Annex I – Environmental and Social Strategy

LACFIN (RG – L1019)

Background

1. The IADB is considering the syndication of a US$ 375 million A/B Loan to the Latin American Capital Finance ("LACFIN") or the "Borrower", a limited liability company organized under Delaware law, headquartered in New Jersey, to design and execute a "Program" to provide loans to the sugar and bio-fuels industries in Latin America and the Caribbean in order to increase availability of financing to sugar mills, ethanol distilleries and other producers of bio-fuels.

2. The total Program size is expected to be US$ 500 million, composed of (i) US$ 125 million in equity provided by the Reservoir Capital Group and of (ii) debt financing provided by the IDB in form of a US$ 125 million Senior A/B Loan in the initial phase and up to US$ 250 million of additional B Loan over time as the Facility portfolio grows and further track record is achieved.

3. LACFIN will finance loans to selected sugarcane growers and processors in the region, as well as associated merchandisers and end-users, which have been sourced and structured by them. The Program is expected to have a life of 10 years with potential extension up to 2 years, matching the length of the Equity commitment. This financing will enable sugar cane producers and processors, as well as producers of other raw materials (e.g. palm oil) for the production of bio-fuels in the target countries to increase their production capacity and efficiency. The Program will provide commodity-based structured financing and pre-export financing for the full production chain, as well as financing of selective medium term capital investments.

4. More specifically, the Program is designed mainly to support:

    a. *Increased sugarcane (and other raw material) production*, through planting to renew existing sugarcane fields, expansion planting of new fields or greenfield projects, regular field maintenance activities, and installation of irrigation systems;

    b. *Enhancement of sugarcane processing activities*, in mills and distilleries including, improving factory efficiency through machinery updates, and installation of new manufacturing systems or upgrading of older systems;

    c. *Sugar and bio-fuel merchandising*, through inventory and pre-export financing; and

    d. *Capital investments* in activities related to the production, processing and merchandising of existing or new sugar and bio-fuel products.

5. In its current appraisal project credit review and approval process, LACFIN assures that all companies/project potentially subject to LACFIN's investment are in compliance with host country laws and regulations, including but not limited to those applicable to environmental, social, health and safety, and labor aspects.

Environmental and Social Impacts and Risk

6. Based on Environmental and Safeguard Compliance Policy (O.P.- 703) Directive B.13, and given this is a financial intermediary project, this operation is not categorized.

7. In general terms, this Program can be considered as an environmental facility, as it is meant to support an increase in generation of energy from non-fossil fuel sources, thus reducing the climatic footprint associated with the energy matrix of host countries.

8. The potential key negative environmental, social, health and safety, and labor impacts associated with this operation are those related to or caused by the specific projects that will be financed by the Program. These impacts and risks can be diverse and their significance will depend on the project characteristics (e.g. location, greenfield or brownfield, agricultural or industrial, etc.).

9. Based upon the nature of the Program and the information available to the IDB at this time, it appears that the potential related environmental, social, health and safety, and labor issues and risks associated with this operation are:

    e. Environmental, social and health and safety direct, indirect and induced impacts associated with the activities of the sub-projects financed by the Program;

    f. Environmental and social cumulative impacts associated with the LACFIN's portfolio;

    g. Environmental credit risks (financial) risks to LACFIN, jeopardizing its sustainability and thus affecting its ability to repay the IDB;

    h. IDB reputation risks associated with sub-borrower and/or sub-projects' environmental, social, health and safety, and/or labor practices, including (i) producing practices (e.g. slave or child labor, pesticides, deforestation, lack of good pollution prevention and control practices), or (ii) lack of compliance with local, international and/or IDB environmental, social, and/or labor policies or requirements; and

    i. To a lesser degree, environmental, social, health and safety or labor liabilities associated with LACFIN's facilities and/or operations.

10. The environmental, social, and health and safety direct and indirect impacts associated with agricultural activities may include:

    j. land use changes, including deforestation, crop/livestock substitution, potential resettlement, impacts on indigenous lands, among others;

    k. use of persistent pesticides;

    l. erosion control and soil fertility/stability (e.g. harvesting practices, cut-and-burn, etc);

    m. air pollution and dust generation;

    n. water management (e.g. water intensive practices);

    o. impact of fertilizers in water bodies; and

p. waste management (e.g. solid waste).

11. It should be noted that LACFIN has the potential for enhancing the positive environmental and social aspect of agribusiness, by canalizing resources to producers usisng BAT and practices, cooperative producers, to name only a few, for which the Program could provide additional incentives.

12. Reputation risks would be associated with any potential involvement by LACFIN with sub-borrower or sub-projects considered unacceptable to the IDB and/or that will face significant public opposition or concerns, such as those activities or practices in the IDB Environmental Exclusion List (e.g. deforestation, slave labor, forced child labor, etc). No such involvement is contemplated.

13. IDB participation will assure that LACFIN develops an environmental management system or, as a minimum, an environmental procedure to appropriately assess and manage any potential environmental and social impacts or risks associated not only with any of the underlying projects, but also with the overall portfolio, paying special attention to:

    q. potentially negative environmental and social cumulative and induced impacts associated with the Program financing many sub-projects located in the same geographical area and/or similar direct and indirect influence areas (e.g. supply chain, crop substitution, alternative sugar use, etc).

    r. sub-project in areas with previous history of child and/or slave labor,

    s. sub-project proposing significant land use changes and the subsequent potential for induced impacts in the frontier forest or indigenous lands,

    t. sub-project pollution prevention and control practices in mills and other processing facilities, and

    u. sub-projects located on industrial parks given the increased risk for existing environmental liabilities.

Strategy for the Environmental and Social Due Diligence

14. The Bank, as part of the due diligence process, will analyze the environmental and social aspects of the Program, prepare an Environmental and Social Management Report (ESMR) for review and approval by the Bank's Environmental and Social Impact Review (ESR), and establish the environmental, social, health and safety, and labor requirements to be presented in the Loan Proposal. The environmental and social due-diligence will specifically include the components listed below:

    a. An assessment of LACFIN and related local partner companies' (such as Cofinamex) portfolio current compliance status with the applicable host countries (national, state, municipal) environmental, social, health and sanitation, and labor regulatory requirements;

    b. An evaluation of LACFIN and related local partner companies'(such as Cofinamex) current client base to assess typical potential environmental and social impacts and risks that could be associated with the Program and assure the existence of adequate management strategies;

c. An assessment of the sufficiency of LACFIN and related local partner companies’(such as Cofinamex) current project appraisal, approval, and monitoring procedures to manage environmental and social liabilities, risks and/or impacts (including potential positive impact enhancement) of financed sub-projects, to determine the need to implement a detailed Environmental Procedure (e.g. screening, selection, and monitoring) or more developed Environmental Managemen System for LACFIN.

d. In the case that the development and implementation of an EMS is deemed appropriate, an evaluation of the LACFIN and related local partner companies’(such as Cofinamex) capability to adequately implement such EMS. This EMS should include as a minimum (i) a list of excluded activities and eligibility criteria which must be reasonable, written, and used in all of LACFIN’s financing, (ii) a written procedures to identify, assess, monitor, and mitigate potential environmental credit risks (including cumulative impacts, potential liabilities, and public concerns) for all operations, (iii) qualified personnel dedicated exclusively to execute the EMS, and (iv) training of LACFIN’s s credit staff.

e. An evaluation of LACFIN and related local partner companies’ (such as Cofinamex)’s and its sub-borrowers’ compliance with the Fundamental Principles and Rights at Work and with any other international labor organization conventions and treaties which have been ratified by the applicable host country.

f. LACFIN`s procedures for screening and selecting local credit partners, as well as LACFIN`s procedures for supervising and reporting on environmental management issues of local credit partners.