
**Evaluation of the Promotion of Environmental
and Social Standards in DEG's Indirect
Financing
Case Study Report – Banco Promerica, El
Salvador**

Prepared for
DEG

November 2016

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Abbreviations

ARAS	Administración de Riesgos Ambientales y Sociales
CEDES	Consejo Empresarial Salvadoreño para el Desarrollo Sostenible (CEDES)
DEG	Deutsche Investitions und Entwicklungsgesellschaft mbH
DFI	Development Finance Institution
E&S	Environmental and Social
ESAP	Environmental and Social Action Plan
ESMS	Environmental and Social Management System
FI	Financial Institution
GRI	Global Reporting Initiative
HACCP	Hazard Analysis and Critical Control Point
H&S	Health and Safety
IFC PS	International Finance Corporation Performance Standards
KPI	Key Performance Indicator
MARN	Ministerio Medio Ambiente y Recursos Naturales (Ministry of Environment and Natural Resources)
NPL	Non Performing Loan
PEF	Private Equity Fund
SARAS	Sistema de Administración de Riesgos Ambientales y Sociales
SME	Small and Medium-sized Enterprise
TA	Technical Assistance
WBCSD	World Business Council for Sustainable Development (WBCSD)

Executive Summary

DEG, as a Development Finance Institution, promotes economic success and sustainable business practices via the financing of private sector clients. DEG's investments extend to countries and sectors with different levels of Environmental and Social (E&S) regulations and standards as well as different degrees of enforcement thereof. In response, DEG requires its clients to implement a series of formalised E&S standards adapted to the clients' activities and context.

To ensure the implementation of E&S standards in its investments with Financial Institutions (FIs) and Private Equity Funds (PEFs), DEG includes requirements for these clients to implement a formal Environmental and Social Management System (ESMS) in its contracts. The ESMS includes the use of a specific Exclusion List in the screening process, the appointment of an E&S Officer to a dedicated role, and the provision of an annual report on E&S performance. The planning and implementation of ESMS at banks, including the appointment of an E&S Officer with responsibilities for management of the ESMS, is central to the achievement of DEG's E&S standards.

DEG is carrying out an evaluation of its overall environmental and social (E&S) risk management for its investments through FIs and PEFs. The evaluation has included a Case Study on the implementation and impacts of DEG's E&S requirements associated with its loan to Banco Promerica in El Salvador (BPSV), which was signed in 2012. DEG provided Technical Assistance (TA) for the design and implementation of an ESMS during 2012-13. This has been used as a blueprint for roll-out to the other eight Promerica group banks across Central America: BPSV is responsible for mentoring two of these banks in implementing their ESMSs and training staff. This Report provides a summary of the Case Study findings from El Salvador.

Overall the ESMS at Banco Promerica is at an advanced stage, with full management support, and has been replicated across the bank's portfolio. The ESMS is well adapted to the risk profile (FI-B) and the stage of development of the clients in relation to E&S compliance. The ESMS has improved the quality of the bank's portfolio and should help to secure additional Development Finance Institution (DFI) credit lines – a direct commercial impact. DEG's role has been well received, particularly in relation to TA, however there are a number of specific areas where further feedback and support could add further value.

The main conclusions and lessons learned from this Case Study are:

- The senior management of Banco Promerica is strongly committed. They saw the benefits of an ESMS in terms of risk and reputation management and as part of their corporate sustainability approach from the outset. The advantage of having the ongoing involvement of a senior individual who has energetically championed the ESMS and provided leadership in the roll-out to other banks is very evident.
- The ESMS has been developed and robustly implemented at Banco Promerica in El Salvador. The case study illustrates the importance of a concrete and practical system, which is proportionate to the E&S risk profile and average loan size and is integrated into the commercial loan assessment process from the earliest stages. For the first three years the focus has been on ensuring that clients meet national E&S regulatory and licensing requirements rather than International Finance Corporation Performance Standards (IFC PS). This is appropriate given BPSV's categorisation as FI-B and the very limited number of high risk projects in its portfolio.
- BPSV has taken a pragmatic approach to recruiting E&S Staff as it is difficult to find experienced E&S professionals in the domestic market. They have instead provided on-the-job E&S training to an experienced senior analyst promoted to the E&S coordinator position, and to young enthusiastic financial analysts who will be able to carry out more complex E&S due diligence assessments and support others. The choice of an individual who understands the bank's procedures and clientele as well as E&S issues has made her an effective gate-keeper to make sure that E&S requirements are fully met.
- Based on its successful ESMS implementation, BPSV is now working with two other banks in the Promerica group to help them adopt the same policies, procedures and tools, adapted where

necessary for their own contexts. This group-wide approach will have advantages in helping Promerica clients export and invest in other Central American markets and will help the bank to bring in lines of credit from other DFIs.

- *There are significant opportunities in E&S investments in El Salvador which could improve the resource efficiency in the bank's key investment sectors including sugar cane, plastics, public transport and freight and other light industrial processes. Banco Promerica group is exploring a Green Line of credit to address some of these opportunities with another DFI.*
- *BPSV and the Promerica group have very good feedback about the support they have received from DEG and its TA Programme. They would very much also appreciate: feedback on their E&S Annual report; further advice and support in developing a central database for E&S assessments and good practice which could be shared across the group; access to useful resources on best practice and legislative requirements in sectors which are new to the bank; and opportunities to take part in training or workshops to exchange good practice and deepen knowledge about green investment opportunities such as renewable energy and resource efficiency with other E&S officers in Central and Latin America.*

1. Context: DEG's E&S Evaluation

1.1 DEG E&S Requirements

Due to the specifics of its portfolio countries and sectors, DEG promotes and controls Environmental and Social (E&S) standards proactively. Therefore, DEG requires its clients to implement a series of formalised E&S standards which are applicable to all of its clients.

These include, among other requirements:

- Screening projects against an Exclusion List;
- Using risk categorisation criteria for clients in different sectors;
- Developing and applying E&S procedures across the investment cycle;
- Assigning responsibility for E&S management;
- Training credit officers in E&S procedures;
- Monitoring E&S performance;
- Requiring annual E&S reporting from clients.

In its contracts with clients, DEG includes clear requirements for clients to structure these components into a formalised Environmental and Social Management System (ESMS).

1.2 Benefits of an ESMS

Implementation of an ESMS reduces the clients' as well as DEG's risk exposure and strengthens the business performance of its clients through:

- Achieving compliance with national regulations and international standards;
- Reducing the number and scale of environmental accidents and social incidents;
- Managing the risks to the reputations of the banks and the businesses in which they invest;
- Enhancing the opportunities for banks to gain access to international finance;
- Improving the motivation of employees at the companies, and meeting expectations of stakeholders related to environmental and social performance;
- Setting a framework to identify viable opportunities for environmental and social investments, such as in water resources management, energy efficiency, etc.

1.3 Purpose of this Evaluation

The purpose of this assignment is to evaluate both the progress and success in relation to the implementation of DEG's E&S requirements within the indirect financing portfolio. The evaluation covers both Financial Institutions (FIs) and Private Equity Funds (PEFs) and includes those that have received Technical Assistance (TA)¹ and those that have not (termed the Control Group).

The steps of the evaluation study include the following:

- a portfolio-wide data and document analysis;
- a representative web-based survey of clients;
- telephone interviews (19 clients);
- Case Study visits (8) within Europe, Latin America, Africa and Asia.

¹ The Technical Assistance (TA) programme is adapted to the client's needs. In its most general form it involves 5 stages: Phase 1: Initial Assessment; Phase 2: Supporting the development of policies, procedures, tailor-made tools, checklists etc.; Phase 3: Review of policies and procedures, on-site training of key staff; Phase 4: Evaluation of the implementation of E&S policies and procedures; Phase 5: Provision of on-going off-site support and final evaluation.

The objectives of the evaluation are provided in Box 1.

Box 1 - Objectives of the evaluation

- Objective 1 - Evaluate the implementation and practical use of ESMS by DEG's clients.
- Objective 2 - Evaluate the effectiveness and impact of ESMS at (i) clients; (ii) sub-projects.
- Objective 3 - Evaluate (i) the functioning of DEG, and (ii) the value-added of DEG (in particular in the TA framework on ESMS).

1.4 Purpose of this Report

This short-form Report summarises the evaluation visit to the Case Study **FI: Banco Promerica El Salvador (BPSV)**.

The Case Studies have been selected in line with agreed criteria, so that they cover a mix of regions (Africa, Latin America, Asia and Europe), a balance of clients with E&S risk categories A (high risk) and B (medium risk), a mix of FIs and PEFs, and a focus on clients that work with SMEs.

Banco Promerica was selected as a Financial Institution that DEG has categorised as E&S risk category B (i.e. its sector portfolio overall is considered as medium-risk), operating in a country where E&S regulations are in place and where enforcement is being taken seriously by government but is still weak compared to other Central American countries such as Costa Rica and Panama.

BPSV received Technical Assistance (TA) from DEG on the design and implementation of its Environmental and Social Management System (ESMS) from 2012 to 2013. The resulting ESMS has been used as a blueprint by the Holding Group for roll-out to the other banks within the group.

This case study included a review of relevant documents (listed in *Appendix 1*), phone calls with the TA consultant, and meetings at BPSV offices in El Salvador. These meetings involved the main points of contact with DEG (Finance Director and External Banking Financial Analyst), the E&S team (Risk Director, E&S officer and financial analysts) and loan officers. In addition, four case studies (sub-projects) were presented by the investment teams and one project was visited. A list of telephone interviews, meetings and visits is provided in *Appendix 2*.

2. Background on Country and Client

2.1 The Country

El Salvador is one of the smallest countries in Central America with a population of about six million, of whom two thirds live in San Salvador. El Salvador was badly hit by the global recession from 2008 onwards but the economy is now recovering, with GDP growth of 2.5% in 2015 and expected to remain at this level for the next few years. El Salvador is a net importer but has strong exports in the textiles, agricultural (sugar cane, cotton, coffee and shrimp) and chemicals sectors. The US is its largest trading partner but most exports are within the Central American region.

Extreme income inequality – with over 37% of the population living below the poverty line – and its history of armed conflict contribute to amongst the highest rates of crime and violence in the region. Security issues have impacted growth in all sectors.

The key E&S issues in recent years have been mainly water-related. Poor controls on effluent water and run-off (particularly in the sugar cane, pig farming and lead batteries sectors) have led to pollution of water courses and conflicts with neighbouring communities. A number of banks have faced reputational risks when green NGOs have become involved. Water scarcity is also a major issue in the 'dry corridor' lowlands and El Salvador experienced droughts in 2014 and 2015, which badly affected commercial farmers' incomes (cotton and sugar) and livelihoods of subsistence households.

The Ministry of Environment and Natural Resources (MARN) is responsible for ensuring implementation of environmental standards as set out in the framework environment law. Expectations of compliance

with national permit and license requirements are reported to be higher in the last few years but MARN does not appear to have the capacity to impose high fines in the case of non-compliance. Few other banks are thought to be fully implementing an ESMS, although Banco Agrícola, El Salvador's largest bank, is presumed to have an IFC-compliant ESMS.

2.2 The Client: Banco Promerica

BPSV is the largest El Salvadorian privately-owned bank, set up in 1996 with contributions from founding shareholders. It is owned by the Promerica Holding Group which includes banks in eight other Latin American countries (Nicaragua, Guatemala, Honduras, Costa Rica, Panama, Ecuador, Dominican Republic and Caymans) with a total of 209 branches.

Currently, BPSV has 41 branches and 1,029 staff of whom 58% are women (and making up 47% of the senior management team). In 2016, BPSV has total assets of US\$ 1.02 billion, a net loan portfolio of US\$ 730 m, US\$ 12m net income.

DEG entered its first financing with BPSV when BPSV expressed interest in receiving a subordinated loan for US\$10m in 2012 and an additional senior loan of US\$15m was agreed in 2016 for on-lending to SMEs.

Commercial loans make up about 50% of BPSV's total portfolio (the rest are individual loans and mortgages). The commercial portfolio is dominated by SMEs and in 2016 the average loan size was US\$131,000. BPSV's few large clients (>US\$3m turnover) only account for 2.3% of all loans and almost all fall under the definition of a medium sized enterprise.

Key sectors for BPSV include construction (offices, commerce and housing), industry (pharmaceuticals, agro-processing) and agriculture (sugar cane, livestock and coffee). Out of a total portfolio of nearly 1,442 commercial loans in 2016, 1,267 were categorised as low E&S risk, 165 as medium risk and only 10 are in high risk sectors. Only two of BPSV's largest 10 clients are in high risk E&S sectors. This breakdown is similar to the portfolio in 2015 and confirms that the categorisation of BPSV as a FI-B remains appropriate.

3. Results and Analysis

This section provides a summary of the key results and analysis from the Case Study. The results are presented against the specific objectives of the assignment as outlined in Box 1 above.

3.1 Objective 1 - Evaluate the Implementation and Practical Use of ESMS by DEG's Clients

3.1.1 Compliance with DEG E&S Requirements

Table 1 provides an assessment of the progress in relation to implementation of DEG's E&S requirements as laid out in the loan agreements for 2012 and 2016.

Since the 2012 Loan Agreement was signed, the client has designed an ESMS with support from TA provided by DEG which has been fully implemented across all commercial lending. BPSV is one of only three banks with a comprehensive ESMS in El Salvador.

The TA consultant's assessment after the final visit in May 2014 was that Banco Promerica was performing satisfactorily on all five levels: organisational buy-in; E&S assessment; monitoring of portfolio/analysis; training and internal communication; and documentation.

Table 1 - Assessment of the implementation of E&S requirements by Banco Promerica

E&S requirements in the 2012 and 2016 Loan Agreements	Compliance	Assessment of implementation
Comply with DEG E&S requirements	✓	A DEG-compliant ESMS system has been applied to all commercial loans for greenfield or brownfield activities of all sizes (not residential or mortgages) since 2013.
Maintain and continuously improve the ESMS (defined in Schedule 1) and at all times conduct its business in accordance with it.	✓	The 2013 ESMS policies and procedures have been applied, with slight amendments to financial risk exposure categories in 2016. Due diligence forms may be reviewed to make them lighter touch. The ESMS being rolled out to other banks is similar, but with resources tailored to local markets, in Guatemala and Honduras. BPSV is the responsible body for the roll-out in these two countries.
Does not fund activities on the exclusion list (Schedule 8)	✓	An exclusion list which includes all DEG and IFC/World Bank sectors was approved and included in the E&S risk policy in 2013 and also excludes non-sustainable tropical forestry activities. No activities on the exclusion list have been funded.
Maintains (i) an Environmental and Social Manager and (ii) an Environmental and Social Coordinator and will notify DEG promptly if the E&S manager or officer ceases to perform this function.	✓	The E&S manager is the Risk Director and has been involved from the outset. The E&S coordinator was in place from 2012 to April 2016 and has now been replaced by a suitably experienced and qualified senior analyst promoted internally. She has undertaken distance learning courses in E&S. DEG has not formally been notified of staff changes as the position has not been vacant.
Submits an E&S Monitoring Report in DEG, IFC or own format which covers the content (laid out in Schedule 10, 2016) including attachments (policy, manual, exclusion list etc.) if they have changed. Reports should be submitted within 120 days after the end of each financial year.	✓	Reports have been filed every year since 2012 for the previous financial year. The report is also being used for other DFIs.
Use reasonable efforts to ensure high risk clients comply with	✓	BPSV has been collecting data on the categorisation of its portfolio since 2015 according to Standard International Trade

<p>applicable IFC PS (2012). If DEG determines on the basis of the E&S Monitoring Report that >20% of the portfolio is high risk, then BPSV should amend its ESMS to ensure compliance with IFC PSs (2016).</p>		<p>Classifications (SITC) and by micro, small, medium and larger companies. High risk E&S projects only account for 10 of some 1,500 total projects and only 2 of BPSV's larger customers are in high E&S risk sectors but between 2015 and June 2016 116 SMEs and 108 larger clients have been visited for due diligence. The ESMS system is consistent with BPSV's FI-B risk categorisation.</p>
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The components of the ESMS for BPSV include the following:

- A policy laying out the procedures, risk categories, roles and responsibilities and an Exclusion List. This covers all activities on the DEG list as well as commercial operations in primary tropical forests or exploitation or trade in tropical hardwoods unless sustainable management systems are in place and operations are duly authorised;
- A risk categorisation matrix integrated from the earliest stages of the loan assessment process and completed by loan officers. Projects are categorised for E&S risk against the MARN checklist (I= low, II= medium or III= high) and according to BPSV's financial exposure (low, medium or high);
- An Excel-based tool allocates an overall risk level (green=low, yellow=medium and red=high) and indicates the due diligence level and reports required: Low (E&S categorisation form and an E&S paragraph in the financial report); medium (same as for low plus a general due diligence questionnaire on environmental, social, labour and management and licensing issues); and high (same as for medium plus a detailed sectoral questionnaire for industry, construction, agriculture, livestock or forestry). The spreadsheet includes linked documents on relevant national laws for existing focus sectors;
- A requirement for all medium and high risk projects to be visited by the loan officer and/or a financial analyst and all E&S assessments for all categories of projects to be signed off by the E&S coordinator before submission to the finance committee;
- A standard E&S clause included in all loan agreements requiring that the borrower not undertake any excluded activities and to comply with national laws; run secure, efficient and safe premises and plant; manage solid waste, liquid waste and chemicals safely; and comply with core labour laws and rights;
- Annual monitoring through site visits to medium and high risk clients by credit officers, including review of updated or renewed permits (MARN and Health, Industry and Work ministries and local authorities), and monitoring of compliance with covenants by the legal department.

3.1.2 Management Commitment

One of the most important factors in BPSV's success in implementing its ESMS has been the buy-in from the senior management of the Promerica Holding Company and of Promerica El Salvador. From the earliest stages of discussion with DEG, senior management saw the importance of structurally mitigating risks they were beginning to face and saw a strategic role for sustainability in the bank's positioning in the market. Risk directors across the group had received training from UNEP and two banks in the group – Nicaragua and Costa Rica – developed their own UNEP-compliant systems. However, these proved too complex for all banks in the group as their portfolio consists of mainly SME clients, and so assistance was sought from DEG to develop a more practical and user-friendly system in El Salvador, with the aim of rolling it out to all other banks in the group.

The BPSV E&S policy was adopted by the holding company in 2013 and both the holding company and BPSV board and senior management remain highly committed. While there is no Board Director with overall E&S responsibility in El Salvador, both the Finance and Risk Directors remain closely involved. The CEO regularly checks progress with senior management and the E&S coordinator. Environmental and social responsibility has become a key part of Promerica's branding across all nine banks in the group.

The El Salvador risk team are now the responsible party for roll-out of the ESMS in Banco Promerica Honduras and Guatemala, while Costa Rica and Nicaragua are each responsible for another two banks. Risk directors and E&S managers from all nine companies meet twice a year to discuss progress and share lessons. Due to his hands-on experience the BPSV Risk Director has become the leader of this group.

Senior management highlight the importance of identifying the right senior person to drive an ESMS implementation project. BPSV has really benefitted from the continuous involvement of a senior individual with a real passion to drive up environmental and social performance of the bank and its clients. In addition, he is supported by a finance team that has been able to bring in additional lines of credit to help achieve this.

3.1.3 Implementation of ESMS

The ESMS system is applied to all commercial clients of the bank including SMEs and larger companies (but not loans and mortgages to individuals). Once the Policy was signed by the Board in 2012 and the ESMS screening tools were developed, the ESMS was quickly applied to all new commercial transactions (677 in the first year) and by mid-2016 had been applied to 1727 SME transactions and 184 larger businesses.

The Exclusion List has been rigorously applied. BPSV and other banks in the group have agreed that they will lend to companies with only up to 10% of their consolidated balance sheets related to tobacco (an important cash crop in Nicaragua) and sugar cane based alcohol (a large sector throughout central America). BPSV has made one such loan to a company with tobacco distribution as part of its activities, although the loan was related to non-tobacco activities.

Over the three years since initial roll out, a strong culture of ESMS implementation has developed amongst relevant staff. Initially, loan officers felt that E&S risk assessment would add to their workload (estimated at about 4 loans each a week). Most of those interviewed reported that, after receiving training and hands-on experience, they found the tools easy to use and in many cases the additional E&S categorisation only added 5 minutes to the process. For an existing client in a known sector, the more detailed forms for a medium risk loan require a site visit and about 4 hours to complete. For new clients or new sectors or which involve reviewing independent environmental impact reports the team need to carry out internet searches before the visit and may have further research to do afterwards. Most staff agreed that E&S due diligence adds interest to the process. The most time consuming part of the process is identifying which permits and licenses are required by MARN or other government departments, checking with the client that these are in place, and collecting copies to attach to the Excel spreadsheet.

The E&S coordinator reports that, almost all loan officers now complete the forms to an adequate level of detail and only in exceptional circumstances do applications go to the Board without an E&S assessment already completed. There have been no cases to date of the Investment Committee rejecting loan applications on the basis of E&S risks. In one case (a quarry and processing plant for construction pigments) the committee requested more information on potential noise and dust issues for the adjacent community and more data on the size of the potential raw material deposit. Once this information had been provided the loan was approved with standard E&S conditions attached.

Two projects flagged as high risk within the ESMS because of the combination of sector and loan to assets ratio were reviewed during the evaluation visit. Both underwent detailed due diligence with questionnaires fully completed and no unmanageable environmental risks identified. The conclusions and recommendations on E&S included in reports to the Investment Committee were appropriate. Both projects were approved with the standard E&S clause included in the contract. There was no requirement for a corrective E&S Action Plan. In both cases, covenants were attached to the contracts but were about managing financial rather than E&S risks. During 2016, another DFI has been negotiating a credit line with BPSV and as part of this process has carried out a desk based due diligence of BPSVs largest 10 clients. The review found that the E&S categorisation and due diligence processes have been appropriate and that there are no remaining E&S concerns.

There have been very few cases where an ESAP has been required. In 2015, one medium risk commercial ice production business had an ESAP attached with conditions met by the client. During 2016 no ESAPs have so far been required.

After nearly three years of implementation the ESMS has been reviewed by the E&S manager and coordinator and minor modifications have been introduced to risk categorisation. Streamlining of due diligence questionnaires is also planned to avoid duplication with the general questionnaire. One of the key success factors has been in making sure that E&S is an integral part of the loan assessment process and built in from the earliest stages. The tools developed with the TA consultants have ensured that the system is simple enough to apply to the whole commercial portfolio. It has also been important to have a strong 'gate-keeper' for the system prepared to reject applications where E&S issues have not been considered sufficiently.

The remaining challenges at this stage are in ensuring that all credit officers collect the necessary detailed information during site visits to make the process as efficient as possible. Also challenging is the task for the E&S officer and financial analysts to identify the necessary E&S risk information and advice on whether companies are complying in higher risk sectors which are new to BPSV such as the pharmaceuticals and chemicals sectors. The team so far has limited experience in these sectors and is increasing its knowledge through internet searches. They do not currently have access to external independent consultants to help interpret reports, carry out due diligence gap analysis with IFC PS or provide specialised training to the team. Monitoring E&S compliance of thousands of small customers using a manual system is also a major challenge.

3.1.4 Resources for ESMS

The ESMS department falls under the Director for Risk (the E&S Manager) who also has overall responsibility for loan officers, financial analysts, the legal department, and admin, documentation and digitalisation departments. The E&S coordinator is the senior financial analyst and reports to the head of Financial Analysis. The original E&S coordinator who worked with the TA team from 2012, left in April 2016, but was immediately replaced by a senior financial analyst who had been working closely with him for 3 years. At the request of senior management, she has undertaken two distance learning E&S Management qualifications (INCAE Business School, Costa Rica and UNEP Finance Initiative). The E&S Officer signs off all reports to the credit committee, provides support to the credit officers, prepares the Annual Report to DFIs and delivers training to all relevant staff.

The E&S officer supports some 25 officers involved in credit operations including 18 credit officers and seven risk analysts. Initial E&S training was provided by the TA consultants for 95% of relevant staff in May 2013. Since then training has been delivered in-house by the E&S officer using the materials developed by the TA consultants, but adapted with three case studies relevant to Promerica's portfolio. During 2015, 40 officers were trained in-house by the E&S officer and a programme of training for new employees and refresher training has been ongoing throughout 2016 including loan officers (Jul-Aug), analysts (Sept), the legal department (Aug), operations (Oct) and senior management (Nov). BPSV has experienced some staff turnover in 2015/6 and found it difficult to recruit loan officers/analysts with prior knowledge of implementing an ESMS. They have therefore opted to recruit inexperienced but bright and enthusiastic younger staff and have given them intensive on-the-job training for the first 6 months, including in E&S. This is resource intensive for the E&S officer but has resulted in a cadre of very able financial analysts who are willing and capable of carrying out additional research on specific E&S issues where needed.

All staff interviewed were enthusiastic about the ESMS tools, appreciated the insights gained into their clients' operations and management capabilities, and are keen to develop their own potential by developing more expertise in key sectors. During late 2016/early 2017 the E&S team aim to provide more in-depth E&S training for two top financial analysts to reinforce the E&S function in 2017.

The E&S officer also provided training to E&S officers and relevant staff in Promerica Honduras (Aug-Sept 2015) and Guatemala (Sept-Oct 2015) to support the roll-out of their ESMSs. She also provides backstopping to the E&S officers when they request a review of E&S assessments of specific projects. This takes an estimated 2-3 days a month. During 2016 all nine Promerica country E&S officers had

additional training in identifying green investment opportunities within their portfolios including energy efficiency, solar photovoltaics and other renewables.

A key lesson from BPSV's experience of building an E&S team in immature E&S markets such as El Salvador is that it is more important to recruit staff with a good understanding of the FI's systems and portfolio and able to command the respect of loan officers and analysts rather than those with a professional background in E&S, as these individuals are often hard to find in these markets. BPSV's approach of bringing on individuals with a high level of commitment and enthusiasm to raise E&S standards and providing on-the-job training has been very effective. In the future the Promerica group would benefit from building an internal network of E&S officers who can share best practice and support each other. They would also benefit from having a call-off arrangement with local independent E&S consultant(s) who can help interpret E&S assessments, carry out due diligence in more technical areas and provide more in-depth training in areas such as renewables and improving resource efficiency in existing clients. This expense would be justified if the group is also successful in developing green credit lines with other DFIs.

3.1.5 E&S Risk Categorisation

Loan applications are assigned an overall risk category based on a combination of their E&S risk as well as BPSV's financial exposure. In the initial policy the thresholds for the bank's financial risk exposure were set in relation to the total value of the loan as follows: low (US\$100K); medium (US\$100-750k); and high (>US\$750k). However, this was causing a bottleneck in terms of the number of projects to be assessed as medium and high risk. During 2016 the thresholds have been changed and are now based on the bank's overall exposure to the client as a percentage of its total capital (patrimoine). The thresholds are now low (<0.25%), medium (0.25-1.5%) and high (>1.5%) which has the effect of raising the threshold of medium risk projects to >US\$200k.

Of BPSV's largest 10 loans only two are high E&S risk and therefore categorised as high risk overall. These are CESCA (an electricity, steam and air conditioning unit business) and SIGMA (an industrial enterprise). All of BPSV's largest 10 clients are listed in the Annual Report to DEG and have been subject of desk based due diligence by IFC. This process found that for all 10 the E&S assessments, clauses in contracts and monitoring were satisfactory and no major unmanaged E&S issues were identified. However, the BPSV E&S team would welcome DEG's help in identifying useful sources to help them assess E&S risks associated with the chemicals and pharmaceuticals sectors which are emerging as new client areas in El Salvador.

3.1.6 E&S Monitoring and Reporting

Promerica carries out general monitoring visits to medium and higher risk clients on an annual basis and the legal team monitors compliance with national permitting requirements and ESAPs, if any are in place. The E&S officer and/or loan officer flags E&S related permits and licenses that will need renewal for all projects and are responsible for checking that updated certificates are available and attached to loan agreements. All E&S reports are currently held on individual analysts' hard drives rather than in a central system. This, and the large number of SME clients, makes monitoring a time consuming task.

BPSV has provided an annual E&S report to DEG, since 2012 which is submitted in March for the previous financial year. The team report that this is straightforward and takes about an hour to prepare. Although other DFI lenders have their own formats both are happy to receive the DEG report to save additional work. If there was a serious incident, then clients would be required to report to BPSV who would in turn report to DEG, but there has not been any incident which would warrant this.

BPSV does not produce external reports on its E&S portfolio or performance and is not a member of Global Reporting Initiative (GRI) or other external initiatives.

3.2 Objective 2 - Evaluate the Effectiveness and Impact of ESMS at (i) Clients; (ii) Sub-projects

3.2.1 Effectiveness and Impact at the Client

Senior management recognise the importance of a well-implemented ESMS not just in order to reduce business risks and strengthen their operations but also in order to contribute to improving Salvadorian business' environmental and social performance. The ESMS is seen as having contributed to BPSV's performance and reputation in El Salvador. BPSV has been one of the fastest growing banks in El Salvador in recent years and the most profitable in terms of return on investment. The risk team considers that a robust risk management system has contributed to improving low Non-Performing Loan (NPL) rate (1.57% in September 2016).

Since implementing the ESMS, BPSV has not had a client that has given them real E&S concerns or presented a reputational risk. During this time no clients have been fined, had licenses removed by MARN, faced opposition for a new project from green NGOs or experienced conflict over E&S issues with local communities, although other banks have had such problems. Bank staff consider that their commitment to E&S performance is now widely seen as part of their high quality, personal service to the SME sector which includes free advice on managing growth and complying with E&S requirements. This is also borne out by customer satisfaction surveys. One exception has been a client of Promerica Honduras that initially agreed to a loan for a high risk palm oil plantation, with an ESAP with stringent E&S requirements attached, which was very quickly repaid, presumably because the client was able to secure a loan from another bank with lower E&S standards.

Having implemented a DEG-compliant ESMS is reported to have made the process of attracting and negotiating new DFI credit lines easier and quicker. BPSV successfully secured \$10m for SMEs from another DFI in 2015 with very similar E&S requirements to DEG. Implementing the same E&S requirements across all banks in the group is also expected to have benefits for BPSV in: making it easier for their clients to expand into other markets; protecting BPSV's reputation; and making it easier to secure credit lines at the group level. For instance, during 2016 Promerica group has negotiated with a DFI a large line of credit for four of its banks including \$20m for BPSV to support its SME clients. Negotiations are also underway with other DFIs for Green credit lines or SMEs. DFIs have reviewed BPSV's existing ESMS and reporting and have been able to allocate funds directly to lending rather than supporting the development of a compliant ESMS.

3.2.2 Effectiveness and Impact at Sub-Projects

For the first phase of ESMS implementation BPSV's focus has been on understanding client activities and ensuring that they meet national E&S laws and that necessary permits are in place. Initially clients are reported to have questioned the level of BPSV's E&S due diligence process, but they are now reported to generally accept the approach in meeting tighter national enforcement and in avoiding business continuation risks. Project reviews and interviews suggest that national legislation remains the major driver for E&S standards with few clients yet exporting beyond Central America and therefore with limited exposure to the E&S expectations of US or European buyers. Clients are also reported to understand that BPSV's access to international lines of credit means that they are able to borrow at interest rates at least 2 percentage points below domestic rates.

The evaluation visit included a review of five sub-projects (pharmaceuticals, plastics, fertilisers, food and sugar cane). In three of the five sub-projects, the BPSV loans have been for modern plant and equipment to replace less efficient and dirtier processes (plastics, foods and pharmaceuticals), in one case the investment was for a modern irrigation system and in the fifth case it was for working capital (with another bank providing a loan for upgrading of plant and equipment). In all five cases the ESMS had been implemented appropriately: none of the activities were on the exclusion list; all projects were compliant with national permitting procedures and secured the necessary E&S licenses; the companies appear to be operating to a good standard of E&S management; and their progress is being monitored by BPSV. In all five cases it is difficult to attribute improvements in E&S performance solely to the client's ESMS requirements since - in theory - these improvements would have been necessary to meet MARN

requirements if loans had been provided by other domestic banks. However, in practice - since very few other banks currently implement a DFI-compliant ESMS and national legislation is not always actively enforced - it is likely that BPSV's approach to ESMS has made a significant contribution to raising E&S performance amongst these sub-projects.

The sub-projects are summarised in Boxes 2 and 3. In another case of a food factory, the client confirmed that the fully-automated production line and new boiler has managed to triple production capacity while reducing overall energy consumption, and has also eliminated dust and odour from this production line within the factory. The level of improvement when compared with the dust emissions and odour from the old production line and boiler in another part of the factory (which will be replaced next) is very marked. In the case of a sugar cane farm the new investment has improved water efficiency through a more efficient irrigation system and meant that the client was much less affected by loss of yield and income during the 2015 drought than other bank clients in the agricultural sector.

In addition, a number of the BPSV sub-projects that have been through the ESMS due diligence process with BPSV appear to have developed a wider interest in improving their social and environmental performance. We consider that, while the improvements made by clients are hard to attribute directly to the ESMS, they are evidence of wider unanticipated benefits of the ESMS approach. For instance, Boxes 2, 3 and 4 demonstrate how BPSV's clients have gone beyond simply managing E&S risks and ensuring they are legally compliant. In all three cases, sub-projects have also invested in social responsibility activities including local hiring, developing apprenticeship schemes for local young people and supporting community development (e.g. school's projects and sporting or cultural facilities). Given El Salvador's troubled recent history these are important attempts to improve community cohesion and reduce crime and violence. In addition, two of the sub-projects have invested in habitat and biodiversity improvements on their factory sites – in one case directly made possible through an additional loan from BPSV. The client confirmed that he had approached BPSV for this additional loan for land for social/sporting facilities and afforestation because he knew from the ESMS due diligence and their constructive relationship that they were enthusiastic about environmental and social performance.

BPSV has not yet focused on investments to reduce climate impacts or improve resource efficiency of existing clients in its portfolio, but this will be the focus of the next phase of ESMS implementation if the bank is successful in negotiating a low interest rate line of credit with another DFI providing green loans. During 2016 the Risk Director and E&S Manager have together identified a number of sectors where environmental or social performance could be improved including clean technologies for sugarcane, plastics and metal sectors, green consumer products, higher energy and safety standards for passenger and freight transport and waste management with energy recovery. However, BPSV feels that, unless green loans are available more cheaply than loans for productive investments, at this stage in El Salvador's development SMEs will always choose to invest in modernising plant and expanding production rather than energy efficiency and renewables.

Box 2 – Fertica Fertiliser and Agro-chemicals plant, (high risk): “BPSV understands the risks and by this the company”

Fertica is a good example of a company in a high risk sector striving to improve its E&S corporate policies and performance. BPSV provided a working capital loan but applied its ESMS due diligence process to all of the company's activities. Although BPSV did not finance actual E&S improvements, through its due diligence assessment process it has increased its understanding of the company's operations, the challenges it faces and whether opportunities to raise E&S standards are being taken. The bank will be well-positioned to work further with this client on eco-efficiency and avoiding climate change if suitable lines of credit become available.

Fertica manufactures complex fertilizers and industrial and plant protection products and employs 175 people at its site in Acajutla. The company operates a complex with four integrated production lines. BPSV has provided a US\$2.8m loan for working capital for raw materials. Although the loan was not for expansion of plant or equipment the project is categorised overall as high risk, reflecting the high risk E&S sector (MARN III) and the size of company (>\$3m sales) and BPSV's financial exposure.

An environmental study to secure MARN permits was prepared by the client when it bought the plant in 2012 covering all the E&S issues associated with fertiliser production including transport and storage of sulphuric acid and fuel oil, air emissions, effluent water discharge and management of solid waste. Permits are also required from the military for

transport and storage of sulphuric acid.



The BPSV loan officer and financial analyst reviewed Fertica's environment report and, through a site visit and completion of the E&S industry checklist, confirmed that measures and management plans for acids and fuel oil, fire, water discharges and air emissions are appropriate. Treated discharge water is held and monitored in a fish pond stocked with Tilapia and Carp before being discharged to the river. Solid waste (mainly extruded polyethylene packaging) is recycled. The company reports annually to MARN and regular inspections are carried out by the Fire Department. No requirements beyond the E&S clause were therefore attached to the loan. The environmental improvements

carried out by the company cannot be directly attributed to BPSV's ESMS requirements since the improvements were associated with another loan and no additional E&S requirements beyond the standard E&S clauses were attached to BPSV's loan.

However, Fertica is a company with a growing interest in improving its social and environmental performance, driven not just by international market pressures, but by a small number of other El Salvadorian businesses, including BPSV, committed to improving the country's environmental and social performance. The company website highlights their commitment to eco-efficiency as part of their overall sustainability policy. Fertica is a founding member of the Consejo Empresarial Salvadoreño para el Desarrollo Sostenible (CEDES) which is the local chapter of the World Business Council for Sustainable Development (WBCSD). The company runs energy and water efficiency campaigns and has reforested an area of 67,000m² and set up the Jardín Industrial Planta de Acajutla. It also has a social responsibility programme which includes work placements for young people, cultural and sporting facilities for its work force and their families.

Box 3 – Laboratorios SyM Pharmaceuticals (medium risk): “Digging into a new sector”

The Jomi Group is an example of a loan for a state of the art factory which has substantially improved the client's productivity while improving E&S performance and left it well-placed to expand to other Central American markets. In order to carry out its ESMS due diligence assessment BPSV has had to increase its understanding of the pharmaceuticals sector and related E&S requirements and issues but this knowledge can now be shared across the group, leaving the bank well-placed to develop other business in this growing sector.



The Jomi Group of companies includes a chain of 30 pharmacies, health clinics, diagnostic laboratories and pharmaceuticals manufacturing. BPSV provided a US\$1.2m loan for upgrading and expanding the pharmaceuticals plant, patents, inventory control area and US\$300k for state of the art production equipment. The company now produces more than 75 products across 15 classes of medication. The industry sector is categorised as medium risk, but the size of the loan and financial exposure means that for BPSV this is a high risk project and required in-depth due diligence assessment.

As a new sector for El Salvador and for BPSV, the financial analyst and E&S coordinator researched the chemicals and processes involved, the likely E&S risks and the Environmental and Health Ministry licenses required. The due diligence process included a site visit to the existing factory, inspection of licenses and discussion of E&S management plans. This confirmed that air quality, dust and noise management were appropriately managed in the old plant and the same standards would be applied. It also confirmed that the new production process would not produce any toxic effluent or solid waste requiring treatment. The company had the necessary licenses in place for safe storage of chemicals, worker H&S and quality control and the latter is displayed at their website. E&S conditions included in the contract require the company to keep licenses up to date and provide copies to BPSV. It is not possible to quantify improvements in environmental performance which have resulted from BPSV's ESMS requirements since the laboratory would have had to meet national E&S regulations to secure its license and no ESAP with additional E&S actions was required. However, since this a growing sector in Central America, the Promerica group will be able to share its learning from this sector and ensure that other similar projects it makes loans for are operating to these standards.

3.3 Objective 3 - Evaluate (i) the Functioning of DEG, and (ii) the Value-added of DEG (in particular in the TA Framework on ESMS).

3.3.1 Functioning of DEG

At the time of first loan, the senior management of the Promerica Holding Company were already committed to developing an ESMS for the Group and had started to do so in Nicaragua and Costa Rica. The requirements for an ESMS system were clearly explained by DEG and were included in the 2012 subordinated loan agreement for BPSV. For the second loan in 2016, the requirements for maintaining the ESMS were again clearly stated in the loan agreement.

DEG's offer of technical assistance in developing a more practical and easy to use ESMS has been very much appreciated by BPSV senior management and the holding group. The ESMS is seen as very well-tailored to Promerica's needs. The E&S policy was adopted by the group in 2013 and the ESMS manual, risk matrix and procedures are being used as the blueprint for roll-out to other banks in the group.

The client had good feedback overall on the support from DEG and excellent feedback on the role of the TA. BPSV's relationship with DEG is reported to be very good and the E&S team have found DEG helpful in resolving issues especially related to the exclusion list (e.g. tobacco or alcohol).

The E&S coordinator reports that now she has established personal contact with the DEG E&S team she looks forward to following up and getting advice on issues in new sectors, as the need arises. The only area where the client reports that support has been limited is in providing feedback on the 2015 E&S Annual Report.

3.3.2 Value-added of DEG

The TA provided by DEG for the support in design and implementation of the ESMS started with the appointment of Steward Redqueen (Netherlands) and a visit in September 2012, followed by development of the ESMS manual in November 2012 and implementation of the pilot stage during January and February 2013. Training sessions for relevant staff were carried out in May 2013 and then the ESMS was fully rolled out. An evaluation visit in May 2014 found that the ESMS was being implemented satisfactorily in all areas with the exception of external reporting. The consultants worked alongside the risk manager and E&S coordinator who remained in post until mid-2016.

The E&S risk manager and coordinator report that the TA consultants were very helpful, open and receptive. The Risk Director of BPSV has provided an endorsement for Steward Redqueen's website and described their support as "a 6-month project with excellent results". The development of documents, guidance tools for investment managers, training presentations and materials and delivery of the training were all reported to be very good. The system is seen as concrete, practical and far easier to implement than the ESMSs initially developed by Promerica banks in Nicaragua and Costa Rica.

BPSV particularly appreciated the early effort the consultants put into understanding the bank's credit approval systems and portfolio and developing a system which would work for the very large number of micro and small businesses in their portfolio. The resulting ESMS manual, tools and documents feel appropriately tailored to the client and have been further tailored by the team to include national legislation sources and MARN risk category lists rather than just IFC sources. Credit officers and financial analysts find this a very useful framework for checking requirements before making a due diligence visit to clients. BPSV would now find it useful to have access to case studies and good E&S practices from elsewhere.

The only area where further TA would have been helpful was in carrying out E&S performance measurement and monitoring: after the TA was completed the team would have liked to still have a direct channel to the consultants to provide advice on preparing Annual Reports.

The TA consultants and BPSV report that they did approach DEG with a proposal to work together to develop a programme for green investments but, since this was not included within the TA framework, BPSV has sought green credit lines from other DFIs.

The Promerica team would now appreciate more assistance from DEG in several areas:

- Feedback on the E&S report. BPSV note that the report appears very process focused rather than providing much understanding of the bank's risk exposure or how effectively risk is being managed and, as they intend to use it as the basis for reporting to other DFIs, would like confirmation that they have completed it appropriately;
- Advice and assistance in setting up a centralised online system for E&S assessment and monitoring to include more resources on specific industries and national standards. Ideally they would like to develop a searchable database that would help analysts learn from the experience of other projects within El Salvador, the Promerica group or other Latin American banks in the DEG family;
- Access to more sources of information on potential E&S issues in sub-sectors and case studies both from within the group and from other banks with good practices to share. This would help them to extend their knowledge on sectors which are not yet well developed in El Salvador;
- Further training for the E&S officer(s) in El Salvador and other banks within the group possibly at a Central or Latin American venue with other banks in the DEG portfolio with opportunities to deepen knowledge on identifying green investment opportunities (e.g. in renewables) and reducing climate change.

4. Conclusions and Lessons Learned

Based on the analysis that is summarised in Section 3, this section lists the conclusions and lessons learned for this case study.

Objective 1 - Evaluate the implementation and practical use of ESMS by DEG's clients

- E&S risks are well-managed as BPSV has a well-functioning E&S system in place while at the same time it has a limited E&S risk exposure.
- **Senior management commitment to E&S** – this case study demonstrates the importance of senior management and board level commitment to an ESMS but also the importance for DEG staff of identifying a senior figure with the interest and enthusiasm to drive implementation and then share lessons on how to do this with other banks.
- **Embedding E&S due diligence from an early stage.** The real strength of the BPSV approach has been in embedding E&S due diligence in the loan approval process from the earliest stages and ensuring that all loan officers and financial analysts are responsible for carrying out assessments. The evaluation visit confirmed that E&S assessments, reporting to investment committees, inclusion of appropriate E&S clauses in contracts and monitoring are robustly applied.
- **Keeping the ESMS simple.** Another strength has been the proportionality of the ESMS to BPSV's loan portfolio. The initial focus has been on equipping staff to understand and monitor compliance with national legislative requirements. DEG could recommend that other clients in countries at a similar stage of development focus training and source materials on national or regional legislation rather than focusing too early on IFC PS, which may only apply to a handful of projects and could be managed with support from external consultants.
- **E&S team** – E&S officers with banking experience are not easy to recruit in El Salvador and BPSV has taken the pragmatic route of training up a very experienced risk analyst with an interest in E&S who has the respect of the loan officers/financial analysts rather than trying to find an experienced E&S person and risk leaving the E&S coordinator post vacant. Intensive on-the-job training with young analysts in El Salvador and E&S coordinators in Honduras and Guatemala has been resource intensive for the BPSV E&S coordinator but has been successful in developing a cadre of experienced analysts able to share experience and provide mutual support. DEG could discuss this approach – with appropriate backstopping support in place – with other clients facing difficulties recruiting experienced E&S coordinators.

Objective 2 - Evaluate the effectiveness and impact of ESMS at (i) clients; (ii) sub-projects

- **Raising the bank's reputation and access to other DFIs** – A DEG compliant ESMS has made it quicker and easier for BPSV and the Promerica Group to access lines of credit from two other DFIs and the ESMS is recognised as adding value in a market where few other banks are implementing such a rigorous ESMS.
- **Highlighting the advantages of ESMS for clients** – BSPV clients have benefited from managing their E&S risks and from access to cheaper international loans. BPSV's clients are also able to point to productivity improvements with improved E&S performance from investing in cleaner technologies. While it is difficult to attribute specific E&S improvements to BPSV's ESMS approach, since compliance with national legislation would have been required for investment from any bank, BPSV's approach with a site visit and detailed questionnaire appear to have raised awareness of the issues and encouraged clients to seek further opportunities to make environmental improvements to their sites and seek ways of improving workforce conditions and investing in their local communities. All sub-projects studied in more depth seem keen to do more in this area.
- **Environmental and social investment opportunities** – The evaluation visit confirmed that there are significant opportunities in E&S investments in El Salvador particularly in better management of water resources and in renewables and energy efficiency. BPSV is gaining valuable knowledge about new investment sectors in El Salvador and understanding of opportunities in client businesses as a result of its due diligence procedures and site visits.

Objective 3 - Evaluate (i) the functioning of DEG, and (ii) the value-added of DEG (in particular in the TA framework on ESMS)

- BPSV and the Promerica group have good relationships with DEG and very much appreciate the assistance they have received and particularly the early efforts of the TA consultants in understanding the bank's portfolio and its loan approval systems and developing a system which is concrete, easy to use and proportionate to the bank's portfolio of clients and projects.
- **Clarification of E&S reporting requirements** – the only area where there has been lack of clarity or feedback is in annual reporting to DEG. There was no feedback on the 2015 report (submitted March 2016). Although this is standard procedure for a category B FI, feedback and guidance would be helpful to the BPSV team so that they know if they have interpreted requirements correctly, are able to advise other banks in the group, and prepare reports which will also be useful to other DFIs.
- **Opportunities to exchange lessons and good practice materials with other E&S coordinators in the region** would really be welcomed, for instance through joint training sessions on green investment and renewable energies. BPSV would also appreciate advice and support in developing a centralised searchable database on assessments and reference materials for sectors which are new to them (e.g. chemical and pharmaceuticals). There is a role for DEG in providing such materials and/or including more on these requests in the scope of work for the TA.
- **Opportunities for green investments.** As a result of its experience with DEG the Promerica group is now actively looking for opportunities to improve E&S performance amongst clients in the most inefficient or potentially pollution prone sectors (e.g. transport, sugar cane, plastics and metals in El Salvador) and to develop green products or renewable energies using credit lines from other DFIs. DEG could start to discuss such opportunities as a second phase of ESMS development with its existing and new clients and consider offering support to develop portfolios and products within the TA framework.