FY 2012 Audit of CIFI's ESMS

Prepared for:
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ENVIRON

1 Executive Summary

1.1 Background

This report, prepared for Corporación Interamericana para el Financiamiento de Infraestructura, S.A. (CIFI) by ENVIRON International Corporation (ENVIRON), represents the annual audit of CIFI's Environmental and Social Management System (ESMS) for the 2012 financial year, which runs from January through December. CIFI's 2012 portfolio retained 21 of 30 loan projects/clients from 2011, and 14 new projects were added in fiscal year (FY) 2012, resulting in a total of 35 projects reviewed in this report. The portfolio is presented in Tables 1.1 and 1.2.

CIFI first implemented its Environmental and Social Management System (ESMS) in 2005 and it addressed the review, categorization and supervision of prospective and approved loans by applying the policies and procedures of the Inter-American Investment Corporation (IIC).

On April 6, 2007, CIFI adopted the Equator Principles (EPs). Going forward (e.g., post the adoption date), CIFI's updated ESMS was based on the Equator Principles, which incorporate the International Finance Corporation (IFC) Performance Standards on Social and Environmental Sustainability and applicable IFC Environmental, Health and Safety (EHS) Guidelines. These policies and guidelines cover environmental, social, health and safety, and labor aspects (which will be referred to as 'E&S' throughout this report). In addition, all CIFI projects should also meet the E&S requirements of the host country.

Under CIFI's ESMS, all projects are categorized in accordance with the EP/IFC project categorization scheme, which assigns all projects an A, B, or C category based on likely, potential E&S impacts (i.e., Category A projects are generally larger in scale and in higher risk sectors while Category C projects are generally smaller and in low risk sectors). All current CIFI loans can be mapped using CIFI's E&S risk categorization matrix, which is based on sector risk (e.g., A, B or C) and the concept of relative transaction risk (See Table 1.3).

The transaction risk concept is that not all transactions carry the same degree of risk for CIFI. For example, a Category A greenfield (e.g., new development) project for which CIFI is the arranger is the highest risk type of transaction given associated sector risk (e.g., Category A projects are often extractive industry projects) and the reality that new projects typically involve significant construction phase impacts (e.g., site clearance, earthworks, roads and associated infrastructure, workers camps) and therefore present greater potential risks than existing operations. Conversely, a Category C asset purchase is considered the lowest risk (e.g., low risk sector and an existing operation with no construction phase).

Table 1.1: New Portfolio Projects (NP)

No.	Country	Sector	Lead Arranger(s)	Structure	CIFI Risk Category
1	Central America	Telecommunications	IFC	Project Finance	B
2	México	Wind Power	IFC/IDB	Project Finance	A
3	Jamaica	Logistics	Scotia Bank	Corporate Finance	B
4	Panamá	Construction and Engineering	CIFI	Corporate Finance	B
5	Argentina	Wind Power	IIC	Corporate Finance	B
6	Costa Rica	Energy and Telecommunications	IDB	Corporate Finance	B
7	Nicaragua	Wind Power	BICSA	Project Finance	B
8	Perú	Tourism	CIFI	Corporate Finance	B
9	Jamaica	Oil& Gas	IIC	Corporate Finance	B
10	Dominican Republic and Jamaica	Oil& Gas	IIC	Corporate Finance	B
11	Honduras	Hydroelectric Power	BCIE / CIFI	Project Finance	B
12	Ecuador	Oil& Gas	WestLB	Project Finance	A
13	Ecuador	Telecommunications	CAF	Corporate Finance	B
14	Jamaica	Tourism	NCB Jamaica Ltd.	Project Finance	B

Table 1.2: Carryover Portfolio Projects (CO)

No.	Country	Sector	Lead Arranger(s)	Structure	CIFI Risk Category
1	Perú	Airports and Seaport	Goldman & Sachs	Corporate Finance	B
2	Panamá	Thermal Power	West LB/HSBC (EPFIs)	Project Finance	B
3	Argentina	Telecommunications	Standard Bank	Corporate Finance	B
4	Guatemala	Hydroelectric Power	CIFI	Project Finance	B
5	Argentina	Oil & Gas	IFC	Corporate Finance	B
6	Dominican Republic	Airports and Seaports	IFC	Corporate Finance	B
7	México	Construction & Engineering	CIFI	Corporate Finance	B
8	Brazil	Oil & Gas	IDB	Project Finance	B
9	Saint Lucia	Telecommunications	Citibank	Corporate Finance	B
10	Chile	Co-Generation (Biomass) Power	IIC	Project Finance	B
11	Honduras	Thermal Power	CABEI	Corporate Finance	B
12	Ecuador	Construction & Engineering	IFC	Corporate Finance	B
13	Guatemala	Co-Generation (Biomass) Power	Bancolombia	Corporate Finance	B

No.	Country	Sector	Lead Arranger(s)	Structure	CIFI Risk Category
14	Argentina	Oil & Gas	IFC	Corporate Finance	B
15	Nicaragua	Geothermal Power	CABEI	Corporate Finance	B
16	Bolivia	Construction Materials	CAF	Corporate Finance	B
17	Colombia	Airports and Seaports	IFC	Project Finance	A
18	Argentina	Airports and Seaports	IIC	Corporate Finance	B
19	Panamá	Thermal Power	BICSA	Corporate Finance	B
20	Colombia	Thermal Power	IFC	Corporate Finance	B
21	Jamaica	Thermal Power	IFC	Project Finance	B

Table 1.3: CIFI ESMS Screen (red denotes highest risk, yellow intermediate, and green lowest). All Projects are listed, with new projects denoted with an asterisk (*).

Transaction Type		Project Category		
		A	B	C
		Relative E&S Risk		
Reputational Risk		**High**	**Moderate**	**Low**
High	**CIFI Arranger/Originator**			
	1. Greenfield		NP11*; CO4	
	2. Expansion		NP8*; NP4*; CO12	
	3. Refinancing		NP14*	
	Local Bank Syndicate			
	1. Greenfield			
	2. Expansion			
	3. Refinancing			
	Intl. bank Syndicate			
	1. Greenfield		NP7*	
	2. Expansion		CO9; CO13	
	3. Refinancing		CO6; NP3*, CO1; CO19	
	Asset Purchase – Local Bank			
	1. Greenfield			
	2. Expansion			
	3. Refinancing			
	Asset Purchase – Intl. Bank			
	1. Greenfield	NP12*		
	2. Expansion		CO2; CO3	
	3. Refinancing			
	MFI A/B Loan			
	1. Greenfield	NP2*; CO17	CO8; CO10; CO15; CO21	
	2. Expansion		NP1*,NP9*, NP10*; CO5; CO7; CO16; CO11; CO14; CO18; CO20	
	3. Refinancing		NP6*; NP5*	
	Asset Purchase - MFI			
	1. Greenfield			
	2. Expansion		NP13*	
Low	3. Refinancing			

1.2 Scope of Review and Report Structure

This report is based on a review of CIFI project files including:

- Loan agreements;
- CIFI's credit proposals (pre-approval project analysis documents);
- Associated environmental background information (e.g., environmental impact assessments/audits and/or environmental management plans, where available);
- Annual monitoring reports and compliance-related data supplied by projects;
- Semi-annual ESMS compliance reports prepared for internal review by CIFI;
- EHS questionnaires; and
- CIFI project supervision reports.

Overall effectiveness of the CIFI's ESMS performance was assessed on the basis of project documentation review. The Executive Summary presents the main findings. A detailed review of CIFI's portfolio for FY 2012, including conclusions and recommendations specific to each project in the portfolio, can be found in Annex B.

1.3 CIFI's Portfolio

CIFI's 2012 portfolio consisted of 35 projects (see Tables 1.1 and 1.2):

- 5 were directly originated by CIFI.
- 22 originated with MFIs or EPFIs;
- 8 originated with other institutions; and

As per CIFI's business plan (see 2.1.4), CIFI's premise is that environmental and social risks are generally lower in transactions originated by MFIs or EPFIs (or equivalents such as Norfund) due to their application of well-established environmental and social policies and procedures.

The 2012 portfolio was spread across various infrastructure sectors as follows:

- Oil & Gas (6);
- Thermal Power (5);
- Airports and Seaports (4)
- Telecommunications (4);
- Construction and Engineering (3);
- Wind Power (3);
- Hydroelectric Power (2);
- Co-Generation (Biomass) (2);
- Tourism (2);

- Other (4).

1.4 Key Conclusions and Recommendations

In consideration of CIFI's performance over the last several years, ENVIRON agrees with the use of CIFI's risk screen (see Table 1.3 above) as an appropriate approach for ESMS application. ENVIRON recommends that CIFI focuses its due diligence attention on:

- Those projects where CIFI is the arranger or originator;
- Higher risk projects (e.g., all Category A projects and category B projects in higher risk sectors – also called "big Bs"). Higher risk sectors would include oil and gas, power generation including hydro, large industrial projects, and major new infrastructure projects with a significant footprint (e.g., new ports or major expansions, high voltage electrical transmission lines, pipelines, roads, airports); and
- Projects originated by entities that are *not* major MFIs, EPFIs, or their equivalent (in terms of adapting best practices and managing E&S issues).

Simultaneously, and in keeping with its business model, CIFI should expend less effort on the application of the ESMS to those transactions that *are* originated by major MFIs or EPFIs due to the fact that these entities apply international best practice and perform their own due diligence.

Additionally, CIFI should also expend less effort on the application of its ESMS when E&S risk is relatively low and experience has shown the likelihood of influencing outcomes and/or obtaining sufficient monitoring information is low (e.g., corporate finance and asset/bonds purchases).

The overall quality of E&S reporting has improved in the past few years across CIFI's portfolio; presumably a result of CIFI's improved implementation of their ESMS and improved due diligence as well as the increasing application of E&S requirements in international infrastructure financing.

2 Corporación Interamericana para el Financiamiento de Infraestructura (CIFI)

2.1 Overview

2.1.1 Background

CIFI is a regional non-bank financial institution that began operation in July 2002. CIFI's paid-in capital is US$ 54.0M and is funded through international bank financing (currently US$ 263M). Its shareholders are as follows:

European Banks and Funds:

- Bankia (Spain)
- Caixa Banco de Investimento (Portugal)
- Norwegian Investment Fund for Developing Countries (NORFUND) (Norway)
- Finnish Fund for Industrial Cooperation LTD (FINNFUND) (Finland)

Latin American and Caribbean Banks:

- HSBC (Panamá)
- Itau Unibanco-Uniao de Bancos Brasileiros (Brazil)
- Banco del Pichincha (Ecuador)

Multilateral Financial Institutions:

- International Finance Corporation (IFC)
- Inter-American Investment Corporation (IIC)
- Central American Bank for Economic Integration (CABEI)
- Caribbean Development Bank (CDB)

2.1.2 Mission

CIFI's corporate mission is to promote and finance infrastructure projects and related services throughout Latin America and the Caribbean. CIFI provides long-term debt financing and advisory services to infrastructure projects sponsored and/or operated by the private sector.

2.1.3 Products and Services

CIFI products and services include:

- Long-term senior loans;
- Subordinated loans as a form of mezzanine financing;
- Credit guarantees and enhancements;
- Leasing transactions;
- Underwriting on a best-efforts basis of corporate debt and quasi-equity instruments; and
- Advisory services/Arranger or Co-Arranger roles.

The terms and conditions of CIFI's loans to a particular company are commensurate with the risk/reward profile of the proposed project.

2.1.4 CIFI's Business Plan

CIFI's business plan calls for CIFI to act either as an arranger of financing or as a participant in transactions arranged by others. When CIFI acts as arranger or co-arranger, and the E&S risk is high, CIFI uses external consultants to carry out appropriate E&S due diligence studies as per CIFI's environmental policy and ESMS. Similarly, CIFI's business plan premise is that environmental and social risks are generally lower in transaction originated by MFIs or EPFIs (or equivalent institutions).

When involved as a participant in international syndicated loans, multilateral A/B corporate loans, or as a purchaser of loan portfolio assets, CIFI faces a dilemma in terms of complying with its environmental policy. This is because CIFI's ability to impose E&S conditions, influence management, or obtain project related E&S information is often limited (as such requests are the purview of the syndicate arranger or manager). CIFI is often a relatively minor participant in many transactions (in terms of percentage of the overall loan) and thus has less influence when it is involved in asset purchase or corporate transactions after a project is under construction or operational.

These risks, however, are further offset by two other aspects of CIFI's business plan:

- CIFI often participates in projects structured by multilateral development institutions (e.g., IIC, IFC, IDB, etc.), bilateral development organizations (e.g., FMO of the Netherlands, DEG of Germany, etc.), or syndicates arranged by major international banks (most of which adhere to the Equator Principles). In such cases, CIFI relies on the adherence of the arrangers to their own E&S policies, procedures, and guidelines, which are usually in line with CIFI's[1]; and
- There is relatively lower risk (in both financial and E&S terms) in an operational project or expansion project than in a greenfield development project, as construction impacts generally have the potential to exceed operational impacts. As of December 31, 2012, 74% of CIFI's outstanding loan portfolio is comprised of corporate finance structures that involve the refinancing or expansion projects.

3 CIFI's Environmental and Social Management System

3.1 Background

Prior to 2005, CIFI used the IIC's environmental and social policy framework (which was based on the older World Bank Safeguard policies and the 1998 World Bank Pollution Prevention and Abatement Handbook EHS guidelines). CIFI developed and began implementing its own Environmental and Social Management System (ESMS) in 2005. CIFI's ESMS was continuously updated and improved over time and in 2007 CIFI incorporated the Equator Principles, IFC Performance Standards, and IFC EHS Guidelines into its ESMS. The ESMS also includes compliance with local requirements. In 2011, CIFI updated and aligned its ESMS with the revised IFC Performance Standards (released on August 1, 2011 and effective on January 1, 2012).

CIFI's current lending guidelines state that "all projects must comply with its Environmental and Social Policies, Fundamental Principles and Rights at Work (ILO, 1998), the guidelines and standards of the World Bank Group EHS Guidelines, the applicable IFC Performance Standards, and the guidelines established by the Inter-American Investment Corporation and the Equator Principles." Applying all these standards across the board, without distinguishing the financial product, CIFI's participation size, influence capacity, EP's nature, and business model, makes compliance unrealistic. This and the upcoming EPs III resulted in the need to

[1] See Tables 1.1 and 1.2 for new and carryover portfolio projects where the lead arranger was an MFI or EPFI.

revise CIFI's ESMS in 2012. In early 2013, CIFI updated its ESMS in order to solve the problem. The new approach that is being implemented in 2013 is summarized in the following table.

Figure 1: CIFI's ESMS: Determining Applicable Policy Approach

Partners	Financial Products	Project Finance	Project Related Corporate Loan[2]	Corporate Loan	Bridge Loan[3]	Project Advisory
IIC		IIC/EP	IIC	IIC	IIC	IIC
IDB		IDB/EP	IDB	IDB	IDB	N/A
IFC		IFC/EP	IFC	IFC	IFC/EP	N/A
Other MDB or Bilateral		EP	EP or IFC[4]	IFC	EP	EP
EPFI		EP	EP or IFC[3]	IFC	EP	EP
Direct Loan		EP	EP or IFC[5]	IFC	EP	EP
Local Bank(s)		EP	EP or IFC[6]	IFC	EP	EP
International Bank (not EPFI)		EP	EP or IFC[5]	IFC	EP	EP

The revised ESMS was finalized and approved in February 2013. Therefore, all portfolio projects from FY 2012 were analyzed against CIFI's 2011 ESMS.

3.2 Process Overview

Table 3.1 presents an overview of CIFI's 2011 ESMS. The credit review process examines the environmental and social aspects of a project, applying E&S due diligence to ascertain that the proposed project is likely to meet CIFI's environmental, social, health, safety, and labor requirements. Projects with serious environmental and related concerns and/or sponsors who show unwillingness to meet underlying environmental responsibilities are rejected. Where gaps are identified, the due diligence, as necessary, details specific corrective actions with an implementation schedule designed so that the project will achieve compliance with the applicable policies, guidelines, and standards in a reasonable time frame.

[2] The EPs apply to Project Related Corporate Loans when the majority of the loan is related to a single project over which the client has effective operational control, the loan tenor is at least 2 years, [the capital cost is at least US$100 million and the individual EPFI exposure is US$50 million.]

[3] The EPs apply to Bridge Loans with a tenor of less than two years that are intended to be refinanced by a Project Finance Loan or a Project-Related Corporate Loan that is anticipated to meet the relevant criteria described in footnote 1.

[4] In most cases, it is expected that CIFI's Project Related Corporate Loans will be below the threshold indicated in footnote 1. However, CIFI will try to apply EP policies even when the threshold is not met. It will be up to the lending consortium to agree on the applicable policy approach, but ideally all EPFIs should follow the same approach.

[5] For risk management reasons, when CIFI is a direct lender, it may be prudent to follow the EPs regardless of whether exposure levels meet the threshold requirements as indicated in footnote 1.

[6] Selection of IFC or EP policy approach will need to be determined in collaboration with other lenders and in consideration of exposure levels and risk issues.

CIFI is required to commission an Annual Environmental and Social Performance Report (i.e., this report) evaluating the environmental, social, labor and occupational, and health and safety performance of CIFI's borrowers for the prior year.

Table 3.1: CIFI's Environmental and Social Management System

Phase	Responsibility	E&S Activities
PRE-SCREENING & SCREENING	Transaction Managers E&S Coordinator E&S Manager	Apply Exclusion list, and if not excluded determine if project meets E&S requirements Review E&S information Assign project category
DUE DILIGENCE (DD)	Transaction Managers E&S Coordinator E&S Manager	Evaluate E&S information **High risk:** external DD **Medium risk:** internal DD + external when needed **Low risk:** internal DD
PEER REVIEW	CIFI Staff: Origination, Supervision, Legal, Credit and E&S	Review E&S information
APPROVAL	Credit Committee	IIC approval necessary for category A projects
DISBURSEMENT	Transaction Managers Corporate Attorney E&S Manager E&S Coordinator	Verify compliance with conditions and covenants
MONITORING	Portfolio Officers E&S Manager E&S Coordinator	Tracks and follow-up with companies or administrative agents about E&S project-specific information, as per loan agreement When acting as sole lender, CIFI takes actions to address non-compliances Produces and updates annual supervision reports, which include an E&S section Annual Environmental Report

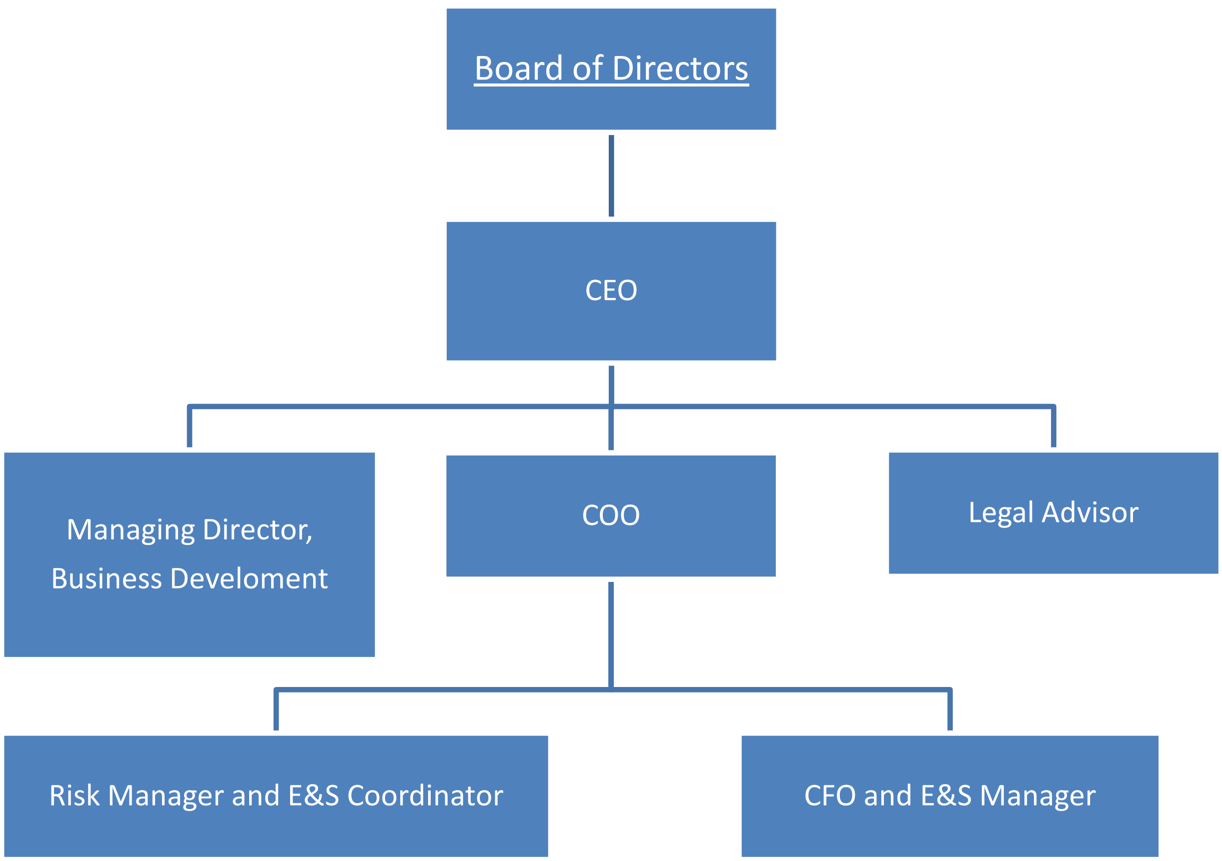
3.3 ESMS Organizational Structure and Responsibilities

CIFI's business model is based on having an efficient organization with a small, core staff structure and an efficient process for loan processing. Responsibilities for implementing the ESMS in 2011 are as follows (see Figure 3.1 for organizational structure):

- The CEO (Juan José Juste) has the ultimate responsibility for ESMS implementation;
- The Managing Director (César Cañedo-Arguelles) has responsibility for identifying and screening possible transactions. The Managing Director, in conjunction with the Environmental and Social Coordinator, manage E&S due diligence and implementation for transactions as required;

- The Environmental and Social Coordinator (Juan P. Moreno and Tatiana Arriaran) categorizes all possible transactions for environmental and social risks and monitors portfolio projects; including all E&S aspects;
- The CFO/Environmental and Social Manager (Cristina Jiménez) has final responsibility for monitoring of the portfolio projects including all E&S aspects; and
- Portfolio Officers (Alejandra Jatem and Janet Sánchez) are responsible for monitoring E&S issues over the life of the loan.

Figure 3.1: CIFI's ESMS Organizational Chart



3.4 Screening and Categorization

The implementation of the Environmental and Social Pre-Screening and Screening Form has proven to be very useful and has helped standardize the screening process at initiation. The forms help gather preliminary information from the borrower including a list of activities in which the project is primarily involved; its environmental, social, and health, safety & labor risks and impacts; the project category, the IFC PSs triggered by the project; and a list of specific measures/conditions required of the client. Once the form is completed, CIFI can better assess the need for external consultancy or a more in-depth internal due diligence process.

CIFI assesses the environmental, social, and reputational risks of projects prior to accepting a deal. In high-risk cases, CIFI seeks advice from the IIC and gathers external information on the project and potential borrower. CIFI typically avoids involvement in projects with higher environmental or social risks (e.g., Category A), preferring Category B or C projects. CIFI outsources E&S due diligence for high risk projects (Category A and "big" Bs), if considered necessary, in accordance with its ESMS.

3.5 Due Diligence

The level of information available for review by CIFI's team during due diligence varies depending on the nature of the transaction (and hence CIFI's level of control/influence in the loan arrangement). CIFI has access to more information when acting as the arranger or co-arranger in project finance syndicate loans. When participating in corporate finance arrangements and bond purchase in the secondary market, CIFI has less leverage and therefore far less success when attempting to obtain relevant E&S information. This limitation affects the degree to which CIFI can assess certain projects in terms of E&S aspects. Currently, CIFI's ESMS does not have formal procedures for reviewing the risk associated with the purchase of bonds. As a risk mitigation measure, CIFI analyzes the environmental risk of bond issuers and does not buy bonds that entail high E&S risks.

The project category is assigned by the E&S Coordinator and the E&S Manager in coordination with the transaction team members.

As a condition to loan disbursement, CIFI requires that the borrower complete an E&S questionnaire with general questions related to the company's policies and strategies in place to manage E&S issues. The purpose of the questionnaire is to provide a general overview of the companies' management of E&S issues. The E&S Questionnaire was updated based on the 2010 revision of CIFI's ESMS to incorporate specific questions regarding compliance with the IFC Performance Standards.

On projects where CIFI has the most leverage (e.g., is the arranger or co-arranger of a new project finance), CIFI conducts full E&S due diligence, prepares an environmental and social action plan and includes specific E&S covenants into the loan agreement. Furthermore, CIFI performs E&S monitoring of the project.

In the Credit Proposal for each project, CIFI includes a section documenting the results of the E&S due diligence, the justification for categorization, and any associated mitigation measures and/or action plan. In most cases, CIFI reviews the E&S requirements of loan agreements and when necessary, incorporates E&S covenants into the legal documentation.

CIFI is actively improving its record-keeping process for each project throughout the investment cycle. All E&S documents received by CIFI are retained as electronic files that are internally accessible to all staff. CIFI has hired a software development company to develop and incorporate an environmental component into CIFI's electronic management information system. The module was implemented in 2012 and allowed CIFI staff to enter the information from E&S questionnaires and forms electronically and create a database containing E&S information.

3.6 Monitoring

As part of the monitoring process, CIFI's Portfolio Officers maintain regular contact with borrowers and/or agent banks to obtain the E&S information requested in the specific loan agreements or any additional information deemed necessary. The Portfolio Officers are generally successful in obtaining E&S information from companies, even in cases where E&S reporting is not required by the legal documentation. Also, CIFI's monitoring includes tracking the projects using external sources such local news and google alerts.

In projects where CIFI syndicates with MFIs (e.g., IFC, IDB, IIC, etc.), and CIFI is not the arranger, CIFI usually has had good access to monitoring documentation (because monitoring and public disclosure are usually required as part of the borrowers' loan agreement with the MFIs).

4 Conclusions and Recommendations

4.1 General Conclusions

ENVIRON has not carried out an annual audit of CIFI's ESMS implementation since fiscal year 2009, and we note a marked improvement in the application of the ESMS. In particular, we endorse CIFI's internal Semi-annual Compliance Reports, which summarize the results of ESMS application to new investments. These were excellent summary documents and evidenced a thorough understanding and application of the ESMS internally. In addition, ENVIRON reviewed CIFI's new (February 2013) ESMS found it an improvement which also retained the stronger elements of the prior system.

In general, projects in CIFI's portfolio comply with local national regulation and standards, and the E&S monitoring is done against national standards (for level of emissions for example). As stated above, it has been challenging for CIFI to apply the EPs to projects that are not new project finance transactions and/or when CIFI is not the arranger. CIFI's ability to influence requirements and/or obtain sufficient E&S information is especially limited in aftermarket transactions (e.g., corporate financing or bond purchases). However, as discussed above, CIFI's risk is generally lower in such transactions for several reasons, but primarily because the projects are already operational.