**Environmental and Social Management Report**

**BAC SME Internationalization Financing Partnership**

**(PN-L1099)**

**(NI-L1085)**

**(ES-L1087)**

**(HO-L1097)**

**(GU-L1081)**

1. **Project Description and Background**
   1. The proposed SME Internationalization Financing Partnership (the “Project”) entails a partnership with BAC International Bank (Panama) and its subsidiaries in Nicaragua (BAC Nicaragua), Honduras (BAC Honduras), El Salvador (BAC El Salvador) and Guatemala (BAC Guatemala), (“BAC”), to expand credit financing to small and medium-sized enterprises[[1]](#footnote-1) (“SMEs”) in Panama, Nicaragua, Honduras, El Salvador and Guatemala, with up to half of the proceeds directed at supporting the internationalization of SMEs, through international trade and investments.
   2. The Project consists of senior unsecured A Loans for up to US$120 million to five BAC’s subsidiaries for up to 6 years, with a two year grace period. Subject to market demand, the IDB will try to syndicate senior unsecured B loans on a best effort basis for an amount to be determined. IDB’s loans would help BAC’s ongoing efforts to increase its lending position to SMEs among its various regional subsidiaries, while also helping the bank diversify its product offering to SMEs in terms of tenors and business lines.
   3. BAC is wholly-owned by Banco de Bogota (Colombia), which is in turn majority-owned by Grupo Aval (approximately 65% as of July 2013) (Colombia). Minority shareholders own the remaining shares (approximately 35% as of July 2013), none of whom individually holds more than 10% of the shares of Banco de Bogota. BAC provides a full range of financial services to corporate clients and individuals. As of December 2012, BAC’s assets amounted to US$10.7 billion, ranking as one the largest banking groups in Central America.
2. **Project Status and Compliance**
   1. The Environmental and Social Strategy (ESS) for the Project was presented in June 2013 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 SME’s loans to be financed by the IDB.
   2. BAC is in compliance with Directive B.02 (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.
3. **Environmental and Social Risks and Impacts**
4. *Potential risks and impacts associated with BAC’s portfolio*
   1. BAC’s assets as of June 2013 amounted to US$11.4 billion, ranking it one of the largest financial groups in Central America. The bank operates one of the most extensive branch networks in the region, with close to 200 branches and about 262 points of sale, over 1,200 ATMs and over 17,000 employees. BAC’s portfolio is varied and overall may be considered as having minimal to moderate environmental and social risks and impacts associated with it.
   2. BAC’s SME portfolio varies throughout the region, depending on the particular country, seeing significant growth in Honduras, El Salvador and Nicaragua, with prospects for growth in Panama and Guatemala. See Table 1 for the distribution of the SMEs clients and the SMEs loans outstanding amount among the BAC subsidiaries as of March 2013.
   3. **Table 1: BAC SME portfolio distribution**
   4. 
   5. BAC’s SMEs portfolio ranges from 2% to 15% of total loans, depending on the country. The portfolio is heavily allocated to commerce and services, with significantly smaller exposure in sectors such as industry, construction, agriculture, and transport. See Table 2 for the composition of the economic sectors supported by the SMEs loans portfolio in each country.
   6. **Table 2: BAC SME portfolio sector distribution**
   7. 
   8. At BAC, the definition of SMEs considers annual sales, number of employees and credit exposure. Small enterprises have annual sales up to US$1 million, with up to 30 employees and a credit exposure below US$350,000; while medium sized enterprises have annual sales of up to US$10 million, with up to 100 employees and a credit exposure below US$1 million.
   9. As per the IDB definition for MSME in C&D countries (OP-580), these are categorized by loan size as follows: microenterprises for loans under US$10,000; small enterprises for loan amounts over US$10,000, up to US$150,000; while medium enterprises consists of loans over US$150,000, up to US$500,000. The loans extended to MSMEs in this Project will be limited to a range of US$10,000, up to a maximum of US$500,000.
   10. 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).
5. *Environmental and social risks associated with BAC’s facilities and human resources practices*
   1. 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 Panamanian, Nicaraguan, Salvadorian, Honduran, Guatemalan 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 drills have been performed.
6. **Environmental and Social Management**
7. *BAC’s Environmental and Social Management System*
   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]](#footnote-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 re-launched and applied to all eligible projects financed by BAC. In 2012, the SARAS underwent two audits, the first an internal audit by BAC and an external audit by FMO.
   2. 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). Operations over US$1 million or with clients for which the resulting consolidated exposure would be over US$1 million are further categorized and assessed accordingly for their environmental and social impacts and risks.
   3. Depending on the country, from 97% to 100% of the portfolio for which the SARAS is applicable has been properly managed and categorized. The 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.
   4. Due to the small size of the loans to be financed with IDB funding (SMEs loans are projected to be on average approximately US$43,500), the operation is considered as low risk, these loans will not be categorized and assessed following the provisions of the SARAS but are screened for compliance with applicable in-county regulations.
   5. In the case of the SME sector, the majority of the overwhelming majority of the portfolio and proposed investments are in the service and commercial sectors (see Table 2, above), where the E&S risks and impacts are minimal to moderate, for which BAC relies on in-country regulations.
8. *Training on Environmental and Social Risk Management*
   1. Overall responsibility of the implementation of the SARAS at BAC rests in the Credit Risk Department, who is in turn supported by two regional coordinators and credit risk coordinators in each country. At the time of the SARAS implementation, BAC conducted internal training for those personnel responsible for the system, many of whom have since undertaken refresher courses[[3]](#footnote-3).
   2. BAC reports on the environmental and social aspects annually to fulfill requirements it has for loans with FMO and IIC.
9. *Corporate Social Responsibility*
   1. BAC has a deep commitment to social corporate responsibility, for which it has developed various initiatives. It has published a Sustainability Report on a yearly basis since 2007 where it presents the year’s work and accomplishments[[4]](#footnote-4). BAC’s social responsibility effort has focused on pursuing and recommending best practices for environmental conservation, especially teaching school children about caring for the environment. (Please refer to <http://www.quierounplanetaverde.com/ahorrando-para-tu-futuro>). Additional information on BAC Credomatic’s mission can be found at <http://www.bac.net/regional/esp/banco/index.html>.
   2. In addition to BAC’s SARAS, which it implements outwardly, for its clients and credit portfolio, BAC also has an internal environmental management system (SGA by its Spanish acronym), which is applied inwardly, focused on BAC’s own operations. SGA seeks consistent improvements and incorporation of best practices to minimize the impact the bank’s own operations. So far the system has been implemented in El Salvador and Guatemala, and there are plans to extend it throughout the region[[5]](#footnote-5). There is 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.
10. **Environmental and Social Requirements**
    1. For this Project which involves individual SME loans ranging in size from US$10,000, up to a maximum of US$500,000 the Bank will require BAC as part of the Loan Agreement to:
    2. Ensure that BAC complies with, (A) all applicable Panamanian, Nicaraguan, Salvadorian, Honduran, and Guatemalan environmental, social, health and safety, and labor regulatory requirements, and (B) in relation to the financing of SME’s, to ensure that each Sub-loan and Sub-Borrower complies with: (1) BAC’s Environmental, social, health and safety and labor (ESHSL) policies and procedures; (2) in-country ESHSL regulations; (3) the IDB List of Excluded Activities for Non-Sovereign-Guaranteed (NSG) operations; and (4) the Fundamental Principles of the Rights at Work.
    3. BAC will implement as a pre-condition to the elegibility of Sub-Loans in high risk sectors; that is, prior to the use of proceeds of the IDB loan in these high risk sectors, the Environmental and Social Due Diligence (ESDD) tools (the “E&S Protocol”) described in items (i) through (iii), below. The E&S Protocol will be a complement to BAC’s SARAS by implementing the following ESDD requirements for Sub-Loans in higher risk sectors (such as agriculture, construction, industry, etc.):
11. under $100,000, ensure and document that the Sub-Borrower’s comply with all national ESHSL laws and regulations.
12. For Sub-Loans over $100,000, but under $250,000, verify that the Sub-Loans or Sub-Borrowers as applicable are up-to-date with all ESHSL related licenses, permits, authorizations and related requirements.
13. Additionally, for Sub-Loans over $250,000 apply sectorial E&S checklists.
    1. BAC will obtain the non-objection of the IDB prior to approving any Category A projects for financing with the proceeds of the IDB loan. Furthermore, even though these circumstances are unlikely, the Loan Agreement will include standard provisions to avoid financing of projects that trigger high risk contextual factors.
    2. Ensure that at least one staff member with responsibility for the compliance of the environmental and social requirements takes part annually in the IIC/IDB Environmental Risk Management training course, or in other ESHS training agreed upon by the IDB, to ensure that BAC continues to remain up to date with its environmental and social risk management expertise.
    3. Cooperate fully with the IDB to perform supervision actions the Bank deems necessary through the life of the loan, including providing access to all relevant documentation, facilities and personnel related to the Sub-Loans, and cooperating fully with any inspection or audit by the Bank, or its designated representatives or consultants.
    4. Present an Annual Environmental and Social Compliance Report (ESCR) with information on the SME portfolio of Sub-Loans, including a breakdown of financing by subsectors and a list of transactions including Environmental risk categorization (according to BAC’s methodology), and any particular ESHSL risk issues identified during screening, the mitigation measures agreed with clients, and their E&S performance status.
    5. Promptly notify IDB of any non-compliances, issues or complaints related to ESHSL matters.
    6. 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 will require BAC to present environmental and social compliance reports to the IDB to assess the environmental and social risks of the portfolio being supported.

1. SMEs are defined as enterprises with up to 100 employees SME loans will be for an amount ranging from US$10,000, up to a maximum of US$500,000, consistent with IDB’s Sector Guideline for SME Finance and Development Programs in LAC (OP-580) definition of SME loans for a C&D country [↑](#footnote-ref-1)
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 Riesgos Ambientales 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. [↑](#footnote-ref-2)
3. BAC offers courses to its employees on energy, paper, and water savings, minimizing waste, minimizing greenhouse gas emissions, ISO 14001, natural disaster preparedness, and occupational safety and security. [↑](#footnote-ref-3)
4. Since 2009, the report has been prepared compliant with GRI standards. For the full report, please refer to <http://www.rscbaccredomatic.com/reporte-sostenibilidad.html> [↑](#footnote-ref-4)
5. While Costa Rica is not part of this transaction, it is important to note that the SGA has also been implemented in that country with great success, with BAC San Jose becoming the first carbon neutral financial institution in Costa Rica. It has also certified ISO 14.001/2004 seven of its administrative buildings [↑](#footnote-ref-5)