

## **ENVIRONMENTAL AND SOCIAL MANAGEMENT REPORT**

**(Schahin BR-L1116)**

### **Background**

Over the last two years in Brazil, the volume of consumer finance has increased substantially due to improvements in the macroeconomic environment such as lower inflation, decreases in the unemployment rate since 2004, and a reduction in the local interest rate. The consumer finance sector in Brazil has grown 25% in the last year with remarkable growth in the personal loan and vehicle financing modalities. Personal loan growth has primarily been driven by the paycheck deductible loans, which as of December 2006 constituted 20.2% of the total consumer finance market, and totaled US\$22.2 billion. This amounts to a 50.4% increase in the volume of paycheck loans in comparison to the December 2005 total.

### **Project Description**

The borrower, Banco Schahin (“Schahin” or Company) is a privately owned commercial bank specialized in consumer and commercial financing that was established in 1989 and is headquartered in São Paulo. Schahin maintains an extensive network of bank correspondents and sales points, which have enabled it to become a significant player in its niche markets, namely payroll deductible lending to public sector employees and consumer financing. With total assets of US\$720.9 million as of December 2006, Schahin is a relatively small bank in Brazil. However, the Bank is the fourth largest bank in Brazil in terms of origination of paycheck deductible loans if off-balance sheet loans are also included.

The purpose of this operation is to support Schahin to increase its consumer financing credit portfolio, to expand access to the international financial markets and to extend the tenor of its funding. The proposed IDB loan would provide a US\$20 million Senior A loan and a US\$15 million B loan, with a tenor of up to seven and five years respectively, which would enable Schahin to expand its activity in the fastest growing consumer finance sector in Brazil: paycheck deductible lending, particularly to public employees and Brazilian National Institute for Social Security (“INSS”) retirees as well as other types of consumer loans. The goal of the project is to expand access to consumer finance and enable a more competitive banking market to ultimately benefit consumers with lower spreads for consumer finance.

### **Environmental and Social Impacts and Risks**

The Committee on Environmental and Social Impact (CESI) approved the Environmental and Social Strategy for the Project on April 6, 2007 and no further action was required.

Based upon the nature of this project (i.e. facility to support the growth of paycheck deductible loans), there should be limited direct environmental, social, or health and safety impacts or risks. The potential key environmental, social, health and safety, and labor issues and risks include (i) Schahin's environmental credit risks, and (iii) IDB reputational risks associated with Schahin's environmental, social, health and safety, and/or labor practices.

Environmental credit risks refer to potential negative effects on Schahin's ability to repay the IDB because of: (i) risks due to Schahin's programs (e.g. lending), such as reduction in asset values held as securities due to environmental issues or social issues (e.g., law suits, fines, etc); and (ii) risks associated with Schahin's facilities and operations, such as environmental liabilities in their buildings/offices due to the existence PCB transformers, asbestos, lead paint, etc., or employees having occupational health and safety problems due to Schahin's working conditions/environment (e.g. inadequate emergency preparedness, lack of fire exits, etc).

Reputational risks refer to the potential for Schahin's lending programs that could jeopardize the Bank's reputation (transferable to the IDB) as a result of unacceptable environmental and social practices, or significant public opposition or major concern in relation to environmental or social matter. Some media reports have criticized paycheck deductible loans noting that this practice can aggravate borrower's financial situation (e.g. retirees living on fixed income could find themselves overextended). Lastly, reputational risks may also be associated with Schahin's involvement in operations that can be considered unacceptable to the IDB such as: (i) goods (companies) which may be considered to be non-eligible according to IDB's exclusion list (e.g., weapons or munitions, radioactive materials, alcohol, tobacco, etc.); (ii) possibility that Schahin's finance application and analysis process may not be equitable, fair, and unbiased in terms of social factors (e.g. gender, age, sex, ethnicity, or cultural heritage etc.); (iii) significantly deficient labor practices by Schahin.

### **Environmental and Social Management**

Schahin follows the environmental policy of The Brazilian National Social & Economic Development Bank (Portuguese acronym- BNDES). This policy includes the use of an exclusion list. Company staff closely monitors borrowers compliance with BNDES requirements, and all aspects of loan transactions (e.g. compliance with local regulations, exclusion list) are evaluated in internal committees before any approval is given.

Schahin's head office is located in the city of Sao Paulo. In terms of their facilities and human resources policies, the Company is in compliance with all applicable local regulations. The Company has a designated officer to manage labor and

safety issues. The building where the main office is located has a 30-person fire brigade including employees from Schahin and employees from other companies in the building, and fire evacuation drills are conducted twice a year.

Schahin has a human resources manual listing hiring, salaries, and promotion procedures. All employees are subject to an Ethics Code and anti-money laundering policy, with effective penalties applied. Schahin's Ethical Code includes a non-discrimination policy. The Company and its full subsidiaries has 384 employees, with gender distribution at 184/200 males to females, including two handicapped employees.

Schahin's portfolio is distributed as follows: 82.76% consumer finance, and 24% corporate loans. The largest component of the consumer finance portfolio is the paycheck deductible lending to both the public sector employees and the INSS retirees.

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### **Environmental and Social Requirements**

The Bank will require as part of the Loan Agreement that Banco Schahin comply with all applicable Brazilian environmental, social, health and safety, and labor regulatory requirements, IDB Exclusion List and applicable IDB policies. The IDB will require Banco Schahin to develop and implement an environmental procedure in form and substance satisfactory to the IDB. This Procedure will include at a minimum: (i) project eligibility criteria (Environmental Exclusion List), (ii) a process for assessing environmental and social aspects and country requirements; (iii) a process for documenting selection, approval and the proposed monitoring activities for small and medium size enterprises (SMS's); (iv) training of the Borrower's personnel in the use of the Environmental Procedure, including provision to IDB of proof thereof; (v) adopt and follow procedures and practices that are equitable, fair and non-discriminatory in terms of race, gender, age, ethnicity or cultural heritage; (vi) Prepare financial education materials for paycheck deductible loans within three months of the closing date. Develop and implement an Environmental Management System within twelve months of the closing date. The IDB will supervise the environmental and social aspects of the Loan Agreement either by an in-house specialist or with external consultants.