**Annex III**

**Environmental and Social Management Report**

**BR-L1366 – BDMG: Innovation in Access to Finance for the Base of the Pyramid Microentrepreneur in the state of Minas Gerais, Brazil**

1. **Overview**
   1. The project objective is to increase access to finance for formally registered *Microenterprise* (MEs) and Individual Microentrepreneur *Microemprendedor Individual* or “MEI”s businesses from the base of the pyramid (BoP) in the state of Minas Gerais (MG) Brazil, through application of an innovative credit methodology developed by the Entrepreneurial Finance Lab (EFL) which helps to overcome the market failure that prevents them from accessing business credit lines. EFL’s unique credit scoring methodology seeks to identify high-potential entrepreneurs based on psychometric factors such as ethics, business acumen and motivation, rather than prior business experience or credit history, and which to date has proven to increase access to finance for new microenterprises, while conserving low default rates for lending banks.
   2. To support the project objective, the Opportunities for the Majority Initiative (OMJ) will enter into a US$10 million risk-sharing facility (RSF) (or its equivalent in Brazilian Reais) with *Banco de Desenvolvimento de Minas Gerais* (BDMG or the “Lender”), the development bank of the state of MG. With the OMJ RSF, BDMG will launch a new financing program for newly formalized MEs, and be the first bank to apply the EFL methodology in Brazil, as it seeks to broaden the base of eligible clients for microenterprise business financing.
   3. The application of the EFL methodology will enable BDMG to reach this underserved market, since this tool is designed to overcome the traditional market failure that prevents MEs from accessing credit lines for their businesses: information asymmetries, due to lack of formal credit record as a business in the financial system, and lack of business track record as well as additional obstacles such as the lack of real guarantees to provide lenders as collateral. The new BDMG loan product will provide a standardized loan amount of up to R$15,000 (approx. US$7,500) with a tenor of 24 months including a 3 months grace period. The project is designed to reach 4,000 MEs during a two year pilot phase. A second two-year phase will be conditioned on the Project’s early results, aiming to expand the credit program to serve MEIs which number over 300,000 companies in the state of MG, thus providing the potential to significantly scale the project.
   4. BDMG was founded in 1962, by the *Lei Estadual 2.067* in the state of Minas Gerais, Brazil to foster sustainable development and social inclusion. BDMG is a closed *Sociedad Anonima* wholly-owned by the government of MG and governed by the Brazilian Corporations Act, as well as by applicable national and state financial system regulations, including Art 13 of the MG State Constitution. BDMG operates in 700 Municipalities of MG, representing 82% of the total Municipalities, 98% of the GDP and 95% of the population. As of December 31, 2011 BDMG’s total assets grew to R$2.84 billion (approx. USD $1.41 billion) with a net income for the year of R$ 82 mm (approx. USD $40 mm).
2. **Status and Compliance** 
   1. The Environmental and Social Strategy (ESS) for the Project was presented in October 2012 to the Environmental Safeguards Review team and no special actions were required. Based on Directive B.13 of the Environment and Safeguards Compliance Policy (OP-703), this Project is classified as a financial intermediary and as such is not categorized according to its potential environment and social (E&S) impacts and risks. Due to the minimum E&S risks associated with ME’s loans to be financed by the IDB, which would be up to BRL 15,000 (approx. US$ 7,500) and with a relatively short tenor of 24 months, the operation is considered as low risk.
   2. BDMG has confirmed that it is in compliance with Directive B.2 (country laws and regulations) of IDB Environment 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.
3. **Environmental and Social Impacts and Risks**

**A. Environmental and social risks associated with BDMG’s portfolio**

* 1. The potential key environmental, social, health and safety, and labor (ESHS) impacts and risks associated with this transaction are mainly those related to the activities of MEs which in overall may be considered as minimaland depend on the type of activity being financed, in this case those related to services and commerce of products.
  2. In terms of social risks, these are also considered to be minimal, since BDMG’s own operational policies prohibit from screening clients based on discriminatory practices. On the other hand, the project is expected to have a positive social impact on the life of microentrepreneurs from the BoP in MG. By allowing many of them to have access to needed capital to overcome this difficult period that immediately follows the formal registration of their business operations, the project will help them to have an improved survival rate and thus maintain a source of income for many families from the BoP.
  3. Considering that BDMG is a branchless development bank, and in order to provide a positive support system to the MEs, BDMG will develop a relationship with a local partner (e.g. Sebrae) to provide on-site and tailored business coaching advice to improve the enterprise management through its *Negocio a Negocio* (N-a-N) program. This will greatly diminish not only the financial risk of the portfolio, but also environmental risk, since any emerging issue can be more immediately identified and addressed accordingly. It is envisioned that the monitoring agents will visit many of the 4,000 clients from the pilot phase at least once during the two year life of the loan. Sebrae has an ambitious goal of providing training for 80,000 MEs in the state of MG during the program period.
  4. BDMG has stated that it has neither financial liabilities in its existing portfolio, related to ESHS issues, nor outstanding ESHS concerns, through involvement in projects, companies or activities considered unacceptable to the IDB that could potentially generate significant public opposition or concerns. BDMG 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 BDMG’s facilities and Human** **Resources practices**

* 1. The potential risks associated with BDMG’s facilities and operations, such as environmental liabilities in their offices or employees having occupational health and safety problems due to working conditions are considered to be minimal. BDMG has stated that they have no material health issues (including legal claims) and do not have any material employee or labor disputes.
  2. Description of Human Resource practices. Currently the Bank has 353 employees as well as analysts, technicians and legal professionals. All professional employees are selected by open public competition in order to attract the best and most qualified talent. In order to develop the knowledge, skills and attitudes relevant to its business BDMG offered 30 thousand hours of training and coaching for its staff in 2012. It also intensified its Quality of Life Program to encourage work-life balance, access to cultural opportunities and support for other family needs. BDMG guidelines for employees’ compensation (salary, pay raise, benefits) and analysis (evaluations) are based on the local legislation, following Brazilian labor regulations. BDMG’s head office is located in Belo Horizonte.

1. **Environmental and Social Management** 
   1. As part of its environmental and social management practices, BDMG requires all of its clients to comply with Environmental, Social, Health and Safety and labor legislation applicable in Brazil and to obtain environmental permits as necessary to obtain the business operating license. Such compliance is mandatory for any company registered with JUCEMG, the state board of trade responsible for registering all companies, and the partner responsible for helping to promote the BDMG-EFL product.
   2. In addition, BDMG has an environmental policy which is applicable to all of its financing operations. Per the terms of *Resolucao* 201-B, BDMG screens all projects financed for environmental risks, and will not support any project identified as potentially hazardous without the company obtaining all environmental licenses required by local legislation. BDMG also adopted *Resolucao* 201-E in order to promote the financing of projects with positive environmental externalities, such as energy efficiency, renewable energy projects, forestry conservation, waste management and others.
   3. BDMG has enacted resolutions requiring that every financial support must be analyzed taking into consideration the relevant local legislation in regard to environmental protection. Moreover, another resolution (*Resolucao* 201-B, Anexo VI-C *Vedacoes, Impedimentos E Itens/Actividades Nao Financiaveis*) provides a list of “non-financeable activities”, which is consistent with the IDB List of Excluded Activities for NSG operations.
2. **Environmental and Social Requirements**
   1. As part of the Loan Agreement between the IDB and BDMG, the IDB will require that BDMG comply with: (i) all applicable Brazilian 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 (iv) *Resolucao* 201-B
   2. IDB will require BDMG to present an Annual Environmental and Social Compliance Report (ESCR) with information on the ME portfolio, including a breakdown of financing by subsectors, and any particular risk issues identified.
3. **Supervision** 
   1. 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 BDMG to present environmental and social compliance reports in form, content and frequency satisfactory to the IDB.