

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

HONDURAS

**GLOBAL CREDIT PROGRAM FOR SAFEGUARDING THE PRODUCTIVE FABRIC
AND EMPLOYMENT**

(HO-L1216)

LOAN PROPOSAL

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ABBREVIATIONS

BANHPROVI	Banco Hondureño para la Producción y la Vivienda
BCH	Central Bank of Honduras
CABEI	Central American Bank for Economic Integration
CNBS	National Banking and Insurance Commission
COC	Concessional Ordinary Capital
ECLAC	Economic Commission for Latin America and the Caribbean
ESMR	Environmental and social management report
FFF	Flexible Financing Facility
GDP	Gross domestic product
IMF	International Monetary Fund
MSMEs	Micro, small, and medium-sized enterprises
NFPS	Nonfinancial public sector
ROC	Regular Ordinary Capital
SEFIN	Ministry of Finance
WHO	World Health Organization

PROJECT SUMMARY

HONDURAS GLOBAL CREDIT PROGRAM FOR SAFEGUARDING THE PRODUCTIVE FABRIC AND EMPLOYMENT (HO-L1216)

Financial Terms and Conditions						
Borrower:	Source	Amount	%			
Republic of Honduras	IDB (Regular Ordinary Capital, ROC):	6,986,000	35			
Executing agency:	IDB (Concessional Ordinary Capital, COC):	12,974,000	65			
Banco Hondureño para la Producción y la Vivienda (BANHPROVI)	Total:	19,960,000	100			
	ROC (FFF) ^(a)	COC				
Amortization period:	25 years	40 years				
Disbursement period:	2 years					
Grace period:	5.5 years ^(b)	40 years				
Interest rate:	LIBOR-based	0.25%				
Credit fee:	^(c)	N/A				
Inspection and supervision fee:	^(c)	N/A				
Weighted average life:	15.25 years	N/A				
Approval currency:	U.S. dollars					
Project at a Glance						
Project objective: The general objective of this project is to support the sustainability of micro, small, and medium-sized enterprises (MSMEs) as employment providers in Honduras amid the COVID-19 crisis. The program's specific objective is to support the short-term financial sustainability of MSMEs.						
Special contractual conditions precedent to the first disbursement of the loan proceeds: The following will be special contractual conditions precedent to the first disbursement of the loan proceeds: (i) a subsidiary agreement has entered into force between the Ministry of Finance (SEFIN), on behalf of the borrower, and BANHPROVI, as executing agency, for the transfer of the loan proceeds and associated obligations, under the terms previously agreed upon with the Bank; and (ii) the Credit Regulations have been approved and entered into force, under the terms previously agreed upon with the Bank (paragraph 3.10).						
Exceptions to Bank policies: None.						
Strategic Alignment						
Challenges: ^(d)	SI	<input checked="" type="checkbox"/>	PI	<input checked="" type="checkbox"/>	EI	<input type="checkbox"/>
Crosscutting themes: ^(e)	GD	<input type="checkbox"/>	CC	<input type="checkbox"/>	IC	<input type="checkbox"/>

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

^(b) 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.

^(c) 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 policies.

^(d) SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

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

I. OBJECTIVE, DESCRIPTION, AND RESULTS MONITORING

A. Background, problem to be addressed, and rationale

- 1.1 **Background.** On 11 March 2020, the World Health Organization (WHO) declared the outbreak of COVID-19, the disease caused by the 2019 novel coronavirus, or SARS-CoV-2, which affects the respiratory system, a pandemic. As of 6 July 2020, WHO has reported more than 11.3 million confirmed cases in 202 countries, resulting in more than 532,000 deaths.¹ In Latin America and the Caribbean, more than 2.8 million confirmed cases of COVID-19² have been reported, with more than 126,000 deaths.³ In Honduras, the first case was recorded on 12 March, and as of 6 July, 22,921 confirmed cases have been recorded, with 629 deaths, representing a fatality rate of 2.7%. Current public spending on health in Honduras in 2019 is very similar to the region's average (7.9% of GDP), and WHO current rates the country at level 2 of 5 in terms of its level of preparedness and capacity to handle public health events.^{4,5}
- 1.2 **Macroeconomic and/or social context.** The economic impacts of COVID-19 will be felt through different channels at different times. The first, associated with the priority of saving lives in the very short term, involves the direct costs of the health sector response. The second is the costs associated with the necessary changes in people's behavior to "flatten the curve" of COVID-19 progression, which will contribute to saving lives. These changes in behavior are resulting in a very significant economic downturn with immediate manifestations and lingering effects, once the health emergency is over. Along this line, from a macroeconomic perspective, in addition to the contraction in domestic demand, the Economic Commission for Latin America and the Caribbean (ECLAC)⁶ estimates other effects, including: (i) slowing economic activity of key trading partners that will impact the demand for exports; (ii) less demand for tourism services; (iii) interruption of global value chains; (iv) falling commodity prices; and (v) worsening financial terms.
- 1.3 In Honduras, the government declared a state of health emergency on 10 February 2020⁷ and began introducing mitigation measures to contain the spread of COVID-19⁸ in March. The principal measures, implemented starting on 16 March, included the closing of (i) the air, land, and sea borders; (ii) schools and government facilities; (iii) businesses, including shopping malls; and (iv) recreational parks. The government also suspended all work activity in the public and private sectors and prohibited public transportation, public events, and

¹ See: WHO COVID-19 Situation Dashboard at [Covid19.who.int](https://covid19.who.int) (14 June 2020).

² At present, all countries in Latin America and the Caribbean have confirmed cases of COVID-19 (14 June 2020).

³ See: [PAHO status report](#) (27 March 2020).

⁴ According to [WHO Country Preparedness and Response Status for COVID-19](#) (20 April 2020).

⁵ The operational readiness index for the COVID-19 response has five levels, with level 5 being the best prepared. The assessment is updated periodically according to the evolution of the status of COVID-19.

⁶ See: [ECLAC press release](#) (19 March 2020).

⁷ See: [Decrees PCM-005-2020](#) (10 February 2020) and [PCM-021-2020](#) (16 March 2020).

⁸ See: [Special Measures for COVID-19 of the Government of Honduras](#) (Updated on 21 June 2020).

all sports, cultural, and social activities. On 8 June, the government began testing a provisional first stage of opening-up, dividing the country into three regions and allowing a percentage of the workforce at public institutions and private businesses to return to their jobs (20% for region 1, 40% for region 2, and 60% for region 3).⁹ In this stage, public transportation, shopping malls, customer-facing businesses, airports, and schools are still closed, and events are prohibited. The country will stay in this stage if infections do not increase in the short term.

- 1.4 The macroeconomic outlook for Honduras for 2020 has deteriorated due to the current situation. Early this year, growth was forecasted to reach 2.7% of GDP,¹⁰ but the economy is now expected to contract by 3.3% to 5.8% of GDP. Economic activity will languish as a result of the isolation measures, leading to a substantial increase in unemployment and underemployment, lower household income, and declining consumption. Along with domestic demand, foreign demand is expected to tighten as well, especially from the United States and the European Union, Honduras's primary trade partners. Remittances are also expected to fall.¹¹ That said, after the sudden decline in GDP in 2020, conditions should begin to return to normal, leading economic activity, employment, and consumption to recover next year. Growth is forecasted to reach 5.1% of GDP in 2021,¹² despite lingering uncertainty over how COVID-19 will ultimately impact the economy. The speed of the response will largely depend on the economic recovery of the United States.
- 1.5 The country's fiscal situation will be affected in the short term, but it should return to its pre-COVID-19 path in the medium term. The nonfinancial public sector (NFPS) fiscal deficit is expected to reach 4% in 2020. In response to COVID-19, the government has deployed a package of spending measures worth approximately 2% of GDP to strengthen the health care system and support families and workers with direct transfers. This increase in public spending, plus the predicted decline in tax revenue of 2% of GDP due to the economic slowdown, explain the rise in the fiscal deficit in 2020.¹³ The country's fiscal planning includes a stand-by arrangement with the International Monetary Fund (IMF) and is anchored in compliance with the Fiscal Responsibility Law, to ensure Honduras will stay on the path of medium-term debt sustainability.¹⁴ The anticipated economic recovery over the course of 2021 should help the country gradually return to the path of fiscal consolidation, and in 2022, Honduras is expected to once again comply with the NFPS deficit ceiling of 1% established in

⁹ This stage may be reversed depending on infection statistics. For example, region 3 suspended this stage from 21 to 28 June 2020. See: [Statements](#) of the Ministry of Security of the Government of Honduras.

¹⁰ IMF. July 2019. "[Honduras: Article IV Consultation](#)."

¹¹ Remittances are expected to decrease as a percentage of GDP, from 21.6% in 2019 to 18.8% in 2020.

¹² IMF. April 2020. "[World Economic Outlook](#)."

¹³ According to Article 4 of the Fiscal Responsibility Law (see [Decree 55-2020](#)).

¹⁴ On 16 July 2019, the IMF approved a US\$311 million contingent credit facility to support Honduras's fiscal stability. On 31 March 2020, the country requested a first disbursement of US\$143 million to support its policies for responding to the COVID-19 crisis. Subsequently, on 7 May 2020, it reached an agreement with the IMF for expanding the credit facility up to US\$530 million. On 3 June, it requested a second disbursement of US\$104 million.

the Fiscal Responsibility Law, which will put it in a solid position for servicing its public debt.¹⁵

- 1.6 **Current constraints on access to financing for micro, small, and medium-sized enterprises (MSMEs) in Honduras.**^{16,17} In Honduras, MSMEs are fundamental to the economy's productive fabric and as employers. In 2017, there were over 147,317 MSMEs in Honduras, employing an estimated 70% of the country's workers. In all, 96% of these businesses are considered to be microenterprises, 3% small businesses, and 1% medium-sized businesses. By sector, most microenterprises (70%), small businesses (60%), and medium-sized businesses (50%) are shops, hotels, or restaurants ([1] of [optional link 3](#)).

Table 1. Official definition of MSMEs in Honduras

Variable	Micro	Small	Medium-sized
Employees	1-10	11-50	51-150

Source: National legal classification of MSMEs ([Decree 135-2008](#)).

- 1.7 Honduran MSMEs already had limited access to financing even before coming up against the economic challenges brought about by the COVID-19 containment measures. According to a 2018 study by the SME Finance Forum, 37% of MSMEs have restricted access to credit ([2] of [optional link 3](#)). The financing gap for formal MSMEs is estimated to be approximately 2.6 times the current level of financial system lending, equivalent to US\$2.9 billion (or 15% of GDP) in unmet demand for credit. These data are consistent with the national survey of MSMEs conducted as part of the World Bank Enterprise Survey in 2016, which showed that: (i) 48.2% of microenterprises and small businesses identified access to or the cost of financing as a major or very significant obstacle; (ii) only 13.8% of microenterprises and small businesses' working capital is borrowed from banks; and (iii) 71.9% of loans to microenterprises and small businesses require collateral worth 231% of the loan amount ([3] of [optional link 3](#)).
- 1.8 Data on the 2019 portfolio of loans to the business sector from the National Banking and Insurance Commission (CNBS) and the Central Bank of Honduras (BCH) confirm that MSMEs receive only a small share of the financial system's credit supply, despite the fact that lending to the private sector in Honduras is on par with the regional average.¹⁸ Financial system loans to the business sector total US\$7.896 billion, but a breakdown of this portfolio by business size shows that only 19% of loans go to MSMEs (16% to small and medium-sized enterprises and 3% to microenterprises). Likewise, 96% of loans to MSMEs are in the national currency and the weighted average rate for the portfolio is 15.4% for loans granted to SMEs and 30.4% for microenterprises. In all, 30% of loans to MSMEs go to working capital (see [4] of [optional link 3](#)).

¹⁵ IMF. June 2019 "[Honduras: Second Reviews Under the Stand-by Arrangement](#)."

¹⁶ For an overall review of the intervention see [optional link 2](#).

¹⁷ See bibliography ([optional link 3](#)).

¹⁸ In 2019, lending to the NFPS accounted for 60% of GDP, in line with countries in the region: Brazil, 62%; Chile, 116%; Colombia, 50%; Mexico, 35%; Peru, 44%; Latin America and Caribbean average, 50% (World Development Indicators, World Bank, 2020).

- 1.9 The supervised financial system in Honduras that grants loans to MSMEs is fundamentally a banking system, since 97.7% of the system's assets belong to 16 banking institutions, and it comprises 15 commercial banks, 1 public bank, and 10 finance companies.¹⁹ At year-end 2019, the financial sector had US\$25.5 billion in assets, equivalent to 102% of GDP. The commercial banks own most of these assets (96%), with the public bank owning 1.7% and the finance companies, 2.2%. The financial system also includes smaller institutions, like private development finance organizations and credit unions.²⁰ Banco Hondureño para la Producción y la Vivienda [Honduran Bank for Production and Housing] (BANHPROVI) is the only public bank operating in the country. It primarily serves as a second-tier bank providing loans and guarantees to ensure that all of the financial intermediaries operating in the financial system are able to offer financing to the productive sector and to MSMEs with more favorable rate and maturity terms (see [optional link 4](#)).
- 1.10 The Honduran financial system has robust solvency for facing adverse scenarios, but the marked decline in economic activity is limiting its capacity to continue offering loans to MSMEs. As of December 2019, financial institutions in Honduras remained solvent, since their capitalization was twice the required regulatory minimum,²¹ arrears were around 2.2% for the banking system and 3.1% for the finance companies, and the MSME loan portfolio scored 6.4% for quality in the highest credit risk categories ([5] of [optional link 3](#)). However, the MSME loan portfolio is expected to deteriorate sharply, due especially to households losing jobs and companies curtailing their activities in the sectors most affected by the economic slowdown, like tourism, transportation, and trade. In addition to the credit portfolio, the financial system will also foreseeably be affected, facing damage to its investment portfolios and increased lending costs. Although the financial sector does have a degree of resilience to these types of adversities, the current situation poses particular challenges to meeting the demand for credit from MSMEs.
- 1.11 The challenges MSMEs face in accessing financing are expected to be exacerbated by the economic contraction of 2020. At present, their main problem is a lack of liquidity to cover fixed costs and to maintain their employees given the sudden reduction in their operating income. Specifically, the hotel, restaurant, transportation, trade, manufacturing, and storage sectors are expected to need significant short-term loans to keep operating and to maintain their levels of employment. A study of credit demand conducted by CNBS in March 2020 estimated that for all MSMEs in the country, the need for credit for working capital during the 12 months following the declaration of the COVID-19 pandemic (May 2020 to April 2021) would total a minimum of US\$734 million, equivalent to around 3% of GDP ([6] of [optional link 3](#)).
- 1.12 The drop in revenue for MSMEs means that their credit risk will go up, and the credit supply will go down. In May 2020, the National Autonomous University of Honduras conducted a national survey of 1,330 MSMEs and large companies—a

¹⁹ See: [List of Supervised Institutions](#) (CNBS, 2020).

²⁰ See: [Annual Report 2019](#) (CNBS, 2020).

²¹ The CNBS requires a capital adequacy ratio (CAR) of 10%. At year-end 2019, the CAR of the participants in the Honduran financial system was 26.5%.

representative sample of the country's business structure—to gather information on businesses' resilience to the crisis caused by COVID-19. The survey showed that: (i) 75% of companies made no sales in April; (ii) 38% had closed temporarily in May; and (iii) 64% reported that in April and May, they needed to suspend or lay off employees due to the COVID-19 crisis. Of the companies that continue to operate, 41% should stay afloat until July 2020 at their current pace of sales. Microenterprises and small businesses have fewer options for making sales (22.6% and 35.1%, respectively) compared to medium-sized and large companies (66.2%) ([7] of [optional link 3](#)).

- 1.13 This situation has significantly worsened perceptions of the MSME sector's credit risk, and has intensified the financial system's preference for maintaining liquidity rather than continuing to lend to MSME clients confronting economic challenges ([8] of [optional link 3](#)). In this regard, 85% of surveyed companies, including those that already had financing, reported that they needed more, and 66% reported that they did not currently have any type of financing. In this context, public policy plays an important role—for example, in providing new credit lines and loan guarantees through second-tier public banks to encourage financial intermediaries to maintain their credit supply for the productive sector ([9] of [optional link 3](#)).
- 1.14 **Challenges and progress.** A key economic policy objective in the context of a profound but temporary shock is to prevent corporate illiquidity from turning into insolvency, with the resultant irreversible loss of capital and jobs for the economy. In safeguarding Honduras's productive fabric from the economic hardships associated with the COVID-19 crisis, the challenge will be to keep open as many as possible of the MSMEs that were commercially viable before the crisis, to prevent short-term bankruptcies and help them gradually return to normal levels of operation once the health emergency has passed. In Honduras, this challenge is particularly important, since the unemployment rate is forecasted to increase 3.9% in 2020 ([10] of [optional link 3](#)).
- 1.15 The government has adopted public policies to address the economic consequences of the COVID-19 health emergency, including a set of measures to support MSMEs. These measures are aligned with the economic, monetary, and financial policy measures being taken by most countries around the world to provide short-term financial support to MSMEs. They can be classified into three major types, designed to: (i) provide more liquidity to the financial system; (ii) prevent depletion of working capital; and (iii) preserve access to credit to provide short-term liquidity (see [optional link 5](#)). The measures taken by Honduras are summarized in Table 2. Their specific objectives are to maintain the financial health of MSMEs during the temporary shock, protect their credit quality, and guarantee the payment chain among producers, suppliers, and distributors.

Table 2. Principal government measures to support MSMEs in Honduras

Type of measure	Description
Provide liquidity to the financial system	<ul style="list-style-type: none"> • Reduction of the monetary policy interest rate: The BCH decreased the monetary policy interest rate by 100 basis points, to 4.5%. • Reduction of BCH lending window interest rates: Starting in April, the interest rate for standing facilities was lowered from 6.25% to 5%, and for direct repurchase agreements, from 7% to 5.5%. • Easing of regulatory requirements: Reduction of mandatory investments in local currency, from 3% to 0%; suspension of BCH money auction in Q2 and Q3 of 2020.
Prevent depletion of working capital	<ul style="list-style-type: none"> • Extension on the filing of tax returns, payments, and contributions: The Productive Sector Relief Law (Decree 33-2020) includes an extension on income and sales tax payments for the 2020 tax period. • Tax discounts: An 8.5% discount for paying income tax before 30 April, and a special additional deduction from gross income equivalent to 10% for keeping employees from the declaration of the state of emergency until December 2020. • Temporary financial relief measures: (i) universal grace period for financial system debtors until 30 June; and (ii) postponement of three BANHPROVI loan payments for loans in the MSME agrifood and tourism sectors.
Preserve access to credit	<ul style="list-style-type: none"> • Freezing of credit history: Maintenance of the credit risk rating registered on 28 February 2020 until October 2020. • Guarantee fund for loans to MSMEs: A US\$100 million fund was created with resources from a Central American Bank for Economic Integration (CABEI) loan approved on 25 April. The fund will guarantee 65% to 90% of loans to MSMEs and will be administered by BANHPROVI. • Loans to finance MSMEs: BANHPROVI will allocate US\$225 million of credit to the sectors affected by the pandemic, with support from a CABEI credit line approved on 8 May.

Source: Web pages of the BCH, Presidency of the Government, [Decree 33-2020](#), and [CNBS circular 006/2020](#).

- 1.16 Honduras has made rapid, notable progress on measures to support MSMEs, but the country still faces the significant challenge of supporting their short-term financial sustainability and preserving the jobs they provide in the economy. The financial sector faces constraints on providing the entire flow of financing needed by MSMEs. This problem will likely be aggravated by: (i) the economic contraction of 2020; and (ii) the expected deterioration of the MSME loan portfolio. Furthermore, some of the government's MSME-support measures put extra pressure on the financial sector and create the challenge of absorbing the delays in loan payments without charging late fees. This could especially affect the financial intermediaries, whose portfolio is focused on MSMEs, since many will probably encounter financial hardship as the COVID-19 crisis drags on. To prevent disruptions to the chain of financing and preserve access to credit for MSMEs when the financial system is stressed, the most common policy measures adopted internationally (and considered the most effective) are public mechanisms for access to lines of credit and guarantees to prevent the financial intermediaries from abruptly reducing the credit supply ([11] of [optional link 3](#)).
- 1.17 These instruments are designed to ensure that the financial intermediaries will continue to provide financing for MSMEs at times when: (i) it is more difficult for them to access external financing; (ii) they are more lending-averse given the

increasing credit risk; (iii) they need to allocate more funds to debt rescheduling or restructuring; and (iv) the MSMEs have fewer assets available to put up as security for accessing loans ([12] of [optional link 3](#)). The principal measures implemented by the Government of Honduras to alleviate the problem of MSME access to short-term financing were the creation of a guarantee fund for loans to MSMEs and the use of BANHPROVI²² as a second-tier public bank for increasing credit to the financial system, with the following objectives: (i) the guarantee fund will reduce the lending risk to encourage financial intermediaries to continue extending loans; and (ii) BANHPROVI will channel fresh resources to the financial intermediaries to give them additional liquidity for granting new loans.

- 1.18 BANHPROVI was created in 2005 and since then has been critical to improving MSME access to financing (paragraphs 1.9 and 3.2-3.3). In the response to the current crisis, it has been playing a pivotal role in the government measures for preserving MSME access to credit listed in Table 2. BANHPROVI has been given the fiduciary responsibility for launching the guarantee fund for loans to MSMEs, which was designed with the BCH from March to June 2020. Moreover, in May 2020, the country signed a sovereign guaranteed loan²³ with CABI to strengthen BANHPROVI's capacity for providing a larger supply of credit to MSMEs, both directly and through the financial intermediaries (paragraph 1.27).
- 1.19 **Proposed intervention.** In support of the public policy measures that Honduras has taken to ease the restrictions on MSME access to financing, the intervention focuses on stimulating the financial system's supply of short-term credit for MSMEs through a global credit program. This program is part of the government strategy for preserving employment in MSMEs and complements the aforementioned initiatives (see Table 2). Likewise, it seeks to alleviate the constraints on access to credit for working capital faced by MSMEs affected by the COVID-19 crisis, thus supporting their survival and preserving employment in these enterprises. This, in turn, will minimize the burden on social protection systems and maximize the speed of economic recovery, once the health emergency has passed. The intervention will be coordinated through BANHPROVI, which will receive Bank support for improving its capacity to extend loans and guarantees to the financial intermediary institutions, to ensure they continue to offer working capital loans to MSMEs affected by the COVID-19 crisis.
- 1.20 **Program targeting.** The proposed program will serve MSMEs, targeting MSMEs involved in tourism²⁴ as the hardest-hit productive sector in the country's economy. Tourism was identified as the sector most vulnerable to the COVID-19 crisis in a vulnerability analysis conducted by the Bank ([optional link 6](#)). This analysis concludes that tourism is the country's most vulnerable sector, since it

²² <http://banhprovi.gob.hn>.

²³ The first disbursement of this loan should take place in the third quarter of 2020.

²⁴ The focus on support for the tourism sector includes all of the tourism subsectors, like lodging, event organizers, tour guides, travel agencies, as well as other associated service subsectors like food and beverages and retail trade, which are active in tourist areas and/or whose earnings directly or indirectly depend on tourism activity.

has the highest probability of suffering diminishing returns and job losses.²⁵ This conclusion is consistent with the aforementioned survey of companies (paragraph 1.12), which also identifies the companies in the tourism sector as the ones with the least financial resilience to the COVID-19 crisis. The program thus serves the most vulnerable groups of companies (MSMEs) and economic sector (tourism) and provides a flexible solution that can be adapted during execution to provide liquidity and take on risk, depending on the financial sector's needs in order to be able to continue providing working capital loans to MSMEs at a time of great uncertainty regarding the evolution of the impact of COVID-19 in the 2020-2021 period.

- 1.21 **Sector description.** The tourism sector provides 11.7% of GDP and 12.2% of jobs.²⁶ Approximately 26.4% of its production is geared towards external demand, which will plummet in the rest of 2020. Macroeconomic estimates of lost tax revenue resulting from the decrease in tourism activity show a US\$677 million drop from pre-COVID revenue forecasts. The sector is estimated to comprise at least 4,088 companies,²⁷ of which 97% are MSMEs. These MSMEs and tourism-dependent enterprises are being particularly hard-hit by the COVID-19 crisis. In the months of April and May 2020, the tourism subsectors that include services like lodging, tour operators, food, arts, events, and recreation reported that they were seeing less than 20% of their typical pre-COVID activity. Although the activity is expected to gradually recover over the next 24 months, there is a high degree of uncertainty ([13] of [optional link 3](#)). The program targets the following specific problems currently facing the tourism sector: (i) within the overall economy, the tourism sector is where MSMEs have experienced the relatively largest increase in credit risk; as a result, the financial sector has reduced its supply of credit to this sector in particular, further exacerbating the existing access-to-financing issues; and (ii) it is one of the sectors with the highest demand for credit for working capital due to its seasonality and the resulting need for companies to purchase inputs for resuming operations, in addition to the necessary expenditure on the biosecurity measures required under the new regulations for preventing infections ([14] of [optional link 3](#)).
- 1.22 **The Bank's experience.** The Bank has extensive experience in designing sovereign guaranteed loan programs aimed at improving MSME access to finance through the financial system's financial intermediaries ([16] of [optional link 3](#)). These programs have been implemented in times of economic expansion, when support focuses on access to long-term finance for production-oriented investments, and in times of economic recession, when support focuses on ensuring that MSMEs do not lose access to liquidity to continue their economic activity. In the last financial crisis confronted by the region in 2007, the Bank played a countercyclical role by expanding the amount of financing and facilities used to address the lack of access to credit faced by the region's MSMEs. For example, liquidity programs for economic growth sustainability were approved in

²⁵ This analysis takes into account the potential occurrence of the following identified risks of the COVID-19 crisis: (i) supply contraction factors; (ii) demand contraction factors; (iii) financial and asset factors; and (iv) other risks of a systemic nature or in the regulatory environment.

²⁶ Information from the World Travel & Tourism Council. The GDP figure includes direct, indirect, and induced effects, and the employment figure includes direct and indirect effects.

²⁷ According to the Directory of Tourism Establishments in Honduras (2020).

2008 and 2009,²⁸ with the aim of reestablishing access to finance for working capital and foreign trade in the productive sectors. This helped to temporarily offset part of the deficit in financing flows to MSMEs resulting from the international financial crisis. With the same objective of stimulating the supply of credit to the productive sectors, the period following the crisis (2009-2013) saw the approval of contingent credit lines²⁹ for providing liquidity to the financial system, as well as global multisector credit programs and, for the most part, specific productive financing programs for MSMEs ([17] of [optional link 3](#)).

- 1.23 Specifically, the Bank has recent experience in several countries of the region supporting public programs to improve MSME access to financing. These programs combine the credit component with support for loan guarantee funds and programs, and notably include: Argentina (loan [1914/OC-AR](#), 2007), Barbados (operation [3390/CH-BA](#), 2014), Chile (loan [4272/OC-CH](#), 2017), Haiti (operation [2416/GR-HA](#), 2010), Jamaica (loan [4115/OC-JA](#), 2017), Nicaragua (loan [3042/BL-NI](#), 2013), and Paraguay (loan [3354/OC-PR](#), 2014). In Honduras, the Bank has recent experience promoting MSME access to financing in key sectors of the economy with one of these programs. The Comprehensive Rural Development and Productivity Project (loan [4936/BL-HO/4940/BL-HO](#), 2019) aims to increase the income of small agricultural producers by providing long-term financing and a guarantee program to take on the risk of producers with higher credit risks. The Bank is also strengthening the public financial sector in Honduras through nonreimbursable technical assistance to BANHPROVI (operation [ATN/OC-17147-HO](#), 2018), which since 2018 has supported the institution in revising its business model to incorporate improvements that will enhance operational efficiency, lead to the development of new financial products, and strengthen the impact of its operations.
- 1.24 **Lessons learned.** The Bank has generated lessons learned from the loan and technical assistance operations mentioned above (paragraphs 1.22-1.23), which are summarized below. For these public policy solutions to be effective, it is crucial to: (i) identify the market failure to be remedied; (ii) target resources on segments in which the effects of credit have a greater impact for the functioning of the economy; (iii) strengthen collaboration between the public and private sectors; (iv) identify the financial instrument or set of instruments that can be implemented in each situation; (v) supervise the financial terms under which the resources are provided to end users in order to prevent market distortions; (vi) guarantee that the executing agency's institutional capacity is sufficient to operationalize the intervention, and evaluate and monitor the subloans and guarantees issued; and (vii) systematically compile, manage, and maintain program data so that the results can be analyzed and continue to be used in future interventions ([18] of [optional link 3](#)).³⁰

²⁸ In 2008, the IDB created the Liquidity Program for Growth Sustainability under the category of emergency lending (document GN-2492-3).

²⁹ "Contingent Credit Line for Development Sustainability" under the Proposal to Establish a Set of Contingent Lending Instruments of the IDB (document GN-2667-2).

³⁰ A more extensive and detailed set of lessons learned is provided in section IV of the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7).

- 1.25 The Bank's lessons learned have been applied to the design of this operation, to ensure that it: (i) leverages the public sector's countercyclical role at a time when private credit is tightening; (ii) targets a sector that is one of the hardest hit by the pandemic while also strategically important to the country's economy; (iii) channels the funds through an executing agency with vast experience collaborating with the private sector to reach the sectors that are least served by the financial system; (iv) includes financial instruments for liquidity support and risk mitigation to address the two-fold issue that Honduran financial intermediaries currently face in serving the tourism sector; (v) provides for BANHPROVI supervision of the financial terms on which the resources are allocated to end-users, to avoid market distortions and ensure that there is no dilution of additionality; (vi) provides for nonreimbursable technical assistance for BANHPROVI as a new Bank loan executing agency, if necessary;³¹ and (vii) includes BANHPROVI's commitment to systematically compile, manage, and maintain program data so that the results can be analyzed and can continue to be used in future interventions.
- 1.26 **Coordination with other Bank projects.** The program is part of the Bank's support for Honduras to address needs arising from the pandemic. In addition to this program, the Government of Honduras asked the Bank to reformulate US\$50 million in portfolio operations, approved on 24 June, reallocating the funds to finance actions planned for the immediate public health response to contain the health crisis and mitigate the pandemic's impact on vulnerable households in the short term. The government also requested an Emergency Program for Macroeconomic and Fiscal Sustainability, which was approved on 8 July and whose objective is to preserve the country's macroeconomic stability through support for the policies the government is implementing to address the pandemic, ensuring the sustainability of public finances and monetary stability by strengthening the respective institutional frameworks. The program also coordinates efforts with other projects now in execution in Honduras, like the aforementioned operation 4936/BL-HO/4940/BL-HO (paragraph 1.23), which has been prioritized by the government as a tool for ensuring food security in light of the effects of the pandemic. This coordination seeks to leverage synergies to increase the impact of Bank actions, consistent with fiscal sustainability, through: (i) temporary application of the measures so that their short-term impact on the public finances is controlled; and (ii) support in financial terms for MSMEs, to ease the cost of financing and preserve jobs, thus contributing to a recovery in tax revenue.
- 1.27 **Coordination with other multilateral organizations and/or cooperation agencies.** The Bank is coordinating with CABEL, which has approved two programs to support the financial sustainability of MSMEs affected by COVID-19 in Honduras. These efforts consist of: (i) a direct loan to BCH, of which US\$100 million have been allocated to the initial capitalization of the guarantee fund for loans to MSMEs, for which BANHPROVI is the trustee; and (ii) a sovereign guaranteed loan for BANHPROVI to allocate US\$225 million to finance the recovery of MSMEs. This program complements both interventions, since it is

³¹ Through the regional technical-cooperation operation "Support to Economic Productivity and Employment in Latin America and the Caribbean in Response to the Economic Shock Caused by the COVID-19 Pandemic" (operation [ATN/OC-18036-RG](#)) (paragraph 1.27).

focused on the tourism sector or activities directly related thereto, and on providing short-term liquidity to MSMEs, while: (i) the guarantee fund supported by the CABEL loan is open to all economic sectors, and only MSMEs with the highest credit ranking in the country are eligible; and (ii) the BANHPROVI credit line will be used to finance longer-term economic recovery and does not specifically target the tourism sector. In addition, the the program's value added through the IDB's complementary technical support (technical-cooperation operation [ATN/OC-18036-RG](#), approved 9 June 2020) to strengthen BANHPROVI's institutional capacity in order to: (i) launch the guarantee fund; (ii) structure the second-tier window financial products for MSMEs affected by COVID-19; and (iii) improve monitoring and evaluation of the interventions conducted is noteworthy.

- 1.28 **Strategic alignment.** The program is consistent with the second Update to the Institutional Strategy (document AB-3190-2) and aligned with the challenges of: (i) social inclusion and equality, through an approach that combines support for MSMEs and the most vulnerable sectors; and (ii) productivity and innovation, through its support for productive financing for MSMEs. In addition, the operation is consistent with the strategic focus area of resource mobilization, through the proposed mechanisms to stimulate the mobilization of private financial sector resources for MSME finance, as well as the company shareholders' own funds. The program will contribute to the Corporate Results Framework 2020-2023 (document GN-2727-12) through the indicator of the number of micro, small, and medium-sized enterprises financed. The program is consistent with the Proposal for the IDB Group's Governance Response to the COVID-19 Pandemic Outbreak (document GN-2996) by being part of the support for safeguarding the productive fabric and employment; and it is consistent with the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7), which underscores the importance of promoting access to finance for the productive sector, as well as the Tourism Sector Framework Document (document GN-2779-7), by supporting the revival of MSMEs in the Honduran tourism sector.
- 1.29 **Gender.** Although the country does not have sufficient data on companies led or owned by women, or on their access to financing, it is estimated that: (i) 35% of MSMEs are women's, and most of these are microenterprises (83%); and (ii) at least 23% of women's enterprises in the formal sector face some kind of constraint on access to financing in Honduras ([15] of [optional link 3](#)). BANHPROVI, like the rest of the financial system, does not currently have standing mechanisms for collecting data disaggregated by gender on loans granted to MSMEs, making it difficult to analyze the participation of women's companies in key sectors like tourism. To address this problem and contribute to broader IDB Group initiatives that seek to map women's enterprises in the country,³² BANHPROVI and the Bank agreed that this program will require the financial intermediaries to report loans granted to MSMEs led or owned by women according to best practices, which will add value to the institution and the financial system to make it possible to: (i) build databases; (ii) develop baselines; and (iii) design new financial products that address the specific problems

³² Initiatives under the program "WeForLac: Women Entrepreneurs for Latin America and the Caribbean from the Women Entrepreneurs and Finance Initiative ([WeFi](#))."

confronting women entrepreneurs. The program will support BANHPROVI in gender-based information-gathering and portfolio-monitoring, in the context of the technical assistance that the Bank plans to provide to BANHPROVI through the technical cooperation operation [ATN/OC-18036-RG](#) (paragraph 1.27).

B. Objectives, components, and cost

- 1.30 **Objectives.** The general objective of this project is to support the sustainability of MSMEs as employment providers in Honduras amid the COVID-19 crisis. The program's specific objective is to support the short-term financial sustainability of MSMEs.
- 1.31 **Sole component. Support for improvement of MSME short-term financial capacity (US\$19.96 million).** Resources under this sole component will be used to help MSMEs affected by the COVID-19 crisis to overcome temporary liquidity problems and meet their commercial and financial obligations, enabling them to continue operating with financing to normalize their business cycles. This component will provide BANHPROVI with resources to: (i) fund credit advance and rediscount lines; and (ii) extend guarantees to financial intermediaries to help them provide new working capital loans to MSMEs.
- 1.32 **Beneficiaries.** Resources under this intervention will be directed to MSMEs affected by the COVID-19 crisis that are linked to the tourism sector due to their high vulnerability to the COVID-19 crisis (paragraphs 1.20 and 3.8). Approximately 1,000 MSMEs linked to the tourism sector will potentially benefit from this program.

C. Key results indicators

- 1.33 **Expected outcomes.** The program's expected impact is to support the sustainability of MSMEs amid the COVID-19 crisis, as measured by MSME employment as a percentage of total employment in the country and MSME employment in the tourism sector as a percentage of total MSME employment in the country. The outcome indicators for the program will be as follows: (i) rate of arrears in the MSME financing portfolio of the BANHPROVI financial intermediaries in the program at 15, 18, and 24 months after program start, compared with the rate of arrears in the MSME financing portfolio of the supervised financial system; and (ii) total value of the BANHPROVI MSME working capital finance portfolio.
- 1.34 **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 as a result of the program. Calculations of the aforementioned flows (discounted at a rate of 12%) yield benefits of US\$3,858,863 and an internal rate of return of 18%. In addition, the sensitivity analysis shows how the program continues to yield benefits in response to changes in the key parameters for their determination ([optional link 1](#)).

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

- 2.1 The total amount of the program proposed herein will be US\$19.96 million, financed with US\$6.98 million in Regular Ordinary Capital resources (ROC) and US\$12.97 million in Concessional Ordinary Capital (COC). The operation will be structured as a global credit loan, since it involves financial intermediation to the beneficiary MSMEs. The disbursement period will be 24 months.

Table 3. Estimated program costs (US\$ million)

Component	IDB (Total)	%
Sole component. Support for improvement of MSME short-term financial capacity.	19.96	100
Total	19.96	100

Table 4. Disbursement schedule (US\$ millions)

Source	Year 1	Year 2	Total
IDB	15.0	4.96	19.96
%	75%	25%	100%

B. Environmental and social risks

- 2.2 In accordance with directive B.13 of the Environment and Safeguards Compliance Policy (Operational Policy OP-703), this operation cannot be classified ex ante, since it involves financial intermediation. Environmental and social due diligence was conducted in accordance with directive B.13, analyzing the program's potential socioenvironmental risks, the applicable regulatory framework, and the executing agency's capacity to manage these risks. Based on the due diligence findings, and given the low risk profile of the eligible loans with program resources, this operation is regarded as low financial intermediation risk (FI-3). Given their size (maximum loan amounts of US\$100,000) and their nature (working capital and a focus on the services sector, especially tourism), the loans will be considered category "C" operations. Loans in categories "A" and "B" will be ineligible for financing.
- 2.3 Loan proceeds will not be used to finance any activities on the program exclusion list (Annex C of the IDB's Environmental and Social Management Report (ESMR)), including primary and secondary sectors, or activities that: (i) involve involuntary physical or economic resettlement; (ii) entail negative impact on indigenous groups; (iii) may cause damage to cultural sites or critical cultural sites; (iv) involve a negative impact on protected areas or RAMSAR sites; and (v) involve the use of invasive species.
- 2.4 The requirements for managing and mitigating potential environmental and social impacts will constitute an Environmental and Social Risk Administration System that will be included in the [Credit Regulations](#), which will be approved as a condition precedent to the first disbursement (see [ESMR](#)).

C. Fiduciary risks

- 2.5 The institutional capacity assessment of BANHPROVI as executing agency shows that it satisfies the necessary conditions to perform fiduciary management activities for the loan operation. The fiduciary risk has been determined to be medium, since this program will be the first that BANHPROVI executes with the Bank. To mitigate this risk, periodic working meetings will be held for program financial supervision.
- 2.6 The institutional capacity assessment of BANHPROVI evaluated its structure, organization, and processes. According the results of this analysis, BANHPROVI has sufficient institutional capacity for the financial management of the program. Likewise, BANHPROVI's staff is qualified to fulfill their duties and execute the program. The institutional capacity analysis shows that BANHPROVI does not have any shortcomings for project coordination; it should therefore be able to execute the program with solvency.

D. Other key risks and issues

- 2.7 **Public management and governance risks.** There is a medium risk that implementation of the measures included in this program will be delayed as a result of the emergency priorities managed by the government, so the resources might not reach the beneficiary MSMEs in a timely manner. To mitigate this risk, the Bank has designed the program to expedite approval processing and execute rapidly, based on its experience with the borrower and the implementation agreements reached with the executing agency.
- 2.8 **Fiscal sustainability risk.** There is a medium risk that the combination of the increased spending to address the health and economic crisis and factors like declining exports and tax revenue will significantly affect the country's fiscal and debt position, jeopardizing fiscal sustainability and damaging the country's sovereign credit rating. To mitigate this risk, the program is aligned with the support the IMF is providing to the country to prepare and monitor the implementation of post-pandemic economic and fiscal recovery plans that will help put the public finances back on a sustainable trajectory in the short and medium terms.
- 2.9 **Execution risks.** Based on the institutional capacity assessment of the executing agency, medium execution risks have been identified, related to the capacity to respond to the growing demand for credit and guarantees and the impact assessment system of BANHPROVI. To mitigate this risk, the Bank plans on providing technical assistance through operation [ATN/OC-18036-RG](#) (paragraph 1.27) in two areas: (i) building the executing agency's institutional capacity to manage the growing demand for financing that it is experiencing in the current economic situation; and (ii) strengthening BANHPROVI's monitoring and evaluation system to improve the measurement of the program's benefits as a public policy tool for safeguarding the business fabric and employment in a context of economic recovery.
- 2.10 **Sustainability.** The program is expected to contribute to mitigating temporary difficulties of access to financing faced by MSMEs as a result of the economic shock caused by COVID-19. Nonetheless, it provides the country with the opportunity to leave these public policy measures in place for the financial support of MSMEs. The demonstration effect of the interventions by

BANHPROVI is also expected to allow it to maintain the current loan and guarantee programs, as well as to develop new products to ease the vulnerability of access to finance experienced by MSMEs in Honduras.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

- 3.1 **Borrower and executing agency.** The borrower for this operation will be the Republic of Honduras, and the executing agency will be BANHPROVI. The borrower, through the Ministry of Finance (SEFIN), and the executing agency will sign a subsidiary agreement for the transfer of the loan proceeds that will specify the parties' obligations and responsibilities. This agreement, which as of July 2020 is in preparation and is slated for approval during the third quarter of the year, will ensure that SEFIN, as the borrower's representative and coordinator of the support the country receives from multilateral organizations and donors, will coordinate with BANHPROVI, as the program executing agency and the country's principal public institution for implementing programs to support financing MSMEs affected by the COVID-19 crisis. The executing agency will be responsible for the administration, execution, control, and monitoring of resources under the operation.
- 3.2 BANHPROVI is a state-owned first- and second-tier financial intermediary geared toward promoting and financing national productive development. It is a public service financial institution, deconcentrated from the BCH, of indefinite duration, with legal liability and its own assets, and administrative, budgetary, technical, and financial independence. BANHPROVI was established in 2005³³ with the mission to promote socioeconomic growth and development by financing initiatives that foster the country's competitiveness and inclusive employment. Its strategic action areas focus on production, housing, and MSME sector development.³⁴
- 3.3 BANHPROVI has an extensive track record in the national financial system acting as a second-tier bank to provide credit and guarantee lines to financial intermediaries. In the past two years, BANHPROVI has increased its loans to the MSME sector by 14%, accelerating this trend by incorporating a number of new financial products to its offering, including loan guarantees. At the end of 2019, BANHPROVI was working with 58 financial intermediaries,³⁵ accumulating a second-tier loan portfolio of US\$334 million and reaching over 10,000 end beneficiaries. The institution's assets totaled US\$440 million at the end of 2019, and it had a total portfolio of US\$404 million, 11% larger than the previous year. The portfolio is concentrated on the housing sector (66%), followed by the production sector (24%) and MSMEs (10%). The tourism sector MSME portfolio is worth US\$11 million. Total portfolio arrears at year-end 2019 were around

³³ Act of establishment in 2005 ([Decree 6-2005](#)), amended in 2014 ([Decree 358-2014](#)).

³⁴ Since 2015 BANHPROVI has been accumulating experience working with multilateral organizations to implement projects for improving MSME access to financing. The institution has executed global credit programs with CABI for US\$55 million and KfW for €17 million.

³⁵ [List of financial intermediaries](#) with which BANHPROVI works.

0.9%.³⁶ BANHPROVI is also responsible for managing several loan guarantee programs for MSMEs, totaling approximately US\$175 million ([optional link 8](#)).

- 3.4 **Execution and administration.** The borrower will transfer the loan proceeds to BANHPROVI, which, as executing agency, will extend subloans and guarantees to the eligible financial intermediaries to fulfill the program objectives, adhering to the provisions of the [Credit Regulations](#). BANHPROVI will execute the program within the framework of its existing organizational, administrative, and financial structure. Program administration and coordination will be the responsibility of BANHPROVI's risk management office.
- 3.5 The executing agency will have fiduciary responsibility for the program resources (which will be kept separate from the executing agency's ordinary resources) and will perform the following functions: (i) open an account from which to make the subloans to the financial intermediaries, so they can in turn extend credit to the MSMEs; (ii) open another account for the funds earmarked for backing the guarantees for the financial intermediaries for the new working capital loans they grant to MSMEs; (iii) prepare execution and physical/financial progress reports for the IDB; (iv) monitor compliance with environmental and social safeguards; and (v) conduct program monitoring and evaluation. The executing agency, through the risk management office and its coordination with the operations and finance offices, will also be responsible for the financial, accounting, monitoring, and evaluation aspects of program management.
- 3.6 **Implementation considerations.** Through the program, BANHPROVI will channel subloans to the financial intermediaries, who will then issue new working capital loans to MSMEs. BANHPROVI will also allocate loan proceeds to backing the issuance of new guarantees for the working capital loans extended by the financial intermediaries to the MSMEs. The working capital loans to MSMEs supported with program resources will have a maximum amount of US\$100,000 (see [optional link 9](#) for further details). With regard to the issuing, management, and repayment of subloans and the guarantees backed by loan proceeds, implementation will be based on BANHPROVI's existing operational policies and the provisions of the Credit Regulations. The financial intermediaries with which the executing agency works will comply with Bank criteria (paragraph 3.7 and the [Credit Regulations](#)) to be eligible under the program. The executing agency will primarily work with financial intermediaries that have a history of serving the MSME market segment, and in particular, significant experience and a sizeable presence in the tourism sector.
- 3.7 To be eligible, financial intermediaries will meet the following requirements: (i) be a financial institution authorized, regulated, and supervised by the Honduran financial system; (ii) comply with the country's regulatory requirements for capital, portfolio quality and provisioning, liquidity, and governance; and (iii) agree to comply with the specific requirements for being a BANHPROVI financial intermediary, including the IDB program requirements set forth in the Credit Regulations. BANHPROVI will verify that all financial intermediaries meet the above requirements, to remain eligible to receive program resources.

³⁶ See [optional link 7](#): BANHPROVI's local credit rating is AA+, granted in 2020 by the risk rating agency Zumma Ratings.

- 3.8 To be eligible, MSMEs must: (i) be incorporated under Honduran law; (ii) possess the licenses and permits required to operate under Honduran law, or be in the process of renewing them, provided they are authorized to operate at the time the subloan contract is signed; (iii) meet the requirements to qualify as an MSME in Honduras according to the country's legal definition;³⁷ (iv) be solvent and creditworthy and satisfy the credit requirements of the financial intermediaries and BANHPROVI, with the exception of any factor that has deteriorated as a result of the COVID-19 crisis; and (v) operate in the tourism sector or in associated activities according to the program eligibility criteria set forth in the [Credit Regulations](#).³⁸
- 3.9 **Credit Regulations.** The Credit Regulations describe responsibilities in the areas of administration, risk management, and coordination between the executing agency and the Bank, as well as the eligibility criteria for the financial intermediaries and the MSMEs, terms and conditions of the subloans and guarantees, tourism-related sectors that may be financed using program resources, and other parameters or restrictions governing the use of program resources. The document also includes agreements for management and monitoring, among other arrangements ([optional link 9](#)).
- 3.10 **Special contractual conditions precedent to the first disbursement of the loan proceeds.** The following will be special contractual conditions precedent to the first disbursement of the loan proceeds: (i) a subsidiary agreement has entered into force between the Ministry of Finance (SEFIN), on behalf of the borrower, and BANHPROVI, as executing agency, for the transfer of the loan proceeds and associated obligations, under the terms previously agreed upon with the Bank; and (ii) the [Credit Regulations](#) have been approved and entered into force, under the terms previously agreed upon with the Bank. These conditions are necessary to establish the structure, guidelines, and procedures to be followed by the executing agency for successful program execution.
- 3.11 **Retroactive financing.** The Bank may retroactively finance eligible expenditures incurred by the borrower prior to the loan approval date, consisting in the granting of subloans and guarantees for loans extended by the intermediary financial institutions to the MSMEs in the tourism sector under the program for up to the amount of US\$3.9 million (20% of the loan amount), provided that requirements substantially similar to those set forth in the loan contract and the [Credit Regulations](#) have been met. These expenditures will have been incurred on or after 24 March, the approval date of the new BANHPROVI provisions on COVID-19³⁹ under which the institution began to grant credit lines and guarantees to intermediary financial institutions to extend new working capital loans to MSMEs impacted by the pandemic (paragraphs 1.17 and 1.18). Even though this predates the date the project officially entered the operations pipeline (document GN-2259-1), authorization of retroactive financing as of that date, as an exception, is justified given the exceptional circumstances surrounding the

³⁷ National legal classification of MSMEs (Decree 135-2008).

³⁸ Financial intermediaries will report the MSME's economic activity to BANHPROVI in order to evaluate their eligibility under the program according to the [National Classification of Economic Activities](#).

³⁹ [Circular PE-10-2020](#) (24 March 2020).

expected impact of the crisis on the deterioration of operations of MSMEs and to help BANHPROVI continue providing rapid support to the tourism sector.

- 3.12 **Procurement.** As a demand-driven financial intermediation program, no procurement of goods, works, nonconsulting services, or consulting services is likely to be required as part of execution. No project execution plan or procurement plan is therefore included in this proposal. Any procurement of nonconsulting or consulting services required as part of program administration and/or evaluation will be conducted in accordance with the Policies for the Procurement of Goods and Works Financed by the IDB (document GN-2349-15) and the Policies for the Selection and Contracting of Consultants Financed by the IDB (document GN-2350-15), or any subsequent updates thereof. For additional details, see the Fiduciary Agreements and Requirements (Annex III).
- 3.13 **Disbursements.** For purposes of program execution, the IDB will disburse the resources under any of the modalities established in the Financial Management Guidelines for IDB-financed Projects (document OP-273-12). Disbursement requests will be accompanied by the information listed in the Credit Regulations. The resources earmarked for the program will be disbursed by the Bank to SEFIN, which will transfer them to BANHPROVI. Disbursements will be made under terms previously agreed upon with the Bank. Disbursement verification will be on an ex post basis, subject to onsite review of the subloans.
- 3.14 **Financial statements and audit.** The executing agency will submit annual audited financial reports for the program and the entity's financial statements in accordance with the terms of reference agreed upon with the Bank, within 120 days following the close of the executing agency's fiscal year. The final financial statements for the program will be delivered within 120 days after the date of the last loan disbursement. The Bank may also request additional reports when it deems such action relevant. The program's annual audited financial reports will be reviewed by an independent audit firm acceptable to the Bank. Alternatively, the program's financial audit may be done by the Office of the Auditor General of Honduras.

B. Summary of arrangements for monitoring results

- 3.15 **Monitoring.** Program execution will be monitored via semiannual progress reports prepared by the executing agency and delivered within 60 days after the close of each six-month period. The reports will use the information commitments set forth in the program's Results Matrix and the [monitoring and evaluation plan](#) as a reference, as well as compliance with the eligibility criteria set forth in the [Credit Regulations](#). This information will be reflected in the progress monitoring reports (PMR).
- 3.16 **Evaluation.** The following approaches will be used as part of the strategy for evaluating program results: (i) a reflexive evaluation, before and after the program, to determine the extent of outcomes and impacts; and (ii) a cost-benefit analysis after the program. The evaluation strategy is described in the monitoring and evaluation plan. The costs of monitoring and evaluation will be covered by the executing agency.

- 3.17 **Information for program monitoring and evaluation.** The executing agency will be responsible for maintaining data gathering and monitoring systems (see [monitoring and evaluation plan](#)). The executing agency will commit to maintain a program monitoring and evaluation system, which it will use to prepare the reports and data delivered to the Bank. For purposes of the evaluation, the executing agency will compile, store, and safeguard all of the information, indicators, and parameters necessary to prepare the project completion report, including annual plans and the final evaluation. The executing agency will bear the costs of evaluation and monitoring in all cases. The additional information required for the evaluation process will be drawn from national and international secondary sources of statistical data and, potentially, reports of relevant organizations.

Development Effectiveness Matrix		
Summary		HO-L1216
I. Corporate and Country Priorities		
1. IDB Group Strategic Priorities and CRF Indicators		
Development Challenges & Cross-cutting Themes	-Social Inclusion and Equality -Productivity and Innovation	
CRF Level 2 Indicators: IDB Group Contributions to Development Results	-Micro / small / medium enterprises financed (#)	
2. Country Development Objectives		
Country Strategy Results Matrix		
Country Program Results Matrix		The intervention is not included in the 2020 Operational Program.
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		Paragraphs 1.19 to 1.21 of the main document
II. Development Outcomes - Evaluability		Evaluable
3. Evidence-based Assessment & Solution		8.5
3.1 Program Diagnosis		2.4
3.2 Proposed Interventions or Solutions		3.6
3.3 Results Matrix Quality		2.5
4. Ex ante Economic Analysis		10.0
4.1 Program has an ERR/NPV, or key outcomes identified for CEA		3.0
4.2 Identified and Quantified Benefits and Costs		3.0
4.3 Reasonable Assumptions		1.0
4.4 Sensitivity Analysis		2.0
4.5 Consistency with results matrix		1.0
5. Monitoring and Evaluation		8.5
5.1 Monitoring Mechanisms		2.5
5.2 Evaluation Plan		6.0
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood		Medium
Identified risks have been rated for magnitude and likelihood		Yes
Mitigation measures have been identified for major risks		Yes
Mitigation measures have indicators for tracking their implementation		Yes
Environmental & social risk classification		B.13
IV. IDB's Role - Additionality		
The project relies on the use of country systems		
Fiduciary (VPC/FMP Criteria)	Yes	Financial Management: Budget, Treasury, Accounting and Reporting, External Control. Procurement: Information System, Price Comparison.
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	Yes	BANHPROVI will benefit from the RG-T3690 for the strengthening of its institutional capacity and monitoring and evaluation system.

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

The operation HO-L1216, in the amount of US\$19.96 million, is part of the Bank's operational response to the COVID-19 Pandemic, Global Credit Programs for the Protection of the Productive Sector and Employment. The general objective of the program is to support the sustainability of micro, small, and medium-sized enterprises (MSMEs) as employment providers in Honduras amid the COVID-19 crisis. The specific objective is to support the short-term financial sustainability of MSMEs.

The loan proposal presents a solid diagnosis of the problem, as well as a review of international evidence. The proposed solutions are an appropriate response to the problems identified in the proposal and their contributing factors. The results matrix is consistent with the vertical logic of the project, presenting adequate indicators at the level of outcomes and impacts. The outcome indicators are appropriately defined to measure the achievements of the project's specific objective; for some of those indicators, the baseline data will be collected after the start of the operation. The impact indicators – (i) the percentage of total MSME employment in total employment in the country, and (ii) employment in the MSMEs in the tourism sector as a percentage of total MSME employment in the country - reflect the contribution to the final objective of the operation.

The economic evaluation shows that the operation is efficient, with an internal rate of return of 18% and an NPV of US\$3.9 million. In a context of high uncertainty, the analysis considers the benefits which are derived from the reduction in sales revenue losses and a higher survival rate of firms that are beneficiaries of the program, as well as of jobs preserved in firm which survive as a result of the program.

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

INDICATIVE RESULTS MATRIX

Project objective:	The general objective of the program is to support the sustainability of micro, small, and medium-sized enterprises (MSMEs) as employment providers in Honduras amid the COVID-19 crisis. The specific objective of the program is to support the short-term financial sustainability of MSMEs.
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Expected Impact

Indicators	Unit of measure	Baseline 2020	Final target 2022	Means of verification	Comments
GENERAL OBJECTIVE: Support the sustainability of MSMEs as employment providers in Honduras amid the COVID-19 crisis					
Indicator 1: MSME employment as a percentage of total employment in the country	%	70	70	Monitoring information processed by the executing agency and the Honduran National Business Council (COHEP)	In 2019, 70% of all jobs in Honduras were at MSMEs (COHEP). The program supports the sustainability of MSMEs as employment providers in the country and contributes to the absolute and relative recovery of employment at MSMEs, returning the country to the precrisis condition observed at year-end 2019. See definition of MSMEs in the monitoring and evaluation plan .
Indicator 2: MSME employment in the tourism sector as a percentage of total MSME employment in the country	%	14.6	22	Monitoring information processed by the executing agency, Honduran Tourism Institute, COHEP, and the Honduran National Chamber of Tourism (CANATURH)	In 2019, 12.2% of all jobs in Honduras were in tourism (World Travel & Tourism Council). All told, 97.11% of tourism companies were MSMEs, with an average of 8 employees. The tourism sector accounted for 22% of MSME jobs in Honduras. In May 2020, MSMEs in Honduras recorded average job losses of 4.4% (COHEP). The first estimates for the tourism sector indicated a loss of 100,000 jobs, or approximately 40% of direct employment in the sector (CANATURH). As the sector hit hardest by the COVID-19 crisis, tourism has lost weight as an MSME employer, dropping from 22% of MSME employment in 2019 to 14.6%, according to the first estimates of job losses in the country. The baseline reflects current estimates of MSME jobs in the tourism sector as a percentage of total MSME employment. This baseline will be updated when final measurements are available for the current estimates. The support from the project should contribute to the absolute and relative recovery of employment in tourism MSMEs, returning it to the precrisis condition observed at year-end 2019.

Expected Outcomes

Indicators	Unit of measure	Baseline 2020	Final target	Means of verification	Comments
Specific objective: Support the short-term financial sustainability of MSMEs					
Indicator 1: Rate of arrears, 15 months after program start, in the MSME financing portfolio of the BANHPROVI financial intermediaries in the program versus the rate of arrears in the MSME financing portfolio of the supervised financial system	%	Baseline	Baseline	Executing agency, program monitoring information, and National Banking and Insurance Commission (CNBS)	<p>This indicator is constructed as a fraction in which the numerator is the weighted average arrears in the MSME financing portfolio of the financial intermediaries with which BANHPROVI expects to work under the program, and the denominator is the average rate of arrears in the MSME financing portfolio of the supervised financial system, which captures the percentage of balances in the MSME loan portfolio risk categories III, IV, and V. See details in the monitoring and evaluation plan.</p> <p>For 2019, the data show the weighted arrears in the MSME portfolio of the financial intermediaries with which BANHPROVI expects to work under the program to be equal to the arrears in the MSME portfolio of the entire regulated financial system (8.4%). While the implementation of grace periods and the measure to freeze the portfolio rating during the COVID-19 crisis means that arrears are artificially carried, and up-to-date data reflecting the effects of the crisis are not available, the data on company closures, the halt of economic activity, and drop in the gross domestic product (GDP) indicate that MSMEs' capacity to remain solvent is impaired. Therefore, the baseline will be calculated once the relief measures have been lifted and the necessary data for calculating it are available. It should be possible to review the baseline before the first program monitoring report. The executing agency will be responsible for gathering the data with the necessary disaggregation to update the baseline. The target for this indicator will be equal to the rate of arrears calculated for the baseline.</p>
Indicator 2: Rate of arrears, 18 months after program start, in the MSME financing portfolio of the BANHPROVI financial intermediaries in the program versus the rate of arrears in the MSME financing portfolio of the supervised financial system	%	Baseline	Baseline	Executing agency, program monitoring information, and CNBS	<p>This indicator is constructed just like indicator 1. See details in the monitoring and evaluation plan.</p> <p>The baseline will be calculated once the relief measures have been lifted and the necessary data for calculating it are available. It should be possible to review the baseline before the first program monitoring report. The target for this indicator will be equal to the rate of arrears calculated for the baseline.</p>

Indicators	Unit of measure	Baseline 2020	Final target	Means of verification	Comments
Indicator 3: Rate of arrears, 24 months after program start, in the MSME financing portfolio of the BANHPROVI financial intermediaries in the program versus the rate of arrears in the MSME financing portfolio of the supervised financial system	%	Baseline	Baseline *0.8	Executing agency, program monitoring information, and CNBS	This indicator is constructed just like indicator 1. See details in the monitoring and evaluation plan . The baseline will be calculated once the relief measures have been lifted and the necessary data for calculating it are available. It should be possible to review the baseline before the first program monitoring report. The rate of arrears should have started to recover 24 months after program start, approaching the ratio seen in 2019. The target is set as a variation of -20% over the baseline, which is assumed to be lower than what was observed in 2019 for the reasons described above.
Indicator 4: Total value of the BANHPROVI MSME working capital finance portfolio	Millions of US\$	10.550	30.510	Executing agency and program monitoring information	The BANHPROVI MSME loan portfolio reached 261,736,948 lempiras in June 2020. To calculate the baseline, the median exchange rate for June of L 24.81 per U.S. dollar, from 17 June (BCH), was used. The target reflects the sum of the current BANHPROVI portfolio and the program funds. Without the program support, the BANHPROVI portfolio for financing MSME working capital would remain at its current total amount in 2022.

Outputs

Outputs	Unit of measure	Baseline 2020	Year 1	Year 2	Final target 2022	Means of verification	Comments
Sole component: Support for improvement of MSME short-term financial capacity (TOTAL COST=US\$19.96 MILLION)							
Output 1: Amount of MSME working capital financing granted	Millions of US\$	0	15	4.96	19.96	Executing agency and program monitoring information	Includes financing with credit and guarantee instruments.
Monitoring indicator 1: Amount of financing issued to women's MSMEs for financing working capital	Millions of US\$	0				Executing agency and program monitoring information	Gender monitoring. Women's MSMEs will be understood to be companies led or owned by women; with over 50% of the capital stock held by women; or at least 25% of the capital stock held by women and at least one woman in a decision-making position.
Monitoring indicator 2: Number of loans or guarantees issued to women's MSMEs for financing working capital	Number of loans or guarantees	0				Executing agency and program monitoring information	Gender monitoring. Women's MSMEs will be understood to be companies led or owned by women; with over 50% of the capital stock held by women; or at least 25% of the capital stock held by women and at least one woman in a decision-making position.
Annual cost:	Millions of US\$	0	15	4.96	19.96		

Country: Honduras **Sector:** CMF **Project number:** HO-L1216 **Year:** 2020
Cofinancing: N/A. **Coexecution:** N/A.

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Executing agency: Banco Hondureño para la Producción y la Vivienda (BANHPROVI).

Project name: Global Credit Program for Safeguarding the Productive Fabric and Employment.

I. THE EXECUTING AGENCY'S FIDUCIARY CONTEXT

1. Use of country systems in the project¹

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

Applicable laws/regulations for the executing agency: Government Procurement Act and its regulations for matters regarding the dissemination of procurement processes and purchasing via electronic catalog/framework agreements, and the Budget Act. BANHPROVI was created by Decree-Law 6-2005, on 26 January 2005.

2. Fiduciary capacity of the executing agency

The fiduciary capacity was evaluated using the Institutional Capacity Assessment Platform (ICAP) (simplified and virtual), concluding that financial management and project coordination is adequate for the management of the operation. As a global credit program, no procurement is envisaged. Therefore, no analysis of procurement capacity was carried out. The executing agency is a first- and second-tier credit institution, deconcentrated from the Central Bank of Honduras, as a public service institution with an indefinite term, independent legal status, its own assets, and administrative, budgetary, technical, and financial independence. It has experience executing other trust funds, including programs by multilaterals, however, it has not executed loan programs with the Bank.

3. Fiduciary risks and mitigation actions

Fiduciary risk: High ☐; Medium ☒; Low ☐

Risk	Risk level (Medium/High)	Mitigation plan
No significant fiduciary risks were identified.	Medium	Despite having a medium risk according to the ICAP, due to a lack of experience working with the Bank, it has a structure and instruments capable of satisfactorily implementing the program.

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

II. CONSIDERATIONS FOR THE SPECIAL PROVISIONS OF THE CONTRACT

Conditions precedent to the first disbursement: There are no conditions of a fiduciary nature.
Exchange rate: For rendering of accounts, the exchange rate on the effective date of the establishment of the respective guarantee for the intermediary financial institution will be used.
Audited program financial statements: The executing agency will submit audited annual financial reports for the program and financial statements for the entity in accordance with the terms of reference agreed upon with the Bank, within 120 days following the close of the executing agency's fiscal year. The final financial statements for the program will be delivered within 120 days after the date of the last loan disbursement. The program's annual audited financial reports will be reviewed by an independent audit firm acceptable to the Bank. The Bank may also request additional reports when it deems such action relevant.
Prohibited practices: In the agreements between the executing agency and its financial intermediaries, and the other contracts financed with Bank resources, the due clauses regarding the Bank's prohibited practices will be included.

III. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

Exceptions to policies and guidelines:

<ul style="list-style-type: none"> No exceptions anticipated. 	
Retroactive financing and/or advanced procurement	<ul style="list-style-type: none"> The Bank may retroactively finance eligible expenditures incurred by the borrower prior to the loan approval date, consisting in the granting of subloans and guarantees for loans extended by the intermediary financial institutions to the MSMEs in the tourism sector under the program for up to the amount of US\$3.9 million (20% of the loan amount), provided that requirements substantially similar to those set forth in the loan contract and the Credit Regulations have been met. These expenditures must have been incurred on or after 24 March, the approval date of the new BANHPROVI provisions on COVID-19² under which the institution began to grant credit lines and guarantees to intermediary financial institutions to extend new working capital loans to MSMEs impacted by the pandemic (paragraphs 1.17 and 1.18 of the main document). Even though this predates the date the project officially entered the operations pipeline (document GN-2259-1), authorization of retroactive financing as of that date, as an exception, is justified given the exceptional circumstances surrounding the expected impact of the crisis on the deterioration of operations of MSMEs and to help BANHPROVI continue providing rapid support to the tourism sector.
Supplementary procurement support	<ul style="list-style-type: none"> N/A.
Alternative procurement arrangements	<ul style="list-style-type: none"> N/A.

² [Circular PE-10-2020](#) (24 March 2020).

Projects with financial intermediaries	<ul style="list-style-type: none"> As this loan is for global credit programs and other operations in which resources are provided to financial intermediaries that will in turn issue subloans or resources via other onlending modalities, it will be stipulated that the Bank's prohibited practices clauses are to be included in the agreements between the borrower, its financial intermediaries, and between the financial intermediaries and the MSMEs. Alternatively, if the effective inclusion of these clauses in the aforementioned contracts is not possible or practical in view of the program's circumstances, the project team may examine other mechanisms to adopt acceptable controls and duly bind the relevant third parties to the Sanctions Procedures. These mechanisms, the design of which will be coordinated with the Office of Institutional Integrity (OII), with support from the Legal Department, will be spelled out in the Credit Regulations.
Procurement agents	<ul style="list-style-type: none"> N/A.
Direct contracting	<ul style="list-style-type: none"> N/A.

Operating expenses will be financed: <input type="checkbox"/> N/A.	Domestic preference: <input type="checkbox"/> N/A.
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General supervision methods for project procurement: N/A.
Supervision method: N/A. For: N/A.

Country thresholds: www.iadb.org/procurement

IV. FINANCIAL MANAGEMENT AGREEMENTS AND REQUIREMENTS

Programming and budget	<ul style="list-style-type: none"> BANHPROVI is an autonomous and independent entity that generates its own resources and manages the resources it administers based on periodic programming, which is based on the scope of the funds it administers and an analysis of the demand for such funds. Periodically, the Ministry of Finance (SEFIN) will transfer the resources that BANHPROVI expects to cover its financial needs from multilateral or other external sources of financing contracted by the country.
Cash and disbursement management	<ul style="list-style-type: none"> Disbursements will be made in the form of advances of funds and reimbursements. Disbursements will be made upon the electronic submission of disbursement requests through the e-disbursement system. If this method cannot be used, during the COVID-19 health emergency, the submission of disbursement request forms signed and scanned via email, sent from an institutional email address with each signing party authorizing the request via email, will be permitted. Bank account: BANHPROVI will receive disbursements from the Bank in a designated account at the Central Bank of Honduras for exclusive program use. Financial plan: Advances will be made for a period of up to six months, depending on the demand for loans.

	<ul style="list-style-type: none"> • Justification of expenditures: Given the complexities specific to the operation entailing coordination with multiple institutions, as well as a post-pandemic context causing delays in administrative and operational procedures, an agreement was reached to set a lower percentage for justification of advanced balances of 70% for the executing agency. • Project cash flow: The funds are disbursed to BANHPROVI in the bank account opened for the program, upon prior approval by SEFIN.
Accounting, information systems, and reporting	<ul style="list-style-type: none"> • Specific accounting standards: The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). • Reports for rendering of accounts: Statement of Cash and Disbursements Made and Statement of Cumulative Investments, prepared on the basis of accounting information taken from the institution's systems. • Accounting method and currency: Accounts will be kept on an accrual basis, but the program's financial reports will be prepared on a cash basis, in U.S. dollars.
External control	<ul style="list-style-type: none"> • With the agreement of the Bank, the executing agency will select and contract the services of an eligible auditor, in accordance with the terms of reference agreed upon with the Bank. Alternatively, the program's financial audit may be done by the Office of the Auditor General of Honduras.
Financial supervision of the project	<ul style="list-style-type: none"> • Financial supervision will be conducted by means of working meetings and the review of reports and audited financial statements, or by another supervision method determined by the Bank.

V. RELEVANT INFORMATION FOR THE OPERATION

Policies and guidelines applicable to the operation

Financial management	Procurement
<ul style="list-style-type: none"> • Document GN-2811 [OP-273-12] 	<ul style="list-style-type: none"> • Document GN-2349-15 • Document GN-2350-15

Records and files

BANHPROVI has physical files, as well as procedures and instructions allowing appropriate records and files to be kept.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/20

Honduras. Loan ____/BL- HO to the Republic of Honduras
Global Credit Program for Safeguarding the Productive
Fabric and Employment

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of Honduras, as Borrower, for the purpose of granting it a financing to cooperate in the execution of "Global Credit Program for Safeguarding the Productive Fabric and Employment". Such financing will be chargeable to the Bank's Ordinary Capital (OC) resources in the following manner: (i) up to the amount of US\$12,974,000, subject to concessional financial terms and conditions ("Concessional OC"); and (ii) up to the amount of US\$6,986,000, subject to financial terms and conditions applicable to loan operations financed from the Bank's regular program of OC resources ("Regular OC"), as indicated in the Project Summary of the Loan Proposal, and subject to the Special Contractual Conditions of said Project Summary.

(Adopted on ____ 2020)