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REGIONAL

INVESTMENT FUND FOR SMALL ENTERPRISES AND PROMOTION OF DOMESTIC SOURCES FOR RISK CAPITAL (TC-97-07-17-8)

DONORS COMMITTEE MEMORANDUM

Original: English

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Abbreviations

AFP	Administradora de Fondos de Pensiones
AFJP	Administradora de Fondos de Jubilaciones y Pensiones
CNV	Comisión Nacional de Valores
CORFO	Corporación de Fomento de Producción
DPA	Dagnino Pastore & Asociados, S.A.
FIDE	Fondo de Inversion de Desarrollo de Empresas
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IIC	Inter-American Investment Corporation
IPO	Initial Public Offering
IRR	Internal Rate of Return
MIF	Multilateral Investment Fund
p.a.	Per annum
SE	Small Enterprise
SEIF	Small Enterprise Investment Fund
SVS	Superintendencia de Valores y Seguros
ULLICO	Union Labor Life Insurance Company
US	United States

Project Abstract

A US$20 million off shore trust will be registered in an appropriate location which offers favorable tax and limited liability treatment to investors. The Regional Trust will invest equally in the shares issued by two individual and independent funds to be established in Argentina and Chile. These Country Funds, in turn, will invest in small enterprises. In the initial phase, MIF will purchase 50% of the total shares of the Regional Trust, and through the Trust 50% of the shares of each Country Fund.

The Project is sponsored by the Union Life Insurance Company, Inc ("ULLICO"). ULLICO, founded in 1927, is a US-based multi-faceted financial service and insurance company, broadly owned by trade union representatives.

Establishing a regional Trust as an umbrella to individual Country Funds will allow international institutional investors to invest in a regionally diversified vehicle, and will allow local institutional investors, including pension funds, to invest in local small enterprises through the Country Funds. In the future, if deemed appropriate, the Regional Trust may invest in shares of funds established in other countries in the region.

The principal objective is to assist small enterprises in their expansion and development through the provision of capital, thereby strengthening the economies of the target countries and creating job opportunities for local workers. The Project will also attempt to induce the participation of local pension funds in the two Country Funds. Although local pension funds have indicated their interest in investing in small enterprises-focused funds, it is likely that the pension funds will not invest until the Country Funds have established a financial track record.

The Country Funds' investment objective will be to achieve an above average total return principally through investment in equity or equity-type instruments of selected small enterprises. The Country Funds will have an initial US$10 million of capital which will target small enterprises that do not have publicly traded securities. Each Country Fund will have a ten-year-term. Combined, the Country Funds will invest in approximately 40 small enterprises over their 10-year life.

Each Country Fund will be managed by a local investment manager. In Argentina, FiduCorp S.A. is the selected manager. In Chile, Proa S.A., a wholly-owned subsidiary of Moneda Asset Management S.A., will provide investment management services to the Country Fund.

Note: This Project Abstract is intended to provide general public information about the Project. It does not constitute an offering of securities of, nor a solicitation for participation in, the Regional Trust or any Country Fund.

EXECUTIVE SUMMARY

EXECUTING AGENCY: A US$20 million off shore trust (the "Regional Trust") to be registered in an appropriate location which offers favorable tax and limited liability treatment to investors. Under the first phase of the proposed project (the "Project"), the Trust will invest equally in the shares issued by two individual and independent funds to be established in Argentina and Chile (the "Country Funds"). These Country Funds, in turn, will invest in small enterprises ("SE"s).

PROJECT SPONSOR: The Project is sponsored by ULLICO Inc. ("ULLICO"). ULLICO is a US-based multi-faceted financial service and insurance company, broadly owned by trade union representatives. Its total assets amount to US$3 billion.

PROJECT OBJECTIVE: The principal objective is to assist SEs in their expansion and development through the provision of capital, thereby strengthening the economies of the target countries and creating job opportunities for local workers. The Project will also attempt to encourage the participation of local pension funds in the two Country Funds. Although local pension funds have indicated their interest in investing in SE-focused funds, it is likely that the pension funds will not invest until the Country Funds have established a financial track record; however, the participation of local pension funds or other local institutional investors is not necessary for the success of the Project.

Establishing a regional Trust as an umbrella to individual Country Funds will allow international institutional investors to invest in a regionally diversified vehicle (the Trust), and will allow local institutional investors (including pension funds) to invest in local SEs through the Country Funds. 1/ If the Regional Trust has completely exited from the Country Funds prior to year 10, one of the objectives of the Project will have been successfully achieved. In the future, if deemed appropriate, the Regional Trust may invest in shares of funds established in other countries in the region. The Country Funds in Argentina and Chile will be test cases.

PROJECT DESCRIPTION: In the initial phase, MIF will purchase 50% of the total shares of the Regional Trust and ULLICO the other 50%. 2/ The Country Funds' investment objective will be to achieve an above average total return principally through investment in equity or equity-type (convertible debt, debt with warrants/options) instruments of selected SEs. The Country Funds will have an initial US$10 million of capital which will target SEs that do not have publicly traded

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1/ Because one of the objectives of the project is to attract local pension funds into small business equity financing, the project decided not to establish one offshore regional fund, but rather to establish individual Country Funds which can attract local institutional investors, and an umbrella Trust which can attract international institutional investors.

2/ In the future, international institutional investors may be invited to invest in the Regional Trust as well, thereby contributing to SE development in the region.

	securities or that have only thinly traded securities. Each Country Fund will have a ten-year-term, and individual investments will have three to five year terms. Exit strategies will include put options, private equity sales to third party investors and initial public offerings on the local securities exchanges. As such, the Funds will seek to achieve medium-to long-term capital appreciation of their portfolio investments; however, in appropriate circumstances, they may also invest in securities offering high current yield in order to maintain a measure of liquidity, thereby making the Funds more attractive to local institutional investors with liquidity requirements. The Country Funds will invest in a combined total of approximately 40 SEs over their 10-year life.
COST AND FINANCING:	MIF SEIF Equity — US$10,000,000 (US$5,000,000 for Argentina and US$5,000,000 for Chile) Counterpart (ULLICO) — US$10,000,000 (US$5,000,000 for Argentina and US$5,000,000 for Chile)
INVESTMENT MANAGER:	Each Country Fund will be managed by a local investment manager ("Manager"). In Argentina, FiduCorp S.A. is the selected manager. In Chile, Proa S.A., a wholly-owned subsidiary of Moneda Asset Management S.A., will provide investment management services to the Country Fund. The Managers' percentage fees will be slightly above typical industry norms due to the small size of the Country Funds and the nature of small business transactions; total compensation will include a management fee paid annually to cover operating costs (estimated at 3.5% of committed capital) and a performance incentive tied to the Fund's net realized gains (25% on profits above 8% cumulative compound preferred return to the investors).
ENVIRONMENTAL /SOCIAL REVIEW:	The project abstract was approved by the Environment and Social Impact Committee on its meeting on June 8, 1998. The Project Document was approved on July 31, 1998.
EXCEPTIONS TO BANK POLICY	None

I. COUNTRY ELIGIBILITY: ARGENTINA AND CHILE

1.01 Argentina and Chile were declared eligible for financing from all modalities of the Multilateral Investment Fund on November 30, 1993 and October 6, 1993 respectively.

II. BACKGROUND

2.01 Latin America has emerged from its debt crisis with strong growth potential derived from both internal and export demand. Accompanied by large-scale privatization and policies seeking to remove constraints to the private sector, the private sector has begun to replace the state sector as the primary catalyst for growth. Increased efficiency can be witnessed in countries such as Argentina, Brazil and Chile. Their economic fundamentals are positive, and include a large and extensive market, extensive resource bases, and an expanding middle class. Macroeconomic policy shifts have resulted in lower inflation and stable exchange rates, thereby increasing the attractiveness of the region. Economies are integrating and thus creating new opportunities, including potential export increases due to new multilateral and bilateral trade pacts. To be realized, however, these opportunities often require corporate restructuring. Domestic corporations and foreign multinationals are positioning themselves to take advantage of the rapid globalization of economic activity. As investment activities increase, so does the demand for long-term financing.

2.02 As a result of these reforms the region is poised to sustain strong economic growth for the coming decades, creating investment opportunities in **small enterprises** ("SE"s) that can grow, but which require a combination of capital, management and technological assistance. SEs must retool to compete in the international markets. However, SEs often lack the ability to tapinto the capital markets or other long-term financing. Thus they are left to operate in an ever more competitive environment without the funds necessary for technological improvements or expansions.

2.03 **Capital markets** within the region remain incapable of providing sufficient equity capital for private sector growth. One of Latin America's challenges is to convert domestic savings into capital avalable for intermediation by local lenders and equity markets. Domestic savings rates in Latin America are lower than in any other region except Sub-Saharan Africa, and have decreased in the past two decades relative to gross domestic product. It is estimated that over US$125 billion per annum of net external capital is required to achieve a 6% rate of economic growth in Latin America at present savings rates. Private foreign capital flows have risen dramatically from US$50.2 billion in 1994 to US$72.9 billion in 1996. Furthermore, net flows from bonds into Latin America reached a record US$28billion in 1996.

2.04 Latin America's market capitalization grew seventeen times from US$22 billion in 1982 to$370 billion in 1997. Nevertheless, in spite of tremendous growth in overall capitalization of the region's public equity markets, the universe of widely traded companies remains relatively small. Equity market activity is dominated by the large, listed companies, and liquidity is driven primarily by foreign funds that trade actively in these securities. Only the largest corporations have access to medium- and long-term debt. Generally, companies with sales below US$30 million haveno such access, as their size precludes the interest of both local and foreign investors. Furthermore, a significant portion of those capital flows tends to be of a shorter maturity, given perceptions of risk which are magnified by weak legislative, judicial and regulatory systems.

2.05 In general, local financial institutions do not provide financing to the SE sector. The system is still suffering from an "inflation hangover" and the broader capital markets have not adjusted to a longer-term mentality. Also retarding development of term lending is the factthat many banking sectors in the

region are still undergoing reform as a result of market liberalization and competition entering from abroad. Privatization of public sector banks is very active and foreign players are setting up their own ventures and acquiring banks. Many of these new participants bring with them the benefits of technology and another capabilities new to the market. Nevertheless, despite progress observed in domestic financial intermediation in the region, the financial market does not see SEs as a target market with interesting advantages.

2.06 There are entrenched problems related to high costs of transaction and risks associated with lenders to SEs, who have difficulty in presenting the collateral required by the financial sector. Supply of listable companies to the public equity markets is limited, due in part to a predominance of family controlled corporations that cannot make the institutional jump involved in meeting listing and reporting requirements. Although SEs in general are flexible to the dynamic changes of the economy, they are faced with other problems related to the implicit costs of "formalization" of their businesses which makes them reluctant to seek access to the capital markets. Until long-term funds are available from other sources, the SE sector must be supported by risk capital which, in addition to capital, provides direct and long-term technical assistance through the investors' participation in management decisions.

2.07 Because of their long-term horizon, **pension funds** are ideally suited to provide a long-term financing basis for the emerging and innovative entrepreneurial sector. Chile, Argentina, Peru, Colombia, and Uruguay have implemented privately-managed, mandatory, defined contribution pension systems: Mexico, Bolivia, and El Salvador should follow soon. There is growing recognition of the importance of private sector professional asset management (i.e. AFJPs--Administradora de Fondos de Jubilaciones y Pensions in Argentina, and AFPs--Administradoras de Fondos de Pensiones in Chile). These trends in most Latin American capital markets may bring about significant expansion. Particularly in Argentina and Chile the privatization of social security services, having converted to individual capitalization funds with private administration, is to be noted, as those pension funds have grown significantly, reaching US$30.4 billion in Chile and US$10.8 billion in Argentina (as of July 1998). Nonetheless, pension funds, which are starting to dominate the capital markets, are not yet strong players in the private placement market-- a potential avenue through which institutional investors could provide capital to "critical middle" firms.

2.08 The most compelling investment opportunities in much of Latin America are in **privately negotiated equity transactions**. The last decade's wave of foreign investment focused on the largest companies in the region which possessed size as well as standing access to global markets. Given that sources of long-term capital are scarce in the region, many privately-held companies are willing to offer investors favorable terms, including investment at low valuations, and minority shareholder protection through arrangements dealing with such matters as business activities, disposal of assets, major capital expenditure programs, independent audits, board representation, and eventual public listing or alternative exit vehicles.

2.09 In Argentina and Chile, the SE sector is crucial for the consolidation of the private sector and for the continued creation of employment. The open economies have created a demand for smaller companies that can respond to the changing business environment quickly; however, in order to respond efficiently these companies need to invest in equipment and technologies which will allow for expansion. The investment climate will be increasingly more receptive to direct equity investment, an appropriate engine for economic growth.

2.10 Private equity transactions allow for substantial gains by capitalizing on market inefficiencies --private equity investments can be made at significantly lower valuations than similar acquisitions in the public

markets. Furthermore, SEs' need for financial or managerial restructuring often obscures their intrinsic value. The estimated P/E ratio for private equity market investments in the region ranges from 3 to6 after the effect of the investment. The infusion of small amounts of capital can significantly increasethe market potential of these companies by allowing them to compete more effectivelyand operate more efficiently. Thus, private equity investors can exit in a matter of years with a handsome rate of return.

2.11 The private equity investment fund industry is only just emerging throughout Latin America, with activity limited to larger companies (buy out funds) or funds with sectoral focus, mainly infrastructure. It will take time before domestic capital markets become strong backers of private investment in Latin America, unless there is a proven record of its attractive returns. Middle market companies are likely to stay outside the mainstream of private investment, and without some initiative, the opportunity to profit from any such companies could be missed. The increased funds of contractual savings under private management can more aggressively seek new areas from which to generate maximum returns, and will eventually buy into equities. Ultimately, this will have a morepositive effect on venture capital and private equity industry, as well as capital market development.

2.12 For these reasons, ULLICO Inc. ("ULLICO") has determined that the establishment of private equity funds targeting small enterprises in Argentina and in Chile can benefit the SE sector in these countries while generating attractive rates of return. Furthermore, ULLICO believes that in the future, such equity funds can provide a tool through which pension funds can invest in SEs and in turn contribute to the development of the labor market.

III. PROJECT SPONSOR

3.01 The proposed project ("Project") is sponsored by ULLICO. The forerunner of ULLICO, the Union Labor Life Insurance Company (currently, a wholly-owned subsidiary of ULLICO), was created in 1925 to address the lack of coverage of unionized labor. ULLICO, a financial holding company formed in 1987, is now a multi-faceted institution with 19 subsidiaries that are involved in the provision of financial services, insurance, and benefits administration. ULLICO has US$3 billion in assets and manages over US$4.7 billion for third party US pension funds and has vast experience in the US capital market. Through direct worker participation on the Board, ULLICO's investments have been oriented toward socially-conscious but productive activities that have ensured competitive return.

3.02 ULLICO, whose board is composed of trade union representatives, has recently started directing the savings of workers'pension funds to the creation of and investment in private equity funds. While the invested funds help create jobs, they also provide means to obtain an attractive return for the workers' pension funds. ULLICO is interested in replicating its US experience in Latin America. It has promised and demonstrated its strong support to the Project, and is willing to contribute its capital to the replication of its model in other countries. Furthermore, ULLICO has contacted and obtained support from several pension funds in Argentina and Chile, which are owned by trade unions ("labor pension funds"); the administrators of these funds have indicated that they will designate a modest portion of their funds to finance SEs, as long as the legal requirements governing their investments are met. 1/

1/ As of July 1998, there are 13 AFPs in Chile and 17 AFJPs in Argentina; there are three labor pension funds in each country, owned by various trade unions including construction, electricity, water, insurance, sanitary, teachers, etc. In 1998 the assets of those labor pension funds are: In Argentina, Claridad (US$232 million), Futura(US$207 million), San José (US$40 million); In Chile, Magister (US$ 362 million), Aporta (US$199 million), Fomenta (US$180 million).

3.03 ULLICO's experiences in the US show that relatively smaller investments in middle market firms can produce substantial improvements in profitability and long-term growth. From late 1995 through the first six months of 1998, ULLICO has generated a 17% rate of return from its private capital fund which invested approximately US$50 million for seven transactions. While being fully aware that these experiences in the US, however relevant, are not necessarily directly applicable to the small business market in Latin America, ULLICO is convinced that it is a sound strategy for unions and community groups to join together to create regional investment funds that prudently channel working people's savings into regional industrial development in middle market manufacturing firms that create jobs and strengthen local communities. ULLICO also believes that a key factor for success is to work together with local fund management companies.

3.04 ULLICO also believes that pension funds must become more active as long-term investors. While these funds can benefit from investing in long-term securities with attractive returns, companies benefit from access to the long-term capital. The increased participation by pension funds is vital if "critical middle" companies are going to survive, and serve their role as centers of job growth and contributors to technological innovation and economic competitiveness.

IV. THE PROJECT

A. Project Concept and Description

4.01 The primary objective of the Project is to facilitate access by SEs to alternative risk capital sources designated to support their growth, incorporate technology, develop new products and invest in potentially more competitive markets. The Project not only seeks to establish an investment vehicle which can provide capital to the SEs in the short-run, but also to attract funds from local pension funds and other institutional investors in the longer-term. The capital made available through this Project will allow SEs to position themselves to compete in the opening markets, and will encourage job creation. The Project will provide new investment opportunities for pension funds and will assist in the broadening and deepening of the capital markets.

4.02 A US$20 million off-shore trust (the "Regional Trust") will be established. Under the first phase of the Project, the Regional Trust will invest equally in the shares issued by two individual and independent funds to be established in Argentina and Chile (the "Country Funds"). These Country Funds, in turn, will invest in SEs locally. In the future, if deemed appropriate, the Regional Trust may invest in shares of funds established in other countries in the region. 2/ The Country Funds in Argentina and Chile will be pilot projects -- testing whether such equity funds assist in the development of SEs and are able to mobilize local institutional investor capital into the sector and also testing whether investing in SEs is attractive to international investors as well. Establishing a regional Trust as an umbrella to individual Country Funds will allow international institutional investors to invest in a regionally diversified vehicle (the Regional Trust), and will allow local institutional investors (including pension funds) to invest in local SEs through the Country Funds.

4.03 In the initial phase, MIF will purchase 50% of the total shares of the Trust, and ULLICO will purchase the remaining 50%. The Country Funds' investment objective will be to achieve an attractive total return principally through investment in equity securities or equity-type (convertible debt, debt with warrants/options) instruments of selected small-sized companies. The Country Funds will have an initial

2/ The Regional Trust's investment guidelines will require that any additional Country Funds be established only in MIF-eligible countries.

US$10 million of capital each that will target SEs which do not have publicly traded securities or, in some cases, that have thinly traded securities.

4.04 The Country Funds' strategy will be to make equity or equity-type investments in a diversified portfolo of privately-held, small sized industrial, consumer, and service companies in Argentina and Chile. Each Country Fund will seek to have board representation in its investee companies in order to play a key role in the financial management, monitoring of operations, and exit strategies. Each Fund will have a duration of ten years, while the average life of the investments is expected to be shorter, ranging from three to five years. The Funds will reinvest earnings, debt repayments, capital gains, and proceeds from the sale of investments for the first five to six years, following which excess earnings will be distributed as capital redemptions and dividends to the investors.

4.05 The Funds will primarily invest in companies whose need for capital is below the threshold of a public offering and/or currently lack access to local capital markets. Sources of long-term capital are scarce in the region, and privately held companies are increasingly willing to offer investors favorable terms, including investments at low valuations, shareholder protection through agreements dealing with such matters as business activities, disposal of assets, major capital expenditure programs, independent audits, board representation, and eventual public listings or alternative exit vehicles. Due to these favorable terms, the Funds expect to make investments resulting in a gross internal rate of return in excess of 30%. Most investments will operate without borrowing since venture capital by its very nature is an alternative capital-funding source.

4.06 From time to time, the Country Funds may also invest, with a short term horizon, in international and local fixed income instruments that meet the Funds' risk return criteria. Up to 20 % of the Country Funds' subscribed capital may be invested at any one time in tactical and temporary investments consisting of liquid debt and equity securities issued by local companies or the Governments of Argentina and Chile which are consistent with the Funds' investment objective. This will allow the Funds to retain some liquidity and thus will increase their attractiveness to local pension funds. 3/

4.07 By providing mezzanine level or expansion capital to small businesses that have established themselves in the market but that are not yet able to access the capital markets for financing, the Country Funds will be able to support SEs in their goal to achieve sustainable growth, while earning an attractive rate of return after a period of three to five years. With the capital provided by the Country Funds, the SEs will be able to expand and improve their competitiveness, and thereby position themselves to raise future capital via local institutional investors or via the stock exchange.

B. Legal Structure

4.08 *Regional Trust*: The Regional Trust will be registered in an appropriate location which offers favorable tax and liability treatment to the investors, with the MIF and ULLICO each contributing US$10

3/ These investments are consistent with the local regulations and will be made with the liquid cash balance in short-term (less than six months) marketable obligations of the US and other governments, dollar and local currency-denominated time deposits and negotiable certificates of deposit issued by reputable banks or mutual funds, or commercial papers. All the instruments should be granted a rating equivalent at least to A-1 by Standard & Poor's and/or of Moody's. The relatively low risk of these instruments will partially offset the higher risk profile of the investment portfolio and provide a source of liquidity. At the same time, the low yield may have an impact on the overall return of the Country Funds.

million. The Regional Trust will subscribe equally to the shares issued by two individual and independent funds (the Country Funds) to be established in Argentina and Chile. MIF and ULLICO officers will constitute the Board of the Regional Trust. The Regional Trust is an investment vehicle only and will have no operating responsibilities. Representatives from each sponsor will sit on the Board 4/ of each Country Fund. Each Country Fund will have an Investment Committee comprised of members of the Management Company and other selected experts. The Boards of the Country Funds will set the investment guidelines. The Investment Committees will make investment decisions based on the guidelines. The Regional Trust will not make any direct investments in SEs.

4.09 Initially, MIF and ULLICO will each own 50% of the Regional Trust, and therefore will each expose 50% of their respective shares to each Country Fund. In the future, international institutional investors may be invited to invest in the Trust as well, thereby contributing to SE development in the region. Establishing a regional Trust offshore will facilitate the entrance of other institutional investors interested in investing in SEs in Latin America.

4.10 *Country Funds*: Each Country Fund will receive an initial infusion of US$10 millionto be used for equity, quasi-equity and convertible debt investments in approximately fifteen to twenty SEs meeting pre-established investment criteria. Each Country Fund will be managed by a local fund management company (the "Managers"). Later in the process the Country Funds will seek investment from local pension funds and other institutional investors. Although desirable, the attraction of these funds is not necessary for the success of the Project, and is a secondary objective.

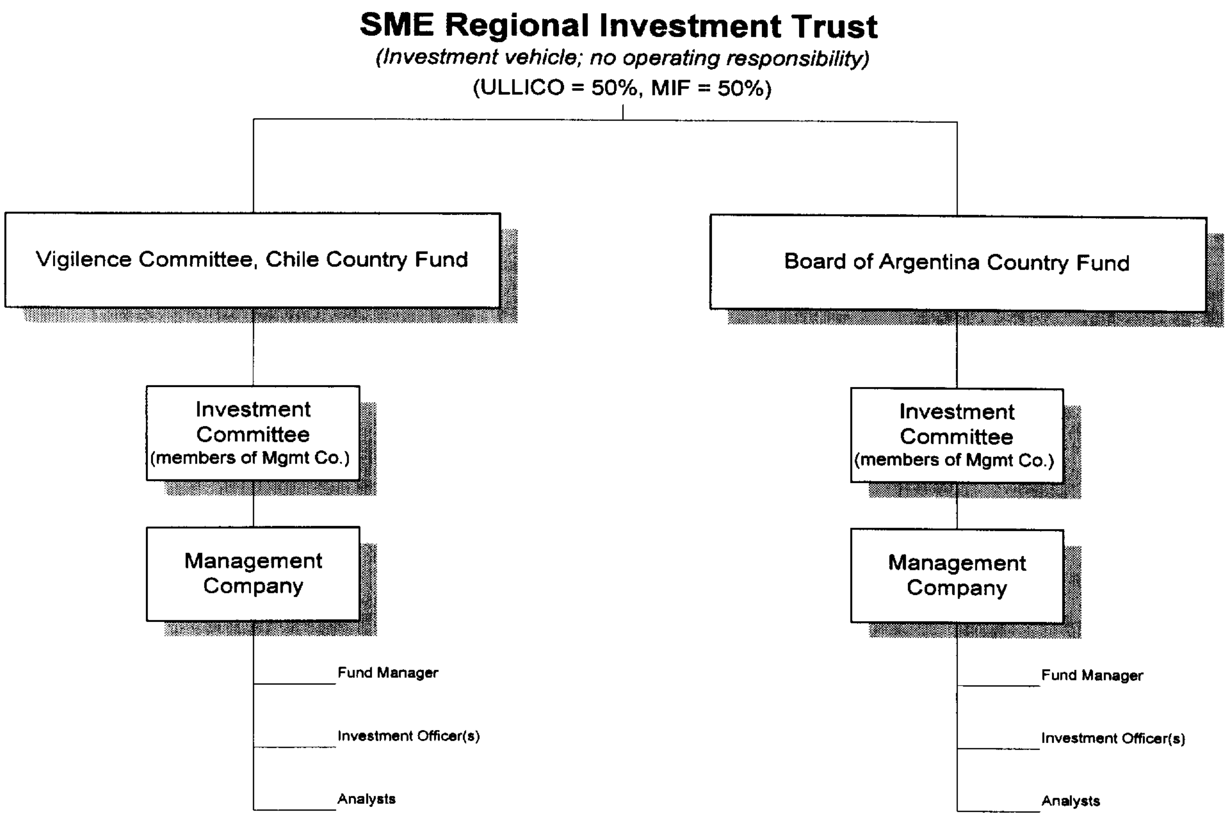
4.11 Each Country Fund will seek long-term capital appreciation through investments in smal private sector companies. The Funds will invest in the development of economicactivities of SEs with a potential for growth, and in particular will focus on the expansion of activities that will assist in the preservation and creation of jobs. Investments will be geared toward technological improvements, development of new products and broadening of markets. In addition, through board representation and supervision by the Managers, the Country Funds will assist the target SEs in business strategy development and general management, thereby adding additional value and an increased multiplier effect of the invested funds.

4.12 In Argentina, the Country Fund will be established as a *Fideicomiso Privado* (Private Trust) and will immediately seek approval from the Comisión Nacional de Valores or CNV as a *Fideicomiso Financiero* (Financial Investment Trust) 5/. Such a structure will enable life insurance companies, pension funds and other institutional investors to invest in the fund at a later date (under guidelines of the CNV fideicomiso financiero must be rated before institutional investors can invest). According to the norms currently promulgated by the Superintendencia of AFJPs, in order to allow for investments by pension funds, an assessment of the Country Fund's assets will be necessary (the assets must be determined to be of a quality equal to the instruments in which AFJP's are currently allowed to invest in directly).

4.13 In Chile, the Country Fund will be established as an EnterpriseDevelopment Investment Fund ("FIDE" - Fondo de Inversión para Desarrollo de Empresas); the constitution of the FIDE should be filed with the Superintendency of Securities and Insurance ("SVS" - Superintendencia de Valores y Seguros).

4/ In Chile, the structure of a FIDE requires a "Vigilance Committee" rather than a Board. A representative from ULLICO and from MIF will make up two of the three Vigilance Committee members.

5/ The option of *Fondo Común Cerrado* (a closed-end fund) remains open as well. A closed-end fund would require that committed capital, term, etc. be defined at the creation of the fund and not change until the fund was liquidated.



Once the risk rating commission (Comisión Clasificadora de Riesgo 6/) has made the formation public, the Country Fund will be classified as a risk-rated vehicle, thus allowing pension funds to invest in the FIDE.

4.14 It is anticipated that in addition to the minimum capital baseprovided by MIF and ULLICO, additional contributions will be sought for the Regional Trust and for the Country Funds from foreign and/or local investors. For example, Corporación de Fomento de Producción ("CORFO"), a national development institution of Chile, has a program through which it makes quasi-equity investments in venture capital funds as a means of supporting the venture capital industry. CORFO has indicated an interest in considering a quasi-equity investment of up to US$10 million in the Chilean Fund.

C. Participation of Pension Funds

4.15 As a secondary objective, the Project intends to mobilize investments from pension funds. Local pension funds are in need of new instruments and companies in which to invest, and the SE sector, which employs large numbers of the countries' workers, can benefit greatly from pension fund capital. Currently, the administrators of pension funds in Argentina and Chile (AFJP/AFP) are subjectto several restrictions regarding investments. Direct equity investment in SEs is considered to be risky and therefore not appropriate for funds entrusted with workers' retirement pension funds. However, once established, the Country Funds can provide an attractive vehicle through which pension funds can direct

6/The Commission is composed of SVS, the Superintendencies of Banks and of Pension Funds Administrators.

their capital to the SE sector. The Country Funds will serve to diversify the risk among several small enterprises and will also contribute managerial advice to the enterprises thereby increasing their value.

4.16 Nevertheless, pension funds are not allowed to invest in any vehicle that has not been risk-rated. Therefore it is anticipated that the first stage of the Project will focus entirely on investing the initial capital of the Country Funds in SEs, and later in the process the Country Funds will seek risk-ratings from the appropriate agencies, thereby allowing **pension fund participation.** 7/

4.17 Once each of the Country Funds has invested a considerable portion of its capital (approximately three to five years into the life of the Funds), the Trust will promote the sale of its shares inthe Country Funds to local pension funds. To do this, the Country Funds will need to obtain a risk rating (based on investment strategy, management capability, and assets) and determine the "fair market price" of their shares (not necessarily on the stock exchange). A risk rating (in Argentina) or approval by its Comisión Clasificadora de Riesgo (in Chile) is a *sine qua non* condition for the entrance of pension funds. In addition, in Argentina, the Superintendencia of AFJPs requires that the underlying assets in the Fideicomiso be of equal quality to those assets in which pension funds are permitted to invest in directly. Thus, approval from the Superintendencia will be required prior to investment by AFJPs. 8/

4.18 ULLICO has committed to selling their shares to labor pension funds if the interest and capacity to invest is there. As the labor pension funds purchase shares in the Country Funds, the Sponsors' ownership would decline. In Argentina, Claridad, Futura and San José funds have expressed interest in investing. In Chile, Magister has expressed interest.

4.19 Each Country Fund will have a life of 10 years and will continue to operate until that time. The Trust will try to exit from the Country Funds by selling shares to pension funds or other institutional investors. It is not expected that an active secondary market necessarily will develop for Country Fund shares. Therefore, the Trust may instead hold its shares until the underlying investments are sold and the Country Funds are liquidated. If the Regional Trust has completely exited from the Country Funds prior to year ten, one of the objectives of the Project will have been successfully achieved.

7/ In Argentina, AFJPs are limited to investing no more than 10% of their total assets in direct investment funds. In Chile, AFPs are limited to 5%. In practice, however, the more liberal legal limits in Argentina have been of little relevance as the AFJPs have followed very conservative investment policies and have stayed well within the permitted limits. In 1989, the law governing investment by Chile's pension funds was changed to allow up to 5% of assets to be invested in specially created "fondos de inversión de desarrollo de empresas" (originally called "fondos de inversión de capital de riesgo"). Due to the newness of the product, problems in the original regulations, and perhaps the original name, these funds were slow to take off. Since that time, several FIDEs have been created. The poor performance of two FIDEs (the Midway and Toronto funds) that were also created in the early to mid 1990s affected the willingness of investors for private equity funds.

8/ In the Chilean system, pension funds are, in theory, permitted to invest in a FIDE upon its creation and listing the FIDE's shares on the stock exchange is also relatively easy. Due to the risk perception associated with small business transactions, however, it is sound practice for the proposed FIDE to develop a financial track record and at a later stage encourage the participation of pension funds. As of July 1998 in Chile, pension funds do not have a positive attitude toward private equity funds due to poor past performance in general, and a lack of liquidity. If pension funds' participation is not foreseen in the short run, the alternative is to create a FICER, Foreign Risk Capital Investment Fund, a vehicle designed to attract foreign investors with tax incentives, yet managed by a Chilean Management Company. Although pension funds are not allowed to invest in FICER, once its financial track record is established, it may be easier to transfer its assets when establishing a FIDE.

Timetable and MIF's exit from the Country Fund and the Regional Trust

4.20 The sole shareholder of each Country Fund will be the MIF/ULLICO Regional Trust. The Trust will be established as a closed-end fund with a 10-year life, and with a self-liquidating mechanism at its tenth year. As for each Country Fund, it will be also constituted as a closed-end, self-terminating fund with a 10-year term under the relevant local legislation. Given the potential to attract local institutional investors in the future, the by-laws of the Trust and each Country Fund will be drafted to provide for the potential sale of shares to new investors, should MIF and ULLICO wish to consider this option in the future. Issues related to valuation of the Country Funds, sale of all or part of MIF or ULLICO shares to new investors or issuance of new shares would be considered at a future date. MIF's exit from the Regional Trust earlier than the 10th year self-termination, will be subject tothese considerations. MIF's Donors Committee will be consulted before any decision is made regarding substantial changes (including an early exit) in the initial structure of both the Regional Trust and each Country Fund.

D. Investment Policies and Criteria

Investment Policies

4.21 Each Country Fund will operate under investment guidelines to be established by its Boardof Directors, and approved by the Board of the Trust. Investments will be made on commercial terms to support small private or thinly traded companies in seeking growth through restructuring, modernization, expansion, acquisition, and/or new product development. The Country Funds will attempt to leverage their resources with other co-investors including local institutional investors and strategic, technological or marketing partners. The Country Funds will normally invest in companies where management and co-investors have a proven track record. In limited cases, and with Board approval, the Funds may structure investments as senior loans; these will be reserved for those projects that have an otherwise adequate capital structure. Annex I summarizes the Country Funds' investment policies.

4.22 Both Country Funds will focus on investments in the SE sector. In Argentina, based on FiduCorp's experience, SEs can be defined by their net assets which range from US$1 to US$3 million. In Chile, based on Moneda Asset's experience, SEs can be defined as having equity between US$ 2 and US$3 million. Individual investments bythe Funds will range between US$500,000 and US$1,500,000 for a stake of 25% to 49% per company (up to 40% in Chile) 9/. The average investment will be US$1 million, and will have a term of three to fiveyears. The Funds will be diversified so that no more than 20% of the Fund's assets will be in any one economic group (related enterprises) and no more than 30 % in any one industrial sector. On average, investments will be structured so as to earn a gross rate of return of 30%.

4.23 The Country Funds will target sectors with a clear competitive advantage-- for example, sectors and companies that are export-oriented, and that benefit from a low-cost, high-growth environment including food and beverage, branded consumer products; retailing; manufacturing; retail financial services; high-tech business services; and media and telecommunications (which are benefitting from the development of infrastructure and communications in both countries). The Funds will not invest in real estate. Furthermore, the Funds will avoid investing incompanies in sectors that rely to a great extent on the informal sector (for example, fresh fruit sales, and textiles). The Funds will target unlisted and in some cases listed (but thinly traded) companies with limited or no access to capital markets, family-owned businesses with generational change and companies in need of growth capital.

9/ In Chile, there is a legal limit of up to 40% ownership by a FIDE in each corporate equity.

4.24 The Country Funds will look for strong management teams; dependable operational cash flows; a strong position relative to market leaders; a three-to-five year operating history(minimum); identifiable barriers to entry in the industry; minimal environmental exposure; a demonstrated ability to export products (or to expand market share); and tangible assets, including real estate, plant and equipment In addition, the Funds will seek to invest in companies in which the investment can lead to developmental benefits such as employment generation, training, involvement of local capital markets, expansion of local markets for products or services, demonstration of projects that can be replicated elsewhere, and use of technologies that are new to the region.

Environmental and Social Criteria

4.25 Investments must meet environmental criteria approved by the Board of each Country Fund. The criteria should be consistent with the IDB's sustainable development policy. The investee companies will be required to meet local environmental and safety regulations, and where appropriate, international standards, if the Manager determines that local standards are inadequate. The Managers will use the criteria in the due diligence process to help identify and eliminate potentially harmful investments from consideration. The criteria will not replace the case-by-case consultations with experts that will be sought for each project.

4.26 Investments must also meet social criteria, which include the monitoring of labor relationswithin the portfolio companies. When assessing potential investments, the Managers of the Country Funds will review the target company's corporate culture and strategy, including employment and labor policies, current employee-management relations, and the potential for employeeparticipation in the company's success.

4.27 Investments will be made in both unionized and non-unionized companies. The Funds do not intend to attempt to impose conditions relating to labor relations on management, the workforce, suppliers, contractors or strategic partners. However, the Fund anticipates that the making of its investments will have a positive effect on employment within the target companies, including job creation.

Exit Mechanism

4.28 The Managers will always carefully consider exit strategies, and will usually require contractual mechanisms for regaining liquidity. The most likelyexit scenarios include sale of the Fund's stake to a strategic investor, sales on the over-the-counter market, syndication of the investment to other institutional investors, sale to management and/or co-investors through put options and buy back arrangements, and when appropriate, the Funds will seek to exit through initial public offerings("IPO") within 36-60 months. Obtaining a position of influence upon the Funds' investment will enable the Funds to determine the optimal time and manner in which to realize their return. When investing in equity, the investment criteria for the Funds will include exit mechanisms that permit the Country Funds' stake to decrease gradually, and to exit completely when the enterprise is able to raise new capital on its own. The corporate finance experience of the Managers will be especially valuable in managing exits.

E. Expenses, Distributions and Management Incentives

4.29 The remuneration paid to the Managers will comprise an annual payment and performance incentive tied to the Fund's net realized gains ("carried interest"). During the first five years of operation, the Fund will pay the Managers an annual fee of 3.5% of committed capital. Thereafter, the annual feewill be 3.5% of committed capital, less the cost basis ofany investments in portfolio companies that have been sold or written off. There will also be a 25% carried interest incentive after the preferred return

of 8 % p.a. for investors. A significant portion of the carried interest will be awarded to the staff who are active in the day-to-day management of the Country Funds. It is anticipated that there will be a "clawback/lookback" provision which allows for a review of the total profit distribution from the Fund at the end of the term. The purpose of this provision is to provide assurance that the incentive payments to the Managers are commensurate with the overall return of the Funds and that the investors (MIF and ULLICO) recover their capital contribution and the hurdle rate before any carried interest is shared.

4.30 Although the overall annual budget is somewhat high in percentage terms, the absolute value is considered reasonable in light of the proactive, labor-intensive role of the Managers and the Funds' focus on small companies.

F. Supervision, Monitoring and Evaluation

4.31 The Managers will provide quarterly financial and portfolio evaluation reports to aid assessment of the success rate of projects supported by the Country Funds. The MIF will also have access to all projects in order to complete in-house supervision, if necessary. All portfolio ventures will provide monthly management reports and quarterly financial and environmental reports to the Managers. The ventures will be audited annually, both from a financial and social/environmental standpoint.

4.32 Each year the Country Funds will issue audited financial statements certified by an internationally recognized accounting firm, and a report describing the portfolio's status. On a quarterly basis, the Funds will issue unaudited financial statements and a valuation review of the portfolio; every six months the Funds will issue summaries on each portfolio company.

V. MANAGEMENT AND GOVERNANCE

A. Board of Directors and Investment Committee

5.01 Each Country Fund will have a Board of Directors (or Vigilance Committee in the case of the Chilean Fund) designated by the principal shareholders, the Trust (and therefore by ULLICO and MIF). The Board will be responsible for setting policy matters, appointing the investment Managers, establishing annual budgets and approving the selection criteria and investment approval process. It will also create an investment committee of the Board to provide oversight, review and approve investment proposals recommended by the Managers and to ensure that all projects meet the investment criteria. The selection and pre-approval of individual investments (which must conform to the investment criteria discussed) will be determined by the Managers, which will subsequently recommend investments to the Funds' Investment Committee for final approval. Members of the Investment Committee which will include key staff members of each selected management company, will be determined by the Board.

B. Management Companies

5.02 The Managers will locate companies, evaluate them, structure the investments, agree on a business plans and propose investments to the Investment Committee. In cases where the proposed investments are outside of the established investment guidelines, the Investment Committee will seek Board approval. For those investments that are approved, the Managers will supervise the implementation of the business plans, including necessary business, financial and management restructuring. The Managers will participate on the boards and key committees of portfolio companies, supervise uses of capital injections, and finally take the necessary steps to achieve a successful divesture. The Managers will report regularly to the Boards of the Country Funds (and through these Boards, to the Board of the

Trust). The Managers will monitor investment criteria as well as the social/environmental impacts of financed projects. The staff of the selected Managers combine experience in venture capital, project management, and commercial banking with relationships with a wide range of stakeholders throughout Latin America. The profiles of the professionals involved in the management ofthe Country Funds are described in Annex II.

5.03 In Argentina, the Country Fund will be managed by FiduCorp S.A. ("FiduCorp"), a financial services company established in 1964, and currently owned by Mr. Zsolt Agárdy. FiduCorp started its business managing collateral guarantees for European banks, and is one of the first financial companies to specialize in venture capital operations in Argentina. 10/ The assets acquired by the company amount to over US$180 million. In 1974, Mr. Zsolt Agárdy joined FiduCorp and developed financial advisory services to local and foreign companies and banking institutions. In the 1980s, as FiduCorp's president, Mr. Agárdy focused the company's efforts on venture capital investing by buying controlling stakes in small companies and then successfully overhauling their management. Beginning in 1986, FiduCorp has been focusing on investments having characteristics traditionally associated with venture capital investing. These characteristics include growth potential, undervalued assets, turnaround situations, brand names, unique products, technical know-how and good management.

5.04 FiduCorp is a group of companies managed and owned by a select group of experienced investors and executives led by Mr. Zsolt Agárdy. Historically the group has not been organized as a fund, however, it is run and operated similarly to a fund management group. FiduCorp acts as the umbrella organization for investments by the group. FiduCorp does not charge management fees to investors. Rather, the group's executives charge board and advisory fees to the operating companies they own and manage. The group has invested in existing as well as start-ups of various industries such as hotel, publishing, stationery, hard copy, office supply, retailing, synthetic fiber and water & waste treatment and, more recently, online Internet financial services. In general, all the investments have resulted in controlling positions, thereby allowing active participation by FiduCorp while deflecting potential hostile takeovers

5.05 In addition, FiduCorp offers financial services, such as merger and acquisition advisory services, corporate restructuring, origination structuring and issuing of corporate debt and equity. In the last few years the group has also participated in several capital market transactions through their brokerage firm, InvestCapital S.A. FiduCorp has significant experience in many Latin American countries including Uruguay, Ecuador, Brazil and Chile. Most recently the group divested some of the investments obtaining very high returns (for example, Hoteles Argentinos S.A., acquired for US$1.9 million in 1988 was sold in early 1998 for US$23 million to the real estate group IRSA, bringing net cash of US$11 million to investors). The investors in the group have invested over US$17 million and have been obtaining a 35% rate of return over the last 10 years. Investments vary from US$2 million to US$7 million. Transaction histories are attached as Annex V.

10/ In the Argentinean private equity market, two funds established by Exxel Group and Oppenheimer are well known as pioneers: Argentine Private Equity I, L.P. closed in 1992; their follow-on fund, Argentine Private Equity Fund II, totaled US$200 million. Subsequently Advent International (Latin America Private Equity Fund, US$200 million target), and WestSphere Equity Investors (South America Private Equity Growth Fund, US$180 million target) came to the market. All these funds were established as offshore limited partnerships, and whose scope and size go beyond the proposed SE market. FiduCorp is virtually the only private equity management company that is locally-owned and independent from any other international affiliation.

5.06 FiduCorp will have an advisory service contract with Dagnino Pastore & Asociados ("DPA"). DPA was founded by the ex-Minister for Economy, José María Dagnino Pastore in 1970. The company has performed over 200 advisory services both in the private and public sectors. These include advisory services in macroeconomic projections, investment valuations, corporate finance, portfolio management and business strategy. In the last two years, DPA has participated in a dozen cases related to SEs in different industries such as telecommunications, food, paper, property registry, telemarketing, banks and real estate. DPA has also participated in the organization and launching of four mutual funds. Through this service contract with DPA, FiduCorp will be positioned to assess the quality of management and strategic plans of target companies, particularly SEs, to monitor investments in a disciplined manner, and to execute turnaround strategies, if necessary.

5.07 In Chile, the Country Fund will be managed by Proa S.A. ("Proa"), a wholly-owned subsidiary of Moneda Asset Management S. A. ("Moneda Asset"). Moneda Asset was established in 1993 as an asset management services company to institutional investors. The assets under management are mainly fixed income securities and equity (public and private), and as of May 1998, the total assets under management amounted to US$173 million. Moneda Asset provides services and products to local and international institutional and high net worth individual investors. As one of the founders, International Finance Corporation ("IFC") owns 20% of its total share. The remaining 80% is owned by four managing partners: José Musalem, Sergio Undurraga, Antonio Cruz, and Pablo Echeverría. 11/

5.08 Moneda Asset owns two separate management companies which are wholly-owned subsidiaries of Moneda Asset: A.F.I. Moneda S.A. ("Moneda")- and Proa, recognizing that listed shares and private equity require different expertise. Thus, each company has its own structure and investment process. In both cases, the board of directors have at least two independent directors out of five. Moneda Asset gives full support to these management companies. Also Moneda Asset has a team of five analysts who provide research and the follow-up of investments. Moneda Asset has recently created a third fund management company, HQM S. A., which is a joint venture formed with Hambrecht & Quist (H&Q), one of the best-known specialized technology investment banks in the United States. HQM, in which Moneda Asset has a 35% participation, is established to manage a fund that will invest in technological companies in Chile; the fund has not yet closed.

5.09 Moneda administers three funds that invest in listed securities. Pionero, a small-cap listed equity fund (launched in March 1994 with a capital increase in March 1995, US$91 million); Moneda Chile Fund Ltd. (launched in August 1995, US$15 million), a Dublin listed foreign investment fund which is structured for foreign investors and can invest up to 20% of its asset in non-listed securities; and Colono (launched in October 1996, US$17 million), a fund that invests in shares listed on the Chilean Stock Exchange with a focus on small companies.

5.10 Proa, the selected manager of the Country Fund, is currently administrating a private equity fund, Proa ("Proa Fund"), launched in October 1995. During the two years and half since its inception, the Fund has invested 83% of the Fund's assets (US$50 million) in private equity of 10 companies. Proa Fund's ownership structure is completely different from that of other domestic private equity funds: private investors own 51% of the Fund, while 37% is owned by pension funds, and 12% by insurance

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11/ The private equity industry in Chile is relatively new, as the longest-standing such fund was established in 1992. There is a trend of consolidation of fund managers. As of June 1998, a total of eight domestic private equity funds operated in the local markets with US$206 million (and the amount of foreign private equity funds is indeterminate).

companies. 12/ Proa has an advisory council, formed by prominent local entrepreneurs, which contributes to the generation of deal flow. In December 1997, the first investment of Proa went public, thereby tripling the investment value. The return of the Fund in 1997 was 18% and the annualized rate of return since inception in dollar terms is 25%. (See Annex VI)

VI. THE MARKET

A. Economy

6.01 The description about the recent economic trend and the market for SE is attached as Annex III.

B. Project Pipeline

6.02 The following is an indicative project pipeline for the two Country Funds:

Location	Description	Amount and Type
Argentina	Direct marketing and telemarketing. The company's advantage is solid management with a clear view of the potential of the business.	US$850,000 in equity
Argentina	Integrated timber/crate production company. Own 200 hectares of eucalyptus. New equipment is needed, including circular saws with double axis capability. This equipment will increase productivity by 35%. Sales in 1996 equaled $1,700,000.	US$500,000 debt.
Argentina	Outdoor furniture production. Main local customer is supermarkets; 50% of sales made in foreign countries (primarily Brazil). Sales in 1996 equaled $3,000,000. The company would like to expand production for export, targeting the Mercosur countries.	US$750,000 in equity
Argentina	Pre-hospital assistance company. Provides emergency medical help to affiliated individuals and institutions. This sector has great growth potential.	US$1.5 million in equity
Chile	Technical graphics company. Digitalizes maps, creates and manages relational databases behind GIS, trains clients in use of GIS-based systems. Sales of US$1,500,000.	US $1.5 million in equity
Chile	Tea salon. This restaurant group has 4 establishments. Makes and sells light meals, pastries, ice-cream and beverages. Younger generation wishes to expand and modernize.	US $1 million in equity
Chile	Plastic packaging manufacturer. Makes bags and wraps which are imprinted with clients logos, product names and information, etc. Has introduced new technology.	US$1.5 million in equity
Chile	Financial Insurance. This business has grown as banks have outsourced certain tasks. The company transports/transfers securities and handles treasury operations.	US$1.5 million in equity

12/ The overall industry average of the shareholding structure of FIDEs is highly concentrated in local pension funds: local pension funds own 81% of the total FIDEs, while insurance companies own 6% and private investors own 13%.

VII. FINANCIAL PLAN

7.01 Investments in both Country Funds will be channeled through the Regional Trust. (US$)

	MIF	ULLICO	TOTAL
Equity Investment in Country Fund in Argentina	$5,000,000	$5,000,000	$10,000,000
Equity Investment in Country Fund in Chile	$5,000,000	$5,000,000	$10,000,000
Total	$10,000,000	$10,000,000	$20,000,000

VIII. FINANCIAL PROJECTIONS

8.01 Estimated financial projections with sensitivity analysis for the Country Funds and Regional Trust have been prepared by the Management Companies, and are available as Annex IV. The projections were prepared based on an analysis of the pipeline status and the expected size of transactions (each Country Fund would invest in approximately 20 enterprises). Successful equity investments are projected to generate returns on the order of 30% per year. However, the overall IRR over the life of the Trust and Country Funds will depend on the timing of investments, mix of products, economy of the countries, etc. It is estimated that the Regional Trust will achieve a pre-tax return to the investors of between 10% and 14% per annum, net of operating expenses, management fees and incentive fees in both Country Funds.

IX. COMPLIANCE WITH MIF ELIGIBILITY CRITERIA AND PROJECT BENEFITS

9.01 The project is fully consistent with both the general purpose of the MIF to stimulate small businesses and the eligibility criteria for the Small Enterprise Investment Fund of the MIF, as it involves the creation of a new venture capital type fund, a mechanism to support small enterprises with strong growth potential that need long-term capital for capacity expansion. The Project's focus will significantly emphasize a niche under-served by the few equity investment funds already established in the region.

9.02 The MIF will have a key role in contributing to an economic multiplier effect within the SE sector, helping to expand small businesses which in turn will seek increased inputs, thereby expanding other businesses and creating jobs.

9.03 Furthermore, the Project will contribute to the development of local capital markets, and will demonstrate to other institutional investors the attractiveness of the SE sector, leading the movement to meet the increasing demands for capital from the SE sector. In doing so, they aim to help overcome an insufficiency of institutional investment capital in the region and attract future investment fund from other capital sources. While investors are reluctant to directly invest in the SE sector, they might be interested in investing in a diversified fund which targets this sector.

X. RISKS AND ISSUES

10.01 *Currency Risk*: The Country Funds' investments will be denominated in local currencies of the host countries; thus, the investment value may be affected by currency fluctuations. Neither Country Fund expects to hedge the currency exposure. This risk should be mitigated by rigorous selection of the

portfolio companies and agreements based on inflation adjusted pricing or dollar cash flows. (Furthermore, since the establishment of Argentina's Convertibility Plan, the Argentinean peso - US dollar exchange rate has been 1:1.)

10.02 *Investee Risk and Return*: An investment in the Regional Trust will involve significant risks due to, among other things, the nature of the Trust's investments. Both Country Fund portfolios will consist primarily of securities of small enterprises, privately-held businesses that are illiquid andinvolve a high degree of business and financial risk. Furthermore, ULLICO's private equity investment experiences in the US may not necessarily be applicable to the small business niche the Project approaches. Therefore, the target return of 30% for each equity investment may be too optimistic, and based on sensitivity analysis of targeted return and possible exits, the overall return on the Funds may be lower than projected. Due to the high rate of failure inherent in investing in start-up projects and to the lesser known nature of small business industries, the Country Funds will focus primarily on established, well-managed enterprises that need to improve their capital structure, retool, modernize their facilities, and/or raise adequate capital to support increased working capital needs as they move into new markets. The chosen Managers have proven track records and are familiar with the local business environments. Furthermore, through board representation, the Managers will provide strategic guidance and oversight to the portfolio companies. The Managers will seek to invest in 20 or more enterprises each, and will make allowances for a range of performances. Diversification will be essential to spread risk within the Country Funds' portfolios. The Managers will aim to balance potential losses by structuring an upside in most investments. The private equity fund approach can produce a significant overall return, as one profitable investment can generate a large enough gain to offset the moderate performance or losses of several others. Also, debt financing is expected to represent a reasonable portion of the portfolio, reducing the risks associated with exit in pure equity investments.

10.03 *Exit Risk*: The Country Funds' investments in companies whose shares are not listed on a stock exchange, or whose shares are listed on a stock exchange or over the counter exchange but are thinly traded, are subject to less liquidity and greater risks than those inherent in publicly, actively traded securities. The Funds generally will attempt to exit or otherwise dispose of their investments through public or private sales or on stock exchanges. Even if the Funds are able to exit by selling securities in a local stock market, the securities markets are substantially smaller, less liquid and more volatile than the major, developed securities markets. The limited liquidity of the securities markets in general and of the types of companies in which the Funds propose to invest, as well as the size and nature of securities markets, may adversely affect the Funds' ability to acquire or dispose of securities at the price and time they wish to do so. However, the Funds will provide mezzanine level or expansion capital to small businesses that have established themselves and will primarily invest in companies whose need for capital is below the threshold of a public offering and/or currently lack access to local capital markets. Furthermore, the Managers shall have proven experience in exiting small sized investments through third-party sales. Their business contacts will be instrumental in supporting the exit of the Funds' investments, which will be protected by the following: board representation for each investment; written commitments to go public within an established period; minority rights; covenants and other contractual safeguards, including exit mechanisms. The ability to structure divestment alternatives before the investment can enhance exit values.

10.04 *Deal Flow Risk*: The number of projects in the Trust's target deal size range may be fewer than anticipated, which could pressure the Country Funds to make lower-quality investments and produce lower-than-expected returns. The business of identifying and structuring investments may become highly competitive, and involves a high degree of uncertainty. However, the Managers have already identified a growing pipeline of potential investments totaling in each country. As this pipeline is the

product of only limited marketing efforts, it is believed that a much larger pool of eligible projects will be readily identified as a result of strategic marketing. One of the advantages of the Managers' extensive networks of referral sources is that they can introduce companies to support services provided by local and international enterprises while using those enterprises as informal marketing agents, other than regular call-on banks, accounting, consulting and law firms. On the other hand, family -owned companies historically have been reluctant to sell equity; however they may be willing to do so as part of an overall financing/strategic advisory package. Target companies face complex strategic/financial issues in today's markets; the Country Fund teams can provide high- level financial engineering and operational know-how as well as access to capital/strategic partners.

10.05 *Conflicts of Interest*: The interests of the Managers and any affiliate of the Managers may conflict with the interests of the Funds and the investors in various ways. The key to managing these conflicts is to a) require full disclosure to relevant parties and b) establish a mechanism in advance for dealing with such conflicts. Since it is impossible to foresee all possible conflicts of interest, the Fund will establish a "Conflict Committee", consisting of the members of the Country Funds' Board of Directors. The Manager will refer material conflicts of interest to the Conflict Committee. The Committee will, by vote of a majority of its non-interested members, determine the manner to address conflicts of interest. The Committee may appoint disinterested persons to settle conflicts, provide for the Fund to dispose of assets upon specified terms, or require interested parties to abstain from investment decisions.

Annex I. Investment Policy

*Unless otherwise noted, the descriptions below apply to country funds both in Argentina and Chile

Investment Strategy Invest in closed corporations with a view to contributing to their expansion and to realizing a significant capital gain over time. Each investment horizon will be three to five years.

Target Industry Growth sectors with clear competitive advantages and identifiable barriers to entry in the industry such as export-oriented companies; suppliers to multinationals; companies benefitting from modernization of socio-economic structures and infrastructure, and from sales/services to privatized industries, or fragmented industries and sizable family-owned companies with generational change, offering potential consolidation. The target sectors will include: food and beverage, branded consumer-related products; retailing; manufacturing; retail financial services; high-tech business services; media and telecommunications. Will avoid the informal sector, and real estate will be excluded.

Target Companies The book value of net assets is between US$1,000,000 and US$3,000,000. The number of employees is less than 100. Invest in companies whose securities are privately held, or are listed on a stock exchange and or in the over-the-counter market but not actively traded. The maximum size of each investment is US$1,5000,000. Exceptionally, these requirements may be waived by the Board of the Country Funds.

Stage of Investment Primarily invest in companies whose need for capital is below the threshold of a public offering and/or currently lack access to local capital markets. Provide mezzanine level or expansion capital to small businesses that have established themselves. Invest in companies in expansion phase with a high degree of development, anticipating the use of proceeds for restructuring, modernization, expansion, acquisition, new products development and similar activities. The Fund will not invest in start-ups or in turnaround situations without an explicit approval by the Board.

Investment Criteria In Argentina, invest for a stake of 25% to 49% per company.

In Chile, invest not more than 40% of the investee company's ownership.

Each investment will be priced to have a gross annual rate of return of 30%.

Business ventures should be backed by an experienced group of managers who have their own money at risk. The prior financial and other performance of the company and its management, and the company's future financial and business prospects must be accepted. Strong position relative to market leaders.

The investment track record must be strong. A minimum three-to-five year operations history. Dependable operational cash flow, with tangible assets.

Development benefits should be noted, such as employment generation, training, involvement of local capital markets for products or services, labor policies, labor-management relation, demonstration of projects that can be replicated elsewhere, and use of technologies that are new to region. Minimal environmental exposure and safety regulations compliance. Investment will be made both in unionized and non-unionized companies.

Diversification
The portfolio will be diversified with specific category limitations for committed capital.
-30% in any one industry.
-20% in one economic group.
Short-term, tactical, liquid equity/debt, fixed income securities investment
-up to 20% of the value of the fund.

Instrument

Invest in either common stock, preferred stock, convertible debt, and subordinated loans with warrants or options. In limited cases, can structure investment as senior loans.

Exit

Determined prior to time of initial investment. The Manager will require contractual mechanism for liquidity. These may include stock puts based on a pre-determined formula, or an unlocking agreement to a strategic partner, who may eventually be the principal or technical partner. A few transactions will be sold on the stock market.

PROPOSED RESOLUTION

REGIONAL. INVESTMENT FUND FOR SMALL ENTERPRISES AND PROMOTION OF DOMESTIC SOURCES FOR RISK CAPITAL.

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 Multilateral Investment Fund, to enter into such agreements as may be pertinent or necessary with ULLICO Inc., a Maryland corporation, as sponsor of an investment fund (the "Fund") to be established for small enterprises for the promotion of domestic sources for risk capital, and with the Fund, its other sponsors and shareholders and their respective subsidiaries and affiliates, and to take such additional measures as may be required, establishing such other terms and conditions as may be appropriate for the protection of IDB/MIF interests in the execution of the operation referred to in Document MIF/AT-____, in order to provide an equity investment in the Fund for the purpose of providing financing in the form of equity and quasi-equity to small enterprises in Argentina and Chile. The President or such designated representative is also authorized to execute any other agreements as may be necessary with other parties to complete this transaction as contemplated in Document MIF/AT-___ ;

2. That up to ten million United States of America dollars (US$10,000,000) is authorized for the purpose indicated in paragraph 1, chargeable to the Small Enterprise Investment Fund of the Small Enterprise Development Facility of the Multilateral Investment Fund.