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REVIEW OF CARIBBEAN FINANCIAL SERVICES CORPORATION

538-0102

Arthur D. Little, Inc.
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A. EXECUTIVE SUMMARY

The major findings of our review of the Caribbean Financial Services corporation are described below:

- o The combination of a lean but effective staff and a cooperative board has provided CFSC with solid management during its first year of operations. Additions to staff of one to three professionals are planned over the next three years.
- o CFSC's marketing efforts have been based on personal contacts of CFSC management and the Board of Directors, cooperation with development organizations, and direct mailings of brochures and annual reports to banks, development banks, accountants, attorneys, and other major industrial enterprises. CPDF has been a particularly valuable source of leads for new projects but banks and other development organizations have not generally directed many worthwhile projects to CFSC. The overriding marketing objective during the first year of operations has been to develop high visibility for CFSC within its potential markets. CFSC's marketing program has successfully generated a solid flow of projects across a wide range of industry sectors and country markets. Marketing of CFSC's services in the future could be enhanced through a clearer understanding of CFSC's lending objectives by the commercial banks and a somewhat more aggressive marketing program overall.
- o Credit evaluation and risk control policies are thorough without imposing an unnecessary paperwork burden on either the bank or borrowers. Projects are being evaluated with a focus on the basic business and financial risks of the project, and consistency with CFSC's developmental objectives. Adequate but not excessive collateral is required of borrowers. Effective credit evaluation and follow-up is supported by a policy of requiring on-going credit evaluation to be carried out by the same CFSC staff member who initially reviewed a given project.
- o As of June 25, 1985, CFSC had committed to lend to fourteen companies a total of US\$3,400,000 of which US\$1,920,000 had been disbursed, leaving US\$1,230,000 undisbursed. The projects are distributed among Barbados, Antigua, St. Lucia, St. Kitts, and Guyana (not financed with USAID funds) and between the tourism, manufacturing, and agribusiness sectors. Most loans have been for plant expansion and/or equipment purchases, but one start-up venture has been financed. The Board of Directors has specifically limited start-up financings in CFSC's early years of operation in order to gain lending experience and to moderate risk. Future plans allow for a larger portion of new venture financing.
- o Our review of CFSC procedures and files uncovered few irregularities in compliance with the CFSC/USAID Loan and Grant Agreement. The specific cases noted and recommendations for their resolution are described in Section E, "CFSC Compliance with CFSC/USAID Loan and Grant Agreement".

- o Based on conservative estimates, minimum demand for CFSC credit which would qualify for USAID funding is about US\$12 million by 3/31/88 with additions beyond that of \$4 million per year. Maximum likely demand would be for almost \$22 million by 3/31/88 with additions of \$8 million per year.

B. INTRODUCTION

This written report responds to a request by the Caribbean Financial Services Corporation (CFSC) to:

- summarize present and projected CFSC operations and determine their relative development (as opposed to commercial banking) orientation;
- estimate expected credit demand through December 31, 1987 to determine if additional USAID loans could be on-lent;
- determine CFSC compliance with terms and conditions of the CFSC/USAID Loan and Grant Agreement; and
- recommend policy and procedural changes which could be introduced to improve CFSC operations.

In addition we have provided a variety of suggestions for the use of remaining grant funds prior to December 31, 1987.

The following information was developed during the period June 17, 1985 to June 27, 1985 through extensive discussions with CFSC personnel, members of its Board of Directors, selected shareholder representatives, USAID personnel and other persons active in the Eastern Caribbean business community. In addition, a review was carried out of CFSC credit files, policies and procedures files, the CFSC/USAID Loan and Grant Agreement dated July 29, 1983, and other relevant reports and files held by CFSC.

C. GENERAL DESCRIPTION OF CFSC OPERATIONS

1. Management and Personnel

The Present Situation

CFSC is currently managed by a staff consisting of the Managing Director, David DaCosta, one Loan Officer, Hazel Highland; and one Secretary, Marcel Corria. Staffing is lean but well suited to the job of running a private development finance institution, especially given the active role played by Board Members in setting credit policy and participating in credit review. The Managing Director, Loan Officer and Board appear to be sensitive to the need for maintaining a balance between the credit review and risk management requirements associated with a commercial bank, and the objectives of a development finance institution. Marketing and credit analysis responsibilities are shared between the Managing Director and Loan Officer, and communication between them and with Board Members seems to be open, friendly, and constructive.

The Future

CFSC expects substantive growth in its loan portfolio in the future to be supported by corresponding additions to staff of at least one to three professionals over the next three years. They foresee substantial lending opportunities in the area of agricultural-related businesses but currently lack the expertise to pursue this area aggressively. One of the professionals hired is likely to have significant agricultural lending experience in order to complement the more general business and development lending experience of current staff. Marketing and credit review responsibilities will continue to be shared among CFSC staff with responsibility for management of the existing portfolio taking a larger proportion of staff time as the institution grows.

2. Marketing

The Present Situation

CFSC's primary marketing objective during its first year of operations has been the development of a high level of visibility in its potential markets--Antigua, Barbados, Belize, Dominica, Grenada, Montserrat, St. Kitts-Nevis, St. Lucia and St. Vincent. Specifically, this marketing effort is designed to encourage the inflow of sound projects requiring medium to long term debt financing. CFSC's efforts have focussed on three major marketing channels:

- Personal contacts of CFSC management and the board of directors,
- Cooperation with development organizations,
- Direct mailing of brochures and annual reports to banks, accountants, attorneys, development banks and other major industrial enterprises.

The CFSC board is directly represented in a number of CFSC's geographic markets and has been an important factor in increasing local business awareness of CFSC services. The members of the board do not actively target specific projects for CFSC's participation. Rather, they serve to connect CFSC with the informal network of business-people in each major country market. Follow-up on specific opportunities is carried out by the managing director and staff.

The managing director and loan officer follow up on leads generated through direct inquiries and initiate new leads through visits to each country market. In the early part of CFSC's first year of operations, the managing director visited many markets for the purpose of increasing the business community's awareness of the financial services that CFSC provides. Follow-up visits have been made when specific projects required evaluation by CFSC. Other business contacts made during these visits continue to be a major factor in generating inquiries from potential borrowers.

Development organizations active in the Eastern Caribbean have been generally helpful to CFSC. CPDF in particular, has provided CFSC with leads and credit analysis assistance that has resulted in 5 loans in CFSC's portfolio, and it is hoped that the Caribbean Food Corporation (CFS) and local DFCS will prove to be good sources in the future.

CFSC has developed a direct mailing list consisting of accounting firms, attorneys, commercial banks, development banks and major businesses. Approximately 500 brochures were sent to all members of the CAIC as an attachment to CAIC's newsletter. These mailings have been helpful in generating visibility for CFSC throughout the Caribbean.

The managing director and loan officer of CFSC have close contacts at many commercial and development banks in the region. The value of these contacts varies among banks and countries. In a few cases, CFSC was able to provide long term credit for projects in which the commercial banks were only prepared to offer short-term financing. Unfortunately, however, most of the inquiries generated through commercial bankers have been for poorly conceived or inadequately capitalized projects that do not justify serious consideration by CFSC.

The following table presents existing CFSC projects and projects under consideration along with the corresponding source of the original marketing lead.

Source of Marketing Leads for CFSC's Existing Loan Portfolio

<u>Borrower</u>	<u>Marketing Contact</u>
Sealy Mattress Antigua	CPDF
Caribblue Hotel St. Lucia	Speech by Managing Director in St. Lucia resulted in inquiry
Marigot Bay Hotel St. Lucia	Visit by Managing Director to St. Lucia

Ferrands Estate Ltd. St. Lucia	Unsolicited inquiry resulted from general publicity i.e. speeches, mailing of brochures, and visits
East Winds Hotel St. Lucia	Referred by previous borrower
Bargas Ltd. Barbados	CPDF
Quality Poultry Products Belize	CPDF
Broilerson Ltd. St. Kitts/Nevis	CPDF
Deco Industries Grenada	Personal visit by Managing Director to Grenada
Spice Island Charters Grenada	CPDF
Gulfstream Industries Barbados	Personal contact of managing director
BRC (West Indies) Ltd. Barbados	Personal contact of Managing Director
West India Biscuit Co. Barbados	Personal contact of Managing Director
Andrew F. Holm Ltd. Antigua	Marketing initiative of Managing Director based on knowledge of new desalination standards in Antigua.
FMB Holdings Ltd. Antigua	Marketing initiative of Managing Director based on knowledge of new desalination standards in Antigua.
Hiline Industries Ltd. Barbados	Unsolicited inquiry based on knowledge of CFSC operations in Barbados
Banks DIH Ltd. Guyana	Inquiry based on brochures sent to area businesses accountants and development organizations.
Peter/Osmond Kelsick Antigua	Personal contact of Managing Director
Fish of Barbados Ltd. Barbados Ltd.	Personal contact of Managing Director
Hill Milling Co Ltd	Personal contact of Managing Director

Current marketing efforts have resulted in a solid inflow of projects, consistent with the original projection for market demand prepared when CFSC was formed. The market focus has been on generating projects that are consistent with CFSC's objective of promoting economic development in the region through providing medium to long term debt financing.

The Future

Marketing efforts in the future are likely to follow along the course set during the first year of operations. Marketing will be opportunistic with the bank casting a wide net for potential projects through continuing a promotional program based on direct mail, personal contacts of CFSC management, and cooperation with area development organizations. Marketing will be more aggressive and will promote both traditional medium to long term debt financing as well as a select portfolio of higher risk projects, some of which may involve equity linked financing. As other products are developed, CFSC's marketing efforts may have to change to support them.

3. Credit Evaluation and Risk Control

Present Policies

CFSC carries out a thorough credit evaluation of all loan applications. Initially, each loan applicant is required to submit a description of their proposed project covering the basic business, critical production and marketing issues, and current financial standing. A copy of the form given to new potential borrowers is shown as Exhibit I.

When the Managing Director is favorably impressed with the economic development impact and business fundamentals of a given project, a complete credit evaluation is carried out covering:

- Project benefits including specific product and company strengths as well as benefits related to economic development, foreign exchange savings, and employment expansion.
- Project risks including those related to the company's basic business, production or marketing uncertainties and/or potential problems with collateral. For start-up ventures, inherent risks in such projects are also noted.
- The company's background and key management personnel.
- Major markets for the company's products.
- The position of the company relative to competitors in the industry.
- Technical aspects of the project such as maintenance, production or regulatory issues. This information may be developed with technical assistance from outside sources such as CPDF and CFC.

Financial information and analysis. For an established company this analysis covers a complete review of its current and projected balance sheet, income statement and cash flow as well as projected capacity to service debt. For start-up firms where historical balance sheets and income statements are not available, the analysis covers the projected financials and assumptions underlying them.

These credit analysis procedures combined with informal inputs sought by the CFSC staff from Board Members with appropriate geographic or line of business expertise, are designed to provide an effective methodology for screening out loan applications that are not consistent with the institution's objectives in terms of risk and economic development benefits.

Risk is evaluated in terms of both business risk and financial risk. Business risk is reflected by project specific production and marketing considerations; financial risk is reflected by the general health of the potential borrower's balance sheet, its leverage, and ability to withstand temporary fluctuations in business conditions without falling into bankruptcy. Credit reviews are carried out on an annual basis for all loans in the portfolio. Ongoing credit evaluation is carried out by the same individual on the CFSC staff who initially reviewed a given project. This approach will tend to encourage careful credit analyses and lending decisions as well as effective follow-up should problems with loan repayments occur.

During its first year of operations, CFSC has tried to limit the combined level of business and financial risk in its portfolio so that a substantive loan loss reserve can be developed to provide a cushion for losses that might result through high risk lending. CFSC has generally not made long term loans to businesses incapable of acquiring working capital from commercial banks and has avoided making equity or convertible debt financing arrangements.

These conditions represent a sound approach for CFSC to take during its first year of operations. The level of risk taken on in the early years of CFSCs operation must, by necessity, be limited in order to avoid the possibility of insolvency due to the impact of one or more failed high risk loan or equity investments.

An evaluation of the loan applications turned down for financing by CFSC in its first year of operations indicates that CFSC's refusal to participate was based on sound operating procedures for a private development finance institution. Specifically, projects were turned down due to one or some combination of the following factors:

- Loan applicant was in default on existing financial obligations.
- Business fundamentals were not promising.
- Type of project inconsistent with CFSC's developmental objectives
- Poor quality of management staff.
- Unrealistic marketing plans.

An evaluation of the existing portfolio and rejected loan applications indicates that CFSC has instituted solid credit review practices and made sound business judgements resulting in a successful first year of operation. True success will not be ascertainable for at least two to three years, however.

The Future

Future policy towards credit evaluation is likely to remain similar to the policy currently in place. CFSC's credit evaluation process is thorough yet does not impose an unnecessary paperwork burden on either the bank or borrower. Plans for the future, however, call for relatively higher risk investments in start-up and early stage projects. Investment in such ventures may be made in the form of equity or convertible debt in order to provide the opportunity for earning higher returns as compensation for the greater risk of these projects. Borrowers with start up projects may require credit review on a more frequent basis as well as CFSC's guidance in making business and financial decisions. Wisely, CFSC plans to move into such projects only on a gradual basis and only with a limited portion of the portfolio. In this way the CFSC staff time required for start up ventures can be made available without neglecting day to day responsibilities for management of low risk projects and ongoing lending activities.

4. Loan Portfolio

The Present

As of June 25, 1985, the Caribbean Financial Services Corporation had committed to lend fourteen companies a total of US\$3,400,000, of which US\$1,920,000 had been disbursed, leaving US\$1,230,000 undisbursed. Of the total commitments, US\$850,000 equivalent (Bds\$1,700,000) was denominated in Barbados currency.

Exhibit 2 (attached) summarizes the existing loan portfolio, undisbursed commitments, and loans under consideration. The purpose of each loan, loan amount, terms, and collection status are noted, as well as the projected effect on employment, foreign exchange earnings, and other benefits. The foreign exchange and employment projections were derived from estimates made by subborrowers and CFSC at the time the projects were approved.

The overall portfolio, as shown in Exhibit 2, reflects a reasonable balance between the objectives of low risk, commercially oriented lending and a more developmentally oriented loan operation, especially considering that CFSC is still in its initial phases of operations and that its Board of Directors was particularly sensitive to the failures of CIC and ADELA, both of which were frequently mentioned by CFSC investors. Therefore CFSC management and the Board deliberately choose a more careful initial stance than they plan to take once an earnings base has been established. For instance, by the third year of operation they plan to set aside US\$500,000 to US\$1 million for a special high risk fund.

The cautionary aspects required in maintaining adequate loan quality and control of risk have been satisfied by:

- Careful evaluation of projects in order to ensure adequate sub-borrower cash flow to cover debt servicing requirements;
- Close attention to the personal integrity and qualifications of loan applicants;
- Adequate (but not excessive) collateralization of loans.

CFSC's developmental goals have been addressed through:

- The extension of debt with longer amortization schedules than commonly extended by commercial banks;
- The granting of grace periods of up to five years on repayment of principal when necessary to allow for the cash flow requirements of borrowers or to allow co-financing from commercial banks to be paid first;
- Close communications with loan applicants to assist them in putting together well designed projects with adequate financial structure. While adequate security is considered to be a necessary factor in loan design, CFSC has said that they consider it only after a careful review of the project, and in no cases will they finance a poorly conceived or excessively high risk project which has abundant security.

In addition to taking a balanced approach between developmental and commercial financing objectives, CFSC has deliberately diversified its loans among industry sectors and countries, although the portfolio mix also reflects the nature and source of the loan demand and the quality of the projects submitted for consideration. Of the fourteen commitments made to date:

Six are in Barbados
Three are in Antigua
Two are in St. Lucia
Two are in St. Kitts
One is in Guyana

In addition, CFSC is currently evaluating:

Three projects in St. Lucia
Two projects in Grenada
One project in Barbados
One project in St. Lucia
One project in Guyana

On an industry basis, loans are distributed among tourism, manufacturing and agribusiness sectors. The majority of loans approved to date are for the expansion of existing plant and/or purchase of equipment. CFSC has, however, provided financing for one start up venture, Fish of

Barbados, which will provide slurry ice, gasoline, and other services to fishing boats in Barbados. The Board and management of CFSC however, have purposely limited the financing of start up ventures in the first year of CFSC's operations in order to gain lending experience and to moderate risk. Future lending plans allow for a larger proportion of new venture financing.

The Board and management have also taken steps to control industry and country risk where appropriate. Loans to Guyana will probably not be a major portion of the portfolio (and none will be financed with USAID funds), and a decision has been made to finance no hotels in Barbados, to not finance hotels without beaches, and to limit the overall proportion of tourist loans in the CFSC portfolio. Loans to finance buildings built for speculative use will also not be undertaken, and the Board has indicated a strong preference for financing of linkages to agriculture, but not direct farming.

It is noteworthy that all of the financing approved and being considered by CFSC involves direct lending by them. While discounting of acceptable commercial bank loans was expected to form a significant portion of the total loan portfolio in the first five years, no discounting has occurred to date and expectations for this type of activity are slim. This reflects the lack of initial enthusiasm shown by the commercial bank branches contacted by CFSC, as well as the existence of numerous opportunities for direct lending.

Loan Portfolio

The Future

The future loan portfolio will undoubtedly continue to reflect a careful approach to credit approval and control, but will contain more projects which would appear initially to have a higher risk of failing. CFSC will attempt to limit the additional risk through careful project design and close attention to projects as they are built and begin to operate. However, CFSC does expect that a loss rate of 2% to 3% against average outstanding loans will be acceptable, given a 6% reserve fund for losses. Additional information on the future portfolio is contained in Section D, Expected Credit Demand.

D. ESTIMATED CREDIT DEMAND

Future credit demand beyond even six months is difficult to specify, due to the unpredictability of the general economic condition of the region. It, in turn is dependent on economic forces in the U.S. and Europe, the interest of U.S. firms in investing in the region, the success of the CBI in providing real opportunities for investment and export, the negotiations with Jamaica and Trinidad to reopen their markets to Caricom goods and the political stability of specific countries. A range of other positive and negative issues which may affect the final outcome are listed below.

Positive

- There is real potential for working closely with the Caribbean Food Corporation, using their technical expertise to assist with project design, and generally using them as a source of potential projects.
- With US\$600 million to US\$ one billion of food being imported into the Eastern Caribbean region, many feel that agro-business represents a major opportunity for the private sector. Such growth would provide CFSC with opportunities for financing of production equipment, packing equipment and related items.
- Members of the Martinique Chamber of Commerce have indicated an interest in setting up manufacturing operations in St. Lucia to take advantage of cheaper labor.
- There is hope that the CBI regulations regarding import of garments into the United States from the Eastern Caribbean will be liberalized.
- CFSC expects to reach a level of equity subscriptions of \$3 million or more by the end of 1985. With earnings included, its legal limit will be more than US\$450,000, which should afford it increased opportunities to place funds.
- The projects which have been financed to date have come into CFSC without excessive searching and promotion on their part. Additional marketing efforts combined with a willingness to extend the limits as to the type and quality of projects considered, should increase the potential size of the portfolio.
- The growth in the number of small entrepreneurs in Barbados as the historically large Barbados companies lost their "stranglehold" on the economy is a pattern beginning to be repeated elsewhere.
- Commercial banks appear to be willing to undertake the short term working capital financing required for projects, if CFSC is willing to finance the medium and long term credit requirements.
- There is a great deal of interest and effort being put by donor agencies into ensuring that development takes place in Grenada. These efforts may help to promote reasonable projects for CFSC financing.

- Belize represents an essentially unexplored market for CFSC to date and may provide some attractive opportunities.
- Some of the types of loans turned down by CFSC in its first year may be acceptable as it broadens the risks it is willing to undertake.

Negative

- There is not a clear consensus among individuals as to the ability of the region to export products into extraregional markets, or its ability to competitively provide food or other products for this region.
- CBI related results are relatively minor to date, with expectations uncertain.
- Joint ventures between foreign and local firms may be more difficult to develop than expected.
- Little potential business seems to be naturally arising in St. Vincent, Montserrat, and Dominica. The development of this business may require significant marketing assistance and effort on the part of CFSC.
- St. Kitts has a limited employment base which soon could limit its ability to further expand its productive sector.
- There is always the potential in the region for political forces to move in such a way as to impede or dissuade private sector development in specific locations.

Exhibit 3, attached, shows both high and low estimates of cumulative disbursements which could be made with USAID funds over the five years from 1984 to 1989. The low estimates were based on the number of loans which have been approved to date (since September, 1984 when the first loan was approved), the average size of existing commitments (significantly above the US\$200,000 we used), the proven ability of CFSC to attract quality staff in quantities sufficient to handle this demand, and projections of the percentage of total disbursements that would meet USAID reimbursement requirements.

It was estimated by CFSC staff, and generally confirmed by other Board members and business people operating in the region, that CFSC could expect at a minimum to receive thirty new projects of acceptable quality for financing during each of the next four years. We lowered that to twenty five to be even more conservative and assumed that only 80% of the projects would meet USAID funding requirements. Using these assumptions, by 3/31/88, (three months after the project completion date of 12/31/87). CFSC can expect, at a minimum, to have disbursed almost twelve million U.S. Dollars in loans which would qualify for USAID funding. One year later, an additional U.S.\$ four million could be disbursed if additional funds were available. Given the straight line nature of our assumptions, four million additional Dollars would be required every year.

It should be noted that these are minimum estimates, based on rather conservative assumptions. While we have not directly allowed for a flattening of loan demand which conceivably could occur as time goes on (if there is a limited number of acceptable projects which can be developed without extraordinary effort), we have also not allowed for the increase in average loan size which would be expected from the impact of inflation. All in all, we feel very comfortable with these demand estimates, as do the staff of CFSC.

The higher end of the estimates, while again based on conservative assumptions regarding average loan size, assumes that fifty loans can be processed each year for the next four years. While CFSC management acknowledges that this level of loans would require them to stretch near their limits, it is not beyond the range of what they can do. Under these assumptions almost US\$22 million of USAID funding could be required before 3/31/88, far above the present USAID loan commitment of twelve million U.S. Dollars.

E. CFSC COMPLIANCE WITH CFSC/USAID LOAN AND GRANT AGREEMENT

The CFSC/USAID Loan and Grant Agreement, dated July 29, 1983, two appendices to it, and six implementation letters with various dates up to November 6, 1984 comprise the base against which CFSC was judged for technical compliance. These documents include numerous program regulations and standards which are to be met by CFSC and to some extent by its customers. Our review of CFSC procedures and files have uncovered surprisingly few irregularities given the complexity of USAID's requirements. Detailed comments which follow, are provided only in those cases where compliance has apparently not taken place or is in doubt, or where regulations require clarification or change.

Loan and Grant Agreement

Sections 5.1, 5.2, 5.3 and 5.4 Conditions Precedent

These have been met, and approved by USAID.

Section 6.1 Project Evaluation

This is the first evaluation.

Section 6.2 Operational Requirements

6.2 a, through and including 6.2 t have all been met, but the following comments should be taken into consideration.

6.2 j - this subsection is written in such a way that CFSC could incur short or long term liabilities from non-concessional sources or concessional sources not approved by AID, up to the maximum debt/equity ratio (6:1, 7:1, 8:1) and then draw down AID funds which would put it over these ratios. It could not, however, first draw AID funds and then exceed the ratio with other source borrowings. This is inconsistent. The purpose of this requirement should be to control the financial risk inherent in CFSC by limiting the amount of debt of any sort it may take on in relation to its equity base. The elimination of the phrase "other than concessional assistance acceptable to CFSC and USAID" should correct the apparent exclusion of all concessional debt (which includes the USAID loan) from the leverage ratio.

6.2 q - In the one case where a board member had a financial interest, the board minutes reflect that the member announced his interest and abstained from voting.

6.2 r - This covenant appears to require prior AID approval for a second loan to an existing customer, when the total amount made available would exceed U.S.\$300,000. As the legal limit of CFSC (15% of equity) is presently at \$353,500 and is expected to rise with additional equity infusions and earnings this year, and as the purpose should be to not allow CFSC to exceed its legal limit (as opposed to a static fixed amount) to any one customer without AID approval, this subsection appears to be wholly unnecessary. The subsection 6.2 h which limits outstanding loans to any sub-borrower to no more than 15% of equity provides sufficient control.

6.2 s - This subsection requires that projects financed by CFSC not "adversely affect the environment". CFSC does not appear to have financed any projects involving pesticides, mining of coral reefs, or exploitation of endangered species; however, the concept of adverse effect is otherwise undefined in the requirements, leaving any other decisions open to interpretation. While we believe that the management and board of CFSC attempt to avoid projects with major negative environmental impacts, more detailed guidelines are required as to what in AID's opinion constitutes adverse affects.

Section 6.3 Risk Minimization Fund

Paperwork completed; first payment due in September 1985.

Section 7.1/7.2 Foreign Exchange/Local Currency Costs

Some local currency costs have been financed with US\$ disbursements from USAID loan or grant funds which seems to be in contradiction to the regulations of this section. This should be reviewed by CFSC and USAID.

All such disbursements have been for goods/services with proper sources/origin, or within exemption levels granted by USAID. CFSC intends this year to establish a system for tracking those which are to be counted against specific exemption levels.

Section 8.4 Rate of Exchange

CFSC has exchanged no currencies to date.

Annex I - Project Description

A. The Project

All enterprises financed have been involved in the productive sector in agro-industry, manufacturing, tourism or supportive service industries.

B.1. Establishment of the CFSC

All elements of this requirement have been met.

B.2.a Discounting of Term Loans

A system for handling discounting has been designed, but to date, banks appear reluctant to participate"

B.2.b. Direct Lending

All requirements for initiation of this program have been met. However the last paragraph, we assume, was written in an attempt to avoid CFSC borrowing U.S. dollars and lending in other currencies which subsequently devalue against the U.S. dollar, thus making it difficult for CFSC to repay USAID. The paragraph as stated does not accomplish this, and can be interpreted to require the opposite of that desired. Therefore, we suggest the following substitution as a reasonable control of unhedged foreign exchange risks.

(\$ LTC collectible amount
equal 115% of their
\$ LTC payables)

"The CFSC will at all times maintain assets in any specific currency equal to at least 100% of CFSC liabilities denominated in that same currency. However, with the exception of U.S. Dollar denominated assets, assets denominated in any specific currency may be no greater than either (1) 115% of liabilities in that currency or 2) that level which would make the difference of assets less liabilities in that currency equal to 20% of CFSC's equity capital, whichever is lower. U.S. Dollar assets will not have upper limits."

B.2.c. Other Financial Services

CFSC has not yet undertaken any formal examination of opportunities to provide other financial services. Brokering Barbados Government debt securities has been informally considered but rejected for the moment in order to concentrate on term loan business. It is expected that other opportunities will begin to be explored as the term lending function matures.

Annex II Standard Provisions Annex

Article B - General Covenants

CFSC so far as we can determine, has met almost all requirements of this article. One exception involves Subsection B. 5. b. regarding books and records adequate to show the nature and extent of solicitations of prospective suppliers of goods and services acquired and the basis of award of contracts and orders. While the spirit of this appears to have been generally followed, the files do not always clearly document the sub-borrowers decision procedures and decision basis (especially when sub-borrowers made equipment purchase decisions prior to approaching CFSC for financing). The other exception involves the requirements of Subsection B. 8 (Information and Marking), which do not appear to be enforced by CFSC.

Article C - Procurement Provisions

Section C. 1 Special Rules

We found no evidence of these rules not being followed.

Section C.2 Eligibility Date

We found no evidence of this rule not being followed.

Section C. 3 Plans, Specifications and Contracts

This section, if it is meant to apply to documentation from sub-borrowers of CFSC (although we were told by USAID that it was not their intent to approve CFSC's customers' construction schedules), appears to be constrictive to the normal flow of business as done in this region. Such requirements have not been followed by CFSC to date. We recommend that AID clarify the requirements of this section and make them more reasonable than they now appear to be.

Section C. 4 Reasonable Price

While some files show that informal or formal competitive bids were sought for goods and services to be financed by CFSC, not all files reflect this information in an explicit statement. In most cases the lack of information reflects the fact that the specific information is yet to be received, but has been requested. In addition, CFSC, in order to protect its own interests, checks with third parties to determine if prices are in line. Furthermore, CFSC management has stated that any loans made with USAID funds where proper documentation is not ultimately received will be funded from equity capital, and repayments made to USAID.

Section C. 5 - Notification to Potential Suppliers

In all instances, sub-borrowers have selected equipment or services prior to approaching CFSC for a loan, in which case notification to USAID has no meaning. This is standard practice in the region.

Section C. 6 Shipping

Discussed in comments on Implementation Letter No. 6.

Section C. 7 Insurance

Discussed in comments on Implementation Letter No. 6.

Section C. 8 U.S. Government Excess Property

Waived in Section I. A. 2. f. of Implementation Letter No. 6.

Implementation Letters No. 1-5

These letters contained no program requirements.

Implementation Letter No. 6

I. Procurement of Goods

A. Generic Eligibility

We found no instances of generically ineligible goods being financed.

A2 a,b,c Eligible Source and Origin

All sub-borrowers have been asked to provide source documents for goods purchased. To the extent they have been provided and so far as we have seen, goods financed have been from 941 or 935 countries, with amounts for 935 (excluding 941) countries below the US\$, 5,000,000 exclusion. Information concerning origin of the goods financed for the most part has not been formally provided by the sub-borrowers, although verbal representations have been made in a few instances. More detailed reporting as to those commodities involving indigenous goods, imported shelf items, and items included under waivers will have to be developed by CFSC in order to properly track compliance with the regulations in the future.

A2d Componentry

No information is available in the CFSC credit files as to the sources of componentry. This information is frequently difficult to determine beyond the final manufacturer. However, To CFSC's knowledge, no componentry from outside 935 countries has been or is expected to be financed with USAID funds.

A2e Nationality of Supplier

From import documentation supplied to CFSC, it appears to CFSC that all suppliers of USAID financed goods are eligible. However, specifically stated nationality information has not been requested by CFSC.

B. Contracting

See earlier notes on Annex II, Article C.

C. Delivery of Commodities

1ai Shipping Ocean Freight Charges

No records are on file which indicate the flags of registry of vessels used for shipping financed goods.

1aii Preference

The loan files for those loans involving the shipment of AID-financed goods do not contain the certification of unavailability of US flag vessels, due to the fact that US source goods have all been imported prior to CFSC financing.

1aiii Ineligible Vessels

CFSC has been verbally told by AID that this requirement no longer exists. Written confirmation of this fact has not been received, however.

1cli Air Freight

As far as CFSC is aware, no material amounts of goods have been imported by air; therefore, the credit files reflect no air freight information.

IC2 Insurance

CFSC requires insurance on the shipping of all goods it finances. However, as it is common practice for the insurance to be placed by the shipper, no specific request has been made by CFSC to change insurance to 941 country firms in cases where the insurance premium has been financed by USAID as part of total equipment cost.

IC3a Marking

No US source equipment has been financed by CFSC prior to its importation into the country of use.

IC3b Publicity

Erection of a sign noting the role of USAID in assisting CFSC has been provided at one sub-project site. Generally, however, CFSC finances projects with the involvement of other lenders and feels that such publicity is inappropriate and unnecessarily burdensome to their customer. CFSC stationery and loan documents are regularly used for loans not involving use of USAID funds; thus inclusion of the AID emblem would require two sets of forms for everything. It is recommended that this issue be negotiated between CFSC and USAID and clear workable guidelines be developed which are acceptable to both parties.

II. Eligibility

Covered in comments on Annex II - Standard Provisions.

III. Disbursement of Loan Funds

c. Disbursements and Control by the CFSC

No discount operations have been undertaken. For direct subloans, CFSC has confirmed the eligibility of goods and services and provided USAID with all related documents.

d. Suppliers Certificate etc.

Where goods have been imported by suppliers (e.g. construction materials) CFSC considers it impractical to obtain original certificates of origin and a supplier's certificate, except where pieces of machinery for material amounts are involved. Therefore, such documentation is generally not on file.

F. RECOMMENDATIONS

Overall, the Caribbean Financial Services Corporation has successfully met its objectives during its first year of operations and only a few recommendations for improved performance are appropriate.

- Additional marketing and communication efforts with the business and banking communities should improve the quantity of acceptable projects. The commercial and development banks need to be brought to a clear understanding of CFSC's market focus so as to encourage cooperation on worthwhile projects and to discourage the commercial banks from referring only low quality, financially unhealthy, unacceptable projects to CFSC. All business related groups in the region should be able to determine those project which are more or less appropriate for CFSC, thus acting as initial source and screening devices for CFSC.
- A plan for filling the gap likely to be left by the possible termination of CPDF in 1987 should be developed. CPDF has been a valuable source of marketing and credit evaluation support. This role will eventually need to be replaced by CFSC staff and/or liaison with other development institutions.
- Careful exploration of potential opportunities in Belize should be undertaken, taking into account the problems of serving a lending market that is far distant from CFSC's office.
- A plan for use of AID grant funds should be prepared to meet current and/or future needs for assistance in the areas of marketing, training, new business development and management of operations.
- Negotiations between USAID and CFSC should be immediately undertaken to clarify or change the problematical regulations and requirements noted in our review of CFSC compliance, or CFSC should devise systems which will allow it to conform to the regulations.

G. POTENTIAL USE FOR USAID GRANT FUNDS

CFSC currently has access to \$400,000 of USAID grant funds. These funds could potentially be used to train staff, develop new markets and products, or provide specialized support to on-going operations.

Relevant training support for current and/or future CFSC staff might include:

- . Agricultural projects evaluation
- . Securities trading
- . Trade finance
- . Seminars and/or meetings with other development finance institutions

In the area of new markets and products, grant funds could be used for:

- . Development of marketing, advertising and promotion programs
- . Marketing research and strategies;
- . Development and testing of new financial service products and/or modifications of existing products;
- . Development and use of fee based products;
- . Evaluation of business opportunities available through cooperation with other commercial and development finance institutions both within the Eastern Caribbean and in other regional markets (such as with BLADDEX);
- . Technical assistance to support loan decisions in industries not well known to CFSC staff;
- . Pricing strategies and related market research related to rates, fees, equity investments, options, etc.;
- . Market studies and/or ongoing liaison for development of leads in markets difficult to serve from Barbados--e.g. Belize.

On-going operations of CFSC could be benefitted by:

- . Assistance in development of management information, and planning and control systems.
- . Expert managerial assistance for workout situations
- . Future evaluation of CFSC's operations consistent with USAID assistance requirements.

Many other potential uses for grant funds will undoubtedly arise in the future. The topics described above point out only some areas of potential value to CFSC in meeting its goals with respect to both regional economic development and financial returns to its shareholders.

CARIBBEAN FINANCIAL SERVICES CORPORATION

1. GENERAL

- Name and Country (full address)
- Contact person - telephone number
- List of sponsors/shareholders and amounts (business/profession)
- Local bankers for the company

2. DESCRIPTION OF PROJECT

- The Product(s)
- The market (local/export)
- Is this project a new venture or expansion or modernization of existing one.
- Technical aspects
Plant location and availability of infrastructural facilities, plant capacity and manufacturing process, availability of manpower, raw materials, utilities.

3. FINANCIAL ASPECTS

Provide total project costs indicating foreign exchange components.

Capital Requirements

	<u>Local Currency</u> <u>(US\$ equivalent)</u>	<u>Foreign Currency</u> <u>(US\$ equivalent)</u>	<u>Total</u>
Land			
Buildings			
Machinery & equipment			
Working capital			
Pre-operational expenses			
Interest during construction			
Provision for contingencies			
	-----	-----	-----

TOTAL

Proposed Financial Structure

	<u>Local Currency</u> <u>(US\$ equivalent)</u>	<u>Foreign Currency</u> <u>(US\$ equivalent)</u>	<u>Total</u>
Equity			
Long term loans (7 years +)			
Medium term loans (1 - 7 years)			
Short term loans			
	-----	-----	-----

TOTAL

Project Study Available (by whom)

- Pre-feasibility
- Feasibility
- Other
- None

4. OTHER INFORMATION

- Employees (categorise)
- Foreign exchange earnings (if any) or savings (by import substitution).

TOTAL LOAN PORTFOLIO (Committed, Disbursed, or Under Consideration)

CUSTOMER	AID LOAN AMOUNT US\$	PURPOSE & GOODS SERVICES FINANCED	TOTAL LOAN COMMITMENT US\$	LOAN TERMS US\$	AMOUNT DISBURSED US\$	COLLECTION STATUS	EMPLOYMENT EFFECT (# Jobs)	FX EFFECT US\$	OTHER BENEFITS
Gulfstream Industries Barbados Assembly of Household Appliances	300,000	Working capital finance for light manufacturing/ assembly operation	300,000	Interest 11% Amortization 2 years	300,000	Current	--	--	--
BRC (M.I.) Ltd. Barbados Manufacturer of pre-fabricated steel bldgs.	325,000	Plant expansion	325,000	Interest 11% Amortization 10 years	325,000	Current	37	Negative	--
Copra Manufacturers Ltd. St. Lucia Copra & Edible oil manufacturing	350,000	Plant expansion	350,000	Interest 11% Amortization 10 years 5 years grace	350,000	Current	3000	Positive	Export oriented and large employer of agricultural workers
West India Biscuit Co. Barbados Biscuit manufacturer	200,000	Plant expansion	200,000	Interest 11% Amortization 7 years 1 year grace	200,000	Current	6	250,000 300,000	--
Andrew E. Ihim Ltd. Antigua Resort Hotel	350,000	Expansion, refurbishing and purchase of desalination plant	350,000	Interest 11% Amortization 10 years 5 years grace	350,000	Current	--	--	Maintain and improve water requirements of hotel operations
HMB Holdings Ltd. Antigua Resort Hotel	120,000	Purchase of desalination plant	250,000 120,000	Interest 11% Amortization 7 years	120,000	Current	--	--	Maintain and improve water requirements of hotel operation

Note: Employment and FX impact are initial estimates

TOTAL LOAN PORTFOLIO (Committed, Disbursed, or Under Consideration)

CUSTOMER	AID LOAN AMOUNT US\$	PURPOSE & GOODS SERVICES FINANCED	TOTAL LOAN COMMITMENT US\$	LOAN TERMS US\$	AMOUNT DISBURSED US\$	COLLECTION STATUS	EMPLOYMENT EFFECT (# Jobs)	FX EFFECT US\$	OTHER BENEFITS
Hiline Industries Ltd. Barbados Handbag manufacturer	0	Purchase of equipment	25,000	6 years - 11% 1 yr principal moratorium	25,000	Current	Positive	Positive	Assist Entrepreneur in import substitution textile industry.
Banks DIH Ltd. Guyana Rum manufacturer	0	Purchase of equipment	300,000	Interest 11% 7 years	90,000	Current			
Peter/Osmond Kelsick Antigua Watersports	0	Purchase of equipment	50,000	Interest 11% 7 years	50,000	Current	3	--	Improve recreation offerings of the tourism industry
Fish of Barbados Ltd. Barbados Fishing services and processing	110,000	Purchase of equipment	110,000	Interest 11% 2 yr prin. moratorium 7 year	110,000	Current	1-2	--	Improve potential for fish export and import substitution
Hill Milling Co. Ltd. Barbados Rice Milling	185,000	Purchase of equipment	185,000	Interest 11% 7 years	--	--	8	\$192,000 per year	Promote small scale milling to increase value added in local markets.

Note: Employment and FX impacts are initial estimates.

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TOTAL LOAN PORTFOLIO (Committed, Disbursed, or Under Consideration)

CUSTOMER	AID LOAN AMOUNT US\$	PURPOSE & GOODS SERVICES FINANCED	TOTAL LOAN COMMITMENT US\$	LOAN TERMS US\$	AMOUNT DISBURSED US\$	COLLECTION STATUS	EMPLOYMENT EFFECT (# Jobs)	FX EFFECT US\$	OTHER BENEFITS
Broilerson (St. Kitts/Nevis) Poultry Processing	185,000	Plant & Building Establish poultry processing operation Total project cost 550,000	\$185,000	\$105,000 for 6 1/2 years with 1 1/2 yr. grace. \$80,000 for 6 yrs. with 1 yr. grace 11% interest	--	--	30	400-500,000 import substitution	First poultry processor in St. Kitts. Jointly financed with C'bean Food Corp.
Electrofab St. Kitts Electrical Components	300,000	Plant Expansion Construction of a factory unit of 14500 sq. ft. for electronic manufacturing operations	300,000	15 years 9 mo. grace on principle and interest 11% interest	--	--	60	Positive	Increase export of electrical components
Marigot Bay St. Lucia Resort Hotel	350,000	Expansion of facilities by 12 units. Additional capacity will increase employment and FX earnings. Total project cost US\$500,000	350,000	7 years Amortization 14% interest	--	--	8-10	US\$150-200,000	--
			3,360,000		1920				

Note: Employment and FX impacts are initial estimates (2,775,000)

TOTAL LOAN PORTFOLIO (Committed, Disbursed, or Under Consideration)

CUSTOMER	AID LOAN AMOUNT US\$	PURPOSE & GOODS SERVICES FINANCED	TOTAL LOAN COMMITMENT US\$	LOAN TERMS US\$	AMOUNT DISBURSED US\$	COLLECTION STATUS	EMPLOYMENT EFFECT (# Jobs)	FX EFFECT US\$	OTHER BENEFITS
Sealy Mattress Antigua Bed & Furniture Manufacturer	350,000	Factory shell improvement of existing facilities. Total project cost US\$860,000	Loan is under consideration for \$350,000	--	--	--	--	--	Improve workplace
Caribblue Hotel St. Lucia Hotel	350,000	Refurbishing program for 102 room hotel. Total project cost US\$450,000	Loan under consideration for \$350,000	--	--	--	--	300-350,000	Upgrade overall facilities
Ferrands Estate Ltd. St. Lucia Quarry	250,000	Rock crushing equip. Increased capacity. Total project cost \$250,000	Loan under consideration for \$250,000	7 years Amortization 11% Interest	--	--	10-20	--	--
East Winds Hotel St. Lucia Resort Hotel	350,000	Expansion of small locally owned hotel. Epan. from 10-25 rooms. Total project cost US\$350,000	Loan under consideration for \$350,000	12 years Amortization 2 years grace 11% Interest	--	--	8-10	\$100-150,000	Expand local interest in hotel plant
Bargas Ltd. Barbados LPG Plant	350,000	Equipment. Process liquefaction of local natural gas. Total project cost US\$2.6 million	Loan under consideration for US\$350,000	6 years Amortization 11% Interest	--	--	15-20	\$500,000	Import substitution
Deco Industries Grenada Clothing	155,000	Plant. Expansion of existing operations	Loan is under consideration for \$155,000	6 years, 1 yr. grace, 11% Interest	--	--	20-50	US\$100-120,000	--
Spice Island Charters Grenada Mariner	300,000	Bldg & equipment expansion of facilities. Total project cost US\$450,000	Loan is under consideration for US\$300,000	--	--	--	15-20	Data being developed	--

Note: Employment and FX impacts are initial estimates

ESTIMATED CREDIT DEMAND FOR CFSC

From CFSC's 1985 Financial statements we observe that:

- o Total loans outstanding as of 3/31/85 = \$1.7 million
- o Total loans qualifying for AID disbursements as of 3/31/85 = \$1.4 million
- o Thus AID qualified disbursements equaled 80% of Total Loans Outstanding.
- o Undisbursed loan commitments as of 3/31/85 = \$.7 million.

We assume for our low level projections that:

- o One half of new loan commitments plus all outstanding commitments from the previous year will be disbursed in each year;
- o New loan commitments are made at the rate of 25 new commitments per year;
- o 80% of loans outstanding will be funded through AID disbursements; and
- o The average loan size is US\$200,000;

Given these assumptions, that CFSC outstanding and cumulative AID disbursements will be as shown below:

Low level Projected Cumulative AID Disbursements (US\$million)				
3/31/85 (Act)	3/31/86 (Est.)	3/31/87 (Est.)	3/31/88 (Est.)	3/31/89 (Est.)
1.4	3.9	7.9	11.9	15.9

For high-end projections of loans outstanding and cumulative AID disbursements, we make all of the same assumptions as in the Low Level Projections except that new loan commitments are made at a rate of 50 new commitments per year.

Under this assumption, cumulative AID disbursements will be as shown below:

High Level Projected Cumulative AID Disbursements (US\$million)				
3/31/85 (Act)	3/31/86 (Est.)	3/31/87 (Est.)	3/31/88 (Est.)	3/31/89 (Est.)
1.4	5.7	13.7	21.7	29.7