Climate-Smart Agriculture (CSA) Risk Sharing Facility for MSMEs

Environmental and Social Management Framework (ESMF)

The Environmental and Social Management Framework (ESMF) describes how the environmental and social impacts and risks of the Facility will be managed and supervised by the Financial Intermediaries (FI), acting in the capacity of Executing Entities (EE), when funding from Green Climate Fund (GCF) is delivered to the Facility's sub-projects. The ESMF presents the general context of the Facility, the process for evaluating FI capacity to manage E&S risks with an appropriately designed Environmental and Social Management System (ESMS), the minimum requirements for the ESMS and the technical funds that will be made available to enhance E&S management where necessary, and the monitoring process.

The ESMF follows the standards of IDB's Environmental and Safeguards Compliance Policy (OP703), as applicable to private sector investments, those of other relevant Inter-American Development Bank (IDB) safeguards policies (see Annex II) and sector guidelines and good international industry practice. The IDB will maintain supervision responsibilities in accordance with the Accreditation Master Agreement (AMA) and/or such other related arrangements with regard to the Programme.

Per relevant IDB Safeguard Policies and implementation arrangement, FIs will be required to develop and implement an Environmental and Social Management System (ESMS) commensurate to the risks. The ESMS will be evaluated, enhanced as necessary with technical cooperation, and implemented prior to first disbursement. The Facility will only permit FIs screened as FI-3 (low risk) or FI-2 (moderate risk) to be considered eligible. Eligible FIs will not be permitted to make loans to high risk (Category A) sub-borrowers.

I. Programme Description and Background

1.1 Agriculture is one of the sectors most vulnerable to climate change and is at the same time a driver and mitigant of the underlying causes of climate change. Therefore, moving the needle on climate change in the LAC region means working in agricultural and forest landscapes. However, climate-smart agriculture (CSA) projects in LAC often have difficulty securing financing for innovation or growth because the financial intermediaries that service this sector do not offer products tailored to the needs of agricultural producers experimenting with new processes or expanding from small, grant-funded pilots.

1.2 The Programme will create a risk sharing Facility that aims to unlock innovative and scalable financial instruments to support the investments in the area of CSA, targeting, during an initial first phase, Mexico and Guatemala. Selected partner Financial Intermediaries (FIs) can include banks/lenders, investment funds, and insurance companies all of which will have extensive experience in deploying financial instruments towards climate-smart agriculture, sustainable land use and forestry projects, as well as a demonstrable track record of working with small holders and micro, small and medium-size enterprises (MSMEs) active in the land use, land use change and forestry sector in the targeted countries. Through the Facility, it is expected that roughly 11,000 sub-borrowers will be reached across the agricultural and forestry supply and production chains. The Facility is expected to receive USD$20 million from the GCF and USD$10 million from the IDB/MIF and to leverage an additional USD$136 million from participating FIs and private sector partners.

1.3 Eligible sub-borrowers under each selected FI will include micro, small and medium-size agricultural producers, cooperatives and community-led MSMEs. Typical sub-loan sizes will range between USD$1,000-30,000 for micro and small-size end-borrowers, and will be used as working capital or for small-scale investment activities. These activities typically may include renovation, rehabilitation and maintenance of crops and productive assets (such as renovation of coffee crops), installation, maintenance or upgrade of climate-smart irrigation systems, bio-digesters, and purchase of climate-resilient animal breeds and seeds. Ticket size will be considerably higher, up to several hundred thousand dollars, for transaction where end-beneficiaries are agro-forestry processing SMEs and/or cooperatives, and in case of equity investments in extreme and catastrophic climate events re-insurance firms.

1.4 In conjunction with loans and grants from the IDB Group, and with substantial leverage of private sector partner funds, the Facility will offer four main types of financial products to the partner FIs: (i) long term and low cost debt funding to be used by the FIs to extend their lending portfolios in the sector of CSA, (ii) guarantee funds, to help the FIs increase the volume of CSA financing and absorb some of the “farmer risk”, (iii) equity investments, including one prospective investment in a regional re-insurance company focused on providing MSMEs with coverage for extreme and climate-related catastrophic risks, and (iv) grants, which will be used to provide technical assistance which can be used to finance, inter alia, feasibility studies, capacity development for FIs and end borrowers, and knowledge products, as well as to partially cover legal and structuring costs for some of the transactions where costs are proportionally large relative to the size of a transaction.

1.5 The participating FIs will provide two key types of financial products to the sub-borrowers: (i) long term debt products that match the needs of the agriculture and forestry sectors, which are not readily available in the market; (ii) insurance products, including parametric insurance, to provide mitigation tools against extreme climate event risks such as extreme foods and draughts, which are expected to occur more frequently and with increased intensity under climate change scenarios. FIs on-lending will target segments of the market that have traditionally limited to no access to the formal financial system. Per the Facility design, the FIs are targeting producers and MSMEs that a Development Finance Institution is unable to reach on a direct basis given the sheer number of transactions and their very limited size.

II. Overview of the Environmental and Social Context

2.1 Agriculture is one of the sectors most vulnerable to climate change, which disrupts value chains and reduces productivity and incomes, particularly for small holders. Similarly, agriculture can be both a driver and mitigant of the underlying causes of climate change. Conversion of forests to other uses, mainly agriculture, was the main source of greenhouse gas emissions in the Latin America and Caribbean (LAC) region between 2001 and 2010, averaging 1.9 billion tons of CO2e. At the same time, forests in the LAC region act as important carbon sinks, sequestering 440 million tons of CO2 equivalents.

2.2 In LAC, moving the needle on climate change means working in agricultural and forest landscapes. While many countries have recognized this reality in their national climate change initiatives (NAMAs, REDD+ strategies, NDCs under the Paris Agreement), countries often do not have the proper instruments to meet their goals, especially in terms of financing and technical assistance.

2.3 In Latin America, MSMEs represent the bulk of about 14 Million agricultural producers who, either individually or as members of a cooperative, participate in local markets and in complex global supply chains. With global food production estimated to increase by at least 60% to meet the demands of a 9 billion population by 2050, MSMEs in the region will need to address the low productivity cycles they are often stuck in. Between 1961 and 2007, the total annual agricultural productivity growth rate in the region was only 1.9 percent – lower than the 2.4 percent estimated for OECD countries. In Central America and Caribbean countries, where limited land availability is a key determinant of production expansion, the growth rate for the same time period was even lower: 1.1%.

2.4 As productivity remains stagnant, the expansion of the agricultural frontier, the indiscriminate use of fertilizers and pesticides, the use of water-intensive production methods and the increased climate variability and risk, pose significant new challenges for MSMEs and ecosystems alike. With the exception of a few sectors which have access to improved crop varieties and yields, through enhanced seeds and irrigation, most agricultural MSMEs in the region still operate within low tech-low investment contexts.

III. Facility Level Evaluation and Categorization of Participating FIs

3.1 Based upon the nature of this Facility to provide financing to FIs that will, in turn, offer financial products and services to small scale agricultural activities, there may be low to moderate indirect environmental, social or health and safety (ESHS) and labor risks and impacts typically associated with the agricultural sector[1]. Cumulative impacts are not a concern with this type of Facility. Nevertheless, pursuant to the relevant IDB environmental and social safeguards standards, applied in accordance with the Accreditation Master Agreement and/or such other related arrangements, specific environmental due diligence is required on each FI to ensure that appropriate and commensurate safeguards are adopted to manage sub-borrower environmental and social risks. Management of this risk will be the responsibility of the participating FI. The evaluation process undertaken by the IDB Group in assessing FI risks and capacity would typically include:

[1] These will vary depending on site specific locations, though are expected to be minimal to moderate in light of the small scale and investment nature (climate-smart agriculture investments). The environmental impacts could include water use, soil erosion, pesticide use, crop residue management, and wastewater management among others. Social impacts may be related to occupational, health and safety and possible physical and chemical hazards associated with pesticide exposure.

i. *Screening* – A standard questionnaire will be sent to interested FIs to evaluate portfolio risk as it pertains to E&S issues. The questionnaire will evaluate likely sub-loan size, tenor, sector, use of proceeds (e.g. working capital, land expansion, investment, etc.), local legislation and adequacy to mitigate typical agricultural risks, geographic location/concentration of sub-borrowers, and country context.

ii. *ESMS Evaluation* – A similar evaluation will be done on the FI's management capacity pertaining to E&S issues. In this sense, the FI will be evaluated on the use and application of an ESMS, the adequacy and sophistication of the system, previous work or existing action plans with other Development Finance Institutions, sub-borrower screening/evaluation process, portfolio risk related to E&S issues, use of action plans to correct identified non-compliance issues, and monitoring process. Section IV below describes the general parameters for the ESMS.

iii. *Categorization* – On the basis of the E&S risk profile of the sub-borrowers combined with the capacity evaluation of the FI, a risk determination will be made, classifying the FI as either low risk (FI-3) or medium risk (FI-2). Higher risk FIs (FI-1) will not be considered under this Facility. Where warranted, the IDB Group's E&S Specialist will undertake a visit to the FI as part of the E&S due diligence process. The risk level will guide the general expectations and requirements pertaining to the scope of the ESMS and the possible use of technical assistance to enhance a given FI's management capacity.

IV. FI Level Procedures for Evaluating Sub-Borrowers - ESMS

4.1 Per the standards of the applicable IDB Environmental and Safeguards Compliance Policy (OP-703), FI borrowers will be required to adopt and implement an ESMS. The specific and standard elements of the ESMS will include: (a) a policy statement that sets forth the FI's policy and standards of performance, (b) roles and responsibilities for E&S management, coordination, and training, (c) review procedures to ensure compliance with the FI's own policies and specific IDB Policies if and when applicable and with the use of customized checklists, (d) development of specific environmental and social action plans as applicable, for loans supported by the Facility, (e) supervision and monitoring of the loan portfolio, and (f) reporting requirements on compliance with the ESMS requirements, including compliance of loans funded with IDB's proceeds with applicable standards, and (g) incorporation of a grievance mechanism as applicable.

4.2 *High Risk Exclusion* – Due to the small dollar amount and the low risk nature of the activities to be financed, resettlement, indigenous peoples, and cultural heritage concerns are unlikely. For the avoidance of doubt, Facility contracts with participating FIs will explicitly exclude these activities from IDB financing.

4.3 *Specific E&S Management* – The participating FI will have to designate a responsible E&S Manager with an appropriate background as the individual responsible for undertaking E&S risk analysis on individual sub-loans, reporting to senior management and areas of concern, and monitoring performance over the life of the individual sub-loan. This individual will serve at the IDB counterpart in periodic evaluation of individual FI performance with regard to the application of IDB Safeguards and operation of the ESMS.

4.4 *Grievance Mechanism – Each participating FI will be required to implement a Grievance Mechanism that can process and respond to individual complaints raised and associated with a particular sub-borrower financed. Where possible, the FI will be expected to manage related complaints and report back to IDB on their resolution.*

4.5 *Monitoring* – In all instances, FIs will be required to submit E&S Compliance Reports that will detail E&S risks present in the portfolio, loans avoided and why, action plans required, sub-project categorization, etc. Additionally, the IDB Group will make available on a voluntary basis a screening and portfolio management tool that will allow the FI to remotely monitor sub-loans through the use of satellite imagery in screening for unintended deforestation.[2] When required, an external consultant will also be engaged to assess the implementation of a given FI's ESMS to determine possible areas for improvement. IDB Group also reserves the right to monitor the implementation of the Bank's requirements and to visit sub-projects as necessary.

V. Consultation

5.1 IDB will engage in a consultation process as part of identifying the specific niche for the FI product being offered. This consultation will be conducted with interested and relevant stakeholders in designing the end-beneficiary product. This process will evaluate whether there are material environmental and social concerns at the end-borrower level that will need to be adequately managed by the FI and incorporated within the ESMS. Given the low risk and small dollar value of sub-loans, it is unlikely that there will be commonly held concerns that are exacerbated by the financial product in question. At the end-beneficiary level, the use of proceeds (working capital, renovation finance, etc.) are unlikely to generate neighbor or other community concerns.

VI. Capacity Building and Technical Assistance

6.1 Roughly USD$3 million in Technical Assistance funds will be channeled through the Facility, including GCF and IDB/MIF funds. These funds will be used for the following main classes of activities:

(i) Capacity development and access to market support for MSMEs end-borrowers. This will include the majority of the TA funds, amounting to roughly two thirds of the total TA envelope. This technical assistance may take the form of consultancies for (i) agricultural extension services for MSME producers; (ii) training to increase productivity and incorporate climate-smart practices and technologies; (iii) feasibility studies for climate-smart interventions in the processing or warehousing of agricultural products; (iv) specialized financial product design by financial institutions; (v) linkage to high-value markets or to value chain actors; (vi)

[2] The tool is called Global Forest Watch Finance, and is being developed by the World Resources Institute in partnership with InterAmerican Investment Corporation. The tool is expected to be live and publicly available by September 2017.

certification (such as Forest Stewardship Program (FSC), various “organic” certifications, etc); or (vii) limited funds may be used to support capacity development for the installation of decentralized small scale renewable energy and efficiency generation systems and/or adaptation technologies such as more efficient irrigation systems.

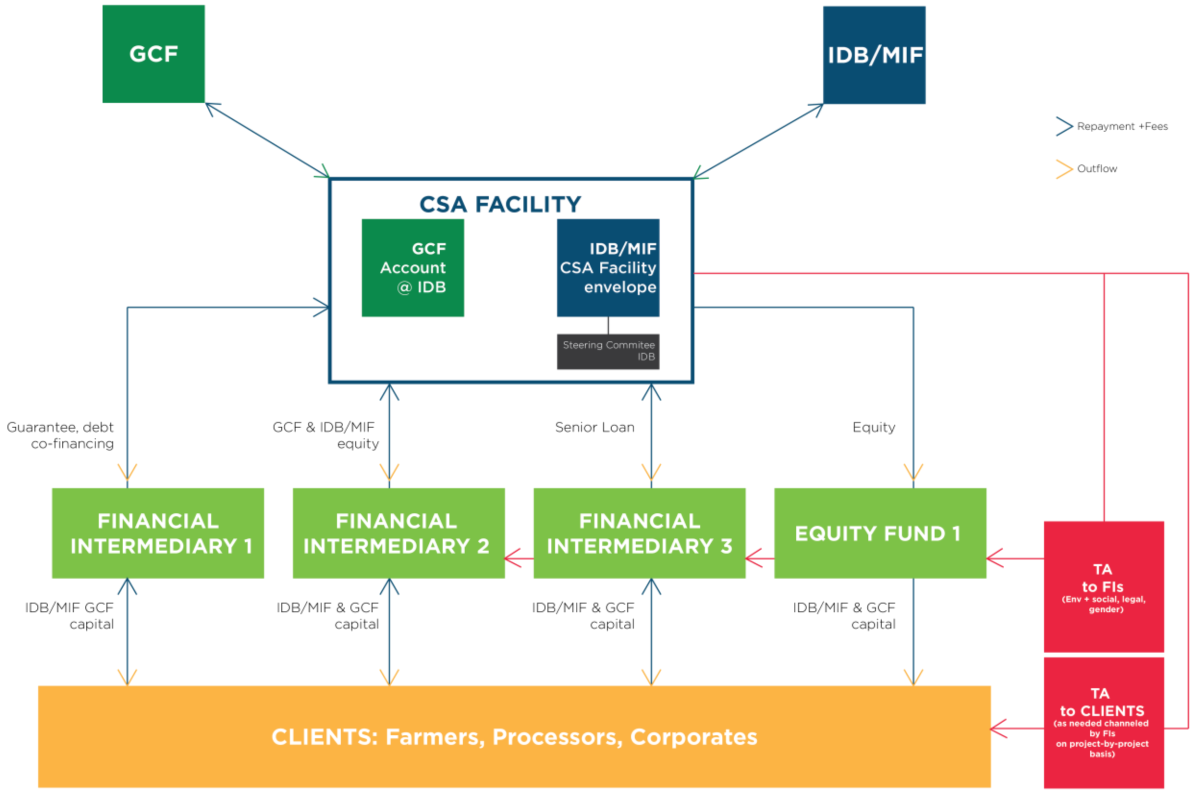
(ii) Support to participating FIs’ to strengthen their capacity for the structuring and implementation of environmental and social management systems (ESMSs) and mainstreaming of gender considerations. During the E&S due diligence, where gaps are identified with regard to key E&S issues, or further capacity building is required, the IDB Group will assist the selected FIs in preparing specific Terms of Reference for expert consultants to assist the FI in strengthening its ESMS and ensuring the presence of adequate safeguards and guidance tools in evaluating and managing funds under the credit line.

(iii) Support to the implementation of the Facility, including knowledge management and dissemination of results to a wide regional and international audience.

VII. Institutional Arrangements

7.1 The Facility will be governed by a Steering Committee in charge of key activities including pipeline origination, evaluation of transaction proposals from partners and development/structuring of individual projects using, IDB, GCF, and local partners’ resources. A Facility Coordinator will be selected through a competitive process, following IDB procurement policies. The Facility Coordinator will be in charge of the day-to-day activities necessary for the management of the Facility and will be responsible for validating investments match with the Facility’s investment criteria, ensuring that the Facility’s transactions demonstrate climate benefits and financially additionality, in line with the principle of minimum concessionality.

7.2 The IDB, as Accredited Entity, will maintain the responsibilities of the Programme to the GCF as per the terms to be agreed between IDB and GCF in the AMA and FAA. The Executing Entities will execute the implementation of the specific transactions to be co-financed with Facility resources, including the structuring and deployment of IDB and GCF capital into the Facility’s portfolio sub-projects. The Executing Entities will be subject to compliance with the Accreditation Master Agreement to be entered into between the GCF and the Accredited Entity and/or such other relevant arrangements. Supplementing this, at the sub-project level, rights and responsibilities of project sponsors, lenders, and other project parties will be defined under the sub-project contracts, completing the governance structure of the Facility. The structure of the proposed intervention is shown in the diagram below:



VIII. General Environmental and Social Requirements

8.1 For this Facility, which will involve lending to FI operations, IDB will require individual FIs to:

i. Comply with all applicable national environmental, social, health and safety, and labor regulatory requirements, and in relation to the financing of SMEs to ensure that each transaction/operation complies with: (a) in-country regulations; (b) the IDB List of Excluded Activities for Non-Sovereign-Guaranteed (NSG) operations[3]; and (c) the Fundamental Principles of the Rights at Work; and (d) the FIs respective Environmental and Social Management System (implemented as a condition for first disbursement).

ii. Develop and Implement an ESMS to the satisfaction of IDB Group. For FIs that have incorporated an ESMS, IDB will review its effectiveness in dealing with the likely risks associated with these sub-loans. The FI will explicitly exclude high risk activities, which may trigger other IDB Policy and Directives (resettlement, biodiversity, indigenous peoples).

[3] See Appendix I.

iii. 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, to ensure that each FI continues to remain up to date with its environmental and social risk management expertise.

iv. Present an Annual Environmental and Social Compliance Report (ESCR) with information on the SME portfolio, including a breakdown of financing by subsectors and Environmental risk categorization, and any particular risk issues identified during screening and mitigation measures agreed with clients.

8.2 The IDB Group will supervise the environmental and social aspects related to the use of the proceeds of the Programme either by an in-house specialist or with external consultants, and if necessary, will require means of enhancing management of impacts and risks.

IX. Appendices

1. **Appendix I: Excluded Activity List**
2. **Appendix II: List of IDB Safeguards Policies**
3. **Appendix III: Eligibility Criteria**

Appendix I. Excluded Activity List

The IDB does not finance projects or companies involved in the production, trade, or use of the products, substances or activities listed below.

- Those that are illegal under host country laws, regulations or ratified international conventions and agreements
- Weapons and ammunitions
- Tobacco[4]
- Gambling, casinos and equivalent enterprises[5]
- Wildlife or wildlife products regulated under Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)[6]
- Radioactive materials[7]
- Unbonded asbestos fibers[8]
- Forestry projects or operations that are not consistent with the Bank's Environment and Safeguards Compliance Policy[9]
- Polychlorinated biphenyl compounds (PCBs)
- Pharmaceuticals subject to international phase outs or bans[10]
- Pesticides/herbicides subject to international phase outs or bans[11]
- Ozone depleting substances subject to international phase out[12]
- Drift net fishing in the marine environment using nets in excess of 2.5 km. in length
- Transboundary trade in waste or waste products[13], except for non-hazardous waste destined for recycling
- Persistent Organic Pollutants (POPs)[14]

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4 This does not apply to project sponsors who are not substantially involved in these activities. "Not substantially involved" means that the activity concerned is ancillary to a project sponsor's primary operations.

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6 www.cites.org

7 This does not apply to the purchase of medical equipment, quality control (measurement) equipment and any equipment where it can be demonstrated that the radioactive source is to be trivial and/or adequately shielded.

8 This does not apply to the purchase and use of bonded asbestos cement sheeting where the asbestos content is<20%.

9 GN-2208-20, Environmental and Safeguards Compliance Policy, dated 19 January 2006, approved by the Board of Executive Directors on 19 January 2006.

10 Pharmaceutical products subject to phase outs or bans in United Nations, Banned Products: Consolidated List of Products Whose Consumption and/or Sale Have Been Banned, Withdrawn, Severely Restricted or not Approved by Governments. (Last version 2001, www.who.int/medicines/library/qsm/edm-qsm-2001-3/edm-qsm-2001_3.pdf)

11 Pesticides and herbicides subject to phase outs or bans included in both the Rotterdam Convention (www.pic.int) and the Stockholm Convention (www.pops.int).

12 Ozone Depleting Substances (ODSs) are chemical compounds which react with and deplete stratospheric ozone, resulting in the widely publicized 'ozone holes'. The Montreal Protocol lists ODSs and their target reduction and phase out dates. The chemical compounds regulated by the Montreal Protocol include aerosols, refrigerants, foam blowing agents, solvents, and fire protection agents. (www.unep.org/ozone/montreal.shtml).

13 Defined by the Basel Convention (www.basel.int).

- Non-compliance with workers fundamental principles and rights at work[15]
- Genetically Modified Organisms (GMOs)
- Permanent use of chemical biocides, as opposed to an integrated pest management approach
- Permanent use of inorganic fertilizers, as in agricultural practices that depend solely on inorganic fertilizers for nitrogen (N), phosphorus (P) and potassium (K) input

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[14] Defined by the International Convention on the reduction and elimination of persistent organic pollutants (POPs) (September 1999) and presently include the pesticides aldrin, chlordane, dieldrin, endrin, heptachlor, mirex, and toxaphene, as well as the industrial chemical chlorobenzene (www.pops.int).

[15] Fundamental Principles and Rights at Work means (i) freedom of association and the effective recognition of the right to collective bargaining; (ii) prohibition of all forms of forced or compulsory labor; (iii) prohibition of child labor, including without limitation the prohibition of persons under 18 from working in hazardous conditions (which includes construction activities), persons under 18 from working at night, and that persons under 18 be found fit to work via medical examination; (iv) elimination of discrimination in respect of employment and occupation, where discrimination is defined as any distinction, exclusion or preference based on race, color, sex, religion, political opinion, national extraction, or social origin. (International Labor Organization: www.ilo.org)

Appendix II. List of IDB Safeguards Policies

IDB's Safeguard Policies are publicly available on IDB's website located at:

http://www.iadb.org/en/topics/sustainability/about-us,19563.html

The following safeguards are available:

- Environment and Safeguards Compliance Policy and Guidelines
- Natural Disaster Risk Management and Guidelines
- Involuntary Resettlement and Guidelines
- Indigenous Peoples and Guidelines
- Gender Equality in Development and Guidelines
- Access to information Policy and Guidelines

Appendix III: Eligibility Criteria

Activities to be financed under this Project will confirm to the following criteria:

a. Eligible activities to be financed under the Facility will include those aimed at reducing vulnerability to climate change and/or increasing the productivity of the MSME ultimate beneficiaries and incorporating adaptation and/or mitigation activities in relation to agriculture, forestry and land use. Eligible activities, which are aligned with the scope of the definition of Climate Smart Agriculture as outlined in the 2015 Joint Report on Multilateral Development Banks' Climate Finance[16], will include the following types of intervention:

   (i) Agricultural activities that improve existing carbon pools (e.g. rangeland management, collection and use of bagasse, rice husks, or other agricultural waste, reduced tillage techniques that increase carbon contents of soil, rehabilitation of degraded lands, peatland restoration, etc.);

   (ii) Afforestation (plantations), reforestation, and sustainable forestry;

   (iii) Livestock or other agricultural activities that reduce methane or other GHG emissions (manure management with biodigesters, etc.);

   (iv) Supplemental and improved irrigation, multi-cropping systems, levelling and other approaches and technologies that reduce risk of crop failures;

   (v) Adoption of sustainable aquaculture techniques to compensate for the reduction in local fish supplies; and

   (vi) Activities aimed at reducing climate variability risk for agro-forestry MSMEs, including insurance against extreme and catastrophic climate events.

b. The MSME Activities related to GCF Portion in a Subsidiary Agreement occur in the Targeted Countries;

c. The MSME Activities target micro, small and medium size companies as defined in each Targeted Country;

d. The MSME Activities exclude any IDB Excluded Activities.

[16] *2015 Joint Report on Multilateral Development Banks' Climate Finance*. Available at: https://publications.iadb.org/handle/11319/7807