MULTISECTOR GLOBAL FINANCING PROGRAM

(UR-0021)

EXECUTIVE SUMMARY

BORROWER:	Eastern Republic of Uruguay	
EXECUTING AGENCY:	Central Bank of Uruguay (BCU)	
AMOUNT AND SOURCE:	IDB: Ordinary capital	US$155,000,000
	Local counterpart funding:	US$ 65,785,000
	Total:	US$220,785,000
	Currency:	U.S. dollars from the Bank's Single-Currency Facility
FINANCIAL TERMS AND CONDITIONS:	Amortization period:	20 years
	Commitment period:	3 years
	Disbursement period:	4 years
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75% on the undisbursed balance

OBJECTIVES: The general objective of the program is to continue the support that the Bank has been providing, through various operations, to development of the Uruguayan financial market, in particular the medium- and long-term market, to meet the investment needs of private businesses. The specific objectives of the program are: (i) to consolidate and expand medium- and long-term financing for private investment projects aimed at the diversification, improvement and expansion of efficient productive activities under market conditions; (ii) to improve access to medium- and long-term financing for micro, small and medium-sized enterprises; and (iii) to support institutional strengthening of the Superintendency of Financial Institutions (SIIF), as well as the Intermediary Financial Institutions (IFIs), in their activities as they relate to the program's objectives; and (iv) to facilitate the development of financial markets by financing the costs of installing the operating capacity needed to launch new products and make more extensive use of those already available, as well as introducing credit lines to cover the maturity mismatches.

DESCRIPTION:

The proposed program consists of providing financing for: (i) expanding the liquidity discount facility for intermediary financial institutions (IFIs) that was created under Multisector Loan I (MSI no. 705/OC-UR) for financing Uruguayan companies at competitive market terms, regardless of size; and (ii) institutional strengthening of the SIIF, the Banco Hipotecario del Uruguay (BHU) [The Mortgage Lending Bank of Uruguay] and the IFIs participating in the program. Resources of the discount facility may be used to finance investments in all areas of private sector activity, except those in the Bank's list of exclusions.

The program's lending resources will be channeled by the BCU through the institutions that make up the financial intermediation system (public and private commercial banks, finance companies and financial intermediation cooperatives) and that fall under the supervision of the SIIF. As with the previous operation (Multisector Loan I), such institutions must comply with the eligibility standards and procedures established by the SIIF for execution of the program.

The program calls at the same time for introduction of other instruments, such as lines of credit to the IFIs to cover the maturity mismatch risk so as to allow for broader arbitration of terms in a context of ensuring adequate liquidity, and lines of credit in support of leasing operations. Subsequently, it is planned to support securitization operations for housing loans, factoring of long-term sales and goods and services contracts, and the necessary legislation is approved.

Resources for institutional strengthening will be channeled by the BCU in support of: (i) modernizing and expanding the capacity of the SIIF to supervise and regulate the current activities of the financial system, as well as those relating to new products; and (ii) developing the capacity of domestic financial entities, as needed, to adapt their management and gain access to the program, and in particular to meet the eligibility requirements for handling new products and microcredits.

Under the proposed operation, Bank resources can be used to finance working capital, microcredit, permanent working capital relating to investment projects, and the purchase of new and used real estate and housing, as was successfully done with the previous operation.

REVIEW OF ENVIRONMENTAL AND SOCIAL ASPECTS: Environmental assessments will primarily be the responsibility of the government's environmental agencies. For the initial environmental classification, as with the MSI operation, they will carry out this responsibility through a unit especially created for this purpose within the CND. The recommendations in the final report on the environmental assessment under MSI have been included in the operating rules to be applied both to the resources of the current program and to recoveries under MSI. While the public and private IFIs participating in the program will have no formal responsibility to conduct an environmental classification of the activities they finance, they will not be able to use program resources to finance any activity or project that has not been environmentally classified by the appropriate agencies.

BENEFITS: Growing competition within MERCOSUR and from outside the region demands greater impetus to the expansion of private investment, to facilitate the restructuring and diversification of the country's productive plant, and this in turn will require strengthening of the financial sector. In this context, the government intends to strengthen the credit intermediation system. To this end, the proposed program will support: (i) expansion in the coverage of medium- and long-term financial resources to embrace all efficient economic activities; (ii) establishment of an institutional basis for making greater use of medium- and long-term credit mechanisms and instruments that will contribute to the development of long-term financial markets, and in particular of fixed-yield markets; and (iii) access to these markets on the part of micro, small and medium-sized enterprises.

By its very nature, an operation that is to provide funding for all efficient private sector activities, in all sectors, is impossible to measure ex-ante as to its specific results, either at the macroeconomic level (GDP, exports) or in terms of the number and amount of loans and the size of the borrowing firm. Nonetheless, the experience under MSI with the BCU proved successful in achieving the objectives proposed, and served to validate the operating scheme selected and the capacity of the Uruguayan system and the BCU to execute the operation.

RISKS: Successful implementation of the proposed program will depend on maintaining a macroeconomic and financial climate that is favorable to the growth of

private investment. On this score, significant results have already been achieved in terms of economic reform and stabilization, and these are expected to be carried further under the current program with the International Monetary Fund. Under these circumstances, the macroeconomic risk is substantially reduced, although there are persistent imbalances in the international economy that could still have adverse repercussions on Uruguay. Careful management will in any case be needed to avoid contagion from unfavorable situations in neighboring countries.

The risk of serious trouble in the financial system is low, thanks to the restructuring that has occurred in recent years, the strengthening that has taken place in the country's supervisory mechanisms, and the reorganization of the public banking sector, all of which should ensure adequate channeling of resources under the proposed program. The introduction of credit lines for IFIs to cover the maturity mismatch risk and the institutional strengthening component to be funded by the program will serve to reinforce this aspect further.

In the past, government intervention in private contracts between debtors and creditors (compulsory refinancing laws) provoked a sharp contraction in private bank lending activity. This risk has now been significantly reduced by measures currently in place, such as the laws governing securitization and investments that facilitate the transformation of business corporations and their operating environment.

ROLE OF THE PROJECT IN BANK STRATEGY FOR THE COUNTRY AND SECTOR:

The proposed program is consistent with the government's development strategy for the period 1995-99, which is centered on a comprehensive program of macroeconomic adjustment with a long-term focus, aimed at enhancing the competitiveness of the Uruguayan economy. The Bank's strategy for Uruguay is to support the government in its efforts at further improving the climate for private investment as the engine of growth.

In this context, the government intends to strengthen the availability of medium- and long-term financing for small and middle-sized enterprises, which represent the major part of the country's industrial plant. The proposed operation will support this government objective, by expanding and consolidating the results achieved under the first global multisector credit program, with respect both to

expanding the supply of long-term financing and developing new financial products and activities in that sector.

POVERTY TARGETING AND SOCIAL SECTOR CLASSIFICATION: The program is not targeted at the reduction of poverty.

SPECIAL CONTRACTUAL CONDITIONS: Prior to the first disbursement: (i) the borrower must sign with the BCU an agreement satisfactory to the Bank, establishing the conditions for transfer of funds provided by the Bank and the obligations of both parties (paragraph 3.10); (ii) the BCU shall provide evidence that the Credit Regulations agreed with the Bank are in force (paragraph 3.27); and (iii) the BCU must sign an agreement with the CND whereby the latter, for purposes of environemtnal control, will conduct an environmental classification of projects under the program (paragraph 3.38).

Within twelve months of the first disbursement by the Bank, the borrower and the Bank shall conduct a mid-term review of objectives and achievements under the program (paragraph 3.43). As well, the environmental assessment and control procedures will be reviewed annually by the Bank (paragraph 3.41), and the disbursement timetable will be adjusted in accordance with paragraph 2.30.

The borrower has requested Bank recognition of disbursements already made or expected to be made prior to the date of approval for the financing. The amounts committed and the procedures used for such disbursements are those of MSI, which are intended to cover the funding gap and so allow continuity until the proposed operation is approved. The project team considers that the Bank could recognize up to US$30 million in this way (paragraph 3.49).

EXCEPTIONS TO BANK POLICY: It is proposed that program resources be eligible for use to finance the purchase of real estate and housing. This is a continuation of the exception approved for execution of MSI.

PROCUREMENT: Not applicable.

I. FRAME OF REFERENCE

A. Macroeconomic context

1. Recent macroeconomic developments

1.1 During the period 1995-97, the government continued its stabilization efforts, based on maintaining an exchange rate anchor, reducing the fiscal deficit, and restructuring the public sector, with an emphasis on social security and reform of the State. GDP rose at an average annual rate of 2.9%; the price index fell from 44% in 1994 to 15% in 1997, reflecting the decline in the monthly pace of devaluation (1.2% in May, 1% in August and 0.8% in November) and the relative price stability prevailing in neighboring countries; the fiscal deficit stabilized at around 1.7%; and exports rose by 12% per year. The increase in exports was however insufficient to balance the merchandise account, which was in deficit throughout the period, as was the current account of the balance of payments.

1.2 The level of economic activity has shown a favorable trend, with GDP growing by 4.0% during the first half of 1998 in comparison with the same period of 1997, although the pace of growth slowed during the second quarter, when GDP expanded by only 1.4%. The country's unemployment rate fell during the May-July 1998 trimester to 10.1%, compared with 12.0% for the same period the previous year. Growth was spread across nearly all activities, except for agriculture and fisheries. Farm output suffered from adverse climatic factors that damaged wheat, barley and sunflower crops. The industrial sector grew by 2.9%. Growth during the first half of 1998 reflected gains in various branches of manufacturing, in particular the chemical industry, where the ANCAP oil refinery returned to service after having been inactive during the first quarter of 1997. Construction activity rose by 4.7%, due largely to greater public investment by the Ministry of Transport and Public works, by UTE and by the National Ports Authority (ANP).

1.3 Inflation shrank from the rate of 17% recorded for the 12 month period ending in September, 1997, to 9.98% for the same period of 1998. This result reflected the declining pace of monthly devaluations (which fell from 0.8% in November to 0.6% in April), a further de-indexing of wage policy, and relative price stability in neighboring countries.

1.4 In the fiscal area, greater tax revenues to the central government and an increase in the operating surplus for public enterprises contributed to a reduction in the consolidated public deficit (including the major costs associated with the reform of the State), from 1.6% of GDP in the twelve month period ending in May 1997, to about 1.0% of GDP in the same period ending in 1998.

1.5 In the external sector, slower export growth, especially toward Brazil cause an increase in the trade deficit from US$406 million in the first half of 1997 to US$423 million in the first half of 1998.

2. Outlook

1.6 In light of the shifting regional and international context, with the resurgence of financial problems both within the region and in the rest of the world, Uruguay's GDP is forecast to grow by between 2.5% and 3% in 1998, reflecting primarily a sharp drop in external demand, and the recessionary adjustment that is affecting its principal trading partner, Brazil. On the other hand, it is expected that the declining trend in inflation will continue, reaching 8.5% - 9% for the year 1998, thanks to the policy of gradually de-indexing wages and public utility tariffs, and the strong deflationary pressures now afoot both within the region and in the rest of the world.

1.7 The current external context makes it necessary to reduce public spending. In this respect, the authorities hope to achieve an additional reduction in the public sector deficit in 1998, because of the sound performance of public finances in the first half of the year.

3. Agreements with the International Monetary Fund

1.8 The authorities have pursued their stabilization plan, with the support of a 21-month stand-by agreement with the IMF that is to run until March 1999. The major features of the government's economic program for 1998 are as follows: (i) to reduce inflation (Dec-Dec) from 15.4% in 1997 to 8.2% in 1998; (ii) to reduce the public sector deficit from 0.1% of GDP in 1997 to a balanced position in 1998, excluding the cost of State reforms (social security and public sector reforms); (iii) to maintain the exchange rate policy of adjusting the nominal rate in line with expected inflation, while applying new reductions to the pace of devaluation: 0.8% in November 1997, 0.7% in January, 0.5% in April, and 0.4% in October 1998; (iv) to change the timing of wage adjustments for public servants, from four-monthly to semi-annual, as of 1998; and (v) changing the maturity profile of the foreign currency debt, from short to long term. The 1997 goals under the stabilization program were achieved as agreed with the IMF.

1.9 The balance of payments will show a higher trade deficit, reflecting: (i) sluggish growth in exports, due to the drop in external demand in general, and from Brazil and Argentina in particular, together with lower prices for Uruguay's principal export products; and (ii) rising imports from Asian countries, whose currencies have been sharply devalued. This wider deficit will be partially offset by the surplus on the services account.

The current account deficit in the balance of payments should be somewhat higher than that recorded for 1997.

B. Inadequate investment levels

1.10 Domestic investment reached levels of 13-14% of GDP in 1993-1997, in part because public investment represented, on average, around 4.5% of GDP. Private investment has recovered from its low levels of 1988-1990, exceeding 9% of GDP on average over the period 1993-1997.

1.11 Despite this recovery in the level of private sector investment, however, it remains inadequate for sustaining long-term growth in the economy. It is essential, therefore, to strengthen mechanisms for channeling domestic savings into productive investment at home. The short-term profile of available financing has improved, with the injection of funds from the global credit programs, and with progress in the placement of instruments on capital markets. Yet there continues to be a shortage of medium- and long-term credit for restructuring, expanding and modernizing companies, especially at the SME level, despite progress in controlling inflation. This situation justifies a second global multisector financing operation.

C. Status of structural reforms

1.12 In the course of recent decades, Uruguay has made a serious and sustained effort at structural reforms intended to liberalize the economy and open it to the play of market forces. The most significant steps have been in the area of exchange rate policy, external trade, prices, and fiscal and monetary policy.

1.13 Policy affecting the exchange rate and the financial sector has liberalized all current and capital transactions. Apart from permitting deposits in foreign currencies, interest rates have been freed, selective credit has been eliminated, and new financial entities have been allowed into the market. With reference to structural reforms, the macrofinancial setting has been strengthened, and has been given a solid new legal and regulatory framework that will ensure its efficiency and solvency. As well, restructuring has begun in the public banking sector, as will be seen below.

1.14 External trade policy has been gradually reducing the maximum tariff levels on imports (from 346% in 1974 to 20% in 1993), while the number of customs categories has been cut from 30 in 1979 to 3 in 1993 (20%, 15% and 10%), in addition to the removal of customs duties under the MERCOSUR accord. Taxes on exports have been virtually abolished, except for a 5% levy on greasy and scoured wool, bone-in meat, live animals, and leather. Exports are exempt from value-added tax, in accordance with the guidelines of the World Trade Organization in this regard.

1.15 Tax policy has reduced the distortions that used to distort relative prices for capital and labor, as well as those that accorded preferences to import substitution. The reforms undertaken in this area include the gradual reduction of import tariffs and the almost complete removal of export taxes, as noted, and reductions in private sector worker and employer contributions to social security and family allowances.

1.16 Policy with respect to controlling consumer prices is limited to maintaining administrative control over a few staple products (milk, bread).

1.17 Income policy for the private sector leaves negotiation of wages and benefits to the two parties concerned. The government has adjusted the frequency of wage and salary adjustments from every four months to semi-annually, effective December 1997.

1.18 Policy with respect to reducing the size of the State has two aspects. The first consists in reducing employment in the public sector, with a view to enhancing its efficiency, under an ongoing program supported by the IDB. The second, based on a law approved in 1995, is directed at reducing the burden of the social security and pensions system on the public finances over the longer term. This reform introduced a mix of private and public pensions, with retirement age limits and salary replacement ratios that are more in line with the life expectancy of the economically active population, both at birth and upon retirement.

D. Macrofinancial context

1. The financial sector: background

1.19 At the beginning of the 1980s, the financial system faced serious difficulties that are still influencing lending activities. Abundant flows of external funds gave rise at that time to the rapid expansion of credit that was used to purchase consumer goods, real estate and livestock, without due consideration to the repayment capacity of borrowers. The accelerated growth of lending by the commercial banks was followed by the collapse of the real estate market, the deregulation of interest rates, increasing dollarization of loans and the devaluation of the Uruguayan peso in November, 1982.

1.20 The freeing of interest rates, which went from negative to positive levels in real terms, combined with the high debt-to-equity ratio of businesses, the effect of the increasing denomination of debt in dollars, and the collapse of the exchange rate system led to several consequences: (i) borrowers (firms or individuals) were placed in a situation where they could not pay their debts, and (ii) the banks were left with large volumes of overdue loans, backed by collateral the value of which fell far short of the amounts loaned against it. Many firms were forced into bankruptcy

protection agreements. Nonperforming loans came to represent a growing percentage of bank portfolios, thus posing a direct threat to the stability of the financial system. The banks were faced with insolvency.

1.21 In the face of this crisis, the BCU purchased nonperforming loan portfolios, the government halted foreclosures, and Parliament approved a series of refinancing laws. This altered the contractual relationship between debtors and creditors, a situation that eroded the confidence of financial institutions in the legal security of contracts. Commercial bank lending to the private sector reflected this loss of confidence, and fell steeply in real terms.

2. <u>Restoring solvency to the financial system</u>

1.22 The problems in the private banking system led to some major adjustments in the second half of the 1980s, and the early years of the 1990s: (i) the private banks were nearly all taken over by foreign banks, which had to clean up their portfolios and inject fresh funds to absorb the losses from nonperforming and unrecoverable debts, and to maintain their solvency, in accordance with new banking standards and supervisory rules; (ii) several firms had to cease borrowing, because of repayment problems or because of composition agreements with their creditors; and (iii) the banks raised their lending rates, except for first class (prime rate) customers, in order to compensate for their nonperforming portfolio, thereby increasing the cost of credit for still-solvent firms.

1.23 The government undertook to improve the solvency, security and stability of the banks and other financial entities by introducing new regulations governing liquidity, portfolio classification, provisioning and capital adequacy, on the basis of the Basel rules, and imposed new information and accounting requirements, together with stricter supervision. Financial legislation was also the subject of major amendments, including the passage of: (i) the Charter of the Central Bank of Uruguay (BCU), in order to equip it with powers to penalize banks, regulate the entry and exit of institutions, and to make it solely responsible for the handling of banks in difficulty; and (ii) a new law on financial entities, which opened up to the entire banking sector activities that had previously been limited to investment banks.

1.24 The Bank's Financial Sector Adjustment Program supported these moves by the government, aimed at restoring the solvency of the commercial banks, strengthening the regulatory mechanisms, and converting the Superintendency of Banks into an effective supervisory body. All of this has helped to return operations to a more normal footing, as will be seen below, and has encouraged the emergence of more sophisticated credit departments and a more cautious approach to the choice of borrowers.

E. Recent situation

1.25 Dollar-denominated demand and savings deposits in the banking system totaled US$7,547 million in December 1997, of which the BROU (Banco de la República Oriental del Uruguay) accounted for one-third. Deposits by non-residents stood at US$2,799 million, and those of residents at $4,748 million. The historical pattern of non-resident deposits reflects the volatility of the exchange systems in neighboring countries. Banks have dollarized their lending, in line with the currency composition of their demand and savings deposits. Dollar deposits from and placements with residents have been virtually even, but non-resident deposits exceeded placements abroad by US$1,622 million in 1997. Placements with residents in dollars rose from US$827 million in 1991 to US$2,797 million in 1997.

Table I-1
PLACEMENTS AND DEPOSITS IN DOLLARS, 1974-1996
(In millions of dollars)

	1974	1979	1982 1/	1985	1989	1991	1994	1996	1997
A. Placements	94	1,016	2,115	1,456	2,069	2,178	3,638	4,673	5,510
BROU	31	234	504	509	796	884	1,306	1,767	1,914
Private banks	62	782	1,611	947	1,273	1,294	2,332	2,906	3,596
Residents	62	732	1,474	738	894	827	1,660	2,275	2,797
Non-residents	-	50	137	209	379	467	672	631	800
B. Deposits	56	911	1,742	1,588	3,648	4,871	5,746	6,716	7,547
BROU	5	97	322	536	1,177	1,626	1,915	2,337	2,560
Residents	5	97	203	392	882	1,268	1,634	1,976	2,183
Non-residents	-	-	119	144	295	358	281	361	377
Private banks	51	814	1,420	1,052	2,471	3,245	3,831	4,380	4,987
Residents	43	539	719	579	1,062	1,358	1,987	2,266	2,565
Non-residents	8	275	701	473	1,409	1,887	1,844	2,114	2,422
C. Balance A-B	38	105	373	-132	-1,579	-2,693	-2,108	-2,043	-2,037
BROU	27	137	182	-27	-381	-742	-609	-570	-646
Private banks, residents	19	192	755	159	-168	-531	-327	9	232
Private banks, non-residents	-8	-224	-564	-264	-1,030	-1,420	-1,172	-1,483	-1,622
Private banks, balance	11	-32	191	-105	-1,198	-1,951	-1,499	-1,474	-1,391
GDP	3,800	7,294	3,540	4,719	7,992	10,041	16,255	18,956	19,959
Placements/GDP	2.4%	13.9%	59.7%	30.9%	25.8%	21.7%	22.4%	24.7%	27.6%
Deposits/GDP	1.4%	12.4%	49.2%	33.7%	45.6%	48.5%	35.3%	35.4%	37.8%
Res. Deposits/GDP	1.3%	8.7%	26.0%	20.6%	24.3%	26.2%	22.2%	22.4%	23.8%

1/ Results for year-end 1982 are heavily influenced by the devaluation that occurred at the end of November 1982.

Source: BCU, Boletín Estadístico, various years.

1.26 Total lending by the private banking system to residents grew from US$1,115 million (74% in dollars) in 1991 to US$3,308 million in 1997, or at an annual rate of 20%. The sector distribution of lending was: consumers 22%; manufacturing 26%; services 15%; trade 25%; agriculture 9% (see table I-2).

1.27 The overall pattern of lending by sector over the period 1991-1997 shows a lower annual rate of growth in credit to manufacturing

(11%) and agriculture (16%), compared to other sectors of the economy, in particular consumer credit (38%), services (30%) and trade (19%). Consumer credit has risen significantly, in line with the higher growth of this macroeconomic variable, which was driven in part by the transfer of resources to older age groups, as a result of the pension reform that flowed from the 1989 plebiscite, and in part by the ready availability of credit, given that the banks preferred to place their funds among a mass of consumers so as to disperse the credit risk. The options for financing purchases on credit have increased in the last few years, thereby encouraging higher sales.

1.28 The more favorable performance of bank credit for services and for retail trade reflects the trend in activities related to the tourism boom in recent years, and the emergence of new shopping centers. The trend in credit to manufacturing reflects some of the problems that this sector is encountering, as it adapts to greater external competition. Nonetheless, the positive behavior of credit also reflects the process of industrial restructuring and a re-ordering of the relative importance of subsectors, as will be seen below. Lending to the various manufacturing subsectors during 1991-1997 reflects the continued dominance of the traditional sectors (food, textiles and leather), while beverages, wood and cork, paper and printing have expanded their share.

TABLE I-2
SECTOR DISTRIBUTION OF PRIVATE BANK LENDING TO RESIDENTS
(In millions of dollars)

SECTOR	1991	% total	1994	% total	1996	% total	1997	% total
Agriculture	125	12.8	191	9.7	241	9.2	312	9.4
Industry	497	37.9	631	32.0	872	33.2	958	29.0
Manufacturing	470	36.0	564	28.6	807	30.7	859	26.0
Construction	27	1.9	67	3.4	65	2.5	99	3.0
Trade	290	28.8	522	28.0	644	24.5	835	25.2
Wholesale	235	23.8	433	22.0	477	18.2	624	18.9
Retail	55	5.0	120	6.1	167	6.4	211	6.4
Services	101	10.4	234	11.9	363	13.8	492	14.9
Consumption	101	10.1	362	18.4	507	19.3	710	21.5
TOTAL	1,115	100.0	1,970	100.0	2,628	100.0	3,308	100.0
GDP	**10,041**		**16,204**		**18,920**		**19,959**	
Credit GDP	11.1%		12.2%		13.8%		15.6%	

Source: BCU, Boletín Mensual

F. Development of the financial sector

1. Size and structure of the banking system

1.29 The Uruguayan banking system consists of 53 financial institutions: 2 official banks (the Banco de la República Oriental del Uruguay, BROU, which is a commercial bank, and the Banco Hipotecario del Uruguay, BHU), 22 private banks, 10 private finance companies, 8 financial intermediation cooperatives, and 11 off-shore entities. The system has 471 branches (132 for the official banks, 231 for the private banks, and 76 for the cooperatives). Finally, there is the National Development Corporation (CND), which was founded in 1985 to see to the rescue of insolvent firms that were deemed to be still viable from an operational viewpoint. Its statutes provided for it to have a mixed capital structure (60% state, 40% private), but only the public portion was subscribed. Among the CND's functions are to promote the creation of new businesses and to invest in priority sectors, to encourage the development of entrepreneurial skills, and to analyze areas for new investments.

2. The Uruguayan financial system and MERCOSUR

1.30 The Uruguayan financial system in its present form is facing a number of challenges, interrelated to a certain extent, that could have a significant impact on it: (i) the creation of MERCOSUR, and the consequent impact on national institutions of direct incursions into domestic markets by financial entities from other countries; (ii) the prospect of continued and reinforced monetary and exchange-rate stability among neighboring countries, and the consequent los of Uruguay's comparative advantage as an off-shore center for non-residents; and (iii) banking disintermediation in lending to corporations, which are turning increasingly to capital markets.

1.31 In this context, questions inevitably arise about the future of the Uruguayan financial sector, and about the manner in which it will participate in an increasingly regionalized (and globalized) system. The major elements in the puzzle are: (i) the relative dimension of markets, as determined by GDP, population, size of financial systems and the relative weight of the banking system; (ii) the degree of harmonization of exchange rate systems, banking regulation and supervision, and fiscal and monetary policies; (iii) the efficiency of the system in each country, with respect to the use of technology, labor rigidities, levels of revenues and costs for services and other products; and (iv) the degree to which the systems can adapt to new financial products and the extent to which these may penetrate may the local and regional market.

1.32 The most appropriate and realistic response would be to develop specialized activities for the regional market, in certain products or financial areas that will permit moderate but solid growth in

the Uruguayan financial sector as part of the regional industry. At the same time, the system could pay greater attention to local needs, secure in the advantages of location, market familiarity and enhanced competitiveness. That new competitiveness, in turn, could be based both on the technology content of the products it offers its customers, and on the cost of its services, which would imply more intensive training of personnel and a greater effort at technological development on the part of the IFIs.

3. Interest rates

1.33 The reforms that were launched in 1974 included adjustments to interest rate ceilings, until they were finally abolished in 1979. This meant that lending and borrowing rates were free to be set by the market. The behavior of lending and borrowing rates over the period 1991-1997 is shown in Table I-3.

TABLE I-3
INTEREST RATES
(Averages, in %)

	1991	1992	1993	1994	1995	1996	1997
I. LENDING							
1. Foreign currency							
Preferential	10.1	8.1	6.6	7.5	9.0	8.5	8.5
Standard	12.2	11.8	11.2	11.7	13.8	13.1	12.7
Manufacturing	8.3	7.9	7.4	9.7	9.8	9.3	9.3
Trade	9.1	8.7	8.2	10.5	10.6	10.7	10.8
Families	10.2	9.5	12.1	13.0	13.7	14.2	15.0
2. National currency							
Preferential	104.9	74.7	60.9	59.7	61.7	48.2	39.2
Standard	152.9	117.8	97.3	95.1	99.1	91.5	71.5
Manufacturing	101.8	70.4	71.1	82.2	57.5	52.0 [1]	37.0 [1]
Trade	115.0	77.8	82.9	87.7	67.5	62.6 [1]	42.4 [1]
Families	139.6	98.1	110.1	103.9	102.4	93.8 [1]	75.6 [1]
II. BORROWING							
1. Foreign currency							
Fixed term deposits (1-6 months)	4.9	3.4	3.1	3.4	4.6	4.8	4.8
2. National currency							
Fixed term deposits (1-6 months)	75.2	54.5	39.4	37.0	38.2	28.1	19.6
III. TREASURY BILLS							
1. In Dollars							
182 days	5.76	4.38	3.69	6.59	6.02	5.38	5.08
364 days	6.94	5.45	4.26	7.40	6.25	6.08	6.17

[1] Effective rates at end of December of each year
Source: BCU, Boletín Estadístico, No. 208, April, 1998.

4. <u>Demand for financial assets</u>

1.34 Since the financial crisis of 1982, the economy has experienced a gradual decline in the demand for financial assets in pesos. The monetary coefficients, measured by the ratios of M1 and M2 to GDP, have decreased steadily from that time, offset by the dollar holdings of residents. If we include the peso equivalent of non-

resident dollar deposits to derive total private sector financial assets (M4) in the banking system, there is an even more marked preference for dollar assets. The growth of non-resident dollar deposits reflects the credibility of the Uruguayan financial system as the depository for financial capital, especially for countries in the region. As can be appreciated from Table I-4, there is a declining ratio of the peso-denominated monetary base, cash and near-cash with respect to GDP, while when total dollar deposits (M4) are included, the trend changes completely.

TABLE I-4
MONETARY INDICATORS
(% of GDP)

	1974	1979	1981	1982	1988	1990	1994	1995	1996	1997
M0	9.8	9.5	6.7	8.3	10.2	6.7	5.6	5.2	5.6	5.3
M1	12.4	10.6	8.4	10.2	7.6	7.5	7.7	7.4	7.2	6.9
M2	18.5	22.9	25.0	26.5	17.9	16.3	12.7	13.3	12.5	11.7
M4	30.4	42.5	49.3	85.2	88.4	117.9	72.2	76.7	77.2	72.5

MO = Monetary base
M1 = Cash, in pesos
M2 = Near-cash, in pesos
M4 = Near cash, pesos plus total dollar deposits
Source: Central Bank of Uruguay, Boletín Mensual various years

5. <u>The need to deepen the capital market</u>

1.35 Businesses tend to finance their investments with their own funds, or through short-term, renewable arrangements with their banks. Medium and longer-term credit has been scarce, and the securities market has not been a major source of business financing. Development of a market for shares and negotiable debt instruments is a key factor for improving business access to medium and longer-term financing. Aspects that will require particular attention in this regard are: (i) expanding medium and long-term credit through the IFIs, particularly for productive activities and industrial restructuring, (ii) developing new products such as securitization and private debt issues as a principal means of developing a capital market, (iii) reinforcing regulation and security mechanisms, particularly for new activities (insurance, securities market, rating agencies and retirement savings fund managers (AFAPs)), and (iv) further strengthening business legislation and property rights.

1.36 The channeling of external savings to priority capital projects will be facilitated by the fact that Duff & Phelps, IBCA, Moody's and Standard & Poor's have recently classified Uruguay as a low-risk country for investment. Their investment grade classification

will make it easier for first-class Uruguayan firms to tap international capital markets.

1.37 In this context, it is interesting to note that the BCU has approved, and Parliament has given preliminary support to, a draft law on securitization whereby assets such as mortgages and other property-backed debt, credit card debt and accounts receivable can be converted into negotiable instruments and placed on the securities market. Other positive factors are: (i) the placement of negotiable company debt, despite some negative experiences that are now being overcome 1/, and (ii) the market entry of AFAPs which, by holding public securities, have apparently helped stimulate demand for private company paper.

1.38 The Bank's Sector Investment Loan No. 703/OC-UR has supported major legislative changes for strengthening the country's capital markets. Other actions by the Bank have provided: (i) financing from the Multilateral Investment Fund (FOMIN) for strengthening the superintendencies of insurance and securities, and (iii) technical assistance for the superintendency of AFAPs. Similarly, a FOMIN operation (TC-9601346-UR) was recently approved for consolidating and deepening the capital market by enhancing the BCU's capacity to regulate and supervise the securities and insurance markets.

G. Strategy and justification for Bank participation

1.39 The proposed program is consistent with the government's development strategy for the period 1995-99, which is centered on a comprehensive program of macroeconomic adjustment with a long-term focus, aimed at enhancing the competitiveness of the Uruguayan economy. As part of this policy, the government approved, in April 1998, the National Strategy for Competitiveness and Employment, which provides concrete measures for stimulating the accumulation of physical and human capital needed to develop a long-term competitive focus. In addition to the new investment law and other steps to update capital market instruments, the government has in place programs to support the growth of labor-intensive micro, small and medium-scale enterprises. These include the expanded funding proposed in this operation; the recent US$30 million recapitalization of the National Development Corporation (CND); a special Bank-supported technology development program (loans No. 646/OC-UR and 647/OC-UR); a program for a business development center with FOMIN funds (TC-9806251); and programs for development in the dairy and farming sectors (loan no. 1063/OC-UR).

1.40 As the preceding paragraph shows, the strategy adopted for Uruguay by the Bank is fully consistent with the government's efforts to

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1/ The BCU has issued new rules for the issuing of negotiable debt instruments.

encourage private investment as the engine of growth. In this context, the specific objective of supporting initiatives for continued improvement in the climate for financing private investment finds concrete expression in this new operation: the Global Multisector Financing Program II, which is a continuation of the US$90 million loan no. 705/OC-UR, approved in late 1992 and now fully disbursed.

H. Experience of the Bank

1.41 The Multisector Credit Program I, for which the present operation would be in large measure an expansion in terms of funding amounts and mechanisms, has been 100% disbursed, despite some initial difficulties. Those difficulties were due to delays in fulfilling the prior conditions, particularly those relating to the effectiveness of the environmental institutions that were to classify and supervise operations, and the BROU's lateness in obtaining a declaration of eligibility from the BCU to take part in the program. Those factors, combined with the sluggish performance of the economy in 1995, led to an extension of 24 months in the disbursement period as originally planned.

1.42 Of the total of 24 banks (2 public) and 8 financial cooperatives, 10 were declared eligible and 9 made use of the program (8 banks and 1 cooperative). The BROU took the largest share (33%), followed by the Comercial (20%), Pan de Azucar (14%) and SURINFVEST (11%). Of the US$205 million used to December 1997, US$90 million represented loan funds, US$86 million came from the subborrower, and US$29 million from the IFIs. It should be noted as well that the portfolio generated by the previous operation (897 loans to February 1998) shows no arrears to the executing agency (BCU), and the proportion of overdue loans in the primary portfolio held by the private IFIs (1.5% in February, 1998, involving only 19 loans with arrears of US$675,000) is in line with overall levels of arrears in the system. Fifty-seven percent of loans went to finance machinery and other capital goods. As well, new products were introduced, such as the integral line of credit for small rural producers (the "La Granja" project), and a start was made by the private commercial banks at building a mortgage loan portfolio of housing at market terms.

II. THE PROGRAM

A. Objectives

2.1 The general objective of the program is to continue the support that the Bank has been providing, through various operations, to development of the Uruguayan financial market, in particular the medium- and long-term market, to meet the investment needs of private businesses. The specific objectives of the program are: (i) to consolidate and expand medium- and long-term financing for private investment projects aimed at the diversification, improvement and expansion of efficient productive activities under market conditions; (ii) to improve access to medium- and long-term financing for micro, small and medium-sized enterprises; (iii) to support institutional strengthening of the Superintendency of Financial Institutions (SIIF) and of the country's Intermediary Financial Institutions (IFIs) in conducting activities tied to program objectives; and (iv) to facilitate the development of financial markets by financing the costs of installing the operating capacity needed to launch new products and make more extensive use of those already available as well as introducing credit lines to cover the risk of maturity mismatches.

2.2 In order to achieve the above objectives, program resources will be used to finance investment projects, located in Uruguay, by private individuals and businesses legally established in Uruguay, in all economic activities permitted by law, with the exception of those activities specifically excluded by the Bank. Fund will also be provided to cover the costs of institutional strengthening for the IFIs, incurred to install the operating capacity needed for launching new products aimed at financing productive investment or making more intensive and effective use of existing capacity.

B. Description of the Program

2.3 The proposed program consists of providing financing for: (i) expanding the liquidity discount facility for intermediary financial institutions (IFIs) that was created under Multisector Loan I (MSI, no. 705/C-UR) for financing Uruguayan companies at competitive market terms, regardless of size; and (ii) institutional strengthening of the SIIF, the Banco Hipotecario del Uruguay (BHU) and the IFIs participating in the program. Resources of the discount facility may be used to finance investments in all areas of private sector activity, except those covered by the Bank's list of exclusions.

2.4 The program's lending resources will be channeled by the BCU through the institutions that make up the financial intermediation system (public and private commercial banks, finance companies and financial intermediation cooperatives) and that fall under the

supervision of the SIIF. As with the previous operation (Multisector Loan I), such institutions must comply with the eligibility standards and procedures established by the SIIF for execution of the program.

2.5 The program calls at the same time for introduction of other instruments, such as lines of credit to the IFIs to cover the maturity mismatch risk so as to allow for broader arbitration of terms in a context of ensuring adequate liquidity, and lines of credit in support of leasing operations. Subsequently, it is planned to support securitization operations for housing loans, factoring of long-term sales and goods and services contracts, as the necessary legislation is approved.

2.6 The credit lines to cover the maturity mismatch risk will be provided to IFIs that are eligible to participate in the program's regular lines of credit. They will provide financing for up to 25% of the portfolio of Class I loans (the highest classification) that have between one and eight years remaining to maturity, and that were made for the purpose of financing investments in private productive activities. The amount of the line may in no case exceed 30% of the IFI's total lending portfolio. The IFIs will pay a fee for subscription to the line of credit. If funds are provided by the line of credit they will be treated as loans, similar to the regular loans provided under the program. The IFIs may only activate the maturity mismatch credit lines when the average level of M3 (defined as currency in circulation, plus demand deposits, plus term deposits by residents in pesos and dollars) for the immediately preceding calendar month has declined by more than 5%.

2.7 Resources for institutional strengthening will be channeled by the BCU in support of: (i) modernizing and expanding the capacity of the SIIF to supervise and regulate the current activities of the financial system, as well as those relating to new products; and (ii) developing the capacity of domestic financial entities, as needed to adapt their management and gain access to the program, and in particular to meet the eligibility requirements for handling new products and microcredit.

2.8 As with the MSI operation, program resources will be transferred by the borrower to the BCU by means of an agreement that will spell out the conditions of transfer and the Executing Agency's obligations as previously agreed with the Bank. Use of program resources will be governed in principle by the eligibility rules for IFIs and by the Credit Regulations, which include the changes needed to adapt the standards and operating regulations of MSI to cover new products, as in the case of lines of credit to cover the maturity mismatch risk and leasing contracts. The eligibility requirements for other new products will be worked out in due course between the Bank and the executing agency, and the appropriate changes will be made to the standards and the

regulations. Introduction of new products will be done through consultation between the BCU and the Bank, to ensure that the appropriate economic and financial conditions are in place, as well as the legal and regulatory framework necessary for launching them. The SIIF will determine which of the IFIs are to be eligible to participate in the program, and will determine the timing and conditions for the introduction of new products. The basic eligibility requirements for IFIs will remain the same as those under the previous loan.

2.9 It is expected that most of the private IFIs and public banks (Banco República and Banco Hipotecario) will participate. To ensure effective use of the resources, the IFIs will be required to submit documentation to the BCU on their subloan contracts, lines of credit covering the maturity mismatch risk, leasing contracts, etc, as the BCU may determine. Once it has checked these documents, the BCU will credit the funds to the IFI in the appropriate account.

2.10 Under the proposed operation, Bank resources will be able to be used for financing working capital for microcredits, permanent working capital relating to investment projects, and the purchase of new and used real estate and housing, as was successfully done with the previous operation. The IFIs will assume the entire credit risk for each subloan they make.

2.11 Subborrowers under the program will be individuals or companies in the private sector, legally established in the county, who in the judgment of the IFIs have the technical, financial, managerial and legal capacity to evaluate the investment project for which funding is sought, and to administer the kind of instrument through which it is to be effected. The IFIs will assume the entire credit risk for each subloan they make.

2.12 It is expected that the CND (National Development Corporation) will provide operational support in those areas that are not strictly related to bank lending (coordination of environmental aspects, program promotion etc.). To this end, the CND will sign an agreement with the executing unit and the borrower.

C. Justification of the multisector credit approach

2.13 The choice of a multisector credit as the instrument for addressing the shortage of medium- and long-term financing in the Uruguayan financial system is based on several considerations. First, channeling resources in this way will help to increase the banking system's sophistication in financing and supporting the goods-producing and service sectors.

2.14 Second, as with the first Multisector Loan, the program's methodology will ensure that funds are allocated transparently, in line with market criteria and project profitability, without

subsidy or pre-assignment to certain entities or sectors, and subject to proper administration and supervision. This is consistent with the Bank's policy to date in operations of this nature, and with the Evaluation Office's recommendations concerning Bank strategy towards financial sector reform and lending programs, which call for there to be a competitive and efficient first-tier system in place, with adequate prudential standards and supervision, to assume responsibility for evaluating the credit risk.

2.15 Third, the distribution of program funds among economic sectors and types of activity will be determined essentially by market conditions. On this point, the cost of funds (interest rates) and the expected return on investment will be particularly important.

2.16 Fourth, the design of the proposed program includes elements that will, on one hand, encourage participating IFIs to engage in loan syndication 2/, and on the other hand will foster the use of various financial instruments for formalizing the loans. These elements are being included on the understanding that promoting competition for resources and the design of marketable financial instruments by the IFIs will make a major contribution to the development of long-term financial markets in general, and capital markets in particular. The program is expected to encourage the IFIs to become involved in transactions involving leasing, securitization, foreign trade, loan syndication, and marketable instruments. Rules governing leasing contracts are being prepared, and the program regulations include the relevant regulatory aspects.

2.17 Syndication will be needed for financing larger-scale investment projects, since IFIs are not allowed to make individual loans in excess of 50% of their net worth. Syndication will also permit the subsequent sale of participations 3/ or the issuing of marketable securities to private investors, thereby allowing the IFIs to achieve greater turnover within the ceilings imposed by the BCU. Similarly, in light of the steps that are being taken to stimulate development of the capital market, it will be possible for the banks, in parallel with the program's medium- and long-term financing, to market shorter-term debt instruments for financing projects of a size that exceeds the limits set for the program itself.

2/ Financing of a project by more than one IFI is permitted, within the per-project financing limits.

3/ The draft law on securitization, which will govern such transactions, has already been given preliminary parliamentary approval.

D. Interest rates and fees

2.18 The annual interest rate applied to credits to the IFIs will be variable. It will be set at the beginning of each month, and will be adjusted semi-annually for loans disbursed and outstanding. In addition to the interest rate, the BCU may charge an annual administration fee on amounts outstanding, to cover its administrative costs, as well as a differential spread, depending on the term and on market conditions. The interest rate, plus the fees and spread, must be enough to cover the financial cost of the resources provided by the IDB, plus the BCU's operating costs incurred in executing the program. Without prejudice to the foregoing, the rate in question may in no case be less than the net financial cost of: (i) 90-day deposits with the BROU and the four private banks that record the greatest volume of deposits for the period under consideration; or (ii) 180-day treasury bills, denominated in US dollars. The net financing cost is calculated as the lending margin of these instruments, based on the most frequent lending rate, cash reserve requirements and earnings, and holdings of government securities during the period. In the case of deposits, the calculation is done on the basis of the most frequently paid rate during the next-to-previous month, while in the case of treasury bills, the basis will be the mean interest rate from the last public auction for the month preceding the period for which the rate is being set. The IFIs will be free to set the intermediation margin charged to the final user under each subloan (see table I-3).

2.19 Interest rates on subloans will be freely set by the financial intermediaries, who will assume the entire credit risk for such transactions. The granting of subloans will be subject to the project assessment performed in each case by the participating IFI.

2.20 Leaving the IFIs free to set the interest rate in light of market conditions is the most effective way to promote the efficient allocation of resources, since:

a. it will ensure that private sector investment decisions reflect economic efficiency criteria, in a context where (i) macroeconomic conditions are satisfactory, (ii) there is a free market environment, and (iii) interest rates in the Uruguayan financial market are in line with those prevailing internationally; and

b. it will mean additionality for the funds provided by the program, by steering the program toward filling a financing gap and thereby maximizing its contribution to the growth of private investment, while avoiding the substitution effect that might arise if interest rates were below market levels.

E. Dimensioning of the program

2.21 The following aspects were taken into account in determining the scale of the program: (i) the investment required for the country to attain GDP growth rates of more than 3% a year; (ii) the potential demand from end-users of the loan, and the willingness of the IFIs to meet such demand; and (iii) the financial and institutional capacity of eligible IFIs to lend resources of the type envisaged in the proposed program. The financial and institutional capacity of the eligible IFIs will be determined by three quantitative criteria: (i) each IFI's line of credit will be restricted to a stated percentage (currently set at 50%) of its net worth; (ii) each IFI may participate with program funds in the syndication of an investment project for up to 50% of the project costs financed; and (iii) the provision of maturity-mismatch credit lines.

2.22 To gauge potential demand for medium- and long-term credit, and the willingness of the IFIs to meet that demand, the BCU conducted a survey of IFIs, which showed a high willingness to participate in the program. This should ensure that program resources are fully utilized, along with repayments from the previous operation.

2.23 Based on the above considerations relating to the demand for credit to finance production activities, the apparent willingness of the IFIs to meet that demand, and the estimated requirements for institutional strengthening, an amount of US$220.8 million is proposed, of which the Bank would finance the equivalent of US$155.0 million from its ordinary capital (OC) (See Table II-1).

2.24 The amount for the credit component will be US$150 million, and under the institutional strengthening component, US$5 million will be allocated to financing investment projects for the institutional strengthening of the SIIF and the IFIs, so that the system will have adequate regulatory and supervisory capacity over the new products aimed at medium- and long-term financing for private investment, and so that it can make more intensive use of its existing capacity.

2.25 Of the US$5 million, up to US$1.5 million will be distributed in the form of non-reimbursable financing, in the following manner: (i) up to US$890,000 to the SIIF, to pay for modernizing and enhancing its capacity with respect both to its supervisory and regulatory tasks over the financial system, and its activities relating to new products; (ii) up to US$375,000 to the BHU, to pay for upgrading its structures and procedures in mortgage administration and to resolve problems in the management of housing complexes; and (iii) up to US$200,000 to other IFIs (public and private) that, in the view of the BCU, need and can justify concessional support to strengthen their operating capacity to handle medium- and long-term financial products. The remainder of this portion will be allocated to contingencies.

2.26 The remaining US$3.5 million will be made available to IFIs (public and private) for purposes similar to those indicated in point (iii) above. These funds will however be fully reimbursable by the IFIs that request them, they will be counted against their line of credit limit as set for the program by the BCU, and will be subject to terms and conditions similar to those for onlending resources. These subloans will have documentation similar to that for other subloans (provision of funds contract) 4/.

2.27 The SIIF will be responsible for evaluating, approving and monitoring the investment plans for IFI projects of this type (as well as for the non-reimbursable funds). Funds earmarked for institutional strengthening projects (reimbursable or not) that are not used within the first three years of program execution will be released for use either in this type of project, or for subloans for non-financial private investments.

TABLE II-1
PROGRAM COST BY SOURCE OF FUNDING
(In US$ millions)

	IDB/OC	Local counterpart 1/	Total
Productive activities	148,450	65,000	213,450
Institutional strengthening	5,000	785	5,785
1. SIIF	890	665	1,555
2. BHU	375	105	480
3. Contingencies	35	-	35
4. IFIs	3,700	15	3,715
a. Reimbursable	(3,500)	(-)	(3,500)
b. Nonreimbursable	(200)	(15)	(215)
Inspection and monitoring	1,550	-	1,550
TOTAL	155,000	65,785	220,785

1/ May include contributions from IFIs and subborrowers.

1. Disbursement schedule

2.28 Table II-2 shows the proposed disbursement schedule for the operation, by year. Calculations include disbursement of the revolving fund and retroactive financing (see paragraphs 3.48 and 3.49).

4/ See paragraph 3.12.

2.29 Based on the continuity criterion for the multisector facility, used in the design of this operation, March 1, 1998, was established as the startup date for the program, following immediately on completion of the MSI, for which disbursements were completed on February 20, 1998.

2.30 The Borrower and the Bank agreed to limit disbursements to 34% of total financing by February 28, 1999, and 67% of the loan amount by February 29, 2000.

2.31 The disbursement amount agreed to for the first year will include reimbursement of up to US$30 million for program expenditures covered by loans between the IFIs and the subborrowers made between March 1, 1998, and the date of approval of the financing by the Board of Executive Directors.

TABLE II-2
FUNDING COMMITMENTS AND DISBURSEMENTS
(In US$ millions)

IDB LOAN	Year 1	Year 2	Year 3	Year 4
Commitments	80	75	-	155
Disbursements	53	51	51	155

2. Local counterpart funding

2.32 Pursuant to Bank policies, the local counterpart resources will be the responsibility of the government, but the contributions of the participating IFIs and end-borrowers would be recognized as part of the counterpart funds. Sub-borrowers will be required to contribute up to 15% of the cost of their projects. For these purposes, the following would not be included as part of the local contribution: (i) recurrent labor costs; (ii) investments made more than 180 days in advance; and (iii) contributions in kind.

2.33 Based on experience with the first multisector loan, it is expected that local counterpart requirements will be exceeded, which implies that the proposed program could have an even greater impact on mobilizing investment. Under the first loan, local contributions amounted to about 55% of the value of investments financed (40% from sub-borrowers and 15% from the IFIs).

III. PROGRAM EXECUTION

A. Borrower and executing agency

3.1 The Eastern Republic of Uruguay would be the borrower. The Central Bank of Uruguay would be the executing agency and financial agent for the borrower. The resources would be channeled by the BCU, which would act as a second-tier institution, while the eligible IFIs would be the first-tier institutions.

B. Institutional aspects

1. The Central Bank of Uruguay (BCU)

3.2 The BCU was created in 1967, with the basic functions of: (i) ensuring internal and external stability of the national currency; (ii) maintaining a sufficient level of international reserves; and (iii) promoting and maintaining the soundness, solvency and proper operation of the national financial system.

3.3 Pursuant to the Financial Sector Adjustment Program, the government won parliamentary approval of the Financial Intermediation Law and a new charter for the BCU. These consolidate the BCU's responsibilities with respect to banking supervision and regulation, and its powers of precautionary intervention in the IFIs when their continued functioning is threatened. In particular, the charter created a Superintendency of Financial Intermediation Institutions (SIIF), which has technical and operational autonomy and reports directly to the Board of Directors, and the post of Superintendent.

3.4 Management of the BCU is entrusted to a Board of Directors that is responsible for policy and general administration. The President, assisted by the Secretary General, represents the BCU and the Board of Directors. In matters relating to property and capital, the President and the General Manager have representational responsibility. The Office of the General Manager and the Superintendency of Financial Intermediation Institutions are responsible for administration.

3.5 The BCU has been restructured administratively, in line with the provisions of its charter. These reforms have enhanced its institutional and managerial capacity to execute and monitor the first multisector loan. In summary, the BCU is deemed to have sufficient capacity to execute the program, and has gained experience through its successful administration of the first multisector loan.

C. Program execution

3.6 Within the framework outlined above, the BCU's activities as program executing agency will be carried out by its regular departments, using the procedure created for the first multisector loan.

3.7 Supervision of program operations will fall to the Office of the General Manager of the BCU and the SIIF. Within the Office of the General Manager, the International Operations Department (AOIN) will administer the operational aspects. The operating rules established for the program, including its regulations, constitute its regulatory framework, and that for any other financing operation of the Bank that uses the BCU as a second-tier institution. The special characteristics of such programs will be reflected in annexes to the regulatory framework.

3.8 The AOIN has direct responsibility for operating the facility. It reports to the General Manager of the BCU, who will be responsible for assigning sufficient personnel to carry out tasks under the program. The SIIF, in turn, will assign staff as needed within its area of responsibility.

3.9 The participating institutions and the eligibility criteria for IFIs and projects will be similar to those of the previous loan. It is expected that most of the private IFIs and the two public banks will participate. The Banco República and the Banco Hipotecario also meet the eligibility requirements, as a result of the Technical Cooperation Program (Loan 664/OC-UR) and the enhanced efficiency of those institutions that was achieved through the conditionality provisions of the Financial Sector Adjustment Program (Loan 626/OC-UR).

3.10 Program resources will be transferred by the Republic to the BCU through an agreement that will spell out the conditions of transfer and the Executing Agency's obligations as previously agreed with the Bank. Conclusion of this agreement will be a condition prior to the first disbursement. Use of program resources will be governed in principle by the eligibility rules for IFIs and the Credit Regulations, which are similar to those for the first multisector program, and will be amended to include the new operating procedures for the maturity mismatch and leasing credit lines. The amendments needed to adapt the rules and regulations to other new products will be worked out in due course between the Bank and the executing agency. The SIIF will determine those IFIs that are eligible to participate in the various components of the program, and will decide the timing and market conditions for launching new products.

3.11 The discount operations will be conducted through the BCU's rediscount window. The basic eligibility requirements, such as meeting the central bank's technical ratios and the standardization

of accounting information, will remain as for the previous loan. In principle, the two official banks (BROU and BHU), the private banks, the finance companies and the credit cooperatives are considered to be eligible. A more detailed analysis of each IFI will determine its degree of participation, based on the above-mentioned eligibility criteria. The Bank and the executing agency will in due course work out the eligibility criteria for IFI access to program funds for financing the planned new products.

3.12 The channeling of program funds through the eligible IFIs will be formalized through a series of individual contracts between the IFIs and the BCU, specifying the total amount available for their use (discount lines, liquidity, securitization, etc.). To ensure that the funds are actually used, the IFIs will sign a provision of funds contract and will submit to the BCU timely documentation relating to contracts for subloans, securitization, leasing, etc., as the BCU may indicate. After verification, the BCU will credit the funds to the appropriate account of the IFI.

3.13 All individuals or corporations of the private sector that are legally established in Uruguay and that, in the opinion of the IFIs, demonstrate that they have the technical, financial, administrative and legal capacity to evaluation the proposed investment projects and to administer the type of instrument involved (credit, leasing etc.) may be sub-borrowers under the program.

3.14 Operational support for tasks other than those of a strictly banking nature (coordinating environmental aspects, program promotion, etc.) will be provided by the CND, which will sign an agreement to this effect with the Executing Unit and Borrower specifying, among other things, the compensation that the CND will receive for its expenses incurred in providing these services. Those expenses must be included in the costs of the program for the purpose of calculating the interest rate to be charged by the BCU to the IFIs for use of program resources (see paragraphs 3.17 and 3.18). Signature of the agreement with the CND will be a condition prior to the first disbursement of funds under the program.

D. Execution procedures

3.15 The BCU, using the services of the SIIF, will determine the eligibility of the IFIs that apply to participate in the program. For each IFI declared eligible to participate in the program, the BCU will establish an operating quota based on its solvency, its degree of compliance with eligibility conditions, its net work, and the product or products to be used. The quota for access to the discount facility will not exceed 50% of the IFI's adjusted net work, or US$45 million, whichever is less. This quota, along with IFI eligibility, will be reviewed periodically in order to incorporate new institutions that meet the requirements, and to suspend or delete those that no longer meet them.

3.16 The operating arrangements for leasing lines of credit will be as follows: the contract will give the IFI rights similar to those specified in the regulations for subloans. The contract will also contain the schedule of lease payments, with the stipulations as set out in the credit regulations.

3.17 The operating arrangements for the discount facility under the program will be as follows: each IFI will submit its application for eligibility to the SIIF, which will analyze it, report to the General Manager as to its compliance with eligibility conditions and the entity's operating quota, inform the IFI of the decision, and notify the International Operations Department (AOIN). Once the IFI begins operations, it will request the AOIN to set its discount line within the assigned quota. The IFI and the BCU will sign the participation agreement and the provision of funds contract referred to in the preceding chapter.

3.18 The new-product operating procedures will adhere to the following guidelines: (i) the BCU will set up and maintain at all times a technical reserve equal to 25% of the portfolio covered by the lines in question; (ii) the portfolio so covered must be specifically itemized and must be class 1 (the highest classification), and it must correspond to financing for private productive investments, essentially similar to those financed through the discount facility; (iii) the Bank will disburse funds for constituting the BCU's technical reserve only when it has verified the eligibility of the portfolio covered under the facility; (iv) the resources of the technical reserve must be kept at all times in interest-bearing investments, with yields no less and risks no greater than those for treasury bills of the Republic, or lent to the IFIs for coverage purposes, under terms and conditions similar to the discount lines; and (v) recoveries from the coverage loans or technical reserves released when the original lines have expired must be used to support new lines or renewals of lines of the same type, or applied to discount lines for normal credits under the program.

3.19 Lines for coverage of the maturity mismatch risk may only be formalized after the BCU has issued, by agreement with the Bank, the pertinent amendments to the credit regulations and the model participation contracts.

3.20 In this context, the IFIs may have access to a special discount facility, the amount of which, for each IFI, will be determined in light of the SIIF's provisions regarding tolerable maturity mismatch levels, the handling of mismatches resulting from the IFIs' maturity schedules for deposits and loans, the quality of the eligible portfolios in light of the economic situation, the prevalence of positive interest yield curves, and the effectiveness of the judicial system for the recovery of overdue loans.

E. BCU intermediation costs

3.21 The BCU will determine the costs associated with operating the facility, taking into account the results of handling the discount facilities under the first multisector loan, and the costs of including new products. The funds for covering those costs will be drawn from the amounts that the BCU receives from the IFIs by way of fees for administering the program portfolio.

3.22 On the basis of the costs referred to above, the BCU will determine periodically the amount of the administration fee to be charged to the participating IFIs, on each occasion making the necessary adjustments to the entire portfolio to compensate for any excess or shortfall in the cost and revenue estimates for the preceding period. The agreement between the borrower and the BCU will include details on the operation of this mechanism.

F. Allocation of credit and cost of funds

3.23 The discount window will be operated in dollars, but the IFIs may make subloans in either dollars or Uruguayan pesos 5/. The annual interest rates charged to the IFIs on discounts will be variable, adjustable semi-annually on the date of commencement of each accrual period. The principles governing interest rates and fees are dealt with in paragraphs 2.22 to 2.24 and 3.17 to 3.18.

3.24 The BCU will determine the maximum amortization period for the subloans to be discounted by the IFIs, which in principle will be between 3 and 10 years, except for: (i) loans for the purchase of housing, in which case the amortization period will be up to 15 years with no grace period; and (ii) working capital loans to microenterprises, which may not be for periods longer than 18 months. Within these limits, the IFIs may freely establish the duration of each subloan based on the useful life of the project, the nature of the investment, and the beneficiary's ability to pay.

G. Eligibility criteria

3.25 The BCU will determine and supervise the eligibility of the IFIs that apply to participate in the program. IFIs that meet the BCU's standards and its duly established eligibility requirements, with their amendments, will be considered eligible.

3.26 The minimum eligibility requirements to be met by an IFI, to the satisfaction of the BCU, will include the following:

5/ They may make loans either in dollar-adjusted $UR or in $UR without exchange adjustment, but in the latter case they must observe all of the regulations and limitations pertaining to currency matching established by the BCU.

a. It must meet the technical ratio requirements of the BCU or must be strictly applying an adjustment plan approved by the BCU;

b. It must have no unresolved issues outstanding with the BCU's Banking Supervision department; and

c. It must present evidence satisfactory to the SIIF that it has the capacity to promote, evaluate and administer the subloans and their recovery, fulfill the goals of the program, and adhere to current banking rules.

H. Credit regulations

3.27 The credit regulations that will govern the program will be in principle and for the most part similar to those agreed with the Bank for the first multisector loan. As with MSI, it is proposed for this operation that an exception be made to the Bank's policy, so as to allow financing for the purchase of real estate and housing. The validity of the credit regulations will be a condition prior to the first disbursement. These regulations are consistent with Bank rules and policies, and with current legal provisions and banking and financial practices in Uruguay, and they embody the principal features of the operation, as follows:

1. IFI obligations and responsibilities

3.28 Participation of an IFI in the program is voluntary, and its eligibility will be considered by the BCU only at the institution's own request. When an interested IFI has been determined to be eligible, it must sign a participation agreement with the BCU stipulating the terms and conditions of the credit line granted to it.

2. Obligations of sub-borrowers

3.29 The subloan contract that in each case will be signed between and IFI and a sub-borrower will include, inter alia, the following obligations: the right of the IFI, the BCU and the IDB, as well as of the entity responsible for external auditing of the program, to inspect and supervise the properties, workplaces and constructions financed, or to be financed, with subloans or lease financing, and the commitment of the sub-borrower to fulfill requirements set forth with respect to subloans in the credit regulations, IFI participation contracts, and the rules established by the BCU pertaining to provision of funds.

3. Guarantees

3.30 The subloans granted by the IFIs will be guaranteed by the beneficiaries to the IFI's satisfaction, pursuant to Uruguayan

legislation and banking regulations. The BCU may request endorsement of such guarantees.

4. Amount of subloans

3.31 The maximum amount of the discount may be the equivalent of 70% of the eligible costs for all of the projects together. The remaining 30% may be covered by the sub-borrower and the IFI with local counterpart resources, pursuant to the conditions set forth in the credit regulations.

3.32 Except where an exception has been expressly authorized by the BCU and the Bank, the IFIs may not use program resources to grant subloans to a single sub-borrower that, when added to any outstanding balances of that borrower under the program, would exceed US$7 million. That amount has been determined jointly with the Uruguayan authorities, based on considerations that include: (i) levels of capitalization and indebtedness of nonfinancial enterprises and of the latter to the banks, (ii) levels of capitalization and indebtedness of the IFIs and of these to the BCU; and (iii) the scale of the Uruguayan economy, in order to facilitate financing for a broad spectrum of projects with due regard to their size and, at the same time, to ensure an acceptable distribution of credit resources and of portfolio risk.

5. Restrictions on the use of program resources

3.33 Program resources will be used to finance acceptable costs, related to projects located within Uruguay. The following will not be considered as acceptable costs:

a. Overhead and administrative costs of sub-borrowers.

b. Restructuring of debts, dividend payments or recoveries of capital already invested.

c. Transfer of assets, among others, acquisition of shares, equity investments and other securities.

d. Severance payments.

e. Recurrent expenses, including taxes.

f. Working capital, except for microenterprises and for permanent working capital related to the execution of financed projects. Permanent working capital is understood as that associated with investments made with resources under the program.

6. Special features

3.34 It is proposed to allow Bank resources under the program to be used to finance working capital for microenterprises, for permanent

working capital related to investment projects, and for the purchase of real estate and housing. The latter two aspects were already included successfully in the previous operation. As well, the program is aimed at improving liquidity conditions, under proper regulation, so as to help expand or consolidate the market for long-term financing. To this end, the spectrum of activities is being extended to appropriate mechanisms and instruments such as: (i) lines of credit to cover the risk of mismatching terms for IFI loans and deposits 6/; (ii) leasing lines of credit; and (iii) securitization of housing loans, long-term sales factoring, goods and services and contracts, and leasing contracts.

3.35 One of the primary objectives of the program is to promote the development of long-term financial markets in general, and of capital markets in particular. Here, the program aims to achieve regulatory and liquidity conditions that foster the emergence of facilities and instruments conducive to the development of such markets, bearing in mind that available experience in emerging domestic capital markets demonstrates that their development, particularly in the early stages, is closely linked to the broadening and deepening of medium- and long-term credit markets and, in particular, to the appearance and widespread use of negotiable fixed-yield (debt) instruments.

3.36 These new products will be introduced gradually, and BCU and the Bank will consult each other to ensure that the appropriate economic and financial conditions are in place, as well as the legal and regulatory framework necessary for launching them. During the project analysis process, the new products to be launched were identified, and a tentative schedule was worked out. The leasing and maturity mismatch credit contracts will be incorporated into the program operating guidelines, and covered by the credit regulations.

I. Environmental aspects

3.37 The environment Committee classified the MSI as a category III operation in 1992, and the committee's recommendations were incorporated into the operational design of the first program. The environmental report on the businesses financed recorded no problem cases; indeed, it showed progress through the substitution of more efficient machinery and the introduction of cleaner processes and technologies. The final report of the environmental consultant confirms those findings.

3.38 In the second program, it is planned to continue with the arrangements already in place, and to include some improvements that were recommended in the final environmental report on MSI,

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6/ The intention is that the IFIs will use their own short-term funds in financing projects, with a liquidity guarantee where necessary.

both in the program itself and in the use of repayments from MSI. These recommendations include: (i) formal notification to DINAMA of the contents of the agreement signed between the Ministry of Economy, the Central Bank, and the National Development Corporation, which is a condition prior to the first disbursement, for purposes of the environmental classification of projects to be financed by the IFIs; (ii) annual review by the Bank of procedures for environmental assessment and classification, and (iii) the CND should have a full-time environmental professional to conduct the environmental assessment and classification. Entry into force of the agreement with the CND for environmental supervision will be a condition prior to the first disbursement.

3.39 The IFIs participating in the program, public and private alike, will have no formal responsibility for conducting an environmental classification of the projects they finance. As with the previous operation, environmental assessment will be the primary responsibility of the state environmental agencies, which they will carry out during the initial classification phase, through an environmental unit set up specifically for that purpose within the CND. The CESI reviewed the proposed scheme and found it satisfactory.

3.40 The program's credit regulations include a commitment by the beneficiary to respect the technical guidelines provided for the execution of works and the operation of the project, relating to the conservation and use of natural resources and the environment, and the right of the BCU and the IFI to suspend disbursements on a subloan or to call it and declare all outstanding debts under it due and payable immediately, if the beneficiary fails to comply with its contractual obligations. Similarly, the participation agreement confirms the IFI's commitment to ensure that beneficiaries meet environmental requirements as established by contract, or as imposed from time to time by the environmental authorities.

3.41 In addition, the loan agreement will include a commitment to the effect that the Bank will review the CND's environmental assessment and classification procedures annually, until funds under the second program are completely disbursed.

3.42 In order to ensure full compliance with environmental provisions, the loan agreement will reiterate the contractual provisions included in the contract for MSI, namely:

a. Within 18 months after the date of the loan contract, the borrower shall, in cooperation with the entities participating in the program, initiate a review of a representative sample of the activities financed with resources of the program, in order to assess the extent to which recommendations on environmental impact alleviation measures have been implemented.

b. During the period of execution of the program the borrower shall present to the Bank each year, together with the progress report referred to in article 7.03 of the General Conditions, an evaluation as to the implementation of recommended measures for alleviating damage to the environment by the activities financed with program resources. If such evaluations should indicate that the recommended action has not been taken, the activities in question shall cease to be eligible for financing with the program's resources.

J. Periodic program reviews

3.43 During program execution the borrower and the executing agency, on the one hand, and the Bank, on the other, will periodically review the interest rates charged on subloans. If need be, the borrower and executing agency will take appropriate measures, consistent with the country's economic policies, to bring the interest rates on the subloans into line with the policy objective sought by the Bank.

3.44 Within 12 months after the date of the first disbursement, the borrower and the Bank will review compliance with the program objectives and the results achieved. If it is felt that the program has not substantially met its objectives, prior to resumption of the financing commitments, the measures that the borrower will have to take to resolve the problems identified will be established. Following this first review, annual reviews will be conducted until the loan is fully disbursed.

K. Ex-post evaluation

3.45 In accordance with Bank policy, and in consultation with the borrower and the executing agency, it has been decided not to include an ex-post evaluation as part of the program. The BCU basis this decision on the grounds that the periodic reviews to be conducted during program execution should provide sufficient information on its progress and results. Nevertheless, it should be noted that an ex-post evaluation could eventually be undertaken without difficulty, since the necessary information will be available.

L. Auditing of the executing agency and the program

1. Internal audit

3.46 Administration of the program by the BCU will be subject to control by the BCU's internal auditing department, which will be responsible for establishing and maintaining administrative, accounting and internal control procedures that are appropriate for the program, pursuant to applicable generally accepted practices.

2. External audit

3.47 The Official Auditing Office of the Republic [Tribunal de Cuentas] will be responsible for external auditing of the program, during execution and for five years after the final disbursement.

M. Revolving fund and retroactive disbursements

3.48 The program may establish a revolving fund equal to up to 5% of the financing provided by the Bank; use of these funds will be subject to the Bank's rules.

3.49 The borrower has asked the Bank to recognize disbursements made or planned prior to the date the financing is approved. The amounts committed and the procedures followed in those disbursements are those of MSI, and are intended to cover the funding gap so that operations under that program may continue until approval of the present operation. The project team considers that the Bank could recognize up to US$30 million in this regard.

IV. PROGRAM FEASIBILITY

A. Economic feasibility

4.1 The diversification and expansion of Uruguay's productive capital requires the further development of financial intermediation. The proposed program is one of the instruments that the government intends to use to facilitate this transformation, on the grounds that global multisector credit programs have been shown, in a context of economic efficiency and competition, to be an effective mechanism for developing the financial system, increasing domestic savings and improving their allocation. As well, the government's macroeconomic and financial policies have created the basic conditions for making the use of such a program feasible for that purpose.

4.2 The program will facilitate private capital formation, which is essential for raising the investment coefficient. As noted above, the Uruguayan economy requires a substantial private investment effort in order to: (i) stimulate and sustain GDP growth; (ii) adjust the productive economy to the process of restructuring necessitated by entry into MERCOSUR; and (iii) expand production and generate employment in the private sector, which in turn will reduce the public sector's role in the economy and in the labor force.

4.3 The program will continue to provide access to medium- and long-term financing for nearly all private activities except for a short list of exclusions. Moreover, the program will provide greater access by medium-and small-scale enterprises, which constitute a high proportion of businesses in the country, by giving the banks flexibility in setting their intermediation margins.

B. Institutional feasibility

1. Executing agency: BCU

4.4 The executing agency, the BCU, has sufficient organizational and administrative resources to administer the program funds in accordance with the guidelines established in the operating rules. The BCU's experience in managing the first multisector loan will expedite progress under the program.

4.5 The BCU has executive, technical and administrative personnel that, in terms of number, experience and professional qualifications, are deemed suitable for carrying out the functions and tasks required under the proposed program.

4.6 The BCU will also receive technical assistance support from FOMIN (TC-96-01-34-6-UR) for strengthening and deepening the country's

capital market. This will help to enhance its regulation and supervision of the securities and insurance markets, a crucial step for the introduction of the new products envisaged under the program.

2. Intermediary financial institutions (IFIs)

4.7 The eligibility criteria for selecting IFIs and monitoring their participation in the program, and the requirements established in the credit regulations and participation agreements, will ensure, on the basis of experience with MSI, that the commercial banks and other participating financial intermediaries will have the necessary operating capacity to act as intermediaries in the program, particularly as regards the strength of their financial position and the quality of their accounting information and credit administration systems needed for proper execution. The non-reimbursable technical assistance component included in the program will help the IFIs to cope with any contingencies that may arise.

C. Financial feasibility

4.8 The proposed program is considered to be financially feasible. The operating arrangements envisage total recovery of operating costs by the BCU and the IFIs. The interest rates and fees that the BCU will charge the IFIs will ensure full coverage of the executing agency's financial and administrative costs. Moreover, the freedom of the IFIs to fix the terms and conditions of subloans (interest rates, fees etc.) will ensure that all their costs are adequately covered.

4.9 Furthermore, based on the executing agency's cost estimates and the margins at the which the IFIs are currently operating, the cost of program resources to the final beneficiaries will be consistent with interest rate levels in the Uruguayan market. It is felt therefore that actual demand for program resources will be commensurate with the estimates.

D. Program benefits

4.10 Growing competition within MERCOSUR and from outside the region demands greater impetus to the expansion of private investment, to facilitate the restructuring and diversification of the country's productive plant, and this in turn will require strengthening of the financial sector. In this context, the government intends to strengthen credit intermediation, and in particular to make medium- and long-term financing more available to small and medium-scale businesses, which represent a major portion of the country's industrial plant, with a strong capacity for diversification and modernization.

4.11 To this end, the proposed program will support: (i) broader distribution of medium- and long-term financial resources;

(ii) deepening and expansion of medium- and long-term credit mechanisms and instruments that will contribute to the development of financial markets, and in particular of capital markets; and (iii) greater access to investment credit for small and medium-sized enterprises.

E. Risks

4.12 Successful execution of the proposed program will depend on maintaining a macroeconomic and financial framework that ensures a favorable climate for the growth of private investment. Important results have already been achieved in terms of economic reforms and stabilization, and these will be further strengthened under the current program with the International Monetary Fund. Under these circumstances, the macroeconomic risk is considerably reduced, but careful management of the economy, and especially of the financial system, will still be required to avoid possible contagion from adverse situations in neighboring countries. In this context, the national authorities are well aware of the dangers, and are ready to react swiftly to any negative developments in the region. This aspect will in fact be reinforced by the institutional strengthening component of the proposed program.

4.13 The risk of serious trouble in the financial system is low, thanks to the restructuring that has occurred in the financial sector in recent years, the steps that have already been taken to strengthen supervisory mechanisms, and the reorganization of the public banks, all of which indicate that the resources of the proposed program should be channeled properly. The introduction of credit lines for IFIs to cover the maturity mismatch risk and the institutional strengthening component to be funded by the program will serve to reinforce this aspect further.

4.14 In the past, state intervention in private contracts between debtors and creditors (compulsory refinancing laws) provoked a sharp contraction in lending from private banks that could still have a negative effect on the pace of execution of the program. Yet while such a risk exists, it has been significantly reduced by the measures already in place, such as the laws on securitization and investments, amendments to leasing contracts, and other reforms that will facilitate the transformation of business corporations and their operating environment. Now that these risks have been allayed, it will be easier to develop financial instruments and mobilize financing for the productive activities targeted by the program.

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PROPOSED RESOLUTION

URUGUAY. LOAN /OC-UR TO THE REPUBLIC OF URUGUAY
(Multisectoral Global Financing Program)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of Uruguay, as Borrower for the purpose of granting it a financing to cooperate in the execution of a multisectoral global financing program. Such financing will be for the amount of up to one hundred and fifty five million dollars of the United States of America (US$155,000,000), which are part of the Single Currency Facility of the Ordinary Capital resources of the Bank, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.