SIMULTANEOUS DISCLOSURE

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

MEXICO

SECOND INDIVIDUAL OPERATION UNDER THE EXPANDED CCLIP TO SUPPORT BUSINESS DEVELOPMENT IN MEXICO

(ME-L1081) (ME-X1010)

LOAN PROPOSAL

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REQUIRED

1. Monitoring and Evaluation Plan
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=36451745
2. Environment and Social Management Report (ESMR)
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=36451717

OPTIONAL

1. Project economic analysis
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=36451767
2. Matrices - Project Risk Management Process
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=36509160
3. National Development Plan. Pillar 4. Environmental Sustainability (Climate Change)
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=35921659
4. National Strategy on Climate Change. Mexico. Executive Summary
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=35921670
5. Special Program on Climate Change 2009 – 2012. Mexico
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=35921662
6. Country Strategy with Mexico, November 2010 – December 2012 (GN-2595-1)
   http://www.iadb.org/es/paises/mexico/estrategia-de-pais,1078.html
7. The Clean Technology Fund (CTF)
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=35921664
8. CTF Investment Plan for Mexico
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=35938545
9. Proposal to establish the Clean Technology Fund (CTF) in the Inter-American Development Bank
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=36519153
10. Program of Contingent Financing for Renewable Energy
    http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=35921673
11. National Competitiveness Survey, Business Financing Sources and Use of Financial Services
    http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=36502800
12. SME financing in Mexico. Recent experience (Ramón Lecuona)
    http://www.ejournal.unam.mx/ecu/ecunam17/ECU001700604.pdf
13. General information on SMEs in Mexico
    http://www.observatoriopyme.org/encuestas-y-estudios/cifras-de-pymes/
14. Quarterly trend in financing to businesses during April-June 2011
    http://www.banxico.org.mx/informacion-para-la-prensa/comunicados/sector-financiero/financiamiento-empresas/%7BF44E633A-8837-9976-2F3D-D273FB2860F4%7D.pdf

ABBREVIATIONS

BANCOMEXT	Banco Nacional de Comercio Exterior, S.N.C.
CCL	Contingent credit line
CCLIP	Conditional Credit Line for Investment Projects
CFE	Comisión Federal de Electricidad [Federal Electricity Commission]
CNBV	National Banking and Securities Commission
CO_2	Carbon dioxide
CRE	Comisión Reguladora de Energía [Energy Regulatory Commission]
CTF	Clean Technology Fund
ESMR	Environment and Social Management Report
GHG	Greenhouse gases
GVC	Global value chains
MT	Metric tons
MW	Megawatts
NAFIN	Nacional Financiera
PCR	Project Completion Report
PEMEX	Petróleos Mexicanos
PIM	Plan de Inversiones de México [Investment Plan for Mexico]
REFF	Renewable Energy Financing Facility
SFP	Secretaría de la Función Pública [Civil Service Secretariat]
SMEs	Small and medium-sized enterprises
UNFCCC	United Nations Framework Convention on Climate Change

PROJECT SUMMARY

MEXICO
SECOND INDIVIDUAL OPERATION UNDER THE EXPANDED CCLIP TO SUPPORT BUSINESS DEVELOPMENT IN MEXICO
(ME-L1081) (ME-X1010)

Financial Terms and Conditions			
Borrower and Executing agency: Nacional Financiera, S.N.C. (NAFIN) **Guarantor**: United Mexican States		Amortization period:	25 years
		Grace period:	5 years
		Disbursement period:	4 years
Source	**Amount**	Interest rate:	LIBOR- based
IDB (Ordinary Capital)	Up to $50,000,000	Inspection and supervision fee:	*
		Credit fee:	*
		Currency: U.S. dollars from the Single Currency Facility Conversion to Mexican pesos: Local Currency Facility (document GN-2365-6)	

Project at a Glance
Project objective/description: This loan to Nacional Financiera (NAFIN), a development bank owned and controlled by the Government of Mexico, is intended: (i) to cofinance power generation projects using renewable energy, as a supplement to loan ME-L1109 which, with resources from the Clean Technology Fund administered by the IDB, established the Renewable Energy Financing Facility (REFF), an integral part of the CTF Investment Plan for Mexico; and (ii) to provide continued support to SME contractors and suppliers to the Mexican oil industry, which was the central objective of the First Individual Operation under the CCLIP (ME-L1051; ME-X1010). The general objectives are also two-pronged and identical to those of the previous operations cited: (i) to contribute to Mexico's effort to enhance the share of renewable energy in power generation and thereby reduce GHG emissions; and (ii) to help strengthen the competitiveness of SMEs that are part of the national oil industry's value chain, by channeling medium- and long-term financing to them. The specific objectives are summarized in paragraph 1.29. Approximately US$40 million is expected to be earmarked for the renewable energy objective, and US$10 million for the SME objective, but these amounts are flexible. The funds will be channeled to their end use by NAFIN, acting essentially as a second-tier bank.
Condition precedent to the first disbursement: Entry into force of the program Operating Regulations, previously agreed with the Bank, and appointment of the program manager (paragraph 3.5).
Special aspects: Funds earmarked for renewable energy projects will, to the extent possible, be disbursed pari passu with funds from loan ME-L1109, which established the REFF (CTF) (paragraph 3.5). The Bank may recognize and reimburse expenses incurred by NAFIN for the program since 18 October 2011 up to a maximum of US$10 million (paragraph 3.4).
Exceptions to Bank policies: None
Project consistent with country strategy: Yes [X] No [ ]
Project qualifies as: SEQ [ ] PTI [ ] Sector [ ] Geographic [ ] Headcount [ ]

* The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

I. DESCRIPTION AND RESULTS MONITORING

A. Frame of reference and problem addressed

1. Frame of reference

1.1 This program is the second individual operation under the expanded ME-X1010 CCLIP, designed as a flexible tool for providing funding and technical assistance to strategic areas of mutual interest to the IDB and two jointly-managed Mexican development banks, NAFIN and Bancomext.[1]

1.2 The first program under the CCLIP, ME-L1051, to promote the development of SME suppliers and contractors for the national oil industry, was intended to strengthen the value chain of Petróleos Mexicanos and, in particular, the SMEs associated with that chain. A second purpose was to provide medium- and long-term financing for renewable energy projects. The program was successful, in that virtually 100% of the funding has been committed (50% disbursed and 50% of the disbursement for wind projects committed, pending execution) although demand was stronger for renewable energy projects than for SME financing, perhaps because of the slow pace of economic recovery following the crisis and the surge in renewable energy projects. For this reason, the second program has the same objectives as the first, but the relative weighting of its components is reversed to meet final demand.

1.3 This operation will also ensure the availability of IDB financing to fulfill in an initial phase the Bank's cofinancing commitment to the Renewable Energy Financing Facility (REFF), funded from the Clean Technology Fund (CTF), which was recently approved by the Board of Executive Directors (ME-L1109).[2] The objective of the REFF is to boost power generation from renewable sources and to reduce greenhouse gas emissions by speeding the pace of investment in the renewable energy field in Mexico. The REFF combines CTF financing (US$70 million with a concessional element of around 45%) with amounts of at least equal size to be funded by the IDB and by NAFIN. The REFF would thus channel a minimum of US$210 million into the objectives mentioned.

1.4 The objectives mentioned in paragraphs 1.2 and 1.3 are recognized as sector priorities in the Report on the Ninth General Increase in Resources of the Inter-American Development Bank, document AB-2764 (Priority 3, Institutions for Growth and Social Welfare, including financial services to SMEs, and Priority 5, Protecting the environment and responding to climate change). Both priorities are reflected in sector strategies of the Bank approved this year (see link 1 and link 2). Finally, the two objectives were built into the Bank's country strategy with Mexico for the period November 2010-December 2012 (document GN-2595-1). The common theme between the two complementary components is the problem of access to credit, which they seek to target. The ME-X1010 CCLIP and the first

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[1] As with the first operation, Bancomext is not expected to participate in this program.

[2] Project ME-L1109 was approved by the Bank's Board of Executive Directors on 17 November 2011.

operation under it (ME-L1051) both envisioned financing for renewable energy-based power plants as a compensatory investment to offset the oil industry's emissions.

1.5 The macroeconomic context for this second program is different from the one that prevailed when the first program was launched. After contracting by 6.1% in 2009, in the wake of the global financial and economic crisis, the Mexican economy grew by 5.4% in 2010 and growth is projected at 3.8% in 2011. With a suitable policy mix and a recovering regional economy, credit to the private sector has been growing again, with low levels of nonperforming loans, provisioned to the extent of 180%.[3] The Mexican financial system found itself in a solid position, able to cope with the crisis successfully and, with appropriate monetary and fiscal policies and the availability of multilateral financing, market turbulence was avoided. Despite this success, and the significant measures adopted to control systemic risks, continuing uncertainty about international financial stability and economic performance mean that multilateral financing is still attractive.

2. The climate change issue and cofinancing of the CTF Renewable Energy Financing Facility – REFF (ME-L1109).

1.6 As explained in detail in the documentation for operation ME-L1109, Mexico faces significant challenges in addressing climate change through the reduction of greenhouse gas (GHG) emissions. According to its official communication to the United Nations Framework Convention on Climate Change (UNFCCC), Mexico ranks 13th in the world for total GHG emissions volume and is the second-biggest CO_2 emitter in Latin America after Brazil. In light of this situation, the Government of Mexico established the National Strategy on Climate Change and more recently, at the 14th UNFCCC meeting, it set a target to reduce GHG emissions to 50% of their 2002 level by the year 2050.

1.7 Investment in renewable energy is also needed from an energy security viewpoint. Mexico is an exporter of oil but it is a net importer of natural gas and oil derivatives, and it is forecast to become a net importer of crude oil, as well, by 2020. This explains why the government is pursuing a strategy to increase the weight of renewable sources in the country's energy mix.

1.8 Mexico has a renewable energy potential that makes feasible and indeed recommendable a strategy focused on promoting alternative energy sources. Wind power represents an important opportunity estimated at 33,000 MW at least. Other significant opportunities lie in small hydroelectric plants (less than 10 MW), geothermal energy and biomass, the unexploited potential of which is estimated at 3,000 MW, 1,500 MW and 9,000 MW, respectively. The potential for solar energy is also substantial, and technologies exist for competitive exploitation in some market segments.

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[3] Bank of Mexico, Annual Report 2010, and Report on the Financial System to September 2011; 2011 IMF World Economic Outlook.

1.9 Nevertheless, despite the GHG reduction target and the drive to reduce dependency on fossil fuels and improve energy security, Mexico is not taking advantage of its enormous potential in renewable energies, essentially because financial and regulatory constraints are holding back the pace of these efforts (see CTF PIM and CTF study).

1.10 In recent years the Bank has developed a multiple strategy for addressing these problems with its own funds and those from the CTF. The CTF Investment Plan for Mexico (PIM), an initiative of the Mexican government approved by the CTF on 27 January 2009, presents a business plan adopted by the government and agreed with multilateral agencies for supporting GHG reduction objectives. The plan outlines the strategy, the sectors and the objectives that must be met through cofinancing by the IDB and the World Bank Group.

1.11 The CTF-PIM for Mexico finds expression in the IDB's contributions to improving the regulatory framework[4] as described in the ME-L1109 operation (paragraphs 1.12 and 1.13 of the loan proposal) which established the REFF. It should be noted that, although the Renewable Energy Act of 2008 established favorable conditions for the development of small-scale renewable energy producers, the complementary mechanisms and the necessary rules and regulations have not been fully developed. This has led private energy promoters to pursue the self-supply market, associating a generator with an energy-intensive business to pool resources and seek financing for the joint venture. Projects of this kind have benefited from recent regulatory changes that call for creation of an "energy bank," firm capacity contribution recognition, reduced and simplified transmission charges, and a transparent pricing system for sales to the Federal Electricity Commission (CFE). Yet developers still face significant risks (for example, the CFE's role as backstop in cases of breach of contract by the off-taker lacks clarity). Summing up, despite positive steps, the legal and regulatory framework for private initiatives in the power generation sector still presents barriers for the development of renewable energy projects.

1.12 In terms of financing for renewable energy development, the IDB provided partial financing (with $30 million from the CTF) for a private wind generating project, EURUS: with a capacity of 250.5 MW, it is Latin America's largest wind farm. Lastly, the CTF Renewable Energy Financing Facility (REFF, ME-L1109), in which the IDB is acting as executing agency for the CTF, seeks to increase investment in renewable energy and overcome the failures that are preventing greater development of renewable energy projects. As noted earlier, the REFF could provide a minimum of US$210 million to finance construction and operation of power plants that would produce electricity from renewable sources, with an installed capacity of approximately 1,000 MW. Typically, these funds will be

[4] Policy Based Loan (PBL) to Support Mexico's Climate Change Agenda (2186/OC-ME) for US$400 million; Residential Use of Renewable Energy and Energy Efficiency in Mexico (ATN/JC-11155-ME) for US$749,000; Sustainable Energy National Program (ATN/OC-11716-ME) for US$1 million; and Support for the Climate Change National Strategy I and II (ATN/MC-11399-ME), US$1 million.

earmarked for self-consumption projects, although the possibility of financing independent producer projects is not discounted. The present operation continues the IDB's commitment to cofinancing for the REFF, which until now has been met with resources available under the ME-L1051 operation, the first program under the CCLIP, which could be supplemented, if the Board of Executive Directors deems it advisable, with another individual operation under the CCLIP.

3. Problems facing SMEs: access to financing and global value chains

1.13 Mexican SMEs[5] are very important in economic terms: they account for 31% of employment and 26% of value added. Yet they represent less than 5% of total exports. Data from various studies reveal that low productivity is one of the endemic problems of SMEs.[6] The problem stems from a multiplicity of factors (for example scale, innovation, training, regulation, informality) among which access to financing under competitive conditions figures prominently.

1.14 One of the characteristics of SMEs is their flexibility and adaptability, which makes them a crucial element in the integration processes of the modern economy. From this broad perspective, the problems that SMEs face in integrating themselves into global value chains (GVC) reduce their growth opportunities. Participation in GVCs is an essential instrument for expanding activities and markets and increasing the productivity of SMEs. The impetus for integration into GVCs, however, requires support from the public sector in order to correct market failures that prevent their development and proper interconnection, and to promote spillover of economic opportunities to the smallest links in the chain.

1.15 Empirical evidence shows that Mexican SMEs have a problem of access to credit that involves multiple factors (Ramon Lecuona, 2009) but that can be summarized as higher interest rates, smaller financing amounts, less favorable maturities and stiffer collateral requirements than in the case of large firms.[7] The survey of business financing, conducted periodically by the Bank of Mexico (cited in the footnote) shows that around 50% of firms have no access to commercial bank credit and must finance themselves through other means (pledges, suppliers, family credit etc.). All the data reinforce the notion that the lack of credit reduces the growth potential of the SME sector and is particularly harmful to SMEs with the greatest capacity for technological and organizational improvements, by limiting medium-

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[5] The National Institute of Statistics and Geography (INEGI) defines SMEs as firms with between 11 and 100 employees in the service and agricultural sectors, and between 11 and 250 employees in the industrial sector. SMEs represent less than 5% (116,000) of all enterprises (although if microenterprises are included this percentage rises to 99.8%). The data presented in this paragraph follow the INEGI definition.

[6] C. Fereraro and G. Stumpo, in "SME Support Policies and Institutions in Latin America," ECLAC, July 2010, presented data for Mexico and indicators on SME productivity.

[7] Bank of Mexico, Quarterly trend in financing to businesses during April-June 2011, and Bank of Mexico, IDB, Banxico, and CNBV, National Competitiveness Survey, Business Financing Sources and Use of Financial Services. Government of Mexico, National program of promotion and access to financing for SMEs, 2001-2009.

and long-term financing. Public intervention to correct this market failure uses many financial instruments to ensure more systematic access for SMEs to credit through commercial banks. In this way, small enterprises can develop a credit and banking track record and the database needed for a better understanding of each enterprise's problems and potential.

1.16 One of the most important value chains in Mexico is led by the national enterprise Pemex, the petroleum industry leader. This key sector in the Mexican economy represents about 5% of the economy's gross value added, it contributes 40% of government revenues, and accounts for nearly 50% of the country's infrastructure investment. The Petróleos Mexicanos Act (November 2008) calls for a national supplier and contractor development strategy to increase the domestic supply component with a view to initiating a strategy for developing productive chains. In pursuit of this strategy, as it relates to medium- and long-term financing needs, the Pemex Act provides for establishment of a trust within NAFIN to promote the development of domestic suppliers and contractors for the state oil industry in order to channel financing to SMEs in combination with NAFIN action.

1.17 In 2010 Pemex was working with 6,800 SME suppliers and contractors in a wide variety of fields.[8] The average size of an SME supplier to Pemex, in terms of sales (NAFIN data) is larger than it is in other sectors. Of course, averages conceal a great diversity and the survey of current and potential suppliers to the national oil industry conducted by the Bank found that financing needs were greater among SMEs than among larger firms. SMEs are more likely to report lack of machinery and inadequate technology, and are more likely to lack lines of credit or to have had loan applications rejected.

1.18 The existing literature on the impact of credit access in terms of SME productivity and competitiveness is still limited. However, a series of recent studies have in a general way demonstrated the relationship between a higher level of credit to the private sector and an increase in productivity (see Monitoring and Evaluation Plan). In the specific case of Mexico, the Comprehensive Evaluation 2008-2009 of the Support Fund for Micro, Small and Medium-Sized Enterprise (Fondo PyME) conducted by the Technological Studies Center of the Monterrey Technology Institute examined the change in total factor productivity as a direct result of programs. For the sample of SMEs benefiting from the fund's programs of access to financing in 2007 in the city of Puebla, the results showed a productivity increase of 4.9%.

1.19 In short, lack of access to credit and constraints on forming into global value chains constitute important restrictions on the growth of SME sales and productivity.

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[8] The Pemex Directory of Suppliers and Contractors (DIPC) has information on current and potential suppliers to Pemex, making it possible to determine their approximate relative size and the goods and services categories in which SMEs participate. These range from electrical equipment, valves, generators, machine tools and pumps to work clothing and footwear, cleaning products and spare parts for processing plants.

4. Nacional Financiera and its role in financing SMEs

1.20 NAFIN is a national credit institution with the mandate to promote savings and investment and provide financial and technical support for Mexico's industrial and economic development. NAFIN currently channels 99.9% of its development activities to the private sector; it has also consolidated its position as a second-tier bank, reducing its first-tier banking activities from 30% in 2000 to 8% at end-June 2011.

1.21 NAFIN has played a decisive role in promoting financing in Mexico and has been a catalyst in increasing the supply of private-sector financing to the SME sector. Its most important programs include: (i) Productive chain program: This program benefits large companies with low credit risk and their suppliers that use invoice discounting; (ii) Guarantees and indirect credit: with this product, NAFIN shares the credit risk with commercial banks; (iii) Microenterprise: this program provides lines of credit at terms of up to two years for working capital and the purchase of fixed assets, benefiting a large number of borrowers; and (iv) Equipment: the importance of this program has decreased in recent years.

1.22 NAFIN's activity is concentrated in short-term financing.[9] However, in partnership with financial intermediaries, NAFIN has established a strong record of lending to SMEs, which could be medium- and long-term borrowers of investment loans.

1.23 NAFIN is a solvent institution with solid risk management practices and the full backing of the Mexican government for its operations. As of June 2011, its net worth was US$1.282 billion. Despite the volatile environment and the decline in economic activity due to the financial crisis, NAFIN generated net profit of US$76 million in 2010, and profits to end-June 2011 were US$87 million. Additional positive indicators of its financial position include portfolio past-due, loan loss provisions, reserves, and capitalization levels.

5. Problems identified and solutions proposed

1.24 Financing is a significant barrier to the development of renewable energy projects in Mexico, due to their characteristics: (i) the high initial investment costs; (ii) the banks' reluctance to develop new lines of business; (iii) the lack of experience in analyzing and structuring renewable energy projects where the regulatory risk is also relatively new for the banks; (iv) the fact that renewable energy projects are jointly developed by a producer and a large consumer (under the self-consumption regulatory model), meaning that risk profiles of clients with different credit histories must be combined; and (v) the lack of regulatory incentives. All these factors have resulted in the lack of adequate financial instruments to support renewable energy projects, which translates into high transaction costs and high interest rates and/or excessive collateral requirements.

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[9] Within its peso-denominated portfolio (85.3% of the total portfolio), which amounts to Mex$122.922 billion excluding mandatory reserves, 51.2% of credits are at terms of up to one year and 14% are between one and two years.

1.25 The leveraging of funds earmarked for financing renewable energy from this second individual operation under the ME-X1010 CCLIP with concessional funding from the CTF and funding from NAFIN will make it possible to begin financing renewable energy projects through direct loans to businesses, or through contingent lines to cover cash shortfalls that emerge during the life of the project. The program should also have a demonstration effect for these projects and, indirectly, contribute to the financial sector's capacity in the renewable energy field. The direct scope of this intervention, using conservative estimates, could expand the country's generation capacity by 1,000 MW (based on a total investment of US$210 million), mobilizing around US$1.54 billion from other sources and reducing GHG admissions by some 2 million metric tons of CO_2 equivalent per year once the plants are commissioned. The additional scope stemming from the demonstration effect is estimated at another 2,000 MW of installed capacity using renewable sources.

1.26 Problems of access to financing are also a constraint on the growth of SMEs and their integration into global value chains that will expand their business opportunities and enhance their productivity. The present operation would provide up to US$10 million to financial intermediaries through NAFIN for medium- and long-term financing to current and potential SME suppliers of Pemex (registered in the Pemex Suppliers Directory), with a view to inducing productivity and competitiveness gains that will allow them to grow and/or insert themselves at every link of the value chain and thereby capture the benefits that, in terms of growth and the learning curve, will flow from direct or indirect linkages with large companies.

1.27 Given that the dimension of the problem identified is out of proportion with the expected size of this SME component, the operation does not constitute a definitive solution. The size of the loan (US$10 million) compared to the Pemex market (total purchases in 2010 of US$14.2 billion and SME purchases of US$1.5 billion) is relatively insignificant, yet this operation cannot be viewed in isolation, but rather must be understood in the broader context of the CCLIP and the strategy of Pemex and the government to support Mexican SMEs, now being pursued through multiple actions and programs. Moreover, a full appreciation of the program's scale should take into account the demonstration effect on financial intermediaries, which will thereby become familiar with the problems and the potentials of SMEs, with a consequent positive impact on future credit.

B. Objectives and components

1.28 The general objective of the second individual operation is two-pronged: (i) to contribute to Mexico's effort to enhance the share of renewable energy in power generation and thereby reduce GHG emissions; and (ii) to help strengthen the competitiveness of SMEs that are part of the national oil industry's value chain, by channeling medium- and long-term financing to them.

1.29 The specific objectives of the program are: (i) to increase investment in renewable energy generation projects; (ii) to familiarize the Mexican banking system with investments in renewable energy generation; and (iii) to support development of SME suppliers and contractors involved in the oil industry's value chains, complementing the actions of the Trust Fund to Promote the Development of National Suppliers and Contractors for the State Oil Industry.

1.30 The final impact of this operation will be, on one hand, an increase in power generation from renewable sources and the consequent reduction in GHG emissions and, on the other hand, an increase in the percentage of the oil industry's purchases from SMEs.

1.31 The program will have the following components: **Component I.** Loan to NAFIN for use in cofinancing operations eligible for the Renewable Energy Financing Facility (REFF) together with CTF and NAFIN resources. By means of this program, NAFIN, acting as a first- or second-tier institution, will channel funds in the form of loans or contingent lines of credit to the developers of power generation plants using renewable sources. This component is expected to consume approximately US$40 million. **Component II.** SME credit: this component will provide funds to NAFIN so that it can offer medium- and long-term credit lines to financial intermediaries (with NAFIN acting as a second-tier institution) for credits and lease financing geared to SME providers and contractors in the Pemex chain, classified as such under the program's Operating Regulations. This component will consume approximately US$10 million.

C. Outcome indicators

1.32 The monitoring and evaluation system for the proposed program will be based on the performance indicators included in the program Results Matrix (Annex II). The indicators for measuring impacts will be: (i) annual power generation from renewable sources (GWh) financed by the REFF and the annual contribution to reducing or stabilizing CO_2 equivalent emissions (MT CO_2) after commissioning of the plants financed by the REFF, in each case with respect to the program's primary objective; and (ii) the percentage of SME purchases by the oil industry, with respect to the results of the SME objective.

1.33 The outcome measurement indicators would be, for the first component: (i) total investment in power generation using renewable energy (US$ millions) taking into account the investments financed by the REFF; (ii) total generating capacity from renewable energy (taking into account REFF and other investments stemming from the learning and demonstration effects). For the SME objectives, the outcome indicators would be: (i) increase in revenue from annual sales of SMEs who benefit from medium- and long-term financing from financial intermediaries with NAFIN lines and participating in the oil industry's value chains (as a proxy for the increase in their productivity); (ii) the percentage that medium- and long-term loans from financial intermediaries to SMEs represent in the NAFIN portfolio; and (iii) weighted average life of SME credits funded by NAFIN.

II. STRUCTURE OF THE OPERATION AND RISKS

A. Component for cofinancing the REFF (approximately US$40 million)

2.1 The Renewable Energy Financing Facility (REFF) will finance power generation projects based on renewable energy that are considered eligible in light of a series of conditions. NAFIN will select a portfolio of projects that meet program conditions, established in the program's Operating Regulations, and will finance them either by itself or through other financial intermediaries, using direct loans or extending contingent lines of credit to the developers. The minimum leveraging level agreed means that all REFF operations will be financed from resources provided by the CTF (US$70 million), the IDB (from the current ME-X1010 CCLIP, operation ME-L1051, this operation, or any others that may be submitted to the Board of Executive Directors for consideration), and NAFIN's own funds. This operation thus contributes to bringing the amount of operation ME-L1109 (REFF) to US$210 million.

2.2 There is no prefixed proportion for the total quantity that NAFIN will devote to direct loans or contingent lines of credit: that proportion will be set by relative demand.

2.3 Eligibility conditions for projects will seek to maximize the results targeted by the CTF. The maximum amount of CTF resources per project will be US$10 million, and the REFF share in the financing of each project will be limited as a general rule to 50%. As well, technological and geographic diversification will be sought (with a rule that no more than 65% of the REFF investment should go to wind farms in Oaxaca, with its exceptional wind conditions). Given the number and nature of the eligibility conditions, NAFIN will allocate the available REFF funds in line with its procedures and by order of submission. The cost for the end borrower will reflect the combined cost of the funding sources involved and the project risk margin that NAFIN applies. The amortization period will be adapted to the type of project: for example, with wind projects the amortization periods would be between 10 and 15 years.

2.4 Consequently, it is not possible to determine a priori the conditions that the end borrower will face, as these will depend on the nature and characteristics of the individual project. NAFIN will provide the Bank with all the information needed to understand product price setting and to confirm that the concessional element implicit in the CTF funds is being passed on to the project developer.

B. Component to promote SMEs in the Pemex chain (approximately US$10 million)

2.5 NAFIN will fund first-tier financial institutions to lend or open lines of credit to SMEs in the national oil industry's supplier and contractor chain. It is important to specify that every participating intermediary financial institution will assume the credit risk for the final sub-borrower and will analyze the project to be financed, make the credit decision, and set the terms and conditions in light of the risk

assumed. In this way, the program design and the pass-through mechanism will ensure that: (i) interest rates are adequate to ensure the expected return on capital used in each specific operation; and (ii) firms that receive funding from the program will be profitable, as the result of a double market auction (all banks, seeking the best firms, and all interested firms, seeking banks that offer the best rate).

2.6 This operation fits within the Mexican government's broader policy of promoting SMEs, as well as the program for expanding SME participation and national content in government procurement. It is also expected that information supplied by NAFIN and the financial intermediaries can be used to measure the effect of financing to SMEs, or "tractor" projects that will stimulate business for other SMEs downstream.

C. Principal risks

2.7 As concerns the REFF cofinancing component, the risks are the same as those for operation ME-L1109. They are described in detail in the risk matrix. Among the risk factors studied (regulatory, donor, project etc.), the most singular is the regulatory risk, as inappropriate regulation in the energy sector can frustrate all the efforts to increase investment in renewable energy. In general terms, the project team considers the risk low, in light of the commitments given by the Government of Mexico, the wealth of unexploited renewable resources, and the potential for growth and employment in the sector, both from the environmental viewpoint and from a strictly economic perspective.

2.8 **Environmental and social risks of the REFF.** The Environmental and Social Strategy considers this program, under the Bank's Environment and Safeguards Compliance Policy (OP-703), as a flexible lending instrument for which ex ante classification of environmental impacts is not feasible (Directive B.13). Therefore no classification of the operation's potential impact is required. Although renewable energy generation projects contribute to a better environment, wind farms and hydroelectric plants and biomass generation can have locally adverse environmental and social impacts, which will vary by project. Mexico has made considerable progress with its environmental standards for wind projects, and NAFIN has been acquiring experience through the EURUS project and with World Bank assistance. In any case, NAFIN will evaluate each project in terms of these risks and will adopt appropriate mitigation measures. The Environmental and Social Management Report (ESMR) describes the broad lines of action to guarantee proper management of these risks, and is essentially supportive of the REFF strategy.

2.9 From the viewpoint of the SME component, the only important risk is that of a downturn in the Mexican economy, sparked by a possible recession in the United States, which would reduce SME demand for financing and/or would increase the past-due component of the portfolio. Given the essentially countercyclical nature of the public banking system, a reduction in economic growth should enhance rather than diminish the importance of NAFIN funding. The same argument holds for a financial crisis that might impact liquidity and credit. In the current uncertain

environment it is difficult to gauge the probability of a US (or global) recession, but financial supervision and the capitalization levels of the Mexican banking system suggest that the impact of a sudden stop in credit could be less than on previous occasions.

2.10 There are financial and fiduciary risks common to both components of the operation. With respect to the first, because the operation is guaranteed by the Mexican government, there is no apparent credit risk for the Bank. NAFIN's franchise value is well established, and it has robust policies and procedures for managing its balance sheet. The set of policies and procedures designed to control NAFIN's financial risks, then, complies with best international practices.

2.11 The fiduciary risk also appears low. NAFIN has been the borrower in many operations with the Bank throughout its history. In 2009 the Bank conducted an institutional capacity analysis of NAFIN (see report), analyzing its structure, organization and processes. All the conclusions of that analysis, as well as recent experience with execution of loan ME-L1051, lead to the conclusion that NAFIN systems are adequate and reliable (see Annex III). The level of institutional capacity and the segregation of responsibilities and records were confirmed during the financial visit conducted on 22 September 2011 (see report). NAFIN will present annual audited financial statements for the program to the Bank.

III. SUMMARY OF IMPLEMENTATION ARRANGEMENTS

A. Implementation arrangements

3.1 The borrower and executing agency for the program will be Nacional Financiera, S.N.C. (NAFIN), with the United Mexican States serving as guarantor.

3.2 NAFIN will execute the program under its current organizational structure. The provisions governing program execution, financial intermediaries' participation, and eligibility of individual loans will be established in the Operating Regulations agreed by the Bank and NAFIN, in accordance with NAFIN and Bank standards and policies, Mexican laws, and practices in Mexico's financial industry

3.3 **Procurement**. As this is primarily a demand-driven program, no purchases of works, goods and services or consulting services have been identified for the program. The Bank's policies and common practice will apply when it is determined whether the end borrowers are private entities or public ones.

3.4 **Disbursements, execution period, and reimbursement of expenses**. Program resources will be committed and disbursed within 48 months following the effective date of the loan contract. The Bank may recognize and reimburse expenses incurred by NAFIN for the program since 18 October 2011 up to a maximum of US$10 million.

3.5 **Disbursement mechanism for the REFF cofinancing**. The disbursement mechanism is identical to that for CTF resources in operation ME-L1109, by which the REFF was established. Essentially, NAFIN will request simultaneous

disbursements from this loan and ME-L1109 (CTF) to fund the REFF. However, circumstances may require non-pari-passu disbursements. Recognizing the need to preserve the leverage ratio at the program level, the contract will provide a mechanism for non-simultaneous disbursements which will limit and correct any imbalances over time. **As a condition precedent to the first disbursement of the program, the executing agency must have approved entry into force of the Operating Regulations previously agreed with the Bank.**

3.6 The Bank will disburse funds to NAFIN in the case of resources for financing direct subloans through reimbursements or advances, in accordance with the Bank's normal practice on the basis of portfolio programming (advances) or the portfolio committed by NAFIN. In the case of funds earmarked for funding contingent credit lines (CCLs), the Bank will disburse them against presentation of the corresponding contracts establishing those lines with the developers. Subsequent verification of CCL disbursements will be subject to the annual review by the program's external auditors, over a period of time that extends beyond execution and will be agreed in the contract and reviewable by the Bank in the future.

3.7 **Disbursement mechanism for funds earmarked to finance SME contractors or suppliers to Pemex**. The two mechanisms contemplated in the first CCLIP program (ME-L1051) will be used: (i) advance of funds; and (ii) reimbursement of expenditures, including on-lending of NAFIN's own resources in accordance with the policy. A condition precedent to the first disbursement is the entry into force of the Operating Regulations, which must have the Bank's no objection.

3.8 **Use of program recoveries**. Program recoveries, whether payments, prepayments, cancellations or terminations of subloans or CCLs, that accumulate in excess of the amounts needed to service the loan, for seven years running from the date of the last disbursement, will be used to finance new operations consistent with program objectives.

B. Monitoring and evaluation arrangements

3.9 **Reports.** The program will be monitored through semiannual reports prepared by the executing agency, measuring progress against the indicators in the Results Matrix and the reports indicated in the General Conditions.

3.10 **Evaluation**. The evaluation will be based on a before-after comparison and will be set out in a midterm and final report with the outcomes obtained vis-à-vis the Results Matrix. This methodology is appropriate for the REFF component (number of potential beneficiaries, small; the contrasted attribution and baseline ratio, availability and robustness of the indicators, clear and very high). With regard to the SME component, the attribution of results to the program is more complex and the program's impact compounds that of other external factors and even that of other SME support programs. This loan is an additional piece of a multi-pronged, broader, and ongoing strategy and, given its size with respect to the overall issue considered, the outcomes of a study attempting to isolate its impact from that of the other actions/factors would be of limited value. In any case, the Bank will try to

monitor the SME support strategy in an immediate future based on a more complete impact study that takes into account the implementation actions of the ME-X1010 CCLIP as a whole and the highest possible number of variables.

3.11 **Information**. NAFIN, in observance of legal recordkeeping obligations, will compile and store all information, indicators and parameters, including annual work plans, midterm review and final evaluation required to prepare the Project Completion Report and the ex post review that the Bank will conduct.

3.12 **Audits.** NAFIN will present to the Bank its own financial statements and those of the program, duly audited by an independent firm acceptable to the Bank. The audit will be performed in accordance with terms of reference previously approved by the Bank and agreed with the SFP. The annual and final audit reports will be presented up to 120 days after the close of the period, fiscal year, and date of last disbursement, respectively. In the case of the CCLs, the annual audit must reflect the use that has been made of the funds committed via that route, as well as the income those funds generate while they are held undisbursed in the program account.

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	Aligned		
Lending Program	Lending to support climate chance initiatives, renewable energy and environmental sustainability.		
Regional Development Goals	(i) Stabilization of CO2 equivalent emissions (metric tons per habitant), (ii) Countries with planning capacity in mitigation and adaptation of climate change, and (iii) Percent of firms using Banks to finance investments.		
Bank Output Contribution (as defined in Results Framework of IDB-9)	(i) Percentage of power generation capacity from low-carbon sources over total generation capacity funded by IDB, (ii) Climate change pilot projects in agriculture, energy, health, water and sanitation, transport, and housing , and (iii) Micro/small/medium productive enterprises financed.		
2. Country Strategy Development Objectives	Aligned		
Country Strategy Results Matrix	GN-2595-1	The operation is aligned with Country Strategy objectives: "implementing the climate change mitigation and adaptation agenda" and "Increase access to financing MSMEs".	
Country Program Results Matrix	GN-2617	The operation was not included in the 2011 Country Program Document.	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability	Highly Evaluable	Weight	Maximum Score
	8.0		10
3. Evidence-based Assessment & Solution	6.4	25%	10
4. Ex ante Economic Analysis	10.0	25%	10
5. Monitoring and Evaluation	5.4	25%	10
6. Risks & Mitigation Monitoring Matrix	10.0	25%	10
Overall risks rate = magnitude of risks*likelihood	Low		
Environmental & social risk classification	B.13		
III. IDB´s Role - Additionality			
The project relies on the use of country systems (VPC/PDP criteria)	Yes	The operation will use the financial management systems of NAFIN.	
The project uses another country system different from the ones above for implementing the program			
The IDB's involvement promotes improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	Yes	CTF Resources (ME-T1168) will be used to strengthen NAFIN's institutional capacity on environmental issues.	
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan.			

This project contributes to the IDB Strategic Objectives "Lending to support climate chance initiatives, renewable energy and environmental sustainability", to the Regional Development Goals "Stabilization of CO2 equivalent emissions", "Countries with planning capacity in mitigation and adaptation of climate change" and "Percent of firms using Banks to finance investments" and to the outputs "Percentage of power generation capacity from low-carbon sources over total generation capacity funded by IDB" and "Climate change pilot projects in agriculture, energy, health, water and sanitation, transport, and housing" and "Micro/small/medium productive enterprises financed". The project is aligned with the country strategy, but it is not included in the CPD 2011.

The project includes two components. The first aims at supporting investment in renewable energy; the second aims at improving the access to finance of SMEs of the oil value chain. Although the two components are relatively well justified, the logical connection between them is not completely clear. Also, the dimensioning of the second component should have better justified. The project metric includes valid indicators at all levels, though some outcome indicators related to the second component could have been more specific. The economic analysis is complete and based on reasonable assumptions, though a broader set of benefit could have been analyzed for the second component. The project document includes a monitoring and evaluation plan. The proposed evaluation methodology is reflexive (before after comparison). The risk matrix is complete, including mitigation measure and indicators to track their implementation.

RESULTS MATRIX
ME-L1081; ME-1010

Program objectives	(A) contribute to Mexico's effort to enhance the share of renewable energy in power generation and thereby reduce GHG emissions; and (B) help strengthen the competitiveness of SMEs that are part of the national oil industry's value chain, by channeling medium- and long-term financing to them
Specific objectives	(1) increase investment in renewable energy generation projects; (2) familiarize the Mexican banking system with investments in renewable energy generation; and (3) support development of SME suppliers and contractors involved in the oil industry's value chains, complementing the actions of the Trust Fund to Promote the Development of National Suppliers and Contractors for the State Oil Industry.

OBJECTIVE A (REFF). To contribute to Mexico's effort to enhance the share of renewable energy in power generation and thereby reduce GHG emissions.

Indicators	Unit	Base (2010)	Year 1	Year 2	Year 3	Year 4	Objective	Description
OUTPUTS								
1. Renewable energy generating plants financed by REFF	Number	0	1	3	3	3	10	Project information from NAFIN as well as the Energy Regulatory Commission (CRE) and the Federal Electricity Commission (CFE).
2. Installed capacity for renewable energy generation financed by REFF	MW	2,282	2,432	2,682	2,982	3,282	3,282	Monitoring: *same as above*.
3. Financing by third parties mobilized for the program	US$ millions	0	231	385	462	462	1.540	Information from NAFIN. Estimate based on a debt/equity ratio of 70/30 in projects, cost of US$2.5 million per MW and US$210 million in funding for the REFF program.
4. Number of financial intermediaries cofinancing projects (not NAFIN).	Number	0	1	3	3	3	10	Information from NAFIN.

Indicators	Unit	Base (2010)	Year 1	Year 2	Year 3	Year 4	Objective	Description
RESULT OF SPECIFIC OBJECTIVE 1: Increase investment in power generation projects using renewable energy								
1. Investment in power generation from renewable sources taking into account investments financed by REFF	US$ millions	4.564	4.939	5.564	6.314	7.064	7.064	Information from NAFIN. Estimate based on an investment cost of US$2.5 million per MW.
RESULT OF SPECIFIC OBJECTIVE 2: Familiarize the Mexican banking system with investments in power generation using renewable energy								
1. Total renewable energy generation capacity, taking into account REFF investments and new investments induced by the demonstration effect	MW	2,282					5,282	Learning and demonstration effects could result in financing of renewable energy generation plants for another 2,000 MW. This estimate is supported by CRE projections to 2015. Information would be obtained from the CRE and from the CFE.
PROGRAM IMPACTS (OBJECTIVE A)								
1. Annual renewable energy generation financed by REFF	GWh	10,309	10,862	11,784	12,891	13,998	13,998	Estimate based on the average use factor for plants in Mexico. To be verified with annual plant use data from CFE.
2. Annual contribution to reducing/stabilizing CO_2 equivalent emissions once the plants financed by REFF are commissioned.	TM CO_2	0	301,686	804,497	1,407,869	2,011,242	2,011,242	Estimate based on forecast output, using the IDB methodology. Monitoring by the IDB and CRE/CFE information.

OBJECTIVE B. To help strengthen the competitiveness of SMEs that are part of the national oil industry's value chain, by channeling medium- and long-term financing to them.

Indicators	Unit	Base line	End Year 1 (Dec/12)	End Year 2 (Dec/13)	Objective	Description and observations
OUTPUT						
1. New medium- and long-term lending by intermediary financial institutions (IFIs) with NAFIN credit lines to SMEs in the oil industry value chains	Number	0	6	6	12	The indicator will measure the number of SMEs that received medium- and long-term loans funded by the program. Information to be provided by NAFIN, based on data from the Trust Fund and financial intermediaries.

Indicators	Unit	Base line	End Year 1 (Dec/12)	End Year 2 (Dec/13)	Objective	Description and observations
RESULT OF SPECIFIC OBJECTIVE 3: To support development of SME suppliers and contractors involved in the oil industry's value chains, complementing the actions of the Trust Fund to Promote the Development of National Suppliers and Contractors for the State Oil Industry**.**						
1. Increase in annual sales by SMEs financed by the program *	Percentage	n.a.	22	22	22	The indicator will measure sales growth for SMEs that obtain funding from the program. The increase in sales is a proxy for the increase in SME productivity. Information sources: NAFIN and PEMEX databases.
2. Percentage of medium- and long-term loans by IFIs to SMEs in the NAFIN portfolio	Percentage	27.5	30	32	32	The indicator will measure the level of medium- and long-term lending by NAFIN to SMEs, as a percentage of total credit granted. Information source: NAFIN portfolio.
3. Weighted average life of new loans to SMEs with NAFIN resources	Months	30.89	34	36	36	The indicator will measure the weighted average life (in months) of new loans to SMEs funded by the program. Information source: NAFIN portfolio.
PROGRAM IMPACTS (OBJECTIVE B)						
1. Percentage of SME purchases by the oil industry	Percentage	11	11	12	12	Information source: future monitoring, Trust Fund indicators, NAFIN and PEMEX databases.

* The level of annual sales by beneficiary SMEs will only be known when the firms are identified, after which the baseline for this outcome will be established.

FIDUCIARY AGREEMENTS AND REQUIREMENTS

COUNTRY: MEXICO

PROJECT NUMBER: ME-L1081

NAME: Second Individual Operation under the Expanded CCLIP to Support Business Development in Mexico

EXECUTING AGENCY: Nacional Financiera, S.N.C (NAFIN)

PREPARED BY: Gloria Coronel (Lead Specialist in Project Financial Management) and Raúl Lozano (Senior Procurement Specialist)

I. EXECUTIVE SUMMARY

This is the second operation under the CCLIP (ME-X1010) for NAFIN, an autonomous government agency established in 1934. The first operation, ME-L1051 financed with loan 2226/OC-ME, was approved in 2009 and became eligible and had its first disbursement in 2011. For the initial operation, an institutional capacity assessment (ICAS) was performed, resulting in an average overall rating of 97.94%, demonstrating an advanced level of development and institutional capacity. That assessment remains valid. In addition, the financial fiduciary team conducted an accounting visit in September 2011 and confirmed the level of development and institutional capacity of NAFIN and the segregation of funds and expenditures financed with resources from loan 2226/OC-ME.

The purpose of the present operation is: (a) to continue support for SME suppliers and contractors to the oil industry, and (b) to supplement financially the Renewable Energy Financing Facility (ME-L1109) financed from the Clean Technology Fund (CTF) resources. NAFIN will provide financial oversight for each operation in separate accounts to facilitate control and accountability for each operation

II. THE FIDUCIARY CONTEXT OF THE EXECUTING AGENCY

For the financial aspects, NAFIN employs a two-currency accounting system—U.S. dollars and Mexican pesos—for which it uses the exchange rate on the date of payment for conversion to U.S. dollars of payments made in Mexican pesos. For credits granted to the first and second-tier banking system, NAFIN uses the Institutional Portfolio Records and Administration System (SIRAC). The information summarized in the SIRAC is tallied daily and reconciled in the Integrated Financial System (SIS). As a bank regulated by the National Banking and Securities Commission (CNBV), NAFIN

must reconcile its accounts on a daily basis. The financial fiduciary team confirmed the strengths of the accounting aspects and the internal control environment. No weaknesses were detected in these areas.

III. Fiduciary Risk Assessment and Mitigation Measures

Contingent credit lines (CCL). The present program, under the component for funding NAFIN to cofinance operations eligible for the Renewable Energy Financing Facility (REFF), together with CTF funds (ME-L1109) will finance CCLs. For disbursing financing for the CCLs, NAFIN will present to the IDB the signed contract committing resources for the CCL, the resources of which will be disbursed sometime after the disbursement period established by contract. NAFIN will maintain the loan proceeds in separate bank accounts, and its accounting records will allow for identification of program funds and their recoveries. NAFIN will present annual audited financial statements to the IDB during program execution, and for the funds disbursed for the CCLs it will present annual audited financial statements for the period required to justify use of the funds disbursed for the CCLs.

ICAS. The 2009 ICAS questionnaires on NAFIN produced scores ranging from 96.46% to 100.00% in each of the functional areas assessed, namely:

- Programming and organization Capacity (POC)
  1. Activities Programming System (PAS)
  2. Administrative Organization System (OAS)
- Execution Capacity (EC)
  1. Personnel Management System (PMS)
  2. Goods and Services Management System (GSMS)
  3. Financial Management System (FMS)
- Control Capacity (CC)
  1. Internal Control System (ICS)
  2. External Control System (ECS)

In the procurement area, the average ICAS score was 86.27% for NAFIN's institutional capacity as executing agent for procurement, which, according to the methodology, demonstrates a <u>sufficient development</u> level for program execution and hence a <u>low risk</u> for all aspects included in the evaluation.

With respect to Programming and Organization Capacities (POC), the score is 98.15%, implying <u>sufficient development</u> and <u>low risk</u>. For Execution Capacity (EC), the score is 96.46% which also reflects sufficient development and low risk. Finally, the assessment of control capacity yielded a score of 100%, again implying <u>sufficient development</u> and

low risk. In conclusion, the average weighted score is 97.94%, which represents a sufficient development and low risk.

IV. Aspects to be Considered in the Special Clauses of Contracts

In order to facilitate contract negotiation for the project team and, primarily, the Legal Department (LEG), the following is a list of those agreements and requirements that must be considered in the special clauses:

a. Conditions precedent to first disbursement: establish an internal bank account within NAFIN and a special account specifically for receiving and recording the loan proceeds relating to the component that will cofinance eligible operations under the Renewable Energy financing facility (REFF) together with resources from the CTF-funded loan.

b. The exchange rate for accounting purposes as agreed with the executing agency will be the exchange rate on the day the payment is recorded in the NAFIN accounting systems, in accordance with Mexican government regulations.

c. In addition, with respect to the Component I funding in support of the REFF, NAFIN will present audited financial statements following the disbursement term for a period of time to be agreed with the Bank, in order to document application of the funds disbursed for CCL.

d. As this is primarily a demand-driven program, no purchases of works, goods, services or consulting services have been identified for the program. When the end borrowers are private entities they must use procurement procedures according to market practice and acceptable to the Bank, in accordance with Appendix IV of the Bank's procurement policies. When the end borrowers are public entities other than those listed in paragraph 3.12 of the procurement policies, they will apply the corresponding sections of Bank policies for the selection and contracting of consultants (document GN-2350-9) or the policies governing the procurement of goods and works financed by the Bank (document GN-2349-9).

e. Prior to carrying out any procurement process, the executing agency will submit the respective procurement plan to the Bank for review and approval, pursuant to the aforementioned procurement policies. During program execution, the plan will be updated at least every 12 months, and all updates will be submitted for Bank review and approval. Procurement will be conducted in accordance with the procurement plan, which will indicate those contracts to be reviewed ex ante and ex post.

V. Agreements and Requirements for Procurement Execution

In the event that loan-financed procurement were to become necessary, the fiduciary agreements and requirements for procurement set forth the applicable provisions:

a. **Procurement execution. Procurement of Works, Goods and Services Other Than Consulting Services:** The contracts for works, goods and services other than consulting

services[1] generated under the project and subject to International Competitive Bidding (ICB) and bidding subject to National Competitive Bidding (NCB) will also be carried out using Bidding Documents coordinated between the Civil Service Secretariat (SFP) and the Bank, and will serve to guide the selection and contracting procedures financed with resources from external loans. They are available on line at: (http://www.funcionpublica.gob.mx/unaopspf/credito/normace.htm). The project sector specialist is responsible for reviewing technical specifications for procurement during the preparatory phase of the selection processes.

b. **Selection and contracting of consulting firms:** Consulting services contracts with firms financed with project funds will be executed using the Standard Request for Proposals (RFP) agreed upon with the Bank and the SFP, which will serve to guide the selection and contracting procedures financed with resources from external loans. Such guidelines are available on line at: (http://www.funcionpublica.gob.mx/unaopspf/credito/normace.htm). The project sector specialist is responsible for reviewing the terms of reference for the contracting of consulting services.

c. **Selection of individual consultants:** Consulting services contracts with individual consultants will be awarded using the model contract for individual consultants agreed upon with the Bank, available on line at: (http://www.funcionpublica.gob.mx/unaopspf/credito/normace.htm).

d. **Others:** It is projected that 100% of loan proceeds will be earmarked for NAFIN which, as a first-tier financial institution, will channel those resources to finance developers' renewable energy-based power generation plants, and as a second-tier bank, will finance lines of credit for financial intermediaries to provide loans and lease financing to SME suppliers and contractors in the Pemex chain.

When the end borrowers are private entities, they must use procurement procedures according to market practice and acceptable to the Bank, in accordance with Appendix IV of the Bank's procurement policies. They must also observe the provisions of Chapter III, Other Methods of Procurement, Section 3.12, Procurement in Loans to Financial Intermediaries.

1. Table of threshold amounts (US$ thousands)

In the event that loan-financed procurement were to become necessary, the following thresholds will apply:

[1] Policies for the Procurement of Goods and Works Financed by the Inter-American Development Bank (GN-2349-9), paragraph 1.1: Services other than consulting services are treated like goods.

Works			Goods[2]			Consulting services	
International Competitive Bidding	National Competitive Bidding	Shopping	International Competitive Bidding	National Competitive Bidding	Shopping	International Competitive Bidding	100% National Short List
>15,000,000	< 15,000,000 and > 500,000	< 500,000	>= 3,000,000	<3,000,000 and >100,000	<100,000	> 200,000	< 500,000

2. Main procurement processes

The executing agency has planned no procurement activities. It is projected that 100% of loan proceeds will be earmarked for NAFIN to channel those resources to finance developers' renewable energy-based power generation plants, and as a second-tier bank, to finance lines of credit for financial intermediaries for loans and lease financing to SME suppliers and contractors in the Pemex chain. When the end borrowers are private entities, they must use procurement procedures according to market practice and acceptable to the Bank, in accordance with Appendix IV of the Bank's procurement policies.

Main procurement categories

Activity	Bidding process	Estimated date	Estimated amount in US$
Goods & Works			
Component 1. Multiple loans and contingent credit lines to developers of power generation projects using renewable sources	Private sector	3 years	70 million
Component 2. Multiple credits and lease financing to SME suppliers and contractors in the Pemex chain.	Private sector	3 years	30 million

* To access the 18-month procurement plan, click here

3. Procurement supervision

Given the project's low level of fiduciary risk, inspection visits will be conducted on an annual basis, if procurement materializes. The executing agency's experience in previous operations, both as the executing agency and financial agent, was taken into account in determining the supervision schedule.

For the program's external audit and overall monitoring, an external auditing firm will conduct an ex post review of any procurement actions and will submit a special notes section with the procurement report, pursuant to the terms of reference agreed upon by the IDB and the SFP.

[2] Includes services other than consulting services.

Thresholds for Ex post Review

Works	Goods	Consulting Services	
15,000,000	3,000,000	500,000	

Note: Threshold amounts calling for ex post review are applied based on the executing agency's fiduciary capacity for program execution and may be modified by the Bank should there be changes in that capacity.

4. Special provisions

Measures to reduce the likelihood of corruption: The executing agency will be diligent in observing the provisions on fraud and corruption established in the Bank's procurement policies.

5. Files and records

The basic original documentation to provide evidence of expenditures to the Bank will remain on file with NAFIN. The Sustainable Projects Division will be responsible for consolidating program financial and procurement information and interfacing with the Bank.

VI. Financial Management

1. Programming and budget

NAFIN has an advanced level of development in its fiduciary systems and must apply national standards, established in the annual budget act issued by the Department of Finance (SHCP). Planning and programming functions and responsibilities are documented in the Financial Planning and Programming Manual, and in the planning policies authorized by the NAFIN Board of Directors and by Congress, pursuant to the act. There are clear, established programming and budgeting procedures certified under ISO 9001-2000. NAFIN has a corporate governance structure to monitor compliance with the plan, meetings are held in various spheres to track the indicators reported to the Board of Directors and to the different operational committees for each process.

2. Accounting and information systems

NAFIN has a financial information system (SIS) for accounting and financial records. This system integrates the information from the SIRAC used for management and supervision of NAFIN's loan portfolio. All financing transactions of the IDB will be registered by NAFIN in its own systems, using the exchange rate on the day of payment for conversion to U.S. dollars of payments in Mexican pesos. As a government agency, NAFIN uses International Public Sector Accounting Standards (IPSAS) and must also comply with the regulations established by the CNBV for banks in Mexico. NAFIN has a Loan and Operations Manual approved by the Board of Directors that specifies the nature, purpose, and outcomes of each operation, and describes operational, authorization, transfer, record keeping, and oversight procedures.

As indicated above, the 2009 ICAS found that NAFIN has an advanced level of development in its financial fiduciary systems, and that level of development, records and

segregation of responsibilities was confirmed in the financial fiduciary visit conducted in September 2011.

NAFIN as an entity is audited annually by (a) the Federal Auditor General (*Auditoría Superior de la Federación*, ASF), (b) the CNBV, and (c) a firm of external auditors. Consistent with IDB policy, NAFIN will present annual audited financial statements of the use of loan funds during the disbursement period. In addition, for Component I, financing for the REFF, NAFIN will present annual audited financial statements following the disbursement period and for a further period of time to be reviewed by the Bank in order to document the use or actual payment to beneficiaries of the funds disbursed for CCLs.

3. Disbursements and cash flow (in coordination with the use or not of the National Cash Management System)

Program resources will be deposited in a special account or one designated for the program. The funds may be on-lent to beneficiaries either directly by NAFIN or through credits to intermediaries which will then make loans to the final beneficiaries. For the CCLs of Component I, the funds disbursed by the IDB, against delivery of contracts signed by NAFIN and the beneficiary, will be kept in a special account or one designated for the program until they are required by the beneficiary, within a period that could exceed the program execution period.

NAFIN will establish a bank account and accounting records to manage and record payments for this operation. Loan disbursements may be made either as (1) advances of funds or (2) reimbursement of expenses. The following may be recognized as expenses: (a) payments made to suppliers/beneficiaries for eligible activities, and (b) contracts signed for contingent credit lines (CCL). Disbursements for expenses actually paid by NAFIN will be reviewed ex post.

As to any payments or disbursements by NAFIN to cover CCL commitments under Component I, NAFIN will present annual audited financial statements for as long after the disbursement period as is necessary (by agreement with the Bank) to document the actual use of the resources disbursed for the CCL.

4. Internal control and internal audit

The Federal Law on the Administrative Responsibilities of Public Servants regulates the activities of personnel who work in entities and agencies of the federal government. Thus, NAFIN has a code of conduct applicable to all employees. As well, NAFIN has an internal control body (OIC). Managers of the OIC are officials of the SFP and its staff are NAFIN employees or persons contracted for ad hoc activities. The SFP approves the annual work plan of the OICs and there are procedures for reporting and monitoring these activities. The OIC is responsible for monitoring compliance with the observations and recommendations made by the ASF, the CNBV, and the firm of external auditors.

5. External control and reports

As noted above, NAFIN is audited annually by the ASF, the CNBV and a firm of external auditors appointed by the SFP. Under the law establishing the responsibilities of

the SFP, the General Directorate of External Audits (DGAE) within the SFP coordinates the appointment of external auditors to audit projects financed by international financial institutions.

In July 2011, the IDB and the World Bank reached agreement with the DGAE on a short list of external audit firms eligible to audit projects financed by the respective IFIs. Similarly, CME/PDP and the World Bank's country office in Mexico have harmonized the general terms of reference, models and formats for audits with the central government in Mexico. These TORs are updated annually and are published on the webpage of the SFP-DGAE.

The audit of resources to finance the CCLs under Component I will be conducted subsequent to the disbursement period for a length of time agreed with the Bank as necessary to document the resources disbursed for the CCLs. This audit will also be a financial audit of the program under the TORs mentioned above.

6. Financial supervision plan

Supervisory activity	Supervision plan			
	Nature and scope	Frequency	Responsible party	
			Bank	Third-party
Operational	Review of technical progress of lending activities. Disbursements. Inspection visits to works on a sampling basis	Annual	Fiduciary and technical team	
Financial	Visit to review/validate control processes for proper recording and monitoring of eligible activities	Annual	Fiduciary team	External Auditor
	Ex post review of disbursements and financial audit	Annual		External Auditor
	Review of payments made by NAFIN after the IDB disbursement period for the CCLs of Component I.	Annual		External Auditor
	Review of disbursement requests and attached reports	Periodic	Fiduciary team	
Compliance	Annual allocation of budgetary resources needed for project execution	Annual	Fiduciary team	Executing agency
	Presentation of financial statements	Annual	Fiduciary and technical team	Executing agency/ External Auditor
	Conditions precedent to first disbursement	One time	Fiduciary and technical team	

7. Execution mechanism

The technical and financial execution mechanism will be centralized in NAFIN, and commitments and payments under the operation will be done by the respective technical and financial areas in NAFIN. Coordination with the IDB will be maintained through the International Agencies Directorate of NAFIN, the same area that serves as financial agent for operations with the Mexican federal government. See the POD for details on the execution scheme.

8. Other financial management agreements and requirements

As indicated in sections 3 and 5 of the chapter on financial management, NAFIN will present annual audited financial statements for a term after the disbursement period to be agreed with the Bank to document the resources delivered under Component I to support the financing of CCLs.