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**The World Bank**

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Report No: PAD1929

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED LOAN

IN THE AMOUNT OF US\$50.0 MILLION

TO THE

ARGENTINE REPUBLIC

FOR A

ACCESS TO LONGER TERM FINANCE FOR MICRO, SMALL AND MEDIUM ENTERPRISES  
PROJECT

October 27, 2016

Finance and Markets Global Practice  
Latin America and the Caribbean Region

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**CURRENCY EQUIVALENTS**  
(Exchange Rate Effective October 26, 2016)

Currency Unit = Argentine Peso (ARS)

ARS 15.2 = US\$1

**FISCAL YEAR**  
January 1 - December 31

Regional Vice President: Jorge Familiar Calderon  
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## ABBREVIATIONS AND ACRONYMS

ACG	Anticorruption Guidelines
AFIP	Federal Administration of Public Revenue (Administración Federal de Ingresos Públicos)
BADLAR	Buenos Aires Deposits of Large Amount Rate
BCRA	Central Bank of Argentina (Banco Central de la República de Argentina)
BDS	Business Development Services
BICE	Bank for Investment and Foreign Trade (Banco de Inversión y Comercio Exterior S.A.)
CAF	Development Bank of Latin American (Corporación Andina de Fomento)
CAR	Capital Adequacy Ratio
CNV	National Securities Commission (Comision Nacional de Valores)
DA	Designated Account
EMP	Environmental Management Plan
ESMF	Environmental and Social Management Framework
FM	Financial Management
FOGAPYME	Public Credit Guarantee Fund for MSMEs (Fondo de Garantía para MIPYMEs)
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
GRS	Grievance Redress Service
IFC	International Finance Corporation
IFR	Interim Financial Reports
IMF	International Monetary Fund
IPPF	Indigenous People's Planning Framework
IT	Information Technology
LAC	Latin America and the Caribbean
LCIP	Line of Credit for Productive Investments (Línea de crédito para la inversión productiva)
MoF	Ministry of Treasury and Public Finance
MoP	Ministry of Production
MSME	Micro, Small, and Medium Enterprise
NPL	Non-performing Loan
OM	Operational Manual
PDO	Project Development Objective
PFI	Participating Financial Institution
PIU	Project Implementation Unit
ROA	Return On Assets
ROE	Return On Equity
SEPYME	MSME and Regional Development Department (Secretaría de Emprendedores y Pequeña y Mediana Empresa)
SFA	Subsidiary Financing Agreement
SGRs	Mutual Guarantee Associations (Sociedades de Garantías Recíprocas)
SME	Small and Medium Enterprise

SOE	Statement of Expenditure
UEPEX	Executing Unit for External Loans ( Unidad Ejecutora de Proyectos Externos)

**BASIC INFORMATION**

Is this a regionally tagged project? No	Country (ies)	Lending Instrument Investment Project Financing
<input type="checkbox"/> Situations of Urgent Need or Assistance/or Capacity Constraints <input checked="" type="checkbox"/> Financial Intermediaries <input type="checkbox"/> Series of Projects		
Approval Date 17-Nov-2016	Closing Date 30-Nov-2021	Environmental Assessment Category F - Financial Intermediary Assessment
Bank/IFC Collaboration Yes	Joint Level Complementary or Interdependent project requiring active coordination	

**Proposed Development Objective(s)**

The Project Development Objectives (PDO) are to improve access to, and strengthen the framework for the provision of, longer term finance for eligible micro, small and medium enterprises.

**Components**

Component Name	Cost (USD Million)	Comments
Line of credit	44.50	The credit line component will provide USD\$44.5 million equivalent to BICE for on-lending through PFIs to MSMEs.
Institutional capacity building of BICE, financial infrastructure reforms, credit guarantee fund, and capacity building for MSMEs	4.55	This component will provide capacity building for BICE's second tier operations, technical assistance for improving the enabling environment for access to finance, and capacity building for MSMEs.
Project management	0.82	This component will provide support for the PIU's capacity to implement the project.

**Organizations**



Borrower : Ministry of Treasury and Public Finance

Implementing Agency : Banco de Inversión y Comercio Exterior (BICE)

**PROJECT FINANCING DATA (IN USD MILLION)**

<input type="checkbox"/> Counterpart Funding	<input checked="" type="checkbox"/> IBRD	<input type="checkbox"/> IDA Credit	<input type="checkbox"/> IDA Grant	<input type="checkbox"/> Trust Funds	<input type="checkbox"/> Parallel Financing
		<input type="checkbox"/> Crisis Response Window	<input type="checkbox"/> Crisis Response Window		
		<input type="checkbox"/> Regional Projects Window	<input type="checkbox"/> Regional Projects Window		
Total Project Cost:	Total Financing:		Financing Gap:		
50.00	50.00		0.00		
	Of Which Bank Financing (IBRD/IDA):				
	50.00				

**Financing (in USD Million)**

Financing Source	Amount
IBRD-86590	50.00
<b>Total</b>	<b>50.00</b>

**Expected Disbursements (in USD Million)**

Fiscal Year	2017	2018	2019	2020	2021	2022
Annual	10.00	20.00	10.00	9.00	1.00	0.00
Cumulative	10.00	30.00	40.00	49.00	50.00	50.00

**INSTITUTIONAL DATA**



## Practice Area (Lead)

Finance & Markets

## Contributing Practice Areas

### Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

#### Gender Tag

Does the project plan to undertake any of the following?

a. Analysis to identify Project-relevant gaps between males and females, especially in light of country gaps identified through SCD and CPF

Yes

b. Specific action(s) to address the gender gaps identified in (a) and/or to improve women or men's empowerment

Yes

c. Include Indicators in results framework to monitor outcomes from actions identified in (b)

Yes

### SYSTEMATIC OPERATIONS RISK- RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	Moderate
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Moderate
6. Fiduciary	Moderate
7. Environment and Social	Substantial
8. Stakeholders	Moderate
9. Other	
10. Overall	Substantial



## COMPLIANCE

### Policy

Does the project depart from the CPF in content or in other significant respects?

☐ Yes ☒ No

Does the project require any waivers of Bank policies?

☐ Yes ☒ No

### Safeguard Policies Triggered by the Project

	Yes	No
Environmental Assessment OP/BP 4.01	✓	
Natural Habitats OP/BP 4.04	✓	
Forests OP/BP 4.36	✓	
Pest Management OP 4.09	✓	
Physical Cultural Resources OP/BP 4.11	✓	
Indigenous Peoples OP/BP 4.10	✓	
Involuntary Resettlement OP/BP 4.12		✓
Safety of Dams OP/BP 4.37		✓
Projects on International Waterways OP/BP 7.50		✓
Projects in Disputed Areas OP/BP 7.60		✓

### Legal Covenants

#### Sections and Description

MSMEs sub-loans (Schedule 2. Section I.E.1 of the Loan Agreement) shall be made only to eligible MSMEs pursuant to the relevant MSME Sub-loan Agreement, under terms and conditions set forth in the Operational Manual and satisfactory to the Bank.

### Conditions

#### Type

Effectiveness

#### Description

The Subsidiary Loan Agreement has been executed on behalf of the Borrower, through MoF and MoP, and BICE.





Type  
Effectiveness

Description  
BICE has duly established BICE PIU in a manner acceptable to the Bank.

## PROJECT TEAM

Bank Staff			
Name	Role	Specialization	Unit
Bujana Perolli	Team Leader(ADM Responsible)	Senior Financial Sector Specialist	GFM04
Martin Ariel Sabbatella	Procurement Specialist(ADM Responsible)	Procurement Specialist	GGO04
Juan Carlos Serrano-Machorro	Financial Management Specialist	Sr Financial Management Specialist	GGO22
Alfonso Garcia Mora	Team Member	Director	GFMDR
Andrea Mara Rispo	Environmental Specialist	Consultant	GEN04
Andres Federico Martinez	Team Member	Senior Financial Sector Specialist	GFM2A
Daniel Ortiz del Salto	Team Member	Operations Consultant	GSP07
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Fabiola Altimari Montiel	Counsel	Senior Counsel	LEGLE
Ilias Skamnelos	Team Member	Lead Financial Sector Specialist	GFM03
Jose Isaac Rutman	Team Member	Consultant	GFM04
Mateo Clavijo Munoz	Team Member	Financial Analyst	GFM04
Monzerrat Garcia	Team Member	Program Assistant	GFM04
Santiago Scialabba	Safeguards Specialist	Social Safeguards	LCC7C
Sergio Daniel Kriger	Team Member	Consultant	GFM04
Victor Manuel Ordonez Conde	Team Member	Finance Officer	WFALA
Zafer Mustafaoglu	Team Member	Program Leader	GFM04

## Extended Team



Name	Title	Organization	Location
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ARGENTINA  
ACCESS TO LONGER TERM FINANCE FOR MICRO, SMALL AND MEDIUM ENTERPRISES PROJECT

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## I. STRATEGIC CONTEXT

### A. Country Context

**1. After taking office in December 2015, the new Argentine Government moved with significant speed to implement reforms.** The Government has rapidly implemented various macroeconomic reforms and initiated a program of structural reforms. These include (a) the elimination of export taxes on major crops, beef, and most industrial manufacturing products and the reduction by 5 percent of export taxes on soy; (b) unification of the exchange rate, effectively ending most foreign exchange restrictions; (c) moving from a system of discretionary to automatically provided import licenses in line with World Trade Organization procedures; and (d) resolution of the dispute with holdout creditors. In addition, the National Institute for Statistics launched a new inflation index and improved the overall quality of statistics. Electricity tariffs and transport fees were increased to reduce subsidies, while protecting low-income users with a social tariff. Broader efforts to reduce energy subsidies (which account for a large portion of fiscal deficit) are under way.

**2. Economic activity is projected to contract in 2016, before growth accelerates in 2017 as the positive impact of the recent policy changes kicks in and the global economy recovers.** Argentina is in the midst of a costly transition to a more sustainable macroeconomic framework. Economic activity will decline by an estimated 1.5 percent this year, taking a toll on labor markets, where 101,000 formal private sector jobs were lost since October 2015 (1.6 percent of total employment<sup>1</sup>). Inflation is running high (estimated at about 40 percent for 2016), however it has decelerated in recent months after an initial jump due to currency depreciation and the reduction of energy and transport subsidies. Fiscal consolidation faces pressures and will likely be more gradual than originally planned due to lower revenues and increased social spending, including adjustment of pension transfers and the settlement of pension system lawsuits.

**3. The Argentine Government has started to address the key macroeconomic imbalances with the objective of creating an environment conducive to economic growth and employment creation.** Argentina offers many opportunities in a weak global environment, and there is a strong interest from foreign investors and firms. Going forward, the country will need to continue building a growth enabling policy framework to enhance credibility and support broad based growth and quality employment. In particular, the following policies will be important to permanently reduce inflation and put Argentina on a sustainable growth path: (a) increase public spending efficiency and reduce the fiscal deficit in line with government targets; (b) continue improving the credibility of the Central Bank and the monetary policy for anchoring inflation expectations; (c) strengthen competitiveness and productivity through an improved business environment and investments in infrastructure and increasing competition in markets and improving the regulatory framework in sectors; (d) continue strengthening the credibility of official statistics; and (e) continue to support better public goods provision and reduce regional disparities (including transportation, health, and education).

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<sup>1</sup> *Observatorio de Empleo y Dinámica Empresarial, Ministerio de Trabajo Empleo y Seguridad Social, May 2016.*



## B. Sectoral and Institutional Context

**4. Argentina's bank-dominated financial sector lags well behind its Latin America and the Caribbean (LAC) peers in size and depth.** The financial system is mainly transactional. Its assets to gross domestic product (GDP) stands at 35 percent, with commercial banks representing over 90 percent of total system assets. Credit to the private sector increased from 9 percent to 14 percent of GDP between 2005 and 2015. However, it remains the lowest in LAC, where the average stood at 46 percent in 2015. The income peer group median is 59 percent, with Chile, Brazil, and Colombia at 110 percent, 68 percent, and 47 percent respectively. Deposits have also lagged behind the regional average. They have remained below 20 percent of GDP since 2005, compared to the LAC average of above 40 percent in 2015.

**5. The banking sector is well capitalized, liquid, and profitable, with a low level of non-performing loans (NPLs).** A capital adequacy ratio (CAR) at 16.2 percent at end-June 2016 indicates an adequate level of capitalization. The sector has ample liquidity, with the liquid assets to total deposits ratio at 31 percent. The funding is conservative, with stable deposits from the public and the private sector constituting the majority of funding. The NPLs ratio stood at 1.7 percent at end-June 2016. Profitability is adequate with Return on Equity (ROE) at 32.7 percent and Return on Assets (ROA) at 4.1 percent, although returns in real terms are low due to the high rate of inflation.

**6. Access to credit is a significant constraint for firms, particularly with regard to medium- to long-term finance for productive investments.** Access to finance is the second most important constraint that firms face, with nearly half of the firms rating it as a major obstacle (compared to 30 percent for LAC).<sup>2</sup> There are substantial gaps in long-term finance to support productive investment evident in the short-term nature of bank loans and amplified by the low depth of capital markets and small size of institutional investors. Argentina has one of the lowest investment to GDP ratios in LAC (less than 15 percent of GDP in 2015),<sup>3</sup> suggesting capital accumulation constraints to economic growth. In the past, the lack of longer-term finance was, to a large extent, the result of macro-financial instability. The short maturity of banks' balance sheets were affected by an unstable economic environment and weak depositor confidence, matched by business strategies focused on consumer lending and sovereign/central bank papers. Consumer loans represent half of the banks' lending portfolios and sovereign/central bank papers about 22 percent of bank assets.

**7. Access-to-finance constraints are further exacerbated during Argentina's economic transformation.** Private sector credit growth stalled in the second half of 2015, due to higher costs and weaker demand.<sup>4</sup> There is a risk that interest and exchange rate volatility during Argentina's economic transition could further affect bank lending.

**8. Micro, small, and medium enterprises (MSMEs) are the most affected by economic volatility and access-to-finance constraints, despite playing a critical role in employment and growth.** Access to finance is a particularly acute problem for MSMEs. Credit to MSMEs accounts for only 2 percent of GDP,

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<sup>2</sup> Enterprise Surveys, 2010.

<sup>3</sup> According to recent research, the annual average rate of capital accumulation in Argentina is 2.3 percent, almost half the rate of 4.2 percent in other peer countries. ("Argentina: Notas de política pública para el desarrollo", World Bank, 2015).

<sup>4</sup> As of October 2015, annual nominal growth (year on year) was about 33 percent—in line with inflation.



when formal MSMEs account for at least 50 percent of GDP<sup>5</sup> and generate about 71 percent of total employment and 47 percent of total sales. According to the 2010 Enterprise Surveys, only 38 percent of formal small firms had a loan or line of credit, compared to 60 and 75 percent of medium and large firms respectively. MSME informality, with the informal economy estimated at over 40 percent of GDP, implies lack of reliable financial statements, limiting the willingness of the banking sector to lend to this segment. Argentina's economic transformation process further amplifies the challenges MSMEs face, as these typically experience sharper drops in the availability of finance compared to larger enterprises.

**9. Only a third of MSMEs in the industrial sector have access to bank credit, and this is dominated by short-term working capital loans.** About 90 percent of credit to MSMEs is short term. The majority of MSMEs rely on internal funds for investment decisions, limiting their capacity to invest and grow. This is in contrast to peer countries.<sup>6</sup> In Argentina, 64 percent of loans have maturities below one year. A third of industrial MSMEs had to stop investment projects, and the credit demand for unfinished projects remains historically high.<sup>7</sup>

**10. The new Government is spearheading structural reforms in the financial sector.** Policy reforms already undertaken include the elimination of caps on consumer and credit card lending rates and of floors on deposit rates. In addition, conditions related to mandated lending under the Line of Credit for Productive Investments (LCIP) program<sup>8</sup> have eased, with high market expectations of a gradual phaseout (especially as the program becomes non-binding under an expected reduction in inflation). The new Government has also highlighted financial infrastructure reforms and the development of nontraditional financial products for MSMEs as crucial for access to finance. These include, among others, reforms in the secured transactions framework, insolvency and creditor rights, the development of factoring and leasing, the development of Mutual Guarantee Associations (*Sociedades de Garantías Recíprocas*, SGRs), and the revamp of the public credit guarantee scheme (*Fondo de Garantía para MIPYMEs*, FOGAPYME). The MoP is championing these reforms, and has established a task force of public and private sector representatives to build consensus. Key players in the financial sector reform agenda include the Ministry of Treasury, BCRA, Comisión Nacional de Valores (CNV), and the Ministry of Justice. In addition to the reforms to be supported by this operation, the World Bank and the authorities are working on housing finance, infrastructure finance, and capital markets development.

**11. This proposed pilot project assists the authorities to lay the groundwork for significant financial sector reforms in Argentina.** The project aims to help the authorities enhance the financial

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<sup>5</sup> This figure is likely higher today, because data is based on a 2004 census. The overall impact is likely even higher if informal firms are included. According to a 2014 survey of nearly 50,000 firms in 104 countries, MSMEs provide as much as two-thirds of all employment, with small firms contributing more to employment in low-income countries. "Who creates jobs in a developing economy?" Ayyagari, Demirgüç Kunt, Maksimovic, 2014.

<sup>6</sup> In the median developing country, 66 percent and 78 percent of small and medium firms, respectively, report having long-term debt. The average maturity of a loan in low-middle and upper-middle countries is three years.

<sup>7</sup> Observatorio PYME, 2014.

<sup>8</sup> This program was adopted in 2012 and modified several times. It mandates the 30 largest banks to lend a share of their deposits for investment purposes at a fixed interest rate and maturity. Currently, it requires banks to lend 14 percent of their deposits at a fixed interest rate of 22 percent to finance investments and up to 30 percent to finance working capital (recently introduced), for a term of 24 months or more (with an effective maturity of at least 36 months). When initially introduced, the BCRA directed banks with a deposit market share greater than 1 percent to lend 10 percent of their deposits at a below-market interest rate of 15 percent, with an effective maturity of at least 36 months, with a one-year grace period, with at least half of these loans to MSMEs.



infrastructure and establish market-based pricing to MSMEs. This is the first World Bank financial sector operation since Argentina's financial crisis in 2001/2002.<sup>9</sup> The financial sector reforms are likely to go beyond the scope and implementation period of this project. Argentina is currently undergoing a transition period and it will take time for the complete phaseout of market distortions (such as the LCIP), which have largely been caused by the macroeconomic conditions, and for the effect of the full range of reforms to kick in.

**12. This proposed operation is highly relevant for the financial sector in Argentina for several reasons.** First, it aims to provide longer-term financing in local currency to the banking sector that is currently limited in the market, which in turn will result in improved loan maturity for MSMEs. Second, it aims to pilot a new engagement for *Banco de Inversión y Comercio Exterior S.A. (BICE)* and the banking sector, through strengthening the institutional capacity of BICE. Third, it is a pilot operation that will start tackling structural deficiencies in the financial sector, such as weaknesses in the financial infrastructure. Fourth, it aims to test the appetite of the banking sector to serve new segments of the MSME population, such as MSMEs that employ indigenous peoples, or have them in the value chains, that promote gender equality, or are first time MSME borrowers of longer term loans in recent years. In the long term, improvements in the enabling environment for access to finance will contribute to the inclusion of unserved MSMEs in the financial sector.

**13. The Government's reform agenda includes strengthening the second-tier lending business model of BICE.** BICE is a small fully state-owned bank. It is focused on first-tier lending, half of which is for SMEs. Although it undertakes second-tier lending, this represents less than 10 percent of its overall portfolio.<sup>10</sup> BICE's two-year business plan projects an increase of second-tier lending to 40 percent, subject to the availability of funding sources.<sup>11</sup> Its new management's long-term vision is to substantially strengthen its second-tier lending role, providing longer-term funding to MSMEs through qualified financial institutions. To support such second-tier growth, BICE will have to improve systems and risk processes, supported by this project.

**14. BICE is supervised by the BCRA, has strong financial fundamentals, and recent governance changes have resulted in the nomination of an independent and qualified board of directors.** BICE is owned 66 percent and 33 percent by the MoP and *Banco Nación* (Argentina's largest state-owned bank), respectively. Shareholding rights are fully delegated to the MoP, which elects members of BICE's board. Recent governance changes have resulted in the nomination of independent and technical board of director members. The World Bank's due diligence assessment of BICE indicates that it has broadly adequate policies and procedures for managing risks. Pending improvements will be supported by this project.

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<sup>9</sup> The 2013 joint IMF/World Bank Financial Sector Assessment Program (FSAP) highlighted major distortions in the financial sector in Argentina and provided recommendations that were not implemented until the new Government took office. An SME access to finance Technical Note was produced during the FSAP, and the developmental challenges it outlines remain largely unchanged. In addition, more recent policy notes were produced in 2015 on the challenges and recommendations for improving long-term finance in Argentina.

<sup>10</sup> BICE is currently engaged with nine qualified banks, representing over 44 percent of the system's loan portfolio.

<sup>11</sup> The funding is expected from foreign lines of credits (Inter-American Development Bank and *Corporación Andina de Fomento* [CAF]), as well as local capital markets issuance.





## C. Higher Level Objectives to which the Project Contributes

**15. The project is fully aligned with the World Bank Group (WBG) Country Partnership Strategy (CPS) for the Argentine Republic for the period of FY15–FY18<sup>12</sup>.** The strategy has three main strategic objectives and pillars: (a) sustaining employment creation in farms and firms; (b) increasing the asset availability of households and people; and (c) reducing environmental risks and safeguarding natural resources. The project supports the strategic objective 1 of sustaining employment creation. Access to finance has been associated with higher employment, especially among MSMEs.<sup>13</sup>

**16. The operation supports the goals of the World Bank to eradicate poverty and increase shared prosperity by providing longer-term finance to underserved eligible MSMEs, thereby supporting their growth.** Research indicates a positive causal relationship between financial development and economic growth (particularly through the credit to firms channel), and also a positive association with declines in income inequality.<sup>14</sup> Lack of financing for a period longer than a year prevents MSMEs from replacing obsolete equipment with newer technology, resulting in lost productive capacity.<sup>15</sup>

**17. The World Bank brings a combination of long-term funding, knowledge of financial intermediary lending and of good practices in financial infrastructure reforms and in environmental and social management.** The World Bank's long-term financing will help BICE offer longer-term funding to participating financial institutions (PFIs), in turn offering longer-term finance to MSMEs. The World Bank also brings significant experience of capacity building of development banks' second-tier lending functions and in secured transactions, insolvency reform, and public credit guarantee schemes. Moreover, the World's Bank's experience in adequate environmental and social management practices will raise BICE's and PFIs' standards in this area, which in turn will contribute to an improvement in MSMEs' environmentally and socially sustainable business practices.

## II. PROJECT DEVELOPMENT OBJECTIVES

### A. PDO

<sup>12</sup> Discussed at the Board of Directors on September 9, 2014 (Report #81361-AR).

<sup>13</sup> World Bank Working Paper, Access to finance and job growth. Ayyagari, Juarros, Martinez Peria, and Singh; 2016. Survey of 50,000 firms across 70 developing countries.

<sup>14</sup> "Who gets the credit? And does it matter? Households versus firms lending across countries", Beck et al., 2012, Journal of Macroeconomics.

<sup>15</sup> Long-term finance tends to be associated with better firm performance, and firms can grow at faster rates than they could attain by relying on internal sources of funds and short-term credit alone, thereby increasing productivity and profitability.



The Project Development Objectives (PDO) are to improve access to, and strengthen the framework for the provision of, longer term finance for eligible micro, small and medium enterprises.

## B. Project Beneficiaries

**18. MSMEs are the project's ultimate beneficiaries.** MSMEs will benefit from access to longer-term finance, as well as from improvements in financial infrastructure that will facilitate access to credit. Eligible MSMEs are expected to benefit from productivity gains, as with longer term financing they would be able to undertake longer term fixed investments. However, since it is not possible to attribute productivity gains only to this project, the project will monitor performance of MSMEs (such as on employment, sales, and exports) as additional indicators (Annex 2).

**19. The implementing agency (BICE) and participating financial institutions (PFIs) will also benefit from the project.** BICE will benefit from capacity building for improving and expanding its second-tier lending business, and from raising environmental and social standards as part of credit risk assessments. PFIs will also benefit from improvements in the financial infrastructure, increased experience of assessing MSMEs for longer term lending, and increased awareness and capacity to assess, monitor, and supervise environmental risks.

## C. PDO-Level Results Indicators

**20. Key PDO indicators include:** (a) ratio of the average portfolio maturity of sub-loans under the project, over the average portfolio maturity of banks' lending portfolio not financed under the project; (b) BICE has a dedicated unit for risk management of second tier operations, with improved capacity for quantitative and qualitative analysis of risks; and (c) a new business development service platform operated by the MSME and Regional Development Department (SEPYME) developed and functioning. Intermediate indicators are elaborated in section VII.

# III. PROJECT DESCRIPTION

## A. Project Components

**21. The project consists of the following three main components:** (a) a credit line intermediated by BICE to PFIs for on-lending to MSMEs; (b) technical assistance and capacity building to: (i) support BICE's strengthening of its second-tier lending business model, (ii) strengthen the financial infrastructure and credit guarantee program that will improve the enabling environment for access to credit, and (iii) enhance the capacity of MSMEs to become bankable; and (c) project management.

**22. The proposed operation aims to address market failures related to the private sector's provision of long term finance.** It will support strengthening BICE's second-tier banking operations and crowd-in private financial institutions to extend longer term local currency financing to MSMEs. The



credit line will introduce longer-term finance for MSMEs, until financial infrastructure constraints are lifted and alternative sources of long-term finance are in place.

**23. Since this is the first World Bank financial sector operation in Argentina designed in a transitory macroeconomic environment, it has been developed as a pilot operation.** It will test the role of BICE as a second-tier lender with stronger capacity to intermediate to the banking sector, the demand for longer-term financing in local currency by banks as well as MSMEs, and whether, if given funding incentives, the banking sector has an appetite for lending to certain segments of MSMEs that may be currently excluded, such as MSMEs that employ indigenous groups or have them in their value chains, that promote gender equality, or that are first time borrowers of longer term loans in recent years, as defined in the operational manual.

#### **Component 1: Line of credit (US\$44.5 Million)**

**24. The credit line component will provide USD\$44.5 million equivalent to BICE for onlending through PFIs to MSMEs.** The Ministry of Treasury and Public Finance (MoF) will be the borrower, bearing the foreign exchange risk and will lend to BICE in local currency. BICE will be the implementing agency, onlending through PFIs to MSMEs. BICE will select PFIs pursuant to criteria agreed between BICE and the World Bank and subject to the latter's no objection. BICE will assume the risk of onlending to PFIs. The selected PFIs will in turn finance MSMEs, which are the final beneficiaries of the credit line. The PFIs will assume the risk of MSMEs, which will be selected based on agreed upon eligibility criteria with the World Bank. There will be no sectoral restrictions. The credit line will be revolving, ensuring that BICE will be flowing repayments into its second-tier lending business rather than direct lending.

**25. Pricing to PFIs and final borrowers will be competitive according to market conditions and, at the minimum, will incorporate administrative costs and the related risks of PFIs and final borrowers.** The significant market advantage to PFIs and final borrowers will be on maturity, by facilitating the provision of longer-term finance to MSMEs without PFIs taking on maturity mismatches. Sub-loans to MSMEs may be made for investment purposes (at least 75 percent of a PFI's portfolio) and for working capital (up to 25 percent of a PFI's portfolio), or as otherwise agreed with the World Bank.

**26. The project design and pricing model take into account the current macroeconomic conditions.** The design of the pricing model in the current macroeconomic conditions is challenging, and thus this operation has been designed as a pilot. There are no market-based interest rates for long term lending in Argentina. The MoF will take on the foreign exchange risk and will pass the cost of IBRD funds to BICE. Given the current macroeconomic context with very high peso interest rates, a swap is unfeasible, as the costs would be very high. While inflation remains high, BICE will onlend to PFIs at similar levels to their average funding costs (as of August 2016, between 10-13 percent) at the time of signing the legal agreement. This rate varies from the BADLAR reference rate, which is the rate for short term big size deposits (at 24 percent as of August 30, 2016). As inflation goes down, and the BADLAR rate declines, BICE will lend to PFIs at the BADLAR<sup>16</sup> rate (plus a spread), up to the defined rate

<sup>16</sup> BADLAR is the most used short-term reference rate for flexible rate financial contracts in Argentine Pesos (for example, commercial paper). This interest rate is constructed by the average weighted rate paid for 30-35 days time deposits above ARS 1 million (approximately US\$70,000). The BADLAR is a credible reference rate for the average cost of funding through big size deposits. The Government issues local currency paper placed in banks and with other institutional investors, with BADLAR as the reference rate.



determined at the time of signing the legal agreement with each PFI. The objective of such a pricing model is to maintain flexibility for macroeconomic adjustments. As market conditions change, BICE and PFIs may renegotiate the financial terms. An OP 10.00 (Investment Project Financing) review will be conducted one year following disbursements to determine any changes in project design. In addition, during the mid-term review, the World Bank and BICE will review the macroeconomic situation and determine any changes needed in the onlending system to PFIs.

**27. PFIs will competitively determine their rate to MSMEs.**<sup>17</sup> In the current near term scenario that BICE lends to PFIs at an average of their funding costs between 10- 13 percent, PFIs would add a spread in the range of 2-6 percent to determine their ultimate rate to MSMEs. Thus, in the near term, the ultimate rate to MSMEs could be in the range of 12-16 percent and 15-19 percent. With the current inflation levels, these would be negative real rates. However, inflation is slowing down and inflation expectations for 2017 support a declining trend. Given that these are longer term loans (with a minimum maturity of 3 years), the negative real rate would not be for the entire life of the loan.

**28. PFIs will be selected by BICE based on their financial health, as well as their capacity to extend sub-financing (see annex 1).** BICE takes the credit risk of PFIs and therefore has a strong incentive to carefully assess their financial health and operational capabilities. The PFI selection is also subject to a no-objection process by the World Bank, while Subsidiary Financing Agreement (SFA) covenants between BICE and PFIs require compliance with local regulations, thereby, supporting continued financial health. PFIs in turn sub-finance to enterprises based on eligibility criteria, terms, and conditions agreed upon with the World Bank. If PFIs do not effectively implement the project, their allocation can be reallocated to other PFIs.

**29. Annex 1 provides a detailed description of the credit line.** It includes the project terms and conditions (a) between the World Bank and the MoF; (b) between the MoF, MoP, and BICE; (c) between BICE and PFIs; and (d) between PFIs and MSMEs.

**Component 2: Institutional capacity building of BICE, financial infrastructure reforms, credit guarantee fund, and capacity building for MSMEs (US\$4.55 million<sup>18</sup>)**

***Subcomponent 2.1. Institutional capacity building of BICE (US\$1.62 million)***

**30. The project will strengthen BICE's capacity to improve and expand its second-tier lending function based on international best practices,** through the provision of support for the introduction of changes in its risk management, policies, and systems.

**31. BICE's capacity for its current level of second-tier operations has been assessed as broadly adequate.** A significant expansion, however, will require improvements. These include: (a) establishing a dedicated unit for credit risk management for second-tier operations; (b) training personnel on financial institution analysis; (c) enhancing the risk analysis of financial institutions by transitioning from Excel to a more robust software; (d) enhancing the qualitative process of evaluating banks, with emphasis on risk management and internal controls; (e) systematizing measurements of risks (liquidity, interest rate,

<sup>17</sup> There is no market reference price in Argentina, with the only existing benchmark for medium- to longer-term credit being the LCIP, at a rate that is mandated by the BCRA.

<sup>18</sup> An amount of US\$0.5 million for subcomponent 2.1 will be allocated during project implementation.



market, operational, credit) through an improved information technology (IT) platform; and (f) improving the capacity of the financial department of BICE by adding a treasury module to the core IT system.

***Subcomponent 2.2. Technical assistance for improving the enabling environment for MSME access to finance (US\$2.25 million)***

**32. The project will provide technical assistance to improve the enabling environment for MSME finance,** through the carrying out of preparatory activities for: (a) modernizing the borrower's secured transactions framework; (b) strengthening the insolvency framework; and (c) strengthening the public credit guarantee fund. Support under this subcomponent will follow a flexible approach to accommodate differential progress among focus areas and to include potential new activities that can arise in the financial sector reform agenda, in line with the objectives of this project.

*a. Secured Transactions Framework*

**33. The project will provide support on the modernization of the secured transactions framework.** The support includes the preparatory work for: (a) drafting of a new Secured Transactions Law; (b) establishment of a modern online collateral registry and development of supporting regulations; and (c) capacity-building and awareness-raising activities.

*b. Insolvency and Creditor Rights Framework*

**34. The project will support the preparatory work for strengthening of the insolvency framework.** The support includes: (a) diagnostic of challenges and draft amendments to the insolvency law; (b) a new draft regulatory framework for insolvency practitioners; and (c) dissemination of activities to inform and train key stakeholders about legislative and regulatory changes.

*c. Credit Guarantee Fund*

**35. The project will provide support to the public credit guarantee fund to provide partial credit guarantees directly to banks and reinsurance to SGRs.** The World Bank is conducting an evaluation of FOGAPYME according to the Principles for Public Credit Guarantees and is designing a pilot program for FOGAPYME to provide partial credit guarantees to selected banks. The project will evaluate the pilot, and, based on the experience, support the credit guarantee fund to provide guarantees directly to banks and serve as a reinsurance scheme for SGRs. This will include work on a revised legal framework, institutional structure, corporate governance, policies and procedures, and adequate staff skills and capacity. The project will also undertake a feasibility study on an automated financing platform, which would link SGRs, the credit guarantee fund, banks, and MSMEs, and will finance the platform following the results of the feasibility study.

***Subcomponent 2.3. Capacity building for MSMEs (US\$0.68 million)***

**36. The project will provide support for strengthening the MSME support programs of SEPYME, through the provision of business development and management tools aiming to make MSMEs more bankable.** The support includes, among others, (a) a diagnostic of the current Business Development



Services (BDS) Program (*Experto PYME*); (b) development of online training material for MSMEs that will form part of the new digital learning platform for MSMEs; (c) design, development, and implementation of an online and interactive business service providers database; and (d) strengthening the capacity of the SEPYME's portal for MSMEs.

### **Component 3: Project management (US\$0.825 million)**

**37. This component will support the BICE Project Implementation Unit (PIU) to implement the project effectively.** This includes, among others: (a) provision of support to coordinate, manage, implement, and supervise the project; (b) the carrying out of progress and results monitoring activities; (c) the carrying out of a midterm review survey to MSME beneficiaries; and (d) the carrying out of the project's financial audits.

**38. This component will also provide a consultancy service for a part-time social development expert to support the National Directorate of Social Innovation,** to promote the credit line among indigenous communities and support PFIs in identifying MSMEs that benefit indigenous peoples as potential beneficiaries.

## **B. Project Cost and Financing**

### **Financing Instrument**

**39. The proposed Investment Project Financing would be a variable spread loan with a final maturity of 32.5 years including a grace period of 7 years, with the MoF as the borrower.**

### **Project Cost and Financing**

Project Components	Project cost	IBRD	Trust Funds	Counterpart Funding
Component 1	US\$44.50 million	100%	—	0%
Component 2	US\$4.55 million			
Component 3	US\$0.825 million			
<b>Total Costs</b>				
Front-end fees	US\$125,000			
Total project costs	US\$50 million			
<b>Total Financing Required</b>	<b>US\$50 million</b>			

## **C. Lessons Learned and Reflected in the Project Design**

**40. International experience suggests that a second-tier model has advantages over direct lending, although mixed experiences with development banks in Latin America highlight the need for adequate management of risks.** Second-tier lending incentivizes private sector financial intermediaries



to enter new markets or expand services to existing markets. Furthermore, second-tier lending avoids potential government interference by introducing a private sector layer between state and ultimate beneficiaries.

**41. World Bank credit lines have been used successfully to alleviate access-to-finance constraints.**

They are often undertaken as a tool to alleviate the lack of longer-term financing to support investment growth and employment generation. Their critical bridge-finance role in the short to medium term needs to be complemented, however, with policies to develop long-term finance (for example, macroeconomic reforms, capital markets development), as well as an adequate financial infrastructure. Independent Evaluation Group's review of eight closed World Bank lines of credit found that they were primarily justified in terms of their direct benefits to recipient MSMEs.<sup>19</sup> Problems in credit line projects have stemmed mainly from weak borrower accountability and management capacity, lack of clearly defined indicators for monitoring the financial performance of PFIs, poor monitoring of the project's impact, inadequate demand from MSMEs, lack of bankable sub-projects, and inflexibilities in project design that make it difficult to adjust to changing situations.

## IV. IMPLEMENTATION

### A. Institutional and Implementation Arrangements

**42. BICE will be the implementing agency for this project.** A PIU to be established in BICE will be responsible to coordinate, manage, implement, supervise, and document all the activities related to the project as established in the loan agreement.

**43. The PIU will be staffed with capable and qualified personnel for the implementation of the project.** The PIU team will be composed of: (a) a project coordinator; (b) a procurement specialist; (c) a financial management (FM) specialist; (d) an environmental and social specialist; (e) a technical expert; and (f) an assistant. The PIU will coordinate closely with the second-tier operations units in BICE (both the credit risk unit and the commercial unit). The responsibilities of the PIU are outlined in Annex 2.

### B. Results Monitoring and Evaluation

**44. The PIU will evaluate progress on the proposed indicators.** The PIU will monitor the PDO and intermediate indicators of the results framework on a semiannual and yearly basis. Further details on the results framework are provided in section VII and in Annex 2, where additional indicators are included for analytical purposes, such as performance of MSMEs, profile of MSMEs, profile of finance, number of MSMEs hiring indigenous peoples' or working with their products, and performance of PFIs.

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<sup>19</sup> Some of the demonstrated benefits included demonstration effects for the financial industry that long-term lending can be a viable business proposition, increased capacity of the wholesale lending institutions, increased diversification of the client base for banks, and improved lending practices to extend medium- to long-term credit (upgrade lending practices from collateral to cash-flow lending), as well as enhanced environmental practices.





### C. Sustainability

**45. Sustainability will be encouraged by the increased capacity building of BICE's second-tier lending model.** As BICE's second-tier lending business grows, PFIs will be able to continue to draw on long-term financing sources from BICE, until longer-term funding instruments are developed in the market.

**46. The financial infrastructure reforms supported by the project will also contribute to the sustainability of impact, as such reforms will enhance the enabling environment for access to credit.**

**47. Sustainability will also be facilitated in the long run by the development of alternative sources of long-term funding in the market.** While the World Bank can play an important catalytic role at this stage by providing the sector with longer-term financing that is currently scarce, it is expected that, in the long run, alternative sources of funding will be developed. The World Bank, primarily through technical assistance, is working with the authorities on the development of longer-term funding instruments.

### D. Role of Partners

**48. The IBRD team and the International Finance Corporation (IFC) have collaborated closely on the design of the project, and will continue to do so during the implementation phase.** The IBRD and IFC teams have coordinated closely on the design of the project and the environmental and social management framework, and are working in a complementary manner in the financial sector. Availability of IBRD's local currency funding to the banking sector complements IFC's US\$ lending to financial institutions for export-oriented SMEs, broadening the universe of beneficiaries. The IFC has provided technical assistance for the preparatory diagnostic of the secured transactions framework, which lays the groundwork for the implementation of one of the subcomponents of this project. During implementation, collaboration will continue on the credit line, environmental and social management aspects, and the secured transactions reform.

## V. KEY RISKS

### A. Overall Risk Rating and Explanation of Key Risks

**49. The overall risk to meet the development objectives of this project is assessed as Substantial.**

**50. The political and governance risk is moderate.** The new Government may face challenges to push through financial sector infrastructure reforms, given the current political environment. This political risk is mitigated as the operation supports all the preparatory work for these reforms, but not the passing of legislation.<sup>20</sup> The Government is taking a consultative approach to policy making. SEPYME

<sup>20</sup> The new Government has successfully passed legislation with regards to SME development and finance, such as the Small and Medium Enterprises Act approved in July 2016 by representatives of different political parties from both the Senate and the Chambers of Deputies of Congress, and amendments to the FOGAPYME law.





in the Ministry of Production has established a Council of Monitoring and Competitiveness of MSMEs, with public and private sector representation, in order to build consensus on reforms affecting MSME finance and development.

**51. The macroeconomic risk is substantial.** Uncertainty over the pace of economic recovery and the success of macroeconomic reforms may negatively impact the development of longer term finance. The new Government may face difficulty in implementing difficult structural reforms to address the fiscal deficit and bring down inflation. Without continued reforms, the targeted fiscal consolidation may be at risk, which in turn could undermine the achievement of inflation targets. A slower than expected reduction in inflation would negatively impact the achievement of the objective of this operation, as inflation undermines the ability of financial institutions to accurately assess credit risks based on borrowers' capacity to repay, and negatively affects the demand for loans. However, a deceleration of inflation in recent months has led to a declining trend in interest rates. It should also be noted that the new Government has already sent several positive signals to the market with reforms that have already been implemented (for example, elimination of export taxes on major crops, unification of the exchange rate, resolution of the dispute with holdout creditors), or are underway.

**52. The environmental and social risk is substantial.** The project faces the risk of implementation delays and of limited compliance with the safeguard instruments, due to PFIs' lack of familiarity with the World Bank's environmental and social safeguard requirements. During project preparation BICE, prepared an environmental and social management framework (ESMF) and an Indigenous Peoples Planning Framework (IPPF) that set up the mechanisms for complying with the Bank's safeguard requirements and mitigating risks. These safeguards instruments were prepared by the borrower and approved by the Bank. BICE consulted widely with stakeholders on these frameworks and incorporated their inputs. In addition, during implementation, BICE's PIU (with a dedicated environment and social expert) and the World Bank team will hold capacity building workshops for PFIs to enhance their understanding of the Bank's safeguard requirements. PFIs will be required to carry out an environmental screening, on-site visits, and assessment of the sub-projects. The Bank team will monitor these risks through regular reporting from BICE and the PFIs, and supervision missions in which BICE and the World Bank will be conducting periodic PFI and MSME on-site inspections.

## VI. APPRAISAL SUMMARY

### A. Economic and Financial (if applicable) Analysis

**53. Given that MSME sub-projects are to be identified by PFIs, with no limits on geography or sector, a traditional economic/financial analysis does not capture the potential gains from MSME investments.**<sup>21</sup> In addition, about 10 percent of project funds will be used for financial infrastructure reforms, which will have significant long-term benefits not easily captured in traditional economic and financial analysis models. Finally, the capacity investments in BICE are also difficult to quantify.

<sup>21</sup> Annex 2 describes the eligibility criteria of MSMEs and terms and conditions of sub-loans under the project.



**54. Nonetheless, evaluations of credit lines in Turkey, indicate positive quantitative results.** An evaluation study of credit lines<sup>22</sup> in Turkey in 2011, indicated that these credit lines helped firms undertake long term investments enabling them to expand output and employment. As assessed by the client firms, an important amount of additional employment has been generated as a result of these credit lines. A significant share of clients stated that they would reduce employment and output without the credits – the employment impact is found to be around 2.6-2.7 percent of employment growth for SME clients (the employment growth rate in Turkey being less than 2 percent annually in the last decade).<sup>23</sup> In addition, BICE's analysis of a sample of MSMEs during 2008 – 2015 in agriculture and light manufacturing, which obtained an investment loan of an average of US\$ 1.2 million, indicated an increase of 112 percent in sales and about 42 percent in the number of employees, in a period of 3 years after obtaining the loan. However, these are self-reported results by the clients.

**55. Through supporting access to finance for MSMEs, the credit line could have an impact on job maintenance, although the direct employment effect is limited due to the pilot size of the operation.** The project supports MSMEs that are estimated to account for 71 percent of employment, but are financially constrained by lack of collateral, poor credit history, and other constraints. In addition, during the ongoing economic transition, MSMEs may need to invest in upgrading their production technologies to adjust to a more competitive environment. While short-term liquidity constraints may have a negative impact on firms' existing employment, improved production technologies could have a positive impact on future employment.

**56. The project will also have significant positive benefits, as a result of the reforms proposed in the technical assistance component, for the implementing agency (BICE), the MoP, final beneficiaries (MSMEs), PFIs, and for overall economic development (see Annex VII).**

## **B. Technical**

**57. The financial condition of BICE is good, and the final interest rates fees will be in line with the market.** Provisions are included in the project to ensure that interest rates and/or other fees reflect the cost of intermediating project funds and an appropriate credit risk margin.

**58. The design of Component 2 reforms is in line with international good practice, based on World Bank experience in other countries and the Argentine context, and incorporates lessons learnt.** The design of the technical assistance reforms have been informed by the joint World Bank/IMF FSAP in 2013, which established the analytical foundation for these reforms. In addition, subsequent technical notes on longer-term finance, credit guarantee schemes, diagnostics undertaken during the course of project preparation on secured transactions, insolvency, and credit guarantees, and the due diligence assessment of BICE, have informed the design of these reforms.

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<sup>22</sup> The study was based on a survey of 400 export finance intermediation loans (EFIL) and SME beneficiary firms, and 200 control firms, from credit lines during 1999-2010.

<sup>23</sup> Comparisons between the client firms and control group firms also revealed that client firms (about half) are more innovative, more likely to conduct R & D, and invest more in machinery and equipment, than the export firms (29 percent) and SMEs (8 percent).



**59. The technical approach of capacity building for MSMEs draws on the World Bank's knowledge of successful support programs for MSMEs.** Key principles include the provision of broad, useful, and easy to access information and enterprise development tools to MSMEs, including an open and updated database of qualified BDS providers.

### **C. Financial Management**

**60. The FM assessment has been completed, and the project's arrangements for oversight and accountability have been agreed.** The project will be implemented by BICE, which is a first time implementing agency with the World Bank. This entity will mostly use its existing IT and organizational infrastructure to manage the operation. However, an FM specialist will be hired to absorb the operational functions associated with the World Bank-financed project, and the UEPEX system will be implemented in BICE for the preparation of accounting records, disbursement applications, and financial reports.

**61. The internal audit of BICE is one of the key controls in the process of monitoring and providing assurance on the use of funds by the PFIs.** This unit conducts random reviews with the aim of ensuring that the funds were used for the intended purposes, and it has adequate capacity to perform its work with appropriate independence and technological infrastructure. However, given the importance of its role and the scale-up in operations that is expected for BICE, the project will strengthen its capacity through training staff in the application of international good practices. BICE will submit to the World Bank audited reports and interim financial reports (IFRs) covering funds received and funds on-lent, capturing loans by PFIs.

### **D. Procurement**

**62. Procurement will be conducted according to the World Bank's 'Procurement Regulations for IPF Borrowers', issued in July 2016, for the supply of goods, works, and non-consulting and consulting services under Components 2 and 3.** The procurement framework does not apply to Component 1, since the sub-loans will be made to private sector MSMEs.

**63. Procurement activities will be undertaken by BICE's PIU.** The capacity assessment of BICE concluded that, although BICE has an overall adequate capacity to successfully carry out the procurement function, a procurement specialist will be hired as part of the PIU to be established. The World Bank will also provide capacity building to BICE's PIU to conduct its procurement activities. BICE, as the implementing agency, developed a Procurement Plan for the first eighteen months of project implementation. The plan foresees four procurement packages (or contracts) for goods (US\$870,000) and five for consulting services (US\$800,000).

### **E. Social (including Safeguards)**

**64. One of the positive social impacts of the project is its potential contribution to increased access to finance for female entrepreneurs.** BICE will allocate additional funds, as an incentive, to PFIs



that can lend to MSMEs that promote gender equality by, *inter alia*, supporting work-life balance and social shared responsibility by men and women in providing daycare to their dependents, ensuring equal treatment for men and women in terms of income, having women as part of their management team, and other criteria as defined in the Indigenous Peoples Planning Framework (IPPF). The project will also monitor an indicator on gender for analytical purposes and to inform the design of future projects.

**65. The policy on Indigenous Peoples (OP 4.10) is triggered.** This is a project in all regions of the country, and indigenous peoples are present in Argentina (about 2.5 percent of the population). Indigenous peoples are among the most vulnerable populations in the country and face serious challenges to have access to services and markets. Thus, there is a very small number of MSMEs owned or managed directly by indigenous peoples and many are informal. In this context, the primary objectives of triggering the Indigenous Peoples Policy are to ensure that: (a) indigenous people groups are afforded opportunities to participate in planning that affects them; (b) opportunities to provide such groups with culturally appropriate benefits are considered; and (c) any sub-project that could have an impact that adversely affect them will not be eligible.

**66. An IPPF was prepared and disclosed by BICE and consulted with indigenous people's leaders, through the National Institute of Indigenous Affairs (*Instituto Nacional de Asuntos Indígenas*) and the Indigenous Participation Council (*Consejo de Participación Indígena*), in July and August 2016.** The IPPF was approved by the Bank. The IPPF has established the procedures to guarantee the indigenous peoples' participation with respect to MSMEs' sub-projects that could affect their interests. The IPPF has set forth adequate mechanisms to ensure that information is available and accessible, to guarantee consultation and participation in a culturally appropriate manner, minimize any potential negative impact, and support the maximization of positive impacts. BICE will allocate additional funds, as an incentive, to PFIs that can lend to MSMEs that employ indigenous peoples or have them in their value chains. In addition, the project will support the National Directorate of Social Innovation (MoP) for raising awareness of the project among indigenous peoples' MSMEs.

**67. The final IPPF documents the results of the consultations and takes into account the participants' views.** One of the main takeaways from the consultation is that it will be necessary to carry out a collaborative approach to engage closely the indigenous communities. The IPPF is an integral part of the project's Environmental and Social Management Framework (ESMF), as an annex, and is part of the project's OM. The final IPPF was disclosed on BICE's website on August 26, 2016 and the World Bank's external website on the same date.

**68. The policy on Involuntary Resettlement (OP 4.12) is not triggered.** Any involuntary land acquisition or associated involuntary resettlement that would trigger the World Bank Operational Policy, OP 4.12, will not be eligible for financing under this project. The ESMF includes a question on involuntary resettlement that will allow PFIs to exclude activities that may result in resettlement impacts. In addition, a list of non-eligible interventions have been included in the ESMF for screening purposes. PFIs will verify that the transactions proposed for financing will be carried out within the land to which applicants have legal titles and no competing claims or legacy exists. PFIs will file the result of verification for record so that BICE and the World Bank can review.



## **F. Environment (including Safeguards)**

**69. The project has been categorized as 'FI' in accordance with World Bank OP 4.01 (Environmental Assessment).** OP 4.01 Environmental Assessment is triggered. Due to the nature of the project, investment finance applications are expected to include machinery purchase/replacement or small-scale construction works. Therefore, it is expected that there will be no large-scale, significant, and/or irreversible impacts. Sub-projects in environmental Category A according to the World Bank's OP/BP 4.01 will not be eligible for funding; neither will subprojects to build or rehabilitate dams, and those included in IFC's exclusion list. The ESMF outlines in detail the excluded activities.

**70. Due to the possibility of a sub-project being in the vicinity of natural habitats, OP/BP 4.04 is triggered.** Significant conversion and/or degradation of natural habitats will not be supported with this credit line and any proposal located in legally protected areas will not be eligible.

**71. Considering that MSMEs in the forest industry may apply for a loan in this credit line, the OP/BP 4.36 is triggered** and the project will only support such MSMEs that can demonstrate certified sustainable forest management practices that conform to the World Bank policy criteria.

**72. The project triggers the OP/BP 4.09 as the agricultural sector is highly likely to demand such loans.** Category B MSMEs that rely on the use of pesticides will be requested to develop and implement an Environmental Management Plan (EMP) that considers Good Practices in the Use of Pesticides, including integrated pest management as relevant. Project funding will not be used for purchase of pesticides nor for activities that apply pesticides of categories not permissible under the policy.

**73. MSMEs could be located in the vicinity of areas designated as sites of physical cultural resources; hence, OP/BP 4.11 is triggered.** Category B MSMEs that might conduct civil works will be requested to develop and implement an EMP that considers specific measures to avoid affecting physical cultural resources. Any proposal located in legally designated areas as sites of physical cultural resources will not be eligible.

**74. An ESMF was prepared by BICE and approved by the Bank.** The environmental procedures defined in the ESMF are consistent with the Government of Argentina's Provincial and Municipal Environmental Assessment requirements and the World Bank's safeguard policies. According to the ESMF, PFIs will be required to carry out an environmental screening, on-site visits, and assessment of the proposed sub-projects. Sub-borrowers will also need to obtain environmental permits, as prescribed by the corresponding provincial and/or municipal regulations, which will be requested by PFIs at application. Category B MSMEs will also be requested to develop and implement an EMP, based on good industrial practices and consistent with the World Bank's guidelines. BICE will be responsible for the quality assurance of these environmental reports and monitoring of sub-projects.

**75. The draft ESMF was disclosed and consulted with key stakeholders in July and August 2016.** The conclusions of the consultations are as follows: (a) SME associations consider it appropriate for MSMEs to implement good practices according to ESMF provisions and indicate a commitment to support MSMEs to improve their socioenvironmental management; and (b) PFIs consider ESMF guidelines relatively consistent with their current ones. The final ESMF documents the consultation



process and its results. The final ESMF was disclosed in BICE's website on August 26, 2016 and the World Bank's external website on the same date.

## **G. Other Safeguard Policies**

**76. The policy on Projects on International Waterways OP 7.5 is not triggered.** Therefore, any subloans involving discharges into or uptakes from tributaries of international watersheds and/or from international rivers will not be eligible under this credit line. This includes projects for irrigation, implying water pumping, effluent discharges, or any project involving a different water use from the one that MSMEs are currently allowed to do by the Argentine authorities. Subprojects to change the water use of the MSME are not eligible if they are located in the listed watersheds outlined in the ESMF.

## **H. World Bank Grievance Redress**

Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit <http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service>. For information on how to submit complaints to the World Bank Inspection Panel, please visit [www.inspectionpanel.org](http://www.inspectionpanel.org).



## VII. RESULTS FRAMEWORK AND MONITORING

### Results Framework

COUNTRY : Argentina

Access to Longer Term Finance for Micro, Small and Medium Enterprises Project

### Project Development Objectives

The Project Development Objectives (PDO) are to improve access to, and strengthen the framework for the provision of, longer term finance for eligible micro, small and medium enterprises.

### Project Development Objective Indicators

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source / Methodology	Responsibility for Data Collection
<b>Name:</b> Ratio of the average portfolio maturity of MSME sub-loans under the project, over the average portfolio maturity of PFI's MSME lending portfolio not financed under the project.		Number	0.00	1.00	Semi-annual	Reports of each eligible PFI	Project Implementation Unit at BICE
<b>Description:</b> Ratio of the average portfolio maturity of MSME sub-loans under the project, over the average portfolio maturity of eligible PFI's MSME lending portfolio not financed under the project is higher than 1.							
<b>Name:</b> BICE has a dedicated unit for risk management of second tier operations, with improved capacity for quantitative and qualitative		Number	0.00	1.00	Semi-annual	Project Report	Project Implementation Unit at BICE



analysis of risks							
Description: Target zero (0) means No; one (1) means Yes.							

Name: New business development service platform operated by SEPYME developed and functioning		Amount(US D)	0.00	1.00			
Description: A new business development service platform will be designed, developed, tested and online, with tools for MSMEs to increase their capacity, including training material and a virtual market for business development service providers and MSMEs. Target zero (0) means Not yet, one (1) means yes							

### Intermediate Results Indicators

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source / Methodology	Responsibility for Data Collection
Name: Volume of Bank Support: Lines of Credit - SME	✓	Amount(US D)	0.00	53000000.00	Semi-annual	Project Report	Project Implementation Unit at BICE
Description: A line of credit is "SME finance" if the supporting subloans have an average out standing balance > microfinance cut-off noted below, but no more than \$300,000. A line of credit is classified "microfinance" if supporting subloans: a) Have an average outstanding balance (gross loan portfolio ÷ number of active borrowers) < 300% of the latest per capita GNI, OR b) Less than \$1,000. EITHER circumstance triggers classification as microfinance. Lines of credit and other funding for retail SME sub-loans by Participating Financial Institutions or Community-Managed Loan Funds. Report the cumulative amounts disbursed as of most recent date available. If a split by micro and SME is not available or possible, please use 50% for each as proxy.							
Name: Volume of Bank		Amount(US	0.00	53000000.	Semi-annual	Project Report	Project Implementation





Support: Lines of Credit - SME		D)		00			Unit
<b>Description:</b> US\$53 million line of credit; US\$44.5 million allocated for the credit line component and an estimated revolving amount of US\$8.5 million. The revolving amount is estimated based on: a) Disbursement of funds as planned; b) Term: 5 years; c) Grace period: 18 months; d) Amortization: Semi-annual; y d) Use of revolving funds: Semi-annual.							
<b>Name:</b> Number of sub-loans provided by selected PFIs to MSMEs with Project funds (cumulative)		Number	0.00	106.00	Semi-annual	Project Report	Project Implementation Unit at BICE
<b>Description:</b> Number of sub-loans provided by selected PFIs to MSMEs using the credit line provided by BICE with Project funds (average amount used for the estimated number is US\$500,000).							
<b>Name:</b> Draft secured transactions law submitted for approval		Number	0.00	1.00	Semi-annual	Project Report	Project Implementation Unit at BICE
<b>Description:</b> Draft secured transactions law submitted for approval. Target zero (0) means Not yet, one (1) means Yes.							
<b>Name:</b> Credit guarantee fund is operationalized		Number	0.00	1.00	Semi-annual	Project Report	Project Implementation Unit at BICE



**Description:** Credit guarantee fund is operationalized (it has policies, procedures, staff, risk management and systems in place to issue guarantees). Target zero (0) means Not yet, one (1) means Yes.

<b>Name:</b> Modern movable collateral registry established		Number	0.00	1.00	Semi-annual	Project Report	Project Implementation Unit at BICE
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**Description:** A modern collateral registry is defined as: a low fee, notice based system, available online for all parties, with minimal formalities, which allows creditors to file their security interests directly and obtain priority over subsequent third parties."0" means No, and "1" means Yes.

<b>Name:</b> Draft Insolvency law amendments submitted for approval		Number	0.00	1.00	Semi-annual	Project Report	Project Implementation Unit at BICE
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**Description:** Draft Insolvency law amendments submitted for approval. Target zero (0) means Not; one (1) means Yes.

<b>Name:</b> Outstanding SME Loan Portfolio	✓	Amount(US D)	2900000000 0.00	2900000000 0.00	Semi-annual	Central Bank of Argentina	Project Implementation Unit at BICE
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**Description:** Provide the outstanding (i.e., not yet repaid or written off) amount of the SME loan portfolio for each PFI or CMLF promoter receiving Bank support. Report the entire portfolio of the institution as of a reasonably recent date, not just the Bank-financed portion.

<b>Name:</b> Portfolio at Risk - SME	✓	Percentage	1.51	1.51	Semi-annual	Central Bank of Argentina	Project Implementation Unit at BICE
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**Description:** Portfolio at Risk = Outstanding (or not yet repaid) balance of all loans where payment is late by > 90 days / Gross outstanding loan portfolio. Report the Portfolio at Risk (PAR) for the PFI's entire SME portfolio. Do not report on the PAR for just the Bank-funded portion. Loans that have been rescheduled or renegotiated should also be included in the numerator of the PAR. Weight each institution's PAR by its outstanding SME portfolio to calculate the average PAR for the project. The optional "breakdown" tab can be used to report by institution.

<b>Name:</b> Return on Assets/Equity	✓	Percentage	33.71	33.71	Semi-annual	Central Bank of Argentina	Project Implementation Unit at BICE
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**Description:** Return on Assets (Equity) = Annual After Tax Profits / Average Assets (Equity) over the Period Return on Assets (Equity) reflects that organization's ability to deploy its assets (equity) profitably. This indicator is used for commercial institutions that do not receive subsidies. The optional "breakdown" tab can be used to report by institution.

<b>Name:</b> Percentage of MSME beneficiaries that feel project sub-finance reflected their needs		Percentage	0.00	75.00	Mid-term	Mid-term survey	Project Implementation Unit at BICE
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**Description:** A mid-term survey will measure the satisfaction of Project beneficiaries with the sub-loan in term of their needs (e.g access to longer term finance). This will exclude satisfaction with FI decisions related to the size, terms and conditions that need to be market based (as required by OP.10.00). The survey results will inform the project implementation, as appropriate.



## Target Values

### Project Development Objective Indicators

Indicator Name	Baseline	YR1	YR2	YR3	YR4	YR5	End Target
Ratio of the average portfolio maturity of MSME sub-loans under the project, over the average portfolio maturity of PFI's MSME lending portfolio not financed under the project.	0.00	1.00	1.00	1.00	1.00	1.00	1.00
BICE has a dedicated unit for risk management of second tier operations, with improved capacity for quantitative and qualitative analysis of risks	0.00	0.00	1.00	1.00	1.00	1.00	1.00
New business development service platform operated by SEPYME developed and functioning	0.00	0.00	0.00	1.00	1.00	1.00	1.00

### Intermediate Results Indicators

Indicator Name	Baseline	YR1	YR2	YR3	YR4	End Target
Volume of Bank Support: Lines of Credit - SME	0.00	9500000.00	27000000.00	39250000.00	52500000.00	53000000.00
Volume of Bank Support: Lines of Credit - SME	0.00	9500000.00	27000000.00	39250000.00	52500000.00	53000000.00
Number of sub-loans provided by selected PFIs to MSMEs with Project funds (cumulative)	0.00	19.00	54.00	79.00	105.00	106.00



Draft secured transactions law submitted for approval	0.00	0.00	0.00	1.00	1.00	1.00
Credit guarantee fund is operationalized	0.00	0.00	1.00	1.00	1.00	1.00
Modern movable collateral registry established	0.00	0.00	0.00	0.00	1.00	1.00
Draft Insolvency law amendments submitted for approval	0.00	0.00	0.00	1.00	1.00	1.00
Outstanding SME Loan Portfolio	2900000000.00					2900000000.00
Portfolio at Risk - SME	1.51					1.51
Return on Assets/Equity	33.71					33.71
Percentage of MSME beneficiaries that feel project sub-finance reflected their needs	0.00	0.00	0.00	75.00		75.00



## ANNEX 1: DETAILED PROJECT DESCRIPTION

COUNTRY : Argentina

Access to Longer Term Finance for Micro, Small and Medium Enterprises Project

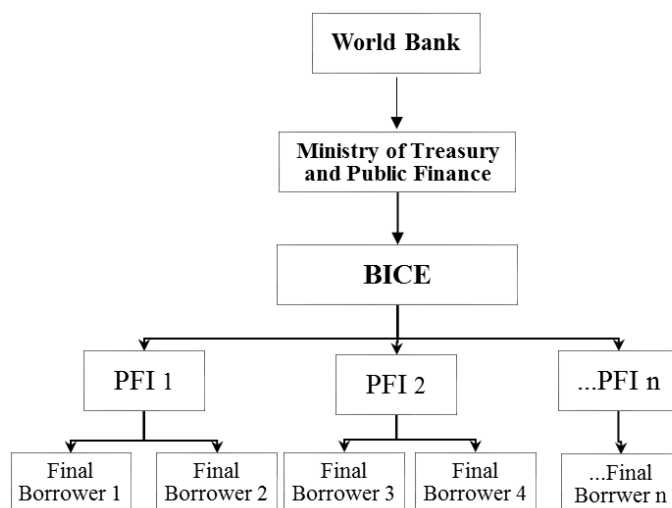
1. The Project Development Objectives (PDO) are to improve access to, and strengthen the framework for the provision of, longer-term finance for eligible micro, small, and medium enterprises.

2. The project consists of the following three main components: (a) a credit line intermediated by BICE to PFIs; (b) technical assistance and capacity building to (i) support BICE in strengthening its second-tier lending business model; (ii) strengthen the financial infrastructure and credit guarantee program that will improve the enabling environment for access to credit, and (iii) increase the capacity of MSMEs to become bankable; and (c) project management.

### Component 1: Line of credit (US\$44.5 million)

3. The credit line component will provide USD\$44.5 million equivalent to BICE for onlending through qualified banks for longer term finance to MSMEs. The MoF will bear the foreign exchange risks and will lend to BICE in local currency for intermediating to PFIs for onlending to MSMEs.

Figure 1.1. Structure for the Credit Line Flow of Funds for Component 1



4. BICE will select PFIs pursuant to criteria agreed between BICE and the World Bank, and subject to its no objection, based on their financial health and capacity to finance MSMEs. The selected PFIs will in turn finance MSMEs, which are the final beneficiaries of the credit line. The PFIs will assume the risk of the final borrowers, which they will select based on agreed upon eligibility criteria with the World Bank. BICE would assume the risk of onlending to PFIs. There will be no sectoral restrictions. The credit line will be revolving, ensuring that BICE will be flowing repayments into its second-tier lending business. BICE will repay the loan according to the arrangements in the subsidiary loan agreement between BICE, MoP, and MoF, subject to the World Bank's no objection.



**5. Pricing to PFIs and final borrowers will be competitive according to market conditions and will, at the minimum, incorporate administrative costs and the related risks of PFIs and final borrowers.** The only significant market advantage to PFIs and final borrowers will be in terms of maturity, by facilitating the provision of longer-term finance to MSMEs without PFIs taking on maturity mismatches. The MoF will pass the cost of IBRD funds to BICE. BICE will onlend to PFIs on sustainable terms similar to their market funding costs at the time of signing the legal agreement or, once the inflation is reduced and the BADLAR rate declines, at the BADLAR rate plus a spread up to the defined interest rate agreed at the time of signing of the legal agreement. As the macroeconomic situation changes, BICE and PFIs may renegotiate the financial terms. The PFIs will competitively determine their rate to MSMEs.<sup>24</sup>

**6. BICE will allocate additional funds, as an incentive, to PFIs that can lend to MSMEs that (a) employ indigenous peoples or have them in their value chains, (b) promote gender equality, or (c) are first-time MSME borrowers of longer term loans in recent years, as defined in the OM.** Through this additional funding incentive, the project also aims to test the appetite of the banking sector to include these segments.

**7. The credit line component will be implemented following the terms and conditions:** (a) between the World Bank and the MoF; (b) between the MoF, MoP, and BICE, (c) between BICE and PFIs; and (d) between PFIs and MSMEs. Some of the terms of conditions may need to be modified during project implementation with prior consent of the World Bank. They are outlined in the OM, which is a living operational document.

**(a) Loan terms and conditions between the World Bank and MoF**

- The selection of IBRD loan characteristics took place during appraisal.

**(b) Loan terms and conditions between BICE, the MoF, and MoP**

- BICE will extend US\$44.5 million to PFIs, subject to an outstanding balance of US\$8.9 million equivalent per PFI,<sup>25</sup> using SFAs. Selection of PFIs and all SFAs are subject to prior review and acceptance by the World Bank. If PFIs are not using the credit line, reallocations are allowed, as agreed with the World Bank.
- BICE will maintain, during project implementation, a PIU with procedures, responsibilities, and qualified personnel capable of implementing all aspects of the project in a satisfactory manner.

<sup>24</sup> There is no market reference price in Argentina, with the only existing benchmark for medium- to longer-term credit being the LCIP, at a rate that is mandated by the BCRA. The LCIP mandates the 30 largest banks to lend 14 percent of their deposits for investment purposes at a fixed interest rate of 22 percent and, for some working capital, at an effective maturity of at least three years.

<sup>25</sup> Up to 20 percent of the line of credit. PFIs will be subject to an outstanding balance of US\$7.4 million equivalent; however, BICE will allocate additional funds, up to US\$1 million equivalent, if PFIs grant longer-term finance to MSMEs that actively promote gender equality and/or the inclusion of ethnic minorities (in particular indigenous peoples) by meeting the inclusion criteria set forth in the IPPF. In addition, PFIs would also be able to expand the amount by US\$0.5 million equivalent when they promote financial inclusion through granting longer-term finance to MSMEs that are first time borrowers of longer term loans in recent years, as defined in the OM.



- BICE must be in compliance with the fiduciary and safeguards requirements listed in the OM.
- For the duration of the project implementation period, beginning with the year 2016, BICE will submit an audit report annually in accordance with the International Standards on Auditing and International Financial Reporting Standards.
- BICE must submit relevant reports including the semiannual unaudited IFRs certified by its management.
- BICE will be subject to monitoring of the PDO and intermediate results indicators in section VII, Results Framework and Monitoring, and the additional indicators in the OM.

**(c) Subsidiary financing terms and conditions for BICE's onlending/financing to PFIs**

- BICE will onlend US\$44.5 million to PFIs. Before final selection of the PFIs, BICE will submit the evaluation report to the World Bank, including financials of the proposed PFIs, together with a request to include the PFIs in the project. The World Bank will review and clear BICE's assessment by conveying no objection for each PFI's participation. The no objection will be based on the criteria included in this section. BICE will send the financials of the proposed PFIs to the World Bank every year to ensure that the selected PFIs continue to meet the required criteria throughout the life of the project. The no objection is not required for the continued participation of the PFIs.

**(i) Eligibility criteria for the PFIs that will be financed by BICE**

PFIs will be selected based on their expression of interest in participating in the project and on BICE's acceptance of their credit risk, as well as the following eligibility criteria, unless otherwise agreed with the World Bank:

- Total assets during the last two fiscal years to exceed a minimum of ARS 2,500 million (or US\$167 million equivalent).
- Compliance with all BCRA prudential norms.
- Not a shareholder of BICE.
- Audited interim financial reports as per BCRA requirements.
- Adequate organization, management, staff, and other resources necessary for its efficient operation.
- Application of appropriate procedures for appraisal, supervision, and monitoring of subprojects.

**(ii) Terms and conditions of subsidiary financing between BICE and PFIs**

- PFIs must start and remain in compliance with the eligibility criteria for PFIs.





- The cost of subsidiary funds will include, at a minimum, the cost of the World Bank funds to BICE plus an onlending margin (or a markup) reflecting: (a) BICE's administrative costs, and (b) a risk margin.
- PFIs will be responsible for verifying that sub-beneficiaries comply with applicable Argentine environmental legislation and regulations and the World Bank policies on environmental assessment, natural habitats, forests, physical cultural resources, pest management, and indigenous peoples (OP/BP 4.01, OP/BP 4.04, OP/BP 4.36, OP/BP 4.11, OP/BP 4.09, and OP/BP 4.10). If any non-compliance is detected, the PFIs will not be entitled to use the funds of the World Bank to onlend to those sub-beneficiaries.
- PFIs will provide BICE with a set of documentation for all sub-finance to enable it to maintain all project records and make them available for ex post review by the World Bank, or by external auditors related to the Project as necessary.
- PFIs and MSMEs will be required to provide reasonable information for the purpose of monitoring and impact assessment during the life of the project (and for a certain period after the project), as may be requested by the World Bank and BICE.

**(d) Sub-finance terms and conditions for PFIs' subproject financing to MSMEs**

**(i) Eligibility criteria for the MSMEs that will be financed by PFIs**

- For the purpose of this project, MSMEs are defined by the official definition of SEPYME (Resolution 24/2001) and its amendments (table 1).

**Table 1: Official MSMEs Definition**

Annual Sales (ARS)	Agriculture	Industry and Mining	Commerce	Services	Construction
Micro	2,000,000	7,500,000	9,000,000	2,500,000	3,500,000
Small	13,000,000	45,500,000	55,000,000	15,000,000	22,500,000
Medium-Small	100,000,000	360,000,000	450,000,000	125,000,000	180,000,000
Medium-Large	160,000,000	540,000,000	650,000,000	180,000,000	270,000,000

Annual Sales (US\$)	Agriculture	Industry and Mining	Commerce	Services	Construction
Micro	133,156	499,334	599,201	166,445	233,023
Small	865,513	3,029,294	3,661,784	998,668	1,498,003
Medium-Small	6,657,790	23,968,043	29,960,053	8,322,237	11,984,021
Medium-Large	10,652,463	35,952,064	43,275,632	11,984,021	17,976,032

*Note:* As defined in the Current Regulation (*Resolución 11/ 2016*). Base on annual turnover.

.Exchange rate of ARS 15.02 = US\$1, effective September 7, 2016.



- All private MSMEs (private ownership of more than 50 percent), irrespective of their sector, will be eligible for participation as sub-beneficiaries on a commercial basis.

**(ii) Terms and conditions of sub-finance between PFIs and MSMEs**

- Sub-loans will be evaluated in accordance with the PFIs' normal project and finance evaluation guidelines. BICE will ascertain the eligibility of the sub-finance provided by the PFIs to ensure that they meet the project requirements, but will not conduct its own evaluation of sub-loans.
- The cost of sub-loans by PFIs to MSMEs will include, at a minimum, the cost of the project funds to PFIs plus an onlending margin, reflecting: (a) the PFI's administrative costs, and (b) a risk margin.
- Sub-loans to MSMEs may be made for investment purposes (at least 75 percent of a PFIs' total portfolio) and for working capital (up to 25 percent of a PFI's total portfolio), except as the World Bank shall otherwise agree.
- The amount of an individual sub-finance will not exceed US\$1.5 million equivalent for MSMEs, except as the World Bank shall otherwise agree. The aggregate amount of outstanding sub-finance to any MSME shall not exceed US\$3 million equivalent, except as the World Bank shall otherwise agree.
- All investment sub-finance to MSMEs must have at least three years of maturity.
- All working capital sub-finance to MSMEs must have at least one year of maturity.
- The first sub-finance by each PFI, irrespective of size, will be subject to prior review by the World Bank. Sub-finances to be provided to an MSME exceeding US\$1 million equivalent will require prior approval by the World Bank.
- All sub-finance not subject to prior review may be subject to ex post review by BICE or by the World Bank to verify compliance with the terms and conditions.
- PFIs will require MSMEs to present the relevant environmental licenses if applicable to ensure that environmental laws and standards in force in Argentina are complied with. The World Bank policy on environmental assessment will also be complied with, as well as the policies on natural habitats, forests, pest management, physical cultural resources, and indigenous peoples.
- Subprojects classified as World Bank's Environmental Category A or involving dams, degradation and/or conversion of natural habitats, and procurement of pesticides will not be financed. Subprojects involving the use of international waterways will not be eligible. Subprojects located in legally protected areas and/or in legally designated areas of physical cultural resources will not be eligible. Subprojects that could have a negative impact on indigenous peoples will not be eligible.



- Subprojects that would trigger OP 4.12 as well as goods, works, non-consulting services, and consultant services on the World Bank's negative list will not be eligible for financing.
- Contracts from sub-beneficiaries where the contracted firms are on the World Bank lists of debarred or suspended firms will not be eligible for financing.
- Sub-beneficiaries will be required to provide reasonable information for the purpose of monitoring and impact assessment during the life of the project (and for a certain period after the project), as may be requested by the World Bank and/or BICE. If any non-compliance is detected, the PFIs will not be entitled to use the eligible funds for the individual MSMEs.
- Sub-beneficiaries are required to comply with the World Bank's 'Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants', dated October 15, 2006 and revised in January 2011 (Anticorruption Guidelines [ACG]), as part of its general obligations relating to the receipt and use of such proceeds of the loan. The ACG in English is available on the World Bank's website (<http://siteresources.worldbank.org/INTLEGSTAFONLY/Resources/AnticorruptionGuidelinesOct2006RevisedJan2011.pdf>).

**Component 2: Institutional capacity building of BICE, financial infrastructure reforms, credit guarantee fund, and capacity building for MSMEs (US\$4.55 million<sup>26</sup>)**

***Subcomponent 2.1. Institutional capacity building of BICE (US\$1.62 million)***

**8. The operation will provide capacity building to BICE to support the strengthening of its second-tier lending business, based on international good practices.** The capacity building will consist of supporting BICE to introduce changes in its risk management, policies, and systems, to be able to improve and expand its second-tier business.

**9. BICE's capacity for expanding its second-tier operations has been assessed as broadly adequate.** BICE's risk assessment of the financial institutions is based mainly on a score drawn from different types of indicators. The quantitative aspects represent 80 percent of the total weight of the analysis, including solvency, asset quality, profitability, efficiency, and liquidity. These indicators are calculated in Excel, once when the bank is initially rated and then updated twice per year. The qualitative aspects of the matrix represent 20 percent of the weight, including quality of management (3 percent), relationship with the BCRA (3 percent), and quality and explicit support of the shareholder (14 percent). No analysis is made for the bank's qualifying aspects of risk management and the quality of its internal control. Based on the results of the matrix, qualified banks get a classification (A, B, or C), the resulting maximum margin of assistance, and guarantees, if they are required. Most of banks are rated B.

<sup>26</sup> An amount of US\$0.5 million for sub-component 2.1 will be allocated during project implementation.



**10. However, for a significant expansion, improvements will be needed in the short to medium term.** These include (a) strengthening the structure of risk analysis of the second-tier operations (for example, creating a specific unit for credit risk management of second tier operations); (b) allocating more human resources trained in the analysis of financial institutions; (c) enhancing the rating matrix of financial institutions by transitioning from Excel to a more robust software and increasing the frequency of updating the rating matrix of financial institutions; (d) enhancing the qualitative process of evaluating banks, with strengthened qualitative analysis for risk management and internal controls; (e) developing technological applications for the automatic measurement of risks, to improve accuracy and security;<sup>27</sup> and (f) improving the capacity of the financial department of BICE by adding a treasury module to the core IT system.

***Subcomponent 2.2. Technical assistance for improving the enabling environment for MSME access to finance (US\$2.25 million)***

**11. The project will provide technical assistance to improve the enabling environment for MSME finance,** through the carrying out of preparatory activities for: (a) modernizing the borrower's secured transactions framework; (b) strengthening the insolvency framework; and (c) strengthening the public credit guarantee fund. Support under this subcomponent will follow a flexible approach to accommodate differential progress among focus areas and to include potential new activities that can arise in the financial sector reform agenda, in line with the objectives of this project.

***a. Secured Transactions Framework***

**12. The secured transactions framework in Argentina has a number of deficiencies that present significant obstacles for MSMEs to leverage their assets for productive growth and obtain the necessary credit for their operations.** One of the most significant issues relates to the limited applicability of non-possessory pledges (largely used to pledge automobiles through *prenda con registro*) and the overreliance on possessory interests on movable property. Also, the deficient enforcement processes present a significant barrier to the existing instruments—even a *prenda con registro* can take several years to enforce after default. Additionally, there is no unified system of guarantees and there is no unified registration system. Thus, it is difficult and costly for creditors to obtain accurate and reliable information on the debtor's assets. Argentina would benefit from the introduction of a functional approach to security interests and by adopting a non-possessory security device that covers all types of equipment, including future assets, inventory, accounts receivables, and others. Argentina would further benefit from the creation of a modern collateral registry that will provide certainty regarding a creditor's priority as well as transparent notice to all third parties.

**13. Thus, the project will support the preparatory work for modernization of the secured transactions framework through:**

- **Drafting of a new Secured Transactions Law.** The drafting of a new and comprehensive law on secured transactions modeled after the UNCITRAL model law on secured transactions and building on the vast experience in the region could have a significant

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<sup>27</sup> Currently, most of the calculation and measurements of risks are done through an MS Excel spreadsheet, which increases the risks of errors and alternations.



impact on strengthening the credit environment in Argentina. The new law will need to facilitate the use of movable collateral, considerably expand the asset base, and, importantly, strengthen the enforcement mechanisms that lenders can use. Aligning the insolvency system to recognize the priorities introduced by the new legal framework will be essential for its full applicability.

- **Establishment of a modern online collateral registry and development of supporting regulations.** A new modern collateral registry is critical to ensure that non-possessory security devices work well in practice as well as in protection of debtors and creditors alike. The regulations will need to create the supporting framework for a modernized online registry.
- **Capacity building and awareness raising.** These reforms represent a significant step forward for the credit environment in Argentina and a change of mindset from spread out collateral laws to a unified functional system, which has proven possible and efficient in other countries. Therefore, it is crucial to the success of the project that lenders, including financial institutions, are thoroughly informed and trained to conduct their business under the new legal regime and are fully aware of the new lending practices that are made possible by the new law. Other relevant stakeholders (business community, government agencies, judges, lawyers) should also be the subject of awareness raising campaigns regarding the new law on secured transactions and the operation of the movable collateral registry.

*b. Insolvency and Creditor Rights Framework*

**14. The insolvency framework in Argentina was widely used after the 2001 crisis, but today it suffers from a number of deficiencies that present obstacles for access to finance, including for MSMEs.** More specifically, the existing Ley de Concursos does not adequately protect the interests of creditors for several reasons. The process is too slow and largely results in the death of companies. The current law also does not allow the debtor to obtain post-commencement financing on preferential or priority terms. The lack of such a provision typically deprives debtors of the necessary resources that will help them keep operating during the course of insolvency proceedings. Finally, the current status of insolvency practitioners does not ensure that they are adequately qualified or monitored to perform the complex duties required by the bankruptcy law.

**15. Thus, the project will support the preparatory work for the following reforms:**

- **Diagnostic of the challenges and draft insolvency law amendments,** to, among others, strengthen creditor participation in the proceedings, require that adequate information be made available to creditors before they vote on the restructuring plan, and allow post-commencement financing.
- **A new regulatory framework for insolvency practitioners.** The current outdated framework governing the role and status of the *síndicos* should be modernized according to international best practices. This would involve a regulation that would create a separate and independent profession. Regulation of the profession would be assigned to



an independent state authority, which would in turn be responsible for setting the qualifications, licensing, and monitoring of insolvency practitioners.

- **Capacity building.** All stakeholders including judges, lawyers, credit institutions, and so on should be properly informed and trained to be able to deal with the new law and regulations effectively.

c. *Credit Guarantee Fund*

**16. In Argentina, the credit guarantee system consists mainly of SGRs.** There is also the public credit guarantee fund (FOGAPYME), which was mainly designed to serve as a reinsurance scheme for SGRs, but it has had very limited operations. The legislation of FOGAPYME was recently changed to enable it to issue guarantees directly to the banks. There is also a provincial fund (FOGABA), which is limited to MSMEs operating in the province of Buenos Aires.

**17. SGRs have the potential to improve access to finance and financing conditions to MSMEs.** SGRs are commercial companies that guarantee loans to MSMEs.<sup>28</sup> They guarantee 100 percent of the loan amount and take counter-guarantees from the SMEs. They can provide guarantees to banks, nonbanks, and instruments issued in the capital market (Cheques de Pagos Diferidos, corporate bonds, financial trust funds, and so on).<sup>29</sup> According to the BCRA regulations, for SGRs registered in the BCRA's register, their guarantee counts as 'Preferred A' collateral, eliminating the need for banks to conduct their own risk assessment and eliminating provisioning requirements. The SGRs assume the risk of defaults and take on responsibility for recovering unpaid repayments.

**18. However, the role of SGRs remains small.** As of February 2016, there were 34 SGRs in Argentina. As of end-2015, 107,682 guarantees had been granted for an amount of US\$973 million (about 5 percent of total financial system lending to MSMEs). They are located mostly in Buenos Aires, Santa Fe, and Cordoba, to operate mainly in trade and industry, and more than 60 percent of guarantees are granted in the province of Buenos Aires. The SGRs' risk funds are small, although growing.<sup>30</sup> On average, SGRs are leveraged about 2.3 times the size of the risk fund, although by regulation leverage can be up to 4 times. Thus, SGRs have the potential to be utilized more by banks and provide more guarantees for MSME loans. The ability of the public credit guarantee fund to serve as a reinsurance scheme for SGRs would contribute to their growth in the future.

**19. The project will provide support to the public credit guarantee fund to provide partial credit guarantees directly to banks and reinsurance to SGRs.** The World Bank is conducting an evaluation of FOGAPYME according to the Principles for Public Credit Guarantees and is designing a pilot program for

<sup>28</sup> SEPYME is the regulator. SGRs consist of *Socios Participes* (SMEs) and one or more *Socios Protectores*. *Socios Protectores* can be companies, provincial or municipal governments, or individuals and can own up to 49 percent of the total capital. *Socios Participes*, which must be at least 120 to become members, contribute with a small investment to the SGR's capital. *Socios Protectores* contribute to the risk fund that covers guarantees granted to SMEs. The incentive of *Socios Protectores* to participate comes from fiscal benefits, as their contribution to the risk fund is exempted from taxes, provided it is not withdrawn for at least two years and that the SGR registers a stock of guarantees equivalent to 80 percent of the risk fund.

<sup>29</sup> CASFOG includes 74 percent of SGRs in the system, more than 8,600 SMEs (more than half of which are in the province of Buenos Aires), and 59 percent of the amount of the risk fund. The biggest one, *Garantizar*, is not part of the association. It works predominantly with its main *Socio Protector* (*Banco Nación*).

<sup>30</sup> Since 2011, the risk funds of SGRs increased by more than 100 percent (from about US\$133 million in 2011 to US\$298 million in 2015).



FOGAPYME to provide partial credit guarantees to selected banks. The project will evaluate the pilot and, based on the experience, support the credit guarantee fund to provide guarantees directly to banks and to serve as a reinsurance scheme for SGRs. This will include work on a revised legal framework, institutional structure, corporate governance, policies and procedures, and adequate staff skills and capacity. The project will also undertake a feasibility study on an automated financing platform, which would link SGRs, the public credit guarantee fund, banks, and MSMEs, and will finance the platform following the results of the feasibility study.

***Subcomponent 2.3. Capacity building for MSMEs (US\$0.68 million)***

**20. The project will provide support for strengthening the MSME support programs of the MSME and Regional Development Department (SEPYME), through the provision of business development and management tools aimed at making MSMEs more bankable.** The support includes, among others, (a) a diagnostic of the current BDS Program (*Experto PYME*); (b) development of online training material for MSMEs that will form part of the new digital learning platform for MSMEs; (c) design, development, and implementation of an online and interactive business service providers database; and (d) strengthening the capacity of the SEPYME's portal for MSMEs.

**Component 3: Project Management (US\$0.825 million)**

**21. This component will support the BICE PIU to implement the project effectively.** This includes, among others, (a) the recruitment and training of a team to coordinate, manage, implement, and supervise the project; (b) progress and results monitoring activities; (c) a midterm review survey to MSME beneficiaries; and (d) annual external audits.

**22. This component will also provide a consultancy service for a part-time social development expert to support the National Directorate of Social Innovation** to promote the credit line among indigenous communities, and support PFIs in identifying MSMEs that benefit indigenous peoples as potential beneficiaries.





## ANNEX 2: IMPLEMENTATION ARRANGEMENTS

### COUNTRY : Argentina

#### Access to Longer Term Finance for Micro, Small and Medium Enterprises Project

#### Project Institutional and Implementation Arrangements

1. **BICE will be the implementing agency for this project.** A PIU within BICE will be responsible to coordinate, manage, implement, supervise, and document all the activities related to the project established in the Loan Agreement.
2. **The PIU will be staffed with capable and qualified personnel for the implementation of the project.** A team will be recruited and trained to coordinate, manage, implement, and supervise project activities. The PIU team will be composed of (a) a project coordinator; (b) a procurement specialist; (c) an FM specialist; (d) an environmental and social specialist; (e) a technical expert; and (f) an assistant.
3. **The responsibilities of the PIU will include, among others,** (a) managing the implementation of project activities; (b) managing the procurement, FM, and safeguards aspects; (c) coordinating the preparation, adjustments, and use of the project management tools, including the OM, Procurement Plan, and disbursement projections; (d) coordinating with the MoP all the technical aspects of Component 2 related to the MoP; (e) monitoring the PDO and intermediate indicators of the Results Framework; (f) consolidating project reports; (g) acting as the main point of contact for the World Bank; (h) monitoring of PFIs to ensure compliance with project criteria; and (i) monitoring the use of the line of credit.
4. **In addition, the project will also provide a consultancy service for a part-time social development expert to support the National Directorate of Social Innovation,** to promote the credit line among indigenous communities and support PFIs in identifying MSMEs that benefit indigenous peoples as potential beneficiaries.

#### Financial Management

5. **The combined fiduciary risk for this project is Moderate.** BICE is a first-time implementing agency and will have to strengthen its capacity to manage this project. This includes the implementation of the UEPEX system and hiring of one FM specialist to absorb the increased workload.
6. **The risk will be mitigated through the following measures:** (a) creation of a PIU at BICE that will include an FM specialist who will be responsible for coordinating the preparation of disbursement applications and the project's financial reports to the World Bank; (b) the preparation of a project OM; (c) the annual external audit that will be conducted under terms of reference acceptable to the World Bank by a private external audit firm; (d) implementation of the UEPEX accounting system in BICE, acceptable to the World Bank; (e) periodic provision of ad hoc fiduciary trainings to project staff; and (f) technical assistance aimed at improving the capacity of BICE's Internal Audit Unit for monitoring and





providing assurance on the use of funds by the PFIs. The main FM arrangements for this project are described below.

**7. The project will be fully integrated with BICE's systems.** BICE is a public bank with an overall solid financial situation and sound FM practices. There is a clear segregation of duties between the staff with respect to evaluation of applications, review of documents and approvals, accounting, and reporting. Work flows specific to the project are documented in the OM. The OM also describes the main internal controls applicable to the project.

### Information Systems/Accounting and Financial Reporting

**8. For managing its institutional accounting records, BICE will use the Bantotal system.** Bantotal is a web-based application widely used in the banking industry in Argentina. This system has integrated modules for the preparation and execution of budget, accounting records, payments, and transfer of funds. Notwithstanding, in addition to Bantotal, the MoF has requested that the project accounting records are maintained in parallel in the UEPEX accounting system, which will be implemented by BICE. The aim is to achieve consistency across the public sector since the UEPEX is used by all other line ministries who manage multilateral-financed projects at the national level. This software's features allow, among others, (a) online recording and monitoring of transactions and (b) reconciliation of advances under the project. The semiannual IFRs will be generated automatically by the system and will be presented to the World Bank no later than 45 days after the end of each calendar semester. The format of the IFRs will be agreed upon with BICE during negotiations.

### Budgeting

**9. Budget execution in Argentina is recorded in the national Government's integrated budget and accounting system (*Sistema Integrado de Información Financiera*) and subject to control over the budgetary execution process.** The allocated and executed portions of the budget will be controlled in the integrated budget and accounting system and in the Bantotal system. A separate budgetary line in the BICE annual budget will be created to allow appropriate monitoring and control of budget resources from different sources and project expenditures.

### Internal Controls and Internal Audit

**10. BICE is under the scope of the General Syndicate of the Nation, which is the Federal Government's internal audit agency under the jurisdiction of the executive branch.** The General Syndicate of the Nation supervises and coordinates the actions of the Internal Audit Units in all government agencies, approves their audit plans, and conducts independent audits.

**11. BICE has an internal control system that complies with the standards issued by the BCRA.** Regulatory requirements are based on good practices contained in the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Report. According to the regulations of the BCRA, BICE has an Audit Committee (where two board members participate). The BCRA has rated the internal audit as acceptable. The processes are formalized in manuals procedures and, in addition, meet the quality standards laid down by ISO 9001.



**12. BICE has a broadly adequate Internal Audit area for current operations.** The head of the internal audit reports to an Audit Committee composed of three members of the board. This area is a key control in the process of monitoring and providing assurance on the use of funds by the PFIs. It has eight professionals with different specialties (accounting, IT, procedures). Both planning and working methods meet the regulatory requirements of the BCRA, which are based on best international practices. The Internal Audit Area of BICE (a) has risk-based planning; (b) applies a cycle approach for the evaluation of internal control; (c) uses sample techniques; (d) uses an adequate methodology for the follow-up weaknesses; (d) in the case of the second-tier activity, revises the controls applied by staff and verifies it with the analysis of samples; (e) has received an adequate rating from the BCRA; and (f) has recently obtained the quality certification issued by IRAM.<sup>31</sup>

#### **External Audit Arrangements**

**13. In line with the regulatory requirements of the BCRA, quarterly and annual financial statements are audited by external auditors.** The external auditor of BICE is one of the four international auditing firms and its activity is being supervised by the BCRA.

**14. Annual project financial statements will be audited based on terms of reference acceptable to the World Bank.** The annual external audit will be conducted under International Standards on Auditing by an auditor acceptable to the World Bank. The audit report shall be submitted to the World Bank within six months after the end of each fiscal year. Annual audits will cover all funding and expenditures reported in the project financial statements. As noted earlier, an external audit firm acceptable to the Bank will be appointed for this project. This arrangement may be revisited from time to time.

#### **Disbursements**

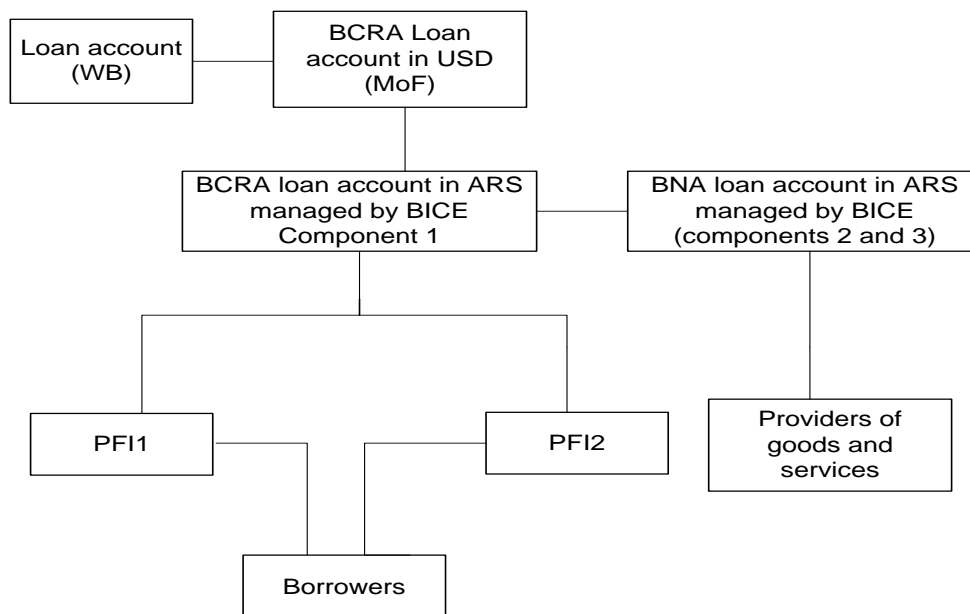
**15. Funds will be disbursed into a U.S. dollar denominated account in the BCRA held by the MoF.** Proceeds from this disbursement will be transferred in local currency to an existing account held by BICE in the BCRA. BICE will use this account for payments under Component 1, whereas for payments under Components 2 and 3, BICE will transfer funds to a different operational account held at the National Bank of Argentina (*Banco de la Nación Argentina*). Figure 2.1 describes the project's flow of funds.

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<sup>31</sup> IRAM (*Instituto Argentino de Normalización y Certificación*) is an Argentine institute that checks and provides valid certificates on the quality and standards of the procedures of firms.



Figure 2.1. Flow of Funds and Disbursement Arrangements



**16. The disbursement procedures are described in the Disbursement Letter.** General arrangements are as follows. The DA in BICE will have a variable ceiling, based on an approved cash forecast to cover project implementation within a period of six months. Withdrawal applications will be submitted by BICE with two signatures indicated in their list of authorized signatures. Minimum value of disbursement applications is USD\$1,000,000. Applications for replenishment of the DA will be submitted to the Bank on a quarterly basis, and will include a reconciled bank statement as well as other appropriate supporting documents.

**17. Reporting on the use of loan proceeds.** Supporting documentation should be provided with each application for withdrawal as follows:

- Records in the form of a Customized Statement of Expenditures (SOE) for Category (1) for Sub-loans granted to MSMEs under Component 1 of the Project.
- Records in the form of standard SOEs for Category (2) Goods, Consultant's Services, Non-Consulting Services, and Training under Component 2 of the Project, and Category (3) Goods, Consultant's Services, Non-Consulting Services, Training, and Operating Costs under Component 3 of the Project.

**18. Disbursements from the IBRD loan account will follow the transaction-based method,** that is, traditional World Bank procedures: advances, direct payments, and reimbursement (with full documentation against Statements of Expenditures [SOEs]). Full documentation in support of SOEs will be retained by BICE for at least two years after the World Bank has received the audit report for the fiscal year in which the last withdrawal from the loan account was made. This information will be made available for review during supervision by World Bank staff and for annual audits that will be required to specifically comment on the propriety of SOE disbursements and the quality of the associated record keeping.



## **Retroactive Financing**

**19. Retroactive financing** in an aggregate amount not exceeding US\$1 million may be made as sub-finance in accordance with criteria and procedures set forth in the Loan Agreement and OM.

## **Procurement**

**20. Procurement will be conducted according to the World Bank's 'Procurement Regulations for IPF Borrowers', issued in July 2016, for the supply of goods, works, non-consulting services, and consulting services for Components 2 and 3.** The application of the 'Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants', dated October 15, 2006 and revised in January 2011 and as of July 1, 2016 (World Bank's ACG), and sanctions procedure will continue to be ensured through the World Bank's model legal agreements for FI operations, which require that ACG provisions apply to the ultimate recipients of World Bank funds. The World Bank's Standard Procurement Documents will govern the procurement of World Bank-financed Open International Competitive Procurement. For procurement involving National Open Competitive Procurement, the borrower may use their own procurement documents, acceptable to the World Bank. All Standard Procurement Documents as well as model contracts should be included in the OM.

**21. The overall project risk for procurement is Moderate.** The activities financed by the project are foreseen to consist of small contracts. In addition, the World Bank will support BICE's capacity to conduct procurement activities.

## **22. Procurement Arrangements**

### **Procurement of Goods**

- **Financial institutions rating IT platform (US\$200,000); Comprehensive risk IT platform (US\$320,000):** The open national competitive procurement approach is supported by the availability of bidders in the local market and the small contracts planned, related to the acquisition of IT platforms. The Request for Bids would be the selection method for these contracts, given that (a) the borrower is able to specify detailed requirements to which bidders respond by offering bids and (b) the platforms are off-the-shelf software available in the market.
- **Treasury module to the core IT system (US\$350,000):** The Direct Selection approach will be the appropriate selection method because improving the capacity of the financial department of BICE requires adding a treasury module to the current core IT system, which is proprietary and obtainable from only one source.

### **Procurement of Consulting Services**

- **Drafting of Secured Transactions Law (US\$200,000), Supporting regulations for online collateral registry (US\$100,000), Diagnostic of challenges and draft amendments to the insolvency law (US\$300,000), and New regulatory framework for insolvency practitioners (US\$100,000):** Considering that these will be small contracts and that a limited number of qualified consultants can carry out these assignments (law firms specialized in the matter),



the suitable market approach would be an open competition in the national market, while Quality- and Cost-Based Selection would be the selection method (considering the nature of the services and the need to take into account the quality of the proposals based on the evaluation of the different solutions and the cost of the services).

- **Operationalization of the partial credit guarantee fund (US\$200,000):** The national market is scarcely developed, thus the open international competitive procurement approach would be the appropriate market approach based on the availability of a well-developed market, with potential proposers who have the adequate expertise in this very specific activity. Quality- and Cost-Based Selection would be the selection method regarding the nature of the services and the need to take into account the quality of the proposals based on the evaluation of the different solutions and the cost of the services.

**Individual consultants.** Individual consultants are selected for an assignment for which (a) a team of experts is not required; (b) no additional office support is required; and (c) the experience and qualifications of the individual are of paramount requirement. The evaluation shall be based on the relevant qualifications and experience of the individual consultant in accordance with provision of paragraphs 7.34 to 7.39 of the Procurement Regulations for IPF Borrowers.

#### **Project implementation support personnel**

- Individuals contracted by BICE to support project implementation, other than individual consultants identified in the Legal Agreement, may be selected by the borrower according to their personnel hiring procedures for such activities, as reviewed and found acceptable by the Bank.

#### **Environmental and Social (including safeguards)**

**23. Environmental and social issues of sub-beneficiaries and their subprojects will be addressed through the sub-finance environmental and social eligibility assessments.** Environmental assessments will be carried out in accordance with Provincial and/or Municipal Environmental Impact Assessment Regulations and World Bank Environmental Assessment (OP 4.01) requirements. All procedural steps related to this assessment are specified in the project's OM, specifically in the ESMF prepared by BICE.

**24. The subprojects should be subjected to an environmental and social review process by PFIs and BICE, who will be responsible for successful implementation of the project.** The PFIs will be responsible for an initial environmental classification of sub-beneficiaries/subprojects and for ensuring that each subproject includes an evaluation of its environmental impact and clearance documentation from the corresponding environmental authorities. Once environmental and social requirements are complied with, PFIs will appraise the proposed sub-loan. Adherence to any environmental and social obligations established by the regulatory authorities and the World Bank safeguard requirements will be monitored by the PFIs and BICE's PIU. BICE will review every loan application and issue a no objection before the PFI approves the loan.



**25. The World Bank will provide its prior review for the first sub-loan submitted by each PFI and every proposal over US\$1 million.** The PFI will provide information on the subproject to BICE for the World Bank's prior review, together with its proposed environmental classification of the subproject (Category B or C) and the advice it proposes to give to the sub-beneficiary regarding additional actions needed to fulfill World Bank requirements as detailed in the OM. After BICE reviews the environmental documentation for the first application, it will submit all the documents to the World Bank for final review. For consequent subprojects, the World Bank will change to spot-checking the environmental and social review process on a post review basis. After the prior review process, BICE will share the relevant due-diligence and environmental and social documentation with the World Bank through frequent progress reports.

**26. BICE's PIU will have a socioenvironmental specialist to lead all tasks related to ensuring adequate environmental and social due diligence.** The socioenvironmental specialist will also be supported by the risk analysts to be appointed in BICE to handle environmental and social management issues. Training sessions for BICE's risk analysts will be organized to build up the capacity and to enhance socioenvironmental management. The socioenvironmental expert will also support PFIs, as necessary, to appropriately apply the guidelines and procedures established in the ESMF.

**27. BICE will also assess the capacities of the PFIs and offer them training, if necessary,** as part of the socio-environmental strengthening capacity program. If as a result of the assessment BICE identifies potential improvement measures, it will ensure that such measures are taken by PFIs.

### **Monitoring and Evaluation**

**28. Key indicators for measuring the PDO include:**

- (a) Ratio of the average portfolio maturity of MSME sub-loans under the project, over the average portfolio maturity of PFI's MSME lending portfolio not financed under the project
- (b) BICE has a dedicated unit for risk management of second tier operations, with improved capacity for quantitative and qualitative analysis of risks;
- (c) New business development service platform operated by SEPYME developed and functioning

**29. Key intermediate results indicators include:**

- (a) Volume of World Bank Support: Lines of Credit - SME (US\$)
- (b) Number of MSMEs getting access to longer-term financing through selected PFIs under the project (cumulative)
- (c) Draft secured transactions law submitted for approval
- (d) Draft insolvency law amendments submitted for approval
- (e) Credit guarantee fund is operationalized



- (f) Outstanding MSME finance portfolio (US\$, million) <sup>32</sup>
- (g) Portfolio quality: Portfolio at risk (%)
- (h) Financial sustainability: Return on Equity (%)
- (i) Percentage of MSME beneficiaries that feel project sub-finance reflected their needs
- (j) A modern movable collateral registry is established

**30. In addition to the above indicators, the project will monitor some additional indicators for analytical purposes and as useful inputs to define policies and projects aimed at further improving MSMEs' access to finance in Argentina:**

- (a) Performance of PFIs under the project: (i) Average maturity of PFIs' portfolio not financed under the project
- (b) Performance of MSMEs: (i) Variation in employment; (ii) Variation in sales; (iii) Variation in exports
- (c) Profile of MSMEs under the project: (i) Size of MSMEs (number of employees); (ii) Economic sector; (iii) Geographical location; (iv) Female owner or shareholder; (v) Number of MSMEs doing business with IPs or working with their products
- (d) Profile of finance under the project: (i) Size of sub-loans; (ii) Maturity of sub-loans; (iii) Interest or markup of sub-loans.

**31. Section VII includes the data source, frequency, and responsibility for data collection for the PDO and intermediate results indicators.** Table 3.1 describes the arrangements for monitoring the additional indicators.

**32. The data will come from BICE's internal reports.** Financial performance of BICE will be monitored through independent auditors' reports and separate management letters confirming adherence to prudential norms.

**Table 3.1: Additional Indicators and Arrangements for Monitoring**

Indicator Name	Frequency	Data Source/ Methodology	Responsibility for Data Collection
<i>Performance of PFIs under the project</i>			
Average maturity of PFIs' portfolio not financed under the project	Annual	Project report	PIU
<i>Performance of MSMEs</i>			
Variation in employment	Annual	Project report	PIU
Variation in sales	Annual	Project report	PIU

<sup>32</sup> The core sector indicators, namely outstanding MSME finance portfolio, portfolio at risk, and return on equity are for monitoring purposes, thus the baseline and targets are the same number. Any changes in these indicators are not attributable to the project, as they refer to the entire portfolio of the banking sector.



Variation in exports	Annual	Project report	PIU
<i>Profile of MSMEs under the project</i>			
Size of MSMEs (number of employees)	Annual	Project report	PIU
Economic sector	Annual	Project report	PIU
Geographical location	Annual	Project report	PIU
Female owner or shareholder	Annual	Project report	PIU
Number of MSMEs doing business with IPs or working with their products	Annual	Project report	PIU
<i>Profile of finance under the project</i>			
Size of sub-loans	Annual	Project report	PIU
Maturity of sub-loans	Annual	Project report	PIU
Interest of sub-loans	Annual	Project report	PIU





## ANNEX 3: IMPLEMENTATION SUPPORT PLAN

**COUNTRY : Argentina**

**Access to Longer Term Finance for Micro, Small and Medium Enterprises Project**

### Strategy and Approach for Implementation Support

1. The implementation support strategy was developed taking into account the risks and mitigation measures related to the operation and targets the provision of flexible and efficient implementation support to the clients.
  - (a) **Technical support.** IBRD implementation support missions will include a financial sector specialist to help guide BICE with project implementation and policy dialogue.
  - (b) **Procurement.** A country office-based procurement specialist will carry out ongoing supervision and will participate in project implementation support missions and site visits, respond to just-in-time requests, and provide ongoing guidance to BICE based on its procurement activities.
  - (c) **FM.** During project implementation, the World Bank will supervise the project's FM arrangements in two main ways: (a) review the project's semiannual project reports as well as BICE's and the project's annual audited financial statements; and (b) during the World Bank's implementation support missions, review the project's FM and disbursement arrangements to ensure compliance with the World Bank's minimum requirements. As required, an FM specialist will assist in the supervision process.
  - (d) **Operations.** During project implementation, the World Bank will provide implementation support to the team members of the PIU in BICE to prepare, update, and use the project management tools, including the OM, work annual plan, procurement plan, and disbursement projection.
  - (e) **Safeguards.** Country office-based environmental and social specialists will conduct supervision and will participate in project implementation support missions and site visits, respond to enquiries from BICE, and provide ongoing guidance to the client based on its environmental and social safeguards activities.

### Implementation Support Plan and Resource Requirements

Time	Focus	Skills Needed	Resource Estimate	Partner Role
First twelve months	Task management	Task team leader/financial sector specialist	8	
	Procurement	Procurement specialist	3	



12–48 months	FM	FM specialist	3
	Safeguards	Environmental and social specialists	4
	Operations support	Operations officer	3
	Technical support	Financial sector specialist	6
	Task management	Task team leader/financial sector specialist	15
	Procurement	Procurement specialist	9
	FM	FM specialist	9
	Safeguards	Environmental and social specialists	12
Other	Operations support	Operations officer	9
	Technical support	Financial sector specialist	12

## Skills Mix Required

Skills Needed	Number of Staff Weeks	Number of Trips	Comments
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## Partners

Name	Institution/Country	Role
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## ANNEX 4: ECONOMIC INDICATORS IN ARGENTINA

	2011	2012	2013	2014	2015 (estimates in red)	2016f (MFMMod)	2017f
<i>(percentage change)</i>							
GDP Growth	6.2	-1.1	2.3	-2.6	2.4	-1.5	3.1
GDP Deflator	23.6	22.3	23.9	40.7	23.8	-	-
CPI INDEC	9.5	10.8	10.9	23.9	-	-	-
CPI Provinces	26.5	22.6	25.2	37.0	28.1	-	-
CPI CABA			26.6	38.0	26.9	-	-
<b>Monetary Indicators</b>							
Exchange Rate, eop (AR\$/US\$)	4.3	4.9	6.5	8.0	13.0	16.2	18.7
Monetary Base	34.6	39.0	23.8	22.5	40.5	-	-
Credit to private Sector	48.2	29.6	31.5	20.1	37.7	-	-
Private Sector Deposits	26.8	30.4	27.9	31.6	47.4	-	-
Central Bank bill rate, 12M (nominal)	14.3	15.0	17.8	29.3	31.5	-	-
Time deposit interest rate, december (nominal)	13.1	13.1	16.0	23.3	27.2	-	-
<i>(percentage of GDP, unless otherwise stated)</i>							
<b>National Accounts</b>							
Nominal GDP (US\$bn)	560	608	622	545	639	549	591
Nominal GDP (AR\$bn)	2,192	2,652	3,361	4,609	5,839	8,174	10,307
Agriculture	7.2	6.3	6.9	7.3	7.6	8.1	8.6
Industry	26.7	26.4	25.9	25.7	25.4	25.7	27.3
Services	49.6	50.4	50.1	50.5	50.6	49.7	50.2
Gross fixed capital formation	21.1	19.7	20.0	19.0	19.5	-	-
<b>Fiscal Accounts (General Government)</b>							
Total Revenues	31.4	32.7	33.0	32.7	34.6	33.8	-
Total Expenditures	34.8	35.3	36.4	38.1	41.8	41.0	-
Current Expenditures	31.1	32.6	33.1	35.7	-	-	-
Wages	9.8	10.5	10.7	10.8	-	-	-
Energy and transport subsidies (Central Govt)	2.8	2.9	3.6	4.7	4.3	-	-
Capital Expenditures	4.2	3.4	4.0	3.7	-	-	-
Interest payments	1.6	1.5	0.8	1.1	1.4	1.5	-
Primary Balance	-1.8	-1.2	-2.6	-4.3	-5.4	-5.2	-
Overall balance	-3.4	-2.6	-3.4	-5.4	-7.2	-7.2	-
Gross Public Debt	36.1	36.5	35.5	41.6	37.4	-	-
Foreign Currency debt	20.3	20.0	20.5	25.4	23.7	-	-
FX debt service (%merchandise trade)	55.5	54.8	219.8	112.4	-194.0	-	-
<i>(US\$ millions, unless otherwise stated)</i>							
<b>Balance of Payments</b>							
Current account balance	-4,471	-1,440	-12,143	-8,075	-15,934	-7,584	-6,623
(% of GDP)	-0.8	-0.2	-2.0	-1.4	-2.5	-1.7	-1.5
Trade Balance	9,019	12,005	1,521	3,107	-3,035	-	-
Fuel and Energy balance	-3,115	-2,150	-6,902	-6,543	-4,614	-	-
Exports of goods and services (fob)	98,423	95,168	90,696	82,158	70,704	-	-
Imports of goods and services (fob)	88,446	83,213	89,735	79,326	75,147	-	-
Intermediate and capital goods (% of merchandise imports)	50.0	48.6	43.9	48.6	52.2	-	-
Consumer goods (% merch imports)	11.4	11.0	10.4	10.5	11.9	-	-
Services balance	-2,235	-2,985	-3,708	-3,075	-3,990	-	-
Tourism balance	-1,139	-4,667	-8,708	-5,423	-8,417	-	-
Income	-13,882	-12,854	-12,279	-10,732	-11,079	-	-
Net profit and dividends	-10,745	-9,193	-8,578	-6,887	-7,637	-	-
Capital and Financial Account	-1,968	-1,349	3,493	9,466	14,304	-	-
Foreign Direct Investment (% GDP)	2.0	2.6	1.6	0.9	1.9	-	-
Gross Reserves, year end	46,376	43,290	30,600	31,443	25,562	-	-
Gross Reserves, (months of imports)	6.3	6.2	4.1	4.8	4.1	-	-

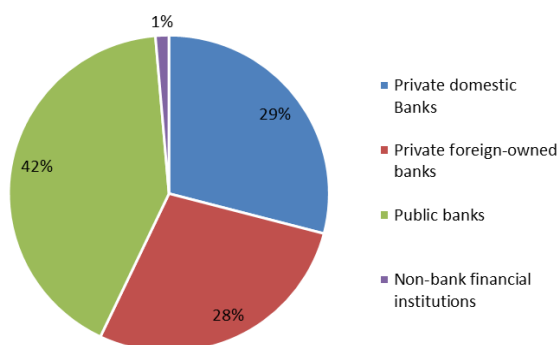


## ANNEX 5: SECTOR AND BICE BACKGROUND

### Sector Background

1. **The Argentinian financial system is dominated by the banking sector.** As of end-June 2016, private banks controlled 57 percent of total financial system assets, with 29 percent of assets being held by domestic banks and the other 28 percent of assets by foreign-owned banks. Public sector banks accounted for 41.6 percent of assets and non-banking financial institutions for 1.4 percent.

Figure 5.1. Financial System Structure as of June-2016 (% of total assets)

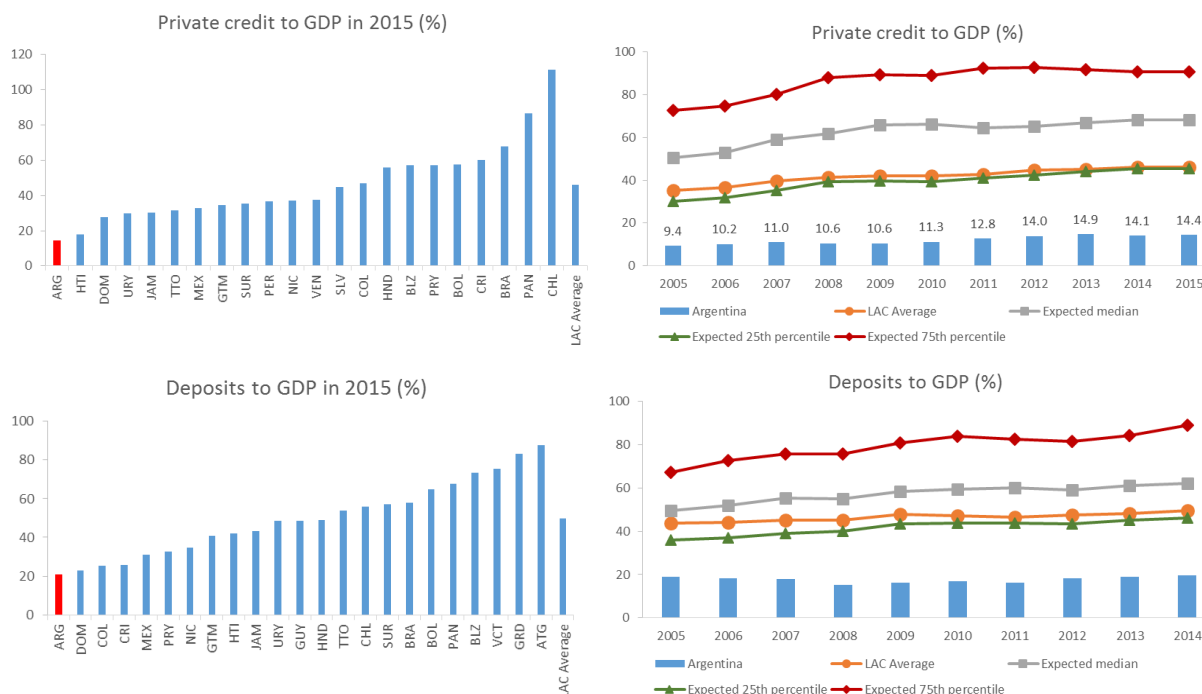


Source: BCRA.

2. **The financial sector in Argentina lacks depth and its small size is a constraint on economic growth.** The financial system in Argentina is mainly transactional, with lack of long-term funding to finance long-term loans. Credit in Argentina is the lowest in the region and has grown slowly over the past decade. Credit to the private sector in Argentina increased from 9.4 percent of GDP in 2005 to 14.4 percent in 2015, while the LAC average increased from 35.2 percent of GDP to 46 percent during the same period. Deposits in Argentina have also lagged behind the regional average. Deposits have remained below 20 percent of GDP since 2005 and the deposit-to-GDP ratio has not increased, while the LAC average has remained above 40 percent of GDP (Figure 5.2).

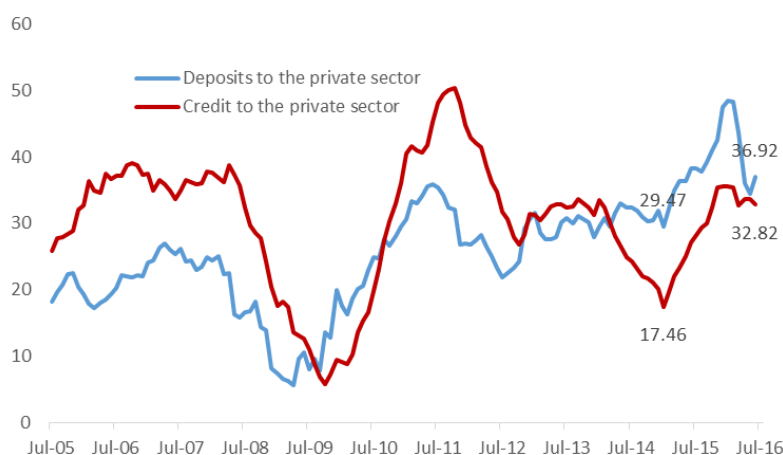


Figure 5.2. Private Credit and Deposits in Argentina



Source: Finstats, IFS and WDI

Figure 5.3. Credit and Deposits Growth in Argentina (%)

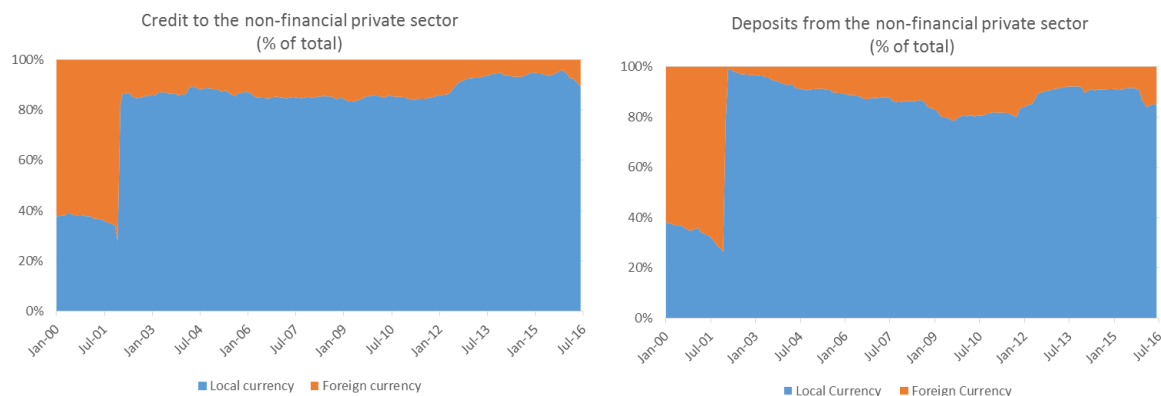


Source: BCRA.

**3. Financial dollarization is low.** As of end-June 2016, only 15 percent of private sector deposits and 11 percent of private sector credit, respectively, are in foreign currency. Following the 2001 crisis, exposure to foreign exchange lending has been prudentially regulated, and foreign exchange loans can be mainly provided to foreign exchange earners (Figure 5.4).



**Figure 5.4. Local and Foreign Currency Credit and Deposits**

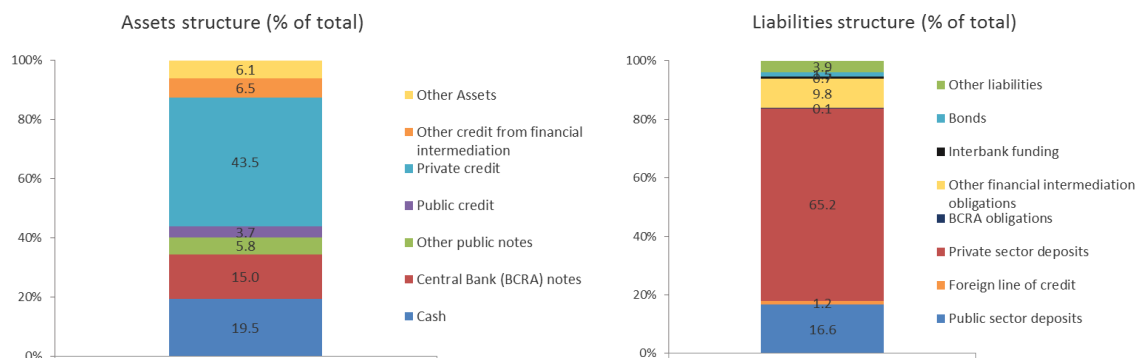


Source: BCRA.

**4. The share of loans to the private sector has increased over the past decade and more than half of private credit is to enterprises.** As of May-2016, total banking system loans amounted to around ARS 976 billion (US\$64 billion), of which 90 percent was to the private sector. In 2005, the share of private sector loans was only 66 percent of total loans, indicating that growth of private sector credit has outpaced that of public sector during the past 10 years. As of June 2016, around 55 percent of private sector credit is to enterprises, while the remaining 45 percent is for to households.

**5. Argentina's banking sector is conservative with most of its funding coming from deposits.** Deposits account for 86.4 percent of total liabilities, with 69 percent from private sector deposits and 18 percent from public sector deposits. A very small share of funding is made through the bond market and borrowings are low. On the asset side, credit represents half of the financial system assets, as banks have focused their business strategies on lending to consumers and state-owned firms. The financial system also invests in profitable sovereign and central bank papers (together representing 22 percent of total assets). Cash represents 20.5 percent of total assets (Figure 5.5).

**Figure 5.5. Balance Sheet of the Banking Sector as of end-June 2016**



Source: BCRA.



Table 5.1. Banking Sector Balance Sheet

(in millions of Argentinian pesos)	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Jun-16
<b>Assets</b>	502,447	616,022	773,784	984,386	1,320,619	1,824,317	2,057,904
Cash	92,710	103,844	147,544	200,085	233,220	370,993	405,499
Public notes	117,554	112,582	123,049	141,380	290,682	388,119	433,150
Private notes	206	211	251	429	1,601	1,897	2,011
Loans	223,638	321,808	419,992	545,067	649,479	887,672	976,019
Loans loss provisions	5,893	6,833	9,171	12,575	16,413	20,700	23,511
Other credit from financial intermediation	38,680	40,424	38,419	41,881	73,882	73,315	133,912
Assets subject to financing leasing	3,644	5,747	6,627	8,831	9,883	11,879	12,144
Other assets	11,747	15,593	19,919	24,445	30,915	47,398	46,044
<b>Liabilities</b>	447,282	548,686	686,291	866,550	1,157,283	1,603,202	1,799,559
Deposits	375,127	461,009	593,275	749,830	975,916	1,352,110	1,503,884
Borrowings	56,378	68,878	65,737	79,853	127,995	179,803	227,493
Other liabilities	15,780	18,802	27,279	36,867	53,386	64,385	60,254
<b>Net Capital</b>	55,165	67,336	87,494	117,835	163,336	221,115	258,345

Source: BCRA.

**6. Due to a heavy reliance on short-term deposits as their funding source, banks mostly grant short-term credit.** Banks' main funding comes from deposits, with more than 90 percent maturing in less than three months. Most deposits are short term due mainly to weak depositor confidence in the banking sector as a result of a history of economic instability. Thus, to avoid building maturity mismatches on their balance sheets, banks have focused heavily on consumer lending and short-term working capital for enterprises. As a consequence, 90 percent of lending is short term.

**7. The banking sector is well capitalized and liquid, with a low level of NPLs.** Capital adequacy at 16.2 percent indicates adequate capitalization. The sector is liquid, with a ratio of liquid assets to total deposits of 31 percent. Credit is well performing, with NPLs to total loans ratio of 1.7 percent.

Table 5.2. Selected Financial Soundness Indicators

(% unless otherwise stated)	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Jun-16
Capital to Risk-Weighted Assets	-	-	-	13.6	14.7	13.3	16.2
Tier 1 Capital to Risk-Weighted Assets	-	-	-	12.5	13.7	12.4	15.3
Liquid Assets to Total Deposits	28.0	24.7	26.8	26.8	26.2	28.2	31.0
Non-performing Loans to Total Gross Loans	1.8	1.2	1.5	1.5	1.8	1.6	1.7
ROA (annual accumulated)	2.8	2.7	2.9	3.4	4.1	4.1	4.1
ROE (annual accumulated)	22.6	25.3	25.7	29.5	32.7	32.4	32.7

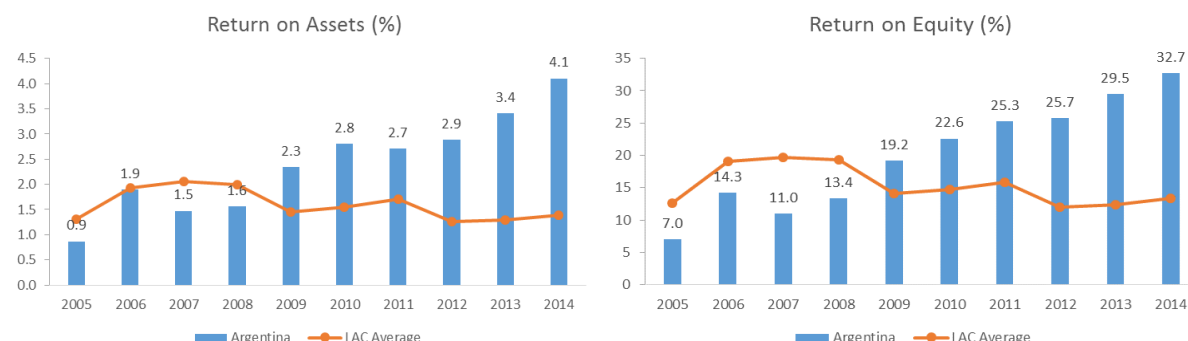
Source: BCRA.

**8. Profitability in the banking sector has improved, despite rising overhead costs and tax costs.** The banking sector's ROA stands at 4.1 percent at end- June 2016, well above the ROA for LAC, which



was at 1.4 percent in 2014. The ROE stood at 32.7 percent at end-June-2016, although the high rate of inflation suggests that the returns in real terms are low (Table 5.3 and Figure 5.6).

**Figure 5.6. Banking System Profitability**



Source: Finstats and BCRA.

**Table 5.3. Banking System Income Statement**

(In percent of total assets, year-to-date average)	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Jun-16
Financial Margin	8.5	8.0	9.2	10.3	11.7	11.8	12.1
Net interest income	4.3	4.6	5.7	5.9	5.8	5.4	4.5
Provisions expenses for losses	0.8	0.7	0.9	1.1	1.0	0.9	0.8
Net non-interest income	3.8	3.9	4.2	4.3	4.3	4.2	3.8
Administrative costs	6.9	6.7	7.0	7.1	7.4	7.7	7.7
Tax costs	1.0	1.1	1.3	1.6	1.8	1.8	1.9
Net profits before income tax	4.0	3.9	4.3	5.0	6.1	6.1	6.1
Income tax	-1.2	-1.2	-1.5	-1.6	-2.0	-2.0	-2.0
Net profit/loss	2.8	2.7	2.9	3.4	4.1	4.1	4.1

Source: BCRA.

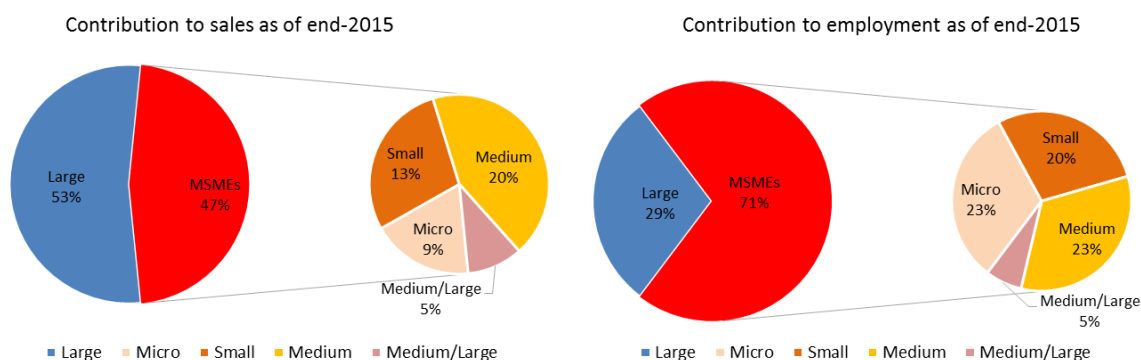
**9. The authorities have strengthened regulations and developed a roadmap for the full implementation of Basel standards.** The BCRA has introduced norms to strengthen banks' comprehensive risk management, align the regulatory framework with all pillars of Basel II, and guide stress testing by banks. In 2015, the operational risk norm was implemented. These are all positive steps for further strengthening the financial system in Argentina. Moving to lower inflation levels with higher predictability would facilitate the forecasting of expected losses and, thereby, implementation of Basel standards.

**10. MSMEs in Argentina play a critical role in the economy.** As of end-2015, about 99.7 percent of total enterprises are MSMEs. MSMEs are estimated to contribute to about 50 percent of GDP, employ 71 percent of the workforce, contribute to 47 percent of sales, and account for 9 percent of the total export value.





Figure 5.7. Contribution of Formal MSMEs to Sales and Employment in Argentina



Source: MoP, AFIP.

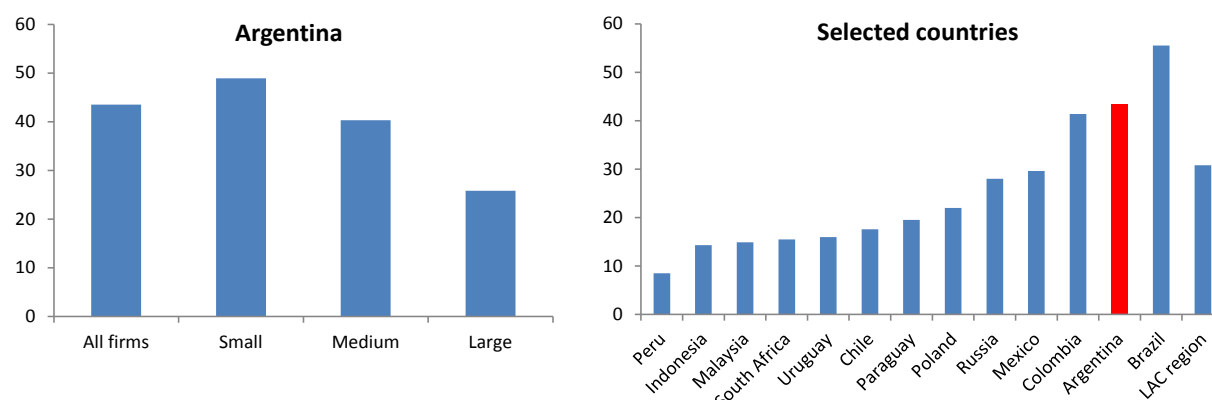
**11. MSMEs are a great source of job creation, especially in agriculture and commerce where they employ most of the workers in the sector.** MSMEs employ more workers across all sectors of the economy than large firms do. The difference between the number of workers employed by MSMEs and large firms is largest in the services and commercial sectors. MSMEs account for more than 90 percent of the employment in the agriculture sector, suggesting MSME development is paramount for employment in the rural areas.

**12. In Argentina, access to finance is the second most important constraint among the top 10 constraints that firms face, following tax rates.** Nearly half of the firms believe access to finance is a major obstacle—higher than the average of 30 percent in the LAC region and higher than in most comparator countries. In 2010, almost half of the small firms, 40 percent of medium firms, and 26 percent of large firms perceived access to finance as a major obstacle.

**13. Lack of funding by MSMEs is likely to have a particularly negative effect on employment.** In Argentina, in the absence of long-term funding, transactions are settled in cash, firms rely on retained earnings to finance investments, and economic agents cannot smooth consumption across the cycle. As a result, investments tend to be limited or delayed. This results in lost productive capacity, eroding competitiveness, exports, sales, and ultimately growth.



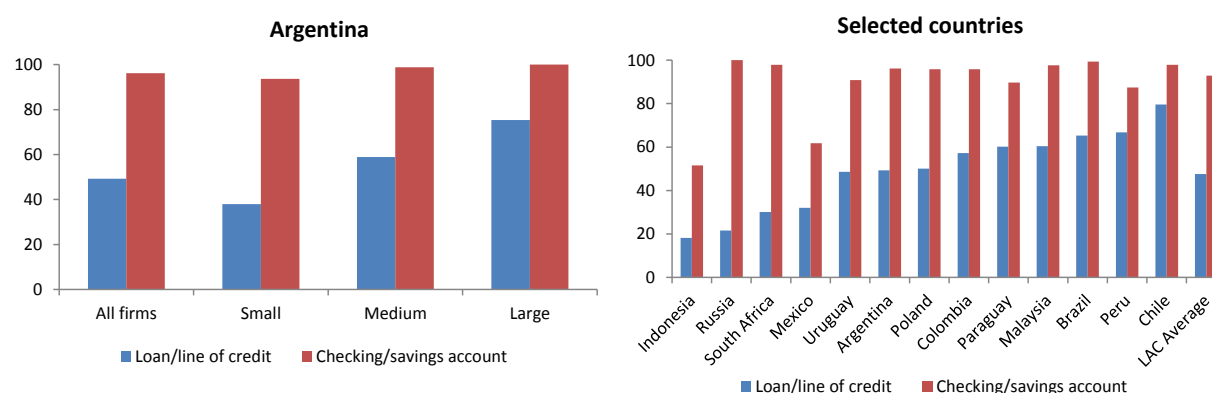
Figure 5.8. Access to Finance as a Major Constraint



Source: Enterprise Survey 2010.

**14. MSMEs especially have less access to a loan or line of credit.** Only 38 percent of small firms had a loan or line of credit, compared to 60 percent of medium firms and 75 percent of large firms. As figure 5.10 suggests, compared to its peers, small firms in Argentina are less likely to have loans or lines of credit. Small firms in only a few of the comparator countries (South Africa, Indonesia, and Russia) had less access to a loan or line of credit than MSMEs in Argentina. Although bank credit to MSMEs has increased since 2009, in 2013, they received only about 13 percent of banking sector credit to the private sector (about 2 percent of GDP).

Figure 5.9. Proportion of Firms with Finance Products



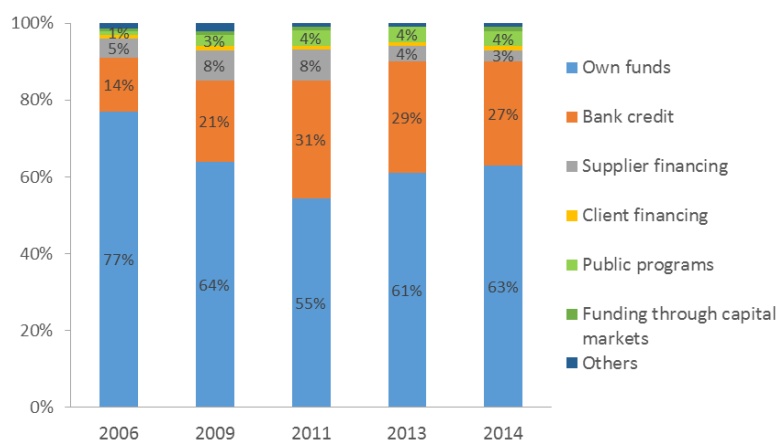
Source: Enterprise Survey 2010

**15. According to the 2014 survey of industrial MSMEs by *Observatorio PYME*, only a third of MSMEs in the industrial sector have access term credit from banks.** The demand for credit needed to finance unfinished projects is not being met, even more so in the areas of the country where there is greater productive potential. In 2014, about 60 percent of MSMEs used own funds for financing, and only 27 percent used bank financing (figure 5.11). The survey also showed that MSMEs are operating at the limit of their capacity (75–80 percent), and have outdated machinery and equipment. To increase



their productive capacity and competitiveness, it is essential they obtain longer-term finance to replace obsolete technology.

Figure 5.10. Sources of Funding for SMEs

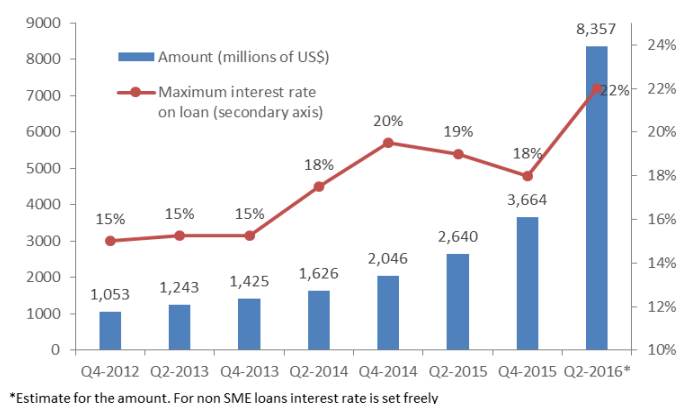


Source: Observatorio PYME, October 2015.

**16. The survey also showed that more than 60 percent of industrial MSMEs do not invest and this share has been increasing since 2010.** Without the ability to invest and grow their operations, MSMEs cannot contribute to job creation, expanding output, exports, and ultimately economic growth. Experience has shown that macroeconomic instability deters investment.

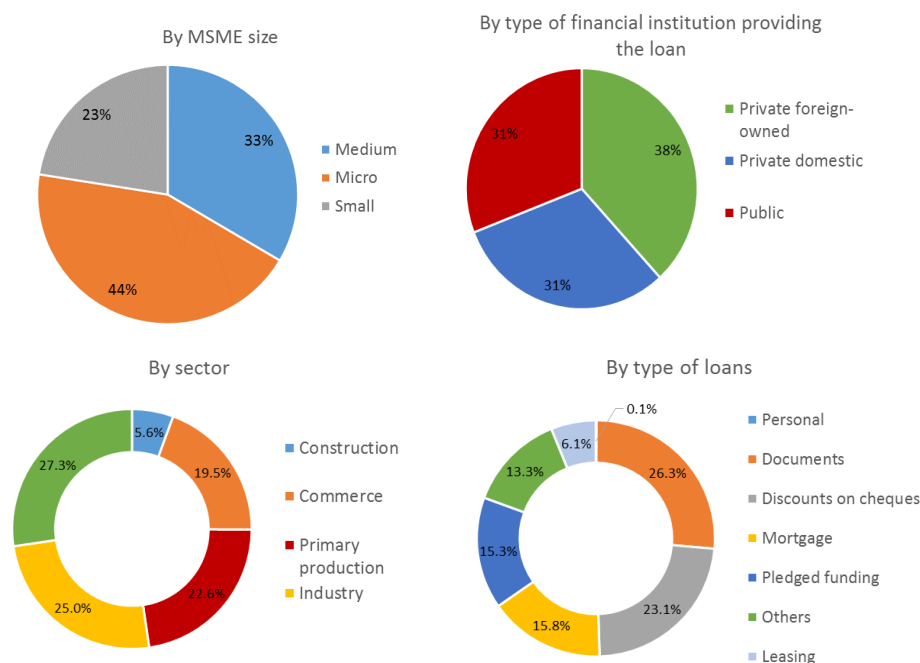
**17. In 2012, the BCRA initiated the LCIP as a regulatory measure to channel resources toward productive activities.** In 2015, new lines of credit were given through the LCIP for a total amount of ARS 51,300 million (US\$3,600 million), out of which around 87 percent was for lending to MSMEs. Figure 5.13 depicts the breakdown of MSME lending through the LCIP.

Figure 5.11. Evolution of LCIP



Source: BCRA.

Figure 5.12. Agreed Loans Amounts to MSMEs in the LCIP as of July 2015



Source: BCRA.

## BICE

### Overview

**18. BICE was created as a bank in 1992, operating for the first ten years exclusively as a second-tier bank.** As a result of Argentina's 2002 financial crisis and the difficulties to evaluate financial institutions, BICE migrated its operations to first-tier banking through investment, foreign trade, and, to a lesser extent, working capital loans. Since 2010, it has been authorized by the BCRA to take deposits (for minimum amounts of ARS 5 million (US\$346,000) and ARS 2.5 million (US\$173,000) for minimum terms of 180 and 365 days respectively<sup>33</sup>). BICE is the only second-tier public bank. BICE has no branches, but it has five regional operational offices located in key cities of the interior of the country. A local credit rating agency (FIX, affiliated to Fitch Rating) has rated BICE with the highest local rating (AAA for long-term debt and A1+ for short-term debt).

### Corporate Governance

**19. In line with the BCRA's regulatory requirements, BICE has shown progress in its corporate governance.** In 2012, BICE issued its Corporate Governance Code and updated its Code of Ethics (published in its website), and has conducted an annual review since then. In 2014, the bank adopted a Manual of Policy and Strategy for Integrated Risk Management and calculation of economic capital (ICAAP). According to the Organizational Chart and the Manual of Missions and Functions, there is an adequate segregation of functions between the board and the senior management. Currently there are 10 committees, including Credit and Lending Transactions (which all the board members are part of); Liquidity and Financial Resources; Audit; Information Technology; and Risk. A sample of minutes from

<sup>33</sup> BCRA Regulation "A" 5841 (Dec 2015).



these committees have shown that they are active, analyze the information and reports received, and—if necessary—raise the topic for the evaluation, consideration, and adoption of decision by the board. The new members of the board have a professional profile, with a high reputation in the market. Aspects in need for improvement, include (a) creation of an Integral Risk Management Unit (currently is not included in the organizational chart and is informally performed by the Operational Risk Unit); and (b) establishment of a specific structure for the risk analysis of banks (separated from special projects).

### ***Risk Management***

**20. BICE's risk management policies have improved in recent years (in line with the regulatory requirements set by the BCRA).** In 2014, the bank adopted a Manual of Policy and Strategy for Integrated Risk Management and calculation of economic capital (ICAAP) using different statistical models. For each type of risk (liquidity, market, interest rate, exchange rate, credit, concentration, and operational risk), a specific area independent from the one that manages the operations, is designated as responsible, with tools to measure the risk in line with the complexity and relevance of each risk. Specific reports are elaborated and sent to higher levels for monitoring the risks. A comprehensive risk analysis is performed by the operational risk unit, including the design and implementation of stress tests and proposals of re-calibration of the corresponding contingency plans. The Risk Committee is involved during regular meetings (quarterly or with a higher frequency, if needed). BICE uses different tools for measuring risks, such as Value at Risk models for market risk, transition matrices for credit risk, Monte Carlo simulations for operational risk, and liquidity gap, among others

### ***Business Model***

#### ***First-tier Business Line***

**21. BICE is the leading bank in the financial system that provides funding for long-term investment.** While public banks and large private banks increased their loans for investment, these were relatively short-term and provided at a fixed interest rate according to BCRA regulation.<sup>34</sup> The financial products offered by BICE include investment and export financing loans, directed to MSMEs, as well as to infrastructure and strategic projects. There are investment loans for MSMEs in local currency, with a fixed interest rate (with a minimum of three-years term), financing loans to exports in foreign currency (average maturity of six months), and some working capital (generally related to investment projects). In 2015, about half of the loans were directed to MSMEs and half to large firms.

#### ***Second-tier Business Line***

**22. Currently, BICE's second tier operations represent about 7 percent of its total loan portfolio.** The second-tier credits are 95 percent in local currency (69 percent of the total portfolio is in local currency) and concentrated mainly on loans to finance investment and leasing. Currently BICE is

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<sup>34</sup> By BCRA regulations, these banks are required to place a percentage of their loan portfolio in loans for investment of a minimum of three-year term and at a fixed interest rate (currently at 22 percent).



intermediating funds through nine banks (representing 44 percent of total loans of the financial system) with credit lines approved for US\$148 million.<sup>35</sup>

**Table 5.4. Composition of First-tier and Second-tier Lending by Currency**

Composition of Lending	ARS	US\$	TOTAL	Percentage per tier
Second-tier lending	284	14	298	7.4%
First-tier lending	2,508	1,226	3,734	92.6%
TOTAL	2,792	1,240	4,032	100.0%
Percentage per currency	69.30%	30.70%	100.00%	

*As of Dec 2015, in millions*

### *Capital Adequacy, Portfolio Quality, and Profitability*

**23. BICE's risk exposure is limited as a result of a low level of leverage and conservative policies.** The solvency and liquidity ratios are very strong, which allows BICE to face stressful situations without significantly affecting their operations. Nevertheless, BICE has developed contingency plans for different stress scenarios.

**24. Capital adequacy. The solvency situation of BICE is robust, reflecting the low level of leverage and the limited amount of risky assets.** The CAR is 49 percent (similar figures for the previous years). This high capitalization enables BICE to face all stress tests with no impact on solvency.

**25. Portfolio quality. Although the NPL ratio has been increasing (with a higher level than in the system), this is due to the situation of two debtors.** The NPL ratio as of December 2015 was 3.7 percent (almost double the average of the system). This performance has been affected by the default of two of the most important debtors of BICE.<sup>36</sup> If these debtors are excluded (with an exposure of ARS 109 million), the NPL ratio would improve significantly (0.7 percent). This 'adjusted' figure shows that the NPL ratio of BICE does not reflect a general weakness on their credit risk analysis.

**26. Profitability. BICE has good profitability (although reduced), mostly arising from foreign exchange gains and holdings of government securities.** The ROA has been around 7 percent in the last three years (slightly above the 6 percent of the system), while ROE has been around 15 percent in the same period (below the 47 percent for the system); the different performance in both indicators is the level of low leverage of BICE. Gains on exchange and government securities holdings accounted for 81 percent of the profits of 2015 and 63 percent in 2014. The low share of profitability arising from financial intermediation is due to the low level of leverage and the low financial net interest margin.

**27. BICE has recently begun to incorporate into their interest rate policy the calculation of the financial cost of their different sources of funding.** The total funding cost includes the interest expense and the impact of the reserve requirement and deposit insurance premiums. BICE aims to establish its interest rates considering its marginal costs of funding plus a spread that takes into account the

<sup>35</sup> Additionally, BICE has qualified nine other banks, whose ratings are overdue. In addition, BICE has rated nine SGRs (with lines of ARS 1,066 million) and two leasing companies.

<sup>36</sup> They received loans from other banks and international financial institutions.

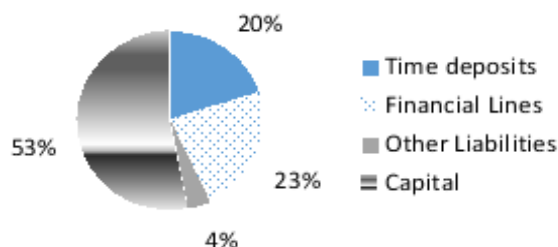


administrative costs, the credit risk (with three risk categories), and the term of the loan. The final objective of the process is to price the different loan products without affecting the value—in real terms—of its capital). Potential interest rate subsidies will only result from the implementation of public policies faced with budgetary appropriations to specific items.

### Funding

**28. BICE is funded mainly through its capital, but also from wholesale deposits and credit lines.** BICE's total liabilities are ARS 3.2 billion (US\$0.2 billion), of which 40 percent are in local currency. Time deposits, both in ARS and US\$, represent 41 percent of total liabilities, and are held by institutional investors (Public Social Security System, guarantee deposits of infrastructure trust funds, and mutual guarantee associations), with an average residual maturity of 180 days. Credit lines constitute 47 percent of total liabilities.<sup>37</sup> BICE's capital (ARS 3.5 billion or US\$0.2 billion) slightly surpasses its total liabilities and is the main funding source for BICE's provision of long-term credits in local currency.

Figure 5.13. Structure of BICE's funding



Source: BICE.

Table 5.5. Key BICE Financial Indicators

(US\$, millions)	2015	2014	2013
Total Assets	529	645	725
Liquid Assets	29	34	92
Loans	287	336	410
Securities	105	133	75
Total Deposits	101	99	108
Shareholders' Equity	210	229	75
Net Interest Income	69	84	88
Net Fee and Commission Income	71	87	92
Gross Profit	62	83	88
Net Profit	37	50	51

<sup>37</sup> 90 percent are foreign lines, of which 77 percent corresponds to the China Development Bank, 21 percent to the CAF, and the remaining 2 percent to Inter-American Development Bank, at an average residual maturity of 4 years.



Key Ratios (%)			
Interest Bearing Assets/Total Assets	83%	84%	78%
Loans/Total Assets	54%	52%	57%
NPLs/Total Loans (Gross)	3,66%	1,90%	0,57%
Demand Deposits/Total Deposits	—	—	—
Loans/Deposits	284%	339%	380%
Average ROA (year to date)	7.0%	7.8%	7.1%
Average ROE (year to date)	15.9%	16.3%	14.6%
CAR	49%	48%	52%

### *Credit Appraisal and Monitoring, and Risk Management*

**29. The Credit Risk Analysis Area has three departments, one of which is in charge of special projects and financial institutions.** The other two departments, each with a team leader and five analysts, are in charge of credit risk analysis of the first-tier operation. The department of ‘Special Projects and Financial Institutions’ encompasses a team leader and one analyst. Special projects are large loans linked to infrastructure projects and renewable energy, while financial institutions refers to the second-tier lending operations.

**30. BICE’s risk assessment of the financial institutions is based, mainly, on a score drawn from different type indicators.** The quantitative aspects represent 80 percent of the total weight of the analysis, including solvency, asset quality, profitability, efficiency, and liquidity. The indicators are calculated in Excel, once when the bank is initially rated and then updated twice per year. The qualitative aspects of the matrix represent 20 percent of the weight, including quality of management (3 percent), relationship with the BCRA (3 percent), and quality and explicit support of the shareholder (14 percent). No analysis is made for the bank’s qualifying aspects of risk management and the quality of its internal control. Based on the results of the matrix, qualified banks get a classification (A, B, or C), and the resulting maximum margin of assistance, if guarantees are required. Most of banks are rated B.

**31. Risk management is carried out by the area of the bank with direct competition on the topic (financial, credit, and operational risk).** Risk management is supplemented by a comprehensive risk analysis performed by the Operational Risk unit, with the intervention of the Risk Committee. BICE uses different tools for measuring risk, such as Value at Risk models for market risk, transition matrices for credit risk, Monte Carlo simulations for operational risk, and liquidity gap, among others.

**32. BICE’s risk management is suitable for its current second-tier operations, but improvements are needed to manage risks as the second-tier lending business expands.** Some of the aspects that should be improved in the next 1–2 years are: (a) strengthening the structure of risk analysis of the second-tier operations (for example, creating a specific unit for credit risk management of second tier operations); (b) allocation of more human resources trained in the analysis of financial institutions; systematization and increase of the updating frequency of the rating matrix of financial institutions; (c) more qualitative analysis of risk management and internal control environment in the process of





evaluating banks; and (d) calculation and measurements of risks (liquidity, interest rate, market, operational, and credit) in a systemic way, using applications with automated data extraction.



## ANNEX 6: FINANCIAL INTERMEDIARY ASSESSMENT

### 1. An assessment of BICE took place by appraisal stage based on eligibility criteria in accordance to OP 10.0:

- (a) The bank must be duly licensed and at least two years in operation.
- (b) The bank's owners and managers must be considered 'fit and proper'. It must have qualified and experienced management and adequate organization and institutional capacity for its specific risk profile.
- (c) The bank must be in 'good standing' with its supervisory authority (that is, it should meet all pertinent prudential and other applicable laws and regulations) and remain in compliance at all times.
- (d) The bank must maintain capital adequacy prescribed by prudential regulations.
- (e) The bank must have adequate liquidity.
- (f) The bank must have positive profitability and an acceptable risk profile. It must maintain the value of its capital.
- (g) The bank must have well defined policies and written procedures for management of all types of financial risks (liquidity, credit, currency, interest rate and market risk, as well as risks associated with balance sheet and income statement structures) and operational risk.
- (h) The bank must classify its assets and off-balance-sheet credit risk exposures (at least four times per year) and make adequate provisions. It must have adequate portfolio quality. The bank should not have more than 10 percent of criticized assets (that is, classified as doubtful and at a loss).
- (i) The bank must have adequate internal audits and controls for its specific risk profile.
- (j) The bank must have adequate management information systems.

### 2. In addition, BICE is expected to fully comply with the prudential regulations of the BCRA

**Table 6.1. Summary of BICE Appraisal**

Criterion	Comments
<b>1. License</b>	Adequate, license since 2010, has highest local credit rating
<b>2. Owners/managers 'fit &amp; proper', governance quality</b>	Adequate, new governance structure, adequately fit and proper, independent management
<b>3. Good standing with the BCRA</b>	Adequate, in compliance with all prudential regulations
<b>4. Capital adequacy</b>	Adequate, reflects low levels of leverage and a limited amount of risky assets
<b>5. Liquidity</b>	Adequate



<b>6. Profitability</b>	Adequate, ROA has been above the financial system average, while ROE below the average due to low levels of leverage
<b>7. Policies and risk management functions</b>	Broadly adequate, risk management functions will be improved through this operation to be able to manage higher volumes of second-tier lending
<b>8. Asset quality and provisions</b>	Adequate, NPL ratio is almost double the system's, but the rise is due to the default of two specific debtors and does not reflect a general weakness in asset quality
<b>9. Internal audit and controls</b>	Broadly adequate, the internal controls and audit functions are broadly adequate. Due to the scale-up in operations that is expected, the project will aim to strengthen its capacity through providing training to the staff in the application of international good practices.
<b>10. Adequate management information systems</b>	Broadly adequate, the project will support additional software to improve the management information systems to strengthen the analysis and reporting of second-tier lending



## ANNEX 7: ADDITIONAL INFORMATION ON THE ECONOMIC AND FINANCIAL ANALYSIS AND LESSONS LEARNED

**1. At the macro level, one important gain is the project's contribution to begin reorienting the financial sector from mainly short-term working capital financing to market-driven longer-term loans, with a view to support Argentina's economic and social development ambitions.** Argentina's Government aims to transition the economy to a stable and market friendly equilibrium, capable of generating sustained higher economic growth and employment. A successful transition to such an economy would require, among others, an effective financial sector that is able to accompany the transition. Although this is a pilot operation, it begins to make critical interventions toward improving the infrastructure of Argentina's financial sector.

**2. The project will also have significant positive benefits, as a result of the reforms proposed in the technical assistance component, for the implementing agency (BICE), the technical agency (MoP), final beneficiaries (MSMEs), PFIs, and for overall economic development.**

- **Benefits for BICE and the MoP.** BICE will benefit from technical assistance, capacity building, and IT investments. It will benefit from technical assistance to strengthen its second-tier lending business and from enhanced capacity to assess and monitor environmental risks. With improved capacity, BICE will be able to extend long-term financing to PFIs in a sustainable prudent manner, which in turn will provide longer-term loans to MSMEs. The MoP will also benefit from the strengthening of capacity of its MSME development entity (SEPYME), which would serve as a market-facilitator between MSMEs and BDS.<sup>38</sup>
- **Benefits for clients.** MSMEs will benefit from improved availability and terms of credit as a result of improved financial infrastructure, may have the ability to obtain a loan, even if they do not have sufficient collateral, through a guarantee from FOGAPYME, and will benefit from BDS to improve the management of their business and financial statements, and become more bankable. Improving access to credit for the MSMEs will increase their ability to expand their operations, finance innovations, improve profitability, and maintain or increase hiring. Reforms in secured transactions and insolvency would lead to (a) improved access to secured credit by permitting businesses to use more of their assets as collateral to gain access to loans; (b) improved terms of credit, including larger amounts, longer terms, and lower interest rates; (c) improved access to unsecured credit by permitting lenders to use their portfolios of unsecured loans as collateral for secured loans; and (d) improved rates of recovery for creditors in case of debtor default. Effective insolvency regimes save struggling firms when possible or reallocate

<sup>38</sup> The use of BDS by MSMEs has shown positive effects in Argentina. Impact evaluations of two competitiveness enhancement programs have demonstrated that MSMEs receiving access to BDS led to an increase in productivity; as a result, beneficiary MSMEs, compared with a control group, increased their level of employment up to 22 percent, their average wages between 2 and 4 percent, and their exports between 6 and 9 percent. Likewise, impact evaluations of similar programs in the region also show positive effects. For instance, in Chile, the Technical Assistance Fund helped MSMEs to increase the level of sales by 20 percent and the level of productivity of its employees by 16 percent.



assets of failing firms more productively. Entrepreneurs are more willing to enter the market when they are not putting their entire personal fortunes at risk.

- **Benefits for financial institutions.** The benefits for financial institutions arise from improvements in the financial infrastructure, ability to reduce credit risk through the availability of a guarantee instrument from FOGAPYME, increased awareness and ability to assess, monitor, and supervise environmental risks, and increased experience assessing MSMEs for long-term lending. A strengthened moveable collateral regime will contribute to the financial institutions' ability to (a) diversify assets and spread risks more efficiently by taking moveable assets as collateral; (b) tap the MSME market that may not own immoveable assets, and thus increase profits; and (c) have highly liquid assets, especially short-term assets such as accounts receivable, which are usually more desired by banks in modern secured transactions systems that protect the rights of creditors adequately. Insolvency laws directly affect the willingness of lenders to extend credit and the terms on which they are prepared to lend.<sup>39</sup> Banks and investors are more willing to lend when they know they can recover at least some of their investment.
- **Benefits for economic development.** Increased access to financial services will deepen the financial sector and foster economic growth. Modern secured transactions and debt resolution systems contribute to increased levels of credit<sup>40</sup> and lower cost of credit.<sup>41</sup>

**3. Important lessons can be drawn from peer country projects, such as Turkey.** A 2011 study based on a survey of final borrowers in Turkey, EFIL and MSME Credit Line Projects: An Assessment of Outcomes' concluded that the projects were successful in targeting the medium- to long-term working capital and investment finance needs of exporters and MSMEs. Lessons learnt from the credit lines in Turkey, and other countries, show that better outcomes are achieved when: (a) key indicators that measure the quality of the loan portfolio are monitored; (b) quantified eligibility criteria for selecting PFIs are used; and (c) sound analysis and data on the financial performance of financial intermediaries and external audit for verification are available and used.

**4. Reforms in financial infrastructure have been found to improve the lending environment and to facilitate access to credit for MSMEs.** In the field of secured transactions, past experience has highlighted the importance of combining the reform of the legal framework for secured transactions with the institutional regime for a collateral registry. In insolvency processes, the balance between debtors' and creditors' interests has been found to be a crucial element in any financial infrastructure reform effort both in the region as well as around the world.

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<sup>39</sup> There are several studies performed, such as a study across France, Germany, and the United Kingdom, that showed that banks price loans based on their rights in case of default and price them higher to mitigate creditor-unfriendly aspects of the bankruptcy law. Similarly, studies have shown that insolvency reforms improve creditor returns in cases of loan default.

<sup>40</sup> In countries where creditors can rely on clear priority rules in case of default, credit to GDP averages 60 percent, compared to an average of 30 percent for countries without a clear creditor protection system.

<sup>41</sup> In industrial countries, borrowers with collateral get 9 times more cash, repayment periods of up to 11 times longer, and interest rates up to 50 percent lower than for borrowers without collateral.