**Annex I**

**ENVIRONMENTAL AND SOCIAL MANAGEMENT REPORT**

**LAC-CHINA INVESTMENT FUNDS**

**LAC China Infrastructure Fund (RG-L1048)**

**LAC China Mid Cap Corporate Fund (RG-L1055)**

**LAC China Natural Resources Fund (RG-L1054)**

1. **Description of the Platform.** The Bank, in partnership with the Export-Import Bank of China (“China Exim”), is designing a platform consisting of three regional investments funds (“LAC China Funds” or “Funds”) as an initiative to support and accompany the process of economic and financial integration between Latin America and the Caribbean (LAC) and China. The LAC China Funds are engineered to attract a geographically diversified pool of investors (including Chinese investors) to deploy risk capital in companies and projects operating in economic activities identified as vital for the development of LAC, namely infrastructure, mid-size companies and natural resources (agribusiness, energy and mining in the pre-production stage).
2. **The** **Funds.** It is expected that the Funds will target US$1.85 billion of capital commitments, US$1billion in infrastructure, US$500 million in mid-size companies and US$350 million in natural resources. The additional equity funding is expected to be contributed mainly by private investors. It is expected that, once launched, the investment vehicles will provide long term financing, through equity and debt, to projects and companies with high developmental impact in LAC. The three Funds will be established in jurisdictions acceptable to IDB, and will have a life of at least 10 years.
3. **LAC-China Infrastructure Fund** The target size of the Fund is US$1 billion and will focus on investments in infrastructure sectors, including among others, roads, ports, rails, airports, storage facilities, and energy. The IDB commitment is expected to be a senior loan of $50 million. **The Fund Manager (FM) will be part of Macquarie Infrastructure and Real Assets** (“MIRA”), a division of Macquarie Funds Group, one of the largest dedicated specialist fund managers in the world.[[1]](#footnote-1) The International Finance Corporation (IFC) and the European Bank for Reconstruction and Development (EBRD), among other multilaterals, have supported Macquarie managed funds in India, Russia and Africa. This is the second time that the IDB has worked in conjunction with MIRA on a fund project. In December 2010, a US$150 million loan was approved in favor of Macquarie Mexican Infrastructure Fund.
4. **LAC-China Mid Cap Corporates Fund**. The size of the LAC-China Mid Cap Corporates Fund (working title) is US$500 million and will focus on mid-size companies in a variety of sectors such as: consumer and retail, distribution and logistics, industrial manufacturing, agribusiness and financial services. The IDB’s commitment is expected to be a senior loan of US$50 million, not to exceed 20% of the size of the Fund. The average size of the transactions is US$20 - 30 million. **The Fund will be managed by Darby,** a well-established manager with solid experience in emerging markets and which has been investing in Latin America since 1994. IDB and IIC have already worked in the past with Darby, having approved three projects with the company as FM: a US$75 million loan to the Darby Latin American Mezzanine Fund approved in 1998 and US$15 million in two IIC equity investments in the Darby ProBanco Funds I and II. Darby also has extensive experience with the requirements of bilateral and other multilateral financial institutions including EBRD, OPIC, FMO, KfW, etc.

1. **LAC-China Natural Resources Fund** The purpose of the LAC-China Natural Resources Fund is to support the production and commercialization of the products necessary to satisfy basic needs in food, minerals and energy. The Fund will invest in a diversified portfolio of commodity-based projects and mostly mid-size companies operating in the agribusiness (40%), energy and renewable investments (30%), and value-added activities related to natural resources and mining at the pre-production stage (30%). The Fund targets to raise a total of commitments of up to US$350-500 million for 10 investments of an average size of US$20-30 million. The FM already has an indicative pipeline of 22 potential projects in 12 countries. The IDB’s commitment is expected to be a senior loan of US$50 million, not to exceed 20% of the size of the Fund. **SinoLatin Investment Advisors (SLIA),** on behalf of its stakeholders SLC Holdings (SLC), and EMP Global (EMP) will act as FM. SLC was formed particularly to take advantage of the opportunities arising from growing China-Latin America cooperation. EMP has a long history of direct investment experience in emerging markets. It also has helped develop and support leading fund managers focused on emerging markets having managed over US$6 billion since 1994. EMP is part of the Central American Mezzanine Infrastructure Fund (CAMIF I), which received a US$60 million debt financing from the IDB.
2. **Additionality.** The IDB will play an essential role for the possible success of the Funds beyond its capital contribution; the participation of the Bank as a lender of the project will facilitate the Funds’ capital raising process thanks to its name brand recognition and risk mitigation. The IDB will be seen as a facilitator for overcoming cultural differences by promoting a better understanding / knowledge of LAC to Chinese counterparts. By supporting the Funds, the IDB contributes to the development of the capital markets in LAC, as this type of vehicle allows institutional investors to diversify their portfolio. IDB has more than fifty years of experience in appraising, structuring and distributing LAC risk in the world of credit markets.
3. In addition, the Funds will conduct their projects in line with multilateral financial institutions’ social and environmental practices. The target investment opportunities will comply with Environmental and Social Management Systems (ESMS) as agreed with the IDB.
4. **IDB Environmental Impact Category.** The Funds were granted eligibility by the Eligibility Review Meeting Committee on April 13, 2011. Based on Directive B.13 of the Environment and Safeguards Compliance Policy, and given that the proposed transaction is considered a financial intermediary; this operation is not categorized according to its potential environmental impacts. Due to the nature of the Infrastructure Fund and the Natural Resources Fund, some of the investments will involve significant environmental and social, health and safety and labor impacts and risks. Thus, the Funds included in this Platform are considered financial intermediation operations with possible significant environmental and social risks and some of the investments will trigger Bank safeguard policies such as the Environment and Safeguards Compliance Policy (OP-703); Involuntary Resettlement Policy (OP-710), Indigenous People Policy (OP-765), Information Disclosure Policy (OP-102) and Natural Disaster Risk Management Policy (OP-704).
5. **Environmental and Social Risks and Impacts.**  The Funds will be designed to invest in infrastructure, natural resources projects and mid-size companies in sectors that can have potentially significant environmental, social, health and safety and labor impacts and risks (direct, indirect or cumulative). The impacts of the underlying projects to be supported by the Fund will be diverse and their significance will depend on project characteristics, such as size, sector, and location. Potential impacts and risks will include aspects of pollution and contamination from the construction and operation of infrastructure as well as risks related to the insertion of the projects in certain specific contexts, including any resettlement, impacts on indigenous peoples, impacts on natural habitats and other social and environmental impacts. In addition, there could be other issues commonly associated with the construction of large infrastructure projects such as labor management aspects, and workers’ health and safety. There could also be environmental financial risks that may have an adverse impact on the Fund. These risks refer to potential negative effects because of environmental or social aspects such as non-performing loans due to environmental or social issues (e.g. cleanup costs, law suits, fines, etc.), or reduction in equity or asset values due to environmental liabilities; and reputational risks as a consequence of Fund investment in projects or companies that may (a) incur in material environmental and social impacts that are not adequately mitigated according with IDB established environmental, social, health and safety, and labor provisions, or (b) have a poor image and/or significant public opposition because of the nature of the project or the historical poor environmental, social, health and safety, and labor practices and/or performance of the companies financed.
6. The potential investments of LAC-China Funds will be subject to an environmental and social review, prior to financing that will be performed by the FM to confirm eligibility and compliance with each Fund’s Environmental and Social Management System (ESMS) that will be developed in accordance with and to ensure compliance with IDB environmental and social policies. The key outcomes of the assessments will be sent to the relevant approval instances in each Fund for review and to confirm compliance with the ESMS to be implemented. In some cases, independent environmental and social consultants will be used to assess compliance with the IDB policies and any potential gaps that might need a corrective action plan. The IDB will provide technical support on environmental, social, health and safety safeguards and practices for the first high risk operations for each fund, and will also be involved in the due diligence process for high risk operations.
7. An annual report will be generated describing the implementation of each Fund’s ESMS, and listing the investments made. Any project that is classified as Category A for its environmental or social impact will require IDB’s non-objection before any commitment on the part of any LAC-China Fund where the use of IDB resources is intended.

# Environmental and Social Safeguards and Risk Management

1. As with other funds, staff of the FM will be ultimately responsible for screening, assessing and managing the environmental and social aspects, and ensuring that projects and their sponsors implement the respective commitments included in each of the Fund’s ESMS. Management of these impacts and risks will require commitment and resources from each of the Funds and the establishment of appropriate arrangements on environmental and social aspects to ensure sustainability and compliance with the requirements of the ESMS throughout the life of each investment.
2. All of the advisors to each of the Funds have significant experience in managing environmental and social aspects consistent with the requirements of MFIs for this type of operations. MIRA has developed several ESMSs for funds in India, Eastern Europe and Africa which have been supported by the International Finance Corporation (IFC) and the European Bank for Reconstruction and Development (EBRD), both MFIs generally participating as equity investors. A subsidiary of EMP Global is the FM for CAMIF, a fund being financed by the IDB. The IDB also financed a fund where Darby was the Fund Advisor. This experience will facilitate the adjustment of each of the Fund advisors’ ESMS to manage the specifics of each fund in a manner that complies with IDB policies and procedures, workers’ rights and labor aspects.
3. Since the Funds’ financial intermediation operations involve low to high risks, each Fund will be subject to the following key principles:

* Compliance with IDB safeguard policies and applicable local environmental and social laws and regulations;
* Each investment will be screened for environmental and social impacts and risks, under criteria for environmental impact categorization that shall be consistent with the IDB categorization;
* Investments will be subject to an environmental and social due diligence review by the Fund Manager and, in the case of high risk operations, due diligence will typically have to be supported by a third party consultant to confirm compliance with the ESMS;
* Require routine reporting and supervision, by each project to each Fund under the ESMS, and by each Fund to the IDB;
* Implement routine audits for category A projects
* Implement corrective action plans as needed to identify and remedy noncompliance;
* The timely disclosure of non-confidential information about potential category A investments for a reasonable time prior to a final decision by the investment committee for each Fund;
* Require adequate contractual remedies for IDB vis à vis each Fund for non-cured non-compliances at both the project and ESMS levels.
* Prepare and submit an Environmental and Social Compliance Report evaluating the environmental and social impacts of its portfolio with special emphasis on assessing the existence of any sensitive environmental and social issues;
* Funds will be required to obtain the Bank’s non-objection before investing in high risk projects where the use of IDB funds is intended.

1. As a general rule for the three Funds, in the case of prospective Category A operations where the use of IDB funding is intended, the ESMS will call for a proactive early communication to the IDB, sharing the results of the due diligence and for IDB’s written input before any investment commitments are made. The IDB will respond to any no-objection request in a timely fashion. Each investment will be carefully assessed during the environmental and social review procedure, which will be conducted by the FM and/or the Due Diligence consultant for each proposed project. The ESMS must be fully implemented before the Fund formally considers any transaction/project. Please refer to next section.
2. Public Consultation is a complex process driven by a number of factors, not in the least national requirements. Although social impacts are generally captured through the initial risk and/or impact assessment of a project, the FM will ensure as part of its due diligence that adequate stakeholder engagement and public consultation (for Category A and, as applicable, Category B projects) were performed as part of project preparation and in compliance with IDB policies.

# Environmental and Social Requirements and Recommendations

1. The IDB will require that the environmental, social, health and safety and labor aspects of potential investments for which the IDB facility is to be utilized during the investment period and eventually of its corresponding portfolio during the life of the loan or Fund be managed in accordance with all applicable environmental, social, health and safety and labor regulatory requirements, with the International Labour Organization (ILO) Fundamental Principles of the Rights at Work, the IDB Safeguard Policies and the ESMS, and that adequate resources be guaranteed for the successful implementation of the ESMS[[2]](#footnote-2). In addition, special emphasis will be placed on ensuring the implementation and availability of measures and mechanisms to address any non-compliance with IDB policies or unmitigated environmental and social impacts or risks during the execution of relevant Fund investments.
2. Each of the respective Fund’s ESMS has a different level of detail, and while the Bank has agreed on the principles of the ESMS, a final version of the ESMS for each Fund will be required prior to Financial Closure and in any case before the Fund makes any investment, whichever occurs first. The ESMS for each Fund will include items such as: (i) an Environmental Policy, (ii) project eligibility and an environmental impact categorization criteria consistent with the IDB Environment and Safeguards Compliance Policy, (iii) project review to identify, assess, mitigate and monitor potential environmental, social and health and safety impacts and risks (including both liabilities and public concerns) and approval process for all operations, (iv) environmental and social Legal Agreement standard terms and conditions, (v) supervision/monitoring requirements, (vi) organizational structure and training, (vii) reporting requirements, and (viii) external ESMS third party audits, as appropriate. The ESMS will assume a risk management approach, and will develop differentiated procedures for the different type of projects (project finance and corporate finance). These components will be extensively detailed in the final ESMS.
3. As part of the contractual arrangements and/or of the ESMS, the Borrower will commit to obtaining the IDB’s non-objection prior to making an investment in a Category A project using IDB resources. Contractual arrangements between the IDB and the Borrower will also include routine reporting and supervision as well as the implementation of audits and corrective action plans as needed to identify and remedy non-compliance.
4. The IDB will conduct periodic reviews of each Fund’s implementation of the respective ESMS and of a sample of investments on which IDB financing was used in each Fund’s portfolio, particularly those investments identified as high risk, and might conduct along the Fund direct supervision activities. An environmental consulting firm will be retained to assist the Bank in such reviews and in the analysis of high risk operations using IDB financing, in the performance of the environmental and social requirements applicable to each underlying project and to assist overall the Bank in assessing the implementation of each of the Fund’s ESMS.

1. <http://www.macquarie.com.au/mgl/au/about-macquarie-group/profile/organisation-structure/mfg> [↑](#footnote-ref-1)
2. IDB policies include Environment and Safeguards Compliance Policy (OP-703), Disclosure of Information Policy (OP-102), Involuntary Resettlement Policy (OP-710), Indigenous Peoples Policy (OP-765), Gender Equality Policy (OP-761) and The Natural and Unexpected Disasters Policy (OP-704). [↑](#footnote-ref-2)