DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

BRAZIL

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

(BR-L1054)

LOAN PROPOSAL

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Electronic Links and References	
Acronyms	IDBDOC referencia # 340106
Basic socioeconomic data	www.iadb.org/res/index
Status of loans in execution	http://ops/approvals/pdfs/BRsp.pdf
Information available in the RE1/FI1 technical files	IDBDOC referencia #367884

ABBREVIATIONS

BACEN	Central Bank of Brazil
BNDES	Banco Nacional de Desenvolvimento Econômico e Social [National Economic and Social Development Bank]
CCLIP	Conditional credit line for investment projects
CMN	Conselho Monetário Nacional [National Monetary Council]
FAT	Fundo de Amparo ao Trabalhador [Workers' Assistance Fund]
IFI	Intermediary financial institution
IPCA	Índice de Preços ao Consumidor Amplo [Broad National Consumer Price Index]
LCF	Local Currency Facility
LIBOR	London Interbank Offered Rate
MCP	Multisector credit program
MSMEs	Micro, small, and medium-sized enterprises
SCF	Single Currency Facility
SEBRAE	Serviço Brasileiro de Apoio às Micro e Pequenas Empresas [Brazilian Support Service for Microenterprises and Small Businesses]
SELIC	Sistema Especial de Liquidação e de Custódia [Special System of Clearance and Custody]
SMEs	Small and medium-sized enterprises
TJLP	Taxa de Juros de Longo Prazo [long-term interest rate]
WAL	Weighted average life

PROJECT SUMMARY

BRAZIL
BNDES: SECOND PROGRAM UNDER THE CCLIP LINE TO SUPPORT MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES
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Financial Terms and Conditions[1]				
Borrower: Banco Nacional de Desenvolvimento Econômico e Social [National Economic and Social Development Bank] (BNDES)			Amortization period:	20 years
Guarantor: Federative Republic of Brazil			Grace period:	4 years
Executing agency: BNDES			Disbursement period:	4 years
Source	**Amount**	**%**	Interest rate:	LIBOR (US$)
IDB (Ordinary Capital)	US$1 billion	50	Inspection and supervision fee:	0%
Local	US$1 billion	50	Credit fee:	0.25%
Total	US$2 billion	100	Currency:	U.S. dollars from the Single Currency Facility
			Conversions to reais (R$)	Local Currency Facility (LCF) and reformulation of the CCLIP

Project at a glance

Project objective:
To support the development and modernization of micro, small, and medium-sized Brazilian enterprises by providing medium- and long-term financing for execution of investment projects designed to make those firms more competitive.

Special contractual conditions:
Prior to the first disbursement of funds for each program under the CCLIP, the borrower will provide evidence that the Credit Regulations agreed upon with the Bank for the operation are in force.

Subloans disbursed between 1 July 2006 and the project approval date, in the amount of US$250 million from the loan, and an equivalent amount from the local counterpart contribution, will be recognized.

Exceptions to Bank policies:
The guarantee by the Federative Republic of Brazil will be limited to debt servicing and to the obligation to take the necessary steps for the borrower to fulfill its positive contractual covenants.

Project consistent with country strategy: Yes [X] No [ ]
Project qualifies as: SEQ [ ] PTI [ ] Sector [ ] Geographic [ ] Headcount [ ]

Verified by CESI on: 13 September 2006
Environmental and social review: N.A.
Procurement: Procurement policies

[1] The interest rate, credit fee, and inspection and supervision fee mentioned in this document are established pursuant to document FN-568-3 Rev. and may be changed by the Board of Executive Directors, taking into account the available background information, as well as the respective Finance Department recommendation. In no case will the credit fee exceed 0.75%, or the inspection and supervision fee exceed 1% of the loan amount.*

* With regard to the inspection and supervision fee, in no case will the charge exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount, divided by the number of six-month periods included in the original disbursement period.

I. FRAME OF REFERENCE

A. Background

1.1 The Bank has conducted four multisector credit programs (MCPs) with the Banco Nacional de Desenvolvimento Econômico e Social [National Economic and Social Development Bank] (BNDES). Because of the success of those programs, in late 2004 the Bank approved a conditional credit line for investment projects (CCLIP) for micro, small, and medium-sized enterprises (MSMEs) together with the first program under this CCLIP. Disbursements under that program are virtually complete. Thus, this program is the second operation under the CCLIP but the first to be processed by the short procedure established for such programs (document GN-2246-1).

1.2 The Board of Executive Directors reformulated the CCLIP (document PR-2909-1) to allow programs under it to be disbursed in local currency.

B. Macroeconomic considerations

1.3 Brazil's macroeconomic situation, as described for the CCLIP, remains unchanged or, in some cases, has improved because of the reduction of foreign debt in hard currency and drop in debt payments to the International Monetary Fund (IMF). Link 1

C. The real sector of the economy

1.4 Micro, small, and medium-sized enterprises (MSMEs) predominate in the Brazilian economy. According to the Serviço Brasileiro de Apoio às Micro e Pequenas Empresas [Brazilian Support Service for Microenterprises and Small Businesses] (SEBRAE), in 2002 MSMEs accounted for 99.69% of all firms and 66.93% of jobs in the country.[1] Therefore, this sector's strength, productivity, growth, and profitability are essential to both Brazil's economy and to employment. The structural situation of formal micro, small, and medium-sized enterprises remains as was described in the CCLIP,[2] namely:

a. Microenterprises are businesses having 19 or fewer employees and gross sales of US$400,000 equivalent per year or less. SEBRAE estimates that there were 4.6 million informal microenterprises in 2002. BNDES performs three different functions in this sector: (i) channeling a large portion of indirect loan (onlending) operations to tax-paying microenterprises (the last IDB program (loan 1608/OC-BR) directed the equivalent of US$299.6 million to such enterprises out of a total of US$990 million); (ii) backstopping informal microenterprises through its Economic Solidarity Departments (lending to

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[1] *Boletim Estatístico de Micro e Pequenas Empresas. Observatório, SEBRAE, 1 Semestre, 2005*. Microenterprises alone accounted for almost 36% of formal employment and small and medium-sized enterprises accounted for the remaining 31%.

[2] MSMEs were categorized according to the MERCOSUR standards (MERCOSUR/GMC/RES 90/93: Policy for support of micro, small, and medium-sized enterprises in MERCOSUR, ratified by Resolution MERCOSUR/GMC 59/98).

microfinance institutions, State development agencies, municipalities, and relevant public and private agencies); and (iii) providing technical assistance, with support from the Bank (under technical-cooperation project ATN/SF-5714-BR), for the development of new products and the institutional strengthening of nongovernmental microfinance organizations;

b. The formal small and medium-sized enterprise (SME) sector is composed of firms having between 20 and 499 employees and gross sales over US$400,000 but under US$20 million per year. According to the Relação Anual de Informações Sociais [annual record of social data] (RAIS), in 2004 SMEs accounted for nearly 11% of all Brazilian exports in 2004.[3] The problems SMEs are having in obtaining financing need to be addressed because their competitiveness is of importance for the entire country, given their role in the modernization of industry, the development of outsourcing, and the reengineering of production processes.

1.5 The core objective of the Government of Brazil's 2004-2007 Multiyear Plan [Plano Plurianual], which has a budget of US$150 billion, is to achieve sustained, socially inclusive growth and promote greater democratization and citizenship. To this end, the plan is broken down into three key "mega" objectives: (i) social inclusion and poverty reduction; (ii) growth that creates jobs, generates income, is environmentally sustainable, and reduces regional inequalities; and (iii) the promotion and expansion of citizenship and the strengthening of democracy. The first two objectives entail the challenge of promoting and strengthening MSMEs by: (a) stimulating cooperativism, the formation of partnerships, and the development of new types of cooperative associations; (b) using the government's purchasing power to strengthen MSMEs; (c) fostering MSME participation in production chains; (d) promoting the formation of MSME associations in order to achieve economies of scale in production and marketing; (e) revamping the tax system to facilitate the creation of microenterprises; (f) providing incentives for microentrepreneurs and small business owners through cooperative associations; (g) making innovative scientific platforms available to MSMEs; (h) promoting policy incentives for the creation of MSMEs that will ensure their formalization and sustainability; (i) providing fiscal, credit, and technological support to MSMEs; and (j) providing a supply of credit and microcredit on suitable terms and conditions.

D. The financial sector

1. The status of intermediation

1.6 The description of the banking system's regulatory structure in the CCLIP remains valid (Link 2). The system still has the strengths described therein, but there are also some persistent challenges to the system caused by structural problems that continue to be addressed by the government and the Central Bank of Brazil

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[3] According to 2004 data from the Ministry of Development, Industry, and Foreign Trade – Foreign Trade Secretariat.

(BACEN). They include the need to lower intermediation costs and to boost the economy's credit supply.

1.7 With respect to lowering intermediation costs, bank spreads remain very high (27.2% in 2004). BACEN has for years been conducting studies to identify the causes of this and then take actions to lower them.

a. On the cause side, a 2005 BACEN study shows the 2004 breakdown for the aforementioned spreads to be 17.67% for taxes (both direct and indirect), 21.56% for administrative costs, about 33.97% for arrears, 7% for the total cost of the *compulsório*, and 19.8% for residuals (e.g., little competition);

b. The steps being taken to optimize the available supply of information and cut transaction costs include: (i) the creation of a risk center; (ii) adoption by the Conselho Monetário Nacional [National Monetary Council] of measures aimed at streamlining lending operations through the use of bank credit cards [cédulas de crédito bancário] (CCB); (iii) the creation of receivables investment funds [Fundos de Investimento em Direitos Creditórios] (FIDC) in order to improve the management of intermediary institutions' portfolio liquidity; and (iv) the CMN's authorization of credit derivative operations. A new bankruptcy law was adopted. In order to heighten competition in the sector, BACEN is also releasing relevant information about the system and is requiring intermediaries to disclose information about their performance.

1.8 With respect to credit volume, the financial system continues not to fully perform its role of financing growth by providing credit to the private sector. In point of fact, total credit from the domestic financial system represented 31.2% of GDP in 2005 (with unearmarked credit representing 20.7% of GDP), whereas the portfolio of federal securities represented 50.4% of GDP in 2005.[4] The reasons for this have to be analyzed from a variety of vantage points: repayment periods, amounts, interest rate levels, and interest-rate volatility.

a. In terms of repayment periods and *system liabilities*, the system has had a high number of short-term deposits, owing to uncertainty about the country's macroeconomic status in the medium term. Consequently, deposit-taking by intermediary financial institutions (IFIs) has continued to be heavily based on short-term instruments (savings deposits and fixed-term certificates of deposit) and non-interest-bearing sight deposits (checking accounts), with 40.5% of deposits in 2006 having maturities under one year, and 65.6% having maturities of 1 to 2 years. Accordingly, IFIs find it very difficult to operate with long-term loans due to potential maturity mismatches (that could pose a threat to their liquidity and solvency). On the *system asset* side, the average for loan portfolios has been approximately 250 days, and for housing mortgages, 1,250 days;[5]

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[4] See 2005 Annual Report of the Central Bank of Brazil, Table 4.6.

[5] See 2005 Annual Report of the Central Bank of Brazil.

b. With respect to the amounts involved, it should be noted that a substantial portion of the system's funding is not readily available, since various targeting mechanisms translate into fewer disposable resources. In 2005, mechanisms of this sort included: (i) sight deposits that were blocked in order to satisfy BACEN's legal reserve requirement (45%) or channeled to the rural sector (14% of the portfolio); and (ii) the *cadernetas de poupança* (savings deposits) for prospective homeowners (7.2% of the portfolio). As a result, readily available funding is scarce and primarily comes from short-term certificates of deposit;

c. In the case of interest rates, credit remains expensive for three reasons: (i) the system's real base rates have been very high for years now (the SELIC rate—see Link 1—was 13.25% in December 2006 as a consequence both of the macroeconomic policies designed by BACEN in an effort to reduce inflation and of the public sector's borrowing requirements); (ii) the directed funding mix is such that the readily available portion of those resources comes primarily from certificates of deposit, which carry rates very close to the SELIC; and (iii) the width of average intermediation spreads. The end result is very high real short-term lending rates;

d. Lastly, the marked degree of rate volatility drives up the level of risk for borrowers by raising the possibility of unforeseen increases in financing costs.

1.9 As a consequence of all these factors, commercial banks continue to extend virtually no medium- or long-term loans, since they would entail such high costs that no intermediary would: (i) have a reasonable expectation that profitable ventures could exist at those rates; and (ii) have incentives to generate long-term liabilities in order to fund such dubious assets.[6] This lack of medium- and long-term credit forces firms that do not have access to capital markets to rely on self-financing or short-term revolving credit, which increases both the cost of funding and the risk of discontinuity.

2. The strategic role of BNDES

1.10 Under these circumstances, the country has cast BNDES in a strategic role as a source of leverage, since it is now, as a result of its characteristics, the only significant source of long-term funding for financial intermediaries. Its key importance is illustrated by the fact that in 2005: (i) the funding it provided the system represented nearly 2.43% of GDP; (ii) its indirect operations accounted for 10.64% of the balance of credit operations by the financial system;[7] and (iii) its indirect operations in the MSME segment accounted for 24.76% of its funding of the system.[8] Link 3

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[6] This situation will be characterized as a structural gap in a later section (paragraphs 1.12, 1.16, and 1.21(a)).

[7] Source: BACEN's Department of Economics, concerning indirect operations of the BNDES system, in December 2005.

[8] According to the BNDES 2005 performance summary.

E. Financing for MSMEs

1. The problem

1.11 The provision of medium- and long-term financing for productive investment has been a recurring problem in Latin America and the Caribbean. Such financing is all the more problematic for MSMEs, whose financial position is characterized by: (i) a lack of transparency and the existence of information asymmetries that have the effect of blocking direct access to capital markets; (ii) the fact that the only remaining source of financing—the commercial banking system—is reluctant to enter a market segment that typically has high administration costs and a high level of perceived risk owing to high business failure rates and insufficient guarantees or collateral; and (iii) a financial structure based on self-financing, supplier credit, and a short-term bank component (which usually depends on the firm's size and is therefore virtually nonexistent for microenterprises) at what are often untenable interest rates from the standpoint of these ventures' rates of return.[9] The fact that MSMEs are so important in terms of both GDP and employment makes this problem an extremely important one, since, given the frailty of their financial foundations, structural shocks can have devastating impacts on the productive fabric and employment, generate social instability, and make the country less competitive.

1.12 Brazilian MSMEs continue to be adversely affected by this general state of affairs, but in their case the problem is compounded by the existence of a structural gap between their ventures' internal rates of return and lending rates (i.e., the average rate charged for financing in the system plus the IFIs' spreads). The end result is that long-term credit is virtually nonexistent in the marketplace.

2. Strategy

1.13 Given the significance of this problem, the government adopted an approach, based on the Constitution of 1988 (Article 239), aimed at softening the impact of successive structural shocks or adjustment policies on MSMEs by setting up programs to mitigate the problem and to provide them with access to medium- and long-term credit. These programs, backstopped by BNDES, thus serve to leverage the development of competitiveness and employment. Their defining features are: (i) the origin of the funds; (ii) the protection mechanisms they employ; and (iii) their distribution channel.

a. **Origin.** The funds come from contributions (a given percentage of total sales) paid by all types of organizations (including public agencies and bodies) into the Workers' Assistance Fund [Fundo de Amparo ao Trabalhador] (FAT). A minimum of 40% of these resources are passed on to BNDES, which in turn channels these earmarked funds into job-creating ventures. These funds: (i) are administered by BNDES, and their authorized uses are, in general

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

terms, specified in advance by the Deliberative Council of the Workers' Assistance Fund (CODEFAT); and (ii) have increasingly been channeled to MSMEs in view of their importance in terms of job creation;

b. **Protection mechanisms**. The Constitution assigns an additional fiduciary role to BNDES in the maintenance of the real value of the FAT funds it administers. This means that BNDES must invest these funds in a way that will fulfill its development and job-creation objectives while also, on average, recouping its principal plus a certain percentage as a hedge against inflation. In order to ensure that these objectives are attained, the following standards and rules have been established: (i) the yield of investments made by BNDES must, as a minimum, be equivalent to its spread plus an annual risk-adjusted inflation rate (the long-term interest rate, *Taxa de Juros de Longo Prazo (TJLP)*;[10] and (ii) BNDES must pay that rate, as applied to the funds at its disposal, into the FAT on an annual basis. This required rate of return on BNDES investments is designed to ensure the fiscal and financial sustainability of its programs.

c. **Distribution channel**. BNDES distributes FAT funds allocated to it for MSMEs via a classic second-tier banking scheme whereby it onlends funds to 137 qualifying intermediaries (as of May 2006), with nearly 16,000 agencies in 2005 using a specialized onlending window for IFIs that are supervised by the central bank and have been declared eligible by BNDES.[11] The funds are onlent at the TJLP rate plus a spread that, in the case of MSMEs, is currently set at 1%, without distinction. Although BNDES provides the loan funds, the IFIs are the ones that screen the credits and that provide BNDES with full surety as to the funds' proper use, and they therefore are at liberty to set their own spread for the borrower.[12] Mean spreads have trended downward since 2003 thanks to the penetration ("capillarity") of the BNDES network and competition among IFIs to place these funds; in 2005 and 2006 (through May) it hovered between 3.03% and 2.8%.

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[10] The TJLP, which was created in 1994: (i) is now governed by BACEN Resolution 2.121, as amended by Resolutions 2.145, 2.335, 2.587, and 2.654; (ii) is calculated for the coming quarter and published by the CMN on the last day of the preceding quarter; and (iii) is expressed in annual terms. Since 1999, the TJLP is computed on the basis of two components: (i) an inflation target, which is prorated over the next 12 months, starting from the first month in which it enters into effect (including that first month), based on CMN annual inflation targets; and (ii) a risk premium that incorporates a real international interest rate and a long-term risk component for Brazil. In the absence of a medium- and long-term credit market and of the corresponding curve, the TJLP is intended to serve as the base rate for what would be long-term rates in a private credit market and thus seeks to filter out short-term rate volatility.

[11] According to a report by the Federação Brasileira de Bancos [Brazilian Bank Federation] (FEBRABAN) released on 8 June 2006, there were 17,515 banking agencies in 2005.

[12] In this manner, loaned funds reach SMEs integrating risks related to the nature of the loan itself and its distribution channel, accumulating (i) public risk of the origin of funds and inflation, integrating both in the TJLP; (ii) BNDES risk, reflected in its spread; and (iii) intermediary financial institution risk, packaged into the spread.

1.14 These results have been in keeping with the system's importance for the Brazilian authorities, since they have channeled very large sums to MSMEs. Thus, from a quantitative perspective, BNDES (i) approved 128,374 operations for MSMEs in 2004, and 108,669 in 2005; and (ii) disbursed R$12.6 billion in 2004 and R$11.7 billion in 2005. From a qualitative perspective, the fund distribution mechanism has some very positive features:

a. Lower delinquency rates than those registered for unearmarked credits (1.05%, compared to 4.2% in December 2005);[13]

b. Amounts that have been channeled to the target groups (the loan amounts under the last IDB program for MSMEs (loan 1608/OC-BR), averaged US$43,960.26 for microenterprises, US$58,414.28 for small businesses, and US$60,930.81 for medium-sized enterprises);

c. Fairly lengthy average repayment periods (an average of 60 months over the past three years);

d. Average spreads of 4.44% applied by IFIs over the past three years;

e. The development of expertise in the IFIs for rating MSME risk, which has enabled them to put together packages to complement BNDES financing (using their own short-term funds to provide working capital for the ventures), thereby attaining a greater degree of bank coverage; and

f. The progressive formalization of MSMEs, which can then become more competitive, pay into the FAT (thereby helping to fund the system), and become part of the tax base.

3. Bank support

1.15 Since 1995, the Bank has been supporting this strategy by undertaking multisector credit programs (MCPs) with BNDES that have been yielding significant results in terms of the amounts they have channeled to the sector and their outcomes. (See below and Link 4).

F. Lessons learned

1. Macrofinance

1.16 Brazil continues to have a structural gap in terms of the relationship between the lending rates charged by financial intermediaries and the rates of return of MSME ventures.[14] This gap stems from the macroeconomic situation and the inefficiencies, as noted earlier, in the workings of the financial system. Central bank studies[15]

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13 Arrearages at 90 days.

14 In 2006, the average lending rate for the system as a whole was 42% per annum (with inflation at 3.14%, the real rate for MSMEs was 39%). The average lending rate for corporate borrowers was 28%.

15 December 2005 study by BACEN: "Economia Bancária e Crédito – Avaliação de 5 anos do Projeto Juros e Spread Bancário" [Banking and Credit Economy – Five-year Evaluation of Banking Spread and Interest Rate Project].

conclude that the level of lending rates is attributable to the combined effect of the level of intermediation spreads (40%) and high deposit rates (60%). In this regard: (i) the consensus view is that the wide spread is accounted for by the structural components discussed above; and (ii) the high deposit rates and their volatility stem from the high SELIC rates set by BACEN in an effort to combat inflation. As noted earlier, the government and the central bank are implementing a strategy designed to eliminate the causes of these problems. Accordingly: (a) the effort to combat inflation, which is being conducted by means of a tight monetary policy based on open market operations, is bearing fruit, since inflation according to the Broad National Consumer Price Index (IPCA) has fallen from a peak of 12.53% in 2002 to 3.14% in 2006; and (b) the results in terms of financial spreads have been less dramatic, with the spread narrowing slightly from 30.01% in December 2003 to 29.84% in April 2006.

1.17 At the same time, and despite the structural measures that have been adopted, the terms in place for the mobilization of resources have not lengthened to any substantial degree, and the system continues to lack a sufficient time horizon for lending operations.

1.18 In keeping with the support the Bank has consistently lent in the region, the government is working to mitigate the symptoms of this problem (the lack of financing for MSMEs) based on an awareness of their role in serving the public interest in the areas of employment and competitiveness. In line with this effort, the BNDES programs have a number of noteworthy features: (i) they provide funds for medium- and long-term productive investments at rates that are in keeping with projects' viability; and (ii) they make it possible to: (a) finance those productive investments with fiscal resources while using the country's network of financial intermediaries as the distribution channel for the funds and ensuring the fiscal/financial sustainability of the system; and (b) boost the production system's competitiveness, set the stage for a stable social situation, and enhance the system's ability to absorb structural shocks.

1.19 This reaffirms the experiences of other countries in the region in the following areas: (i) the ability to mobilize savings and effectively channel them to investment is influenced by monetary stability and financial repression; (ii) the extension of maturities and lending terms is the result of a process in which those circumstances are necessary but not sufficient conditions; and (iii) the lack of medium- and long-term financing for MSMEs can be mitigated by action on the part of government authorities.

2. Program structure

1.20 In situations such as this, the Bank has provided support for the sector through MCPs designed to help provide funding for MSME activities on softer terms and conditions than those dictated by existing equilibrium trends in the market. These programs necessarily entail the transfer of fiscal resources to the MSMEs. The philosophy and features of the MCPs are synthesized in Link 5.

1.21 Within the context of this philosophy, Brazil displays a number of distinct features that, despite rendering some of the requirements the Bank has traditionally placed on MCPs unviable, abide by their underlying philosophy (essentially, the nonintroduction of relevant distortions). For this reason, the CCLIP fully accepts the onlending mechanisms of BNDES's Indirect Operations System for its programs (Link 5). In this regard:

a. The current situation (i) falls within this philosophy and these features; (ii) maintains the structural gap between between lending rates and MSME ventures' rates of return (real rates for 2006 for MSMEs were 39%); (iii) maintains the fact that IFIs operating in the BNDES system do not introduce relevant distortions in the system (despite the program funds being onlent at rates below the system's average deposit rate);[16] and (iv) makes full use of existing fund onlending mechanisms in the Indirect Operations System.

b. The prospects are positive for the differentials between the average system deposit rate and the program's onlending rate, as seen in the following ways:

- In 2006, the deposit rate for commercial banks (*Taxa Básica Financeira*) [Basic Financial Rate] (TBF), published by BACEN, was 14.683% on average for the year, whereas the cost of BNDES resources onlent to commercial banks (TJLP plus its spread) was at 8.8% (5.88% below the market rate). Nevertheless, in December 2006, as a result of the progressive success of monetary policy, the reduction of short-term rates caused commercial bank deposit rates to rise to 12.63% for the year (as a result, the difference between that rate and the cost of BNDES funds was reduced to 4.78% for the year);
- The yield curve is inverted in Brazil (making long-term rates lower than short-term rates). This means that the rate of return for long-term national treasury-issued securities (in reais) or for global bonds maturing in 2016 and 2022 was roughly 10% annualized, at the end of December 2006;
- Both facts seem to indicate that, with continued structural reform, the structural rate gap could continue to decrease and the convergence of the SELIC and TJLP rates would be maintained, which would mean that over the medium term funds could be onlent at the system's mean lending rate.

G. Rationale and relevance

1.22 As has been stated, MSMEs remain one of the most vibrant sectors in the country's economy and are the strongest job creator. The stabilization of macroeconomic conditions has set the stage for a gradual increase in private investment, which has fueled demand for medium- and long-term investment loans. Under these

[16] Insofar as (i) the potential distortion effects of those differentials on preexisting allocations of capital are mitigated by the positive features of the onlending system; and (ii) there are no indications that negative incentives are generated that tend to perpetuate the causes of the problem. (see Link 5)

circumstances, and given MSMEs' difficulties in obtaining financing, their only sources of medium- and long-term bank credit are the programs financed by BNDES. The government continues to place a high priority on MSMEs as part of its growth strategy and to consider the continued promotion of this sector's expansion, integration, and access to financing as essential.

1.23 In an effort to attain these objectives, and in line with the priorities of both the government and the Bank's country strategy with Brazil, the program has been designed to:

a. Continue to dovetail with the government's policy of seeking to expand the supply of long-term financing, strengthen the MSME segment, and deepen its role in integrating the Brazilian economy with the rest of the world, and fit in with the financing strategy and priorities set by the Ministry of Development for BNDES;

b. Remain consistent with the Bank's country strategy with Brazil (2004-2007) within the spirit of the Nuevo León initiative, which is aimed at boosting support for MSMEs. The Bank's course of action, pursuant to the Monterrey Consensus (2002) as it relates to the prioritization of effective use of resources, is divided into four main areas, one of which is supporting MSMEs with medium- and long-term credits for financing investment projects. In addition, as part of its objective of macroeconomic stability, the Bank recognizes the importance of financial system reform, not only because of the effect that a deepening of the credit market has on growth, but also because public resources must be readily available in order to mount a comprehensive effort;

c. Continue to take the form of a multisector credit program (MCP), given their proven operational effectiveness in responding to the types and structure of the target groups' demand for credit (numerous small-scale projects in a wide variety of economic sectors and geographic regions throughout the country), thereby: (i) providing access to a wide spectrum within the group through the use of fairly small loans; (ii) ensuring the transparency of resource allocation based on profitability and market criteria, and guaranteeing proper management and oversight; and (iii) using the BNDES system to maximize the impact of these resources in financing efficient investment projects that will boost competitiveness;

d. Continue to operate under the framework of the CCLIP, given its rationale, relevance, and additionality.[17]

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[17] CCLIPs are designed to provide a credit line for additional investment projects in cases where the Bank has consecutively financed similar ones. In order to benefit from one of these lines, it is essential that: (i) the previous projects have been executed in a fully satisfactory manner; (ii) the financed projects have been properly operated and maintained; and (iii) that the proposed executing agency be the same and have a track record of good governance. These three requirements are perfectly met in the program proposed herein.

1.24 From these perspectives, the program, like its precursors, seeks to mitigate symptoms of the existing structural problems by covering part of the shortfall of medium- and long-term financing for MSMEs. Therefore, and drawing on the experience gained, *the foreseeable impacts of the program would be relevant from several perspectives*, namely:

a. ***From a financial standpoint***, the quite positive characteristics described in paragraph 1.14 of the BNDES package of indirect operations—and, hence, of the programs included in it—do not need to be altered;

b. ***From an economic standpoint***, the programs have always been in keeping with their inherent philosophy**.** While their financial characteristics fell within design expectations, and since the IFIs act as an incentive-compatible mechanism for selecting the most viable companies, the impact of their projects (assuming the economy's structural variables remain constant) would be determined by market conditions. The IFIs would choose the best firms under the program and, as these enterprises repaid the credits (with suitably low delinquency rates), market mechanisms would ensure that the best projects were selected.[18]

- Given this dynamic, the program, like each of the previous operations, does not consider it possible to determine the impacts that each of the programs would have on an *a priori* basis. Nonetheless, given how important it was to conduct *ex post evaluations of what outcomes the market makes it possible to attain at each point in time*, the sample designed in 1999 will continue to be used as an ad hoc mechanism, to be managed by the Bank's Country Office in Brazil, for monitoring and assessing these projects' economic impact on investment and employment on an ongoing basis using a representative sample of beneficiary MSMEs;

- The findings for that sample as regards the impact of the last project indicate the following: (i) gross sales rose by 31%; (ii) the number of jobs climbed from 20,507 to 23,136 (a 13% increase, with an average of 12 jobs being created per subloan); (iii) the sums invested were on the order of 1.76 times as much as the amount of program financing (the MSMEs' own capital inputs plus the working capital provided by the IFIs); and (iv) the entrepreneurs who were surveyed rated 91% of the operations as satisfactory or very satisfactory.

c. ***From the standpoint of the reinvestment of program resources in eligible credits*** (a key factor in gauging BNDES' commitment to MSME development), an analysis of the past five years indicates that BNDES: (i) has

[18] Equating this with a design criterion focused solely on disbursements would be an inappropriate interpretation of the MCPs, since one of their core features is that they rely on the market to ensure that the operations will have the maximum impact at any given point in time.

not amortized its counterpart contributions and has consequently maintained surplus program funding; and (ii) has increased program allocations by over R$3 billion. BNDES has therefore contributed more than required to comply with the contractual terms and conditions relating to the reinvestment of program-generated funds. BNDES, in the framework of the CCLIP, committed itself to maintain this policy for this program; Link 4

d. ***From the standpoint of other financial additionalities***, the program:

- will continue to promote the development and deepening of financial markets by enabling IFIs to generate funds, by providing financing, on market terms and conditions, for use as working capital. This will: (i) deepen banking coverage; (ii) permit targeted lending;[19] and (iii) gradually formalize MSMEs, which, once they begin to engage in formal banking operations, can then boost their competitiveness, become part of the tax base, and pay into the FAT (thereby helping to fund the system);
- would be positive for lengthening maturities on system liabilities, because loan maturities in the financial system are largely determined by the level of risk perceived by depositors. This, in turn, is influenced by a number of factors, including the quality of institutional assets and the volatility of macroeconomic variables. From both of these standpoints, the program will have a positive impact on the length of maturities in the system for the following reasons: (i) if the BNDES system's delinquency rate stays low, the market will view the IFI portfolio as a quality portfolio; and (ii) BNDES policies contribute to macroeconomic stability;
- would minimize the asymmetric-information costs borne by IFIs by helping them to obtain information on borrowers, their businesses, and their use of the loans, thereby enabling them to narrow their spreads. At the same time, the commercial banking system will continue to develop appropriate technology for MSME credit management which will outlive the MCP and facilitate the extension of bank credit to this sector.

H. Scope

1.25 The size of the second program under the CCLIP has to be in keeping with existing needs and the disbursements made in recent years. Based on an evaluation of demand, it is estimated that a program of US$1 billion with a commitment period of up to three years would have an additionality in the real sector of the economy equivalent to those of previous programs. An operation of this scale could be executed without difficulty (as in previous cases) and could finance nearly 10,500

[19] According to the Bank's own estimates for previous programs, 20% of the credits funded by IFIs have gone to microenterprises and 60% to small and medium-sized enterprises (Source: permanent representative sample developed by the Bank's Country Office in Brazil with assistance from the University of Brasilia).

new credit operations per year, which would entail disbursements equivalent to those that have been made up to now. Link 4

II. THE PROPOSED PROGRAM

A. Objectives and strategy

2.1 The objective of the proposed program is to support efforts to progressively strengthen private-sector MSME competitiveness and job creation by providing medium- and long-term financing for investment projects. The program will be aligned with preceding operations and with the strategy for supporting the government's efforts to make the country's production sectors more competitive.

B. Description

2.2 Under the proposed program, medium- and long-term financing will be channeled by BNDES to MSMEs through regulated IFIs for investment projects aimed at expanding, modernizing, and diversifying the production activities of ventures that display the requisite technical, financial, economic, legal, and environmental viability.

2.3 Program resources, which will total US$2 billion, will be used to provide *real*-denominated financing for eligible firms for use in investment projects and as permanent working capital. The program will (i) have a three-year execution period; (ii) use funds drawn on the Single Currency Facility, in U.S. dollars from the Bank's Ordinary Capital; and (iii) be subject to the Local Currency Facility under the terms approved by the Board of Executive Directors in the reformulation of the CCLIP. All funds will be channeled by BNDES through second-tier mechanisms of proven efficiency. The activities and components involved in this operation are described in the attached logical framework. Operational policies are reflected in the respective Credit Regulations agreed upon by the Bank and BNDES, which must enter into effect prior to the first disbursement.

C. The loans

2.4 The credit to be provided to microenterprises and microentrepreneurs (individuals), will be packaged as *real*-denominated subloans. These subloans will be for a maximum of US$200,000 and will be granted to units having gross annual sales of up to US$400,000. The funds for small businesses will take the form of *real*-denominated subloans of up to US$850,000 and will be granted to firms having gross annual sales of between US$400,000 and US$3.5 million. The funds for medium-sized enterprises will be used to provide *real*-denominated subloans of up to US$3 million to firms having gross annual sales of between US$3.5 million and US$20 million.[20] This credit will be granted for use in financing investments and as

[20] These amounts are also contractually denominated in reais. The maximum amount of the balances due on subloans granted to a subborrower, funded with resources from the program and from previous programs, may not exceed these ceilings. In recent years, BNDES has consistently sought to focus the credit line increasingly on microenterprises and small businesses.

working capital for projects designed to modernize and expand production and service activities.

D. The onlending system

2.5 Based on the lessons learned about the structure of the programs, the onlending systems, rates, and spreads that will be used for MSME loans will be the same as those now in use in the BNDES system, applied through the CCLIP, which are: (i) the TJLP; (ii) the usual BNDES spread (1%); and (iii) the spread used by the IFIs, which they set at their discretion.

E. Currency

2.6 The program will be funded in U.S. dollars. The exchange-rate risk to which BNDES will be exposed when it converts the IDB loan into reais (R$) will be adequately covered, since BNDES policies (which are regulated by BACEN) stipulate that it must fully cover its exchange-rate risk at all times. It accomplishes this through: (i) financial matching of all of its operations using a methodology that conforms to the usual practices in this area; and (ii) adequate provisioning.

2.7 At the same time, and to minimize this exchange-rate risk, BNDES will have the right, under the provisions of the **Local Currency Facility** (LCF), to convert program balances for disbursement in reais. In this regard, the LCF:

a. holds that loans continue to be approved in one of the four currencies offered under the Single Currency Facility (the Swiss franc, the euro, the Japanese yen, or the U.S. dollar), and in U.S. dollars under the Dollar Window, Emergency Lending Facility (ELF), or Private Sector Lending (PSL);

b. allows borrowers to request (i) that all or some of future loan disbursements be made in local currency; (ii) that, additionally and whenever possible, existing balances pending reimbursement be converted, on a case-by-case basis, to local currency; and (iii) that, in both cases, the Bank provide the financing in local currency, subject to currency availability and market conditions;

c. provides that each transaction requires (i) that that borrower have obtained timely government authorizations; (ii) that the Bank have access to its financing in local currency in the most efficient manner through the various mechanisms available in the marketplace;[21] (iii) that the financial conditions offered reflect the best prevailing market conditions from the standpoint of minimizing cost at the time of each conversion and for the type of funding

[21] The Bank (i) will decide whether bonds or swaps would be most appropriate from the standpoint of the actual cost of the loan, to respond to borrower requests related to size and maturity; and (ii) has the right, pursuant to the loan contract, not to provide financing in reais if market conditions are unfavorable.

requested by the borrower;[22] and (iv) that it is possible to mitigate potential financial risks;

d. bases this mitigation on the matching finance design, which is supported by three pillars: (i) maintaining the profile of Bank loans (for terms and amortization schedules); (ii) Management's recommendation to the Board of Executive Directors (as stated in the Facility) that, as a general rule, the Bank abstain from maintaining liquidity in local currency; and thus necessarily (iii) the cash flow profiles of liabilities to be issued be adapted to the cash flow profile for Bank loans.

2.8 ***The reformulation of the CCLIP approved by the Board of Executive Directors*** in order to expand BNDES's financing possibilities allows for conversions of disbursements into the program's local currency to have two financial conditions in addition to those established in the LCF:

a. **Concerning the amortization profile**. BNDES-requested conversions can set their terms and amortization schedules in relation to final maturity dates and weighted average life (WAL).[23] In this regard, in the program:

- the matching finance design will be maintained, but would be based on (i) the general recommendation that the Bank refrain from maintaining liquidity in local currency; and (ii) adaptation of the profile of the Bank's loan to the conditions of the financing it obtains (and not the other way around, as the LCF does).[24] *The Bank would thus be in a position to offer financing in reais to BNDES under the best financial conditions available in the marketplace, even if the financing did not have the exact same profile as the original loan*;

- subject to market conditions, the Bank would modify the profiles of each disbursement such that each one could have a different repayment structure with regard to the final maturity and WAL of the original contract. However, such flexibility would be subject to the restriction that the WAL and the final term of the modified repayment periods of the disbursements taken together did not exceed those in the original contract. *The repayment structures could thus be bullet maturities (a single payment at maturity), with shorter maturities and/or extended grace periods, provided that: (i) the Bank's lending authority and total equity-to-loan ratio (TELR) were not affected; and (ii) the municípios did not enjoy different financial terms from the Bank's other borrowers*; Link 6

22 In the case of BNDES, variable interest rates could be fixed or variable (CDI) or could be associated to inflation indices (IGP-M or IPCA), depending on borrower willingness and market availability.

23 The period of weighted life is defined as the time from the date the loan is signed to the date of repayment of installments, calculated for all pending disbursements in local currency.

24 The Bank's borrowers have the right to shorten the amortization schedules of their operations.

- the modified amortization structures will be designed by mutual agreement between BNDES and the Bank, so as to ensure that under no circumstances do they adversely affect fulfillment of the program's development objectives.

b. **Price based on actual financing costs**: In cases where it is operationally possible (essentially in those cases in which the Bank can source its financing in local currency by issuing bonds): (i) a pass-through of the effective cost of the Bank's sourcing to the borrower would be possible; and (ii) the lending rate on such conversions would reflect the Bank's cost of sourcing plus the spread applicable to Ordinary Capital loans. *Thus, the risk premium provided for in the LCF would not apply and the flexibility introduced in the repayment profiles would become feasible*. Link 7

2.9 Historically, the operational characteristics of the BNDES MCP programs have entailed making a small number of large disbursements, with a high degree of flexibility in timing. Both characteristics make the programs very well-suited for use of the Facility.

2.10 The conversions to local currency under the program will require an exception to the LCF, with respect to the nonapplicability of the funding in local currency interruption clause.[25] In this regard,

a. as a result of this, disbursements or conversions into reais already made for BNDES will be maintained in that currency on BNDES' balance sheet, even if the Bank's access to financing in reais is interrupted. *Therefore, BNDES will not be affected by contingent risks in foreign currency originating from the credit risks of the counterparties chosen by the Bank for funding*;

b. the risk that the Bank's access to financing in local currency could be interrupted could only occur: (i) if its source of financing was the swap market; (ii) in case of default by the counterparty in such operations; and (iii) if such default was combined with a market interruption in which the Bank—after having done everything possible and subject to its internal policies and guidelines—was unable to replace its financing in reais (prior to expiration of the disbursement deadline and with the same type of basic rate). The likelihood that this risk would materialize is considered very low and its impact limited:

- In cases where the Bank funds itself through a bond issue, there is simply no possibility of interruption in its funding;

- Under the scenario that the Bank funds itself through swaps, the likelihood of counterparty default is considered small because the Bank follows strict policies that (i) require the counterparties to have a high

[25] This clause establishes that the Bank may revert local currency conversion to convertible currency if funding in local currency is interrupted and the Bank cannot obtain replacement financing.

rating (A+ or higher) from the rating agencies; (ii) require collateral guarantees; (iii) presuppose their replacement if they begin to have financial problems; (iv) allow for the possibility that not all swaps be made fully with the same counterpart; and (v) provide for the swap counterpart to be replaced in the event of default;

- In addition, the likelihood that a market disruption would prevent replacement of Bank financing in reais is considered even lower.

c. In any case, if as a result of an interruption of its financing in reais under the scenarios analyzed, the Bank found itself in a currency mismatch situation: (i) it would be the result of unforeseeable circumstances inherent in the banking business that would have ensued subsequently and in relation to some initial transactions designed to avoid such a mismatch; (ii) it would not imply a violation of the Agreement Establishing the Bank, according to the Legal Department's legal opinion of 8 August 2006;[26] and (iii) financial risks could ensue that would have to be managed in a suitable manner;

d. These financial risks are not considered to be material; Link 8

e. In any case, if such a market interruption were to occur, the Bank would not be required to continue disbursing in local currency, inasmuch as conversions are always subject to market availability.

2.11 The additionality of the possibilities opened up by the LCF, as redefined for the CCLIP, would come from the way BNDES uses them. If the country's macroeconomic situation remains positive (which is allowing for adoption of policies to progressively reduce the debt in U.S. dollars and to gradually reduce spreads between U.S. dollar and reais rates), BNDES would opt to exercise the right to convert to local currency whenever the Bank offered financial conditions that were in its interests.

2.12 In such a case, disbursements in reais funded through issuance of long-term bonds would allow the Bank to obtain an additional benefit, namely, collaborating in developing and strengthening the yield curve in offshore reais markets, thus responding to the request by the National Treasury (subject, of course, to the principle of providing financing to BNDES in local currency in the most cost-effective manner).

F. Scale, Bank financing, disbursements, and costs

2.13 An evaluation of the potential demand for financing indicates that the program could tentatively be executed in three years. Since, for the most recent operation, the individual BNDES loans averaged the equivalent of US$64,800, it is estimated that the program could finance approximately 10,500 new credit operations per year Link 4. In that regard:

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[26] The Agreement Establishing the Bank prohibits the Bank from having a currency mismatch in its balance sheet.

a. the sources of program financing will be the US$1 billion loan plus US$1 billion in local counterpart funding (including the funds of both BNDES and the subborrowers, which will be equivalent to at least 15% of each subloan in the first program under the credit line);

b. the US$1 billion in IDB loan funds will be in dollars (Single Currency Facility, LIBOR-based) and will be drawn from the Bank's Ordinary Capital;

c. BNDES could opt to request partial execution at the adjustable rate for the Single Currency Facility;

d. the loan could be disbursed in reais with the features of the LCF and the reformulation of the CCLIP;

e. the commitment and disbursement periods for program resources have been set at three and four years, respectively (the funds will be considered to have been committed when the borrower has notified the IFIs that the respective credit lines are available);

f. the estimated timetable provides for total disbursements of US$660 million per year, with 50% of this sum being disbursed by BNDES and 50% by the Bank. This provision is subject to the BNDES system's financing requirements, however;

g. subloans disbursed between 1 July 2006 and the program approval date in the amount of US$250 million from the loan and an equivalent amount from the local counterpart contribution will be recognized.

2.14 Program costs will be distributed as follows:

Table II-2- Program Cost, by Source of Financing
(millions of US$)

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

III. IMPLEMENTATION

A. Borrower, executing agency, and guarantor

3.1 The borrower and program executing agency will be the Banco Nacional de Desenvolvimento Econômico e Social [National Economic and Social Development Bank] (BNDES), which was founded by Law 1628 of 1952 and is regulated by Law 5662 of 1971. The guarantor will be the Federative Republic of Brazil. The guarantee would be limited to debt servicing and to the obligation to take the necessary steps for the borrower to fulfill its positive contractual covenants. In that regard, the Federative Republic: (i) will not assume responsibility for

making the counterpart contributions, since they are not provided for in the national budget and would be difficult to add given current fiscal constraints; and (ii) in no case can directly assume the positive covenants of BNDES (as a bank).

3.2 Under its charter, BNDES is authorized to secure the necessary domestic and external financial resources for its operations. Previous programs have demonstrated that BNDES has the necessary experience and incentives to execute this project.

B. IFI eligibility

3.3 Commercial and multipurpose banks (both private and public) possessing a development banking portfolio, investment banks, development banks, and other regulated institutions that meet the requirements established by BNDES can qualify as IFIs for the purposes of the program. The procedures involved in determining the eligibility of IFIs working with the BNDES system and their risk ratings include an initial assessment for those purposes, the establishment of a credit limit, and semiannual monitoring of each institution's economic and financial performance in order to provide a basis for reaffirming or modifying the risk ratings and lending ceilings. The current screening process entails strict eligibility criteria based on a comparative index methodology for similar IFIs. This methodology looks at: (i) variations in risk indices; (ii) the statistical significance of the resulting values; (iii) the financial agents' size, quality, and risk concentration; and (iv) the level of management and management changes. It also covers the performance and quality of the IFIs' portfolios of loans funded with BNDES resources. This last factor is of particular importance in rating the institution and in the semiannual reviews of its credit ceilings. These criteria are in keeping with current BACEN regulations concerning solvency, liquidity, and rates of return, as well as with BNDES' internal policies on eligibility and credit ceilings. Link 9

3.4 In order to participate in BNDES' Indirect Operations Programs, IFIs must: (i) comply with BACEN regulations, since BACEN oversees the system; (ii) have borrowings from the BNDES system consistent with the risk assessments performed; (iii) submit an independent, external audit each year that is free of exceptions or relevant observations; (iv) have no payments arrears with BNDES from previous operations; (v) commit to full disclosure of relevant information concerning subborrowers in the program upon request to the Bank or BNDES; (vi) allow the body selected by the Federative Republic of Brazil to audit and inspect program operations; and (vii) have a reporting system that provides information on the nature of subprojects, their financing sources and conditions, progress in their execution, and their payment status.

C. Operational aspects

1. Operating procedures

3.5 All (100%) of the program funds will be channeled through IFIs. The operational procedures, which have already been drawn up, are the standard ones used for BNDES credit lines and were employed in the first program under the CCLIP.

2. IFI financial responsibility

3.6 The IFIs will be wholly responsible for evaluating the risk associated with subborrowers and for the decision to grant financing in accordance with the Regulations and with BNDES' policies on indirect operations with MSMEs. The IFIs will assume responsibility for the servicing and repayment of the subloans to BNDES, regardless of whether or not the subborrowers fulfill their servicing obligations with the IFIs.

3. Credit Regulations

3.7 The program will have its own Credit Regulations: (i) that are consistent with the regulations and policies of BNDES and the Bank and with the financial practices and laws in force in the country; (ii) that reflect its main features; and (iii) whose approval by the Bank and implementation by BNDES will be a condition precedent to the first disbursement. The main provisions include those set out below. Failure to comply with these provisions will result in the denial of access to financing:

a. Subborrowers and use of the funds

3.8 Private-sector MSMEs and individuals, as defined in Brazilian law, which are legally resident in the country may participate as borrowers in the program if, in accordance with the program and in the judgment of BNDES and the participating IFIs, they possess the administrative, technical, financial, legal, and environmental capacity to execute the projects for which the loans are extended.[27] Program funds are to be used to finance IFI subloans for fixed investments or for use as permanent working capital for the execution of investment projects by qualifying Brazilian MSMEs.[28] "Permanent working capital" is defined as capital associated with fixed investments financed by the program. IFIs must immediately deliver to BNDES any and all funds obtained through the recovery of subloans or the receipt of advance payments on such subloans, in accordance with the latter's operating procedures.

b. Participation of IFIs

3.9 The financial institutions cited in paragraph 3.3 and other regulated entities that meet the limits and requirements set forth in the BNDES operational policies now

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[27] The obligations of subborrowers are set out in Article 10 of the Credit Regulations.

[28] All projects that are financed with program resources are required to have the corresponding financial and environmental feasibility study prepared in accordance with BNDES policies.

in force, which have been incorporated into the Credit Regulations for each operation, will be eligible to participate in the program as IFIs.

c. Financial terms and conditions of subloans

3.10 ***Maturities***: Subloan maturities will be determined by the IFIs in accordance with each project's characteristics and the subborrower's repayment capacity, bearing in mind the conditions set forth in BNDES operational policies and the maximum limits established in each set of Credit Regulations.

3.11 ***Denomination*****:** The funds onlent through IFIs to subborrowers will be denominated in reais (R$).

3.12 ***Interest rates and other financial charges*****:** The final rate applied to subborrowers will be consistent with Bank policies for that type of financing and, in all instances, will include the respective intermediation spread for each IFI, which will be freely negotiated by the IFI and the subborrower. The annual interest rate to be charged on loan funds onlent to IFIs will be the basic long-term interest rate (TJLP), plus a spread currently set at 1%. This rate will be adjusted quarterly. Any change in the interest rate modality or the spread applied by BNDES must, as in the case of the other provisions contained in the Credit Regulations, have the Bank's approval prior to its application to subloans financed with program resources.

3.13 ***Delinquency charges***: BNDES and the IFIs, in each case, may include interest charges and financial penalties for delinquency in the event of nonperformance of the relevant onlending and subloan contracts.

3.14 ***Subprogram limits*****:** The Credit Regulations will establish the following limits: (i) the subloan ceilings for micro, small, and medium-sized enterprises under this program are the equivalent of US$200,000, US$850,000, and US$3 million, respectively; (ii) the ceilings for the balances due on subloans funded with program resources or loans granted under previous IDB-funded programs are the same as above; and (iii) in the event that BNDES, BNDESPAR (Link 3), the IFIs, their shareholders, or groups to which they belong hold voting shares (equal to or greater than 15% of such shares) in the enterprise applying for a subloan, the extension of said loan will be contingent upon the express approval of BNDES and the nonobjection of the Bank.

3.15 ***Disbursement procedures:*** Funds will be disbursed by BNDES to IFIs, through each subloan, so that they may then onlend those funds to eligible firms in accordance with established BNDES procedures for such operations. To date, the onlending of such resources has been channeled through the FINAME and BNDES Automático facilities.

d. Restrictions on the use of program funds

3.16 Program funds may not be used to finance the following: (i) the purchase of immovable assets; (ii) dividend payments or recovery of invested capital; (iii) the purchase of equities, bonds, or other movable assets; (iv) subborrowers' general or administrative expenditures; (v) projects that do not meet the environmental

standards set forth under Brazilian law or established by the relevant public agencies; (vi) debt refinancing; and (vii) working capital other than permanent working capital associated with a project or with imported inputs or inputs having a significant import content, in accordance with BNDES' operational policies. IDB financing may not be used for any of the following purposes either: (a) tax payments; (b) the purchase of used movable goods, except in the case of used equipment and machinery that has an independent technical and economic appraisal, with the prior approval of the Bank; and (c) the purchase of goods and services from countries that are not members of the Bank.

e. Environmental and social monitoring

3.17 In accordance with procedures in place for CCLIPs, The Committee on Environment and Social Impact reviewed the project report for the Line and found BNDES' current environmental monitoring mechanisms to be satisfactory. In this regard:

a. BNDES has a *comprehensive mechanism for project environmental quality control* designed on the basis of the environmental standards of the Conselho Nacional de Meio Ambiente [National Environmental Commission] (CONAMA) that is fully operational. With respect to this program:[29]

- This mechanism is composed of: (i) internal environmental policies and procedures that emphasize rating, approval, and monitoring of performance of contractual obligations pertaining to loans granted by IFIs; (ii) review of the files on each loan operation to verify that they contain, as appropriate, the proper environmental certificates issued by the competent authorities, and on-site supervision of program users based on the sample prepared jointly by the Bank's Country Office in Brazil and BNDES; and (iii) to date, the mechanism has functioned satisfactorily;[30]
- The subloans (i) by their nature carry little environmental risk;[31] and (ii) may be granted only to projects that submit the necessary authorizations and fully comply with Brazilian environmental legislation.

b. As for the government's social strategy, as described in paragraph 1.5 since 2002 BNDES has employed the concept of social inclusion as a basic guideline for its operations and has been supporting projects that have a direct impact on the population's living conditions;

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[29] The requirements set forth in the Environmental Procedures and SEA Guidance for CCLIPs are not applicable insofar as they were not written for MCP operations.

[30] BNDES has submitted an environmental monitoring report on each of the operations financed by loans 1125/OC-BR, 1175/OC-BR, 1374/OC-BR, and 1608/OC-BR.

[31] Using guideline B.13 of the Bank's environmental policy, the subloans fall under Category C as described in Policy B3.

c. The conclusions of the program's Environmental Monitoring Report (loan 1608/OC-BR) state that (i) funds disbursed to date (US$990 million) have financed 31,755 operations; (ii) borrower compliance with environmental legislation through pertinent certifications has been required of every operation; (iii) all operations are considered Category C; (iv) the sample BNDES maintains reviewed 1,186 operations in 2005; and (v) 219 monitoring visits have been made.

3.18 For these reasons, the program will use the current environmental monitoring mechanisms and procedures described above, which are similar to those for previous programs.

f. Procurement structure

3.19 Procurements under the program will adhere to the provisions of the Bank's new procurement policies (documents GN-2349-7 and GN-2350-7), with particular attention to paragraph 3.12 of the former document, which addresses loans to financial intermediaries. That paragraph states, "…the procurement is usually undertaken by the respective beneficiaries in accordance with established private sector or commercial practices". Furthermore, Appendix IV (Policies for Procurement in Loans to the Private Sector) states, "…the Bank ensures that such procedures result in competitive market prices for the goods and services and that these meet the needs of the project."[32]

3.20 The program, just as in all previous BNDES programs, is characterized by the fact that the Bank financing: (i) will be combined with financing from BNDES, in much greater quantity, with commingling of funds; and (ii) will be disbursed through two programs (FINAME and BNDES Automático), from among existing programs under the BNDES Indirect Operations mechanism. The overriding principle of these programs is to foster and develop domestic industry, in particular, the MSMEs (with the impacts that are laid out in paragraphs 1.14 and 1.24b).

3.21 The focus of these programs has been considered acceptable because (i) the impact these programs have had in developing domestic industry (according to a principle explicitly stated in the Bank's procurement policies, paragraph 1.2c); (ii) they allow for the financing of goods with up to 40% nondomestic content; (iii) the small average size of each operation, namely, US$44,000 for microenterprises, US$58,000 for small businesses, and US$61,000 for medium-sized enterprises; (iv) they allow for the financing of imported goods under other programs (BNDES Automático and BNDES Importação); (v) the disallowance of differentiated treatment of program funds (given the aforementioned commingling of funds); and (vi) the existence of a large number of foreign firms belonging to member countries with productive processes in Brazil that utilize FINAME. Link 10

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[32] It is important to mention that for the vast majority of MCPs approved by the Bank in recent years under the old policies (nine programs since 1998, in an amount of US$5.025 billion) it was not necessary to make reference to the application of the policy because the size of subloans was always relatively small and current competitive market practices were always applied.

D. Implementability and institutional framework responsible for execution

3.22 The implementability of the program derives from the institutional structure of BNDES. Prime responsibility for coordinating execution of the program will be borne by the unit in charge of operations with international agencies within the Departamento de Captação de Recursos [Borrowings Department] (DECAP) in the BNDES financial cluster. The BNDES departments responsible for the evaluation of financial agents, operations, and portfolio monitoring will also be directly involved in executing these programs. The Bank will supervise and oversee the program through its Country Office in Brazil and the BNDES/IDB joint technical committee (see below). Link 11

E. Program and executing agency audits

3.23 BNDES and the IFIs will keep special records on the operations financed with program resources. They will include records of: (i) the amounts of the subloans funded by the Bank and by the local counterpart; (ii) the interest falling due and collected on the funds used; (iii) the subloans granted; and (iv) the establishment and use of loan-loss provisions. These data should permit the preparation of annual statements of account, income statements, and other program reports.

3.24 Auditing of the program's financial statements will be the responsibility of the Secretaria Federal de Controle [Federal Secretariat for Auditing] (SFC). BNDES' audits will be conducted by an independent auditing firm that meets with the satisfaction of the Bank. Audits of previous programs demonstrate the capacity for financial management and the presence of accounting systems and internal controls, which render preventive measures unnecessary. The scope of the audits and the deadlines for their submission will be determined in accordance with the Bank's policies.

F. Evaluations

1. Regular financial evaluations

3.25 In accordance with Bank policy, during program execution the borrower and the executing agency, on the one hand, and the Bank, on the other, are to review the interest rates being applied to subloans on a regular basis. The borrower will, if necessary, takes appropriate steps, in keeping with the country's economic policies, to reconcile the subloan interest rates with the Bank's policy objectives. Should changes occur in the applicable base rate, its method of calculation, or the way in which BNDES's basic spread is computed, such changes must be approved by the Bank before they take effect in subloans under the program.

2. Midterm review

3.26 Within the time frame set for the progam (18 months after the first disbursement or once 50% of the loan has been committed, whichever comes first), the borrower and the Bank will review program performance. This review will cover the following: (i) objectives and outcomes, based on the attached Logical Framework and Table of Indicators and on the means of verification set forth therein; Link 12

(ii) environmental requirements, in accordance with Brazilian law and Bank policies; and (iii) the tangible forms in which BNDES pursues its objectives of social inclusion. If it is found that the program has not achieved its objectives to a substantial extent, then appropriate steps will be taken.

3. Ex post evaluation

3.27 In accordance with Bank policy and following consultations on the subject, the executing agency has decided not to include an ex post evaluation among the program activities. BNDES has based its decision on the grounds that the regular evaluations of the CCLIP programs during their execution will provide sufficient information on their progress and outcomes. It is possible, however, that the ex post evaluation could be conducted nonetheless, since the necessary information will be available.

G. Sharing experience

3.28 During program execution, BNDES and the Bank will exchange technical information of mutual interest through the aforementioned joint technical committee. At these meetings, discussions will cover the program's progress and the following topics: (i) the performance of the CCLIP and the advisability of introducing new products; (ii) the exchange and dissemination of experiences with credit programs and programs aimed at developing new financial products for the MSMEs of the region; (iii) implementation of the framework of impact indicators; and (iv) the operational characteristics of the disbursements in local currency.

IV. VIABILITY, RISKS, AND BENEFITS

A. Viability of the CCLIP and the program

1. Macroeconomic

4.1 In 2005 and 2006, the country's level of activity grew (by 2.9% and 3.7%, respectively), and its fiscal accounts remained on a solid footing. (The public sector had an average primary surplus equivalent to 4.5% of GDP from 2003 to 2005 and to 3.8% in 2006.) The positive expectations generated by its performance and the scope of the program relative to the level of unmet demand for medium- and long-term credit provide grounds for the belief that both will be macroeconomically viable.

2. Institutional

4.2 Current banking laws, their supplementary regulations, and the supervisory policies and procedures of BACEN and BNDES provide an appropriate framework for regulating the performance of financial agents and safeguarding their solvency, stability, and liquidity. In addition, BNDES: (i) has demonstrated, through this analysis and experience with previous programs, that it performs its duties responsibly and competently; (ii) has the experience, administrative and operational capacity, and qualified personnel to execute the proposed program; (iii) has the only

IFI network in the country of sufficient quality and scope to ensure a broad distribution of the operation's resources across regions and sectors; and (iv) has the appropriate evaluation and oversight procedures, standards, and capacity to ensure the satisfactory operational management of a program of this size.

3. Economic and financial

4.3 As has been true of previous programs, the economic viability of the program stems from the nature of these initiatives. Since the basic financial features of previous programs will be maintained and the IFIs will serve as incentive-compatible mechanisms for selecting the most viable companies, the impact of the projects they choose (assuming the economy's structural variables remain constant) will be determined by market conditions. The IFIs will choose the best firms and, as these enterprises repay the credits (with suitably low delinquency rates), the market will ensure that the best projects are selected. Viewed in this light, the impact indicators can only be regarded as *a priori* estimates.

4.4 The financial viability of the program will be determined by interest rates, the maintenance of the value of the credit to be provided, and the ready availability of the local counterpart funds. The subloan finance charges will enable BNDES and the IFIs to cover their financial costs and administrative expenses, realize a reasonable profit, and offset their credit risk. The borrower will assume the exchange-rate risk, if any, associated with this credit operation by repositioning its loan portfolio in order to keep its currency mix in balance without altering the organization's overall risk profile. The local counterpart funds will be composed of the contributions mentioned in paragraph 2.13a.

4.5 In sum, in order to become more competitive, the Brazilian economy needs to deepen its financial activities in various areas and boost their efficiency, particularly with regard to the availability of medium- and long-term financing for the modernization of MSMEs, which play an important role in the country's production apparatus for goods and services. To that end, the program will: (i) promote the expansion of medium- and long-term financing to cover private-sector activities conducted by these enterprises; and (ii) indirectly (by increasing the supply of financing available under suitable terms and conditions) help deepen medium- and long-term credit markets (particularly for small and medium-sized entrepreneurs), thereby contributing to the consolidation of the country's economic base and the expansion of its domestic market.

B. Risks

4.6 The success of the proposed program will hinge upon the continued existence of a macroeconomic and financial framework that is conducive to the development of private investment. The risk that imbalances will arise in the financial system is now quite small, given the system's consolidation and the strengthening of regulatory and oversight mechanisms.

4.7 In addition, the structure of the program will mitigate, insofar as possible, the macrofinancial risks (paragraph 1.28d) by acting as a catalyst for sound practices. This catalytic effect will be transmitted via the demands that BNDES will make of the IFIs concerning the use of rigorous screening and portfolio monitoring mechanisms. Past experience with BNDES attests to its efficient execution of MCP programs and its achievement of a high degree of capillarity in its credit operations, together with delinquency rates that are consistently below the average for loan portfolios in the banking system as a whole.

C. Poverty-targeting and social sector classification

4.8 Although the productive investments to be financed by the program will create new jobs in a business segment that primarily employs people from lower-income groups, thereby having a positive impact in these sectors, this is not a poverty-targeted operation according to Bank definitions.

BNDES: Second Program under the CCLIP Line to Support Micro, Small, and Medium-sized Enterprises (BR-L1054)
Logical Framework

Goal	Indicators	Means of verification	Assumptions
Goal (in relation to MSMEs participating in the program)			
Progressive strengthening of competitiveness and job creation in the MSME segment of Brazil's private production sector	a. Number of jobs created in subborrowers participating in the program*	a. IDB/BNDES statistical sample and the Annual Record of Social Data [Relação Anual de Informações Sociais] (RAIS) database	The country's macroeconomic and fiscal situation remains stable following the program's completion.
	b. Gross annual sales of subborrowers participating in the program*	b. IDB/BNDES statistical sample	The financial system remains solid and continues to increase the credit supply.
	c. Failure rate for subborrowers participating in the program*	c. IDB/BNDES statistical sample and SEBRAE study	The IFIs' portfolios are sound, thereby encouraging them to continue using these lines and the associated financing. MSME demand for medium- and long-term credit for use in eligible projects remains high.
	* See the table of indicators in the attached table.		**Market mechanisms continue to allocate BNDES funds to the best projects.**
Purpose (in relation to the IFIs' dealings with MSMEs)			
The MSMEs obtain medium- and long-term funds for eligible projects and see an improvement in their access to the financial system.	18 months into each program and upon each program's completion: a. Time profile of onlending operations**	a. BNDES Corporate Information System (OPE)	MSME demand for medium- and long-term credit for use in eligible projects remains high.
	b. Levels of activity in the FINAME and BNDES Automático credit lines**	b. BNDES Corporate Information System (OPE)	

Goal	Indicators	Means of verification	Assumptions
	c. Time required for subborrowers to access credit** d. Additional project financing supplied by entrepreneurs or other sources.** e. The IFI delinquency rate for the program's subborrowers versus the delinquency rate for unearmarked funds in the system** ** See the table of indicators in the attached table.	c. IDB/BNDES statistical sample d. IDB/BNDES statistical sample e. Information from the BNDES International Finance Department	The IFI portfolios are sound, thereby encouraging them to continue using these lines and the associated financing.
Components (BNDES' dealings with IFIs)			
The extension by BNDES of medium- and long-term credit lines (FINAME and BNDES Automático) to IFIs	18 months into the program and upon its completion: a. Number of participating IFIs*** b. Quota assigned and reported*** c. Level of IFI capillarity*** d. Average IFI spread for each product and the movement of those spreads*** *** See the table of indicators in the attached table.	a. b. c. Internal reports of BNDES Credit Department d. IDB/BNDES statistical sample	Brazil's economy continues to offer a suitable climate for private investment. The MSME segment identifies profitable projects that are bankable for IFIs and generates a demand for medium- and long-term credit on the terms offered by the BNDES system. The risk borne by BNDES in working with the IFIs remains low and disperse. The IFIs: • **Assume MSME risk for eligible projects** under the terms set forth in the Credit Regulations and support the execution of those projects **by providing loan packages to supply the necessary working capital.**

Goal	Indicators	Means of verification	Assumptions
			• Apply spreads that are compatible with the projects' rates of return.
Activities (of BNDES)			
a. Continued monitoring of the financial status of the IFIs by BNDES b. Continued operation of the FINAME and BNDES Automático lines c. Continued supervision of operations by BNDES/DEAOI	18 months into the program and upon its completion a. **Evaluation and monitoring** of the IFIs by the BNDES Credit Department continues as before. b. Eligible **subloans** and **operation of the lines of credit** (FINAME and BNDES Automático) continue as before in accordance with the Credit Regulations. c. Annual **inspections** by BNDES/DEAOI continue to take place as before in accordance with the internal rules and policies of BNDES.	a. Report of BNDES Credit Department b. Records of BNDES Corporate Information System (OPE) c. Records of physical inspections of BNDES/DEAOI Indirect Operations Department	The relevant (legal, fiscal, and environmental) regulatory framework is satisfactory for program implementation. BNDES maintains its institutional capacity to administer the planned volume of credit lines for the program. The IFIs: • Remain interested in using the FINAME and BNDES Automático credit lines, given the demand for credit for eligible projects. • Maintain their status as approved borrowers with BNDES. • Continue to apply narrower risk-adjusted spreads under these programs than for outside loans.

BNDES: Second Program under the CCLIP Line to Support Micro, Small, and Medium-sized Enterprises (BR-L1054)
Logical Framework

Indicators	Baseline	Market estimates
* **Goal**		
a. Number of jobs created in the subborrowers participating in the program.	a. The statistical sample of the Country Office in Brazil shows a 13% increase in jobs on the payrolls of subborrower firms from the time the subloan was granted.	a. Increase in the number of jobs in subborrowers participating in the program, by size of enterprise: - Micro: 65% - Small: 15% - Medium: 10% (greater than those given in the Annual Record of Social Data [Relação Anual de Informações Sociais] (RAIS) database)*
b. Gross annual sales of subborrowers participating in the program.	b. The statistical sample of the Country Office in Brazil shows a 31% increase in the annual gross sales of subborrower firms from the time the subloan was granted.	b. Increase in the gross annual sales of subborrowers participating in the program during the review period, by size of enterprise: - Micro: 85% - Small: 25% - Medium: 15% *
c. Failure rate for subborrowers participating in the program.	c. The baseline starts from zero at the outset of the program; failure rates for 1996-2000 are evaluated by SEBRAE: - Micro: 38.5% - Small: 37.9% - Medium: 36.7%	c. The failure rate for subborrowers participating in the program is 50% less than the failure rates given in the most recent SEBRAE study available
** **Purpose**		
a. Time profile of onlending operations. b. Level of activity in the FINAME and BNDES Automático credit lines.	a. Profile of disbursements under loan 1374/OC-BR: 2002 = 46%; 2003 = 53%; and, 2004 = 1%, and loan 1608/OC-BR: 2005 = 50%, 2006 = 49%, and 2007 = 1%. b. According to the monitoring report on IDB Contracts 1374 and 1608, program breakdowns were as follows: **IDB 1374** / **IDB 1608** a) By product: - FINAME: 75% / 97% - BNDES Automático: 25% / 3% b) By total funds: - Micro: 24.4% / 30.1%	a. The provisional timetable for onlending operations calls for the disbursement of 33% of the funds per year; under no circumstances is the disbursement rate to fall below 15% of the total. b. The program is based on the assumption that the market will allocate resources efficiently based on the signals sent out by the real sector of the economy.

Indicators	**Baseline**	**Market estimates**
	- Small: 36.6% 34.7% - Medium: 39.0% 35.2% c) Disbursements by region: - North: 4.2% 4.5% - Central-West: 8.2% 6.6% - Northeast: 12.4% 11.5% - Southeast 44.3% 42.7% - South: 30.9% 34.7% d) Disbursements by sector: - Agriculture: 2.2% 1.1% - Mining: 1.7% 0.9% - Manufacturing: 24.4% 21.3% - Commerce: 15.2% 5.8% - Services: 56.5% 70.9%	
c. Time required for subborrowers to access credit.	c. The baseline will be set by reference to the final results of the IDB/BNDES statistical sample, which will be used to compare, by size and product, the firms' founding dates with the length of time they have been clients of the IFI and the date the subloan was granted.	c. The program will attempt to keep close watch over the amount of time that it takes for MSMEs to become bona fide borrowers within the financial system.
d. Additional project financing supplied by entrepreneurs or IFIs.	d. The baseline will be set by reference to the preliminary outcomes of the IDB/BNDES statistical sample in loan 1608/OC-BR, which will reflect the following list: (i) FINAME*:* (a) program resources; (b) entrepreneurs' own funds and other sources of funding; (ii) BNDES Automático: (a) program resources; (b) entrepreneurs' own funds and other sources of funding. Preliminary outcomes work on a multiplier of 1.76.	d. The program will attempt to maintain the investment multipliers attained for each product.
e. The IFI delinquency rate for the program's subborrowers versus the delinquency rate for unearmarked funds in the system.	e. In December 2005, the delinquency rate (up to 90 days) for individuals and corporations, with the IFIs in the sample was 2.08%, whereas the delinquency rate as of that date for the system as a whole (BACEN) for operations involving unearmarked funds was 4.2%.	e. The aim of the program is for the ratio between the two delinquency rates to remain constant.

Indicators	Baseline	Market estimates
***** Components**		
a. Number of participating IFIs.	a. A total of 82 IFIs participated in loan 1374/OC-BR, and 65 IFIs participated in loan 1608/OC-BR. In loan 1608/OC-BR, the 10 largest IFIs disbursed 82% of the program funds.	a. Of the 248 institutions in the financial system that are registered with the BNDES system, 50 are active competitors for the funds made available by the Indirect Operations System. The program maintains that number of participating IFIs.
b. Quota assigned and reported.	b. Given the nature of the risk analysis process, there can be no baseline for this indicator.	b. N.A.
c. Level of IFI penetration ("capillarity").	c. The potential penetration of points of sale in loan 1374/OC-BR was 15,098 points of sale, whereas loan 1608/OC-BR had about 16,500 points of sale.	c. The level of penetration offered by IFIs increased from 15,098 to approximately 16,500 points of sale.
d. Average IFI spread for each product and movement of those spreads.	d. The baseline will be set with reference to the final results of the IDB/BNDES statistical sample for loan 1608/OC-BR. The average spread for the loan 1608/OC-BR sample was 4.64%.	d. The program will attempt to keep close watch over trends in the spreads applied by the IFIs, disaggregating such trends by firm size, length of time the firm has been a client, etc.

Note: This benchmark is simply an approximation of what appears to be credible at the time of writing. Be that as it may, the fact remains that the market is the only mechanism that will ultimately determine the impact of a Multisector Credit Program (MCP) at any given point in time.

* The market estimates shown here are based on the findings for the statistical samples prepared for loans 1125/OC-BR, 1175/OC-BR, 1374/OC-BR, and 1608/OC-BR.

COMPONENTS
A) NUMBER OF PARTICIPATING INTERMEDIARY FINANCIAL INSTITUTIONS
(AMOUNTS IN US$)

	IFI	Total	Percentage	Cumulative
01	Banco Bradesco S.A.	370,021,518	21.33%	21.33%
02	Banco Volkswagen S.A.	262,991,151	15.16%	36.48%
03	Banco Daimlerchrysler S.A.	227,616,034	13.12%	49.60%
04	Banco Dibens S.A.	151,689,721	8.74%	58.34%
05	Banco Safra S.A.	73,938,441	4.26%	62.61%
06	Unibanco – União de Bancos Brasileiros S.A.	72,191,406	4.16%	66.77%
07	Banco Volvo S.A.	66,503,375	3.83%	70.60%
08	Banco ABN AMRO Real S.A.	64,550,310	3.72%	74.32%
09	Banco do Brasil S.A.	62,907,617	3.63%	77.95%
10	Caixa Econômica Federal	60,614,935	3.49%	81.44%
11	Banco Itaú S.A.	43,976,738	2.53%	83.97%
12	Banco CNH Capital S.A.	42,548,677	2.45%	86.43%
13	Caterpillar Financial S.A. – Crédito financiamento e investimento	39,278,241	2.26%	88.69%
14	Banco regIonal de Desenvolvimento do Extremo Sul	30,957,557	1.78%	90.47%
15	Banco Sudameris Brasil S.A.	20,678,270	1.19%	91.67%
16	Banco Mercantil do Brasil S.A.	19,139,124	1.10%	92.77%
17	BankBoston Banco Múltiplo S.A.	14,858,595	0.86%	93.63%
18	Banco BMG S.A.	11,796,538	0.68%	94.31%
19	Banco do Estado de São Paulo S.A. – BANESPA	11,543,507	0.67%	94.97%
20	Banco Santander Brasil S.A.	10,576,345	0.61%	95.58%
	Other Banks	76,683,546	4.42%	100.00%
Subtotal		**1,735,061,644**	**100.00%**	
Subborrowers		**244,939,036**		
Total		**1,980,000,680**		

PURPOSE
B) LEVELS OF ACTIVITY OF FINAME AND BNDES AUTOMÁTICO LINES
(AMOUNTS IN US$)

By product

Modality	Medium	Micro	Small	Overall total	%
BNDES Automático	12,086,179	9,681,052	19,347,108	41,114,340	2.4
FINAME - Agrícola	1,315,040	203,398	534,112	2,052,550	0.1
FINAME - Automático	597,397,699	511,904,854	582,366,186	1,691,668,739	97.5
FINAME - Automático	226,015			226,015	0.0
Overall total	**611,024,934**	**521,789,305**	**602,247,405**	**1,735,061,644**	**100.0**

By disbursement size and region

Firm size	Center-West	Northeast	North	Southeast	South	Total	%
Medium	35,574,093	91,340,226	23,410,886	299,376,400	161,323,329	611,024,934	35.2
Micro	31,634,489	45,057,234	18,886,947	194,862,519	231,348,117	521,789,305	30.1
Small	47,097,680	63,332,789	35,013,582	247,265,378	209,537,977	602,247,405	34.7
Total	**114,306,261**	**199,730,248**	**77,311,415**	**741,504,297**	**602,209,423**	**1,735,061,644**	**100.0**
%	**6.6%**	**11.5%**	**4.5%**	**42.7%**	**34.7%**	**100.0%**	

By disbursement to sectors

Sectors	Total	%
Agriculture	19,723,449	1.1
Mining	15,309,694	0.9
Manufacturing	369,434,287	21.3
Commerce	101,006,869	5.8
Services	1,229,587,345	70.9
Total	**1,735,061,644**	**100.0**

OTHER INFORMATION (AMOUNTS IN US$)

Total requested (US$)	Geoeconomic region					
Firm size	**Center-West**	**Northeast**	**North**	**Southeast**	**South**	**TOTAL**
Medium	35,574,093	91,340,226	23,410,886	299,376,400	161,323,329	611,024,934
Micro	31,634,489	45,057,234	18,886,947	194,862,519	231,348,117	521,789,305
Small	47,097,680	63,332,789	35,013,582	247,265,378	209,537,977	602,247,405
Total	**114,306,261**	**199,730,248**	**77,311,415**	**741,504,297**	**602,209,423**	**1,735,061,644**

Number of operations	Geoeconomic region					
Firm size	**Center-West**	**Northeast**	**North**	**Southeast**	**South**	**TOTAL**
Medium	464	863	331	3,313	2,148	7,119
Micro	795	1,207	506	5,448	5,965	13,921
Small	819	1,166	626	4,375	3,729	10,715
Total	**2,078**	**3,236**	**1,463**	**13,136**	**11,842**	**31,755**

Average operation amount	Geoeconomic region					
Firm size	**Center-West**	**Northeast**	**North**	**Southeast**	**South**	**TOTAL**
Medium	76,668	105,840	70,728	90,364	75,104	85,830
Micro	39,792	37,330	37,326	35,768	38,784	37,482
Small	57,506	54,316	55,932	56,518	56,191	56,206
Total	**55,008**	**61,721**	**52,844**	**56,448**	**50,854**	**54,639**

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION

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

The Board of Executive Directors

RESOLVES:

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