First Annual Report on the Latin America Small Business Lending Initiative
August 2008

I. Overview

This report summarizes the first year of implementation of the Latin America Small Business Lending Initiative (the "Initiative"), launched by U.S. Treasury Secretary Paulson in June 2007 to expand and improve the access of small businesses in Latin America and the Caribbean to commercial financing. The effort is intended to accelerate the job creation and poverty-reduction that small businesses provide. Expanding small business ownership helps create more sustainable, stable economies with broader economic opportunities.

The three-part initiative is jointly supported by the U.S. Treasury Department, the Inter-American Development Bank (IDB), and the Overseas Private Investment Corporation (OPIC). Each of these entities has complementary roles to play in the Initiative. The first pillar attempts to bridge the information gap that often prevents banks from lending to small companies through the introduction of new lending models tailored to small firms. Banks need the tools to assess the value and risk of lending to smaller companies that do not have traditional collateral structures or formal financial statements. In order to help build capacity for banks to quickly and accurately assess the credit quality of small companies, the Multilateral Investment Fund (MIF), an arm of the IDB, has provided technical cooperation grants to local banks to strengthen their capacity in lending to the small business sector. This assistance includes consulting services related to credit officer training, material development, software and computer equipment, and credit scoring systems.

The second pillar involves sharing the initial risk of lending to new, small businesses to help banks address the uncertainty about lending to this market segment. The Inter-American Investment Corporation (IIC) and OPIC are providing loans and guarantees to banks that commit to initiating or expanding their small business lending. OPIC offers risk-sharing guarantees and loans to eligible banks to catalyze financing for small and medium enterprises (SMEs) through three vehicles: (1) Credit guarantees for U.S. bank loans to banks in Latin America to support "on-lending" (when one bank borrows from another bank and uses those funds to make smaller loans) to small businesses; (2) Guarantees on bond issues to allow local financial institutions, including microfinance institutions, to raise funds to finance SME loans in the local capital markets; and (3) Guarantees to local banks on portfolios of small business loans in which OPIC and the local banks would share risk of loss. The IIC provides a similar menu of options to financial institutions in Latin America for on-lending to SMEs and provides technical advice based on its more than ten years of lending to the sector. The IIC can target institutions which do not qualify for OPIC support.

The third pillar is focused on improving the regulatory environment to support small business lending. In many cases, bank regulatory authorities perceive small businesses to be high risk borrowers and impose heavy collateral and/or provisionary requirements. The introduction of best practice regulatory models will help ensure prudentially sound lending while avoiding requirements more suited to lending to larger firms. The Treasury Department's Office of Technical Assistance identifies legislative and regulatory obstacles to small business lending in targeted Latin American countries and recommends the design and implementation of regulations and oversight of credit providers to small businesses. In addition, the MIF will engage at a regional level through the Latin American Association of Supervisors of Banks of the Americas (ASBA) to facilitate cross-border seminars and workshops to define and promote the adoption of best practices in SME and micro-lending among its members.

The Initiative was designed to show measureable results in the form of an increasing volume of lending by commercial banks to small business, and a decrease in the average loan size in order to reach the smallest businesses of the region where the poverty reduction and employment gains are multiplied. The participating banks have agreed to report on lending indicators in order to measure the impact of the Initiative.

II. ONE YEAR LATER

Since its launch, the Initiative has been very active in advancing the three goals originally established by Secretary Paulson:

i) Introduce new lending models that fit the unique characteristics of smaller firms.

In September 2007, the MIF committed $10 million in technical assistance grants to the Initiative and has since been actively promoting the Initiative among financial institutions in Latin America and the Caribbean. The first agreement was signed in November 2007 with BanCentro in Nicaragua for $500,000 (with an additional $500,000 contribution by BanCentro) to develop new financial products for small businesses, expand BanCentro's small business loan portfolio, strengthen capacity of its human resources in the analysis and management of risks specific to the small business sector and adopt international best practices in implementing and expanding its small business program. Another $500,000 grant was approved by the MIF in July 2008, with a matching counterpart contribution, to provide technical assistance to Banco Agromercantil and support it in its efforts to increase its operations with small businesses in Guatemala.

Next Steps

In the first quarter of 2008, the MIF started to receive applications from financial institutions throughout the region, and is currently analyzing requests from banks in Mexico, Central America and the Caribbean. Pending their approval, four to six new technical assistance projects could begin operations in late 2008. MIF grants will be used to help banks strengthen their capacity to lend to the small business sector. The MIF estimates that it will approve around $3 million in grants in 2008, with matching funds from the recipient banks. In addition, the MIF is preparing a study on best practices in developing small business lending products and will host and present the study results in an October 2008 workshop in Paraguay. The five countries in the MIF study are Ecuador, Guatemala, Mexico, Peru, and Trinidad & Tobago. The MIF is also creating a web site to link consultants with expertise in micro and small business development services with private banks in the region.

ii) Assume a portion of the risk associated with small business lending.

In September 2007, OPIC launched its participation in the Initiative by committing $150 million to provide financing and guarantees for small business loans in Latin America and the Caribbean. Already, OPIC has approved $53 million in loans to banks in Honduras, Costa Rica, Ecuador, and Paraguay to expand their operations in the small business sector. Typically, OPIC assumes between 50-80% of the commercial risk attached to each loan and in some cases provides additional inconvertibility of currency coverage as well**.** IIC has signed six deals for a total of $14.5 million.

Institution	***Country/Institution***	***Project Size*** ***($mil)*** *2/*	***Projected # Loans***	***Average Loan Size***
OPIC	Honduras	$15.0	2,300	$25,600
OPIC	Costa Rica	$18.8	135	$140,000 1/
OPIC	Ecuador	$10.0	22,000	$3,000
OPIC	Interbanco (Paraguay)	$1.2	20	$59,000
OPIC	BBVA (Paraguay)	$5.7	107	$53,000
OPIC	Banco Regional (Paraguay)	$2.1	27	$77,000
IIC	Edyficar (Peru)	$5.0		
IIC	Demerara Bank (Guyana)	$2.0		
IIC	Costa Rica	$2.0		
IIC	Mexico	$3.0		
IIC	Credipyme (Mexico)	$1.0		
IIC	Microfin (Uruguay)	$1.5		
TOTAL		**$67.2**		

1/ Under the terms of this loan agreement, the local bank is required to allocate at least 50 percent of OPIC proceeds for loans under $100,000 to SMEs. The other 50 percent is allocated for a combination of SME and mortgage lending.
2/ Counts funds dedicated specifically to the Initiative.

<u>Next Steps / Loan Pipeline</u>

OPIC has $100 million in loans in the pipeline to banks in Central America. A portion, to be determined, of each loan will be dedicated to small business lending. OPIC continues to generate interest from both “upscalers” – existing micro-finance institutions seeking to move into the small business sector – and “downscalers” – large commercial banks seeking to do the same. IIC has six transactions in its pipeline for a total of $15.0 million. The potential transactions are in the Dominican Republic, Guatemala, Nicaragua, Honduras, Paraguay and Mexico.

iii) Ensure that small business lending is not unnecessarily constrained by burdensome regulations or bureaucracy.

To kick off its program, OTA along with the MIF and OPIC presented the Initiative to the Latin American Bankers Association (FELABAN) in November 2007 which was well received. In early February, 2008, a U.S. Treasury/ OTA team undertook a mission to **Peru** to meet and discuss the legal and regulatory constraints to small business lending with the supervisory authority, local banks, non-bank financial institutions, and a number of small business entrepreneurs. The findings of the mission were then shared with the participants in the U.S. Treasurer's Financial Inclusion Conference in mid-February, 2008. Also in February 2008, OTA met with officials from **El Salvador, Guatemala and Honduras** to discuss technical assistance in designing and implementing regulations, and oversight of credit providers to small business borrowers.

The MIF met with Latin American bank regulators in early 2008 to identify the critical challenges that they confront in setting up prudential frameworks for an evolving financing landscape. Specific areas of collaboration and follow-up actions were identified.

Next Steps

The U.S. Treasury/ OTA team has now been invited by the monetary authorities of three Central American countries (El Salvador, Guatemala, and Honduras) to undertake technical assistance missions during the latter half of 2008. Peru has also indicated its desire to have a second U.S. Treasury/ OTA mission. The team will meet the central bank, ministry of finance, financial supervisory authority, local banks, non-bank financial institutions, and a number of small business entrepreneurs in each of these countries to discuss the legal and regulatory constraints to small business lending. Based on its analysis, the team will prepare detailed recommendations for consideration by the authorities. Wherever possible, U.S. Treasury/ OTA missions to Latin American under the Initiative will be timed to coincide with MIF and OPIC missions to the target countries in order to maximize synergy among the three agencies. OTA will also contact the authorities in countries where commercial banks are receiving MIF technical assistance under the Initiative to explore additional opportunities.

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