

Environmental and Social Management Report
Banco Agricola
ES-L1033

Project Description

The proposed project consists of an A/B Loan to Banco Agricola S.A. y Subsidiarias (BA). The Loan will provide Banco Agricola, the largest bank in El Salvador, with medium-term financing to MSME. The project will consist of: an A Loan of up to US\$20 million to be funded by the IDB and a B Loan to be defined depending on market conditions and up to US\$20 million and funded through the sale to commercial lenders.

The project will encourage medium-term lending to MSMEs, which is a strategic sector to foster sustained economic growth in El Salvador. According to statistics from the Salvadorian Chamber of Commerce, 96.4% of the companies in El Salvador are MSMEs and they generate 65.5% of the employment in the country. Currently BA serves more than 8,700 MSMEs, especially in the commerce and industry sectors.

Project Status and Compliance

The Environmental and Social Strategy (ESS) for the project was presented on January 19th, 2009 to the Environmental Safeguards Review (ESR) team. The ESR requested that a detailed analysis of the current and future MSME portfolio, and a review of the possible impacts and risks associated with natural disasters be added to the strategy for due diligence. These references were made and submitted to ESR on January 22nd.

Based on Policy Directive B.13, and given this is a financial intermediary project, this operation was not categorized.

BA 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 laws and regulations including permits and authorizations.

Portfolio and Organization

Banco Agricola's lending activity to companies is divided into three sectors: International, Corporate¹ and Commercial, which are grouped under the "Vice-presidency of Enterprises."

For administrative and organizational purposes the Commercial Banking operations (which had a total portfolio value of US\$430.58 million in December 2008) are divided into four departments: Micro and Small enterprise (US\$113.60 million, 26%); Medium enterprise (US\$150.04 million, 35%); Construction (US\$40.13 million, 9%); and Agriculture (US\$126.81 million, 29%). This project will provide funds for the Micro and Small Enterprise and Medium Enterprise

¹ In December 2008 the value of the Division for Corporate Loans and the Division for International Business portfolios were US\$661.7 million and US\$231.1 million respectively.

departments, which together make up Banco Agricola's "Mipyme" or MSME portfolio. It will not provide funding for investments in construction and agriculture operations.

Currently BA serves more than 8,700 MSMEs. BA characterizes MSME's as having an annual revenue of between US\$25 thousand and US\$5 million. Those clients with an annual revenue above US\$5 million are managed and administered by the "Corporate Lending" department.

In December 2008 the Mipyme lending portfolio had a value of US\$151.6 million. This is broken down as follows: Commerce (42%, US\$63.6 million); Services (20%, US\$29.5 million); Industry (13%, US\$20.3 million); Construction² (10%, US\$14.4 million) with the remaining 15% split between transport and other operations.

The average size of Banco Agricola's Mipyme operations are as follows: Micro: \$10,463; Small: \$17,995 and Medium \$80,766. Example MiPyme clients include: a cleaning company (Micro Enterprise) requesting a US\$7,000 loan to purchase a new truck to expand the reach of its business; a clothing manufacturing company (Small Enterprise) requesting a line of up to US\$50,000; and a gas station owner (Medium Enterprise) looking to consolidate and expand the construction of the gas station.

Facilities and Human Resources

Banco Agricola's head office is located in San Salvador. In addition it has 62 branches, 26 corporate mini-branches and a network of agencies in the United States that handle remittances. BA has a total of 2,612 employees of which 56% are women and 44% men. Its upper management is composed of 2 women and 10 men.

The environmental and social risks associated with BA facilities and operations, are considered to be minimal. BA has stated that has no existing environmental financial liabilities associated with its facilities. BA has stated that they have no material health issues (including legal claims). They have however disclosed that they have one pending labour dispute with an employee based in the Los Angeles Agency in California in the United States, lodged in 2006. The initial claim made by the employee was for an injury claim. This claim was denied on several grounds, after which time the employee filed a discriminatory claim for dismissal. Banco Agricola legal counsel is working to resolve this case as quickly as possible; however there have been delays on the side of the workers' compensation attorney.

Environmental and Social Impacts and Risks

The potential key environmental, social, health and safety, and labor impacts and risks associated with this Facility are mainly those related to the activities of MSME clients to be financed by Banco Agricola.

² It is important to note the distinction between the construction portfolio included in the Mipymes and that which is managed by the Construction department. The former refers to existing micro, small and medium enterprise clients that operate a business from their residential property, where construction is not necessarily the principal activity, whereas the Construction department originates operations where the principal activity is construction.

Possible risks could include trade and commerce of products and substances subject to bans and international phase outs (commerce); occupational health and safety (industry, construction); poor land use (construction); noise and air pollution (industry, construction), natural disasters, such as earthquakes, volcanic eruptions, forest fires and land slides³. Given the size and nature of the MiPyme portfolio, these risks are considered minimal and will be reduced or mitigated through the application of an appropriate Environmental Management System.

BA has stated that, to the best of its knowledge after due inquiry, it has no financial liabilities in its existing portfolio, related to environmental, social and health and safety issues. BA has stated that, to the best of its knowledge after due inquiry, it has no outstanding environmental, social, health and safety 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. BA has also stated that, to the best of its knowledge after due inquiry, its finance application and analysis process is equitable, fair, and unbiased in terms of social factors.

Environmental and Social Management

Environmental and Social Management System

On December 11th 2008 Banco Agricola's "*Políticas y Sistema de Gestion Ambiental*" (*Environmental Management System (EMS) and Policy*) was approved⁴. This EMS is consistent with Grupo Bancolombias "*Politica de Gestion Ambiental*". Banco Agricola's EMS details its objectives, structure, documentation, roles and responsibilities, the methodology for evaluation of environmental risk of new clients and projects, employing an A, B, C categorization of environmental impact and risk (A being high, B, moderate and C low). The EMS also includes the exclusion lists for both IFC⁵ and IDB⁶. This policy and procedures were designed to focus on corporate and international banking, as well as large scale construction and agricultural projects, rather than the MSME sector.

BA has an Environmental Risk Categorization list included in its EMS; however it is yet to begin work on its implementation. BA is in the process of designing an implementation plan to address both this and how the environmental requirements will be detailed in loan contracts with its

³ El Salvador is the second most deforested country in Latin America after Haiti. Large scale deforestation has had serious environmental, social, and economic impacts. In particular soil quality and erosion are key issues in El Salvador, and have left the country vulnerable in particular to mudslides. In October 2005, landslides resulting from a series of storms killed more than 50 and required the evacuation of more than 34,000 residents. El Salvador is prone to seismic activity, has 20 active volcanoes and is susceptible to forest fires.

⁴ Bancolombia, Colombia's largest financial institution, through its wholly owned subsidiary Bancolombia Panama, acquired a majority stake in BA in April 2007.

⁵ In 2004, BA signed a US\$50 million loan with IFC that required the bank to develop an environmental management system (EMS) to ensure that relevant operations (e.g. project finance, corporate lending, leasing, but not including individual mortgage lending) comply with the applicable environmental and social requirements in El Salvador.

⁶ In December 2008 the participation of BA in the IDB Trade Finance Facilitation Program (TFFP) was approved with an uncommitted credit line of US\$40 million in support of trade finance transactions with tenors of up to 3 years. As part of the TFFP Agreement to be signed with Banco Agricola, they will agree to implement the IDB's environmental and social procedures including the application of the IDB trade finance exclusion list.

clients as well as how to ensure performance monitoring and evaluation. The implementation plan will also specifically look at how the principals of its EMS will be applied to MSME operations to ensure that possible risks associated with this portfolio (see previous section) are mitigated.

The EMS clearly establishes the roles and responsibilities for environmental and social risk management in Banco Agrícola. With the approval of the Policy the roles of Environmental Manager, Environmental Coordinator and Environmental Co-Coordinator were created. These are not new positions, rather additional roles given to key personnel. The roles of Environmental Manager and Coordinator have been given to two Risk Management Professionals. The role of Environmental Co-Coordinator has been given to one professional under the responsibility of the Manager for Commercial Banking. The EMS also includes reference to collaboration with the Human Resources Department to provide staff in the relevant departments with training on the Environmental policies and procedures.

Facilities and Human Resources Management

BA has a series of ten human resource policies (covering recruitment, selection, evaluation, training, labor relations) which were last updated in 2005. The Human Resources department is in the process of reviewing and updating these and expects Management to approve these by May 2009. BA has stated that it practices fair and unbiased labor practices related to sex, age, ethnicity, cultural heritage, and collective bargaining and complies with the core labour standards, as well as other applicable national laws such as the “*Ley de Equiparación de oportunidades para las personas con Discapacidad*” (*Equal Opportunities for Persons with Disability Law*). All BA staff receive medical (and dental) insurance or assistance as well as other benefits including life insurance and disability allowances. The human resources department details these and other benefits in a brochure which is made available to all staff.

BA has a long standing commitment to social responsibility, one of its ten principal corporate values. These values are clearly stated in Banco Agrícola’s Code of Ethics which was approved in August of 2008. A copy is provided to all employees.

Banco Agrícola’s Executive Committee approved its *Política de Continuidad del Negocio* (*Policy for Business Continuation*) in September 2008. The policy focuses on 4 key areas: People, Processes, Infrastructure and Technology. During the final quarter of 2008 BA focused on implementation of this policy and ensuring consistency with Grupo Bancolombia’s overall strategy in this area. BA conducts annual emergency drills (the last taking place in November 2008) and annual inspection of all fire extinguishers and equipment. Currently BA facilities are lacking clear emergency exit signage.

Environmental and Social Requirements

The Bank will require as part of the Loan Agreement that BA comply with all applicable Salvadorian environmental, social, health and safety, and labor regulatory requirements; IDB List of Excluded Activities for Non-Sovereign-Guaranteed (NSG) operations; the Fundamental Principles of the Rights at Work; and its EMS.

Prior to financial closure, the IDB will require BA to present an Environmental, Social and Health and Safety (ESHS) Action Plan in form and substance satisfactory to the IDB that includes the chronogram for the implementation of BA's EMS to its MSME financial operations as well as a chronogram for conducting emergency evacuation drills and implementing evacuation and emergency exit signage in all BA facilities

The level of detail of the EMS will be commensurate to the potential environmental and social risk associated with Banco Agricola's portfolio, and will include at a minimum: (i) MSME project eligibility criteria (Environmental Exclusion List); (ii) a process for assuring MSME compliance with local environmental and social legal requirements, (iii) mechanisms for assessing and managing environmental and social aspects, including natural disasters, associated to its MSME portfolio (MSME checklist); and (iv) a process for documenting evaluation, approval and monitoring performance associated to its MSME portfolio; and (v) training.

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 BA to present environmental and social compliance reports in form, content and frequency satisfactory to the IDB.