

## Investment Activities

### **MIF/IDB Environmental and Social Guidelines for MIF Financial Intermediary Operations**

#### **I. INTRODUCTION**

1.1 The Multilateral Investment Fund (MIF) is a special fund administered by the Inter-American Development Bank (IDB) and is part of the IDB Group, which also includes the Inter-American Investment Corporation (IIC). The MIF operates through a variety of financial instruments including loans, equity investments, and grants. It is MIF policy that all its operations are carried out in an environmentally and socially responsible manner, and in accordance with the established policies and procedures of the IDB, with each project undergoing review by the Committee for Social and Environmental Impact (CESI).

1.2 The main channels for both equity and loan investments made by the MIF are through financial intermediaries (FIs), which include regional, national and sectoral investment funds, banks and other financing mechanisms that act as the MIF's vehicles to provide funding for small and medium enterprises (SMEs). (SMEs are defined here as enterprises with less than 100 employees and less than US\$3-5 million in annual sales.) These MIF operations are characterized by a number of factors including: (i) they are focused exclusively on micro, small and medium enterprises; (ii) they offer a diversified array of financial tools including minority equity investment; and (iii) they are managed by private sector fund managers that must be competitive while managing a high risk portfolio. These characteristics require that the IDB's environmental and social management policies and practices be adapted to reflect these various factors, while maintaining the overall policy goal of ensuring environmental and social soundness and sustaining the financial security of individual investments. The IIC undertakes similar initiatives as the MIF and has developed a set of environmental guidelines for FIs, which serve as the basis for these guidelines.

1.3 The purpose of this document is to outline the procedures to be used in environmental review and management for FI operations of the MIF, which are targeted on reaching SMEs. (MIF initiatives that focus on providing financing for microenterprises will adhere to a different set of environmental guidelines and/or procedures.) The MIF needs to ensure the proper implementation of its environmental mandate in its FI operations while respecting the principle of delegated responsibility, which characterizes these operations.

## II. ENVIRONMENTAL DUE DILIGENCE BY THE MIF

2.1 Objective: The general objective of these procedures is to ensure that FI projects of the MIF include adequate provisions for actions necessary to prevent, control and mitigate adverse impacts on the environment and to maintain environmental quality, in accordance with the MIF guidelines set forth in Schedule A. More specifically, these procedures are meant to provide the project staff with guidance on how to integrate environmental requirements into FI operations, in a manner that takes into account resource constraints both financial terms and management capacity.

2.2 Appraisal: Prior to establishing a relationship with a prospective FI, the MIF will conduct environmental due diligence on the potential partner(s) and the proposed pipeline of operations. Issues to be considered include the environmental performance and environmental risks and liabilities associated with the FI and its investment portfolio, its environmental policies, procedures and capabilities, the nature of the loans and investments to be supported with the use of MIF funds, and the need for technical assistance to facilitate the adoption of environmental procedures satisfactory to the MIF. During appraisal, MIF will examine the FI's institutional capacity for the environmental review and management of its investments.

2.3 Responsibility for Subproject and Investment Review: The review of all subproject or individual investments of a particular FI is the responsibility of the Fund Manager and each subproject must conform to the MIF Environmental guidelines, with all Local and National environmental laws, regulations and standards, and to the procedures agreed upon between the FI and the MIF, in accordance with the provisions of Section III of these guidelines.

2.4 Training: To assist the Fund Managers in this effort, the MIF will provide them with appropriate environmental review training and ongoing support from the MIF office. This means that FI personnel will need a basic understanding of the issues in order to refer clients with significant environmental or occupational health and safety issues to technical assistance and other service providers. FIs that acquire this capacity will also have a comparative advantage in encouraging their clients to adopt sound environmental and occupational health and safety practices that would enhance their productivity and well being as part of their overall business development strategy.

2.5 Procedures and contractual requirements: In accordance with the content outlined in these guidelines, MIF shall:

(a) include in each project abstract for an FI operation a reference to the application of these guidelines, the preliminary information available with respect to the environmental and social management capacity of the FI and the nature of its portfolio, and any special environmental and social issues to be reviewed during project appraisal;

(b) include in the Donor's Memorandum the standard requirements established in these guidelines, any special requirements identified during appraisal, and any waivers and exceptions with the corresponding justification;

(c) include in the agreement for each FI operation contractual covenants that conform in substance to the clauses set forth in Schedule B;

(d) Carry out periodic independent supervision of the environmental performance of its FIs, particularly when considering extensions of disbursements periods or additional funding;

(e) Submit the above documentation to the CESI in accordance with CESI procedures. The CESI will evaluate MIF FI operations in accordance with the requirements set forth in these guidelines by short procedure, and will request a formal review only if special issues are identified;

(f) Submit documentation to the PIC in accordance with OP-102.

### **III. DUE DILIGENCE REQUIREMENTS FOR FIs**

3.1 The MIF requires its FIs to assess potential environmental and social risks, impacts and opportunities associated with their operations, to ensure environmental reviews, audits or assessments, are conducted where appropriate, and to require that the environmental and social standards of the MIF are satisfied. Each FI is required to have in place and comply with policies and procedures that meet the requirements of these guidelines, however, it may adjust these policies and procedures to suit the specific structure of the institution, or the nature and size of the operations in its portfolio, provided such adjustments are agreed to by the MIF.

3.2 FIs are therefore to adhere, at a minimum, to the following basic requirements, which will be incorporated into the legal documentation of the respective operation:

(i) Environmental and Social Procedures: As part of the EMS described in item (iii) below, each FI will have in place or develop and implement environmental procedures satisfactory to the MIF

and integrate them into its credit/investment decision-making and monitoring procedures. These procedures should include the following elements:

(1) Screening: As part of the appraisal of individual sub-projects or investments, the FI will: a) apply the exclusion list set forth in Schedule C; and b) consider environmental and social risks associated with the deal and classify it into one of the following three categories based on their potential environmental and social impact and resulting necessary level of analysis:

Category I: Projects that have no or only negligible anticipated direct or indirect environmental impact.

Category II: Projects that may have moderate, specific environmental impacts for which mitigating measures can be designed.

Category III: Projects that may result in diverse and significant adverse environmental impacts. Projects in this category would not be eligible for financing with MIF funds.

(2) Environmental Screening and Review Criteria: Encompassed within the environmental review process are the following points, when appropriate:

a. Compliance with local and national environmental laws, regulations and standards b. Sustainable use of natural resources c. Pollution control measures (air, water and soil) and waste management (liquid, solid and hazardous) d. Use of hazardous materials e. Occupational health and safety f. Protection of cultural and natural heritage areas and sensitive ecosystems g. Adherence to acceptable labor practices h. Exposure to natural hazards

(3) Corrective Action Plan. The FI shall make reasonable efforts to assist any company in which they have invested MIF resources, in complying or continuing to comply with all applicable national and local requirements, and with MIF Environmental requirements as set forth in these guidelines, though this may require additional assistance by the MIF. As promptly as possible after becoming aware of any activity which does not comply with the applicable National and Local requirements, or with the MIF Environmental requirements, the FI shall: a) undertake reasonable efforts to cause such project to implement a Corrective Action Plan, which shall entail the development and implementation of a remediation plan to enable the investment to carry out its business in accordance with MIF Environmental requirements and with National and Local requirements; b) use reasonable efforts to replace the investment in the project on commercially reasonable terms, taking into account liquidity, market constraints and fiduciary responsibilities, if

any project does not implement a Corrective Action Plan as provided in (a) above, within a reasonable time; and c) report any continuing non-compliance to the MIF as soon as practicable.

(iii) Environmental training: Within 12 months of the Effective Date of MIF financial resources, the FI shall have had at least two of its employees attend a MIF sponsored or approved environmental training event, though this requirement may be waived if, in the judgement of the MIF, the FI's portfolio or its demonstrated environmental management capacity justify such a waiver. If for any reason, trained environmental staff leave the FI, then new FI employees must attend the next scheduled MIF-sponsored or approved environmental training. All costs associated with attendance of the environmental training are the FI's responsibility, though the MIF can make provisions to assist the FI with some of the costs borne by participating in these events if it is deemed justified by the MIF.

(iv) Environmental management systems (EMSs): FI's with portfolios that routinely require them to screen and/or review projects that have environmental or social impact issues, should designate at least one qualified employee (e.g., one of the employees who attended the aforementioned environmental training) to establish and oversee an EMS satisfactory to the MIF, and to ensure that the EMS remains in effect and is systematically applied. Moreover, depending on their size and nature of operations, each FI should either rely on this same employee or contract an external consultant to conduct reviews of each investment based on MIF requirements, as well as on local and national environmental requirements. The EMS shall be part of the overall management system of the FI relevant to the environmental, health, safety and labor aspects of the FI's own operations and of the sub-projects or investments in its portfolio. The EMS shall include organizational structure, responsibilities, procedures and resources to: a) apply the screening and review procedures described in items (i) and (ii) above; b) impose requirements on each investment (either immediately or, if a Corrective Action Plan is used, over a specified period of time) to carry out its business in accordance with MIF Environmental Guidelines, any other environmental policies and standards of the FI, and National and Local requirements; and b) monitor the environmental, health, safety and labor performance of each investment against applicable standards MIF resources for the FI operation. The FI shall not amend, modify or rescind the EMS without the prior approval of the MIF.

(v) Environmental Supervision and Performance Report: The FI will have to submit to the MIF periodic reports on the implementation of its environmental procedures and EMS, and on the environmental performance of its portfolio, as promptly as practical, but in no event more than ninety (90) days after the close of each fiscal year. The Environmental Supervision and Performance Report shall include the following:

(1) The results of the FIs screening and review procedures (See Schedule C)

(2) Environmental Certifications. A certification of environmental compliance with respect to each of the companies the FI invests in during the life of each respective agreement. If an investment is classified as environmentally sensitive in accordance with the EMS, such certifications shall be based on an independent environmental report. In all other cases, such certifications shall be based on the company's own certification.

(3) A description of any investment not currently in compliance with environmental and social requirements as set forth in the EMS approved by the MIF and of the actions the FI has taken or intends to take to correct the situation.

## **Schedule A: MIF Environmental and Social Requirements**

The reference guidelines for substantive standards to be applied to individual subprojects and investments are as follows:

1. Any pertinent local laws and regulations, including obligations of international treaties to which the host country is a party or signatory.

Local and National standards must be considered sufficient, or especially complemented by arrangements that result in substantial compliance with the following:

2. World Bank standards for the particular industry as set forth in the Pollution Prevention and Abatement Handbook.

3. The IFC 1998 Guidelines on Occupational Health and Safety

4. The IDB policy on Involuntary Resettlement (OP-710)

5. IFC guidance on harmful and child labor

## **Schedule B: Environmental Procedures and Restrictions for MIF Financial Intermediaries**

1. Investment Limitations. The Fund will make investments only in a prospective Portfolio Company:

(a) which is not engaged in or does not intend to engage in a Prohibited Activity nor engage in an activity classified as Category III (as defined in Section 3 below);

(b) (i) whose operations are in compliance with the applicable Local Environmental Requirements and the Environmental Guidelines (each as defined in Section 3 below), or (ii), if such prospective Portfolio Company's operations are not so in compliance, such prospective Portfolio Company has adopted a Corrective Action Plan (as defined in Section 3 below) which addresses such non-compliance;

### 2. Environmental Management

(a) Promptly after the Initial Closing, the Manager will:

i) send at least two of its senior executives to an environmental training program acceptable to the MIF;

(ii) establish and implement an Environmental Management System, or EMS (as defined in Section 3 below);

(iii) appoint at least one of such senior executive to implement and supervise the EMS and to supervise reviews of the Portfolio Companies with respect to the Local Environmental Requirements and the Environmental Guidelines;

(iv) if such senior executive ceases to perform such duties, promptly appoint a new person to replace him or her, and ensure that such new person attends a similar training program; and

(b) Within 90 days after the close of each Fiscal Year of the Fund, the Fund will furnish the MIF with an Environmental Performance Report (as defined in Section 3 below);

(c) The Fund will use its best efforts to cause the Portfolio Companies to continue (i) to comply with applicable Local Environmental Requirements and Environmental Guidelines and (ii) not to engage in any Prohibited Activity;

(d) As promptly as possible after becoming aware of any activity by a Portfolio Company that does not comply with applicable Local Environmental Requirements and Environmental Guidelines, or which is classified as a Prohibited Activity, the Fund will (i) use its best efforts to cause such Portfolio Company to implement a Corrective Action Plan; and (ii) if any Portfolio Company does not implement a Corrective Action Plan as provided in clause (i), use reasonable efforts to dispose of the Fund's investment in such Portfolio Company on commercially reasonable terms, taking into account liquidity, market constraints and fiduciary responsibilities.

(e) not amend, modify, or rescind the EMS without the approval of the MIF.

3. Definitions. For purposes of this Exhibit, the following terms have the following definitions:

a) "Category III Project" means a project which is likely to have significant adverse environmental impacts that are sensitive, diverse or unprecedented, examples of which are the following:

Projects with large resettlement components and all projects with potentially major impacts on human populations:

Projects with large resettlement components and all projects with potentially major impacts on human populations;

Projects affecting indigenous or tribal populations;

Projects that include the manufacture, use or disposal of environmentally significant quantities of pest control products;

Manufacture, transportation and use of hazardous and/or toxic materials;

Domestic and hazardous waste disposal operations;

Projects which pose serious occupational or health risks.

(b) "Corrective Action Plan" means a remediation or corrective action plan, including the details of an implementation schedule and costs, which upon implementation will enable a Portfolio Company to carry out its business in compliance with the Local Environmental Requirements and the Environmental Guidelines.

(c) "Environmental Guidelines" means (i) the sector-specific guidelines set forth in the Pollution Prevention and Abatement Handbook, published by the World Bank Group, or (ii) in the absence of an applicable guideline for a sector, the World Bank's "General Environmental Guidelines".

(d) "Environmental Management System" or "EMS" means the part of the overall management system of the Fund relevant to the environmental aspects of its investments and includes organizational structure, responsibilities and resources to (i) assess the degree of environmental compliance of potential Portfolio Companies; (ii) impose requirements on a Portfolio Company (either immediately or, if a Corrective Action Plan is used, over a specified period of time) necessary to carry out its business in accordance with the Environmental Guidelines; and (iii) monitor the environmental performance of the Portfolio Companies against applicable standards.

(e) "Environmental Performance Report" means a written report, to be prepared by the Manager, reporting on the environmental compliance of the Company's Portfolio Investments for the previous Fiscal Year based on the requirements set forth herein and the Environmental Management System.

(f) "Local Environmental Requirements" means the applicable environmental, requirements, and any child labor and forced labor laws, rules and regulations (including international treaty obligations, if any) of the government where the Portfolio company is located be in effect.

(g) "Prohibited Activities" means:

Large-scale mining, oil and gas exploration or development and supporting services, if such services are directly related to exploration or development.

Speculative real estate investing or trading.

Production or activities involving harmful or exploitative forms of forced labor or harmful child labor.

Production or trade in a product or activity that is illegal under the laws of Local government or international conventions and agreements. Production or trade in weapons and munitions.

Production or trade in alcoholic beverages (excluding beer and wine).

Production or trade in tobacco.

Gambling, casinos and equivalent enterprises.

Trade in wildlife or wildlife products regulated under the Convention on International Trade in Endangered Species of Wild Fauna and Flora.

Production or trade in radioactive materials.

Production or trade in unbonded asbestos fibers.

Commercial logging operations or the purchase of logging equipment for use in primary tropical moist forest.

Production or trade in products containing PCBs.

Production or trade in pharmaceuticals subject to international phase-outs or bans.

Production or trade in pesticides/herbicides subject to international phase-out or bans.

Production or trade in ozone depleting substances subject to international phase-out.

Drift net fishing in the marine environment using nets in excess of 2.5 kilometers in length.

## **Schedule C: Exclusion List for MIF Financial Intermediary Guidelines**

MIF does not finance the following projects:

Large-scale mining, oil and gas exploration or development and supporting services.

Speculative real estate investing or trading.

Production or activities involving forced labor or harmful/exploitative child labor. (Forced labor means all work or service, not voluntarily performed, that is extracted from an individual under threat of force or penalty. Harmful child labor means the employment of children that is economically exploitative, or is likely to be hazardous to, or to interfere with, the child's education, or to be harmful to the child's health, or physical, mental, spiritual, moral, or social development.)

Production or trade in any product or activity deemed illegal under host country laws or regulations or international conventions and agreements.

Production or trade in weapons and munitions.

Production or trade in alcoholic beverages that are prohibited in the host member country.

Production or trade in tobacco.

Gambling, casinos and equivalent enterprises.

Trade in wildlife or wildlife products regulated under CITES (Convention on International Trade in Endangered Species of Wild Fauna and Flora).

Production or trade in radioactive materials. This does not apply to the purchase of medical equipment, quality control (measurement) equipment and any equipment where IFC considers the radioactive source to be trivial and/or adequately shielded.

Production or trade in or use of unbonded asbestos fibers. This does not apply to the purchase and use of bonded asbestos where the asbestos content is <20%.

Commercial logging operations or the purchase of logging equipment for use in primary tropical moist forest. Primary forest is defined as relatively intact forest that has been essentially

unmodified by human activity for the previous 60 to 80 years. Tropical moist forest is generally defined as reforest in areas that receive not less than 100 mm of rain in any month for two out of three years and have an annual mean temperature of 24 degrees Celsius or higher.

Production or trade in products containing PCBs. (PCBs are polychlorinated biphenyls—a group of highly toxic chemicals. PCBs are likely to be found in oil-filled electrical transformers, capacitors and switch-gear dating from 1950-85.)

Production or trade in pharmaceuticals subject to international phase-outs or bans.

Production or trade in pesticides/herbicides subject to international phase-outs or bans.

Production or trade in ODSs subject to international phase-out. (ODSs are Ozone Depleting Substances: Chemical compounds that 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. ODSs are found in some aerosols, refrigerants, foam blowing agents, solvents, and fire protection agents.)

Drift net fishing in the marine environment using nets in excess of 2.5 km. in length.