

**Environmental and Social Management Report**  
**Banco Lafise Bancentro (Nicaragua), SME Finance Partnership**  
**(NI-L1075)**

**I. Project Description and Background**

- 1.1 The objective of the Partnership with Bancentro is to increase access to financing for SMEs in Nicaragua. The Project is part of the LACC Subordinated Debt Facility (RG-X1088) approved by the Bank's Board of Executive Directors in August 2010 and consists of a subordinated loan of up to US\$ 10 million to provide Bancentro with long-term financing to support its SME loan portfolio.

**II. Project Status and Compliance**

- 2.1 The Environmental and Social Strategy (ESS) for the ES-L1084 was presented to the Environmental Safeguards review team and no special actions were required. Based on Directive B.13 of the Environment and Safeguards Compliance Policy (OP-703), this Project is classified as a financial intermediary and as such is not categorized according to its potential environment and social (E&S) impacts and risks.
- 2.2 Bancentro implemented an environmental and social management system (ESMS) in 2009, and has indicated capacity to assess and manage environmental and social risks in SME lending. Bancentro's dominant portfolio concentration is in agriculture, presenting low to moderate environmental and social risk. The average value of sub-loans is considered low at US\$33,000. Given management capacity and low transaction sizes, this operation is classified as low risk.
- 2.3 Bancentro has confirmed that it is in compliance with Directive B.2 (country laws and regulations) of IDB Environmental and Safeguards Compliance Policy, complying with all applicable legal and regulatory environmental, social, health and safety, and labor (ESHS&L) laws and regulations.

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

*A. Potential risks and impacts associated with Bancentro's portfolio*

- 3.1 Within their SME<sup>1</sup> portfolio, Bancentro has the following sector concentrations as of December 2012: Agriculture (44%), Commerce (37.8%), Livestock (7.8%), and Manufacturing (2.8%). Agricultural lending is primarily concentrated in coffee, rice, sugar and peanuts and is mostly oriented towards working capital loans, and as described is often below US\$200,000 and therefore presents low environmental and social risk. The majority (90%) of Bancentro's portfolio is categorized as low risk according to their ESMS (see

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<sup>1</sup> SME are defined as having annual sales of less than C\$10,000,000 (USD \$414,000) and fewer than 100 employees.

below for further detail). Two transactions have received a high risk rating for which Bancentro developed and incorporated Action Plans into the loan agreements as conditions of the disbursement.

- 3.2 The ESHS impacts and risks associated with loans to SMEs in Bancentro's portfolio are likely to be small in nature. The dollar size of sub-project loans is low, and any likely environmental and social impacts relate to lending in agriculture, livestock and manufacturing. The ESHS risks and impacts could include, for example: i) habitat conversion and degradation (agriculture, livestock); ii) poor land use (manufacturing, agriculture, livestock), iii) stress/contamination of water resources (agriculture, livestock), iv) waste management (livestock, agriculture), v) use of migratory or informal labor (agriculture, livestock).

*B. Environmental and social risks associated with Bancentro's facilities and human resources practices*

- 3.3 Bancentro has stated that they have no material health issues (including legal claims) and do not have any materials employee or labor disputes. Bancentro has also indicated 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). Bancentro's guidelines for employee compensation (salary, pay raise, benefits) and analysis (evaluations) are based on the local legislation, following also Nicaraguan labor regulations. This is defined in their HR labor policy.

#### **IV. Environmental and Social Management**

*A. Bancentro's Environmental and Social Management System*

- 4.1 Bancentro's ESMS was developed in 2005 (and updated in 2009) with the support of external consultants, and is available to all staff on the bank's internal intranet site. Environmental and social risk analysis is undertaken on all corporate and SME loans above US\$50,000. For values between US\$50,000-200,000, analysis included a detailed discussion with the client, a summary of which is included in the loan documentation. For all values above US\$200,000, a more robust analysis is carried out to include an environmental and social assessment (see point c)). The system applies four levels of analysis following a review against an exclusion list in identifying environmental and social risk, which involve:
- a) E&S issue identification – a basic high risk screen is used to identify issues, and client management of these issues
  - b) Environmental categorization – A common A, B, C methodology is applied that categorizes risk by sector activity and sub-loan value.
  - c) Environmental and social risk analysis – Based on the sector risk (A, B, C) and the amount of financing offered, specific environmental and social due diligence is undertaken guided by specific questionnaires customized to the sector risk. The checklists evaluate operational issues as well as possible site contamination when land is taken as collateral. This evaluation also includes

assessment of labor and working conditions, prevention of contamination, community health/security assessment, and biodiversity analysis.

- d) Monitoring of Environmental and Social Risk – in the final stage, the bank monitors specific action plans, covenants, or corrective action plans agreed with the client.
- 4.2 With Category A and B projects, Bancentro will agree with the client, as necessary, to undertake environmental impact assessments, and corrective action plans, incorporating the latter into loan documentation. Disbursement of funds in some instances is conditional on completion of action plan items. In instances of non-compliance, the bank's legal documentation includes clauses for cancelation of the loan or an increase in interest rates.
- 4.3 The development of Bancentro's ESMS stemmed from conditional obligations with loans from other multi-lateral development banks. Management of E&S risks is overseen by the Credit Department.
- 4.4 Through a loan with the Central American Bank for Economic Integration (CABEI), Bancentro is also developing a sustainable agriculture line for on-lending to café, cocoa, and rice farmers. The loan involves technical assistance to help support sustainability certification of the crops in question.

***B. Training on Environmental and Social Risk Management***

- 4.5 Management has been regularly trained on E&S issues and analysis. In 2011, a corporate-wide training on environmental analysis was given to all bank analysts both in corporate and regional offices.

**V. Environmental and Social Requirements**

- 5.1 For this operation which involves SME lending for an average value of US\$33,000, the Bank will require Bancentro as part of the Loan Agreement to:
  - (i) Comply with all applicable Nicaraguan environmental, social, health and safety, and labor regulatory requirements, and in relation to the financing of SMEs to ensure that each loan complies with: (a) in-country regulations; (b) the IDB List of Excluded Activities for Non-Sovereign-Guaranteed (NSG) operations; and (c) the Fundamental Principles of the Rights at Work; and (d) its Environmental and Social Management System.
  - (ii) Ensure that at least one staff member with responsibility for the ESMS implementation and maintenance take part in the IIC/IDB Environmental Risk Management training course, or a similar workshop by other organizations such as UNEP-FI, to be agreed upon by the IDB, to ensure that Bancentro continue to remain up to date with its environmental and social risk management expertise.
  - (iii) Present an Annual Environmental and Social Compliance Report (ESCR) with information on the SME portfolio, including a breakdown of financing by subsectors and Environmental risk categorization (according to Bancentro's methodology), and any particular risk issues identified during screening and mitigation measures agreed with clients.

- 5.2 The IDB will supervise the environmental and social aspects related to the use of the proceeds of the IDB loan either by an in-house specialist or with external consultants, and if necessary, will require means of enhancing management of impacts and risks.