Environmental and Social Management Report
Banco BAC San Jose Financing Facility
(CR-L1059)

I. Project Description and Background

1.1 The proposed project entails a financing facility (the "Facility") that will enable Banco BAC San José, S.A. ("BAC"), a market leader in the banking sector and the largest among private-sector banks, to expand its mortgage lending financing to the segment of middle and lower-middle income families and increase its loan portfolio to small and medium-sized enterprises ("SME") in Costa Rica. The Facility, with a tenor of up to five years, would provide a senior A loan (the "A Loan") of up to US$40 million to be financed by IDB and a targeted B Loan (the "B Loan") to be financed by commercial investors in an amount to be determined based on the market conditions and needs of the client, which is estimated at approximately $10 million. The Facility would be the largest IDB transaction with a financial institution in Costa Rica combining *mortgage* and *SME financing*.

1.2 Banco BAC is part of BAC Credomatic, which is wholly-owned by Banco de Bogota, which is in turn majority-owned by Grupo Aval (65%) from Colombia. Minority shareholders own the remaining shares (35%), none of whom holds more than 10% of the shares of Banco de Bogota. BAC Credomatic is ISO 9000 certified and provides a full range of financial services to corporate clients and individuals. BAC has a deep commitment to social corporate responsibility. It has published a Sustainability Report on a yearly basis since 2007 where it presents the year's work and accomplishments[1]. BAC's social responsibility efforts are focused on financial education and environmental sustainability. Additional information on BAC Credomatic and BAC Costa Rica's mission can be found at http://www.bac.net/regional/esp/banco/index.html

II. Project Status and Compliance

2.1 The Environmental and Social Strategy (ESS) for the Project was presented on January 11, 2012 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. Due to the minimum E&S risks associated with mortgage lending financing and SME's loans to be financed by the IDB, which would be on average of US$42,000, for micro and SME loans ranging from US$1,000 to US$2 million, the operation is considered as low risk.

2.2 BAC has confirmed that it is in compliance with Directive B.02 (country laws and regulations) of IDB Environmental and Safeguards Compliance Policy, complying with all

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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 BAC's portfolio

3.1 Banco BAC's assets as of June 2011 amounted to US$2.3 billion, ranking as the largest private bank in Costa Rica. BAC's portfolio is varied and overall may be considered as having minimal to moderate environmental and social risks and impacts associated with it. As of December 2011, the sectors in which BAC was working were: commercial (47%), services (18%), tourism (17%), construction (11%); industry (4%) and agriculture (3%). BAC's SMEs portfolio accounts for approximately 26% of the entire corporate portfolio and is also diverse, with significant participation in sectors such as: commercial (53%) and services (37%), and significantly smaller exposure in sectors such as industry, tourism, housing, agriculture, transport, and construction. For BAC, a "Small Enterprise" is such with a maximum of 100 employees, and a "Medium Enterprise" is defined as an enterprise with between 100 and 250 employees. As of December 2011, BAC's mortgages accounted for about 36% of its total portfolio.

3.2 The ESHS impacts and risks associated with loans to SMEs will be of varied nature depending mainly on the type of activity being financed. These ESHS risks and impacts may be minimal to moderate, for example: i) related to trade and commerce of products and substances subject to bans and international phase outs (trade finance); ii) habitat conversion and degradation (construction, agriculture, transport, energy); iii) aquatic biodiversity loss (fisheries); iv) solvent emissions and waste (print shops, tanneries); v) occupational health and safety (industry, construction, agriculture); vi) poor land use (construction, agriculture); vii) noise and air pollution (industry, construction), increased greenhouse gas emissions (industry, energy). The key ESHS risks and impacts associated with mortgage lending on new and existing houses are typically related to the magnitude and the location of each individual property to be mortgaged and include: i) properties located in areas where previous use/activities (i.e. abandoned landfills or waste disposal areas, industrial facilities)may have resulted in localized environmental problems such as soil and ground water contamination, which may present a human health risk; ii) particularly in older properties, properties with the existence of lead based paint, friable asbestos containing materials, or presence of hazardous gases/materials; iii) properties located in areas at high risk to natural hazards, such as floods, seismic events, and fires; iv) properties located in areas near important or sensitive environmental areas (e.g. containing threatened or endangered species, tropical rain forests, natural parks, etc.) v) properties located in areas with particular social issues such as the displacement of illegal settlements occupying the property or land on which the property is located; vi) Potential discrimination and barriers for an equitable process of providing the mortgages taking into consideration ethnicity, sex, religion, age, etc.

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

3.6 BAC has stated that they have no material health issues (including legal claims) and do not have any materials employee or labor disputes. BAC 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). BAC guidelines for employees' compensation (salary, pay raise, benefits) and analysis (evaluations) are based on the local legislation, following also Costa Rican labor regulations. In order to prevent and mitigate possible emergencies, BAC implemented the *Plan de Emergencia y Contingencia*, for which the staff has been trained and emergency evacuation drillshave been performed. BAC's head office is located in San Jose, Costa Rica.

IV. Environmental and Social Management

A. BAC's Environmental and Social Management System

4.1 BAC has received support from other development institutions such as the Netherlands Development Finance Company (FMO) and the Inter-American Investment Corporation (IIC), which required BAC to develop an Environmental and Social Management System (ESMS)[2]. In 2006, BAC developed the Manual of Procedure for the Environmental and Social Risk Analysis System (SARAS acronym in Spanish), to identify evaluate and manage E&S risks that may result from projects or activities to be financed. In November 2011, the SARAS was relaunched and applied to all eligible projects financed by BAC. The SARAS applies a tiered approach for safeguarding operation. All operations are screened against an exclusion list (new, renewal or modifications), which is consistent with the IDB's List of Excluded Activities for Non-Sovereign Guaranteed Operations (NSG) and operations. OperationsaboveUS$1 million are further categorized and assessed accordingly for their environmental and social impacts and risks.

4.2 Reportedly, 94% of the portfolio is being managed through the SARAS. BAC portfolio does not include SMEs which could pose significant environmental and social risks such as tanneries or SMEs managing significant amount of hazardous chemicals. SMEs in the industry sector account for 4% of the portfolio and the loans to companies involving metal-mechanic or other industrial activities are usually above 1 million dollars and thus subject to the SARAS and thus subject to categorization and further assessment.

[2]The SARAS sets out six steps to be taken with any operation to be financed by BAC. This is based on i) eligibility, ii) initial identification of environmental and social risks (using the Formulario de Identificacion de RiesgosAmbientales y Sociales) which helps determine the level of environmental evaluation required, iii) internal investigation based on historic information, iv) classification of projects/activities according to their categorization model A, B or C (considering the type of operation, size, location, nature and magnitude of impacts and risks) which is consistent with IDB Environment and Safeguards Compliance Policy, v) detailed evaluation of environmental and social risks, specifically those categorized as A and B; and vi) monitoring. In addition, the document includes as annexes i) a list of excluded activities consistent with the NSG List of Excluded Activities, ii) a procedure for project selection according to their risk, iii) instructions to prepare an Environmental Impact Analysis, iv) a format for an Environmental Protection Plan, v) a format to perform an Environmental Audit and vi) an Environmental Diagnose Questionnaire.

4.3 Due to the small size of the loans to be financed with IDB funding (SMEs loans are in average of US$42,000 and mortgage loans fluctuate between US$50,000 and US$150,000), these loans will be not be categorized and assessed following the provisions of the SARAS but are screen for compliance with applicable in-county regulations

B. Environmental and Social Management System for SMEs

4.4 BAC's management of E&S risks and impacts related to small enterprises is mainly focused on the agricultural sector. BAC's clients in this sector are primarily producers of rice and beans that are also part of the "*Tierra Fertil*" program. This initiative is a joint effort among BAC, Hortifruti and Wall Mart to promote sustainable production and fair market. Farmers receive technical support to preserve the environment following quality standards, making properly use of agrochemicals, controlling water for irrigation, controlling pests and using new technologies to enhance organic production.

4.5 In the case of the other SME sectors, the majority of the portfolio and proposed investments are in the service and commercial sectors, where the E&S risks and impacts are minimal to moderate, for which BAC relies on in-country regulations.

C. Environmental and Social Management System for Mortgages

4.6 BAC's management of E&S risks and impacts associated with residential mortgages relies on Costa Rican environmental legislation and banking regulations. Under Costa Rican banking regulations (SUGEF 1.05) land use, protected areas and natural/historical patrimony must be considered as part of the valuation and assessment of land and buildings for housing. To that end, an independent assessment is undertaken by authorized inspectors ("*peritos*") which report on the location of the property and its size, description of the land/property and adjacent lands/properties, whether liabilities exist, soil use, access to land, utilities provision (electricity, water and sewerage, etc) and fire safety. In order to evaluate a mortgage request, BAC requests a copy of the land registry plans and titles of the property, the independent assessment and checks to ensure that there are no outstanding liabilities on the property. For a new construction, BAC requests in addition a municipal permit.

D. Training on Environmental and Social Risk Management

4.7 Overall responsibility of the implementation of the SARAS at the local level is with the Risk Manager in collaboration with the Chief of Risk and three Risk Analysts. On the other hand, at the regional level this task is responsibility of the Regional Risk Manager and the Regional Manager for Social Responsibility. Internally BAC has conducted internal training for those personnel responsible for the implementation of the SARAS. BAC reports on the environmental and social aspects annually to fulfill requirements it has for loans with FMO, and IIC.

E. Corporate Social Responsibility

4.8 As part of Banco BAC's commitment to corporate social responsibility, it has developed various initiatives, for example, it has published a Sustainability Report on a yearly basis since 2007 where it presents the year's work and accomplishments[3]. BAC's social responsibility efforts are focused on financial education and environmental sustainability. On the former, BAC supported the Ministry of Education in implementing the financial education course used in the Costa Rican public education system. BAC is also one of the largest volunteering organizations in Costa Rica as measured by the number of volunteering hours relative to employee population. In 2009, it approved the policy that established an environmental and social risk management system for its lending operations.

4.9 BAC's certification to ISO 14001:2004 obtained in 2010 for two of its administrative buildings, confirms a strong commitment to environmental management, promoting certain activities (waste reduction, GEI emissions and energy, water and paper consumption), to demonstrate their environmental performance and support to sustainable development. As a complement, BAC's certification to the Occupational Health and Safety Management Systems OHSAS 18001:2007 helps ensure the social management and control of BAC's health and safety risks and improve their OH&S performance.

V. Environmental and Social Requirements

5.1 For this operation which involves mortgage lending financing and SME's loans of an average of US$42,000 to support mainly commercial and services activities, the Bank will require BAC as part of the Loan Agreement to:

(i) Comply with all applicable Costa Rican environmental, social, health and safety, and labor regulatory requirements, and in relation to the financing of SME's 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) BAC's Environmental and Social Risk Analysis System (*SARAS*).

(ii) Complement on a best efforts basis the current assessment prepared by the inspectors ("*Peritos*") for mortgage financing with simple questions directed to identify key risks, mainly the likelihood of soil and water contamination due to properties located in areas where previous use/activities (i.e. abandoned landfills or waste disposal areas, industrial facilities) may have resulted in localized environmental problems which may present a human health risk and properties located in areas at high risk to natural hazards, such as floods, seismic events, and fires.

(iii) Ensure that at least one staff member with responsibility for the SARAS 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 BAC continue to remain up to date with its environmental and social risk management expertise.

(iv) Present an Annual Environmental and Social Compliance Report (ESCR) with information on the mortgage and SME portfolio (commercial, services, tourism,

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construction, industry and agriculture) including a breakdown of subsectors, the implementation of the SARAS and whether there are potential operations with high E&S impacts and risks

5.2 The IDB will supervise the environmental and social aspects related to mortgages and SME lending with emphasis on 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 for enhancing the management of impacts and risks.