc.) identified in project Environmental Management Plan (see paragraph 4.8 for description), and any other project or applicable environmental, health and safety document, such as corrective action plans, emergency response or contingency plans, environmental impact assessment, and health and safety plans.
4. The project and the project company must comply with any other requirements that may be identified during the Fund's due-diligence process.

4.8 The Fund will use a "Environmental Management Plan" related to each project as the basic document which defines the measures to be undertaken to protect the environment, social and health and safety. Thus each projects must have an written Environmental Management Plan (EMP), which includes, at a minimum, the following (note: the final EMS will include a specific format/outline): description of environmental and social mitigation measures and monitoring programs to be implemented; description of the health and safety measures and programs to be implemented; description of emergency/contingency procedures to be implemented; description of environmental, health and safety responsibilities; and estimated cost and time schedule to implement each individual component of the EMP.

4.9 The basis for the project Environmental Management Plan will depend on the specific project and associated characteristics. Summarized below are the Fund's basic requirements in terms of the studies/documentation to be used to define the contents of the EMP. A "major" project will be defined as a project that is likely to have significant adverse environmental and social impacts that are sensitive (i.e., irreversible, affect vulnerable groups or ethnic minorities, or involve involuntary displacement or resettlement), diverse, or unprecedented. A project will be defined as major based upon the preliminary due-diligence review of the project by the Fund's designated environmental consultant (refer to section IV.B for discussion of the Fund's process for analysis of potential projects).

1. For projects that are considered "major", the Fund will require the sponsor to undertake a full-scale Environmental Impact Assessment (EIA) according to generic Terms of Reference for EIAs as defined in the Banks guidance for EIAs. The Fund will also require the sponsor to consult with stakeholders on preparation and results of the EIA for major projects, disclose to the public the EIA results, and prepare and implement a formal Public Consultation and Disclosure Plan (PCDP). Darby will develop as part of the final EMA, a suggested Terms of Reference for the contents of a PCDP based upon the

Bank's Resource Book on Participation and IFC's good practice manual for consultation and disclosure.

2. For projects that are not considered major, the Fund will require the project sponsor to provide environmental and social assessment information in the form of a partial or supplementary EIA, a resettlement plan, or other specific environmental analyses depending on the potential environmental and social impacts of the project. The Fund's environmental consultant will assist the prospective investee in developing the Terms of Reference (Scope of Work) for these types of environmental assessments.
 3. For projects with existing operations, the Fund will require the project sponsor to provide an environmental, health and safety audit and, if any non-compliance exists, then an associated corrective action plan. Darby will develop as part of the final EMA, a suggested Terms of Reference for the contents of the environmental audit.
- 4.10 In terms of public disclosure by the Fund, an Environmental Summary Memorandum (ESM) for each project will be made available to the public prior to a final decision by the Fund's Board of Directors. The ESM will include a summary of the key environmental and social issues associated with the project, the proposed mitigation measures, monitoring and management plans, and applicable cost and schedule information. The ESM will be prepared by the Fund's environmental consultant, as part of due-diligence.
- 4.11 In addition to the Fund's disclosure activities, the Fund will request of specific projects that an appropriate level of public disclosure/consultation activities be implemented given the specific aspects and characteristics of the project. For all major projects, the Fund will require the sponsor to consult with stakeholders on preparation and results of the EIA for major projects, disclose to the public the EIA results, and prepare and implement a formal Public Consultation and Disclosure Plan.

B. Process

- 4.12 The process by which the Fund will implement the Environmental Management System for specific projects is presented in Table 4-4 and summarized below. This process is integral to the overall Fund investment process.
- 4.13 At the stage of initial inquiry, the Fund will apply its Exclusion List (see Table 4-1) to the potential project. If the project is engaged in an excluded activity, the prospective investee company or project sponsor will be so informed, and further consideration of financing for the project will be terminated.
- 4.14 When the Fund it conveys an expression of interest with respect to a project, the prospective investee company or project sponsor will be informed in writing of the applicable environmental, social and health and safety requirements (e.g., see

paragraph 4.7). The Fund will request that the prospective investee company or project sponsor provide information in the context of these concerns. The Fund will provide to the prospective investee company or project sponsor an Environmental and Social Screening Form (finalized version to be part of the final EMS) to assist in identification of potential issues of concern

- 4.15 As part of preliminary due diligence and in order to determine the level of environmental compliance and to identify potential ecological and social issues, the Fund's designated environmental Consultant will perform a review of the environmental and social information provided by the prospective investee. During this review the Consultant may choose to rely upon environmental and social analysis previously prepared by third parties in relation to the project, and /or may conduct a site visit, as necessary. The Consultant will determine whether the proposed project is likely to have significant adverse environmental and social impacts that are sensitive (i.e., irreversible, affect vulnerable groups or ethnic minorities, or involve involuntary displacement or resettlement), diverse, or unprecedented. These will be considered major projects for the purpose of environmental and social review.
- 4.16 The Fund's mandate letter or Memorandum of Understanding to the prospective investee company or project sponsor will include a section on environmental and social issues detailing additional analyses or actions that must be performed by the prospective investee, based on the recommendation of the Consultant, before or during Darby's due diligence process (refer to section IV.A for general requirements).
- 4.17 As part of the due-diligence, the Consultant will review the additional analyses required and recommend through the Project Principal further development of environmental management, corrective measures, or action plans, as may be warranted. Based on the results of the due diligence, the Consultant and Project Principal will notify the Managing Directors of the status of environmental and social issues by preparing an Environmental Summary Memorandum (ESM) that will then be transmitted to the Investment Committee. The ESM will include a summary of the key environmental and social issues associated with the project, the proposed mitigation measures, monitoring and management plans, and applicable cost and schedule information.
- 4.18 Based upon the ESM and related information, the Investment Committee may approve undertaking final negotiations toward commitment. These negotiations will incorporate environmental and social covenants, including both standard covenants (i.e., applicable to all projects), and, as necessary, project-specific requirements into legal documentation for the project. The ESM for all projects will be disseminated or otherwise adequately disclosed to allow for access by the public, including the affected population. The Investment Committee cannot refer

a project to the Board of Directors for approval unless all environmental and social issues have been addressed to the satisfaction of the Investment Committee.

- 4.19 Disbursement of funds will not be made unless the applicable host country environmental governmental authority has provided some form of project approval (e.g., approval of EIA, issuance of initial or preliminary environmental license, etc.). Similarly, disbursement may be phased and tied to the implementation of the Environmental Management Plan or Corrective Action Plan.
- 4.20 Darby will monitor the environmental and social performance of all investments in the Fund's portfolio. Darby will develop a project specific description of monitoring and reporting requirements to be provided to each investee company, and each investee company will in turn provide an annual performance report relative to environmental and social requirements stipulated in the investment agreement (the final EMS will contain generic reporting requirements and formats). Darby will discuss these issues with each investee company in the course of its normal supervision and evaluation of its investment portfolio. From time to time, Darby may also conduct independent audits of investee project environmental and social performance as part of its overall supervision process.

C. Resources

- 4.21 The General Partner (Darby) manages the Fund. Darby's Board of Directors will have the power to approve or disapprove all investment recommendations made by the Investment Committee. The Investment Committee, which is chaired by the Managing Partner, will review and approve all investment proposals for recommendation to Darby's Board of Directors. Refer to section II.D and II.E for details. The Investment Committee will ensure that all investment decisions are supported by appropriate documentation.
- 4.22 The Managing Partner will have oversight for environmental and social issues, including the following specific responsibilities:
- reporting to the Board of Directors on these issues;
 - assuring that sufficient internal and external resources have been committed to allow for the effective implementation of the EMS;
 - review of the environmental policy and procedure on a periodic basis; and
 - submittal of any required documentation or notification to the Inter-American Development Bank.
- 4.23 The Managing Directors will ensure that the procedure is implemented for each project. To assure execution of project review and appraisal, the Managing Directors will rely upon designated Environmental Consultants (see paragraph 4.26 for description).

- 4.24 The Chief Counsel will ensure that the appropriate covenants are incorporated in each investment agreement and that supplemental legal documentation further reflects as appropriate agreements made relative to environmental and social aspects.
- 4.25 The project principal is the Investment Officer for the project. The project principal will work with the consultant to communicate environmental and social concerns and to resolve outstanding issues with the Fund clients.
- 4.26 An Environmental Consultant will be designated each project to perform the environmental and social review so that all investments will meet the environmental and social criteria of the Fund. The preliminary due-diligence will be in general performed by environmental consultants on retainer agreement with the Fund. The due-diligence will be performed by consultants on retainer or individual specialists as warranted by the project under review. The Managing Directors will select the designated consultant from a file of qualified environmental and social consultants. Generic Terms of Reference for these consultants will be developed as part of the final EMS.
- 4.27 Internal staff training sessions and briefings on the EMS and other related environmental issues and procedures will be provided to all applicable Fund personnel. The form and content of environmental training will be developed as part of the final EMS.

V. RECOMMENDATIONS

- 5.1 The Bank will require the Darby Fund to continuously operate an Environmental Management System (EMS), for which the EMS must be approved by the IDB. The Bank will make failure to fully comply with the final Environmental Management System an event of default of the IDB loan/financing.
- 5.2 The Bank will require prior to financial closure, a finalized Environmental Management System, which is subject to IDB approval.
- 5.3 The Bank will require prior to first disbursement, evidence of full implementation of the Environmental Management System.
- 5.4 The Bank will require for each disbursement, certification of compliance with all Environmental Requirements, description of any non-compliance with any Environmental Requirement and action plan to correct non-compliance, and description of any known environmental and social liability, including without limitation environmental claim or material compliant.

- 5.5 The Bank will require an annual Environmental and Social Compliance Report to be submitted by the Fund. The Bank will also implement other supervision activities (e.g., assessment of funds environmental management system prior to the first subproject review by the fund (start-up of fund), review of sub-set of the funds subprojects at some date (e.g., 1 to 2 years) after start-up of fund, review of designation of major projects, etc.). The form and substance of the report and other activities will be finalized as part of the Loan Contract and the final Environmental Management System.
- 5.6 The Bank must be consulted before the Fund approves or implements any change to the Fund's Environmental Management System which may result in a material environmental or social change, affect or impact.
- 5.7 The Bank will require written notification by Fund within 30 days the Fund becomes aware, or should have been aware, of: any project financed by the Fund for which significant environmental, social or health and safety issues or problems have arisen/occurred or any material non-compliance with the Bank's Environmental Requirements.
- 5.8 The Bank will require access, for internal Bank use only, to any project specific environmental, health or safety documentation.
- 5.9 The Bank will retain the right to prevent the use of Bank funds for the financing of any project, that in the Bank's determination, does not comply with Bank policies or does not adequately protect the environmental, social, or health or safety aspects.

TABLE 4-1
DARBY FUND ENVIRONMENTAL MANAGEMENT SYSTEM POLICY

Darby Latin American Mezzanine Investments (“Darby”), as General Partner of the Darby Latin American Mezzanine Fund, L.P. (the “Fund”), will ensure that each and every investment of the Fund is made with due regard to environmental, occupational health and safety (EH&S), and social aspects. Further, it is the Fund’s desire to promote the positive EH&S and social aspects/components of projects in which it invests.

All projects in which the Fund invests must comply with all applicable environmental, occupational health and safety laws and regulations of the host country in which the project is located, including applicable international environmental treaties or conventions for which the host country is a signatory. In addition, all projects must meet the relevant Sector Guidelines of the World Bank Group and any project-specific commitments identified during the due diligence process (see Appendix B). Further, the Fund will adhere to the Inter-American Development Bank’s policy on Involuntary Resettlement (OP-710) and will consider adopting additional policies, relative to ecological and social matters, as and when they are developed by IDB. Such guidelines and policies, however, will not be applied retroactively to investments previously made by the Fund. In order to ensure adherence to the standards set out in the above-mentioned guidelines and policies, the Fund will follow the process that is described in the next section. Darby will not make an investment in any project unless the environmental, occupational health and safety, and social aspects have been addressed to the satisfaction of the Investment Committee, and unless the appropriate host country environmental governmental authority has issued some form of project approval.

As Chair of the Investment Committee, the Managing Partner will assure conformance with this Policy, and the Managing Directors, the Chief Counsel, principals and consultants, as will be designated from time-to-time, will be responsible for its execution. This Policy along with the procedure, responsibilities, reporting requirements, and related items identified below constitute the framework of Darby’s environmental management system. The Managing Partner will provide this framework document to all members of the Board, all members of the Investment Committee, and all employees of Darby.

TABLE 4-2
PROJECTS NOT ELIGIBLE FOR FINANCING BY DARBY FUND

- Large-scale mining, oil or gas exploration or development.
- Real estate development.
- Production or activities involving forced labor or harmful/exploitative forms of child labor.
- Production or trade in any product or activity deemed illegal under host country laws or regulations.
- Production or trade in weapons and munitions.
- Production or trade in alcoholic beverages (excluding beer and wine).
- Production or trade in tobacco.
- Gambling, casinos and equivalent enterprises.
- Trade in wildlife or wildlife products regulated under CITES.¹
- Production or trade in radioactive materials.²
- Production or trade in or use of unbonded asbestos fibers.³
- Commercial logging operations in or the purchase of logging equipment for use in primary tropical moist forest or other temperate forests.⁴
- Production or trade in products containing PCBs.⁵
- Production or trade in pharmaceuticals subject to international phase-outs or bans.
- Production or trade in pesticides/herbicides subject to international phase-outs or bans.
- Production or trade in ozone depleting substances (ODSs) subject to international phase-out.
- Drift net fishing in the marine environment using nets in excess of 2.5 km. in length.⁶
- Operations or trade related to the importation, storage and treatment or disposal of toxic or hazardous wastes which do not comply with the international conventions (e.g., Bazel Convention).

¹ CITES: Convention on International Trade in Endangered Species of Wild Fauna and Flora.

² This does not apply to the purchase of medical equipment, quality control (measurement) equipment and any equipment where Darby considers the radioactive source to be trivial and/or adequately shielded.

³ This does not apply to the purchase and use of bonded asbestos cement sheeting where the asbestos content is <20%.

⁴ Primary forest is defined as relatively intact forest that has been essentially unmodified by human activity for the previous 60 to 80 years. Tropical moist forest is generally defined as forest in areas that receive not less than 100 mm of rain in any month for two out of three years and have an annual mean temperature of 24° C or higher.

⁵ PCBs: polychlorinated biphenyls—a group of highly toxic chemicals. PCBs are likely to be found in oil-filled electrical transformers, capacitors and switchgear dating from 1950 -1985.

⁶ Ozone Depleting Substances (ODSs): Chemical compounds which react with and deplete stratospheric ozone, resulting in the widely publicized ‘ozone holes.’ The Montreal Protocol lists ODSs and their target reduction and phase-out dates. ODSs are potentially used in products such as aerosols, refrigerants, foam blowing agents, solvents, and fire protection agents.

TABLE 4-3
REQUIRED SECTOR GUIDELINES FOR FUND PROJECTS

WB Pollution Prevention Handbook	IFC guidelines
<ol style="list-style-type: none"> 1. Aluminum Manufacturing 2. Base Metal and Iron Ore Mining 3. Breweries 4. Cement Manufacturing 5. Chlor-Alkali Plants 6. Coal Mining and Production 7. Coke Manufacturing 8. Copper Smelting 9. Dairy Industry 10. Dye Manufacturing 11. Electronics Manufacturing 12. Electroplating Industry 13. Foundries 14. Fruit and Vegetable Processing 15. General Environmental Guidelines 16. Glass Manufacturing 17. Industrial Estates 18. Iron and Steel Manufacturing 19. Lead and Zinc Smelting 20. Meat Processing and Rendering 21. Mini Steel Mills 22. Mixed Fertilizer Plants 23. Monitoring 24. Nickel Smelting and Refining 25. Nitrogenous Fertilizer Plants 26. Oil and Gas Development (Onshore) 27. Pesticides Formulation 28. Pesticides Manufacturing 29. Petrochemicals Manufacturing 30. Petroleum Refining 31. Pharmaceutical Manufacturing 32. Phosphate Fertilizer Plants 33. Printing Industry 34. Pulp and Paper Mills 35. Sugar Manufacturing 36. Tanning and Leather Finishing 37. Textiles Industry 38. Thermal Power—Guidelines for New Plants 39. Thermal Power—Rehabilitation of Existing Plants 40. Tourism and Hospitality Development 41. Vegetable Oil Processing 42. Wood Preserving Industry 	<ol style="list-style-type: none"> 1. Airports 2. Ceramic Tile Manufacturing 3. Construction Materials Plants 4. Electric Power Transmission and Distribution 5. Fish Processing 6. Food and Beverage Processing 7. Forestry Operations: Logging 8. Gas Terminal Systems 9. General Health and Safety Guidelines 10. Geothermal Projects 11. Hospitals 12. Hotels 13. Offshore Hydrocarbon Projects 14. Polychlorinated Biphenyls (PCBs) 15. Pesticide Handling and Application 16. Plantations 17. Port and Harbor Facilities 18. Public Road Transportation Operations 19. Rail Transit Systems 20. Roads and Highways 21. Telecommunications 22. Wildland Management 23. Wind Energy Conversion Systems 24. Wood Products Industries 25. Waste Management Facilities 26. Wastewater Reuse

TABLE 4-4
ENVIRONMENTAL MANAGEMENT SYSTEM INVESTMENT PROCESS

<u>INVESTMENT PROCESS ACTIVITY</u>	<u>ENVIRONMENTAL & SOCIAL ACTIVITY</u>
<i>Initial Inquiry</i>	<ul style="list-style-type: none"> • Apply exclusion list.
Expression of Interest	<ul style="list-style-type: none"> • Inform investee in writing of requirements. • Provide Screening Form.
Preliminary Due Diligence	<ul style="list-style-type: none"> • Review Screening Form and other information provided, and determine if <i>major</i> project. • Conduct site visit as necessary.
Mandate Letter or Memorandum of Understanding	<ul style="list-style-type: none"> • Specify analysis and/or action to be performed by investee, including if full EIA and PCDP are needed. • Assist sponsor in preparing ToR for EA. • Notify IDB if major project.
Due Diligence	<ul style="list-style-type: none"> • Review Environmental Assessment and Environmental Management Plan documentation or other information (i.e., PDCP) provided by investee. • Specify corrective measures or action plan as warranted, including implementation schedule and costs. • Prepare Environmental Summary Memorandum (ESM) for Managing Directors and Investment Committee.
Final Negotiations	<ul style="list-style-type: none"> • Ensure action/management plans are developed. • Incorporate environmental and social covenants into legal documentation.
Commitment	<ul style="list-style-type: none"> • Disseminate ESM to public. • Notify IDB of Commitment (non-major projects).
Disbursement	<ul style="list-style-type: none"> • Ensure conditions have been met
Supervision	<ul style="list-style-type: none"> • Evaluate performance at least annually. • Provide annual report to IDB describing the status of environmental compliance of existing portfolio.