

## EXECUTIVE SUMMARY

### BORROWER AND

#### GUARANTOR:

Inter-American Investment Corporation (IIC)

#### EXECUTING AGENCY:

IIC

#### AMOUNT AND SOURCE:

IDB ordinary capital: \$300 million  
Borrower and final beneficiaries: \$600 million  
Total: \$900 million

#### FINANCIAL TERMS AND CONDITIONS:

Amortization: lump-sum payments equal to each individual disbursement due 15 years after the date of the respective disbursement;  
Resource commitment: four years;  
Disbursement period: five years;  
Currency: United States dollars only;  
Interest rate: London Inter-Bank Offered Rate (LIBOR)-based cost of funding each disbursement in United States dollars made by the Bank for the purpose of the loan;  
Spread: as may be established by the Bank every six-months in accordance with the Bank's lending rate policy;  
Inspection and Supervision fee: none;  
Credit fee: none.

#### OBJECTIVES:

The objectives of the loan are: (i) to provide funds to finance such profitable and environmentally sound medium- and long-term private sector investments as the IIC may identify in accordance with their Board-approved lending guidelines; (ii) to provide comfort to potential commercial lenders; (iii) to encourage private lenders to provide the IIC with resources at attractive rates; and (iv) to indicate the measure of shareholder support by making funding available at preferred cost.

#### DESCRIPTION:

The Programme will respond to the credit needs of the small- and medium-sized segment of the region's private sector which typically have difficulties in obtaining reasonably-priced financing from other sources and will strengthen and consolidate the IIC as an important channel of resources for private sector lending in Latin America and the Caribbean.

The Corporation has now completed its seventh year of operation, during which time it has functioned through

its authorized capital, earned surplus, reserves and borrowings, leveraged on a 1:1 ratio. Commitments are now approaching the limit of the IIC's authorized availabilities. In 1995, the IIC's Board of Governors authorized an increase in the debt-to-equity ratio from 1:1 to 3:1 as part of an unanimously approved action plan. By allowing the deployment of the new leverage ratio, the Programme will enable the IIC to continue providing medium- and long-term financing directly to private enterprises in the region.

The Programme will assist in the creation of new enterprises, as well as in the expansion, restructuring and privatization of existing businesses. The Programme will encompass a wide range of sectors. Proceeds of the IDB loan would be used exclusively to provide loan financing for Programme projects.

The Programme will assist the IIC in its role as catalyst for the mobilization of additional resources and for the transfer of technology and know-how for projects financed under the Programme. This will be achieved through cofinancing and syndications, by supporting the underwriting of securities and by the identification of joint venture partners.

**ENVIRONMENTAL  
CLASSIFICATION:**

The Environment Committee, at its meeting of 17 December 1996, classified this as a Category II operation.

**IMPACT ON POVERTY:**

The Programme does not satisfy the criteria which would allow it to be regarded as one aimed at reducing poverty, as established in the guidelines of the Eighth Replenishment.

**BENEFITS:**

The Programme will free more of the IIC's own resources for equity investments (resources of the IDB loan cannot be used for these purposes). Furthermore, the Programme will support projects which, in addition to providing potentially profitable investment opportunities, have an important impact on job creation and foreign exchange generation. IIC estimates suggest that projects in the Corporation's future active portfolio, which will be partially financed under the Programme, when fully disbursed would generate annual export revenues of more than \$1 billion and value-added in excess of \$1.5 billion, as well as creating close to 100,000 direct and indirect jobs. In addition, the Programme should facilitate the transfer of resources and technology and may indirectly assist in the promotion of economic integration.

As a result of the increased lending capacity brought about by the Programme, the IIC will strengthen its ties with the Bank, particularly with the Multilateral Investment Fund and the Private Sector Department, with which it already has developed a substantial working relation, in order to foster a more favourable climate for the advancement of private initiative and competitiveness in the region.

Other important benefits are linked to the IIC's ability to mobilize additional resources for private sector projects in the region; indeed, the Programme should enable the Corporation to provide supplementary credits to potential clients which have already managed to obtain partial funding for their projects.

**RISKS:**

The Bank's loan will account for one-half of the Corporation's borrowing capacity under its newly increased leverage ratio of 3:1. Currently, approximately 16% of the IIC's portfolio is non-performing. If the same proportion were to apply to a portfolio funded primarily by the IDB operation and if most of these loans ultimately were to be written off, a significant share of the Corporation's own capital would be lost. However, IIC loans are well-collateralized, at about one and a half to two times loan values, and in the event of having to move against collateral, the IIC is likely to recover amounts due. Moreover, the IIC plans to expand lending to slightly larger and more established borrowers, typically representing lesser risks than current small- and medium-sized borrowers and should therefore be able to reduce the incidence of non-performance and write-off.

With only seven years of operations, three of which have been difficult, the IIC has not yet consolidated itself as an institution. It is still building up its portfolio and has a limited repayment record. However, there have been no delays or problems in meeting payments to all of its creditors on schedule. Moreover, inasmuch as the shareholders and Boards of Executive Directors of both the Bank and the Corporation overlap almost entirely, it is believed that this inherently provides sufficient safeguards to ensure oversight and mitigate risk.

It is important to note that the Board of Governors of the IIC requested an independent review of the Corporation's portfolio prior to incurring debt in an amount which would exceed the previously authorized 1:1

gearing ratio. In its report to the IIC Board of Executive Directors on 14 January 1997, the independent firm (Borgatti Associates) reported in their conclusions that "having reviewed the IIC's portfolio, investment practices and risk management controls, it is our opinion that the Corporation is positioned to increase its gearing without incurring undue risks."

**THE BANK'S STRATEGY:**

The Agreement Establishing the Inter-American Development Bank, in order to further encourage and accelerate the economic and social development of borrowing member countries, gives the institution a mandate to, inter alia., promote the investment of private capital for development purposes, encourage private investment in projects and enterprises and to supplement private investment when private resources are not available on reasonable terms and conditions.

The mandate of the Bank's Governors for the Eighth General Increase in the Resources of the Bank recognizes that the economic and social development strategies being followed by borrowing member countries are placing an ever increasing emphasis on the role of the private sector. The Governors point out that all of the efforts being deployed will be insufficient to achieve borrowing member countries' objectives in this regard unless medium- and long-term financing facilities are made available for the private sector. The Governors therefore specifically charge the Bank to continue to assist in the development of small- and medium-sized private companies by, inter alia., making global credit loans to the IIC.

**EXCEPTIONS TO  
BANK POLICIES AND  
PRACTICES:**

In line with the terms and conditions requested by the Corporation, the credit fee would not be applied; the inspection and supervision fee would not be applied; the Exchange Risk-Sharing System (Currency Pool System - CPS) would not be applied; the U.S. dollar window would not be used; the Single Currency Facility would not be used; the semi-annual payment requirement would not be applied; and the 12 month limit on retroactive financing would not be applied. These matters have already been the subject of detailed and extensive consultation with the Board of Executive Directors, whose Policy Committee agreed to the policy waivers necessary to accommodate the terms and conditions requested by the IIC.

**SPECIAL**

**CONTRACTUAL  
CONDITIONS:**

- a. The borrower shall not be charged a credit fee or an inspection and supervision fee.
- b. The borrower shall not request individual disbursements for amounts of less than \$25,000,000.
- c. Disbursements shall not exceed an aggregate amount of \$100,000,000 during any 12 month period.
- d. Prior to the first disbursement, the executing agency shall present to the Bank the updated "Operating, Financial and Investment Policy Regulations" as approved by the IIC Board of Executive Directors, which will be the operating and credit regulations of the Programme.
- e. No sub-loan financed from the proceeds of the Bank loan shall exceed 2.5% of the total of the financing, unless otherwise agreed by the Bank and the borrower.
- f. The loan proceeds shall not be used to finance (i) enterprises with partial public sector share of more than 50%; (ii) projects employing technologies which may be harmful to environmental conservation, public health and personal safety; (iii) goods and services originating in countries which are not members of the IDB; (iv) general and administrative expenses, salaries or remunerations of the staff of the borrower or of sub-borrowers; (v) purchase of shares or securities in companies, convertible bonds, and other monetary assets; (vi) working capital, except structural working capital associated with the project; (vii) vehicles for personal use; (viii) projects which use hazardous wastes covered by the Basle agreement; and (ix) projects which do not conform with the environmental procedures outlined in chapter III, section B, below.
- g. If the interest earned by the executing agency is greater than the amount needed to cover its financial and administrative costs, the executing agency will use the difference only for the granting of new credits which conform to the Operating Regulations of the Programme.

- h. The borrower and the IDB will meet periodically to assess technical, financial and operational matters relating to the Programme. At such meetings the executing agency will: (i) submit a report on the accounts of the Programme, including timely annual financial statements of sub-borrowers, duly certified by independent public accountants acceptable to the executing agency; (ii) a report on sub-loans which have been granted under the Programme; and (iii) an inventory of the environmental category of projects financed under the Programme.
- i. Throughout the period of the Programme, the borrower will not borrow more than twice its net equity at 31 December 1996 and will cap its outstanding liabilities at an amount of \$300 million.
- j. Throughout the period of the Programme and up to five years following the date of the last disbursement of the Bank's financing, the financial statements of the borrower shall be submitted to the Bank within 180 days after the close of the borrower's fiscal year, duly certified by an internationally accepted firm of independent public accountants.

Note: The draft loan contract is available on request to members of the Board of Executive Directors.

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REGIONAL  
INTER-AMERICAN INVESTMENT CORPORATION  
MULTISECTOR GLOBAL CREDIT PROGRAMME

(RG-0014)

I. FRAME OF REFERENCE

A. Macroeconomic framework

- 1.01 Falling growth rates and the decrease in domestic demand stemming from the debt crisis of the early 1980s were, with very few exceptions, reflected in an under-utilization of productive capacity and a marked decline in investment in Latin America and the Caribbean during the 1980s. Highly indebted countries were confronted with both external credit constraints and a heavy debt service burden, which together reduced financing and income opportunities and led to a contraction of domestic demand. In many cases, constraints placed on import capacity by a lack of foreign exchange forced countries to cut back investment expenditures, particularly purchases of machinery and equipment.
- 1.02 Investment decisions taken by the region's private sector depend to an important degree on factors relating to the context in which firms operate, such as a stable policy environment, the characteristics of financial markets and the level of confidence and access to appropriate infrastructure, for the most part inadequate during the 1980s. Three critical elements of the macroeconomic context which influenced investment decisions in the 1980s were the instability of exchange rates, interest rates and consumer prices. Small- and medium-sized private sector enterprises were particularly affected and their capital requirements remained considerably more unattended than those of others sectors.
- 1.03 Following the economic crises of the 1980s, Latin American leaders and policy makers reassessed their approach to the management of their economies and to the promotion of economic and social development. Adjusting the relative roles of the public and private sectors was central to the new approach adopted by most governments throughout the region. Key features included removing barriers to growth in the private sector, fostering savings and investment, deregulation, and the privatization of state-owned enterprises, much of which contributed to stabler exchange rates, lower interest rates and diminished inflation, and which led to the beginnings of economic recovery in most countries. Moreover, capital flows to the region resumed. The recovery, occurring in a context of greater stability and relaxed external constraints, contributed significantly to raising investment rates. The growth in the flow of foreign direct investment, coupled to higher rates of domestic savings in many countries, also contributed to higher levels of investment, supported by a commitment to reform, especially with regards to fiscal balance,

price stability and the permanent removal of barriers to the flow of inward investment. However, the bulk of capital flows went to only four countries: Argentina, Brazil, Chile and Mexico.

- 1.04 Most borrowing member countries rapidly adopted new economic policies in which private entrepreneurs and private savings, both foreign and domestic, have come to play a major role in achieving development objectives. Many countries have already made considerable progress in appraising, designing and implementing new policies, often in close cooperation with the Bank. However, the small- and medium-sized private sector enterprises were slow to reap the benefits of this changed and improved environment due in great measure to being perceived as significantly greater risks by financial institutions and capital markets.
- 1.05 Reform agendas, when they are comprehensive and far-reaching, require patience, political commitment and discipline, together with steadfast support from international financial institutions. To the extent that such reform agendas were adopted, much of the desired effect was achieved, particularly in boosting economic performance (although their impact on income distribution, employment and poverty is still uncertain). Indeed, during the first three years of the decade regional economic growth averaged over three percent per annum in an environment of enhanced macroeconomic stability, which stimulated sizable investment, both foreign and domestic. Until the closing days of the year, 1994 was poised to register a continuation of the positive trends of the previous three years, with GDP rising by approximately four percent. However, the Mexican crisis and the impact it had on international market perception of the region temporarily put a halt to the notion that the reform process was nearly complete.
- 1.06 Notwithstanding the shocks provoked by the crisis, in 1995 these managed to be confined to Argentina and Mexico. Indeed, economic growth in the remainder of the region remained steady in 1995. Moreover, although overall investment in the region rose by less than 0.5 percent, this was due only to significant declines in Argentina and Mexico, and to a lesser extent in Venezuela. Investment in the rest of the region was reasonably stable.
- 1.07 Preliminary data for 1996 would suggest that economic recovery is under way in the region, particularly in Argentina and Mexico. Although regional GDP is estimated to have expanded by approximately three percent, many countries experienced lower growth rates than in previous years. Deteriorating exchange rates and higher domestic interest rates in many countries appear to have contributed to a slowdown in the growth of investment (except for Argentina, Chile and Mexico). Capital flows do not appear to have increased, but the composition did change. Public capital flows dropped, whilst private capital flows recovered, but did not surpass the amounts registered during the early 1990s. Most of these capital flows were accounted for by very few countries, and an important proportion was privately contracted debt to finance public sector disequilibria. Productive inward investment does not appear to have regained its earlier dynamism and once again small- and medium-sized



private sector enterprises seem to have been the most affected in this regard.

- 1.08 Recent data<sup>1</sup> suggests that the value-added of the industrial sector in Latin America and the Caribbean amounts to approximately \$420 billion, of which small- and medium-sized enterprises accounted for one-third. Assuming a 5% annual growth rate for the sector between 1997 and 2001, the average increase in small- and medium-sized enterprise industrial value-added would amount to about \$7 billion per year. The average capital/output ratio for industrial manufacturing in the region is conservatively estimated at approximately 2.5. Even at the risk of underestimating the average amount of capital required to obtain a given unit of output, the annual average requirement for long-term funding for small- and medium-sized enterprises would be more than \$17 billion.
- 1.09 Small- and medium-sized enterprises in most countries in the region obtain the bulk of both their debt and equity financing from non-banking sources (internal cash-flows, loans and investments from relatives, friends, etc.). Indeed, even though it is difficult to obtain reliable information on this topic, it would appear that in the more advanced countries in the region, no more than 5% to 8% of long-term funding requirements are met by financial markets, whilst in the least advanced the proportion is probably below 3%. The corresponding average range for small- and medium-sized enterprises in OECD countries is 20% to 25%, rising to 44% in the case of the United States.

## B. General framework

### 1. Role of the IIC

- 1.10 The IIC is a multilateral investment corporation which promotes the economic development of its borrowing member countries by stimulating the establishment, expansion and modernization of private enterprises in Latin America and the Caribbean, particularly small- and medium-sized enterprises. As part of its mission to support the private sector, the IIC does not seek government guarantees. Although the IIC is an affiliate of the IDB, it is legally autonomous and its resources and Management are separate from those of the Bank.
- 1.11 The IIC can provide medium- and long-term loans or guarantees directly to private enterprises which have difficulties raising financing from other sources on reasonable terms and conditions, and can make equity and quasi-equity investments in the same type of enterprises. The IIC can also provide lines of credit to private sector financial intermediaries, as well as to enterprises with partial share participation by governments or other public sector entities.

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<sup>1</sup> Inter-American Development Bank. "Economic and Social Progress in Latin America." Baltimore: The Johns Hopkins University Press. 1995.

- 1.12 As a complement to these activities, the IIC provides advisory services to private sector firms, which include financial engineering of new investments, restructuring of companies, identifying joint venture partners and facilitating transfer of technology. Moreover, the IIC can provide fee-based services to governments to assist them in modernizing their inward investment policies and developing capital markets. The IIC can also provide assistance for the privatization of publicly-owned companies, particularly medium-sized companies. Although authorized to provide guarantees, it has not done so to date.
- 1.13 The IIC supports sound projects which have a developmental impact: they must create jobs, generate foreign exchange, foster the transfer of technology, and assist in the promotion of economic integration in the region. As indicated earlier, the Corporation gives preference to small- and medium-scale private sector projects because in most borrowing countries these projects are sponsored by small- and medium-sized companies, which employ about half of industrial labour, account for approximately one third of total output and represent the principal source of urban-based jobs.
- 1.14 The IIC can also raise additional funds through co-financing, syndications, country venture funds, joint investments and underwriting of securities.
- 1.15 The Corporation contracts with its clients to lend at prevailing market rates in the relevant markets for similar companies in a specific borrowing member country. The IIC defines market rates as a spread over a base-rate, typically the six-months London Inter-Bank Offered Rate (LIBOR) for United States dollars. The IIC are limited to providing up to one-third of the total financing required for a start-up enterprise, or one-half of the financing of an expansion, thus ensuring that the IIC acts as a catalyst to mobilize other financial resources for productive investments. The IIC usually extend loans for terms of five to ten years, with an average grace period of two years.

## 2. Development of the IIC

- 1.16 Discussions leading to the creation of the IIC began in the early 1980s when Bank shareholders determined that to best meet the growing needs of the region's private sector, particularly small- and medium-sized enterprises, it was necessary to have a separate but affiliated institution devoted exclusively to fulfilling these needs. The Agreement Establishing the Inter-American Investment Corporation went into effect in March 1986.
- 1.17 The basic organization of the IIC was completed in early 1989, when managerial, professional and support staff were engaged and when basic procedures and operating policies were put in place. The Corporation grew rapidly during their first four years, with annual approvals rising steadily from three in 1989 to 31 in 1993. In anticipation of an increasing pace of operations to be financed with additional capital contributions from member countries, staffing was increased. However, in

1993 it became clear that a capital replenishment would not be forthcoming. The slow growth of the earning asset base of disbursed loans, coupled with historically low interest rates and the burden of a top-heavy management structure, resulted in a significant loss of \$7.4 million in 1993.

- 1.18 Consequently, the Corporation undertook a major restructuring which consisted of reducing the staff by almost one half and focusing operations primarily on lending and equity investments. As a result of these cost control measures and of fostering a growing earning assets base, the overall situation of the institution has recovered, albeit slowly.
- 1.19 The Corporation's Board of Governors approved a new action plan for the IIC during its tenth Annual Meeting in Jerusalem in April 1995. A key feature of the action plan was the amendment of the Agreement Establishing the IIC in order to increase the institution's funding and to enable them to operate with greater flexibility. The agreed upon amendments are: (i) to increase the Corporation's authorized debt-to-equity ratio of 1:1 to 3:1, (ii) to authorize the admission of non-IDB member countries, and (iii) to ease the regional ownership requirements for companies receiving IIC financing.
- 1.20 The borrowing member countries have agreed to grant certain privileges to the Corporation, most importantly immunity of assets from confiscation or expropriation and exemption from all taxes. The Corporation filed a request with both the Basle Committee and the European Union to benefit from the capital adequacy ratios of 20% assigned to commercial banks for lending to multilateral development banks such as the IDB.<sup>2</sup> The request was approved on 15 December 1995.
- 1.21 The IIC's Board of Governors requested an independent review of the Corporation's portfolio of loans and equity investments prior to incurring debt in an amount which would exceed their previously authorized 1:1 debt-to-equity ratio. The purpose of the review was to evaluate current risk evaluation and management procedures, adequacy of provisions, and overall quality of the portfolio, in order to ensure that the IIC will have the ability to develop and manage a sound portfolio of earning assets, which will be capable of generating a reasonably secure cash flow to support increased debt service obligations.
- 1.22 The IIC selected the consulting firm of Borgatti Associates, which presented their report to the IIC Board of Executive Directors on 14 January 1997.<sup>3</sup> Their report is based on observations and findings obtained from a review of a representative sample of approximately 30 individual operations, including field site visits to 18 of them in eight countries, as well as a review of internal policy documents and interviews

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<sup>2</sup> The capital adequacy guidelines were issued prior to the start up of the Corporation.

<sup>3</sup> Document CII/GN-112.

with IIC Management.

- 1.23 After their review of the IIC's portfolio, Borgatti Associates concluded that in their opinion the Corporation is positioned to increase its gearing ratio without incurring undue risks. However, they recommend that in accordance with their discussions with IIC Management, growth be accompanied by measures to enhance transaction processing.

### 3. Relationship between the IDB and the IIC

- 1.24 The Agreement Establishing the IDB permits direct lending to the private sector without government guarantees and indeed there was a small amount of such lending in the early years of Bank operations. However this type of lending fell into disuse and the Bank shifted its support for the private sector via lines of credit to intermediary development finance institutions--mainly in the public sector--for on-lending to private sector borrowers.
- 1.25 As mentioned in section A of this chapter, as a result of the economic crises of the 1980s, many borrowing member countries began to alter their development strategies quite significantly and started to adopt major market-oriented reforms which emphasized the role of the private sector. The Bank's shareholders recognized the importance of this shift and realized that the Bank needed to strengthen its ability to reach the private sector. This recognition had three distinct consequences. First, was the establishment of the IIC to address the needs of one of the most dynamic components of the private sector in the region, namely small- and medium-sized private enterprise; second, was the establishment of the Multilateral Investment Fund to encourage the development and implementation of investment reforms and thereby encourage significantly increased levels of both foreign and domestic private investment; and third, was to target five percent of the resources of the Eighth Replenishment for direct lending to the private sector without government guarantees to finance activities traditionally undertaken by the public sector, such as infrastructure projects.
- 1.26 The IIC and the Bank have overlapping shareholders and Board of Executive Directors, Twenty four of the 26 borrowing member countries of the Bank are members of the Corporation, as are 11 of its 20 non-borrowing members. Moreover, 22 of the Corporation's 26 Executive Directors and Alternate Executive Directors sit on the 28-member Board of Executive Directors of the IDB. Finally, the President of the Bank is the Chairman of the IIC's Board of Executive Directors.
- 1.27 The resources and Management of both institutions are legally separate from one another. However, the Bank provides several services to the Corporation free of charge or at cost. In addition, the Bank often calls upon the advisory services of the Corporation in order to promote its own programmes throughout the region and in many instances acts in concert as the "IDB Group." The relationship between the institutions is governed by document CS-2238, "Guidelines for the Cooperation between the Inter-American Development Bank and the Inter-American Investment Corporation,"

which was approved by both Boards of Executive Directors and which institutionalizes general criteria for systematic cooperation.

- 1.28 The Bank has made one loan to the Corporation. A \$210 million loan, at 50 basis points over the IDB's cost of borrowing, was approved early in 1993 (730/OC-RG) to finance a Multisector Global Credit Programme, the total cost of which was estimated at \$630 million. The Corporation drew down \$75 million and made an early repayment of the same amount in 1994 when they identified lower cost sources of funding; the disbursement period for the \$135 million balance expired on 26 March 1996 and the Loan Contract has been terminated.
- 1.29 The execution of the Programme funded by the previous loan has been satisfactory. The IIC have provided financing in IDB member countries for both start-up enterprises and expansion of the productive capacity of existing businesses, as well as lines of credit to local private sector financial institutions for on-lending to smaller private sector companies.

#### 4. IDB loan policy issues

- 1.30 In view of Bank policy<sup>4</sup> which allows making non-sovereign guaranteed loans to regional and sub-regional multilateral development institutions whose objectives and purposes match those of the IDB for the financing of specific eligible projects, the proposed loan would be considered a part of the Bank's regular lending activities, i.e., it would not be scored against the 5% limit of commitments for direct lending to the private sector without a government guarantee corresponding to the IDB-8 lending programme. However, the Board of Executive Directors have taken note of the fact that a loan of the proposed size would entail a material increase in this type of exposure. Should a \$300 million loan be approved and disbursed in a relatively short period of time, the outstanding balances of non-sovereign guaranteed OC loans to regional and sub-regional development institutions would account for approximately 2% of the OC loan portfolio.

#### 5. Legal considerations

- 1.31 On 19 July 1991, the Bank's General Counsel issued a Legal Opinion regarding the possibility of making a loan to the Corporation. The Legal Opinion, which is based on a review of the Agreement Establishing the Inter-American Development Bank and the Agreement Establishing the Inter-American Investment Corporation, states that it is indeed possible for the Bank to make such a loan and that there is no legal impediment in either Agreement which would preclude the Bank from granting or guaranteeing global loans to the IIC for the financing of specific projects which, in accordance with both Agreements, serve to accelerate the economic and social development of regional developing member countries. Management believe that this Legal Opinion should also be applied for the purposes of the Loan Proposal being made in this document.

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<sup>4</sup> Operational Policy OP-306.

- 1.32 The Legal Department remain of the view that it is possible for the Bank to make loans from its OC resources to the Corporation only for a Multisector Global Credit Programme and that there are no legal impediments which would preclude the IIC from borrowing funds from the IDB for these purposes.
- 1.33 The Corporation is authorized by its Agreement, as amended, to borrow funds in an amount not to exceed the sum of 300% of its subscribed authorized capital, plus its earned surplus and reserves. At 31 December 1996, the IIC's authorized capital was \$200 million, which was fully subscribed, and its earned surplus was \$18.7 million. The Corporation has two outstanding borrowings, both with commercial banks: a \$75 million loan from Fuji Bank, which is fully disbursed, and a \$75 million loan from Deutsche Bank, of which \$20 million have been disbursed. The proposed IDB loan of \$300 million therefore falls well within the IIC's borrowing authority.

#### 6. Activities to be supported

- 1.34 The Programme will fund growth project financing, directly with private sector enterprises and through private financial intermediaries. Such financing will be composed of term loans and could be accompanied by other financial services at the discretion of the IIC's Board of Executive Directors.
- 1.35 Allocation of resources, portfolio management, geographic distribution of assets, and other matters pertaining to the operating criteria of the IIC will apply as established and may be amended by their Board of Executive Directors from time to time.
- 1.36 The Programme would only cover lending operations, as the IIC's equity and quasi-equity investment activities are funded exclusively with the IIC's own subscribed capital resources and retained earnings.

#### 7. IIC income policy

- 1.37 The Corporation establishes interest rate levels on loans which will cover the cost of funds and administrative expenses, and generate an adequate profit margin (see chapter IV, section 4(c), below).
- 1.38 Although IIC loans are priced in accordance with risk and return considerations, as well as market conditions in borrowing member countries for similar type operations, the Corporation's policy is to keep the average portfolio spread within a 3% - 6% percent target. For the years 1994, 1995 and 1996, the average spread was 3.5%.
- 1.39 In order to assure their ability to be matched on interest rates, the IIC uses LIBOR as the basis for all operations in assets and liabilities.

C. IDB strategy

- 1.40 The mandate of the Governors for the Eighth General Increases in the resources of the Bank (see document AB-1704) states that the economic and social development strategies being followed by borrowing member countries are placing a greater emphasis on the role of the private sector. Moreover, the Governors indicate that in the economic reforms currently being undertaken, public sector involvement in the production of goods and in the delivery of services is fading, leaving the State free to concentrate on shaping a stable macroeconomic and legal environment which will be conducive to private investment.
- 1.41 Support of the private sector is expected to: (i) promote small- and medium-sized commercial operations; (ii) expand the business base of borrowing member countries; and (iii) be consistent with national development strategies. Indeed, many of these countries have found that support of small- and medium-sized enterprises attracts entrepreneurs and that the job-generating capacity of these enterprises is greater than that of any other sector.
- 1.42 However, the Governors point out that all of the efforts being deployed will be insufficient to achieve the afore-mentioned objectives unless medium- and long-term financing facilities are made available for the private sector.
- 1.43 The IDB is therefore called upon by the Governors to, inter alia., continue to assist in the development of small- and medium-sized private companies, particularly through global credit loans. In so doing the Governors specifically direct the Bank to draw on the IIC's capacity and experience and, where appropriate, the actual execution of global lines of credit.

D. Loan rationale

- 1.44 In order to sustain the desired growth of the Corporation's business in response to accelerated private sector demand in the region, it will be necessary to increase the Corporation's access to funding at attractive terms and conditions; in the short run for immediate portfolio development and in the long run in response to the demands of capital requirements for their projected level of activity.
- 1.45 The Corporation's ability to make equity investments in small- and medium-sized enterprises is limited to its authorized capital and retained earnings; equity investments in these types of enterprises generally should not be financed through borrowings because the cash flows they generate are still too uncertain. The ability to fund their loans from third party sources would free more of the IIC's own resources for equity investments, which is a key component of the Corporation's mandate.
- 1.46 In order to gain greater market access and eventually secure an investment-grade rating, the Corporation would like to strengthen its market profile as a prudent and creditworthy borrower. An important

element to obtain such a rating from the rating agencies is evidence of shareholders' support, which should be confirmed by periodic capital increases, and in the case of many international financial institutions, adequate allocations of callable capital. Other considerations include conservative financial policies, in particular with respects to asset/liability management, liquidity and loss provisions, the soundness of the investment portfolio, which should have a low incidence of arrears and assets whose value may be impaired.

- 1.47 When applied to the IIC, these creditworthiness criteria suggest that the Corporation would probably not qualify for an investment grade rating at the present time. The Corporation has a limited track record and its shareholders have only very recently begun to study the possibility of eventually considering a capital replenishment;<sup>5</sup> they must rely instead on an increase in leverage as a source of funding. Whilst the IIC's financial policies are on a par with those of other financial institutions with investment-grade ratings, and its investment portfolio remains basically sound, it typically invests in little known small- and medium-sized companies which are perceived as high risk by most lenders. However, the IIC stands to enhance its credit standing by building upon its special relationship with its parent institution, the IDB, in the form of a substantial loan with attractive terms and conditions.
- 1.48 Whilst the Corporation is evolving towards a steady growth rate and earnings maturity in the portfolio, it will continue to experience low profitability for several more years. The ability of the IIC to access capital markets without IDB support for new debt financing at advantageous terms and conditions is less than optimal.
- 1.49 Alternatives to the proposed borrowing from the Bank would be to borrow smaller amounts at potentially higher costs directly from the market, or to curtail activities, and thus inhibit growth, until such time as the Corporation's balance sheet permitted adequate and well-priced independent funding. This, however, would not necessarily be consistent with the development of the private sector in the region, particularly small- and medium-sized enterprises, where there is substantial pent-up demand for fresh investment capital, or with the IDB Group's objectives of vigorous support for the private sector.
- 1.50 Notwithstanding the availability of such a loan from the Bank, the IIC would seek financing from other lenders and would prefer not to draw down resources from the loan unless the all-inclusive rate accruing on third party funds were approximately 20 basis points higher than that charged on the IDB financing. This may allow the Corporation to fund itself at attractive rates by relying on its special relationship with the Bank.

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<sup>5</sup> See document CII/GN-109 of 17 October 1996 and document CII/GN-115 of 23 April 1997.



## II. THE PROGRAMME

### A. Objectives

- 2.01 The purpose of the Programme is to respond to the growing demand in the region for financing of private sector small- and medium-sized enterprises, specifically term loans to private sector borrowers without government guarantees. This purpose is consistent with the IIC mandate to provide long-term loans and equity investments primarily to small and medium-sized private sector enterprises, to fund the creation of new enterprises, and to finance the expansion, restructuring, or privatization of existing businesses.
- 2.02 Key objectives which the IIC wish to attain with the proposed loan are: (i) to provide funds to finance such profitable and environmentally sound medium- and long-term private sector investments as they may identify in accordance with their Board-approved lending guidelines; (ii) to provide comfort to potential commercial lenders; (iii) to encourage private lenders to provide resources at attractive rates; and (iv) to indicate the measure of shareholder support by obtaining funding at preferred cost. As indicated in the previous chapter, the Corporation would prefer to borrow from commercial sources; they are of the view that an effective manner in which commercial resources can be mobilized would be to have the Bank provide "gap" financing, i.e., have a precommitment to lend from the Bank in the event that at any given time commercial sources are unavailable, or unreasonably priced.

### B. Description

- 2.03 The proposed loan would help finance a Multisector Global Credit Programme, consisting of existing projects with total costs amounting to approximately \$1.3 billion, for which as of 31 December 1996 loans in an aggregate amount of \$240.4 million have already been approved and partly disbursed, and future projects with total costs estimated at \$1.2 billion. Proceeds of the proposed loan would be used exclusively to provide loan financing and under no circumstances can be used for equity investments.
- 2.04 The Programme is expected to: (i) promote small- and medium-sized commercial operations; (ii) expand the business base of borrowing member countries; and (iii) be consistent with national development strategies. Indeed, many borrowing member countries have found that support of small- and medium-sized enterprises attracts entrepreneurs and that the job-generating capacity of these enterprises is greater than that of any other sector.
- 2.05 The Programme would fund direct loans and lines of credit to financial intermediaries. Consistent with the Corporation's policies, resources from the Programme would be channelled to small- and medium-sized companies which have difficulty in obtaining financing from other sources on reasonable terms and conditions. They are expected to further economic

development by, inter alia., creating jobs, broadening capital ownership, generating net foreign exchange income, facilitating the transfer of resources and technology, and promoting domestic savings

C. Dimensioning of the Programme

- 2.06 The Corporation's initial loan request was for a \$600 million loan. After discussions by the Boards of Executive Directors of both the Bank and the Corporation, IIC Management agreed to a loan in an amount of \$300 million.
- 2.07 The size of the proposed operation was influenced by (i) the Action Plan approved by the IIC's Board of Governors in May, 1995; (ii) the operating programmes submitted to the IIC Board of Executive Directors in conjunction with the administrative budgets; (iii) the provisions of the Agreement Establishing the IIC, as amended, which limits corporate borrowing to an amount not in excess of 300% of subscribed capital, plus its earned surplus and reserves; and (iv) the above-mentioned discussions with both Boards of Executive Directors.
- 2.08 Due to staffing constraints, as explained elsewhere in this document, only modest growth in the number of new project loans committed is anticipated for the next several years. The Corporation may approve some 25 project loans annually by the year 2000. The volume of loans included in the Programme would thus not grow rapidly. Under the latest financial projections, qualifying loan commitments would not reach the level of IIC's available funding (net worth plus committed lines of credit, including the proposed loan) until at least the year 2001. Projections therefore suggest that the \$300 million loan will be able to meet the Corporation's current needs.

D. Cost and financing

1. Cost

- 2.09 The total cost of the Programme is estimated at a minimum of \$900 million, of which \$300 million (up to 33%) would be financed by the proposed IDB loan through the IIC, and at least \$600 million would consist of (i) borrower equity and debt; (ii) other equity participants; and (iii) other co-financing lenders.
- 2.10 The basis for determining the cost of the Programme is the average actual percentage participation of the IIC in project financing. As indicated earlier, the Corporation, in accordance with their policies, observe a maximum participation of 33% in start-up projects and 50% in expansions.

2. IDB financing

- 2.11 The proposed share of the financing of total costs is less than 60%, which is consistent with policy guidelines. The source of funds would be the ordinary capital resources of the Bank. The amount of the financing would be \$300 million. Payments of amortization and interest would be made in U.S. dollars only, in accordance with the provisions in the proposed loan

contract. The IIC's character as a U.S. dollar lender only, with receipts in U.S. dollars only, explains why payments would be made exclusively in U.S. dollars, rather than in the pool of currencies of the Bank's Exchange Risk Sharing System (CPS).

- 2.12 The Corporation's request is for the proposed loan to be LIBOR-based and denominated and disbursed in United States dollars only. Bank policy for the OC requires the use of the CPS or the Single Currency Facility (SCF) for all borrowers, with two exceptions: loans funded from the \$2 billion United States Dollar Window and loans for private sector borrowers without a government guarantee. The proposed loan does not qualify for funding under either programme and could not access the SCF inasmuch as the SCF is pool-based and not LIBOR-based.
- 2.13 The IIC would amortize the financing by means of lump sum payments equal to each individual disbursement due 15 years after the date of the respective disbursement. Lump sum payment arrangements would be administratively simpler for the Corporation than rolling over portions of the financing as they become due. Such arrangement would also free the IIC from the need to match the amortization schedules of its loans to clients and its borrowings from the Bank. The amounts of the financing would in effect be permanent working capital for the IIC and would therefore not be subject to semi-annual amortization.
- 2.14 These amortization conditions are similar to those of the previous Bank loan to the IIC. Bank policy requires loans to be amortized in equal semi-annual payments; this is an important financial policy inasmuch as the Bank relies on a continuous flow of repayments to fund a part of its lending programme. Nevertheless, for a loan of the proposed size, the financial impact of the suggested amortization schedule would not be significant.
- 2.15 The IIC would pay interest semi-annually on the outstanding daily balances of the loan. The first payment would be made six months after the date of the proposed loan contract and would be at a rate per annum for each semester as determined by the LIBOR-based cost of funding each disbursement in U.S. dollars made by the Bank for the purposes of the financing, plus a spread as may be established by the Bank from time to time in accordance with its lending rate policy. The Corporation contracts with its borrowers to lend on set terms, including a set base-rate. In order to be consistent with this lending structure, as well as with its own policies, the IIC needs to fund itself with a set base-rate as well, i.e., match-fund its assets and liabilities.
- 2.16 The term for the commitment of the financing would expire four years after the effective date of the loan contract. The term for disbursement of the financing would expire five years after the date of the loan contract.
- 2.17 The terms and conditions outlined in this section differ from those applied by the Bank to other ordinary capital borrowers because the IIC believe that they are necessary to ensure the success of the operation. In order to process the proposed loan with the terms and conditions

requested by the IIC, the Board of Executive Directors was consulted prior to loan preparation. Specifically, Management asked for waivers including: (i) the commitment and the inspection and supervision fees; (ii) the CPS requirement; and (iii) the semi-annual repayment requirement. Management held detailed and extensive consultations with the Board on these issues and at their 5 August 1996 meeting, the Board's Policy Committee authorized Management to proceed as stated above, but did not agree to an additional request to waive the interest rate spread, indicating that it had to be the same as that for the Bank's regular OC pool-based loans.

- 2.18 The Corporation also asked for a non-financial waiver indicating that they may require the use of a portion of the proceeds of the loan to finance part of their existing loan portfolio in order to release IIC resources to (i) fund equity investments; and (ii) support portfolio restructuring. Bank policy<sup>6</sup> does allow retroactive financing of an existing and fully performing loan portfolio approved by the borrower during a period of up to 12 months preceding the approval of the Bank loan by the Board of Executive Directors. However, the Corporation in all likelihood will wish to retroactively finance loans approved beyond the 12 month period, up to 48 months, for which the Board have agreed to grant a waiver of this requirement.
- 2.19 In order to assist the Board in their decision whether to grant the waivers necessary to meet the Corporation's request, Management carried out a series of analyses to determine their impact on the Bank's balance sheet. These analyses suggest that the impact would be of limited significance and only during the first four years of the loan.<sup>7</sup>

### 3. Counterpart funding

- 2.20 The counterpart funding accounts for approximately 67% of the total cost of the Programme and would come from joint contributions by sub-borrowers and other participating financial institutions. In accordance with established Bank policy, payments by sub-borrowers to their individual projects for recurrent labour expenses, working capital, previous investments and contributions in kind would not be computed as counterpart funding.

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<sup>6</sup> Operational Policy OP-507.

<sup>7</sup> See document GN-1925: "Proposed Loan from the IDB to the IIC. Consultation on Policy issues."

### III. EXECUTION OF THE PROGRAMME

#### A. Programme regulations

- 3.01 The borrower and guarantor of the loan, as well as the executing agency of the Programme shall be the Inter-American Investment Corporation. The Programme will be executed in accordance with the IIC's Operating, Financial and Investment Policy Regulations.<sup>8</sup>

#### B. Environmental considerations

- 3.02 Although it is difficult to determine on an ex-ante basis whether individual projects will have a positive or negative impact on the environment, it is possible to identify projects which would be financed by the Programme that could have indirect and positive impact on it, such as those that use non-polluting technologies, those which install more energy-efficient equipment, those which are specifically designed for waste treatment and recycling, etc. On the other hand, it is also possible to identify projects that could be financed by the Programme, which could have an adverse impact on the environment, depending on their size, their location, and the technology they employ; however, Management are of the view that the Corporation have the necessary tools to exercise the necessary control over such situations.
- 3.03 All projects financed by the IIC are subject to an environmental review in order to ensure that they comply with national and local government environmental laws, regulations and standards and that they are consistent with the general objectives of the IIC's environmental guidelines,<sup>9</sup> which practically mirror those of the Bank. Moreover, the IIC require compliance with their environmental guidelines, relevant regulations, or compliance levels in all of their loan and partnership agreement contracts.<sup>10</sup> These regulations follow either accepted international sector standards (for example, those of the American Petroleum Institute in the case of oil and gas production projects) or those of the United States Environmental Protection Agency (EPA), the Canadian Environmental Agency (CEA) and the United Nations World Health Organization (WHO). The IIC undertake periodic supervision missions of their direct project investments--generally on an annual basis--which include review of environmental issues and compliance with any environmental conditions

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<sup>8</sup> Document CII/GN-27-10, approved by the IIC Board of Executive Directors on 26 October 1989; and document CII/GN-27-11 approved on 14 September 1993.

<sup>9</sup> Document CII/GP-5-2, Procedures for Environmental Review of IIC Projects, approved by the IIC Board of Executive Directors on 19 March 1991.

<sup>10</sup> Article I, section 1.01(vi)(x); Article V, section 5.01(x) and exhibit G.13 of the standard IIC Loan Agreement Contract, as well as Appendix C of the IIC's standard Partnership Agreement Contract.

stipulated in the contracts.

- 3.04 The review is carried out by staff engineers who have complete access to the resources of the Bank's Environment Division. The IIC have a five-step procedure to ensure that all projects include adequate provisions to prevent, control and mitigate negative impacts on the environment and to improve environmental quality.<sup>11</sup> The five steps of the review are: (i) project screening; (ii) setting terms of reference for the review of environmental issues; (iii) environmental impact assessment; (iv) incorporation of environmental protection and mitigation measures in the loan and partnership agreements; and (v) project supervision.
- 3.05 For loans provided to, or administered by financial intermediaries, sub-borrowers' projects must comply with national environmental laws, regulations and standards. In this regard, intermediaries are required to obtain certification to this effect. Moreover, financial intermediaries are informed of the IIC's environmental guidelines and procedures and are required to submit on a semi-annual basis a written Project Supervision Report for each sub-loan funded with an IIC loan, which both in form and substance must be satisfactory to the IIC. This Report includes, inter alia., information regarding compliance with environmental regulations.
- 3.06 Disbursement requests must be accompanied by documentation certifying compliance with the environmental clauses of the loan and partnership agreement contracts. If this documentation is not satisfactory to the Corporation, then disbursements can be withheld for IIC Management consultations.
- 3.07 The Environment Committee of the Bank, at their 17 December 1996 meeting, classified the Programme as a Category II operation.

C. Procedure for procurement and contracting

- 3.08 The Bank's tender procedures shall be applied by the IIC for all procurement of goods, services and works financed with resources of the Programme whenever an acquisition is made by any public sector entity. A corporation or any other entity in which government participation is equal to 50 percent of their capital is considered to be part of the public sector for the purposes of the Programme.
- 3.09 The list of countries eligible as suppliers of goods and services for projects financed with credits granted under the Programme, as well as in the awarding of construction contracts, shall include all IDB member countries.

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<sup>11</sup> The Corporation's procedures require early identification of the type and magnitude of potential environmental problems and the corresponding action that each project may require, as well as supervision of environment-related activities throughout the execution phase of project.

D. Use of recoveries

- 3.10 Any funds from amortization payments of the credits granted with resources of the Programme accruing in excess of the amount necessary to service the proposed IDB loan may only be used to grant new credits substantially consistent with the norms that will be established in the loan contract and in the Programme Regulations.<sup>12</sup> After five years from the date of the last disbursement of the Bank's financing, the IDB and the IIC may agree to allow other use of the recoveries, as long as it is consistent with the basic objectives of the Programme, or, to reduce the period during which this obligation remains in effect.

E. Disbursements

- 3.11 The Bank's financing shall be disbursed in United States dollars only, in two or more tranches of no less than \$25 million each. Setting a minimum amount for each disbursement simplifies the administration of the loan for both the Bank and the Corporation.
- 3.12 Inasmuch as the Corporation shall endeavour to first secure financing for the Programme from other lenders, it will not request disbursements from the Bank unless the all-inclusive rate accruing on third party funds were approximately 20 basis points higher than that charged on the IDB financing.
- 3.13 The IIC would be prepared to limit its request for disbursements during any given 12-months period to an aggregate amount equivalent to one-third of the total loan amount.
- 3.14 The Bank shall make every effort to disburse the resources of each tranche within a period of 30 days from the date on which the IIC submits a disbursement request. The Bank intends to match-fund these transactions; consequently, it will have to fund each disbursement individually and will therefore require a certain amount of time to mobilize the necessary resources at appropriate terms and conditions. A 30-day period is considered to be prudent.

F. Monitoring and evaluation

- 3.15 The Corporation and the Bank shall hold periodic meetings during the execution of the Programme in order to discuss technical, financial and operational matters of interest to either institution. The purpose of the meetings, inter alia., is to provide incentives to strengthen and consolidate inter-institutional relations, as well as to monitor and evaluate the Programme and the IIC. The format and content of these meetings shall be defined by the Bank and the Corporation after the loan proposal is approved.

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<sup>12</sup> See paragraph 3.01, and document CII/GN-27-10, op.cit.

3.16 The following topics are amongst those which should be discussed during formal meetings between the Bank and the Corporation.

a. Inter-institutional relations

- (i) Exchange of information on matters such as pricing policies and procedures for programming operations by both institutions in borrowing member countries, including an analysis of any strategy for diversification of IIC activities to new sectors and the identification of opportunities for co-financing operations between the Corporation and other financial institutions.
- (ii) Advice from the Bank on securing resources in international capital markets.

b. Monitoring and evaluation of the Programme and the IIC

- (i) Maintenance of an open forum to conduct an analysis of the achievements resulting from Programme execution and to propose solutions to problems which may arise. Data gathered by the IIC pursuant their evaluation guidelines would also be examined.
- (ii) In order to allow the Corporation to address possible new modalities for financial and operation services, consultations with the Bank would also permit identification of any potential requirement the IIC may have, with a view to carrying out any actions necessary for strengthening the institution.

G. Ex-post evaluation

3.17 In accordance with Bank policy, and following consultations with the borrower, it has been decided not to include ex-post evaluation as part of the Programme. This decision has been taken in view of the fact that the IIC's evaluation mechanisms should provide sufficient information on the performance and results of the Programme. Moreover, should it be decided at a later date to carry out an ex-post evaluation, the necessary information would be available.

H. External audit

3.18 Throughout the period of Programme execution and up to five years following the date of the last disbursement of the Bank's financing, the financial statements of the Programme and of the IIC throughout the life of the proposed loan contract, shall be submitted to the Bank each year after auditing by a firm of independent public accountants acceptable to the Bank.



I. Inspection and supervision

- 3.19 The Bank shall establish such inspection and supervision procedures as it may deem necessary to ensure the satisfactory execution of the Programme. The IIC shall extend all the cooperation which the Bank requires for the most effective accomplishment of this purpose.

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#### IV. THE BORROWER AND THE EXECUTING AGENCY

The borrower and the executing agency will be the Inter-American Investment Corporation, which will channel credit funds to sub-borrowers either directly or through intermediary financial institutions. The guarantee for the loan will be the general responsibility of the borrower.

##### A. Inter-American Investment Corporation

###### 1. Functions

- 4.01 As indicated earlier in this document, the mandate of the IIC is to promote the economic development of its borrowing member countries through a catalytic support to the establishment, expansion and modernization of private enterprises, particularly small- and medium-sized entities.
- 4.02 This mandate is implemented by providing financial instruments, specifically medium- and long-term loans, guarantees, equity investments and quasi-equity investments directly to private enterprises in the region, especially those that are identified as having difficulty generating comparative financing from other sources. Entities with partial ownership by governments (up to 50%) are also eligible for IIC financing. The IIC also grants lines of credit to private financial intermediaries for on-lending in special areas. Whenever possible, the IIC tries to stimulate additional resources through co-financing, syndication, underwriting and other services. As part of this process, the IIC also offers advisory services to their clients.
- 4.03 In addition to traditional lending operations, the IIC purchases shares of capital stock in approved companies. Such investments are not made with the limited intention of capital gains per se, although such objective is factored into any investment analysis, but rather to identify projects which fulfill the development mandate of the IIC and to assist those projects by direct participation through the development or expansionary phase. Once it is demonstrated that the project has achieved a self-sustaining level relative to the growth objectives, IIC policy requires the sale of the shares.

###### 2. Organizational structure

- 4.04 The IIC operates from corporate headquarters in Washington, D.C., has three regional representative offices in Colombia, Costa Rica and Uruguay, located in the IDB's country offices. IIC staff are authorized to use the facilities of IDB country offices throughout the region.
- 4.05 The Corporation is managed by a Board of Governors, a Board of Executive Directors, the Executive Committee of the Board of Executive Directors, and the General Manager.

- 4.06 The Board of Governors, with full powers of the Corporation, is composed of one representative from each borrowing and non-borrowing member country; unless indicated to the contrary by a member country, the official elected to the Board of Governors of the Inter-American Development Bank shall also be the Governor of the IIC for that member country. Those borrowing member countries of the IDB which are not shareholders of the IIC are Belize and Suriname, although both have applied for membership. Those non-borrowing member countries of the IDB which do not participate in the IIC are Belgium, Canada, Croatia, Finland, Norway, Portugal, Slovenia, Sweden, and the United Kingdom. Other non-borrowing member countries have indicated that they would be prepared to become Corporation shareholders.
- 4.07 Responsibility for the operation of the Corporation is vested with the Board of Executive Directors. Currently, this Board is constituted with 13 Executive Directors. The Chairman of the Board of Executive Directors of the IIC is the President of the Inter-American Development Bank.
- 4.08 The Executive Committee of the Board of Executive Directors reviews all loans and investments proposed by the Corporation. Any Executive Director may request that a transaction, whether approved or rejected by the Committee, be submitted to the full Board for consideration; however, if no such request is forthcoming over an established period of time, the decision of the Committee carries the weight of the full Board.
- 4.09 The General Manager of the IIC is elected and serves at the discretion of the Board of Executive Directors. The role of the General Manager is that of chief executive officer for the organization and operation of the Corporation. The position has been vacant since 11 August 1993 and since then has been occupied on an ad interim basis by the Manager of the IIC's Operations Department.
- 4.10 As of 31 December 1996, IIC staff, including Management, totalled 69 employees. Of this number, approximately 71% are classified as professional staff, with the balance occupying support and administrative positions. Relative to allocation of personnel, the IIC has four designated staff units and Table 1 in Appendix 4 outlines the distribution of staff by classification and by unit.
- 4.11 As indicated in paragraph 1.18, the Corporation undertook a major restructuring in 1994. The IIC is now organized in one line department, the Operations Department, which is sub-divided into three geographical regions, each headed by a Coordinator. This department manages the core business of the Corporation and represents 58% of total staff. This department is supported by two Divisions: the Legal Division and the Finance, Risk Management and Administration Division.
- 4.12 As of 1 January 1997, the IIC established a Special Operations Unit reporting directly to the General Manager. The function of this Unit is to develop and execute strategies for handling problem assets. This function was previously dispersed throughout the institution. By centralizing this important function IIC Management are of the view that

they will be able to concentrate in a significantly more focussed manner on problem operations. This was also a recommendation made by the Borgatti Associates report.

### 3. Policy and procedural guidelines

- 4.13 The IIC's policy guidelines include comprehensive delegated approval authority for all aspects of their activity, as approved and periodically reviewed and amended by the Board of Executive Directors. The application of these guidelines are managed by various internal committees, specifically Operations, Finance, Management, and Portfolio Supervision, which meet normally on a weekly basis to review operational and policy matters.
- 4.14 The procedures for processing project applications are satisfactorily structured, but somewhat lengthy.<sup>13</sup> Given the high cost associated with processing these requests, the Corporation are seeking to shorten the time it takes them to do so. The appraisal procedure is designed to screen out unacceptable operations at the earliest possible stage in order to prevent unwarranted expense. An application has to complete four stages: pre-appraisal, appraisal, project document preparation, and review. The Operations Committee must approve successive development of an application through approval and submission to the Executive Committee of the Board for approval, whose decision is binding. Subsequently, the decisions of the Executive Committee are forwarded to the Board of Executive Directors, where they are noted. For operations that advance normally, the average time required for processing is approximately 24 weeks.

### 4. Portfolio policies

#### a. Liquidity and risk assets management policies

- 4.15 (i) Liquidity. The Corporation must maintain liquid assets or undrawn committed lines of credit equal to 100% of the undisbursed commitment, or 65% of projected three year net cash flow, whichever is greater. These funds may be invested under three guiding criteria of security, liquidity factor, and yield. Securities which meet this test must offer a top credit rating and have access to an active secondary market. The duration of the portfolio cannot exceed 48 months.
- (ii) Risk assets. Risk assets are devoted to term loans, equity and quasi-equity investments, and other special activities such as establishment of investment funds and securities underwriting. Every operation must have some development attributes (employment generation, transfer of technology, etc.) and is expected to serve as a catalyst to the flow of private capital.

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<sup>13</sup> This issue was specifically raised in the Borgatti Associates report.

- 4.16 The Corporation diversifies its portfolio as to countries, sectors, and projects and is limited to the higher of portfolio composition or net worth, as follows: (i) 20% per country; (ii) 10% per sector; and (iii) 5% per project. As of 31 December 1996, the Corporation's portfolio was within these guidelines.
- 4.17 An additional general guideline is that the Corporation's exposure should not exceed 33% of either the project cost, nor should the Corporation's equity participation exceed 33% of the share capital of the host entity. As of 31 December 1996, the Corporation's exposure was within this general guideline.

b. Activity

- 4.18 Any borrowing member country is eligible for IIC facilities, and the Corporation endeavours to maintain a reasonable distribution of its risk assets amongst borrowing member countries. The Corporation may operate in any economic sector and avoids concentrations in sectoral exposure in the portfolio. The largest sector concentration is in agroindustry, which accounts for under 8% of the portfolio.
- 4.19 Eligible enterprises may be private or semi-public entities (up to 50%), which are incorporated and domiciled in a borrowing member country and must be entities which are majority owned by nationals of that member country. This condition applies to direct IIC involvement with the entity or indirect loan investment through a financial intermediary.
- 4.20 The Corporation gives preference to small- and medium-sized entities, which are defined for said purposes as detailed in Table 2 in Appendix 4.

c. Terms and conditions

- 4.21 The IIC typically extends loans with maturities of five to ten years, with an average grace period of two years.
- 4.22 The general policy for pricing IIC services and investment of assets is to generate sufficient profits to demonstrate a reasonable return on invested capital, and thus to increase net worth, and to qualify for borrowings in the international capital market in support of the resource base.
- 4.23 Accordingly, the Corporation charges normal fees for financial services (commitment, late payment, guarantee, etc.), and interest rates are based on a spread over 6-month LIBOR to reflect both risk and competitive market conditions. As indicated in paragraph 1.38, the spread ranges between 300 and 600 basis points, with an average of 350 basis points.
- 4.24 The Corporation are aware that the pricing of their loans in general, and those to financial intermediaries in particular, must be consistent with interest rates in local markets, as well as with Bank guidelines. Otherwise, IIC lending could undercut not only the Bank's position, but the policies of the host countries as well.

- 4.25 Return on equity and quasi-equity investments are similarly market-determined, relative to the progressively higher degrees of risk.

d. Risk management procedures

- 4.26 Internal rating and audit. The Corporation has a Portfolio Supervision Unit within the Finance, Risk Management and Administration Division, which monitors the outstanding loan and investment portfolio. This includes loan administration (oversight on loan servicing, documentation, provisions, etc.); compliance with reporting, contractual obligation; supervision of special features under investment agreements, such as conversion options, sales, puts, profit participation, dividend, etc.; and portfolio audit.
- 4.27 With regards to audit, the Corporation developed a comprehensive Credit Risk Rating System (CRRS) in 1990, which it updated in 1994.<sup>14</sup> The application of the CRSS, as well as the portfolio analyses results of the Supervision Unit, are reviewed by the Portfolio Supervision Committee, which meets monthly and takes decisions if corrective action is indicated.
- 4.28 External audit. As part of their routine annual examination of the IIC, the external auditors (appointed by the Board of Governors), in addition to reviewing financial statements, and both the results and the methodology of the IIC portfolio risk rating, conduct an independent risk audit of the portfolio to determine the soundness of the risk assets and the adequacy of the provisions.

e. Loss provisions

- 4.29 The IIC has a methodology for creating reserves against possible losses in the project portfolio, which includes general loss provisions for the total portfolio, and specific loss provisions for individual risks, identified with varying degrees of permanent impairment in value.
- 4.30 General loss provisions are applicable to both loans and equity investments at the rate of 4%, based on amounts outstanding. Moreover, the level of general provisions may be increased at the discretion of Management if the risk profile of the portfolio so warrants. At 31 December 1996, general provisions represented 4.8% of assets not classified as impaired.<sup>15</sup>

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<sup>14</sup> See document CII/GN-35-3, approved 19 December 1994.

<sup>15</sup> The Corporation recognizes loan impairment when it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impairment is measured as the excess of the recorded investments in the impaired loan over the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral-dependent.

- 4.31 Specific loss provisions are also generated for both loan and equity investments and are allocated when an individual asset has been determined to have suffered a permanent impairment in value. Loan loss provisions are allocated on the basis of individual analysis of the present value of expected cash flows, in accordance with FASB 114. A similar analysis is applied to equity investments.
- 4.32 The level of loss provisions established by the IIC is adequate and consistent with risk management in other comparable multilateral institutions.<sup>16</sup> At 31 December 1996, total provisions represented 10.3% of aggregate outstanding portfolio, compared to 7.1% at 31 December 1995.
- 4.33 The IIC's external auditors (Price Waterhouse, LLP) completed their planned audit of the Corporation's financial statements for the years ended 31 December 1996 and 1995, and issued an unqualified opinion on 4 February 1997. However, as a result of their review, they identified weaknesses in the process surrounding the evaluation of the provision for losses, which they considered to be a reportable condition.<sup>17</sup>
- 4.34 Price Waterhouse provided IIC Management with their findings and Management agreed to implement specific procedures and fully address their recommendations. Moreover, as required by generally accepted auditing standards, on 28 February 1997 the external auditors made a report on the matter to the Budget, Financial Policies and Audit Committee of the IIC's Board of Executive Directors.
- 4.35 The external auditors' concern relates to the timing of the recognition of an attributed valuation allowance for individual loans and investments. They are of the view that additional provisions should be provided as temporary impairments in the timing and amounts of expected cash flows are identified. The Corporation normally establish an additional provision, when, in the judgement of Management, an operation is permanently impaired, but they do not systematically do so if the impairment is perceived to be temporary.
- 4.36 In conjunction with the external audit and discussions between the external auditors and IIC Management, the provision for losses for the year ended 31 December 1996 was increased by approximately \$2.1 million.

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<sup>16</sup> On a comparative basis, the International Finance Corporation (IFC), a mature institution with almost 40 years of portfolio experience, registered a weighted average loss provision on the total portfolio in 1996 of 11.2%, up from 10.7% in 1995. Under normal circumstances this pool of funds has proven to be an acceptable level of provisions for possible losses in the IFC Portfolio.

<sup>17</sup> A reportable condition is a condition in which the design or operation of the internal control structure could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of Management in the financial statements.

- 4.37 The external auditors are of the view that the provision for loan losses at 31 December 1996 is within an acceptable range, but at the low end of that range, whilst IIC Management believe that it is somewhat higher in the range. This is an area of judgement and subject to interpretation; IIC Management and Price Waterhouse disagreed only as to the point within the acceptable range for which such a provision is stated. The Corporation's general reserve at 31 December 1996 stood at 4% of unimpaired loans in accordance with the IIC's established policy in the matter. Weaknesses identified by the external auditors indicate that the identification of loans for specific attribution of provisions is not timely enough and that the 4% general reserve coverage may be further diluted if other loans were moved to specific reserve categories. The external auditors also noted weaknesses in the application of the Corporation's Credit Risk Rating System<sup>18</sup> in that they do not fully use the existing numeric rating system to adequately differentiate project risks.
- 4.38 The external auditors recommended that in order to address the weaknesses they identified, the Corporation should recognize on a more systematic basis that an operation is impaired and thus requires an attributed valuation allowance when an adverse event occurs prior to a missed principal or interest payment. Moreover, Price Waterhouse recommended that the Corporation should evaluate more uniformly, in a sufficiently conservative manner, the likelihood and timing of positive outcomes in assessing the collectability and specific provisioning requirements of loans which are in contractual default. The external auditors noted instances in which provisions were established based on a subjective evaluation of project sponsors, guarantors, or other factors indicating a positive outcome, even though such a position could not necessarily be supported, or despite the fact that previously anticipated positive outcomes had failed to occur.
- 4.39 Although the current CRRS is adequately designed to identify risk, IIC Management have made a commitment to their Board of Executive Directors to enhance the application of the CRRS in order to meet the external auditors' concerns regarding more timely provisioning as risk factors are identified through expanded documentation of assessments and a formalized ranking procedure which provides a classification benchmark for broader categorization of operations. Furthermore, to ensure a reasonable basis for conclusions, IIC credit risk analysts will be required to document all pertinent factors used for credit assessment and review purposes. Moreover, IIC Management are establishing additional operational guidelines to supplement those currently in use, in order to monitor project status more effectively. Finally, IIC Management have agreed to establish new guidelines to address the issue of periodicity of updated collateral appraisal in order to ensure that timely and relevant information is available when needed.

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<sup>18</sup> See document CII/GN-35-3, op. cit.



f. Classification

4.40 As of 31 December 1996, \$346.7 million had been disbursed by the Corporation, representing 95 projects with varying combinations of equity investments and loans. With the exception of nine operations accounting for \$35.5 million of outstanding disbursements and for which provisions equal to 48% of this amount have been allocated, the portfolio appears to be performing adequately, as was confirmed to the IIC Board of Executive Directors by the Borgatti Associates report.

4.41 The nine problem operations as of 31 December 1996 are the following:

(i) One fully disbursed \$5 million loan operation in Argentina. Amortization payments are in arrears, but interest payments are current. A restructuring plan has been submitted but has not yet been agreed to. Although full recovery is unlikely, there is a good chance for a partial recovery, and therefore should not be a total write-off.

(ii) One \$8 million loan operation in Brazil, of which \$5 million is outstanding. Interest payments are in arrears; the first amortization payment, due in July 1997, is unlikely. A rescue plan has been launched but a successful outcome is doubtful. The IIC will likely have to move against collateral; specific provisions equal to 28% of principal have been allocated and a partial write-off is probable.

(iii) One fully disbursed \$4.8 million loan operation, also in Brazil. Amortization and interest payments are both in arrears. Specific provisions equal to 92% of principal have been allocated. Recovery is unlikely. The IIC will in all likelihood have to move against collateral, which is inadequate. A substantial partial write-off is likely.

(iv) One \$6.5 million loan operation, also in Brazil, of which \$6 million is outstanding. Interest payments are in arrears; the first amortization payment, due in May 1998, is unlikely. Specific provisions equal to 28% of principal have been allocated. The IIC is re-examining the possibility of selling the loan, at a loss, to another creditor. A write-off is likely.

(v) One \$800,000 loan operation in Guyana, of which \$750,000 is outstanding. Amortization payments are in arrears, but interest payments are current. The operation is being re-examined, even though arrears are expected to be cleared during the course of the year.

(vi) One fully disbursed \$3 million loan operation in Mexico. Amortization and interest payments are both in arrears. To date \$1.32 million have been recovered, and an additional amount may be recovered. Specific provisions equal to 50% of remaining principal balance have been allocated. The borrower has declared bankruptcy. The IIC has moved against collateral. A partial write-off is likely.

(vii) One \$3.1 million operation, also in Mexico, with \$1.89 million of outstanding debt and \$560,000 equity. Amortization and interest payments

are both in arrears. Specific provisions equal to 91% of the principal of the loan and 100% of the equity have been allocated. A rescue plan has been launched, but its outcome is doubtful. The IIC will probably have to move against collateral. A partial recovery is probable. A partial write-off is likely.

(viii) One \$6.4 million operation in Uruguay, with \$5.02 million of outstanding debt and \$1.12 million in equity. Amortization and interest payments are both in arrears. Specific provisions equal to 80% of the principal of the loan and 100% of the equity have been allocated. A rescue plan has been launched, but its outcome is highly doubtful. The IIC will have to move against collateral, which is inadequate. A small partial recovery is probable. A large partial write-off is likely.

(ix) One \$4 million loan operation in Venezuela, of which \$2.5 million had been originally disbursed. Interest payments are in arrears; the first amortization payment is due in January 1998. The loan was restructured; maturity and grace periods were extended; \$1.5 million of equity was converted into debt. The borrower seems to be improving, and output should expand as a result of the overall recovery of the Venezuelan economy. Arrears will probably be cleared this year. Recovery is likely.

- 4.42 All of these projects are under constant review in order to determine their continued viability and the resultant course of action for the IIC. As mentioned in paragraph 4.12, the newly created Special Operations Unit will now have full-time responsibility for this function, as a result of which it is expected that many problems will find a solution.

g. Planning

- 4.43 The Corporation presented an Action Plan for the period 1995-1997 to their Board of Governors, which was approved in May 1995 and has guided operational planning over the last three years. The Corporation develops annual operating programmes which are submitted to the Board of Executive Directors in conjunction with the annual administrative budget. The execution of the operating plan is reviewed continuously, aided by the IIC's project pipeline data base, as well as by the short- and long-range corporate financial models (24 months and 10 years, respectively).
- 4.44 The Corporation's current operating plan is aimed at increasing activities to the maximum sustainable level. An increase in the volume of loan and equity operations will include undertaking a few larger-scale transactions with more established enterprises, many with co-financing potential. The average size of operations is expected to increase from less than \$5 million currently, to about \$6 million, which is within existing IIC guidelines (see Table 2 in Appendix 4). The IIC will continue to commit an increasing amount of its authorized capital to equity investments; however, as of 1998 the Corporation, under current conditions, will have to begin to curtail this activity, to the extent that aggregate outstanding amounts reach levels close to the total amount of authorized capital, which is the only source of funding the IIC has for equity investments.

B. Financial review

1. Capital composition

- 4.45 As previously indicated, the IIC is owned by 24 borrowing and 10 non-borrowing member countries . There is only one Class of share.
- 4.46 The authorized capital of the IIC is \$200,000,000, which is fully subscribed. There is no callable capital. The balance of the capital account is composed of retained earnings, which as of 31 December 1996 stood at \$19.9 million. The debt-to-equity ratio, which rose from 0.37 in 1994 to approximately 0.45 in 1996, is considered to be acceptable, taking into account the composition and profile of the liquidity of the Corporation's assets and liabilities, and should be sufficient to support the expansion of activities contemplated by the Programme that would be financed by the proposed Bank loan. Until April 1995, the authorized debt-to-equity ratio was 1:1; in 1997 it was increased to 3:1.

2. Assets

- 4.47 The Corporation's total assets, after having fallen in 1994 as a result of the prepayment of the \$75 million outstanding balance of the first IDB loan and of an accounting adjustment to the value of its investments in marketable securities,<sup>19</sup> have risen by approximately 3.6% in the past two years, from \$295 million in 1994 to \$317 million in 1996. The most important components are the loan portfolio, accounting for 66% of the total, followed by marketable securities, accounting for 20% and by equity investments, accounting for 11%. The IIC maintain a close balance between their assets and liabilities, both in the foreign exchange it uses and in the interest rates it pays and charges; they therefore have no foreign exchange or interest rate risk exposure.
- 4.48 As of 31 December 1996, total costs of projects financed through equity investments and direct loans amount to \$1 billion. Taking into account the beneficiaries of IIC credit lines intermediated by local institutions, as well as venture capital funds, the resources committed to date by the Corporation are providing financing to approximately 1,300 private sector enterprises. The total investment cost of projects to which the IIC have committed funds exceeds \$2 billion.

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<sup>19</sup> At 1 January 1994 the IIC was carrying \$211.1 million in liquidity. At 31 December 1994 net disbursements for the year reached \$58 million. The Corporation determined to reduce their carrying costs by prepaying \$75 million of their outstanding liabilities. Moreover, in accordance with SFAS 115, as of 1 January 1994 the IIC began to mark-to-market its investments in marketable securities. As a result, in 1994 the Corporation suffered a \$150,000 reduction in the net value of marketable securities due to net unrealized losses.

### 3. Loan portfolio

- 4.49 The loan portfolio increased 15% between 1994 and 1996. According to the portfolio diversification strategy followed by the IIC, no more than 20% of the portfolio is invested in any one country and no more than 10% is concentrated in any single sector. The composition of the portfolio during the past three years has remained stable. Not including commitments to the financial services sector, which amounts to \$141.9 million<sup>20</sup> and which is spread amongst a wide array of enterprises to which IIC funds are ultimately directed through line of credit operations (\$101 million), and venture funds (\$31.8 million), the largest sector concentration is in agroindustry (processing), which accounts for 7.5%. In no case does the IIC's exposure to a single enterprise exceed 5% of authorized capital; in most cases it is significantly less, with an average investment size of about \$4 million.
- 4.50 The IIC strategy also requires that at least 35% of financing be directed toward IDB Group "C" and "D" countries. The distribution of loans amongst countries has not registered any particular change. At 31 December 1996, 45% of loans had been granted to borrowers in IDB group "A" countries, 18% to group "B" countries and 37% to group "C" and "D" countries. Currently, the largest country exposure is in Brazil (18.2% of active commitments).
- 4.51 The performance of the loan portfolio has deteriorated since 1994. Indeed, as of 31 December 1996, approximately 16.3% of loans were in arrears, compared to 6.7% in 1994. As indicated in section A.4.e. of this chapter, loss provisions at 31 December 1996 amounted to 63% of the total of loans with amounts in arrears, or to 2.6 times the total amount of past due principal and interest.
- 4.52 Loans placed in non-accrual status at 31 December 1996 totaled \$38.3 million, up from \$23.1 million in the previous year. Allowances for losses against those loans were almost trebled in 1996, rising from \$5.6 million to \$15.8 million. Had these loans not been in non-accrual status, income from loans would have been approximately \$4 million higher in 1996.

### 4. Equity investment portfolio

- 4.53 In 1996 equity investments reached \$42.1 million, of which several operations, accounting for 8.3% of the total, were considered problem investments. The Corporation have allocated provisions equivalent to almost 83% of the total value of problem investments.

### 5. Liabilities

- 4.54 Over 95% of the IIC's liabilities between 1994 and 1996 were accounted for by loans. In 1994 the IIC had one \$210 million loan, from the Bank, with

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<sup>20</sup> As of 31 December 1996, the total outstanding portfolio amounted to \$273.6 million, of which \$231.5 million were loans and \$42.1 million equity investments.

a fixed 50 basis points spread (730/OC-RG), of which \$75 million were drawn down. The \$75 million were repayed in 1994 and the Loan Contract for the \$135 million balance has been terminated. In 1993 the IIC contracted a \$75 million loan with Fuji Bank at 17.5 basis points over six-month LIBOR, which has a bullet repayment in 2001 and which is fully disbursed, and in 1995 a \$75 million loan with Deutsche Bank at 14 basis points over one-, three- and six-month LIBOR, which has a bullet repayment in 2000, of which \$10 million were disbursed in 1995 and a further \$10 million in 1996. At 31 December 1996 the Corporation had an outstanding loan balance of \$95 million. The Corporation's liquidity of \$61 million at 31 December 1996, plus the anticipated portfolio recoveries of \$201 million in the next five years, is 1.6 greater than the \$95 million outstanding liabilities, plus the \$65 million of undisbursed commitments.

- 4.55 The cost of servicing these liabilities is believed to be adequately covered by the yields of the Corporation's portfolios.

#### 6. Net income

- 4.56 Net income for 1996 was \$1 million, return-on-assets 0.3% and return-on-equity 0.5%. Although these indicators are positive, they are quite meagre and reflect the need for the IIC to increase their level of activities and to improve the performance of their portfolio.
- 4.57 A closer examination of the ratios included in Table 5 in Appendix 4 suggests that even though the Corporation managed to marginally reduce non-financial costs and to increase total income during the years under review, they failed to increase profitability, due primarily to the high level of provisions, which absorbed 27% of total gross financial income in 1994-96 and 42.4% in 1996 alone.

#### 7. Projections

- 4.58 The projections in this section are all based on the assumptions for the next ten years outlined in Appendix 1. The IIC's loan and equity portfolio is expected to remain basically sound. The loan portfolio build-up over the next ten years is considered to be adequate to sustain a steady revenue stream to cover the IIC's operating costs and to yield a return on shareholders' equity, after expenses, in the 2.5% to 3% range, which is in line with current shareholder guidelines.

##### a. Equity and borrowing capacity

- 4.59 Given the IIC's net equity (subscribed capital, plus retained earnings, plus reserves) at 31 December 1996, the Corporation would be able to borrow up to approximately \$650 million and to increase its assets to about \$875 million.
- 4.60 However, as a matter of both prudent financial and operational management, the Corporation would not borrow more than twice its net equity at 31 December 1996, i.e. \$219 million, but would cap its total outstanding liabilities at an amount of \$300 million, equal to the proposed loan.

b. Growth

- 4.61 Projections for the next ten years suggest that only modest growth is anticipated; the number of commitments would increase from 18 for an amount of \$72 million, in 1996, to an annual average of 23 for an amount of \$138 million, until 2006. This would bring the Corporation's cumulative commitments by 31 December 2006 to over \$2 billion.
- 4.62 Moreover, the Corporation's total assets are projected to increase by 6.5% per annum, from \$317 million in 1996, to \$593 million in 2006, in contrast to a 3.5% annual growth rate between 1994 and 1996.
- 4.63 Assuming that loan activity continues to grow based on borrowed funds, the Corporation could experience a drop in earning in 1999 and 2000, owing to the lag between incurring the growing costs associated with increased promotion and investment activity and realizing greater interest income from a larger outstanding portfolio. Supplemental fee-generating advisory work would need to be undertaken to increase revenues in 1999 and 2000 to prevent return-on-equity falling below the 3% target. The return on the Corporation's assets after 2000 is projected to stabilize at slightly less than 6%, based on estimated returns from a mature equity portfolio.

c. Creditworthiness

- 4.64 Despite the 3:1 authorized debt-to-equity ratio, projections suggest that during the next three years it will be less than 1:1, and between 2000 to 2006 it will not grow beyond 1.2:1. This, coupled to an improvement of the IIC's overall portfolio, as well as to the pledge to maintain the portfolio provisioning ratio at levels at least similar to those of 1996, would ensure that the Corporation's creditworthiness will remain basically sound.

d. Liquidity

- 4.65 Interest coverage, as well as allocations to provisions, are projected to remain at levels considered to be sufficient during the next ten years. Moreover, during the next ten years liquid assets (cash, due from banks, and marketable securities), are projected to remain at levels of no less than 1/3 of anticipated use of funds in any one given year, which is deemed to be adequate to meet the Corporation's needs.

e. Return on equity and on assets

- 4.66 The projections for the next ten years suggest that the successful execution of the proposed Programme would lead to a significant increase of return-on-equity, from 0.5% in 1996, to 5.6% in 2006. Return-on-assets would also increase, but at a slower rate, from 0.3% in 1996, to 2.8% in 2006. Assuming an inflation rate of 3% per annum, the projections suggest that this would permit the Corporation to meet their target that returns at least match inflation, beginning in 2002.

## V. FEASIBILITY OF THE PROGRAMME

### A. Feasibility

- 5.01 In view of the economic and policy framework which now predominates in practically all borrowing member countries, where private sector activities are being encouraged, the Corporation could play an important role in promoting small- and medium-sized enterprises which have not been major beneficiaries of higher rates of domestic investment, or of increased flows of foreign capital throughout the region in recent years. A multisector global credit programme, such as the one being proposed, should make a meaningful contribution by making funding resources available for the financing of profitable medium to long-term investment projects sponsored by these types of enterprises. Successful projects should also help beneficiaries to adapt to changing market conditions and to improve their prospects for financing future expansion from traditional market sources.
- 5.02 Private investors throughout the region, both foreign and domestic, generally seek to invest in larger, more structured companies, through the stock market, or in money-market instruments, in order to achieve higher returns within short time horizons. Investments in the market segment typically targeted by the IIC are slow to mature and are likely to generate uneven returns. Moreover, foreign investors tend to seek opportunities on a world-wide scale and are not necessarily committed to host countries. The IIC is unique amongst international financial institutions active in the region because they can provide financing to those small- and medium-sized private enterprises which lack access to sources of formal financing. Indeed, few financial institutions, public or private, foreign or domestic, supply financing in any significant amounts to these types of enterprises, particularly long-term debt and equity financing, which is essential to achieve sustainability. The Corporation are reasonably well-placed to assist in the removal of some of these obstacles, not only because they can provide resources, but because of the demonstration effect their operations often have, thus ensuring the overall feasibility of the Programme.
- 5.03 The Corporation have been able to fulfill most of their mandate and have managed to channel long-term funding to the region. However, an important component of their mandate is to provide equity financing and they will progressively be unable to do so from their limited capital base. The proposed Programme should enable the IIC to free their own resources for equity investments and permit expanded lending activities, all within the context of a prudent use of their increased debt-to-equity ratio. The Programme would allow the IIC to approximately double the current volume of resources being channelled to their borrowers, which in turn should also strengthen the institution's balance sheet by increasing their earning assets base.

- 5.04 The feasibility of the Programme is contingent on several factors, over some of which, such as market interest rates, and economic performance in borrowing member countries, the IIC have no control. However, those factors, such as administrative expenses, identification and appraisal of new investment opportunities, monitoring of the active loan and investment portfolio, and allocation of staff to fee-generating advisory services, over which the IIC do exercise some control, would be administered in light of the institution's recent experience in managing to recover from, at times, a very difficult situation; this should ensure the institutional feasibility of the Programme.
- 5.05 The general principles of the Programme have been designed to parallel the IIC's own operating and financial guidelines, which after close examination are believed to be sound and adequate to ensure the financial feasibility of the Programme, particularly to the extent that there is enough flexibility built into the guidelines to adjust to changing financial conditions.
- 5.06 Potential sub-borrowers will be subject to a financial analysis, an overall risk assessment and a project appraisal and will have to abide by loan conditions set by IIC Management. Inasmuch as the Corporation have been strengthening these key functions, the feasibility of the Programme appears to be likely.
- 5.07 In order to ensure that projects financed by the Corporation are environmentally feasible, the Programme specifically requires compliance with IIC environmental procedures, which are consistent with the Bank's environmental policies.

## B. Benefits

- 5.08 The IIC complement the Bank by providing direct investment facilities without government guarantees, as well as related services to small- and medium-sized private sector enterprises, areas in which the Bank is in many ways restricted. These facilities and services supplement the regional development designs of the IDB and include the following:

- a. Significant development impact for the region. In addition to important benefits in areas such as employment and value-added, there would be gains in export development, technology transfer, and regional integration. Specifically, the IIC estimate the annual impact through 1996, with 113 active projects representing commitments amounting to \$450 million, of which almost 90% has been disbursed, to have been:

- export revenue:	\$686 million
- value-added:	\$3 billion
- employment generation:	84,000 jobs
- technology transfer:	12 projects
- procurement:	\$906 million



The IIC estimate that the annual impact of the proposed Programme on the region should at least match these figures, which could climb to more than \$1 billion for export revenue, \$4.3 billion for value-added, close to 100,000 direct and indirect jobs for employment generation, and \$1.3 billion for procurement.

- b. Direct support to emerging capital markets through both financing and advisory services. This represents an important supplement to the Bank's efforts in this area, as witnessed, inter alia., by agreements entered between the IIC and the MIF, and the IIC and the Bank's Private Sector Development Department.
  - c. Specialized project financing capability. Expert staff in the broad area of investment finance is required for implementation of the IIC's overall mandate. This expanded capacity will serve as an important complement to IDB operations, particularly within the context of Eighth Replenishment objectives.
- 5.09 Within the guidelines of its Agreement, as well as of its current Action Plan and Management Policy, the IIC have considerable flexibility on how they may allocate resources, through its various financing instruments, directly to projects.
- 5.10 It is expected that the Programme will assist in the strengthening, coordination and consolidation of the private sector endeavours of the so-called "IDB Group" in Latin America and the Caribbean. The IIC has unique experience in dealing with the private sector, particularly with the small- and medium-sized enterprises which make up the majority of their client base. Indeed, and as has often been previously highlighted, this base is widely acknowledged to be high-risk and therefore has not been able to obtain resources to the same extent that microenterprise has through the MIF and NGOs, and at the other end of the spectrum, infrastructure-type projects which have been able to take advantage of international capital market liquidity, as well as the Bank's own Private Sector window. This experience, strengthened by the Programme, will provide an important complement to Bank actions and will enable to better address, in a more integrated manner, the needs of the region's private sector as a whole.
- 5.11 This loan, the second made to the Corporation by the Bank, will assist the IIC in strengthening their record as prudent and responsible borrowers and will make a long-term contribution by providing a not insignificant measure of financial independence. The loan will enhance the IIC's creditworthiness as perceived by potential lenders; indeed, the willingness of the Bank to grant this second loan to the IIC is a clear indication of shareholder support and should encourage private lenders to furnish resources at terms and conditions they would otherwise be reluctant to agree to.
- 5.12 The ability of the Programme to finance past disbursements of eligible loans will allow the Corporation to free and make available for equity investments that part of their share capital resources currently invested

in loans. It would also provide comfort to potential lenders by ensuring that, should funding not be available from other sources, the IIC would have resources to fund their outstanding loan portfolio. Such comfort should bolster the IIC's capacity to borrow from the market.

C. Risks

- 5.13 The Bank's loan will account for one-half of the Corporation's borrowing capacity under their newly increased debt-to-equity ratio of 3:1. Currently, the IIC have approximately 16% of their portfolio which is non-performing. If the same proportion would apply to a loan portfolio primarily funded by the IDB operation, and if most of these loans ultimately have to be written off, a significant share of the Corporation's own capital would be lost. However, IIC loans are well-collateralized at about one and a half to two times loan value, and in the event of having to move against collateral, the IIC are likely to recover amounts due. Moreover, the IIC plan to expand lending to slightly larger and more established borrowers, typically representing lesser risks than current small- and medium-sized borrowers and should therefore be able to reduce the incidence of non-performance and write-off.
- 5.14 With only seven years of operations, three of which have been difficult, the IIC have not yet consolidated as an institution. They are still building up their portfolio and have a limited repayment record. However, the quality of the portfolio has been slowly recovering and there have been no delays or problems in meeting payments to all of their creditors on schedule. Moreover, inasmuch as the shareholders and Boards of Executive Directors of both the Bank and the Corporation overlap almost entirely, this should provide sufficient safeguards to ensure oversight and mitigate risk.
- 5.15 Whilst on average the Corporation is expected to be profitable, net income is likely to fluctuate from year to year due to several factors. First and as previously indicated, the IIC concentrate their activities on a high-risk segment of the market and even with good and reliable appraisal mechanisms in place, there always will be a few transactions which will inevitably fail. Second, the IIC's current focus on equity investments, most of which have yet to mature, coupled to the cyclical nature of economic activity, may occasionally have a negative impact on a number of active projects in its portfolio. Third, the IIC remain small in terms of authorized capital and total assets, making them vulnerable to losses on investments since they have not yet achieved a critical mass which would allow the institution to absorb the risks inherent to their principal clients, namely small- and medium-sized private enterprises.
- 5.16 As indicated in previous chapters, the Board of Governors of the IIC requested an independent review of the Corporation's portfolio prior to incurring debt in an amount which would exceed the previously authorized 1:1 gearing ratio. In their summary to the IIC Board of Executive Directors on 14 January 1997, the independent firm (Borgatti Associates) reported in their conclusions that "having reviewed the IIC's portfolio, investment practices and risk management controls, it is our opinion that

the Corporation is positioned to increase its gearing without incurring undue risks."

D. Impact on low income population

- 5.17 Although the Programme is designed to finance small- and medium-sized private sector enterprises in many sectors of economic activity, and it does have an employment-creating impact, it does not target social sectors or specifically address social needs; it therefore does not satisfy the criteria set forth in paragraph 2.15 of the Eighth Replenishment document (AB-1704), which would allow it to be regarded as a programme aimed at reducing poverty.

E. Natural disasters and participation of women in Programme benefits

- 5.18 The Programme is neutral with regards to natural disasters and the participation of women in the benefits of the Programme.

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**INTER-AMERICAN INVESTMENT CORPORATION  
ASSUMPTIONS FOR FINANCIAL PROJECTIONS 1997-2006**

**I. Basic Assumptions**

1. **Approval capacity:** defined in document CII/GN-64-2 as the sum of subscribed capital, retained earnings, loan repayments, loan and equity sales, and borrowing authority, as defined below.
2. **Borrowing authority:** Article III, section 7(a) of the Charter (as amended) provides for a gearing ratio up to 3 times the sum of subscribed capital plus earned surplus and reserves. It is assumed that the IIC will limit the level of indebtedness in practice to 2:1.
3. **Commitment authority:** undisbursed commitments are limited to the sum of liquid assets plus undisbursed committed lines of credit.
4. **Yearly approvals:** the projected level of approvals intended to utilize the transferable resources of the Corporation under the existing operating strategy. The level of approvals is adjusted to accommodate a cap on total outstanding liabilities of \$300 million.
  - 4.1 **Number of approved projects:** volume of approvals is projected to increase to \$150 million in 1997 (25 projects) and to then moderate at \$138 million (23 projects) for the remainder of the projection period. Approval of new projects is driven by investment reflows, increase in gearing ratio and additional borrowings against future net income, taking into consideration the cap on total borrowing outstanding of \$300 million.
  - 4.2 **Pre-approval attrition:** a drop-out ratio from appraisal to approval of 15% is assumed (target rate). For every five projects approved it is assumed that six projects will need to be appraised in the field.
  - 4.3 **Average size:** the projections assume an average IIC investment size of \$6.0 million. Current pipeline supports this assumption, with IIC investments expected to range from \$2 million to \$10 million.
5. **Committed projects:** an estimated 15% of the volume approved is canceled prior to commitment. It is assumed that the lag between approval and commitment averages 5.5 months (based on actual experience).
6. **Post-commitment attrition:** 10%, in line with IIC's experience to date.
7. **Equity and Loan Mix:** although the existing strategic plan emphasizes

equity operations, the ability to sustain a high percentage of equity approvals is constrained by the need to reserve a portion of IIC's capital to contend with unforeseen losses on the portfolio. The level of capital reserves has been established as the greater of 15% of the outstanding

loan portfolio or 1/3 of subscribed capital and retained earnings. A second constraint on the level of equity investments is that these are funded solely from IIC's own capital and retained earnings, not borrowed funds.

Equity investments are projected to reach 20% of the volume approved in 1997 and 1998, based on existing pipeline. The constraint imposed by required capital reserves will result in a reduction in equity approvals to 10% of total transaction volume from 1999 and thereafter.

8. **Equity characteristics:** of the total resources allocated to equity investments throughout the projection period, 25% will be invested in turn-around companies in bigger countries or other investments with the opportunity to realize dividends or capital gains in a relatively short time (from 2-6 years). Traditional equity investments will receive the remaining 75% of resources to be channeled in the form of equities.
9. **Loan Life:** loan life is assumed to be eight years, composed of a three year grace period and five years for repayment.
10. **Investment Disbursement Profile:** based on an analysis of actual portfolio behavior to date, loan disbursements are assumed to be distributed over three years with 63% of committed amounts disbursed in the year of commitment, 20% in the second year and 17% in the third year. The assumptions for equity investments follow a slower disbursement rate, with 52% of committed amounts disbursed in the year committed, 17% in the second year and 31% in the third year.

Historical Disbursement Profile												
	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12
Loan	28%	15%	16%	4%	10%	5%	4%	1%	2%	3%	2%	10%
Equity	30%	10%	12%	---	1%	7%	9%	---	---	---	1%	30%

## II. Income Statement

11. **Portfolio Fee Income:** the sum of front-end fees, commitment fees, and appraisal fees.
  - 11.1 **Front End Fee:** 1% of the amount of the IIC investment, payable

within the quarter in which the loan has been committed.

- 11.2 **Commitment Fee:** 0.5% of the undisbursed balance of each loan calculated from the commitment date and payable on each loan payment date.
- 11.3 **Appraisal Fee:** \$40,000 per project, based on 1996 actual average. On average, 30% of these fees are paid to consultants retained by

IIC during appraisal; hence, only 70% of the gross fees are recognized as IIC revenue.

- 12. **LIBOR:** LIBOR is projected based on the Bloomberg spot forward quote (from 24 January 1997) for 6-month LIBOR for July of each year.
- 13. **Loan Interest:** calculated for each loan for each period. Interest revenue is based on LIBOR, plus an average spread of 3.6% times the average outstanding loan balance of the current and previous years, minus outstanding loans in non-accrual. A non-accrual rate of 13% of active loan portfolio is assumed, based on the actual average non-accrual rate for 1996. Although the nonaccrual rate is anticipated to decline simply as a function of growth in the outstanding portfolio, as well as a result of efforts currently underway to enhance overall credit quality, no improvement in this ratio is projected.
- 14. **Short-Term Investment Interest Income:** the average yearly investment balance, times LIBOR (1996 results matched LIBOR, while 1995 results yielded LIBOR + 40 basis points).
- 15. **Capital Gain (Loss) from Liquid Portfolio:** no assumptions are made of any potential capital gain (or loss) which could derive from successful (or unsuccessful) market positioning.
- 16. **Dividends and Capital Gains for Traditional Investments:** 15% of the traditional equity investments are assumed to begin paying dividends at an annualized rate of 5% of the outstanding equity investment balance (net of equity sales) two years after disbursement; 50% are assumed to pay dividends after 5 years, and 35% pay no dividends. This tranche of equities is assumed to be sold: 45% after 5 years and 55% after 10 years, at a premium equivalent to an annualized rate of 8%.
- 17. **Dividends and Capital Gains for "Fast-track Investment Portfolio":** this track of equity investments targets high-dividend-paying and quickly-appreciating opportunities. For purposes of conservatism, the dividend yield and capital gain rates have been projected at the same levels as for the "traditional" equity tranche. It is assumed that 90%

pay dividends in the second year at an annualized rate of 5%. The investments are assumed to be sold 50% after two years and 50% after six years of disbursement at a capital gain equivalent to an annualized rate of 8%.

18. **Advisory Services and Other Fee-based Income:** derived from the following business activities: advisory services, co-financing and IDB related services. Fee income is projected based on the following assumptions:

18.1 **Advisory Services Income:** income related to work for unrelated third parties, projected at \$1.6 million in 1997 and \$2.0 million in 1998 and 1999, based on the IIC's agreement with the AIG/GECC Infrastructure Fund (LAIF) for related project development work.

18.2 **Co-financing fees:** the percentage of loan transactions with co-financing features is projected at 25%, based on current pipeline. A mobilization ratio of 3.3:1 is assumed, based on actual experience and the characteristics of the current pipeline. IIC would raise \$3.30 of third party financing for each dollar of IIC loans committed. A fee of 1% is earned on all participated amounts when committed. In addition, an average of \$15,000 per year participation fee is charged per transaction.

18.3 **MIF:** revenue is based on the existing fee schedule agreed between the IIC and the MIF. It is expected that IIC will undertake 9 appraisal operations per year and receive an average of \$100,000 in fees per project. This activity is assumed to continue until the year 2000.

19. **Administrative expense:** expenses include both fixed and variable components. The variable components are subject to increase with the level of new transaction volume and growth in the cumulative number of active projects. The 1997 administrative budget and staffing level is adequate for the Corporation to maintain an annual output of about 25 projects for its own account per year, undertake project appraisal activities for MIF and LAIF and to administer a portfolio of about 150 active projects.

No changes in the relationship between administrative expense and volume of activity are included in the projections; as a result, administrative expenses are assumed to increase proportionately with increases in number of active projects, although this is considered a "worst case" outcome.

19.1 **Fixed administrative expense:** (40% of total administrative expenses based on 1997 proposed budget) primarily corporate overhead, including office occupancy, IDB services and general management and essential support staff. These expenses are

assumed to increase by 3% per year, reflecting inflation.

- 19.2 **Variable expenses related to new project promotion and appraisal:** (38% of total administrative budget) primarily comprising operations staff salaries, benefits, technical and legal consulting, travel and communications. These expenses are subject to increase in direct proportion to the percentage increase in annual appraisals in excess of the number budgeted for 1997 (29 for IIC own account, 9 for MIF and approximately 6 appraisals for LAIF), with a minimum annual increase of 3% per year for inflation. Although LAIF and MIF advisory work is projected to be discontinued in 1999 and 2000, the staff resources freed up are not projected to be fully utilized. Some staff attrition is therefore likely, although not incorporated in the assumptions.
- 19.3 **Variable costs related to supervision and administration of the active portfolio:** (22% of administrative budget) primarily comprising operations and finance staff salaries, benefits, related technical and legal consulting, travel and communications. These expenses are subject to increase in direct proportion to the growth in the aggregate number of active approvals beyond 150 (a level likely to be reached by 1998), with a minimum annual increase of 3% per year.
20. **Interest expense:** it is assumed that IIC borrows at LIBOR plus 14 -17.5 basis points (the rate on existing borrowings) with an average of 16 basis points.
21. **Post-retirement benefits:** these consist of tax reimbursement and medical insurance for retirees. FAS 106 requires that companies recognize the cost over the average service period of employment. IIC policy is to fund the Post-Retirement Benefit Plan in an amount equal to the annual cost (based on actuarial assumptions) plus the annual amortization of service cost prior to 1995 over a 20 year period. It is assumed that this expense will increase by the same percentage as administrative expenses.

### III. Balance Sheet

22. **Loan and equity provisions and write-offs:** total loss provisions are projected at the rate as of 31 December 1996 (10% for loans and 9% for equity). This level of loss provision accounts both for specific provisions for impaired assets and general loss provision (at least 4% of portfolio). To reflect the impact of impaired loans, the projections assume that investments are written-off in an annual amount equivalent to the average loss provision over the same period as the principal is scheduled to be recovered.



23. **Liquidity:** liquid assets cover 100% of committed and undisbursed equity investments plus 50% of the undisbursed loan commitments. The Corporation is able to minimize its liquid asset holdings by including the unused portion of committed borrowings in the calculations of the liquidity pool. A minimum liquid asset balance of approximately \$50 million will be maintained.
24. **Borrowings:** pursuant to the Agreement Establishing the IIC, total corporate borrowing cannot exceed 300% of total equity (the sum of subscribed capital, retained earning and reserves). It is projected that the Corporation will contract lines of credit at least equal to the full borrowing capacity, but will draw on resources only as necessary to fund projected growth in the loan portfolio. Outstanding corporate debt would not exceed 2.1 times total capital plus retained earnings. It is assumed that the IIC will borrow in 10 million increments, with 7-year bullet maturities.
25. **Share capital:** as of 31 December 1996, IIC's authorized capital was US\$200 million, which was fully subscribed. No increase in share capital is included in these projections.

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**BALANCE SHEET  
(US\$ MILLIONS)**

	ACTUAL	PROJECTED										
	1996	1997	1998	1999	Increase 1997-1999	2000	2001	2002	2003	2004	2005	2006
<b>ASSETS</b>												
Short Term Investment	\$60.94	\$54.56	\$58.89	\$52.96	(\$1.58)	\$54.44	\$49.89	\$52.95	\$53.09	\$54.85	\$55.42	\$55.42
Gross Loan Portfolio Outstanding	\$231.51	\$252.01	\$275.79	\$309.07	\$57.07	\$343.89	\$381.75	\$418.18	\$444.20	\$458.99	\$485.57	\$488.89
Less: Cum. Loan Provision	(\$24.02)	(\$25.20)	(\$27.58)	(\$30.91)	(\$5.71)	(\$34.39)	(\$38.17)	(\$41.82)	(\$44.42)	(\$45.90)	(\$48.56)	(\$48.87)
Net Loan Portfolio Outstanding	\$207.49	\$226.81	\$248.21	\$278.17	\$51.36	\$309.50	\$343.57	\$376.36	\$399.78	\$413.09	\$436.02	\$438.02
Gross Equity Outstanding Portfolio	\$43.27	\$88.89	\$84.80	\$102.64	\$35.96	\$110.49	\$110.15	\$104.85	\$99.22	\$94.88	\$91.38	\$87.50
Less: Cum. Equity Provision	(\$4.08)	(\$8.00)	(\$7.63)	(\$9.24)	(\$3.24)	(\$9.94)	(\$9.91)	(\$8.42)	(\$8.93)	(\$8.54)	(\$8.22)	(\$7.87)
Net Equity Portfolio Outstanding	\$39.20	\$80.88	\$77.17	\$93.41	\$32.72	\$100.54	\$100.24	\$95.23	\$90.29	\$86.32	\$83.14	\$79.62
Net Disbursed Portf. Outstanding	246.70	\$267.49	\$325.38	\$371.57	\$84.08	\$410.04	\$443.81	\$469.79	\$480.07	\$499.41	\$502.15	\$517.64
Receivables & Other Assets	9.48	\$10.32	\$11.29	\$12.95	\$2.34	\$14.08	\$15.83	\$17.04	\$18.19	\$18.79	\$19.08	\$19.83
<b>TOTAL ASSETS</b>	<b>\$17.12</b>	<b>\$352.37</b>	<b>\$395.88</b>	<b>\$437.20</b>	<b>\$84.84</b>	<b>\$478.58</b>	<b>\$509.33</b>	<b>\$538.79</b>	<b>\$561.24</b>	<b>\$573.65</b>	<b>\$578.83</b>	<b>\$582.92</b>
<b>LIABILITIES &amp; CAPITAL</b>												
Current Maturities Long Term Debt	0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$75.00	\$0.00	\$10.00	\$10.00	\$30.00	\$40.00	\$40.00
Net Prior Long Term Borrowing	85.00	\$95.00	\$125.00	\$165.00	\$70.00	\$130.00	\$170.00	\$260.00	\$270.00	\$280.00	\$230.00	\$210.00
New Long-Term Borrowings	10.00	\$0.00	\$0.00	\$0.00	\$10.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Total Borrowings Outstanding	95.00	\$125.00	\$125.00	\$165.00	\$80.00	\$245.00	\$270.00	\$290.00	\$300.00	\$300.00	\$280.00	\$280.00
Accounts Payable & Other	3.47	\$3.47	\$3.47	\$3.47	\$0.00	\$3.47	\$3.47	\$3.47	\$3.47	\$3.47	\$3.47	\$3.47
Subscribed Capital	200.00	\$200.00	\$200.00	\$200.00	\$0.00	\$200.00	\$200.00	\$200.00	\$200.00	\$200.00	\$200.00	\$200.00
Less: Portion not yet Paid	0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Paid Capital	200.00	\$200.00	\$200.00	\$200.00	\$0.00	\$200.00	\$200.00	\$200.00	\$200.00	\$200.00	\$200.00	\$200.00
Unrealized Gain on Equity	(1.25)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Retained Earnings	19.90	\$23.90	\$27.20	\$26.74	\$4.04	\$30.10	\$35.87	\$40.32	\$57.88	\$69.58	\$63.18	\$69.52
<b>TOTAL LIABILITIES &amp; CAPITAL</b>	<b>\$17.12</b>	<b>\$352.37</b>	<b>\$395.88</b>	<b>\$437.20</b>	<b>\$84.84</b>	<b>\$478.58</b>	<b>\$509.33</b>	<b>\$538.79</b>	<b>\$561.24</b>	<b>\$573.65</b>	<b>\$578.83</b>	<b>\$582.92</b>

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**INCOME STATEMENT  
(US\$ MILLIONS)**

	ACTUAL	PROJECTED										
	1996	1997	1998	1999	Cumulative 1997-1999	2000	2001	2002	2003	2004	2005	2006
<b>REVENUES</b>												
Loan Interest	\$18.09	\$19.53	\$23.04	\$25.07	\$67.63	\$28.42	\$31.84	\$35.48	\$38.58	\$40.81	\$42.05	\$43.51
Fee Income	\$1.87	\$2.18	\$2.30	\$2.34	\$6.80	\$2.41	\$2.41	\$2.41	\$2.41	\$2.41	\$2.41	\$2.41
Dividends	\$0.30	\$0.55	\$0.77	\$1.09	\$2.40	\$1.42	\$1.72	\$1.93	\$2.01	\$2.00	\$1.98	\$1.88
Capital Gain (Loss) from Equity Inv. Portfolio	\$2.89	\$0.70	\$1.38	\$1.54	\$3.62	\$2.60	\$6.73	\$9.64	\$9.25	\$8.18	\$8.94	\$10.49
Income from Liquid Assets	\$3.10	\$2.84	\$3.41	\$3.41	\$9.67	\$3.35	\$3.35	\$3.45	\$3.58	\$3.70	\$3.62	\$3.93
Capital Gain (Loss) from Liquid Portfolio	(\$0.15)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Advisory Service Fees	\$0.12	\$1.88	\$2.00	\$2.00	\$5.88	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Co-financing	\$1.25	\$1.71	\$1.38	\$1.46	\$4.54	\$1.53	\$1.81	\$1.88	\$1.74	\$1.80	\$1.88	\$1.82
MIF and IOB Infrastructure Projects	\$0.40	\$0.92	\$0.92	\$0.92	\$2.77	\$0.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
<b>TOTAL REVENUES</b>	<b>27.88</b>	<b>\$30.07</b>	<b>\$35.20</b>	<b>\$37.82</b>	<b>\$103.09</b>	<b>\$40.65</b>	<b>\$47.78</b>	<b>\$54.88</b>	<b>\$57.57</b>	<b>\$58.88</b>	<b>\$61.08</b>	<b>\$64.04</b>
<b>EXPENSES</b>												
Interest Expenses	\$5.33	\$6.43	\$9.58	\$11.85	\$27.84	\$14.76	\$17.16	\$18.92	\$20.20	\$20.79	\$20.84	\$20.43
Provisions (Gen + Spec)	\$10.84	\$6.86	\$9.19	\$10.87	\$26.92	\$10.62	\$10.50	\$10.45	\$10.45	\$10.45	\$10.45	\$10.45
Administrative Expenses	\$9.71	\$11.82	\$12.18	\$12.55	\$36.56	\$12.87	\$13.28	\$13.66	\$14.22	\$14.75	\$15.17	\$15.58
Termination Program	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Postretirement Benefit Fund	\$1.00	\$0.95	\$0.98	\$1.01	\$2.94	\$1.03	\$1.02	\$1.10	\$1.14	\$1.19	\$1.22	\$1.25
<b>TOTAL EXPENSES</b>	<b>\$26.87</b>	<b>\$26.07</b>	<b>\$31.90</b>	<b>\$36.28</b>	<b>\$94.25</b>	<b>\$39.29</b>	<b>\$41.99</b>	<b>\$44.12</b>	<b>\$46.01</b>	<b>\$47.18</b>	<b>\$47.47</b>	<b>\$47.69</b>
<b>NET INCOME</b>	<b>\$1.01</b>	<b>\$4.00</b>	<b>\$3.30</b>	<b>\$1.54</b>	<b>\$8.84</b>	<b>\$1.36</b>	<b>\$5.77</b>	<b>\$10.45</b>	<b>\$11.36</b>	<b>\$11.71</b>	<b>\$13.08</b>	<b>\$16.38</b>

TABLE 1 <sup>1</sup> DISTRIBUTION OF IIC STAFF 1 January 1997					
UNIT	MGMT	PROF	ADMIN	TOTAL	%
General Manager	1	1	2	4	6%
Operations Department	1	29	10	40	58%
Finance, Risk Mgmt. and Administration Division	0	12	4	16	23%
Legal Division	0	5	4	9	13%
<b>Total</b>	<b>2</b>	<b>47</b>	<b>20</b>	<b>69</b>	<b>100%</b>

TABLE 2 IIC DEFINITIONS OF SMALL- AND MEDIUM-SIZED ENTERPRISES			
	SMALL	MEDIUM	LARGE
ASSETS	UP TO \$10M	\$10-35M	OVER \$35M
SALES	UP TO \$10M	\$10-35M	OVER \$35M
EMPLOYEES	UP TO 250	250-750	OVER 750
APPROVED FINANCING	58%	31%	11%

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<sup>1</sup> Includes the field officers in Colombia, Costa Rica and Uruguay. These field officers assist in all areas of Corporation activity, but primarily with supervision of existing projects, as well as new project identification, and preliminary screening and client application.

TABLE 3							
IIC - SUMMARY BALANCE SHEET (in US\$ millions at 31 December)							
	1994		1995		1996		94-96
	Amount	%	Amount	%	Amount	%	Amount Change
<b>ASSETS</b>							
Cash, Banks & Marketable Securities	78	26	44	14	61	20	(17)
Loans (net)	180	61	220	72	207	65	27
Equity investments (net)	30	10	32	11	39	12	9
Other assets (net)	7	3	10	3	10	3	3
<b>Total Assets</b>	<b>295</b>	<b>100</b>	<b>306</b>	<b>100</b>	<b>317</b>	<b>100</b>	<b>22</b>
<b>LIABILITIES &amp; EQUITY</b>							
Accounts payable	4	1	3	1	3	1	(1)
Borrowings	75	25	85	28	95	30	20
<b>Total Liabilities</b>	<b>79</b>	<b>26</b>	<b>88</b>	<b>29</b>	<b>98</b>	<b>31</b>	<b>19</b>
Paid in capital	199	68	199	65	200	63	1
Retained earnings	17	6	19	6	19	6	2
<b>Total Liab. &amp; Equity</b>	<b>295</b>	<b>100</b>	<b>306</b>	<b>100</b>	<b>317</b>	<b>100</b>	<b>22</b>

TABLE 4				
HC - SUMMARY INCOME STATEMENT (in US\$ millions at 31 December)				
INCOME	1994	1995	1996	ACUM. 94-96
Marketable securities	3.8	3.8	3.0	10.6
Loan portfolio	14.6	20.0	19.0	53.6
Equity investments	0.8	0.1	3.5	4.4
Advisory services & others	1.2	2.5	2.4	6.1
<b>Gross Income</b>	<b>20.4</b>	<b>26.4</b>	<b>27.9</b>	<b>74.7</b>
<b>EXPENSES</b>				
Administrative	12.1	8.9	9.7	30.7
Provisions	1.5	6.2	10.8	18.5
Borrowings	5.8	5.1	5.3	16.2
Others (Post. RE1)	--	0.8	1.0	1.8
<b>Total Expenses</b>	<b>19.4</b>	<b>20.9</b>	<b>26.9</b>	<b>67.2</b>
<b>Net Income</b>	<b>1.0</b>	<b>5.5</b>	<b>1.0</b>	<b>7.5</b>

TABLE 5			
IIC - COMPARATIVEEVOLUTION OF KEY FINANCIAL INDICATORS			
INDICATORS (US\$ millions)	1994	1995	1996
1. Average total assets	330	300	311
2. Average earning assets	324	292	301
3. Gross financial income GFI	9	24	26
4. Administrative expenditures & other benefits	12	10	11
5. Average total gross portfolio	193	248	273
6. Provisions (annual expense)	1.5	6.2	10.8
<b>RATIOS (%)</b>			
3/2 Gross financial return ratio	5.9	8.2	8.5
4/1 Non-financial carrying cost ratio	3.6	3.2	3.4
6/5 Portfolio provisioning ratio	0.8	2.5	4.0
6/3 GFI exhaustion ratio	7.9	25.8	42.4

**PROPOSED RESOLUTION**

**REGIONAL. LOAN /OC-RE TO THE INTER-AMERICAN INVESTMENT  
CORPORATION**

**MULTISECTOR GLOBAL CREDIT PROGRAMME**

The Board of Executive Directors

**RESOLVES:**

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Inter-American Investment Corporation, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a multisector global credit programme. Such financing will be for the amount of up to three hundred million dollars of the United States of America (US\$300,000,000) from the Ordinary Capital resources of the Bank and it will be subject to the "Terms and Financial Conditions" and the "Special Contractual Conditions" of the Executive Summary of the Loan Proposal.