

# ENVIRONMENTAL AND SOCIAL MANAGEMENT REPORT

## Access2Services-Brazil and Chile

### 1.0 PROJECT DESCRIPTION

#### A. The Borrowers:

- 1.1 **Banco BICE** is a multiple service bank specialized in offering financial services to mid size companies and small corporates. Banco BICE also serves the retail segment, basically individuals in the ABC1 segment, and together with its subsidiaries offers comprehensive financial services that range from commercial lending to investment management, advisory, leasing and securities and insurance brokerage.
- 1.2 **Bicbanco** is a multiple service bank within the middle-market segment of the Brazilian Banking system. Bicbanco is specialized in offering commercial credit to more than 7 thousand SME clients in Brazil, keeping its focus on working capital transactions guaranteed by receivables and short maturities.
- 1.3 The transaction consists of two senior loans to Banco BICE in Chile (US\$50,000,000 unsecured A loan) and Bicbanco in Brazil (US\$50,000,000 unsecured A Loan plus approximately US\$200,000,000 unsecured B Loan). The core proceeds of the loans will target:
  - a. Green financing in the case of Banco BICE, whereby the bank will focus the portfolio growth on environmentally sustainable projects, such as renewable energy, energy efficiency, sustainable forestry, biofuels, sustainable transportation, sustainable tourism, sustainable agriculture, sustainable building, cleaner production.
  - b. Support for the SME portfolio growth in the case of Bicbanco, in particular the smaller segment of its portfolio and located in the less developed Center and Northeast States of the country (i.e., Pará, Pernambuco, Rio Grande do Norte, Bahia, Goiás and Mato Grosso).
- 1.4 These core activities will be accompanied by a pilot project to support the development of the Access2services Lines in the health and education sectors. The pilot will require projects to: draw a minimum percentage of beneficiaries from low-middle income groups or be located in low to middle income municipalities, and have all licenses to operate. The pilot will include financing for the following eligible activities: ( **a** ) **Health:** General and specialized hospitals, Ambulatory Clinics, Child Care, Elderly Care, Rehabilitation Centers, Pharmacies, Ambulances, Test laboratories; ( **b** ) **Education:** Primary, secondary and higher education, Vocational and professional training, Teachers and educators training centers, Instructional model consulting firms, School food suppliers, School transportation suppliers, Scientific research centers.
- 1.5 **Financial Intermediary:** Based on Directive B.13 of the Bank's Environment and Safeguards Compliance Policy (OP-703), and given that the borrowers of the proposed credit

facilities are financial intermediaries (FI); this transaction is not categorized according to its potential environmental and social risks and impacts. Some of the sectors identified for the use of loan funds are low or medium risk (i.e., the health and education sectors, and sustainable building and other green line projects depending on location and scale); however, biofuels, small hydros and agribusiness or other SMEs in the Northeast of Brazil, as well as some of the industrial sectors served by both banks (mining, forestry, paper, textiles, sugar and alcohol, etc.) have the potential to have significant social and environmental impacts and risks (see Section V). Consequently, it is expected that individual transactions may include subprojects that if classified according to IDB's classification system could fall in categories A (high) -very unlikely and only in the case of hydros in BICE-, B (medium), or C (low) impact. As a result, this operation is considered as a low to high risk financial intermediaries operation.

## **2.0 TRANSACTION OVERVIEW**

### **A. Banco BICE, Chile**

- 2.1 Banco BICE focuses on two main segments: 1) wholesale banking specializing in businesses of all sizes, but concentrated on medium companies and small corporates; and 2) retail banking, concentrated on middle to higher income individuals. Banco BICE's wholesale portfolio includes several sectors such as real-state, agro industry, retail sales, electricity, gas, water, health, education, mining and forestry. The breakdown of the commercial portfolio by economic segment includes a variety of segments such as, construction, agribusiness, infrastructure, mining, forestry, food industry, paper, textile, fishing, and others. The retail portfolio is still small and includes housing, credit cards and consumer loans, with a higher concentration on housing.
- 2.2 Banco BICE's green lending which will be supported by the operation focuses on non-conventional renewable energies (small and medium renewable energy plants, according to the terminology of the Chilean Ministry of Energy). Projects in this area remain relatively small and primarily focused on mini hydro power plants. Currently, Banco BICE has a total of 15 projects in its portfolio for an amount of US\$200 million and 85MW of installed capacity. Projects range from very small hydros (3 MW) to projects up to 12MW.
- 2.3 The funds will provide Banco BICE with long-term on balance sheet funding to finance primarily Banco BICE's development of an environmentally sustainable loan portfolio in line with the Green Lines Generic Eligibility Guidelines to be agreed between BICE and IDB. In addition, the proceeds will also be used to finance the health and education sectors in line with the Pilot Project Eligibility Criteria to be agreed between BICE and IDB. The core proceeds of the Loan to Banco BICE will be in line with those established under the Green Line's eligibility criteria, that is, environmentally friendly projects such as renewable energy, energy efficiency, sustainable forestry, biofuels, sustainable transportation, sustainable tourism, sustainable agriculture, sustainable building, and cleaner production. The concentration in renewable and mini hydros, is expected to continue and also to include other renewable energy projects such as biomass projects, wind power projects and solar power plants.

### **B. Bicbanco, Brazil**

- 2.4 Bicbanco is specialized in offering commercial credit to more than 7 thousand SME clients in Brazil, keeping its focus on working capital transactions guaranteed by receivables and short maturities; this concentrates 96% of its portfolio. Bicbanco's portfolio includes several sectors, such as construction and real estate, sugar and ethanol, medical services, transport, retail, health and education services, and several others. Bicbanco serves SMEs with annual sales between US\$30 million to US\$300 million. Portfolio breakdown per economic sector is as follows: follows: industry 44.0%, services 33.6%, commerce 13.5%, individuals 3.7%, agriculture 2.3%, public sector 1.7% and financial intermediaries 1.2%.
- 2.5 The funds will provide Bicbanco with long-term on balance sheet funding to finance primarily the SME portfolio growth, particularly in financially underserved areas of Brazil such as those of the Center and Northeast States of the country (i.e., Ceará, Pernambuco, Rio Grande do Norte, Bahia, Goiás and Mato Grosso). In addition, proceeds will also be used to finance the health and education sectors in line with the Pilot Project Eligibility Criteria.

### 3.0 **INSTITUTIONAL AND LEGAL FRAMEWORK**

3.1 **Applicable Sectors and Institutional Framework:** The sectors designated to receive financing are (1) Green lines in Chile, (2) SMEs in the Center and Northeast of Brazil; and (3) health and education sectors.

3.2 **Applicable Legislation in Chile:** The relevant regulatory framework is established in the *Ley de Bases Generales del Medio Ambiente* (Law 19.300) and its complementary norms (regulations, quality standards, emission standards, decontamination plans) in addition to the environmental management instruments such as the EIA system which are publicly available at the CONAMA and Environment Ministry websites.

3.3 **Applicable Legislation in Brazil:** The relevant regulatory framework includes a complex set of laws and regulations including State and Municipal laws (which are key with respect to environmental assessment and licensing) and, among others, the major framework laws listed below as identified in Bicbanco's environmental policy documentation:

LAW N°. 6938 -- 1/08/1981.	Establishes the National Environmental Policy its objectives, application and formulation mechanisms.
LAW N°. 6902 --27/04/1981	Regulates the establishment of Ecological Stations, Environmental Protection Areas and related provisions.
LAW N°. 6803 -- 02/07/1980	Establishes basic directives for industrial zoning in critical pollution areas.
LAW N°. 5868 -- 12/12/1972	Establishes the national system of rural cadaster.
LAW N°. 6766 --19/12/1979	Regulates the subdivision of urban land
LAW N°. 5197 -- 03/01/1967	Regulates fauna protection.
LAW N°. 5106 -- 02/09/1966	Establishes fiscal incentives for Forest enterprises.
LAW N°. 4771 -- 15/09/1965 amended by LAW N°. 5870 de 26/03/197	Institutes the new Forest Code.
LAW N°. 7347 -- 24/07/1985	Regulates civil public action for liability related to damage caused to the environment, to consumers, to property and rights of artistic, esthetic of historical value.
LAW N°. 7802 --11/07/1989	Regulates research, experiments, production, packing, labeling, transport, storage, commercialization, advertising, utilization, importation, exportation, final disposal of residues and packaging materials, registration and classification, control, inspection and verification with respect to agrochemicals and their components.
LAW N°. 7754 --14/04/1989	Establishes measures for the protection of forests at the nascent of rivers.
LAW N°. 7735 --22/02/1989	Creates the Brazilian Institute of Environment and Natural Resources.
LAW N°. 7661 de 16/05/1988	Institutes the National Coastal Management Plan.

LAW N°. 7653 -- 12/02/1988	Alters arts. 18, 27, 33 e 34 of Law n° 5197 (1967) on fauna protection.
LAW N°. 8171-- 17/01/1991	Agricultural Policy.
Law N°. 8001 -- 13/03/1990	Defines the percentage of distribution of financial compensation under Law n° 7.990 (1989).
Law N°. 7990 -- 28/12/1989	Establishes financial compensation for States, the Federal District and Municipalities as a result of the exploitation of oil and natural gas, water resources for generation of electricity, and mineral resources in their respective territories, continental platform, territorial sea or exclusive economic (Art. 21, XIX of the CF).
Law N°. 7805 -- 18/07/1989	Alters decree-law no. 227 (1967) and creates the regime of permits for “garimpo” activities.
Law N°. 8005-- 22/03/1990	Collection and update of the credits of the Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis (Ibama).
Law N°. 8112 --11/12/1990	Juridical regime for federal public servants.
LAW N°. 6453 de 17/10/1977	Regulates civil and criminal liability for damages and actions related to nuclear activities.
LAW N°. 8666 de 21/06/1993	Regulates art. 37 (XXI) of the Federal Constitution on bidding and acquisition rules for the Public Administration.

3.4 **Compliance Status:** BICE and Bicbanco are implementing their respective Environmental Management Systems, which include screening intended to review the compliance of the companies and/or projects they finance with applicable Chilean and Brazilian legislation (see Section 5) and, where applicable, with exclusion lists and other MDB Lender requirements.

3.5 The proposed operation will provide the opportunity to review the effectiveness of these systems and, integrate additional procedures, if necessary, related to the implementation of the IFC performance standards, and hence international good practices in the benchmarks and monitoring tools utilized by the Borrowers under their existing systems, at least with respect to the transactions funded with the proceeds of the IDB’s loans.

#### **4.0 ENVIRONMENTAL AND SOCIAL RISKS AND IMPACTS**

##### **A. Existing Portfolio**

4.1 The Bank may face potential reputational risks from BICE’s and BIC’s overall portfolios particularly in the hydropower sector in Chile, and agribusiness, meat production and other industries in Brazil. Other reputational risks for the Bank could potentially arise from BICE and Bicbanco projects involving agriculture, aquaculture and livestock, biofuels, sustainable forestry and compliance with pollution prevention requirements in other industrial sectors. These potential risks include the possibility that projects have directly or indirectly caused the conversion of natural habitat and loss of biodiversity, increased soil erosion and sedimentation, used banned pesticides, violated Brazilian or Chilean labor laws, or used land without a clear title. The large number of projects and short average loan tenure makes it virtually impossible to fully assess the reputational risk to the Bank from the current portfolios.

4.2 However, BICE and Bicbanco are respected banks with well established business lines and MDB experience and currently apply E&S policies and procedures that consider compliance with Chilean and Brazilian laws and with applicable MDB Exclusion Lists. Both countries have fairly comprehensive frameworks that consider major social and environmental risks and impacts. Therefore, provided that BICE and Bicbanco continue to implement their E&S

management systems, the probability of a any reputational risk to the Bank should be manageable as demonstrated by the experience to date.

4.3 As outlined in Section 6.0 below, adherence to IFC performance standards would further mitigate these risks with respect to the use of proceeds, and would also contribute to the Borrowers' overall capacity to adhere to international good practices. Given the challenges inherent in the application these standards, Bank supervision will play an important role.

## **B. Environmental Risks and Impacts of the New/Proposed Operations**

4.4 Below is a brief overview of the potential social and environmental risks and impacts associated with some of the key sectors in which the loan funds will be invested. Many of these are considered low to “significant” by the Bank, which necessitates that BICE and Bicbanco, through their ESMSs or otherwise will have to require some of their clients to evaluate and manage the environmental and social risks and impacts of the projects and activities financed with the use of proceeds, as discussed in more detail in Section 6 below.

**4.5 Agriculture, biofuels and sustainable forestry projects:** The environmental and social risks and impacts involved with projects in these sectors generally include habitat alteration, loss of biodiversity, introduction of non-native or invasive species, impacts on water quality, loss of soil productivity from erosion, hazardous materials management, aesthetic impacts, occupational health and safety issues, and community health and safety issues. Mainly, the establishment of plantations may involve the conversion of the existing vegetation cover to native and/or non-native commercial species, resulting in the potential loss of habitat diversity and a corresponding loss of wildlife and plant species. On-going agricultural concerns, besides needing to demonstrate that their land take is compliant with biodiversity and land rights requirements, (may also present ongoing issues related to: exotic species—intentional or accidental introduction, water use and quality—negative impacts on downstream biota and communities, or fisheries due to water withdrawal, erosion, contamination from effluents and run-off, changes in water temperature; soil erosion and productivity loss due to change in vegetation cover, erosion, water channeling, impacts to chemical balance and micro flora and fauna; hazardous materials management including minimization of agrochemical use, storage, disposal and management of spills of lubricants and agrochemicals; occupational health and safety and overall labor standards—physical hazards, noise and vibrations, exposure to fires and pesticides, labor practices; community health and safety—exposure to fire and pesticides, heavy vehicle traffic, impacts on water quality and availability; and other social impacts such as deterioration of access or quality of natural resources—impacts on subsistence activities and on recreational and tourism use.

**4.6 Renewable Energy: (a) Wind farms: the social and environmental** impacts from wind farms include habitat loss and biodiversity issues, soil erosion and sedimentation, noise, bird/bat collisions, occupational health and safety, community health and safety, and aesthetics. **(b) Small Hydro:** Small-scale hydro schemes tend to have relatively modest and localized impacts on the environment that arise mainly from construction activities and from changes in water quality and flow on ecosystems (aquatic ecosystems and fisheries) and on water use. However, there is need to evaluate carefully the context in which they are placed and their

potential cumulative impacts. The factors that harm a river habitat with large hydropower projects are also at play with small projects: interrupted water flow, barriers to animal movement, water loss from evaporation and loss of biodiversity from the sacrificed portion of the river are some examples. Smaller dams also present additional issues related to storage that may require construction of more low-head systems than anticipated, silting and nutrient overloading more easily eutrophication due to shallower depth, and more methane per unit area than a deeper water bodies and overall greater disruption per kilowatt of power generated.

**4.7 Rural/Sustainable Tourism:** the environmental and social impacts and risks from rural tourism include construction and traffic impacts, , social impacts from the use and restriction of resources and influx of outsiders, resource consumption, air emissions, generation and treatment of wastewater, hazardous materials management, waste generation and disposal, , noise, the use of pesticides.

**4.8 Health and Education Facilities:** These facilities which are at the core of the projects targeted by the pilot Access2services program require routine attention with respect to construction impacts and risks. In addition, site screening with respect to seismic risk in Chile, flood risk in Brazil, other natural hazards and contaminated land and nearby sources of pollution and noise is also necessary. Furthermore, health facilities require specific attention to management of waste, emissions to air and waste discharges, and the implementation of health waste management systems that address the segregation and appropriate disposal of medical wastes and address the occupational hazards for medical and health personnel as a result of exposure to infections and diseases.

**4.9 Positive Impacts/Benefits:** The engagement of local FIs in funding high social added value investments is key to ensure a sustainable source of funding to these sectors in the long run. The proposed project will be the first of IDB support of health and education sectors through FIs and will help IDB advance towards its goal of promoting economic, social and environmental sustainability.

## **5.0 ENVIRONMENTAL, HEALTH & SAFETY, SOCIAL, AND LABOR MANAGEMENT**

**5.1 Environmental, Social, Health and Safety Management Systems:** BICE and Bicbanco have in place ESMSs under which they have been working with MDBs including IIC in the case of BICE and IDB and IFC in the case of Bicbanco. Their respective systems are described in more detail in this Section.

**5.2 BICE :** has in place an environmental policy since 2007 that encompasses: (i) implementing corporate environmental values through the risk evaluation methodology established as part of the credit evaluation process of its corporate banking; (ii) require compliance with the environmental management conditions established in the agreements entered into with multilateral financing institutions; (iii) mitigate credit risks through the recognition and control of risks associated with companies and sectors that have medium to high exposure to

environmental risks; and (iv) support the generation of a corporate culture that attaches importance to management of environmental risks.

- 5.3 BICE has an environmental coordinator who answers to the Credit Manager and is in charge of defining and managing environmental risks in the credit process, training account executives with respect to environmental risks, and implementing and reporting on the environmental and social requirements of multilateral lenders. The standards applied by BICE are essentially those established by Chilean laws and regulations including those related the environmental assessment process. Under a contract with the IIC, BICE has also applied the IDB's Exclusion List and reported satisfactory performance in October 2010.
- 5.4 **Bicbanco** has an environmental policy and procedure, in place since June 2011,<sup>1</sup> that requires each client and supplier to be assessed with respect to environmental and social performance on the basis of generic and for key sectors sectoral questionnaires.<sup>2</sup> Particular focus is given to compliance with relevant Brazilian laws and regulations. Clients who are found to have infractions with respect to use of slave, child or analogous labor, or environmental crimes may have their access to credit restricted. Bicbanco also classifies its clients in High, Medium and Low Risk according to sustainability questionnaires and to standardized ratings and reports issued by a third party (SERASA Experian). Non-complying and high risk clients may be barred from credit or required to implement a corrective Action Plan. Bicbanco also applies Exclusion Lists to operations funded with the proceeds of MDB loans including IDB. Bicbanco system calls for annual supervision and reporting.<sup>3</sup>
- 5.5 Bicbanco's policy and procedures contemplate the mainstreaming of its environmental and social requirements by assigning roles and responsibilities for implementation as follows:
- Agency network and central administration—conducts the client analysis, requesting clients to fill out the sustainability questionnaires, and communicates issues and required actions to clients.
  - Credit Area—considers the environmental and social rating in the credit process.
  - Sustainability Area—supports other areas in complying with Bicbanco's sustainability policy though training, tools, information systems and contractual follow-up.
  - Illegality Prevention Area—updates lists of infractions and client profiles monthly or based on media reports, with respect to slave and child labor issues and environmental crimes and issues alerts to other areas, including referring matters to the Blue Committee.
  - Blue Committee---evaluates infraction and non-conformity situations and recommends credit bars or restrictions.
  - Governance Committee ---makes final decision on client bar, restriction or rehabilitation.

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<sup>1</sup> Bicbanco has implemented a number of changes to its ESMS in the last year. Many of these changes were initiated in response to a compliance review undertaken under an existing IDB operation that identified the need for strengthening Bicbanco's policies and practices.

<sup>2</sup> Currently model sustainability declarations are available for 10 sectors, in addition to the generic format: agribusiness, construction and engineering, metallurgy, health, commercial services, energy generation and distribution, transport and logistics, food industry, meat processing, sugar and alcohol.

<sup>3</sup> In 2010, Bicbanco was ranked Brazil's most sustainable medium-sized bank by the Management & Excellence consulting firm/Latin Finance Magazine for the fourth consecutive time. The ranking follows criteria which measure corporate governance, sustainability and social responsibility. Bicbanco was ranked third in Latin America. Bicbanco is also part of the ISE.

- Transparency, equity and accountability area—prepares compliance reports and compiles rating documents and questionnaires.

5.6 Bicbanco's and BICE's systems are fundamentally geared to respond to the requirements of local laws and to apply existing MDB's environmental requirements. Both banks are currently engaged in the sectors to be served by the use of proceeds which facilitates their understanding of the issues associated with these sectors., Both banks will keep enhancing their current systems if necessary to achieve and demonstrate compliance with the IFC performance standards and this could require specific efforts from the environmental and social management systems of each bank to strengthen their environmental and social due diligence and compliance assurance tools.

Furthermore, it is expected that the Green Line Eligibility Criteria would provide a further environmental and social risk mitigant.

## **6.0 RECOMMENDATIONS**

6.1 The use of proceeds will include projects that will generate low, medium and high risk environmental impacts (categories C, B and A under the Bank classification system) that require risk management measures consistent with the Bank's customary Environmental and Social Requirements for FIs, which for this operation include the following:

6.2 **Environmental and Social Requirements:** Compliance with Borrower policies, applicable laws and the IFC performance standards

6.3 **Management Systems:** Implementation of BICE and Bicbanco ESMS to the transactions funded with IDB's funds.

6.4 **Use of Proceeds Eligibility** application of IDB's List of Excluded Activities.

6.5 **Prior Consultation with IDB:** BICE will consult with the Bank before using IDB loan proceeds to finance any activities classified in category A (High impact under BICE's systems).

6.6 **Supervision and Monitoring:** BICE's or Bicbanco's environmental coordinator or responsible department will monitor Sub-Loan supported projects for compliance with the Environmental and Social Requirements. Project due diligence, monitoring and reporting is required for all Sub-Loans during the active phase of any investment in accordance with the scope commensurate with the category assigned to the project according to the level of risk or impact. On an annual basis, and at the time of delivery of the Annual Review of Operations (ARO) and other supervision reports, the Borrower will present an environmental and social compliance report according to the standard format included in the loan agreement, including monitoring reports for each active Category A operation, funded with IDB use of proceeds, in a format that covers the applicable environmental and social requirements. ESG will work with the client in order to review the operations during



supervision to implement the actions needed to fulfill the Environmental and Social Requirements including the IFC Performance Standards.