Appraisal Environmental and Social Review Summary

Appraisal Stage

(ESRS Appraisal Stage)

Date Prepared/Updated: 04/20/2020 | Report No: ESRSA00723
A. Basic Project Data

<table>
<thead>
<tr>
<th>Country</th>
<th>Region</th>
<th>Project ID</th>
<th>Parent Project ID (if any)</th>
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<tr>
<td>Ecuador</td>
<td>LATIN AMERICA AND CARIBBEAN</td>
<td>P172899</td>
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Project Name: Promoting Access to Finance for Productive Purposes for MSMEs

Practice Area (Lead): Finance, Competitiveness and Innovation

Financing Instrument: Investment Project Financing

Estimated Appraisal Date: 4/21/2020

Estimated Board Date: 6/23/2020

Borrower(s): Corporación Financiera Nacional

Implementing Agency(ies): Corporación Financiera Nacional

Proposed Development Objective(s)

The project development objective is to promote access to finance for productive purposes for micro, small and medium enterprises (MSMEs) in the context of the COVID-19 crisis.

Financing (in USD Million)

<table>
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<tr>
<th>Total Project Cost</th>
<th>Amount</th>
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<td>260.00</td>
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B. Is the project being prepared in a Situation of Urgent Need of Assistance or Capacity Constraints, as per Bank IPF Policy, para. 12?

No

C. Summary Description of Proposed Project [including overview of Country, Sectoral & Institutional Contexts and Relationship to CPF]

The project is a US$ 260 million IBRD Financial Intermediary Financing that will be executed in five years with the objective of promoting access to finance for productive purposes for micro, small, and medium enterprises (MSMEs) in the context of the COVID-19 crisis. The proposed Project would support the borrower and implementing agency, CFN, to: (i) strengthen the institutional capacity of CFN, (ii) develop and/or improve financial products to promote access to finance; and, (iii) create and expand second-tier lending operations for MSMEs. MSMEs are the main project beneficiaries. There are about 900,000 firms in Ecuador: 91 percent of firms are micro enterprises, 7 percent are small, and the remaining 2 percent are split between medium and large firms.
The proposed Project consists of four main components: (1) Strengthening the institutional capacity of CFN; (2) Development and improvement of financial products to promote access to finance for MSMEs; (3) Credit line intermediated by CFN to PFIs for on-lending to MSMEs; and (4) Project management.

Component 1 – Strengthening the Institutional Capacity of CFN (US$ 3 million, IBRD). This component will provide technical assistance and capacity building to CFN. Under this component the Project will finance, inter alia:

(a) Design of a corporate governance strengthening plan for CFN to incorporate international best practices in terms of mandate definition, and board appointment and composition, among others, and to align with the expected legislative and regulatory changes;
(b) Assessment of the financial viability of CFN to ascertain the true extent of the quality of its assets and clean up its balance sheet. Accordingly, this activity will also include the design of an NPL resolution strategy that would reflect the macroeconomic context, the legal and judicial systems, the fiscal capacity of the government and the type of assets in the NPL stock;
(c) Assessment of the current strategy of CFN and development of a new business plan to align with the results of the corporate governance reform and the financial viability assessment;
(d) Design and implementation of a monitoring and evaluation strategy to measure the effect of access to credit on final borrowers, including female-owned enterprises and first-time borrowers;
(e) Design and implementation of an environmental and social management system and standards for CFN’s second-tier lending; and
(f) Technical assistance to strengthen the capacity of financial intermediaries accessing second-tier financial products, including the strengthening of their environmental and social management systems.

Component 2 – Development and Improvement of Financial Products to Promote Access to Finance for MSMEs (US$ 42 million, IBRD). This component will support CFN to develop new or improve existing financial products to promote access to finance for productive purposes, especially for MSMEs. Specifically, under this component the Project will finance:

(a) Subcomponent 2a – technical assistance (US$ 2 million, IBRD). Under this subcomponent, the Project will finance a technical assistance program aimed to (i) strengthen NGF, especially its risk management system and pricing policy; and, (ii) design, test and evaluate new financial products for MSMEs with potential to be scaled up (e.g. risk sharing facilities, alternative financial instruments, climate resilience financial products, specialized products for female-owned MSMEs and IPAM-owned MSMEs, FinTech solutions).
(b) Subcomponent 2b – capitalization of NGF for special COVID-19 program (US$ 20 million, IBRD). This subcomponent will support the activation of a special emergency guarantee program to alleviate the economic effects of the COVID-19 crisis on productive MSMEs, guaranteeing liquidity and covering their working capital and investment needs to maintain productive activity and employment. Under this subcomponent, the Project will capitalize a special guarantee program, which will be part of NGF’s capital and will be extended to PFIs that will lend to beneficiary MSMEs.
(c) Subcomponent 2c – capitalization of NGF for standard programs (US$ 20 million, IBRD). This subcomponent will support the standard operations of NGF. Under this subcomponent, the Project will capitalize NGF, which will use
its equity to provide guarantees to PFIs that will lend to beneficiary MSMEs for working capital and investment purposes. It is expected that final borrowers will include firms from sectors with high potential for productivity growth as well as female-owned enterprises, IPAM-owned MSMEs and first-time borrowers.

Component 3 – Credit Line Intermediated by CFN to PFIs for On-Lending to MSMEs (US$ 213 million, IBRD). This component will support CFN to establish and expand second-tier lending operations to serve MSMEs through the commercial and the cooperative banking sector. Under this component, the Project will finance the provision of lines of credit to eligible private PFIs, which in turn will on-lend to eligible private MSMEs. CFN will assume the credit risk of the PFIs, while the latter will take on their books the credit risk of the MSMEs. Beneficiary MSMEs will get access to finance for working capital and investment purposes. It is expected that final borrowers will include firms from sectors with high potential for productivity growth as well as female-owned enterprises, IPAM-owned MSMEs and first-time borrowers.

Component 4 – Project Management (US$2 million, IBRD). This component will focus on supporting CFN to effectively execute the Project. Under this component, the Project will finance, inter alia:

(a) Recruitment and training of the Project Coordination Team (PCT) members including, if necessary, specialists responsible for procurement procedures, financial management, environmental and social management, and the overall execution of the Project;
(b) Acquisition of equipment and furniture for the PCT;
(c) Monitoring and evaluation activities;
(d) Study tours for relevant CFN staff;
(e) Stakeholder and citizen engagement plan, including implementation of a Grievance Redress Mechanism (GRM);
(f) Communication strategy; and
(g) Project’s financial audits.

D. Environmental and Social Overview

D.1. Project location(s) and salient characteristics relevant to the ES assessment [geographic, environmental, social]

The Project will support second-tier lending operations nationwide. Second-tier meaning a credit line intermediated by Corporación Financiera Nacional (CFN) to Participating Financial Intermediaries for on-lending to micro, small, and medium enterprises (MSMEs). CFN will use the WB funds to enable PFIs to channel investments with MSMEs. The exact location of the MSMEs to be financed will not be known until implementation.

The Project will finance loans disbursed through eligible PFIs to MSMEs for productive purposes, meaning working capital or investments that will help firms run their businesses, improve their production processes, improve businesses management, and create or improve their products. The project will not finance consumer loans, housing
loans, student loans, etc. The number of private banks and large financial cooperatives with the potential to become eligible isn’t yet known.

The proposed Project consists of four main components: (1) Strengthening the institutional capacity of CFN, which will provide technical assistance and capacity building to CFN on, among others to design and implement the ESMS for CFN’s second-tier lending; (2) Development and improvement of financial products to promote access to finance for MSMEs; (3) Credit line intermediated by CFN to PFIs for on-lending to MSMEs; and (4) Project management.

As part of Component 3, CFN is seeking to establish and expand second-tier lending operations to serve MSMEs through private commercial banks and the cooperatives. The Project will finance the provision of lines of credit to eligible private PFIs, which in turn will on-lend to eligible private MSMEs. CFN will assume the credit risk of the PFIs, while the PFIs will assume the credit risk of the MSMEs. Beneficiary MSMEs will get access to finance for working capital and investment purposes. It is expected that final borrowers will include firms from sectors with high potential for productivity growth mainly: commerce and services (main economic sectors generating more than 60% in sales), manufacture (21%), and agriculture (6%) as well as female-owned enterprises and first-time borrowers. Eligible MSMEs will not receive loans for land acquisition or for new primary production activities that would require the expansion of the current footprint.

Clearly defined eligibility criteria detailed in the Project Operations Manual will be followed during the implementation of the Project. These criteria will ensure that the loan proceeds are used for the intended purposes following the obligations described in the Loan Agreement, including E&S requirements. Only FI subprojects entailing low and/or moderate E&S risks will be financed with this operation; specifically, CFN has created an exclusion list of activities, works or projects that CFN will refrain from financing as part of this line of credit with the WB (refer to ESS1 for further detail).

D. 2. Borrower’s Institutional Capacity

CFN will be the Borrower and project implementing agency. CFN is authorized, regulated and supervised by the Superintendency of Banks of Ecuador (SBE). It was founded in 1964. CFN’s sole shareholder is the Central Bank of Ecuador (BCE). CFN has written policies, manuals and procedures for the management of its financial and operational risks. CFN has a management information system that allows the monitoring of the financial and risk situation, including the preparation of various reports (weekly, monthly, quarterly and annual) addressed to internal (CFN) and external (SBE, credit risk rating agency, external auditors) audiences. The organizational structure of CFN is in line with what is required by regulation, observing separation of functions and internal control systems.

CFN has currently an E&S Risk Management System (Sistema de Administración de Riesgos Ambientales y Sociales - SARAS in Spanish) in place to vet first-tier lending operations according to the scope of activities and potential E&S impacts, the type of environmental license required in Ecuador and CFN’s exclusion list. Bank’s due diligence indicates that CFN’s ability to manage social and environmental risk and impacts for second-tier lending in accordance with the Bank’s ESF is limited due to:

(i) The SARAS does not apply to FI Subprojects financed by second-tier lending operations.
(ii) The SARAS categorizes first tier lending operations, but there isn’t a structured follow up and monitoring after the loan has been approved such as an ESMS.
(iii) Even though CFN has environmental specialists and social-communication specialists integrated into the “gerencias de creditos” within the organization, it does not have a dedicated unit to manage environmental and social aspects of its operations.

(iv) Lack of experience on WB projects and compliance with WB’s safeguards requirements: CFN is implementing a lending operation with the Corporación Andina de Fomento (CAF). Also, CFN has previously managed funds from the Inter-American Development Bank (IADB) and the Agence Française de Développement (AFD), the French development agency. However, the institution is a first-time borrower of the World Bank Group and has no experience implementing WB’s safeguards and/or ESF requirements.

CFN will need specific strengthening measures to implement the provisions established in the ESF relevant to the Project. Specific proposed areas of improvement and institutional strengthening measures include, among others:

(i) The Project will support CFN to design and implement an effective and functional Environmental and Social Management System (ESMS) to manage E&S risks in its second-tier lending, ensuring that PFi}s and beneficiary MSMEs comply with the E&S provisions set forth in the Project’s Loan Agreement. The design and implementation of the ESMS will be financed under Component 1.

(ii) CFN will maintain, throughout project implementation, a Project Coordination Team (PCT), located within CFN’s “Gerencia de Negocios Financieros y Captaciones”. The PCT will be responsible for coordinating the implementation, supervision, completion, and documentation of all the activities related to the Project, including coordinating the procurement, financial management, disbursements, and environmental and social aspects of the Project, in accordance with the provisions of the Loan Agreement. The PCT will be composed of key staff from CFN at central and regional levels with functions, experience, responsibilities and qualifications acceptable to the World Bank. PCT staff members will comply with the roles and responsibilities set out in the operations manual for a core team, including an E&S Senior Representative and an E&S specialist, to be hired/appointed 30 days after project effectiveness. These specialists will be trained on ESF requirements and on the implementation of the ESMS for second tier credit line, and will receive implementation support from the Bank as needed. Recruitment and training of the PCT members will be financed as part of Component 4.

Mentioned strengthening measures have been included in the Project’s draft ESCP.

II. SUMMARY OF ENVIRONMENTAL AND SOCIAL (ES) RISKS AND IMPACTS

A. Environmental and Social Risk Classification (ESRC)  

Environmental Risk Rating  

The environmental proposed risk classification for the Project is Moderate under the World Bank ESF. Considering the nature and magnitude of the potential environmental risks and impacts of FI subprojects they would be: (i) predictable and expected to be temporary and/or reversible; (ii) low in magnitude; (iii) site-specific, without the likelihood of impacts beyond the actual footprint of the project; (iv) low probability of serious adverse effects to human health and/or the environment (e.g., do not involve use or disposal of toxic materials, routine safety precautions are expected to be sufficient to prevent accidents, etc.). The activities of the FI subprojects will no increase water and energy consumption due to the manufacturing of new products, increment air pollution because
of industrial processes, e-wastes from computer hardware upgrades, among others. Also, no loans that would lead to significant adverse impacts on biodiversity and habitats, or on cultural heritage, would be supported. CFN has created an exclusion list to delineate the FI subprojects that will not be subject to investment with this credit line with the World Bank. Ultimately, only low and/or moderate risk investments will be financed.

**Social Risk Rating**

Social risk rating is classified as moderate at this stage considering the nature and magnitude of the potential social risks and impacts of FI subprojects. Main risks are related to: labor issues through deficient compliance with labor regulations such as Health and Safety; lack of participation of small cooperatives and MSMEs in remote areas of the country due to lack of access to clear and culturally appropriate information; and possible exclusion of some subgroups among the MSMEs due to limited efforts from second tiers FI regarding strategies/approaches to address specific ethnic needs to ensure successful participation of these groups in accessing the offered product. For example, this could include information and communication campaigns with cooperatives that provide loans to MSMEs run by IP, in remote areas or to women run businesses. No adverse impacts on indigenous peoples are expected, whereas PFIs will be encouraged to lend to IP-owned businesses. Nevertheless, under Subcomponent 2a. the Project will finance a technical assistance program aimed to design, test and evaluate new financial products for MSMEs with potential to be scaled up including risk sharing facilities, alternative financial instruments, climate resilience financial products, specialized products for female-owned MSMEs, and Indigenous peoples MSMEs. Land acquisition and resettlement will not be supported and loans that would result in either are included as part of the exclusion list. Also, Sexual Exploitation and Abuse (SEA)/Sexual Harassment (SH) risks will be assessed and addressed in implementation, including screening and putting in the corresponding measures to prevent and mitigate the SEA/SH risks. Key activities proposed under the project will include the provision of loans targeting Micro, Small & Medium Enterprises (MSMEs) through a number of private banks and large financial cooperatives with potential to become eligible that are not identify yet. The ESMS will be developed in a culturally appropriate manner to allow for proper engagement with IPs and Afro-descendants. In addition, eligibility criteria for FI subprojects will include E&S considerations as well as the implementation of a culturally appropriate Grievance-Redress Mechanism (GRM).

B. Environment and Social Standards (ESSs) that Apply to the Activities Being Considered

B.1. General Assessment

**Overview of the relevance of the Standard for the Project:**

This standard is relevant. CFN will design and implement an ESMS for this second tier credit line with the WB, which will include a categorization process for assessing the E&S risk level of each of the proposed loans. This ESMS, to be ready for implementation 90 days after Effectiveness date and/or before the start of the activities of Component 2b, 2c and 3 of the Project. The ESMS will be commensurate with the nature and magnitude of environmental and social risks and impacts of FI subprojects, the types of financing, and the overall risk aggregated at the portfolio level, in line with para. 40 of the E&S Policy. The ESMS will include at a minimum the following components (refer to ESS9 for further details on the ESMS and its different components): (a) E&S policy; (b) E&S procedures and capacity to screen subprojects conduct due-diligence to evaluate E&S risk and assign risk category; (c) systems/processes for due
diligence to evaluate, monitor, review and manage E&S risks and impacts of subprojects; (d) organizational capacity and competence; and (e) external communications and reporting mechanisms on E&S performance.

The ESMS will specifically include the following elements to avoid and/or mitigate potential E&S risks and impacts, relevant to ESS1:

1. Exclusion list. As an important part of the ESMS, CFN has created an exclusion list of activities, works or projects that CFN will refrain from financing as part of this line of credit with the WB. The CFN Exclusion List for the credit line with the WB explicitly includes projects involving substantial and high-risk activities/sectors, such as: involuntary resettlement; infringement of natural and critical natural habitats: production or commercialization of any product or activity considered illegal according to the laws or regulations of Ecuador; production or activities affecting lands owned or claimed by indigenous peoples; production or trade of alcoholic beverages (except beer and wine); production, trade, storage or transport of large volumes of hazardous chemicals; and any dams that would be considered high or substantial risk to support.

2. Process of E&S Risks and Impacts Identification. CFN is expected to have as part of the ESMS robust procedures for screening, review, and approval of E&S assessment. This includes a process for categorizing projects based on their level of E&S risks and using as reference the WB’s criteria for E&S risk categorization of projects, E&S due diligence, and E&S monitoring and reporting for implementation of their first-tier and second-tier lending. CFN’s ESMS will ensure that any PFI receiving funds is compliant with WB ESF requirements, and has an ESMS to manage the ESHS aspects of its subloans (for implementation of the credit line, CFN will enter into a Subsidiary Financing Agreement with eligible PFIs to on-lend to eligible MSMEs through Subloan Agreements). E&S obligations will be contractually passed through to PFIs and MSMEs.

Regarding non-discrimination provisions, CFN lending policies, criteria and procedures and related capacity will be assessed and improved as needed to ensure the institution does not discriminate against and provide reasonable accommodations for vulnerable and minority groups (IPs, afro-Ecuadorians, women, people with disabilities, LGBTQ individuals, other racial and ethnic minorities, etc.). Specifically, the Project will promote a gender equality approach within this component and will include a specific gender indicator in the results matrix to measure the number of MSMEs owned and/or led by women receiving subloans with Project funds.

ESS10 Stakeholder Engagement and Information Disclosure
This standard is relevant due to the potential risk that some of the targeted beneficiaries might be excluded from the project.

CFN will provide loans for productive purposes to Micro, Small & Medium Enterprises (MSMEs) through second-tier lending operations channeled by several commercial banks and cooperatives in the country. The Project will help CFN expand its activities and loan portfolio through PFIs and reach more MSMEs and provide financial support to more regions in the country. Among those PFIs, CFN will be able to work with cooperatives that serve and understand how to serve vulnerable groups and indigenous populations around the country. CFN has prepared a draft SEP, consistent with ESS10, that includes: i) activities carried out by CFN to provide inputs for the project design and elaboration of
draft SEP; ii) preliminary stakeholder identification (FPIs and MSMEs) and analysis of vulnerable subgroups within the MSMEs; iii) strategies, proposed activities, type of information and dissemination means to be used to inform stakeholders and collect their feedback during the different phase of the project; iv) timeline; v) follow-up and monitoring regarding the SEP implementation; vi) institutional arrangement including personnel, functions and responsibilities regarding SEP as well as budget for its implementation; vii) GRM that will be implemented for the project. Given the existing global pandemic and advisories against public meetings, CFN’s initial consultations will take place through the disclosure of the draft SEP on its web page [www.cfn.fin.ec], and all possible efforts will be made to collect and record stakeholders’ opinions through digital and remote technology (social medias, video calls, virtual meetings, Skype, email, and other virtual technologies) – prior to Appraisal. Timeline for the final version will be part of the ESCP.

Thus far, CFN has carried out initial information and consultation sessions regarding the financial product and credit lines with relevant private lending institutions, including environmental and social requirements. Once the ESMS is completed additional information and consultations will be carried out to informs PFIs of these requirements. Ten information sessions were carried out between February 3rd and February 7th, in Quito and Guayaquil, with representatives of PFIs (four private banks and two financial cooperatives), three services sector business, and three productive sector organizations (banana production and export, coffee production and export, small industries (food, graphic, chemical and plastic, leather and footwear, lumber, broadcasting, construction material, metal mechanics, textiles and clothing). The 24 participants, including 10 women, hold decision-making positions in their respective institutions. Their inputs served to inform the design of the financial product to be offered. As well, participants expressed interest in receiving support to implement the SGAS that will be part of the loan contract for second tiers lending operations in the context of the proposed credit line. Once CFN has draft versions of other agreed ESF instrument (ESCP, LMP, SGAS, Exclusion List) these will be disclosed on their web page [www.cfn.fin.ec] if at that time advisories against public meetings still holds CFN’s will use digital and remote technology. Once public gatherings are permitted CFN will dissemination mechanisms such as meetings, interview and surveys, and collection of end users testimonies, among others).

CFN currently has a Grievance Redress Mechanism (GRM) available to the public to receive claims and consultations. However, CFN will need to adapt this mechanism to comply with ESS10 requirements, this will be a requirement under ESCP to be completed 60 days after effectiveness.

B.2. Specific Risks and Impacts

A brief description of the potential environmental and social risks and impacts relevant to the Project.

ESS2 Labor and Working Conditions

This standard is relevant.

This project is classified as an FI project and ESS2 applies to the responsible FI itself as well as to the second tier PFIs. CFN has a Human Resources department, called Gerencia de Talento Humano, that coordinates internal labor management in the institution. This unit will be responsible for preparing Labor Management Procedures (LMP) for CFN and the criteria to be included into the ESMS for the second tier PFIs in accordance with national legislation and
requirements under ESS2 and ESS9. The LMP will be an integral part of CFN’s and each PFI’s ESMS that is being prepared to comply with ESS2 and ESS9 requirements for first and second-tier lending operations. CFN is in the process of completing a draft LMP focusing on labor procedures for CFN’s staff working directly with the project at central and regional levels and will develop labor criteria to be included into the ESMS that will be prepared for second-tier lending operations. The LMP will also address MSMEs direct workers and corresponding sector legislation, and indirect workers (contracted workers) in the event some of the subprojects require civil works to be carried out. No community workers or primary suppliers are foreseen in the context of the subprojects that would be financed with the project line of credit.

In terms of risk associated with sexual harassment, CFN has a code of ethics that includes language related to sexual harassment in the institution. For the second-tier lending, the project will include sexual harassment and non-discrimination requirements in the 2nd tier provisions of the LMP and will rely on monitoring, supervision and spot checks to assess associated risks as well as the GRM. The preliminary draft LMP includes information on relevant Ecuadorian law, rules, and regulations related to ESS2, and where gaps are identified, complement them with measures in the LMP consistent with ESS2. CFN should provide adequate information with documented evidence of the application of such procedures during project implementation. The LMP includes the design and implementation of a labor grievance redress mechanism (GRM) to be developed by CFN as well as by each PFI for their workers. These GRMs are separate from that described under the ESS10 for works and activities carried out by sub-borrowers or contractors on sub-projects. Details of this “Labor” GRM will be included in the ESMSs for each of the 2nd tier FIs.

At this stage of the project, subprojects of the MSMEs are not yet identified. However, given that some subprojects funded by CFN may require labor due to construction or civil works, CFN’s ESMS needs to address labor risks, for example due to labor influx of temporary workers, risk of forced and child labor and Occupational Health and Safety (OHS), and ensure that sub clients will adopt and monitor labor management procedures consistent with local laws and ESS2. In this context, the CFN is required to ensure that PFI subprojects to MSMEs will have and maintain procedures relating to working conditions and terms of employment, non-discrimination and equal opportunity, and grievance mechanisms for their own workers. CFN’s ESMS also needs to ensure that the PFI subprojects have and enforce Environmental Health and Safety (EHS) procedures including specific instruments to protect the health and safety of workers.

CFN’s existing ESMS for its first-tier lending operations includes as part of its exclusion list, according to national labor regulations, any activities, works, or projects that involve “child labor, non-compliance with the fundamental principles of workers’ rights, forced labor, exploitation, discriminatory practices (…)” (Normativa de la CFN, Anexo A: Lista de Exclusión). These types of regulations and provisions already included in its first-tier operations exclusion list will also apply to second-tier lending operations and will also be part of CFN’s 2nd tier ESMS screening process.

Given that labor procedures and requirements will be an integral part of CFN’s ESMS and that the ESMS for second tier lending will be prepared as a condition of effectiveness, a draft version of the LMP will be prepared and disclosed before Bank’s board approval and will be completed within 60 days of effectiveness. This will be a requirement under ESCP.
ESS3 Resource Efficiency and Pollution Prevention and Management

This standard is relevant but given the nature of the sub-projects is likely to be addressed through screening and compliance with local/national laws per paras. 14 and 16 of ESS 9.

FI subprojects for activities and sectors of substantial and/or high risks won’t be financed with this operation. CFN’s ESMS will include provisions to consider ESS3 requirements in the screening of all FI-Subprojects to exclude any subprojects with significant adverse impacts related to this standard. Even though the exact investments to be financed by MSMEs will not be known until implementation, no significant pollution and resource efficiency issues are expected to arise in the supported subprojects.

As described under the E&S Overview section, clearly defined eligibility criteria will be followed during the implementation of the Project. Eligibility criteria for productive investments (e.g., new equipment and machinery, vehicles, etc.) to be financed by MSMEs will include the use of best available technology (BAT), energy efficiency, and low-carbon considerations, as defined in the Operations Manual.

Given the nature of the sub-projects and the focus on providing a line of credit for working capital, there will be only a negligible difference in GHG emissions, thus no GHG accounting will be done for the Project.

ESS4 Community Health and Safety

This standard is relevant but given the nature of the sub-projects is likely to be addressed through screening and compliance with local/national laws per paras. 14 and 16 of ESS 9.

For subprojects to be financed by CFN, CFN’s ESMS will assess sub-project activities that may pose community health and safety risks. Given that the Project will finance loans to MSMEs for productive purposes, meaning working capital or investments that will help firms to run their businesses, improve their production process, improve business management, create or improve their products, the most important community health and safety potential risks could be related to temporary construction such as dust, noise, disposal of hazardous and non-hazardous wastes, safe operation of vehicles etc. Labor influx and related risks are not expected. The ESMS will include provisions to consider ESS4 requirements in the screening of all FI-Subprojects to exclude activities that could involve significant risks associated with community health and safety.

ESS5 Land Acquisition, Restrictions on Land Use and Involuntary Resettlement

This standard is not relevant. The project won’t support land acquisition. Land acquisition will be part of the exclusion list that will be developed as part of the project. In addition, the project won’t support any sub-projects that require expropriation of land under Ecuadorian expropriation law. Any subproject including a footprint expansion will be subject to due diligence to verify that it does not include physical or economic displacement, restriction of access, or any ESS5 related adverse impacts, and projects with such impacts will be screened out.
ESS6 Biodiversity Conservation and Sustainable Management of Living Natural Resources

This ESS is not expected to be relevant to the project.

Eligible MSMEs will not receive loans for land acquisition or for new primary production activities that would require a footprint expansion. The ESMS will incorporate a list of excluded activities that could result in substantial or high risk Environmental and Social impacts, including interventions that interfere with natural and/or critical natural habitats, specifically those that involve significant conversion or significant degradation of these habitats.

In circumstances where the potential subprojects of the MSMEs involve new or renewed forestry or agricultural plantations, the ESMS will include specific requirements to make sure that these do not convert or degrade any critical habitat and that are only of low or moderate risk nature. For subprojects involving primary production and harvesting of living natural resources, the ESMS will include provisions requiring the assessment of the overall sustainability of these activities, as well as of their potential E&S impacts, in line with paras. 31-35 of ESS6. Also, in view of the potential for plantation subprojects to introduce invasive alien species, the ESMS will ensure such subprojects are designed to prevent and mitigate these potential threats to natural habitats.

The relevance of this ESS will be further assessed during project implementation and as part of the ESMS. Even if subprojects with minor impacts on biodiversity cannot be excluded, these impacts are expected to be addressed through compliance with local/ national laws per paras. 14 and 16 of ESS 9.

ESS7 Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities

This standard is relevant but given the nature of the sub-projects it will be addressed through screening, mitigation measure and compliance with local/ national laws per paras. 14 and 16 of ESS 9 included in the ESMS

CFN’s exclusion list for first-tier lending states that no activities, works, or projects will be financed that “violate the rights of indigenous, Afro-Ecuadorians and other ethnic minorities, as established in Ecuadorian laws and in the international conventions” (Normativa de la CFN, Anexo A: Lista de Exclusion). Similar provisions will apply to second-tier lending operations and will be also part of its ESMS screening process and exclusion list for the project, complemented as needed to exclude any projects that involve substantial or high risks or adverse impacts on indigenous peoples. Given the presence of indigenous peoples and Afro-descendants throughout Ecuador, CFN’s ESMS and SEP will contain measures to encourage PFIs to lend to IP led/owned businesses, non-discrimination provisions and ensure that that IPs have equal access to project information and benefits. Under Subcomponent 2a. the Project will finance a technical assistance program aimed to design, test and evaluate new financial products for MSMEs with potential to be scaled up including specialized products for female-owned MSMEs, and Indigenous peoples MSMEs. In addition, the Project will help CFN implement a monitoring and evaluation strategy so the institution can measure development impact by economic sector, geographic areas and MSMEs getting access to finance for the first time including Indigenous Peoples-owned MSMEs. However, the project will not have any direct incentives or eligibility criteria targeting indigenous populations and no IPPF or IPP will be developed.
ESS8 Cultural Heritage

This standard is relevant but given the nature of the sub-projects is likely to be addressed through screening and compliance with local/national laws per paras. 14 and 16 of ESS 9.

It is not anticipated that FI subprojects will have direct or indirect impacts on tangible or intangible cultural heritage and the exclusion list will incorporate restriction for financing projects located i) within a legally protected area or a legally defined buffer zone; ii) located in, or in the vicinity of, a recognized cultural heritage site; or, iii) specifically designed to support the conservation, management and use of cultural heritage. CFN’s ESMS will include provisions to consider ESS8 requirements in the screening of all FI-Subprojects to exclude activities that could involve significant impacts on cultural heritage. It is important to note that Ecuador has a well-developed legislative framework for the protection of its cultural, historical and archeological heritage under the environmental licensing process. Therefore, for any subprojects, including earth movement, the ESMS will include the preparation of a chance find procedure in accordance with national laws and regulations.

ESS9 Financial Intermediaries

This standard is relevant.

The project aims at supporting CFN to establish and expand second-tier lending operations to serve MSMEs through private PFIs. CFN will assume the credit risk of the PFIs, while the latter will take on their books the credit risk of the MSMEs. As such CFN is required under this operation to monitor and manage the environmental and social risks and impacts of the 2nd tier FI Subprojects through an ESMS.

WB has conducted a detailed evaluation of the CFN’s environmental and social management procedures, which will serve as a starting point for designing the ESMS for the second-tier operations to be financed with project funds. Under the proposed operation, CFN will be required to develop, implement, and maintain this ESMS, consistent with the requirements set out in ESS9 and proportionate to the 2nd tier FI subproject risks. The ESMS, will be ready for implementation 90 days after Effectiveness date.

The ESMS, as defined in ESS9, will include:
(a) E&S policy: CFN has an environmental and social policy for all its operation; however, for this credit line with the WB, CFN will create a specific one in compliance with the ESF.
(b) Clearly defined E&S procedures and capacity: to screen subprojects (application of exclusion list, review of industry sector and technical aspects of each subproject) and conduct due-diligence to evaluate E&S risk and assign risk categories (low, moderate, substantial and high risk). High and substantial risk subprojects will be excluded.
(c) Systems/processes for due diligence to evaluate, monitor, review and manage E&S risks and impacts of subprojects: evaluate the E&S performance of on-going subprojects and the portfolio on a periodic basis.
(d) Organizational capacity and competence: including a budget and a senior management position designated for reporting on the ESMS as well as providing training and capacity-building on ESMS procedures and performance.
(e) External communications and reporting mechanisms on E&S performance.

Likewise, CFN will require that the participating PFIs implement or update their ESMS. The requirements of the ESMS for PFIs will be the same as those requested by the WB to CFN. The ESMS should include at a minimum the following components (refer to ESS9 for further details on the ESMS and its different components) : (a) E&S policy; (b) E&S procedures and capacity to screen subprojects conduct due-diligence to evaluate E&S risk and assign risk category; (c) systems/processes for due diligence to evaluate, monitor, review and manage E&S risks and impacts of subprojects; (d) organizational capacity and competence; and (e) external communications and reporting mechanisms on E&S performance.

CFN will require each PFI to appoint a senior representative from their management/administration to have overall responsibility for environmental and social performance, and an environmental and social specialist to be responsible for the day-to-day implementation of the ESMS.

More information on the Exclusion List and evaluation of E&S risks is detailed in the sections under ESS1-8 above.

C. Legal Operational Policies that Apply

| OP 7.50 Projects on International Waterways | No |
| OP 7.60 Projects in Disputed Areas | No |

III. BORROWER’S ENVIRONMENTAL AND SOCIAL COMMITMENT PLAN (ESCP)

<table>
<thead>
<tr>
<th>DELIVERABLES against MEASURES AND ACTIONs IDENTIFIED</th>
<th>TIMELINE</th>
</tr>
</thead>
<tbody>
<tr>
<td>ESS 1 Assessment and Management of Environmental and Social Risks and Impacts</td>
<td></td>
</tr>
<tr>
<td>CFN will design and implement an ESMS for activities of Subcomponent 2b, 2c and Component 3</td>
<td>07/2020</td>
</tr>
<tr>
<td>Setting up Project Coordination Team (PCT ) at CFN with the inclusion of environmental and social specialist to manage the ESMS and designate an E&amp;S senior representative.</td>
<td>06/2020</td>
</tr>
<tr>
<td>ESS 10 Stakeholder Engagement and Information Disclosure</td>
<td></td>
</tr>
<tr>
<td>a). CFN will prepare and publicize a preliminary version of the SEP.</td>
<td>04/2020</td>
</tr>
<tr>
<td>b). Update, adopt and implement the SEP. Implementation throughout the project and updates will be made as needed (changes in the project).</td>
<td>07/2020</td>
</tr>
</tbody>
</table>
Communication Strategy to promote the activities of the project. This will be relevant in Ecuadorian indigenous languages, particularly in regions with this population. 07/2020

### ESS 2 Labor and Working Conditions

a). CFN will prepare and disseminate a preliminary labor management procedure (LMP) aligned with EAS2, including occupational health and safety (SSO) and measures related to emergency preparedness. 06/2020

CFN will establish, implement and maintain a grievance redress mechanism (GRM) for project workers, as described in the LMP. 05/2020

### ESS 3 Resource Efficiency and Pollution Prevention and Management

As part of the ESMS, procedures will be in place to assess ESS3 07/2020

### ESS 4 Community Health and Safety

As part of the ESMS, procedures will be in place to assess ESS4 07/2020

### ESS 5 Land Acquisition, Restrictions on Land Use and Involuntary Resettlement

### ESS 6 Biodiversity Conservation and Sustainable Management of Living Natural Resources

### ESS 7 Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities

### ESS 8 Cultural Heritage

### ESS 9 Financial Intermediaries

A plan for CFN to prepare, consult and implement the second tier ESMS as a condition of effectiveness 04/2020

Develop and implement an ESMS for subcomponents 2b, 2c and Component 3 acceptable to the World Bank 07/2020

CFN will require PFIs to develop, update or adopt an environmental and social management system (ESMS) in order to receive funding for sub-projects. 07/2020

Capacity building and training for CFN and the PFIs for ESMS development requirements. 12/2020

### B.3. Reliance on Borrower’s policy, legal and institutional framework, relevant to the Project risks and impacts

**Is this project being prepared for use of Borrower Framework?**  
No

**Areas where “Use of Borrower Framework” is being considered:**  
None
### IV. CONTACT POINTS

<table>
<thead>
<tr>
<th>World Bank</th>
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</thead>
<tbody>
<tr>
<td>Contact:</td>
<td>Pietro Calice</td>
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<table>
<thead>
<tr>
<th>Borrower/Client/Recipient</th>
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<tr>
<td>Borrower:</td>
<td>Corporación Financiera Nacional</td>
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### V. FOR MORE INFORMATION CONTACT

The World Bank  
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### VI. APPROVAL

<table>
<thead>
<tr>
<th>Task Team Leader(s):</th>
<th>Pietro Calice, Daniel Ortiz del Salto</th>
</tr>
</thead>
<tbody>
<tr>
<td>Practice Manager (ENR/Social):</td>
<td>Valerie Hickey Cleared on 20-Apr-2020 at 09:31:57 EDT</td>
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