

PROJECT ABSTRACT

PROJECT NUMBER: PE- L1018
Project Name: BBVA Banco Continental Guarantee and Financing Facilities.
IDB PARTICIPATION: APPROXIMATELY UP TO US \$ 195 MILLION
DEPARTMENT: PRIVATE SECTOR DEPARTMENT
STATUS: APPROVED BY PSC
APPROVAL DATE: AUGUST 25, 2006

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Background

The Peruvian economy has shown steady and significant growth expanding at an average rate of 5.5% per year over the last 5 years. Main macroeconomic fundamentals have strengthened; inflation rate has been within the range of 1.5%-3.5% while the fiscal deficit was reduced from 2.3% to 0.4% of GDP and the current account balance also improved from -1.9% of GDP to 1.3% of GDP. Peru's creditworthiness benefited from these trends, with the improvement of key sovereign financial ratios that ultimately determined an upgrade of the long-term foreign currency rating to BB+.

However, economic growth has not been fully matched by the improvement of social indicators. Social indicators in the housing sector also lag behind. The Peruvian housing deficit is estimated between 1.7 million units (Peruvian Construction Chamber, Capeco) and 2.7 million units (Mi Vivienda) consisting of around 70% quantitative deficit while the remaining 30% represents a qualitative deficit as housing units fall below the minimum living standards.

The mortgage portfolio as percentage of GDP has been steadily growing since 1999, with an average annual growth of 22% since 2001, led by per capita GDP growth coupled with wider availability of mortgage facilities provided by the financial system and the Government. However, despite government efforts through the Mi Vivienda program, as of year-end 2005, the mortgage market in Peru represented only 12.1 percent of total loans in the financial system and 2.4% of GDP, compared to Colombia with 21.2% and 4.5% and Chile with 20% and 14.4% respectively.

Project Description

The Project under consideration envisions an IDB partial credit guarantee to enhance a Residential Mortgage Backed Securities Program ("RMBS") to be issued by BBVA Banco Continental S.A. ("Continental") and IDB financing in United States Dollars and/or Soles for mortgage origination and subordinated debt for an aggregate amount of up to one hundred and ninety five million United States dollars (US\$ 195,000,000).

IDB's participation in the project is consistent with the strategy to enhance competitiveness and the efficient development of the private sector. The project provides comprehensive support for mortgage origination and to strengthen the Peruvian financial system by providing long-term financing to a key financial institution.

Environmental and Social Impacts and Mitigation Measures.

The potential key negative environmental, social, health and safety, and labor impacts associated with this operation are those related to or caused by the specific projects financed by *Continental*. These impacts can be diverse and their significance will depend on the project characteristics (e.g. sector, type, location, etc.). The operations with the greatest potential of generating environmental and social impacts are Corporate Loans in the sectors of manufacturing, mining, forestry, and fisheries, which roughly compose one-third of the Bank's portfolio. Other area that could present some – albeit minimal – environmental, social, or health and safety concerns to *Continental* includes their individual residential loan program, due to environmental risks (e.g., mortgage properties located in areas susceptible to natural hazards, such as floods, seismic events, fires or hurricanes; or mortgaged properties built on land which may be contaminated due to previous land use activities, such as illegal dumping).

Additionally, there are some potential environmental credit risks to the IDB associated to

- (i) mortgages or other assets provided as collateral which due to environmental liabilities or risks may have a lower than estimated value,
- (ii) environmental, social, health and safety and/or labor issues in *Continental* Corporate Loans, that may result on material impacts to *Continental* (e.g. clean-up costs, fines, etc) thus affecting its cash flow and its ability to repay the IDB, and
- (iii) to a lesser extend environmental, social, or health and safety risks associate with *Continental* facilities (e.g. poor emergency preparedness practices in cases of fires, and/or earthquakes, etc).

There are also potential reputation risks that could be transferred to the IDB in the case *Continental* inappropriate manages environmental, social, health and safety, or labor matters.

The *BBVA* group is a subscriber to the Equator Principle, and thus is committed to comply with the IFC safeguard policies for any project finance over US\$ 10 million. *Continental* does not have an Environmental Management System (EMS) yet, but as of September 2006, the credit manual was modified to specifically incorporate a section on environmental and social impacts. Since this date, every new Corporate Loan or renewal of an existing one, undergoes an environmental and social revision, that as a minimum has to present a copy of the environmental license granted by the sector's environmental authority.

Based upon information provided by *Continental*, their facilities are in compliance with all relevant in-country environmental, health and safety legal requirements. *Continental* performs evacuation drills every year in all of the facilities across the country, and has trained evacuation brigades at every floor in all of their facilities.

Additionally, *Continental* has issued its first *Informe Annual 2005 de Responsabilidad Corporativa*, which includes details on the environmental footprint of the Bank's operations reporting water, electricity, diesel and printer toner consumption, solid waste generation, paper recycled, and CO₂ emissions generated by Bank-operated vehicles. This report also mentions several social programs *Continental* is involved in through its Foundation, which include community outreach programs, and a special alphabetization program through out the country.

Continental has a Code of Ethics which documents non-discriminatory policies. Based on information provided by *Continental* its loan/mortgage approval and/or foreclosure procedures is equitable, fair and unbiased in terms of social factors (e.g., gender, age, sex, ethnicity, or cultural heritage etc.). There were no noted major labor problems associated with *Continental* and the company reports to practice fair and unbiased labor practices related to sex, age, ethnicity, cultural heritage, and collective bargaining. *Continental* has a well-developed human resource department which keeps statistics of the payroll, disaggregated by gender, age, and hierarchy. Even though there is a homogenous gender distribution with an even number of men and women across the Bank, at higher hierarchical levels the ratio of men to women is roughly 4:1. Currently the Bank does not have any employees with physical disabilities.

Environmental and Social Requirements.

The Bank will require as part of the Loan Agreement that *Continental* complies with all applicable environmental, social, health and safety, and labor regulatory requirements of Peru and with all environmental and social provisions of the Loan Agreement. Additionally, prior to closing the Subordinated Tranche, *Continental* will inform the Bank regarding the remaining steps to fully adapt to the Equator Principles, including the development of an Environmental, Social and Health and Safety Action (ESHS Plan) in form and substance satisfactory to the IDB, including as a minimum (i) a timetable for the development and implementation of an Environmental Management System (EMS) for all of *Continental's* financial operations (e.g. corporate and commercial loans, mortgages, etc), and (ii) a plan of action to provide greater opportunities for women to reach higher levels in the organization, as well as the inclusion in the payroll more employees with physical disabilities.