DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK
MULTILATERAL INVESTMENT FUND

NICARAGUA

FINANCIERA NICARAGÜENSE DE DESARROLLO SOCIEDAD ANÓNIMA (FINDESA)

(TC-0203015-NI / TC-0203016-NI)

DONORS MEMORANDUM

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CONTENTS

APPENDICES

Proposed resolution

ABBREVIATIONS

AECI	Agencia Española de Cooperación Internacional
CABEI	Central American Bank for Economic Integration
CESI	Committee on Environment and Social Impact
CIDA	Canadian International Development Agency
DID	Développement International Desjardins
FINDE	Asociación Fondo Nicaragüense de Desarrollo
FINDESA	Financiera Nicaragüense de Desarrollo Sociedad Anónima
FNI	Financiera Nicaragüense de Inversiones
GTZ	German Agency for Technical Cooperation
HIVOS	Humanist Institute for Co-operation with Developing Countries
IFC	International Finance Corporation
INDE	Instituto Nicaragüense de Desarrollo
IRR	Internal rate of return
LAC	Latin American Countries
MIF	Multilateral Investment Fund
NGO	Nongovernmental Organization
SBIF	Superintendencia de Bancos y Otras Instituciones Financieras

FINANCIERA NICARAGÜENSE DE DESARROLLO SOCIEDAD ANÓNIMA (FINDESA)

(TC-0203015-NI / TC-0203016-NI)

EXECUTIVE SUMMARY

Executing agency:

Capital Investment:
Financiera Nicaragüense de Desarrollo Sociedad Anónima (FINDESA)

Technical Cooperation:
Financiera Nicaragüense de Desarrollo Sociedad Anónima (FINDESA)

Loan:
Financiera Nicaragüense de Desarrollo Sociedad Anónima (FINDESA)

Project number:

TC -0203016-NI	- capital investment of up to	US$ 500,000
	- loan of up to	US$1,000,000
TC-0203015-NI	- technical assistance of up to	US$ 250,000

Beneficiaries: FINDESA and the microenterprise and small business sector in Nicaragua.

Objectives: This project is in line with the Multilateral Investment Fund (MIF) strategy of working with the private sector to promote sustainable development of micro-financing in LAC through specialized intermediaries with the capacity to serve large numbers of micro and small business entrepreneurs efficiently and with a profitable rate of return.

Financial Objective:

a. Capital will be invested over a term of 4-6 years, during which period investors may expect an internal rate of return (IRR) in the order of 14%.

b. According to business plans and financial projections submitted, FINDESA should receive an annual average return on investment of around 19%.

Development Objectives:

a. The funds disbursed by the MIF will enable FINDESA to finance approximately 2600 microenterprises. The resources invested by the MIF will serve as a catalyst for the recruitment of two international private sector partners: Développement International Desjardins (DID) of Canada, and Stichting Hivos-Triodos Fonds, managed by the Triodos Bank of the Netherlands. These two investors will take an active role in corporate governance of the institution and, in the case of Desjardin, will act as technical adviser by transferring the methodology needed to mobilize resources and training FINDESA's personnel in the means for attracting deposits.

b. The technical assistance resources provided by the MIF will co-finance a program to develop new financial services in FINDESA, including: saving accounts, attracting deposits and transmitting remittances from Nicaraguan emigrants. In addition, a new banking establishment will be opened in Waslala (Department of Matagalpa) which has no formal financial institution at present.

Financing: The MIF's commitment is for the sum of up to US$500,000 in capital contribution, up to US$1,000,000 as a loan, and up to US$250,000 in technical assistance.

Capital Investment (Facility III-B)

The MIF's capital commitment is denominated in local currency up to a sum equivalent to US$500,000. The initial MIF contribution is estimated at US$380,000, with the remainder to be kept in reserve in the event new increases in capital are required.

MIF	US$380,000 (10%)
Stichting Hivos-Tridos Fonds-Tridos Bank:	US$380,000 (10%)
Développement International Desjardins (DID):	US$380,000 (10%)

The initial capital contribution from each of the MIF's international partners—Stichting Hivos-Triodos Fonds and Développement International Desjardins (DID)—will be approximately US$380.000, giving each partner a 10% stake in FINDESA's corporate assets.

Technical Cooperation (Facility III-A)

The MIF's Technical Cooperation commitment is US$250,000, which will be supplemented by up to an additional US$400,000 in contributions from other possible donors, including: AECI, CIDA, HIVOS, and counterpart funding from FINDESA.

MIF	US$250,000
HIVOS (The Netherlands)	US$ 90,000
AECI (Spain)	US$120,000
CIDA (Canda)	US$ 90,000
FINDESA	US$100,000
Total	US$650,000

Loan (Facility III-B)

Once FINDESA has obtained authorization to accept deposits and has successfully implemented a plan for attracting same, it will gain access to a US$1,000,000 loan from the MIF, provided it has established satisfactory financial conditions and the project is proceeding according to plan. These funds will be used exclusively to finance microenterprises and small businesses in Nicaragua. This loan will have a repayment period of 4 years and will be disbursed in two tranches. Its interest rate will be determined on the basis of current market conditions.

Terms

Capital Investment

The investment period will have a limit of 6 years. At the end of the fourth year, the shares will be offered to local partners and a strategic shareholder willing to purchase the holdings of the international partners will be sought. If no such purchaser can be found, the national shareholders will undertake to purchase the shares belonging to the MIF and the other two international partners at book value and on a joint and several basis. This purchase of shares will be carried out in three phases with one-third being sold in the fourth year of the investment, another third in the fifth year, and the final third in the sixth year.

Technical Assistance

The disbursement period for the technical assistance component will be up to 4 years.

Loan

The loan will have a repayment period of up to 4 years.

Exceptions to Bank policy: None.

Environmental and social review: The Committee on Environment and Social Impact (CESI) approved this project at its meeting of 26 July 2002. The Committee's suggestions have been taken into account in designing the project.

Description: With this investment, the MIF will attract two international private sector partners who will contribute funds and financial technology, as well as participating in the corporate governance of FINDESA, thus strengthening the institution and turning it into a properly supervised full-service financial intermediary capable of mobilizing funds on financial markets.

This project is consistent with the basic mandate of the MIF which includes promoting the development of microenterprises by investing resources and providing institutional strengthening for specialized intermediaries that cater to the small business market. As well, the project forges links with other strategically chosen private sector investors, in this case Développement International Desjardins (DID) of Canada and Stichting Hivos-Triodos Fonds, managed by the Triodos Bank of the Netherlands, as called for in the "Report of the Working Group on MIF Strategy" of July 28, 2000 (document MIF/GN-56).

This MIF initiative will permit FINDESA to broaden the scope of its activities by designing new financial services and expanding into new areas of the country. The new financial services offered to microenterprises include deposit facilities, saving accounts and expanded acceptance and utilization of 'smart' cards. The use of so called smart cards to access approved credit and deposits is a new product in Nicaragua's microenterprise sector. The new market components that FINDESA will be able to serve thanks to this project are the area of Waslala in the Department of Matagalpa, and Nicaraguan emigrants wishing to send family remittances from Costa Rica through that country's Banco Nacional to accounts with FINDESA.

This operation is intended to have a **demonstration effect** on Nicaraguan organizations that provide loans to enterprises outside the formal financial system. This project in Nicaragua is intended to demonstrate that growth potential and opportunities to devise new and innovative financial services are increased when these organizations join the financial system, begin attracting private investors, and become known to the public at large.

Risks: **Risk**: Corporate governance and business administration among financial institutions. Neither the MIF nor either of its two international partners has a permanent presence in Nicaragua, making it difficult to supervise and monitor investments in that country. **Mitigating factors**: As one condition of their investment, the international partners will have the right to appoint two of the six directors that sit on FINDESA's Board of Directors. Working as a team, the international partners have agreed upon a mechanism by which they will be represented at each monthly meeting of the Board of Directors. And in its capacity as technical partner, DID has scheduled 10 missions to FINDESA during the first 24 months of the project. Legal provisions have been included which require that strategic decisions and all measures which would alter the structural nature of FINDESA must be approved by shareholders representing 75% of the share capital, or by a qualified majority of the members on the Board of Directors, as the case may be.

Risk: Association with non-profit institutions (NGOs). The MIF and its international partners will be in partnership with NGOs that have been legally constituted to operate on a not-for-profit basis and have no clearly defined system of property rights. **Mitigating factors**: The process in this case does not differ substantially from similar conversions of NGOs into limited companies for the purpose of creating financial intermediaries in other parts of Latin America, and in which the MIF has participated as a shareholder. However, to ensure that the process is transparent and all interested parties are made aware of the change, the SBIF has been notified concerning the intentions of the international partners, and a copy of the Shareholder's Agreement signed between the parties will be sent to the Superintendency in due course. The GTZ, as the agency that originally subsidized the loan program which gave rise to this organization, has also been informed of the operation.

Risk: Financial return. There is a risk that outside factors such as a system-wide financial sector crisis, ill-conceived public policies, devaluation or other external macroeconomic shocks could undermine the viability and profitability of FINDESA. **Considerations**: In addition to the normal due diligence, project organizers obtained access to assessments of FINDESA carried out by other finance and bond-rating agencies. The historic rates of return achieved by FINDE, when it served as an NGO, and that of FINDESA, now that it operates under prudential regulations set by the SBIF, have been consistently satisfactory. **Mitigating factors:** The spread, levels of return and financial stability of FINDESA are consistently sound, and the margin in foreign currency accounts is kept in check by balancing assets and liabilities in foreign currencies. The institution is in a good position to weather possible external shocks.

Risk: FINDESA has not yet received authorization from the SBIF to accept deposits from the public, which limits its ability to grow and to access financial markets. **Mitigating factors:** Développement International Desjardins (DID) of Canada will act as technical partner as well as one of the sources of capital for this operation. The experience gained by the Desjardins group in the Province of Quebec, where it has a 48% share of the deposits in that market's financial system, is truly remarkable. Desjardins specialists will assist FINDESA in the design and implementation of its strategy for attracting deposits in Nicaragua's financial system. The coordination of ongoing work between DID and FINDESA has already begun and an atmosphere of wholehearted cooperation has been created.

Risk: Exchange risk. A major devaluation could erode the quality of the institution's assets and undermine its ability to repay the loans. **Considerations:** FINDESA keeps a steady balance between the amount of assets in foreign and local currencies to avoid a gap in its foreign currency liabilities. **Mitigating factors:** The technical assistance project will help FINDESA to mobilize deposits, and this in turn will give access to a broader and more diversified source of financing. The amount of family remittances entering Nicaragua constitutes an important source of foreign exchange which increases the ability of FINDESA's customers to pay, and at the same time lowers the risk of exchange problems.

I. APPROVAL OF ELIGIBILITY BY THE MIF

1.1 The MIF's Policy and Operations Committee found the operation eligible for financing under the Small Microenterprise Development Facility. This project is consistent with the MIF's basic mandate to develop microenterprises as set out in the Report of the Working Group on MIF Strategy" of July 28, 2000 (MIF/GN-56). Moreover, with this project the MIF seeks to form an association with private international investors, involving them in the micro-financing industry. The participation of the MIF has been instrumental, serving as a catalyst and encouraging two international private sector partners, Développement International Desjardins (DID) of Canada, and Stichting Hivos-Triodos Fonds, managed by the Triodos Bank of the Netherlands, to become shareholders of FINDESA.

1.2 The addition of these private international partners is expected to improve corporate governance under the FINDESA inasmuch as they are active investors who will sit on the development finance company's board of directors, helping to determine the institution's course and strategy. Bringing these international private sector partners on board will create an effective means for improving the competitiveness of FINDESA, boosting confidence in the institution and facilitating its penetration of financial and capital markets.

1.3 The major innovation with this operation is the connection it forms with financial intermediaries that will transfer to FINDESA the technology and expertise needed to succeed in an environment in which internationalized financial markets are increasingly important. Linking FINDESA to these partners will give the institution a new perspective. With its experience in development finance, Développement International Desjardins (DID) of Canada will act as technical partner, adding value to FINDESA's services. The Triodos Bank of the Netherlands, in its role as a financial institution dedicated to mobilizing resources from socially responsible European investors, will supply FINDESA with funding at market terms and without undermining the objectives of profitability and efficiency. Both agencies—DID of Canada and Triodos Bank of the Netherlands—have co-financed various micro-finance projects before in association with the MIF.

1.4 The operation will serve as a model primarily for those institutions that offer micro-financing outside the formal financial system. The rapid growth and unmet demand for financial services among microenterprises should induce the NGOs to formally register as financial intermediaries despite being required to pay income tax and render accounts to the SBIF, since to do otherwise would leave them with only limited capacity to grow. According to von Stauffenberg,[1] the capacity for leveraging resources is much greater for institutions operating within the formal

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1 Von Stauffenberg Damián, Trends in Latin American Microfinance, in The Microbanking Bulletin, Issue No. 8, November 2002.

financial system, since they have a gearing ratio of 4.5: 1, compared to a ratio of 1.3: 1 for those in the informal sector who operate outside the financial system.

1.5 Participation by the MIF in FINDESA has acted as a catalyst, leading Développement International Desjardins (DID) of Canada and Stichting Hivos-Triodos Fonds - Triodos Bank of the Netherlands to participate as well. The ample experience and good reputation of these institutions will help to strengthen FINDESA as a financial intermediary. The commercial relationship which the MIF enjoys with these international partners is excellent, and the objectives and views which the three institutions share concerning topics in development finance are both compatible and mutually complementary.

1.6 **Développement International Desjardins (DID) of Canada.**[2] DID is a subsidiary of Mouvement Desjardins, Quebec's most important finance agency and the sixth largest financial institution in Canada. Mouvement Desjardins consists of a network of 901 financial service cooperatives with assets totaling 84.7 billion dollars as of December 31, 2002. The Desjardins cooperative movement was founded in the year 1900 and currently holds 48% of all deposits under the financial system of the Province of Quebec. Of historical importance as well is the fact that the first cooperative established in the United States was created by Desjardins in the State of New Hampshire.

1.7 Initially founded as a series of savings and loan associations, the Mouvement Desjardins over the years has adapted to community expectations and the needs of its members. Today, Desjardins owns some twenty different companies offering a wide range of complementary services ranging from brokerage insurance through financial trust and industrial and commercial investment services. The members of the savings and loan associations making up the network of cooperatives and companies belonging to the Mouvement Desjardins are the ones who, in accordance with the spirit of cooperativism, determine the basic principles that have guided the Mouvement Desjardins for over a century.

1.8 Développement International Desjardins (DID) is a Canadian company specializing in technical support and investment in the community finance sector within developing and emerging countries. Currently DID is supporting organizations in 20 or so countries in Africa, Latin America, the Caribbean, Asia and Eastern Europe.

1.9 **Stichting Hivos-Triodos Fonds – Triodos Bank of The Netherlands.**[3] Triodos Bank is a private bank established in the Netherlands with social, cultural and environmental objectives. Social consciousness permeates the daily operations of

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[2] For further information visit: http://www.did.qc.ca

[3] For further information visit: http://www.triodos.com/

the bank. Since its founding in 1980 Triodos Bank has been known for its innovative approach and pioneering work in the area of sustainable development. Triodos Bank lends only to organizations and businesses that pursue social, environmental and cultural values in the fields of renewable energy, social housing, health services and social security, fair trade, organic foods, rural activities and socially-aware enterprises. High on its list as well is lending to institutions involved in the micro-finance sector in developing countries, using funds provided by depositors and investors interested in advancing the cause of social justice in a context that encourages sustainable development. As of December 31, 2002, Triodos Bank NV had a net worth of €79 million, with total assets of €829 million and a bottom line showing profits of €2.6 million for 2002.

1.10 Triodos Bank manages a number of funds including Hivos-Triodos Fonds. This fund was created in 1994 as a joint initiative with the Humanist Institute for Cooperation with Developing Countries (HIVOS), and will supply the resources to be invested in FINDESA.

II. BACKGROUND

A. Other MIF micro-financing projects in Nicaragua

2.1 This project is consistent with and will follow up on the achievements of other microenterprise development initiatives financed by the MIF in Nicaragua: Project ATN/MT-7975 is intended to strengthen Nicaragua's banking authority, the SBIF (Superintendencia Bancaria y de Instituciones Financieras), thereby reinvigorating and improving the efficiency of capital markets; Project MIF/AT-365 enabled the nongovernmental organization FINDE to modernize its operations, restructure and reorganize its administration to function as a fully-licensed financial intermediary; a similar initiative (Project MIF/AT-221) enabled Fundación CHISPA to join the formal sector as a financial institution; and to help deal with the effects of Hurricane Mitch on Central America, Project MIF/AT-220 provided resources for various Nicaraguan institutions serving that country's microenterprises. These projects created the institutional foundation and framework needed to carry out the operation proposed in this document, although differing from this initiative in that they did not include a direct investment component. This will be the time that the MIF has participated directly in share capital in Nicaragua. Until now, the MIF had contributed only indirectly to the financing of micro-finance institutions in Nicaragua through the PROFUND and LACIF funds.

B. Demand

2.2 According to estimates based on data supplied by the Instituto Nacional de Estadística y Censos, the total number of microenterprises and small businesses in Nicaragua is around 420,000 units at present. In terms of employment, small, medium-sized and micro-businesses account for some 63% of the country's non-agricultural economically active population (EAP). A large part of the labor force in urban areas is employed by the informal sector. Given its relative importance to Nicaragua's manufacturing sector, as well as its job-creation capacity, this group is essential to the economy and its development through expansion of credit and financing institutions will have a positive impact on efforts to reactivate the country's productive sector.

C. Supply

2.3 It is estimated that about 20% of the country's microenterprises have access to credit from micro-financing institutions. There is a broad range of institutions offering loans to microenterprises: finance companies, NGOs, savings and loan societies and multi-service cooperatives. Nicaragua's Micro-Finance Association (ASOMIF) has 16 member firms whose aggregate loan portfolio amounts to US$52 million.

2.4 Of all of the institutions providing credit to microenterprises, only two (Confia S.A. and FINDESA) operate within the formal financial system and under prudential standards established by the SBIF. Under those standards, these two institutions are subject to periodic review and must submit reports, and the resulting information is open to public scrutiny,[4] improving its quality and ensuring accountability to depositors, investors and other stakeholders.

2.5 By operating under the supervision of the SBIF these institutions are allowed to accept deposits from the public, enabling them to finance and grow their credit operations, as well as offer their customers other financial services.

D. The project: objectives and description of the investment

2.6 This operation has three components: (a) the first and most important is the co-financing provided in conjunction with two private sector institutions, Développement International Desjardins (DID) of Canada and Stichting Hivos-Triodos Fonds of the Netherlands, to be invested in the shares of the development finance company FINDESA, to strengthen its financial structure and improve its corporate governance (this investment will be made in accordance with strict commercial criteria); (b) the second component in the operation consists of a technical cooperation designed to strengthen the company's institutional capacity, in particular by improving its ability to attract deposits from the public, expanding its area of coverage and launch new services for the transfer of family remittances from Nicaraguan emigrants in Costa Rica; and (c) the third component consists of a loan to FINDESA at market terms and conditions, for onlending to micro and small

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4 For examples see http://www.Superintendencia.gob.ni

businesses. This credit facility will be available to the institution when it has developed its capacity to mobilize deposits.

2.7 The share package to be purchased by the MIF together with the other two international investment partners, Développement International Desjardins and Stichting Hivos-Triodos Fonds, represents 30% of the institution's corporate assets. Each investor will thus hold a 10% share in the company. Depending on average annual devaluation of the Córdoba, the investment is expected to yield an internal rate of return in US dollars of between 6% and 22%. The three investors will operate as a single block over a 4-6 year period, acting through the company's decision-making bodies to influence strategies and improve corporate management, thus strengthening its institutional capacity.

III. BORROWER - FINANCIERA NICARAGÜENSE DE DESARROLLO SOCIEDAD ANÓNIMA (FINDESA)

A. Analysis of the Institution

3.1 The origins of FINDESA date from 1963, the year in which the Instituto Nicaragüense de Desarrollo (INDE) was created. INDE is one of Nicaragua's oldest NGOs and it continues in operation today, promoting education programs and technical assistance, providing training programs for cooperatives, and supporting projects aimed at improving the conditions under which micro and small businesses operate. In 1993 INDE began a program to finance microenterprises using funds provided by the German technical cooperation agency GTZ. This program is now separate from INDE and has been carried out by another nonprofit organization by the name of Asociación Fondo del Instituto Nicaragüense de Desarrollo (FINDE). FINDE's objective is to fund the development of microenterprises and small businesses in the different economic sectors.

3.2 The GTZ made its support conditional upon FINDE's maintaining asset value, for which policies were designed and resources were organized to ensure that loans would be granted in a manner that covered costs, and to guarantee that the project is financially self-sustaining. The GTZ foresaw the need to create an autonomous and highly competent institution, and proceeded to recruit a qualified manager to carry out this task. In October of 2001, authorization was obtained from the SBIF to create the Financiera Nicaragüense de Desarrollo Sociedad Anónima (FINDESA), organize the institution and ensure compliance with Law No. 314 "Act Governing Banks, Non-banking Financial Institutions and Financing Groups".

3.3 INDE then moved the principal assets and liabilities used in its financial intermediation activities to the limited company FINDESA, which was duly constituted on February 12, 2002, as shown in the Mercantile Register. All legal requirements having been satisfied, on March 13, 2002, the SBIF authorized

FINDESA to begin financial intermediation operations in accordance with the Special Act Governing Financial Investment Companies et al, except for the operations involved in raising funds from the public. Only when FINDESA could demonstrate to the SBIF that it has the organizational structure, technology and physical facilities required to carry out that activity, will it receive authorization to accept deposits. The risk analysis, disbursement and loan recovery methods employed by FINDESA have proven to be efficient, commercially viable and highly effective. Compared to other Latin American institutions specializing in micro-financing, the performance of which is reported in the Microbanking Bulletin,[5] FINDESA has achieved better than average results. Annex VI contains a table comparing FINDESA's results with those of the most important micro-financing institutions in Latin America and the World.

3.4 As indicated in the authorization granted by the SBIF, as well as in the present assessment, one of the biggest challenges facing FINDESA is that of developing its capacity to attract deposits and expand its loan portfolio. To date FINDESA has advanced small amounts of credit to thousands of entrepreneurs; these lines of credit are financed with the proceeds of loans that FINDE obtains from international organizations such as GTZ, CABEI, Dexia Micro-Credit Fund and LACIF[6]. Once it receives a license to accept deposits from the public, FINDESA will be able to mobilize more funds within the local financial system and from the public at large, and—most importantly—will have an opportunity to offer a range of other services in addition to loans, among which the handling of family remittances and utilization of debit cards may be mentioned.

B. Asset structure and ownership rights

3.5 FINDESA has subscribed and paid-in capital of thirty-eight million six hundred fifty-five thousand Córdobas (C$38,655,000), divided into 7731 common shares with a nominal value of C$5000 each. As of April 30, 2003, the book value is US$385 per share, with total assets amounting to US$2,895,724. The MIF's capital investment will go entirely to increase FINDESA's net assets. With this level of solvency, the commitment to refrain from distributing dividends for the next three years, and a long-term subordinated loan from one of its member NGOs, the institution presents a degree of capital adequacy well beyond that of its competition, higher even than that of Nicaragua's financial system. The joining of Stichting Hivos (Triodos) and DID will reduce the participation of several Nicaraguan shareholders whose relative share of capital will be diluted, except for one shareholder who will be liquidating his holdings altogether due to residing outside the country. For the MIF, the addition of these two international partners is of

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[5] The Microbanking Bulletin is a publication containing information on the world's major micro-financing institutions. <www.themix.org>

[6] The MIF is a shareholder of LACIF, with an 18.41% share of its assets.

paramount importance in that they share the same vision of the micro-financing industry and lend added prestige to the institution. In addition to its capital contribution, Stichting Hivos (Triodos) has also approved a medium-term loan to FINDESA for US$1,000,000, and as technical partner, DID will mentor the institution in developing its program to attract deposits.

3.6 The principal institutional partners of FINDESA are the Instituto Nicaragüense de Desarrollo (INDE), and the Asociación Fondo del Instituto Nicaragüense de Desarrollo (FINDE). Both institutions are non-profit NGOs, and each of them possesses 20% of FINDESA's capital stock. By law, no shareholder which is not itself a financial intermediary or investor specializing in this type of operation, may hold more than 20% of the capital shares in a financial intermediary.

3.7 The principal private sector Nicaraguan shareholders are Gabriel Solórzano and Javier Solórzano, the two together possessing 31% of the company's common shares. With the addition of the DID and Stichting Hivos (Triodos), the share held by the Solórzano brothers is reduced to 11.6%. Gabriel Solórzano will continue as a shareholder and Chairman of FINDESA; Javier Solórzano, who now resides outside Nicaragua, will cease to be a partner. The Solórzano family owns various businesses in Nicaragua, including the Hotel Holiday Inn de Managua, Budget Rent a Car, a company which maintains and repairs cellular telephones, and a specialized store that sells photographic supplies. The Hotel Holiday Inn was co-financed by the Inter-American Investment Corporation (IIC). Because of this being a highly competitive business in Nicaragua, plus the drop-off in tourism following the 9-11 attacks, this loan is being rescheduled. Gabriel Solórzano is the manager of the Hotel Holiday Inn and also serves as Chairman of FINDESA's Board of Directors. Mr. Gabriel Solórzano is a professional involved not only in business activities, but also in civic endeavors, currently serving at President of the Civic Ethics Group and Transparency International in Nicaragua, an institution formed for the purposes of strengthening democracy in Nicaragua.

Partner	As of 30 April 2003 No. of Shares	Partic. %	On entry MIF/IDB No. of Shares	Partic. %	On entry DID-Hivos Triodos No. of Shares	Partic. %
FINDE	1,545	20.0	1,545	18.0	1,720	20.0
INDE	1,545	20.0	1,545	18.0	1,720	20.0
Gabriel I. Solórzano P.	1,308	16.9	1,308	15.2	1,000	11.6
Javier Solórzano P.	1,082	14.0	1,082	12.6	0	0.0
Jaime M. Lacayo P.	357	4.6	357	4.2	200	2.3
Benjamín Vides D.	345	4.5	345	4.0	300	3.5
Alejandro Gurdián H.	173	2.2	173	2.0	150	1.7
Domingo J. Chamorro V.	173	2.2	173	2.0	150	1.7
Guillermo F. Jacoby S.	357	4.6	357	4.2	180	2.1
Ramiro E. Castillo C.	437	5.7	437	5.1	300	3.5
Ricardo A. Cuadra G.	78	1.0	78	0.9	0	0.0
Gilberto Cuadra S.	331	4.3	331	3.8	300	3.5
MIF	0	0.0	869	10.1	869	10.1
DID					860	10.0
Hivos-Triodos					851	9.9
TOTAL	7,731	100.0	8,600	100.0	8,600	
Exchange: 1 US$ = C$14.57	14.57					
Total number of shares	7,731		8,600		8,600	
Nominal value per share (Córdobas)	5,000					
Book value per share (Córdobas)	5,618					
Book value per share (in US$)	385.6					
Total capital stock (Córdobas)	38,655,000		43,000,000		43,000,000	

3.8 Benjamín Vides, formerly with the Inter-American Development Bank and ex-manager of the Banco Hipotecario de El Salvador, became involved with FINDESA at the suggestion of Stichting Hivos-Triodos, one of the institutions he provided with advisory services. Since retiring from the Banco Hipotecario, he has become a member of FINDESA's Board of Directors where he serves as Vice-Chairman. Mr. Vides has invested approximately US$100,000 in common shares of the finance company.

3.9 Jaime Lacayo is general manager of FINDESA. His work has been instrumental in achieving the excellent quality of the current loan portfolio. Mr. Lacayo developed the highly efficient risk analysis, disbursement and loan recovery methods employed by FINDESA. And finally, Mr. Lacayo has invested the sum of US$100,000 in shares, giving him a 4.6% share in the institution. Guillermo F. Jacoby is the President of the Instituto Nicaragüense de Desarrollo (INDE) and sits as that institution's representative on FINDESA's Board of Directors, at the same time acting as Secretary of that Board. Mr. Jacoby is a business leader and university professor, and has also invested US$100,000 in the company. Gilberto Cuadra is the head of Banco Central de Nicaragua. Messrs. Alejandro Gurdían, Domingo Chamorro, Ramiro Castillo and Ricardo Cuadra are Nicaraguan businessmen. According to references received in the course of performing due diligence, and in consulting the SBIF, Canadian Consulate and local law offices, the private shareholders in FINDESA have a uniformly solid reputation in Nicaragua.

C. Board of Directors

3.10 The Board of Directors has five members at present. With the addition of the international shareholders a sixth member will be added, and two of the directors will be appointed by the international partners.

3.11 The local shareholders have experience with business activities in Nicaragua's private sector. Mr. Ricardo Cuadra and Mr. Vides have considerable experience in banking. The international partners Desjardins (DID) and Stichting Hivos-Triodos Fonds, coming from a private sector background, are expected to contribute—in addition to their financial investment—expertise in the form of strategic management of FINDESA to ensure its consolidation as a financial intermediary and full participant in Nicaragua's financial system.

D. Administration and organization

3.12 **Board of Directors.** Consisting at present of five members: Gabriel Solórzano, Chairman; Benjamín Vides, Vice-Chairman; Ricardo Cuadra, Treasurer; William Jacoby, Secretary; and Ramiro Castillo, Director.

3.13 **Management.** General management is the responsibility of Jaime Lacayo who has had a leading role in the company since the time when it operated as an NGO, and who was instrumental in its transformation to a development finance company with limited liability status. The main challenge Mr. Lacayo faces is that of adapting the organization to the requirements of a financial intermediary, which has led him in the past year to concentrate on putting together a management team (see the curriculum vitae of the company's senior executives in Annex V) and strengthening the institution's operational areas. To this end, a new credit manager, a risk assessment manager and an internal auditor have been recruited, and a new marketing department created. The new challenges of operating as a financial intermediary within the formal financial system, while at the same time experiencing accelerated growth, have required Mr. Lacayo to delegate responsibilities and surround himself with highly trained personnel.

3.14 **Geographical coverage.** The company has ten branches spread along the Pacific coast and in the northwest region of the country. The cities with branches are: Managua (2), Masaya, Rivas, León, Chinandega, Estelí, Sébaco, Matagalpa, Rio

Blanco and Ivan Montenegro. Each branch is administered by a manager and operates as a profit center. FINDESA has a total of 102 employees, of which 24 are loan officers. It must be noted that the loan portfolio is distributed evenly among the ten branches, which helps to ensure geographical diversification of risk.

E. Financial services and methodology

3.15 FINDESA offers small loans (on average US$1200), having determined that no one loan should exceed 1.5% of the company's net worth. At present, that upper limit would be set at US$33,400. The minimum amount for a loan is set at US$130. As of 31 March 2003, FINDESA's loan portfolio totaled US$11.2 million, distributed among 10,134 operations, most of them in the trade and service sectors.

3.16 The company offers various **credit services** to its customers. The most commonly used is the conventional line of credit, but FINDESA also offers the "Finde-Cash" debit card, short-, medium- and long-term loans for the purchase of capital goods, short-term loans for working capital, discounting of bills or drafts, credit documents or invoices.

3.17 Financing is available to cover feasibility studies for purposes of expansion or industrial rehabilitation, or for short- and medium-term agricultural, livestock and forestry loans. FINDESA also offers exchange services, issuance of guarantees, and personal loans.

Total Lending per sector, October 2002 - March 2003

Sector	No. of Loans	Total: US$	No. of Loans	Total: US$
	October 2002		March 2003	
Trade	2771	4,805,603.5	2904	5,392,688
Manufact.	373	623,019.0	386	725,744
Agriculture	102	393,136.7	136	388,224
Personal	3782	1,519,940.9	5589	1,598,076
Services	814	1,715,720.4	905	2,042,688
Livestock	169	740,843.2	146	892,269
Mortgages	42	144,780.8	68	170,539
Total	8053	9,943,044.5	10134	11,210,227

3.18 The company's loan portfolio grew by 13% between October 2002 and March 2003, while its geographical coverage of borrowers and enterprises rose by 26%. It is important to remember that FINDESA's coverage includes rural areas located in remote areas of the country.

3.19 Under FINDESA's credit policy, only physical persons who manage microenterprises or legal entities and have the ability to execute or and operate business projects are eligible to receive loans, and only if they have at least one year of experience in the activity in question and the ability to pay; and provided their business is income-producing, the economic activity to be financed is their principal source of income, and they post sufficient security to guarantee the amount of the loan.

3.20 The repayment terms are up to 18 months for working capital loans, and up to 36 months in the case of loans for purchasing fixed assets. The form of payment may be weekly, biweekly, monthly, quarterly, annually, at maturity or tailored to the particular project.

3.21 A dynamic borrower classification system has been established which depends upon the type of transactions customers have had with FINDESA, their credit history and the quality of the guarantee provided. Under this system, a customers are considered excellent if they maintain a classification of AAA, AA, or A; very good if they have a classification of BBB, BB or B; good if they receive a C classification; and either satisfactory or unacceptable if they are classified as D or E, respectively. Based on their credit history, loan officers can decide to offer a reduced rate of interest, allow automatic approval of repeated loans or increase the amount of a loan. By the same token, they may decide to impose penalties in the case of nonperforming loans, reducing benefits received in the past, or even canceling the customer's eligibility.

3.22 Surety may be in the form of collateral, personal, or mixed **guarantees**. The coverage of the guarantee is established on the basis of the classification assigned to the customer and the amount requested. In the case of mortgage guarantees, the security provided must be equivalent to 150% of the amount financed; and for collateral or fiduciary guarantees, the proportion of cover must be equivalent to 200%.

3.23 The administrative **fee** is to be charged on the day following that on which a payment became past-due, regardless of the form of payment agreed on (whether weekly, biweekly, monthly, quarterly, etc.). If within 15 days after the start of administrative collection procedures the arrears have not been cleared, the loan is sent to legal counsel for extrajudicial collection; and if within 30 days of becoming past-due the amount owing has not been paid, the loan will be sent for collection by court order.

F. Financial analysis

3.24 This section is based on financial statements as of 31 December 2002, audited by Price Waterhouse Coopers (Annex I), and the interim reports of 31 March 2003.

(i) Arrears Rate and Portfolio Quality

a. FINDESA's handling of collections and its definition of payment arrears are both very strict. A loan is deemed to be in arrears beginning on the first day after a payment is due, and if it continues in arrears on day 31 thereafter, the entire balance of the outstanding principal is considered due and payable. Similarly, a loan is deemed to be in default if the borrower uses the loan proceeds for purposes other than those authorized in the investment plan, if there is unlawful withdrawal or misuse of the security given in guarantee, if the borrower withholds financial information or refuses to provide information on the security, or the information required to monitor performance of the relevant investments. And finally, an operation is deemed to be in default whenever borrowers suffer a significant setback in their financial status.

b. The following table based on the preceding definition of arrears shows the status of loans at each branch:

FINDESA: Loan Portfolio Balance per Branch, March 2003 (US$)

Branch	No. of Loans	Balance US$	Arrears of 1-30 days	More than 30 days	Total Arrears	Arrears (%)
Managua	1,887	1,657,449	54,411	24,772	79,183	4.8%
Rio Blanco	1,227	1,897,452	28,539	8,860	37,398	2.0%
León	1,299	1,239,748	32,199	2,518	34,718	2.8%
Masaya	759	687,921	23,544	29,967	53,512	7.8%
Matagalpa	857	1,180,220	17,677	4,086	21,763	1.8%
Rivas	722	712,949	41,633	5,497	47,130	6.6%
Sebaco	546	863,361	7,508	18,494	26,002	3.0%
Chinandega	845	964,182	15,661	29,355	45,016	4.7%
Esteli	932	1,197,996	25,074	1,511	26,585	2.2%
Ivan Negro	1,060	1,066,278	44,533	41,026	85,558	8.0%
Total	10,134	11,467,556	290,779	166,086	456,865	4.0%

c. The overall arrears rate totals 4%, which indicates an extraordinarily high-quality loan portfolio. Breaking down this arrears rate for total time in default shows 2.54% for delays of less than 30 days, and 1.45% for defaults greater than 30 days, proving that the majority of arrearages are due to temporary circumstances. It must be added that this high quality portfolio, while due in part to the strict policy regarding administrative and judicial collection procedures, may also be traced to the recent turning over of credit transactions from the NGO to FINDESA in which only good quality assets were transferred. Not that this fact should in any way detract from the NGO's risk handling prowess and ability to keep arrearages to a minimum similar to that recorded by FINDESA.

(ii) Solvency and capital adequacy

a. FINDESA shows a fairly low gearing ratio (total assets/equity of 5:1). It is expected that as the institution increases its ability to attract deposits from the public, this ratio will rise. As of December 1, 2002, the provisions made exceed nonperforming loans (121%), so that the asset level is sufficient to cover possible credit risk problems.

b. The liquidity of the institution is satisfactory, retained earnings represent approximately 10% of assets and 14% of liabilities, with both percentages on the rise. Since the institution does not have any demand deposits, management of FINDESA's liquidity is relatively straightforward and its cash flow is adequate.

(iii) Rate of return and earnings management

a. Return on equity (ROE) and on assets (ROA) are 18.1% and 3.7%, respectively. These rates are lower than those obtained by the NGO prior to the creation of FINDESA, but are nonetheless highly satisfactory and above the average for similar financial institutions in Nicaragua and Latin America. Profit and other margins show a slight dip which can be explained as follows: (a) by operating as a limited company FINDESA became subject to income tax, whereas before it had been exempt; (b) financial earnings have dropped by a proportionally larger amount than financial costs; and (c) the physical infrastructure and human capital required for operating in the formal financial system are more onerous than those required previously.

b. Summary of financial history:

	FINDE ONG 12/31/2001 US$	FINDESA 12/31/2002 US$
Total assets	9,619,836	13,265,150
Net portfolio	7,238,993	10,360,558
Total liabilities	7,621,365	10,576,879
Net worth	1,998,471	2,688,271
Financial earnings	3,039,645	3,061,509
Financial expenses	890,233	1,006,602
Administrative costs	1,410,541	516,497
Other expenditures	233,963	50,546
Net profit	504,907	487,865
Equity capital/total assets	21%	20.3%
ROA	5.2%	3.7%
ROE	25.3%	18.1%
Nonperforming loans/total portfolio	2.4%	2.5%
Number of loans outstanding	5,208	10,134
Total number of employees	81	94

IV. THE OPERATION

A. Capital Investment

4.1 This component is intended to achieve an internal rate of return in the order of 14%, in addition to improving FINDESA's corporate management.

B. Principal terms and conditions of the investment

4.2 **Amount:** The MIF will invest local currency up to the equivalent of US$500,000 in newly issued common shares of FINDESA. These shares will be purchased at book value on the date of sale.

4.3 **Target Market:** FINDESA will operate on a for-profit basis, offering financial services at competetive rates. The target market is the microenterprise and small business sector of the Republic of Nicaragua.

4.4 **International investors:** The MIF, Développement International Desjardins, and Stichting Hivos-Triodos Fonds will comprise the block of international investors, and will own 30% of the capital equity of FINDESA.

4.5 **Duration of the Investment:** At any time beginning on the fourth anniversary of the date on which its shares are subscribed and paid in, but prior to the sixth anniversary of the date of subscription and payment, the MIF may offer its shares for sale to the other partners, or otherwise to outside investors.

4.6 **Exit:** At the end of the fourth year, the shares will be offered to local partners and a strategic shareholder will be sought. If no purchaser can be found, the national shareholders will undertake as an irrevocable obligation and on a joint and several basis, to purchase the shares belonging to the MIF and the other two international partners at book value. This purchase of shares will be carried out in three phases with one-third being sold in the fourth year of the investment, another third in the fifth year, and the final third in the sixth year.

4.7 **Corporate Management:** The MIF, Développement International Desjardins and Stichting Hivos-Triodos Fonds shall have the right to appoint two of the six directors making up the Board of Directors of FINDESA. The international investors will be represented at each meeting of the Board of Directors by directors preferably resident in Nicaragua or Central America. In addition, DID and Triodos officials will attend periodically at meetings of FINDESA's Board of Directors. DID, in its capacity as technical partner, has scheduled 10 missions to FINDESA in the first 24 months of the operation.

4.8 **Limitation on exposure to credit risk:** FINDESA may not grant loans to individuals, enterprises or affiliated entities in amounts which exceed 1.5% of its net equity at the time such loans are granted.

4.9 **Restricting competition:** Throughout the period during which the international investors remain as partners in FINDESA, their national partners undertake not to compete with FINDESA in its financial intermediation activities aimed at the microenterprise and small business sector in the Republic of Nicaragua.

4.10 The financial results and desired impact of the investment are as follows:

Financial Results	2003	2004	2005	2006
ROE	22%	21%	21%	18%
Net profit (US$)	609,000	775,000	956,000	964,000
IRR				16%
Loan portfolio (US$)	13,563,000	15,598,000	17,938,000	19,700,000
Coverage Results				
Agencies	10.00	11.00	11.00	11.00
Loan average (US$)	1,150.00	1,350.00	1,450.00	1,550.00
No. of borrowers (Active)	11,793.91	11,554.07	12,371.03	12,709.68
New customers in Waslala			500	1,000

C. Technical Assistance

4.11 This technical assistance will strengthen the institutional capacity of FINDESA, enabling it to attract deposits from the public and thus become a fully operational financial intermediary. This assistance will also develop and strengthen FINDESA's capacity to manage family remittances sent by Nicaraguan emigrants residing in Costa Rica. Finally, in order to expand its geographical coverage, this technical assistance will enable FINDESA to open a new agency in Waslala, a town that is located in a rural area of the Department of Matagalpa some 300 km from Managua, and that currently lacks the presence of a formal financial intermediary.

D. Attracting deposits and providing remittance services

4.12 In addition to its capital investment, the MIF in conjunction with other potential donors, including Hivos Triodos, Agencia Española de Cooperación Internacional (AECI) and the Canadian International Development Agency (CIDA), will provide FINDESA with technical assistance resources to develop a service for mobilizing resources by attracting savings deposits, as well as the capacity to handle transfers in the form of family remittances. One of the aims of this project is to help FINDESA tap into a portion of the flow of remittances which Nicaraguan emigrants residing in Costa Rica send back to their families in Nicaragua.

4.13 This technical cooperation is designed to:

a. Reduce dependence on lines of credit provided by international creditors and at the same time diversify its sources of funding, ensuring a less concentrated mix of liabilities.

b. Expand FINDESA's range of financial products and services.

c. Lower the financial cost of funds.

d. Meet performance objectives set by the SBIF.

e. Ensure efficient and secure mobilization of deposits.

f. Provide FINDESA with the technology required to launch its new financial services.

g. Develop the skills needed to offer family remittance service.

h. Expand coverage of financial services for the existing client base, and extend FINDESA's catchment area to include new regions.

4.14 The authorization received from the Superintendencia de Bancos y Otras Instituciones Financieras (SBIF) allows FINDESA to operate as a registered financial entity, but does not include a license to accept savings deposits. To the international investors, the ability to attract such deposits is essential for its institutional development since this will give FINDESA access to local financial markets, and this in turn will increase its growth potential and give the institution greater capacity to meet its customers' demands for financial services.

4.15 In addition to providing investment funds, Développement International Desjardins will serve as technical partner offering training, expertise and advisory services in areas related to the mobilization of resources. Desjardins and FINDESA personnel have jointly prepared a workplan (Annex II), the costs of which will be financed in the following manner by potential donors and FINDESA itself:

Utilization of Funds per Source of Financing (US$)

Source / Activity	MIF	Hivos/ Triodos	Agencia Española de Coop. Intl. (AECI)	Canadian International Development Agency (CIDA)	FINDESA	Total
1. Development plan for attracting savings deposits, and Environmental study.	60,000					60,000
2. Organization and operations manuals.	15,000	50,000	35,000		20,000	120,000
3. Training program for employees.				90,000	30,000	120,000
4. Implementation of service to handle remittances.	70,000				10,000	80,000
5. Investment in information technology. Software and point-of-sale cards.	75,000				25,000	100,000
6. Investment in advertising for savings and remittance services.		40,000	60,000		10,000	110,000
7. Investment in public image for the new savings and remittance services.			25,000		5,000	30,000
8. Vision and corporate governance under the Board of Directors. Opening of a new rural office.	30,000					30,000
Total	250,000	90,000	120,000	90,000	100,000	650,000

E. Brief description of the family remittance project

4.16 In 2001 Nicaragua received a total of US$758 million in family remittances sent home by Nicaraguans living outside the country. It is estimated that Nicaraguans living in Costa Rica are sending home approximately US$230 million per year.[7] This flow of funds is very important to the national economy since it represents 36% of Nicaragua's GDP and some 38% of total assets in its financial system. FINDESA plans to recycle a portion of these incoming resources through its network of 10 branches located in strategic areas close to community markets and

[7] Source: Family remittances to Nicaragua: opportunities to increase the economic contributions of Nicaraguans living abroad. Manuel Orozco, Report commissinoned by the U.S. Department of Agriculture under a PASA from the U.S., Agency for International Development, March 10, 2003; plus MIF estimates.

lower socioeconomic neighborhoods where microenterprises tend to set up shop and people often have relatives that have emigrated to other countries.

4.17 A considerable percentage of the remittances sent to Nicaragua originate in Costa Rica. With help from the MIF, FINDESA has established contact with the Banco Nacional de Costa Rica and is negotiating an agreement to create a mechanism for transmitting remittances between the two institutions. The Banco Nacional has better geographical coverage than any other financial institution in Costa Rica, with a total of 143 branches spread throughout the country and a major presence in rural areas where poverty is greatest, and where many Nicaraguan emigrants have gone to work as farm laborers, cutting sugarcane, harvesting coffee, working on the banana plantations, etc.

4.18 This agreement is intended to connect the network of Banco Nacional offices with those of FINDESA. Ideally, the mechanism created will also incorporate services for receiving and sending remittances, making these services more accessible to the 10,000 clients being served by FINDESA at present, and to a large number of potential customers who are now using alternative methods to send money home, many of which bypass the financial system altogether.

4.19 But FINDESA plans to extend its services for sending and receiving remittances well beyond the simple transmission of funds. Its objective is use this service as a springboard for offering a range of financial services to Nicaraguan emigrants in Costa Rica and their relatives in Nicaragua. When withdrawing the funds sent from abroad, customers will learn about other financial services available from FINDESA that they may wish to take advantage of, such as mortgage loans, savings instruments and accounts allowing access by debit card. The MIF is funding the design of a similar project between an Ecuadoran micro-financing institution and several European banks. That initiative is proving to be both very successful and highly innovative.

4.20 The following table provides a summary of the results expected from the technical assistance program:

Results expected from the technical assistance	Year 1	Year 2	Year 3	Year 4
Attracting savings deposits				
Authorization from the SBIF	X			
% of total deposits/total lending	5%	25%	50%	>65%
Amount (in equivalente US$) in savings accounts	0	70,000	540,000	2,000,000
Organization, operations and internal audit manuals	X			
Training program	X	X		
Training for personnel in Nicaragua	33	33		
Training for personnel in Canada (including grants)	3	3		
Opening of rural office in Waslala		X		
Nicaragua-Costa Rica remittance services				
Agreement with correspondent intermediary in Costa Rica	X			
Training for staff of FINDESA	X			
Readying transmission software	X	X		
Average number of transmission sent per month	500	625	750	830
Average amount of remittances	80	90	100	110
Amount from remittances deposited in savings	48,000	67,500	90,000	109,560
Number of savings accounts opened by emigrants	200	280	350	450
Number of remittances accruing annually	6,000	7,500	9,000	9,960
Program to advertise savings accounts and remittances	X			
Technology for savings account and remittance modules	X			

F. Loan

4.21 This loan will be used to expand the credit services that FINDESA offers to micro and small businesses. The loan resources will be available once the program for attracting savings deposits has been successfully implemented and total deposits received from the public reaches twice the amount of the loan. It is estimated that with this loan FINDESA will be able to finance approximately 500 microenterprises per year.

G. Terms and conditions of the loan

4.22 **Amount:** Up to US$1,000,000. The loan will be disbursed in two tranches of US$500,000 each.

4.23 **Term of loan:** Up to 4 years.

4.24 **Interest rate:** The rate of interest will be determined at the time agreement is reached on the utilization of each tranche, based on the prevailing rates on Nicaragua's financial market on the date of disbursement. This method has been used because a rate lower than the average cost of financing would act as a disincentive for the project to attract savings deposits, while a rate too high would make it impossible for FINDESA to lend to the microenterprise sector at competitive rates. The main parameters to be used in determining the interest rate are:

- Minimum rate: six-month LIBOR + 4%

- References: (i) the rate of interest on the loan must be higher than the interest paid to depositors by private sector banks under similar terms and conditions, as published by the Banco Central de Nicaragua; (ii) the rate of interest on the line of credit must be equal to or greater than those charged on similar transactions by the institutions that finance this type of intermediary, e.g. the Central American Bank for Economic Integration (CABEI), Financiera Nicaragüense de Inversiones (FNI), and International Finance Corporation (IFC); (iii) the rate of interest on the loan must be in line with the rates charged by for-profit private sector institutions such as LACIF, Acción Investments in Microfinance and PROFUND.

4.25 **Term of each tranche:** Neither tranche may exceed four years. Each tranche will have a grace period of two years, and will be repaid in four payments at six-month intervals.

4.26 **Utilization of funds:** FINDESA must use the resources received under this loan solely for the purpose of increasing its portfolio of loans to microenterprises (defined as production units having up to US$10,000 in assets, 1-10 employees and an owner who works alongside them).

4.27 **Eligibility requirements:** The loan will not be disbursed until FINDESA has succeeded in attracting deposits of at least US$1,500,000 from the public. In addition, FINDESA must: (i) provide a plan—including quantifiable objectives and goals—for placing the requested funds with Nicaraguan microentrepreneurs; (ii) show proof of compliance with the financial variable; (iii) be up to date with its reporting requirements vis-à-vis the MIF.

4.28 In order to be eligible to receive and maintain this Loan, FINDESA must meet the following financial conditions:

Financial Conditions

Arrears > 30 days	< 8%
(Past-due portfolio - provisions) / net worth	< 10%
Return on equity (ROE)	> 10%

H. Environmental Considerations

4.29 The Committee on Environment and Social Impact (CESI) approved this project at its meeting of July 26, 2002. The Committee's suggestions have been taken into account in designing the project.

V. RISKS AND MITIGATING FACTORS

5.1 **Risk**: Corporate governance and business administration among financial institutions. Neither the MIF nor either of its two international partners has a permanent presence in Nicaragua, making it difficult to supervise and monitor investments in that country. **Mitigating factors**: As one condition of their investment, the international partners will have the right to appoint two of the six directors that sit on FINDESA's Board of Directors. Working as a team, the international partners have agreed upon a mechanism by which they will be represented at each monthly meeting of the Board of Directors. And in its capacity as technical partner, DID has scheduled 10 missions to FINDESA during the first 24 months of the project. Legal provisions have been included which require that strategic decisions and all measures which would alter the structural nature of FINDESA must be approved by shareholders representing 75% of the corporate assets, or by a qualified majority of the members on the Board of Directors, as the case may be.

5.2 **Risk**: Association with non-profit institutions (NGOs). The MIF and its international partners will be in partnership with NGOs that have been legally constituted to operate on a not-for-profit basis and have no clearly defined system of property rights. **Mitigating factors**: The process in this case does not differ substantially from similar conversions of NGOs into limited companies for the purpose of creating financial intermediaries in other parts of Latin America, and in which the MIF has participated as a shareholder. However, to ensure that the process is transparent and all interested parties are made aware of the change, the SBIF has been notified concerning the intentions of the international partners, and a copy of the Shareholder's Agreement signed between the parties will be sent to the Superintendency in due course. The GTZ, as the agency that originally subsidized the loan program which gave rise to this organization, has also been informed of the operation.

5.3 **Risk**: Financial return. There is a risk that outside factors such as a system-wide financial sector crisis, ill-conceived public policies, devaluation or other external macroeconomic shocks could undermine the viability and profitability of FINDESA. **Considerations**: In addition to the normal due diligence, project organizers obtained access to assessments of FINDESA carried out by other finance and risk-appraisal agencies. The historic rates of return achieved by FINDE, when it served as an NGO, and that of FINDESA, now that it operates under prudential regulations set by the SBIF, have been consistently satisfactory. **Mitigating factors:** The spread, levels of return and financial stability of FINDESA are consistently sound, and the margin in foreign currency accounts is kept in check by balancing assets and liabilities in foreign currencies. The institution is in a good position to weather possible external shocks.

5.4 **Risk:** FINDESA has not yet received authorization from the SBIF to accept deposits from the public, which limits its ability to grow and to access financial markets. **Mitigating factors:** Développement International Desjardins (DID) of Canada will act as technical partner as well as one of the sources of capital for this operation. The experience gained by the Desjardins group in the Province of Quebec, where it has a 48% share of the deposits in that market's financial system, is truly remarkable. Desjardins specialists will assist FINDESA in the design and implementation of its strategy for attracting deposits in Nicaragua's financial system. The coordination of ongoing work between DID and FINDESA has already begun and an atmosphere of wholehearted cooperation has been created.

5.5 **Risk:** Exchange risk. A major devaluation could erode the quality of the institution's assets and undermine its ability to repay the loans. **Considerations:** FINDESA keeps a steady balance between the amount of assets in foreign and local currencies to avoid a gap in its foreign currency liabilities. **Mitigating factors:** The technical assistance project will help FINDESA to mobilize deposits, and this in turn will give access to a broader and more diversified source of financing. The amount of family remittances entering Nicaragua constitutes an important source foreign exchange which increases the ability of FINDESA's customers to pay, and at the same time lowers the risk of exchange problems.

VI. EXCEPTIONS TO THE BANK'S POLICIES

6.1 None.