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URUGUAY

MICROLENDING BY LOCAL CREDIT UNIONS IN URUGUAY

(UR-M1004)

Small Enterprise Development Facility

Line of Activity for Strengthening Financial Institutions for Microenterprise

LINE OF ACTIVITY MEMORANDUM

This document was prepared by the Project team comprised of the following members: Carla Bueso (MIF); María Victoria Saénz (MIF); Alfredo Echegaray (COF/CUR); Michael Steidl (Consultant); Paula Giraldez (LEG/OPR); and Fermin Vivanco (SDS/MSM), Project Team Leader.

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ABBREVIATIONS

AECI	Agencia Española de Cooperación Internacional (Spanish Agency for International Cooperation)
BCU	Central Bank of Uruguay
BROU	Banco de la República Oriental del Uruguay
CND	Corporación Nacional de Desarrollo (National Development Corporation)
COFAC	Cooperativas Federadas de Ahorro y Crédito (Federated Credit Unions)
EAP	Economically active population
FUAAM	Fundación Uruguaya de Ayuda y Asistencia a la Mujer (Uruguayan affiliate of Women's World Banking)
FUCAC	Federación Uruguaya de Cooperativas de Ahorro y Crédito (Uruguayan Federation of Credit Unions)
GDP	Gross domestic product
IDB	Inter-American Development Bank
MIF	Multilateral Investment Fund
NGO	Nongovernmental organization

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I. EXECUTIVE SUMMARY

Name of the project:	Microlending by Local Credit Unions in Uruguay
Executing agency:	Federación Uruguaya de Cooperativas de Ahorro y Crédito (Uruguayan Federation of Credit Unions—FUCAC)
Beneficiaries:	The direct beneficiaries will be approximately 2,000 microentrepreneurs in the provinces of Uruguay. The indirect beneficiaries will be 5 credit unions affiliated to FUCAC.
Financing:	MIF (Nonreimbursable): US$200,000 FUCAC: US$135,000 Total: US$335,000
Objectives:	The project's general objective is to improve access to credit for microenterprises in the provinces and on the outskirts of Montevideo. Its specific objective is to expand specialized financial services to the microenterprises of the local credit unions affiliated to FUCAC. To achieve those objectives, the project will support: (i) the development of the microlending products offered by the credit unions; (ii) strengthening of the credit unions' administrative and financial management systems; and (iii) strengthening of FUCAC's monitoring of beneficiary credit unions.
Execution timetable:	Execution period: 36 months Disbursement period: 42 months
Contractual clauses:	As conditions precedent to the first disbursement of MIF funds, FUCAC must have appointed a Project Director and presented, to the Bank's satisfaction, agreements signed with at least four of the five local credit unions that will be participating in this technical cooperation project.
Exceptions to Bank policy:	None

Environmental and social review:	The project activities will not have any direct effect or impact on the environment.
Coordination with other governmental development agencies:	The project has been coordinated with the Spanish Agency for International Cooperation (AECI), which has underwritten a €10 million loan, which includes financing for microfinance institutions and credit unions.

II. BACKGROUND AND JUSTIFICATION

A. Microenterprise in Uruguay

2.1 **Employment, underemployment, and poverty.** Traditionally, Uruguay had been one of the countries in Latin America with the highest share of formal employment among the economically active population. Occasionally, this was mentioned as one of the reasons why microfinance did not develop in the country. The crisis in 2002 altered that scenario. According to the Ongoing Household Survey (*Encuesta Continua de Hogares*—ECH) of 2003, unemployment in that year was 16.9% and underemployment nearly 20%. The same survey showed the incidence of poverty doubling between 1999 and 2003, by which year 30% of the population was poor. Some of the jobs lost in the formal sector were absorbed by (formal or informal sector) microenterprise, which represented an economic survival option for the un- and underemployed.

2.2 **Quantifying microenterprise and its importance.** Only enterprises with between one and four employees and assets of up to US$20,000 are officially classified as microenterprises in Uruguay. Mercosur, on the other hand, establishes different criteria in respect of the number of employees for microenterprises in the manufacturing or services sectors. This discrepancy suggests it might be best to use the regular international definition (up to 10 employees). Using that definition, the National Institute of Statistics of Uruguay (INE) registers 118,000 formal microenterprises. According to the National Directorate for Crafts and Small and Medium-sized Enterprises (DINAPYME), over 90% of Uruguayan companies are microenterprises and they employ nearly 40% of private sector workers.[1] Informal microenterprises would appear to number over 150,000, judging by a comparison between the ECH data and the numbers of registered companies.

2.3 **Characteristic features and problems of microenterprises.** Uruguayan microentrepreneurs typically have high academic and technical qualifications. According to surveys carried out by the Uruguayan Federation of Credit Unions (FUCAC), 38% of microentrepreneurs have had business training and 21% have taken part in at least one course related to their line of business. As for formal education, 50% have been to high school, 20% have a university education, and 20% have had a specialized technical education. Thus, access to technical and administrative expertise does not appear to be a limiting factor for the development of Uruguayan microenterprises.

2.4 Nevertheless, Uruguayan microenterprises have greater difficulty obtaining financing than their counterparts in other countries of the region, owing to the fact that they do not meet the guarantee and presentation of financial statements requirements, the latter being a prerequisite for obtaining a business loan from a

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[1] See the information published on the DINAPYME website, http://dinapyme-redsur.mailcom.net/.

regulated and supervised institution in Uruguay. Furthermore, microenterprises encounter a financial system that, with few exceptions, attaches little priority to, or lacks the technical capacity and interest in, developing credit instruments tailored to their specific needs.

B. Microfinance in Uruguay

2.5 **Background.** Some financial institutions, especially state-owned banks and the credit unions, have begun to look more favorably at microlending. In that process, the Bank has played a leading part, with three multisector credit loans, which included financing for microenterprises. Multisector credit loan I (US$90 million) was fully disbursed between 1994 and 1998, and multisector credit loan II (US$155 million) was disbursed between 1999 and 2002. This loan included a component for the institutional strengthening of the Superintendency of Banks and the Banco de la República Oriental del Uruguay (BROU). Multisector credit loan III (US$180 million), which began in 2002, has disbursed approximately US$106 million.

2.6 In addition, three microfinance institutions have received IDB/MIF technical cooperation support for institution-strengthening: FUCAC, ATN/ME-6243-UR (see 2.18), Fundación Uruguaya de Asistencia y Ayuda a la Mujer (FUAAM), ATN/ME-6741-UR, and Cooperativas Federadas de Ahorro y Crédito (COFAC) ATN/ME-7312-UR.

2.7 The financial crisis in 2002 dampened enthusiasm for microfinance, with grave repercussions for microfinancial services, because the banks liquidated in the wake of the crisis included some with the largest networks of branches in urban and rural centers outside Montevideo. In the country as a whole, private banks have lost some 430,000 customers since 2002, with consequences that are clearly visible outside the capital.[2]

2.8 This financial disintermediation process has curtailed financing options for microenterprises in Montevideo and, above all, in the rest of the country, where numerous bank branches have disappeared. In several major towns, there is no institution in the formal financial system to lend to microenterprises and small businesses.

2.9 **Microfinance.** Today, most financial institutions do not provide financing to microenterprises, except indirectly via consumer loans, which are very popular in Uruguay. Seventy-five percent of Uruguayan adults are listed in private credit bureaus. The two state banks, BROU and Nuevo Banco Comercial, account for 61% of banking system assets[3], but they are still suffering the effects of the crisis

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[2] See Economist Intelligence Unit: Uruguay Country Profile 2004.

[3] Report of the Central Bank of Uruguay for second quarter 2004.

that began in 2002. The 13 private banks have experienced high arrears rates since 2002 and have stopped providing microloans to low-income individuals.

2.10 Sixty-five credit unions (*cooperativas de ahorro y crédito*) in particular are involved in microfiannce. Of these, four are supervised by the BCU, which authorizes them to attract savings. This credit union sector focuses on consumer loans to a range of socioeconomic strata. Among the unregulated credit unions, there are, in particular, some traditional, highly solvent cooperatives with a conservative strategy and some new, faster-growing cooperatives, which operate as consumer finance companies.

2.11 **Microlending.** Generally speaking, the main sources of financing for microentrepreneurs are consumer credit lines and credit cards offered by active commercial banks. Currently, regulated and supervised microfinance is available from: (i) BROU, which has decided to resume lending to microenterprises and small and medium-sized businesses, after a period in which it stopped doing so because of the crisis; (ii) COFAC, which has a clientele of 3,900 microentrepreneurs and a portfolio totaling US$7.9 million, as well as 4,200 small business owners with a portfolio totaling US$57 million; and (iii) FUCAC, which has 2,600 customers and a portfolio of US$1.9 million. Unregulated microfinance institutions comprise FUNDASOL, which has 2,000 customers and a portfolio of US$1.8 million, and FUAAM with some 2,000 customers and a portfolio totaling approximately US$1 million.[4] Microfinance portfolios are estimated to be between one half and one third of what they were prior to 2002.

2.12 **Regulatory environment.** The regulated and supervised institutions are only authorized to serve formal sector microenterprises that can present financial statements. They can serve informal microenterprises indirectly via personal and consumer loans to their owners or members of their immediate families. Unregulated institutions also serve informal microenterprises.

C. FUCAC and the Local Credit Union Network

2.13 **FUCAC and microlending.** In 2002, FUCAC gave up its plans to stage a massive, direct foray into the microfinance market and instead embarked on a new downsizing strategy, in which it would operate as a first-tier cooperative in Montevideo and as a second-tier institution in its network in the rest of the country.

2.14 In 2004, in the framework of that strategy, FUCAC started a pilot project that entails lending to microenterprises through some of the local credit unions in its system. As part of the pilot, five credit unions—COMAJA (in Artigas, with branches in Bella Unión and Rivera), CAYCPA (Florida), COMAC (Treinta y Tres) COOPACE (in Fray Bentos, with branches in Mercedes and Young), and

[4] All microfinance supply data were obtained directly from management in each institution.

Cooperativa Caja Central, which operates in the suburban and rural area northeast of Montevideo,[5]—have been selected by FUCAC and the Bank for downscaling to services for microenterprise.

2.15 These credit unions meet the following **eligibility criteria**: **(i)** *local market penetration:* with 48,000 members, these credit unions have penetrated more than 30% of households in the departments in which they are located, and far higher percentages in some of the towns where they have offices, such as Fray Bento. They are therefore well-known players in local economies: an asset likely to ensure that their microlending projects also achieve a high rate of penetration in their service areas; **(ii)** *solvency:* with one exception, the credit unions' solvency exceeds 90 percent of their assets, which will allow them to expand their microenterprise portfolio, using external second-tier resources of both FUCAC and the National Development Corporation (CND), and remain solvent; (iii) a long record of service outside the capital: the four provincial credit unions have been geared to local needs for over 30 years. They have offices near the center of town and the municipal population refers to them as "the cooperative." The prestige enjoyed by these credit unions stems from the fact that in many localities they are the only lending institutions apart from BROU and, in some places, COFAC; **(iv)** *determination to be local development agents*: in many towns outside the capital, where there is no longer any lending to small-scale economic agents, the credit unions are the only institutions interested in lending to local microentrepreneurs, and they have told the Bank that they would like to learn how to do so appropriately. That determination underlies their commitment to lend US$1 million to microenterprises by 2007; and **(v)** participation in the *downscaling pilot project:* with a specific microlending product, which represents a substantial change for the credit unions and their customers, compared to the consumer credit they are used to. Thanks to advice and impetus from FUCAC, this pilot project got underway in third quarter 2004.

[5] Also participating in the pilot project are a cooperative based in Montevideo, CACSCEA (which has branches in Salto, Paysandú, Minas, and Paso de los Toros), and FUCAC's Caja Central.

Table 1. The Local Credit Unions

NAME	LOCALITY	No. of members	Households in the departments where they are located	Household penetration	Assets US$ Million	Capital US$ Million	Capital as a % of assets
COMAJA	Artigas, Bella Unión, Rivera	15,694	48,947	32%	1,972	1,851	94%
CAYCPA	Florida	6,315	20,599	31%	1,010	981	97%
COMAC	Treinta y Tres	4,602	15,542	30%	1,613	1,596	99%
COOPACE	Fray Bentos, Young, Mercedes	16,258	38,440	42%	2,209	2,185	99%
CAJA CENTRAL	Suburban and rural northeastern Montevideo	5,012	N/A	N/A	1,130	229	20%
All	Outside the capital	47,881			8,741	7,499	86%

2.16 **The local credit unions' downscaling to microenterprise project.** So far, the local credit unions in the FUCAC network have focused on consumer credit and have not ventured into the microlending market in their areas on a large scale. However, they have discovered that a high percentage of their customers engage in microenterprise. For instance, COMAC in Treinta y Tres estimates that half its customers run their own businesses. This substantially restricts lending to customers because loans have to be calculated in respect of a wage that does not reflect actual capacity to pay, either because it pertains to a husband or wife, or because it is one of several sources of income. Under these circumstances, the five local credit unions mentioned above are planning a downscaling to services for microenterprise, but are encountering the following problems: **(i)** they lack experience and technical expertise with regard to the methodology of microlending. In particular, they are accustomed to estimating the amount of the loan on the basis of the payroll of the employees who make up their clientele, but lack methodologies for assessing the credit risk of microenterprises; **(ii)** they lack products tailored to the needs of that target group and credit officers experienced in dealing with microenterprises. Accordingly, the credit technology promoted by FUCAC should be tested before the microlending product is introduced on a large scale in local credit unions. In particular, it needs to be aligned with best practices in the industry, the specific needs of customers outside the capital, and the characteristic features of local credit unions; and **(iii)** they have financial administration shortcomings that constitute obstacles for downscaling to services for microenterprises. First, the members of the Boards of the credit unions have considerable experience with their own credit unions, but lack sufficient technical know-how regarding the characteristics of microlending. That gives rise to misconceptions of what microlending is and to delays or distortions in introducing the product. Second, portfolio management, internal audit, and marketing systems are not in a position to meet the demands of microlending.

2.17 At the same time, as the promoter of microlending in affiliated credit unions, FUCAC has some limitations with respect to its oversight and monitoring of them.

Specifically, the information technology communication systems and management's information, oversight, and monitoring system have the following weaknesses: (i) the lack of an effective management information system to support oversight and ongoing monitoring by FUCAC of the microlending operations of the local credit unions; (ii) the lack of specific software to guarantee a steady flow of online network communications between the local credit unions and FUCAC; and (iii) the lack of computerized data security systems and policies to ensure safe communications via the local credit union network. These shortcomings impair the ability of FUCAC to promote and monitor microlending in its network of affiliated credit unions.

D. Project strategy and cooperation with other donors

2.18 **Project strategy and eligibility.** This project's strategy is to assist institutions that are strongly rooted in their local communities to enter the microlending market in an efficient and sustainable manner. It will support the development of products tailored to the needs of the microenterprise sector and their implementation, the adaptation of the credit unions' management systems, and the development of the oversight and monitoring capabilities of FUCAC, as the promoter of microlending in local credit unions. Appendix 4 shows how the project meets the eligibility criteria for the IDB/MIF Second Line of Activity for the Strengthening of Microfinance Institutions.

2.19 **The Bank's strategy with the country.** This project's strategy coincides with the last IDB country strategy with Uruguay of October 2000, which identifies support for the competitiveness of the Uruguayan economy as a priority area. Two areas covered by this project have been explicitly singled out as areas of action: (i) support for competitiveness and efficiency in the financial sector and, within that area, promotion of new product development, financial activities, and market segments; and (ii) in connection with the promotion of urban and rural microenterprise competitiveness, "assistance for banks and cooperatives, introducing lending methodologies that are appropriate to the sector."

2.20 **Previous experience with FUCAC.** In 1998, FUCAC received a subordinated seven-year loan from the MIF in the amount of US$1.25 million, at 10% interest, to expand coverage to microenterprises (10/MS-UR). In 2002, at the request of the MIF, it was agreed that FUCAC would return 50% of the loan, which it did in July of that year, while the other half of the loan remained in effect. The technical cooperation component was executed to the Bank's satisfaction, according to the final evaluation of the project in 2001. The reasons for the partial return of the loan were: (i) the abrupt decline in the demand for credit as a result of the financial crisis; (ii) the agreement under which FUCAC would transfer its branch offices to COFAC along with 70% of its staff and its assets and liabilities, in exchange for FUCAC's investment in a pension fund management company; and (iii) over-dimensioning of the MIF loan, given FUCAC's new financial position.

2.21 **Lessons learned.** Two lessons were learned from that experience. The IDB/MIF learned that close monitoring of microfinance projects, timely reaction, and corrective action in the event of crisis represent value added for an executing agency and contribute to its viability as an institution. For its part, FUCAC learned that in Uruguay it is difficult to launch a large-scale microfinance project successfully, even for experienced institutions with international backing, because informal microenterprise is less densely concentrated and because of the restrictions imposed on regulated institutions.

2.22 **Additionality.** This project does not duplicate the previous FUCAC operation because, unlike that operation, this project focuses on downscaling consumer-credit-oriented credit unions outside Montevideo.

2.23 **Cooperation with other donors.** The analysis mission coordinated this project with the Spanish Agency for International Cooperation (AECI), which has signed a €10 million loan agreement for financing microlending through the CND. Twenty-five percent of that loan may be channeled through unregulated intermediaries, such as the aforementioned local credit unions, to finance microenterprises.

III. THE PROJECT

A. Project objectives and description

3.1 The project's general objective is to improve access to credit for microenterprises in the provinces and on the outskirts of Montevideo. Its specific objective is to expand specialized financial services to the microenterprises of the local credit unions affiliated to FUCAC.

3.2 To achieve those objectives, the project will support: (i) the development of the microlending products offered by the credit unions; (ii) strengthening of the credit unions' administrative and financial management systems; and (iii) strengthening of FUCAC's monitoring of beneficiary credit unions.

3.3 **Component I: Development of microlending products in local credit unions**. The purpose of this component is to prepare credit unions that are members of FUCAC to offer (at least) one credit product tailored to the needs and risks of microenterprises. Three kinds of actions will be undertaken to achieve that purpose: **(i)** *design and adjustment of lending procedures:* an international consulting firm will be hired to design a credit product based on experience of best practices in microfinance tailored to local circumstances in Uruguay. This entails: (a) identifying the specific characteristics of the local entrepreneurs to be served; (b) designing policies and processes related to the microlending products to be offered; and (c) designing the risk assessment methodology; and (d) drafting, pilot-

testing, and validating of new microlending manuals; **(ii)** *long-term management advisory services:* a consulting firm will be hired to: (a) advise on the introduction of credit technology in the credit unions; (b) train management teams in the credit unions and FUCAC officers in oversight and monitoring of the microlending system in local credit unions; (c) produce the lending manual; (d) design an incentives-based wage policy for operational staff compatible with institutional objectives; and (e) design a management information, oversight, and monitoring system that will enable FUCAC to monitor the development of the microloan portfolio in the credit unions and, if necessary, to recommend corrective actions; and **(iii)** *training*: credit counselors will receive classroom and on-site training in the new credit instruments.

3.4 **Component II: Strengthening administration and management in local credit unions.** The purpose of this component is to prepare the administrative systems of local credit unions that are members of FUCAC to manage microlending efficiently and in a sustainable manner. The actions in this component include: **(i)** *development of a microlending product marketing system:* a commercial management consulting firm will be hired for the five credit unions in the project to design a joint brand name for the system and cross-sales of other financial products; **(ii)** *internal audit*: internal audit consultants will be hired to: (a) identify the principal operating risks attached to microlending by the credit unions; (b) design internal audit mechanisms; (c) write the manuals; and (d) train internal auditors how to apply them. The objective of this activity is to provide FUCAC and the local credit unions with the technical tools they need to achieve efficiency and security in microlending; **(iii)** *financial management:* a consulting firm will be hired to design and implement financial oversight and management mechanisms in line with best practices in the management of microfinance institutions, in order to achieve efficient resource management; **(iv)** *environmental policy*: a consulting firm will be hired to help FUCAC implement the Bank's environmental guidelines for microfinance projects (see 8.1); **(v)** *governance:* executives in the credit unions will receive training in microfinance in order to ensure that the institutions are well managed as they enter a new field. Training will be provided through seminars and workshops by experts in this field and through exchanges of information with successful microlending projects in Uruguay and abroad; and **(vi)** *information systems:* financing will be provided to adapt computer systems to the requirements generated by microlending, via procurement of hardware, software, and appropriate adaptations.

3.5 **Component III: Strengthening of FUCAC's oversight and monitoring capabilities.** The idea of this component is to guarantee the efficiency and sustainability of the microlending product offered by affiliated credit unions by strengthening FUCAC's oversight and monitoring capabilities. The following actions are planned: **(i)** the security of electronic data: a consulting firm will be hired to: (a) analyze security features of operations using the cooperatives' network; and (b) define the policies and investments needed to achieve security in

operations, maintenance, and communications; **(ii)** *communications:* financing will be provided for the purchase and installation of software that will ensure a constant flow of information via the network between the credit unions and FUCAC; and **(iii)** *managerial information, oversight and monitoring*: financing will be available to hire a consulting firm for the managerial information system and oversight and monitoring of microlending by the credit unions on the basis of specifications drawn up by the long-term consultant (see 3.3).

3.6 **Other activities.** The project's budget includes funding for a Project Director, including transportation and per diem for oversight and monitoring trips to credit unions outside Montevideo. The Project Director will be responsible for coordinating and monitoring the activities planned and will liaise between FUCAC and the Bank.

IV. COST AND FINANCING

4.1 The project's total budget amounts to US$335,000. Of that, the MIF will finance US$200,000 (60% of the project total), on a nonreimbursable basis. The balance of US$135,000 will be financed out of FUCAC's own funds and those of the participating credit unions. FUCAC will be responsible for raising the counterpart contribution from participating credit unions and will guarantee the local contribution should the credit unions not be in a position to deliver the funds committed. At least 50% of the counterpart will be in cash.

Table 2 – Project Budget (US$)

Description	MIF	Local	Total
I. Development of microlending by the credit unions	61,000	31,000	92,000
II. Strengthening of the local credit unions	68,000	72,000	140,000
III. Strengthening of FUCAC's oversight and monitoring capabilities	28,000	11,000	39,000
IV. Evaluation, audit, and coordination of the project	43,000	21,000	64,000
TOTAL	200,000	135,000	335,000
In %	60%	40%	100%

V. EXECUTING AGENCY AND MECHANISM

A. The executing agency

5.1 FUCAC was founded in 1972 by eight credit unions as a second-tier institution for the credit union sector. Today the FUCAC network comprises 12 credit unions throughout the country with approximately 150,000 active members. FUCAC is a credit union supervised by the Central Bank and it describes itself as "a

cooperatively owned banking institution specializing in microfinance." It conducts first-tier operation in Montevideo and—through member credit unions—second-tier operations outside the capital.

B. Beneficiary institutions: the credit unions affiliated to FUCAC

5.2 Five credit unions that are members of FUCAC will be the project's beneficiaries. Four of them are outside the capital, where financial disintermediation has been more severe, due to the reduction in the number of branches of the banks with national networks. Shortages in the supply of credit sharply curtail financing for microenterprise. For that reason, the project's credit unions may have a significant role. The remaining credit union is located in a rural and suburban area in the northeastern part of Montevideo, where FUCAC does not operate, which would enable the project to introduce microlending to a part of the capital that has not been served by the traditional banking sector.

5.3 **Strengths and weaknesses.** With total assets of US$8.7 million, the credit unions are most effective in less densely populated environments. Their solvency—with total capital of US$7.5 million, covering 86% of their assets—has enabled them to survive the crisis besetting the banking system since 2002. Their sound financial position stems from their very conservative approach to external indebtedness. At the same time, their liquidity provides backing for a strategy of expansion to new products and markets. The weaknesses of these credit unions lie, first, in their relatively old-fashioned management, organizational, and information systems, and, second, in the still incipient nature of their experience with microlending. The project will provide the funds needed to remedy these shortcomings.

5.4 **Governance.** With support from the German Confederation of Cooperatives (DGRV), FUCAC is embarking on a governance project in the local credit unions, which will include drafting a good governance manual, training, and a study of domestic rules and regulations. An effort will be made to coordinate with the National Internal Audit Office (*Auditoría Interna de la Nación*) in the drafting of prudential standards for the credit unions.

5.5 **Supervision and control.** The development of FUCAC's oversight and monitoring capabilities and the strengthening of managerial capacity in the credit unions are geared to enhancing the management and oversight skills of their executive bodies and to ensuring that the credit unions are eventually in a position to be supervised.

5.6 **Responsibilities.** The IDB will sign an agreement with FUCAC, under which FUCAC will execute this project. FUCAC will hire the consultants and training services included in the budget, in accordance with IDB/MIF rules and procedures. The project will hire a technical director to monitor, coordinate, and supervise the work of the consultants, organize the training, and coordinate the development and installation of software, as well as the procurement of hardware. The technical

director will also develop an ongoing monitoring mechanism to ensure the consistency of the information sent to the IDB.

5.7 **Counterpart contributions.** Accounting records will be kept of counterpart resources contributed by FUCAC, as the executing agency, and by the credit unions, as the beneficiary institutions.

5.8 **Execution and disbursement periods.** The project execution period will be 36 months and the disbursement period 42 months.

5.9 **Procurement of goods and services.** To hire the services of consultants and trainers, and to procure software using MIF resources, FUCAC must comply with all the rules, procedures, and policies established by the IDB for those purposes.

5.10 **Special conditions.** As conditions precedent to the first disbursement of MIF funds, FUCAC must have appointed a project director and presented, to the Bank's satisfaction, the agreements signed with at least four of the five local credit unions governing their participation in this technical cooperation project.

VI. MONITORING AND EVALUATION

6.1 **Monitoring.** FUCAC will be responsible for compiling and analyzing the data needed to monitor project execution and the indicators established in the Logical Framework (Annex I) on an ongoing basis. The management information system included in Component III should generate the required data. FUCAC and the IDB will use the monitoring system to supervise and evaluate the project. This system should be considered both in drafting half-yearly progress reports and for midterm and final reports. The IDB's Country Office in Uruguay bears chief responsibility for monitoring the project and will be supported by SDS/MSM and the MIF in evaluations and in the exchange of information and lessons learned from similar projects.

6.2 **Reports.** For each of the years following the first tranche release, FUCAC will submit half-yearly progress reports to the IDB, within 60 days following the end of each semester. At a minimum, those reports will detail progress made toward fulfillment of project objectives and include information on the status of: (i) new microlending products and the methodologies and policies associated with them; (ii) their implementation in the credit unions, including information on the performance of the microloan portfolio in each one; (iii) the development and implementation of computer systems; (iv) the quality of technical assistance *in situ* and its results; (v) the training of credit officers in the credit unions, including data on the number of officers trained and the methodology used; (vi) the training of managers and executives in the credit unions, including a description of the courses, their contents and methodology, as well as a brief evaluation by participants;

(vii) changes in the performance indicators for FUCAC and each of the five credit unions participating, together with a description of the extent of compliance with the annual targets for the Logical Framework indicators (Annex I). The reports will also include a summary of budget performance and of counterpart contributions in cash and in kind.

6.3 In reviewing the progress reports, the Country Office will check that at least four of the five credit unions comply with the quantitative indicators. If they do not, it may halt disbursements until the factors preventing the achievement of targets have been identified and measures adopted, to the Bank's satisfaction, to overcome them, including replacement of one of the participating credit unions by a new one.

6.4 Upon project completion, within 120 days of the last disbursement for the project, FUCAC will deliver a final report to the Bank containing a synopsis of the principal achievements, experiences, and lessons learned from the activities carried out by the project, in order to facilitate dissemination of the experience acquired during execution.

6.5 **Evaluations.** When at least 50% of the MIF resources have been disbursed, or 18 months of execution have elapsed, whichever is sooner, the Bank will use project funds to commission a midterm evaluation to analyze: (i) effectiveness and efficiency in project execution; (ii) lessons learned during execution; and (iii) recommendations for improvements during the second half of the execution period, to ensure that targets are met. In addition, when 90% of the Bank's resources has been disbursed, the Bank will commission a final evaluation to measure: (i) extent of compliance with the specific objective and achievement of the project targets; (ii) the levels of efficiency, effectiveness, additionality, and sustainability of the project's components; (iii) the impact on the project beneficiaries and participants, taking both quantitative and qualitative indicators into account; and (iv) lessons learned and best practices.

VII. BENEFITS AND RISKS

7.1 **Benefits:** First, the project will have a beneficial impact on the competitiveness of microentrepreneurs in the provinces of Uruguay and in a rural area northeast of Montevideo. This clientele does not currently receive financial services. The project will enable microenterprises to gain access to financing and in this way partially overcome a constraint on their entrepreneurial development. Second, the project will have a beneficial impact on financial system deepening. The technical cooperation operation will enable a network of credit unions to introduce a lending product that few institutions currently offer in Uruguay. Moreover, the new supply of financial products will be focused on areas outside the capital that, in the past two years, have suffered from the closing down and withdrawal of the financial system.

7.2 **Risks.** The project faces two risks: (i) that weaker than expected performance with respect to growth, profitability, or payment arrears triggers a decline in support for downscaling on the part of the credit unions' members or boards of directors; and (ii) that the microlending products developed by the project do not elicit as favorable a response from customers as was expected and that quantitative targets in respect of the number of customers are not met. To minimize both risks, the project will hire an international consulting firm to monitor the project closely and meetings will be held with the boards of local credit unions to raise their awareness about the differences and challenges associated with the microfinance business.

VIII. ENVIRONMENTAL AND SOCIAL IMPACT

8.1 The new guidelines[6] for microenterprise projects indicate that projects in the Line of Activity for Strengthening Financial Institutions for Microenterprise do not present an abstract or profile to CESI. The project's activities will not involve direct relations with microlending customers, nor with the environment. Nevertheless, FUCAC will be given didactic material and information on environmental conservation and the safety and occupational health of FUCAC microentrepreneurs and employees. The project budget includes funds for hiring a consultant specializing in this field, to advise FUCAC on the best use to make of these materials and to help establish a policy of incorporating environmental protection criteria and occupational health criteria in its loans.

[6] "Guidelines for Environmental and Social Impact Due Diligence for IDB Microenterprise Operations," SDS/MSM, 2003.

LOGICAL FRAMEWORK
MICROLENDING BY LOCAL CREDIT UNIONS IN URUGUAY

Narrative summary	Indicators	Means of verification	Assumptions
Goal			
To improve access to credit for microenterprises in the provinces and on the outskirts of Montevideo	By the end of year three of the project, the volume of special credit available for microenterprise through the FUCAC system has increased by US$2 million.	Portfolio reports, management information system	Macroeconomic situation and economic policy do not have a detrimental effect on microenterprise and small businesses.
Purpose			
To expand specialized financial services to the microenterprises of the local credit unions that are FUCAC members	By the end of year three: Four credit unions in the FUCAC network serve at least 1,500 microentrepreneurs with less than 5% of arrears in their over-30-days loan portfolio and an efficiency ratio (administrative expenses/average gross portfolio) below 18%	Project reports, management information system Portfolio reports, management information system Financial statements, management information system	The credit unions allocate sufficient resources to introduce credit to microenterprise on a commercially viable scale. Banking system authorities accept methodologies associated with microlending.
Components			
Development of microlending in rural credit unions	By the end of year three: At least one microlending product is offered to at least 200 customers of each credit union. Managers trained in best microlending practices are managing portfolios with an efficiency ratio of 18% or better. Credit officers have been trained in microlending analysis and administration and are managing microlending portfolio with less than 5% arrears.	Portfolio reports, credit policy Project reports, interviews with managers Project reports, credit officers' on-site visits, analysis of performance indicators	Microlending products tailored to the needs of microentrepreneurs have been developed. Local credit unions maintain the financial performance forecast in the project.

Narrative summary	Indicators	Means of verification	Assumptions
Strengthening of management in rural credit unions	By the end of year three: Credit union managers have been trained in commercial microlending management skills. A shared microlending management system has been developed. An internal audit system has been developed and implemented in the credit unions. Financial management in the credit unions has improved. Information systems have been adjusted to meet microlending requirements.	Project reports, interviews with directors Project reports, on-site verification situ Internal audit manuals, interviews with auditors Analysis of performance indicators, interviews Project reports, on-site verification	Management and the boards of directors of the credit unions remain committed to the project.
Strengthening of FUCAC's oversight and monitoring capabilities	A computerized communication system has been installed. Management information, oversight, and monitoring system has been designed and implemented.	Project reports, on-site verification Project reports, on-site verification	FUCAC allocates sufficient resources for oversight and monitoring of microlending in rural credit unions.

Activities	Indicators	Means of verification	Assumptions
Component I: **Strengthening of microlending products in credit unions that are FUCAC members** Consultants advise on the design and adjustment of credit processes Long-term management advisory services. Training for credit officers	By the end of the second semester: (i) Identification of the specific characteristics of the microentrepreneurs to be served has been completed. (ii) Design of the policies and processes associated with the microlending products to be offered has been completed. (iii) The methodology and tools for training the new loan officers have been drafted. By the end of the fourth semester: (i) The risk assessment methodology has been worked out. (ii) Training of the first round of credit officers is completed. (iii) The new microlending manuals have been drafted, tested, and validated. (iv) A remunerations policy has been designed for operational personnel, with incentives compatible with institutional objectives. (v) A management, oversight, and monitoring information system has been designed that will enable FUCAC to monitor developments in the credit unions' microlending portfolio on an ongoing basis.	Project reports, interviews with directors Project reports, on-site verification Internal audit manuals, interviews with auditors Analysis of performance indicators, interviews Project reports, on-site verification	Microentrepreneurs in the project areas respond favorably to the supply of new products by the credit unions, by applying for loans and repaying them as scheduled.

Activities	Indicators	Means of verification	Assumptions
	By the sixth semester: (i) Actions to support implementation of lending technology in the credit unions have begun. (ii) The credit unions’ management teams and FUCAC executives have begun to be trained in oversight and monitoring of microlending in the local credit unions. (iii) The new, already validated, lending manual has been implemented.		
Component II: **Strengthening of management in the credit unions that are FUCAC members** Consulting services for the development of a microlending marketing system Internal audit consulting services Financial administration consulting services Environmental policy consulting services Governance training for senior executives Development of information systems	By the end of the fourth semester: (i) A joint brand name for the system has been worked out, along with interlocking sales of other financial products. (ii) The main operational risks of credit union microlending have been identified and strategies devised to minimize them. (iii) Internal audit mechanisms have been designed and put in place. By the end of the sixth semester. (i) Internal audit manuals have been drafted and implemented. (ii) Internal auditors have been taught how to use them.		Managers and executives in the credit unions remain interested in, and committed to, the project and benefit from the project’s activities.

Activities	Indicators	Means of verification	Assumptions
	(iii) Measures have been designed for implementing the Bank's environmental impact guidelines for microenterprise projects. (iv) Executive committees in the credit unions have been trained in microlending. (v) Computerized data systems have been adapted to meet microlending requirements.		
Component III: **Strengthening of FUCAC's oversight and monitoring capabilities** Consultants advise on secure computerized data systems Management software for on-line transactions Communication, oversight, and monitoring system	By the end of the sixth semester: (i) Security issues in connection with operations on the credit union network have been detected. (ii) Policies and procedures for secure transactions have been established. (iii) Software needed to ensure free-flowing communications between the credit unions and FUCAC is up and running. (iv) The system for overseeing and monitoring the performance of local credit unions in microlending is up and running.		
Evaluation, Auditing and Coordination of the Project Project coordination Evaluations Audits Contingencies	By the end of the project: FUCAC has effectively coordinated project activities. Scheduled evaluations and audits have been carried out.		

Appendix 1 to Logical Framework
Quantitative Indicators

	Base (regulated credit unions)	Historical data of the Participating Credit Unions			EST.	Projections for Participating Credit Unions					
		Dec 2001	Dec 2002	Dec 2003	Dec 2004	Year 1		Year 2		Year 3	
Microlending Indicators (shaded figures = indicators as per contract)						Acceptable minimum	Project target	Acceptable minimum	Project target	Acceptable minimum	Project target
Number of borrowers	> 2.000	**0**	**0**	**0**	**0**	> **300**	**400**	> **1,125**	**1,500**	> **1,500**	**2,000**
COMAJA (Artigas, Bella Unión, and Rivera)		0	0	0	0	40	80	150	300	200	400
CAYPA (Florida)		0	0	0	0	40	80	150	300	200	400
COMAC (Treinta y Tres)		0	0	0	0	40	80	150	300	200	400
Coop. Caja Central (Montevideo)		0	0	0	0	40	80	150	300	200	400
COOPACE (Fray Bentos, Young, Mercedes)		0	0	0	0	40	80	150	300	200	400
Nonperforming portfolio (> 30 days), weighted average	<5%	**N/A**	**N/A**	**N/A**	**N/A**	< **8.0%**	**5.0%**	< **7.0%**	**5.0%**	< **6.0%**	**5.0%**
COMAJA (Artigas, Bella Unión, and Rivera)		N/A	N/A	N/A	N/A	7.0%	5.0%	7.0%	5.0%	7.0%	5.0%
CAYCPA (Florida)		N/A	N/A	N/A	N/A	7.0%	5.0%	7.0%	5.0%	7.0%	5.0%
COMAC (Treinta y Tres)		N/A	N/A	N/A	N/A	7.0%	5.0%	7.0%	5.0%	7.0%	5.0%
Coop. Caja Central (Montevideo)		N/A	N/A	N/A	N/A	7.0%	5.0%	7.0%	5.0%	7.0%	5.0%
COOPACE (Fray Bentos, Young, Mercedes)		**N/A**	**N/A**	**N/A**	**N/A**	7.0%	5.0%	7.0%	5.0%	7.0%	5.0%
Gross portfolio	>US$2 MM	0	0	0	0	200,000	400,000	750,000	1,500,000	1,000,000	2,000,000
Retention index					N/A	50	75	60	80	70	85
Credit officer productivity	>100	N/A	N/A	N/A	N/A	40	65	120	200	200	333
Institutional Indicators					**2004**	**Year 1**		**Year 2**		**Year 3**	
Nonperforming portfolio (> 30 days)	<20%	12.0%	19.0%	21.0%	18.0%	20.0%	17.0%	18.0%	15.0%	16.0%	14.0%
Operating expenses index (portfolio)	**<25%**	**15%**	**16%**	**16%**	**16%**	**17.0%**	**16.0%**	**17.0%**	**15.0%**	**17.0%**	**14.0%**
COMAJA (Artigas, Bella Unión, and Rivera)		13%	13%	16%	15%	17.0%	16.0%	17.0%	15.0%	17.0%	14.0%
CAYCPA (Florida)		16%	17%	17%	16%	17.0%	16.0%	17.0%	15.0%	17.0%	14.0%
COMAC (Treinta y Tres)		11%	12%	12%	13%	17.0%	16.0%	17.0%	15.0%	17.0%	14.0%
Coop. Caja Central (Montevideo)		18%	18%	16%	17%	17.0%	16.0%	17.0%	15.0%	17.0%	14.0%
COOPACE (Fray Bentos, Young, Mercedes)		19%	19%	18%	18%	17.0%	16.0%	17.0%	15.0%	17.0%	14.0%
Average total return on capital, 5 credit unions	>1%	14%	12%	5%	7%	5%	10%	5%	10%	5%	10%

QUALITATIVE INSTITUTIONAL INDICATORS

Indicator	August 2004	March 2008
Microlending products in local credit unions	▪ The five local credit unions are beginning to offer loans to microenterprises and small businesses ▪ Credit union managers and loan officers not yet sufficiently familiar with microlending technology and methodologies	▪ At least one financing product is available to microenterprise ▪ Managers trained in best microlending practices ▪ Credit officers trained in microlending analysis and administration
Management of local credit unions	▪ Directors of credit unions lack know-how on commercial management of loans to micro enterprises and small businesses	▪ Directors trained in commercial microlending
	▪ Credit unions lack shared microlending management systems	▪ Shared microlending system developed
	▪ Credit unions' internal audit systems are not in a position to oversee microlending	▪ Credit unions' internal audit system developed and implemented
	▪ Financial management in the credit unions does not ensure efficient handling of resources for microlending	▪ Improved financial management in the credit unions
	▪ Information systems are not in a position to handle microlending	▪ Information systems tailored to microlending requirements
FUCAC's monitoring capabilities	▪ Electronic communication system not yet sufficiently secure and efficient for FUCAC to carry out effective monitoring	▪ Electronic communication system installed
	▪ No management information system exists	▪ Management information and monitoring system designed and implemented

LIST OF FINANCIAL AND INSTITUTIONAL INDICATORS

Note:
Unless otherwise stated, indicators refer to the end of the fiscal year

Indicator category and name	Formula / definition	Benchmark[1]
Market penetration		
Gross portfolio	Total current loans outstanding.[2]	N/A
Number of borrowers	Number of borrowers with cash balances with the institution	N/A
Retention index	Total customers at end of period – Total new customers acquired during the period)/Total customers at start of period.	
Profitability		
Average return on capital	Net earnings/Average capital for the period[3]	15-30%
Productivity and Efficiency		
Operating expenses index (portfolio)	Operating expenses/Average gross portfolio for the period	15-25%
Credit officer productivity	Number of loans/Number of credit officers	
Portfolio Quality		
Nonperforming portfolio > 30 days	Outstanding nonperforming loans > 30 days [4]/Gross portfolio	3-6%

[1] The benchmark indicates the reasonable range.
[2] This definition includes all loans, whether restructured or not; it does include interest receivable
[3] (Total capital at end of current period + Total capital at end of previous period)/2. Note: all grants must be included in capital.
[4] Does not include refinanced or restructured loans.

SECOND LINE OF ACTIVITY FOR STRENGTHENING FINANCIAL INSTITUTIONS FOR MICROENTERPRISE
MINIMUM CRITERIA FOR ELIGIBILITY

Criterion	Credit Unions	Supervised institutions - Downscaling	Local credit unions in the FUCAC network (downscaling)
Type of institution in each category	Credit unions or other institutions structured like cooperatives	Comprises commercial banks; nonbank financial institutions; institutions specializing sin microfinance, etc.	5 credit unions (*Cooperativas de Ahorro y Crédito*) not regulated by the Central Bank, that are members of the FUCAC network
Specialization	More than 75% of microfinance institutions revenue derived from financial services. Not applicable to service specialization programs	Institution specializing in the provision of financial services	100% of revenue comes from interest on loans, investments in financial instruments, and quotas.
Scale / size	> 1,000 microenterprise customers Institutions with < 3 years in operation: > 600 microenterprise customers	**Existing programs**: > 1,000 microenterprise customers **New programs**: Contribution of own funds > US$1 million	At least 10,000 of their 48,000 customers are estimated to be microentrepreneurs. The credit unions have no microlending product.
Portfolio quality	The default rate (>30 days) of the institution is equal to or below the higher of: (i) 10%; or (ii) the country's commercial bank average plus 30% (calculated according to domestic regulations).	The default rate (>30 days) overdue loan ratio of the institution is equal to or below the higher of the following: (i) 10%; or (ii) the country's commercial bank average plus 30% (calculated according to domestic regulations).	The default rate (>30 days) of the local credit unions is18%. That of the Uruguayan financial system (simple averages as of September 2004) is as follows: Regulated cooperatives: 26.4% Government banks: 34.2% Private banks: 9.8%
Sustainability	At least 100% operational sustainability	The institution is financially sound as indicated by its return on capital and capital adequacy ratios within the range considered acceptable by the country's regulatory authority.	For the past three years the project's local credit unions have been profitable despite the 2002 financial crisis.

Criterion	Credit Unions	Supervised institutions - Downscaling	Local credit unions in the FUCAC network (downscaling)
Degree of dependence on concessional resources	No or very little use of concessional resources. No more than 30% of liabilities were granted to it on highly concessional terms.	No or minimal use of concessional resources	They do not receive grants.
Institutional commitment	Interest in the proposed operation is manifested in business plan or declaration by an executive organ. The MIF contribution in individual financing operations may not exceed 30% of the gross portfolio of the beneficiary MFI.	Interest in the proposed operation is manifested in the business plan or declaration by an executive organ. **New programs** will also show proof of commitment to serve the sector (e.g., Microenterprise Department, personnel assigned to it, etc.).	They undertake to invest at least US$1 million in microlending by 2007.
Accountability and transparency	The General Assembly approves management and audit reports each year. External audits of financial statements required at least biannually.	Complies with requirements of the supervisory authority with respect to production of reports and audits	Under FUCAC supervision, they comply with good government practices for credit unions.
The government's opinion	Nonobjection of the government. In cases in which an institution begins to be regulated (*formalización*), the Superintendency issues an opinion in favor where warranted.	Nonobjection of the government	Nonobjection
History of previous projects with IDB/MIF and/or other donors	Successful handling and execution of any previous activity financed by IDB/MIF or other donors		They have no previous experience with the IDB/MIF.
Other IDB/MIF technical assistance	The proposal neither conflicts nor overlaps with other IDB/MIF programs for microfinance institutions in the country.		No such programs exist.
Extent of contribution and impact on the activities proposed	The proposal exhibits a high degree of additionality, reflected in innovation, a significant expansion, service to neglected areas, etc.		Neglected areas will be serviced through some of the few entities in existence in those areas.

Itemized Budget

	MIF	FUCAC	Credit unions	FUCAC / Credit unions	Total
Development of Microlending Products in the Credit Unions	**61,000**	**15,000**	**16,000**	**31,000**	**92,000**
Technical assistance	40,000	8,000	7,000	15,000	55,000
Design and adaptation of lending procedures	*10,000*	*2,000*	*2,000*	*4,000*	*14,000*
Long-term advisory services for management	*30,000*	*6,000*	*5,000*	*11,000*	*41,000*
Training	21,000	7,000	9,000	16,000	37,000
Training for loan officers in credit instruments	*21,000*	*7,000*	*9,000*	*16,000*	*37,000*
Strengthening of Credit Union Management	**68,000**	**38,000**	**34,000**	**72,000**	**140,000**
Technical Assistance	38,000	8,000	4,000	12,000	50,000
Consulting services to develop a microlending marketing system	*15,000*	*2,000*	*1,000*	*3,000*	*18,000*
Internal audit consulting services	*10,000*	*2,000*	*1,000*	*3,000*	*13,000*
Financial management consulting services	*10,000*	*2,000*	*1,000*	*3,000*	*13,000*
Consulting services on environmental policy	*3,000*	*2,000*	*1,000*	*3,000*	*6,000*
Training	25,000	8,000	10,000	18,000	43,000
Governance	*25,000*	*8,000*	*10,000*	*18,000*	*43,000*
Software and hardware	5,000	22,000	20,000	42,000	47,000
Information systems	*5,000*	*22,000*	*20,000*	*42,000*	*47,000*
Strengthening of FUCAC's Monitoring Capabilities	**28,000**	**6,000**	**5,000**	**11,000**	**39,000**
Technical Assistance	4,000	2,000	1,000	3,000	7,000
Consulting services on computerized data security issues	*4,000*	*2,000*	*1,000*	*3,000*	*7,000*
Software and hardware	24,000	4,000	4,000	8,000	32,000
Communications	*15,000*	*2,000*	*2,000*	*4,000*	*19,000*
Management information, oversight, and monitoring	*9,000*	*2,000*	*2,000*	*4,000*	*13,000*
				0	*0*
Project Evaluation, Auditing, and Coordination	**43,000**	**10,500**	**10,500**	**21,000**	**64,000**
Project management, supervision, and monitoring	*20,000*	*8,000*	*8,000*	*16,000*	*36,000*
Evaluations	*8,000*	*0*	*0*	*0*	*8,000*
External audit	*5,000*	*0*	*0*	*0*	*5,000*
Contingencies	*5,000*	*0*	*0*	*0*	*5,000*
Travel and per diem	*5,000*	2,500	2,500	5,000	10,000
	200,000	**69,500**	**65,500**	**135,000**	**335,000**
	60%	21%	20%	40%	100%

Projects in Uruguay

Microlending by Local Credit Unions in Uruguay
FUCAC - UR-M1004

A. Similar or related MIF projects

None

B. Projects related to the same sector or beneficiary

Project number/ Date of approval	Project title, executing agency, and amount	Date of signature and original disbursement period in months	Percentage disbursed	Comments: satisfactory execution or problems with execution, including delays, extensions, reformulation, change in executing agency, etc.
ATN/ME-6741-UR 9 November 1999	Institutional strengthening of Fundación Uruguaya de Ayuda y Asistencia a la Mujer (FUAAM) FUAAM - MIF contribution US$250,000	9 November 1999 19 February 2005	98%	Project performance satisfactory; no problems detected.
ATN/ME-7312-UR 25 January 2001	Institutional strengthening of Cooperativa Nacional de Ahorro y Crédito (COFAC) COFAC - MIF contribution US$300,000	25 January 2001 26 October 2005	81%	Project performance satisfactory; no problems detected.

PROPOSED RESOLUTION

Urugauy. Nonreimbursable Technical Cooperation for Microlending by Local Cooperatives in Uruguay

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank or such representative as he shall designate is authorized, in the name and on behalf of the Bank, as Administrator of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the Federación Uruguaya de Cooperativas de Ahorro y Crédito (FUCAC), and to take such additional measures as may be pertinent for the execution of the project proposal contained in Document MIF/AT-____ with respect to a technical cooperation for microlending by local cooperatives in Uruguay.

2. That up to the amount of US$200,000, or its equivalent in other convertible currencies, shall be authorized for the purpose of this resolution, chargeable to the technical cooperation resources of the Small Enterprise Development Facility of the Multilateral Investment Fund.

3. That the above-mentioned sum is to be provided on a nonreimbursable basis.