

BRAZIL

**BNDES: THIRD PROGRAM UNDER THE CCLIP LINE TO
SUPPORT MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES**

(BR-X1001; BR-L1178)

LOAN PROPOSAL

This document was prepared by the project team consisting of: Felipe Gómez-Acebo (ICF/CMF), Project Team Leader; Juan Antonio Ketterer (CMF/CAR); Juan José Durante (ICF/CMF); Andrea Terán (ICF/CMF); Esteban Piedrahita (ICF/CMF); Jaime Mano (CMF/CMF); Cynthia Colaiacovo (LEG/SGO); and Annabella Gaggero (ICF/CMF).

CONTENTS

PROJECT SUMMARY

I.	DESCRIPTION AND RESULTS MONITORING	1
A.	Frame of reference, problem addressed, rationale	1
1.	Frame of reference	1
2.	Problem addressed	3
3.	Rationale	4
B.	Objectives, components, and features	6
C.	Results indicators.....	6
II.	FINANCING STRUCTURE AND MAIN RISKS	7
A.	Financing instrument.....	7
1.	Features of the loan	7
2.	Use of the resources	7
B.	Main risks and mitigants	8
III.	IMPLEMENTATION AND MANAGEMENT PLAN.....	10
A.	Summary of implementation arrangements	10
1.	Borrower, executing agency, and guarantor	10
2.	Execution and administration	10
3.	Disbursement conditions, execution period, and timetable.....	13
B.	Monitoring and evaluation system	13

ANNEXES AND ELECTRONIC LINKS

PRINTED ANNEXES		
Annex I: Results Framework		
Technical documents in electronic format	Topics discussed	Hyperlinks/ Preparation status
Required		
Safeguard policy filter		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1327075
Environmental and social strategy		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1424670
Preparation timetable and resources		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1414099
Annual work plan (AWP)	N/A	
Monitoring and evaluation arrangements	N/A	
Optional		
Link 1. Macroeconomic issues		http://opsws3.reg.iadb.org/IDcswebservices/getDocument.aspx?DOCNUM=1327099
Link 2. Regulatory structure and trends in the financial system		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1327091
Link 3. Structural steps taken to correct failures in the financial system		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1420040
Link 4. BNDES		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1327093
Link 5. Features and impacts of previous operations		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1327095
Link 6. Lessons learned		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1599496
Link 7. BNDES credit card		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1404962
Link 8. Institutions responsible for execution		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1327090
Link 9. Allocation of quotas to IFIs		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1327098
Link 10. Companies whose assets utilize borrowers via FINAME		http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1408694

ABBREVIATIONS

BACEN	Central Bank of Brazil
BNDES	Banco Nacional de Desenvolvimento Econômico e Social [National Economic and Social Development Bank]
CCLIP	Conditional credit line for investment projects
GDP	Gross domestic product
IFI	Intermediary financial institution
MCP	Multisector credit program
MERCOSUR	Southern Common Market
MSMEs	Micro, small, and medium-sized enterprises
SELIC	Sistema Especial de Liquidação e de Custódia [Special System of Clearance and Custody]
TJLP	Taxa de juros de longo prazo [long-term interest rate]

PROJECT SUMMARY

BRAZIL

BNDES: THIRD PROGRAM UNDER THE CCLIP LINE TO SUPPORT MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES (BR-X1001; BR-L1178)

Financial Terms and Conditions ¹				
Borrower: Banco Nacional de Desenvolvimento Econômico e Social [National Economic and Social Development Bank] (BNDES) Guarantor: Federative Republic of Brazil Executing agency: BNDES		Amortization period:		20 years
		Grace period:		4 years
		Disbursement period:		4 years
Source	Amount	Interest rate:		LIBOR US\$
IDB (Ordinary Capital)	US\$1 billion	Inspection and supervision fee:		*
Cofinancing	--	Credit fee:		*
Local	US\$1 billion	Currency:		U.S. dollars from the Single Currency Facility
Total	US\$2 billion	Conversions to Brazilian reais:		Local Currency Facility and reformulation of the CCLIP
Project at a Glance				
Project objective and description:				
To support the development and modernization of Brazilian micro, small, and medium-sized enterprises by providing medium- and long-term financing for execution of investment projects designed to make those firms more competitive.				
Special contractual conditions:				
Prior to the first disbursement of funds for each program under the CCLIP, the borrower will provide evidence that the Credit Regulations agreed upon with the Bank for the operation are in force.				
Subloans disbursed between 1 February 2008 and the project approval date, in the amount of US\$250 million, will be recognized against the loan proceeds, and an equivalent amount will be recognized against the local counterpart contribution.				
Exceptions to Bank policies:				
The guarantee furnished by the Federative Republic of Brazil will be limited to debt servicing and to the obligation to take the necessary steps for the borrower to fulfill its positive contractual covenants.				
Project consistent with country strategy:		Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>		
Project qualifies as:		SEQ <input type="checkbox"/> PTI <input type="checkbox"/>	Sector <input type="checkbox"/>	Geographic <input type="checkbox"/> Headcount <input type="checkbox"/>

* The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

I. DESCRIPTION AND RESULTS MONITORING

A. Frame of reference, problem addressed, rationale

1. Frame of reference

- 1.1 *Background.* Multisector credit programs (MCPs) are the Bank's main tool for support to the private sector.¹ In Brazil, the Bank has conducted seven MCPs with Banco Nacional de Desenvolvimento Econômico e Social [National Economic and Social Development Bank] (BNDES). One of these is a US\$3 billion conditional credit line for investment projects (CCLIP) for micro, small, and medium-sized enterprises (MSMEs), approved in late 2004. Two US\$1 billion programs have been approved under this CCLIP, and each is fully disbursed. This program is the third and final operation under the CCLIP.
- 1.2 *Macroeconomic considerations.* Brazil's macroeconomic situation, as described for the CCLIP, has displayed improvements that led Standard & Poor's to raise the sovereign credit rating to investment-grade on 30 April 2008. ([Link 1](#))
- 1.3 *The real sector of the economy.* Micro, small, and medium-sized enterprises predominate in the Brazilian economy,² and their structural situation remains as was described in the CCLIP. Their significance can be measured by the fact that: (i) according to the Serviço Brasileiro de Apoio às Micro e Pequenas Empresas [Brazilian Support Service for Microenterprises and Small Businesses] (SEBRAE), in 2006 microenterprises and small businesses accounted for 98% of all firms and 67% of formal employment in the country; and (ii) in 2004 small and medium-sized enterprises accounted for 39.2% of formal employment³ and 11% of all exports.⁴ This sector's strength, productivity, growth, and profitability are therefore essential both to Brazil's economy and to employment.
- 1.4 *The financial sector.* The description of the banking system's regulatory structure in the CCLIP remains valid. Its current features are summarized in [Link 2](#). The system still has the strengths described therein, but also faces some significant and persistent challenges. They include the need to lower intermediation costs and to boost the economy's credit supply.

¹ An OVE evaluation of MCPs over the past 15 years indicates that: (i) MCPs alone have accounted for 48% of Bank funds targeted to the private sector; and therefore (ii) "de facto, MCPs are the Bank's main private sector tool."

² MSMEs were categorized according to the MERCOSUR standards (MERCOSUR/GMC/RES 90/93: Policy for support of micro, small, and medium-sized enterprises in MERCOSUR, ratified by Resolution MERCOSUR/GMC 59/98). Under these standards: (i) microenterprises include entities having up to 19 employees and annual gross sales equivalent to US\$400,000; and (ii) small and medium-sized enterprises (SMEs) in the formal sector include firms having 20 to 499 employees and gross annual sales of more than US\$400,000 and less than US\$20 million.

³ According to the 2004 *Relação Anual de Informações Sociais* [Annual Social Information Report] (RAIS).

⁴ According to 2004 data from the Ministry of Development, Industry and Foreign Trade.

- 1.5 With respect to intermediation costs, bank spreads remain very high (22.4% in 2007), despite a sizable reduction in recent years (nearly eight percentage points since 2003). This places them among the highest in the world.
- a. On the cause side, the Central Bank of Brazil (BACEN) indicates that the 2006 breakdown for the spreads was 15.9% for taxes (both direct and indirect), 16.9% for administrative costs, about 43.4% for arrears, 4.7% for the total cost of the *compulsório*, and 19.02% for residuals (e.g. little competition).⁵
 - b. To reduce the spread, the government and BACEN have taken steps to optimize the available supply of information and cut transaction costs. ([Link 3](#))
- 1.6 With respect to credit features, the financial system continues not to fully perform its role of financing growth by providing credit to the private sector. In point of fact, despite improvements in recent years, total credit from the domestic financial system represented 34.8% of GDP in December 2007 (with unearmarked credit representing 24.6% of GDP), whereas the portfolio of federal securities represented approximately 46% of GDP.⁶ The reasons for this have to be analyzed from a variety of vantage points: repayment periods, amounts, interest rate levels, and interest-rate volatility.
- a. With respect to repayment periods and *system liabilities*, the system has had a high number of short-term deposits, owing to uncertainty about the country's macroeconomic status in the medium term. Consequently, deposit-taking by intermediary financial institutions (IFIs) has continued to be heavily based on short-term instruments. In December 2007, 38.5% of deposits had maturities under one year, and 18.9% had maturities of one to two years (totaling 57.4% of deposits with maturities of up to two years).⁷ Accordingly, IFIs find it very difficult to operate with long-term loans due to potential maturity mismatches. On the *system assets* side, the average maturity for loan portfolios in 2007 was approximately 350 days.
 - b. With respect to the amounts involved and *system liabilities*, a substantial portion of the system's funding is not readily available, since various targeting mechanisms translate into fewer disposable resources. In December 2007, mechanisms of this sort included: (i) sight deposits that were blocked in order

⁵ See "Relatório de Economia Bancária e Crédito" [Banking and Credit Economy Report], Chapter II, BACEN, 2006; and "Revisitando a metodologia de decomposição do spread bancário no Brasil" [Revisiting the methodology for bank spread breakdowns in Brazil], Costa and Nakane, 2004.

⁶ The data is important from two perspectives: (i) on the one hand, the domestic financial system is channeling a significant portion of domestic savings (according to regional standards); but (ii) on the other hand, bank liabilities are funneled largely to investment in securities rather than to credit.

⁷ See "Estatísticas de depósitos a prazo" [Time deposit statistics], BACEN, December 2007. The maturities are longer due to the effect of time deposits issued by banks for their leasing subsidiaries (not subject to the *compulsório* until 31 January 2008).

to satisfy BACEN's legal reserve requirement (45%) or channeled to the rural sector (25%); and (ii) the *cadernetas de poupança* (savings deposits) for prospective homeowners (7.2% of the portfolio). Moreover, on the *system assets* side, the size of the federal securities portfolio significantly reduces available credit.

- c. With respect to interest rates, credit remains expensive for three reasons: (i) the system's real base rates have been very high for years now (the SELIC rate][—see Link 1](#)—was 11.75% in April 2008 as a consequence both of the macroeconomic policies designed by BACEN in an effort to reduce inflation and of the public sector's borrowing requirements); (ii) the directed funding mix is such that the readily available portion of those resources comes primarily from certificates of deposit, which carry rates very close to the SELIC; and (iii) the width of average intermediation spreads. The end result is very high real short-term lending rates.
- d. With respect to interest-rate volatility, the continued high levels drive up risk for borrowers by raising the possibility of unforeseen increases in financing costs.

2. Problem addressed

- 1.7 The provision of medium- and long-term financing for productive investment has been a recurring problem in Latin America and the Caribbean. Such financing is all the more problematic for MSMEs, whose financial position is characterized by: (i) a lack of transparency and the existence of information asymmetries that have the effect of blocking direct access to capital markets; (ii) the fact that the only remaining source of financing—the commercial banking system—is reluctant to enter this market segment; and (iii) a financial structure based on self-financing, supplier credit, and a short-term bank component at what are often untenable interest rates from the standpoint of these ventures' rates of return.⁸ The fact that MSMEs are so important in terms of both GDP and employment makes this problem an extremely important one, since, given the frailty of their financial foundations, structural shocks can have devastating impacts on the productive fabric and employment, generate social instability, and make the country less competitive.
- 1.8 Brazilian MSMEs continue to be adversely affected by this situation, but in their case and as described in the CCLIP, the problem is compounded by the existence of a structural gap between their ventures' internal rates of return and lending rates (i.e. the average rate charged for financing in the system plus the IFIs' spreads). The end result is that medium- and long-term credit is virtually nonexistent in the marketplace. This lack of credit forces firms without access to capital markets to

⁸ For a more detailed synthesis of the conceptual problems related to financing MSMEs, see that chapter of the 2004 *Report on Economic and Social Progress in Latin America* (IPES).

rely on self-financing or short-term revolving credit, which increases both the cost of funding and the risk of discontinuity.

3. Rationale

- 1.9 As described in the CCLIP, MSMEs remain one of the most vibrant sectors in the country's economy and are the strongest job creator. The stabilization of macroeconomic conditions in recent years has set the stage for a gradual increase in private investment, which has fueled MSMEs' demand for medium- and long-term investment loans. Under these circumstances, and given MSMEs' difficulties in obtaining financing, their only sources of medium- and long-term bank credit continue to be the programs financed by BNDES.
- 1.10 *The country's strategy.* The government continues to place a high priority on MSMEs as part of its growth strategy and to consider the continued promotion of this sector's access to medium- and long-term financing as essential. Under these circumstances, the country has cast BNDES in a strategic role as a source of leverage, since it is now, as a result of its characteristics, the only significant source of long-term funding for financial intermediaries. Its key importance is illustrated by the fact that in 2007: (i) its Indirect Operations System accounted for nearly 3% of GDP; (ii) these operations accounted for 8.8% of the balance of credit operations by the financial system;⁹ and (iii) its operations in the MSME segment accounted for around 2% of the financial system.¹⁰ Nevertheless, from a percentage standpoint, its relative role in the domestic financial system is shrinking in the face of the increasing momentum of private sector financing offered at much shorter terms. ([Link 4](#))
- 1.11 These results have been in keeping with the system's importance for the Brazilian authorities, since they have efficiently channeled very large sums to MSMEs. Thus, from a quantitative perspective, BNDES (i) approved 49,047 operations for MSMEs in 2006, and 85,746 in 2007; and (ii) disbursed R\$8.107 billion in 2006, and R\$12.127 billion in 2007. From a qualitative perspective, the fund distribution mechanism has some very positive features:
- a. Lower delinquency rates than those registered for unearmarked credits (2.3%, compared to 4.3% in December 2007);¹¹
 - b. Amounts that have been channeled to the target groups averaged US\$59,757 for microenterprises, US\$77,152 for small businesses, and US\$121,135 for medium-sized enterprises in the last program under the CCLIP;
 - c. Fairly lengthy average repayment periods (an average of 60 months over the past three years);

⁹ Source: "SGS: Sistema Gerenciador de Séries Temporais" [Time Series Management System], BACEN.

¹⁰ According to the BNDES "Relatório da Administração" [Administration Report], 2006.

¹¹ Arrearages over 90 days. Source: BNDES and BACEN, 2007.

- d. Average spreads of 2.66% applied by IFIs over the past three years;
 - e. The development of expertise in the IFIs for rating MSME risk, which has enabled them to put together packages to complement BNDES financing (using their own short-term funds to provide working capital for the ventures), thereby attaining a greater degree of bank coverage.
- 1.12 *Bank support.* Since 1990, the Bank has been supporting this strategy by undertaking MCPs with BNDES that have been yielding significant results, in particular: (i) from a financial standpoint, the overall results discussed in the preceding point; and (ii) in terms of impact on the real economy, medium- and long-term investments that MSMEs would otherwise be unable to undertake. Thus, the two programs implemented under the CCLIP have enabled 31,316 MSMEs to invest a minimum of US\$4 billion (taking into account only a 15% contribution from the entrepreneur). ([Link 5](#))
- 1.13 In that regard, the results of the ad hoc sample done by the Bank's Country Office in Brazil indicate that, for the enterprises included in the sample: (i) 77.9% of the program resources were disbursed to microenterprises and small businesses, and the remaining 22.1% went to medium-sized enterprises; (ii) annual sales of these enterprises rose by about 40.7% (71% for microenterprises, 32% for small businesses, and 43% for medium-sized enterprises); (iii) the number of jobs increased by 32.3%, from 38,000 to 50,000 (34% for microenterprises, 17% for small businesses, and 13% for medium-sized enterprises); (iv) the sums invested were 134% of the amount of program financing (the MSMEs' own capital contributions plus the working capital provided by the IFIs); and (v) the entrepreneurs who were surveyed rated 96% of the operations as satisfactory or highly satisfactory.
- 1.14 Consequently, the time is right for another program that, like those before, will mitigate the symptoms of the existing structural problems by alleviating the lack of medium- and long-term financing for MSMEs. To that end, the program has been designed to:
- a. Continue to dovetail with the government's policy of seeking to expand the supply of long-term financing in order to strengthen MSMEs and deepen their role in integrating the Brazilian economy with the rest of the world, according to the priorities set by the Ministry of Development for BNDES;
 - b. Remain consistent with the Bank's country strategy with Brazil (2004-2007) within the spirit of the Nuevo León initiative, which is aimed at boosting support for MSMEs. The Monterrey Consensus (2002), as it relates to prioritization of the use of resources, identifies four main areas for the Bank, one of which is supporting MSMEs with medium- and long-term credits for financing investment projects;
 - c. Continue to take the form of a multisector credit program (MCP), given its proven additionality in responding to the types and structure of the target

group's demand (numerous small-scale projects in a wide variety of economic sectors and geographic regions throughout the country), thereby ensuring (i) access to a wide spectrum within the target group; (ii) fairly small loans in local currency; (iii) transparent allocation of resources based on profitability and market criteria; (iv) proper management and oversight; (v) maximized impact in financing efficient investment projects that will boost competitiveness; and (vi) that all of this will be accomplished at minimum cost to the Bank;¹²

- d. Continue to operate under the framework of the CCLIP (given the rationale, relevance, and additionality described above);
- e. Be of sufficient scope to support BNDES in meeting private sector demand for term financing. ([Link 5](#))

B. Objectives, components, and features

- 1.15 *Objective.* The objective of the proposed program is to progressively strengthen private-sector MSME competitiveness and job creation by providing medium- and long-term financing for investment projects.
- 1.16 *Component.* The program is designed with a single component, consisting of a US\$1 billion loan and the corresponding local counterpart, to be used by BNDES to finance MSMEs through the IFIs.
- 1.17 *Features.* Under the proposed program—the third and final program under the US\$3 billion CCLIP for MSMEs approved by the Bank in 2004—medium- and long-term financing will be channeled by BNDES to MSMEs through regulated IFIs for investment projects aimed at expanding, modernizing, and diversifying the production activities of ventures that display the requisite technical, financial, economic, legal, and environmental viability.

C. Results indicators

- 1.18 It is very important to emphasize that in this operation, as with any MCP loan, the IFIs will select the most viable companies and ventures, such that the impact of their projects (assuming the economy's structural variables remain constant) will be determined by market conditions. The IFIs will choose the best firms and, as these enterprises repay the credits (with suitably low delinquency rates), market mechanisms will (i) ensure that the best projects are selected, and (ii) set the level of the indicators. Given this dynamic, any indicator, whether for a goal or purpose, could be regarded only as an *a priori* estimate of what the market may achieve, and thus could never gauge the success or failure of the operation.
- 1.19 On that basis, the following principal indicators for the program are included in the Results Matrix: (i) at the level of *output*, retention of BNDES's second-tier lines (the only factor within the project's reach); and (ii) depending on fulfillment of the

¹² This set of additionalities has always led the government to seek support from the Bank's public sector window for operations of this kind.

basic external assumptions of this type of program (mutual willingness of the MSMEs and IFIs to obtain and extend credit): (a) as intermediate *outcomes*, changes in the loan repayment period and additional financing contributed to the project by the entrepreneurs or IFIs; and (b) as final *outcomes*, the level of disbursements and the quality of the portfolio (see Annex I).

- 1.20 To increase the volume of information that can be used to quantify the impact of the operation, and in addition to the Results Matrix, the sample designed in 1999 will continue to be used as an ad hoc mechanism, to be managed by the Bank's Country Office in Brazil, for monitoring and assessing these projects' economic impact on investment and employment on an ongoing basis using a representative sample of beneficiary MSMEs.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instrument

1. Features of the loan

- 2.1 The sources of program financing will be the US\$1 billion loan plus US\$1 billion in local counterpart funding, including the funds of both BNDES and the subborrowers (which will not exceed 15% of the total amount of the subloans).
- 2.2 The Bank loan: (i) will have a three-year execution period; (ii) will use funds drawn on the Single Currency Facility, in U.S. dollars from the Bank's Ordinary Capital (LIBOR-based); (iii) may be partially executed at the request of BNDES, at the adjustable rate for the Single Currency Facility; and (iv) may be disbursed in Brazilian reais (R\$), under the terms approved by the Bank's Board of Executive Directors in the reformulation of the CCLIP, subject to the Local Currency Facility (LCF).
- 2.3 Program costs will be distributed as follows:

Table II.1. Program Cost, by Source of Financing
(in US\$ millions)

Investment component	IDB	Local contribution	Total
Credit	1,000	1,000	2,000
Percentage	50%	50%	100%

2. Use of the resources

- 2.4 Program resources, which will total US\$2 billion, will be used in full to provide *real*-denominated financing for eligible firms for use in investment projects and as permanent working capital. All funds will be channeled by BNDES through second-tier mechanisms of proven efficiency. The activities and components involved in this operation are described in the attached Table of Indicators. Operational policies are reflected in the respective Credit Regulations agreed upon

by the Bank and BNDES, which must enter into effect prior to the first disbursement.

- 2.5 *The loans.* The credit to be provided to microenterprises and microentrepreneurs (individuals) will be packaged as *real*-denominated subloans. These subloans will be granted to units having gross annual sales of up to US\$400,000. The funds for small businesses will take the form of *real*-denominated subloans and will be granted to firms having gross annual sales of between US\$400,000 and US\$3.5 million. The funds for medium-sized enterprises will be used to provide *real*-denominated subloans to firms having gross annual sales of between US\$3.5 million and US\$20 million.¹³ The maximum subloan amounts for each group are stipulated in each of the different programs that BNDES will finance using the program resources. This credit will be granted for use in financing investments and as working capital for projects designed to modernize and expand production and service activities.
- 2.6 *The onlending system.* The following rates and spreads will be used for MSME loans by BNDES:
- a. The BNDES Automático and FINAME programs will use the rates and spreads now in use in the BNDES system, applied through the CCLIP, which are: (i) the long-term interest rate (*taxa de juros de longo prazo*, TJLP); (ii) the usual BNDES spread, currently 1%; and (iii) the spread used by the IFIs, which they set at their discretion. ([Link 6](#))¹⁴
 - b. For loans made through the new BNDES Card, the arrangement is reversed: (i) the interest rate for the subborrower is fixed and is set monthly on the basis of the market rates for National Treasury Bills; (ii) the spread between that rate and TJLP funding is distributed 65/35 percent between BNDES (at a minimum of TJLP + 2%) and the IFIs; and (iii) the credit limit is determined by the IFIs for each subborrower for which they assume risk, based on the respective credit analysis. ([Link 7](#))

B. Main risks and mitigants

- 2.7 *Macroeconomic and macrofinancial risk.* The success of the proposed program will hinge upon the continued existence of a macroeconomic and financial framework that is conducive to the development of private investment. Despite the recent turbulence in the international financial markets, the risk that imbalances will arise in the financial system is now quite small, given the system's consolidation and the strengthening of regulatory and oversight mechanisms. The structure of the

¹³ The maximum balances owed on subloans granted to a subborrower using resources from this program and the preceding ones may not exceed the respective ceilings.

¹⁴ This link is especially important (and so, as an exception to normal practice, has been translated into English) in relation to: (i) the nature of the program (and the CCLIP) as supporting private sector development; (ii) the theoretical basis for both; (iii) their consistency with non-sovereign guaranteed programs; and (iv) their compatibility with the program in preparation with Banco do Brasil.

program will mitigate, insofar as possible, the macrofinancial risks by acting as a catalyst for sound practices. This catalytic effect will be transmitted via the demands that BNDES will make of the IFIs concerning the use of rigorous screening and portfolio monitoring mechanisms. Past experience with BNDES attests to its efficient execution of MCP programs and its achievement of a high degree of capillarity in its credit operations, together with delinquency rates that are consistently below the average for loan portfolios in the banking system as a whole.

- 2.8 *Fiduciary risk.* The operation is regarded as having a very low fiduciary risk, since BNDES has satisfactorily executed four MCPs and the first two programs under this CCLIP for MSMEs. This means that:
- a. BNDES: (i) has demonstrated, through this analysis and experience with previous programs, that it is fully competent to perform its duties; (ii) has the experience, administrative and operational capacity, and qualified personnel to execute the proposed program; (iii) has the only IFI network in the country of sufficient quality and scope to ensure a broad distribution of the operation's resources across regions and sectors; and (iv) has the appropriate evaluation and oversight procedures, standards, and capacity to ensure the satisfactory operational management of a program of this size.
 - b. Current banking laws, their supplementary regulations, and the supervisory policies and procedures of BACEN and BNDES provide an effective framework for oversight of IFI performance and their solvency, stability, and liquidity.
- 2.9 *Financial risks.* The risks of this operation will be no different from any MCP. The financial viability of the program will be determined by interest rates, the maintenance of the value of the credit to be provided, and the ready availability of the local counterpart funds. The subloan finance charges will enable BNDES and the IFIs to cover their financial costs and administrative expenses, realize a reasonable profit, and offset their credit risk.
- 2.10 *Exchange-rate risk.* The program will be funded in U.S. dollars or Brazilian reais. In the first case, the exchange-rate risk to which BNDES will be exposed when it converts the IDB loan into reais will be adequately covered, since BNDES policies (which are regulated by BACEN) stipulate that it must fully cover its exchange-rate risk at all times. It accomplishes this through: (i) financial matching of all of its operations using a methodology that conforms to the usual practices in this area; and (ii) adequate provisioning. At the same time, and to minimize this exchange-rate risk, BNDES will have the right, under the terms approved by the Board of Executive Directors in the reformulation of the CCLIP and under the provisions of the Local Currency Facility, to disburse the program in reais and/or to convert the balances disbursed in U.S. dollars to reais.
- 2.11 *Environmental and social risks.* In connection with approval of the CCLIP, the Committee on Environment and Social Impact (CESI) reviewed the project report for the line and found the environmental monitoring mechanisms to be satisfactory.

The quality of these mechanisms has been maintained, or will improve with possible support from a World Bank operation that has been recommended by the External Financing Commission (COFIEX) for structuring and negotiation.

- 2.12 As the third MCP targeted to MSMEs, the operation: (i) has features indicating that there are no significant environmental or social risks; (ii) as such, no classification is required under Directive B.13 of the Environment and Safeguards Compliance Policy (document GN-2208-20 and Operational policy OP-703); and (iii) will include a clause in the Loan Contract establishing that projects financed with the program resources must comply with Brazilian environmental laws in force. (See the Environmental and Social Strategy.)

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

1. Borrower, executing agency, and guarantor

- 3.1 The borrower and program executing agency will be BNDES, chartered under Law 1628 of 1952 and governed by Law 5662 of 1971. The guarantor will be the Federative Republic of Brazil. The guarantee will be limited to debt servicing and to the obligation to take the necessary steps for the borrower to fulfill its positive contractual covenants. In that regard, the Federative Republic: (i) will not assume responsibility for making the counterpart contributions, since they are not provided for in the national budget; and (ii) in no case can directly assume the positive covenants of BNDES (as a bank).
- 3.2 The implementability of the program derives from the institutional structure of the executing agency, BNDES. Prime responsibility for coordinating execution of the program will be borne by the unit in charge of operations with international agencies within the Departamento de Captação de Recursos Institucionais [Institutional Borrowings Department] (DECRI) in the BNDES financial cluster. The BNDES departments responsible for the evaluation of financial agents, operations, and portfolio monitoring will also be directly involved in executing these programs. The Bank will supervise and oversee the program through its Country Office in Brazil and the BNDES/IDB joint technical committee. ([Link 8](#))

2. Execution and administration

- 3.3 *IFI eligibility.* Commercial and multipurpose banks (both private and public) possessing a development banking portfolio, investment banks, development banks, and other regulated institutions that meet the requirements established by BNDES for its indirect operations programs can qualify as IFIs for the purposes of the program. In order to qualify, IFIs must: (i) comply with BACEN regulations, since BACEN oversees the system; (ii) have borrowings from the BNDES system

- consistent with the risk assessments performed;¹⁵ (iii) submit an independent, external audit each year that is unqualified and free from material objections; (iv) have no payments arrears with BNDES from previous operations; (v) commit to full disclosure of relevant information concerning subborrowers in the program upon request by the Bank or BNDES; (vi) allow the body selected by the Federative Republic of Brazil to audit and inspect program operations; and (vii) have a reporting system that provides information on the nature of subprojects, their financing sources and conditions, progress in their execution, and their payment status.
- 3.4 *IFI financial responsibility.* The IFIs will be wholly responsible for evaluating the risk associated with subborrowers and for the decision to grant financing in accordance with the Credit Regulations and with BNDES policies on indirect operations with MSMEs. The IFIs will assume responsibility for the servicing and repayment of the subloans to BNDES, regardless of whether or not the subborrowers fulfill their servicing obligations with the IFIs.
- 3.5 *Credit Regulations.* The program will have Credit Regulations: (i) that are consistent with the regulations and policies of BNDES and the Bank and with the financial practices and laws in force in the country; (ii) that reflect its main features; and (iii) whose approval by the Bank and implementation by BNDES will be a condition precedent to the first disbursement. Failure to comply with these provisions will result in the denial of access to financing:
- a. Subborrowers and use of the funds. Private-sector MSMEs and individuals, as defined in Brazilian law, which are legally resident in the country may participate as borrowers in the program if, in accordance with the program and in the judgment of BNDES and the participating IFIs, they possess the administrative, technical, financial, legal, and environmental capacity to execute the projects for which the loans are extended. Program funds are to be used to finance IFI subloans for fixed investments or for use as permanent working capital for the execution of investment projects by qualifying Brazilian MSMEs.
 - b. Financial terms and conditions of subloans. (i) Subloan maturities and amounts will be determined by the IFIs in accordance with each project's characteristics and the subborrower's repayment capacity, bearing in mind the conditions set forth in BNDES operational policies and the maximum limits established in the Credit Regulations; (ii) the funds onlent through IFIs to subborrowers will be denominated in reais; and (iii) the final rate applied to subborrowers will incorporate the respective intermediation spread for each IFI.

¹⁵ The risk evaluation and eligibility activities of the IFIs operating in the BNDES system are described in [Link 9](#).

- c. Restrictions on the use of program funds. Program funds may not be used to finance the following: (i) the purchase of immovable assets; (ii) dividend payments or recovery of invested capital; (iii) purchase of equities, bonds, or other movable assets; (iv) subborrowers' general or administrative expenditures; (v) projects that do not meet the environmental standards set forth under Brazilian law or established by the relevant public agencies; (vi) debt refinancing; and (vii) working capital other than permanent working capital associated with a project or with imported inputs or inputs having a significant import content, in accordance with BNDES's operational policies. The Bank loan proceeds may not be used for any of the following purposes: (a) tax payments; (b) the purchase of used movable goods, except in the case of used equipment and machinery that has an independent technical and economic appraisal, with the prior approval of the Bank; and (c) the purchase of goods and services from countries that are not members of the Bank.
- 3.6 *Procurement structure.* Procurements under the program will adhere to the provisions of the Bank's procurement policies (documents GN-2349-7 and GN-2350-7), with particular attention to paragraph 3.12 of the former document, which addresses loans to financial intermediaries. That paragraph states that the procurement is usually undertaken by the respective beneficiaries in accordance with established private sector practices acceptable to the Bank. For this reason, the program will not require a work plan (*stricto sensu*) or a procurement plan, since they are not applicable for this type of program.
- 3.7 *Operating procedures.* All (100%) of the program funds will be channeled through IFIs in the BNDES system. The operational procedures for execution, which are already in place, are the standard ones for credit lines in the BNDES system and were employed in the first and second programs under the CCLIP. Accordingly:
- a. In the program: (i) the Bank and BNDES will continue working together to support a government-led strategy for a sector or subsector in a comprehensive and coordinated manner (see paragraphs 1.9 et seq.); (ii) the funding provided to the sector will be used to support a single sector investment program; (iii) the agreed common approaches will continue to be followed; and (iv) transaction costs will be kept lower.
 - b. The Bank resources will continue: (i) to be commingled with financing from BNDES; (ii) to depend on its fiduciary framework; and (iii) to be disbursed through programs under the BNDES Indirect Operations System.
 - c. With respect to monitoring, evaluation, and oversight: (i) indicators with their respective baselines are given in Annex I; (ii) monitoring and evaluation will be done in the program evaluations and by sampling as described in paragraph 1.20; and (iii) the financial statements will be audited by the Secretaria Federal de Controle [Federal Secretariat for Auditing] (SFC).

- d. Consequently, the operating procedures for the operation will have an effect consonant with the sector-wide approach (SWAp) methodology established in policy document GN-2330-6.
- 3.8 Lastly, the overriding principle of the MSME programs under the BNDES's Indirect Operations System is to foster and develop domestic industry, particularly MSMEs. This principle, which is fully consistent with Bank policies, has been considered acceptable in all the MCPs with the BNDES owing to: (i) the considerable positive impact these programs have had in developing domestic industry (see paragraph 1.10 and [Link 5](#)); (ii) the average size of each operation, namely, US\$60,000 for microenterprises, US\$77,000 for small businesses, and US\$121,000 for medium-sized enterprises; (iii) the fact that they allow for the financing of imported goods under other BNDES programs; (iv) the disallowance of differentiated treatment of program funds (given the existing commingling); and (v) the existence of a large number of foreign firms belonging to member countries with productive processes in Brazil that utilize financing from BNDES programs. ([Link 10](#))

3. Disbursement conditions, execution period, and timetable

- 3.9 The commitment and disbursement periods for program resources have been set at three and four years, respectively (each year, the funds will be deemed committed when the borrower has notified the Bank of its financing request for the following year of program execution). The projected timetable provides for total disbursements of US\$660 million per year, with 50% of this sum being disbursed by BNDES and 50% by the Bank. However, this provision will be subject to the BNDES system's financing requirements.
- 3.10 Subloans disbursed between 1 February 2008 and the operation approval date, in the amount of US\$250 million, will be recognized against the loan proceeds, and an equivalent amount will be recognized against the local counterpart contribution.

B. Monitoring and evaluation system

- 3.11 *Program and executing agency audits.* BNDES and the IFIs will keep special records on the operations financed with program resources. They will include records of: (i) the number and amount of the subloans funded by the Bank and by the local counterpart; (ii) the interest falling due and collected on the funds used; and (iii) the establishment and use of loan-loss provisions. These data should permit the preparation of annual statements of account, income statements, and other program reports.
- 3.12 Auditing of the program's financial statements will be the responsibility of the Secretaria Federal de Controle [Federal Secretariat for Auditing] (SFC). BNDES's audits will be conducted by an independent auditing firm that meets with the satisfaction of the Bank.
- 3.13 *Midterm review.* Within the time frame set for the program (18 months after the first disbursement or once 50% of the loan has been committed, whichever occurs

- first), the borrower and the Bank will review program performance. This review will cover the following: (i) objectives and outcomes, based on the attached Table of Indicators and on the means of verification set forth therein; (ii) environmental requirements, in accordance with Brazilian law and Bank policies; and (iii) the tangible forms in which BNDES pursues its objectives of social inclusion.
- 3.14 *Ex post evaluation.* In accordance with Bank policy and following consultations on the subject, the executing agency has decided not to include an ex post evaluation among the program activities. BNDES has based its decision on the grounds that the regular evaluations of the CCLIP programs during their execution will provide sufficient information on their progress and outcomes. It is possible, however, that the ex post evaluation could be conducted nonetheless, since the necessary information will be available.
- 3.15 *Sharing of experience.* During program execution, BNDES and the Bank will exchange technical information of mutual interest through the aforementioned joint technical committee. At these meetings, discussions will cover the program's progress and the exchange and dissemination of experiences with credit programs and programs aimed at developing new financial products for the MSMEs of the region.

RESULTS MATRIX
BNDES: THIRD PROGRAM UNDER THE CCLIP LINE TO SUPPORT
MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES (BR-L1178)

Objective of the operation	To progressively strengthen private-sector MSME competitiveness and job creation by providing medium- and long-term financing for investment projects
Purpose of the operation	To channel medium- and long-term funds to MSMEs for eligible investment projects and improve MSME access to the financial system.

INDICATORS ¹							Description
	Base	Year 1	Year 2	Year 3	Year 4	Target	
COMPONENT: Extension of medium- and long-term credit lines (FINAME, BNDES Automático, and BNDES Card) by BNDES to intermediary financial institutions (IFIs).							
<i>Output</i>							
IFIs are able to access credit lines for medium- and long-term financing using program resources.	0	Up to 100%	Up to 100%	Up to 100%	Up to 100%	Up to 100%	This percentage indicates BNDES's capacity to loan program funds (if there is market interest in borrowing them).
PURPOSE: MSMEs, through the IFIs, obtain medium- and long-term funds for eligible investment projects.							
<i>Intermediate outcomes</i>							
Changes in the loan repayment period under the program, with respect to the average maturity in the financial system.	Longer than system	Longer than system	Longer than system	Longer than system	Longer than system	Longer than system	This indicator compares loan maturities under the program to maturities in the financial system. Hence, it indicates the need for the program. The cell will show the average maturity and the percentage of medium- and long-term loans in the program for the respective year compared to the average maturity for financial intermediaries as a whole. <i>Baseline:</i> In 2007, the average maturity for system assets was 350 days.

¹ In this operation, as in any MCT, the IFIs will select the most viable projects, so their impact will be bounded by market conditions. Consequently, goal or purpose indicators are only an estimate of what the market may achieve.

INDICATORS ¹							Description
	Base	Year 1	Year 2	Year 3	Year 4	Target	
Additional financing contributed by entrepreneurs and/or IFIs for investment projects.	12.4%	15%	17%	19%	21%	21%	<p>This indicators shows the percentage of the total amount of the program-supported projects that is contributed by entrepreneurs and/or IFIs.</p> <p><i>Baseline:</i> The <i>relatório de acompanhamento</i> [monitoring report] for program 1608/OC-BR indicates that entrepreneurs contributed 12.4% of the total value of the projects. The August 2007 sample of 308 firms, taken from the <i>in loco</i> monitoring system, yielded a figure of 34% for the same program.</p>
<i>Final outcome</i>							
IFIs have access to medium- and long-term credit lines using Bank resources and can obtain program funds.	0%	33%	66%	100%	100%	100%	<p>Level of program lending that is absorbed by existing demand. This percentage represents the cumulative lending level compared to the total amount of financing allotted by the Bank through the program.</p> <p><i>Baseline:</i> According to the monitoring report, the funds under program 1608/OC-BR were disbursed as follows: 50% in 2005, 49% in 2006, and 1% in 2007.</p>
Delinquency rate on IFI subloans under the program compared to the delinquency rate for unearmarked funds in the system.	Lower than system	Lower than system	Lower than system	Lower than system	Lower than system	Lower than system	<p>This indicator shows the performance of subborrowers under the program to remain IFI customers. The cell will show the delinquency rate of subborrowers compared to the system.</p> <p>Since the IFIs will select the most viable companies and ventures, the impact of the projects financed will be determined by market conditions. As these enterprises repay the credits with delinquency rates similar to those in the financial system, market mechanisms will ensure that the best projects are selected. Thus, comparison between the quality of the market portfolio and that of the program is key in determining the program's success.</p> <p><i>Baseline:</i> The delinquency rate (up to 90 days) of the financial system as a whole for operations with unearmarked funds was 3.4% as of December 2007 (BACEN). The August 2007 sample of 308 firms under program 1608/OC-BR showed only 3 in arrears (approximately 1%).</p>

To increase the supply of information that can be used to quantify the impact of the operation, the following indicators will be surveyed:

GOAL: Progressively strengthen private-sector MSME competitiveness and job creation						
INDICATORS²	Year 1	Year 2	Year 3	Year 4	Target	Description
<p>Level of activity of financed programs and products:</p> <ul style="list-style-type: none"> • By company size • By disbursements in regions • By disbursements in sectors 	<p>The program levels of activity in each year and by company size, region, and sector will depend on the market and demand. All that can be said is that, with the recent introduction of the BNDES Card, the proportion of disbursements to smaller companies (microenterprises and small businesses) and to sectors with a high concentration of microenterprise activity (e.g. services and commerce) is expected to increase with respect to the outcomes of program 1608/OC-BR.</p>					<p>The program assumes that the market will efficiently allocate the resources based on signals from the real economy.</p> <p><i>Baseline:</i> In program 1608/OC-BR, the disbursements were distributed as follows:</p> <p>a) By company size:</p> <ul style="list-style-type: none"> - Microenterprises: 30.1% - Small businesses: 34.7% - Medium-sized enterprises: 35.2% <p>b) By region:</p> <ul style="list-style-type: none"> - North: 4.5% - Northeast: 11.5% - West central: 6.8% - Southeast: 42.7% - South: 34.7% <p>c) By sector:</p> <ul style="list-style-type: none"> - Agricultural: 1.1% - Mining: 0.9% - Industry: 21.3% - Commerce: 5.8% - Services: 70.9%
Number of participating IFIs	60	60	60	60	60	<p>The program will seek to retain a significant number of IFIs as participants.</p> <p><i>Baseline:</i> 62 of the 140 IFIs in the BNDES system (with 16,000 points of sale) participated in program 1608/OC-BR. The 10 largest disbursed 81% of the program funds.</p>

² The FIN indicators do not, in and of themselves, constitute program objectives. They are approximate market projections of the program's impact by the project team.

GOAL: Progressively strengthen private-sector MSME competitiveness and job creation						
INDICATORS²	Year 1	Year 2	Year 3	Year 4	Target	Description
Cumulative growth in the number of employees of subborrowers in the sample.	20%	25%	30%	35%	35%	This indicator tracks trends in the number of employees of subborrowers in the program sample. <i>Baseline:</i> The last statistical sample (August 2007) of 308 companies under program 1608/OC-BR (disbursed in 2005 and 2006) shows a 32% increase in jobs among subborrowers and an average of 39 jobs created by subborrowers since the loans were made.
Cumulative growth in gross sales of subborrowers in the sample (in reais).	25%	32%	40%	45%	45%	This indicator tracks trends in gross annual sales of subborrowers in the program sample. <i>Baseline:</i> The last statistical sample under program 1608/OC-BR shows that subborrowers' sales in reais increased 41% since the loans were made.
Average spread of IFIs on subloans in the sample. ³	5.5%	5.25%	5%	4.75%	4.75%	The program sample is intended to closely follow trends in the spread applied by the IFIs according to the company's size, age, etc. <i>Baseline:</i> The average spread of the sample for program 1608/OC-BR was 5.32%. (The minimum was 0.2%; the maximum was 11%). Average spread by company size: <ul style="list-style-type: none"> - Microenterprises: 5.97% - Small businesses: 5.32% - Medium-sized enterprises: 4.37%
Average years of difference between the age of each company and the length of its relationship with the IFI. ⁴	11	10.5	10	9.5	9.5	<i>Baseline:</i> The most recent sample under program 1608/OC-BR shows that the average age of the companies is 17.4 years, and the average length of their relationship with an IFI is 6.3 years; based on this approximation, therefore, the average loan access time is 11.1 years.

³ With the introduction of the BNDES Card, the spread is expected to increase slightly, at least initially, with respect to the previous program.

⁴ Approximates the amount of time necessary to become borrowers.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-____/08

Brazil. Individual Loan ____/OC-BR to the Banco Nacional de Desenvolvimento Econômico e Social (BNDES) of the Federative Republic of Brazil. Utilization of the resources of the Conditional Line of Credit for Investment Projects established by Resolution DE-116/04. Third Program under the CCLIP Line to Support Micro, Small and Medium-Sized Enterprises

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to utilize the resources of the Conditional Line of Credit for Investment Projects approved pursuant to Resolution DE-116/04, by entering into such contract or contracts as may be necessary with the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), as Borrower, and the Federative Republic of Brazil, as Guarantor, for the purpose of granting the former financing for an individual operation for cooperating in the execution of the third program under the CCLIP line to support micro, small and medium-sized enterprises. Such financing will be in the amount of up to US\$1,000,000,000, from the resources of the Single Currency Facility of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.