

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**EL SALVADOR**

**ACCESS TO CREDIT PROGRAM FOR MICRO, SMALL, AND MEDIUM-SIZED  
ENTERPRISES (MSMEs)  
(ES-L1156)**

**THIRD INDIVIDUAL OPERATION UNDER THE CONDITIONAL CREDIT LINE FOR  
INVESTMENT PROJECTS (CCLIP) TO FACILITATE ACCESS TO BUSINESS  
AND HOUSING LOANS  
(ES-O0009)**

**LOAN PROPOSAL**

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## **ABBREVIATIONS**

Bancóldex	Banco de Desarrollo Empresarial de Colombia [Colombian Business Development Bank]
BANDESAL	Banco de Desarrollo de la República de El Salvador [Development Bank of the Republic of El Salvador]
BCR	Banco Central de Reserva [Central Reserve Bank of El Salvador]
BFA	Agricultural Development Bank [Banco de Fomento Agropecuario]
ESMS	Environmental and social management system
FSV	Fondo Social para la Vivienda [Low-Income Housing Fund]
IVAE	Economic Activity Volume Index [Índice del Volumen de Actividad Económica]
SOFR	Secured Overnight Financing Rate
SSF	Superintendencia del Sistema Financiero [Office of the Superintendent of the Financial System]

## PROJECT SUMMARY

### EL SALVADOR

### ACCESS TO CREDIT PROGRAM FOR MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES (MSMEs) (ES-L1156)

Financial Terms and Conditions				
Borrower and executing agency:			Flexible Financing Facility <sup>(a)</sup>	
Development Bank of the Republic of El Salvador (BANDESAL)			Amortization period:	25 years
Guarantor:			Disbursement period:	4 years <sup>(b)</sup>
Republic of El Salvador			Grace period:	5.5 years <sup>(c)</sup>
Source	Amount (US\$)	%	Interest rate:	SOFR-based
Inter-American Development Bank Ordinary Capital: <sup>(a)</sup>	100,000,000	100	Credit fee:	<sup>(d)</sup>
			Inspection and supervision fee:	<sup>(d)</sup>
Total:	100,000,000	100	Weighted average life:	15.25 years
			Approval currency:	United States dollars
Program at a Glance				
<b>Program objectives:</b> The general development objective is to support the growth of MSMEs in El Salvador by financing BANDESAL’s second-tier lines. The specific development objective of the program is to promote the expansion of access to medium- and long-term productive credit for Salvadoran MSMEs through support for BANDESAL’s engagement.				
<b>Special contractual conditions precedent to the first disbursement of the loan:</b> A special contractual condition precedent to the first disbursement of the loan proceeds is the approval by BANDESAL of the <a href="#">Credit Regulations</a> for this program, under terms previously agreed upon with the Bank (paragraph 3.10).				
<b>Exceptions to Bank policies:</b> The Board of Executive Directors is requested to approve a partial waiver of the Policy on Guarantees Required from the Borrower (OP-303) enabling the Republic of El Salvador to guarantee only those financial obligations deriving from the loan contract between the Bank and BANDESAL (paragraph 3.11).				
Strategic Alignment				
Challenges: <sup>(e)</sup>	SI <input checked="" type="checkbox"/>		PI <input checked="" type="checkbox"/>	EI <input type="checkbox"/>
Crosscutting themes: <sup>(f)</sup>	GE <input checked="" type="checkbox"/> and DI <input type="checkbox"/>		CC <input checked="" type="checkbox"/> and ES <input type="checkbox"/>	IC <input type="checkbox"/>

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

<sup>(b)</sup> In accordance with document AB-2990, disbursement of the loan proceeds will be subject to the maximum limits: (i) up to 15% during the first 12 months; (ii) up to 30% during the first 24 months; and (iii) up to 50% during the first 36 months, in all cases as of the date of loan approval by the Bank's Board of Executive Directors (paragraph 2.2).

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

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

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

<sup>(f)</sup> GE (Gender Equality) and DI (Diversity); CC (Climate Change) and ES (Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

## I. DESCRIPTION AND RESULTS MONITORING

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

#### 1.1 Background to the Conditional Credit Line for Investment Projects (CCLIP).

This program is the third individual operation under the CCLIP to Facilitate Access to Business and Housing Loans ([ES-O0009](#)), which was approved along with its first individual operation in July 2020 for US\$400 million. Two individual operations have been approved under the CCLIP thus far. The First Program of Access to Lending for the Recovery of Micro, Small, and Medium-sized Enterprises (MSMEs) ([5083/OC-ES](#)), was approved for US\$200 million with the objective of supporting the sustainability of MSMEs in El Salvador by financing second-tier lending for the Development Bank of the Republic of El Salvador (BANDESAL). The second operation, the Low-Income Housing Finance Program ([5352/OC-ES](#)), approved in September 2021 for US\$50 million (awaiting legislative ratification), will be executed by the Low-Income Housing Fund (FSV). The objective of the CCLIP is to promote productive activities and social welfare in El Salvador by providing access to credit in the business and housing sectors. The first program has been successful because it has aligned BANDESAL's objectives with those of the government to support the recovery of the business fabric during and after the COVID-19 crisis. Execution of the program began in mid-2021, and 91% of the total amount has already been disbursed. The CCLIP will be implemented under the Multisector Modality II (MM-II), pursuant to the criteria specified in the Proposed Amendments to the Conditional Credit Line for Investment Projects (CCLIP) and the Multiphase Program Loans (document GN-2246-13). The liaison agency will be El Salvador's Department of Trade and Investment ([optional link 8](#)).

#### 1.2 Macroeconomic context.

El Salvador's economy, the fourth largest in Central America, is dollarized, outward-looking, and vulnerable to external shocks and natural disasters. It is also highly dependent on the economic performance of the United States and on remittances.<sup>1</sup> Due to the COVID-19 crisis, gross domestic product (GDP) decreased by 8.2% in 2020;<sup>2</sup> it then recovered in 2021, achieving growth of 10.3% due to the post-pandemic rebound effect and the backing of remittances and exports. Projected growth for 2022 is 2.6%.<sup>3</sup> The low growth of the past two decades is mainly attributable to lower contributions in terms of both capital and total factor productivity.<sup>4</sup> The COVID-19 pandemic drastically changed El Salvador's outlook as of March 2020.<sup>5</sup> Although the country quickly adopted containment measures against COVID-19<sup>6</sup> and fiscal measures to buffer its impact on households and companies, the pandemic led to an increase in poverty from 22.8% to 26.2% between 2019 and 2020.<sup>7</sup> In 2020, owing to the decline in GDP,

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<sup>1</sup> Remittances account for over 20% of GDP in El Salvador ([IDB, 2020](#)). In 2021, 94.9% of remittances originated from the United States ([BCR, 2022](#)).

<sup>2</sup> More information on the country's economic indicators and regional comparators are available at [World Economic Outlook](#) and [Central American Monetary Council](#).

<sup>3</sup> Official data from the [BCR](#).

<sup>4</sup> Barrios, J.J. et al (2019): Impulsando el Crecimiento Inclusivo y Sostenible.

<sup>5</sup> COVID-19 was classified as a pandemic on 11 March 2020.

<sup>6</sup> [Expansión. Datos Macro](#).

<sup>7</sup> [Office of Statistics and Census](#). 2020.

decreased tax collection, and increased public spending in response to the pandemic, the nonfinancial public sector closed with a deficit of approximately US\$2.5 billion (10.1% of GDP), increasing the public debt balance to US\$22.625 billion (91.8% of GDP).<sup>8</sup>

- 1.3 **Global economic crisis and its impact on the Salvadoran economy.** The negative impacts of the COVID-19 pandemic and Russia's invasion of Ukraine have led to a global economic downturn. At the beginning of 2022, the global inflation rate (7.8%) and inflation in emerging markets and developing economies (9.4%) reached their highest levels since 2008<sup>9</sup> due to bottlenecks in supply chains and rising food and energy prices. A post-pandemic rebound led to global growth of 5.7% in 2021; however, this rate is projected to fall to 2.9% in 2022. Consistent with these trends, El Salvador's consumer price index increased by 6.6%, or 3.8% more than in the previous year.<sup>10</sup> El Salvador's economy is expected to return to low levels of average growth of approximately 2.1% between 2023 and 2027; in other words, lower than pre-pandemic levels (average of 2.5% between 2015 and 2019).<sup>11</sup>
- 1.4 **Financial system overview and economic outlook.** The local financial system includes 12 private commercial banks, 2 State-owned commercial banks, 6 credit unions, 1 federation of credit unions, and 4 credit and savings associations.<sup>12</sup> Growth in the system is driven by lending to the manufacturing industry and its value chain, as well as the service, construction, and commerce sectors. At the end of 2021, intermediary financial institutions (IFIs) were performing well with respect to portfolio quality, reserve coverage,<sup>13</sup> and equity ratio indicators (15.9%). IFIs also had stable deposits and high liquidity, as well as a positive trend for return indicators ([optional link 2](#)). In the months prior to the pandemic and in 2020, the system experienced a credit crunch, owing to the economic downturn, but it has been recovering since the end of 2021. By March 2022 the loan portfolio totaled US\$16.21 billion with growth of 8%<sup>14</sup> over March 2021. However, portfolio balances grew, largely as a result of the impact on balance sheets of the measures adopted by authorities during the COVID-19 pandemic, such as mandatory deferrals of customer loan installments, refinancings, and restructurings that were in effect until March 2021. Conversely, the number of loans issued decreased by 10,007 between 2019 and 2021,<sup>15</sup> namely to the commerce, agriculture, service, and manufacturing industry sectors. Most of the portfolio is concentrated in large companies (49.2%), followed by medium-sized enterprises (13.9%) and microenterprises (5.6%).<sup>16</sup> The economic outlook<sup>17</sup> is not

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<sup>8</sup> Vulnerabilidad del Sistema Financiero en el Salvador, Carlos Acevedo, 2021.

<sup>9</sup> [Global Economic Prospects](#). World Bank. 2022.

<sup>10</sup> [Central American Monetary Council](#). 2022.

<sup>11</sup> World Economic Outlook. International Monetary Fund, 2022.

<sup>12</sup> [Revista Panorama Financiero 2021](#). Office of the Superintendent of the Financial System (SSF). Edition 22.

<sup>13</sup> The liquidity reserve totalled US\$2.7286 billion, or US\$299.1 million more than required, which shows an average compliance of 117.5%. This is due to the application of technical standards for the calculation and use of the liquidity reserve on deposits and obligations (Technical Standard 28).

<sup>14</sup> Revista Mirada Financiera, Edition 24, SSF, 2022.

<sup>15</sup> SSF database, 2021.

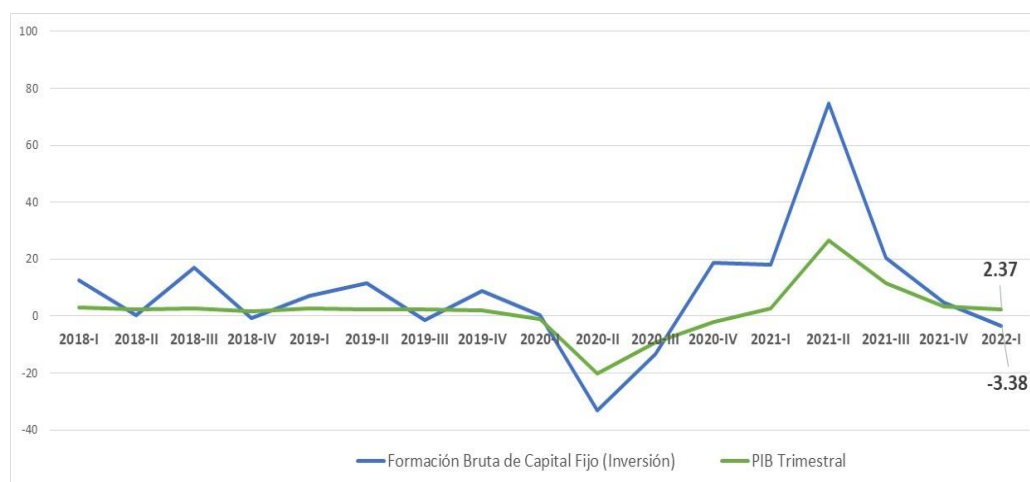
<sup>16</sup> Revista Panorama Financiero, Edition 24, SSF, 2022.

<sup>17</sup> Economic growth projections. BCR. May 2022.

entirely positive, and this could curtail the recovery of credit considering the heightened risks faced by companies, most of which are MSMEs. Moreover, public and private intermediaries' access to funding sources could be negatively impacted, leading to decreased lending rates.

- 1.5 The quarterly GDP growth rate for the first quarter of 2022 was 2.4% (see Figure 1), signaling a trend towards low growth levels, comparable to pre-pandemic levels, and reflecting the presence of companies that have not yet recovered from the pandemic's effects. Likewise, the Economic Activity Volume Index (IVAE),<sup>18</sup> which reached maximum growth of 29.9% in May 2021 during the economic recovery, began to trend downward, falling to 1.7% in February 2022. The largest declines in this indicator were in the manufacturing industry, construction, financial activities and insurance, and real estate sectors. Aggravating this outlook is a 3.4% decrease in investment in the first quarter of 2022, which will adversely affect the economy's growth.

**Figure 1. GDP and gross capital formation trends 2018-2022**



Source: Prepared by the authors based on BCR data.

- 1.6 **Restrictions in access to credit.** According to 2016 local estimates,<sup>19</sup> only 12% of adults in the country have access to credit. This figure is consistent with 2017 international estimates,<sup>20</sup> which indicate that 11% of adults have access to credit, well below the 20.8% average for Latin American and Caribbean countries. The information available confirms that loans are prioritized for the business sector, as 35% of adult borrowers use loans to expand or launch a business or to purchase inputs, machinery, and equipment.<sup>21</sup> The financial system's role is to channel loans

<sup>18</sup> The main objective of the IVAE is to track year-on-year trends in productive activity and, therefore, provide signals to economic agents on the trend-cycle of economic activity and its changes.

<sup>19</sup> BCR (2016). National Survey of Access to Financial Services.

<sup>20</sup> [Global Financial Index](#). World Bank.

<sup>21</sup> Op. cit. BCR. 2016.



to companies, enabling them to perform their activities more productively.<sup>22</sup> However, regardless of their size, economic sector, or the geographic area of their operations, companies in El Salvador have suboptimal access to credit.<sup>23</sup> In 2016, estimates indicated that only 40.2% of companies had a bank loan or line of credit, compared with 47.7% of those in Latin America and the Caribbean, and that 20.7% identified access to lending as the main factor impeding their development.<sup>24</sup>

- 1.7 MSMEs<sup>25,26</sup> comprise the segment with the greatest difficulties in accessing credit, despite their importance and contribution to the economy ([optional link 3](#)).<sup>27</sup> According to information available on the demand from MSMEs: (i) 99% of Salvadoran microenterprises, especially those dedicated to commerce, frequently obtain informal loans under usurious financial terms;<sup>28</sup> (ii) only 68,000 of the country's 317,000 micro and small enterprises obtain loans, and only 31,000 obtain them from IFIs that are part of the regulated financial system;<sup>29</sup> (iii) only 29% of MSMEs have lines of credit or loans;<sup>30</sup> and (iv) 18% of MSMEs find it difficult to access credit, and 36% consider it very difficult.<sup>31</sup> Research conducted in March 2022 found that: (i) 80% of surveyed small business owners and/or entrepreneurs obtain loans through the unregulated financial system on unfavorable terms due to legal requirements and screens that hinder their access to the regulated market; and (ii) 45% of these same enterprises, especially small subsistence enterprises, reported that their financial situation had deteriorated after two years of the pandemic.<sup>32</sup>
- 1.8 On the supply side, according to December 2021 information from El Salvador's Office of the Superintendent of the Financial System (SSF), the 89,199 loans to MSMEs accounted for only 4% of the over 2,000,000 loans issued throughout the system. This demonstrates the incipient penetration rate in terms of number of loans. In addition, the US\$3.501 billion borrowed by MSMEs accounted for 22% of the system's total loan balance. Loan indicators for MSMEs showed an inverse relationship between average amounts and interest rates, given that a smaller loan

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<sup>22</sup> While in El Salvador there is no evidence of a relationship between lending and productivity, international studies demonstrate causality between the level of development of the financial system and economic growth (Rajan y Zingales, 1998; Beck et al, 2000), mainly through its effect on productivity (IDB, 2010; Arizala et al, 2013).

<sup>23</sup> International Labour Organization (2019). National Enterprise Survey.

<sup>24</sup> [Enterprise Surveys](#). World Bank 2017.

<sup>25</sup> The Act to Promote, Protect, and Develop Micro and Small Enterprises and documents from the Ministry of Economy establish company classification by size, as outlined in [optional link 3](#).

<sup>26</sup> In addition to MSME, other abbreviations used in this document include MSEs (micro and small enterprises) and SMEs (small and medium-sized enterprises). These are based on the groupings used in the information sources that were consulted.

<sup>27</sup> The latest economic census, in 2005, estimated that MSMEs represented 99.5% of all companies, employed 65.5% of workers, and created 42.7% of value added.

<sup>28</sup> Salvadoran Bank Association (2019).

<sup>29</sup> National Survey of MSEs 2017. BCR. 2017.

<sup>30</sup> National Survey of MSME Access to Financing. BCR. 2019.

<sup>31</sup> Ibid.

<sup>32</sup> Características del Crédito Otorgado por el Sector No Regulado en El Salvador. Universidad Tecnológica de El Salvador and the Salvadoran Bank Association, 2022.

- entails proportionally higher operating costs and risk, and therefore requires a higher return.
- 1.9 According to calculations based on SSF data, as well as the behavior of BANDESAL's portfolio, in May 2022 the MSME finance gap exceeded US\$10.902 billion. This gap is not being adequately covered, despite increased programs and funding for this sector ([optional link 4](#)).
  - 1.10 **Strategic sectors for growth and their access to credit.** Considering the country's productive matrix, the follow strategic sectors were identified due to their capacity to contribute to economic recovery and growth, based on their contributions to GDP in 2019: (i) manufacturing industries (15%); (ii) land vehicle and motorcycle commerce and repair (11%); (iii) real estate activities (7%); (iv) financial and insurance activities (6%); (v) construction (6%); and (vi) agriculture, livestock, forestry, and fishing (5%).<sup>33</sup> These sectors account for 50% of GDP. Therefore, business credit is concentrated in some of these sectors: commerce (28.1%), manufacturing industry (20%), services (17.6%),<sup>34</sup> and agriculture (5.9%). The agriculture sector's share of the total portfolio has been decreasing since 2019.
  - 1.11 **Diagnostic assessment of business credit by gender.** Like the rest of the Latin American and Caribbean region, El Salvador lacks gender-disaggregated data on finance, which precludes an accurate diagnostic assessment of the credit gap and the state of productive financing for women-led or women-owned MSMEs based on an official definition. International and regional evidence indicates that women entrepreneurs face greater obstacles in terms of both supply and demand for finance.<sup>35</sup> There are also supply-side restrictions, such as gender biases (conscious or unconscious) in the practices of financial institutions and a dearth of financial products and services with appropriate value propositions for women entrepreneurs.<sup>36</sup>
  - 1.12 In addition to the systemic difficulties faced by the country's enterprises, women entrepreneurs have been disproportionately impacted by the COVID-19 pandemic and subsequent restrictions on access to credit, because their businesses are concentrated in the service sector, which has been hit harder by the crisis. The available information shows that, just as in the rest of the region, women's participation in El Salvador's financial system is limited: approximately 11% of Salvadoran women have loans from a formal financial entity.<sup>37</sup> This becomes even more relevant considering that women own 60% of the country's MSMEs, concentrated primarily in the microenterprise segment, and that only 15.6% of these businesses finance their investment with bank loans, in comparison with 27.3% of men's businesses. Moreover, women's businesses report a rate of rejection of credit applications that is four times higher than that of men's businesses.<sup>38</sup> Approximately

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<sup>33</sup> BCR data, 2019.

<sup>34</sup> Revista Panorama Financiero, SSF, Edition 22.

<sup>35</sup> Brecha de género en el acceso al financiamiento en Centroamérica y República Dominicana. IDB (2021).

<sup>36</sup> Discriminación de género en el mercado de créditos de consumo. Chile's Financial Market Commission (2020).

<sup>37</sup> World Bank's [Global Financial Index](#).

<sup>38</sup> Enterprise Surveys (2016). According to this survey, 3.5% of enterprises with a female lead manager reported that their application had been rejected, in comparison with 0.8% of enterprises with a male lead manager.

19% of the MSME finance gap in El Salvador corresponds to the women-led or women-owned enterprise segment.

- 1.13 **Credit for the sustainable growth of MSMEs.** The sudden stop in economic activity stemming from the COVID-19 crisis impacted IFI lending to the business sector. IFIs responded by providing loans for working capital,<sup>39</sup> renegotiating or relaxing the terms for existing loans, and following measures established by the authorities to freeze loan payments, interest charges, and penalties. While these provisions did not have any immediate impact on borrowers' credit ratings, they carry a foreseeable risk of deterioration in portfolio quality and liquidity pressures due to the dynamic of new lending. During the 2021 reopening and recovery, 92% of MSMEs resumed sales, though 7 of every 10 MSMEs were only operating at 25% of their productive capacity despite perceiving increased demand.
- 1.14 Evidence suggests that IFIs behave in a procyclical manner and can restrict lending in periods of economic recession such as the one generated by the pandemic.<sup>40</sup> Without adequate countercyclical sources of finance, IFIs could reduce their incentives to maintain their supply of finance to MSMEs during crises and in subsequent periods of recovery and sustained growth. The business fabric in periods of recovery and sustained economic growth will be different than it was prior to the COVID-19 crisis. The surviving MSMEs will need financing that enables them to grow in a sustained manner, and this means access to medium- and long-term productive financing. The Salvadoran government is driving initiatives to promote productivity. For example, it is using its main financial arm, BANDESAL, to support the recovery of the MSME sector through medium- and long-term productive financing lines. This support complements private sector efforts, as the private sector still requires this type of finance to leverage additional resources and reduce the current finance gap, which is estimated to have grown.<sup>41</sup>
- 1.15 **BANDESAL's role in promoting economic recovery.** The confluence of the COVID-19 crisis and the current context is having a serious impact on the economy and, consequently, on the MSME sector, which accounts for over 90% of the productive fabric. BANDESAL has played a significant role in supporting the MSME sector through various financing programs and technical support. Its objective is to contribute to the economic and social development of productive sectors—particularly the business sector, which includes MSMEs—through second- and first-tier lines and the administration of funds and trusts such as the Salvadoran Trust Fund and the Economic Development Fund.<sup>42</sup> BANDESAL has also provided a wide range of financial and nonfinancial services for productive sectors lacking financial support, through the Salvadoran Trust Fund, and specialized technical assistance through the consolidation of the Business Training and Development Center. As of June 2022, 61% of BANDESAL's loans were concentrated in second-tier lines (US\$352 million) and 39% in first-tier lines (US\$226.7 million). Second-tier lines

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<sup>39</sup> Banco Hipotecario took a leadership role in providing liquidity loans to MSMEs.

<sup>40</sup> IDB (2020). Latin American and Caribbean Macroeconomic Report. Policies to Fight the Pandemic.

<sup>41</sup> According to BANDESAL calculations, with data from the financial system and the SSF, the MSME finance gap was approximately US\$6.878 billion.

<sup>42</sup> The BANDESAL Law authorizes the institution to conduct financial operations on market terms, acting through IFIs or directly with eligible entities.

recorded disbursements of approximately 107,300 loans through 52 first-tier IFIs<sup>43</sup> between January and July 2022. These second-tier lines, in turn, are estimated to have leveraged over US\$400 million in private sector resources. A total of 66% of all second-tier BANDESAL loans were granted to MSMEs ([optional link 5](#)). Although BANDESAL has played a critical role in increasing MSME access to credit, under optimal funding conditions it would only have the capacity to cover US\$1.072 billion of the total finance gap mentioned in paragraph 1.9 over the next three years. The Bank covers over 35% of the funding required to meet these financing needs, thereby becoming one of the institution's main partners in supporting efforts to expand the MSME sector's access to finance.

- 1.16 **Rationale for the operation.** The State-owned development bank has played a significant role in supporting the MSME sector by providing sources of finance to support this sector. During the pandemic, public Salvadoran banks have supported the sector through liquidity lines, thereby preventing the bankruptcy of many businesses that remain in operation to this day and continue to meet their financial obligations. The current challenge is to maintain this support during the recovery phase, in a context of discouraging economic growth prospects. BANDESAL needs to increase its financing capacity through long-term funding that will enable it to serve more MSMEs and support the growth and consolidation of the productive fabric in a post-pandemic recovery phase. This operation aims to continue to support the growth of the MSME sector through medium- and long-term finance for MSMEs that access BANDESAL financing through IFIs (second tier). Through the program, the Salvadoran government will strengthen its commitment to the growth and consolidation of this sector, given its strategic importance to the country's economic recovery.
- 1.17 **Impact evaluations of similar operations.** The results of the short-term impact analysis of BANDESAL's productive loans confirm the program's internal and external validity. This analysis was conducted in the framework of the project completion report for operation [3271/OC-ES](#), which found that productive loans financed by BANDESAL improve clients' performance in the financial market.<sup>44</sup> There are also several empirical partial equilibrium studies that show the positive outcomes of finance on companies' performance and the impact on employment. De Negri et al. (2011) analyzed the effectiveness of public credit lines in promoting the performance of Brazilian companies. This study found that the credit lines provided by the Brazilian Development Bank (BNDES) and the Brazilian Innovation Agency had a positive impact on employment growth and exports, although it did not find a significant effect on labor productivity. The effect on employment throughout the period of analysis was greater than 20% under different specifications, and greater than 40% on exports. In another study, Eslava, Maffioli, and Meléndez Arjona (2012) analyzed the impact of lending activity by the

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<sup>43</sup> BANDESAL also serves IFIs not overseen by the SSF, such as nongovernmental organizations, microfinance institutions, and cooperatives; therefore, its intervention perimeter is larger than the 25 IFIs mentioned in paragraph 1.2.

<sup>44</sup> With a BANDESAL loan, the probability of obtaining additional loans from other sources increases by 3 percentage points, which is 4.2% above the mean value of the controls. This increase in debt does not impact the probability of entering into default; in fact, it decreases by 2 percentage points, or 23% in comparison with the mean value of the controls.

Colombian Business Development Bank (Bancóldex) on the performance of firms, based on data spanning several years from manufacturing companies with 10 or more employees. After correcting for selection biases, and using econometric techniques, they found significant increases in output (24%), employment (11%), investment (70%), and productivity (about 10%) over four years following their first Bancóldex loan.

- 1.18 **Sector experience and lessons learned.** BANDESAL is executing operation [5083/OC-ES](#) (paragraph 1.1). In addition, loans have been issued for an average amount of US\$25,000, terms of more than 12 months, and grace periods of up to 36 months. These resources have been channeled through 29 IFIs, which, in turn, have granted more than 4,000 loans; of these, 43% were to women-owned MSMEs. This proposed operation is expected to provide loans to MSMEs with productive credit needs that have not yet been covered by previous operations ([optional link 4](#)). While the final consulting report containing the midterm evaluation for operation [5083/OC-ES](#) is expected by the end of 2022, the main preliminary lessons learned that will be implemented in this proposed operation include: (i) developing and strengthening the relationship with IFIs is key to increasing awareness of the importance of collecting information from users; (ii) strengthening the monitoring and evaluation team and teams to verify and gather information in the field is critical; and (iii) it is essential to strengthen IFIs' capacities relative to the classification and reporting of loans with potential for climate change mitigation and adaptation, as well as loans targeting women entrepreneurs.
- 1.19 **Coordination with the IDB Group.** The program will seek complementarity and synergies with the IDB Group's public and private sectors.
- a. **Complementarity with other IDB operations.** There is complementarity with program [5083/OC-ES](#), currently being executed by BANDESAL (paragraph 1.16) with the objective of supporting the sustainability of MSMEs in El Salvador by financing second-tier lines, inasmuch as the proposed operation will continue to provide this support in the post-pandemic phase of economic growth. There is complementarity with program [4567/GN-ES](#) (approved in July 2018 for US\$20 million, of which 25% of resources have been executed), also being executed by BANDESAL with the objective of financing SME investments in energy efficiency projects, given that the knowledge that it generates will support the analysis of this proposed operation's green financing prospectuses. There is also complementarity with program [4977/OC-ES](#) (approved in January 2020 for US\$20 million, of which 33% of resources have been executed) that the Agricultural Development Bank (BFA) will execute as a first-tier bank, targeting MSEs from highly marginalized municipios. BANDESAL and the BFA will combine credit dispersal mechanisms in the first and second tiers, which will ensure that the financing reaches more MSMEs and achieves broader geographic coverage.
  - b. **Complementarity with IDB Lab and IDB Invest.** This program will coordinate with IDB Lab as part of operations such as [ATN/ME-17758-ES](#) (approved in December 2019 for a total of US\$450,000, of which 40% of resources have been executed), an operation that seeks to create digital tools to strengthen capacities

and improve options for accessing credit, and operation [ATN/FG-19205-RG](#)<sup>45</sup> (approved in March 2022 for US\$400,000 and not yet in execution), which seeks to create the foundation for the development of a fair and inclusive data economy by promoting the innovation and competitiveness of SMEs. In the case of IDB Invest, complementarity is key to initiate and maintain a dialogue with local IFIs to enhance the IDB Group's integrated support, where BANDESAL's lines are instrumental in reaching sectors and niches that IDB Invest has neither the experience nor the financial conditions to serve. Therefore, this operation seeks to serve types of MSMEs that are different from those served by IDB Invest, thereby responding to complementary financial needs.

- 1.20 **Additionality and value added by the Bank.** The Bank is supporting BANDESAL in a context of economic crisis in which MSMEs will need resources with favorable terms to finance their recovery and growth plans. This support sends a strong signal of confidence to the market, which will generate value to attract additional finance from agencies wanting to broaden the program's reach. Through [ATN/OC-17746-ES](#) the Bank is having a strategic impact on BANDESAL in terms of the importance of monitoring and evaluation, improved identification and gathering of information on climate financing, as well as on finance for women entrepreneurs. BANDESAL has developed a monitoring and evaluation strategy for its programs and has invested its own resources in strengthening its information technology systems for gathering and processing information. Through [ATN/OC-17811-RG](#), BANDESAL has initiated an internal training process on gender equity and is committed to classifying and analyzing gender-disaggregated data, with a view to identifying potential gaps or biases in the provision of finance to women entrepreneurs. Lastly, through [ATN/OC-18934-RG](#), the Bank has begun working with BANDESAL to review its current and potential portfolio to define criteria for investments targeting climate change mitigation and adaptation, which will enable the identification and classification of this type of subloan.
- 1.21 **Strategic alignment.** The program is aligned with the Second Update to the Institutional Strategy (document AB-3190-2), through the following development challenges: (i) productivity and innovation, by expanding access to finance for MSMEs through BANDESAL's second-tier lines; and (ii) social inclusion and equality, by promoting the financial inclusion of MSMEs affected by the COVID-19 crisis with a view to contributing to their economic recovery. The program is also aligned with crosscutting themes (i) gender equality, since it will provide access to finance for women-owned/led MSMEs, as 30% of the program's second-tier resources will focus exclusively on this segment; the program will also facilitate the design of gender-based data intelligence and will enhance IFIs' preparedness by strengthening their investments with a gender lens (paragraph 1.25), and (ii) climate change, inasmuch as in accordance with the [joint methodology of the multilateral development banks for tracking climate finance](#) for [mitigation](#) and [adaptation](#), 20% of the operation's resources are invested in climate change mitigation and adaptation activities through MSME loans for investments with positive environmental impacts. The program also contributes to the Corporate Results Framework 2020-2023 (document GN-2727-12), through the following indicators:

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<sup>45</sup> Technical cooperation classified as Client Support.



(i) women beneficiaries of economic empowerment initiatives; and (ii) MSMEs financed. Moreover, the program is aligned with the Sector Strategy: Institutions for Growth and Social Welfare (document GN-2587-2), particularly its component focusing on enhancing the productivity and growth of SMEs. It is also consistent with the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7), by improving the efficiency and scope of banking credit intermediation to the productive sector. The program is consistent with the IDB Group country strategy with El Salvador 2021-2024 (document GN-3046-1), inasmuch as it is aligned with the strategic objective of facilitating access to finance for MSMEs, serving the priority area of reactivation and restructuring of production by improving MSME access to credit and incorporating the crosscutting themes of adaptation to climate change, women's empowerment, and gender equality, promoting lending to MSMEs. In addition, the operation addresses the productive development dialogue area because of its direct link with MSME finance.

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

- 1.22 **Objectives of the operation.** The general development objective is to support the growth of MSMEs in El Salvador by financing BANDESAL's second-tier lines. The specific development objective of the program is to promote the expansion of access to medium- and long-term productive credit for Salvadoran MSMEs through support for BANDESAL's engagement.
- 1.23 **Sole component: Productive credit (US\$100 million).** The program's resources will support the recovery and growth of MSMEs by financing medium- and long-term productive financing. Eligible IFIs that access BANDESAL's second-tier lines will onlend the resources provided under this component through subloans<sup>46</sup> to MSMEs. The subloans will finance productive activities that increase the business operativity of MSMEs, including fixed assets and working capital, and, as a result, promote their recovery and growth. The financial terms and conditions will be freely agreed upon by the IFIs (paragraph 3.5) and MSMEs (paragraph 3.6) but will include, at minimum: (i) economically profitable interest rates; (ii) terms of six months or longer; (iii) a degree of transfer of the benefit of the grace period; and (iv) amounts not exceeding US\$500,000,<sup>47</sup> except in special cases where the Bank has given its prior acceptance. This component will mainstream considerations related to women's restrictions to finance, for which 30% of the program resources will be channeled to this segment. Specific activities will also be incorporated to strengthen institutions in the women entrepreneur segment (paragraph 1.25). In addition, 20% of program resources will finance climate change mitigation and/or adaptation activities. The [Credit Regulations](#) will include further details on the terms and conditions, as well as more detailed selection criteria for IFIs and MSMEs.

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<sup>46</sup> "Subloans" are defined as medium- and long-term loans provided by eligible IFIs to eligible sub-borrowers, pursuant to the terms outlined in the [Credit Regulations](#). "Sub-borrowers" are defined as individuals and businesses, from all sectors of the economy, that qualify as MSMEs under El Salvador's legislation and BANDESAL's internal policies.

<sup>47</sup> According to the experience gained in this CCLIP's first operation (5083/OC-ES), through which 4,599 loans have been issued to date, only 32 loans are larger than US\$500,000, and the remaining 4,567 loans are smaller than US\$500,000. The average amount of the 4,599 loans is US\$25,000. A limit of 20% of the total transaction amount has been established for subloans of US\$500,000.

- 1.24 **Program management.** Program administration, auditing, monitoring, and evaluation costs will be covered by BANDESAL using own resources.
- 1.25 **Gender considerations.** Given the gender gap in the country and the disproportionate effects that the COVID-19 crisis has had on women, as well as on the potential for women-led or women-owned MSMEs to contribute to the country's economic recovery, this operation will consider specific actions to serve women-led projects. BANDESAL will take measures to design gender-disaggregated data intelligence that will generate new information on women's behavior within it. Efforts will be made to systematize institutional strengthening sessions for IFIs on gender-related topics so they are better prepared to serve the female market, and these could be financed through the technical cooperation that will support this loan.<sup>48</sup> In addition, BANDESAL will channel 30% of program resources towards a second-tier line exclusively targeting MSMEs led or owned by women. These measures, in addition to the institutional strengthening that BANDESAL has been undertaking, are expected to help maintain the share of this type of subloan within BANDESAL's institutional MSME portfolio and facilitate the intervention's long-term sustainability as a result of improved information-gathering procedures.
- 1.26 **Climate change considerations.** The [Credit Regulations](#) will include project selection and monitoring criteria, as well as the indicative positive list of investments with impacts on climate change mitigation and adaptation, which will be the output of the green label model currently being prepared with BANDESAL ([optional link 6](#)). The list will be applied to the program's subloans to MSMEs with a view to monitoring their evolution and contribution to BANDESAL's institutional goals as a member of the Green Protocol for the Financial System of El Salvador. It may also apply the guidelines established in the Guide to Climate Finance in El Salvador. In all, 20% of program resources will be used to finance climate change mitigation and/or adaptation activities.
- 1.27 **Beneficiaries.** The end beneficiaries of the program will be sub-borrowers, specifically individuals and businesses from all sectors of the economy that qualify as MSMEs based on the country's legal system and BANDESAL's internal policies, and that also meet the requirements outlined in paragraph 3.8 ([optional link 3](#)). The operation has a multisector approach and may finance sectors including commerce, services, manufacturing industry, small-scale construction, and agriculture. The program will support the recovery and growth of MSMEs in the context of the global economic crisis in terms of economic growth, inflation, external events, and supply chain delays. Therefore, it is expected to benefit profitable MSMEs in general, as well as those that have survived the pandemic-related crisis and are now in a phase of recovery and consolidation. Sub-borrowers must have the ability and will to pay, in accordance with the assessments carried out by eligible IFIs. Ex ante estimates have identified 4,141 MSMEs as program beneficiaries and sub-borrowers.

### C. Key results indicators

- 1.28 **Expected results.** The program's expected impacts on the economic recovery of MSMEs will be measured through: (i) average sales revenue of MSMEs supported by

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<sup>48</sup> The technical cooperation profile is currently being prepared, and this has been included in the technical cooperation requirements for 2023.



the program; and (ii) percentage of jobs at MSMEs attributable to the lines supported by the program, as a percentage of total jobs in the country. The indicators associated with the program's specific development objectives will be: (i) rate of arrears for the MSME productive financing portfolio supported by the program, compared with the average rate of arrears for the financial system; (ii) percentage of medium-term credit (6 months or longer) in the MSME productive financing portfolio supported by the program; (iii) leveraging of productive financing resources achieved by MSMEs because of the program; (iv) total amount of the MSME productive financing portfolio; and (v) proportion of productive financing (of more than 6 months) provided to women-owned MSMEs within the total portfolio amount.

- 1.29 **Economic viability.** The economic evaluation identifies the flows of benefits and costs generated by the program. The benefits consist of the economic value of the reduction in sales revenue losses, the benefits derived from a higher rate of business survival, and the benefits of jobs preserved because of the program. Calculations of these flows (discounted at a rate of 12%) yield benefits of US\$21.75 million and an internal rate of return of 19.1%. In addition, the sensitivity analysis showed robust positive results to changes made in the determining parameters used to estimate program benefits ([optional link 1](#)).

## II. FINANCE STRUCTURE AND MAIN RISKS

### A. Financing instruments

- 2.1 **Program costs and programming.** The program is a global credit investment loan for US\$100 million financed from the Bank's Ordinary Capital. It is the third operation under the CCLIP ES-O0009 and the second operation in the business sector (CCLIP Multisector Modality II), executed by the same executing agency. As with previous operations executed by BANDESAL, Bank resources will be disbursed within 48 months of the entry into force of the loan contract and will be committed within 45 months of that same date. The term and annual disbursement amounts were estimated based on the disbursement restrictions outlined in paragraph 2.2 and BANDESAL's internal projection models, with variables that consider: (i) the dynamics of high demand for credit from MSMEs during an economic recovery period; (ii) the availability of long-term international sources of finance; and (iii) the volatility of liquidity levels in the local financial market due to the uncertainty faced by economic agents. Importantly, execution planning ([required link 1](#)) is consistent with the disbursement restrictions (paragraph 2.2) (see Table 1):

Table 1. Program disbursement schedule

	Year 1	Year 2	Year 3	Year 4	Total
US\$ millions	15	15	20	50	100
%	15	15	20	50	100

Table 2. Estimated program costs (US\$ millions)

Components	IDB (Total)	%
Sole component. Productive credit	100	100
<b>Total</b>	<b>100</b>	<b>100</b>

- 2.2 **Restrictions on the pace of disbursements.** Pursuant to document AB-2990, disbursement of the loan proceeds will be subject to the following maximum limits: (i) up to 15% during the first 12 months; (ii) up to 30% during the first 24 months; and (iii) up to 50% during the first 36 months, in all cases as of the date of loan approval by the Bank's Board of Executive Directors. These limits may be rendered inapplicable to the extent that the requirements set forth in the Bank's policy have been fulfilled, provided that the borrower has been notified of the same in writing.

**B. Environmental and social risks**

- 2.3 In accordance with the Environmental and Social Policy Framework (document GN-2965-23), this operation is classified as intermediated financing, and its environmental and social risk classification is moderate. Its disaster and climate risk classification is also moderate. The operation will finance sectors including commerce, services, manufacturing industry, small-scale construction, and agriculture. The environmental and social due diligence findings indicate that most subloans financed under the program will have a low socioenvironmental risk, while a few potential subloans will have a moderate risk. Subloans that will not be financed by the program include category "A" and "B" subloans or those with higher socioenvironmental risk, or subloans financing the procurement or installation of solar panels. The program's environmental and social risks will be managed through its Environmental and Social Management System (ESMS), which will include compliance with the terms of the IDB Environmental and Social Exclusion List, local legislation, and additional exclusion and eligibility criteria. These environmental and social requirements will comprise the program's ESMS and will be incorporated into the [Credit Regulations](#). For more details, see the [Environmental and Social Management Report \(required link 2\)](#).

**C. Fiduciary risks**

- 2.4 The results of the institutional analysis indicate that BANDESAL has a high level of capacity to manage operations and presents a medium-low fiduciary management risk, considering that although the institution lacks experience with IDB contracting procedures, this experience is not required because the program will not carry out procurement. Moreover, BANDESAL's experience is recent, as it is currently executing operations [4567/GN-ES](#) and [5083/OC-ES](#). BANDESAL's experience as an executing agency has been positive, as evidenced by the satisfactory performance of both operations to date.

**D. Other key issues and risk**

- 2.5 **Economic and financial risk.** There is a high risk that BANDESAL's funding costs will increase owing to the increase in international benchmark rates. This would lead to higher interest rates for lines of credit provided to end beneficiaries, thereby reducing the demand for loans. BANDESAL will mitigate this risk by continually monitoring macroeconomic conditions to gradually modify its financing terms for IFIs.
- 2.6 **Institutional risk.** There is a medium-high risk associated with the potential for inadequate coordination between the different agencies (Ministry of Finance and BANDESAL) involved in the program's entry into force. This could cause considerable delays that would affect the program's execution timeline. BANDESAL will mitigate this risk by ensuring the timely coordination and performance of required functions, in parallel with the Bank's approval of the operation.

- 2.7 **Human resource risk.** There is a medium-high risk associated with the increased workload of BANDESAL staff responsible for managing international cooperation programs. Consequently, they may not be able to take on the program's new responsibilities, leading to delays in the program's physical and financial execution. To mitigate this risk, the Bank will provide support through technical cooperation funds, anticipated for 2023, which will aim to strengthen the units responsible for project execution.
- 2.8 **Sustainability.** BANDESAL will execute program resources using preferential financial terms and conditions that IFIs can transfer to MSMEs, but that, at the same time, ensure sufficient financial returns to cover costs and generate profits. Therefore, BANDESAL will be able to reinvest the funds obtained in more transactions of a similar nature in the medium and long term. Reinvested resources must adhere to the same guidelines in terms of the proportion of funds targeting women-led enterprises and climate change finance.

### III. IMPLEMENTATION AND MANAGEMENT PLAN

#### A. Summary of implementation arrangements

- 3.1 **Borrower, executing agency, and guarantor.** BANDESAL will be the borrower and executing agency for this operation, with sovereign guarantee provided by the Republic of El Salvador. BANDESAL is an autonomous public credit institution with an indefinite term of existence, independent legal status, and its own assets. It was established through Legislative Decree 847 of 22 September 2011, which includes the BANDESAL Law. At the end of June 2022, BANDESAL had US\$668 million in assets, financed by US\$392 million in liabilities and US\$276 million in equity. At that time, it also had a US\$523 million loan portfolio, net of reserves for loan losses, of which 67% was in second-tier banking operations through IFIs and only 33% was in first-tier operations. Its profits from January to June 2022 were US\$6.3 million, representing a 1.0% return on assets and a 2.2% return on equity. Notably, the portfolio generated from resources from the first CCLIP operation [5083/OC-ES](#) has a default rate of zero. BANDESAL is overseen by the Office of the Superintendent of the Financial System (SSF) and complies with the regulations issued by the Central Reserve Bank of El Salvador (BCR). Moody's Investor Service confirmed its rating of Caa3 for BANDESAL in May 2022 ([optional link 5](#)).
- 3.2 **Execution and administration.** BANDESAL's Funding and Development Management Division will be responsible for coordinating the arrangements for program execution. Its responsibilities will include: (i) preparation, implementation, and coordination of annual work plans; (ii) monitoring of budgets, program accounting, financial administration, reports, and disbursement requests; (iii) preparation of technical, execution, and financial reports; (iv) program monitoring and evaluation; (v) program evaluation at the end of the execution period; (vi) monitoring of contracting of the external auditor and implementation of their recommendations; and (vii) acting as the program's point of contact with the IDB. The results of the institutional capacity assessment performed during the third quarter of 2022 using the simplified methodology, since BANDESAL is currently executing a similar operation, confirmed that BANDESAL continues to have adequate capacity to conduct the financial management and administration of this operation's resources. BANDESAL will use this capacity to identify end

- beneficiaries, provide loans, and carry out the program's auditing and reporting to the Bank based on the highest standards of transparency, according to the guidelines established in the [Credit Regulations](#). The opportunities for improvement identified will focus on strengthening the division responsible for reviewing the quality of information required for program monitoring and evaluation ([required link 3](#)).
- 3.3 Operation 5083/OC-ES, the first program under the CCLIP ES-O0009, reached eligibility in August 2021. In all, 91% of loan proceeds, or approximately US\$149 million, have been disbursed, which corresponds to more than 4,000 productive loans. According to the program monitoring report from the end of 2021, the program's performance is satisfactory; therefore, given BANDESAL's experience, the probability of achieving the operation's development objectives is high.
- 3.4 The final report from the midterm evaluation is expected by the end of 2022, and it will identify the lessons learned and improvements that can be implemented in this operation ([optional link 9](#)); among the preliminary findings of the analysis is the conviction by BANDESAL, IFIs, and MSMEs that this type of operation is indispensable to their development and that program resources have played a vital role in ensuring that MSMEs not only do not disappear but also are able to retool and/or grow their businesses. Regarding the environmental and social safeguards of operation 5083/OC-ES, BANDESAL's performance in applying the program's ESMS has been satisfactory, which is based on compliance with local legislation and application of BANDESAL's environmental management policy and environmental management methodology, a program exclusion list, and specific eligibility and exclusion criteria.
- 3.5 **Strategic coordination mechanisms.** BANDESAL will proactively coordinate with the formal interagency and cross-sector mechanisms established for public and private initiatives supporting MSMEs. These mechanisms will improve BANDESAL's strategic orientation and ensure that it carries out timely, appropriate actions to issue the program's subloans. Regarding coordination with the liaison agency, which is El Salvador's Department of Trade and Investment ([optional link 8](#)), BANDESAL will meet with the department at least once a year to review progress in program execution and the achievement of targets, as well as to jointly propose, if necessary, operational modifications to improve program performance. BANDESAL will send the Department reports and documents pursuant to section B, "Summary of arrangements for monitoring results," enabling it to monitor the program. If necessary, BANDESAL and the Department may reach additional agreements. BANDESAL will implement the required coordination measures with the Ministry of Finance, especially between the President of BANDESAL and the Ministry of Finance's Division of Investment and Public Credit, with the objective of ensuring appropriate coordination throughout program execution.
- 3.6 **Credit Regulations.** The program [Credit Regulations](#) will establish the program's terms and conditions, including the specific characteristics of MSME subloans, limits on the use of funds, the application of the ESMS to the program including the exclusion list and monitoring of socioenvironmental considerations, fiduciary obligations, and monitoring and evaluation requirements ([optional link 6](#)). Any modifications to the [Credit Regulations](#) must have clearance from the Bank and/or its no objection.

- 3.7 **Intermediary financial institutions.** The program will include IFIs that are subject to the SSF's inspection and surveillance, as well as unregulated IFIs that meet the conditions stipulated within BANDESAL's risk management system, and that have financing quotas with BANDESAL. BANDESAL's eligibility evaluation system is set out in institutional credit policies approved by its board of directors<sup>49</sup> and reviewed by the SSF, and its approach is risk-based. If necessary, the [Credit Regulations](#) will include additional or complementary information on the program's eligibility criteria.
- 3.8 **Eligibility of MSMEs.** To be sub-borrowers, MSMEs must comply with the following requirements, in addition to those outlined in paragraph 1.27: (i) be a creditworthy borrower; and (ii) meet the IFIs' credit requirements.
- 3.9 **Subloan eligibility criteria.** Subloans may finance the productive activities (procurement of fixed assets and related working capital) of MSMEs supported by the program (for more details, see the [Credit Regulations](#)) in sectors such as commerce, services, manufacturing industry, small-scale construction, and agriculture.
- 3.10 **Special contractual conditions precedent to the first disbursement of the loan.** A special contractual condition precedent to the first disbursement of the loan proceeds is the approval by BANDESAL of the [Credit Regulations](#) for this program, under terms previously agreed upon with the Bank. This condition is justified since the [Credit Regulations](#) include details pertaining to the guidelines that will be adopted in the program's sole component, as well as the socioenvironmental conditions pursuant to the terms of the Environmental and Social Review Summary ([required link 2](#)).
- 3.11 **Exceptions to Bank policies.** The Board of Executive Directors is requested to approve a partial waiver of the Policy on Guarantees Required from the Borrower (OP-303) enabling the Republic of El Salvador to guarantee only those financial obligations deriving from the loan contract between the Bank and BANDESAL. This partial waiver is justified since, in accordance with Salvadoran authorities, Article 11 of the Basic Law on Public Financial Administration determines that the obligations associated with loan execution are outside the legal mandate of the Republic of El Salvador. This waiver was granted for operations [4977/OC-ES](#), [4567/GN-ES](#), and [5083/OC-ES](#).
- 3.12 **Procurement and contracting.** The program is structured as a global credit loan. Funds will be provided to BANDESAL to rediscount eligible credit operations for IFIs, which will onlend these resources to individuals or businesses performing activities that are consistent with the applicable Credit Regulations; therefore, it will be governed by the terms of the Policies for the Procurement of Goods and Works financed by the Inter-American Development Bank (document GN-2349-15).
- 3.13 **Disbursements.** The IDB will disburse program resources in the form of advances. Their frequency is determined by the program's financial programming for a period of six months, in accordance with the Financial Management Guidelines for IDB-financed Projects (document GN-2811-1) described in Annex III. The Bank will disburse a new advance when at least 80% of the cumulative total of previous

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<sup>49</sup> The three essential policies are: (i) counterpart risk policies for institutions under SSF supervision; (ii) counterpart risk policy for financial intermediaries not supervised by the SSF; and (iii) counterpart risk policy for corporations, cooperative corporations, and coffee plantation and sugar mill cooperative associations.



disbursements has been substantiated. Disbursement requests will be accompanied by a duly supported financial plan based on the requirements of the [Credit Regulations](#). BANDESAL will prepare annual disbursement schedules covering a rolling period of at least 12 months, based on which disbursements will be formulated for 6-month periods.

- 3.14 **Financial statements and audit.** Audits of the program's financial statements will be conducted in accordance with the procedure previously agreed upon with the Bank. Within 120 days following the end of each program fiscal year, and within 120 days after the last disbursement, throughout the original disbursement period and any extensions thereof, the executing agency will submit the program's audited financial statements, accompanied by the opinion of an independent audit firm acceptable to the Bank.

**B. Summary of arrangements for monitoring results**

- 3.15 **Monitoring.** Program execution will be monitored through semiannual progress reports from the executing agency, which are to be submitted within 60 days following the end of each six-month period. The reports will use as a reference the information commitments in the Results Matrix and the financial progress reports referenced in the General Conditions of the loan contract, as well as the fulfilment of the eligibility criteria outlined in the [Credit Regulations](#). These reports will be reflected in the progress monitoring reports.
- 3.16 **Evaluation.** The evaluation strategy for program results will follow several approaches: (i) a reflexive evaluation, before and after the program, demonstrating the scope of outcomes and impacts; and (ii) an ex post cost-benefit analysis of the flows of benefits and costs stemming from the program, following a similar strategy to the one used for the ex ante cost-benefit analysis. The program calls for the preparation of a quasi-experimental difference-in-differences impact evaluation with a treatment group consisting of the program's MSME beneficiaries, and a control group consisting of eligible MSMEs that are not program beneficiaries. The evaluation strategy is described in the [monitoring and evaluation plan \(required link 3\)](#). The executing agency will cover the costs of evaluation and monitoring.
- 3.17 **Information for program monitoring and evaluation.** The executing agency will be responsible for maintaining data collection and monitoring systems. This agency will also commit to maintaining a monitoring and evaluation system for the sole component, based on which it will prepare the reports and data to be submitted to the Bank. For purposes of the evaluation, the executing agency will compile, store, and safeguard all the information, indicators, and parameters, including the annual plans and the final evaluation, as required to prepare the project completion report. The additional information required for the evaluation process will be drawn from national and international secondary sources of statistical data and, potentially, reports from relevant organizations.

**IV. ELIGIBILITY CRITERIA**

- 4.1 **CCLIP eligibility criteria.** The MM-II CCLIP to Facilitate Access to Business and Housing Loans ([ES-O0009](#)) continues to meet the eligibility criteria set forth for this modality in document GN-2246-13, since:

- a. The CCLIP's multisector objective, to promote productive activities and social welfare in El Salvador by providing access to credit in the business and housing sectors, continues to be among the priorities defined in the IDB Group's country strategy with El Salvador 2021-2024 (document GN-3046-1), since it contributes to the reactivation and restructuring of production and addresses the crosscutting themes of adaptation to climate change, women's empowerment, and gender equality, by facilitating loans to MSMEs that respond to these sectors and market segments.
- b. The Department of Trade and Investment will be the liaison agency for the CCLIP, as appointed by the Salvadoran government ([optional link 8](#)). The Department has authority to coordinate and monitor the programs financed under the CCLIP, based on the powers established in Chapter X of Decree 1 of 2 June 2019, Official Gazette 101, Volume 423. The Department will observe the flow of operations in each sector and formulate modification proposals to achieve the CCLIP objectives if it deems such action necessary. Coordination arrangements between BANDESAL and the Department are indicated in paragraphs 1.1 and 3.5.

4.2 **Eligibility criteria for the third operation under the CCLIP.** This third individual operation is eligible under the MM-II CCLIP to Facilitate Access to Business and Housing Loans ([ES-O0009](#)) as a second individual loan operation and it meets the specific criteria for individual loan operations (document GN-2246-13), given that:

- a. The results of the institutional capacity analysis demonstrate that BANDESAL has a high level of capacity to carry out the financial and administrative management of program resources, a satisfactory level of achievement of development objectives, and low fiduciary risk levels (paragraphs 2.4 and 3.2). Notably, according to the program monitoring report from the end of 2021, BANDESAL's performance in terms of its execution and achievement of results in both operations has been satisfactory. The specific actions to improve BANDESAL's capacities, according to the institutional capacity analysis recommendations, will be financed with technical cooperation resources and include opportunities to improve the gathering and verification of information required for program monitoring and evaluation. These weaknesses will be addressed (paragraph 3.2). To date, the midterm evaluation has been conducted for operation 5083/OC-ES ([optional link 9](#)), and, relative to environmental and social safeguards, BANDESAL's performance has been satisfactory (paragraph 3.4).
- b. The proposed program contributes to the achievement of the multisector objective of the CCLIP ES-O0009, to promote productive activities and social welfare in El Salvador by providing access to credit in the business and housing sectors, as it finances access to credit for the business sector (paragraphs 1.1, 1.22, and 1.23).
- c. This loan proposal for the third program will be supported by technical cooperation that will finance specific actions to improve BANDESAL's capacities, in response to the recommendations emerging from the institutional capacity analysis. Opportunities have been identified to improve the gathering and verification of information required for program monitoring and evaluation, weaknesses that will be addressed with this entity (paragraph 3.2).

Development Effectiveness Matrix		
Summary		ES-L1156
I. Corporate and Country Priorities		
Section 1. IDB Group Strategic Priorities and CRF Indicators		
Development Challenges & Cross-cutting Issues	-Social Inclusion and Equality -Productivity and Innovation -Gender Equality and Diversity -Climate Change	
CRF Level 2 Indicators: IDB Group Contributions to Development Results	-Micro / small / medium enterprises financed (#) -Women beneficiaries of economic empowerment initiatives (#)	
2. Country Development Objectives		
Country Strategy Results Matrix	GN-3046-1	Facilitate access to finance for MSMEs.
Country Program Results Matrix	No	The intervention is not included in the 2022 Operational Program.
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		
II. Development Outcomes - Evaluability		Evaluable
3. Evidence-based Assessment & Solution		10.0
3.1 Program Diagnosis		2.5
3.2 Proposed Interventions or Solutions		3.5
3.3 Results Matrix Quality		4.0
4. Ex ante Economic Analysis		10.0
4.1 Program has an ERR/NPV, or key outcomes identified for CEA		1.5
4.2 Identified and Quantified Benefits and Costs		3.0
4.3 Reasonable Assumptions		2.5
4.4 Sensitivity Analysis		2.0
4.5 Consistency with results matrix		1.0
5. Monitoring and Evaluation		8.3
5.1 Monitoring Mechanisms		4.0
5.2 Evaluation Plan		4.3
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood		Medium Low
Environmental & social risk classification		FI
IV. IDB's Role - Additionality		
The project relies on the use of country systems		
Fiduciary (VPC/FMP Criteria)	Yes	Procurement and contracting: Information system, Price comparison method, individual consultants.
Non-Fiduciary		
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project		

**Evaluability Assessment Note:** The Credit Access Program for Micro, Small and Medium Enterprises (MSMEs) has a total budget of US\$100 million and is the third operation under a CCLIP that seeks to promote productive activity and social welfare in El Salvador through credit access for businesses and housing. The specific objective of this new operation is to promote the expansion of access to medium and long-term productive credit for Salvadoran MSMEs, through support for BANDESAL's actions. The achievement of this specific objective is expected to contribute to the general objective of Supporting the growth of MSMEs in El Salvador, through the financing of BANDESAL's second-tier lines. It should be noted that there is perfect alignment between the objective of the CCLIP and the objectives of this third operation.

There is vast theoretical and empirical support in the economic literature to the negative effects of credit restrictions on growth. In addition, the empirical evidence also indicates that MSMEs are the most damaged by the lack of access to credit, having their sales, investments, and productivity damaged by this market failure. The diagnosis of the project clearly makes the connection between the theory and the context of El Salvador, presenting data that reasonably support the hypothesis that BANDESAL needs to expand its funding in order to expand loans to MSMEs. The project also presents data supporting the effectiveness of the proposed solution (second-tier loans targeting MSMEs).

The Results Matrix (RM) is adequate, and the indicators are aligned with overall empirical evidence, with the economic theory and with the declared objectives for the project and for the CCLIP. The targets are also reasonable and supported by the available data. At the specific objective level, indicators seek to evaluate the potential effects of IDB funding on BANDESAL's loan portfolio, on portfolio delinquency and on the leverage of resources promoted on MSMEs. At the general objective level, it will seek to evaluate potential effects on firm's economic growth (measured by sales and employment).

The economic analysis is adequate, with reasonable and standard assumptions and sensitivity analysis. The estimated net present value of the program is US\$21.75 million, and the internal rate of return is 19.1%. Finally, the evaluation plan is adequate. He proposes to carry out a before and after analysis of the indicators associated with specific and general objectives. However, this exercise will not allow for causal attribution.



## RESULTS MATRIX

<b>Project objective:</b>	The specific development objective of the program is to promote the expansion of access to medium- and long-term productive credit for Salvadoran MSMEs through support for BANDESAL's engagement. The general development objective is to support the growth of MSMEs in El Salvador by financing BANDESAL's second-tier lines.
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### GENERAL DEVELOPMENT OBJECTIVE

Indicators	Unit of measure	Baseline value	Baseline year	Final target	Means of verification	Comments
<b>General development objective:</b> The general development objective is to support the growth of MSMEs in El Salvador by financing BANDESAL's second-tier lines.						
<b>Indicator 1:</b> Average sales revenue for MSMEs supported by the program.	US\$	202,688	2022	227,010	BANDESAL's Management Information System (SIG) enhanced with data provided by IFIs and semiannual monitoring report.	See <a href="#">monitoring and evaluation plan</a> .
<b>Indicator 2:</b> Jobs at MSMEs because of program lending, as a percentage of total jobs in the country.	%	3.7	2022	3.7	BANDESAL SIG enhanced with data provided by IFIs, data from the Salvadoran Social Security Institute (ISSS), and semiannual monitoring report.	See <a href="#">monitoring and evaluation plan</a> .

### SPECIFIC DEVELOPMENT OBJECTIVES

Indicators	Unit of measure	Baseline value	Baseline year	Final target	Means of verification	Comments
<b>Specific development objective:</b> The specific development objective of the program is to promote the expansion of access to medium- and long-term productive credit for Salvadoran MSMEs through support for BANDESAL's engagement.						
<b>Indicator 1:</b> Rate of arrears for the MSME productive financing portfolio supported with program resources, compared with the average rate of arrears for the financial system.	%	56	2022	56	BANDESAL SIG, SSF information, and semiannual monitoring report.	See <a href="#">monitoring and evaluation plan</a> .
<b>Indicator 2:</b> Percentage of medium-term credit (6 months or more) for the MSME productive financing portfolio supported by the program.	%	96.64	2022	96.64	BANDESAL SIG and semiannual monitoring report.	See <a href="#">monitoring and evaluation plan</a> .

Indicators	Unit of measure	Baseline value	Baseline year	Final target	Means of verification	Comments
<b>Indicator 3:</b> Leveraging of productive financing resources achieved by MSMEs with program support.	%	10.1	2022	10		See <a href="#">monitoring and evaluation plan</a> .
<b>Indicator 4:</b> Amount of the MSME productive financing portfolio.	US\$ millions	182.9	2022	282.9		See <a href="#">monitoring and evaluation plan</a> .
<b>Indicator 5:</b> Percentage of medium-term credit (more than 6 months) provided to women-owned MSMEs.	%	10.83	2022	13.46		Pro-Gender Indicator. See <a href="#">monitoring and evaluation plan</a> .

#### OUTPUTS

Outputs	Unit of measure	Baseline value	Baseline year	Year 1	Year 2	Year 3	Year 4	Final target	Means of verification	Comments
<b>Sole component:</b> Productive credit (US\$100 million).										
<b>Output 1:</b> Amount provided to MSMEs as productive credit with program support.	US\$ millions	0	2022	4.5	4.5	8.5	32.5	50	BANDESAL SIG and semiannual monitoring report.	See <a href="#">monitoring and evaluation plan</a> .
<b>Output 2:</b> Amount provided to women's MSMEs as productive credit with program support.	US\$ millions	0	2022	7.5	7.5	7.5	7.5	30		Pro-Gender Indicator. See <a href="#">monitoring and evaluation plan</a> .
<b>Output 3:</b> Amount provided to MSMEs as productive credit to finance investments with potential climate change mitigation and/or adaptation and environmental sustainability with program support.	US\$ millions	0	2022	3	3	4	10	20		See <a href="#">monitoring and evaluation plan</a> .

Country: El Salvador

Division: IFD/CMF

Operation No.: ES-L1156

Year: 2022

## FIDUCIARY AGREEMENTS AND REQUIREMENTS

**Executing agency:** Development Bank of the Republic of El Salvador (BANDESAL)

**Operation name:** Access to Credit Program for Micro, Small, and Medium-sized Enterprises (MSMEs)

### I. FIDUCIARY CONTEXT OF THE EXECUTING AGENCY

#### 1. Use of country systems in the operation

<input checked="" type="checkbox"/> Budget	<input checked="" type="checkbox"/> Reports	<input checked="" type="checkbox"/> Information system	<input type="checkbox"/> National Competitive Bidding (NCB)
<input checked="" type="checkbox"/> Treasury	<input checked="" type="checkbox"/> Internal audit	<input checked="" type="checkbox"/> Shopping	<input type="checkbox"/> Others
<input checked="" type="checkbox"/> Accounting	<input checked="" type="checkbox"/> External control	<input type="checkbox"/> Individual consultants	

#### 2. Fiduciary execution mechanism

<input checked="" type="checkbox"/>	Special features of fiduciary execution	<p>The program is structured as a global credit loan. Funds will be provided to BANDESAL to rediscount eligible credit operations for IFIs, which will onlend these resources to individuals or businesses performing activities that are consistent with the applicable Credit Regulations; as such, it will be governed by the terms of the Policies for the Procurement of Goods and Works Financed by the IDB (document GN-2349-15).</p> <p>As a demand-driven program with a sole component dedicated exclusively to financing subloans, program execution will not include the procurement of goods, works, services, or consulting services. Sub-borrowers will carry out procurement and contracting related to the subloans and the applicable regime. Therefore, the proposal does not include a procurement plan.</p>
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#### 3. Fiduciary capacity

Fiduciary capacity of the executing agency	<p>BANDESAL has the necessary capacity to execute the third program under the CCLIP ES-O0009, given that: (i) the results of the institutional capacity assessment performed using the simplified methodology confirm that the entity has the financial and fiduciary capacity to act as the executing agency; (ii) BANDESAL's performance executing previous Bank-financed operations has been satisfactory; and (iii) this third program complements the objectives of the first two operations, which focus on business and housing credit.</p>
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4. Policies and guidelines applicable to the operation: The Financial Management Guidelines for IDB-financed Projects (OP-273-12 or its current version) will apply to financial management. The program is not expected to involve procurement, as it will have a sole component dedicated exclusively to loans.

5. Exceptions to policies and guidelines: None.

## II. CONSIDERATIONS FOR THE SPECIAL PROVISIONS OF THE LOAN CONTRACT

<p><b>Exchange rate:</b> Pursuant to the terms of Article 4.10 of the General Conditions, the parties agree that the applicable exchange rate will be the rate indicated in section (b)(i) of said Article. To determine the equivalency of expenditures in local currency from the local contribution, or of expenditure reimbursements from the loan proceeds, the agreed exchange rate will be the rate in effect on the date on which the borrower, executing agency, or any other individual or legal entity to which the authority to incur expenditures is delegated effectively makes the respective payments to the contractor, supplier, or beneficiary.</p>
<p><b>Type of audit:</b> Special-purpose audit to be conducted by a Bank-eligible independent auditing firm, which will submit reports within 120 days after the close of each fiscal year and the date of the final disbursement.</p>

## III. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

<input checked="" type="checkbox"/>	<p>Records and archives</p>	<p>The documentation for the subloans financed by the operation will be kept at the IFIs that review and approve credit applications, evaluating aspects such as the eligibility of the operation as provided in the Credit Regulations. Therefore, the IFIs fully assume the credit risk and will be solely responsible for monitoring the portfolio.</p> <p>BANDESAL's Administrative and Document Management Department will be responsible for keeping program records and files. The official disbursement request forms will be used for program report preparation and record-keeping, listing the subloans subject to rediscount under the program's financing.</p>
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## IV. AGREEMENTS AND REQUIREMENTS FOR FINANCIAL MANAGEMENT

<input checked="" type="checkbox"/>	<p>Programming and budget</p>	<p>BANDESAL will manage the program budget, applying the mechanisms and procedures used for its own budget, which is prepared annually for the fiscal year beginning on 1 January and ending on 31 December of each year and includes projections for the first- and second-tier loan portfolios. The programming is reviewed each week on a rolling 12-month forward basis, and projections are monitored each month for submission to its board of directors, compared with actual figures. There is an established process for their preparation, approval, and execution. Pursuant to the Financial System Act to Promote Development, the budget will be submitted to its board of directors for clearance and subsequent submittal for approval by its board of governors. Although unusual for BANDESAL, if the budget requires amendment, the same procedure needs to be followed for approval.</p> <p>The formulation and execution of BANDESAL's budget will be carried out in Excel; however, a specific line of credit will be created for the program to facilitate the control and monitoring of conditions, allocations, and availabilities in the Sistema Banca 2000, which draws upon information from the approved budget and integrates accounting records with treasury operations.</p>
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☒	Treasury and disbursement management	<p>The IDB will disburse operation ES-L1156 resources in the form of advances, although other modalities may be used, subject to the Bank's prior agreement. Disbursement requests will be accompanied by the list of subloans eligible for rediscount pursuant to the terms of the <a href="#">Credit Regulations</a>. BANDESAL will prepare annual disbursement schedules covering a rolling period of at least 12 months.</p> <p>BANDESAL will open an exclusive current account in the BCR to receive and manage operation ES-L1156 funds.</p>
☒	Accounting, information systems, and reporting	<p>BANDESAL will be responsible for program accounting using its own accounting system, in which accounting and treasury operations are integrated and referenced to information from the approved budget. The movement of funds under the program will be shown in BANDESAL's financial statements in expressly designated accounts. To prepare its financial statements, BANDESAL will apply generally accepted accounting standards for El Salvador and regulations issued by the SSF. The program's special-purpose financial statements will be prepared separately on a cash accounting basis in accordance with the provisions of the Bank's Financial Management Guidelines for IDB-financed Projects (OP-273-6) and the Guide for Financial Reports and Management of External Audits, using information generated by Sistema Banca 2000, which will identify by source code any transactions payable with loan proceeds. The general ledger accounts to be used for program execution and records should be identified, so that the relevant information is clearly and easily identifiable.</p>
☒	Internal control and internal audit	<p>As a public financial institution, BANDESAL applies the technical standards of specific internal control issued under the legislative provisions and the internal and external rules applicable to BANDESAL and the funds it manages, and based on the global Committee of Sponsoring Organizations of the Treadway framework. It has an Audit and Control Division that reports directly to the board of directors, as well as an Audit and Control Committee. Additionally, as an autonomous public lending institution, it applies the International Standards for the Professional Practice of Internal Auditing (ISPPA).</p> <p>Within its organizational structure, BANDESAL has a Risk Division responsible for the evaluation, monitoring, and supervision of risks generated by its operations, including counterpart risk evaluation for each IFI in the local financial system.</p>
☒	External control and financial reports	<p>External control of the program will be performed by a firm of independent external auditors acceptable to the Bank. BANDESAL will be responsible for contracting the firm, and it may be the same one that audits the entity's financial statements, to achieve an integrated view of executing agency and program management control. If contracting is carried out specifically for the project, it will be governed by BANDESAL's contracting policies. The terms of reference will be previously agreed upon with the Bank, and the terms of reference and requests for proposals will be subject to the Bank's prior no objection. To ensure the effectiveness of the audit work, the firm will be engaged no later than September of the fiscal year in execution that is to be audited.</p> <p>Using own resources, BANDESAL will cover the costs for annual external audits and the final external audit.</p>
☒	Financial supervision of the operation	<p>The operation requires medium financial supervision, which, in addition to external control, implies financial supervision visits that will take place, initially, every six months.</p>

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-\_\_\_/23

El Salvador. Loan \_\_\_\_/OC-ES to Banco de Desarrollo de la República de El Salvador  
(BANDESAL).

Access to Credit Program for Micro, Small, and Medium-sized Enterprises (MSMEs)  
Third Individual Operation under the Conditional Credit Line  
for Investment Projects (CCLIP) to Facilitate Access  
to Business and Housing Loans (ES-O0009)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with Banco de Desarrollo de la República de El Salvador (BANDESAL), as borrower, and with the Republic of El Salvador, as guarantor, for the purpose of granting the former a financing aimed at cooperating in the execution of Access to Credit Program for Micro, Small, and Medium-sized Enterprises (MSMEs), which constitutes the third individual operation under the Conditional Credit Line for Investment Projects (CCLIP) ES-O0009, approved by Resolution DE-87/20 on July 29, 2020. Such financing will be for the amount of up to US\$100,000,000, from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on \_\_\_\_\_ 2023)