

## **BANCO FICOHSA**

### **HO L1067**

## **ENVIRONMENTAL AND SOCIAL MANAGEMENT REPORT**

### **I. Project Description**

- 1.1. The proposed project consists of a financing facility (the “Facility”) for Banco Financiera Comercial Hondureña, S.A. (“Ficohsa”) for approximately US\$20 million to support the development of a loan portfolio of environmentally sustainable, “green”, projects, mostly with corporates, small-size corporate, and small and medium enterprises (“SMEs”). The Facility would consist of a secured senior A loan for up to US\$10 million from the IDB; subject to market demand, a B Loan of up to US\$10 million or such other amount to be determined based on market conditions, and an expected co-loan from OFID for up to US\$10 million would complete the Facility. In addition, the OPEC Fund for International Development (“OFID”) is expected to also participate with a co-financing of approximately US\$10 million.
- 1.2. The proposed Facility will support Ficohsa’s initiative to develop a portfolio of environmental sustainable projects in Honduras, particularly in the areas of renewable energy, energy efficiency and efficient production, sustainable agriculture and agribusiness.

### **II. Project Status and Compliance**

- 2.1. The Environmental and Social Strategy for the Project was presented and approved on July 7, 2010 by the Environmental Safeguards Review team, no further action was required.
- 2.2. Based on Directive B.13 of the Environment and Safeguards Compliance policy (“Environment Policy”), and given this is a financial intermediary, this Facility was not categorized.<sup>1</sup>
- 2.3. Ficohsa has confirmed that it is in compliance with Directive B.2 (country laws and regulations) of the Environment Policy, complying with all applicable legal and regulatory environmental, social, health and safety, and labor laws and regulations including permits and authorizations.
- 2.4. Ficohsa is in compliance with the Environmental and Social Requirements of two previous facilities (a senior A/B loan and a trade finance facility)<sup>2</sup>.

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<sup>1</sup> In view of the nature and concentration of its portfolio, Ficohsa operations are not expected to raise any significant issues related to indigenous, tribal or afro-descendant groups.

<sup>2</sup> Project numbers HO-L1036 and HO-L1012

### **III. Environmental and Social Impacts and Risks**

#### *A. Environmental and social risks associated with Ficohsa's portfolio*

- 3.1. This Facility will target corporates, small-size corporates and SMEs which are defined by Ficohsa based on annual sales. Ficohsa defines corporates as companies with annual sales of more than US\$5 million, small-size corporates as companies with annual sales of US\$1 to US\$5 million and SMEs as companies with annual sales up to US\$1 million. Loans for these different targets groups may vary based on the type of financing the client requires. Ficohsa's total loan portfolio as of January 1<sup>st</sup> 2010 represents a total value of US\$1,043 million with the most exposure in real estate (28%), industry (25%), services (19%), consumers (12%), commerce (8%), local governments (4%), agriculture (2%) and transport (1%). Most environmental and social risks are involved in Ficohsa's financing of industrial activities in the manufacturing sector (food and beverage and textile manufacturing) and industry (e.g. cement factories). The textile manufacturing sector, in particular, can pose potential credit and reputational risks due to the high level of public scrutiny around this sector. Industrial companies such as cement factories can have large impact as well due to the nature of their activities. Ficohsa's SME portfolio carries less Environmental, Social, Health and Safety (ESHS) risks due to the average size of loans in that segment as well as the different sectors in which the clients are active. In the SME portfolio (as of January 1<sup>st</sup> 2010) the most significant sectors are: services (26%), commerce (23%), real estate (22%), small-size industry (15%), consumers (4%), transport (4%), agriculture (2%).
- 3.2. There may be specific ESHS and labor risks and impacts related to investment in activities in certain sectors of Ficohsa's portfolio, for example related to occupational health and safety (industry and real estate development); noise and air pollution (industry and real estate development); contamination of land and water (industry) as well as natural disasters, such as earthquakes, forest fires and landslides.
- 3.3. These risks are considered minimal to moderate and can be mitigated and managed with the implementation of an Environmental and Social Management System (ESMS) to ensure that sub-loan supported activities adhere to good environmental and social practices. Given that the Facility will focus on loans that result in energy savings/efficiency including energy and industrial technology and/or integrated waste management, water and wastewater treatment projects, the potential risks may be further reduced with the introduction of robust eligibility criteria to ensure that each investment has a positive environmental impact.
- 3.4. Ficohsa has stated that it has no financial liabilities in its existing portfolio, related to ESHS issues. Ficohsa has stated that it has no outstanding ESHS concerns, through involvement in projects, companies or activities considered unacceptable to the IDB that could potentially generate significant public opposition or concerns, for example due to inappropriate development location or more specifically, labor in the textile sector. Ficohsa has also stated that its

finance application and analysis process is equitable, fair, and unbiased in terms of social factors (e.g. gender, age, ethnicity, or cultural heritage).

*B. Environmental and social risks associated with Ficohsa's facilities and Human Resources practices*

- 3.5. The risks associated with Ficohsa's facilities and operations, such as environmental liabilities in their offices due to asbestos, lead paint, etc. or employees having occupational health and safety problems due to working conditions (e.g. inadequate emergency preparedness, lack of fire exits, etc) are considered to be minimal. Ficohsa's head office is located in Tegucigalpa, Honduras, and consists of two six floor buildings. In terms of emergency preparedness, the bank has frequent emergency drills, an Emergency Plan, a Crisis management plan, as well as a voluntary Emergency Brigade consisting of 54 trained employees. Furthermore, Ficohsa has rolled out several campaigns to reduce energy and water use as well as to promote responsible consumption including workshops for employees and volunteering programs.
- 3.6. Ficohsa has a well developed Human Resources Policy Manual, "Manual de Recursos Humanos", that outlines recruiting, training, and compensation procedures and practices that includes non-discriminatory clauses with regards to gender, age, social origin, religion and persons with disability. All employees are subject to an Ethics Code and anti-money laundering policy, with effective penalties applied. The bank has also developed several HR programs focusing on career development, retention reduction and a positive working environment. Ficohsa sets itself targets in order to improve its rating on the 'Great place to Work-Index' and has indeed improved its position in 2009. Ficohsa has stated that they have no material health issues (including legal claims) and do not have any material employee or labor disputes.

**IV. Environmental and Social Management**

*A. Environmental and Social Risk Management System*

- 4.1. In previous years, DEG (funder), FMO (shareholder) and the IDB (funder) have required Ficohsa to establish an Environmental and Social Management System (ESMS). By the end of 2008, Ficohsa had hired the consultancy company Eco-consulta to assist the bank in developing and implementing such a system. This ARAS (*Analisis de Riesgo Ambiental y Social*) was developed during 2009 and in January 2010, Ficohsa received a certificate from FMO that acknowledged the quality and adequacy of its ARAS for managing the environmental and social risks associated with its portfolio. More recently in the third quarter of 2010, the ARAS was tested in a pilot project and employees have been trained on the application of the ARAS. On October 7, 2010, the ARAS was officially approved by the Board, published internally in order to be applied to all credit applications of US\$250,000 and above.

- 4.2. Credit applications, to which the ARAS is applied, are screened against an Exclusion List (which is consistent with the IDB Exclusion List), categorized (low, medium, high), and are evaluated on the basis of their potential ESHS risks and impacts. Ficohsa applies national legislation as a standard to all loans and IFC Performance Standards to those loans with high environmental and/or social risk. In addition, Ficohsa includes a standard ESHS clause in the loan agreement with the client and if necessary, specific ESHS conditions related to the loan will be included in the contract as well.
- 4.3. For loans below US\$250,000, Ficohsa checks a client's compliance with applicable national environmental and social legislation, but it does not apply its ARAS to loans nor does it apply any other sort of mechanism to identify, evaluate and mitigate environmental and social risks associated with those loans. Formally, Ficohsa does not apply IDB's Exclusion List to these loans, however, it has confirmed ex-post that no clients were identified which were engaged in activities excluded by IDB's Exclusion List.
- 4.4. The Investment Officers and Credit Risk Officers are jointly responsible for applying the ARAS to the bank's operations. All involved personnel have been trained on environmental and social risk management and the application of the ARAS, both through participation in the online UNEP FI training course on Environmental and Social Risk Analysis and tailor-made in-house workshops given by EcoConsulta. In the case of high risk loans or loans with specific ESHS characteristics, Ficohsa outsources the ESHS evaluation to one of the two external specialists that it has identified and who have been certified by the Honduran Secretaria de Recursos Naturales y Ambiente.
- 4.5. The responsibility for the development, implementation and coordination of the ARAS is carried by a multi-disciplinary team consisting of representatives of different involved departments. Each coordinates a specific part of the ARAS; Siham Gabrie (Manager Corporate Banking) and Luis Pineda (Vice President Corporate Banking) are responsible for the identification of environmental and social risk, Marco Perez (Credit Risk Manager) for the evaluation and Tomás Sanchez (Deputy Manager Portfolio Management) for the monitoring. Max Contag (Corporate Vice President) carries final responsibility for the ARAS. All team members have built capacity on environmental and social risk management as they have participated in the online UNEP FI training course on Environmental and Social Risk Analysis and/or the Sustainability in Finance training course organized by FMO as well as the tailor-made in-house workshops given by EcoConsulta.
- 4.6. Ficohsa has chosen to test and calibrate the ARAS at a level (US\$250,000 and above) where environmental and social risks are the most material. Implementation of the current ARAS will take until the third quarter of 2011 after which Ficohsa envisions developing an approach for loans below US\$250,000 (mostly for SMEs) based on lessons learned.
- 4.7. Based on the current situation, loans provided by Ficohsa under the proposed Green Line Facility would be subject to the same ARAS conditions as other

loans provided by the bank. The expected size of an average loan under the proposed Facility is over US\$250,000, but loans of smaller sizes are a possibility. In the case of a loan below US\$250,000, the IDB will require Ficohsa to individually apply the ARAS to these loans.

- 4.8. The IDB supports Ficohsa in its decision to apply this threshold as it enables the bank to test and calibrate the system at a level where most clients are familiar with environmental and social risks management. However, Ficohsa will be required to gradually lower this threshold and extend the scope of the ARAS to all loans to be financed with IDB use of proceeds within 12 months of publication of the ARAS (October 7, 2010). This will require a simplification of procedures in order to maintain practicality and feasibility at the SME level. The Exclusion List will be applied for all IDB use of proceeds regardless of amount from the inception of the operation.

*B. Corporate Social Responsibility (CSR)*

- 4.9. Ficohsa has a strong commitment to its CSR efforts and applies this to its internal processes and its relationship with external stakeholders. Internally, the bank endeavors to reduce its environmental footprint through energy efficiency and recycling initiatives as well as to be a good employer by providing competitive compensation packages, career development programs, a sound working environment and motivating Employee Volunteering Program. Externally, Ficohsa engages with many different stakeholders on environmental and social issues. Suppliers are screened on environmental and social conditions and invited to participate in CSR workshops while clients can join a workshop on the importance of environmental and social risk management for a bank. Ficohsa also has a non-profit foundation (Fundación Ficohsa para la Educación Infantil) with the purpose of providing support for pre-school education to children living in poor communities in 18 cities of Honduras. Ficohsa now supports 119 preschools servicing more than 7,600 children.

**V. Environmental and Social Requirements**

- 5.1. As part of the IDB-Ficohsa Loan Agreement, the IDB will require that Banco Ficohsa comply with: (i) all applicable Honduran ESHS, and labor regulatory requirements, (ii) IDB List of Excluded Activities for Non-Sovereign-Guaranteed (NSG) operations, (iii) the Fundamental Principles of Rights at Work (together referred to as the IDB Environmental and Social Requirements), and exclusively with respect to the IDB sub-loans (iv) the IFC Performance Standards.
- 5.2. The IDB will require that Ficohsa use all reasonable efforts to keep operational its existing Environmental and Social Management System (ARAS) with respect to the sub-loans to be financed with IDB funds.
- 5.3. If Ficohsa wishes to use IDB funds for sub-loans below the ARAS threshold of US\$250,000, the IDB will require that Ficohsa present an Environmental and Social Action Plan (ESHS Action Plan) for extending the scope of the ARAS to

loan amounts below US\$250,000 within 60 days before the expected date of disbursement of the first sub-loan below US\$250,000. This ESHS Action Plan will be in form and substance satisfactory to the IDB and specifically includes a chronogram for the following elements:

- The development and implementation of a simplified procedure to manage the ESHS risks and impacts associated with loans below the current US\$250,000 ARAS threshold (within 12 months of the IDB's approval of the Action Plan). At a minimum this simplified procedure should include:
    - A process for assuring compliance with the IDB Environmental and Social Requirements as relevant according to risk level;
    - Mechanisms for assessing, categorizing (high, medium or low) and managing environmental and social aspects associated with sub-loans below US\$250,000 to be financed with IDB's funds;
    - A process for documenting evaluation and monitoring performance.
  - The development and roll out of training of involved personnel on applying the new simplified procedure.
- 5.4. Until such time as the above ESHS Action Plan has been implemented, those sub-loans below US\$250,000 will be treated as an exception to the ARAS threshold and will be subject to the existing ARAS procedure.
- 5.5. The IDB will supervise the environmental and social aspects of the Loan Agreement either by an in-house specialist or with external consultants, and require Ficohsa to present environmental and social compliance reports in form, content and frequency satisfactory to the IDB.