MULTISECTOR GLOBAL CREDIT PROGRAM

(BR-0155)

EXECUTIVE SUMMARY

BORROWER:	Banco Nacional de Desenvolvimento Econômico e Social [National Bank for Economic and Social Development] (BNDES)
GUARANTOR:	The Federative Republic of Brazil
EXECUTING AGENCY:	Banco Nacional de Desenvolvimento Econômico e Social [National Bank for Economic and Social Development] (BNDES)

AMOUNT AND SOURCE:

IDB:	US$300 million (OC)
Local counterpart funding:	US$300 million
Total:	US$600 million

FINANCIAL TERMS AND CONDITIONS:

Amortization period:	20 years
Disbursement period:	4 years
Interest rate:	variable
Inspection and supervision:	1%
Credit fee:	0.75%

OBJECTIVES: The objectives of the program are to support: (i) the development and modernization of the Brazilian productive sector by providing financing to private enterprises on internationally competitive financial conditions as to both terms and costs; and (ii) concomitantly, a shift of the financial system toward the development of medium- and long-term commercial and investment credit in a setting of low inflation.

DESCRIPTION: The proposed operation would consist of a loan of US$300 million for the financing of a program of medium- and long-term credit to Brazilian private enterprises for modernization and expansion projects that meet the requirements for technical, financial-economic, legal, and environmental viability of the program. All the program resources will be channeled by BNDES through intermediary financial institutions (IFIs) found eligible under criteria agreed upon with the IDB, which will use those resources to make loans to finance the acquisition, installation and startup of capital goods. Since much of the lending business of most of the IFIs working with BNDES is done with small and medium-sized enterprises (SMEs) (in sub-loans of under US$3 million), the program will

contribute to the expansion and conversion of this category of enterprises. Thus the program continues the effort begun in 1990 with a previous loan (602/OC-BR), made to lay a foundation for the development of the medium- and long-term credit market, focusing this time almost exclusively on SMEs.

COFINANCING: The Export-Import Bank of Japan (JEXIMBANK) has expressed interest in cofinancing the operation in an amount of up to US$300 million; negotiations are already well advanced, and the operation is expected to be concluded shortly.

JUSTIFICATION: With the macro-financial shift taking place in Brazil under the *Plano Real*, the country is only just beginning to build up an adequate supply of medium- and long-term private funds in the financial system. Several alternatives have been considered (multisector global credit, an IDB guarantee to BNDES, an IDB contingent (standby) credit line to back commercial paper placed at medium and long term on the capital market, and credit guarantee funds), and it has been concluded that, in the present circumstances, multisector global credit is the most appropriate tool for dealing with the lack of medium- and long-term financing in the Brazilian financial system, and particularly for the SMEs.

Channeling funds of the program through the IFIs in the BNDES system will make it possible to contribute to the development of sound bank portfolio management practices at a time when there is a recognized need to strengthen such management in the commercial banks as they make the macrofinancial transition to a market in which lending is the principal mode of operation.

The choice of BNDES as the executing agency of the program was based on the following considerations: (i) the possibility of channeling all the financing through the IFIs associated with BNDES in the form of loans with low limits which will generate a capillary flow of those resources through the banking system and make them more accessible to SMEs, and (ii) the successful results of the previous operation (602/OC-BR), which demonstrated the capacity of BNDES as executing agency for programs of this type and its particular aptitude for service to SMEs through the IFIs (56% of the resources involved operations carried out through IFIs; 55% went to SMEs).

ENVIRONMENTAL CLASSIFICATION: The Environment Committee, at its meeting of July 18, 1995, classified this as a Category III operation. The environmental report was approved with recommendations at the meeting of October 16, 1995.

The previous operation had included a mechanism for the environmental quality control of subprojects on the basis of the environmental standards of the Comissão Nacional do Meio Ambiente [National Environment Commission] (CONAMA). This mechanism has functioned satisfactorily, on the whole, and would be retained without major changes in the new program. However, it has been agreed with BNDES that certain measures will be taken to strengthen its environmental controls and thereby guarantee the environmental quality of projects.

IMPACT ON POVERTY: Since the purpose of the program is to finance private investment in several productive sectors, it does not satisfy any of the criteria established in the Eight General Increase in Resources which would enable it to be classified as poverty-targeted.

BENEFITS: The program would provide the private sector with long-term funds for investment to modernize productive operations, reduce its costs and make it more competitive. In addition, the proposed credit line would continue the effort begun in the previous loan to lay the foundations for development of the medium- and long-term credit market, with emphasis on the development of portfolios for SMEs.

RISKS: Brazil has made major strides in the reform and stabilization of the economy, especially since implementation of the *Plano Real*. In these circumstances, there are two risks to be mentioned: (i) the macroeconomic risk of difficulties arising to hinder the permanent solution of the fiscal problems; and (ii) the adaptability of the credit system to operate in conditions of lower inflation. In the former case, the prospects for a successful outcome to the *Plano Real* are good, and the fiscal situation will be under control if its present management continues. In the latter, it must be pointed out that the program tends to mitigate the risk by operating as a catalyst for sound practices during the transition by requiring the rigorous application of procedures for the selection and monitoring both of portfolios and of participating IFIs, and also by making available to the IFIs long-term resources that will permit a more balanced development of their credit portfolios.

THE BANK'S COUNTRY AND SECTOR STRATEGY:

The proposed program is consistent with the financing strategy and priorities agreed upon by the Bank and the Brazilian authorities, particularly with regard to the objective of enhancing productive capacity, reducing production and distribution costs, and speeding up the development of the domestic market for medium- and long-term credit. Another important objective is that of strengthening the role of the State-owned banks as second-tier institutions and, in particular, to increase IFI financing to SMEs.

SPECIAL CONTRACTUAL CONDITIONS:

Prior to the first disbursement, the borrower will present evidence that:

a. the program's Credit Regulations are in force and include (i) the conditions and parameters for the eligibility of IFIs and subborrowers, and their contractual relationships with BNDES; (ii) formulas to ensure access for SMEs to the program, including the requirement that the program resources be used in subloans of amounts not to exceed US$3 million in local currency; (iii) a provision that the finance charges to be paid by the IFIs will be calculated on the basis of the interest rate called the long-term interest rate [taxa de juros de longo prazo] (TJLP), adjustable quarterly, plus an onlending fee of up to 4.5% and, for the subborrowers, an additional onlending fee of up to 2% owing to the constitutional limitation of 12% on interest rates, though IFIs would also be free to charge other commissions; and (iv) mechanisms for the monitoring of IFIs and operations under the program by BNDES and for bank supervision by the Central Bank of Brazil (BACEN); and

b. the necessary steps have been taken to comply with the recommendations made by the Bank's Environment Committee when approving the environmental summary on the operation.

I. FRAME OF REFERENCE

A. Macroeconomic context

1.1 For several decades Brazil had one of the highest national economic growth rates in the world, until recession and inflation set in and the investment ratio began to fall in the early 1980s, leading to a decline in industrial productivity (3.5% in the 1950s, 2.5% in the 1960s and 1970s, and only 1% in the 1980s) and therewith in the economy's general competitiveness.

1.2 The economic measures of the 1980s failed to contain the inflationary spiral, particularly because there was no rein on the fiscal deficit. Both orthodox and experimental approaches (the *Plano Cruzado* and the *Plano Collor*) failed to produce the hoped-for results. At the beginning of the 1990s inflation reached 84% a month.

1.3 This process was reversed in the 1993-1994 biennium when, under a new economic strategy, GDP grew approximately 10%. Similarly, the investment ratio recovered, and unemployment contracted, for the first time in several years, to 5.3% in 1994 and 4.5% so far in 1995. The improvement in the goods and services sector coincided with a significant drop in the rate of inflation to 35% in the year ending in June 1995.

1.4 This surprising shift in the economic situation was the result of two complementary sets of economic policies. Firstly, the structural reforms begun in the early 1990s, which included reforms in the public sector, economic integration and a more open economy, the effects of which began to be felt in the 1990s with advances in productivity and competitiveness, an important result of which was a growth in exports. And secondly, the launching of the *Plano Real* in 1994, which brought a new approach in national economic policy to eliminate the causes of chronic inflation and its adverse effects on investment, capital markets, and income distribution. 1/

1/ The *Plano Real* is essentially a stabilization program in three stages. The opening stage was to balance the federal budget. The main idea was to avoid financing public expenditures with the effects of inflation. Traditionally, the federal budget had been approved with a sizable nominal deficit. The real situation was quite different, however: expenditures remained fixed in nominal terms while taxes were pegged to the price index. The fact was that inflation helped balance the budget. To this impact of inflation was added the more traditional one of the inflation tax. The second stage consisted in the introduction, in March 1994, of a stable unit of account, the Unidade Real de Valor (URV) with a maximum exchange parity of R$1 (real) = US$1 applicable to all contracts in the economy, which had no indexing clause. The third stage converted, on July 1, 1994, the URV into the new unit of currency called the <u>real</u> (R$) with a maximum parity of R$1 = US$1, with which contracts in URVs acquired a fixed value in nominal terms.

1.5 Under the *Plano Real* public revenues rose substantially in real terms with the increase of economic activity; efforts were made to control evasion by strengthening tax administration; a tax on financial transactions was introduced; 20% of fiscal expenditures were sterilized by setting up the Fondo Social de Emergência [Emergency Social Fund] (FSE), which reduced transfers of revenue to states (17.2% and 14.1% of federal revenues in 1993 and 1994, respectively); and contributions to social security increased. The increase in revenue proved enough to keep the budget in overall balance despite a rise in expenditures, which occurred in spite of the delay in approving the budget. This delay enabled the Executive Branch to hold those expenditures to the levels of the previous year for part of the year.

1.6 The current monetary policy is restrictive as a rein on liquidity, for which it resorts to limitations on expansion of the monetary base. Starting in July 1994 the Central Bank (BACEN) has taken several measures to control credit and monetary aggregates to reduce consumption and promote savings. In addition, it has limited trading in commercial paper by banks and prohibited the use of postdated checks.

1.7 More recently, the government stopped indexing wages to eliminate its negative effects on inflation. Despite the gains made, consolidation of the government's program remains dependent on implementation of the institutional changes presented to the Congress, which remove the structural causes of the fiscal deficit.

1.8 The administration that took office on January 1, 1995, placed great emphasis on continuation of the *Plano Real*. It placed even greater emphasis on the reform and modernization of the public sector, on opening up the economy to international competition, and on consequent modernization of the productive sectors. The proposed program would support the government in the accomplishment of those objectives.

B. The economic/financial context

1. The banking system

1.9 The Brazilian banking system consists of federal banks (Banco do Brasil, BNDES, and Caixa Econômica); three regional banks (Banco da Amazônia, Banco do Nordeste, and Banco Meridional), 27 state banks, and some 260 private-sector banks (209 multiple-service banks, 35 commercial banks, and 16 investment banks). The federal and state banks handle the accounts of government at their respective levels and provide banking services in rural areas and to low-income customers, and marginally remunerative services. BNDES is the only source of medium- and long-term funds on the market, and provides them through its network of associated intermediary financial institutions (IFIs). The state banks typically financed their respective state and local governments until 1993, when Law 1996 was approved putting an end to the practice. The private banks are under tightly concentrated ownership and operate as

multibanks, grouping all their financial business under a holding company or in segments. Through subsidiaries they engage in leasing and underwriting operations, trade securities, and manage funds. Their banking operations are currently concentrated in short-term consumer credit, mortgage loans under the Federal Housing System, and other short-term activities such as the arbitrage of public securities. There is also a subsector of foreign banks (CITIBANK, Bank of Boston, Lloyds Bank) which operate on an equal footing with the Brazilian banks.

2. <u>Credit supply and demand</u>

1.10 Historically, as a result of high rates of inflation, the monetary demand in Brazil had declined significantly, and was replaced by highly liquid assets (near money). Bank deposits and loans were made at progressively shorter terms. As a result, bank financing to the private sector became virtually nonexistent. With the persistence of inflation and the impossibility of attracting funds for more than 30 days, banks made very few loans, all at very short term.

1.11 Despite the gains of the *Plano Real*, which partly reactivated the supply of credit to the private sector, that supply is still available largely at short term. This is because of the persistence of uncertainties about the performance of the economy in the macro-financial sphere and because of the lack of success so far in significantly lengthening the terms of deposits. The IFIs attract funds for financing loans using short-term instruments such as fixed-term and interbank deposits (bank deposit certificates [CDB] and interbank deposit certificates [CDI]) and non-interest-bearing demand deposits (current accounts). The term of financing from these sources is, for the most part, one month, and the IFIs continue to operate with loans at very short term. The lack of medium- and long-term credit to finance a growing demand for enterprise modernization and expansion is forcing those enterprises to rely on internal funds or short-term credit, which increases the funding risk. Similarly, the great majority of the financing for expansion or conversion of the productive capacity of large enterprises is accomplished with retained earnings and/or private international placements.

1.12 For the reasons considered, a significant increase in the availability of medium- and long-term resources in the financial system to meet the demand for expansion of productive capacity and/or improved utilization of the existing capacity is not feasible in the very near future. In fact, the only significant source today of such financing is the funds intermediated by the IFIs of the BNDES system. In 1994 those funds accounted for 5% of gross capital formation in the country.

1.13 As a result of the gains in fiscal adjustment and inflation reduction accomplished by the *Plano Real*, the basic issue now facing Brazilian private banks is the transition from banking centered on the arbitraging of public securities through management of the daily float to banking for the provision of credit with earnings mainly from the intermediation spread between deposits and

loans made. In this setting great importance attaches to measures that support the financial system's transition to the development of medium- and long-term commercial and investment credit and reduce the emphasis on expansion of consumer credit. The credit discipline built into the proposed operation would support that transition to a system operating in a setting of low inflation.

3. The regulatory system

1.14 The Brazilian financial system's regulatory structure is headed by the Conselho Monetário Nacional [National Monetary Council] (CMN), whose members are ministers, directors of the Central Bank, and the Chairman of the Comissão Nacional de Valores Mobiliários [National Securities Commission] (CVM). The Central Bank regulates the banking system, supervises it through on-site inspections (there are about 600 inspectors to visit banks, especially those with problems), and monitors the information provided by the banks. The performance standards of the system are based on a set of criteria known as the CAMEL system (capital, asset quality, management, earnings, and liability structure), on the basis of which institutions are rated by categories and on the quality of their performance and financial situation. The CVM regulates and supervises the securities market, the Superintendencia de Seguros Privados [Superintendency of Private Insurance] (SUSEP); the Institutos de Resseguros do Brasil [Reinsurance Boards] (IRB) regulate and supervise insurance companies, and the Ministry of Planning has similar functions on the mortgage market.

1.15 In August 1994 the CMN adopted Resolution 2099 approving the standards on financing and capitalization that have governed the banking system since April 1995, following those established by the Basel Agreement and so conforming to international standards on liquidity and solvency. 2/ The standards are applied to multibanks and to commercial, investment, and development banks, to mortgage banks, and to commercial leasing, credit, finance, and

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2/ The resolution has four annexes. Annex I contains the rules for the operation, transfer, and reorganization of financial institutions. Annex II establishes the minimum requirements of paid-in capital and net worth. Annex III has the rules for the conduct, installation, and operation of the financial institutions licensed by BACEN. Annex IV lays down the new rules for determining the net worth adjusted for the degree of risk of the asset structure of each institution, introducing the standard of a minimum of 8% of total assets, weighted by risk. The risk weights are as follows: Brazilian government bonds, 0%; advances to brokers and home mortgages, 20%; state government bonds, 50%; and loans and other assets, 100% provisioning. For loans past due for more than 60 days reserves must be set aside as follows: loans fully guaranteed, 20%; partially guaranteed, 50%; unguaranteed, 100%. Partially and fully guaranteed loans past due for more than a year require 100% provisioning.

investment companies. 3/ From the prudential and regulatory standpoint, and particularly in the context of the structure of incentives in existence down to the advent of the *Plano Real*, the Brazilian banking system (apart from poorly managed state banks) may be described as profitable, technologically sophisticated, and capable of rapid adaptation.

4. Small and medium-sized enterprises

1.16 The market deficiencies reflected in a dearth of long-term financing in the financial system affect primarily SMEs. SMEs constitute a very important part of the country's industrial apparatus, and as such have an essential role to play in the strategy for industrial modernization. 4/ Hence their problems must be seen to if the Brazilian government's goal of opening markets is to be attained. What is more, the government regards subcontracting arrangements, 5/ of which SMEs are the cornerstone, as a priority for the country's development. For this reason it has assigned highest priority to the upgrading of their productive plant through appropriate provision of medium- and long-term financing. The Bank's strategy as set forth in the country paper concurs with that priority.

3/ BACEN has determined that some 22 banks did not comply within the established deadline, and required them to present plans for increases in capital. In this process some major banks were taken over, and plans for their restructuring, rescaling, or takeover by other institutions are in progress. For example, Banco Econômico was taken over by BACEN, has been evaluated by the Swiss Bank Corp., and plans are moving forward for its rescaling and sale.

4/ In Brazil there are 3.5 million commercial, industrial, and service enterprises. Less than 1% employ more than 500 persons; 1% are medium-sized enterprises employing 100 to 500 persons; and the remaining 99% are microenterprises and small businesses. Small and medium-sized enterprises employ 79% of the labor force (30 million persons), provide 42% of the wages paid, and represent 75% of sales and 30% of GDP. Source: UNDP and BNDES, *As Micro, Pequenas e Medias Empresas*, No. 17, 1995.

5/ The Brazilian term "terceirização" (outsourcing) refers to the process whereby major industrial enterprises seek to improve their efficiency by subcontracting the provision of intermediate goods and services to small and medium-sized enterprises.

II. THE PROGRAM

A. Objectives and strategy

2.1 The objectives of the program are to support: (i) the development and modernization of the Brazilian productive sector by providing financing to private enterprises on internationally competitive financial conditions as to both terms and cost; and (ii) a shift of the financial system toward the development of medium- and long-term commercial and investment credit in a setting of low inflation.

B. Description

2.2 The proposed operation would consist in the provision of a loan of US$300 million from the IDB currency pool for the financing of a program of US$600 million in medium- and long-term credit to Brazilian private enterprises for modernization and expansion projects that meet the technical, financial-economic, legal, and environmental feasibility requirements of the program.

2.3 All the resources will be channeled by Banco Nacional de Desenvolvimento Econômico e Social [National Economic and Social Development Bank] (BNDES) (as a second-tier institution) through the eligible IFIs subject to the criteria laid down in the Credit Regulations of the program. 6/ The program resources will be used to finance capital goods (and associated working capital) needed for the execution of projects for the modernization, expansion, and diversification of production in the country's private sector. Since the credit activities of the IFIs are done almost entirely with small and medium-sized enterprises (which constitute about 90% of their customers), the program will operate with subloans whose ceiling amount (US$3 million) 7/ makes them particularly suited to meet the financing needs of projects for the expansion or restructuring of enterprises of this kind.

6/ The BNDES system currently has a network of more than 200 eligible financial agencies. The active participants in the program are expected to be private commercial and investment banks, the former because of their extensive network of agencies throughout the country, and the latter for their experience in granting medium- and long-term loans. Regional and state development banks would participate to a very limited degree because: (i) their indebtedness to BNDES is generally high; and (ii) in many cases their access would be restricted by their low performance levels.

7/ The BNDES definition describes the SMEs as enterprises with annual sales in Brazilian reais equivalent to less than US$15 million. The financial analysis of the debt servicing capacity of SMEs in Brazil currently indicates that only in exceptional cases could loans of more than US$3 million be allowed.

2.4 The resources will be channeled through IFIs for the dual purpose of: (i) encouraging the development of medium- and long-term credit intermediated through the commercial banks; and (ii) ensuring the participation of SMEs in the use of the program's resources by making them available through IFIs. This strategy is consistent with the present division of operational spheres established in BNDES, which generally only makes direct loans to large enterprises, and leaves to the financial agencies the responsibility of channeling resources to smaller private enterprises.

C. Justification of the approach adopted for the program

2.5 The choice of multisector credit to address the problem of lack of medium- and long-term financing in the Brazilian financial system is based on the following arguments. Firstly, channeling funds of the proposed program through the IFIs of the BNDES system will make it possible to go on contributing to the building of a banking system in close touch with the activities of analysis, financing, and support of productive sectors. The importance of this is enhanced both by the approach of the program as a catalyst for the development of medium- and long-term credit and by the development of sound portfolio management practices at a time when there is recognition of the need to strengthen that management in the commercial banks in their macrofinancial shift from a market that emphasized float management to one in which the making of loans is the principal modus operandi.

2.6 Secondly, other schemes for encouraging the supply of medium- and long-term credit pose substantial problems as a quick and effective response: (i) the effectiveness of a backup facility 8/ would be seriously compromised in the short term by a lack both of resources and of mechanisms for placement at medium and long term on the Brazilian capital market, which is no impediment to pursuing their development in the future; (ii) the provision of IDB guarantees in support of BNDES operations to obtain external resources directly, though conceptually valid, is unacceptable to BNDES, which considers that its future international funding operations would be "contaminated"; and (iii) credit guarantee funds would come too late (and only complement the proposed operation) in that they would not in themselves cover the immediate scarcity of medium- and long-term funds that prompted the Government of Brazil's request for the proposed operation. Lastly, while other operations are under consideration or have been approved, such as the one for technological support and training (880/OC-BR), their specificity makes them less useful than multisector credit for responding promptly to the level and quality

8/ A stand-by facility provided to back up medium- and long-term commercial paper on the capital market issued either by IFIs for reinvestment of the proceeds or directly by enterprises to obtain financing for their projects.

of the demand for long-term credit funds existing in the country in the present macrofinancial conditions.

2.7 In addition, the choice of BNDES as executing agency is prompted by factors of particular significance including: (i) the possibility of channeling the entire financing through the BNDES system would make it possible to cover almost the full spectrum of demand through the eligible IFIs in loans of relatively small amounts, which would make for a highly capillary flow of the funds through the private banking system; (ii) the possibility of ensuring that the resources are allocated pursuant to market criteria, transparently, without subsidies, and guaranteeing their proper administration and supervision; 9/ (iii) the successful results of the previous operation (602/OC-BR) demonstrated the capability of BNDES as an executing agency for programs of this kind; and (iv) during the execution of program 602/OC-BR, BNDES took several measures for its institutional improvement, such as setting up a single credit committee, adopting an enterprise rating system, 10/ analyzing the long-range entrepreneurial strategies of the principal customers, performing sector studies, and developing indicators of competitiveness with a view to a comprehensive credit policy for evaluation of the risk of a loan in relation both to the enterprise and to the sector in which it operates.

D. The setting of interest rates

2.8 Despite the success already scored by the *Plano Real* in terms of economic stabilization and reactivation, it has not yet been possible to strengthen the meager capacity of the financial market to mobilize medium- and long-term resources because short-term speculation continues to prevail in funding activity. However, the measures taken by the monetary authorities are gradually rectifying the structure of terms and conditions of financial transactions. Moreover, containment of inflation has restored some confidence to savers. Similarly, consolidating the control of monetary policy in BACEN and raising the legal reserve requirements on deposits at very short term are encouraging banks to take deposits at gradually longer terms.

2.9 In the opening stage of consolidation of fiscal equilibrium, the effects of the *Plano Real* on the remonetization of the economy, accompanied by increased preference for liquid assets, compelled

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9/ The assurance that this aspect will be properly covered in the program stems from the design, during the analysis, of mechanisms for the determination of IFI eligibility, portfolio evaluation and monitoring, and the setting of interest rates that avert distortions and cover the funding costs of the financial institutions involved.

10/ The term "enterprise" includes both financial (IFI) and nonfinancial enterprises.

the monetary authorities to keep real interest rates high. In these circumstances, the reference interest rate (TR) 11/ was out of step with the rate of inflation, a condition incompatible with the long-term financing of productive projects in an economy more open to commercial and financial flows from abroad.

2.10 In December 1994, the TR was replaced by the long-term interest rate (TJLP) as the reference rate for long-term credit operations. In the absence of a market-determined medium- and long-term yield curve, the monetary authorities designed the TJLP as a proxy for the cost of long-term financing based on the yields and terms of the domestic and foreign government debt. 12/ This variable rate is calculated as a weighted arithmetical mean of the return on long-term certificates of external public debt (TDE) and certificates of domestic public debt (TDI), with weights of 75% and 25%, respectively. The return on the TDE is calculated as the mean of the internal rate of return of external certificates under the "Responsibility of the Federal Government" (Responsabilidade da União) weighted by the outstanding balances and average terms of more than two years. The value of TDEs is tied to the market value of each certificate and to the performance of the London Interbank Offered Rate (LIBOR). In the absence of a major secondary market for TDIs, as a reference their cost used the yield weighted by the volume of the issue and the days of the term that have passed, of the type D (US$) and H Treasury Notes (NDT) with maturities of at least six months; the return on dollar Treasury Notes (NDT-D) is tied to changes in the U.S. dollar and that of local-currency Treasury Notes (NDT-H) is pegged to the TR.

2.11 The information obtained on the TJLP points to a positive performance in real terms (above 12% including the onlending charges of BNDES and the IFIs). Moreover, this rate is consistent with movements on the market as evidenced by the government's NDT placements and, as a result of the way it is calculated, is also consistent with the medium-term movement of funding costs. While the TJLP appears to be nominally lower than the TR, the total financial cost of a loan based on the TJLP is higher owing to the method by which it is applied, which provides for the capitalization of a high percentage of the accrued interest (TJLP -6%). The calculations done show that in a 5-year loan

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11/ The TR was calculated as the mean of the rates paid by the leading Brazilian banks on 30-day bank certificates of deposit.

12/ The supply of long-term credit in Brazil is inelastic beyond a given term, which prevents the plotting of a curve for medium- and long-term yields, that is, the curve becomes vertical for maturities of more than one year. Moreover, the need for "matching" with sources of funding puts this intermediation beyond the reach of the IFIs. For example, in a recent international placement, BRADESCO, the largest private bank in Brazil, could obtain terms of only 210 days.

operation including a 4-year grace period, at current interest rates the total financial cost at the end of the period at the TJLP would prove higher for an IFI than that of applying a TR without capitalization (see Table II-1).

TABLE II-1
COMPARISON OF EFFECTIVE FINANCIAL COSTS
OF FINANCING FOR IFIs
TJLP BASIS VS TR BASIS

Loan 1/	YEAR 1	2	3	4	5	TOTAL PAYMENTS (YEARS 1 TO 5)
JLP BASIS 2/						
Interest during the period						
- paid	10.5	12.5	14.8	17.6	58.3	113.7
- capitalized	18.8	22.3	26.5	31.5	-	-
Principal (with capitalization)						
- repaid during the period	-	-	-	-	199.1	199.1
- balance due at close of period	118.8	141.1	167.6	199.1	-	-
Total paid for the period	10.5	12.5	14.8	17.6	257.4	312.8
TR BASIS 3/						
Interest during the period						
- paid	36	36	36	36	36	180.0
- capitalized	-	-	-	-	-	-
Principal						
- repaid during the period	-	-	-	-	100	100.0
- balance due at close of period	100	100	100	100	-	-
Total paid for the period	36	36	36	36	136	280.0
Net present value of flows (4)						
TJLP Basis	9.5	10.3	11.1	12.0	158.9	201.8
TR Basis	32.7	29.7	26.9	24.5	84.0	197.8

Notes:

1/ A loan of R$100 at 5 years with a 4-year grace period and payment of interest accrued on balances. To simplify, a single service payment at the close of each year is assumed.

2/ TJLP for the entire period: 24.75% p.a. (rate in Aug/95); IFIs being charged a margin of 4.5% p.a. over TJLP; capitalizable portion: TJLP -6% p.a.

3/ TR for entire period: 36% p.a. (rate in Aug/95); no provision made for additional margin or capitalization of interest.

4/ Discounted at rate of 10.125% p.a., which corresponds to the annualized average monthly change in the IGP-DI for the period July-Sept/95.

IGP-DI = general price index - domestic supply

2.12 The financial charges on funds onlent to the IFIs and subborrowers will be based on the TJLP. BNDES will charge the IFIs an onlending fee, which is currently of up to 4.5% p.a., and the IFIs will charge the subborrowers one of up to 2%, 13/ to which they may freely add other commissions. This interest-setting mechanism is being used in BNDES operations similar to those that will be carried out under the proposed program, and as were carried out in the recent FINEP operation (880/OC-BR), which also provides long-term credit funds for small and medium-sized enterprises. BNDES is able to assume the exchange risk of the program resources as part of its joint operations and at no additional cost to itself. It will provide coverage by repositioning its portfolios through its foreign exchange financings of imports of capital goods for industrial retrofitting. Using the TJLP in local currency eliminates the exchange risk for the subborrower.

2.13 Periodic reviews of interest rates will ensure that the cost of the program resources is not subject to distortions, which could impair accomplishment of the program's purposes. 14/

E. Sizing of the program, its costs and financing

2.14 Modernizing and expanding the productive capacity of enterprises to enable them to compete internationally is bound to increase the demand for long-term credit. In the present circumstances BNDES is the only source of such credit (see section III-A).

2.15 The sources of additional long-term external resources that would be available to BNDES in the coming years to meet requirements for financing of this type would be: (a) the IDB loan of US$300 million; and (b) a probable loan, also for US$300 million, from the Export-Import Bank of Japan (JEXIMBANK) to cofinance the proposed operation. JEXIMBANK has expressed to BNDES its interest in this regard. It is obvious from this that, despite the magnitude of these operations, which would permit the disbursement of an additional US$150 million a year over the next four-year period, a sizable gap would remain between the supply of and demand for medium- and long-term financial resources to meet the needs of the productive sector. Lastly, it must be noted that BNDES system loans cover about 55% of the investments of a project. It is therefore considered that this program would provide financing for investments totaling about US$1 billion.

13/ The interest rate is prohibited by the Constitution from exceeding 12%, for which reason the TJLP has a capitalizable portion (TJLP -6%), and the IFIs charge a variety of fees.

14/ These reviews will involve both the interest rates and the fees charged by BNDES and the participating IFIs.

2.16 The total cost of the proposed program is estimated at the equivalent of US$600 million broken down as follows:

TABLE II-2
COST OF THE PROGRAM, BY SOURCE OF FINANCING
(in millions of U.S. dollars)

Investment category	IDB	Local contribution	Total
Loans	297	300	597
Inspection and supervision	3	-	3
Total	300	300	600
Percentage	50	50	100

F. <u>IDB financing</u>

2.17 As can be seen in the foregoing table, the IDB loan, entirely in foreign exchange from the ordinary capital resources, would be in the amount of US$300 million equivalent, or 50% of the total cost of the program, in keeping with the Bank's policy for programs in Group A countries as established in document AB-1378.

G. <u>Local counterpart</u>

2.18 The local counterpart resources would be put up by BNDES, other sources, and the end beneficiaries. BNDES has opened negotiations for a loan from JEXIMBANK for this operation, which, if it materializes, may be used to cover the local counterpart requirements of the program. It should be noted, however, that if that loan is not forthcoming, BNDES has other sources of funds in amounts sufficient to meet satisfactorily the program's local counterpart requirements (see Annex I-1). The proceeds from recoveries of earlier IDB loans may not be used as local counterpart contribution.

H. <u>Disbursement timetable</u>

2.19 The timetable for disbursements by year is shown in Table II-3.

TABLE II-3
Disbursements under the program
(in millions of dollars)

SME loans	Year 1	Year 2	Year 3	Year 4	TOTAL
IDB	60	100	90	50	300
BNDES	60	100	90	50	300
TOTAL	120	200	180	100	600

III. EXECUTION OF THE PROGRAM

A. The borrower, executing agency and guarantor

3.1 The borrower and executing agency for the program would be Banco Nacional de Desenvolvimento Econômico e Social [National Bank for Economic and Social Development] (BNDES), created by Law 1,628 of 1952 and governed by Law 5,662 of 1971. The guarantor of the operation would be the Federative Republic of Brazil.

3.2 Within the institution, the program will be implemented by the Office of International Organization Operations (GEPIN) in the Funding Department (DECAP), a unit answerable to the financial and international area and also to the Credit Department (DCRED).

1. Origins and objectives

3.3 BNDES is a public enterprise with legal status under private law and its own equity, established for the principal purpose of promoting the country's economic and social development. It is authorized to obtain the domestic and foreign resources needed for the conduct of its operations and is subject to the rules and regulations of the Conselho Monetário Nacional [National Monetary Council] (CMN). BNDES is the principal instrument for implementation of the federal policy of promoting private investment and is administratively linked to the Ministry of Planning and Budget. In this setting, BNDES has chosen five priority areas of action: (i) modernization, adaptation and expansion of the economic infrastructure; (ii) support to foreign trade; (iii) restructuring and modernization of industry; (iv) protection of the environment; and (v) privatization with emphasis on public utilities. In relation to (iii), BNDES emphasizes the development of SMEs that supply inputs, parts, and components for large enterprises in order to enhance the systemic competitiveness of the production chain. To accomplish its objectives, BNDES provides financial support to the private sector in the financing of investments to increase the production capacity of the national economy and make it more competitive. The institution has two wholly-owned subsidiaries, BNDES Participações S.A. (BNDESPAR) and Agência Especial de Financiamento Industrial [Special Industrial Financing Agency] (FINAME), which, together with the bank, make up the BNDES system.

2. Organization and functions

3.4 The higher management of BNDES is in the hands of a council of 11 members appointed by the President of the Republic. This council lays down the general guidelines for the operations of BNDES in accordance with the policies of the federal government. The board of directors, consisting of a chairman, a vice chairman

and four directors, is the highest-ranking executive management body. This board approves operations in amounts above R$5 million and may delegate the approval of operations in lesser amounts to other administrative organs and officers. BNDES has a control board which examines the financial statements presented by the board and oversees certain activities.

3. <u>The credit operations of BNDES</u>

3.5 The BNDES system grants loans in virtually every sector of the economy. At first its objective was to complement measures of the Government of Brazil in the creation of industries of key importance for the development of the national economy. Its operations were directed preponderantly at the financing of public sector projects in basic industry, energy, and transportation. More recently it has shifted its orientation to the financing of private sector projects which can improve the country's capacity for entering world markets on a competitive basis. In 1982, 69% of its financing went to the public sector; this proportion declined to 19% in 1989 and to 5% in 1994 (see also paragraph 1.2 in Annex I-1).

3.6 Another important change in the operations of BNDES has been a significant increase in indirect operations through the IFIs. During 1985-1990, 32% of the loans approved were channeled in that way. Starting in 1990, to promote participation by banks in the domestic medium- and long-term credit market and afford more equitable access to its resources for a larger number of enterprises, particularly SMEs, the emphasis was placed on using this arrangement in all the regions of the country by setting up a network of IFIs (there are some 200 at present). In support of this process, the IDB, in the last global credit operation, agreed with BNDES that at least 55% of the program resources were to be placed through the IFIs. BNDES complied in full with this agreement: indirect placements have accounted for 57% of the resources disbursed so far (over 95%).

3.7 The elegibility criteria that BNDES applies to the IFIs are based on parameters of: (i) authorized maximum indebtedness levels; (ii) liquidity and profitability levels; and (iii) financial ratios to determine the soundness of their portfolios, their administrative capacity, and BNDES's prior experience with the given IFI. These criteria will be discussed in chapter IV. It should be noted that, to ensure that loans granted maintain financial conditions that adequately cover the institution's operating and funding costs and yield positive rates in real terms, BNDES adjusts the principal of its loans: for loans denominated in local currency these adjustments are based on the long-term interest rate (TJLP)

capitalization mechanism and for those denominated in foreign exchange on the BNDES currency basket. 15/

3.8 The volume of BNDES's operations has grown steadily to an annual average equivalent to US$4.8 billion in the last four fiscal years. In 1994 approvals totaled US$5.5 billion in current terms. The sector distribution was as follows: processing industries 46%, services 32%, agriculture 21%, and other sectors 1%. Annual disbursements in the last four years averaged the equivalent of US$4 billion (83% of approvals).

4. Economic-financial and operational performance

3.9 The BNDES system manages resources valued at US$49 billion under its direct investment programs or through onlending to the IFIs. The main sources of the system's own funds (US$41.6 billion) are the Fundo de Amparo ao Trabalhador [Workers' Relief Fund] (FAT) and foreign borrowings. The FAT was created by the Constitutional Reform of 1988, which prescribed that at least 40% of the FAT receipts were to be deposited in BNDES. The FAT is the largest source of financing for BNDES (27% of its resources in 1994) 16/. The rest of the resources (US$7.4 billion) are those of the Administered Funds (the Merchant Marine Fund, the National Development Fund, and the Social Participation Fund).

3.10 In December 1994, of the US$41.6 billion in assets of the system, the credit portfolio came to US$25.6 billion (62% of the total). The net worth of BNDES totaled US$13.1 billion, an adequate level of capitalization (32%) relative to the institution's total assets. Annex I-1 describes the salient aspects of the financial structure of BNDES and its evolution in the last four years based on data from its audited financial statements.

3.11 Given the current conditions in the Brazilian financial sector, BNDES will remain, at least in the coming years, the main source for the channeling of medium- and long-term intermediated resources for modernization of the Brazilian productive sector. In consequence, its development policies and strategy will be of vital importance for the supply and allocation of medium- and long-term credit. In earlier stages BNDES functioned under directed credit arrangements, but since the end of the 1980s has taken concrete steps away from that approach by reducing operations with public sector borrowers, strengthening its project evaluation and analysis procedures, and establishing eligibility criteria for and evaluating the solvency of its borrowers and financial intermediaries. In 1994, 96% of its operations were with the

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15/ In either case the financial costs are positive in real terms and higher than the cost of the Bank's OC funds.

16/ The FAT is owned by the workers and administered by BNDES with their participation.

private productive sector. Moreover, in keeping with that shift of strategy and in an effort to contribute to the development of the market for medium- and long-term credit intermediated by commercial banks, BNDES has been lending increasingly to the productive sectors through its IFI network.

5. Earlier IDB loans to BNDES

a. Summary

3.12 The IDB has granted eight direct loans to BNDES totaling the equivalent of US$426.4 million. Six of these have been amortized in full; one has been totally disbursed and is in process of amortization; and the latest (602/OC-BR), described in the paragraphs that follow, has a balance pending disbursement of US$20 million.

b. Loan 602/OC-BR

3.13 Objectives and description. The purpose of loan 602/OC-BR, signed on January 15, 1991, was to support the productive sector development program executed by BNDES. The program resources were used to finance the installation, expansion, modernization, and diversification of a broad spectrum of activities, such as manufacturing, transportation, warehousing, telecommunications, energy, social infrastructure, agriculture, technological development, and the environment.

3.14 The original cost of the program was US$500 million, with IDB financing of US$250 million and a local contribution of US$250 million made by BNDES. Later the Export-Import Bank of Japan (JEXIMBANK) supported the program with cofinancing of US$250 million, which raised the amount of the program to US$750 million.

3.15 The program resources committed as of December 31, 1994 totaled US$719.5 million (Table III-1), of which US$526 million had been disbursed. On that date US$30 million in IDB funds were pending disbursement, which figure dropped to US$20 million as of June 30, 1995. To complete the disbursements, a one-year extension of the contractual deadline, to January 15, 1996, was authorized. The reason for this extension of the disbursement period was that the operation had to be rescheduled in view of the increased amount of the operation with the JEXIMBANK cofinancing.

TABLE III-1
Loans: breakdown by size
(millions of U.S. dollars)

Amount (millions)	Number	%	Total value	%	Average amount
Under US$3	712	92	311.2	43	0.4
US$3 to US$5	35	4	138.6	19	4.0
US$5 to US$10	13	2	94.1	13	7.2
Over US$10	11	2	175.6	25	16.0
Total	771	100	719.5	100	0.9
Made through IFIs		96		56	

Source: BNDES

3.16 The resources of the IDB and JEXIMBANK were used to provide partial financing for the importation of inputs, auxiliary equipment, and machinery originating chiefly in the United States (37.4%), Germany (20.6%), Switzerland (6.4%), and Italy (4.2%). The remaining 31.4% came from other IDB member countries.

3.17 During the execution of the program the interest rates charged on subloans made with resources of the financings were positive in real terms.

3.18 The projects were satisfactorily supervised by the operational areas of BNDES. Its project analysts evaluated them, made on-site inspections, and verified that payments to external suppliers and the importation of goods matched. The Funding Department of the Financial and International Area was in charge of the program and provided efficient coordination.

B. Operation of the program

1. Operating procedures

3.19 The procedures provided for execution of the proposed program are essentially the same as those used in the previous operation with BNDES (602/OC-BR), which are considered adequate for the needs of the new project. The resources of the Bank's loan would be transferred to BNDES for placement through the IFIs. They would be used to finance investment projects of mostly small and medium-sized Brazilian enterprises.

3.20 The program would be administered by BNDES, which would determine the eligibility and credit-line limits of the participating IFIs,

and would oversee compliance by them with the contractual obligations and the provisions of the program's Credit Regulations, which would govern the use of its resources. The IFIs would bear the technical responsibility for evaluating the projects and assume primary responsibility for monitoring them and for the associated commercial and credit risks.

3.21 The procedures would conform in their details to the "Políticas operacionais do sistema BNDES" (Operating policies of the BNDES system), a document that meets the requirements established by the Bank for these operations.

3.22 Enterprises interested in obtaining program funds would present to an IFI a letter applying for credit, together with the information required for evaluation of the project.

3.23 The program would run on the basis of the automatic indirect operational procedures established by BNDES's above-mentioned operating policies document, the document "Critérios gerais" of June 1995, and the document "Indústria" of March 1995, whereby subloans would be made directly by BNDES-accredited IFIs part of whose authorized lines of credit were still unused. This procedure is consistent with the BNDES automatic processing program.

2. The executing unit

3.24 The administration and control of the program will be assigned to GEPIN and DECAP, which is in charge of BNDES external financing and coordinates and executes activities relating to international loans, and to the DCRED, which evaluates the IFIs and their credit-line ceilings.

3. Financial agents

3.25 As previously noted, the BNDES operating strategy favors greater IFI participation in the channeling of funds. To this end BNDES has instituted the automatic processing program, which shortens the processing of a loan to five working days and requires the IFI to present, following its approval, only a project brief summarizing the salient aspects of the project, the characteristics of the operation and the financial plan with the terms and conditions of the corresponding loan operation. Afterwards BNDES oversees compliance with the established requirements.

3.26 An IFI is eligible in principle if it is authorized to operate with the Central Bank (BACEN). However, IFIs must also satisfy the criteria of BNDES, which are spelled out in paragraphs 3.31 and 3.32. On this basis the financial agents are then rated and ranked, and the ranking is used to determine the level of credit to be awarded to each of them.

4. Credit Regulations

3.27 The draft Credit Regulations that would govern the program are presented as Annex II-1. They are consistent with the Bank's rules and policies and with the legal provisions and the banking and financial practices in effect in Brazil. BNDES will have to have placed those regulations into force prior to the first disbursement.

a. The subborrowers

3.28 The subborrowers under the program would be small and medium-sized enterprises which, in the judgment of the IFIs, possess the administrative, technical, financial, and legal capacity to execute and operate projects to be financed by the IFIs.

b. Eligibility of financial agents

3.29 In BNDES, the accrediting and monitoring of financial agents is assigned to the Credit Department. The provisions in force cover the criteria for the eligibility of financial agents for both BNDES and for FINAME. The salient aspects of selection of financial agents by BNDES are as follows: (i) the BACEN parameters (referred to in paragraph 1.15, footnote 2), which establish the net worth requirements and the rules for calculating it in accordance with the risk structure of the assets of each institution; and (ii) the ceilings on general indebtedness with the public and the BNDES system. These appropriate levels of liquidity, solvency, and earnings are based on the weighted performance of 14 financial indicators on which is based the classification that produces the quality ranking of the financial agents used to determine the level of credit to be assigned to each of them.

3.30 BNDES works with private and public commercial, multiple-service, investment, and development banks as well as with finance corporations. Of about 260 institutions authorized to operate on the financial market, 200 are registered as financial agents of the BNDES system. Until recently 60 of them – 27 public and 33 private – had unused credit margins.

3.31 BNDES monitors and controls the financial agencies by means of off-site analysis based on monthly financial statements that are forwarded simultaneously to BNDES and to BACEN's Audit Department, and periodic on-site inspections to check records and assess the IFI's management performance.

3.32 In addition, to participate in the program a financial agent must not only conform to the general criteria and standards established by BNDES, but must also: (i) maintain a ratio of debt to BNDES of not more than twice its net worth; (ii) not be in default on any obligation to BNDES; (iii) present annual reports containing an unqualified opinion of independent auditors; (iv) consent to the

auditing of the program operations by the Department of the National Treasury or its authorized agent; (v) provide information requested by BNDES and the IDB on the projects financed by the program; and (vi) maintain financial information on the program loans which identifies the amount of the subloan, the sources of financing of the project, the sector, the goods and services financed, recoveries, the status of the portfolio, and other data which facilitate the monitoring of the subloan. These requirements are spelled out in the program's Credit Regulations, which BNDES will put into effect as a condition precedent to the first disbursement of the operation.

c. Use of the proceeds of subloans

3.33 The resources of the program may be used to finance fixed investments and permanent working capital related to the execution of projects that are technically, institutionally, environmentally, and legally feasible, and whose financial and economic returns are judged adequate by the IFIs.

3.34 The resources provided by BNDES and other sources will be regarded as local counterpart, including cash contributions by subborrowers of up to 15% of the total cost of the program. This contribution may not include: (i) recurring labor costs; (ii) working capital; (iii) investments already made; or (iv) contributions in kind. Recoveries of earlier IDB loans may not be used as part of the local counterpart contribution.

d. Credit ceilings

3.35 The program resources will be allocated: (i) 100% through the IFIs; and (ii) in subloans in amounts not to exceed the equivalent of US$3 million.

e. Restrictions on the use of the program resources

3.36 Resources of the program may not be used to finance: (i) the acquisition of real estate; (ii) payment of dividends or return on invested capital; (iii) purchases of shares, bonds, or other securities; (iv) general or administrative expenses of subborrowers; (v) projects not in compliance with Brazilian environmental legislation; or (vi) debts.

f. Restrictions on the use of the financing

3.37 The resources of the financing may not be use to finance: (i) taxes; (ii) working capital, except for inputs that are imported or have a high imported content, up to an aggregate amount not to exceed 15% of the value of the IDB's financing; (iii) purchases of used movables, except as cleared by the Bank; or (iv) acquisitions of goods or services from countries that are not members of the IDB. In relation to (iii), clearance will require

presentation to the IDB by BNDES of a specific request accompanied by an independent evaluation demonstrating the technical and economic advantages of the acquisition, and stating also the probable useful life of the equipment or machinery and indicating that its cost, including that of reconditioning it, is reasonable relative to the FOB cost of new equipment or machinery of similar characteristics.

3.38 Subloans to be made with resources of the program will be subject to the following rules: (i) the maximum amount of the subloans to any single beneficiary may not exceed the equivalent of US$5 million, including the outstanding balances of subloans previously granted with resources of the present program or of loan 602/OC-BR; and (ii) subloans with resources of the program will be subject to the express approval of BNDES and to the Bank's clearance when BNDES, BNDESPAR (see paragraph 1.14 of Annex I-1), the IFIs, or their majority shareholders, or groups to which they belong, hold 15% or more of the voting stock in the enterprise requesting the subloan.

3.39 The terms of the subloans will be set by the IFIs within the limits established by BNDES's current operating policies, having regard to the specific characteristics of the project and the subborrower. Except by express authorization of the IDB at the request of BNDES, the terms of subloans will not exceed 12 years, including a grace period of up to four years.

g. Financial conditions

3.40 The subloans of the program will be denominated in local currency. The financial charges to the IFIs and subborrowers will be based on the long-term interest rate (TJLP). This rate is variable, adjustable quarterly, and calculated as a weighted arithmetical mean of the yield on domestic and foreign long-term public debt securities placed on the market. In addition, BNDES will charge the IFIs an onlending fee (up to 4.5%) and they in turn will charge the subborrowers one of up to 2%, plus other commissions freely agreed upon. This interest-setting mechanism is being applied for BNDES operations similar to those that will be carried out under the proposed program, and as were carried out in the recent FINEP [Financiadora de Estudos e Projetos — Agency for the Financing of Studies and Projects] operation (880/OC-BR), which also provides long-term credit to small and medium-sized enterprises. BNDES is able to assume the exchange risk of the program resources as part of its joint operations (paragraph 2.12). 17/

17/ Provisions of the BNDES board require the matching of assets and liabilities by currency.

h. Conservation of natural resources and preservation of the environment

3.41 The Bank's Environment Committee has classified this program as a category III operation. In all subloan contracts the IFIs will include the requirement that the subborrower commit himself to the rational management of natural resources and preservation of the environment. If any project might pose a threat to the environment, BNDES or the IFI must require, before the subloan is approved, that the necessary measures be taken to mitigate its negative effect.

3.42 Within specific limits of magnitude and as determined by CONAMA, projects will be subject to the obtaining of: (i) a prior permit based on a diagnosis of its possible adverse impacts; (ii) a permit for execution or installation authorizing commencement of the physical works of the project in accordance with the approved specifications; and (iii) an operating permit issued before the project goes into service.

3.43 BNDES has incorporated the procedures established by CONAMA to detect the negative impacts on the environment of the projects it finances and to take the appropriate preventive or mitigating measures. In keeping with the government's environmental policy, in 1989 BNDES organized its Environment Office (GEMAM) as an autonomous operational unit to evaluate environmental matters. This unit was subsequently upgraded and is now the Department of the Environment and Macrosectoral Studies (DEMES) in the planning area. The IFIs are required to make sure that projects to be financed comply with the environmental standards established by BNDES and CONAMA, for which purpose they must send BNDES the environmental evaluation conducted for subloans together with the project briefs.

3.44 The Bank's environmental summary recommended that BNDES: (i) add an expert in matters of environmental pollution to the staff of GEMAM; (ii) formally approve an environmental policy and/or procedure emphasizing classification, approval authority, and monitoring compliance with the decisions; and (iii) prepare an annual report on the environmental aspects of the program for presentation to the Bank. Acting through GEMAM, BNDES would also: inform the loan officers of the IFIs on the types of industrial plants with equipment and machinery that are potentially harmful to the environment and on available alternative (clean) technologies; request them to report on applications for loans to replace such machinery and to support them, when appropriate, by issuing opinions on those requests; visit the industrial plants in question; propose corrective measures; train IFI personnel in environmental matters; and maintain contact with the government's environmental agencies. The results of those activities will be described in the aforementioned annual report. Implementation of

these recommendations constitutes a condition precedent to disbursement of the resources of the loan proposed herein.

5. Supervision of the program

3.45 BNDES would supervise the proposed program through its technical units. The IDB would carry out its inspection and supervision of the program through its Country Office in Brazil.

6. Auditing of the program and of the executing agency

3.46 BNDES and the IFIs will keep records showing the amounts of the subloans made with funds of the IDB and of BNDES, subborrowers, and other sources. BNDES will also have to keep certified records of the interest accrued and collected on the resources used and subloans made, and on the establishment and use of loan-loss provisions, etc. These data should make it possible to prepare annual balance sheets, income statements, and other reports on the program.

3.47 The program's financial statements would be audited by the Department of the National Treasury. BNDES would be audited by a firm of independent auditors of established professional competence satisfactory to the IDB.

7. Periodic evaluation of the program

3.48 During execution of the program, the borrower and executing agency, on the one hand, and the Bank, on the other, will periodically review the interest rates being charged on subloans. The borrower and executing agency would, if necessary, take measures consistent with the country's economic policies to harmonize the interest rates of the subloans with the Bank's policy objective.

3.49 Within 12 months following the date of the first disbursement from the financing, or when 50% of the loan has been committed, whichever comes first, the borrower and the Bank will review accomplishment of the program objectives and the results achieved. If it is considered that the program has not substantially accomplished its objectives, measures will have to be decided upon to solve the problems detected before the commitments of the financing may be resumed.

8. Ex post evaluation

3.50 Pursuant to the Bank's policy, in consultation with the borrower and executing agency, the latter decided not to include an ex post evaluation in the program activities. BNDES based its decision on the fact that the periodic evaluations of the program, during its execution, will provide enough information on its progress and results. Nevertheless, an ex post evaluation could be conducted easily since the information required for such purpose will be available.

IV. FEASIBILITY AND RISKS

A. Economic feasibility

4.1 The essential purpose of the *Plano Real* adopted by Brazil is to stabilize domestic prices and make the country's production competitive with the rest of the world. In this setting, the Brazilian government's macroeconomic and financial policies are creating the conditions that make it feasible to use a program such as the one proposed for the stated purposes. Achieving these results requires major investments in modern technology, equipment and machinery to improve production processes and enhance their international competitiveness. The support required is not limited to one sector. Economic growth in a setting of no inflation and international openness demands a frontal assault in all activities, which is why this is a multisector program.

B. Institutional feasibility

1. BNDES

4.2 The analysis done shows that BNDES is performing its functions responsibly and competently. Its procedures and standards conform to the requirements of operations of this kind. Moreover, it has the experience and the administrative and operational capacity to execute the proposed program. Its technical units are staffed with trained personnel qualified to administer the resources effectively.

2. Intermediary financial institutions

4.3 The IFIs through which the program resources would be channeled to productive sectors would be selected by BNDES on the basis of strict rating criteria confirmed through the experience acquired in the previous operation. The standards and procedures implemented for the monitoring of the IFIs are appropriate. Lastly, the current banking laws, their complementary regulations, and the supervision procedures and rules of BACEN and BNDES provide a suitable regulatory framework for the performance of the IFIs and to safeguard their solvency, stability, and liquidity.

C. Financial feasibility

4.4 The financial feasibility of the program depends on the interest rates set, maintenance of the value of the credits, and the timely availability of the local counterpart contribution. Subloans with program resources would be made in local currency. The executing agency will assume the exchange risk arising out of the Bank's financing by repositioning its loan portfolio to maintain its exchange equilibrium without altering the institution's overall exposure.

4.5 The finance charges on subloans under the program would be variable based on the long-term interest rate (TJLP) and would allow BNDES and the IFIs to defray financial costs and administrative expenses, earn a reasonable profit, and cover the credit risk.

4.6 The local counterpart contribution to the program would consist of contributions made by BNDES, the beneficiaries, and other sources, such as JEXIMBANK. BNDES would have no difficulty in making its contribution under any of these formulas. In sum, the local counterpart contribution is expected to be available when needed for execution of the program.

D. Benefits of the program

4.7 The program would provide the private sector with long-term funds for investment to modernize productive operations, reduce its costs, and make it more competitive. In addition, the proposed credit line would continue the effort begun with the previous loan to lay the foundations for development of the medium- and long-term credit market, with emphasis on the development of portfolios for SMEs.

E. Risks of the program

4.8 The successful progress of the proposed program depends on the maintenance of a macroeconomic and financial framework in which conditions are favorable to the development of private investment. The Government of Brazil has achieved important results in stabilization and reform of the economy, which will be maintained in the medium term. However, macroeconomic conditions will be evaluated in periodic reviews of the program. The positive results are expected to continue.

4.9 The operation entails no significant risks as to the performance of the executing agency on the institutional or lending side. BNDES is an institution with a sound track record both in its general operations and in its operations with the Bank.

4.10 The risk in relation to the IFIs covers two aspects: the first would be an unexpected reappearance of macroeconomic instability, which could significantly affect the operation and quality of subloans. The second is the possibility of a deceleration in the rate of lending under the program owing to the negative effects of a resumption of inflation, which would diminish the incentives to the private investor and, at the same time, generate conditions that would make banks more cautious in their credit policies or shift their operations back to management of the float of government securities (see paragraph 4.8).

F. Benefits of the program to low-income groups

4.11 The objective of the program is to finance private investment in different productive sectors. Accordingly, it does not satisfy any of the criteria established in the Eighth General Increase in Resources to fulfill the objective of poverty reduction.

G. Effects of the program on women

4.12 This program is not designed to benefit women directly. Hence no identifiable specific effects are detected in this direction. However, making the program accessible to small and medium-sized enterprises will definitely result in benefits to women as borrowers and/or employees.

H. Conclusion and recommendation

4.13 The Government of Brazil has assigned its highest priority to the program. It is found to be economically, institutionally and financially feasible; it is consistent with the Bank's policies; and it contributes to attainment of Brazil's objectives of economic stabilization and openness. Accordingly, Management recommends to the Board of Executive Directors that the proposed financing be approved.

I. SALIENT ASPECTS OF BNDES'S FINANCIAL STATEMENTS

1.1 What follows is a commentary on the aspects of the financial structure of BNDES considered most important based on the institution's audited financial statements. 1/

1. Assets

Stated in millions of U.S. dollars of December 1994, BNDES's total assets grew over the last three years at a cumulative average rate of more than 7.25% a year, rising from US$33,624 in 1991 to US$41,625 at the close of 1994. The largest item is the loan portfolio, which throughout the period has remained at around 60% of total assets, followed by permanent investments with around 30%, the remainder being other assets, mainly liquid investments. The entity maintains a strict balance between its assets and liabilities in foreign currency and between the rates of interest charged on its loans and paid on its borrowings, and so presents no exposure either to exchange or interest rate risks.

2. Loan portfolio

1.2 This item grew a significant 19% in the stated period. Notable in this performance was the shrinking share of the public sector, from 52% in 1989 to 22% at the close of 1994, when a mere 4% of loans went to that sector. These figures attest to the success of BNDES's shift in lending policies of recent years, in line with the government's policies for reducing the direct role of the State in production and supporting the development of private investment to make the country's private enterprise competitive as the economy opens to the outside world.

1.3 On December 31, 1994, about 7.4% of the total portfolio was in arrears. This was substantially lower than at the close of 1990, when 12% of the portfolio was past due, and attests to a remarkable improvement in the institution's credit management. It must be noted concomitantly that: (i) the defaults occurred only in BNDES's direct loan portfolio; and (ii) BNDES maintains loss reserves of 20% for the total portfolio in arrears, and generally requires real guarantees valued at not less than 130% of the loans it makes. BNDES's portfolio remains markedly concentrated, with 26% placed with only 10 of its customers.

1.4 BNDES's largest single debtor is the National Treasury, with obligations equivalent to about US$2.1 billion, which it has been

1/ A comparative table of the performance of the leading items in the financial statements is attached at the end of this annex.

gradually reducing (see paragraph 1.2, above). The loans made to State-owned enterprises and regional and state banks are guaranteed by the respective governments. It should also be noted that a legal resolution now prohibits BNDES from engaging in direct operations with State-owned enterprises or public entities, with singular exceptions such as the financial support provided for construction of the metro in Brasilia. Regional and state banks transfer the resources onlent by BNDES to the private sector. Loans to the public sector are spread among some 100 enterprises, and direct loans in the private sector have been made to about 600 firms. About 200 IFIs are channeling the funds of the BNDES system to some 10,000 private customers.

1.5 It is worth noting, however, that the agency is openly striving to get away from the previous concentration (see paragraphs 3.6 and 3.7) and achieve what has come to be called greater "capillarity" of the resources, which consists in endeavoring to provide equitable and transparent access to as many enterprises as possible throughout the country, giving preference, as far as possible, to SMEs. To this end, BNDES is increasingly lending through its network of financial agents and, in particular, through the so-called automatic system, through which the network of IFIs (200 of them), using BNDES onlending credit lines, can carry out operations of up to R$5 million without prior authorization from BNDES. Of all disbursements made in 1991 (US$3.077 billion), 47% were made through IFIs, and of those almost half were made through the automatic system, compared with more than 71% – about US$3.94 billion – in 1994, of which, again, half was placed through the automatic modality.

1.6 Under the program considered here the indirect loans would be made through this automatic mechanism, which is regarded as essential to accomplish the program's objectives.

3. Liabilities

1.7 BACEN's regulations do not allow BNDES to receive sight or term deposits from the public. Moreover, the situation on the Brazilian financial markets in the last decade has deprived BNDES of direct long-term national savings in any significant amounts. Similarly, the perception of the country risk on international markets has also impeded the entity's obtaining financial resources at the terms and prices it requires for its operations.

1.8 In this situation, the resources of BNDES have been limited for the most part to its own and those provided by the Fundo de Amparo ao Trabalhador [Workers' Relief Fund] (FAT) institutional funds, while domestic and foreign borrowings have remained small. On average, between 1990 and 1994 internal funds financed about 31% of BNDES liabilities, the FAT funds 55%, and domestic and foreign borrowings 10%; the remaining 4% was miscellaneous liabilities.

1.9 It may be noted, however, that this structure is highly stable owing not only to the reduced leverage, but also to the fact, illustrated in the following table, that the institutional funds do not entail net demands for reimbursement in the near term, which gives the institution an excellent financial coverage of its obligations.

BNDES - PROFILE OF DEBT COVERAGE ON 12/31/94
Figures in millions of Brazilian reais

ITEM	1995	1996	1997	1998	POST 1998	TOTAL
ASSET POSITION						
Liquidities	1,865					1,865
Notes and securities (net) 1/					1,182	1,182
Loan portfolio	3,053	2,979	2,699	2,524	10,515	21,770
TOTAL	**4,918**	**2,979**	**2,699**	**2,524**	**11,697**	**24,817**
LIABILITY POSITION						
Borrowings						
- domestic	90	83	58	50		281
- foreign	230	166	138	251	484	1,269
Institutional funds (PIS/PASEP, FAT, etc.)					21,324	21,324
Other obligations 2/	1,155					1,155
TOTAL	**1,475**	**249**	**196**	**301**	**21,808**	**24,029**
Net position in the period	3,443	2,730	2,503	2,223	(10,111)	788
Cumulative net position	3,443	6,173	8,676	10,899	788	

1/ It is assumed that all positions, notes and securities are to be held at long term.
2/ It is assumed that the entire amount of "Other obligations" is on call.

SOURCE: BNDES – Audited financial statements

4. Equity

1.10 On December 31, 1994, the equity of BNDES totaled the equivalent of US$13.078 billion, of which the equivalent of US$5.138 billion was capital stock, and the equivalent of US$6.381 billion represented reserves. The debt-to-equity ratio has held steady at about 2.2 since 1990 and is judged adequate in light of the composition and liquidity profile of the entity's assets and liabilities.

5. Income statement

1.11 The results of 1994 (see Table 3) show a net profit before taxes equivalent to US$1.148 billion, with a return on assets (ROA) of 2.8% and a return on equity (ROE) of 8.8%. These results reveal a pronounced improvement over the two preceding years, in which the indicators were 0.5% and 1.5%, respectively, for both periods.

1.12 This improved profitability is the outcome of a combination of factors the most important of which is improved management, which has resulted in the placement of more resources, improved collections, and the signally successful conduct of new programs, such as the national divestiture program, in which BNDES, as agent for the federal government, took in receipts 10 times greater in 1994 than in the preceding year. The financial margin, defined as the gross profit from financial intermediation on average liquid assets (cash + notes and securities + loan portfolio) came to 3.9%. Meanwhile, administrative and personnel costs amounted to 0.33% of the average liquid assets and to 0.25% of average total assets, which levels have held without major change in recent years.

INCOME STATEMENT **In millions of U.S.dollars on 12/31/94**		
Income from financial intermediation		
- lending operations	3,082	
- others	509	3,591
Less: expenditures for financial intermediation		(2,524)
Gross profit from financial intermediation		**1,067**
Plus: other operating income and expenditures (net)		168
Operating income		**1,235**
Plus: nonoperating income		156
Plus: monetary correction		(243)
Net profit before taxes		**1,148**
Taxes		(496)
Net profit after taxes		**652**
ROE (before taxes) (1992 = 1.5%, 1993 = 1.5%)		8.8%
ROA (before taxes) (1992 = 0.5%, 1993 = 0.5%)		2.8%
Gross margin on average liquid assets		3.9%
Interest income on loan portfolio		12.8%

6. Auditing

1.13 BNDES has an Internal Auditing Department, which reports directly to the Office of the President. Its financial statements and the accounts of the programs and trust funds in its charge are reviewed

by public auditors of the Department of the National Treasury and independent external auditing firms. Though BNDES is not subject to review by the Audit Department of BACEN, its accounts are overseen by inspectors of the Office of the Auditor General of the Republic.

7. Subsidiaries

1.14 On December 31, 1994, contributions to the capital of subsidiary enterprises constituted virtually all (99.4%) of BNDES's permanent investments. FINAME accounted for 4.2% and BNDESPAR for the rest. FINAME holds assets equivalent to about US$8.743 billion. Of this amount, 98% represents its portfolio of loans to IFIs, as it makes no loans directly to enterprises. The proportion of loans in default is slight. BNDES is the sole owner of FINAME and its principal supplier of resources (the equivalent of US$7.848 billion on December 31, 1994). FINAME carries out its own programs (the automatic, special agricultural and FINAMEX programs) and also conducts BNDES programs, such as the automatic BNDES program.

1.15 BNDESPAR contributes to the financing of firms through stock participations and the subscription of bond and stock issues. On December 31, 1994, its assets totaled the equivalent of US$9.48 billion, almost all of the resources coming from BNDES in the form either of loans (22%) or of contributions to capital (77%). Under the BNDES system, BNDESPAR is the privatization agent, an activity in which it has acquired a great deal of experience in the last three years.

BNDES BALANCE SHEET

	Figures in millions of constant U.S. dollars in December 1994								
ASSETS	**1991**		**1992**		**1993**		**1994**		**Change 1992 - 1994**
Cash and sight deposits	225	-	753	2	2,274	6	2,204	5	+ 116
Notes and securities	1,442	4	2,524	7	1,289	3	1,397	3	
Loans (net)	21,485	64	21,547	57	22,383	59	25,611	62	+ 19
Permanent investments (net)	8,929	27	11,452	30	10,575	28	11,246	27	+ 7
Other assets (net)	1,543	5	1,394	4	1,384	4	1,168	3	
TOTAL ASSETS	**33,624**	**100**	**37,670**	**100**	**37,905**	**100**	**41,626**	**100**	**+ 24**
LIABILITIES									
Institutional resources (FAT-PIS/BASEF, etc.)	18,481	55	20,594	55	20,967	55	22,721	55	+ 23
Borrowings - domestic	601	2	462	1	1,769	5	2,817	7	+ 25
Borrowings - foreign	2,853	8	2,456	6	2,194	6	1,501	3	
Other obligations	1,612	5	1,820	5	1,079	3	1,509	3	(6)
TOTAL LIABILITIES	**23,547**	**70**	**25,332**	**67**	**26,009**	**69**	**28,548**	**68**	**+ 21**
Net worth	10,077	30	12,338	33	11,896	31	13,078	32	+ 30
TOTAL LIABILITIES AND NET WORTH	**33,624**	**100**	**37,670**	**100**	**37,905**	**100**	**41,626**	**100**	**+ 10**

Note: Figures adjusted to December 1994 based on the general price index – domestic supply (IGP-DI).
Exchange rate on December 31, 1994: US$1= R$0.846
Source: BNDES - Audited financial statements

MULTISECTOR GLOBAL CREDIT PROGRAM
(BR-0155)

IDB – BNDES
CREDIT REGULATIONS

ARTICLE 1. Objective and definitions

The objective of the multisector global credit program (the Program) is to grant financing for investment projects for the establishment, expansion, modernization and diversification of private enterprises in the productive sector of Brazil.

These Regulations establish the terms and conditions that will govern the Program, which will be partially financed by the Inter-American Development Bank (IDB) under the contract for IDB loan __/OC-BR to Banco Nacional de Desenvolvimento Econômico e Social (BNDES). This Program will be executed by BNDES, which will use its network of intermediary financial institutions (IFIs) to allocate resources in accordance with the provisions of these Regulations.

ARTICLE 2. Subborrowers or beneficiaries

Subloans under the program may be obtained by Brazilian private enterprises in the productive sector, as defined in the national laws, which are legally established in the country and which, in the judgment of BNDES and the IFIs, have the administrative, technical, financial, legal and environmental capacity to execute the projects to be financed.

ARTICLE 3. Participation of the IFIs

The IFIs that may participate in the Program are private and public commercial banks carrying development portfolios, multiple-service banks, investment banks, and development banks that conform to the ceilings and other requirements set by BNDES for indirect operations with IFIs in keeping with its current operating policies, which are hereby made a part of these Regulations, and which:

a. abide by the criteria set forth in Central Bank (BACEN) guidelines on financing, capitalization, liquidity and solvency of the banking system;

b. maintain a debt-to-equity ratio, with regard to debt to the BNDES system, not exceeding 2:1;

c. submit an outside audit report containing an unqualified opinion;

d. are not in arrears with BNDES, and have not so been in the six months preceding the operation for which financing is being considered;

e. provide all information on the projects financed by the Program that BNDES, and the IDB through BNDES, may reasonably request;

f. consent to the auditing of the Program by the Federal Audit Office of the Federative Republic of Brazil or a body authorized by it; and

g. have a system of financial information for the Program, which identifies the amounts and financial conditions of subloans, the sources of financing of the projects, the sectors in which those projects operate, the financed parts of those projects, recoveries, the status of their portfolios, and other data to facilitate the identification and monitoring of each subloan.

ARTICLE 4. Sources of program funds

The total cost of the Program has been estimated at the equivalent of US$600 million, to be funded with proceeds from IDB loan __/OC-BR equivalent to US$300 million and local counterpart funds equivalent to US$300 million. Resources provided to projects by BNDES and other sources will be considered local counterpart funding.

Cash payments by subborrowers, not to exceed 15% of the amount of the Program, may be considered local counterpart funding provided they are not for or in the form of: (a) recurring labor costs; (b) working capital; (c) investments already made; or (d) contributions in kind.

Resources originating directly or indirectly from financing under other IDB loans may not be considered part of the total cost of the Program or of the total financing of a project.

ARTICLE 5. Use of Program resources

The resources of the Program may only be used to finance fixed investments and their associated permanent working capital for the execution of projects that are technically, institutionally, environmentally and legally feasible and have an adequate financial and economic rate of return. Permanent working capital is understood as that related to investments made with Program resources.

Recoveries and repayments received in advance of the contractual maturity of a subloan made by an IFI and financed under the Program will be applied on the same date and in the same amount to repayment of the IFI's corresponding obligations to BNDES.

ARTICLE 6. Restrictions on the use of Program resources

The resources of the Program may not be used to finance:

a. purchases of real estate;

b. payments of dividends or return of invested capital;

c. purchases of shares, bonds or other securities;

d. general or administrative expenses of subborrowers;

e. projects that do not meet the environmental criteria established in Brazilian law by the competent government agencies; or

f. debts.

ARTICLE 7. Restrictions on the use of IDB financing

The resources of the IDB financing (loan __/OC-BR) may not be used to finance:

a. payments of taxes;

b. working capital, other than permanent working capital, except for imported inputs or those with a high percentage of imported content, up to a total equivalent to 15% of the amount of the IDB financing;

c. purchases of used movable goods, excepting used equipment and machinery, the purchase of which shall be subject to clearance by the IDB. To this end, BNDES must first present to the IDB a specific request accompanied by an independent evaluation attesting to the technical and economic expediency of the purchase and stating the probable useful life of the equipment or machinery and that its cost, including overhaul, is reasonable relative to the FOB price of new equipment or machinery of similar characteristics; or

d. purchases of goods and services from countries that are not members of the IDB.

ARTICLE 8. Financial terms and conditions of subloans

a. Terms

The terms of subloans will be set by the IFIs pursuant to BNDES's operating policies and having regard to the particular characteristics of the project and subborrower.

Unless otherwise approved by the IDB at the request of BNDES, the longest terms for the amortization of subloans shall be:

(i) for fixed investments, up to twelve years, including a grace period of up to three years; and

(ii) for associated permanent working capital, up to three years, including a grace period of up to one year.

b. Interest rates and other financial charges

Resources onlent through IFIs to subborrowers will be denominated in local currency.

The annual interest rate to be charged on onlendings of program resources to IFIs and for the making of subloans will be the long-term interest rate (TJLP) or any other interest rate that may replace it subject to agreement between the Bank and BNDES; it will be set at the time of contracting for the given operation and adjusted quarterly. In addition, the onlending rate must cover the operating costs of BNDES. In its calculation of those operating costs BNDES must include, at the very least, the following items:

(i) financing costs;

(ii) credit risk;

(iii) loan-loss provisions;

(iv) administrative expenses; and

(v) a reasonable profit.

In addition to the interest rate, BNDES may charge in its operations a spread and fees in amounts it may freely agree on with the IFIs based on the characteristics, terms and conditions of each operation.

c. Penalty fees

In each case BNDES and the IFIs may include in their onlending and sublending contracts default interest and penalties for late payment in the event of nonfulfillment of contractual obligations.

ARTICLE 9. Lending limits

The following limits shall apply:

a. the maximum amount of a subloan made with resources of the Program shall be the equivalent of US$3 million;

b. the maximum amount of the outstanding balances of the subloans made to a subborrower with resources of the Program and of loans under earlier programs for which the IDB has provided financing shall be the equivalent of US$5 million; and

c. if BNDES, BNDESPAR, its IFIs, its majority stockholders, or groups to which they belong, hold 15% or more of the voting stock of an enterprise requesting a subloan, the use of resources of the Program to make that subloan shall require the express approval of BNDES and the nonobjection of the IDB.

ARTICLE 10. Obligations of subborrowers

Under the contracts made with subborrowers, they shall be required to:

a. use the proceeds of a subloan exclusively for execution of the respective project;

b. allow the IDB, BNDES and the respective IFIs to examine the goods, installations, works and structures associated with execution of the project financed;

c. furnish all information that the IDB, BNDES and the IFIs may reasonably request in relation to the project financed and to the financial situation of the subborrower;

d. fulfill the conditions of the subloan contract subject to suspension of the respective disbursements by the IFIs, BNDES and the IDB;

e. furnish sufficient and specific security to the IFIs;

f. insure the goods and assets included in the project and those provided by way of security for amounts and under conditions in keeping with prevailing commercial practice in the country;

g. authorize suspension of disbursements of the proceeds of the subloan in the event of nonfulfillment of the contractual obligations;

h. repay immediately the entire outstanding balance if resources of the subloan are used in a manner different from that provided in the investment plan of the project;

i. take all appropriate measures to ensure that the contracts for works and services, and the purchase of goods for the project, are carried out at a reasonable cost, taking into account quality, efficiency and other pertinent factors; and

j. obtain the certificates and permits required by the laws and administrative provisions in force in the country and state.

ARTICLE 11. Appraisal of projects

For every project financed with resources of the Program, at least an assessment of its financial feasibility shall have been made in accordance with the applicable standards of BNDES, which are made an integral part of the present Regulations.

ARTICLE 12. Disbursement procedures

The Program resources shall be disbursed by BNDES to the IFIs for onlending to subborrowers following the procedures adopted by BNDES for operations of this kind.

ARTICLE 13. The environment

Subloans shall be made only for projects that have received the requisite authorizations and are in full compliance with Brazilian legislation on the environment.

If a project poses any threat to the environment, BNDES or the IFI, as appropriate and in accordance with the applicable operating rules of BNDES, which are an integral part of these Regulations, shall require that the subborrower, before the subloan is approved, adopt necessary measures to mitigate those negative effects.

ARTICLE 14. Supervision of projects

In supervising the execution of each project financed with resources of the Program, BNDES and the IFIs shall follow the inspection procedures prescribed in their operating rules, which shall permit, without prejudice to the other contractual obligations, effective verification of the contributions made to each project by its beneficiaries.

BNDES and the IFIs shall keep appropriate records to show the investments under the Program, both the amounts of the subloans and of the other resources needed for their complete execution. These records shall identify the subloans made and, in the case of BNDES, the use made of recoveries of those subloans.

ARTICLE 15. Amendments to the Regulations

BNDES and the IDB may, by mutual agreement, make changes in these Regulations and in complementary policies and operating rules that are part of the present Regulations to adapt them to new circumstances or conditions that could arise during execution of the Program. Any amendment to these Regulations shall apply only to subloans made after the entry into force of that amendment.

In the event of any conflict between these Regulations and the contract for loan __/OC-BR signed by BNDES and the Bank, the provisions of the contract shall prevail.

ARTICLE 16. Information

BNDES shall use circulars to inform the IFIs about the objectives, availability of resources and conditions governing the Program.

BR-0155

PROPOSED RESOLUTION

BRAZIL. LOAN /OC-BR. TO THE BANCO NACIONAL
DE DESENVOLVIMENTO ECONOMICO E SOCIAL
Multisectoral Global Credit Program

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 Banco de Desenvolvimento Economico e Social, as Borrower, and the Federative Republic of Brazil, as Guarantor, for the purpose of granting the former a financing to cooperate in the execution of a Multisectoral Global Credit Program. Such financing will be for the amount of up to three hundred million dollars of the United States of America (US$300,000,000), or its equivalent in other currencies, except that of Brazil, which are part of the Ordinary Capital resources of the bank, and it will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.