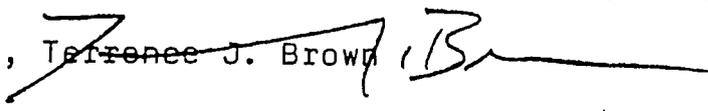


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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

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JUN 19 1986

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR (LAC)

FROM: LAC/DR, Terrence J. Brown 

Problem: Your approval is required to amend the project authorization (TAB A) for the SOLIDARIOS grant project AID/LAC -G-1291 (No. 598-0587), to enable the creation of an international credit guaranty system and to permit the disbursement of obligated funds through FY 1987.

Background. SOLIDARIOS is a consortium of twenty National Development Foundations (NDFs) located in fourteen countries of Latin America and the Caribbean. SOLIDARIOS was established in 1972 by 14 NDFs to consolidate their efforts in fund raising, program planning, and institutional strengthening. By 1983, over 370,000 people were benefiting annually from its programs in 13 countries.

On July 25, 1978, the Bureau approved a \$4.0 million grant to SOLIDARIOS, this was later increased to \$5.1 million. The purpose of the grant is to expand SOLIDARIOS financial assistance programs in support of its member NDFs. SOLIDARIOS established a development loan fund which has been capitalized by the AID grant, through grants and loans from international governmental and private agencies, and through contributions from the private sectors of the countries of its member foundations. To date, four organizations have invested \$9.5 million in the development fund -- AID contributed 48.5%, IDB 24.3%, the EEC 23.2%, and PACT 4.0%.

The fund's resources have been used to finance small projects in agricultural development, marketing, small investment credit, urban employment generation, and community action programs; all designed to improve the living standards of the lowest income groups. Project objectives are to induce and support the entry of project beneficiaries into the formal commercial lending sector of their respective countries in order to prepare them for self-supportive development activities in the future.

Discussion: From project inception, SOLIDARIOS has on-lent \$7.6 million. Of this credit, 45% was facilitated by AID, 28% by IDB, 22% by the EEC, and 5% by PACT. However, beginning in the late 1970's the international debt crisis weakened the NDFs' liquidity and capacity to repay their U.S. dollar loans to SOLIDARIOS*. Lending of US dollars to NDF's has decreased because of these repayment difficulties.

*SOLIDARIOS estimates that the rapid devaluation of local currencies causes a yearly loss of value of its portfolio of dollar-denominated loans of about \$0.8 million.

To allow the NDFs to gain access to domestic institutional credit, SOLIDARIOS requested authority from A.I.D. to utilize grant funds to acquire assets that would be acceptable to guaranty loans made by foreign banks in the currencies of the NDF countries. This authority was granted in Project Implementation Letter No. 7, dated March 4, 1982. Because the system is not yet fully developed to attract the participation of interested financial institutions, only one loan for some \$0.35 million equivalent has been obtained through a secured letter of credit from Bank of America.

To meet increasing capital demands of its NDFs this year SOLIDARIOS has placed special emphasis on the full implementation of a broadly accepted credit guaranty system and on negotiating the prompt recuperation of outstanding NDF debt.* On February 11, 1986, the new President of SOLIDARIOS visited Washington to request AID's approval of his plan to strengthen SOLIDARIOS financial position to expand its credit guaranty capacity. Based on the positive results of the meeting with SOLIDARIOS officers on that date, Tony Velasquez participated in the formulation of the conceptual framework for the proposed strengthening of the credit guaranty system.

SOLIDARIOS submitted this proposal on February 27, 1986.** It shows that the institution could start operations before the end of this year using a guaranty fund of over \$2.6 million. At the end of the year its assets will consist of the loan portfolio generated to date with the A.I.D. grant resources (\$0.846 million), new assets acquired with the proceeds of the grant disbursement of \$0.7 million, and other highly liquid reserves worth \$1.1 million.

The initial essential part of the fund's strength would come from the assets acquired with this year's proposed A.I.D.-disbursement of \$0.7 million. As this will constitute twenty-seven percent (27%) of the total initial capitalization of the fund, SOLIDARIOS will assign from the start highest priority to the development of its system in countries where A.I.D. operates its programs, and will ensure that of the total guaranties issued, a percentage at least equal to the A.I.D. contribution to the guaranty fund will be issued to fund eligible projects in those countries.

Over time, the value of the asset pool that constitutes the guaranty fund will be enhanced by a 5% guaranty fee payable directly to SOLIDARIOS by the borrower or lending institution, the yield of the assets that form the guaranty fund, and recuperations of guaranteed loans paid to the participating banks.

*The most recent analysis of its portfolio of loans indicates that as of October 31, 1985, the total outstanding debt was \$5.948 million -- capital \$5.328 million and interest \$0.620 million.

**Available in the project file.

To launch its program, SOLIDARIOS will acquire fully secured prime U.S. bank obligations which will be used to secure standby letters of credit. These will be issued to foreign participating lending institutions to guaranty recuperation of 75% of outstanding balances in local-currency loans made to their eligible borrowers under the program.

Eligible borrowers are NDFs which would in turn lend to small businesses, or small businesses which would have been identified by the NDFs and placed in contact with a participating lending institution. The borrowers will be required to pledge all their project\$ assets as additional security of the loans also guarantied by SOLIDARIOS. Having subrogation rights in all the loans it pays under its guaranty, the assets additionally pledged by the borrowers will enhance SOLIDARIOS guaranty capacity -- by leveraging the assets of the guaranty fund with the assets pledged by the local borrowers.*

Thus, the loan guaranty program of SOLIDARIOS will be operated with the participation of U.S commercial banks, a group of participating foreign banks, and the technicians organized to provide services through another recently developed program, "SOLIDARIOS CONSULTORES". If the system is operated as expected and additional strength is necessary, an additional disbursement of \$0.4 million would be recommended in 1987, if funds are available. These A.I.D. contributions of \$1.1 million plus \$63,942.85, are already authorized and obligated under the grant.

Various alternatives to the guaranty mechanism described above were considered in the design process. These alternatives included using the Federal Reserve Letter of Credit (FRLC) or Letters of Commitment** to guaranty the availability of US dollars to pay defaulted local currency loans, or withholding disbursement of grant funds until qualified defaulted loans were identified for payment.

Although adequate to guaranty availability of funds, none of these instruments would have helped enhance the financial position of SOLIDARIOS to guaranty the letters of credit issued in favor of the local currency lenders. For it is only by providing for the institution's own financial strength that the project purpose of expanding its financial assistance programs through guarantying operations of local banks can be attained.

*See attached table and graphic presentation of key financial variables.

**Commonly used by the Agency in its procurement operations.

This has been identified as the only plausible alternative to the direct lending program that is now in jeopardy due to the international financial crisis and the unprecedented devaluation of local currencies with respect to the dollar.

We propose helping SOLIDARIOS to create and manage a growing, self-sustaining credit guaranty system with the active participation of commercial banks and private support systems in its area of influence. Unless the grant funds are disbursed and invested by SOLIDARIOS in profitable assets, the credibility of the institution among potential private participants will decay, and the guaranty fund could neither grow nor become self-sustaining.

Specifically, using FRLC or Letters of Commitment neither the indispensable participation of local banks nor the opportunities for the capitalization of the fund, described in paragraph four of page two, would be forthcoming. Moreover, the project purpose of establishing a guaranty program managed by SOLIDARIOS could not be met unless disbursements are tranching in accordance with the needs of credit programs of participating banks.

The existence of a financially viable fund is a prerequisite for local bank participation in a broad, long-term credit program. SOLIDARIOS must provide the basis to justify procurement and investment of resources in a multitude of loans over time, instead of a loan-by-loan guaranty program that cannot be related to the lenders short, medium and long range operational objectives and profit goals.

In this connection, it is noted that SOLIDARIOS assessment of credit demand is based on discussions with local banks and on historical credit needs of the populations served by its fourteen NDFs -- over 370,000 persons. It will be necessary that the assets of the guaranty fund, enhanced with the disbursement of \$0.7 million in grant funds, be available to obtain the standby letters of credit required over the next 12 months.

Under SOLIDARIOS proposal, over the next ten years the guaranty system could be used to stimulate some \$82.0 million dollar equivalent of credit (at today's exchange rates), from at least eight of the fourteen banking systems in SOLIDARIOS area of influence. In addition, by the tenth year the system will control about \$52.0 million worth of assets, and its guaranty liability would exceed the \$34.0 million -- before full utilization of a credit guaranty capacity of more than \$69.0 million.*

*See attached table and graphic presentation of key variables.

We feel that the proposed policy for the use of financial resources (including those additional resources expected to be provided under the grant) is prudent and essential to the development of SOLIDARIOS guaranty capacity. The information submitted to obtain our approval shows that the control of key variables that will affect the self-sufficiency and growth of the credit guaranty program will be within the technical capacity of SOLIDARIOS.

The last AID-funded evaluation of the institution also supports this strategy and recommends the emphasis on credit guaranty operations as the economically viable alternative to direct lending of US dollars.

We recognize that our support of this pilot guaranty program could lead other entities to request assistance for similar purposes before the generic system is fully tested. Therefore, it is recommended that the Bureau withhold consideration of any such proposals until the design specifications for the effectiveness and efficiency of the experimental model are found reliable.

While we believe that A.I.D. should support the proposed strengthening of the credit guaranty system, to prevent further delay in the implementation and testing of the model, and to ensure the achievement of the purpose and objective of the grant, the grantee shall agree that:

1. If the system is not in operation by September 30, 1987, the AID Grant funds used to enhance the fund's capitalization shall be returned to AID, along with the yield of the assets acquired with those funds, before December 31, 1987, and
2. If after the system is established all or part of the assets acquired with the grant funds provided by AID are not used for a continuous period of twelve months as specified to guaranty loans, the grant funds used to acquire said assets shall be returned to AID, along with the yield of those assets during said period, before December 31, of the year in which the period expired.

In view of the above we propose that AID/W:

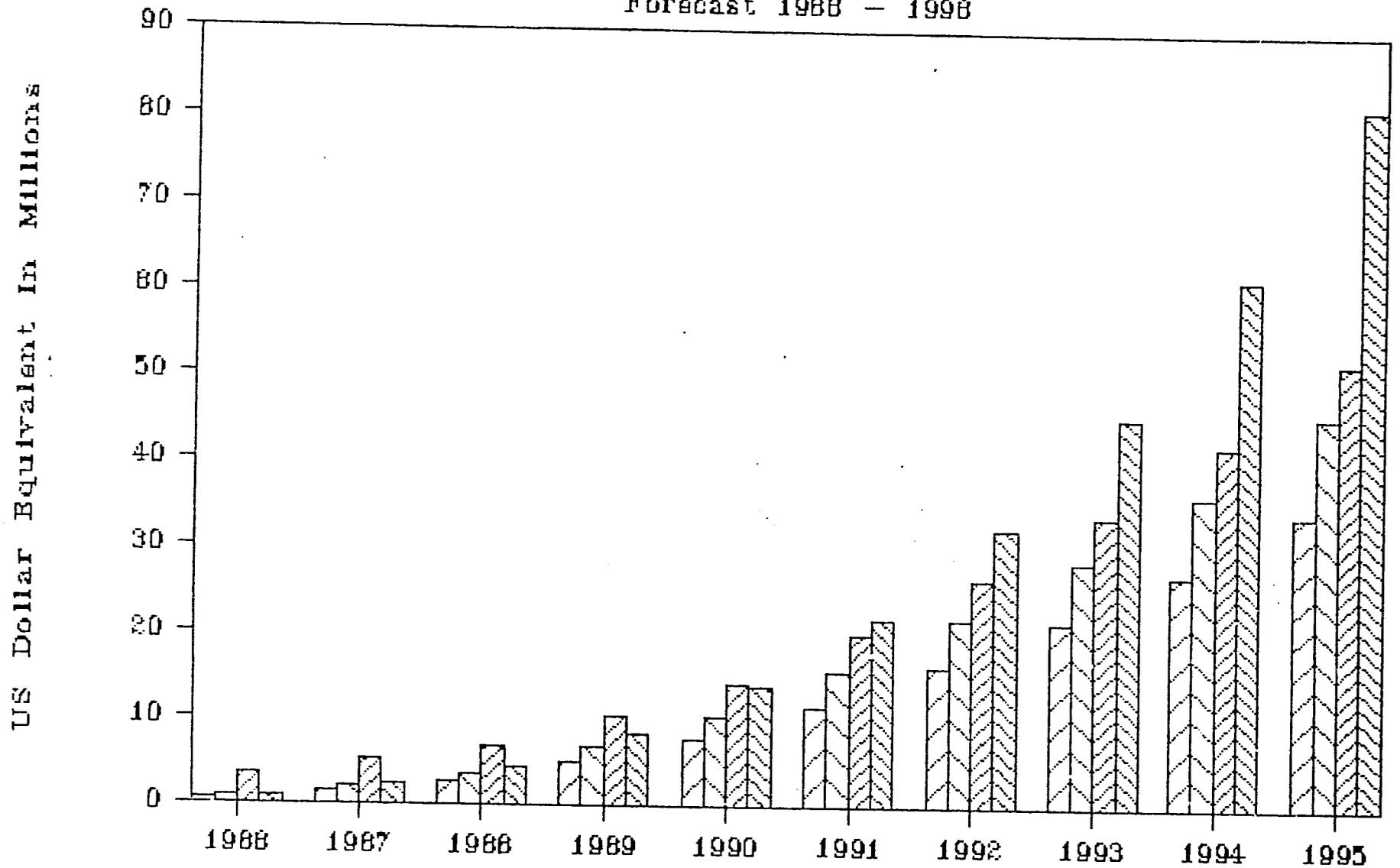
1. Execute the letter to the President of SOLIDARIOS defining the new system, and the Grant Authorization Amendment -- attached;
2. Sign the Grant Agreement Amendment with SOLIDARIOS;
3. Process a disbursement of the assential \$0.7 million, to create the necessary financial strength to attract the attention of the financial institutions that are to participate as lenders under the program;

4. Disburse in FY 1987 an additional increment of \$0.4 million to enhance the asset pool of the guaranty fund, if needed, and if funds are available;
5. Assist SOLIDARIOS to contract specialized financial and legal assistance to complete the technical and legal arrangements ("implementation phase") for credit guaranty operations in four priority countries -- Up to \$61,000 of funds currently in the pipeline will be used to develop four country-specific operations manuals which are compatible with prevailing legal codes and business practices; and
6. Request that SOLIDARIOS immediately contract a banking/finance expert to manage the guaranty system on a full-time basis.

Recommendation: That you sign the attached letter informing SOLIDARIOS of our approval of their proposed use of grant resources in the development of the credit guaranty system, and the Amendment No. 5 of the PAF.

SOLIDARIOS Guaranty System

Forecast 1988 - 1998



No. 10
 No. 3
 No. 9
 No. 2

10. Guaranty Liability 3. Portfolio 9. Total Asset Pool 2. Cumulative Credit

SOLIDARIOS -- Credit Guaranty System
 Ten Variables -- First Ten Years
 In Millions of Dollars

No.	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
1. Credit	1.00	1.50	2.00	4.00	5.50	8.00	10.50	13.00	16.00	20.00
2. Cumulative Credit	1.00	2.50	4.50	8.50	14.00	22.00	32.50	45.50	61.50	81.50
3. Portfolio	1.00	2.25	3.73	6.80	10.50	15.63	21.80	28.68	36.35	45.60
4. Income	0.17	0.28	0.36	0.49	0.59	0.78	0.95	1.15	1.37	1.66
5. Expenses	0.09	0.13	0.16	0.21	0.32	0.41	0.56	0.70	0.86	1.04
6. Net Income	0.08	0.15	0.20	0.28	0.27	0.37	0.39	0.45	0.51	0.62
7. Counterguaranty	1.00	2.30	3.70	6.80	10.50	15.90	22.20	29.20	37.00	46.40
8. Fund Balance	2.61	3.15	3.33	3.53	3.75	4.32	4.32	4.66	5.07	5.53
9. Total Asset Pool	3.61	5.45	7.03	10.33	14.25	20.22	26.52	33.86	42.07	51.93
10. Guaranty Liability	0.75	1.69	2.79	5.10	7.88	11.72	16.35	21.51	27.26	34.20

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D C 20523

Project Authorization and Request for Allotment of Funds
(Amendment No. 5)

Name of Entity : SOLIDARIOS
Name of Project : SOLIDARIOS Development Fund
Number of Project : 598-0587

Pursuant to Section 106 of the Foreign Assistance Act of 1961, as amended, the SOLIDARIOS Development Fund Project was authorized on July 25, 1978 (the "PAF"). The PAF was amended on May 18, 1981, March 24, 1983, September 27, 1984, and September 20, 1985. The PAF is hereby amended in its entirety as follows:

Project Authorization and Request for Allotment of Funds

Name of Entity : SOLIDARIOS
Name of Project : SOLIDARIOS Development and Guaranty Funds
Number of Project : 598-0587

Pursuant to Section 106 of the Foreign Assistance Act of 1961, as amended, I hereby Authorize a grant to SOLIDARIOS, a private, non-profit consortium, incorporated in the Dominican Republic ("SOLIDARIOS"), of not to exceed Five Million One Hundred Thousand Dollars (\$5,100,000), over a twelve-year period from the date of initial authorization, subject to availability of funds in accordance with the AIO/OYB allotment process, to help in financing certain foreign exchange and local currency costs of goods and services required for the project as described in the following paragraph.

The project consists of the establishment of a credit fund and a credit guaranty fund to support the investment programs of national development foundations ("NDFs") which are members of SOLIDARIOS, and to provide technical support to these NDFs for the development and implementation of projects to low income groups and individuals (the "Project").

I hereby authorize the initiation of negotiation and execution of the Project Agreement by the officer to whom such authority has been delegated in accordance with A.I.D. regulations and Delegation of Authority, subject to the following essential terms and covenants and major conditions as A.I.D. may deem appropriate:

A. Source and Origin of Goods and Services

Except for ocean shipping, goods and services financed by A.I.D. under the Project shall have their source and origin as permitted by Chapter 16B1(b) of the Supplement B to A.I.D. Handbook 1, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by A.I.D. under the Grant shall, except as A.I.D. may authorize in writing, be financed in flag vessels of the United States.

B. Conditions Precedent to Initial Disbursement

Prior to any disbursement or issuance of any commitment document under the Project Agreement, SOLIDARIOS shall furnish in form and substance satisfactory to A.I.D.:

1. A certified copy of its corporate charter and by-laws, duly authorized by its Executive Committee.

2. Certified copies of SOLIDARIOS handbooks, which shall include:
 - (a) Policies and procedures for administration and operations of the credit, guaranty, and technical assistance programs, covering:
 - (i) Research and Planning, Design and Implementation, Operations Support, Monitoring, and Evaluation.
 - (ii) The procedures to be followed for the objective and comprehensive review and authorization of all projects to be financed under the programs -- to assure that such projects are economically justified, technically sound, and will have the desired impact on the specified target group of beneficiaries, and
 - (iii) A description of the control system used in the administration of the programs showing SOLIDARIOS procedures for monitoring compliance with adopted eligibility criteria for lenders, borrowers, projects, and loans under the programs.
 - (b) The first year operations plan for the programs,
 - (c) The job descriptions and curriculum vitae of the personnel assigned to administer the programs, and
 - (d) The format for the periodic progress reports mentioned under D. 10 hereof.

3. A statement that, unless otherwise agreed in writing by A.I.D., all assistance provided by SOLIDARIOS under the programs shall be for the direct benefit of the NDF's target groups.

C. Condition Precedent to Disbursement for Other than Technical Assistance

Prior to any disbursement or the issuance of any commitment documents under the Project Agreement, SOLIDARIOS should furnish to A.I.D. evidence in form and substance satisfactory to A.I.D. that it has contracted for the services of a full-time consultant to prepare the country-specific operations manuals required to offer credit guaranty services.

D. Covenants

Except as A.I.D. shall otherwise agree in writing, SOLIDARIOS shall covenant that it:

1. Will acquire fully insured assets to establish a guaranty fund in a prime bank in the District of Columbia to guaranty the standby letters of credit issued by said bank to guaranty the recuperation of local-currency loans made by participating foreign banks.
2. Shall establish the guaranty fund in 1986 with an initial capacity of no less than two million six hundred thousand dollars (\$2,600,000), and it will be initially capitalized by SOLIDARIOS as follows:
 - (a) The assets representing the portfolio of direct dollar-denominated loans made to the foundations with A.I.D. grant resources, which as of the date hereof are valued at eight hundred and forty-six thousand dollars (\$846,000),
 - (b) Highly liquid assets valued at one million one hundred thousand dollars (\$1,100,000), and
 - (c) Assets acquired with the seven hundred thousand dollars (\$700,000) of grant resources provided by A.I.D. after the date hereof.
- 3 Will complete the implementation phase of its credit guaranty program, enlist the participation of financial institutions as lenders in at least four of the selected countries, and issue guaranties in at least one of the same countries before September 30, 1987. These countries are Colombia, Costa Rica, Ecuador, Guatemala, Mexico, and Uruguay.
4. Will allocate to projects in countries where A.I.D. operates its programs a percentage of its guaranty capacity that shall be at least equal to the percentage the A.I.D. contribution is of the total capitalization of the guaranty fund.
5. If the implementation phase is not completed by this date, the purpose and objective of the grant would not have been achieved and, therefore, shall reimburse to A.I.D. before

December 31, 1987, the value of the assets acquired with the grant funds disbursed after the date hereof, along with the yield of those assets to this date, except that reasonable expenses incurred by SOLIDARIOS to liquidate said assets and reimburse said funds may be deducted from the sum to be reimbursed to A.I.D.

6. If after the system is established all or part of the assets acquired with the grant funds are not used to guaranty loans, during a continuous period of twelve months, the purpose and objective of the grant would not have been achieved and, therefore, shall return to A.I.D. the grant funds used to acquire said assets along with the yield of those assets during said period, before December 31, of the year in which the period expired.
7. If the guaranty fund is liquidated by mutual agreement, twenty-seven percent (27%) of the net proceeds shall be refunded to A.I.D., up to the amount of its initial contribution.
8. Will charge a fee that shall be adjusted from time to time in accordance with program needs, but in no event shall be greater than 5% percent of the principal amount of each loan made (the "Guaranty Fee") by a financial institution participating in its credit guaranty program.
9. Will not issue to any participating lender guaranties for more than five percent (5%) of the guaranty fund.
10. Will submit periodic progress reports as follows:
 - (a) In January, detailing the progress in implementing the previous year's operations plan -- with comments on its relative success in enhancing the financial strength and growth of the guaranty program, and
 - (b) In July, detailing the progress being made in implementing the year's operations plan,
11. Will include in the reports under (10), the following information:

- (a) Names and socioeconomic profile of the recipients of the financial assistance provided under the guaranty program, by project, country, and economic activity,
- (b) Loan terms and expected financial impact on the borrowers,
- (c) Portfolio level and arrears and losses by participating bank, and
- (d) Financial statements of the credit guaranty program as of the date of the report.

Dwight Ink

Dwight Ink
Assistant Administrator
Bureau for Latin America
and the Caribbean

Date August 5, 1986

Clearances:

GC/LAC, GDavidson	Draft	Date	<u>5/6/86</u>
LAC/DP, JFrancis	Draft	Date	<u>5/5/86</u>
LAC/DP, PMaguire	Draft	Date	<u>5/5/86</u>
LAC/DR, RJordan	Draft	Date	<u>5/6/86</u>
LAC/DR, ILevy	Draft	Date	<u>5/6/86</u>

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