

Environmental and Social Management Report
Brazil
Banco ABC Brasil Green Financing Partnership
(BR-L1413)

I. Project Description and Background

- 1.1 The objective of the proposed Green Financing Partnership with Banco ABC Brasil, S.A. (“ABC”) is to expand access to long term financing for eligible private environmentally-friendly investments in Brazil, in particular S&E and biomass projects. The Partnership consists of a senior unsecured loan for approximately US\$150 million, comprised of an up to US\$75 million A-Loan from IDB, an up to US\$25 million Co-loan from the China Co-Financing Fund for Latin America and the Caribbean, and an approximately US\$50 million B-loan to be syndicated among international financial institutions. Under this Green Financing Partnership, the use of proceeds is exclusively for ethanol, sugar, and biomass on-lending.
- 1.2 Through the proposed Partnership, IDB will provide ABC with stable and targeted long-term financing, otherwise insufficient in the market, and with specific technical tools to support the growth of its green lending portfolio in Brazil. This would contribute to expand the availability of private sector financing to eligible biofuel and biomass producers in adequate terms and conditions, thereby supporting productivity, capacity expansion and pre-export investments in these sectors in order to address Brazil’s required energy supply expansion and the continued transformation of its energy matrix towards a more climate-friendly mix.

II. Project Status and Compliance

- 2.1 The Environmental and Social Strategy (ESS) for the Project was presented 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.
- 2.2 ABC is in the process of developing an Environmental and Social Management System (ESMS) following a loan agreement signed with IFC in March 2014. The ESMS will ensure compliance with local law in Brazil, the IFC exclusion list, and procedures for evaluating, managing and monitoring E&S risks for SMEs. Under IDB’s Green Financing, ABC will target corporate lending to exclusively sugar, ethanol and biomass producers for pre-export finance, working capital, sugar cane fields re-planting and expansion, merchandizing the harvest, equipment purchase and potentially mill capacity expansion, among other uses of funds, for values averaging US\$5 million. Due to the use of proceeds, sector, and loan values, this operation is classified as medium risk (FI-2).
- 2.3 ABC has confirmed that it is in compliance with Directive B.2 (country laws and regulations) of IDB Environmental and Safeguards Compliance Policy, complying with

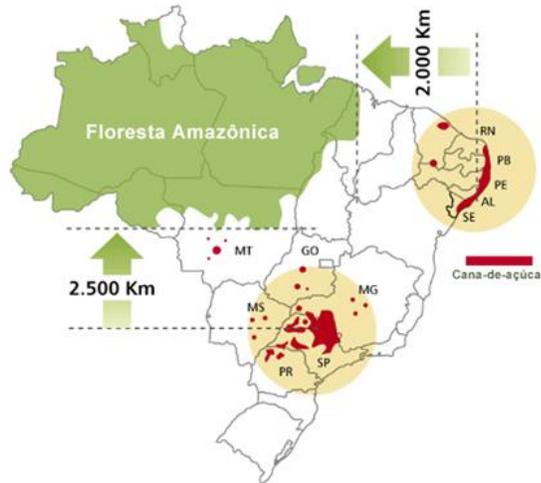
all applicable legal and regulatory environmental, social, health and safety, and labor (ESHS&L) laws and regulations.

III. Environmental and Social Risks and Impacts

A. *Potential risks and impacts associated with ABC's portfolio*

- 3.1 As a mid-tier corporate bank, ABC has targeted clients across sectors providing various types of corporate, trade and pre-export-related finance. Its most significant portfolio concentrations are across the following sectors: Financial Institutions (17.2%), Heavy Industry (11.2%), Agribusiness (10.6%), Cooperatives (8.4%), Transport (7.1%), Buildings and Real Estate (6.1%). Other sector lending with the potential for environmental and social impact include Construction and Utilities, both of which represent 5% or less in their portfolio. The bulk of ABC's financing has been directed at operation finance rather than investment finance (excluding loans financed by the BNDES credit line¹), mainly because of the limited availability of long term funding to match investment project maturities. ABC's primary financial products are equipment finance (25%), 3-5 year pre-export financing (20%), guarantees (16.4%), export credit notes (12.5%), working capital loans (9%), and letters of credit (5.4%). Under IDB's proposed Green Financing, ABC would expand its credit portfolio of pre-export finance and working capital and identify potentially larger ticket specific financing in the sugar, ethanol and biomass sectors. For ABC's sugar, ethanol and biofuel current credit portfolio, the average tenor of loans is as follows: up to one year (46%), 1-2 years (25%), 2-3 years (16%) and 3-5 years (13%).
- 3.2 In the context of ABC's lending operations, the ESHS impacts and risks associated with sub-loans can be minor to significant in nature. Specific to sugar, ethanol and biomass, the focus of this Green Financing, the ESHS risks could include, among others: i) land degradation and conversion (land use change) and impacts on water bodies (extraction, diversion, run off); ii) community impacts (land acquisition, tenure, impact on economic livelihoods); iii) biodiversity impacts associated with conversion of natural habitats and in rare cases impacts on critical natural habitats (crop plantation); iv) worker health and safety impacts during harvest (biofuels, agriculture); v) labor related issues (plantation, operation); vi) local food security concerns whereby biofuel feed stocks replace local food crops (biofuels); vii) contamination and waste and effluent management issues (agriculture, biofuels). These risks will be managed through the application and operation of ABC's Environmental and Social Management System (ESMS) to ensure application of local law, IDB exclusion list, and specifically IFC Performance Standards for sub-loans with a project size in excess of US\$10 million under IDB's Green Financing.

¹ This is exclusive to ABC's credit line with BNDES, specifically dedicated for equipment financing across sectors, which includes its own environmental and social evaluation (see Section IV).



3.3 Brazil retains a dominant global position in sugarcane production due to its relative low cost and high yield. The market forecast for 2013-14 estimates that roughly 597 million cubic meters will be crushed of which 45% will be converted to sugar (55% to alcohol), with an average of 60% being exported. Production is concentrated in the northeast and mid-south region of the country (see adjacent map²). As sugar and ethanol represent a significant portfolio concentration (10.6%), ABC conducts an annual market analysis on the sector to identify thematic trends among their 83 clients within the sector. Several dominant themes include: (i) higher production costs and lower yield in northeast, which represents only 8% of crushing capacity, (ii) dominance of midsouth in production where 88% is mechanised, (iii) overall falling productivity due to poor weather, low international price, and need for crop renovation.³

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

3.4 ABC has stated that they have no material health issues (including legal claims) and do not have any material employee or labor disputes. ABC has also indicated that its credit application and analysis process is equitable, fair, and unbiased in terms of social factors (e.g. gender, age, ethnicity, or cultural heritage). ABC's guidelines for employee compensation (salary, pay raise, benefits) and analysis (evaluations) are based on the local legislation, following also Brazilian labor regulations. This is defined in their HR labor policy.

IV. Environmental and Social Management

A. ABC's Environmental and Social Management System (ESMS)

4.1 ABC is in the process of finalizing the development of its ESMS to comply both with the conditions set forth under a loan with IFC for SME lending, and in accordance with Brazilian Central Bank regulation that, as it has been anticipated, will in the near future require financial institutions to evaluate, manage and monitor environmental and social

² Brazilian Sugarcane Industry Association (UNICA). The map shows in red the concentration of plantations and mills producing of sugar, ethanol and bioelectricity.

³ Analysis prepared by ABC.

performance.⁴ ABC is drafting the details of the policy and E&S manual with support from an external consultant, and will present both documents to its Board for approval in August, 2014. The development of their ESMS is being done so as to align with existing procedures within ABC, define clear guidance, strategy and mitigants to environmental and social risk, and ensure that ABC's approach to environmental and social risk analysis is understood as an additional component of ABC's existing risk management culture.

4.2 The components of ABC's existing environmental and social analysis include the following components:

- **Exclusion and Restrictions List:** ABC applies the IFC exclusion list to all clients/loans, and limits their combination of loans and guarantees to defined 5% limit total in certain sectors like weapons, spirits, and tobacco.
- **Categorization:** ABC categorizes an operation based on the Ministry of Environment's (Conama) classification. Category A operations include activities in construction, mining, oil and gas, steel and metals, and chemicals. Sugar and alcohol are considered Category B operations by ABC's definition.
- **Questionnaire:** ABC applies a generic environmental and social questionnaire to all Category A clients, and for Category B clients with a credit limit in excess of BRL 20 million (approximately US\$8.8 million). The questionnaire requests information on E&S management, permits, internal capacity, track record of performance, certification standards, and amount and frequency of training, among other items. The questionnaire is treated as a self-declaration and signed by the borrower's legal representation.
- **Licensing Requests:** Licenses are requested currently only under their BNDES line, and when projects are considered 'project like' in nature.
- **E&S Analysis and Monitoring:** ABC's credit department undertakes E&S analysis. This is done through key word searches on various information portals, registry analysis to determine particular fines or lawsuits, and in instances where real estate is taken as collateral, an external E&S audit is undertaken to assess site specific contamination. The credit team evaluates each client's specific information on an annual basis.

4.3 E&S Management will be managed by the Risk department and carried out in close collaboration with Credit and Legal. The plan is to train four credit analysts to serve as E&S champions within ABC.

B. A Model for an Environmental and Social Management System, and Application of the IFC Performance Standards

4.7 On approval of IDB's Financing, and prior to making any investments, ABC will be required to enhance and apply their ESMS⁵, or alternatively design a specific procedure for the deployment of IDB resources (the "Procedure"), that complies with the Environmental and Social Requirements, in this case defined as ABC's Environmental and Social Policy (in development), E&S Manual (in development), the environmental, social, health and safety and labor laws and regulations of Brazil, the IDB List of Excluded Activities and the IFC Performance Standards (the latter specifically for sub-projects in excess of US\$10 million). The ESMS or Procedure will detail environmental, social, labor, health and safety

⁴ The details of this legislation and its actual application are pending.

⁵ IDB and ABC will agree to an action plan for implementation.

policies and procedures to properly identify, assess, categorize, mitigate and monitor the potential environmental and social impacts and risks associated with each sub-loan where IDB resources are used.

- 4.8. The specific and standard elements of the ESMS or Procedure will include: (a) a policy statement that sets forth ABC's policy and standards of performance, (b) roles and responsibilities for E&S management, coordination, and training, (c) review procedures to ensure compliance with ABC's policies and the IFC Performance Standards when applicable (exclusion list, eligibility, screening, categorization, environmental assessment requirements, due diligence, IFC ESHS guidelines, public disclosure, grievance mechanism, and investment agreements), (d) development of specific Environmental and Social Management Plans (ESMPs) and systems, as applicable, for loans supported by the IDB's Green Financing, (e) supervision and monitoring of the loan portfolio, and (f) reporting requirements on compliance with the ESMS or Procedure requirements, including compliance of loans funded with IDB's proceeds with applicable standards. In instances where ABC finances a project/operation considered as high risk⁶ according to the high risk categorization procedure agreed with IDB and for which the IFC Performance Standards apply, ABC will be required to conduct an independent environmental and social evaluation, identify gaps relevant to the IFC Performance Standards and include the necessary measures such as covenants or an action plan with the sub-borrower.

V. Environmental and Social Requirements

- 5.1 For this operation which will involve corporate lending under IDB Green Financing for an expected average value of US\$5 million per sub-loan exclusively to ethanol, sugar and biomass sub-borrowers, IDB will require ABC as part of the Loan Agreement to:
- (i) Comply with all applicable Brazilian environmental, social, health and safety, and labor regulatory requirements, and in relation to the financing of sub-loans with IDB's proceeds ensure that each loan complies with: (a) ABC's environmental, social, health and safety and labor related policies; (b) in-country regulations; (c) the IDB List of Excluded Activities for Non-Sovereign-Guaranteed (NSG) operations; (d) the Fundamental Principles of the Rights at Work; and (e) the IFC Performance Standards (the Environmental and Social Requirements) for specific sub-projects above US\$10 million, and for sub-projects below US\$10 million where the Biofuels Scorecard has triggered an orange flag (red flags are excluded).
 - (i) Enhance ABC's current ESMS, or develop a corresponding Procedure, specific to IDB's use of funds, to include, implementation of: (i) a High Risk Sector Checklist to categorize operations into Category A, High B, B, and C operations with corresponding management responses, to be agreed with IDB before closing, (ii) application of the IDB Biofuels Scorecard, (iii) policies and procedures to ensure compliance with the Environmental and Social Requirements (including the IFC Performance Standards as required) as detailed in paragraphs 4.7- 4.8 above. A final version of the ESMS and Procedure will be required to be

⁶ Assumed to be Category A operations, and some high risk Category B, which might present the potential for significant environmental and social impacts.

approved by the IDB and formally adopted and put into effect according to an agreed Action Plan by ABC prior to IDB disbursement and kept operational through the life of the IDB Green Financing.

- (ii) For IDB defined Category A operations, demonstrate that ABC has achieved the agreed management capacity milestones set out in the ESMS, and present each operation for IDB's non objection. For High Risk Category B operations, provide IDB with a summary E&S investment review for the first three sub-loans for IDB non-objection. In both instances, comply with the engagement of external experts as noted in paragraph 4.8.
- (iii) For asset specific sub-loans above a project size of US\$10 million, apply IDB's Greenhouse Gas calculator to estimate the net emissions reduced, and report on an annual basis. Engage with clients on discussions to certify their biofuel production in accordance with an agreed international standard.
- (iv) Assign roles, responsibilities and resources for the ESMS to a qualified Environmental Manager, and ensure that at least one staff member with responsibility for the ESMS 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, annually, to ensure that ABC continues to remain up to date with its environmental and social risk management expertise.
- (v) Present an Annual Environmental and Social Compliance Report (ESCR) with information on the Green Financing portfolio, including a list of individual investments and their E&S category breakdown of financing and Environmental risk categorization, and any particular risk issues identified during screening and mitigation measures agreed with clients. ABC will require Sub-borrowers to provide external review of their compliance reports for high risk operations as applicable in accordance with the monitoring provisions of the IFC Performance Standards, and may use the support from external experts to carry out its own monitoring when it considers necessary.

5.2 The IDB will supervise the environmental and social aspects related to the use of the proceeds of the IDB Financing either by an in-house specialist or with external consultants, and if necessary, will require actions to address impacts and risks and /or enhance their management.