

GLOBAL CREDIT PROGRAM TO MICROENTERPRISES II

(PE-0189)

EXECUTIVE SUMMARY

BORROWER AND GUARANTOR: The Republic of Peru

EXECUTING AGENCY: Corporación Financiera de Desarrollo S.A. (COFIDE)
[Development Finance Corporation]

AMOUNT AND SOURCE: IDB: US\$30,000,000 (OC)
Local counterpart funding: US\$12,860,000
Total: US\$42,860,000

FINANCIAL TERMS AND CONDITIONS: Amortization period: 25 years
Disbursement period: 3 years
Commitment period: 2.5 years
Interest rate: variable
Inspection and supervision: 1%
Credit fee: 0.75%
Currency: US\$ single currency facility

OBJECTIVES: The program's general objective is to support development of (urban and rural) microenterprises that are commercially viable and are their owners' main source of income. The specific objectives are to: (i) give microenterprises greater access to credit and other financial-sector services; and (ii) continue the process of forming an institutional base of financial intermediaries capable of providing the microenterprise sector with increasing and uninterrupted service.

DESCRIPTION: Financing from the program will be designed to increase the capacity of IFIs in the formal sector (banks, private development finance companies, CMACs, CRACs and small-business and microenterprise development institutions) to provide credit to microenterprises on a sustained basis and on terms comparable with those available on the market. The program is multisectoral in nature. Its resources will be used to finance short- and medium-term loans to eligible individuals or juridical persons in the microenterprise sector. Those loans are to go toward financing working capital or purchasing fixed assets to establish, consolidate, and improve the productivity of the recipients' businesses. The

present program builds upon the credit component introduced in the first global microenterprise credit program, launched in 1996.

**ENVIRONMENTAL AND
SOCIAL IMPACT
REVIEW:**

The importance of the measures conducted under the first global microenterprise credit program is emphasized. They will continue under this program and consist of the following: (i) help the IFIs classify the main types of microenterprises and their environmental impact and, especially, determine measures that will mitigate any adverse effects on the environment; (ii) assign the subloans an environmental classification; and (iii) contract a specialized firm to monitor and ensure that environment-related measures taken by the IFIs and the microenterprises are properly implemented.

BENEFITS:

The expanded financial services planned under the proposed program are expected to have a positive socioeconomic impact as they will open up more opportunities for employment and income for the neediest groups. The program's resources will ultimately go to microentrepreneurs with viable businesses. Beneficiaries will be offered a quick and timely financial product that will enable them to take advantage of the opportunities afforded by the growth either already posted or projected in Peru's economy. Where the financial system is concerned, the program will help expand and diversify the range of financial services available for microenterprise. This, in turn, will increase the competition to serve this market segment and thus help lower interest rates and transaction fees.

POVERTY TARGETING:

The nature of the program is such that it automatically qualifies as "targeting low-income groups" (poverty-targeted investment).

RISKS:

One of the program's main risks is that the anticipated impact may not be obtained if the macroeconomic and financial climate makes it difficult to sustain a steady and efficient flow of credit resources to the microenterprise sector. However, that risk is minimized by the favorable medium-term prospects for Peru's economy due to the authorities' adherence to the economic program; consolidation of the reforms introduced at the start of the decade, and the measures taken to cope with a possible deepening of the Asian crisis. The second risk is that for reasons beyond its control, COFIDE might not be in a position to avoid selecting IFIs that are not financially sound. To minimize this risk, however, the program design has built the

necessary safeguards into the Credit Regulations. Also, COFIDE has recently established a special unit for risk analysis. A third risk, which is that demand falls short of expectations, is highly unlikely since the operation was scaled on the basis of a conservative demand forecast. Furthermore, the technical assistance to transfer the credit technology from the Microglobal I program, which is getting underway, will provide ample support for creating increased institutional capacity to lend resources to a sector that still receives few services from the financial system.

**THE PROJECT'S
ROLE IN THE
BANK'S COUNTRY
AND SECTOR
STRATEGY:**

The proposed operation fits into the Banks' strategic areas in the country and in the sector, especially given its support to microenterprise and job creation. The Bank's strategic areas of operation in Peru for the 1998-2000 period, as enumerated in the country paper, are: (i) support for modernization of the economy, which includes the second stage of the structural reform process and support to small businesses and microenterprise to improve their productivity; (ii) support for job creation, poverty reduction and the delivery of social services; and (iii) modernization of the State. The operation is also an integral part of the measures planned for the "Micro 2001 Program," in which support to microenterprise in the region is expected to top US\$500 million.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

- (a) Prior to the first disbursement from the program, COFIDE must submit the following to the Bank's satisfaction: (i) the contract signed with the borrower for the transfer and execution of the program; (ii) evidence that the Credit Regulations are in effect; and (iii) at least eight (8) subsidiary participation agreements signed with eligible IFIs. COFIDE will also be required to submit its financial statements and those of the program, audited annually for the duration of the program's disbursement period and for up to another three (3) years from the date of the last disbursement.
- (b) (i) the commitment to put recoveries to the specified use for the indicated time period (see paragraph 3.3); (ii) presentation of the environmental evaluation within the first six months of every calendar year, starting the year after the first disbursement from the loan (see paragraph 3.7); (iii) inclusion of the information indicated in paragraph 3.8 as part of the semiannual progress reports;

(iv) presentation of the financial statements of COFIDE and of the program, every year for the duration of the disbursement period and for up to three more years after the date of the last disbursement (see paragraph 3.9); (v) presentation of the results of the ex post evaluation of the program (see paragraph 3.10); and (vi) recognition of expenditures that can be charged against the local counterpart funding and the Bank financing, effective June 30, 1998 (see paragraph 3.12).

I. FRAME OF REFERENCE

A. The microenterprise sector

- 1.1 Based on a 1996 nationwide household survey (Ministry of Labor), the total number of microenterprises operating in Peru is estimated at 2,386,000; 43% are in the Lima metropolitan area. These businesses employ six million people, which is 75% of the economically active population (EAP). The sector accounts for an estimated 40% of the gross domestic product (GDP). The same survey found that women accounted for 41% of the EAP; in microenterprise specifically, their share was estimated to be the same or even slightly higher. These figures are some of the highest in Latin America.
- 1.2 The vast majority of the microenterprises are owned by low-income persons. A recent market study of Greater Lima found that for at least one out of every four low-income families, 1/ a family-owned microenterprise was its main source of income. As to the impact microenterprise has on employment, at least two out of every three families can be said to depend on microentrepreneurial earnings for their living. The same study also found that these were very informal businesses; four out of every five interviewed reported that they did not figure in the taxpayer master file [Registro Único de Contribuyentes] (RUC). It was also noted that the microenterprises' chief activity was trade.
- 1.3 The data cited above confirm the sector's socioeconomic importance, as it employs a large percentage of women and low-income workers. Thus, measures to strengthen the sector will have a positive socioeconomic impact by improving opportunities for job creation and income for the most vulnerable groups.
- 1.4 Thus far, the microenterprise sector's capacity to perform well on markets that are becoming more and more competitive owing to globalization, technology and other factors, has been limited. The obstacles restricting access to entrepreneurial development services (training, advisory services, marketing techniques, information and others) and to proper financial services have hampered the sector's economic growth. As a result, a number of activities are needed in a variety of areas if the sector is to perform better in the future. The operation proposed in this profile, which ties in with the efforts started under the Bank's Microglobal I program in 1995, focuses on solving the problems associated with access to financial services.

1/ *Apoyo Opinión y Mercado S.A.*, Lima, July 1996. Data for socioeconomic levels C and D, based on information from the national standard-of-living measurement survey.

B. Microentrepreneurial demand for financial services

- 1.5 The access of Peru's urban and rural microenterprises to formal financial services has improved considerably. In 1994, some 35% of poor households that had borrowed, had gotten their loans from private individuals (moneylenders and the like). ^{2/} By 1996, that figure had dropped to 21%. The difference was made up by the substantial increase in the presence of formal financial services (banks, for example). While the trend is indeed encouraging, the percentage of low-income people brought into the banking system is still small. That figure includes microentrepreneurs who took out personal and/or small-business loans from municipal and rural savings and loan banks and from commercial banks. In general, then, there is an interesting opportunity for expansion to meet the large, unsatisfied demand for financial services among low-income sectors, and for microenterprise in particular.

C. The financial system and services to microenterprise

1. Evolution of the financial system

- 1.6 The financial system's growth in recent years is reflected in the upturn in intermediation, which rose from 3.4% of GDP in 1990 to 23.5% of the GDP in 1996. Moreover, the legal framework introduced with the new banking law in force since 1996 provides a better climate for the system's development. The principal changes introduced by the new law were intended to standardize the type of operations that institutions in the financial system can perform and to make them sounder. In addition, the law calls for the assessment and management of market risk, and much more stringent classification of loan portfolios.
- 1.7 Between 1990 and 1996, foreign investment in the sector rose more than fivefold, and was at US\$665 million by 1996. Favorable economic indicators, low levels of intermediation and the potential for developing new products were attractions for international financing groups. When these interests entered the picture, particularly the Spanish and Chilean interests, they injected a new dynamic, generating fierce competition to expand the market in those segments that had not been part of the banking system and to broaden the range of services offered. The heightened competition now apparent in the sector has gradually lowered the interest rates on loans and reduced the banking institutions' financial spread.
- 1.8 By the end of March 1998, the system's total assets topped US\$28 billion. The financial system is made up of: 25 commercial banks; 7 finance companies; 9 leasing agencies; Banco de la Nación;

^{2/} Data supplied by Cuanto S.A., national standard-of-living measurement survey [Encuesta Nacional sobre Medición de Niveles de Vida (ENMNIV), 1994 and 1996.

Corporación Financiera de Desarrollo S.A. [Development Finance Corporation] (COFIDE); 14 municipal savings and loan banks [cajas municipales de ahorro y crédito] (CMACs); 16 rural savings and loan banks [cajas rurales de ahorro y crédito] (CRACs); and the savings and loan cooperatives. The commercial banks account for 81.5% of the system's assets (US\$22.5 billion) and have 939 branch offices and 25,700 employees; Banco de la Nación accounts for 9% of the assets; COFIDE 4.3%; the leasing companies 3.1%; and the finance companies and the savings and loan banks and cooperatives 2.1%.

- 1.9 The financial performance of the commercial banks in 1997 and early 1998 was satisfactory, despite a climate overshadowed by the effects of the "El Niño" phenomenon, the crisis in Asia, and implementation of the new regulations set forth in the banking law. Lending during that period was up by 27%, deposits by 16%, and net worth by 20%. One of the main effects of the economic slowdown was a decline in portfolio performance: delinquent portfolio's share of total portfolio rose from 7.9% at the end of 1996 to 8.8% in March of 1998. However, loan-loss provisioning was up by 28.2% in 1997 and by 10.8% for the first quarter of 1998. Over the next few years, the banks are expected to continue to face more competition, forcing them to be more efficient and innovative to look for new lines of business that differ from traditional banking.

2. Bank service to low-income sectors

- 1.10 Over the last three years, banking services to low-income workers (wage earners and microentrepreneurs), who had traditionally been overlooked as a client sector, have grown considerably with the introduction of new products and services. The first specialized institutions to enter the Peruvian market were three Chilean-owned banks that began to compete aggressively with a local bank associated with a chain of shops and engaged in lending in that same market. By the end of 1997, five banks and two finance companies were offering personal loans to low-income sectors. Their combined portfolio was some US\$490 million. Lending to microenterprise is only just beginning, and at present stands at about US\$35 million.
- 1.11 Banks that are new to lending to these sectors begin by concentrating on employees of big businesses, whose credit is backed by their monthly income. However, given the nature of Peru's economy, in which informal businesses are so prevalent and so much of the EAP is engaged in microenterprise, some IFIs have planned, or in other cases been forced by competition, to expand their services to include microentrepreneurs. This is necessitating changes in their credit technology to enable them to operate with other data variables and cope with the problems of generating the information needed to examine loan applications from microenterprises. From a conceptual standpoint, the adjustment is not so dramatic. Both for consumer loans and loans to microenterprise, the "technologies" are for lending and managing

small loan portfolios that average no more than US\$1,000 and have a person/family as the end client. The difference here is that the borrower's main source of income is not a salary but the borrower's microenterprise. In recent years, two new financial intermediaries have entered the scene, both of which are targeting microenterprise as their priority clients.

3. Savings and loan banks

- 1.12 In addition to the institutions described above are others that have traditionally financed low-income groups, microenterprise in particular. They include the 12 municipal savings and loan banks (CMACs) with a total portfolio of US\$87 million, and the rural savings and loan banks (CRACs) that, although new to the scene, already have a portfolio of US\$45 million. The rural and municipal savings and loan banks have a combined microenterprise portfolio of approximately US\$65 million.
- 1.13 The CMACs were a joint creation of the Peruvian and German governments. The Bank joined the effort in 1992, under the Small Projects Financing Program. This experience was pivotal in getting the formal financial sector interested in serving the microenterprise sector. It demonstrated that it could be done profitably and on a large scale, while attracting sizeable amounts of savings at the same time.
- 1.14 The CMACs have been an institutional model and a laboratory of microenterprise credit technology in various countries of the region and in Peru itself. But the competition is such that many CMAC officers and staff are being lured away by commercial banks operating in the same market segment. The former CMAC staff bring with them their clients, training and work experience. Other problems facing the CMAC system include administrative deficiencies that are to some extent related to their ownership structure and limitations in their capital base. A committee is now examining ways to privatize these agencies, but their continued existence as an integrated system is still uncertain. The Bank's sectoral investment loan includes technical assistance to support the introduction of private capital in the ownership of these institutions.

D. The Bank's first global microenterprise credit program

- 1.15 In September 1995, the Bank approved its first global microenterprise credit program (Microglobal I), which consisted of a line of credit in the amount of US\$25 million, plus another US\$10.7 million in local counterpart funds, channeled through COFIDE. The resources were made available at market prices to banks and regulated IFIs that met the eligibility requirements. Demand thus far has been strong.

- 1.16 At the same time, a technical cooperation program was approved in the amount of US\$3.95 million (US\$2.75 million from the Swiss government and US\$1.25 million in local counterpart funding). It included: (i) transfer of credit technology to the IFIs; (ii) expansion of the central risk data unit operated by the Superintendency of Banking and Insurance (SBS); (iii) advisory services for COFIDE and monitoring of the IFIs; and (iv) enhancement of the IFIs' environmental awareness.
- 1.17 The first component is the most important in terms of amount and concept, since its purpose is to transfer credit technology to the IFIs interested in entering this segment of the market. The main idea is to introduce a new financial product: microcredit (fast and timely; small amounts amortized over short periods and basically for working capital and such). This requires: (i) preparing a new type of credit analyst (someone who comes from the same neighborhoods, is familiar with the sector and works on the "street" in close contact with clients); and (ii) adapting operating procedures and adjusting organizational structures (creating a microlending department in each participating bank). Due to delays during the international bidding procedures for contracting the firm, this component did not get underway until mid-1998. The work to be carried out will be essential for developing an institutional capacity in four or five IFIs and for securing the additional funds to be furnished by this project, thus providing strategic support to strengthen Peru's financial system.
- 1.18 By late March, COFIDE had placed loans in the amount of US\$29 million chargeable to the program resources. Approximately US\$14 million went to seven banks; US\$13 million to seven CMACs; US\$2 million to three CRACs; and US\$0.3 million to a small-business and microenterprise development institution [entidad de desarrollo de pequeña y microempresa] (EDPYME). More than 29,000 loans have already been granted. The average amount was US\$1,042, well below the US\$5,000 maximum specified in the Credit Regulations, indicating that the program is reaching the target population. Of the total amount of these loans, 32% went toward fixed assets; the remaining 68% went toward working capital. A breakdown of the recipient microenterprise by type of business found that: 61% engaged in trade; 12% in services; 9% in industry; 12% in farming; 4% in transport; and 2% in other lines. This was consistent with the spread of business within the microenterprise sector. The geographic distribution has been very broad, probably because of the diversity and coverage of the participating IFIs. Only 22% were in the department of Lima. In fact, the funds reached all 21 of the country's departments. Women's participation was also significant, as they accounted for 40% of the program's clients, consistent with their share of the EAP.
- 1.19 A preliminary evaluation of this program found that: (i) demand exceeded expectations because of the prevailing macroeconomic conditions (stability and the pace of economic growth), stiff

competition from new market niches in the financial system, and the presence of an initial institutional base already equipped to provide services to microenterprise (the CMACs); (ii) not only was the target group reached, but the average loan amount was almost five times smaller than the amount allowed under the Credit Regulations; (iii) wide geographic coverage was achieved, and a sizeable number of rural microenterprises were served; (iv) a quick and timely mechanism for transferring funds to the IFIs was put into place; (v) a modern credit history data system -the first in the region- was installed and will reduce the transaction costs and promote competition; (vi) two important IFIs were enlisted to conduct a successful pilot test of microenterprise financing as a new area of business; and (vii) the participating IFIs were given high marks by the risk classification firms and in every case had less delinquency in their portfolios than those of the system.

- 1.20 It was also established that support for development of new financial services for the sector needed to continue in the future and that the process was still in the early stages. Therefore, the following was needed: (i) concomitant technical assistance in credit technology and (ii) a stable base of resources to develop platforms of specialized services within the IFIs.

E. Credit information

- 1.21 As noted in paragraph 1.15, under the parallel technical cooperation in the first microglobal credit program a small component was planned that included resources to expand the SBS' central risk data unit. The purpose of this component was to add to the information available in the SBS system, which had records only for loans over the equivalent of US\$5,000. This posed a serious obstacle to checking the credit history of persons or companies with small debit balances, the volume of debt typical among the target group. For the SBS, the expansion of the central risk data unit was a challenge. The volume of data would increase, which meant that its data-processing capacity would have to be augmented. Then, too, some IFIs were reluctant to release information about their clients, particularly those IFIs that for a number of years had specialized in serving the low-income sectors, where such information is a very valuable asset.
- 1.22 Despite these problems, early in 1998 the SBS installed a system that operates quickly and smoothly, either via the Internet or on tape. All the IFIs and the private credit bureaus have access. This small measure brought a dramatic change in the market for small loans in Peru and will be a cornerstone in the development of services in the area of microlending. Information is critical input for credit-related decisions. As of a few months ago the IFIs began to lend based on information about applicants' indebtedness. Now they can determine whether an applicant has a poor credit history, whether an applicant's ability to generate income is sufficient to ensure payment of the loan installments,

and whether the data in the system squares with the data supplied by the applicant on the loan application. The transaction cost for the credit analysis is minimal, since the service is provided at no charge by the SBS and competition in the charges billed for such services by private credit bureaus is strong.

- 1.23 Although this system was not installed until early this year and sufficient credit history data are not yet available, it has already proved to be highly useful to the IFIs, which are now rejecting loan applications based on potential over-indebtedness problems they see in some of their clients. This avoids the problem of a possible "bubble" at the small-loan and consumer-loan levels, while at the same time lowering the cost of credit analysis by the IFIs and fostering competition, which in the medium term will help to reduce the spreads.
- 1.24 The enhanced availability of SBS information has been a key factor in the development of three private credit bureaus, which use the data from the Superintendency as a starting point, and then back it up by: (i) checking the legitimacy of the identification number and the names of the persons, with the national bureau of identification and vital records [Registro Nacional de Identificación Civil] (RENIAC) 3/; (ii) checking against the taxpayer records at the National Tax Administration [Superintendencia Nacional de Administración Tributaria] (SUNAT) 4/, which allows them to determine even whether an applicant is current on tax payments; (iii) accessing information from complaints on file with the Chambers of Commerce; (iv) adding credit information from commercial establishments that are not part of the financial system; (v) securing information from electric

3/ RENIAC is currently engaged in a modernization and computerization process in which it is eliminating any mistaken information involving persons with more than one identification number or errors in its records.

4/ SUNAT uses a simplified system (RUS) for microentrepreneurs who have no more than four dependents, only one establishment or stand, and a monthly income of no more than US\$4,500. With this system, it is easier for the RUC to get microenterprises into the formal system, as it operates through a network of decentralized offices and has simple forms for people to fill out. This system has brought about an enormous increase in the number of microenterprises on file in recent years: only two years ago there were fewer than 200,000 on record. Now there are more than 600,000. Most IFIs that are now aggressively getting into the business of lending to low-income sectors are requiring an RUC number on the loan application, which enables them to obtain data and check the "character" of the prospective customer. This, combined with companies that demand a receipt for the goods and services they purchase, are the factors driving this formalization process.

power or telephone companies; and (vi) updating the information in the database by consulting the sources mentioned above.

- 1.25 Microentrepreneurs and borrowers in general are gradually beginning to grasp how essential it is to stay current in one's payments in order to avail oneself of the different services available in the market, especially credit. In the medium and long terms, these advances are expected to help improve the terms for these services (terms, interest rates, and the like) and the customers' willingness to pay.

F. The government's strategy

- 1.26 One priority of the Peruvian government's strategy is to promote microenterprise as an alternative means of improving employment and income among the less advantaged sectors, combatting poverty, and providing a more solid social base for the structural reforms achieved. The strategy, therefore, aims to further the growth of microenterprise by providing it with more and better financial and nonfinancial services, and to build up the institutional capacity of the institutions that provide these services.

G. The Bank's strategy

- 1.27 The Bank's strategic operating areas in Peru for the 1998-2000 period, as defined in the country paper, are: (i) support for modernization of the economy, which includes the second stage of the structural reform process and support to small businesses and microenterprise to improve their productivity; (ii) support for job creation, poverty reduction and the delivery of social services; and (iii) modernization of the State. The proposed operation falls under areas (i) and (ii) above, and is also an integral part of the measures planned under the "Micro Program 2001," in which support to microenterprise in the region is expected to top US\$500 million.

H. The Bank's experience

- 1.28 Since 1992, the Bank has approved 27 operations aggregating US\$12.7 million under the Small Projects Financing Program to finance loans to microenterprise, plus US\$3.7 million for institutional strengthening of the intermediaries involved (16 lending NGOs and 10 CMACs). Experience varied according to the intermediary: the CMACs, for example, not only disbursed the resources but also strengthened their own financial position and operations in the process; the lending NGOs, on the other hand, had less success. Given these results, for the last three years interventions in the sector by way of NGOs have focused mainly on nonfinancial services (training, technical assistance, information and the like). Also, efforts involving NGOs have concentrated on rural districts and depressed areas in the highlands and forests. In 1997, for example, two technical operations in the amount of US\$774,000 were approved for indigenous groups (campesinos and

natives), aimed at enhancing their ability to manage their microenterprises and boosting their products' market penetration. In September of this year, four small projects totaling US\$1,540,000 are expected to be approved. They will help small-scale farmers improve the productivity of their land and better manage their affairs, while increasing value added at the local level and marketing new products with wider profit margins.

- 1.29 Also in the area of entrepreneurial services, MIF resources have been provided to support key sectors like tourism in areas with enormous potential, like Ayacucho. To that end, in early 1998 a program of US\$1.6 million was approved, earmarked primarily for training with a view to developing tourism services. The IDB is preparing an operation for approval in the fourth quarter of 1998, this one to provide support to small-scale entrepreneurs engaged in the manufacture and sale of leather goods and shoes. The project is designed to upgrade the skills of human resources and to raise the productivity and marketing of businesses in that sector.
- 1.30 In the financial sector, the Bank has joined the stringent adjustment process with a sectoral operation approved in 1992, for a total of US\$200 million, to reduce the State's participation in banking; liquidate development banking; re-scale the Banco de la Nación; reorganize the Banco Central de Reserva; strengthen the Superintendency of Banking and Insurance (with the corresponding amendment of the standards of financial prudence); and revamp the pension systems. In 1994 the Bank approved a multisectoral credit loan (PROBID) of US\$100 million, executed through COFIDE, to finance long-term projects in medium- and large-sized businesses. Moreover, one component of the sectoral investment program approved at the end of 1996 helped implement a second round of reforms designed to strengthen the legal and regulatory bases of the banking system. It also included assistance for modernization of COFIDE and studies to support privatization of the CMACs. An MIF grant in February 1998 provided financing for creation of a bank training institute which will train human resources for growth of Peru's financial system. Lastly, in the next few months a small-business development program (PE-191) is expected to be approved in the amount of US\$70 million. Its purpose is to expand financial services to businesses larger than those targeted in this project.

II. THE PROGRAM

A. Objectives

- 2.1 The program's general objective is to support development of microenterprises 5/ (either urban and rural) that are commercially viable and are the owners' principal source of income.
- 2.2 The program's specific objectives are: (i) to give microenterprises greater access to credit and other financial-sector services, and (ii) to continue to form an institutional base of financial intermediaries capable of providing the microentrepreneurial sector with increasing and uninterrupted service. The indicators used to verify the program's accomplishments are shown in the Logical Framework (Annex I).

B. Description

- 2.3 The financing from the program will go toward increasing the capacity of IFIs in the formal sector (banks, finance companies, CMACs, CRACs and EDPYMEs) to provide credit to microenterprise on a sustained basis and on terms comparable to those available on the market. The funds will be used to finance short- and medium-term loans to eligible individuals or juridical persons in the microenterprise sector. Those loans are to go toward financing working capital or purchasing fixed assets to establish, consolidate, and improve the productivity of the recipients' businesses.
- 2.4 COFIDE, acting as a second-tier public bank, will allocate the program funds to eligible IFIs by means of a financing mechanism based on advances and applying strict ex post controls.
- 2.5 Basically, the resources from this second stage will be added to those already provided under the credit component of the original program and will be administered by COFIDE pursuant to a single set of guidelines (terms, conditions, brand names, and the like). The Microglobal line has been well received in the financial system, since IFIs that want to specialize in providing services to this sector have to be able to rely on a stable source of resources for lending in order to be able to mount operational platforms for sustained and increasing service to microenterprise.
- 2.6 The mechanics for transferring funds to the IFIs will be the same as the mechanics introduced in the first stage, and will replace

5/ The definition of a microenterprise in the Credit Regulations is a business that has fewer than 10 employees and possesses assets of up to US\$20,000, excluding real property.

the customary rediscount procedure used in multisectoral credit operations for larger loans. COFIDE will channel and transfer program resources to eligible IFIs by approving loans of up to four years, at a rate that must, as a minimum, be equivalent to the average rate payable on 360-day term deposits, adjusted for purposes of the statutory reserve requirement. The time limit for using the proceeds of approved loans (commitment period) will be one year. COFIDE will charge a commitment fee on approved undisbursed loan balances. The loans approved for the IFIs will be disbursed in the form of advances, and the IFIs will have 90 days to demonstrate the onlending of the disbursed loan funds. For the life of the respective loan, an IFI's portfolio of onlending to microenterprise will have to be higher than the balance due to COFIDE that was financed with funds from this program. The IFIs and their clients will freely set the interest rates they consider appropriate for each subloan.

- 2.7 Under the program, COFIDE will be able to grant loans to the IFIs in either U.S. dollars or local currency. In the latter event, COFIDE's financial area is prepared to obtain the requisite coverage to assume the exchange risk.
- 2.8 The multisectoral nature of the program, the allocation of its funds on market terms and intermediation by the most efficient IFIs will allow the program funds to be channeled in rapid and timely fashion, without the need for cumbersome administrative procedures. The IFIs will assume the full credit risk for the subloans, which will be granted under financial terms freely agreed upon between the parties. With the subloans, the credit methodology to be used will follow the experience of Microglobal I's best practices in this area, and will rely on analysis of the credit history and monitoring of the "credit subject," rather than analysis and credit control of the "project" to be financed. Monitoring the "project" to be financed is in itself very difficult in the case of financing for working capital, and even less feasible in the case of microenterprise; in other words, when the borrower is the owner of an economic unit characterized by the indivisibility of the domestic unit and the business *per se*.
- 2.9 Although this second stage does not feature a parallel technical cooperation component, execution is in fact complemented by the technical cooperation arranged for the first phase, which is still in progress. The main purpose of the technical assistance in the first phase is to support development of an institutional framework that ensures microenterprises' uninterrupted access to credit. Specifically, this component: (i) strengthens COFIDE, especially in microenterprise lending; (ii) transfers appropriate credit technology to the IFIs, with due regard to gender issues in the area of microenterprise credit; (iii) expands the central risk data unit operated by the SBS; and (iv) heightens the IFIs' environmental awareness, especially that of their microenterprise loan officers. The main thrust of this technical cooperation is to

transfer appropriate credit technology to the IFIs by means of a specialized consulting company with experience in this field. The technical cooperation started in the second half of 1998, will continue until midway into the year 2000.

C. Cost and financing

- 2.10 The financing plan would be the one shown below (in millions of US\$):

Credit	IDB	Local contribution	Total
a. Resources for onlending	29.70	12.86	42.56
b. Inspection & Supervision (1%)	0.30		0.30
Total	30.00	12.86	42.86
	70%	30%	100%

- 2.11 The total cost of the proposed program would be the equivalent of US\$42.86 million. Up to the equivalent of US\$30 million (70%) will be financed by the Bank, on a reimbursable basis, in United States dollars, chargeable to the Bank's ordinary capital (OC) under the Single Currency Facility. COFIDE will finance up to the equivalent of US\$12.86 million (30%) as the local counterpart.
- 2.12 In this way, the IFIs will be assured of financing for 100% of their microenterprise lending. It is proposed that all funds that COFIDE channels to the target group from its credit lines for microenterprise after the date of approval of the operation, be recognized as counterpart funds, provided the IFIs onlend these funds in accordance with the Credit Regulations.

III. EXECUTION OF THE PROGRAM

A. Borrower and executing agency

- 3.1 The borrower and guarantor for the program will be the Republic of Peru, represented by the Ministry of Economy and Finance (MEF). The executing agency for the credit program will be COFIDE, which will channel the program funds to subborrowers through formal intermediary financial institutions (IFIs) that meet the eligibility requirements set for the program. Before the first disbursement from the loan funds, the borrower and COFIDE will conclude an agreement by which the former will transfer the program resources to the latter in accordance with the conditions laid down in the loan contract with the Bank.

B. Program Credit Regulations

- 3.2 The Credit Regulations for the program will be very similar to those currently in effect for Microglobal I, which provide for the allocation of the resources to participating eligible IFIs by means of a financing mechanism based on advances, in accordance with the requirements of financial prudence. COFIDE will conclude subsidiary participation agreements with participating eligible IFIs. A condition precedent to the first disbursement will be that COFIDE has put into effect the Credit Regulations negotiated with the Bank and that it has concluded at least eight (8) subsidiary participation agreements with participating eligible IFIs. The Credit Regulations proposed for this operation appear in Annex II.

C. Use of recoveries

- 3.3 Recoveries will be used to finance new loans for activities of the same kind provided for in the Credit Regulations unless five years after the date of the last disbursement of the Bank's loan the Bank and the borrower, through COFIDE, agree to another use that does not deviate from the loan's basic objectives, or agree to shorten the period of validity of this obligation.

D. Advances of funds and disbursements

- 3.4 Based on the Bank's recent experience with the Microglobal I program and on the projected demand for the resources of this operation, the project team is recommending an advance of up to 10% of the Bank's contribution, in the form of a revolving fund.

E. Environmental considerations

- 3.5 The present operation was approved by the TRG/CESI at its meeting on May 29, 1998. There, emphasis was placed on the socioeconomic importance of the microenterprise sector, which provides jobs for a

significant number of women and low-income workers. It was reported that the measures taken to improve financial services were expected to have a positive socioeconomic impact in terms of opening up opportunities for job creation and income for the most vulnerable groups. It was also noted that women's involvement in the first phase had been extensive, as they had accounted for 40% of the beneficiaries, which is consistent with their percentage share of the EAP.

- 3.6 From the environmental standpoint, the first stage of the microglobal program included measures to raise environmental awareness both among the microenterprises and the IFIs. Specifically, the following measures were carried out: (i) support to the IFIs with classification of the main types of microenterprises and their environmental impact and, especially, measures that would mitigate any adverse effects on the environment; (ii) environmental classification of subloans; and (iii) contracting of a specialized firm to monitor and ensure that environment-related measures taken by the IFIs and the microenterprises were properly implemented.
- 3.7 An evaluation was done in May of this year which demonstrated the importance of the environmental-protection measures and made recommendations that COFIDE is now carrying out. Within the first six months of each calendar year for the duration of the program, COFIDE is also required to submit to the Bank an environmental evaluation of a sample of microenterprises financed with program resources.

F. Monitoring

- 3.8 Supervision of the program will be the responsibility of the Bank's country office in Peru, with assistance from the project team. In addition to the monitoring that the Bank will carry out through its normal procedures, COFIDE undertakes to submit to the Bank semiannual progress reports showing the following: (i) program funds actually placed as agreed; (ii) the use made of the recoveries; (iii) the interest rates actually charged to the IFIs; (iv) the number of subloan contracts executed; (v) the number of subborrowers served, classified as either individuals and or juridical persons, and then broken down by economic activity, subloan terms, region, gender and environmental category; and (vi) the arrears rate of the program subloans portfolio. COFIDE will also be required to report on the performance of other indicators to be specified for monitoring the program's achievements.
- 3.9 COFIDE is to submit its financial statements, and the financial statements for the program, each year throughout the program disbursement period and for three years after the end of that period. The statements must have been duly audited by a firm of independent public accountants acceptable to the Bank.

G. Ex post evaluation

- 3.10 The ex post evaluation of the program will be done within one year from the date of the last disbursement by the Bank to COFIDE, in combination with the evaluation of the Microglobal I program. It will be performed by independent private consultants specially engaged for that purpose and financed under the technical cooperation that was part of Microglobal I. The ex post evaluation will be based on the information gathered from the subborrowers by the IFIs participating in the program. Thirty days after having completed the evaluation, COFIDE will submit it to the Bank.
- 3.11 The methodology to be used for the ex post evaluation will be the one agreed on by COFIDE and the Bank. The evaluation will include, among other items, an analysis of the following aspects: (i) the operating and financial efficiency of the IFIs participating in the program; (ii) the movements in effective interest rates charged to the program subborrowers; (iii) an analysis of the economic, social and environmental impact of the program subloans, based on a random sample of subborrowers.

H. Recognition of expenditures

- 3.12 To ensure the continuity of the microenterprise onlending that began under Microglobal I, the Bank may recognize expenses incurred since June 30, 1998, as chargeable to the loan and to the local counterpart, provided they conform to the program's Credit Regulations.

IV. THE INTERMEDIARY INSTITUTION

A. COFIDE

1. Nature and objectives

- 4.1 Corporación Financiera de Desarrollo S.A. [Development Finance Corporation] (COFIDE) is a public financial institution established under private law. 97% of its capital is held by Corporación Nacional de Desarrollo S.A. [National Development Corporation] (CONADE); the remaining 3% is held by the Andean Development Corporation. COFIDE is organized as a corporation and has administrative, economic and financial autonomy. It is governed by Decree Law 206, as amended by Decree Law 25,382 and Decree Law 25,694 and by its by-laws.
- 4.2 Pursuant to the principles of the Bank's financial sector adjustment loan, the government has converted COFIDE into the country's sole public second-tier agency, authorized to grant loans exclusively through other IFIs, to channel funds to the private sector. At the end of 1994, COFIDE's direct portfolio was sold to the Ministry of Economy and Finance by Supreme Decrees 124-94-EF and 140-94-EF, thereby clearing COFIDE's portfolio. This operation culminated in the first quarter of 1997.
- 4.3 COFIDE's mission is to contribute to Peru's economic and social development by attracting and intermediating funds to finance investment, thereby complementing the private sector's activity on the markets for long-term financing and Peruvian export goods. Here, the stimulus to microenterprise and small business is central to the Corporation's objectives.

2. Organizational structure

- 4.4 Under the program to restructure State financial agencies, COFIDE has been modernized in recent years and has become much more efficient. New management techniques have been introduced and new information-processing technology acquired. Institutional rightsizing measures have been taken and the organization's structure changed. A drastic reduction-in-force was carried out, which reduced staffing from 570 at the end of 1990 to 125 at the present time. The most skilled employees were kept on and investments were made in training and special courses for young professionals who have the potential for executive careers.
- 4.5 In terms of formal organization, COFIDE's general manager and audit unit report to a board appointed by the shareholders' meeting. The manager's office has under it five line departments and two support departments. The line departments are: (i) the loan department, responsible for placing the corporation's resources in the

financial system; (ii) the development department, responsible for the selection and qualification of intermediaries and for performance of nonfinancial activities; (iii) the finance department, responsible for the corporation's financial policy, securing of resources and internal control by profit and cost centers; (iv) the risk department, responsible for managing the risk associated with the loan portfolio and the market risk; and (v) the trust department, responsible for overseeing trust funds and trusts (such as the citizen participation program). The support departments are legal counsel and information processing and administration. The latter provides administrative support and formulates policies on personnel and procurement of goods and services.

3. Sources of funds and main operations

- 4.6 Of liabilities totalling US\$860 millions as of the end of 1997, COFIDE's main source of funds was a group of foreign commercial banks which provided lines of credit of US\$415 million in U.S. dollars, almost four times the amount from that source in 1996. The Andean Development Corporation (CAF) has now dropped to second place in this respect, financing various lines representing a debit balance of US\$125 million. The IDB is the third most important source, with a debit balance of US\$105 million. Risk classifying agencies such as Apoyo S.A., Duff & Phelps del Perú, and the Pension Fund Administrators' Oversight Office have granted top rating to the promissory notes backed by the Corporation. On the liability side, this shows how COFIDE's financial position has evolved and been consolidated since its operations were restructured and modernized.
- 4.7 COFIDE is managing a total of six programs or lines of credit for the IFIs in Peru's financial sector: (i) the multisectoral investment program, made up of the PROMICRO, PROPEM and PROBID, according to the size of the beneficiary business; (ii) the multisectoral working capital lines, for businesses that need short- and medium-term financing; (iii) rural sector support programs; (iv) foreign trade programs; (v) the multisectoral privatization credit program; and (vi) the credit line for nontraditional financial intermediaries, exclusively for financial intermediaries with registered corporate capital of up to approximately US\$300,000.
- 4.8 In 1997, the loans approved by COFIDE amounted to US\$1.189 billion, up by 51% over the 1996 level and 100% over the 1995 level. As a result, by late 1997 COFIDE's current portfolio totaled US\$792 million, up by 26% over the previous year. Medium- and long-term operations totaled US\$509 million, accounting for 64% of the portfolio. The remainder were short-term operations; of these, the working-capital lines accounted for 25% and the foreign-trade lines the other 11%. Under the PROBID, approvals totaled US\$39 million and financed 67 investment projects. The IDB's

Microglobal I Program had US\$15 million in approvals in 1997, which meant that loans disbursed from this line totaled US\$29 million.

4. Principal financial indicators

- 4.9 COFIDE's financial and operating efficiency has improved over the past five years. In 1997, its operating expenses represented 14.1% of financial income and 1.1% of average total assets, as compared with the 1996 figures of 14.5% and 1.3%, respectively. That same year, COFIDE posted net earnings of US\$12.8 million, up by 11% over the 1996 figure. At the close of that year, its total assets were at US\$1.180 billion, a 46% increase over the preceding year, with a rate of return of 1.4%.
- 4.10 The increased pace of placements reflected a substantial increase in the productivity of COFIDE's human resources, which rose from US\$4 million per employee to US\$6 million in 1997. That growth was also matched by an improvement in the portfolio's quality, as shown by the drop in the figure for the portfolio in arrears and in legal collection, which dropped from 1.3% in 1996 to 1% at the close of last year.

COFIDE: Principal Indicators

INDICATORS	12/31/97	12/31/98
In millions of US\$		
Assets	1,180	810
Loans Balance	792	630
Liabilities	922	643
Equity	28	167
Net Income	13	12
Gross Loans/Staff	6	4
In percentages		
Average Return on Equity Capital	5.3	7.1
Average Return on Assets	1.4	1.5
Non Perf. Loans/Gross Loans	1.0	1.3
Operating Costs/Total Assets	1.1	1.3
Risk-weighted Assets/Net Worth	4.0	5.7

V. VIABILITY AND RISKS

A. Socioeconomic viability

1. For microenterprises

- 5.1 The end recipients of the program funds will be microentrepreneurs who are commercially viable (in the opinion and at the risk of the IFIs). They will be offered a quick and timely financial product that enables them to take advantage of the economic opportunities presented by the economic growth already posted and anticipated in Peru's economy. The present document underscores the socioeconomic importance of the microenterprise sector, which provides employment to a large percentage of economically active women and low-income workers. Accordingly, the measures designed to improve financial services are expected to have a positive socioeconomic impact in the form of expanded job and income opportunities for the most vulnerable groups.
- 5.2 By introducing more services and increasing competition among service providers, one of this program's contribution to the growth of a market in financial services to the microenterprise sector will be to lower the high administrative costs of IFIs serving the microenterprise sector. Another important factor in supporting the development of this market and lowering the IFIs' transaction costs is the availability of information on microenterprises' transactions and credit history, thanks to the technical cooperation provided under the Microglobal I program, which financed expansion of the SBS' central risk data unit. The banking sector's increasing participation in this market will improve the IFIs' administrative efficiency, another way to lower transaction costs for microenterprise subborrowers.
- 5.3 At the same time, having stable access to a timely lending product offered efficiently by IFIs operating in an increasingly competitive credit market will help the target group to raise its level of disposable liquidity. In other words, for microenterprises that have already been able to develop a relationship with a bank or banks, the effective cost of borrowing will go down; those that have not yet had access to formal credit will have the chance to reduce their reliance on even more costly informal financing.

2. Poverty targeting

- 5.4 The operation is designed to foster development of Peru's formal and informal microenterprise sector. It will also help to consolidate and increase microenterprise earnings, generate employment in the sector, and complement the Peruvian government's efforts to reduce poverty. The program's beneficiaries will be the

women and men who own microenterprises, members of their families and wage earners dependent on jobs offered in the sector. The nature of the program is such that it falls automatically into the category "targeting low-income groups" (poverty-targeted investment).

B. Institutional viability

- 5.5 The institutional viability of the program's "wholesaler" (COFIDE) is assured because of its experience managing the previous line and other external lines of credit (the IDB multisectoral program, the CAF and others) and its healthy financial situation, which will allow it to operate efficiently and without problem, as evident from the detailed institutional analysis contained in the preceding chapter.
- 5.6 In addition to the obviously growing interest on the part of the institutions that took part in the Microglobal I program, the design phase of this second operation detected a significant number of IFIs clearly hoping to participate. Throughout preparation of this program, a continuous dialogue has been kept up with banks specializing in services to low-income sectors, which want very much to take part. The smaller financing agencies, at least, are interested in joining the program, as are a number of EDPYMEs that have been licensed to operate in recent months.

C. Financial viability

- 5.7 The program has been designed along the same lines as the first operation, whose financial feasibility is established, and has COFIDE's counterpart resources guaranteed. One special feature to ensure viability is the flexibility of the interest rate, which has to be adjusted every three months to be consistent with the terms prevailing on the financial market. The effective minimum rate that COFIDE must charge the IFIs under the program, ensures that sufficient financial revenue will be generated to service the loan with the Bank and cover its administrative costs.
- 5.8 The eligibility criteria are intended to ensure the IFIs' efficiency and solvency. The IFIs will examine the subborrowers' credit history, assume the full credit risk, and freely set the financial terms for the subloans. This basic feature of the program, namely that the IFIs are responsible for determining the anticipated costs and returns, will ensure that this program is viable for the financial system. The evaluation of the first stage found that by avoiding bureaucratic ex ante controls and delegating responsibilities to the IFIs, the market system was strengthened and active control was kept in the hands of oversight agencies.
- 5.9 Bringing microentrepreneurs into the formal credit market will broaden the financial system's operating base, as low-income sectors are added. This will diversify risk and make the financial

system less dependent on its operations with medium- and large-sized businesses. Added benefits will accrue from the likely increase in demand for other types of financial services, which will ultimately increase the IFIs' earnings.

- 5.10 The program will provide the IFIs with stable financing, allowing them to reduce the volatility of and diversify their liabilities. It will make it easier for them to plan the growth of their microenterprise loan portfolios, while investing in systems, service infrastructure and human resources. The increase in their loan portfolios will also enable the IFIs to achieve economies of scale and thus improve their operating and financial efficiency. Finally, the visible growth of their total assets will enhance the IFIs' institutional credibility on financial markets, which is essential for attracting additional savings from the public and for issuing medium- and long-term debt instruments.

D. Risks

- 5.11 The chief risk, which is that the program would not have the expected financial and economic impact, would be a factor if the economic, financial and institutional environment necessary for efficient channeling of credit resources to the microenterprise sector was lacking. That risk is minimized by the favorable outlook for Peru's economy in the medium term, thanks to the authorities' adherence to the economic program; the consolidation of reforms introduced at the start of the decade; and the steps taken to cope with a possible deepening of the Asian crisis. In addition, the program also provides for the measures needed to monitor for the presence of the enabling institutional and financial climate.
- 5.12 The second risk is that COFIDE, for reasons beyond its control, might not be in a position to avoid selecting some IFIs that are not financially sound. Although the Credit Regulations contain the necessary precautions to avoid such a situation, the information from the SBS, which COFIDE uses as its main source of information to verify compliance with the financial ratios required of IFIs that wish to take part in the program, might in some cases make it difficult to determine the economic performance of certain CRACs and savings and loan cooperatives. Accordingly, the Superintendency of Banks and the National Federation of Savings and Loan Cooperatives in Peru [Federación Nacional de Cooperativas de Ahorro y Crédito] (FENACREP), with the support of the Canadian technical cooperation, are attempting to improve the cooperatives' information and control systems. During the first stage, however, COFIDE has been cautious and developed its own specialized risk-analysis area.
- 5.13 A third risk might be that demand is much lower than anticipated by the program. This is unlikely, since the operation was scaled on the basis of conservative projected credit demand figures. In

addition, the efforts under the parallel technical assistance with regard to the credit technology component, provide important support for creating greater institutional capacity to lend resources to a sector that has thus far received very little in the form of services from the financial system.

LOGICAL FRAMEWORK
GLOBAL CREDIT PROGRAM TO MICROENTERPRISES II
PE-0189

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
Developing microenterprises (small) that are commercially viable and whose owners' principal source of income is from the sale of their products or services.	<p>An increase in the number of microenterprises served by the financial sector.</p> <p>An increase in the financial system's microenterprise portfolio.</p>	<p>COFIDE's reports</p> <p>Performance evaluation reports</p> <p>SBS bulletins and listings from its risk information unit.</p>	Sustained macroeconomic stability
Providing microenterprises greater access to financial services provided by the financial system. The process of forming an effective network of financial intermediaries providing a growing and sustainable service to the microenterprise sector.	<p>An increase in the number of participating IFIs with institutional structures prepared to serve the sector.</p> <p>An increase in the number of loans that participating IFIs grant to microenterprise.</p> <p>Participating IFIs' development of products especially tailored to the sector.</p> <p>An increase in the participating IFIs' own funds that they put toward their microenterprise loan portfolios.</p>	<p>Documentation of disbursement requests</p> <p>COFIDE's reports</p> <p>Verifiers' reports</p> <p>Financial audit of the program</p> <p>Project completion report (PCR)</p> <p>Inspection visits and management missions</p> <p>Ex post evaluation</p>	<p>Maintenance of a regulatory framework and adequate supervision of the financial system</p> <p>An increase in competition within the financial system</p>
Ensuring that funds from the IDB for COFIDE to be transferred to the participating IFIs are used for the purpose of credit to the participating IFIs.	<p>Onlending of program resources during execution, in accordance with the agreed upon terms.</p>	<p>Disbursement requests from COFIDE to the Bank</p> <p>COFIDE's reports to the Bank</p> <p>Support documentation from the IFIs to COFIDE (transfers and lists)</p>	<p>IFIs' access to program resources.</p> <p>The availability of resources in U.S. dollars and in local currency.</p>

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>of the program among the IFIs of agreements with the g IFIs on of the IFIs processing of credit line requests tion of the credit lines granted</p> <p>and efficient recovery of the pursuant to the terms and set forth in the Credit s.</p> <p>ment and/or new onlending of the lines of credit.</p>	BUDGET		
	Lines of Credit:	Documentation of disbursement requests	Eligibility of the IFIs
	IDB Resources US\$30.00 million	COFIDE's reports	Demand for resources on the part
	COFIDE Resources <u>US\$12.86 million</u>	Verifiers' reports	COFIDE's capacity for swift proces
	T O T A L US\$42.86 million	The program's audited financial statements	Demand of the microentrepreneurs
		Project completion report (PCR)	IFIs' services to microenterprise sa
		Inspection visits and management missions	
		Ex post evaluation	

PROPOSED RESOLUTION

PERU. LOAN ____/OC-PE TO THE REPUBLICA DEL PERU
(Global Credit Program to Microenterprises II)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republica del Perú, as Borrower, for the purpose of granting it financing to cooperate in the execution of a Global Credit Program to Microenterprises II. Such financing will be for up to the amount of thirty million dollars of the United States of America (US\$30,000,000) from the Single Currency Facility of the Ordinary Capital of the Bank, and it will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.