

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**PARAGUAY**

**THIRD INDIVIDUAL OPERATION UNDER THE EXPANDED  
CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS  
(CCLIP) TO PROVIDE FINANCING TO AGENCIA FINANCIERA DE  
DESARROLLO (AFD)**

**(PR-L1062, PR-X1001)**

**LOAN PROPOSAL**

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ELECTRONIC LINKS	
<b>REQUIRED</b>	
1.	Monitoring and evaluation plan <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36421061">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36421061</a>
2.	Environmental and Social Management Report (ESMR) <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272147">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272147</a>
<b>OPTIONAL</b>	
1.	Macroeconomic analysis (*) <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272042">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272042</a>
2.	Estimate of demand <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272075">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272075</a>
3.	Agencia Financiera de Desarrollo (AFD) <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272088">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272088</a>
4.	Outcomes achieved with the first program under the CCLIP <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272105">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272105</a>
5.	Housing financing <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272124">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272124</a>
6.	AFD windows <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36292584">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36292584</a>
7.	Credit Regulations of AFD <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272156">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272156</a>
8.	Cost-benefit analysis <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272173">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36272173</a>

(\*) For the purposes of the Bank's Access to Information Policy (document GN-1831-28), these documents will not be made available to the public.

## **ABBREVIATIONS**

AFD	Agencia Financiera de Desarrollo
CCLIP	Conditional Credit Line for Investment Projects
DEM	Development Effectiveness Matrix
ESMR	Environmental and Social Management Report
FSO	Fund for Special Operations
GDP	Gross domestic product
IFIs	Intermediary financial institutions
INCOOP	Instituto Nacional de Cooperativismo [National Credit Union Administration]
IRR	Internal rate of return
OC	Ordinary Capital
SENAVITAT	Department of Housing and Habitat

## PROJECT SUMMARY

### PARAGUAY

#### THIRD INDIVIDUAL OPERATION UNDER THE EXPANDED CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS (CCLIP) TO PROVIDE FINANCING TO AGENCIA FINANCIERA DE DESARROLLO (AFD) (PR-L1062, PR-X1001)

Financial Terms and Conditions					
Borrower: The Republic of Paraguay  Executing agency: Agencia Financiera de Desarrollo (AFD)			Parallel financing		OC
			OC	FSO	
		Amortization period:	30 years	40 years	20 years
		Grace period:	5.5 years	40 years	5 years
		Disbursement period:	4 years	4 years	4 years
Source	Program (US\$)	Interest rate:	LIBOR-based	0.25%	LIBOR-based
Parallel financing (OC) (80%)	25.6 million	Inspection and supervision fee:	*	0	*
Parallel financing (FSO) (20%)	6.4 million	Credit fee:	*	0	*
OC financing	18.0 million				
<b>Total</b>	<b>50.0 million</b>	Currency:	U.S. dollars from the Single Currency Facility	U.S. dollars	U.S. dollars from the Single Currency Facility
Project at a Glance					
<b>Project objective/description:</b> The general objective of the program is to help increase competitiveness and employment in Paraguay's productive sector by channeling medium- and long-term financing. Its purpose is to expand the supply of medium- and long-term credit to finance eligible investment projects. (paragraph 1.29)					
<b>Special contractual clauses:</b> The following are conditions precedent to the disbursement of resources under the third individual operation: (i) entry into force of the agreement signed between the borrower and AFD; (ii) entry into force of the executing agency's Operating Manual authorizing intermediary financial institutions (IFIs) to qualify for the financing; and (iii) approval and entry into force of the Credit Regulations. (paragraph 3.3)					
<b>Project consistent with country strategy:</b>		Yes <input checked="" type="checkbox"/> [X]		No <input type="checkbox"/> [ ]	
<b>Project qualifies as:</b>		SEQ <input type="checkbox"/> [ ]	PTI <input type="checkbox"/> [ ]	Sector <input type="checkbox"/> [ ]	Geographic <input type="checkbox"/> [ ] Headcount <input type="checkbox"/> [ ]

\* 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 the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

## **I. DESCRIPTION AND RESULTS MONITORING**

### **A. Frame of reference, problem addressed, and rationale for the Bank's support**

#### **1. Frame of reference**

- 1.1 The Bank has been supporting the reforms being pursued by the Paraguayan government with regard to its role in the financial system, which have included, in particular, the creation of Agencia Financiera de Desarrollo (AFD) as a State-owned second-tier development bank.<sup>1,2</sup> To complement this support, the Bank approved an expanded Conditional Credit Line for Investment Projects, or CCLIP (PR-X1001)<sup>3</sup> in March 2008 to provide financing to AFD in the amount of US\$150 million, as well as the first individual operation under the CCLIP, in the amount of US\$50 million (PR-L1024). The second operation under the CCLIP was approved in September 2009 in the amount of an additional US\$50 million. The proposed individual operation, for US\$50 million, constitutes the third and last operation under the CCLIP.

#### **2. Macroeconomic situation**

- 1.2 The Paraguayan economy recovered in 2010 after GDP declined by 3.8% in 2009 as a result of a drought and the global economic crisis. In 2010, the country experienced unprecedented economic growth as GDP rose by 15%, the highest rate in the last 50 years. This brought economic growth to an average rate of 5.7% for the five preceding years, above the 4.1% average growth rate for 2001 to 2010. This growth was driven mainly by the buoyancy of the agricultural sector and related activities as well as of industry, transportation, construction, commerce, and finance. In addition, consumption and private investment surged on higher household purchasing power, improved economic prospects, greater access to credit, and increased government spending.
- 1.3 The strong performance of the Paraguayan economy has taken place within a context of international recovery from the crisis. The degree of recovery has varied from one region to the next, with Latin America standing out as one of the fastest-growing regions. Paraguay, like other emerging and developing economies, has posted vigorous growth largely for having avoided large financial and fiscal excesses before the crisis. Nonetheless, following the high economic growth recorded in 2010 more modest growth is expected in coming years. For example, International Monetary Fund estimates place Paraguay's GDP growth at 5.6% in 2011. The Central Bank of Paraguay and the Ministry of Finance expect GDP to continue to rise as a result of the consolidation of trends in the domestic market and rising productivity in the agroexport sector.

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<sup>1</sup> AFD was created by Law 2640/05 and began operations on 29 May 2006.

<sup>2</sup> Mainly operations PR-0144 (loan 1428/OC-PR – Sector Program for Public Banking Reform – PROPEF) and PR-L1012 (loan 1682/OC-PR – Programmatic Public Financial Reform Operation), together with complementary operations included in the programmatic approach (PR-L1011/loan 1818/OC-PR – Institutional Strengthening of the National Credit Union Administration (INCOOP)).

<sup>3</sup> The CCLIP concept, exclusively applicable to loans, was expanded to the use of guarantees.

- 1.4 Paraguay's fiscal performance has improved considerably in recent years thanks to higher tax receipts and a prudent handling of spending and debt. Just as in the preceding five years, in 2010 fiscal accounts ended the year in positive territory. At year-end 2010, the fiscal account surplus was equivalent to 1.4% of GDP as revenue grew at a faster pace than spending. The increase in revenue stemmed mainly from the 23.9% surge, in nominal terms, in tax collections over 2009. The strong fiscal performance was driven by the robust domestic economy overall. Paraguay has achieved significant debt consolidation in recent years, with debt falling from 50.5% of GDP in 2002-2003 to 16.1% in 2010, thanks to prudent fiscal management combined with high economic growth.
- 1.5 However, in late 2010 and early 2011 the general price level in Paraguay rose, reflecting several factors, in particular, higher prices for products associated with agricultural commodities, meat and meat substitutes, and oil products, as well as stronger domestic demand. At year-end 2010, inflation stood at 7.2%, very close to the upper end of the Central Bank's target range (5% +/- 2.5%),<sup>4</sup> after rising to a 10.2% year-on-year rate in May, well above the target. To bring the inflation rate back to within the target range, the monetary authorities have taken a series of measures, most notably, raising the interest rate of monetary regulation instruments and the legal reserve requirement, thus withdrawing the liquidity stimulus they had implemented in response to the external crisis that broke out in 2008.
- 1.6 The first months of 2011 saw the guaraní appreciate against the United States dollar, prompting the Central Bank to intervene in the exchange market so as to stem the decline in the nominal exchange rate. The Central Bank plans to assume a more prominent role in the foreign currency market in the remaining months of 2011 (see [Macroeconomic analysis](#)).

### 3. The financial system

- 1.7 The principal indicators of Paraguay's financial system have performed well in recent years (Table 1). The main components of the system are: (i) banking institutions, which account for 76% of total assets; (ii) credit unions, with a 19% share of assets; (iii) financial institutions, with 4%; and (iv) currency exchange offices, which account for the remaining 1%.

**Table 1. Principal Indicators of the Financial System (%)**

	2006	2007	2008	2009	2010
Assets/GDP	34.68	39.47	43.27	52.35	55.71
Deposits/GDP	27.70	31.61	33.01	41.60	42.91
Loans/GDP	18.24	21.16	24.72	28.96	35.08
Return on equity	23.4	25.1	28.0	22.8	25.25
Return on assets	3.1	2.9	3.3	2.4	3.37
Delinquency rate	5.4	3.4	2.8	2.5	2.2
Provisions/Past-due loans	70.7	80.5	90.5	100.2	153.97

<sup>4</sup> Since 2005, the Central Bank has set an indicative target for annual inflation.

- 1.8 The bulk of the loan portfolio of banks and finance companies is in the agricultural sector, which at year-end 2010 accounted for 21% of total borrowing, followed by the consumer sector, with 14%; the service sector, with 13%; the wholesale sector, with 12%; the livestock sector, with 11%; and industry, with 9%. Banks' highest exposure is in the agriculture and livestock sector, while consumer lending rose sharply in recent years as a result of the recovery in the domestic economy.
- 1.9 The quality of the financial sector's portfolio improved, with the arrears rate falling from 5.4% in December 2006 to just over 2% in December 2010. The ratio of loan-loss provisions (reserves) to past-due loans rose to a more-than-acceptable 154%. In part, this increase was due to the banks' conservative management in addition to changes in regulations that require raising the percentage of generic loan-loss provisions.
- 1.10 Paraguay's financial system had a solvency level of 16% in 2010, above the 10% required by the regulatory agency and the 8% required by Basel. This shows that the financial system has taken a conservative position vis-à-vis the risk assumed by the banks and has large capital reserves, allowing it to handle higher growth in risk assets in coming years.
- 1.11 Liquidity in the financial sector has declined in recent years (as lending has risen), but at year-end 2010 it nonetheless stood at 35% of all deposits (see Table 1). In keeping with their conservative risk management, the banks in the system have elected to maintain high liquidity levels. This liquidity, however, is generally short-term given the structure of the terms of deposits. Nevertheless, the supply of long-term funding remains limited and is very closely associated with long-term liabilities, most of which originate in operations with AFD.
- 1.12 Despite the high liquidity, banks have succeeded in maintaining good levels of returns, with return on equity rising from 23.4% in 2006 to 25.3% in late 2010. They have become more profitable mainly because of the growth of the most lucrative sectors such as consumer lending, which have higher spreads, and because of higher fees.
- 1.13 In the early months of 2011, the financial system was stable. This stability has not yet been significantly threatened by the international crisis, owing largely to the country's sound macroeconomic performance, banks' conservative management, and the relatively low degree of integration of Paraguay's financial system into the global economy. Use of banking services, measured by the ratio of total lending to GDP, climbed sharply, from about 25% in 2006 to 45% at the end of 2010. The ratio of total deposits to GDP jumped from 16% in 2006 to 40% in late 2010. Demand for loans in local currency has also increased, rising to 65% of all borrowing.
- 1.14 **Problem addressed.** Despite its substantial progress in recent years, the financial system has structural weaknesses that prevent it from meeting the demand for credit among local production sectors. The unmet demand for medium- and long-term



credit is particularly acute. Companies require considerably more financing than the amount available in the financial sector (see paragraph 1.16).

- 1.15 These structural weaknesses mainly result from: (i) the absence of a developed capital market; (ii) the lack of institutional investors; (iii) the absence of a government bond market; and (iv) the absence of a pension superintendency to regulate the long-term investments of the principal funds. These shortcomings are compounded by the short-term structure of deposits in both the public and the private sectors. This deposit structure restricts medium- and long-term lending by intermediary financial institutions (IFIs). Indeed, about 90% of deposits are placed for a term of less than one year, while approximately 80% are for less than 180 days, and just over 70% have terms of less than 90 days. This is the result of depositor caution in the wake of the financial crises of recent years. As a way to control the risk of term mismatches on their balance sheets, banks have traditionally limited medium- and long-term credit (both to individuals and businesses). Just over 70% of loans are for terms of less than 180 days.<sup>5</sup> The financial sector consequently offers less attractive instruments, adjusted for inflation and with variable rates, and long-term lending is practically nonexistent.
- 1.16 The lack of availability of long-term credit directly undermines companies' capacity to invest. The financing needs of Paraguay's private sector are equivalent to about 10% of GDP,<sup>6</sup> of which only 4% is provided by the financial sector. This lack of investment translates into low competitiveness, especially for small and medium-sized enterprises, which have limited access to credit. These companies employ approximately 47%<sup>7</sup> of the country's labor force. In addition, the time it takes for companies to see a return on their investments is incompatible with the structure of the terms in the banking system, generating mismatches in loan amortization periods. This is one reason Paraguay stands in last place among Latin American countries on the Global Competitiveness Index.<sup>8</sup>
- 1.17 This structural problem has had an impact across the remaining sectors, including the housing sector, the development of which depends largely on long-term financing. The lack of long-term financial products for the low-income population in Paraguay exacerbates the country's housing deficit. The supply of commercial financial products for new home purchases or home improvements for individuals earning less than four times the minimum wage is limited or nonexistent, and AFD is their only source of financing. Currently, 804,017 families<sup>9</sup> lack adequate housing, and an additional 15,000 new housing units are needed each year. In the

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<sup>5</sup> The purpose of creating AFD in 2005 was, in fact, to provide the financial system with sources of medium- and long-term financing.

<sup>6</sup> Estimates from the private sector, Centro de Investigaciones Económicas [Center for Economic Research] study, 2011.

<sup>7</sup> General Directorate of Statistics, Surveys, and Census, 2011.

<sup>8</sup> Prepared by the World Bank, 2010.

<sup>9</sup> Department of Housing and Habitat (SENAVITAT).

major cities, including Asunción, one in three families rents or shares a dwelling. This lack of financing has a direct impact on job creation and on the companies that provide essential inputs for housing construction.

- 1.18 **The current context.** The creation of AFD was intended to mitigate the structural flaw of market terms in order to spur economic development and job creation by channeling medium- and long-term financing to the private sector through IFIs. The Bank has been supporting AFD to allow it to (i) secure a regular flow of financing; (ii) carry out medium- and long-term planning; and (iii) build credibility and confidence in its ability to carry out its mandate. Over its nearly four years of operation, AFD has succeeded in:
- a. Becoming the main source of long-term financing in the financial system while at the same time offering terms that are considerably longer than the average for the system ([Link 3](#)).
  - b. Significantly expanding its lending activities (62% portfolio growth since 2008), which have been boosted by the Bank's support through financing provided by the first and second programs under the CCLIP, representing 36% of the AFD portfolio as of the end of April 2011 ([Link 4](#)).
  - c. Demonstrating with the long-term financing that it has placed in the financial system that the sector needs that financing and that the participating IFIs allocate it responsibly.
- 1.19 The participation of AFD, along with the improved economic environment, helped lengthen terms in the system from 0.75 years in 2006 to 2.0 years in 2010.<sup>10</sup> Longer terms will allow companies to make larger investments, thereby promoting job creation and higher competitiveness.
- 1.20 Despite the longer terms, AFD's funding is inadequate to meet the growing structural needs of Paraguay's productive sector. To date, because of the problems noted above, it has been impossible to develop alternative additional sources of medium- and long-term financing. AFD projections for 2012 indicate a need for US\$80 million a year in funding, as a result of existing demand in the private productive sector for the different lines of financing offered by AFD through IFIs. The proposed US\$50 million program will be used to meet a portion of these needs. The rest of the funding will come from a local bond issue by AFD and other liabilities. The Ministry of Finance has signed a framework agreement with AFD authorizing the institution to issue up to 250 billion guaraníes (approximately US\$30 million) in bonds in order to provide resources in local currency. The agreement calls for a series of measures by the executive branch and AFD to

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<sup>10</sup> Data presented by the Superintendency of Banks since the creation of AFD.

continue providing fresh resources for the institution by way of capitalization.<sup>11</sup> ([Link 2](#) and [Link 3](#)).

#### **4. Rationale for the Bank's support**

- 1.21 **Actions of the government and the Bank.** The improved macroeconomic environment in recent years has generated stability and allowed investors to begin to change the structure of deposits and institutions to raise the threshold of deposit terms. The government is carrying out a series of regulatory changes that will allow for an improvement in institutional investments. The Bank has conducted a diagnostic assessment of the capital markets and developed a technical assistance process through which it will support the Paraguayan government's reforms. It is also supporting the government in designing a pension superintendency. Once created, the superintendency will regulate the investment activities of insurance funds. As these changes will not be immediate, AFD intervention is necessary to ensure the continuity of long-term financing and to generate a demonstration effect for the system.
- 1.22 The program will help support the medium- and long-term credit supply such that: (i) the productive sector is strengthened; and (ii) the gap between supply and demand for housing is narrowed. As demonstrated by previous operations, activities such as those mentioned in paragraph 2.3 (b) will not be financed by the private sector unless AFD has financing to supplement the funding structure of the IFIs and thus prevent mismatches when loans intended for medium- and long-term investments are made. Data collected by the Superintendency of Banks on the composition of loans and deposits in the financial system (banks and finance companies) for April 2006 through April 2011 make clear that the mismatches between the terms of deposits and those of loans have persisted over time. Nonetheless, an analysis of the composition of lending shows that the percentage of loans made for three years or more rose from 9% (April 2006) to 24% (April 2011). This may be largely due to the emergence of AFD, enabling the leveraging of long-term operations.
- 1.23 **The country's strategy in the sector.** With the Bank's support and to implement its productive development policy, the government has introduced a strategy for financial activity based on differential treatment for the various types of services and their inherent risks. AFD plays a key role in that strategy, as evidenced by its participation in medium- and long-term financing and by its own evolution in less than five years of operation.
- 1.24 **The Bank's support in the sector.** In recent years the Bank has supported reforms needed to boost the public financial sector and enhance the capacity of the regulatory agency that oversees it. The Bank has conducted such operations as:

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<sup>11</sup> For its part, AFD has been making improvements in its human resources strategy in order to grow its portfolio, providing training courses and increasing pay to become more competitive with the local banking market. The Bank has a technical assistance program for institution-strengthening in the pipeline for 2012.

- (i) the investment sector reform operation; (ii) two global credit programs for microenterprises; (iii) a series of technical cooperation and institutional strengthening operations for the Superintendencies of Banks and Insurance and the National Credit Union Administration (INCOOP); (iv) the programmatic operation to support the country in reforming public finance, specifically the legal reform of second-tier public activity, which paved the way for the creation of AFD; and (v) the CCLIP to provide financing to AFD and the individual operations under the CCLIP.
- 1.25 In line with these activities, the Bank is developing the second phase of the Programmatic Public Financial Reform Operation<sup>12</sup> approved in 2005 and is supporting the government through: (i) the creation of spaces to enable the coordination of public-sector financial institutions; (ii) financing for AFD, under the CCLIP; (iii) a technical cooperation operation to support the modernization of the farm credit agency Crédito Agrícola de Habilitación; and (iv) a program to support Banco Nacional de Fomento in its efforts to make its operations more efficient and harness its substantial potential in terms of liquidity and capital adequacy to fulfill its role of financing the productive sectors. In addition, through program ATN-MT/7926-PR, the Bank is helping the government carry out a series of training courses in compliance with the requests made by the South American Financial Action Task Force in its most recent review.
- 1.26 The two previous individual operations under the CCLIP (loans 1968/BL-PR and 2150/BL-PR), for a total of US\$100 million, sought to provide funding to AFD, an entity that accounts for a large portion of the system's long-term financing. As of April 2011, all of the funds provided under loan 1968/BL-PR, equivalent to US\$50 million, as well as US\$25 million of loan 2150/BL-PR,<sup>13</sup> had been disbursed. The remaining US\$25 million has been committed, pending the completion by the IFIs of the documentation required for disbursement to approved operations. The rate of approval is approximately US\$10 million a month. The following noteworthy outcomes have been obtained with the funds disbursed under the first program:
- a. **Financial results:** (i) 2,181 onlending operations; (ii) average term of 9.2 years for onlending operations in local currency and 6.7 years for those in foreign currency, both considerably longer than the terms offered in the financial system; (iii) final rates, on average, of 9.75% in foreign currency and 13.13% in local currency;<sup>14</sup> (iv) average IFI spreads of 2.4% for foreign currency loans and 4.78% for local currency loans;<sup>15</sup> (v) onlending operations

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<sup>12</sup> According to the strategy agreed upon with the government as part of the programmatic operation, the two core areas of the operation will seek (i) to restructure the second-tier public-sector financial institutions (PR-L1012); and (ii) to streamline first-tier public finance.

<sup>13</sup> Although the studies corresponding to the second program under the CCLIP have not been conducted, 50% of the program resources have been disbursed and have followed the same patterns as the first program.

<sup>14</sup> Without the Mi Crédito product in the portfolio, the average rate is 12%.

<sup>15</sup> Without the Mi Crédito product, the average spread is 4.3% .

targeting: (a) small businesses and producers (average loan of US\$14,000); and (b) the purchase, construction, and improvement of housing for low-income segments of the population (average loan of US\$27,000).

- b. **Economic impact:** (i) 62% of the program resources<sup>16</sup> supported medium- and long-term productive investments that micro, small, and medium-sized businesses and agricultural producers otherwise would not have been able to make; (ii) the remaining 38% of resources supported long-term financing for home construction and improvement through financing that previously did not exist in the system, at the same time helping to reduce the country's housing shortage and to address the need for new homes ([Link 5](#)).

- 1.27 This individual operation seeks to expand the system's scarce supply of long-term financing (structural flaw), channeling resources to the Paraguayan productive sector to offer mainly investment loans in both U.S. dollars and guaraníes under the same conditions as the first and second programs under the CCLIP. Although the operation is upon demand, it is expected to target the small and medium-sized enterprise, housing, and agriculture sectors.
- 1.28 **The Bank's country strategy with Paraguay.** This operation is consistent with the country strategy for the period 2009-2013, which proposes targeting the Bank's action to the following areas: (i) strengthening public administration to enable government institutions to make better policies, provide better public services, and offer legal certainty to individuals and for investments; (ii) strengthening productive development and competitiveness by deepening the financial sector, providing infrastructure, and expanding markets; and (iii) increasing opportunities for the low-income population through support coordinated with the development of rural communities, expansion of coverage to early childhood, improvements in the coverage and quality of basic education, and expansion of coverage for the population with access to conditional cash transfers. The program will be aligned with the strategic objectives described in item (ii), with respect to deepening the financial system, and will be in compliance with the guidelines established for the Ninth General Increase in the Resources of the Bank, in particular the indicator of micro, small, and medium-sized enterprises financed.

## **B. Objective, components, and characteristics**

### **1. Objective**

- 1.29 The general objective of the program is to help increase competitiveness and employment in Paraguay's productive sector by channeling medium- and long-term financing. Its purpose is to expand the supply of medium- and long-term credit to finance eligible investment projects.

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<sup>16</sup> Of which the agriculture and livestock sector accounts for 57%, small and medium-sized enterprises, 32%, and microenterprises, 11%.

## **2. Components and characteristics**

- 1.30 This individual operation proposes a single component of medium- and long-term funding for intermediary financial institutions (IFIs) to finance investment projects in the Paraguayan productive sector.
- 1.31 The proposed operation: (i) is for US\$50 million; (ii) is the third and final individual operation under the US\$150 million CCLIP approved in March 2008; (iii) will fund AFD with loans only; and (iv) maintains the general conditions established in the CCLIP.

### **C. Results indicators**

- 1.32 The following **impact** indicators will be used: (i) gross annual receipts of the program's subborrowers; and (ii) number of employees of the program's subborrowers.
- 1.33 The main program indicators are included in the results matrix (Annex II): (i) at the **outcomes** level: (a) the number of operations financed; (b) the average term of loans made with the proceeds from the Bank's loan; (c) the number of persons per housing group who gain access to decent housing; (d) the internal rate of return (IRR) of the projects financed; (e) cofinancing contributed for the program's onlending operations for the same term as the program by intermediaries (IFI contribution); and (f) the quality of the program's onlending portfolio corresponding to IFIs versus the system's rating structure; and (ii) at the **product** level: (a) the number of families who gain access to new housing; and (b) the number of loans made to micro, small, and medium-sized enterprises and to individuals.

## **II. FINANCING STRUCTURE AND RISKS**

### **A. Financing instruments**

#### **1. Source of financing**

- 2.1 The proposed program will be a multisector loan. The Bank will provide financing in the form of two loans<sup>17</sup> for a total of up to US\$50 million from blended resources. Depending on the availability of the respective resources, US\$32 million will come from parallel financing (OC/FSO) as a loan with two sources to be disbursed *pari passu* in an 80% and 20% blend, respectively. The US\$18 million to be provided under the second loan will come from the Ordinary Capital.

#### **2. Use of resources**

- 2.2 AFD will transfer the resources to the IFIs subject to the terms set forth in the program's Credit Regulations. The funds will generally allow AFD to provide stable long-term financing to the IFIs. In turn, the IFIs may extend: (i) long-term loans to the productive sector for development programs and projects; and

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<sup>17</sup> The expanded CCLIP permits two types of financing: (i) loans; or (ii) guarantees for bond issues.

(ii) financing for the purchase, construction, and improvement of housing. The loans provided by the IFIs may be cofinanced.

2.3 AFD will provide financing to the IFIs subject to the terms of current AFD programs ([Link 6](#)), namely:

- a. **Financing:** (i) rates will be fixed or variable and will be determined as the program's lending rate plus AFD's spread; (ii) AFD assumes the risks of the IFIs; (iii) AFD's spread is set with consideration for its nature as a nonprofit development agency that aims to maintain sustainability; (iv) AFD is regulated by the Banks Act and the Superintendency of Banks; and (v) the IFIs assume the end-borrower risk.
- b. **Eligibility:** In accordance with the current AFD windows, the following projects may qualify for program resources: (i) financing of fixed assets and operating capital for members of cooperatives that provide rural microcredit; (ii) financing of fixed assets and operating capital for microenterprises and small businesses; (iii) projects to implement, expand, and improve the activities of small and medium-sized enterprises; (iv) production cooperatives: agricultural machinery, working capital and housing, and investment and livestock projects of the respective members; (v) cattle ranches: purchase of breeding stock (cows and bulls), infrastructure improvements, and procurement of items including machinery, tools, and vehicles; (vi) investment projects that increase the domestic value-added of commodities, reduce bottlenecks in basic infrastructure, and make more intensive use of domestic labor; (vii) financing of housing construction, purchases, and improvements; (viii) industrial, commercial, or service development projects; (ix) projects targeting the productive forestry sector; (x) financing for advanced human capital training; and (xi) other programs identified by the executing agency's governing board.
- c. **Size of onlending operations:** The maximum amount will be set in the Credit Regulations.

2.4 The proposed program will continue having positive effects on the financial system from different vantage points. Specifically:

- a. It will promote deepening and development of the financial market by allowing IFIs to generate resources through working capital financing for projects under market conditions. This will lead to: (i) deepening of banking services; and (ii) targeted lending.
- b. The average loan term in a financial system largely depends on how risky depositors perceive the system to be, which, in turn, is determined by a number of variables, including the quality of institutions' assets and the macro volatility of the economy. From both standpoints, the program will be positive for terms in the financial system since, to the extent that the arrears rate for the AFD portfolio remains low, market agents will tend to perceive the portfolio

of the IFIs (including the aforementioned working capital) as a quality portfolio.

**Costs table for the third individual operation (US\$ millions)**

<b>Investment component</b>	<b>IDB</b>	<b>AFD</b>	<b>Total</b>
Loans	49.95	0	49.95
Administration/Evaluation and monitoring	0.05	0	0.05
<b>Total</b>	<b>50</b>	<b>0</b>	<b>50</b>

## **B. Main risks and mitigating factors**

- 2.5 **Macroeconomic risks.** Good performance of the operation will generally require maintaining a framework associated with fiscal sustainability, reducing financial vulnerability, and maintaining an investment climate conducive to growth in private investment. Changes in these variables could affect the outcome indicators, but they cannot be mitigated by the program.
- 2.6 **Public management and governance.** The Paraguayan government's executive branch chooses the members of AFD's governing board. Although administration of AFD is dependent on the executive branch's decisions, there are some circumstances that mitigate this situation. Thus: (i) area managers are highly qualified professionals selected for their abilities; (ii) the law requires that professionals with a high degree of technical experience be appointed and, since its creation, the institution has had a professional management and technical structure; (iii) AFD is an autonomous institution governed by the Banks Act; and (iv) its charter includes two additional elements of control: (a) an auditor appointed by the Controller General of the Republic; and (b) an external audit every 12 months to be contracted through international competitive bidding.
- 2.7 **Environmental and social risks.** As a multisector credit program, the operation will help AFD obtain funds for second-tier loans. Accordingly, there are no direct environmental or social impacts. In accordance with the stipulations of directive B.13 of the Environment and Safeguards Compliance Policy (documents GN-2208-20 and OP-703), this operation does not require classification. As a second-tier bank, AFD does not conduct verifications for each project, leaving this task to the first-tier entities based on the terms of the contracts with them. However:
- Its regulations include the stipulation that for products that exceed a given amount and represent a greater environmental risk, AFD must request the necessary environmental licenses and permits from the Department of the Environment;
  - A negative list indicates products that are not eligible for financing with microcredit unless an environmental impact study is submitted;



- c. Moreover: (i) the Credit Regulations will stipulate that violations of environmental law will result in early termination of the loan and will make companies ineligible for the program; and (ii) the midterm review will specify the environmental impact of a representative sample of loans under the program. Thus, the program will promote environmental improvement measures and will ensure that the projects financed comply with country's laws and regulations (ESMR).

### **III. IMPLEMENTATION AND MANAGEMENT PLAN**

#### **A. Summary of implementation arrangements**

##### **1. Borrower and executing agency**

- 3.1 The executing agency for the program will be Agencia Financiera de Desarrollo (AFD). The Republic of Paraguay will be the borrower, acting through the Ministry of Finance, and will transfer the funds to AFD in accordance with the agreement signed with the agency and under the same conditions in which it receives the funds.

##### **2. Execution and administration**

- 3.2 AFD will be responsible for: (i) executing and supervising appropriate use of the loan proceeds; (ii) providing the necessary human, technological, and budgetary resources as planned and on schedule; (iii) presenting the required documentation to the Bank to comply with disbursement and other operational conditions required for execution.
- 3.3 **For program execution, the following conditions precedent to the disbursement of loan proceeds will be met: (i) entry into force of the agreement signed between the borrower and AFD; (ii) entry into force of the executing agency's Operating Manual authorizing intermediary financial institutions (IFIs) to qualify for the financing; and (iii) approval and entry into force of the Credit Regulations.** Thus:
  - a. **Agreement between the borrower and AFD.** The agreement will regulate the conditions associated with the transfer of funds and their repayment.
  - b. **IFI accreditation system.** First-tier financial intermediaries, banks, and cooperatives regulated by the Superintendency of Banks and INCOOP that comply with the applicable regulations, meet eligibility criteria, and satisfy AFD's risk assessment may participate as IFIs of the programs under the CCLIP. They will be responsible for: (i) evaluating the subborrower risk and making lending decisions based on the conditions set forth in the Credit Regulations and AFD's operating regulations; and (ii) assuming responsibility vis-à-vis AFD for the servicing and repayment of onlending operations in a manner fully independent of subborrowers' compliance with the servicing of their loans.

- c. **Credit Regulations.** The program's Credit Regulations: (i) will be consistent with the standards and policies of AFD and the Bank, as well as with the country's financial laws and practices; (ii) will cover the main characteristics of the program in terms of use of resources, onlending eligibility, and beneficiaries; (iii) will stipulate that noncompliance with the provisions will impede access to financing; (iv) will have to be approved and enacted by AFD to the Bank's satisfaction as a condition precedent to the disbursement of resources; and (v) will state that the Bank's no objection will be required for any future amendments to the Credit Regulations. [Link 7](#) contains AFD's current Regulations, which have the no objection of the Bank and were used in the first and second programs under the CCLIP.

### **3. Disbursement and execution characteristics**

- 3.4 The execution and disbursement periods for the program will be 48 months. The operation's disbursements will take the form of an advance of funds in response to a demonstrated demand for funds for a six-month period and in accordance with the policy for this modality. Market demand for the funds will determine the actual disbursement schedule.<sup>18</sup>

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

- 3.5 Program monitoring and evaluation: (i) will follow general Bank procedures, including a midterm review and project monitoring report; and (ii) will include the presentation by AFD of periodic reports, at the Bank's request and until execution of the CCLIP has concluded, which are to include the progress of ongoing operations and the program's results based on the results matrix (table of results and goal indicators). This monitoring system will permit interaction and feedback between the project team, the Bank's Country Office in Paraguay, AFD, and the borrower when evaluating the success of the programs under the CCLIP. The program also calls for a series of monitoring and evaluation actions, which are described in the monitoring and evaluation plan.
- 3.6 For supervision purposes, external audits of AFD will be conducted by a firm of independent auditors acceptable to the Bank, in accordance with the applicable policy, and will be financed by AFD.

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<sup>18</sup> See the estimate of demand for the third program under the CCLIP in [Link 2](#).

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	Aligned		
Lending Program	Lending to small and vulnerable countries.		
Regional Development Goals	Percent of firms using Banks to finance investments.		
Bank Output Contribution (as defined in Results Framework of IDB-9)	Micro/small/medium productive enterprises financed.		
2. Country Strategy Development Objectives	Aligned		
Country Strategy Results Matrix	GN-2541-1	Reform Public Banks.	
Country Program Results Matrix	GN-2617	The project is included in the 2011 Country Program Document.	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability	Highly Evaluable	Weight	Maximum Score
	7.1		10
3. Evidence-based Assessment & Solution	6.3	25%	10
4. Ex ante Economic Analysis	8.5	25%	10
5. Monitoring and Evaluation	6.3	25%	10
6. Risks & Mitigation Monitoring Matrix	7.5	25%	10
Overall risks rate = magnitude of risks*likelihood	Low		
Environmental & social risk classification	B.13		
III. IDB's Role - Additionality			
The project relies on the use of country systems (VPC/PDP criteria)	Yes	Financial Management: Budget and Treasury. Procurement: Information System and Shopping Method.	
The project uses another country system different from the ones above for implementing the program			
The IDB's involvement promotes improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
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			
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan.			

The project is aligned with IDB institutional priorities defined by the Ninth GCI. The POD identifies priorities related to the Bank's lending program and the project's contribution to: (i) the IDB's lending objective "Lending to small and vulnerable countries; (ii) the Regional Development Goals "Percent of firms using Banks to finance investments" and (iii) the Bank output contribution to regional development goals 2012-2015 "Micro/small/medium productive enterprises financed". The project is included in the CPD and it is aligned with the CS objective of "reforms of public banks". The project logic and justification are clear and based on a good diagnostic. However, the discussion on the potential effectiveness of the intervention is rather limited. The results matrix is complete and most of the indicator is adequate; some impact indicators lack baseline and target values. The economic analysis of the project is mostly adequate, although a more precise definition of benefits should have been included. The project includes a monitoring and evaluation plan. A quasi-experimental methodology will be used for the impact evaluation. The risks identifies in the risk matrix are reasonable. However, some risk mitigation measures do not have a clear indicator to track their implementation.

## RESULTS MATRIX

Objective of the program	The general objective of the program is to help increase competitiveness and employment in Paraguay’s productive sector by channeling medium- and long-term financing.							
Purpose of the program	Its purpose is to expand the supply of medium- and long-term credit to finance eligible investment projects.							
IMPACTS								
Indicators	Unit	Baseline	Year 1	Year 2	Year 3	Year 4	Target	Description/source
Average term of loans is the same as in the financial system	Years	1.55	2.0	2.0	2.0	2.0	2.0	This indicator makes it possible to track the average term of loans in the financial system. Source of information: Superintendency of Banks
Gross annual receipts of the program’s subborrowers	Billions of guaraníes	N/A	N/A	N/A	N/A	N/A	N/A	This indicator shows the performance of gross annual receipts (sales) of the program's subborrowers. Higher receipts are evidence of improved levels of competitiveness. Means of verification: National Economic Survey Study. The banks will begin to report with this operation, based on the first two operations. AFD
The IRR of the projects financed		Greater than or equal to IRR of the productive sector	Greater than or equal to IRR of the productive sector	Greater than or equal to IRR of the productive sector	Greater than or equal to IRR of the productive sector	Greater than or equal to IRR of the productive sector	Greater than or equal to IRR of the productive sector	According to this index, if the IRR of companies financed by the program is equal to or greater than the average IRR of their productive sector, wealth has been generated as set forth in the program indicators and competitiveness has risen. Means of verification: AFD/IFI
Number of employees of the program’s subborrowers	Persons	N/A	N/A	N/A	N/A	N/A	N/A	This indicator makes it possible to track the level of employment of the program's subborrowers, in terms of the number of jobs generated or maintained. Means of verification: National Economic Survey Study. The banks will begin to report with this operation, based on the first two operations. AFD

OUTPUTS								
Indicators	Unit	Baseline	Year 1	Year 2	Year 3	Year 4	Target	Description/source
Number of houses financed	Number	0	250	250	250	250	1,000	This indicator makes it possible to determine the number of houses financed and therefore calculate the reduction in the country's housing deficit. Source of information: SENAVITAT
Number of operations financed	Loans	3,126	196	196	196	196	3,910	Number of operations 25% above the average number of loans in the first two programs. Baseline: 3,126 companies Source of information: AFD
Number of persons per housing group who gain access to decent housing	Persons	0	1,000	1,000	1,000	1,000	5,000	Source of information: SENAVITAT
Number of loans made	Companies/ persons	0	700	700	700	700	2,500 to 3,000	Number of companies financed with program resources Source of information: AFD
OUTCOMES								
Indicators	Unit	Baseline	Year 1	Year 2	Year 3	Year 4	Target	Description/source
Average term of the loans made with the proceeds of the financing	Years	8					10	100% of the funds lent for terms of 10 years, on average, which will help to increase the average term of loans in the banking system. Source of information: AFD
Cofinancing contributed for the program's onlending operations for the same term as the program, by intermediaries (IFI contribution)	%	5%	5%	5%	10%	10%	15%	This percentage represents the contribution of the IFIs with regard to the total for each loan. Means of verification: AFD

## **FIDUCIARY AGREEMENTS AND REQUIREMENTS**

**Country:** Paraguay  
**Project number:** PR-L1062      **Name:** Program to Provide Financing to AFD  
**Executing agency:** Agencia Financiera de Desarrollo (AFD)  
**Prepared by:** Alberto de Egea and Mariano Perales – Fiduciary Specialists

### **I. EXECUTIVE SUMMARY**

1. The fiduciary management of the proposed program was evaluated on the basis of the “Proposal for Operational Development,” which states that the program’s objective will be to continue supporting the progressive strengthening of competitiveness in Paraguay’s productive sector by financing medium- and long-term business ventures for investment projects and development programs, subject to the terms set forth in the program’s Credit Regulations.
2. Given that this operation aims to provide funding and to intermediate resources through the Paraguayan banking system, which, in turn, will make it possible for medium- and long-term loans to be issued, the party responsible for the resources, vis-à-vis both the government and the Bank, is Agencia Financiera de Desarrollo (AFD). Created by Law 2640/05, AFD is the only second-tier public-sector bank that makes its credit products available to the public exclusively through authorized cooperatives, banks, and finance companies. It does not make loans directly to final beneficiaries. AFD has a long and successful track record in managing the funds entrusted to it, and therefore meets the required fiduciary standard.
3. The program does not include financing from other multilateral institutions.

### **II. FIDUCIARY CONTEXT OF THE EXECUTING AGENCY**

1. The executing agency has suitable systems in place for the fiduciary management of the resources intended for loan intermediation. Operating efficiency is measured by the ratio of operating costs to assets, which should gradually approach 1%. The operating efficiency index was below 1% at 31 December 2010. Although the index rose slightly, from 0.89% to 0.97%, it remained below the 1% strategic target used to measure AFD’s efficiency. This increase was the result of the rising operating costs required to maintain a suitable organizational structure and ensure the continued growth of AFD’s operations.
2. Regarding systems and processes, important contracts have been entered into for specialized technical maintenance and support services for telephony, communications, and server infrastructure, at both the hardware and software level. Regarding software, the aim is to boost the use of AFD’s current resources.

3. Work has begun on tasks such as implementing the agency's intranet. This communication tool will be highly useful for the agency and is expected to come online in mid-2011. Second, activities to upgrade and improve the Integrated Financial System (Java) have been carried out in order to improve the services that it provides and conform to the agency's new requirements and regulating agencies' recommendations. Third, actions have been taken to improve information system security by making the necessary changes to the Server Room and installing access-control devices, ambient-monitoring and security devices, redundant acclimation equipment, and automatic fire-detection and extinction systems specifically designed for this type of room, and carrying out a general rearrangement of the electricity and network wiring in the Server Room.
4. Similarly, specialized services have been contracted to provide: server replication at an external site to prevent interruptions in services; and communications equipment and server maintenance so as to ensure the availability of technological resources during system failures and the adaptation of configurations when needed. In addition, AFD now has an external site to store backup copies of data.
5. There are also plans to contract consultants to upgrade the area's procedures so as to ensure that processes conform to best practices. Specialized services contracted in 2010 for the support and maintenance of technological infrastructure (telephony, communications, alternate site, servers, etc.) will continue to be provided.
6. The optimization of the Integrated Financial System (Java) will continue, and efforts to address the major challenge of designing the Guarantee Fund System will begin. In addition, the need to acquire systems to automate process management and enhance the integrated management of internal processes will be explored.

### **III. FIDUCIARY RISK EVALUATION AND MITIGATION MEASURES**

1. The Paraguayan government's executive branch chooses the members of AFD's governing board. Although administration of AFD is dependent on the executive branch's decisions, there are circumstances that mitigate this situation. Thus: (i) area managers are highly qualified professionals selected for their abilities; (ii) the law requires that professionals with a high degree of technical experience be appointed and, since its creation, the institution has had a professional management and technical structure; (iii) AFD is an autonomous institution governed by the Banks Act; and (iv) its charter includes two additional elements of control: (a) an auditor appointed by the Controller General of the Republic; and (b) an external audit every 12 months to be contracted through international competitive bidding.
2. Given AFD's high degree of specialization in financial-intermediation management and in light of its achievements in previous operations, the fiduciary risk is considered low; the proposed mitigation measures correspond to risks associated with monitoring and tracking and the timeliness and adequacy of the counterpart funds, if applicable.

#### IV. CONSIDERATIONS FOR THE SPECIAL PROVISIONS OF CONTRACTS

1. In order to streamline contract negotiations by the project team, primarily the Legal Department, the specific agreements and requirements that are to be considered for the special provisions are described below:

For program execution, the following conditions precedent to the disbursement of loan proceeds will be met:

- (i) Entry into force of the agreement signed between the borrower and AFD;
- (ii) Entry into force of the AFD system for accrediting the IFIs; and
- (iii) Approval and entry into force of the Credit Regulations. Thus:

Agreement between the borrower and AFD: The agreement will regulate the conditions associated with the transfer of funds and their repayment;

IFI accreditation system: First-tier financial intermediaries, banks, and cooperatives regulated by the Superintendency of Banks and INCOOP that comply with the applicable regulations, meet eligibility criteria, and satisfy AFD's risk assessment may participate as IFIs of the programs under the CCLIP. They will be responsible for (i) evaluating the subborrower risk and making lending decisions based on the conditions set forth in the Credit Regulations and AFD's operating regulations; and (ii) assuming responsibility vis-à-vis AFD for the servicing and repayment of onlending operations in a manner fully independent of subborrowers' compliance with the servicing of their loans;

Credit Regulations: The program's Credit Regulations (i) will be consistent with the standards and policies of AFD and the Bank, as well as with the country's financial laws and practices; (ii) will cover the main characteristics of the program in terms of use of resources, onlending eligibility, and beneficiaries; (iii) will stipulate that noncompliance with the provisions will impede access to financing; (iv) will have to be approved and enacted by AFD to the Bank's satisfaction as a condition precedent to the disbursement of resources; and (v) will state that the Bank's no objection will be required for any future amendments to the Credit Regulations. Link 8 contains the AFD's current Regulations, which have the no objection of the Bank and were used in the first and second programs under the CCLIP.

- a. The exchange rate agreed on with the executing agency for accounting purposes will be the rate published by the Central Bank of Paraguay on the date of the expenditure in question.
- b. The program's financial statements will be prepared annually at the close of the fiscal year and delivered 120 days after the close; semiannual execution and financial reports will be submitted within 60 days after 30 June and 31 December of each year.
- c. In addition, as set forth in the contract, AFD's financial statements will be submitted annually.



- d. The auditing firms responsible for both financial statements must be acceptable to the Bank before preparing the auditing reports.

## **V. FIDUCIARY ARRANGEMENTS FOR PROCUREMENT**

1. **Procurement execution:** The Bank's procurement policies will not apply; hence, AFD will transfer the resources to the IFIs subject to the terms set forth in the program's Credit Regulations. The funds will generally allow AFD to provide stable long-term financing to the IFIs. In turn, the IFIs may extend: (i) long-term loans to the productive sector for development programs and projects; and (ii) financing for the purchase, construction, and improvement of housing. Both types of financing will be subject to the conditions set forth in the program's Credit Regulations.
2. **Records and files:** The program execution unit, within AFD, is in charge of keeping the program's records and files. The reports of the executing agency will use the approved formats or procedures, which are described in the program Operating Regulations.

## **VI. FINANCIAL MANAGEMENT**

### **1. Programming and budget**

As an autonomous entity, AFD has resources granted by the State for its operations; however, the agency has discretion to use those resources in accordance with its needs.

The AFD is an autonomous, self-governing agency under public law, as set forth in Law 3330/07 "Amending Articles 1, 3, 5, 6, and 14 of Law 2640/05." Its mission is to promote economic growth and job creation by channeling medium- and long-term financing to the private sector through banks, finance companies, and cooperatives (IFIs).

Programming, administration, and budget execution are the responsibility of the Administration and Finance Office, which is to follow the zero-based budgeting system. Its planning system is consistent with annual and multiyear lending plans. Initially, there may be challenges in terms of the availability of the resources under the program, especially because the National Congress must ratify the program in order for the budget to be released. Nevertheless, the Bank expects that alternate sources will provide funds for program startup.

It is agreed that prior to the first disbursement, the borrower will provide the resources necessary to launch the program at a minimum level to supplement the resources to be provided by the Bank for the first year of execution.

### **2. Accounting and information systems**

In 2010, several activities were carried out to optimize this area's performance, including automating processes, updating the fixed-asset information system, and incorporating AFD's accounting system into the public accounting system (Sistema Integrado de Contabilidad, or SICO) as required by the Ministry of Finance.

The accounting principle applied is the accrual basis; however, the cash basis is used for the accounting of projects partially financed by the Bank. Financial reports will be prepared and submitted to the auditors in accordance with national practices and International Standards on Auditing and International Financial Reporting Standards.

### **3. Disbursements and cash flow**

The treasury division comprises an operations assistant and a financial assistant. Together with the budget and financial planning manager and the accountant, these officials will be part of the Administration and Finance Office. The management team also includes an administrative services manager. The loan proceeds will be disbursed to a special account through advances governed by the demand for operations. In addition, expenditures reimbursed through direct payments will be used by AFD for the operation. The actual demand for resources will determine their execution schedule.

### **4. Internal control and internal auditing**

The basic objectives of internal control are as follows:

- a. Promoting operational efficiency
- b. Obtaining reliable financial information
- c. Protecting the institution's assets
- d. Ensuring adherence to the administration's policy

The internal auditing function has been strengthened by the hiring of an internal information technology auditor and an assistant auditor. The procedures required to hire another assistant auditor are near completion. The intention is to achieve more efficient control and broaden the scope of all operations carried out by AFD as a second-tier institution, in order to minimize control risk.

### **5. External control and reports**

AFD's financial statements as at 31 December 2010 were audited by the independent auditing firm PricewaterhouseCoopers, which issued an unqualified opinion and made no observations. The cost of the audit was covered by the AFD using own resources.

1. The program will be audited by an independent auditing firm acceptable to the Bank, according to the procedures established in the new auditing guidelines in effect for 2010; previous programs have been audited and the opinions contained no major observations.
2. The program resources are expected to cover the cost of the program audit.

### **6. Financial supervision plan**

Financial supervision will be conducted in three ways: (i) through the review of disbursement reports and inspection visits; (ii) through on-site visits scheduled by the Bank; (iii) through the review of the financial information provided in the financial statements and execution reports.

**7. Execution mechanism**

AFD will be responsible for:

- (i) Executing and supervising appropriate use of the loan proceeds;
- (ii) Providing the necessary human, technological, and budgetary resources as planned and on schedule;
- (iii) Presenting the required documentation to the Bank to comply with disbursement and other operational conditions required for execution.

Agreement between the borrower and AFD: The agreement will regulate the conditions associated with the transfer of funds and their repayment;

Credit Regulations: The program's Credit Regulations (i) will be consistent with the standards and policies of AFD and the Bank, as well as with the country's financial laws and practices; (ii) will cover the main characteristics of the program in terms of use of resources, onlending eligibility, and the beneficiary; (iii) will stipulate that noncompliance with the provisions will impede access to financing; (iv) will have to be approved and enacted by AFD to the Bank's satisfaction as a condition precedent to the disbursement of resources; and (v) will state that the Bank's no objection will be required for any future amendments to the Credit Regulations. Link 8 contains the AFD's current Regulations, which have the no objection of the Bank and were used in the first and second programs under the CCLIP.

**8. Other financial management agreements and requirements**

N/A

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-\_\_\_/11

Paraguay. Loan \_\_\_\_/OC-PR and \_\_\_\_/BL-PR to the Republic of Paraguay. Third Individual Operation under the Expanded Conditional Credit Line PR-X1001 to Provide Financing to the Agencia Financiera de Desarrollo (AFD)

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to utilize the resources of the Expanded Conditional Credit Line approved pursuant to Resolution DE-34/08 to enter into such contract or contracts as may be necessary with the Republic of Paraguay, as Borrower, for the purpose of granting financing for the third individual operation to the Agencia Financiera de Desarrollo (AFD).

2. The financing mentioned in paragraph 1 above will be for an amount of up to US\$43,600,000, and will be composed of:

- (a) A loan for the amount of up to US\$18,000,000 from the resources of the Single Currency Facility of the Bank's Ordinary Capital; and
- (b) A parallel loan within the framework of the multilateral debt relief and concessional finance reform of the Bank of up to the amount of US\$25,600,000, from the resources of the Single Currency Facility of the Bank's Ordinary Capital.

3. Such financing will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

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

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-\_\_\_/11

Paraguay. Loan \_\_\_\_/BL-PR to the Republic of Paraguay. Third Individual Operation under the Expanded Conditional Credit Line PR-X1001 to Provide Financing to the Agencia Financiera de Desarrollo (AFD)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to utilize the resources of the Expanded Conditional Credit Line approved pursuant to Resolution DE-34/08 to enter into such contract or contracts, as may be necessary, with the Republic of Paraguay, as Borrower, for the purpose of granting financing for the third individual operation to the Agencia Financiera de Desarrollo (AFD). Such financing will be for the amount of up to US\$6,400,000 from the resources of the Bank's Fund for Special Operations, corresponds to a parallel loan within the framework of the multilateral debt relief and concessional finance reform of the Bank, 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 \_\_\_\_\_)