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INVESTMENT OPPORTUNITY PROPOSAL
FOR
REVOLVING FUND

US$10,000,000 PRIVATE ENTERPRISE IMPORTER GUARANTEE FACILITY

ON BEHALF OF

LONDON FORFAITING COMPANY

and/or

INTERNATIONAL COMMERCIAL BANK, PLC

and/or

ATLANTIC FINANZ AG

and/or

MIDLAND BANK AVAL, LIMITED

and/or

SKANDIFINANZ AG

OFFICE OF INVESTMENT
BUREAU FOR PRIVATE ENTERPRISE

November 8, 1988

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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Note: Segments of this IOP were drawn from the paper "Trade Development in Asia and the Near East," Mr. D. Cahn, 1987 and "Review of Activities Designed to Encourage International Trade and Direct Foreign Investment in ANE Client Countries," Mr. L. Rudel assisted by Mr. P. Ide, 1987, among other unpublished works.

GUARANTEE FACILITY

FORFAITING

I. EXECUTIVE SUMMARY

The project

1.01 PRE proposes to utilize its direct guarantee authority to promote the flow of trade credit to A.I.D.-assisted countries. This global facility will take one of the following forms:

Scenario No. 1

- Any A.I.D.-assisted country.
- Four (4) individual IFI facilities at $2.5 million each for an aggregate $10 million obligation in FY 1989.

Scenario No. 2

- Any A.I.D. bilateral-assisted country.
- Three (3) individual IFI facilities at $3 million each for an aggregate $9 million obligation in FY 1989.

This project will attract an equal amount of private sector credit to match our 50% guarantee of trade related notes to mobilize between $18-$20 million in new trade credit. The project will center on "Forfaiting." Forfaiting is the term generally used to denote the buying, without recourse, of obligations, usually trade drafts or promissory notes arising from international trade transactions.

This proposal has been developed as a PRE project in support of A.I.D.'s "Trade and Investment" initiative. Our goal is to provide a credit bridge between importers in A.I.D. countries and U.S. exporters.

This project is expected to evolve into a joint effort among, A.I.D., U.S. & F.C.S. (Commerce Department), OPIC, EXIM, and the USAID missions.

Products

1.04 IFI's will purchase trade notes (at a discount) resulting from LDC importers' purchase of U.S. goods on credit. These notes can be held by participating IFI's as earning assets under PRE's guarantee, or used as liquidity instruments through resale in the secondary market without PRE's guarantee. Through this facility selected IFI's will become the "noteholder" (forfaiter) and purchase, without resource to the seller, promissory note(s).

Each promissory note eligible for coverage under this forfaiting guarantee facility would have the following characteristics:

A. Amount - $500,000 or less principle and interest with PRE guaranteeing up to 50% or a maximum of $250,000

B. Origin: Any A.I.D.-assisted country

C. Repayment: Up to five (5) years

D. Interest Rate: Fixed at market

E. Currency: US Dollars

F. Origination: Through participating IFI's

G. Purpose: Purchase of U.S. capital goods

Risk

1.05 As an unsecured guarantor to the LDC importer, PRE's risk is multifaceted.

- Transactional risk (default) by the LDC importer and/or their local bank which will avalize their notes.

- Country risk (economic and political) in the LDC's in which U.S. exports are directed and from which our guaranteed notes must be repaid.

- Institutional risk (credit and liquidity) in the IFI's selected to act as forfaiters on our behalf.

- Exchange risk (non-convertibility) in LDC importers not having access to hard currency to meet repayment.

- Legal risk, with A.I.D. becoming the holder in due course of defaulted notes forwarded to us by the IFI's.

These risk factors are present in many A.I.D. projects. We believe the risk to the RF in the forfaiting facility is manageable based on PRE's position as a guarantor to an IFI which would share the underlying risks with PRE. The selected IFI's would use their standard credit approval policy in acceptance of notes. Our participation would be directive to support SME's who want to purchase U.S. goods (additive) but require some credit support to do so.

Project Timetable

1.06	IOP	11/88
	P/A Negotiations	11/88
	Loan Review Board	12/88
	IP	1/89
	P/A Signing	3/89
	First Disbursement	8/89

II. TRANSACTION SUMMARY

The following are the major terms of the proposed forfaiting guarantee facility between A.I.D./PRE and selected IFI's.

These terms are for discussion purposes only and do not constitute an offer or agreement. Terms are subject to further negotiation by all parties, as well as certain A.I.D. standard requirements and restrictions.

AMOUNT:	Scenario No. 1	Scenario No. 2
	$10,000,000	$9,000,000

GUARANTEED IFI'S: LONDON FORFAITING COMPANY
and/or
INTERNATIONAL COMMERCIAL BANK, PLC
and/or
ATLANTIC FINANZ AG
and/or
MIDLAND BANK AVAL, LIMITED
and/or
SKANDIFINANZ AG

OWNERSHIP: All privately owned and operated (National origin, Swiss, German and British)

PURPOSE: To partially guarantee, up to 50%, trade notes resulting from the importation of U.S. capital goods by A.I.D.-assisted countries.

CO-FINANCING: Our non-funded A.I.D. guarantee will mobilize at least $20 million in additional trade credit for A.I.D.-assisted countries.

The following terms and conditions will govern our project agreement between A.I.D./PRE and the guaranteed IFI's.

TERM OF GUARANTEE: Seven (7) years from signing Contract of Guaranty.

SUB-NOTES: Up to five (5) years.

DRAWDOWN: Within one (1) year from execution of the project agreement.

GUARANTEE FEE: 1% p.a. collected semi-annually in advance.

COMMITMENT PERIOD: Up to nine (9) months

SECURITY: None

INTEREST: N/A

GRACE PERIOD: N/A

PREPAYMENT: N/A

CURRENCY OF PAYMENT: All fees are payable by the IFI's in advance in U.S. dollars.

TRANSACTION SIZE: A maximum transaction size U.S. $500,000 (principal and interest) for any one subborrower (50%/$250,000 guaranteed). A.I.D./PRE's guarantee is in U.S. dollars. Underlying guaranteed notes are also to be in U.S. dollars.

CONDITIONS PRECEDENT: All notes placed under A.I.D.'s umbrella guarantee are to cover the importation of U.S. capital goods by the private sector in an A.I.D. country for their own "in country" use.

SUBBORROWER RESTRICTIONS: All subborrowers will be private sector importers (No parastatal ownership permitted).

REPORTING: Standard A.I.D./PRE forms.

SETTLEMENT OF CLAIMS: Any defaulted notes covered by A.I.D.'s guarantee will be covered up to 50% up to the maximum of $250,000 per any one subborrower by drawing against our guarantee payable through the Office of Financial Management.

TECHNICAL ASSISTANCE: PRE/I and PRE/PD will provide up to $150,000 from core funds including the PEDS and Financial Markets projects to support education in selected A.I.D.-assisted countries and the U.S.A. on the concept of forfaiting. Joint marketing efforts by A.I.D. with OPIC and EXIM as well as selected USAID's will be covered by these funds. This component will include a provision for Mission "buy-ins" of another $100,000 in PD&S funds for country specific replication work. A full action plan for this activity will be a part of any subsequent Investment Proposals (IP's).

III. FORFAITING - A TRADE AND INVESTMENT TOOL

"A forfait" describes a financial technique which combines the characteristics of many other kinds of trade instruments. It is generally classed as a "supplier" credit: that is, the exporter is required to provide financing as an integral part of the sale of goods and services. Assuming the exporter does not choose to retain this risk on his own books as a receivable, he may consider structuring the transaction to include negotiable notes which they can sell to a bank or private investor, hence the origin of "a forfait" paper.

Today it is one of the most common methods of financing international trade in goods and services coming out of Western Europe. This technique is most useful to obtain financing for less-developed countries (LDC's) outside normal banking channels. The bulk of all A.I.D.-assisted countries are LDC's and many do not have access to additional credit through formal banking channels.

The market for non-recourse paper of this kind started in the 1950's and originally concentrated on East-West trade. Most transactions covered shipments of raw materials which could be rapidly converted into manufactured goods and reexported, requiring a simple, short-term trade financing mechanism. The market for such paper is now virtually worldwide, and includes medium-term transactions as well.

Forfaiting can be described as follows:

As in normal letter-of-credit operations, the obligation to pay is represented solely by an underlying note or bill of exchange, and is completely separated from the commercial transaction.

It is in the form of negotiable bills of exchange or promissory notes including only the most essential terms of a legal obligation to pay: fixed amounts and maturity dates, and the names of the obligor and, in most cases, their guarantor.

The note stands on its own, without recourse to either the exporter or any intermediary purchaser. An endorser can of course be held liable for fraud or misrepresentation, but not for non-payment.

"A forfait" paper is normally issued on a discount basis, that is, the interest rate is implied in the principal amount due; this practice means that most "a forfait" notes do not indicate an interest rate on their face, and are sold "flat", i.e., for a fixed cash price. More recently some paper has been sold based on an explicit interest rate, using a fixed rate or some established floating rate benchmark.

Interest is calculated on a 360 day basis, although the alternative 365 day basis is sometimes used, as agreed during the negotiations between the exporter/importer and their forfaiter.

The term is usually five years or less, and occasionally for less than one year. The interest rate calculation usually includes compensation for 5-10 days grace after each payment date to allow for delays.

Amounts are generally $1 million or less to facilitate easy marketability, but larger amounts are also common.

There is generally no security, and the notes rank as junior obligations of the debtor. However, many importers who avail themselves of the "a forfait" technique are sufficiently weak credit risks to require a guarantee or aval from an established international bank to provide a marketable note. Most often the guarantee is from an institution in the importer's country, meaning that the commercial risk may be guaranteed but the country risk remains.

Notwithstanding its junior status, "a forfait" paper has generally been excluded from restructurings because of its special importance in everyday trade, the fact that the paper is often held by small investors with whom it would be difficult to negotiate new terms, and because of problems in reconstructing an interest rate on discounted notes.

"A forfait" notes are usually denominated in commonly traded convertible Eurocurrencies such as U.S. Dollars, Deutschmark, Swiss Francs or Yen. But exotic currencies are not unknown depending on the size of the transaction and the confidence of local "a forfait" traders to market the paper.

The note or bill of exchange is expressed in the simplest terms, without the usual covenants and protections often found in bank loan agreements, such as representations and warranties (conditions precedent), acceleration and cross default provisions, restraints on issuing senior debt ("pari passu" clauses), and various restrictive financial ratios. An "a forfait" note does not even indicate the law or courts ("jurisdiction") governing disputes -- not a trivial matter with respect to a business transaction which may involve four or five different countries.

Payment must be unconditional and without any reductions for fees or withholding taxes. Nonetheless, taxes may be imposed by the government where the note is discounted or paid, and the investor should be aware of such potential levies.

Individual notes can be separated and sold independently of the others, and may obviously bear a different amount, maturity and even interest rate. This divisible feature significantly improves the marketability of the underlying loan transaction.

Forfaited paper is basically a two-name obligation, involving a debt of the local importer and the unconditional guarantee of their bank. In most cases, only the guaranteeing bank's credit is involved in assessing the credit. The forfaiting house will supply a list of local banks whose aval or guarantee it will accept for the amount and term required. In most cases, these are the largest and best-known local institutions with some international standing.

Through close business connections and published rate sheets, most forfaiting houses are in close contact with other forfaiting institutions, but there are often differences, both in price, appetite for term credit and country availability, from one forfaiting house to another.

Despite its relative simplicity, non-recourse financing can be more expensive than other forms of credit because the lender has so little protection against loss, despite the presence of a guarantee. This is in contrast to the commercial paper market in the United States, which is very similarly structured but remains the cheapest source of funding for many large companies. The key difference is of course that prime American commercial paper borrowers are first-rate credits and the paper is rarely longer than 180 days, while a forfait borrowers -- even with a guarantee of a local bank -- generally represent far less than a prime risk.

Advantages and Disadvantages of Forfaiting

(1) Advantages

A forfaiting situation is likely to be successful when the U.S. exporter is unwilling to finance on open account or retain the LDC's importer's note on their books. This may be because they are unwilling to assume the risk, or need the cash for continuing business. Of course the exporter has to weigh the cost of forfaiting against profit margins and other exposure to the same country (many exporters will carry a certain amount of such risk on their own books, but they usually have internal limits).

Forfaiting is most advantageous to increase business with countries who remain creditworthy, but where the exporter does not wish to increase their exposure.

The documentation is relatively simple and transactions can be finalized with a minimum of legal complications.

The loan is divisible into as many parts as there are notes, as each note represents a complete "loan" and is a legally binding obligation. Thus it becomes easier to market because investors seeking smaller portions, or only certain maturities, can find paper to suit their individual portfolios or risk-appetite.

(3) Disadvantages

Forfaiting may be more expensive if other bank credit is still available.

For the holder of the notes, the limited documentation may offer less legal protection in the even of default. But practice has shown that debtor countries are most unwilling to default on such paper, or include it in reschedulings, because of its importance to their everyday import-export business.

A Typical Transaction (see chart no. 1)

An exporter, such as AJAX, Inc., is preparing to offer to sell a printing press to Djibouti. The importer, under severe foreign currency restrictions, will not consider bids without certain financing terms, e.g., five years maturity, 20% due annually in semi-annual payments. Sometimes the importer will also specify that financing costs cannot exceed a fixed percentage rate (in which case the excess needs to be factored into the overall price).

AJAX, Inc., has the following alternatives: (1) keeping the obligations on open account, or in the form of notes, in its own portfolio or receivables; (2) selling the notes with recourse (to avoid expanding its balance sheet); (3) selling the notes without recourse. For many less-developed countries, the U.S. exporter might only consider the latter alternative, for risk-control reasons.

Before making its offer, AJAX is then likely to approach several of its commercial banks to review their interest in financing the transaction, involving direct financing to the importer, or a transaction which includes the importer's bank, in either case a "buyer's" credit. This form of financing was traditionally used for large, long-term projects. More recently such syndications have been established for smaller, shorter-term purchases of capital goods as they provided more formal documentation than the open lines of credit which U.S. banks had previously relied upon for trade financing.

Alternatively, AJAX may consider structuring the notes in "a forfait" form as a "supplier's credit", negotiated with one of the specialty forfaiting firms. To strike a deal, AJAX will have to accept a discounted price for the Djibouti notes which reflects not only their maturity but the Djibouti risk; once sold, AJAX is only required to indemnify the holder against suits rising from non-delivery or faulty workmanship.

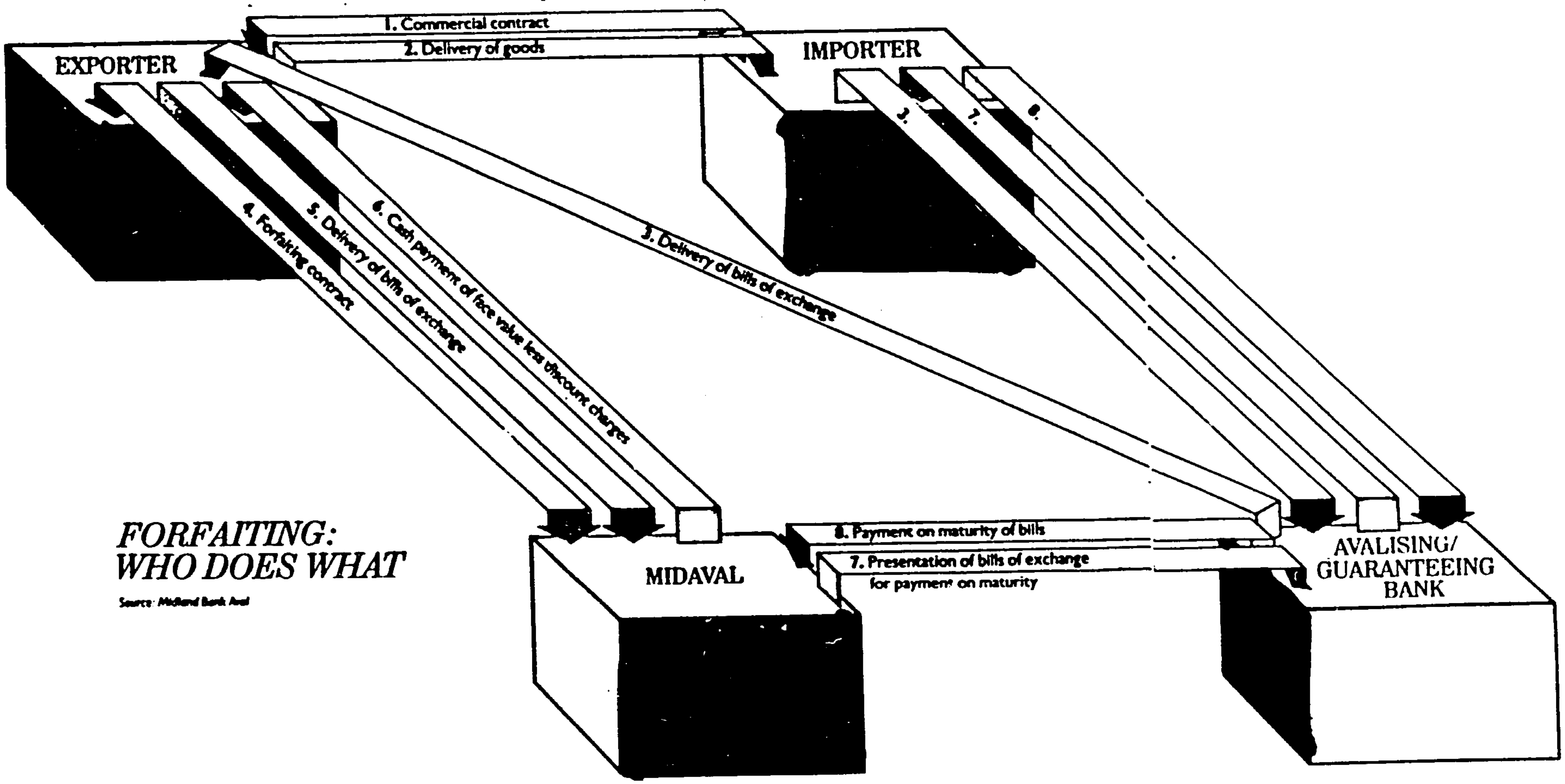
Conclusion

Non-recourse financing has been very successful in Europe in promoting trade with less-developed countries; the technique offers a flexible yet clear alternative in many cases where other forms of credit are unavailable. With the many reschedulings of recent years, however, some countries have simply been eliminated in using this financing method, while for more developed countries the competition has driven interest spreads down. This situation suggests that the time has come for risk-sharing between exporter and importer.

For the especially disadvantaged countries, it is unlikely that traditional "a forfait" financing is the solution, as the risks are simply too great for a financial intermediary to earn a reasonable profit. Even in Europe, forfaiting doesn't work for these particularly credit-poor nations. In such cases, guarantee programs sponsored in whole or part through donors may be the only alternative.

The growth of non-recourse financing in Europe along with the proven success of their export companies, suggest that smaller U.S. companies may need to become more knowledgeable about supplier credits in planning their export strategies with A.I.D.-assisted countries and their counterpart private sector importers.

CHART 1


1. Commercial contract
2. Delivery of goods
EXPORTER
IMPORTER
3.
7.
8.
4. Forfaiting contract
5. Delivery of bills of exchange
6. Cash payment of face value less discount charges
3. Delivery of bills of exchange
8. Payment on maturity of bills
7. Presentation of bills of exchange
for payment on maturity
MIDAVAL
AVALISING/
GUARANTEEING
BANK
FORFAITING:
WHO DOES WHAT
Source: Midland Bank Aval

IV. PARTICIPATING INTERMEDIATE FINANCIAL INSTITUTIONS

Since the "a forfait" market was started, and is still based, in Europe, PRE has the highest chance of success in tapping this financial resource through European institutions. Only private sector intermediate financial institutions (IFI's) are being considered. A cross section of forfaiting houses who already have a solid business base in the developing world are targeted.

Screening included consideration of the existence of branch offices in the USA to act as feeders of transactions to the European forfaiting market. An effort to enlist those houses with a broad geographical representation in the USA (i.e., New York, Chicago, Los Angeles) is also a part of the IFI selection process.

Introductory meetings with a number of IFI's were held in Zurich and London, and negotiations with a short list of forfaiters took place in September 1988. PRE believes that three or four of the following candidate IFI's are expected to participate. They are:

- London Forfaiting Company
  International House
  1, St. Kalharine's Way
  London, E.1.

- International Commercial Bank, PLC
  52-54, Leadenhall Street
  London, EC3A 2BX

- Atlantic Finanz A.G.
  Othmarstrasse 8
  CH-8034 Zurich
  (01) 47 26 37

- Midland Bank Aval, Limited
  135-141, Cannon Street
  London, EC4N 5AY

- Skandifinanz A.G.
  Schipfe 3
  8001 Zurich
  (01) 229 3911

These IFI's were surveyed to determine the project design structure most suitable to their market and findings are covered in Annex E, "Design Survey "Task No. 11" by Dr. H. Reeb, attached. A summary follows:

Scenario 1

- Enhancing creditworthiness of the importer and/or the importer's bank.

This scenario accounts for the best response to a given country's economic development. For this purpose a detailed analysis of local conditions and performances would have to be carried out.

Personnel would be needed to supervise the implementation of the conditions of such schemes as well as the creditworthiness of the importer and/or the local bank.

We believe that only private sector financial institutions would be in a position to perform such a detailed task. A.I.D. and its USAID missions are not equipped for this task.

It must be kept in mind that the cost for such a procedure could become prohibitive, as the responsibility of the researching group becomes important. We therefore feel that this scenario should be restricted to specific countries where its application would be possible, with a considerable joint effort between A.I.D. and IFI's.

Recommendation

Defer this design for a later project when it can be structured as a country specific intervention under the control of a USAID mission.

Scenario 2

- Intervention at the exporter's level.

This scenario accounts best for supporting U.S. exports to A.I..D. countries and would certainly give the exporter an advantage over those not provided with this guarantee.

A point in favor of this scheme would be that the complete transaction could be wound up in the U.S. and be geared to the needs of U.S. exporters doing business with A.I.D.-assisted countries.

A large number of potential exporters to target countries will have to be interviewed, analyzed and finally selected as to their financial position, their ability and good standing in the business sector, to be considered for an A.I.D. guarantee.

The exporter usually operates on the basis of a confirmed L/C. He may draw under given circumstances on a lending facility to finance longer term repayments, adding the financing cost to the contract. However, the exporter will agree to pay a risk sharing premium to the guarantor only when he can increase his business volume or reduce the amounts he holds on his books at risk in certain countries. Usually the exporter will not consider development aspects in his dealings with the importer.

Scenarios 1 and 2 cover situations when the partners (exporter and/or importer) are still negotiating. From experience, we know that such negotiations fail, sometimes at a proportion of 4 out of 5. Consequently, the impact of this scheme is limited, since it is obvious that A.I.D. cannot negotiate deals with all potential exporters or importers.

Recommendation

Other USG agencies are better suited for this type of intervention (i.e., EXIM Bank and OPIC). A.I.D. should not consider this method of intervention.

Scenario 3

- Agreement with a forfaiting institution.

In this scenario, the transaction has been concluded and is presented to a forfaiter for financing.

This scenario has additional features. It enables the partners to deal in an environment where all the aspects of risk evaluation and financing structures are covered.

In scenarios 1 and 2 all the background information will have to be assembled and throughout the duration of a financing transaction maintained by either the exporter or by the organization charged by A.I.D.

In scenario 3, this is all taken care of by the forfaiters who are specialists in this field and do take care of the information gathering process.

Once a forfaiter has accepted the deal, he can choose to house it under A.I.D. guarantee. This decision is influenced by the acceptability of the country risk and the local bank's credibility.

Recommendation

A.I.D. should not attempt to duplicate or change the current forfaiting market but rather influence it for the benefit of A.I.D.-assisted countries. This can best be accomplished by working with IFI's to deliver credit for SME importers of U.S. goods and services.

The forfaiting business is handled very discreetly. The IFI's we intend to work with are investors not brokers. Trade notes purchased and placed under the A.I.D. umbrella guarantee will, in most cases, be held to maturity.

A forfaiter usually operates with a very limited staff. In general, they are tied to a large bank or a trading house. Such a cooperative arrangement allows them to get information on country risk and guarantor acceptability. At the same time, this provides a financial fallback position for the forfaiter in their parents liquidity.

In close cooperation with its parent company, country limited are established which the forfaiter is bound to respect. Willingness to do business with new countries or additional risk to countries already being serviced is determined by the bank or group that the forfaiter is associated with, by their overall business activity, and by their aggregate portfolio mix.

Through the use of a partial (50%) A.I.D. guarantee on an umbrella basis, we hope to influence the forfaiters to increase their credit activities with targeted developing countries and/or add new selected A.I.D.-assisted countries to their client list.

With the acceptance of this IOP, individual Investment Proposals (IPs) and Congressional Notifications (CNs) will be prepared for each of the IFI's selected.

V. CURRENT MARKET IMPERFECTIONS

The constraints and opportunities to effective participation in a free and open system of international trade can be grouped into the following categories.

1. Active government barriers. These include such policies as tariffs and quantitative restrictions, restrictive import licensing, import substitution subsidies, government monopolies, etc. Many investment restrictions also inhibit the trade which often accompanies investment.

2. Passive government barriers. These encompass insufficiencies in the law, including lack of recognition and enforcement of property rights in general and of intellectual property in particular, lack of contract enforcement, and ineffective criminal sanctions against fraud, embezzlement, and other business crimes. Reputable international traders, both buyers and sellers, often will refuse to trade with a country which lacks such protections. Other passive barriers include administrative delays and unpredictability which inhibit trade and investment, often by domestic parties as well as foreign ones.

3. Financial barriers. Trade will be inhibited in countries where financial markets are not sufficiently developed to meet the needs of businesses for working capital, trade financing and, long-term lending (for imports of machinery, construction material, and other capital goods)

4. Business transactions and linkages. At the basic level, business representatives in a country must have the know-how and sophistication to understand, negotiate, and enter into the full range of international business transactions and relationships, including manufacturers representation, dealerships, licensing and franchise arrangements, co-marketing and co-production agreements, joint ventures, etc. The application of this capacity includes the development of private sector institutions and practitioners to promote individual transactions in international trade (both imports and exports), as well as long-term trade and investment relationships.

5. Market information. Signals from the marketplace of international trade will not be heard or heeded by businesses in a country which lacks institutions or sophistication to understand them. This includes more than knowing where demand exists for what can be produced. It extends to packaging and quality standards and other factors which enhance market entry.

No one project can address all these constraints. PRE's targeted intervention through this importer guarantee facility (forfaiting) is directed to influence institutional change through a transactional activity. The thrust of our effort is to mitigate financial barriers. These are both internal to developing countries and external in the credit risk perception that financial institutions in developed countries have in dealing with smaller importers in developing countries.

Missions can work with PRE's Revolving Fund, Financial Markets and Private Enterprise Development projects to stimulate the development of appropriate institutions and mechanisms to support the financial requirements of A.I.D.-assisted countries to more fully participate in international trade and investment.

VI. CONTRIBUTION TO DEVELOPMENT

A.I.D.'s role in encouraging international trade with its client countries stems from a recognition that trade provides a vehicle for the efficient transfer of resources, needed for sustained and efficient economic growth. Trade is often referred to as an instrument of growth. The main theme of the World Bank's "World Development Report 1987" is growth through trade. It demonstrates that free trading policies work better than protectionism in giving LDCs the best chance for rapid economic growth.

A typical exporter, looking around the world for opportunities, would seek a higher return on his business in an LDC than he would in an industrialized, open market country to compensate him for his perceived barriers to entry and higher business risks. Even among LDCs, the rates of return needed to attract foreign trade will vary, depending on local conditions (political stability, corrupt practices, government restrictions, etc.).

A.I.D. project activities, policy dialogue and conditionality are interventions designed to reduce the severity of these market imperfections, thereby increasing the flow and reducing the cost of capital, technology, goods and services for its client countries. Expanded trade offers the potential for LDC to tap into additional private sector resources to contribute to its economic development goals.

A.I.D.'s policy for trade development, as described in the A.I.D. Policy Paper, "Trade Development" dated July 1986, "...is designed to encourage LDCs to utilize international trade as a key instrument in the process of achieving broad based, sustained economic growth, and place a greater reliance on complementary domestic competitive markets that support more open trade policies. A major focus of the trade development policy is on building developed country and LDC private enterprise ties on a continuing, long term basis, consistent with broad American objectives of trade liberalization.

"...the policy directs that A.I.D. policy dialogue, programs, and projects (1) establish a policy environment that is conducive to private enterprise and expanded participation in international trade; (2) encourage the transfer of technology, skills, and information required to expand and diversity LDC agricultural and industrial bases for export production in areas with comparative advantages; (3) support trade and investment promotion efforts; (4) introduce or expand private sector competition in the export or import of essential or economically important commodities; (5) broaden the scope of export development projects to provide for greater U.S. - LDC two way trade opportunities; and (6) encourage prudent investments in infrastructure to improve an LDC's trade position.

"...even if program or project interventions may not be called for, policy dialogue activities should be considered and carried out if at all possible...."

Other A.I.D. policy documents, which elaborate on these basis guidelines are:

- A.I.D. Policy Paper - Private Enterprise Development, Revised March 1985;
- A.I.D. Policy Paper - Co-Financing, May 1983 (see Annex C attached).

A. Impact of Trade on A.I.D. Policy Areas

The proposed PRE intervention offers positive results several A.I.D. policy areas.

6.01 This is first and foremost a capital markets project as the trade bills and notes underlying each import into an LDC will be negotiable. This is expected to have a rippling effect on local and foreign markets that trade in "a forfait" paper.

6.02 Private sector development is promoted by helping privately owned firms gain access to U.S. capital goods through the credit enhancement features of this guarantee facility.

6.03 The project has considerable potential for institutional building in modifying the image of A.I.D.-assisted countries credit worthiness to the international trading and financial community acting as IFI's for this project.

6.04 An element of technology transfer exists in the movement of U.S. capital goods into A.I.D.-assisted countries upgrading their current production capabilities and introducing new manufacturing techniques.

B. Relationship to CDSS

This project meets the trade and development objectives of the CDSS for numerous USAIDs in the three A.I.D. regional bureaus.

C. Relation to PRE Objectives and Policies

This project also meets PRE's guidelines for management of Revolving Fund investments. These are as follows:

6.05 Has a demonstration effect by introducing a new financing mechanism as: (a) an additional source of credit for the importation of capital goods; and (b) an alternative to public sector subsidized facilities.

6.06 Is innovative by illustrating how A.I.D. can join with the private sector to mobilize additive credit on commerical terms for our client countries.

6.7 Targets development impacts appropriate to A.I.D.-assisted countries by responding to identified credit constraints on the importation of capital goods necessary for the expansion of the private sector in LDC's.

In addition, each project will meet the required guidelines as follows:

- Each guaranteed IFI will be for U.S. $3 million or less.

- PRE's guarantee is for 50% or less of each project.

- Subloans will be priced at market rates set by the IFI's.

The guarantee will be issued under Section 108 (as amended) as legislatively permitted.

VII. MONITORING

Monitoring will be ongoing throughout the life of the project. A specific reporting form will be tailored to track performance under this guarantee facility.

Of interest to A.I.D. is to establish the base line of activity to our target market (A.I.D.-assisted countries) prior to our facility and periodically thereafter. This will be required to measure additionality and determine sustainability.

Key information to be tracked on a semi-annual basis will include:

- New countries accepted by IFI's as a result of our guarantee.
- Increased country risk limits for countries already serviced by IFI's as a result of our guarantee.
- New local banks accepted as avalizing institutions on "a forfait" notes as a result of our guarantee.
- Increased aval credit limits for local banks already acceptable to IFI's as a result of our guarantee.
- More favorable credit terms to SME's as a result of our guarantee, i.e., lower rates, large credit line, longer loan terms, etc.
- Others to be defined.

In addition, the IFI's financial health will be monitored to cover:

- Annual audited financial statements.

Responsibility for project monitoring will reside with PRE.

VIII. EVALUATION

The first evaluation of this demonstration project will be conducted by PRE two years following the initial issuance of our guarantee. The evaluation is intended to provide guidance to A.I.D. and the IFI's as to adjustments in project design and implementation which would improve developmental results. Additionally, the evaluation will formulate conclusions as to the project's replicability by the regional bureaus and/or individual USAID's.

Specific issues to be addressed as part of the evaluation will include:

- Responsiveness of LDC importers and U.S. exporters to this method of trade credit.
- Distillation of the different procedures used by IFI's to deliver this credit to SME importers in A.I.D.-assisted countries.
- Identification of actions taken within A.I.D.-assisted countries and IFI's which have affected the success of this project.

The evaluation will be conducted by technical consultants retained by PRE.

IX. PROPOSED TIMETABLE

Summary of Concept	8/88
Investment Opportunity Proposal	11/88
Project Agreement Negotiations	11/88
Loan Review Board	12/88
Investment Proposal	1/89
Project Agreement Signing	3/89
First Disbursement	8/89

X. REPLICATION

The linkage of trade with investment by U.S. companies tends to follow satisfactory trading experiences. U.S. companies, particularly mid-sized companies, seem to want to learn about local operating conditions and business practices, and need a chance to identify suitable local partners, before exposing themselves to the risks of equity investment. This project is designed to begin that process.

Policy dialogues on trade is generally suspect by LDC officials for advancing U.S. commercial interests. Consequently, such dialogues tend to have limited impact on the LDCs trade policy. Assistance projects which focus on technical and administrative improvements in the absence of policy changes have disappointing results. USAID efforts to raise the level of sophistication of the public debate on trade policies encourage local interest groups to argue for policy changes or provide data and analysis to policy makers to demonstrate the efficacy of policy change, may contribute to locally self-generated policy changes. These limitations argue for long and sustained efforts by mission personnel, and flexibility to respond quickly but thoughtfully to opportunities. It is believed that this project can produce those opportunities.

In discussing trade related activities with host governments, USAID leverage may be limited as these activities often have a low priority on the part of the host government when they are competitive with other public sector activities for funding out of the A.I.D. country aid level. As a result, we will include in the project some provision for replication by the central bureau's and PRE's Revolving Fund to insure a sizeable activity. The additive nature of this arrangement can insure host country acceptance.

Private sector projects are sometimes asked to serve many A.I.D. objectives to gain approval. In some instances, this causes the project design to become skewed and negatively impacts the core project objective. Every effort will be made not to over design follow-on projects. Modifications are expected, however, the crux of the project will remain trade credit for the benefit of SME's in A.I.D.-assisted countries.

This project covers activity No. 1. Follow on projects by PRE are envisioned as follows:

<u>Activity No. 1 - FY 1989</u>

- PRE
- $10,000,000 (total)
- European IFI's
- SME importers in selected A.I.D.-assisted countries

<u>Activity No. 2 - FY 1990</u>

- PRE and/or Regional Bureau's
- $10,000,000 (each)
- European IFI's
- Region specific (i.e., Africa)

<u>Activity No. 3 - FY 1991</u>

- Selected USAIDs
- $10,000,000 (each)
- American IFI's
- Country specific (i.e., Philippines)

It is believed that the long term, sustained effort required to influence trading patterns and produce a positive developmental impact can best be accomplished through the layering of projects.

The dissemination of information in the USA and in selected A.I.D.-assisted countries through a joint effort of USGA's is required to ensure the success of this initiative.

ANNEXES

A. Risk Analysis

B. Financial Data on IFI's

- International Commercial Bank PLC
- Atlantic Finaz & Verwaltungs AG
- Skandifinanz AG

C. A.I.D. Policy Papers

- Trade Development
- Private Enterprise Development
- Co-Financing

D. Forfaiting as a Financing Method for International Trade by C.P. Stanton

E. Design Survey "Task No. 11" by Dr. H. Reeb

ANNEX A

Risk Analysis

The issuance of an PRE guarantee as credit enhancement for importers in A.I.D.-assisted countries involves a number of significant risks, including but not limited to the following:

- Transactional risk in the default of the SME importer and/or their local bank which has avalized their notes.

  By allowing established IFI to select subborrowers under their normal credit and aval standards, this risk factor should be mitigated. Since IFI's will be at risk for at least 50% of the guaranteed trade notes we can assume a level of commercial prudence in acceptance of transactions to be housed under our guarantee.

- Country risk in the economic and political environment in which A.I.D. does business. This is a given we must accept as part of our developmental mandate. Our project is designed to support trade in those countries most in need of credit enhancement.

  Because of the maximum 5 year life of the subloans, and the bulk of trade credit being for shorter tenors, we have the same level of risk as the commercial lenders to these countries.

- Institutional risk in the credit and liquidity of the IFI's used to deliver this trade credit project. The risk of the importers is guaranteed (avalized) by their local bank. The risk of that local bank is shared 50/50 between the IFI's and A.I.D.

  The IFIs we have selected are all major firms with substantial financial debth (see Annex B). It is most unlikely that they would fail during the seven year life of this project. As such, institutional risk is not a major factor in this project.

- Exchange risk in the non-convertibility of local currency to U.S. dollars to repay our guaranteed trade notes is the area of most concern.

  Under our guarantee to the IFI's, we not only guarantee repayment, but we stipulate repayment in U.S. dollars. As a result, the importer could fully repay his loan to his local bank in local currency, his local bank could be willing but unable to convert this local currency to U.S. dollars. This would trigger a call on our U.S. dollar guarantee even though the importer has delivered local currency for settlement. This is a key element of the "a forfait" market and our guarantee facility--it calls for repayment on time and in U.S. dollars.

  A.I.D. has no direct control on this risk factor and is exposed for up to 50% of the face value of trade notes not repaid in U.S. dollars. We see no available method to hedge this risk at this time.

- Legal risk in A.I.D. becoming the "holder in due course" of defaulted notes forwarded to us by IFI's once collection efforts have been exhausted. It would then be our decision to move into the courts, or not, to seek repayment. Based on past experience, this area has proven to be a sensitive one. Alternatives will be worked out with GC/PRE to address this concern.

  These risk factors are present in many PRE projects and deemed manageable. Nevertheless, losses will occur.

  With the conversion of the Revolving Fund to a direct guarantee authority leveraged off reflows, future activities will be even more dependent on the income streams from past projects. This project has only one income flow, the guarantee fee. In order to determine the total annual income flow and the level of losses it could support on a breakeven basis, Table 1 has been prepared.

In conclusion, it has been determined that this project has a limited income generation capability as compared to fully funded facilities that earn a fee and an interest rate. As a result, the risk of loan losses exceeding fee income is likely.

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TABLE 1

Fee Income on Guaranteed Notes

Fee Rate	Full Utilization	Annual Income1/
1% p.a.	U.S. $10,000,000	U.S. $100,000

Assumptions

1/ Full disbursement of guarantee facility and funds available to cover losses.

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ANNEX B

Financial Data on IFI's

The individual or consolidated financial statements for selected IFI's are attached without comment.

Based on the size of our guarantee facility with any one IFI in relation to their aggregate size in assets and known prime parentage, they are accepted as creditworthy and liquid without further analysis.

A copy of their latest annual report is available upon request. English translations will be made available at the IP level. All are privately owned and operated.

Annual Report 1987

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Consolidated Balance Sheet

as at 31st December 1987

	Note	1987	1986
Assets:		**£**	£
Balances with bankers, money at call and short notice, U.K. Treasury and Eligible Bills and cash in hand		**134,307,440**	164,419,650
Deposit with Bank of England		**406,000**	423,000
Deposits over 1 month with Banks and other financial institutions, short-term loans and interest receivable		**261,001,576**	315,953,189
Loans to Local Authorities		**10,950,000**	13,950,000
Listed Investments	9	**29,017,858**	27,327,628
Loans and Advances exceeding one year, less provisions		**399,061,619**	455,634,833
Lease Debtors	10	**40,906,349**	41,779,070
Fixed Assets	11	**100,965**	107,967
Deferred Taxation	14	**5,561,290**	—
		£881,313,097	£1,019,595,337
Financed by:			
Share Capital			
Authorised:			
Ordinary shares of £1 each		**24,000,000**	24,000,000
Issued and fully paid:			
Ordinary shares of £1 each		**24,000,000**	24,000,000
Reserves		**18,535,736**	38,240,741
		42,535,736	62,240,741
Subordinated Loans	13	**17,768,811**	22,597,423
Members' Funds		**60,304,547**	84,838,164
Deferred Taxation	14	**13,776,262**	18,818,785
Current and Deposit Accounts and interest payable		**807,232,288**	915,938,388
		£881,313,097	£1,019,595,337

These financial statements were approved by the Board of Directors on 7th March, 1988.

W. JAHN, *Chairman*

G. J. SAPSTEAD, *Managing Director*

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Ten Year Record

Item	31.12.84	31.12.85	31.12.86	31.12.87
	£	£	£	£
Profit before taxation	**10,948,503**	**11,790,418**	**11,819,712**	**(33,566,086)**
Taxation (net)	(4,887,523)	(5,484,733)	(5,462,995)	13,861,081
Profit after taxation but before release from provision for deferred taxation	**6,060,980**	**6,305,685**	**6,356,717**	**(19,705,005)**
Release from provision for deferred taxation	—	—	—	—
Profit after taxation	6,060,980	6,305,685	6,356,717	(19,705,005)
Dividends Paid	1,200,000	1,200,000	1,200,000	—
Retained profit transferred to Reserves	4,860,980	5,105,685	5,156,717	(19,705,005)
Reserves at 1st January	23,117,359	27,978,339	33,084,024	38,240,741
	27,978,339	33,084,024	38,240,741	18,535,736
Capitalisation	—	—	—	—
Reserves at 31st December	27,978,339	33,084,024	38,240,741	18,535,736
Share Capital	24,000,000	24,000,000	24,000,000	24,000,000
Subordinated Loans of Members (translated as necessary at rate 31st December)	28,889,636	23,191,680	22,597,423	17,768,811
MEMBERS' FUNDS at 31st December (exclusive of extensive standby facilities)	**£80,867,975**	**£80,275,704**	**£84,838,164**	**£60,304,547**

ATLANTIC FINANZ + VERWALTUNGS AG ZURICH

Atlantic Finanz + Verwaltungs AG, Othmarstrasse 8, CH-8034 Zürich, Telefon 01 47 26 37,
Telex 817 187, Telefax 01 251 79 64

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BILANZ
NACH GEWINNVERTEILUNG

		31.12.87		31.12.86
AKTIVEN				
Kassa- und Postcheckguthaben	Fr.	18,912.18	Fr.	8,849.28
Bankendebitoren auf Sicht	Fr.	7,719,790.93	Fr.	8,046,434.31
Bankendebitoren auf Zeit	Fr.	6,885,000.00	Fr.	6,255,000.00
Debitoren, Forderungen, Wechsel	Fr.	78,676,357.90	Fr.	77,240,998.03
Wertschriften und Beteiligungen	Fr.	20,145,946.70	Fr.	13,758,826.05
Mobiliar	Fr.	1.00	Fr.	1.00
Sonstige Aktiven	Fr.	1,690,667.25	Fr.	854,129.75
	Fr.	115,136,675.96	Fr.	106,164,238.42

	31. 12. 87	31. 12. 86
PASSIVEN		
Banken	Fr. 46,777,552.70	Fr. 40,207,254.00
Kreditoren	Fr. 12,901,761.49	Fr. 10,706,477.49
Sonstige Passiven	Fr. 22,949,505.03	Fr. 23,399,368.09
Dividende	Fr. 1,200,000.00	Fr. 1,200,000.00
Aktienkapital	Fr. 15,000,000.00	Fr. 15,000,000.00
Gesetzliche Reserve	Fr. 4,300,000.00	Fr. 4,200,000.00
Spezialreserve	Fr. 11,300,000.00	Fr. 10,800,000.00
Gewinnvortrag	Fr. 707,856.74	Fr. 651,138.84
	Fr. 115,136,675.96	Fr. 106,164,238.42

Skandifinanz AG Zürich

Geschäftsbericht / Annual Report 1987

8001 Zürich, Schipfe 2
Briefadresse / Postal address:

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Bilanz per 31. Dezember 1987 (nach Gewinnverteilung)
Balance Sheet as of 31st December 1987 (after distribution of profit)

Aktiven *Assets*	1987 SFr.	1986 SFr.
Kassa und Postcheckguthaben Cash and postal giro account	16 148	32 220
Bankendebitoren auf Sicht Due from banks, demand	5 486 267	9 656 600
Bankendebitoren auf Zeit Due from banks, time	32 305 924	96 044 009
– davon mit Laufzeit bis zu 90 Tagen – of which maturing within 90 days	[17 028 413]	[69 667 155]
Wechselportefeuille Bills of exchange	74 309 740	63 950 933
Kontokorrent-Debitoren ohne Deckung Overdraft facilities, unsecured	1 661 730	1 513 909
Kontokorrent-Debitoren mit Deckung Overdraft facilities, secured	1 783 316	6 006 892
Feste Vorschüsse ohne Deckung Term loans, unsecured	16 612 526	23 112 977
Feste Vorschüsse mit Deckung Term loans, secured	52 364 815	66 557 024
Wertschriften Securities	12 444 019	10 534 683
Dauernde Beteiligungen Permanent participations	1 190 000	1 190 000
Sonstige Aktiven Other assets	4 285 313	5 870 162
	202 459 798	284 469 409

Passiven *Liabilities*	1987 SFr.	1986 SFr.
Bankenkreditoren auf Sicht Due to banks, demand	**15 282 146**	21 547 105
Bankenkreditoren auf Zeit Due to banks, time	**136 128 927**	208 690 639
– davon mit Laufzeit bis zu 90 Tagen – of which maturing within 90 days	**[76 149 041]**	[133 070 470]
Kreditoren auf Sicht Demand deposits	**2 456 424**	3 539 318
Kreditoren auf Zeit Time deposits	**4 000 000**	9 293 746
– davon mit Laufzeit bis zu 90 Tagen – of which maturing within 90 days	**[4 000 000]**	[9 293 746]
Sonstige Passiven Other liabilities	**21 914 393**	19 363 654
Dividende Dividend payable	**1 200 000**	1 200 000
Aktienkapital Share capital	**8 000 000**	8 000 000
Gesetzliche Reserve Legal reserve	**2 530 000**	2 450 000
Freie Reserve Special reserve	**10 700 000**	10 100 000
Vortrag auf neue Rechnung Retained earnings carried forward	**247 908**	284 947
	202 459 798	284 469 409

Ertrag *Income*	**1987** **SFr.**	1986 SFr.
Aktivzinsen Interest income	**13 617 479**	13 249 656
Ertrag der Wechsel Income from bills	**7 325 136**	8 554 321
Ertrag aus Wertschriften Income from securities	**535 237**	722 895
Kommissionsertrag Commission income	**290 375**	632 632
Ertrag aus Handel mit Devisen Income from foreign exchange	**248 433**	1 049 245
Übriger Ertrag Other Income	**991 850**	424 400
	23 008 510	24 633 149

Gewinn- und Verlustrechnung per 31. Dezember 1987
Statement of Income for the year ended 31st December 1987

Aufwand *Expenses*	**1987** **SFr.**	1986 SFr.
Passivzinsen Interest expenses	**15 581 787**	16 725 581
Kommissionsaufwand Commission expenses	**256 082**	331 727
Personalkosten Personnel expenses	**2 146 691**	2 177 522
Pensionskassenbeiträge Pension fund contributions	**239 973**	200 067
Geschäfts- und Bürokosten Office expenses	**1 485 840**	1 267 062
Steuern Taxes	**560 230**	588 000
Abschreibungen und Rückstellungen Write-offs and provisions	**894 946**	1 450 341
Reingewinn Net profit	**1 842 961**	1 892 849
	23 008 510	24 633 149

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ANNEX C

A.I.D. Policy Papers

- Trade Development
- Private Enterprise Development
- Co-Financing

(Available upon request from PPC)

A.I.D. Policy Paper
Trade Development

U.S. Agency for International Development
Washington, D.C. 20523
July 1986

PN-AAV-461

A.I.D. Policy Paper

PRIVATE ENTERPRISE DEVELOPMENT

(REVISED)

U.S. Agency for International Development
Washington, D.C. 20523

March 1985

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A.I.D. Policy Paper

CO-FINANCING

U.S. Agency for International Development
Washington, D.C. 20523
May 1983

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ANNEX D

Forfaiting as a Financing Method for International Trade

by C.P. Stanton

Not attached, but available upon request from PRE/I.

International Science and Technology Institute, Inc.
Headquarters 1129 20th Street N.W. Washington D.C. [illegible]
202/785-0831 • Telex 272785 ISTI UR • FAX 202 [illegible]

FORFEITING AS A FINANCING METHOD FOR INTERNATIONAL TRADE

by

Charles P. Stanton

Paper Prepared for the
International Science and Technology Institute, Inc.
at the Request of the Bureau for Private Enterprise
of the Agency for International Development (A.I.D.)
of the U.S. Department of State

November, 1987

ANNEX E

Design Survey "Task No. 11"

by Dr. H. Reeb

Not attached, but available upon request from PRE/I.

PDC-
CONTRACT NO DPC-2002-C-00-7184-00 ISTI

TASK No 11

Consulting Assignment

Consultant:

Dr. Heinz Reeb
c/o EDESA MANAGEMENT AG
Kreuzstrasse 26
P.O. Box 490
CH - 8034 Zurich
Switzerland

May 31, 1988
HR/cl

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