

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**BRAZIL**

**EMERGENCY PROGRAM TO MITIGATE THE ECONOMIC EFFECTS OF THE  
CORONAVIRUS -BRDE (EMERGENCY PROSUL)**

**(BR-L1555)**

**LOAN PROPOSAL**

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## CONTENTS

### PROJECT SUMMARY

I.	DESCRIPTION AND RESULTS MONITORING .....	1
A.	Background, problem to be addressed, and rationale .....	1
B.	Objectives, components, and cost .....	14
C.	Key results indicators .....	14
II.	FINANCING STRUCTURE AND MAIN RISKS .....	15
A.	Financing instruments .....	15
B.	Environmental and social risks .....	16
C.	Fiduciary risks .....	16
D.	Other key risks and issues.....	16
III.	IMPLEMENTATION AND MANAGEMENT PLAN .....	17
A.	Summary of implementation arrangements .....	17
B.	Arrangements for results monitoring .....	20

## APPENDIXES

Proposed resolution

ANNEXES	
<b>PRINTED ANNEXES</b>	
Annex I	Development Effectiveness Matrix (DEM) – Summary
Annex II	Results Matrix
Annex III	Fiduciary Agreements and Requirements (simplified format)

LINKS	
<b>REQUIRED</b>	
1.	<a href="#">Simplified monitoring and evaluation plan</a>
2.	<a href="#">Environmental and social management report (ESMR)</a>
<b>OPTIONAL</b>	
1.	<a href="#">Economic viability rationale</a>
2.	<a href="#">Diagnostic assessment of MSME issues</a>
3.	<a href="#">Bibliography</a>
4.	<a href="#">Summary of the main economic, monetary, and financial policy measures adopted in response to the COVID-19 global pandemic</a>
5.	<a href="#">Brazil: Vulnerability of productive sectors amid the spread of COVID-19</a>
6.	<a href="#">Economic activity and impacts of COVID-19 on economic sectors in the South Region of Brazil</a>
7.	<a href="#">Brazil: Summary of the main economic, monetary, and financial policy measures adopted in response to the COVID-19 global pandemic emergency</a>
8.	<a href="#">Program Operating Regulations</a>
9.	<a href="#">2020 Annual Public Policy and Corporate Governance Letter - BRDE</a>
10.	<a href="#">Policies to Fight the Pandemic: 2020 Latin American and Caribbean Macroeconomic Report</a>
11.	<a href="#">Safeguard Policy Filter (SPF)</a>

## ABBREVIATIONS

AFD	Agence Française de Développement
BACEN	Banco Central do Brasil [Central Bank of Brazil]
BNDES	Banco Nacional de Desenvolvimento Econômico e Social [Brazilian Development Bank]
BRDE	Banco Regional de Desenvolvimento do Extremo Sul
CAF	Andean Development Corporation
ECLAC	Economic Commission for Latin America and the Caribbean
FGV	Fundação Getúlio Vargas
GDP	Gross domestic product
IBGE	Instituto Brasileiro de Geografia e Estatísticas [Brazilian Institute for Geography and Statistics]
IMF	International Monetary Fund
IPEA	Instituto de Pesquisa Econômica Aplicada [Institute for Applied Economic Research]
LAC	Latin America and the Caribbean
MSEs	Micro and small enterprises
MSMEs	Micro, small, and medium-sized enterprises
PEU	Project execution unit
R\$	Brazilian real
RAIS	Relação Anual de Informações Sociais [Annual Social Data Report]
SEBRAE	Serviço Brasileiro de Apoio às Micro e Pequenas Empresas [Brazilian Micro and Small Enterprise Support Service]
SMEs	Small and medium-sized enterprises
SNF	Sistema Nacional de Fomento [National Development Finance System]
WHO	World Health Organization

## PROJECT SUMMARY

### BRAZIL EMERGENCY PROGRAM TO MITIGATE THE ECONOMIC EFFECTS OF THE CORONAVIRUS -BRDE (EMERGENCY PROSUL) (BR-L1555)

Financial Terms and Conditions					
Borrower and executing agency:			Flexible Financing Facility <sup>(a)</sup>		
Banco Regional de Desenvolvimento do Extremo Sul (BRDE)			Amortization period:	15 years	
			Disbursement period:	2 years	
Guarantor:			Grace period:	5.5 years <sup>(b)</sup>	
Federative Republic of Brazil			Interest rate:	LIBOR-based	
			Credit fee:	<sup>(c)</sup>	
Source	Amount (US\$)	%	Inspection and supervision fee:	<sup>(c)</sup>	
IDB (Ordinary Capital):	50,000,000	100	Weighted average life:	10.25 years	
Total:	50,000,000	100	Approval currency:	U.S. dollars	
Project at a Glance					
<b>Project objective/description:</b> The overall objective of the program is to support the sustainability of micro, small, and medium-sized enterprises (MSMEs) as employment providers in the states of Brazil's South Region amid the COVID-19 crisis. The specific objective is to support the short-term financial sustainability of MSMEs located in the South Region of Brazil.					
<b>Special contractual conditions precedent to the first disbursement of the loan proceeds:</b> The first disbursement of the loan proceeds will be contingent upon the approval and entry into force of the <a href="#">program Operating Regulations</a> under the terms previously agreed upon with the Bank (paragraph 3.7).					
<b>Exceptions to Bank policies:</b> The Board of Executive Directors is asked to approve a partial exception to the Bank's Policy on Guarantees Required from the Borrower (Operational Policy OP-303), so as to exempt the States of Paraná, Santa Catarina, and Rio Grande do Sul from guaranteeing performance and any local counterpart obligations as required under paragraph 3.4.2 (b) of the aforementioned policy. The Federative Republic of Brazil will be the guarantor of the financial obligations of the loan, including interest and fees, as required under paragraph 3.4.2 (a) of OP-303 (paragraph 3.9).					
Strategic Alignment					
<b>Challenges:</b> <sup>(d)</sup>		SI	<input checked="" type="checkbox"/>	PI	<input checked="" type="checkbox"/>
<b>Crosscutting themes:</b> <sup>(e)</sup>		GD	<input type="checkbox"/>	CC	<input type="checkbox"/>
				IC	<input type="checkbox"/>

<sup>(a)</sup> Under the terms of the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule as well as currency, interest rate, and commodity conversions. The Bank will take operational and risk management considerations into account when reviewing such requests.

<sup>(b)</sup> Under the flexible repayment options of the Flexible Financing Facility, changes to the grace period are permitted provided that they do not entail any extension of the original weighted average life of the loan or the last payment date as documented in the loan contract.

<sup>(c)</sup> The credit fee and the inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable policies.

<sup>(d)</sup> SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

<sup>(e)</sup> GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

## I. DESCRIPTION AND RESULTS MONITORING

### A. Background, problem to be addressed, and rationale

- 1.1 **Background.** On 4 February 2020, faced with the threat of COVID-19, the Brazilian government declared a state of emergency.<sup>1</sup> This declaration preceded the announcement by the World Health Organization (WHO) recognizing the disease as a pandemic caused by the novel Coronavirus (SARS-CoV2) and affecting the respiratory system.<sup>2</sup> As of 4 November 2020, according to WHO, more than 47,059,867 cases and 1,207,327 deaths had been confirmed worldwide, with 5,504,206 cases and 160,253 deaths in Brazil. According to the Ministry of Health, the country's South Region had a total of 729,121 cases and 14,241 deaths, for an incidence of 2,432 cases and 47.5 deaths per 100,000 inhabitants.<sup>3</sup> In addition, according to WHO, Brazil is at level four of five in terms of its preparedness and capacity to manage public health events.<sup>4</sup> In all, Latin America and the Caribbean have reported 11,428,364 cases and 404,574 deaths. In South America, the situation is unfortunately becoming increasingly concerning. The subregion has become an epicenter of the disease, according to WHO.<sup>5</sup> Brazil has the world's third largest number of cases and is the region's hardest hit country. If it were a country, the South Region of Brazil would have the thirteenth largest number of cases in the world, ahead of nations such as South Africa, Germany, and Chile.<sup>6</sup> The number of cases and deaths is expected to continue to rise.
- 1.2 **Macroeconomic and/or social context.** The global situation has undergone a radical change. As a result, the world economy is heading into a recession, with short-term prospects of a sharp decline in both output and income and a rise in unemployment.<sup>7</sup> The economic impacts of COVID-19 will be made manifest through different conduits at different times. First are the direct costs related to the health sector response and associated with the priority of saving lives in the very near term. Second are the costs associated with the required change in people's behavior to "flatten the curve" of COVID-19 progression and help to save lives. These behavioral changes may stem from government mandates (closing schools, lockdowns, etc.), business decisions (teleworking, cutting back production, etc.), or decisions made by consumers (reducing social contact).

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<sup>1</sup> The Minister of Health declared a "public health emergency of national significance" through [Portaria 188 de 3 de fevereiro de 2020](#), which took effect a day after its publication. The state of disaster was recognized by [Decreto Legislativo 6 de 20 de março de 2020](#), under the terms of the presidential request ([Mensagem 93 de 18 de março de 2020](#)).

<sup>2</sup> See: [opening address](#) by the Director-General of the WHO at the press conference on COVID-19 held on 11 March 2020.

<sup>3</sup> See: [WHO COVID-19 Situation Dashboard](#) (4 November 2020) and [Painel Coronavírus, Ministério de Saúde](#) (4 November 2020).

<sup>4</sup> See: [WHO COVID-19 Country Preparedness and Response Status for COVID-19](#) (March 2020).

<sup>5</sup> See: [Media Briefing](#) (22 May 2020).

<sup>6</sup> As of 4 November 2020, these countries had the following number of cases: South Africa: 727,595; Germany: 560,379; and Chile: 514,202 ([WHO COVID-19 Situation Dashboard](#)).

<sup>7</sup> See: [IMF The Great Lockdown: Worst Economic Downturn Since the Great Depression](#) (14 April 2020).

- 1.3 The change in behavior has led to a significant economic downturn, with immediate manifestations and long-term effects, even after the health emergency is over. From a macroeconomic perspective, with shrinking domestic demand, the Economic Commission for Latin America and the Caribbean (ECLAC) sees five conduits through which the impacts of the crisis will be passed on to the region's economy:<sup>8</sup> (i) slowing economic activity for key trading partners, affecting exports; (ii) lower demand for tourism services; (iii) interruption of global value chains; (iv) falling commodity prices; and (v) worsening financial terms.
- 1.4 In this context, the COVID-19 crisis comes at a time when the Brazilian economy was gradually returning to a path of growth.<sup>9</sup> The pandemic's impact on economic activity in the country is expected to be severe.<sup>10</sup> The Focus report,<sup>11</sup> which reflects the expectations of the financial market in Brazil, forecasts a 4.81% drop in gross domestic product (GDP) in 2020. Economic policy has addressed the outlook for a rise in unemployment and a decline in income by adopting monetary and fiscal measures.<sup>12</sup> The former include reducing the interest rate and the reserve requirements for banks while to expand credit, prudential rules have temporarily been relaxed. The latter include measures exceeding the equivalent of 10% of GDP<sup>13</sup> to cushion the negative impact of the crisis on income (especially for the poorest), on employment, and, to the extent possible, on micro, small, and medium-sized enterprise (MSME) production and the general situation of these businesses in the country.<sup>14</sup> In addition, in view of the state of emergency in the context of the health crisis, the Government of Brazil introduced special procedures to streamline the evaluation and preparation approval process for externally funded programs.<sup>15</sup> For a summary of the economic, monetary, and

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<sup>8</sup> See: [ECLAC bulletin](#) (19 March 2020).

<sup>9</sup> Starting in 2018, the economic activity data indicated that the process of recovery of the Brazilian economy had gained some traction: the changes in fiscal policy had reduced the growth of public sector debt and improved the outlook for the future. By January 2020, it was projected that the debt would amount to 78.2% of GDP in 2020 and then decline, reaching 67.3% of GDP in 2028. See: [Carta de Conjuntura](#) (Institute for Applied Economic Research (IPEA), 2019) and [Relatório de Projeções da Dívida Pública](#) (Brazilian National Treasury, 2019).

<sup>10</sup> An interregional computable dynamic general equilibrium model can help to more accurately begin to estimate the economic impacts of COVID-19 in Brazil. A study led by Porsse et al. (2020) considers two simulation scenarios. The first scenario assumes that the economic system is affected through two conduits: a work supply shock stemming from the morbidity and mortality rates caused by the pandemic; and a temporary, two-month shutdown of economic activity due to social distancing. The second scenario adds the effects of the fiscal measures adopted by the federal government to counteract the impact of COVID-19 on the Brazilian economy. For 2020, the results indicate a 1.87% reduction in the GDP growth rate under scenario 1 and a GDP growth rate reduction of 1.21% under scenario 2. The federal government measures examined in this study help to mitigate the projected drop in GDP growth rate by about 35%. See: [Impactos Econômicos da COVID-19 no Brasil](#) (Federal University of Paraná, April 2020).

<sup>11</sup> See: [Focus report](#) (30 October 2020).

<sup>12</sup> See: [Summary of measures taken](#) (BACEN, 2020).

<sup>13</sup> See: [Economic Policy in Latin America and the Caribbean in the Time of COVID-19](#) (IMF, 2020).

<sup>14</sup> See: [Carta de Conjuntura](#) (IPEA, 2020).

<sup>15</sup> [Resolução COFLEX N° 2 de 13 de abril de 2020](#) establishes limited periods and reduced requirements for considering external credit operations, allowing project preparation to be approved as projects arise, thus eliminating the need to wait for approval meetings that in prior years were conducted two to four times a year.

financial policy measures adopted by Brazil to deal with the emergency, see [optional link 7](#). For general elements of the intervention, see [optional link 2](#) and [optional link 6](#).

**1.5 Current limitations on MSME access to finance in Brazil's southern states.<sup>16</sup>**

The current situation is unlike the 2007 global crisis. Then, the world's financial sector and real economy lacked the liquidity needed to absorb the losses resulting from the poorly managed origination and marketing of financial assets. The present crisis is causing a significant retraction in the supply and demand curves, increasing the risks in the financial sector, the perverse effects on employment, and the death of businesses, especially MSMEs.

**1.6 In Brazil, MSMEs<sup>17</sup> account for 99.5% of all businesses, 58% of the country's jobs, and 44.3% of the total wage bill.<sup>18</sup> According to data from the Brazilian Ministry of Economy's Annual Social Data Report (RAIS) for the South Region (states of Paraná, Rio Grande do Sul, and Santa Catarina, which are the operational focus of Banco Regional de Desenvolvimento do Extremo Sul (BRDE)), the importance of MSMEs in this territory is greater than the national average: they account for 99.6% of all businesses, 64.8% of all jobs, and 56.9% of the total wage bill<sup>19</sup> in the region (see Table 1).<sup>20</sup>**

**Table 1. Breakdown of businesses in the South Region by size, number of businesses, number of jobs, and wage bill**

Business size	Number of businesses	%	Number of formal jobs	%	Wage bill (in R\$ millions)	%
Microenterprise	702,990	85.0	1,731,606	21.1	5,171,196	17.4
Small business	104,948	12.7	1,989,839	24.2	6,197,451	20.8
Medium-sized enterprise	16,018	1.9	1,607,970	19.5	5,559,604	18.7
<b>MSME</b>	<b>823,956</b>	<b>99.6</b>	<b>5,329,415</b>	<b>64.8</b>	<b>16,928,251</b>	<b>56.9</b>
Large business	3,433	0.4	2,896,337	35.2	12,796,928	43.1
<b>Total</b>	<b>827,389</b>	<b>100</b>	<b>8,225,752</b>	<b>100</b>	<b>29,725,179</b>	<b>100</b>

Source: RAIS (2018).

<sup>16</sup> See: [Bibliography \(optional link 3\)](#).

<sup>17</sup> Based on the MSME classification by number of employees in the RAIS data, which exclude informal enterprises: microenterprises, up to 9 employees; small businesses, between 10 and 49 employees; and medium-sized enterprises, between 50 and 249 employees. The information related to the MSME credit balance is based on the [DataSebrae](#) panel, developed by the Brazilian Micro and Small Enterprise Support Service (SEBRAE) in partnership with the Central Bank of Brazil (BACEN) and taxonomically organized on the basis of the gross operating revenue of the enterprises, as follows: microenterprises, up to R\$360,000; small businesses, between R\$360,000 and R\$4.8 million; and medium-sized enterprises, between R\$4.8 million and R\$300 million.

<sup>18</sup> See: [optional link 2](#).

<sup>19</sup> Microenterprise: up to 9 employees; small business: between 10 and 49 employees; medium-sized enterprise: between 50 and 249 employees, [Anuario Caged dados Rais 2018](#).

<sup>20</sup> For more details on MSMEs' share in the economy in Brazil's South Region, see: [Participação das micro e pequenas empresas na economia brasileira](#) (SEBRAE, 2015) and [Desenvolvimento da Região Sul do Brasil](#) (BNDES, 2014).



- 1.7 Regarding access to finance, the monthly supply of credit to MSMEs in the Brazilian financial system has declined from about R\$742.700 billion (US\$148.500 billion) in 2014 to approximately R\$515.900 billion (US\$103.200 billion) in 2019. The supply of credit for large businesses remained relatively stable at approximately R\$860.000 billion (US\$172.000 billion) over the same period. MSME risk (represented by the delinquency rate), while having diminished in recent years, continues to be practically twice as high as the risk posed by transactions with large businesses in Brazil (see Table 2).

**Table 2. Breakdown of credit balances and delinquencies in the Brazilian financial sector by business size**

Business type	Dec/2014		Jun/2019	
	Balance (R\$ millions)	Delinquency (%)	Balance (R\$ millions)	Delinquency (%)
Microenterprise	58,700	10	47,900	10
Small business	194,000	7.9	139,900	8.3
Medium-sized enterprise	490,000	5.3	328,100	5.9
<b>MSME</b>	<b>742,700</b>	<b>6.35</b>	<b>515,900</b>	<b>6.92</b>
Large business	851,500	2.9	863,500	3.3
<b>Total</b>	<b>1,594,200</b>	<b>4.5</b>	<b>1,379,400</b>	<b>4.64</b>
<b>% MSME</b>	<b>46.6%</b>	<b>N/A</b>	<b>37.4%</b>	<b>N/A</b>

Source: DataSebrae.

- 1.8 In general terms, access to finance for MSMEs in Brazil is an issue. The country's MSMEs suffer from credit rationing, which affects their viability, growth, and ability to boost productivity.<sup>21</sup> This is particularly significant when one considers that MSMEs are inordinately dependent on liquidity as a critical ingredient for survival.<sup>22</sup> Close to half of MSMEs stay in business for only four years, partly due to low productivity and lack of credit.<sup>23</sup> MSMEs largely rely on their own resources and on suppliers as sources of credit. Only 11% of MSMEs report having obtained loans from private-sector banks, while 5% report obtaining loans from credit cooperatives, 11% from public-sector banks, and 3% with microcredit.<sup>24</sup>
- 1.9 This situation tends to become considerably worse in times of crisis such as the present, when MSMEs are perceived as being riskier due to their capital structure and collection cycles (they have shorter maturity cycles and greater guarantee requirements, largely due to lower capitalization levels), and are therefore left more exposed to crisis-driven volatility. This is made clear by observing the path of MSME credit balances in the South Region of Brazil during the country's recent

<sup>21</sup> See: [Demografia das empresas](#) (IBGE, 2017) and [Sobrevivência das empresas no Brasil](#) (SEBRAE, 2016).

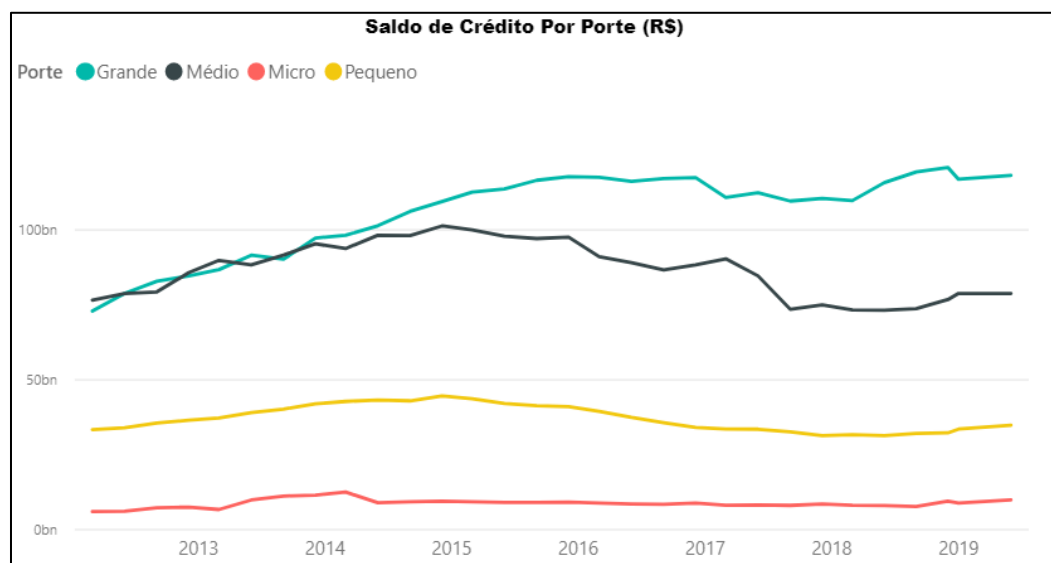
<sup>22</sup> MSMEs have a substantially higher share in credit transactions for working capital purposes. In 2019, MSMEs accounted for 57.8% of the credit balance for working capital in Brazil. See [optional link 2](#).

<sup>23</sup> 47.5% of businesses in Brazil survive after four years of activity, according to the [IBGE](#) (2015).

<sup>24</sup> See: [O financiamento das MIPE no Brasil](#) (SEBRAE, 2017).

(2015-2018) economic recession, which had a particular impact on small and medium-sized enterprises (see Figure 1).<sup>25</sup>

**Figure 1. Path of credit balances in the South Region by business size (2013-2019)**



Source: [DataSebrae](#).

- 1.10 For MSMEs, vulnerable as they are to economic decline, the uncertainty associated with the progress of COVID-19 and described in paragraphs 1.2-1.4 is expected to exacerbate the existing problems in obtaining access to finance, particularly the absence of liquidity sources and alternatives to sustain these businesses amid a drop in their operating revenue.
- 1.11 According to a survey on the impact of COVID-19 on micro and small enterprises (MSEs) in Brazil conducted from April 2020,<sup>26</sup> 58.9% of those surveyed reported having temporarily shut down their business activities, 87.5% indicated that revenue had declined, 18.1% reported a need to cut back on the number of workers, and 54.9% indicated that financing would be required to keep their business operating without any layoffs. However, only 11.3% of the businesses that had sought financing had obtained a loan, while 29.5% were still awaiting a response from the financial institution and 59.2% had had their application denied. In the case of the South Region, 51.8% of businesses indicate that they will need financing to continue to operate without any layoffs, while 64.0% of businesses believe that, if current conditions persist for more than three months, they will not survive.<sup>27</sup> A subsequent survey conducted in early May 2020 by SEBRAE and

<sup>25</sup> Brazil's GDP growth (annual %) was -3.5% in 2015, -3.3% in 2016, 1.06% in 2017, and 1.11% in 2018. See: [World Bank data](#).

<sup>26</sup> See: O impacto da pandemia do coronavírus nos pequenos negócios – Resultados nacionais – Segunda edição (SEBRAE, 2020). The survey covered 6,080 businesses that are representative of a universe of 17.2 small enterprises in all Brazilian states.

<sup>27</sup> Ibid., [Análise por região geográfica](#).

Fundação Getúlio Vargas (FGV) confirmed the continuity of this scenario, at a time when the restrictive measures in Brazil had been in effect for two months. The research shows that despite the emergency economic package announced by the federal government, the situation for MSEs remained critical amid a decline in sales (with 88.9% of the surveyed businesses reporting a drop in monthly revenues) and the near absence of working capital loans to finance expenditures during this period (with 68.1% reporting a need for credit to keep their enterprise afloat without having to resort to layoffs).<sup>28</sup>

- 1.12 The foregoing shows that times of crisis such as the present are characterized by a general dearth of liquidity and funding alternatives. The fast-occurring and sharp imbalance between financing needs and credit availability alters the relative prices of credit and, coupled with higher perceived risk, limits access to finance. When the market fails to respond, the government has to step in with measures that foster and provide liquidity.<sup>29</sup> In this regard, Brazil's National Development Finance System (SNF) is strategically positioned to respond to the COVID-19 crisis. Comprised of a group of public institutions (public development banks, commercial banks with development portfolios, cooperative credit banks, and development agencies), the SNF is devoted to financing priority sectors and activities for development as well as segments of the population and the economy that are unable to satisfy their funding needs in the private financial system.<sup>30</sup> In the South Region, BRDE<sup>31</sup> operates as the regional public development bank. In performing its role, in line with the public policies of the states comprising the South Region,<sup>32</sup> BRDE seeks to promote and carry out actions designed to lead to economic and social progress through planning, technical (institutional and credit) support, and other incentives. BRDE works through credit lines (using its own resources, bank lines, and funds from federal and international agencies) and equity interest in enterprises and investment funds, supporting growth and innovation in businesses in the South Region.<sup>33</sup> In March 2020, BRDE held an active MSME credit portfolio

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<sup>28</sup> See: [Crédito no Brasil para MPES em Tempo de COVID-19](#) (SEBRAE, 2020).

<sup>29</sup> See: [Por qué o crédito secou?](#) (Valor Invest, 2020).

<sup>30</sup> See: [Sistema Nacional de Fomento – Financiando o Desenvolvimento](#) (ABDE, 2018).

<sup>31</sup> BRDE was authorized to operate in 1961, before the enactment of Law 4,595 of 31 December 1964 creating the National Monetary Council and the Central Bank of Brazil. BRDE was founded along with CODESUL under an agreement signed by the States of Rio Grande do Sul, Santa Catarina, and Paraná on 15 June 1961 in the city of Curitiba (Paraná) and approved by the respective Legislative Assemblies, as follows: in the state of Rio Grande do Sul, by Legislative Decree 1,528 of 22 August 1961; in the state of Santa Catarina, by [Lei 744 de 17 de agosto de 1961](#); and in the state of Paraná by [Resolução 7 da Assembleia Legislativa de 17 de agosto de 61](#). Its bylaws were amended over time with BACEN approval. BRDE is considered a public financial-sector enterprise and is part of the indirect administration of all three states, as shown in reports prepared by its legal advisors and delivered to the Bank, thereby confirming its eligibility under the IDB Policy on Eligible Borrowers (Operational Policy OP-301).

<sup>32</sup> The Governments of Rio Grande do Sul, Santa Catarina, and Paraná declared a state of emergency, adopting social distancing measures, shutting down commerce, services, and events, and introducing business support policies (particularly aimed at MSMEs). See: [Medidas dos Governos Estaduais para contenção da COVID-19](#) (FGV/IBRE, 2020).

<sup>33</sup> See: [Carta Anual de Políticas Públicas e Governança Corporativa](#) (BRDE, December 2019).

totaling R\$152.2 million (US\$29.3 million).<sup>34</sup> The sectors it serves are agriculture and livestock (6.6%), industry (39.5%), and trade and services (53.9%). Its (90-day) delinquency rate as of year-end 2019 was 1.11% and thus lower than the average of 4.64% for SNF portfolios in Brazil.<sup>35</sup> BRDE is aware of its position as a development bank and seeks to play a countercyclical role amid the COVID-19 crisis in Brazil's South Region. With its low exposure to market risks, BRDE is able to properly manage its incremental credit risk. In addition, BRDE has adequate capital and liquidity levels for carrying out its duties in a crisis context.

- 1.13 BRDE's actions are particularly important in the current context, for two reasons: first, because the South Region will be one of those hardest hit by the COVID-19 crisis;<sup>36</sup> and second, because this will affect the economic and employment levels in a region of great importance for the national economy. With a Human Development Index exceeding the national average of 0.778 in the states of Paraná, Rio Grande do Sul, and Santa Catarina (respectively 0.792, 0.787, and 0.808),<sup>37</sup> the South Region's GDP has been growing slightly as a share of national GDP. In 2012, the South Region accounted for 16.2% of Brazil's GDP and was ranked as the country's second most important region. In 2017, the region went on to account for 17% of the national GDP.<sup>38</sup> Since 2016, the economy of the South Region has proven to be more resilient than its counterparts in the other regions. The labor market also had a positive performance in 2019 as 143,273 jobs were created amid a recovery in the services and trade sectors.<sup>39</sup> In this context, complementing the actions by the Governments of the States of Paraná, Rio Grande do Sul, and Santa Catarina to safeguard the productive fabric and employment, BRDE is expected to continue to serve the entire MSME segment, under a traditional approach.<sup>40</sup>
- 1.14 **Gender.** Brazil does not have disaggregated gender data sufficiently adequate to provide an understanding of the situation of women-owned or women-led businesses at the national level or by state. Meanwhile, existing information suggests that 12% of businesses owned or led by men face constraints in

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<sup>34</sup> In terms of providing lines of credit for various market segments using its own funds, until 24 March 2020 BRDE only offered financing through investment lines with associated working capital. From that date onward, with the creation of the Recupera Sul line of credit, BRDE shifted its focus to concentrate exclusively on providing working capital finance for businesses located in areas directly or indirectly affected by the COVID-19 pandemic.

<sup>35</sup> See: [Demonstrações Financeiras em 31 de dezembro de 2019](#) and Credit Risk Monitoring and Recovery Report (BRDE, December 2019).

<sup>36</sup> In the two scenarios described in the study by Porsse et al. (2020), [Impactos Econômicos de COVID-19 no Brasil](#), the states of the South Region are among the hardest hit, with a negative impact on GDP exceeding the national average. In the first scenario, in the absence of federal government measures, the projected change in GDP would be -4.92% (Santa Catarina), -4.68% (Rio Grande do Sul), and -4.37% (Paraná), compared to a national average of -3.98%. In the second scenario, with federal government measures, the projected change in GDP would be -4.56% (Santa Catarina), -4.10% (Rio Grande do Sul), and -3.85% (Paraná), compared to a national average of -3.34%.

<sup>37</sup> See: [Radar IDHM: 2012 a 2017](#) (IPEA, 2019).

<sup>38</sup> See: CAGED data, 2019.

<sup>39</sup> See: [Boletim Regional](#) (BCB, Abril 2020).

<sup>40</sup> See: [O BNDES e as micro, pequenas e médias empresas](#) (September 2019) for a discussion on the importance of businesses in Brazil.

obtaining access to credit, compared to 15% of those owned or led by women.<sup>41</sup> While there is no available information to determine the financing gap confronting women-owned or women-led small and medium-sized enterprises (SMEs) in the South Region, nationwide data suggest that this gap is on the order of US\$15 billion.<sup>42</sup>

- 1.15 **Challenges and progress.** This scenario, aggravated by the health crisis, jeopardizes the short-term financial sustainability of MSMEs in the South Region. To safeguard the productive fabric affected by the economic difficulties associated with the COVID-19 crisis, the challenge is to keep afloat the largest possible number of MSMEs that were commercially viable before the crisis so as to enable them to continue to operate normally.
- 1.16 For MSMEs, as indicated above, operating conditions tend to be stricter, and the risks assumed by financial institutions are greater than in credit transactions with large businesses. Without working capital, MSMEs are unable to operate; thus, there is a close relationship between working capital and their survival. MSMEs are important job creators, favoring social inclusion. In addition, MSMEs tend to represent access to the job market for vulnerable segments of the population, who, lacking the academic skills generally required by larger companies, would otherwise be unable to find employment.<sup>43</sup> For these reasons, Brazil is in the process of implementing immediate measures to alleviate this problem, requiring greater fiscal effort and increased liquidity (through an expansion of the monetary base, financial assistance to MSMEs for payroll payments, and flexibility in the prudential regulation of the largest financial institutions to boost the operating leverage of large private- and public-sector federal banks), as well as risk taking (specifically through repo transactions and an expansion of guarantees).<sup>44</sup>
- 1.17 However, the existence of intrinsic failures in the functioning of the financial sector (such as market concentration)<sup>45</sup> heightens the need to promote the availability of credit in sectors with high positive externality for the economy. In this regard, public development banks in Brazil have made significant contributions toward reducing the financing gaps for MSMEs. Furthermore, they play an important countercyclical role in response to financial crises by supporting investment and mobilizing financial resources in times of recession, helping governments find the path to economic recovery. Despite having a small share of total credit in the financial

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<sup>41</sup> [MSME Finance Gap](#) (World Bank, 2018).

<sup>42</sup> See: [DataSebrae Crédito](#) and [Empreendedorismo Feminino](#) (SEBRAE, 2020).

<sup>43</sup> See: [Las PYMES: Antídoto Contra la Pobreza](#) (Cámara Argentina de Comercio y Servicios [Argentine Chamber of Commerce and Services], 2018).

<sup>44</sup> See: [Brazil's Policy Responses to COVID-19](#) (Ministry of Economy, 14 April 2020).

<sup>45</sup> The system is highly concentrated, with the five largest banking institutions (RC5) accounting for 79.5% of total assets, 82.9% of total deposits, and 82.2% of total credit transactions in the country (BACEN, 2019). This high concentration in the financial system tends to lead to more expensive interest rates as a result of limited competition. It has also been argued that, given the positive relationship between concentration and bank fragility, increased competition reduces a country's likelihood of suffering a systemic banking crisis. See: Boyd and De Nicolo, The theory of bank risk taking and competition revisited, 2005.

sector,<sup>46</sup> subnational public development banks controlled by Brazilian states (such as BRDE<sup>47</sup> in Brazil's South Region) are an essential conduit for enabling the resources available for loan transactions in the financial sector to effectively reach local MSMEs, particularly in times of crisis.

- 1.18 **Proposed intervention.** As shown above, MSMEs have significant financing needs during this crisis, especially to ensure their immediate survival, posing a challenge to the financial sector in Brazil. In response to these needs, the proposed intervention focuses on providing support in the form of financial mechanisms designed to stimulate the supply of short-term credit liquidity for MSMEs through a global credit program with BRDE. The program seeks to reduce the constraints on access to credit faced by MSMEs affected by the COVID-19 crisis, thus supporting their survival and preserving employment. This, in turn, will minimize the burden on social protection systems and maximize the speed of economic recovery once the health emergency has passed. A partnership with BRDE is both necessary and strategically significant, for two reasons: through regional alliances, BRDE has a presence in the entire South Region; and the countercyclical nature of the response requires a greater appetite for risk than is accepted by the private-sector financial system. With this intervention, BRDE is expected to help preserve productive activity in the South Region as well as part of the employment created by MSMEs. Considering BRDE's track record and the requirements established in this program, loan operations will be financed from US\$5,000 up to US\$1 million per enterprise.
- 1.19 Thus, the aim is to complement the government's efforts through a program focused on providing access to finance for MSMEs in the South Region by channeling resources through BRDE. The actions of BRDE are in line with the credit policies and other measures adopted at the national level, as well as regionally by the governments of Paraná, Rio Grande do Sul, and Santa Catarina.<sup>48</sup>
- 1.20 **Size of the operation.** In general, providing liquidity and supporting improved access to credit have been the policies most frequently adopted by governments in Latin America and the Caribbean to support the productive structure and avoid layoffs and the shuttering of businesses. These policies include greater allocations of public resources to credit lines, extended grace periods, and preferential terms

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<sup>46</sup> According to data from the Central Bank of Brazil, the public sector continues to account for most credit transactions in the financial sector involving the three aforementioned segments (about 49% of credit balances in the financial sector). This is particularly due to the performance of two large financial institutions: Banco do Brasil and Caixa Econômica Federal. However, State-owned financial institutions (State development banks such as BRDE and development finance agencies) only account for 1.1% of total credit transactions conducted by the public-sector financial system. See: [Estatísticas Monetárias e de Crédito do Banco Central do Brasil](#).

<sup>47</sup> Subnational institutions with development mandates which, aside from their own resources, may only use resources from government funds and programs; federal, state, or municipal budgets; and national and international development agencies and financial institutions.

<sup>48</sup> The state governments declared a state of emergency, which was soon raised to a state of disaster, and established committees to confront the crisis. They also extended the due dates for the imposto sobre a circulação de mercadorias e serviços [value added tax] (ICMS). In addition, the complementarity is embodied in the way BRDE operates, since it is a major onlender of financing from federal programs, such that its direct operations cover amounts, and consequently risks, that are on average differentiated from its onlending programs.



for productive investment, particularly for SMEs. Although most of the resources have been devoted to the creation of credit mechanisms, the measures identified in some cases are still considered insufficient, given the magnitude of the problem. In Brazil, the resources allocated to measures associated with the granting of credit in response to the COVID-19 crisis represent about 3.9% of GDP, below that of other economies in the region (Chile: 11.4%; Colombia: 8.0%; and Peru: 7.6%).<sup>49</sup>

- 1.21 The participation of public development banks has been significant in this regard, since they normally have the ability to assume comparatively greater risks than commercial banks, especially for MSMEs. Traditionally, public development banks have played a crucial countercyclical role in response to global financial crises, helping to support investment and mobilize financial resources in times of recession, helping governments with economic recovery.<sup>50</sup> In this context, BRDE created a new credit line product for MSMEs, the Programa emergencial de crédito para recuperação da economia da Região Sul [Emergency credit program for economic recovery of the South Region] (Recupera Sul). This program is solely aimed at financing working capital for businesses directly or indirectly affected by the COVID-19 pandemic in the states of Paraná, Rio Grande do Sul, and Santa Catarina.<sup>51</sup> Based on its operating capacity, BRDE expects to be able to address a demand for short-term working capital finance of about R\$1.250 billion (approximately US\$250 million). To this end, it will have access to R\$1.000 billion (US\$200 million) in resources from various funding sources and its own capital, with the difference of R\$250 million (US\$50 million) to be provided by the Bank. In the first months of operation of Recupera Sul, BRDE received R\$1.500 billion (US\$300 million) in requests for working capital finance, confirming the high demand level and the suitability of the financial solution being offered to MSMEs.
- 1.22 This program's resources will help increase BRDE's capacity to assume its critical role of providing timely, ongoing access to credit, with longer repayment terms, higher amounts and levels of risk, which complement the programs provided by the federal government. Thus, the program seeks to help alleviate the impact of the reduced revenue for companies caused by the decline in demand, promoting the activity necessary for a rapid recovery in the most vulnerable sectors.
- 1.23 **Program targeting.** The proposed program adopts a multisector approach designed to respond to demand and serve MSMEs in all sectors targeted by BRDE's productive portfolio through the credit line Recupera Sul.<sup>52</sup> The need is imminently expected to be relatively greater in the industrial and trade and services sectors, considering the history of MSME private demand for BRDE working capital lines<sup>53</sup> and the importance of these sectors, described in paragraph 1.13,

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<sup>49</sup> ECLAC, "Sectors and Businesses Facing COVID-19: Emergency and Reactivation," July 2020.

<sup>50</sup> ECLAC, "Sectors and Businesses Facing COVID-19: Emergency and Reactivation," July 2020.

<sup>51</sup> In accordance with BRDE Internal Resolution 2615, approved on 24 March 2020. Previously, BRDE provided working capital finance for MSMEs through investment projects with associated working capital in the proportion required by the investment project (typically between 10% and 30%).

<sup>52</sup> Or through the credit line that replaces it, through the IDB's prior approval.

<sup>53</sup> 2019 approvals of working capital for MSMEs by sector: agriculture (6.7%), industry (39.5%), and trade and services (53.8%).

which have been clearly affected by the liquidity crisis as shown by the vulnerability analysis set out in [optional link 5](#) for Brazil and in [optional link 6](#) for the country's South Region. Thus, the program combines catering to the most vulnerable MSMEs and sectors with flexible execution to adapt to the uncertainty over how COVID-19 will progress.

- 1.24 **The Bank's experience.** The Bank has extensive experience in designing sovereign guaranteed loan programs aimed at improving MSME access to finance through financial intermediaries. These programs have been implemented both in times of economic expansion, when support focuses on access to long-term finance for production-oriented investments, and in times of economic recession, when support focuses on ensuring that MSMEs do not lose access to liquidity to continue their economic activity. In the last financial crisis confronted by the region in 2007, the Bank played a countercyclical role by expanding the amount of financing and facilities used to address the lack of access to credit faced by the region's MSMEs. For example, liquidity programs were approved in 2008 and 2009 to sustain economic growth.<sup>54</sup> These programs were aimed at restoring access to working capital and foreign trade finance for productive sectors and thus partially and temporarily offsetting the insufficient financing flows to MSMEs brought about by the global financial crisis. In the period following the crisis (2009-2013), with a similar aim of stimulating the supply of credit to finance productive sectors, the Bank approved contingent credit lines<sup>55</sup> to provide liquidity to the financial system as well as multisector global credit programs and, for the most part, specific productive financing programs for MSMEs.
- 1.25 In Brazil, the Bank has supported multisector interventions aimed at MSME capital investments and productivity increases, including program [2236/OC-BR](#) and, more recently, operation [4672/OC-BR](#) with Banco Nacional de Desenvolvimento Econômico e Social (BNDES). In 2014, the Bank's Office of Evaluation and Oversight (OVE) published the results of an empirical analysis of the various programs launched by the Bank to support MSMEs in Brazil.<sup>56</sup> The various interventions analyzed show that credit support is the only type of support that significantly affects all outcome variables and that its most positive impact is on employment and compensation. In addition, several studies<sup>57</sup> have confirmed that MSME access to public lines of credit in Brazil has a significant positive effect on the employment levels and gross revenues of these businesses.

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<sup>54</sup> In 2008, the IDB created the Liquidity Program for Growth Sustainability (document GN-2492-1) under the category of emergency lending.

<sup>55</sup> Development Sustainability Contingent Credit Line under the Proposal to Establish Contingent Lending Instruments of the IDB (document GN-2667-2).

<sup>56</sup> Uma Análise Comparativa das abordagens do BID no Apoio às PMEs: Analisando Resultados no Setor Industrial Brasileiro, IDB, Washington, 2014. This analysis defines MSMEs as businesses with 1 to 250 employees. It covers programs implemented in Brazil between 2003 and 2012. The methodology used was a fixed effects model combined with propensity score matching techniques, applying a difference-in-difference estimate to show robustness.

<sup>57</sup> De Negri, J., A. Maffioli, C. Rodriguez, y G. Vazquez, The impact of public credit programs on Brazilian firms. IDB Working Paper Series 293. Washington, DC, 2011; Machado, L., M. Parreiras, and V. Peçanha. Avaliação de impacto do uso do Cartão BNDES sobre o emprego formal nas firmas de menor porte, BNDES, Brazil, 2011; Albuquerque, B. et al. Uma solução automatizada para avaliações quantitativas de impacto: primeiros resultados do MARVIM, BNDES, Brazil, 2017.



- 1.26 **Lessons learned.** The Bank has gathered extensive experience and generated substantial knowledge regarding the design and implementation of MSME finance policies with a special focus on certain sectors or value chains. For these public policy solutions to be effective, it is critical to: (i) identify the market failure to be remedied; (ii) strengthen collaboration among public stakeholders with authority on this issue; (iii) strengthen collaboration between the public and private sectors, since the latter can help to identify solutions to problems; (iv) focus the interventions on overcoming the identified obstacles; (v) identify the instrument or set of instruments that can be deployed in each situation; and (vi) combine the most cost-effective instruments for each situation.
- 1.27 The IDB also has relevant experience in designing solutions to mitigate problems of access to finance faced by MSMEs. The following lessons have been learned from these actions: (i) leverage the countercyclical role of this type of operations in times of tightening credit; (ii) target resources toward segments where lending will have greatest impact on the functioning of the economy (logistics chains) and the well-being of society (the most vulnerable productive sectors); (iii) supervise the financial terms on which the resources are allocated to end-users, to avoid market distortions and ensure that there is no dilution of additionality; (iv) guarantee that the executing agency's institutional capacity is sufficient to operationalize the intervention and to evaluate and monitor the subloans and guarantees issued; and (v) systematically compile, manage, and maintain program data so that the results can be analyzed and continue to be used in future interventions.<sup>58</sup>
- 1.28 Based on this experience, particularly the Bank's prior work designing and executing multisector credit programs with BNDES (paragraph 1.22), the design of this program incorporates the following lessons learned: (i) properly supervise the financial terms on which the resources are allocated to end-users, to avoid market distortions and ensure the intervention's additionality; (ii) support the institutional capacity of BRDE to evaluate and monitor the subloans, introducing risk management practices; (iii) establish relationships with the staff responsible for program activities, so that they commit to using the resources in a way designed to ensure high quality in program execution; (iv) foster the use of a formal monitoring and evaluation system to develop local capacity and an understanding of the importance of accountability; and (v) systematically compile, manage, and maintain program data so that the results can be analyzed and used in future interventions. The possibility of strengthening BRDE's institutional capacity in these areas through IDB technical cooperation resources is a significant nonfinancial additionality of this operation.
- 1.29 **Coordination with other Bank projects.** The program coordinates efforts with various supports, such as: (i) the immediate public health response; (ii) strengthening of fiscal policy and management; and (iii) safety nets for vulnerable populations. In addition, it coordinates efforts with other projects that will very soon go into execution in Brazil ([4672/OC-BR](#) and [5115/OC-BR](#)) and will play an essential role in addressing needs arising from the pandemic. This coordination

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<sup>58</sup> Section IV of the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7) discusses a more extensive and detailed set of lessons learned from the Bank's experience in the sector, as well as the experience of other multilaterals, academic researchers, and other major stakeholders in public policy design to support MSMEs.

will take place through the exchange of information, good practices, and topics related to the collection of data on gender and the evaluation of results and impacts. Technical cooperation operation [ATN/OC-18036-RG](#), which is aimed at supporting the response of other Latin American and Caribbean countries to the economic shock caused by the COVID-19 pandemic, will also be critical to the implementation of this program (paragraphs 1.32 and 2.7). Furthermore, the program is coordinating efforts with IDB Invest, which has been addressing MSME financing requirements together with private financial institutions in Brazil, particularly through operations [12948-02](#), [12979-01](#), [11843-02](#), and [12433-01](#). This coordination seeks to leverage synergies so as to boost the impact of the Bank's interventions, consistent with fiscal sustainability, through: (i) temporary application of the measures, to control their short-term impact on public finance; and (ii) support for the MSMEs' financial conditions, to cushion financing costs and maintain employment, contributing to a recovery in tax revenue collection.

- 1.30 **Coordination with other donors.** In addition to coordination on the issue of gender (paragraph 1.32), work will be done on complementarity in public investments and financing for working capital for local MSMEs with international financial institutions that have recently provided financing to BRDE (World Bank, Agence Française de Développement (AFD), and the Andean Development Corporation (CAF)), to ensure the approach of the efforts to benefit the economic recovery of Brazil's South Region.
- 1.31 **Strategic alignment.** The program is consistent with the second Update to the Institutional Strategy (document AB-3190-2) and aligned with the challenges of: (i) social inclusion and equality, through an approach that combines support for MSMEs and for the most vulnerable sectors (paragraphs 1.18, 1.20, and 1.22); and (ii) productivity and innovation, through its support for productive financing for MSMEs. The program will contribute to the Corporate Results Framework 2020-2023 (document GN-2727-12) through the indicator of the number of MSMEs financed. The program is consistent with the Proposal for the IDB Group's Governance Response to the COVID-19 Pandemic Outbreak (document GN-2996), as part of the support for safeguarding the productive fabric and employment. It is also consistent with the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7), which emphasizes the importance of promoting access to finance by the productive sector. Lastly, the operation is included in the Update of Annex III of the 2020 Operational Program Report (document GN-2991-3).
- 1.32 **Gender considerations.** With a view to addressing the systematic absence of relevant data, the Bank will support BRDE using resources from technical cooperation operation [ATN/OC-18036-RG](#). Among other objectives, this operation will support the gathering and monitoring of gender-disaggregated data on business owners or leaders, in accordance with best practices, so as to generate databases, develop baselines, and support the design of new financial products that address the specific problems faced by women entrepreneurs. This action will be coordinated with similar efforts under another operation currently in preparation with BRDE and with other donors and public development banks in order to

generate specific outcomes for both BRDE and public development banks in Brazil.<sup>59</sup>

## **B. Objectives, components, and cost**

- 1.33 **Objectives.** The overall objective of the program is to support the sustainability of MSMEs as employment providers in the states of Brazil's South Region amid the COVID-19 crisis. The specific objective is to support the short-term financial sustainability of MSMEs located in the South Region of Brazil.
- 1.34 **Single component. Support for improvement of short-term financial capacity (US\$50 million).** The resources of this component will be used to help MSMEs affected by the COVID-19 crisis (paragraph 1.23) to overcome temporary liquidity problems and continue to operate. This multisector component calls for providing liquidity to MSMEs by means of working capital financing (subloans) provided by BRDE through the Recupera Sul line of credit.<sup>60</sup>
- 1.35 **Beneficiaries.** Resources under this intervention will be directed to MSMEs affected by the COVID-19 crisis. To be eligible, a beneficiary needs to be an MSME according to the definition used by BRDE (see paragraph 1.6). The loan proceeds will be used to finance working capital under the Recupera Sul line offered by BRDE. The specific eligibility criteria will be described in detail in the [program Operating Regulations](#) and are summarized below in paragraph 3.5. Based on the information available on the sector and the preliminary analysis conducted by BRDE, the minimum number of beneficiary MSMEs is estimated at 112. This analysis is based on a portfolio distribution by size of enterprise in which the share of medium-sized enterprises exceeds 31% (with 40.5% microenterprises and 28.5% small enterprises), which brings the average credit for the indicative portfolio up. Meanwhile, medium-sized enterprises are those with the highest average number of employees (over 100, compared to 3 and 19 for the micro and small enterprises, respectively), and they have potential linkage effects since they associate with a larger number of other enterprises and are the hardest hit recently by the reduced access to credit (paragraph 1.9). Therefore, if a high share of medium-sized enterprises is maintained in the portfolio, the impact in terms of jobs saved and income of companies that survive thanks to the program remains relevant and consistent with the expected support for the most vulnerable sectors (paragraphs 1.22 and 1.31).<sup>61</sup>

## **C. Key results indicators**

- 1.36 **Expected outcomes.** The program's expected impact is to support the sustainability of MSMEs amid the COVID-19 crisis, as measured by the

<sup>59</sup> The IDB's Gender and Diversity Division has been working with BRDE since 2019, and the work planned in the technical cooperation operation will coordinate these efforts. A dialogue is also under way with the initiative that the Embassy of the United Kingdom is undertaking to bring the Women in Finance Charter to Brazil in the framework of the Green Finance Prosperity Fund Programme.

<sup>60</sup> If the Recupera Sul line is replaced by another in the future, BRDE will obtain the Bank's prior approval.

<sup>61</sup> It should be noted that since this programs was designed to be demand-driven: (i) the average value of the loan and the number of resulting beneficiaries are indicative and, while based on real, historical BRDE portfolio data, conservative assumptions have been made; and (ii) BRDE's operating track record is strongly aligned with the most vulnerable sectors.

percentage of formal employment created by MSMEs in the region (states of Paraná, Rio Grande do Sul, and Santa Catarina) in relation to total employment in the region. The outcome indicators associated with the specific program objective will be as follows: (i) delinquency rate of the MSME working capital finance portfolio 6 and 12 months after the start of the program relative to BRDE's overall delinquency rate; and (ii) total MSME working capital finance portfolio amount achieved due to the program's support.

- 1.37 **Economic viability.** The economic evaluation identifies the flows of benefits and costs generated by the program. The benefits consist of the economic value of the higher rate of business survival, as reflected principally by the value of the jobs saved as a result of the program. Calculations of the aforementioned flows (discounted at a rate of 12%) yield benefits of US\$11.3 million and an internal rate of return of 20.7%. Furthermore, the sensitivity analysis shows that the program's net present value is robust to variations in key parameters such as the rate of survival of businesses or the impact on sales ([optional link 1](#)).

## II. FINANCING STRUCTURE AND MAIN RISKS

### A. Financing instruments

- 2.1 The total amount of the proposed program will be US\$50 million from the Ordinary Capital resources. The operation will be structured as a global credit loan, since it involves financial intermediation to the beneficiary MSMEs in the South Region of Brazil. The disbursement period will be up to two years, considering BRDE's operating capacity to meet the projected demand and the need to allow its MSME portfolio to grow at a prudent rate.<sup>62</sup>

**Table 3. Estimated program costs (US\$ millions)<sup>63</sup>**

Component	IDB (total)	%
Single component. Support for improvement of short-term financial capacity	50.0	100
<b>Total</b>	<b>50.0</b>	<b>100</b>

**Table 4. Disbursement schedule (US\$ millions)**

Source	Year 1	Year 2	Total
IDB	30.0	20.0	50.0
<b>Total</b>	<b>30.0</b>	<b>20.0</b>	<b>50.0</b>
<b>%</b>	<b>60</b>	<b>40</b>	<b>100</b>

<sup>62</sup> BRDE is expected to submit partial disbursement requests to the Bank every six months. The number and frequency of disbursement requests to be submitted to the Bank will depend on the actual MSME demand and on the BRDE's analysis of the subloans best suited to be included in each portfolio of disbursement requests. The amortization period for this program was made compatible with BRDE's need to minimize the risk of cost and maturity mismatches of its assets and liabilities.

<sup>63</sup> The program's administration, evaluation, and audit costs will be covered using BRDE administrative resources as part of the institution's normal operations.

## **B. Environmental and social risks**

- 2.2 In accordance with directive B.13 of the Environment and Safeguards Compliance Policy (Operational Policy OP-703), this operation cannot be classified ex ante, since it involves financial intermediation. The environmental and social due diligence was performed in compliance with directive B.13, analyzing the program's potential socioenvironmental risks, the applicable regulatory framework, and the executing agency's ability to manage such risks. Based on the due diligence findings, and given the low risk profile of the eligible financing with program resources, this operation is regarded as medium risk. By reason of its size (estimated average of about US\$445,000 per MSME subloan) and nature (short-term support for working capital only), the financing will be classified as category "C." Loans in categories "A" and "B" will be ineligible for financing.
- 2.3 Resources from the subloans will not be used to finance any activities in the program's exclusion list, which includes the following: (i) activities/sectors that involve high socioenvironmental risk; and (ii) activities that entail: (a) involuntary physical or economic resettlement; (b) negative impact on indigenous groups; (c) potential damage to cultural sites or critical cultural sites, (d) negative impact on protected areas or Ramsar convention sites, or (e) the use of invasive species.
- 2.4 The requirements for managing and mitigating potential environmental and social impacts will be consolidated into an environmental and social risk management system that will be part of the program Operating Regulations, the approval of which is a condition precedent to the first disbursement (see environmental and social management report ([ESMR](#))).

## **C. Fiduciary risks**

- 2.5 The institutional capacity assessment of BRDE shows that it satisfies the necessary conditions to perform fiduciary management activities for the loan operation. Since BRDE is a regulated financial institution, the fiduciary risk has been determined to be low. An evaluation conducted through the Institutional Capacity Assessment Platform (ICAP) did not identify any financial management weaknesses at BRDE.

## **D. Other key risks and issues**

- 2.6 **Development risk.** There is a medium risk that the resources will be insufficient to meet the demand for MSME finance. To mitigate this risk, the Bank has designed the intervention to yield the maximum possible impact and has sought to coordinate with all relevant stakeholders, to ensure that the response is commensurate with MSME financing needs.
- 2.7 **Public management and governance risks.** There is a medium risk that implementation of the measures included in this program will be delayed as a result of the emergency priorities managed by the government, so the resources might not reach the beneficiary MSMEs in a timely manner. To mitigate this risk, the Bank has designed the program to expedite approval processing and execute rapidly, highlighting the dialogue with the counterpart by moving forward with the preparation of the program's [Operating Regulations](#) for approval, which will accelerate the start of execution. Since this is the first operation with the Bank, as

identified in the institutional capacity assessment on BRDE, technical cooperation resources may be provided to assist in program execution and monitoring.<sup>64</sup>

- 2.8 **Fiscal sustainability risk.** There is a medium risk that the combination of the health and economic crisis and external factors, such as the falling price of commodities, will significantly affect the fiscal and debt position of the South Region states and the country as a whole, jeopardizing fiscal sustainability. To mitigate this risk, the Bank, together with other international agencies, is supporting Brazil's postpandemic economic and fiscal recovery plans, which should enable the country to return to a sustainable path in terms of public finance.
- 2.9 **Sustainability.** The program is expected to contribute to easing the temporary difficulties faced by MSMEs as a consequence of the COVID-19 pandemic. Nonetheless, it offers the country, and specifically the states of Paraná, Santa Catarina, and Rio Grande do Sul, the opportunity to leave support mechanisms in place for future emergencies. The demonstration effect of the interventions is expected to enable preventive programs to be developed that reduce MSME vulnerability.

### III. IMPLEMENTATION AND MANAGEMENT PLAN

#### A. Summary of implementation arrangements

- 3.1 **Borrower and executing agency.** The borrower and executing agency in this operation will be BRDE. The Federative Republic of Brazil will be the guarantor of the borrower's financial obligations arising from the loan contract, including the payment of principal, interest, and other fees. BRDE will be responsible for the administration, execution, control, and monitoring of resources under the operation.
- 3.2 **Execution and administration.** BRDE will have fiduciary responsibility over the program resources and will perform the following duties: (i) make disbursements to eligible MSMEs to fulfill the objectives of the program in accordance with the provisions of the loan contract and the program Operating Regulations; (ii) manage the program resources through a dedicated account; (iii) prepare execution and physical/financial progress reports for the IDB; (iv) monitor compliance with the loan contract and the program Operating Regulations;<sup>65</sup> and (v) conduct program monitoring and evaluation.
- 3.3 BRDE will create a project execution unit (PEU) to manage the program and ensure proper compliance with the loan contract and the [program Operating Regulations](#). BRDE will implement the program through the PEU, based on its current organic structure. The PEU will be responsible for supervising proper use of the program's financial resources and providing in timely fashion the human and technical resources required to implement the program. The PEU will report to BRDE's Planning and Sustainability Superintendency and will coordinate with the

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<sup>64</sup> The proceeds of technical cooperation operation Support for safeguarding the productive fabric and employment in Latin America and the Caribbean in response to the economic shock caused by the COVID-19 pandemic ([ATN/OC-18036-RG](#)) are expected to be available in 2020.

<sup>65</sup> Including compliance with environmental and social safeguards and the provisions on prohibited practices.



New Business Department. Members of the Credit and Control Superintendency and the Risk and Compliance Superintendency will be part of the PEU.

- 3.4 The program Operating Regulations, agreed upon by the Bank and BRDE, will establish the provisions that will govern program execution and the eligibility of MSMEs for financing with program resources, in accordance with the policies and procedures of both institutions. For institutional information on BRDE, see [optional link 9](#).
- 3.5 **Implementation considerations.** Using resourcesw from the global credit program, BRDE will provide credit for working capital to eligible MSMEs through subloans under the Recupera Sul line offered by BRDE. To be eligible, MSMEs will be asked to meet the following requirements: (i) be a business organized under the laws of Brazil; (ii) possess the proper licenses and permits to operate under the laws of Brazil; (iii) fulfill the requirements for qualifying as MSMEs under the criteria used by BRDE; (iv) be solvent and creditworthy and satisfy the BRDE's credit requirements, with the exception of any factor that has deteriorated as a result of the COVID-19 crisis; and (v) operate in the South Region of Brazil. Projects with environmental and social risks classified under categories "A" or "B" will not be eligible for financing. No single subloan to an MSME may exceed US\$1 million (approximately R\$5.35 million).
- 3.6 **Program Operating Regulations.** The execution of the program will be governed by the provisions of the loan contract and the [program Operating Regulations](#), which will include: (i) the specific procedures, conditions, and requirements regarding the use of program resources and financial management of the program; (ii) the technical, regulatory, and financial criteria for obtaining subloans; (iii) the disbursement arrangements; (iv) the eligibility criteria for MSMEs; (v) the monitoring and evaluation requirements; (vi) the structure of the PEU and a list of its responsibilities; (vii) environmental and social considerations of the program. Considering the periods for the use of program resources, the version of the [program Operating Regulations](#) agreed upon with BRDE is attached.
- 3.7 **Special contractual conditions precedent to the first disbursement of the loan proceeds: The first disbursement of the loan proceeds will be contingent upon the approval and entry into force of the [program Operating Regulations](#), under the terms previously agreed upon with the Bank.** This condition is essential to establishing the structure, guidelines, and procedures to be followed by the executing agency for successful execution of the program.
- 3.8 **Exceptions to Bank policies.** The Board of Executive Directors is asked to approve a partial exception to the Bank's Policy on Guarantees Required from the Borrower (Operational Policy OP-303), so as to exempt the States of Paraná, Santa Catarina, and Rio Grande do Sul from guaranteeing performance and any local counterpart obligations as required under paragraph 3.4.2 (b) of the aforementioned policy. The Federative Republic of Brazil will be the guarantor of the financial obligations of the loan, including interest and fees, as required under paragraph 3.4.2 (a) of OP-303. There are precedents for this request in terms of operations with similar execution arrangements in the region.<sup>66</sup> In addition to the

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<sup>66</sup> [2120/OC-CO](#).

financial soundness and ample capacity to contribute a local counterpart during the program's execution period.<sup>67</sup> BRDE, which has its own assets and administrative, technical, and financial autonomy, has the necessary legal stability to implement the program's activities. In addition, it has satisfactorily executed resources from public funds and second-tier public development banks in Brazil, such as BNDES and Financiadora de Estudos e Projetos (FINEP) (both of which are borrowers and executing agencies under IDB programs). BRDE has recently approved loan operations with the World Bank, AFD, and CAF, thus supporting its institutional capacity.

- 3.9 **Retroactive financing.** The Bank may retroactively finance, as a charge against the proceeds of the loan, up to US\$10 million (20% of the loan amount) in disbursements made by the borrower to eligible MSMEs for subloans issued prior to the loan approval date, provided that requirements substantially similar to those established in the loan contract have been fulfilled. Such expenses will have been incurred on or after 24 March 2020, the date of BRDE approval of the use of its own resources for Recupera Sul.<sup>68</sup> Even though this predates the project officially entering the pipeline (document GN-2259-1), and considering the demand for financing already received by BRDE (paragraph 1.21), authorization of retroactive financing on an exceptional basis is justified as of that date, given the exceptional circumstances surrounding the global health emergency.
- 3.10 **Procurement and contracting.** As a demand-driven financial intermediation program, no procurement of goods, works, nonconsulting services, or consulting services is expected to be required as part of execution. No project execution plan or procurement plan is therefore included in this proposal. Any procurement of nonconsulting or consulting services required as part of program administration and/or evaluation will be conducted in accordance with the Policies for the Procurement of Goods and Works Financed by the IDB (document GN-2349-15) and the Policies for the Selection and Contracting of Consultants Financed by the IDB (document GN-2350-15), or as subsequently updated. For additional details, see the Fiduciary Agreements and Requirements (Annex III).
- 3.11 **Disbursements.** Resources for the program will be disbursed by the IDB to BRDE in the form of advances of funds and/or reimbursements, as established in the Financial Management Guidelines for IDB-financed Projects (document OP-273-12) or current IDB policies. Disbursements will be subject to ex post verification. In all cases, before proceeding to the disbursements, the subloan portfolio to be recognized in the program will be subject to an IDB review.<sup>69</sup>
- 3.12 **Financial statements and audit.** The executing agency will deliver audited annual financial statements for the program in accordance with the terms of reference agreed upon with the Bank, within 120 days after the close of each fiscal year or

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<sup>67</sup> BRDE is subject to oversight by the Central Bank of Brazil with the same rigor as any other financial institution operating in Brazil.

<sup>68</sup> BRDE Resolution 2615, 24 March 2020.

<sup>69</sup> BRDE is expected to submit partial disbursement requests to the Bank every six months. The number and frequency of disbursement requests to be submitted to the Bank will depend on the actual MSME demand and on the BRDE's analysis of the subloans best suited to be included in each portfolio of disbursement requests.



after the date of the last disbursement. Audits will be performed by the Tribunal de Contas [State Audit Office] of the State of Rio Grande do Sul or by a Bank-eligible external audit firm under the procedures established in the current audit guidelines.<sup>70</sup>

**B. Arrangements for results monitoring**

- 3.13 **Monitoring.** Program execution will be monitored via semiannual progress reports prepared by the executing agency and delivered within 60 days after the close of each six-month period, and a final report to be delivered no later than six months after the conclusion of the loan disbursement period. The reports will be based on the reporting commitments included in the Results Matrix, as well as compliance with the Bank's eligibility and supervision criteria set out in the [program Operating Regulations](#) (see [monitoring and evaluation plan](#)). These reports will be reflected in the progress monitoring reports (PMRs).
- 3.14 **Evaluation.** The strategy for evaluating program results will adopt two approaches: (i) a reflexive evaluation, before and after the program, to determine the extent of outcomes and impacts; and (ii) an ex post cost-benefit analysis of the flows of benefits and costs generated by the program, following a similar methodology to the one used for the ex ante cost-benefit analysis. In addition, the final program evaluation will include a qualitative analysis that discusses the lessons learned during the execution of the program. The evaluation strategy is described in the monitoring and evaluation plan.
- 3.15 **Information for program monitoring and evaluation.** The executing agency will be responsible for maintaining data gathering and monitoring systems (see [monitoring and evaluation plan](#)). The executing agency will commit to maintain a program monitoring and evaluation system, which it will use to prepare the reports and data delivered to the Bank. For purposes of the evaluation, the executing agency will compile, store, and safeguard all information, indicators, and parameters necessary to prepare the project completion report, including annual plans and the final evaluation. The executing agency will bear the costs of evaluation and monitoring in all cases. The additional information required for the evaluation process will be drawn from national and international secondary sources of statistical data and, potentially, reports of relevant organizations.

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<sup>70</sup> Audit costs will be financed with BRDE administrative resources.

Development Effectiveness Matrix		
Summary		BR-L1555
I. Corporate and Country Priorities		
1. IDB Group Strategic Priorities and CRF Indicators		
Development Challenges & Cross-cutting Themes	-Social Inclusion and Equality -Productivity and Innovation	
CRF Level 2 Indicators: IDB Group Contributions to Development Results	-Micro / small / medium enterprises financed (#)	
2. Country Development Objectives		
Country Strategy Results Matrix		
Country Program Results Matrix	GN-2991-3	The intervention is included in the 2020 Operational Program.
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		See paragraphs 1.16 to 1.19 of the main document
II. Development Outcomes - Evaluability		
		Evaluable
3. Evidence-based Assessment & Solution		9.0
3.1 Program Diagnosis		2.4
3.2 Proposed Interventions or Solutions		3.6
3.3 Results Matrix Quality		3.0
4. Ex ante Economic Analysis		8.0
4.1 Program has an ERR/NPV, or key outcomes identified for CEA		3.0
4.2 Identified and Quantified Benefits and Costs		3.0
4.3 Reasonable Assumptions		1.0
4.4 Sensitivity Analysis		0.0
4.5 Consistency with results matrix		1.0
5. Monitoring and Evaluation		7.0
5.1 Monitoring Mechanisms		2.5
5.2 Evaluation Plan		4.5
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood		Low
Identified risks have been rated for magnitude and likelihood		Yes
Mitigation measures have been identified for major risks		Yes
Mitigation measures have indicators for tracking their implementation		Yes
Environmental & social risk classification		B.13
IV. IDB's Role - Additionality		
The project relies on the use of country systems		
Fiduciary (VPC/FMP Criteria)	Yes	Financial Management: Budget, Treasury, Accounting and Reporting, External Control, Internal Audit.  Procurement: Information System, Price Comparison, Contracting Individual Consultant.
Non-Fiduciary	Yes	Environmental Assessment National System.
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	Yes	The program will benefit from ATN/OC-18036-RG to support BRDE with the execution of this program, regarding program monitoring and impact evaluation, and the creation of mechanisms to follow up on gender issues. BRDE has a track record of support from IDB in energy efficiency and green bonds.

Note: (\*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

The operation BR-L1555, in the amount of US\$50.0 million, is part of the Bank's operational response to the COVID-19 Pandemic, Global Credit Programs for the Protection of the Productive Sector and Employment. The general objective of the program is to support the sustainability of micro, small, and medium-sized enterprises (MSMEs) as employment providers in the states of the South Region of Brazil amid the COVID-19 crisis. The specific objective is to support the short-term financial sustainability of MSMEs located in that region.

The loan proposal presents a solid diagnosis of the problem, as well as a review of international evidence. The proposed solutions are an appropriate response to the problems identified in the proposal and their contributing factors. The results matrix is consistent with the vertical logic of the project, presenting adequate indicators at the level of outcomes and impacts. The outcome indicators are appropriately defined to measure the achievements of the project's specific objectives. The impact indicator – the percentage of total formal employment in MSMEs in relation to total employment in the region - reflects the contribution to the final objective of the operation.

The economic evaluation shows that the operation is efficient, with an internal rate of return of 21% and an NPV of US\$11.3 million; these values are quite sensitive to changes in some of the assumptions. In a context of high uncertainty, the analysis considers the benefits which are derived from the reduction in sales revenue losses and a higher survival rate of firms that are beneficiaries of the program, as well as of jobs preserved in firms which survive as a result of the program.

The monitoring and evaluation plan proposes a reflective analysis of the outcome and impact indicators included in the result matrix, complemented by an ex-post cost benefit analysis as well as a qualitative study of the main challenges in the execution of the program and the proposed solutions. The monitoring and evaluation activities will be carried out by the Banco Regional de Desarrollo del Extremo Sur as the executing agency, in coordination with the Bank.

## RESULTS MATRIX

<b>Project objective:</b>	The overall objective of the program is to support the sustainability of micro, small, and medium-sized enterprises (MSMEs) as employment providers in the states of Brazil's South Region amid the COVID-19 crisis. The specific objective is to support the short-term financial sustainability of MSMEs located in the South Region of Brazil.
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### EXPECTED IMPACT

Indicators	Unit of measure	2020 baseline	Final target	Means of verification	Comments
<b>OVERALL OBJECTIVE: SUPPORT THE SUSTAINABILITY OF MSMEs AS EMPLOYMENT PROVIDERS IN THE STATES OF BRAZIL'S SOUTH REGION.</b>					
<b>Indicator 1:</b> Percentage of formal employment created by MSMEs in the region in relation to total employment in the region.	%	65	65	Annual Social Data Report (RAIS). The verification will be made on the basis of the most recent report available within the period in which the evaluation is conducted following the completion of program execution.	Measures the number of formal jobs in MSMEs over the total number of formal jobs in the region. Uses a simple average of the percentages observed in the three states in which BRDE operates: Paraná, Rio Grande do Sul, and Santa Catarina. For the baseline, these values are: 63%, 65%, and 66% for Paraná, Rio Grande do Sul, and Santa Catarina, respectively. <sup>1</sup> The target is to maintain the baseline proportion, which entails the expectation that MSME employment will decline less than, or only as much as, total employment in the region's three states.

### EXPECTED OUTCOMES

Indicators	Unit of measure	2019 baseline	Final target	Means of verification	Comments
<b>Specific objective 1: Support the short-term financial sustainability of MSMEs located in the South Region of Brazil.</b>					
<b>Indicator 1.</b> Delinquency rate of the MSME working capital finance portfolio 6 months after the start of the program, relative to the delinquency rate of the total BRDE portfolio.	Ratio	1.86	1.80	Program monitoring information collected by the executing agency.	Delinquency is measured in accordance with the BACEN criteria, which include payments more than 90 days past due. The ratio measures the delinquency of the target portfolio (MSME working capital (BRDE's Desenvolve Sul and Recupera Sul lines)) over the delinquency of BRDE's total portfolio prior to the crisis and 6 months after the start of the program. $\text{Ratio} = \frac{\text{Delinquency MSME working capital portfolio (\%)}}{\text{Delinquency total BRDE portfolio (\%)}}$

<sup>1</sup> RAIS/Ministry of Economy. Prepared by the authors based on the CEMPRE/IBGE classification.

					The baseline is the ratio, according to the above-described formula, for data as of 31 December 2019. The values are 2.07% for the MSME portfolio and 1.11% for the total BRDE portfolio, resulting in a ratio of 1.86. The same ratio is projected for the target, using the data from 31 December 2017 as a benchmark, since they were heavily affected by the economic recession at the time. The values are 7.84% for the MSME portfolio and 4.35% for the total BRDE portfolio, resulting in a ratio of 1.80.
Indicators	Unit of measure	2019 baseline	Final target	Means of verification	Comments
<b>Indicator 2.</b> Delinquency rate of the MSME working capital finance portfolio 12 months after the start of the program relative to BRDE's overall delinquency rate.	Ratio	1.86	1.80	Program monitoring information collected by the executing agency.	<p>Delinquency is measured in accordance with the BACEN criteria, which include payments more than 90 days past due.</p> <p>The ratio measures the delinquency of the target portfolio (MSME working capital (BRDE's Desenvolve Sul and Recupera Sul lines)) over the delinquency of BRDE's total portfolio prior to the crisis and 12 months after the start of the program.</p> $\text{Ratio} = \frac{\text{Delinquency MSME working capital portfolio (\%)}}{\text{Delinquency total BRDE portfolio (\%)}}$ <p>The baseline is the ratio, according to the above-described formula, for data as of 31 December 2019.</p> <p>The same ratio is projected for the target, using the data from 31 December 2017 as a benchmark, since they were heavily affected by the economic recession at the time.</p>
<b>Indicator 3.</b> Total MSME working capital finance portfolio amount achieved due to the program's support.	R\$ millions	152.2	432.2	Program monitoring information collected by the executing agency.	<p>The indicator measures only the MSME portfolio of (100%) working capital transactions under BRDE's Desenvolve Sul and Recupera Sul lines. The baseline is the portfolio balance amount as of 31 December 2020. The target is based on a projection, which uses the same portfolio composition as the baseline portfolio and only considers the program resources.</p> <p>For reference purposes, the composition of the baseline portfolio is respectively 6.62%, 39.54%, and 53.84% for primary, secondary, and tertiary sectors.</p>

# OUTPUTS

Outputs	Unit of measure	2020 baseline	2021	2022	Final target	Means of verification	Comments
<b>Component 1: Support for improvement of short-term financial capacity (TOTAL COST=US\$50 MILLION)</b>							
<b>Output 1:</b> Amount provided to finance working capital for MSMEs.	US\$ millions	0	30	20	50	Program monitoring information processed by the executing agency.	The target is total program resources.
Annual cost:	US\$ millions	0	30	20	50		

**Country:** Brazil      **Sector:** CMF      **Project number:** BR-L1555      **Year:** 2020  
**Cofinancing:** No      **Coexecution:** No

## FIDUCIARY AGREEMENTS AND REQUIREMENTS

**Executing agency:** Banco Regional de Desenvolvimento do Extremo Sul (BRDE)  
**Project name:** Emergency Program to Mitigate to the Economic Effects of the Coronavirus - BRDE (Emergency Prosul)

### I. Fiduciary Context of the Executing Agency

#### 1. Use of country systems in the project<sup>1</sup>

<u>Budget</u> <input checked="" type="checkbox"/>	<u>Reporting</u> <input type="checkbox"/>	<u>Information system</u> <input checked="" type="checkbox"/>	<u>National competitive bidding (NCB)</u> <input type="checkbox"/>
<u>Treasury</u> <input checked="" type="checkbox"/>	<u>Internal audit</u> <input checked="" type="checkbox"/>	<u>Shopping</u> <input checked="" type="checkbox"/>	<u>Advanced NCB</u> <input type="checkbox"/>
<u>Accounting</u> <input checked="" type="checkbox"/>	<u>External control</u> <input checked="" type="checkbox"/>	<u>Individual consultants</u> <input type="checkbox"/>	<u>Consulting firm</u> <input type="checkbox"/>

Governing laws and regulations: Law 8,666: Federal Bidding and Contracts Law, Law 10,520: Pregão Eletrônico [Electronic Reverse Auction] Law.

#### 2. Fiduciary capacity of the executing agency

The institutional capacity assessment was conducted virtually, using ICAP questionnaires. In the fiduciary areas involved in execution of this program, the fiduciary risk is considered low. The reason for this is that BRDE has a long track record, a solid organizational structure, and adequate risk management. In addition, BRDE is supervised by the State Audit Office of Rio Grande do Sul (TCE-RS) and the Central Bank of Brazil, and its operations are audited by an independent private-sector firm. At present, BRDE also receives resources for credit transactions from the World Bank and other external financial institutions.

#### 3. Fiduciary risks and mitigation actions

**Fiduciary risk:** High ☐; medium ☐; low ☒

Risk	Risk level	Mitigation plan
No fiduciary risks were identified.		

### II. Considerations for the Special Provisions of the Contract

<b>Conditions precedent to the first disbursement:</b> None of a fiduciary nature.
<b>Exchange rate:</b> The exchange rate for account rendering purposes will be (i) for advances of funds: the exchange rate in effect at the time of conversion of the advanced funds from the program currency to local currency; and (ii) for reimbursements: the exchange rate in effect on the date of the disbursement by BRDE to the subborrowers.

<sup>1</sup> Any system or subsystem that is subsequently approved may be applicable to the operation, in accordance with the terms of validation by the Bank.

**External audit:** BRDE will deliver the program's financial statements, audited by the TCE-RS or by an independent audit firm acceptable to the Bank, within 120 days following the close of BRDE's fiscal year. The terms of reference for these audits will be agreed upon with the Bank in due course.

### III. Agreements and Requirements for Procurement Execution

#### Exceptions to policies and guidelines

No exceptions to the Bank's fiduciary policies are anticipated.

<b>Retroactive financing and/or advance procurement<sup>2</sup></b>	<ul style="list-style-type: none"> <li>The Bank may retroactively finance, as a charge against the proceeds of the loan, up to US\$10 million (20% of the loan amount) in disbursements made by the borrower to eligible MSMEs for subloans issued prior to the loan approval date, provided that requirements substantially similar to those established in the loan contract have been fulfilled. Such expenses will have been incurred on or after 24 March 2020, the date of BRDE approval of the use of its own resources for Recupera Sul. Even though this predates the project officially entering the pipeline (document GN-2259-1), and considering the demand for financing already received by BRDE (paragraph 1.21 of the main document), authorization of retroactive financing on an exceptional basis is justified as of that date, given the exceptional circumstances surrounding the global health emergency.</li> </ul>
<b>Supplementary procurement support</b>	<ul style="list-style-type: none"> <li>Not applicable.</li> </ul>
<b>Alternative procurement arrangements</b>	<ul style="list-style-type: none"> <li>Not applicable.</li> </ul>
<b>Projects with financial intermediaries</b>	<ul style="list-style-type: none"> <li>Since this is a loan for global credit programs and other operations involving the provision of subloans or other forms of onlending, the agreements between the borrower and its financial intermediaries and between the latter and the subborrowers shall include the appropriate clauses on the Bank's prohibited practices. Alternatively, should it be impossible or impracticable to include these clauses in the aforementioned agreements due to the circumstances of the program, the project team may examine other arrangements to adopt acceptable controls and duly bind any relevant third parties to the Sanctions Procedures. Such arrangements, which will be designed in coordination with OII and with the support of LEG, will be described in the <a href="#">program Operating Regulations</a>.</li> </ul>

<sup>2</sup> In accordance with the Bank policy on retroactive financing, recognition of expenditures, and advance procurement (document GN-2259-1), or the equivalent policy in effect at the time of the operation.

<b>Procurement agents</b>	<ul style="list-style-type: none"> <li>Not applicable.</li> </ul>
<b>Direct contracting</b>	<ul style="list-style-type: none"> <li>Not applicable.</li> </ul>

<b>Operating expenses:</b> <input type="checkbox"/> Not applicable.	<b>Domestic preference:</b> <input type="checkbox"/> Not applicable.
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<b>General supervision methods for project procurement:</b> Not applicable.	
<b>Supervision method:</b> Not applicable.	<b>For:</b> Not applicable.

**Thresholds by country:** [www.iadb.org/procurement](http://www.iadb.org/procurement).

#### IV. Agreements and Requirements for Financial Management

<b>Programming and budget</b>	<ul style="list-style-type: none"> <li>BRDE has administrative autonomy and its own legal status. As a public institution, it complies with the national regulations governing national development finance institutions and therefore autonomously prepares and executes its budget and activity programming. BRDE annually prepares its business plan and investment budget, which are then submitted to the Conselho de Desenvolvimento e Integração Sul [South Development and Integration Council] (CODESUL) for approval.</li> </ul>
<b>Cash and disbursement management</b>	<ul style="list-style-type: none"> <li>Disbursements of loan proceeds will be made in U.S. dollars, primarily in the form of reimbursement of expenditures and/or advances of funds. The disbursement requests will be delivered to the Bank in accordance with the requirements set out in the loan contract as well as in the <a href="#">program Operating Regulations</a> and the Bank's Financial Management Guidelines.</li> <li>For advances of funds, BRDE will submit a financial plan with estimates on placement of funds for up to six months. A new funds advance may be requested once supporting documentation has been provided that accounts for at least 80% of the previously disbursed proceeds. The Bank will deposit the funds in U.S. dollars in the bank account designated by BRDE to be used exclusively for the program.</li> </ul>
<b>Accounting, information systems, and reporting</b>	<ul style="list-style-type: none"> <li>BRDE is in compliance with the rules issued by the Central Bank of Brazil for banks in Brazil, and it applies Brazilian reporting standards. BRDE has a technology infrastructure with adaptations for external financing, including from the World Bank, Agence Française de Développement (AFD), and others. In its capacity as a financial institution, it has a series of information systems designed for credit analysis and provision. These systems have been used with success in controlling loans after they have been provided, and they will be used for this operation.</li> <li>BRDE will record all IDB financing transactions using: (i) the exchange rate in effect at the time of conversion of the advanced funds from the program currency to local currency in the case of IDB resources; and (ii) the exchange rate in effect on the date of transfer of funds to beneficiaries in the case of reimbursement of expenditures and recognition of expenditures.</li> </ul>



<b>External control</b>	<ul style="list-style-type: none"> <li>BRDE will deliver audited financial statements for the program within 120 days following the close of its fiscal year. These statements will be audited by the TCE-RS or by an independent audit firm acceptable to the Bank, in accordance with terms of reference previously agreed upon with the Bank.</li> </ul>
<b>Financial supervision of the project</b>	<ul style="list-style-type: none"> <li>The Bank will conduct ex post spot inspections of the program.</li> </ul>

## V. Relevant Information for the Operation

### Policies and guidelines applicable to the operation

<b>Financial management</b>	<b>Procurement</b>
<ul style="list-style-type: none"> <li>Document GN-2811 [OP-273-12]</li> </ul>	<ul style="list-style-type: none"> <li>Document <a href="#">GN-2349-15</a></li> <li>Document <a href="#">GN-2350-15</a></li> </ul>

### Records and files

<p>The documents evidencing the subloans financed through the operation will be held at BRDE. This institution has an adequate information system, and no risks or issues are expected to arise in terms of record-keeping and rendering of accounts.</p>
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DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-\_\_\_\_/20

Brazil. Loan \_\_\_\_/OC-BR to Banco Regional de Desenvolvimento do Extremo Sul (BRDE)  
Emergency Program to Mitigate the Economic Effects of the Coronavirus – BRDE  
(Emergency PROSUL)

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 Banco Regional de Desenvolvimento do Extremo Sul (BRDE), as Borrower, and with the Federal Republic of Brazil, as Guarantor, for the purpose of granting the former a financing aimed at cooperating in the execution of the Emergency Program to Mitigate the Economic Effects of the Coronavirus – BRDE (Emergency PROSUL). Such financing will be in the amount of up to US\$50,000,000 from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on \_\_\_\_ 2020)