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BRAZIL

**GLOBAL CREDIT PROGRAM FOR SAFEGUARDING THE PRODUCTIVE FABRIC
AND EMPLOYMENT IN THE STATE OF ESPÍRITO SANTO**

(BR-L1556)

LOAN PROPOSAL

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ABBREVIATIONS

BACEN	Central Bank of Brazil
BANDES	Banco de Desenvolvimento do Espírito Santo S/A [Development Bank of Espírito Santo S/A]
BNDES	Banco Nacional de Desenvolvimento Econômico e Social [National Economic and Social Development Bank]
ECLAC	Economic Commission for Latin America and the Caribbean
FUNDES	Fondo de Desarrollo de Espírito Santo [Espírito Santo Development Fund]
IBGE	Instituto Brasileiro de Geografia e Estatística [Brazilian Institute of Geography and Statistics]
IJSN	Instituto Jones dos Santos Neves
IMF	International Monetary Fund
LIBOR	London Interbank Offered Rate
MSMEs	Micro, small, and medium-sized enterprises
PMU	Program management unit
R\$	Brazilian reais
RAIS	Relação Anual de Informações Sociais [Annual Report on Social Data]
SEBRAE	Serviço Brasileiro de Apoio às Micro e Pequenas Empresas [Brazilian Microenterprise and Small Business Support Service]
WHO	World Health Organization

PROJECT SUMMARY

BRAZIL GLOBAL CREDIT PROGRAM FOR SAFEGUARDING THE PRODUCTIVE FABRIC AND EMPLOYMENT IN THE STATE OF ESPÍRITO SANTO (BR-L1556)

Financial Terms and Conditions				
Borrower and executing agency:			Flexible Financing Facility ^(a)	
Banco de Desenvolvimento do Espírito Santo S/A [Development Bank of Espírito Santo S/A] (BANDES)			Amortization period:	25 years
Guarantor:			Disbursement period:	2 years
Federative Republic of Brazil			Grace period:	5.5 years ^(b)
			Interest rate:	LIBOR-based
Source	Amount (US\$)	%	Credit fee:	(c)
			Inspection and supervision fee:	(c)
IDB (Ordinary Capital):	30,000,000	100	Weighted average life:	15.25 years
Total:	30,000,000	100	Approval currency:	U.S. dollars
Project at a Glance				
Project objective/description: The general objective of the program is to support the sustainability of micro, small, and medium-sized enterprises (MSMEs) as employment providers in the state of Espírito Santo amid the COVID-19 crisis. The specific objective is to support the short-term financial sustainability of MSMEs in Espírito Santo.				
Special contractual conditions precedent to the first disbursement of the loan proceeds: As special contractual conditions precedent to the first disbursement of the financing, the borrower will present evidence of: (i) the approval and entry into force of the program Operating Regulations , under the terms previously agreed with the Bank; and (ii) the creation of the project management unit, with its respective powers, as described in the program Operating Regulations (paragraph 3.7).				
Exceptions to Bank policies: A partial waiver of the Policy on Guarantees Required from the Borrower (Operational Policy OP-303) is requested from the Board of Executive Directors, so that the State of Espírito Santo guarantees the obligations in the positive covenants and the obligations to eventually provide local counterpart funds. The Federative Republic of Brazil will only guarantee the financial obligations of the loan contract.				
Strategic Alignment				
Challenges: ^(d)		SI <input checked="" type="checkbox"/>	PI <input checked="" type="checkbox"/>	EI <input type="checkbox"/>
Crosscutting themes: ^(e)		GD <input checked="" type="checkbox"/>	CC <input type="checkbox"/>	IC <input type="checkbox"/>

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

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

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

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

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

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problem to be addressed, and rationale

- 1.1 **Background.** On 11 March 2020, the World Health Organization (WHO) declared the COVID-19 outbreak a pandemic. COVID-19 is a respiratory disease caused by the novel coronavirus, or SARS-CoV-2.¹ According to the WHO, as of 30 September 2020 there were over 33.4 million confirmed cases in 216 countries, areas, and territories, resulting in around 1,003,497 deaths, with 4,754,464 cases in Brazil and 142,058 deaths there.² The Ministry of Health of Brazil indicates there have been 130,636 cases and 3,538 deaths in the state of Espírito Santo.³ According to the WHO, the country is at level four of five in terms of its preparedness and capacity to manage public health events.⁴ Over 9,210,987 cases of COVID-19 and 338,823 deaths have been reported in Latin America and the Caribbean, affecting almost all countries of the region. Unfortunately, the particular situation of South America is increasingly concerning. The region has become a new epicenter of the disease, according to a recent statement by the WHO.⁵ Brazil has the third highest number of people affected in the world and the most in the region.
- 1.2 **Macroeconomic and/or social context.** The situation across the globe has changed radically. As a result, the global economy is heading towards a recession, with the prospect of a sharp drop in GDP and revenue and an increase in short-term unemployment.⁶ The economic impacts of COVID-19 will be felt through different channels at different times. The first, associated with the priority of saving lives in the very short term, is the direct costs of the health sector response. The second is the costs associated with the necessary changes in people's behavior to "flatten the curve" of COVID-19 progression and help save lives. These behaviors may be the result of government mandates (closing schools, canceling public events, etc.), decisions made by companies and other institutions (teleworking, cutting back production, etc.), and decisions made by consumers (reducing social contact).
- 1.3 The aforementioned changes in behavior led to a very significant economic downturn with immediate manifestations and effects that will linger longer than expected, even once the health emergency is over. From a macroeconomic perspective, in addition to shrinking domestic demand, the Economic Commission for Latin America and the Caribbean (ECLAC) sees at least five channels through which the impacts of the crisis will be passed on to the region's economy:⁷ (i) slowing economic activity of key trading partners that will impact demand for exports; (ii) lower demand for tourism services; (iii) interruption of global value chains; (iv) falling commodity prices; and (v) worsening financial terms.

¹ [Opening remarks](#). WHO Director-General. Media briefing on COVID-19 (11 March 2020).

² [WHO COVID-19 Situation Dashboard](#) (30 September 2020).

³ [Painel Coronavírus Brasil](#) (30 September 2020).

⁴ [WHO COVID-19 Country Preparedness and Response Status for COVID-19](#) (March 2020).

⁵ [Media Briefing](#) (22 May 2020).

⁶ [International Monetary Fund \(IMF\). The Great Lockdown: Worst Economic Downturn Since the Great Depression](#) (April 2020).

⁷ [ECLAC press release](#) (March 2020).

- 1.4 In this context, the Brazilian economy faces a crisis at a time when growth had been gradually recovering after a negative period.⁸ COVID-19 is expected to have a strong impact on economic activity.⁹ The Relatório Focus [Focus Report],¹⁰ which reflects the expectations of Brazil's financial market, estimates a decrease of 5.28% in GDP for 2020. To respond to the prospect of increased unemployment and decreased income, monetary and fiscal measures have been adopted as part of economic policies.¹¹ In terms of unemployment, the interest rate and proportional required bank deposits were reduced and credit expansion measures were adopted by temporarily adjusting prudential regulations.¹² With respect to income, the measures implemented already exceed 10% of GDP.¹³ These measures are intended to reduce the negative impact of the crisis on income, particularly for the poorest population; on jobs; and to the extent possible, on the productivity and situation of the country's micro, small, and medium-sized enterprises (MSMEs).¹⁴ In addition, the Brazilian government established special procedures to streamline the evaluation and authorization process to prepare programs with foreign sources of finance, since a public state of emergency was declared as a result of the health crisis.¹⁵ For a summary of the main economic, monetary, and financial measures that Brazil adopted in response to that emergency, see [optional link 5](#).
- 1.5 **Economic context and status of COVID-19 in the state of Espírito Santo.** Within the national context, Espírito Santo declared a state of emergency on 13 March 2020¹⁶ and established response committees to address the crisis. The State adopted several health measures to contain the spread of COVID-19¹⁷ and is already showing clear signs of a contraction in economic activities.¹⁸ According to the Brazilian Institute of Geography and Statistics (IBGE), the consumer price index for the metropolitan area of Vitória, the capital, showed deflation of 0.09% for April. Industrial production in the state decreased 16.7% in April 2020 compared to March 2020. During the same period, the retail and services sales volume decreased 17.8% and 14.3%, respectively, based on a year-on-year comparison (2020 versus 2019).¹⁹ The impacts of the crisis on the state's economy are expected to be proportionally larger than what is predicted nationwide.²⁰ Therefore,

⁸ Economic activity data indicated that as of 2018, the recovery of Brazil's economy had gained some traction. Fiscal policy changes had reduced the growth of public-sector debt and improved the prospects for its future path. See [Carta de conjuntura](#) (Institute for Applied Economic Research, 2019) and [Relatório de Projeções da Dívida Pública](#) (National Treasury of Brazil, 2019).

⁹ For an estimate of the impacts of COVID-19 in Brazil, see [Impactos Econômicos da COVID-19 no Brasil](#) (Universidade Federal do Paraná, April 2020).

¹⁰ [Relatório Focus](#) (August 2020).

¹¹ [Measures to Face the COVID-19 Crisis](#) [Central Bank of Brazil (BACEN), 2020].

¹² [Presentation](#), for details on BACEN's adjusted prudential regulations.

¹³ [Economic Policy in Latin America and the Caribbean in the Time of COVID-19](#) (IMF, 2020).

¹⁴ [Carta de conjuntura](#) (Institute for Applied Economic Research, 2020).

¹⁵ [COFLEX Resolution 2 of 13 April 2020](#) established limited terms and reduced requirements to consider foreign credit operations, authorizing the preparation of projects as they emerge.

¹⁶ [State of Espírito Santo Decree 4593-R](#).

¹⁷ [Medidas dos governos estaduais para contenção da COVID-19](#) (Fundação Getulio Vargas, 2020).

¹⁸ [Panorama Econômico do Espírito Santo, first quarter 2020](#) [Instituto Jones dos Santos Neves (IJSN), 2020].

¹⁹ [Nota conjuntural IPCA](#) (Education and Industrial Development Institute of Espírito Santo/Ideies, 2020) and situation reviews on [Produção Industrial](#), [Comércio Varejista](#), and [Serviços](#) (IJSN, 2020).

²⁰ For an estimate of the impacts that COVID-19 has caused in Brazil, specifically in Espírito Santo, see [Impactos Econômicos da COVID-19 no Brasil](#) (Universidade Federal do Paraná, April 2020).

Espírito Santo adopted its own economic measures to alleviate the effect of the crisis, such as delaying tax payments and providing lines of credit to MSMEs through public banks.²¹ For a detailed analysis of the impact of COVID-19 on the economy of Espírito Santo, see [optional link 7](#). For general aspects of the intervention, see [optional link 2](#).

- 1.6 **Current constraints on access to finance for MSMEs in the state of Espírito Santo.**²² Unlike during the 2007 global financial crisis, in which the financial sector and the real worldwide economy lacked more liquidity to withstand the losses resulting from poor management in the process of originating and marketing financial assets, the current crisis has caused a significant retraction of supply and demand curves. This has created larger risks in the financial sector and has had harmful effects on employment and the survival of businesses, particularly MSMEs.
- 1.7 Brazil's MSMEs²³ account for more than 99.5% of companies, 58% of jobs, and 44.3% of payroll.²⁴ In turn, in Espírito Santo, MSMEs provide a higher share of employment than the national average. According to data from the Ministry of Economy's Annual Report on Social Data, MSMEs in Espírito Santo, which account for 99.5% of companies in the region and 49.7% of the state's wage bill, employ 63.2% of the workers.²⁵

Table 1. Breakdown of companies in Espírito Santo by size, number, and number of jobs created

Type of enterprise	Number of companies	%	Number of formal jobs	%	Wage bill (in R\$ millions)	%
Micro	61,565	82.6	182,517	20.6	278.9	12.6
Small	10,890	14.6	206,190	23.3	405.6	18.3
Medium-sized	1,691	2.3	170,843	19.3	416.4	18.8
MSME	74,146	99.5	559,550	63.2	1,100.9	49.7
Large	374	0.5	325,792	36.8	1,112.0	50.3
Total	74,520	100	885,342	100	2,212.9	100

Source: Annual Report on Social Data (RAIS) (2018).

- 1.8 With respect to access to finance, Brazil's financial system has reduced its monthly credit exposure for the MSME sector from nearly R\$742.7 billion (US\$148.5 billion) in 2014 to approximately R\$515.9 billion (US\$103.2 billion) in 2019. In addition, exposure for large companies has remained relatively stable at approximately R\$860 billion (US\$172 billion) throughout the same period. Although it decreased in recent years, the average risk for MSMEs (represented by the rate of arrears of

²¹ [Espírito Santo: Medidas econômicas de enfrentamento à COVID-19](#) (Department of Development, 2020).

²² Bibliography, [optional link 3](#).

²³ The general classification for MSMEs uses data from the Annual Report on Social Data, which does not include informal businesses. MSMEs are classified based on the number of employees, as follows: microenterprises (up to 9 employees); small businesses (between 10 and 49 employees); and medium-sized enterprises (between 50 and 249 employees). Data regarding the MSME lending balance is based on the [DataSebrae](#) panel developed by the Brazilian Microenterprise and Small Business Support Service (SEBRAE) in partnership with BACEN. It is based on a system that ranks the gross operating revenue of companies as follows: microenterprises (up to R\$360,000); small businesses (between R\$360,000 and R\$4.8 million); and medium-sized enterprises (between R\$4.8 million and R\$300 million).

²⁴ [Optional link 2](#).

²⁵ [Características do Emprego Formal no Espírito Santo - 2018](#) (IJSN, 2019).

the analyzed portfolio) continues to be twice the risk for lending operations with large companies in Brazil (see Table 2).

Table 2. Breakdown of the credit balance and arrears in Brazil's financial sector, by company size

Type of enterprise	Dec. 2014		June 2019	
	Balance (R\$ millions)	Arrears (%)	Balance (R\$ millions)	Arrears (%)
Micro	58,700	10	47,900	10
Small	194,000	7.9	139,900	8.3
Medium-sized	490,000	5.3	328,100	5.9
MSME	742,700	6.35	515,900	6.92
Large	851,500	2.9	863,500	3.3
Total	1,594,200	4.5	1,379,400	4.64
% MSME	46.6%	N/A	37.4%	N/A

Source: DataSebrae.

- 1.9 In general terms, access to finance is a problem for Brazilian MSMEs. The country's MSMEs face rationing in the lending market, which impacts their viability, growth, and ability to boost productivity.²⁶ This is particularly relevant given that MSMEs are more dependent on liquidity resources, which are critical to their survival.²⁷ Almost half of MSMEs last no longer than four years, due in part to their low productivity and lack of credit.²⁸ To obtain credit, these companies also greatly depend on their own resources and financing from their suppliers. Only 11% of MSMEs indicated that their loans were from private banks, while 5% obtained them from credit unions, 11% from State-owned banks, and 3% obtained microloans.²⁹
- 1.10 This baseline situation tends to considerably worsen at times of crisis. MSMEs are more exposed to the volatility related to crises because there are higher perceptions about their risk based on their capital structures and collection cycles. They also have shorter maturity cycles and more collateral requirements due largely to their lower levels of capitalization. This is visible through the evolution of the MSME lending balance in Espírito Santo during the recent economic recession in Brazil, from 2015 to 2018.³⁰

²⁶ [Demografia das Empresas e Estatísticas de Empreendedorismo](#) (Brazilian Institute of Geography and Statistics (IBGE), 2017) and [Sobrevivência das Empresas no Brasil](#) (SEBRAE, 2016).

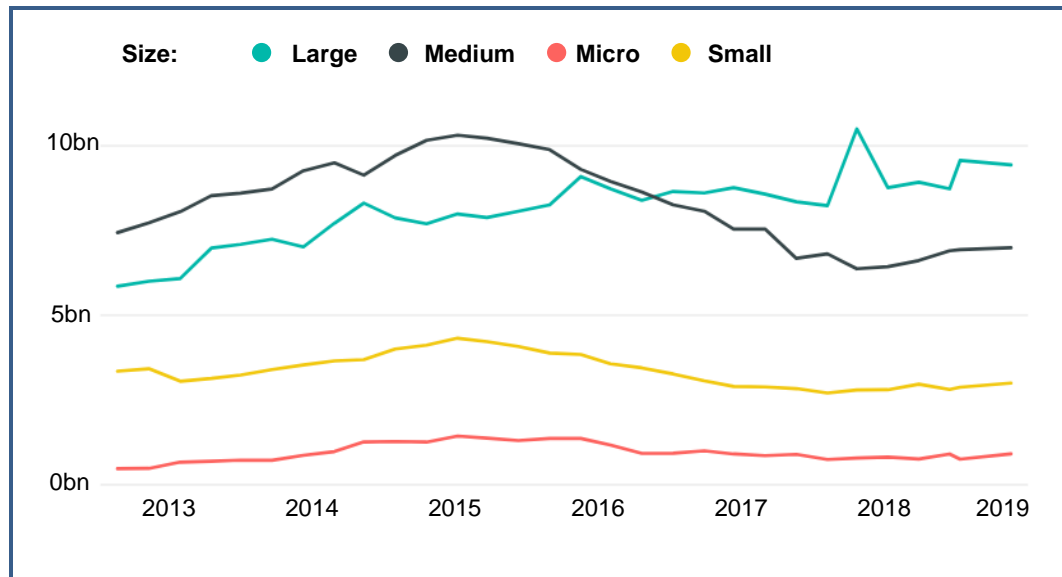
²⁷ MSMEs have substantially higher participation in lending operations for working capital. In 2019, they accounted for 57.8% of the working capital lending balance for Brazil ([optional link 2](#)).

²⁸ After four years of activity, 47.5% of Brazil's companies survive, according to the [IBGE](#) (2015).

²⁹ [O Financiamento das MPE no Brasil](#) (SEBRAE, 2017).

³⁰ Brazil's annual GDP growth was -3.5% (2015), -3.3% (2016), 1.06% (2017), and 1.11% (2018) ([World Bank data](#)).

Figure 1. Evolution of the credit balance in Espírito Santo by company size (2013-2019)
(in R\$ billions)
Credit balance by size (R\$)



Source: DataSebrae.

- 1.11 For this sector, which is particularly vulnerable to economic decline, the uncertainties caused by the progression of COVID-19 described in paragraphs 1.2-1.4 are expected to worsen access to finance issues, impacting the liquidity needed to maintain their activities given the decrease in their operating revenues.
- 1.12 In a survey among microenterprises and small businesses about the impact of COVID-19 conducted in Brazil in early April 2020,³¹ 58.9% said they temporarily suspended operations, 87.5% said their revenue decreased, 18.1% indicated they needed to reduce the number of employees, and 54.9% stated they needed to obtain financing to keep the company operating without cutting jobs. However, among companies that sought access to finance, only 11.3% had obtained a loan, 29.5% were waiting for a response from the financial institution, and 59.2% had their application denied. In Espírito Santo, 52.9% of companies reported a need to obtain financing to keep operating without layoffs. Also, 65% stated that if the current conditions lasted more than three additional months, the business would not survive. A later survey conducted in early May 2020 by SEBRAE and the Fundação Getúlio Vargas confirmed that this situation continued after two months of restrictive measures in Brazil. In this context, research shows that despite the emergency economic package announced by the federal government, microenterprises and small businesses still face a critical situation as a result of decreased sales (88.9% reported reduced monthly revenue) and almost nonexistent financing for working capital to cover their expenses during this period (68.1% said they need a loan to keep operating without having to lay off employees).³²

³¹ *O impacto da pandemia de coronavírus nos pequenos negócios – 2ª edição, Resultados Nacionais* (SEBRAE, 2020).

³² [Crédito no Brasil para MPEs em tempo de COVID-19](#) (SEBRAE, 2020).

- 1.13 The above demonstrates that times of crisis such as this are characterized by a general shortage of liquidity and financing options. The rapid, sharp imbalance between financing requirements and lending availability alters the relative prices of credit. Because this is associated with increased perceptions of risk, it limits access to finance. When the market does not respond, the government needs to take action through measures that promote liquidity and replace the lack of finance.³³ Therefore, the Brazilian National Development System (SNF) is in a strategic position to act and address the crisis caused by COVID-19. This system, which is comprised of a group of public institutions—such as public development banks, commercial banks with development portfolios, savings and loan associations, and development agencies—is aimed at providing financing to priority sectors and activities for development, as well as to segments of the population and economic activities that are unable to meet their financing needs through the private financial system.³⁴ In Espírito Santo, the Banco de Desenvolvimento do Espírito Santo S/A (BANDES)³⁵ is the local public development bank. Aware of its role and aligned with the public policies of the government of Espírito Santo, BANDES seeks to promote long-term sustainable development through its products and services, emphasizing good management, responsible lending, and the quality of its portfolio. BANDES provides lines of financing and also administers Espírito Santo's development funds, offering guarantee options through guarantee funds and supporting the growth of the state's enterprises through investment and revenue-sharing funds.³⁶ In March 2020, BANDES had a lending balance of R\$770 million (US\$154 million) made up of 32,111 loan contracts. While its main line of business has historically been farming microcredits, BANDES has a lending balance of more than R\$235 million (US\$47 million) with MSMEs (24.3% microenterprises, 19.9% small businesses, and 55.7% medium-sized enterprises) and a growing focus on the industrial, services, and commerce sectors (respectively 46%, 25%, and 16% of the loans provided between May 2019 and May 2020). Fitch Ratings recently gave BANDES a rating of BB- international and AA local, underscoring an upward trend in asset quality and returns in the first half of 2020, despite the effects of the COVID-19 pandemic on the local economy.^{37,38}
- 1.14 The actions that BANDES takes are particularly important at this time. While Espírito Santo has a high Human Development Index (0.740), ranking as the seventh state in Brazil,³⁹ its share of GDP compared to national GDP has been declining. In 2012, Espírito Santo accounted for 2.4% of Brazil's GDP and ranked 11th in economic significance. In 2016, it only accounted for 1.7% of Brazil's GDP

³³ [Por que o crédito secou?](#) (Valor investe, 2020).

³⁴ [Sistema Nacional de Fomento – Financiando o Desenvolvimento](#) (Associação Brasileira de Desenvolvimento, 2018).

³⁵ BANDES was established pursuant to [State of Espírito Santo Law 2413 of 20 June 1969](#). BANDES is a financial institution that is part of the State of Espírito Santo's public administration. The State is currently the majority shareholder (owning 83.6% of the capital stock) and controlling party for BANDES. Pursuant to the bylaws of BANDES, the State of Espírito Santo will hold at least 51% of the entity's total voting shares.

³⁶ [Technical note](#) (BANDES, 2020).

³⁷ [Technical note](#) (BANDES, 2020).

³⁸ [Main Rating Fundamentals](#) (Fitch, 2020).

³⁹ [Atlas of Human Development in Brazil](#) (United Nations Development Programme, 2010).

and was ranked 14th in the country.⁴⁰ Since 2016, Espírito Santo's activity level indicator has consistently been below comparable domestic levels, continuing this downward trend. However, the job market showed positive performance in 2019 with 16,293 jobs created, driven by a rebound in the services and commerce sectors.⁴¹ The crisis caused by COVID-19 (paragraph 1.5) poses a strong threat to this trend and the jobs that were created. Although BANDES serves the entire MSME segment, it is expected to proportionally provide more support to meet the imminent needs of the small and medium-sized enterprise segment. The share of jobs created by this segment in Espírito Santo exceeds the national average (see Table 1).⁴² This approach also aligns with State of Espírito Santo Law 11011 of 2019, which reflects the new guidelines and priorities established by the State government for BANDES.⁴³

- 1.15 **Challenges and progress.** Given this scenario, which is aggravated by the current health crisis, the short-term financial sustainability of MSMEs in Espírito Santo is at risk. In shielding the productive fabric of the State of Espírito Santo from the economic hardships associated with the COVID-19 crisis, the challenge will be to keep open as many as possible of the MSMEs that were commercially viable before the crisis, while also supporting the value chains to which many of them belong, so that they can continue operating normally.
- 1.16 With respect to MSMEs, as mentioned above, lending requirements tend to be more strict and financial institutions assume larger risks compared to lending operations for large companies. MSMEs are unable to operate without working capital. Therefore, the survival of an MSME and its working capital are closely related. These companies play an important function as job creators, which favors social inclusion. Moreover, MSMEs are the gateway to the job market for vulnerable segments of the population, who might otherwise be unable to enter this market because they lack the academic credentials that larger companies usually require.⁴⁴ Accordingly, Brazil is implementing immediate measures to alleviate this problem. These measures entail a wider fiscal effort and liquidity expansion, which will broaden the monetary base, provide financial assistance for payroll payments to MSMEs, and increase the flexibility of prudential regulations for the largest financial institutions in order to raise the operating leverage of large private and public national banks. This also includes risk-taking through repo operations and particularly the expansion of guarantees.⁴⁵
- 1.17 Nevertheless, the existence of inherent shortcomings in the operation of the financial sector (for example, the market is concentrated in a few financial institutions)⁴⁶ heightens the need to promote the supply of credit in sectors with

⁴⁰ [Contas Regionais](#) (IBGE, 2016).

⁴¹ [Panorama Econômico do Espírito Santo, fourth quarter 2019](#) (IJSN, 2020).

⁴² [O BNDES e as micro, pequenas e médias empresas](#) (September 2019).

⁴³ [Carta Anual de Políticas Públicas e Governança Corporativa 2020](#) (BANDES, 2019).

⁴⁴ [Las PyMEs: antídoto contra la pobreza](#) (Cámara Argentina de Comercio y Servicios, 2018).

⁴⁵ [Brazil's Policy Responses to COVID-19](#) (Ministry of Economy, 2020).

⁴⁶ The system is highly concentrated, with the five largest banks accounting for 79.5% of total assets, 82.9% of deposits, and 82.2% of the country's total credit operations (BACEN, 2019). The financial system's high concentration tends to result in higher interest rates due to less competition. It is argued that having more competition reduces the probability of a country suffering a systemic banking crisis, given the positive relationship between the concentration and fragility of banks (Boyd and De Nicoló, *The Theory of Bank Risk Taking and Competition Revisited*, 2005).

high positive spillover effects for the economy. In this respect, Brazilian public development banks have significantly contributed to closing the financing gaps for MSMEs and played an important countercyclical role in response to financial crises. They support investment and financial resource mobilization during recessions, helping governments in their quest for economic recovery. Despite their small share of the total amount of financial sector lending,⁴⁷ subnational public development banks controlled by the states, such as BANDES⁴⁸ in Espírito Santo, are an essential channel to effectively offer resources available from active operations in the financial sector to local MSMEs, especially during times of crisis.

- 1.18 **Gender.** While there is not adequate disaggregated data to understand the situation of companies owned or run by women in Brazil, available information points to them having constraints in access to credit. In September 2015, SEBRAE performed a crosscutting analysis by gender of borrowers in Brazil. Men not only represented the highest proportion of borrowers but also accounted for the largest part of loans taken out by microenterprises and small businesses in Brazil. Of the total value of loans to microenterprises and small businesses, 69% went to men and 31% to women. Although comparable data for small and medium-sized enterprises is not available, experience around the globe suggests that women's share falls as company size increases. Men account for the majority of loans of all types (working capital, investment, staff turnover, accounts receivable, other, and specific resources). In part, this is due to the fact that the majority of owners of formal enterprises are men (66.7%, in Espírito Santo).⁴⁹ In turn, nationwide data on small and medium-sized enterprises suggest that 12% of companies owned or run by men face constraints in accessing credit, compared to 15% of those owned and run by women.⁵⁰ And while there is no information that makes it possible to determine the financing gaps that women-owned and women-run small and medium-sized enterprises face in Espírito Santo, at the national level data suggest it to stand at US\$15 billion.⁵¹ The only information that exists for Espírito Santo is from BANDES administrative data, which indicates that 14.9% of its portfolio went to women-owned companies. This situation needs to be addressed and underscores the need for a gender approach in BANDES' operations, without further reducing women's participation in businesses and the share of credit granted to women-run MSMEs.
- 1.19 **Proposed intervention.** As shown above, MSMEs' financing needs during this crisis, particularly in the short term for ensuring immediate survival, are significant and pose a challenge for Brazil's financial sector. In response to that need, the proposed intervention focuses on supporting financial mechanisms to stimulate the supply of short-term liquidity to MSMEs through a Global Credit Program with

⁴⁷ According to data from BACEN, the public sector still concentrates the majority of its financial sector lending operations among the three segments mentioned (nearly 49% of the financial sector's lending balances). This is mostly due to the performance of two large financial institutions: Banco do Brasil and Caixa Econômica Federal. However, State-owned financial institutions (state development banks like BANDES and promotion agencies) only account for 1.1% of the amount of the loans issued by the financial sector ([Estatísticas monetárias e de crédito](#) from the Central Bank of Brazil).

⁴⁸ Subnational institutions with development mandates that, in addition to their own resources, may only use resources from official funds and programs; federal, state, and municipal budgets; development agencies; and national and international financial institutions.

⁴⁹ [DataSebrae](#) Crédito and [Empreendedorismo Feminino](#) (SEBRAE, 2020).

⁵⁰ [MSME Finance Gap](#) (World Bank, 2018).

⁵¹ Ibidem.

Espírito Santo's state development bank. The program seeks to alleviate the constraints on access to credit faced by MSMEs affected by the COVID-19 crisis, thus supporting their survival and preserving employment in these enterprises. This will minimize the burden on social protection systems and maximize the speed of economic recovery once the health emergency has passed. In keeping with BANDES' approach, the program will focus on small and medium-sized enterprises (paragraph 1.14). Partnering with BANDES is both necessary and strategic given its presence throughout Espírito Santo, through its business agents, and the countercyclical role of the response, which requires a greater risk appetite than what the private financial sector accepts. With this intervention, BANDES is expected to help preserve productive activities in Espírito Santo and the jobs created by MSMEs, particularly in the hardest hit sectors, such as industry, retail trade, and services.

- 1.20 This operation seeks to complement government efforts through a program focused on providing credit to MSMEs in Espírito Santo, channeling resources through BANDES. BANDES's actions are in line with the lending policies and other measures taken at the national level, as well as those taken by Espírito Santo (paragraph 1.5).
- 1.21 **Size of the operation.** In this context, BANDES created a new MSME working capital credit line product called "Giro Emergencial" [emergency draft], under its "PROES Emergencial" program, to provide working capital loans for MSMEs in an expanded context of support from the Government of Espírito Santo for MSMEs affected by the COVID-19 crisis. It expects to be able to meet demand for working capital financing in the short term of some R\$250 million (approximately US\$50 million), for which it will use own resources in the amount of R\$50 million (US\$10 million), resources from the Espírito Santo Development Fund (FUNDES)⁵² for R\$50 million (US\$10 million), with the R\$150 million (US\$30 million) balance to be met with resources from the Ordinary Capital of the Inter-American Development Bank (IDB) through this program. That demand was identified based on historical trends of the credit balance in Espírito Santo and BANDES' operating capacity.
- 1.22 **Program focus.** The proposed program could serve all the sectors in BANDES' MSME portfolio, through the Giro Emergencial line of financing. An imminent need in a higher proportion is expected in the small and medium-sized enterprise segment (paragraph 1.33). As paragraph 1.13 shows, these sectors are primarily industry (where 27% of program resources are to be allocated) and trade and services (where 73% of program resources are to be allocated), all of which have clearly been affected by the liquidity crisis and are crucial for creating jobs (72% of jobs in Espírito Santo) and spurring the local economy (95% of gross value added in Espírito Santo).⁵³ In that regard, there are no plans to finance activities in the primary sector of the state's economy (agriculture, livestock, and extractives). Although these are important traditional activities, they have been less affected by the crisis, as demonstrated in the vulnerability analysis for Brazil ([optional link 6](#)) and in particular for Espírito Santo ([optional link 7](#)). Thus, the program pairs serving

⁵² [FUNDES](#) (Secretaria de Desenvolvimento do Governo de Espírito Santo, 2020).

⁵³ [Características do Emprego Formal no Espírito Santo](#) (IJSN, 2019) and [PIB Estadual 2010-2017](#) (IJSN, 2019).

MSMEs as a whole and the most vulnerable sectors, with flexibility in execution to adapt to the uncertain evolution of COVID-19.

- 1.23 **IDB experience.** The Bank has extensive experience in designing sovereign guaranteed loan programs aimed at improving MSME access to finance through financial intermediaries. These programs were implemented in times of economic expansion, when support focuses on access to long-term finance for production-oriented investments, and in times of economic recession, when support focuses on ensuring that MSMEs do not lose access to liquidity to continue their economic activity. In the last financial crisis the region faced in 2007, the Bank played a countercyclical role by expanding the amount of financing and facilities used to address the lack of access to credit faced by the region's MSMEs. For example, liquidity programs for growth sustainability⁵⁴ were approved in 2008 and 2009 with the aim of restoring access to finance for working capital and foreign trade in the productive sectors. This helped to temporarily offset part of the deficit in financing flows to MSMEs resulting from the international financial crisis. With the same objective of stimulating the supply of credit to the productive sectors, the period following the crisis (2009-2013) saw the approval of contingent credit lines⁵⁵ for providing liquidity to the financial sector, as well as global multisector credit programs and—primarily—specific productive financing programs for MSMEs.
- 1.24 Specifically in Brazil, the Bank has supported recent interventions for MSMEs (loans [2236/OC-BR](#) and [3866/OC-BR](#), the latter of which was under a conditional credit line for investment projects (CCLIP) ([BR-O0001](#)) with the National Economic and Social Development Bank (BNDES), which already has another operation approved (loan [4672/OC-BR](#)) that is beginning implementation). In 2014, the IDB Office of Evaluation and Oversight published the findings of an empirical analysis of different programs with which the IDB supports MSMEs in Brazil.⁵⁶ Of the various interventions analyzed, it was found that credit support was the only one that had a significant impact on all the outcome variables, and the most positive impact on employment and wages. Several studies⁵⁷ have also found that access by MSMEs to Brazilian public credit lines has a significant positive impact on employment and companies' gross revenue.
- 1.25 **Lessons learned.** The Bank has extensive experience and has generated substantial knowledge regarding the design and implementation of policies to support MSME finance with a special focus on certain sectors or value chains. For these public policy solutions to be effective, it is crucial to: (i) identify the market failure to be addressed; (ii) strengthen cooperation among public actors with expertise in the relevant area; (iii) strengthen cooperation between the public and private sectors, since the latter can help find solutions to problems; (iv) focus

⁵⁴ In 2008, the IDB created the Liquidity Program for Growth Sustainability under the category of emergency lending (document GN-2492-1).

⁵⁵ "Contingent Credit Line for Development Sustainability" under the Proposal to Establish Contingent Lending Instruments of the IDB (document GN-2667-2).

⁵⁶ [Uma Análise Comparativa das abordagens do BID no Apoio às PME: Analisando Resultados no Setor Industrial Brasileiro](#) (IDB, 2014). The analysis defines MSMEs as companies with 1 to 250 employees. It includes programs implemented in Brazil from 2003 to 2012. The methodology used was a fixed effects model combined with propensity score matching (PSM) techniques, and it applies a difference-in-difference estimate for robustness testing.

⁵⁷ [The impact of public credit programs on Brazilian firms](#) (IDB, 2011). [Avaliação de impacto do uso do Cartão BNDES sobre o emprego formal nas firmas de menor porte](#) (BNDES, 2011). [Uma solução automatizada para avaliações quantitativas de impacto: primeiros resultados do MARVIm](#) (BNDES, 2017).

actions on overcoming the obstacles found; (v) identify the financial instrument or set of instruments that can be implemented in each situation; and (vi) utilize the most cost-effective combination of instruments for each situation.

- 1.26 The Bank also has relevant experience in designing solutions to mitigate the access to finance issues that MSMEs and value chains face. The following lessons have been learned from these actions as a whole: (i) leverage the countercyclical role of this type of operation when credit is tightening; (ii) target resources toward segments where lending will have the greatest impact on the functioning of the economy (logistics chains) and the well-being of society (the most vulnerable productive sectors); (iii) supervise the financial terms on which the resources are allocated to end users, to avoid market distortions and ensure that there is no dilution of additionality; (iv) guarantee that the executing agency's institutional capacity is sufficient to operationalize the intervention, and evaluate and monitor the subloans and guarantees issued; and (v) systematically compile, manage, and maintain program data so that the results can be analyzed and continue to be used in future interventions.⁵⁸
- 1.27 Based on that experience, some lessons learned were included in the program design: (i) include adequate supervision of the financial conditions under which the resources are granted to end users, to avoid market distortions and ensure the intervention's additionality; (ii) support BANDES' institutional capacity to evaluate and monitor subloans, as well as risk management practices; (iii) establish a relationship with staff responsible for program activities, so they commit to using the resources so that the program is executed with high quality; (iv) foster the use of a formal monitoring and evaluation system to build local capacity and understand the importance of accountability; and (v) systematically compile, manage, and maintain program data so that the results can be analyzed and continue to be used in future interventions. The possibility of building BANDES' institutional capacity in these areas, using IDB technical cooperation resources, represents significant nonfinancial additionality in this operation (paragraph 2.7).
- 1.28 **Coordination with other IDB projects.** This operation coordinates efforts with the "Program for Promotion and Innovation of Access to Multisector Medium and Long-term Credit for Productive Investments by Micro, Small, and Medium Enterprises" (loan [4672/OC-BR](#)), focused on promoting MSME investment in Brazil (implementation phase), together with the "IDB-BNDES MSME Financing Emergency Global Credit Program for Safeguarding the Productive Fabric and Employment" (loan [5115/OC-BR](#)), which was recently approved, for safeguarding the productive fabric and employment at the national level. To contribute to the fiscal sustainability of Espírito Santo and reduce the cost of tax compliance by companies, the "Fiscal Management Modernization Project for the State of Espírito Santo" (loan [4741/OC-BR](#)) will have a decisive positive effect on program sustainability, and thus a special effort will be made for there to be coordination between the teams. The technical cooperation operation "Support to Economic Productivity and Employment in Latin America and the Caribbean in Response to the Economic Shock Caused by the COVID-19 Pandemic" ([ATN/OC-18036-RG](#)), which seeks—particularly on crosscutting issues such as gender (paragraph 1.30)

⁵⁸ Section IV of the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7) discusses lessons learned from the IDB's experience in the sector, including those from other actors (academia and multilaterals).

and environmental and social management— to support the response by countries in Latin America and the Caribbean to the economic shock caused by the COVID-19 pandemic, will also be essential for program implementation (paragraph 2.7). Likewise, the program coordinates efforts with IDB Invest, which has been meeting MSMEs' financing needs together with private financial institutions in Brazil, in particular through the following operations: "Financial Inclusion Partnership – Nubank" ([12948-02](#)), Banco ABC – Social Bond ([12979-01](#)), "Daycoval Sustainable Financing Partnership" ([11843-02](#)), and "Omni Microfinance Partnership" ([12433-01](#)). This coordination seeks to leverage synergies to increase the impact of the IDB's actions, consistent with fiscal sustainability, through: (i) temporary application of the measures so that their short-term impact on public finances is controlled; and (ii) financial support for MSMEs, to ease the cost of financing and preserve jobs, thus contributing to a recovery in tax revenue.

- 1.29 **Strategic alignment.** The program is consistent with the second Update to the Institutional Strategy (document AB-3190-2) and aligned with the challenges of: (i) social inclusion and equality, through an approach that pairs support for MSMEs involved in the most vulnerable sectors of the state and sustaining employment among vulnerable populations; and (ii) productivity and innovation, through support for productive financing for MSMEs, particularly in sectors with the highest gross value added for the state economy (paragraph 1.22). The program is also aligned with the crosscutting issues of gender equality and diversity, by monitoring the evolution of the portfolio of working capital operations, to help close the gender gap (paragraph 1.30). The program will contribute to the Corporate Results Framework 2020-2023 (document GN-2727-12) through the indicator of the number of "micro, small, and medium-sized enterprises financed." The program is consistent with the Proposal for the IDB Group's Governance Response to the COVID-19 Pandemic Outbreak (document GN-2996), as part of the support for safeguarding the productive fabric and employment, and is consistent with the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7), which emphasizes the importance of promoting the productive sector's access to finance. Lastly, the program is included in the Update of the Annex III of the 2020 Operational Program Report (document GN-2991-3).
- 1.30 **Additional gender considerations.** In order to address the systematic lack of relevant data in Espírito Santo, the operation provides for the collection and monitoring of data disaggregated by the sex of the person who owns or runs the company, in accordance with best practices. Also, with a view to boosting the current share of working capital loans for MSMEs originated by women (from 14.9% to 20%) under this program, BANDES pledged to take concrete steps to promote the Giro Emergencial line (dissemination materials and events) aimed at women entrepreneurs in Espírito Santo, leveraging key actors such as the Federação das Indústrias do Espírito Santo (FINDES), for industry, the Federação do Comércio do Espírito Santo (FECOMERCIO), chambers of shopkeepers, for commerce, and SEBRAE. To stem a potential widening of the gender gap due to the COVID-19 crisis (if significant deviations in access to finance in women-run MSMEs are found (<20%)), measures will be taken to correct any deviation through the program Operating Regulations, and an Action Plan could also be requested from BANDES containing specific steps to that end. The specific promotion actions and potential corrective measures will be supported with technical cooperation resources (paragraph 1.28).

B. Objectives, components, and cost

- 1.31 **Objectives.** The general objective of the program is to support the sustainability of MSMEs as employment providers in the state of Espírito Santo in Brazil amid the COVID-19 crisis. The specific objective is to support the short-term financial sustainability of MSMEs in Espírito Santo.
- 1.32 **Sole component. Support for improvement of short-term financial capacity (US\$30 million).** Resources under this component will be used to help MSMEs affected by the crisis resulting from the COVID-19 pandemic to overcome temporary liquidity problems and continue operating (paragraph 3.4). This component would provide liquidity to MSMEs through working capital loans (subloans) granted by BANDES, through the Giro Emergencial line of financing.
- 1.33 **Beneficiaries.** Resources under this intervention will be directed to helping microenterprises and small businesses affected by the COVID-19 crisis. To be eligible, the beneficiary needs to be an MSME, as defined by BANDES (see Table 1). The resources will be used to finance, through loans (subloans), working capital under BANDES' Giro Emergencial line of financing. The specific eligibility criteria will be described in detail in the program [Operating Regulations](#) and are summarized in paragraph 3.5. Based on available information on the sector and the preliminary analysis by BANDES, the number of beneficiaries is estimated at 300 MSMEs (see Table 3) in the 78 municípios in Espírito Santo.

Table 3. Estimated beneficiaries and universe of jobs with the potential to be saved in Espírito Santo

Type of enterprise	Companies to be financed	Average number of jobs (2008)	Total estimated jobs in beneficiary companies
Micro	30	2.96	89
Small	150	18.93	2,840
Medium-sized	120	101.03	12,124
Total	300	50.18	15,053

Source: BANDES estimates based on data from RAIS 2018.

C. Key results indicators

- 1.34 **Expected outcomes.** The expected impact of the program is that it would support the sustainability of MSMEs in the face of the COVID-19 crisis, measured as a percentage of jobs in MSMEs in Espírito Santo out of total employment in the state. The outcome indicators, associated with the program's specific objective, will be: (i) relative rate of arrears in the portfolio of working capital financing 6 and 12 months into the program, compared with BANDES' overall rate of arrears; (ii) total amount of the working capital portfolio of MSMEs thanks to program support; and (iii) share of MSME working capital loans originated by women out of the total MSME working capital portfolio.
- 1.35 **Economic viability.** The economic evaluation identifies the flows of benefits and costs generated by the program. The benefits consist of the economic value of the increase in firms' survival rate, as reflected primarily in the value of the jobs preserved as a result of the program. Calculations of the aforementioned flows (discounted at a rate of 12%) yield benefits of US\$26.45 million and an internal rate of return of 26%. Additionally, the sensitivity analysis shows the program to

have a net present value that is robust to variations in key parameters such as the firm survival rate, the impact on sales, the average number of employees, and duration of unemployment ([optional link 1](#)).

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

- 2.1 The total amount of the proposed program will be US\$30 million from the Ordinary Capital resources. It will be implemented through a Global Credit loan, given that it is financial intermediation for beneficiary MSMEs in the state of Espírito Santo in Brazil. The disbursement period will be two years, given BANDES' operating capacity to meet projected demand and the need to allow for prudent growth of its MSME portfolio.⁵⁹

Table 4. Estimated program costs (US\$)⁶⁰

Component	IDB	%
Sole component. Support for improvement of short-term financial capacity	30,000,000	100
Total	30,000,000	100

Table 5. Disbursement schedule (US\$ millions)

Source	Year 1	Year 2	Total
IDB	20.0	10.0	30.0
Total	20.0	10.0	30.0
%	67	33	100

B. Environmental and social safeguard risks

- 2.2 In accordance with Directive B.13 of the Environment and Safeguards Compliance Policy (Operational Policy OP-703), this operation cannot be classified ex ante, since it involves financial intermediation. The environmental and social due diligence was performed in compliance with Directive B.13, analyzing the program's potential socioenvironmental risks, the applicable regulatory framework, and the executing agency's ability to manage risk. Based on the due diligence findings and given the low risk profile of the eligible loans with program resources, this operation is regarded as medium risk. Given its size, with average loans estimated at around R\$37,500 (US\$7,500), R\$400,000 (US\$80,000), and R\$740,625 (US\$148,125) for micro, small, and medium-sized enterprises respectively, and their nature focused solely on support for short-term working

⁵⁹ BANDES is expected to submit partial disbursement requests to the IDB every six months. The number and frequency of the disbursement requests presented to the IDB will depend on actual demand from MSMEs and on BANDES' analysis.

⁶⁰ The program administration, evaluation, and auditing costs will be covered with BANDES administrative resources.

capital needs, the loans will be Category “C”. Loans in Categories “A” and “B” will not be eligible for financing.

- 2.3 Resources from the subloans will not be used to finance any of the activities on the program’s exclusion list, including: (i) activities/sectors with high socioenvironmental risk, and (ii) activities that involve: (a) involuntary physical or economic resettlement, (b) negative impact on indigenous groups; (c) damage to cultural sites or critical cultural sites, (d) negative impact on protected areas or Ramsar convention sites, or (e) the use of invasive species.
- 2.4 The requirements for managing and mitigating the potential environmental and social impacts will comprise an Environmental and Social Risk Management System (SARAS) that will be incorporated into the program [Operating Regulations](#), approval of which is a condition precedent to the first disbursement (see Environmental and Social Management Report [[ESMR](#)]).

C. Fiduciary risks

- 2.5 The institutional capacity assessment of BANDES shows that it meets the necessary conditions to perform fiduciary management activities for the loan operation. Since BANDES is a regulated financial institution, the fiduciary risk has been determined to be low since, as per the institutional capacity assessment, BANDES does not have financial management weaknesses.

D. Other key risks and issues

- 2.6 **Development risk.** There is a medium risk that the resources will be insufficient to meet the demand for MSME finance. To mitigate this risk, the IDB has designed the intervention to yield the maximum possible impact and has sought to coordinate with all relevant stakeholders, to ensure that the response is proportionate to MSME financing needs.
- 2.7 **Public management and governance risks.** There is a medium risk that implementation of the measures included in this program will be delayed as a consequence of the emergency priorities managed by the government, so the resources might not reach the beneficiary MSMEs in a timely manner. To mitigate this risk, the IDB has designed the program to expedite approval processing and execute rapidly. Likewise, preparation of the program Operating Regulations with BANDES has been moving forward, which will make it possible to accelerate the start of execution. Since this is BANDES’s first operation with the IDB, technical cooperation resources will be provided to assist with program execution and monitoring (paragraph 1.28). This could position BANDES as a driver for the sustainable recovery of Espírito Santo.
- 2.8 **Fiscal sustainability risk.** There is a medium risk that the combination of the health and economic crisis and external factors, such as the falling price of oil, will affect Espírito Santo’s and Brazil’s fiscal and debt position, jeopardizing fiscal sustainability. To mitigate this risk, the IDB is supporting the post-pandemic economic and fiscal recovery plans for the country and the state (paragraph 1.28).
- 2.9 **Sustainability.** With respect to the sustainability of the measures, the program is expected to help ease the temporary difficulties faced by MSMEs as a consequence of the COVID-19 pandemic. Nonetheless, it offers the country, and Espírito Santo in particular, the opportunity to leave support mechanisms in place

for future emergencies. The demonstration effect of the interventions is expected to enable preventive programs to be developed that reduce MSME vulnerability.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

- 3.1 **Borrower and executing agency.** The borrower and executing agency for this operation will be BANDES. The Federative Republic of Brazil will be the guarantor for the borrower's financial obligations stemming from the loan contract. BANDES will be responsible for the administration, execution, control, and monitoring of resources under the operation.
- 3.2 **Execution and administration.** BANDES will have fiduciary responsibility for the program resources and will perform the following functions, among others: (i) make the subloans to eligible MSMEs to fulfill program objectives under the provisions of the loan contract and the program [Operating Regulations](#); (ii) administer loan proceeds through a separate account; (iii) prepare execution and physical/financial progress reports for the IDB; (iv) monitor compliance with applicable environmental and social safeguards and the provisions on prohibited practices; and (v) conduct program monitoring and evaluation.
- 3.3 BANDES will establish a program management unit (PMU) to execute the operation and ensure effective fulfillment of the loan contract and the program [Operating Regulations](#). BANDES will execute the program through this PMU, using BANDES' current organizational structure, and will be responsible for supervising the appropriate use of the program's financial resources and providing the human and technical resources for program execution in a timely manner. The PMU will have members from some areas of BANDES, who will perform these functions: (i) Commercial Department: researching and formulating requests for financing; (ii) Credit Analysis Department: analyzing the technical and financial viability of requests for financing; (iii) Monitoring Department: verifying compliance with the legal and environmental conditions of the subloans; (iv) Credit Recovery Department: following up on loan repayment defaults, conducting negotiations and renegotiations, and performing credit recovery actions; (v) Risk, Internal Control, and Compliance Department: monitoring the credit risk for, *inter alia*, the credit portfolio associated with Bank resources; (vi) Comptroller's Department: preparing the accounting records for the operations for BANDES' financial statements; (vii) Finance Department: disbursing resources from the IDB and sending subsequent repayments; (viii) Legal Department: advising on legal and contractual matters; and (ix) Planning and Processes Department: coordinating the PMU and preparing and submitting information and reports requested by the Bank.
- 3.4 The program [Operating Regulations](#) will include the provisions for program execution and eligibility of the MSMEs that will receive financing from loan proceeds. The Bank and BANDES will agree upon these Operating Regulations, pursuant to the policies and procedures of both institutions. For institutional information on BANDES, see [optional link 9](#).
- 3.5 **Implementation considerations.** Through this program, BANDES will grant working capital loans directly to eligible MSMEs, through subloans under the Giro Emergencial product. To be eligible, MSMEs must meet the following requirements: (i) be incorporated under the laws of the country; (ii) have the

appropriate licenses and permits to operate under Brazilian law; (iii) meet the requirements to qualify as an MSME under the criteria used by BANDES; (iv) be solvent and creditworthy and meet BANDES' credit requirements, with the exception of any factor that has deteriorated as a result of the COVID-19 crisis; and (v) operate in Espírito Santo. No subloan to an MSME may exceed US\$1 million (approximately R\$5 million).

- 3.6 **Program Operating Regulations.** Program execution will be governed by the provisions of the loan contract and the program [Operating Regulations](#), which will include: (i) the specific procedures, conditions, and requirements on the use of resources and financial management of the program; (ii) the technical, regulatory, and financial criteria for access to subloans; (iii) the disbursement mechanisms; (iv) the eligibility criteria for MSMEs; (v) the monitoring and evaluation requirements; (vi) the structure of the PMU and a description of its responsibilities; and (vii) the program's applicable environmental and social considerations.
- 3.7 **Special contractual conditions precedent to the first disbursement of the loan proceeds. As special contractual conditions precedent to the first disbursement of the financing, the borrower will present evidence of: (i) the approval and entry into force of the program [Operating Regulations](#), under the terms previously agreed with the Bank; and (ii) the creation of the project management unit, with its respective powers, as described in the [Operating Regulations](#).** These conditions are necessary to establish the structure, guidelines, and procedures the executing agency is to follow for successful execution of the program.
- 3.8 **Exceptions to Bank policy.** A partial waiver of the Policy on Guarantees Required from the Borrower (Operational Policy OP-303) is requested from the Board of Executive Directors, so that the Federative Republic of Brazil will only guarantee the financial obligations and the State of Espírito Santo will obtain a waiver regarding the obligations in the positive covenants and of having the borrower eventually provide local counterpart funds. BANDES has legal status and legal authorization to conduct the activities planned for this program, as well as its own assets and administrative, technical, and financial autonomy. It has satisfactorily executed resources from public funds and second-tier public development banks in Brazil such as BNDES and FINEP (both of which are borrowers and executing agencies for IDB programs). This is supported by the administrative, financial, economic, and management autonomy of BANDES as it relates to the State of Espírito Santo; its track record of fulfilling financial commitments and maintaining prudent debt levels to meet its financial obligations with the Bank;⁶¹ and the favorable results of the institutional capacity assessment.
- 3.9 **Retroactive financing.** The Bank may retroactively finance, from the loan proceeds, disbursements made by the borrower to issue subloans to eligible MSMEs prior to the loan approval date for up to US\$6 million (20% of the loan amount), provided that they have met requirements substantially similar to those established in the loan contract and the program [Operating Regulations](#). Such expenditures must have been incurred on or after 13 April 2020,⁶² when BANDES launched its Giro Emergencial working capital financing product in response to the

⁶¹ [Technical note](#) (BANDES, 2020).

⁶² That date is after the WHO declared a pandemic (11 March 2020) and after Espírito Santo declared an emergency (13 March 2020). See paragraphs 1.1 and 1.5.

crisis caused by COVID-19.⁶³ Even though this predates the project officially entering the pipeline (document GN-2259-1), authorization of the retroactive financing on an exceptional basis is justified as of that date, given the exceptional circumstances surrounding the global health emergency.

- 3.10 **Procurement.** As a demand-driven financial intermediation program, no procurement of goods, works, nonconsulting services, or consulting services is likely to be required as part of execution. No project execution plan or procurement plan is therefore included in this proposal. Any procurement of nonconsulting or consulting services required as part of program administration and/or evaluation will be conducted in accordance with the Policies for the Procurement of Goods and Works Financed by the IDB (document GN-2349-15) and the Policies for the Selection and Contracting of Consultants Financed by the IDB (document GN-2350-15), or as subsequently updated. For additional details, see the Fiduciary Agreements and Requirements (Annex III).
- 3.11 **Disbursements.** Resources for the program will be disbursed by the IDB to BANDES via the modality of advance of funds and/or reimbursements, as established in the Financial Management Guidelines for IDB-financed Projects (document OP-273-12) or current IDB policies. Disbursement requests will be accompanied by the information listed in the program [Operating Regulations](#). Disbursements will be verified ex post. In all cases, before proceeding with disbursement, the portfolio of subloans to be recognized in the program will be subject to review by the IDB (paragraph 2.1).
- 3.12 **Financial statements and audit.** The executing agency will deliver annual audited financial reports for the program under the terms of reference agreed upon with the Bank, within 120 days after the close of each fiscal year or after the date of the last disbursement. Audits will be performed by the State of Espírito Santo Audit Office or an independent audit firm under the procedures established in the current audit guidelines.

B. Summary of arrangements for monitoring results

- 3.13 **Monitoring.** Program execution will be monitored through semiannual progress reports from the executing agency presented to the IDB within 60 days following the end of each six-month period and a final report to be presented up to six months after the end of the loan disbursement period. The reports will be based on the reporting commitments included in the results matrix for each operation, as well as compliance with the eligibility criteria set out in the program [Operating Regulations](#) (see [Monitoring and evaluation plan](#)). These reports will be reflected in the progress monitoring reports (PMR).
- 3.14 **Evaluation.** Two approaches will be used as part of the strategy for evaluating program results: (i) a reflexive evaluation, before and after the program, to determine the extent of outcomes and impacts; (ii) an ex ante cost-benefit analysis of the flows of benefits and costs from the program, using a strategy similar to the one used for the ex ante cost-benefit analysis. In addition, the end-of-program evaluation will include a qualitative analysis discussing the lessons learned during

⁶³ BANDES has experienced growing demand for the Giro Emergencial line and had lent R\$36.7 million (US\$7.3 million) at the close of August 2020.

program execution. The evaluation strategy is described in the [monitoring and evaluation plan](#).

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

Development Effectiveness Matrix		
Summary		BR-L1556
I. Corporate and Country Priorities		
1. IDB Group Strategic Priorities and CRF Indicators		
Development Challenges & Cross-cutting Themes	-Social Inclusion and Equality -Productivity and Innovation -Gender Equality and Diversity	
CRF Level 2 Indicators: IDB Group Contributions to Development Results	-Micro / small / medium enterprises financed (#)	
2. Country Development Objectives		
Country Strategy Results Matrix		
Country Program Results Matrix	GN-2991-3	The intervention is included in the 2020 Operational Program.
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		See paragraphs 1.15 to 1.17 in loan document.
II. Development Outcomes - Evaluability		Evaluable
3. Evidence-based Assessment & Solution		10.0
3.1 Program Diagnosis		3.0
3.2 Proposed Interventions or Solutions		4.0
3.3 Results Matrix Quality		3.0
4. Ex ante Economic Analysis		10.0
4.1 Program has an ERR/NPV, or key outcomes identified for CEA		3.0
4.2 Identified and Quantified Benefits and Costs		3.0
4.3 Reasonable Assumptions		1.0
4.4 Sensitivity Analysis		2.0
4.5 Consistency with results matrix		1.0
5. Monitoring and Evaluation		7.0
5.1 Monitoring Mechanisms		2.5
5.2 Evaluation Plan		4.5
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood		Low
Identified risks have been rated for magnitude and likelihood		Yes
Mitigation measures have been identified for major risks		Yes
Mitigation measures have indicators for tracking their implementation		Yes
Environmental & social risk classification		B.13
IV. IDB's Role - Additionality		
The project relies on the use of country systems		
Fiduciary (VPC/FMP Criteria)	Yes	Financial Management: Budget, Treasury, Accounting and Reporting, External Control, Internal Audit.
Non-Fiduciary	Yes	Environmental Assessment National System.
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	Yes	Will benefit from TC ATN/OC-18036-RG to support BANDES in the program execution, in particular to support monitoring and evaluation on the program's impact. BANDES has previous experience in IDB support in the development of financing green lines to support MiPyMEs energy efficiency, which gained its institutional capacity with respect to environmental and social safeguards.

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

Evaluability Note:

The operation BR-L1556, for USD30 million, is part of the Bank's operational response to the COVID-19 Pandemic through the Global Credit Program for the Defense of the Production and Employment. The general objective of the program is to support the sustainability in the face of the COVID-19 crisis of Micro, Small and Medium-sized Enterprises (MSMEs) as a support for employment in the State of Espírito Santo (ES) in Brazil. The specific objective is to support the short-term financial sustainability of the MSMEs located in ES.

The loan proposal presents a solid diagnosis of the problem, as well as a review of international evidence. The proposed solutions are an appropriate response to the identified problems and their contributing factors. The results matrix is consistent with the vertical logic of the project, presenting adequate indicators at the level of outcomes and impacts. The outcome indicators are appropriately defined to measure the achievement of the project's specific objective. The impact indicators reflect the contribution to the general objective of the operation.

The economic evaluation shows that the operation is efficient, with an Internal Rate of Return of 26% and a NPV of \$ US26.45 million. In a context of high uncertainty, the analysis considers two types of benefits, the reduction in the income drop of the benefited companies and the preservation of employment in companies that survive thanks to the program. The costs considered in the analysis are the totals involved in the execution of the operation.

The monitoring and evaluation plan proposes a reflective analysis of the outcome and impact indicators included in the result matrix, complemented by a review of the theory of change, an updated review of international evidence and qualitative studies. The monitoring and evaluation activities will be carried out by the executing agency in coordination with the Bank.

RESULTS MATRIX

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

Indicators	Unit of measure	Baseline (2020)	Final target	Means of verification	Comments
<u>GENERAL OBJECTIVE: To support the sustainability of MSMEs as employment providers in the state of Espírito Santo amid the COVID-19 crisis.</u>					
Indicator 1: Percentage of employment in MSMEs in Espírito Santo out of total employment in the state.	%	63.2	63.2	Annual Report on Social Data (RAIS) of the Ministry of Economy of Brazil and Instituto Jones dos Santos Neves (IJSN).	The program aims to establish a target comparable to the situation before the crisis, since the impact on employment in MSMEs in Espírito Santo is not expected to be greater than the impact on the state's total employment. Baseline values are those reported in the RAIS.

EXPECTED OUTCOMES

Indicator	Unit of measure	Baseline 2020	Final target	Means of verification	Comments
Specific objectives: Support the short-term financial sustainability of MSMEs.					
Indicator 1: Relative default rate six months into the program in the MSME working capital loan portfolio, compared to BANDES's overall default rate.	Rate	0.96	0.96	Program monitoring and supervision information collected by the executing agency.	<p>The program aims to establish a target of maintaining the relative default level. In other words, the quality of the MSME working capital portfolio will not deteriorate more than the quality of BANDES's overall portfolio. The baseline is obtained from data provided by BANDES: target portfolio default = 13.7% and total portfolio default = 14.3%, resulting in a rate of 0.958.</p> <p>This rate corresponds to the default rate (%) of the MSME working capital portfolio divided by the default rate (%) of BANDES's overall portfolio.</p>
Indicator 2: Relative default rate 12 months into the program in the MSME working capital loan portfolio, compared to BANDES's overall default rate.	Rate	0.96	0.96	Program monitoring and supervision information collected by the executing agency.	<p>The program aims to establish a target of maintaining the relative default level. In other words, the quality of the MSME working capital portfolio will not deteriorate more than the quality of BANDES's overall portfolio. The baseline is obtained from data provided by BANDES: target portfolio default = 13.7% and total portfolio default = 14.3%, resulting in a rate of 0.958.</p> <p>This rate corresponds to the default rate (%) of the MSME working capital portfolio divided by the default rate (%) of BANDES's overall portfolio .</p>
Indicator 3. Total amount of MSME working capital portfolio resulting from program support.	R\$ millions	235.36	385.36	Program monitoring and supervision information collected by the executing agency.	<p>The measurement of the MSME portfolio does not include individuals.</p> <p>The baseline corresponds to the portfolio value as of February 2020.</p> <p>The target assumes that program resources (US\$30 million) are equivalent to R\$150 million, using an exchange rate of R\$5/US\$.</p>
Indicator 4. Share of working capital loans for MSMEs originated by women out of the total MSME working capital portfolio.	%	14.9	20	Program monitoring and supervision information collected by the executing agency.	<p>The measurement of the MSME portfolio does not include individuals.</p> <p>The baseline corresponds to the portfolio share as of February 2020.</p> <p>Loans originated by women are understood to be all loans provided to enterprises in which 50% or more of the stock is controlled by women.</p> <p>Pro-gender indicator</p>

OUTPUTS

Output	Unit of measure	Baseline 2020	Year 1	Year 2	Final target	Means of verification	Comments
Sole component: Support for improvement of short-term financial capacity (Total cost = US\$30 million).							
Output 1: Amount provided to finance working capital for MSMEs.	US\$	0	20	10	30	Monitoring and supervision information processed by the executing agency.	This is determined considering BANDES's operating capacity and the need to allow for prudent growth of its MSME portfolio through disbursement requests every six months.
Milestone: Amount provided to finance working capital for MSMEs originated by women.	US\$	-	-	-	-	-	With respect to the milestone, loans originated by women are understood to be all loans provided to enterprises in which 50% or more of the stock is controlled by women. The value of this milestone is expected to reach US\$6 million by the end of the program, consistent with the percentage target established in outcome indicator 4. Pro-gender indicator
Annual cost:	US\$ million	0	20	10	30		

Country: Brazil
Cofinancing: No

Sector: CMF

Project number: BR-L1556
Co-Execution: No

Year: 2020

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Executing agency: Banco de Desenvolvimento do Espírito Santo S/A (BANDES)
Project name: Global Credit Program for Safeguarding the Productive Fabric and Employment in the State of Espírito Santo

I. THE EXECUTING AGENCY'S FIDUCIARY CONTEXT

1. Use of country systems in program¹

Budget <input checked="" type="checkbox"/>	Reporting <input type="checkbox"/>	Information system <input checked="" type="checkbox"/>	NCB <input type="checkbox"/>
Treasury <input checked="" type="checkbox"/>	Internal audit <input checked="" type="checkbox"/>	Shopping <input checked="" type="checkbox"/>	Advanced NCB <input type="checkbox"/>
Accounting <input checked="" type="checkbox"/>	External control <input checked="" type="checkbox"/>	Individual consultants <input type="checkbox"/>	Consulting firm <input type="checkbox"/>

Applicable laws/regulations: BANDES was established on 20 February 1967, pursuant to Law 2279 of 1 February 1967. Its original name was Companhia de Desenvolvimento Econômico do Espírito Santo (CODES). In November 1969, pursuant to Law 2413 of 1969, CODES became BANDES, as it is currently known, with powers and responsibilities assigned by the Central Bank of Brazil (BACEN) to provide medium- and long-term finance.

2. The executing agency's fiduciary capacity

An assessment of the fiduciary capacity of the executing agency that was conducted using the Institutional Capacity Assessment Platform—both simplified and virtual—determined that its financial management and project coordination are sufficient to administer this operation. While this is the Bank's first operation with BANDES, this institution has more than 50 years of tradition and experience in the sector. It is a state public banking institution overseen by BACEN, and its main function is to promote financing for the state's economic development.

3. Fiduciary risks and mitigation measures

Fiduciary risk: High ☐ ; Medium ☐ ; Low ☒

Risk	Level of risk	Mitigation plan
No fiduciary risks were identified.		

¹ Any system or subsystem subsequently approved may be applicable to the operation, in accordance with the terms of the Bank's validation thereof.

II. CONSIDERATIONS FOR THE SPECIAL PROVISIONS OF THE CONTRACT

Conditions precedent to the first disbursement: None of a fiduciary nature.
Exchange rate: For purposes of accountability, the exchange rate will be: (i) for advances, the exchange rate in effect on the date on which the advances were converted from the operation's currency to the local currency; and (ii) for reimbursements, the exchange rate in effect on the date that BANDES disbursed the funds to the subborrowers.
External audit: Audited financial statements will be submitted within 120 days following the end of each fiscal year and during the original disbursement period or any extensions thereof and within 120 days following the date of the last disbursement of the loan, accompanied by the opinion of the State of Espírito Santo Audit Office or an independent audit firm acceptable to the IDB, and in accordance with the terms of reference agreed upon with the Bank.

III. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

Exceptions to policies and guidelines

No exceptions to the Bank's fiduciary policies are anticipated.

Retroactive financing and/or advance procurement²	<ul style="list-style-type: none"> The Bank may retroactively finance, from the loan proceeds, disbursements made by the borrower to issue subloans to eligible MSMEs prior to the loan approval date for up to US\$6 million (20% of the loan amount), provided that they have met requirements substantially similar to those established in the loan contract and the program Operating Regulations. Such expenditures must have been made on or after 13 April 2020,³ when BANDES launched its working capital financing product (Giro Emergencial) in response to the crisis caused by COVID-19.⁴ Even though this predates the project officially entering the pipeline (document GN-2259-1), authorization of the retroactive financing on an exceptional basis is justified as of that date, given the exceptional circumstances surrounding the global health emergency.
Additional procurement support	<ul style="list-style-type: none"> Not applicable.
Alternative procurement arrangements	<ul style="list-style-type: none"> Not applicable.

² Pursuant to the Bank Policy on Recognition of Expenditures, Retroactive Financing, and Advance Procurement (document GN-2259-1), or the equivalent policy in effect at the time of the operation.

³ That date is after the WHO declared a pandemic (11 March 2020) and after Espírito Santo declared an emergency (13 March 2020). See paragraphs 1.1 and 1.5 of the loan proposal.

⁴ BANDES has experienced growing demand for the Giro Emergencial line and had lent R\$36.7 million (US\$7.3 million) at the close of August 2020.

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

Operating expenses will be financed: <input type="checkbox"/> Not applicable.	Domestic preference: <input type="checkbox"/> Not applicable.
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General project procurement supervision method: Not applicable.	
Supervision method: Not applicable.	For: Not applicable.

Country thresholds: www.iadb.org/procurement

IV. FINANCIAL MANAGEMENT AGREEMENT AND REQUIREMENTS

Programming and budget	<ul style="list-style-type: none"> BANDES is a government enterprise with legal status and its own assets that complies with country regulations promulgated under the annual State Budget Act. Its planning, programming, and budgeting functions and responsibilities are documented in its organizational manuals and approved annually by its Board of Directors, pursuant to the guidelines of the State of Espirito Santo's government.
Treasury and disbursement management	<ul style="list-style-type: none"> Disbursement mechanism. The disbursement mechanism will include submission of physical disbursement requests. During the health emergency caused by COVID-19, signed and scanned disbursement requests may be delivered via email, provided that they are sent from an institutional email address and each signatory authorizes the request via email. Currency for disbursement. The loan will be disbursed in U.S. dollars. Disbursement modalities. The loan proceeds will be disbursed under the modalities of advances of funds and reimbursement of expenditures.

	<p>Disbursement requests will be submitted to the Bank pursuant to the requirements established in the loan contract, the Operating Regulations, and the Financial Management Guidelines for IDB-financed Projects.</p> <ul style="list-style-type: none"> • Advance of funds. With every request for advance of funds, BANDES will submit a financial plan covering up to six months, including estimates of the subloans to be issued. Before requesting a new advance, BANDES will justify at least 80% of the total cumulative balance pending justification. The Bank will verify the documentation through sampling and on an ex post basis. • Designated bank account. The IDB will process disbursements and deposit the resources in U.S. dollars into the bank account designated by BANDES to be used exclusively for the operation.
Accounting, information systems, and reporting	<ul style="list-style-type: none"> • BANDES will use its own financial information system, which is deemed satisfactory to support the accounting and financial records for its operations. However, it currently does not support records and control of operations in foreign currency. To address this, a financial management module will be developed and integrated into the current system. Otherwise, a system with the capacity to process program disbursements and financial statements, as well as the basic reports requested by the Bank, will be purchased. • BANDES complies with BACEN's rules for banks in Brazil and follows Brazilian standards for reporting. • BANDES will record all IDB-financing transactions using: (i) the exchange rate in effect on the date on which the advances were converted from the operation's currency to the local currency, for IDB resources; and (ii) the exchange rate in effect on the date of transfer to the beneficiaries for expense reimbursements and recognition of expenditures charged to local counterpart resources.
External control	<ul style="list-style-type: none"> • BANDES will submit to the Bank audited financial statements for the program within 120 days after the close of the fiscal year. These statements will be audited by the State of Espírito Santo Audit Office or an independent audit firm acceptable to the IDB, in accordance with the terms of reference previously agreed upon with the Bank.
Project financial supervision	<ul style="list-style-type: none"> • The Bank will perform verifications for the program through sampling and on an ex post basis.

V. RELEVANT INFORMATION FOR THE OPERATION

Policies and guidelines applicable to the operation

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

Records and files

BANDES has an adequate information system, and no risks or problems are anticipated in terms of records or accountability.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/20

Brazil. Loan ____/OC-BR to Banco de Desenvolvimento do Espírito Santo S/A - BANDES.
Global Credit Program for Safeguarding the Productive Fabric and Employment
in the State of Espírito Santo

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with Banco de Desenvolvimento do Espírito Santo S/A - BANDES, as borrower, and with the Federative Republic of Brazil, as guarantor, for the purpose of granting the former a financing aimed at cooperating in the execution of the Global Credit Program for Safeguarding the Productive Fabric and Employment in the State of Espírito Santo. Such financing will be for the amount of up to US\$30,000,000 from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on ____ 2020)