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MEXICO

REFORMULATION OF THE GEOTHERMAL FINANCING AND RISK TRANSFER PROGRAM TO FINANCE THE GLOBAL CREDIT PROGRAM FOR SAFEGUARDING THE PRODUCTIVE FABRIC AND EMPLOYMENT

(MODIFICATION OF LOAN CONTRACT 3178/OC-ME AND RESOLUTIONS DE-38/15 AND DE-41/18)

REFORMULATION PROPOSAL

This document was prepared by the project team consisting of: This document was prepared by the project team consisting of: Fernando de Olloqui (IFD/CMF), Project Team Leader; Christiaan Gischler and José Antonio Urteaga (INE/ENE), Project Team Co-leaders; Leticia Riquelme, Isabelle Braly-Cartillier, and Fanny Porras (IFD/CMF); Agustin Filippo, Claudia Grayeb, Miguel Taborga, and Edna Miranda (CID/CME); María Paula Gerardino (SPD/SDV); Miriam Garza (VPC/FMP); and María Sofía Greco (LEG/SGO).

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ABBREVIATIONS

BANCOMEXT	Banco Nacional de Comercio Exterior
CCLIP	Conditional credit line for investment projects
CIF	Climate Investment Funds
CNBV	Comisión Nacional Bancaria y de Valores [National Banking and Securities Commission]
CTF	Clean Technology Fund
ECLAC	Economic Commission for Latin America and the Caribbean
FIRA	Fideicomisos Instituidos en Relación con la Agricultura
FND	Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero [National Finance Agency for Agricultural, Rural, Forestry, and Fisheries Development
GDP	Gross domestic product
IMF	International Monetary Fund
Mex$	Mexican pesos
MSME	Micro, small, and medium sized enterprises
NAFIN	Nacional Financiera S.N.C. Institución de Banca de Desarrollo
OECD	Organisation for Economic Co-operation and Development
PDB	Public Development Bank
SHCP	Department of Finance
SME	Small and medium sized enterprises
WHO	World Health Organization

I. PROJECT DESCRIPTION AND RESULTS MONITORING

A. Loan reformulation request

1.1 **Request from the borrower and guarantor.** The borrower, Nacional Financiera S.N.C. Institución de Banca de Desarrollo (NAFIN) and the guarantor (through the Department of Finance (SHCP)) have asked the Bank to reformulate the "Geothermal Financing and Risk Transfer Program" (see optional link 9 and optional link 10). The program's financing structure consists of two sources of financing: a total of $54.3 million in funds from the Clean Technology Fund (CTF) (grants GRT/TC-14424-ME, GRT/TC-17351-ME, and GRT/TC-14423-ME) for Components 1 and 3; and a total of $54.3 million in funds from the Bank's Ordinary Capital resources (loan 3178/OC-ME, the fourth individual operation under Conditional Credit Line for Investment Projects (CCLIP) ME-X1010[1]) for Component 2. The request is to use all financing from the Bank's Ordinary Capital to support institutional programs that will boost economic recovery through loans to small and medium-sized enterprises (SMEs)[2] through NAFIN's financial intermediation network, to address the negative economic impact of the ongoing public health crisis caused by COVID-19. Components 1 and 3 and their respective sources of financing will remain unchanged.

1.2 **Loan objective and current status.** The program objective is to increase power production from geothermal sources so as to contribute to the diversification of the energy matrix and reduce dependency on fossil fuels and greenhouse gas emissions in Mexico. It is organized into the following components: Component 1, Risk mitigation for geothermal projects in the early stages of exploration, chargeable to contingent recovery investment operation (investment grants GRT/TC-14424-ME and GRT/TC-17351-ME); Component 2, Financing for the operation phase (including development of geothermal plants and transmission lines), chargeable to global credit program 3178/OC-ME; and Component 3, Technical assistance to support program execution and other implementation costs chargeable to nonreimbursable technical-cooperation funding GRT/TC-14423-ME.

Table 1.Cost of the current program (US$ millions)

Component	IDB	CTF	Total
Component 1. Risk mitigation for geothermal projects in the early stages of exploration	-	51.5	51.5
Component 2. Financing for the operation phase (including development of geothermal plants and transmission lines)	54.3	-	54,3
Component 3. Technical assistance to support program execution and other implementation costs	-	2,8	2,8
Total	**54.3**	**54.3**	**108.6**

1.3 The program was approved by the Board of Executive Directors in May 2014. Little headway was made in project execution because the competitive advantages of geothermal power were not factored into the design of the new competitive bidding

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[1] The objective of the CCLIP is to make Mexican companies more competitive by channeling medium- and long-term financing for investment projects in different sectors.

[2] For purposes of this program, the term SME generically includes microenterprises.

processes for renewable energy projects under the framework of the country's energy sector reform, which led to less interest in geothermal energy among developers, and because the program's design did not help mitigate exploratory risks at the right moment. In August 2018, a reformulation that adapted the program to conditions on the Mexican electricity market was approved, thereby making the program viable.[3] The program has been designed to cover the geothermal project cycle, which starts with an exploration phase (Component 1) followed by an operation phase (Component 2). As of this writing, the call for geothermal developers has concluded, and efforts are underway to launch the call for geothermal drillers, which should close in the last quarter of 2020. This phase is proceeding according to the originally planned timeline. Subsequently, the program's nonreimbursable resources (grant ME-G1005)[4] will be used to finance drilling campaigns with contingent aid arrangements. To date, the Component 1 resources have not been disbursed or executed, and, therefore, neither have the Component 2 resources (loan 3178/OC-ME). The Component 2 activities would not start until after the exploration and drilling phase has been completed.[5]

1.4 **Description of the proposed change.** Under this proposal, the project funds allocated to Component 2 activities (a total of US$54.3 million financed by loan 3178/OC-ME) will be subject to reformulation pursuant to the terms set forth herein. The reformulation will entail modifications to the objective and use of the funds allocated to financing the activities described in Section I.C. and, by extension, the expected outcomes (paragraph 1.35). However, it will not change the type of instrument (global credit), the amount of the loan or its financial terms and conditions, the borrower and executing agency (NAFIN), or the guarantor (United Mexican States). This intervention falls within the framework of the Bank's operational support for economic productivity and employment set forth in paragraphs 3.13 and 3.14 of document GN-2996, by supporting financing for micro, small, and medium-sized enterprises (MSMEs). Separately from loan 3178/OC-ME, execution of Components 1 and 3 of the program will continue with their established financing sources under project ME-G1005, pursuant to the new program results matrix (see optional link 11). The specific objective of project ME-G1005 is to promote geothermal exploration to facilitate the financial closing so plants can subsequently be built and operated. The revised results matrix for the program differs from the current matrix in that: (i) Component 2 and the corresponding output have been eliminated; and (ii) the expected outcomes associated with Component 2 have been moved and are now impact indicators under the new matrix because their financing is contingent.

1.5 To ensure the future continuity of the "Geothermal Financing and Risk Transfer Program," when the government requested the loan reformulation, it indicated, through the SHCP, that NAFIN should have access to the resources needed to restore the initial amount of loan 3178/OC-ME, the subject of this reformulation.

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3 The second reformulation, proposed herein, was prompted by the crisis stemming from the COVID-19 pandemic, as explained in the diagnostic assessment found in paragraphs 1.6 through 1.9.

4 The US$54.3 million in aid from the CTF for Components 1 and 3 is pooled under project code ME-G1005 in accounts GRT/TC-14424-ME, GRT/TC-17351-ME, and GRT/TC-14423-ME. The proceeds of loan 3178/OC-ME for Component 2 are pooled under project code ME-L1148.

5 At year-end 2019, the project was classified as "satisfactory" in the project monitoring report.

This will ensure that funds are available for the construction phase, to finance developers to build geothermal plants for power production and the associated transmission lines once the drilling phase has concluded, which could take up to three years. NAFIN has confirmed the work schedule established for implementation of the agreed-upon program activities. The Bank has ensured that the requisite coordination with the administration unit of the Climate Investment Funds (CIF) has taken place, and the CIF has issued its no objection to proceeding under the proposed terms, in accordance with its internal regulations.

B. Background, problem addressed, and rationale

1.6 **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 2019 novel coronavirus, or nCoV2019. As of 22 July, WHO had reported more than 14 million confirmed cases of COVID-19, resulting in some 612,000 deaths.[6] Almost 3.9 million cases and 164,000 deaths have been reported in Latin America and the Caribbean,[7] while those figures stand at 350,000 and around 40,000, respectively, in Mexico. The number of cases and deaths in Mexico are expected to rise, as the country is still in phase 3, in which the spread of the disease is at its most intense. WHO classifies Mexico at level 4 (out of 5) in terms of its preparedness and ability to manage public health events.[8] To respond to the pandemic, the Department of Health instituted a nationwide social distancing program on 23 March, which was in effect until 30 May 2020. Since that date, a stoplight system that shows epidemiological risk at the state level has been used to indicate a return to normal.[9]

1.7 **Macroeconomic context.** The economic impacts of COVID-19 will be felt through different channels at different times. The first, associated with the priority of saving lives in the very short term, 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, which will contribute to saving 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.), or decisions made by consumers (reducing social contact).

1.8 Public policies and changes in behavior will lead to a very significant economic downturn with immediate manifestations and lingering effects, 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 for transmission of the crisis's impacts to the region's economy:[10] (i) slowing economic activity of key trading partners that will impact the demand for exports; (ii) less demand for tourism

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6 WHO Coronavirus Disease (COVID-19) Dashboard.

7 COVID-19 Situation in the Region of the Americas. Report from the Pan American Health Organization (PAHO).

8 WHO COVID-19 Country Preparedness and Response Status for COVID-19. Based on five levels assessing operational capacity compared to response category, with level 5 indicating greatest capacity.

9 See Stoplight system for epidemiological risk.

10 ECLAC press release (19 March 2020).

services; (iii) interruption of global value chains; (iv) falling commodity prices; and (v) worsening financial terms. For general aspects of the intervention, see optional link 2.

1.9 With regard to Mexico, International Monetary Fund (IMF) projections indicate that gross domestic product (GDP) could contract up to 10.5% in 2020, a more severe contraction than the 9.4% forecast for Latin America and the Caribbean,[11] due to a sharp drop in private consumption, a contraction in exports resulting from lower demand in the United States, and a slowdown in industrial activity—notably manufacturing and construction—that began in 2019.[12] The effects of this began to show in the first quarter of this year, with GDP contracting 1.6% relative to the previous quarter. The recent drop in oil prices will also have a negative impact on public finances as a result of decreased tax revenue and the precarious financial position of Petróleos Mexicanos (PEMEX).

1.10 **Diagnostic assessment of MSMEs and their financing.**[13] In Mexico, there are 4.7 million MSMEs,[14] 95% of which are microenterprises. Much of the country's economic activity (52%) and employment (68.4%) is closely tied to these businesses, which illustrates their significance to the dynamics of the country's economy. Nearly half of MSMEs (46.7%) are in the trade sector, employing 37.9% of the working population, while 39.2% are in nonfinancial private services, employing 39.3%.

1.11 On the whole, the Mexican financial system has low levels of penetration, which is reflected in financing conditions. Domestic credit issued to the private sector in the country amounts to 36% of GDP, versus 49% in Latin America and the Caribbean and 90% in the countries of the Organisation for Economic Co-operation and Development (OECD).[15] In addition, MSMEs run up against greater financing restrictions. Loans to SMEs accounted for 11.8% of financing for the nonfinancial private sector, significantly less than consumer credit (26.3%) and home loans (20.2%). The SME lending portfolio accounted for 23.7% of loans to companies, a very low figure given the importance of SMEs to the country's economy.[16] The total portfolio of loans issued to SMEs by regulated financial institutions comprises 738,700 loans with a balance of around US$20 billion, serving just over 400,000 companies. Grouping the portfolio originated between August 2016 and July 2017 by intended use of loan proceeds, 83% of the balance and 55.6% of the loans went

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11 IMF, World Economic Outlook Update, June 2020. For comparative purposes, Mexico's GDP contracted 5% in 2009.

12 IDB (2020). *El impacto del COVID-19 en las economías de la región (Centroamérica).*

13 For more information see optional link 5.

14 According to the Department of Economy's official classification, MSMEs can have up to 250 employees and Mex$250 million in sales. All told, 99% of companies in the country are MSMEs.

15 Other countries like Chile (112% of GDP), Colombia (47% of GDP), and Brazil (60% of GDP) have higher rates than Mexico. The indicator is defined as domestic credit to the private sector by financial and nonfinancial entities and public sector lending to the private sector (as a percentage of GDP). This is a broad World Bank definition from its World Development Indicators (WDI). 2017 data.

16 Basic indicators on loans to SMEs (data from July 2017), Bank of Mexico.

to working capital. A survey reveals that only 23% of MSMEs have obtained financing from commercial banks.[17]

1.12 MSMEs are also more vulnerable to economic shocks. Due to smaller companies' relatively fragile financial structure, they heavily depend on financing for liquidity to withstand fluctuations in the business cycle.[18] In times of crisis, credit restrictions tighten, which can lead MSMEs to produce less and employ fewer people than they would like. With regard to the ongoing crisis, a survey of 5,800 microenterprises and small businesses in the United States showed that 43% of businesses are temporarily closed and that businesses have downsized their workforce by an average of 40%. Furthermore, 75% indicated that their liquidity reserves would allow them to stay afloat for two months at most.[19] This is relevant considering that, in Mexico, MSMEs employ an average of 79% of workers in the sectors most affected by the pandemic (paragraph 1.17).[20]

1.13 The financial sector is up against a series of constraints on providing all the financing that MSMEs will need during this crisis, both in the short term, to ensure MSMEs' immediate survival, and in the medium term, to stimulate a rapid recovery of economic activity and employment in the country. Looking to the 2009 crisis, credit to businesses sharply declined, with the percentage of businesses that used bank credit falling from 30% in late 2008 to 20% in late 2009.[21] The proposed intervention focuses on supporting financial mechanisms to stimulate the supply of short-term liquidity for MSMEs from financial intermediaries through a global credit program, targeting vulnerable sectors. 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, in turn, will facilitate a faster economic recovery once the public health emergency has passed.

1.14 **Challenges and progress.** In shielding the economic fabric from the economic hardships associated with the COVID-19 crisis, the challenge will be to keep as many of the MSMEs that were commercially viable before the crisis as possible open, while also supporting the value chains to which many of these enterprises belong, so that they can continue operating normally.

1.15 Mexico has been relying on public development banks (PDBs) to provide MSMEs with access to financing. The numerous entities comprising the PDB system[22]

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[17] National Institute of Statistics, Geography, and Information (INEGI) National Survey of Financing for Companies (2015).

[18] There is literature showing that MSMEs are more susceptible to economic fluctuations because their access to credit is more restricted. See M. Gertler and S. Gilchrist, "Monetary policy, business cycles, and the behavior of small manufacturing firms," Quarterly Journal of Economics, Vol. 109, No. 2 (1994).

[19] A. Bartik, et al. (2020), "How are small businesses adjusting to COVID-19? Early evidence from a survey," National Bureau of Economic Research (NBER) working paper series, No. 26989.

[20] Statistical Insights: Small, Medium, and Vulnerable. (April 2020). OECD.

[21] *Evolución del Financiamiento a las Empresas durante el Trimestre Octubre – Diciembre de 2009*, Bank of Mexico (February 2010).

[22] NAFIN, Banco Nacional de Comercio Exterior (BANCOMEXT), Sociedad Hipotecaria Federal, S.N.C (SHF), Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero (FND), Fideicomisos Instituidos en Relación con la Agricultura (FIRA), and Banco Nacional de Obras y Servicios Públicos, S.N.C (BANOBRAS).

assist MSMEs based on the economic sector to which they belong (e.g. industrial, export, rural, construction, etc.). An estimated 65% of loans given to SMEs in Mexico are backed by PDBs.

1.16 Through the reformulation of this program, the government aims to strengthen the response of PDBs to the current crisis, in addition to the other measures it has announced in the financial sector, namely: (i) the government has said that it will implement a program through which it will issue one million microloans of approximately US$1,000 each for microbusinesses registered in the Federal Government Welfare Census;[23] (ii) the Bank of Mexico announced measures to ensure liquidity for banks and businesses that may require U.S. dollars to contend with deteriorating financial conditions worldwide, as well as additional actions aimed at providing liquidity to stimulate domestic markets and solidify the channels through which credit is issued, particularly to SMEs and households whose sources of income have temporarily dried up; and (iii) the National Banking and Securities Commission (CNBV) temporarily issued special accounting criteria for credit institutions on consumer, home, and commercial loans for customers whose source of payment has been affected by the crisis. As a result, banks may offer loan payment facilities, such as freezing debt payments.

1.17 **Program targeting.** The reformulation seeks to ease the credit constraints facing MSMEs affected by the COVID-19 crisis. The program will provide access to financing for MSMEs, based on a multisector approach and in accordance with demand. Though the program's approach to loan placement is multisector and demand-based, significant emphasis will be placed on the productive sectors identified as most vulnerable in the economy. The degree to which the crisis affects MSMEs depends on the economic sector in which they operate. In Mexico, at the aggregate level, the most significant impact is on the services sector, which contributes almost two-thirds of GDP, followed by the trade sector.[24] Together these two sectors provide 77% of jobs in the country. In this manner, the program aims to support sectors in which the largest percentage of people are at risk of losing their jobs. An analysis of NAFIN's portfolio of working capital loans in recent months confirms this, as 89% of loans placed in that period have been to MSMEs in the services and trade sectors, which reflects the strong demand for resources from these MSMEs (paragraph 1.31). NAFIN's placement of second-tier loans to MSMEs increased 4.5-fold from February to March 2020, reflecting an extraordinary increase in companies' demand for resources once the pandemic erupted.

1.18 In this program, NAFIN will focus on financing for microenterprises, as that is the size of most businesses in the services and trade sectors, two sectors served only by NAFIN and not by other PDBs (FIRA serves agroindustry SMEs and BANCOMEXT serves SMEs in the export sector). This multisector approach, focused on trade and services, is consistent with the sectors identified in the vulnerability analysis (optional link 8) conducted by the Bank, which stresses the vulnerability of various services and trade subsectors, like tourism, retail trade, and

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[23] The government program targets a different market than this operation, as it focuses mainly on smaller-sized companies and loans (microloans).

[24] Group of Economists and Associates.

transportation.[25] These economic sectors are contending with all of the risks associated with a drop in domestic demand and, on the supply side, impacts on the available workforce and the disruption of supply chains, which will lead to financial restrictions and the potential need to downsize, cease payment on short-term liabilities, and discontinue operations.

1.19 Given these circumstances, the program will only finance working capital loans, to MSMEs to support their survival and preserve employment, which will in turn facilitate a faster economic recovery once the public health emergency is over. The proposed intervention will foster the supply of liquidity to companies, by channeling resources through specific second-tier financing from NAFIN, the principal public development bank serving MSMEs in Mexico (paragraph 3.2). In light of the fact that NAFIN's main objective is to support industrial and technological policy focused on the country's growth and development in order to create more and better companies that create more and better jobs, the focus on SMEs is a key component of its strategy.

1.20 The consequences of the public health emergency lead to a decline in the underlying economic activity of MSMEs, which already face challenges accessing credit under normal circumstances. This means that companies that already have loans and others that do not currently receive financing from the system are urgently seeking financial support so they can continue to operate and, by extension, maintain the jobs they create. The proposed operation aims to provide funding for NAFIN to extend lines of credit to financial intermediaries, thereby expanding the supply of commercial credit to MSMEs in multiple sectors, mainly industry, trade, and services. By benefiting MSMEs, which tend to face greater hurdles accessing credit amid a crisis, the program would help maintain employment levels. It should be noted that NAFIN plays an important role in issuing private financing to smaller businesses. Approximately 60% of private loans to SMEs have a NAFIN guarantee, which shows how relevant this institution is in ensuring that private sector credit will continue to flow to these enterprises.

1.21 **The Bank's experience and lessons learned.** The Bank has extensive experience in designing sovereign guaranteed loan programs aimed at improving MSME access to finance through financial intermediaries ([8] of optional link 3). These programs have been implemented in times of economic expansion, when support focuses on access to long-term finance for production-oriented investments, and in times of economic recession, when support focuses on ensuring that MSMEs do not lose access to liquidity to continue their economic activity. In the last financial crisis confronted by the region, 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 sustainability[26] were approved in 2008 and 2009 with

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[25] See optional link 8. Two manufacturing sectors (auto parts and the textile industry), as well as agroindustry, are also among the most vulnerable sectors. To interpret the results of the vulnerability analysis, two factors must be taken into account: (i) the sample (taken by Bank sector specialists in March 2020) is considered to already have been affected by the impact of COVID-19 on economic activity, meaning that a low-vulnerability rating does not reflect normal circumstances; and (ii) the global index should not be taken as a gauge for prioritizing the financing needs of the analyzed sectors.

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

the aim of reestablishing access to finance for working capital and foreign trade in the productive sectors. This helped to temporarily offset part of the deficit in financing flows to MSMEs resulting from the international financial crisis. With the same objective of stimulating the supply of credit to the productive sectors, the period following the crisis (2009-2013) saw the approval of contingent credit lines[27] for providing liquidity to the financial sector, as well as global multisector credit programs and—by far the majority—specific productive financing programs for MSMEs (see optional link 2).

1.22 The 2008-2009 financial crisis demonstrated that Mexico's PDBs are a vehicle for the implementation of countercyclical policies (see optional link 7) thanks to their experience operating a broad array of instruments to cover producers' financing needs.

1.23 The IDB has ample experience working with the Mexican Development Bank system, including experience with financing for MSMEs, particularly those in the agriculture and rural sectors. The following operations are of note: (i) three operations (loans 3302/OC-ME, 3531/OC-ME, and 4276/OC-ME)[28] with FND under CCLIP ME-X1024 (US$1 billion), whose objective was to help raise primary sector productivity by improving rural economic units' access to financing to make productive investments and promote financial inclusion to benefit the rural sector through access to productive credit for rural economic units; and (ii) two operations (loans 3335/OC-ME and 3701/OC-ME)[29] with FIRA as the executing agency under CCLIP ME-X1021 (US$300 million), which seek to promote private investment in production-restructuring and enterprise- and export-development, boosting productivity by promoting more efficient use of natural resources in Mexico's rural sector while increasing the supply of long-term financing and financial resources. Execution of these operations has been very successful. This operation is consistent with previous efforts to support agroindustry MSMEs, but stands apart inasmuch as it emphasizes working capital financing to keep viable companies in the sector from going bankrupt during the COVID-19 crisis, while also expanding the MSMEs served, as it is a multisector program that includes the trade, services, and industry sectors. NAFIN has executed two programs (loans 2226/OC-ME and 2671/OC-ME)[30] under CCLIP ME-X1010 (US$1.2 billion) to promote the development of SME suppliers and contractors for the national oil industry and provide medium- and long-term financing for renewable energy projects. Prompted by the government's strong push to reduce greenhouse gas emissions with

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

[28] Loan 3302/OC-ME, First Program for Productive Rural Financing (US$400 million); loan 3531/OC-ME, Second Program for Productive and Inclusive Rural Financing (US$400 million); and loan 4276/OC-ME, Third Program for Productive and Inclusive Rural Financing (US$500 million).

[29] Loan 3335/OC-ME, First Program for the Financing of Rural Sector Production Restructuring and Investment Projects (US$50 million); and loan 3701/OC-ME, Second Program for the Financing of Rural Sector Production Restructuring and Investment Projects (US$50 million).

[30] Loan 2226/OC-ME, Program to Promote the Development of SME Suppliers and Contractors for the National Oil Industry (US$301 million); and loan 2671/OC-ME, Second Individual Operation Under the Expanded CCLIP to Support Business Development in Mexico (US$50 million).

proceeds from the CTF allocated to loan 2843/OC-ME,[31] these programs focused on renewable energy projects with exceptional results.

1.24 **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 ([8] of optional link 3). 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 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. This program incorporates the lessons learned regarding the importance of targeting and identifying the right instrument (funding) to address the specific financing needs (short-term liquidity) of vulnerable and strategic sectors (MSMEs in several sectors) through a public actor specialized inthe issue (NAFIN).

1.25 The Bank also has relevant experience in designing solutions to mitigate the problems of access to finance faced by MSMEs and value chains. The following lessons learned extracted from those activities have been used in the design of this operation: (i) leverage the countercyclical role of this type of operation in times of tightening credit, such as the current crisis; (ii) target resources toward segments where lending will have the greatest impact on the functioning of the economy and the well-being of society, (in this case, MSMEs); and (iii) guarantee that the executing agency's institutional capacity is sufficient to operationalize the intervention and evaluate and monitor the subloans (paragraphs 2.7 and 3.4).[32]

1.26 **Coordination with other Bank projects:** The program coordinates efforts with other initiatives in the pipeline that aim to address needs arising from the pandemic in Mexico, especially the need to safeguard the productive fabric and employment. It complements an operation approved on 30 June 2020 (loan 5063/OC-ME, for US$100 million), which has NAFIN as the borrower and FIRA as the executing agency. That operation supports MSMEs in a different sector (agroindustry) than the ones that would receive assistance under this program. This program also complements a program announced by IDB Invest and the Mexican Business Council, which will finance reverse factoring operations by seeking to leverage US$2.5 billion from private sector banks, ultimately benefiting 30,000 SMEs in one year. This complements the proposed program mainly through the instruments adopted, since this operation supports SMEs' immediate working capital liquidity needs, while reverse factoring assists SMEs with discounts on their invoices with large companies for sales made.

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[31] Loan 2843/OC-ME, Third Individual Operation under the Expanded CCLIP to Support Business Development in Mexico. Renewable Energy Financing Facility (US$100 million).

[32] Section IV of the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7) discusses a more extensive and detailed set of lessons learned from the Bank's experience in the sector, as well as the experience of other multilaterals, academic researchers, and other major stakeholders in public policy design to support MSMEs.

1.27 **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 its support for employment generated by MSMEs; and (ii) productivity and innovation, through its financing to sustain operations of businesses. In addition, the operation is consistent with the strategic focus area of resource mobilization, through the proposed mechanisms to stimulate the mobilization of private financial sector resources for MSME finance, as well as the company shareholders' own funds. The program will contribute to the Corporate Results Framework 2020-2023 (document GN-2727-12) through the indicator of the number of micro, small, and medium-sized enterprises financed. The program is consistent with the Proposal for the IDB Group's Governance Response to the COVID-19 Pandemic Outbreak (document GN-2996), as part of the support for safeguarding the productive fabric and employment. The program is also consistent with the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7) through its support for SME financing.

1.28 **Special gender considerations**. Though this operation would not include any targeting to address specific gender considerations, it will indirectly address these issues by virtue of the sector and segment it targets. Evidence shows that gender roles have led to many women working in sectors such as trade and services, two sectors that employ 53.7% and 25%, respectively, of women in the workforce. Furthermore, data from the International Finance Corporation (IFC) indicate that 30% of MSMEs are led by women and that 35% of women-led MSMEs report significant constraints in access to finance. Thus, the program should support enterprises that employ women.

C. Objectives, components, and cost

1.29 **Objectives.** The general objective is to support the sustainability of micro, small, and medium-sized enterprises (MSMEs) as the largest source of employment in Mexico, amid the COVID-19 crisis. The specific objective is to support the short-term financial sustainability of MSMEs. The intervention is structured as a loan with one sole component.

1.30 **Sole component. Support for the short-term financial sustainability of MSMEs (US$54.3 million).** Resources under this component will be used to help MSMEs affected by the current public health and economic crisis overcome temporary liquidity problems and continue operating. This component includes mechanisms for providing liquidity to MSMEs following a multisector, demand-based approach, especially for obtaining financing for working capital.

1.31 The loans will be issued via NAFIN's second-tier operations, through eligible financial intermediaries, in accordance with the terms of the program Operating Regulations. The total balance of NAFIN's second-tier portfolio through various instruments is US$6.75 billion, of which approximately US$3.37 billion (Mex$74,823,500,000) is for working capital. The portfolio mainly focuses on the trade, services, and manufacturing sectors. An analysis of NAFIN's working capital

funding portfolio from March 2020 on shows that demand has been concentrated in services,[33] trade,[34] and MSMEs in the services and trade sectors.

1.32 The program's main conditions will be reflected in the program Operating Regulations and will include: (i) the characteristics of the MSMEs, which must be individuals or legal entities incorporated under Mexican law, with up to 250 employees and up to Mex$250 million in sales (see additional criteria in paragraphs 1.34 and 3.6); (ii) the eligible activities, which for the most part must be within the trade, services, or manufacturing sectors; (iii) the criteria and processes for identifying eligible financial intermediaries (paragraph 3.5); (iv) the maximum loan amount for MSMEs, up to US$500,000; and (v) the type of eligible loan, which must be for obtaining financing for working capital, that is to say, to cover the companies' operational and liquidity needs. The financing conditions of subloans derived from program funds will be the prevailing market conditions in accordance with the lending policies of NAFIN and the financial intermediaries, and subloans will be denominated in Mexican pesos. Working capital loans can be issued to businesses following the institution's credit guidelines.

1.33 **Program administration.** Administration, monitoring, evaluation, and audit expenses will be covered with NAFIN funds.

1.34 **Beneficiaries.** Resources under this intervention will be directed to MSMEs affected by the COVID-19 crisis. The program could benefit up to 6,472 MSMEs, depending on the demand that arises. It will indirectly benefit those businesses' employees by helping them keep their jobs in the short term.

D. Key results indicators

1.35 **Expected results.** The program's expected impact is to support the short-term financial sustainability of MSMEs amid the COVID-19 crisis, as measured by employment at MSMEs as a percentage of total employment in the country. The program's outcome indicators will be: (i) ratio between the rate of arrears for NAFIN's MSME portfolio and the rate of arrears for the national financial system's MSME portfolio, six months after program start; (ii) ratio between the rate of arrears for NAFIN's MSME portfolio and the rate of arrears for the national financial system's MSME portfolio, 12 months after program start; and (iii) the balance of NAFIN's MSME working capital portfolio.

1.36 **Economic viability.** The economic evaluation identifies the flows of benefits and costs generated by the program. The benefits consist of the economic value of the reduction in sales revenue losses, the benefits derived from a higher rate of business survival, and the benefits of jobs preserved as a result of the program. Calculations of the aforementioned flows (discounted at a rate of 12%) find that the program should have an aggregate net benefit of US$30.11 million, with an internal rate of return of 19%. Additionally, the sensitivity analysis shows that the net present value of the program remains positive for a reasonable range of values of the parameters considered key for the analysis (see optional link 1).

[33] Including, among others, the following subsectors: (i) restaurants, (ii) hotels, and other temporary lodging services; (iii) automotive repair and maintenance; and (iv) real estate services.

[34] Including, among others, the following subsectors: (i) consumer goods; (ii) automotive retail; and (iii) the retail and wholesale trade of food products.

II. Financing of the Reformulation and Main Risks

A. Financing instruments

2.1 The total amount of the proposed reformulation is US$54.3 million from the Bank's Ordinary Capital. The operation will be structured as a global credit loan, since it involves financial intermediation to the beneficiary MSMEs.

2.2 The execution and disbursement periods will be one year, since the nature of the program is to help companies with urgent liquidity needs and NAFIN has confirmed that there is a high demand for financing among MSMEs.

Table 2. Estimated program costs (US$ millions)

Component	IDB	%
Sole component. Support for the short-term financial sustainability of MSMEs	54.3	100.0
Total	**54.3**	**100.0**

B. Environmental and social safeguard risks

2.3 Disbursements have begun for Component 3 of the geothermal program, technical assistance to support program execution (funding GRT/TC-14423-ME). However, no disbursements have been made under Component 1 of the program or under Component 2, the loan that would be reformulated. As a result of this reformulation, the proceeds of loan 3178/OC-ME that would have financed Component 2 of the program to be reformulated would be redirected in full to this operation. Therefore, the reformulation will not generate any liabilities or environmental or social impacts.

2.4 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 and the executing agency's ability to manage them. Based on the due diligence findings, and given the low risk profile of the eligible loans with program resources, this operation is regarded as low financial intermediation risk (FI-3). Given their size and nature (very small-scale working capital subloans for an average financing amount of US$8,390 and a maximum amount of US$500,000, issued to MSMEs, primarily microenterprises, and with a focus on trade and services), the loans will be classified as Category "C." Loans in Categories "A" and "B" will be ineligible for financing.

2.5 Resources from this operation will not be used to finance: any activity listed on the program Exclusion List (Annex C), including activities/sectors that entail: (i) high socioenvironmental risk; (ii) involuntary physical or economic resettlement; (iii) negative impact on indigenous groups; (iv) damage to cultural sites or critical cultural sites, (v) negative impact on protected areas or Ramsar convention sites, or (vi) the use of invasive species.

2.6 The requirements for managing and mitigating potential environmental and social impacts will constitute an Environmental and Social Risk Administration System

that will be included in the program Operating Regulations, which will be approved as a condition precedent to the first disbursement (see the environmental and social management report).

C. Fiduciary risks

2.7 Prior project-execution experiences with NAFIN (loans 2226/OC-ME, 2671/OC-ME, 2843/OC-ME, 3178/OC-ME, and 3237/OC-ME) confirm that it has a good control environment, systems, processes, and records for executing operations and identifying expenses financed with IDB resources. The fiduciary team was able to verify that the internal control environment and systems are adequate for managing this new operation. Therefore, the fiduciary risk is considered to be low.

D. Other key issues and risks

2.8 **Fiscal sustainability risk.** There is a medium-level risk that the combination of the health and economic crisis and external factors, such as the falling price of oil, will significantly affect the country's fiscal and debt position, jeopardizing fiscal sustainability. To mitigate this risk, the Bank, together with other international organizations, will provide technical assistance to the country to prepare and monitor the implementation of post-pandemic economic and fiscal recovery plans that will help put the public finances back on a sustainable trajectory.

2.9 **Development risk.** There is a medium risk that the allocated funds will be insufficient to meet the demand for finance among MSMEs should the health and economic crisis worsen or go on for an extended period, causing many to shut down their operations. To mitigate this risk, the Bank has sought to coordinate with NAFIN to ensure that the response be commensurate with the sector's MSME financing needs, especially over the short term. NAFIN also has supplementary programs and resources to meet the needs of MSMEs over the course of the economic recovery.

2.10 **Sustainability.** The program is expected to contribute to easing the temporary difficulties faced by MSMEs as a consequence of the COVID-19 pandemic and, in doing so, maintain employment at these businesses and keep them operating. This will in turn lead to economic recovery. The program offers the country the opportunity to leave support mechanisms in place for future emergencies. The demonstration effect of the interventions is expected to enable the development of preventive programs to reduce MSME vulnerability.

III. Implementation and Management Plan

A. Summary of implementation arrangements

3.1 **Borrower and executing agency.** NAFIN will be the borrower and executing agency. The executing agency will be responsible for the administration, execution, control, and monitoring of resources under the operation. This operation will also have the sovereign guarantee of the United Mexican States over the borrower's financial obligations.

3.2 **Execution and administration.** NAFIN is a federal government entity with legal personality and its own budget. Its goal is to promote economic development in

Mexico by facilitating access to financing and other business development services for MSMEs, entrepreneurs, and priority investment projects, while helping to build financial markets and serve as a trustee and financial agent of the federal government. In doing this, it seeks to drive innovation and increase productivity, competitiveness, job creation, and regional growth. The entity is governed by financial regulations and subject to monitoring and oversight by the CNBV. NAFIN is a creditworthy institution with good risk management practices, an active portfolio of US$11 billion, and some US$1.8 billion in assets as of 31 March 2020.

3.3 NAFIN will use the loan proceeds to provide financing to its authorized financial intermediaries, which will be able to offer subloans to eligible beneficiaries in adequate conditions, to finance eligible investment projects (the subloans may be cofinanced).

3.4 The executing agency, using its human and technological resources, will be responsible for execution and supervision of appropriate use of the resources to be used by financial intermediaries for eligible subloans and will perform the following functions: (i) making disbursements to eligible financial intermediaries for lending of the resources to eligible beneficiaries to meet the program objectives under the provisions of the program Operating Regulations; (ii) preparing execution and financial progress reports for the Bank; (iii) monitoring compliance with environmental and social safeguards; and (iv) program monitoring and evaluation.

3.5 The eligible financial intermediaries may be the 148 institutions currently in NAFIN's network of financial intermediaries, of which 98 are nonbank institutions (66%) and 50 are banks and their subsidiaries (34%), in addition to other financial intermediaries that join the network during the program. To be eligible, the financial intermediaries must comply with the qualitative and quantitative requirements that NAFIN establishes for its network, including but not limited to: (i) a minimum of two years of lending experience; (ii) an accounting record based on CNBV criteria; (iii) a loan process that is documented at all stages (policies and procedures); (iv) facilities, structure, and information systems in place that allow them to properly control and attend to the various stages in the loan process; (v) minimum criteria for the past-due portfolio and capitalization ratios; (vi) portfolio rating methodology and preventive reserves in place; and (vii) maximum level of portfolio concentration. NAFIN will verify that all financial intermediaries satisfy the above requirements to remain eligible for the program. The eligible financial intermediaries will evaluate sub-borrowers' risk and decide whether to issue financing pursuant to the provisions of the program Operating Regulations and NAFIN's operating guidelines.

3.6 In addition to the requirements set forth under the description of the "sole component," for MSMEs to be eligible to receive credit, they will be individuals or corporations established under Mexican law that are dedicated to eligible activities and fulfill the requirements established for that purpose by the financial intermediary issuing credit.

3.7 **Special contractual conditions precedent to the first disbursement of the redirected resources. The borrower will provide evidence, to the Bank's satisfaction, of: (i) appointment of the program coordinator at NAFIN.** This is necessary to ensure adequate intrainstitutional coordination for program execution

and administration, since several NAFIN departments will be involved; **and (ii) approval of the Operating Regulations under the terms previously agreed upon with the Bank**, since they will make it possible to establish the structure, guidelines, and procedures for successful program execution (paragraph 3.8).

3.8 The program Operating Regulations describe responsibilities in the areas of administration, risk management, and coordination between the executing agency and the Bank, as well as the eligibility criteria for beneficiaries, subprojects, and financial intermediaries. The document also includes agreements for management, monitoring, and other arrangements. The program Operating Regulations will be consistent with NAFIN, and IDB policies and with Mexico's financial laws and practices. Any modifications to the Operating Regulations will require the IDB's no objection.

3.9 **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).

3.10 **Disbursements:** Resources for the program components will be disbursed by the IDB to NAFIN via the modality of advance of funds and/or reimbursements, as established in the Financial Management Guidelines for IDB-financed Projects (document OP-273-6) or current IDB policies. Disbursements will be made as reimbursements to NAFIN for transfers made to financial intermediaries that have both available credit and have submitted contracts for subloans in compliance with the eligibility criteria established in the program Operating Regulations. Disbursement verification will be on an ex post basis, subject to review of the subloans.

3.11 **Expenditure reimbursement.** The expenditure reimbursement method is expected to be used for the first disbursement request, once the amendatory contract has entered into effect and disbursement of redirected resources has been declared eligible. The borrower can be reimbursed for expenses incurred on or after 11 March 2020, the date WHO declared the COVID-19 pandemic a global emergency (paragraph 1.6), from the redirected Bank loan proceeds, provided the expenses meet the program eligibility criteria and the other provisions of the loan contract and the program Operating Regulations. It is anticipated that recognition of expenditures could reach 20%. This is justified by the extraordinary demand for resources reported by NAFIN's financial intermediaries since early March because of the economic impact of the COVID-19 crisis, which led to a lack of liquidity for businesses and the expectation that their operations will be adversely affected. The increased demand for financing among MSMEs is reflected in the fact that NAFIN's lending to MSMEs increased 4.5-fold from February to March 2020 (paragraph 1.17). Thus, the declaration of the pandemic is considered the base date, as that is when the executing agency began to contend with extraordinary

levels of demand for resources at financial intermediaries arising from a lack of liquidity among companies in several sectors.

3.12 **Financial statements and audit.** The executing agency will submit audited financial statements for the project within 180 days after the close of the fiscal year pursuant to the terms of reference agreed upon with the Civil Service Department. The final financial statement will be submitted within 180 days after the last disbursement. The fiscal year is from 1 January to 31 December of each year.

B. Summary of arrangements for monitoring results

3.13 **Monitoring.** Project execution will be monitored via six-monthly progress reports prepared by the executing agency and delivered within 60 days after the close of each six-month period. The reports will be based on the reporting commitments included in the results matrix for each operation and the financial progress reports indicated in the general conditions of the loan contract, as well as compliance with the eligibility criteria set out in the program Operating Regulations (see required link 1). These reports will be reflected in the progress monitoring reports.

3.14 **Evaluation.** The strategy for evaluating program results will follow the approach for a reflexive evaluation, before and after the program, to determine the extent of its results. The evaluation strategy is described in the monitoring and evaluation plan (see required link 1). The executing agency will bear the costs of evaluation and monitoring.

3.15 **Information for program monitoring and evaluation.** The executing agency will be responsible for maintaining data gathering and monitoring systems (see required link 1). The executing agency will commit to maintain a system for monitoring and evaluation of all components, 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 of the information, indicators, and parameters necessary to prepare the project completion report, including annual plans and the final evaluation. The executing agency will bear the costs of evaluation and monitoring. 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.

IV. RECOMMENDATION

4.1 On the basis of the evidence and documentation submitted by the borrower, together with the analysis described in the foregoing sections, and in accordance with paragraph 6 of the List of Matters That Can Be Considered by the Board via Short Procedure (document CS-3953-4) and in Resolution 28/20 approved 7 April 2020, Bank Management recommends that the Board of Executive Directors approve, via short procedure, the proposed loan reformulation, pursuant to the terms and conditions described herein, through adoption of the attached draft resolution.

Development Effectiveness Matrix		
Summary ME-L1148		
I. Corporate and Country Priorities		
1. IDB Group Strategic Priorities and CRF Indicators		
Development Challenges & Cross-cutting Themes	-Social Inclusion and Equality -Productivity and Innovation	
CRF Level 2 Indicators: IDB Group Contributions to Development Results	-Micro / small / medium enterprises financed (#)	
2. Country Development Objectives		
Country Strategy Results Matrix		
Country Program Results Matrix		The intervention is not included in the 2020 Operational Program.
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		See paragraphs 1.14 to 1.20 of the main document
II. Development Outcomes - Evaluability		Evaluable
3. Evidence-based Assessment & Solution	9.0	
3.1 Program Diagnosis	2.4	
3.2 Proposed Interventions or Solutions	3.6	
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, External Control, Internal Audit. Procurement: Information System.
Non-Fiduciary		
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	No	

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

Evaluability Note

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

The loan proposal presents a good diagnosis of the problem, as well as a review of international evidence. The proposed solutions are an appropriate response to the problems identified in the proposal and their contributing factors. The results matrix is consistent with the vertical logic of the project, presenting adequate indicators at the level of outcomes and impacts. The outcome indicators are appropriately defined to measure the achievements of the project's specific objective. The impact indicator – Percentage of employment in MSMEs over total employment in the country - reflects the contribution to the final objective of the operation.

The economic evaluation shows that the operation is efficient, with an internal rate of return of 19% and an NPV of USD30,11 million. In a context of high uncertainty, the analysis considers the benefits which are derived from a higher survival rate of firms that are beneficiaries of the program, as well as of jobs preserved in firms which survive as a result of the program.

The monitoring and evaluation plan proposes a reflective analysis of the outcome and impact indicators included in the result matrix. The monitoring and evaluation activities will be carried out by the Nacional Financiera S.N.C (NAFIN), as the executing agency, in coordination with the Bank.

RESULTS MATRIX

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

EXPECTED IMPACT

Indicator	Unit of measure	Baseline 2019	Final target (2021)	Means of verification	Comments
GENERAL OBJECTIVE: Support for the sustainability of MSMEs amid the COVID-19 crisis					
Indicator 1: Employment at MSMEs as a percentage of total employment in the country	%	68.4	68.4	Information from the National Institute of Statistics, Geography, and Information (INEGI)	A target value similar to precrisis levels should be established.

EXPECTED OUTCOMES

Indicator	Unit of measure	Baseline February 2020	Final target (2021)	Means of verification	Comments
Specific objective 1: Support for the short-term financial sustainability of MSMEs					
Indicator 1: Ratio between the rate of arrears for NAFIN's MSME portfolio and the rate of arrears for the national financial system's MSME portfolio, six months after program start	Number	1.35	Equal to baseline	Program monitoring information collected by the executing agency and regular reports from the National Banking and Securities Commission (CNBV).	The indicator is defined as: $$Indicator\ 1\ = \frac{NAFIN\ MSME\ rate\ of\ arrears}{financial\ system\ MSME\ rate\ of\ arrears}$$ The rate of arrears for NAFIN's MSME portfolio is calculated using a proxy, which is the loss rate for the NAFIN-guaranteed portfolio for MSMEs, of which 95% is for working capital. This should be updated during the program with the rate of arrears for the largest financial intermediaries. The rate of arrears for the financial system's MSME portfolio is obtained from the SME nonperforming loan ratio for all full-service banks, according to CNBV monthly reports. The baseline corresponds to the measurement in February 2020 (NAFIN MSME rate of arrears=8%; financial system MSME rate of arrears=5.93%). The target corresponds to the first measurement, to be obtained six months after program start. The aim is to maintain a value that is similar to the precrisis level.
Indicator 2: Ratio between the rate of arrears for NAFIN's MSME portfolio and the rate of arrears for the national financial system's	Number	1.35	Equal to baseline	Program monitoring information collected by the executing agency and regular reports from the CNBV.	The indicator is defined as: $$Indicator\ 2\ = \frac{NAFIN\ MSME\ rate\ of\ arrears}{financial\ system\ MSME\ rate\ of\ arrears}$$ The rate of arrears for NAFIN's MSME portfolio is calculated using a proxy, which is the loss rate for the NAFIN-guaranteed portfolio for MSMEs, of which

Indicator	Unit of measure	Baseline February 2020	Final target (2021)	Means of verification	Comments
MSME portfolio, 12 months after program start.					95% is for working capital. This should be updated during the program with the rate of arrears for the largest financial intermediaries. The rate of arrears for the financial system's MSME portfolio is obtained from the SME nonperforming loan ratio for all full-service banks, according to CNBV monthly reports. The baseline corresponds to the measurement in February 2020 (NAFIN MSME rate of arrears=8%; financial system MSME rate of arrears=5.93%). The target corresponds to the second measurement, to be obtained 12 months after program start. The aim is to maintain a value that is similar to the precrisis level.
Indicator 3: Balance of NAFIN's MSME working capital portfolio	Mex$ billion	74.8235	76.011	Program monitoring information collected by the executing agency	The indicator is measured as the balance of the portfolio of working capital loans to MSMEs. The baseline is the balance as of February 2020. Due to the uncertainty about portfolio performance—the second-tier portfolio shrank 11% in 2019 but has been increasing in recent months due to the heightened demand for credit as a result of the crisis—the conservative assumption is that the balance will increase proportionately to the program funds. If these funds were not available, there would be less financing for MSMEs by an amount equal to the program value. At the time this document was prepared, the exchange rate was around Mex$22 per US$1.

OUTPUTS

Output	Unit of measure	Baseline 2020	2020	Final target (2021)	Means of verification
Sole component: Support for the short-term financial sustainability of MSMEs (total cost=US$54.3 million)					
Output 1: Amount of working capital loans made to MSMEs	US$ million	0	54.3	54.3	Program monitoring information processed by the executing agency
Annual cost:	US$ million	0	54.3	54.3	

Country: Mexico **Sector:** CMF **Project number:** ME-L1148 **Year:** 2020
Cofinancing: Not applicable (N/A). **Co-execution:** N/A

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Executing agency: Nacional Financiera S.N.C. Institución de Banca de Desarrollo (NAFIN)
Project name: Global Credit Program for Safeguarding the Productive Fabric and Employment

I. Fiduciary Context of the Executing Agency

1. Use of country systems for the project[1]

Budget ☒	Reports ☒	Information system ☒	NCB ☐
Treasury ☒	Internal audit ☒	Shopping ☐	Advanced NCB ☐
Accounting ☒	External control ☒	Individual consultants ☐	Consulting firm ☐

Applicable laws and regulations:

Of the several laws that apply, the most important one is the Federal Budget and Fiscal Responsibility Act, which is designed to regulate activities in the areas of programming, budgeting, approval, execution, control, and evaluation of federal government revenue and expenditure. Subjects required to comply with the provisions of this law must ensure that the management of federal government resources is guided by the principles of legality, honesty, efficiency, effectiveness, economy, rationality, austerity, transparency, control, accountability, and gender equity.

2. Fiduciary capacity of the executing agency

NAFIN has acted as an executing agency in the past, and its institutional capacity has been proven in several previous operations, including a US$1.2-billion conditional credit line for investment projects (operation ME-X1010) and the operations under that line (loans 2226/OC-ME, 2671/OC-ME, and 2843/OC-ME. This prior experience has proven that the executing agency has highly developed fiduciary systems and that risk as regards the fiduciary execution of the program is low. No weaknesses that could compromise effective project execution were identified.

3. Fiduciary risks and mitigation measures
Fiduciary risk: High ☐; Medium ☐; Low ☒

Risk	Risk level (Medium/High)	Mitigation plan
No fiduciary risks were identified.		

[1] Any system or subsystem subsequently approved may be used for 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: There are no conditions of a fiduciary nature.
Exchange rate: For financial reporting, the exchange rate used will be the one published in Mexico's official gazette on the effective date on which the executing agency makes the respective payments or transfers. Article 4.01(b)(ii) of the general standards.
Audited financial statements for the program: The executing agency will submit audited annual financial statements for the project within 180 days after the close of the fiscal year pursuant to the terms of reference agreed upon with the Civil Service Department. The final financial statement will be submitted within 180 days after the last disbursement. The fiscal year is from 1 January to 31 December of each year.

III. Agreements and Requirements for Procurement Execution

No procurement is expected under this project as it is a loan for global credit programs.

Expenditure reimbursement	• The expenditure reimbursement method is expected to be used for the first disbursement request, once the amendatory contract has entered into effect and disbursement of redirected resources has been declared eligible. The borrower can be reimbursed for expenses incurred on or after 11 March 2020, the date WHO declared the COVID-19 pandemic a global emergency (paragraph 1.6 of the main document), from the redirected Bank loan proceeds, provided that those expenses meet the program eligibility criteria and the other provisions of the loan contract and the program Operating Regulations. It is anticipated that recognition of expenditures could reach 20%. This is justified by the extraordinary demand for resources reported by NAFIN's financial intermediaries since early March because of the economic impact of the COVID-19 crisis, which led to a lack of liquidity for businesses and the expectation that their operations will be adversely affected. The increased demand for financing among MSMEs is reflected in the fact that NAFIN's lending to MSMEs increased 4.5-fold from February to March 2020 (paragraph 1.17 of the main document). Thus, the declaration of the pandemic is considered the base date, as that is when the executing agency began to contend with extraordinary levels of demand for resources at financial intermediaries arising from a lack of liquidity among companies in several sectors.
Additional procurement support	• N/A.
Alternative procurement arrangements	• N/A.
Projects with financial intermediaries	• 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 program Operating Regulations.
Procurement agents	• N/A.
Direct contracting	• N/A.

Operating expenses will be financed: ☐ N/A.	**Domestic preference:** ☐ N/A.

General project procurement supervision method:	
Supervision method: N/A.	**For:** N/A.

Country thresholds: www.iadb.org/procurement

IV. Financial Management Agreements and Requirements

Programming and budget	The operation's disbursements will be labeled as external credit and counted toward NAFIN's assigned budget ceiling.
Cash and disbursement management	• **Disbursement method:** Disbursements will be made in the form of advances of funds and reimbursements. • **Disbursement mechanism:** Disbursements will be made upon submission of disbursement requests through electronic disbursements. Due to the crisis, disbursement requests may be scanned and submitted electronically, as established by the Bank's Legal Department. • **Bank account:** Program funds will be kept in a bank account that is exclusively for the program. • **Financial plan:** Advances will be made for a period of up to 12 months, depending on the demand for subloans. For advances of more than six months, justification of the need for a period longer than six months will be provided. • **Percentage for financial reporting:** 80% of the balance of advances pending justification. In the case of advances, the borrower and/or executing agency can justify the expenditures when resources are transferred to financial intermediaries and/or beneficiaries through subloans issued directly by NAFIN, as established in the program Operating Regulations. In the case of reimbursements, reimbursement requests should be submitted with a list of transfers made to financial intermediaries for second-tier operations or to

	beneficiaries for subloans issued directly by NAFIN, in accordance with the eligibility conditions set forth in the program Operating Regulations. • **Project resource flow:** Funds will be disbursed to NAFIN in its capacity as borrower and executing agency. NAFIN in turn will transfer funds to financial intermediaries or directly disburse subloans to beneficiaries.
Accounting, information systems, and reporting	• **Specific accounting standards:** Government Accounting Act and government accounting system, partially based on International Financial Reporting Standards. • **Financial reporting:** List of transfers made for eligible loans according to the program Operating Regulations. NAFIN's accounting and financial system should make it possible to identify transfers to financial intermediaries and/or subloans financed by the program issued through financial intermediaries. • **Accounting method and currency:** Cash-based. Reports will be presented in the local currency and in U.S. dollars. Reports submitted to the IDB will be prepared on a cash basis with the corresponding adjustments made.
External control	• **External auditing:** The borrower and the executing agency will select and engage the services of an eligible auditing firm acceptable to the Bank in accordance with the terms of reference previously agreed upon with the Civil Service Department.
Project financial supervision	• **Ex post supervision:** Financial supervision will be conducted by means of visits to NAFIN, working meetings, and reviewing reports, including the audited financial reports.

V. Relevant Information for the Operation

Policies and guidelines applicable to the operation

Financial management	**Procurement**
• Document GN-2811 [OP-273-12]	• Document GN-2349-15 • Document GN-2350-15

Records and files

NAFIN has digital and physical files, as well as procedures and instructions that ensure that the appropriate records and files are kept.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/20

Mexico. Reformulation of the Geothermal Financing and Risk Transfer Program for the financing of the Global Credit Program for Safeguarding the Productive Fabric and Employment (Amendment to Loan Contract No. 3178/OC-ME and Resolutions DE-38/14 y DE-41/18)

The Board of Executive Directors

RESOLVES:

1. To approve the reformulation of the Geothermal Financing and Risk Transfer Program, as described in document PR-_____,and to authorize that the undisbursed and uncommitted amount of Loan No. 3178/OC-ME, up to the amount of US$54,300,0000 from the resources of the Bank's Ordinary Capital, in order to finance the Global Credit Program for Safeguarding the Productive Fabric and Employment, in accordance with the terms and conditions established in the aforementioned document.

2. 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 Nacional Financiera, S.N.C, as Borrower, and with the United Mexican States, as Guarantor, to amend Loan Contract No. 3178/OC-ME for the purpose described in this Resolution.

(Adopted on ____________ ___2020)

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