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**FEASIBILITY STUDY FOR A
GUARANTY FACILITY FOR
SECTION 936 OF THE
CBI PROGRAM**

Final Report

June 1990

Price Waterhouse



June 8, 1990

Carolyn Crabbe
Investment Officer
Bureau for Private Enterprise
Agency for International Development
321 21st Street, N.W.
Washington, DC 20523

Dear Carolyn:

We are pleased to present ten copies of the Final Report of our Feasibility Study for a Guaranty Facility for Section 936 of the CBI Program. The successful implementation of the Section 936 CBI program has been constrained by the absence of viable credit enhancement sources. This study, intended to examine the feasibility of using the Private Sector Revolving Fund Guarantee Authority managed by PRE, will provide the background and recommendations necessary to assist PRE in addressing this issue.

We appreciate the opportunity to be of service to you on this important assignment. Please feel free to call us if you require any further assistance.

Sincerely,

J. Richard Breen
Director,
Financial Sector Development Project

cc: Sandra Frydman, PRF/PD/FSDP

TABLE OF CONTENTS

I. Executive Summary.....1

II. Introduction

 A. Objectives.....5

 B. Background

 1. Historical Perspective.....5

 2. Puerto Rico's CBI Program.....6

 3. Recent Developments.....6

III. Review of CBI Investments

 A. Introduction.....8

 B. Analysis of 936 Portfolio.....9

 C. Existing CBI Investments

 1. Summaries of Existing Projects.....11

 2. Potential Projects.....16

IV. Analysis of Demand for Section 936 Loan Guarantee

 A. Introduction.....17

 B. Constraints to Increased CBI Investments

 1. Commercial and Sovereign Risk.....17

 2. Project Size.....18

 3. U.S. and Puerto Rican Government Requirements.....19

 4. The Approval Process.....19

 5. Absence of TIEA Countries.....19

 C. CBI Financial Institutions.....20

 D. Other Financial Institutions.....24

V. Conclusions and Recommendations.....26

APPENDICES

Appendix I List of CBI Projects

Appendix II Caribbean Basin Commercial Banks and Subsidiaries

**Appendix III Law No. 9 - Caribbean Basin Project
Financing Authority**

**Summary of Caribbean Basin Partners for
Progress Partnership Agreement**

Appendix IV List of Interviews

I. EXECUTIVE SUMMARY

A. Background

The passage in 1986 of Section 936(d)(4) of the IRS Code, made available some \$14 billion in earnings of U.S. companies in Puerto Rico for medium and long-term financing of private sector projects in the Caribbean Basin. However, only seven projects have been funded under this program since its inception, a level far below that anticipated by the U.S. Congress, the Puerto Rican Government and the business community in the Caribbean Basin.

Through an intricate system of available tax benefits, the 936 companies have been encouraged to retain the income generated by their Puerto Rican operations for up to 10 years. Residing within the financial institutions of Puerto Rico, mainly in the commercial banks such as Citicorp and Chase Manhattan, these funds have been used to generate economic development in Puerto Rico.

B. Objectives

The purposes of this study are:

- o To identify the constraints to the use of 936 funds from the point of view of both the lender and the borrower
- o To determine whether a 50% guarantee provided under the Private Sector Revolving Fund managed by PRE/I would be useful in increasing the flow of funds
- o To recommend a workable guarantee structure and other measures necessary to address the constraints identified.

C. Review of CBI Investments

The 936 investment portfolio in Puerto Rico is a conservative, short-term one, characterized by high-yield instruments such as certificates of deposits, repurchase and reverse repurchase agreements, GNMA bonds, AFICA bonds and other instruments required under the Puerto Rican Industrial Incentives Act.

Drawing on these funds available through the financial institutions and the Puerto Rican capital markets, seven projects have been funded in the Caribbean Basin. These are:

- o The ABC corrugated box factory in Dominica. This project was \$2 million in size and involved the construction of a corrugated box factory in Dominica.

The loan was made by Citibank with a parent company guarantee.

- The purchase and lease of aircraft by Air Jamaica. This project was funded by a bond issue managed by Drexel Burnham Lambert, Puerto Rico Inc. It was \$51 million in size and was guaranteed by American Express Bank and Sanwa Bank.
- The construction and equipping of a power barge for the Dominican Republic. This project which is being undertaken by Seaboard Marine involves the sale of electricity to the Government of the Dominican Republic. The loan for this \$18 million project was made by Chase Manhattan with a parent guarantee.
- The modernization and expansion of the long-distance telephone system in Barbados. This project involved the purchase of telecommunications equipment by the Barbados External Telephone Company, a subsidiary of Cable & Wireless. The loan, extended by Scotiabank, totaled \$13 million. A comfort letter was provided by the parent company.
- The refurbishing of the Wyndham Rose Hall Beach and Country Club in Jamaica. Chase Manhattan issued a 10-year, (\$4 million) note to finance the refurbishing of the Wyndham Rose Hall Beach and Country Club in Jamaica. A full guarantee was provided by OPIC
- The purchase of pre-fabricated houses from Puerto Rico by the Government of Jamaica. One of the first to be funded under the program, this project involved the purchase of pre-fabricated houses from Puerto Rico. Financing from this project totaling \$8.7 million was made available by the Government Development Bank of Puerto Rico (GDB) and the Puerto Rico Industrial Development Company (PRIDCO).
- The construction of the Puerto Rico - Jamaica "branch" of the AT&T Transcaribbean Cable. A total of \$17 million was raised through a bond issue in Puerto Rico to finance the Jamaican section of AT&T's Transcaribbean Fiber Optic Cable. Credit enhancement was provided by AT&T.

These projects range from \$2 million to \$51 million in size and have established the pattern to 936 lending activities. An analysis of the loan structures used for each of these projects shows that in all instances but one, either off-shore guarantees were obtained for cross-border lending or the transaction was structured to ensure that all risk would be U.S. risk.

Guarantee coverage included all risks and was obtained from a number of sources including the U.S. Government, regional governments, parent companies and other financial institutions.

C. Conclusions and Recommendations

Based on the interviews conducted with financial institutions and investors in Puerto Rico, Barbados, Jamaica and the Dominican Republic, the following conclusions were made:

- o U.S. commercial and investment banks require a full (100%) guarantee for all risks associated with Section 936 loans.
- o Partial guarantees will not be attractive to U.S. commercial and investment banks but might be to Canadian banks and other selected financial institutions.
- o Even if full guarantee coverage is available, U.S. commercial and investment banks will only consider projects in excess of \$3 million.
- o Canadian commercial banks are willing to consider projects in the range of \$1 and \$3 million, with or without a guarantee.
- o Investors and banks in the Caribbean Basin are reluctant to engage in foreign currency borrowing or lending because of the associated exchange and transfer risks.
- o CBI financial institutions generally believe that any guarantee fee in excess of 1% would be unattractive.

We do not believe that a 50% guarantee will be attractive to the U.S. commercial and investment banks in Puerto Rico but will be attractive to the Canadian commercial banks. If PRE/I wishes to pursue the development of a guarantee facility on this basis, we recommend the following approaches:

- o Providing full guarantee coverage for projects between \$1 million and \$3 million in size
- o Providing full guarantee coverage for levels of sovereign risk, backed by negotiated agreements with CBI Central Bank authorities
- o Limiting guarantee coverage to projects generating foreign exchange or having access to export earnings in off-shore accounts

- o Limiting implementation to certain countries where foreign exchange markets are relatively stable.

II. INTRODUCTION

A. Objectives

Since the passage in 1986 of Section 936(d)(4) of the IRS Code, the movement of loans into the Caribbean Basin from Section 936 funds in Puerto Rico has not occurred at the rate expected by the U.S. Congress and the Caribbean Basin countries. Whether this was due to Puerto Rican promotion efforts which created unrealistic expectations or to fundamental flaws in the concept, it is generally believed that the program has not lived up to expectations. In order to increase the flow of funds, PRE/I has undertaken an examination of the feasibility of establishing a guarantee facility for loans made under this program.

The purpose of this study is three-fold:

- o To identify the constraints on the use of Section 936 both from the lenders' and the borrowers' points of view
- o To determine whether a 50% guarantee made available to Section 936 loans to projects of between \$1 million and \$3 million in size would assist in increasing the flow of funds into the Caribbean Basin;
- o To make recommendations on the structure of such a facility and other measures to address the constraints identified in the study.

B. Background

1. Historical Perspective

Under Section 936 enacted in 1976, U.S. subsidiaries in Puerto Rico were permitted to distribute profits to parent corporations on a current basis and receive a credit in the U.S. The possibility of having immediate access to the profits of their subsidiaries in Puerto Rico as well as the tax incentives structure developed by the Puerto Rican Government, attracted a large number of U.S. companies to the island. The funds generated by the companies under Section 936 were welcomed by the Puerto Rican banking sector which was then experiencing a liquidity crisis. The massive inflows of external funds eased the banks' liquidity situation and laid the foundation for the revival of the Puerto Rican economy by reducing the cost of funds to the banks and the ultimate borrowers.

In addition to encouraging significant amounts of private capital inflows into the economy, Section 936 fueled the indirect and direct creation of jobs throughout the society. It is estimated that for each direct job created under Section 936, about one or

two jobs are created indirectly. Section 936 is responsible not only for the generation of employment for Puerto Rico's economic revival of the early 1980s, but also responsible for the development of the infrastructure, the provision of affordable housing and the financing of domestic industry.

2. Puerto Rico's CBI Program

During debate of the Tax Reform Act in 1986, the U.S. Congress raised the issue of replacing Section 936 with a wage credit arguing that the original objective of Section 936--the generation of employment in Puerto Rico--was no longer being addressed efficiently under Section 936. In an effort to preserve these benefits, the Government of Puerto Rico concluded an agreement with the U.S. Congress and the Department of the Treasury which is embodied in Section 936(d)(4), commonly known as the 936 CBI Program.

The intention to replace Section 936 in 1986 created concern within the Puerto Rican government and banking communities as well as among the 700 U.S. companies with operations in Puerto Rico enjoying the benefits of Section 936. In order to preserve the benefits under this section of the IRS code, the Puerto Rican Government concluded an agreement with the U.S. Congress, specifying that the funds generated under Section 936 would be used to finance private sector projects in the Caribbean Basin countries which were beneficiaries of the Caribbean Basin Economic Recovery Act (CBI) and which had signed Tax Information Exchange Agreements (TIEAs) allowing the IRS access to the financial accounts of U.S. citizens in that country.

3. Recent Developments

With the passage of Section 936(d)(4), the burden of overseeing and promoting the program fell to the Puerto Rican Economic Development Administration (FOMENTO) and the Commissioner of Financial Institutions as the regulator of the commercial, investment and savings banks in Puerto Rico. Promotion of the program began immediately, and Jamaica, Barbados, Grenada and Dominica were among the first countries to conclude TIEAs with the U.S. and to enact the necessary enabling legislation.

Promotion of the program, however, outpaced the creation of Puerto Rican Government and U.S. Treasury structures needed to implement the program. Projects were approved on a case-by-case basis. Delays in the program were significant, discouraging both the financial institutions in Puerto Rico and the potential investors and commercial banks in the Caribbean Basin from participation in the program.

Within Puerto Rico, responses to the program were mixed. After years of having exclusive access to the 936 funds, Puerto Rican

authorities were concerned about both the movement of funds away from the island and possible competition from the Caribbean Basin. In response to this concern, the Government initially attempted to promote the concept of "twin" or complementary plants which encouraged 936 companies to move part of their production (primarily the labor-intensive activities) off-shore into the Caribbean Basin. This arrangement has been utilized by many of the 936 companies including Westinghouse (which established several plants in the Santiago Free Zone in the Dominican Republic), Johnson & Johnson, SmithKline Beecham and TII Industries.

Another group that was slow to support the program was the Puerto Rican financial institutions. The financial sector in Puerto Rico had grown substantially since the original passage of Section 936 in 1976. Financial activities, including those of the commercial and investment banks, were limited to the Puerto Rico market, and focused on the deposits of the 936 companies.

Since these activities did not involve any cross-border and minimal commercial risk (because the clients were primarily the 936 companies themselves), lending within the Caribbean Basin was unfamiliar and approached with caution. Traditionally-required lending guarantees were not available in the Caribbean Basin and large "bankable" projects to which the commercial and investment banks were accustomed, were difficult to identify.

Finally, there were the 936 companies themselves, the legal owners of the 936 deposits who shared the concerns of the Puerto Rican financial institutions about the creditworthiness of the loans and the risks associated with lending into the Caribbean Basin. Furthermore, even though the companies had already made investments in the Caribbean through "twin" plant arrangements, the demand for such plants on the part of the 936 companies could not be sustained. This was especially true in the case of the capital-intensive pharmaceutical companies.

Significant 936 loan activity has developed only within the last year, three years since the passage of the law in 1986. A noticeable change has occurred in the program due to the increase in the number of TIEA countries in the Caribbean Basin with the addition of the Dominican Republic and Trinidad and Tobago; the development of temporary U.S. Treasury Regulations establishing the parameters of the program and clearly defining the criteria for eligible investors and projects; recent legislation establishing the Caribbean Basin Project Financing Authority in Puerto Rico; and actual finalization of transactions and disbursement of funds to several projects throughout the region.

III. REVIEW OF CBI INVESTMENTS

A. Introduction

The portfolio of investments of the 936 companies and the financial institutions in Puerto Rico are determined by two factors: the conservative, short-term financing requirements of the 936 companies and the applications of Regulation 3582 and the Puerto Rican Industrial Incentives Act.

Within Puerto Rico, the Commissioner for Financial Institutions is responsible for the enforcement of Regulation 3582, used to regulate the financial institutions located in Puerto Rico. Regulation 3582, which determines how banks invest their 936 deposits, has three goals: 1) to channel 936 funds into eligible activities and reserve requirements that will promote economic development in Puerto Rico, and 2) control the interest paid on 936 investments to ensure that the ultimate borrower will benefit from lower rates and 3) to ensure a more even distribution of 936 deposits among the banks.

Under the regulation, the banks must place 23-24% of their 936 deposits as follows: 15% to the Government Development Bank (GDB); 1-2% in the Economic Development Bank (EDB); and 7% in other high priority development activities. To ensure that deposit rates do not go up, the regulation requires the financial institutions to generate additional investment in eligible activities under the tablita (if rate is 70% of the Eurodollar rate) and the index which is related to the investment of 936 funds outside of Puerto Rico and the Caribbean Basin.

The rates payable on 936 investments as well as the rates available on 936 funds being lent to the CBI countries differ depending on the time of the year. During June and December, when requirements such as the payment of dividends on the mainland cause the 936 companies to repatriate their profits, both the rates paid on the investments and those available on 936 loans increase. In 1988, the 936 companies withdrew \$242 million from Citibank and Chase Manhattan, the largest holders of 936 deposits. Rates during these months can increase to more than 82% of the Eurodollar rate, causing the financial institutions to generate even more eligible activities to fulfill the requirements of Regulation 3582. The cost can be significant. The 936 companies generally maintain their profits in Puerto Rico for the remainder of the year unless there is an emergency need for funds as in the case of Johnson & Johnson several years ago when its sales of Tylenol fell in the U.S.

While the Industrial Development Income (IDI) generated by the 936 companies in terms of profits and investment income is considered tax-free in the U.S., it is taxed upon repatriation to the mainland by the Government of Puerto Rico. This "tollgate

tax," as it is commonly known, is 10% if immediate repatriation occurs.

The Government has developed a system of tax benefits to encourage the 936 companies to retain their profits in Puerto Rico. This system entails the reduction of the tollgate over a period of time. If 50% of the IDI is invested, then a 5% tollgate is charged on the invested portion while the uninvested portion remains at 10%. However, if 50% is invested in Puerto Rican municipal bonds for 5 years, no tollgate tax is charged on any income. This is also the case if 50% is invested for 10 years in investments which qualify as 2j investments.

These are the main determinants of the investment portfolio of the 936 companies. Because of this incentive structure, the 936 companies generally maintain their profits in Puerto Rico for up to 8 years and funds are repatriated to the mainland between years 8 and 10. For this reason, most loans and bonds, such as those issued by AFICA, have tenors of 5, 8 or 10 years to accommodate the companies.

Company funds are managed primarily by the Treasurers or Comptrollers of the 936 companies. Investments in Puerto Rico are considered to be U.S. risk and the market is full of high-quality instruments which are backed by the U.S. Government, the Puerto Rican Government or the 936 companies themselves. Therefore, all the investment risk in the Puerto Rican market is assumed by the financial institutions and the 936 companies themselves.

B. Analysis of the 936 Portfolio in Puerto Rico

As of February 1990, the amount of 936 funds in Puerto Rico, in terms of eligible funds invested in eligible instruments, was \$9.3 billion of which 63.23% was in commercial banks, 13.42% in savings banks and 23.32% in brokerage houses. The Section 936 portfolio is mainly divided among five major instruments: Short-term investments (primarily 90-day certificates of deposit); repurchase agreements (repos); AFICA bonds, GNMA Bonds and 2j investments. These instruments, summarized in Exhibit I, can be described as follows:

o Direct Deposits and Certificates of Deposit

For the most part, the portfolio maintained by the 936 companies is a short-term, conservative one. Its emphasis on yield is reflected in the large portion of 936 funds held in the commercial and savings banks. Most of these are held in certificates of deposit (CDs) in such banks as Citibank, Chase Manhattan, Banco Popular, Banco de Ponce and Scotiabank. Direct deposits are also held in savings institutions which

account for 936 funds. In some cases, the funds in the savings banks come from reverse repurchase agreements. However, these instruments have dropped from \$1.5 billion in 1988 to \$1.2 billion at the end of 1989 with the drop in 936 business for the investment banks from 936 companies from \$2.8 billion (1988) to \$2.5 billion (1989).

o Repurchase Agreements (repos)

Repurchase Agreements (repos) are deposits effectively secured by ownership of securities. They are used by investment banks to channel funds to financial institutions that would not receive 936 funds directly. Under investment agreements, 936 companies agree to place a certain amount of 936 funds with the brokerage house for a period of time (about 5 years) for investment in various 2j investments.

Among the most common types of repos are those which allow 936 companies to purchase U.S. Government issued or backed securities, such as GNMA bonds (Ginnie Maes) with the understanding that the brokerage house will repurchase the securities generally within a year but more often in 90 days. In a simultaneous transaction, the brokerage house enters into "reverse" repos with savings banks and other institutions for the purchase of securities (Ginnie Maes) making the funds available for other activities. The 936 companies are thus provided a form of "medium-to long-term" investment without being tied into a rate over the long-term.

o AFICA Bonds

Established in 1977 under Act No. 121, the Puerto Rico Industrial Medical Education and Environmental Pollution Control Financing Authority (AFICA) was created for the purpose of promoting economic development and social welfare in Puerto Rico. It provides eligible private entities with access to the tax-exempt capital market in order to obtain financing for qualified projects. AFICA obtains funds through the issue of tax-exempt revenue bonds. The loan agreement between AFICA and the private borrower provides the security and the source of payments for the bonds. As of June 1989, AFICA had revenue bonds outstanding to the amount of approximately \$1.8 billion. The terms of the bonds generally range from 5 to 10 years and are priced at LIBOR relative to the tenor of the bond.

936 INVESTMENT PORTFOLIO

Instrument	Maturity	Yield (%)
CDs	90 Days	7.00
	180 Days	7.50
Repos	90 Days	7.27
	180 Days	7.17
AFICA Bonds	5 Years	7.88
	8 Years	8.13
Ginnie Maes*	9 Years (Average)	8.90
P.R. Municipals**	5 Years	6.60
	8 Years	6.75

Source: Paine Webber, 4/25/90

NOTES:

*8.5% coupons without premium

**Insured AA rated issues

10a

o GNMA Bonds (Ginnie Maes)

These mortgage bonds, issued in Puerto Rico and backed by the Government National Mortgage Association (GNMA), are high credit quality, high-yield instruments that generally have a tenor of 15 to 20 years. These are long-term instruments which are subject to the prepayment of the underlying mortgages making the term uncertain. For these reasons, they have limited appeal to 936 company treasurers unless portfolio management techniques can be applied to mitigate the prepayment risk. However, 936 funds do find their way indirectly into Ginnie Maes through the reverse "repos" described previously.

o Other 2j Investments

Under Section 2j of the Puerto Rican Tax Incentives Act of 1987, 936 companies are directed to place their funds in a number of specific investments. The interest and dividends on 936 funds invested in these instruments are tax exempt and qualify for special tollgate tax treatment. Investments covered in Section 2j include construction and housing loans; obligations of the Puerto Rico Conservation Trust, Farm Credit Banks of Baltimore; maritime and air operations; capital liabilities and preferred stock issued by financial institutions in Puerto Rico under The Puerto Rican Banking Act (Act No. 55, May 12, 1933); and 936 deposits or investments made by banks, savings and loans, savings banks, brokerage houses and other similar institutions. It is estimated that \$4-\$5 billion are invested directly in 2j assets.

C. Existing CBI Investments

1. Summaries of Existing Projects

Even though the Section 936 program has been in existence for several years, the investments financed under this program number only about seven. The 936 CBI investments examined in this section are limited to projects funded directly from Section 936 funds on deposit at Puerto Rican financial institutions in CBI beneficiary countries which have signed TIEAs. The projects under consideration in this section do not include projects undertaken in non-TIEA countries funded from non-possession source income. A project summary is contained in Exhibit II and a complete list of projects is contained in Appendix I. The latter includes projects funded with and without 936 funds in TIEA and non-TIEA countries.

All of the projects described in this section have similar

characteristics. They are large projects; the smallest one being \$2 million and the largest \$51 million. Furthermore, all the loans or notes, with one exception, have been guaranteed either by other commercial banks (as in the case of Air Jamaica), by parent companies, or by the U.S. Government (as in the cases of AT&T and Wyndham Rose Hall respectively). All of these were off-shore guarantees. Finally, most of the transactions were conducted in Puerto Rico with Puerto Rican institutions to avoid or reduce cross-border exposure. Inconvertibility and other sovereign risks were assumed by the borrowers or guarantors. The only exception, the loan to the Barbados External Telephone Company (BET), was one in which Scotiabank, the creditor bank, assumed the cross-border risk.

o ABC Container (Dominica), Ltd.

In April 1989, ABC Container, a manufacturer of corrugated boxes in Puerto Rico, decided to establish a box factory in Dominica to provide carton containers to Dominica's banana industry. The borrower in this case was ABC Container (Dominica) Ltd and the amount of the loan was \$2.1 million. The funds were disbursed in August 1988 and the term was for 10 years. The size of loan made by Citibank Puerto Rico to the Puerto Rican subsidiary, an existing customer of the bank, is the smallest loan made to date under the program. While the bank is assuming the credit risk associated with the loan, this is expected to be minimal since the company is an existing client. Furthermore, the transaction was conducted in Puerto Rico, with a Puerto Rican company guarantee and the cross-border risk is being assumed by the borrower rather than the bank.

o Air Jamaica

This transaction involved the purchase and lease by Air Jamaica of two aircraft (Airbus A300-B4s) valued at \$65 million by Air Jamaica and was based on two finance leases with ALG Puerto Rico, a leasing company organized as a corporation in Puerto Rico as an eligible "similar" institution under Regulation 3582. Fifty percent-owned by ALG, Inc, a Missouri-based company, the corporation was able to finance the acquisition and leasing of aircraft to Air Jamaica through the issue of \$51 million of notes (Series A--\$14,000,000; Series B--\$15,000,000; Series C--\$5,000,000 and Series D--\$17,000,000). The rate on the Series A notes was set at 81%, Series B at 83%, Series C at 83% and Series D at 88% with the initial rate based on 90-day LIBOR as of the date of issue (August 1989). The notes have varying maturities with the Series A and B due in 1994 and 1997 respectively

and Series C and D due in 2000.

These notes were guaranteed by a letter of credit from American Express Bank Ltd and a "wraparound" letter of credit from Sanwa Bank. They will be retired through lease payments from Air Jamaica into a sinking fund managed by American Express. To secure its obligation under the lease arrangement, Air Jamaica made security payments of \$4,750,000. The aircraft leases are guaranteed by the Government of Jamaica and the aircraft are registered in all the countries to which the airline flies, making repossession possible in case of default. Exchange and inconvertibility risks have been assumed by the borrower, a government-owned institution and, currently a net user rather than generator of foreign exchange. There have been no agreements between Air Jamaica and the Bank of Jamaica for priority access to foreign exchange. Funds were disbursed in August 1989.

o The Barbados External Telephone Company (BET)

One of the unique transactions conducted under the program, this loan, which amounted to \$13 million, will be used for the purchase of switching equipment, PBX systems, and cables for the expansion and modernization of the long-distance telephone system in Barbados. The rate on the loan was 80-85% of LIBID (30-180 days' 936 rate plus 1/4).

Unlike the others, this transaction did not involve the use of an off-shore guarantee. Ownership of BET is 60% by Cable and Wireless (C&W), 25% by the Barbados government and 15% by others. As an existing client of Scotiabank Barbados Ltd, BET was able to approach Scotiabank Puerto Rico for 936 funding based on a recommendation and credit analysis conducted by the local bank. In this case, the funds will be lent off-shore (in Barbados) and Scotiabank will assume both the credit and cross-border risk. As the majority shareholder in BET, C&W provided a comfort letter (which is not legally binding) to cover the transaction.

However, the decision to fund this transaction and accept the risk on the part of Scotiabank was based on C&W's status as an existing client of Bank of Nova Scotia on a worldwide basis as well as BET's reliability in generating foreign exchange through a monopoly on the island's long-distance traffic. The loan was made in the context of Scotiabank's C&W exposure worldwide, its country exposure limit in Barbados and the strength of

BET's creditworthiness.

o AT&T Fiber Optic Transcaribbean Cable

The first project to be funded under the temporary U.S. Treasury regulations was the \$17 million loan used to fund the section of the Trans Caribbean Fiber Optic Cable which serves the Dominican Republic, Jamaica and Colombia. The major issue in the funding of this transaction was the determination of the portion of the Cable which could be considered eligible CBI/TIEA investments. Since the Dominican Republic was not a TIEA country, the only section of the \$180 million project which qualified was the \$17 million Jamaican portion.

The financing was accomplished through the issue of 10-year notes (renewable after 5 years for an additional 5 years). The interest rates on the notes were based on the 936 90-day floating rate (about 78% of LIBID). The notes were managed by a syndicate of banks with Chase Manhattan as the lead bank and the Banco de Ponce, Banco Popular, Paine Webber and Citicorp as participants. Most of the issue was purchased by Chase with a small part by Banco de Ponce.

In this case, as in the case of BET, the creditworthiness of AT&T provided the basis for the transaction as only issues that are rated AA or better are attractive in the Puerto Rican market. In addition, the transaction was conducted in Puerto Rico with a Puerto Rican-based company with any cross border risk being assumed by the borrower.

o Seaboard Overseas Ltd

The first project to be completed in the Dominican Republic under its recently signed TIEA involved the construction and equipping of a 40 megawatt power barge for the sale of electricity to the Corporacion Dominicana de Electricidad (CDE). The amount of the loan was \$18 million and has been made by Chase Manhattan in the form of a "bullet" loan to be repaid in 8 years. A parent guarantee provided for loan repayment based on an arrangement with the Government of the Dominican Republic for the purchase payments to be made in foreign currency. Since the company is not a Dominican company (the loan was made to Transcontinental Capital, a Bermuda subsidiary of Seaboard Marine, a small, U.S.-based multinational with a Puerto Rican subsidiary), the bank is not assuming any cross-border risk and the foreign currency risk is

being assumed by the borrower. The rate in this case was about 85% of LIBID.

o Wyndham Rose Hall Beach and Country Club

Part of the Government of Jamaica's efforts to privatize its hotels, this project is being financed through the Jamaican debt conversion program by Trammell Crow, the U.S.-based owner of the Wyndham chain of hotels which is purchasing this hotel property. The 936 loan, a 10-year note for \$4 million at 86% of LIBID through Chase Manhattan, to be used for the refurbishing of the hotel.

The perceived risks of this transaction were minimal due to Trammell Crow's reputation as a well-known and financially sound member of the U.S. real estate community. Moreover, the transaction was backed by a U.S. Government guarantee provided by the Overseas Private Investment Corporation (OPIC). This was a full guarantee covering both sovereign and commercial risks associated with the transaction.

o Jamaican Housing Project

One of the first projects to be funded under Section 936(d)(4) was the purchase of 754 pre-fabricated houses by the Government of Jamaica from Puerto Rico. This purchase which was made using 936 funds on deposit in the GDB and funds from the Puerto Rico Industrial Development Company (PRIDCO) amounting to \$8.7 million at a rate of 85% of LIBOR against an official Government of Jamaica guarantee. This involved the placement of foreign currency in an off-shore U.S. account by the government to secure the loan. Even though the transaction was undertaken, it is highly unlikely that the Jamaican Government will finance a similar transaction because of its effect on the foreign exchange reserves of the Bank of Jamaica. The terms of the loan were \$7.5 million from the GDB for 16 1/2 years at 8% and \$1.2 million from PRIDCO for 10 years at 8 1/2%. The funds were disbursed in October 1987.

Most well-developed projects have been accepted after consideration by the commercial banks. One of the first projects to be actively considered and rejected for financing, was the construction of the Spanish Fort Free Zone in Jamaica. This project was estimated to cost between \$17-\$23 million and was to be funded in part by the National Bank of Commerce in Jamaica. To conclude the transaction, Drexel Burnham Lambert Puerto Rico sought a guarantee from OPIC which was refused on the grounds

that the proposed manager of the Free Zone had no prior experience in the management of a private free zone nor any equity participation in the project. Unable to obtain credit enhancement, the developer lost interest in the transaction.

2. Potential Projects

At the present time, FOMENTO is considering several projects for funding which include Abbott Laboratories (Dominican Republic), the Caribbean Methanol Company (Trinidad and Tobago), and Phoenix Park (Trinidad and Tobago). These projects have been approved by the Commissioner of Financial Institutions and FOMENTO without the disbursement of funds.

In the case of Abbott Laboratories, the company plans to use \$4.5 million to construct a "twin plant" in the Dominican Republic to produce intravenous solutions. Expected to be funded in 1990, the plant will be located in one of the Dominican free zones.

In the case of Caribbean Methanol Company, a joint venture between a Trinidad Life Insurance company and foreign investors, the funds will be used for the construction of Trinidad's second methanol plant. The project size is \$79 million and is expected to receive an OPIC guarantee. Citibank will loan 936 funds for a term of 8 years. Disbursement of funds is planned for May 1990.

Finally, in the case of Phoenix Park, a joint venture between the Trinidad Government and a private investor, the 936 funds will be used to build a facility to separate butane and methane from natural gas. The estimated project size is \$6.5 million and funding will be provided by Citibank. Credit enhancement in this case will be provided by Dupont during the construction phases. The terms of the loan is 9 years and the expected date of disbursement is April 1990.

In addition to these projects which have received approval, there are several projects with the potential of qualifying for 936 funding. A \$1-\$3 million project by Chestnut Hill Farms in the Dominican Republic, a subsidiary of Seaboard Marine, involves the export of melons and winter vegetables to the U.S. market. Preliminary discussions have ascertained that Seaboard Marine is willing to provide a guarantee of all the risks associated with the project. On this basis, the Banco de Progreso is interested in seeking 936 funds for financing. In addition, Royal Bank of Canada in Barbados is considering two tourism projects for \$1 million and \$10 million respectively in size. Finally, Canadian Imperial Bank in Barbados is looking into the funding of a project for the manufacture of pharmaceuticals. The company involved is currently a supplier to Eli Lilly.

Exhibit II**Summary of 936 CBI Investments**

Project	Country	Lender	Rate (%)	Tenor (years)	Size (\$M)	Credit Enhancement
AT&T Transcaribbean Fiber Optic Cable	Jamaica	Public Offering	78/LIBID	10	17	100% -- Parent
Jamaica Housing Project	Jamaica	GDB	85/LIBOR	10-16.5	8.7	100% -- GOJ
ABC Container (Dominica) Ltd	Dominica	Citibank	n/a	10	2.1	100% -- Parent
Air Jamaica	Jamaica	Public Offering	83/LIBOR	Varies	51	100% -- American Express Bank/ Sanwa Bank
Barbados External Telephone Company	Barbados	Scotiabank	85/LIBID	3-5	13	Comfort letter--Parent
Seaboard Overseas Ltd	DR	Chase Manhattan	85/LIBID	8	18	100% -- Parent
Wyndham Rose Hall Beach and Country Club	Jamaica	Chase Manhattan	86/LIBID	10	4	100% -- OPIC

16a

IV. ANALYSIS OF DEMAND FOR SECTION 936 LOAN GUARANTEES

A. Introduction

In order to successfully analyze the demand for a 936/CBI investment guarantee, it is necessary to examine some of the existing constraints to increased 936 lending, not only in Puerto Rico but also in the Caribbean Basin. This analysis will assist in determining the feasibility of the facility, identifying the issues that would have to be addressed in the structuring of such a mechanism and targeting potential markets for the sale of this product.

The major concern of the Puerto Rican financial institutions as holders and lenders of 936 funds is transfer risk. Puerto Rican commercial and investment banks are unwilling to lend or raise funds in the Puerto Rican markets without full, off-shore guarantees. While the concerns of the regional commercial banks are similar, their focus is on foreign exchange risk especially in Jamaica and the Dominican Republic. For this reason, most of the local banks lend in local currency and would only consider foreign currency lending if the foreign exchange risk can be removed. However, in Barbados, Royal Bank of Canada and Canadian Imperial Bank have foreign currency loans in their portfolios with tenors as long as 7 years. In Jamaica, Citibank lends only in foreign currency.

B. Constraints to Increased CBI Investments

1. Commercial and Sovereign Risk

For the commercial banks, and indeed any of the financial institutions engaged in lending activities in the 936 marketplace in Puerto Rico, the reduction of commercial and sovereign (inconvertibility, political violence and expropriation) risks are of major importance. Although banks may differ with regard to which risk is more important--some are more concerned about sovereign risk--all are in agreement that projects which produce additional risk exposure in the Caribbean Basin is unacceptable. This conservative approach to risk is dictated not only by the banks' basic commercial lending practices, but also by the requirements of the U.S. bank regulatory agencies.

While the regulatory agencies maintain that the decision to lend in CBI countries is not determined by banking regulations, but rather by bank management, bank examiners have developed a loan portfolio classification system based on the decisions of the Inter-Agency Country Exposure Review Committee (ICERC), an inter-agency group with representatives of the Office of the Comptroller, the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Board of Governors. This classification

system rates a bank's loan portfolio according to its exposure in developing countries and has the potential effect of downgrading the bank's lending portfolio. As a result, Puerto Rican commercial banks are willing to lend to projects only when the cross-border and commercial risks can be guaranteed off-shore. The burden that these regulations place on the banks in terms of off-shore guarantees has been one of the chief obstacles to the success of the program.

Most of the Section 936 loans to date have been made with an off-shore guarantee from either parent companies or the U.S. Government, as in the case of The Wyndham Rose Hall in Jamaica or a CBI Government, as in the case of the Jamaican Housing Project. The BET project in Barbados, however, is one which did not receive an off-shore guarantee.

2. Project Size

Of all the projects funded to date under Section 936, project size has ranged from \$2 million to \$51 million, the size of the Air Jamaica transaction. Citibank is currently considering the funding of two projects in Trinidad and Tobago for \$70 million and \$79 million respectively. If funded, these will be the largest projects under the 936 CBI Program. Puerto Rican commercial and investment banks generally maintain that projects of less than \$6 million in size hold little interest for them as it is not cost-effective to develop and complete such transactions. Furthermore, based on the transaction costs of a bond issue through AFICA, some bankers feel that a project must be between \$10 million and \$12 million in size to justify the transaction costs expected under the newly-created Caribbean Basin Project Financing Authority which has yet to be utilized.

Not only are small projects not cost-effective in terms of transaction costs, they are also riskier. This characteristic makes the identification of suitable guarantee sources more difficult. Since credit enhancement has been a prerequisite for 936 funding, small projects have not been actively considered. The funding of the ABC Corporation in Dominica was an exception to the rule because the company was an existing client of Citicorp in Puerto Rico. That funding for projects this size or smaller, will continue to be the exception is evident from the size of both projects that have received funding and those actively under consideration.

Within Puerto Rico itself, the issue of project size differs from bank to bank. While most of the U.S. commercial banks fund only large projects and are unwilling to consider projects of less than \$6 million, this is not the case with the Canadian Banks such as Scotiabank and Royal Bank of Canada. This difference in focus may be reflective of the fact that the Canadian bank network is found primarily in the smaller Eastern Caribbean

islands and Barbados. These banks were willing to consider project sizes of between \$1 and \$3 million.

3. U.S. and Puerto Rican Government Regulations

Initially, one of the major constraints to the implementation of the 936 CBI program was the absence of U.S. Treasury and Puerto Rican Government regulations governing the program. While the language contained in Section 936(d)(4) contained references to "active business assets" and "development projects," the exact meaning of these terms stayed undefined until September 1989 when the U.S. Treasury published its temporary regulations. The regulations contained definitions, but they also contained important restrictions on the purposes for which 936 funds could be used. The regulations contained no references to the use of 936 funds for privatization, one of the main generators of private sector projects in the region and trade financing. In addition, they placed limits on the use of 936 funds for refinancing (only assets that were less than 5 years old) and on working capital loans. In Puerto Rico, the charter of the GDB limits the use of 936 funds on deposit in the GDB to the funding of "twin plant" projects.

4. The Approval Process

The delay in the formulation of Treasury Regulations at the start of the program, together with the required approval process in Puerto Rico which involved FOMENTO and the Commissioner of Financial Institutions, caused significant delays in the approval process and discouraged potential investors and commercial banks. In the absence of published regulations, projects had to be approved by the U.S. Treasury on a case-by-case basis and the guidelines were developed in an ad-hoc fashion. Financial institutions and investors seeking to lend and borrow under the program had to guess at the types of projects that would meet with Treasury approval and then expend money and time to obtain that approval and "no objection" letters from the IRS.

Since the publication of the regulations, financial institutions and investors have more precise guidelines making their decisions. However, because of the "due diligence" requirements placed on the Commissioner of Financial Institutions in Puerto Rico with respect to the administration of the program, case-by-case project approvals are still required by the Commissioner. These are not granted unless projects are accompanied by an opinion of Puerto Rican counsel that the project falls within the Treasury guidelines. For CBI financial institutions and investors, these requirements are costly.

5. Absence of TIEA countries

During the early years of the program, the participation of the

CBI countries was limited by the requirement laid down by the U.S. Treasury that only countries that had concluded TIEAs with the U.S. could participate in this program. For countries with a sociedad anonima commercial system--which included most of Central America--the possibility of participation was limited. Since this was not a problem in the English-speaking Caribbean, the first countries to sign TIEAs were Barbados, Jamaica, Grenada and Dominica. However, the financial institutions in Puerto Rico believed that the investment opportunities offered by these countries were few, and this attitude limited the expansion of the program.

C. CBI Financial Institutions

The participation of CBI financial institutions in the 936 program has been limited for the following reasons:

o 936 loans must be booked in Puerto Rico

In order for a loan to be considered eligible according to the Puerto Rican and U.S. Treasury Regulations, it must be made from 936 funds on deposit in Puerto Rico. In addition, the lender must be an "eligible financial institution" under Regulation 3582 and must be located and incorporated in Puerto Rico. Furthermore, approval of 936 loans must be made on a case-by-case basis by FOMENTO and the Commissioner of Financial Institutions who now requires the opinion of Puerto Rican legal counsel that the transaction falls within the current guidelines established by the U.S. Treasury.

These restrictions have made the involvement of a local financial institution unnecessary as is evident when examining the projects already funded in certain countries. In the case of the loan to BET in Barbados made by Scotiabank, the loan appeared on the books of Scotiabank de Puerto Rico even though BET was an existing customer of Scotiabank in Barbados who was responsible for the credit analysis. This was also true in the case of projects funded by Chase Manhattan and Citicorp. Transactions are completed directly between the banks in Puerto Rico and the investors and commissions are paid to the Puerto Rican institution. Furthermore, in all the cases to date (with the exception of Scotiabank) the loans were made to U.S. or Puerto Rican parent companies rather than subsidiaries in the Caribbean Basin.

o Guarantees are required for 936 loans

Because of the concerns of the Puerto Rican financial institutions with the sovereign risk associated with

loans made in the Caribbean Basin, the guarantee requirement is being strictly enforced. Full, off-shore guarantees are being sought for any kind of financing, regardless of the size of the project. This issue was the subject of a letter from the Commissioner of Financial Institutions to ICERC explaining the inconsistencies of the classification system used by the Committee and the requirements of the 936 program to seek an exemption for loans made under Section 936(d)(4) from automatic adverse classification. ICERC responded that it was unable to consider loans on a case-by-case basis and that there was nothing available to mitigate the transfer risk associated with 936 loans. It further suggested that the banks consider an off-shore, third party guarantee to reallocate the ultimate risk.

With the exception of Scotiabank, which in Puerto Rico is regulated as a U.S. financial institution, all of the loans to date have been made based on off-shore guarantees. This requirement for lending into the Caribbean Basin has served to discourage the participation of local CBI financial institutions unable to identify guarantee sources. It is applicable not only to financial institutions and investors in the Caribbean Basin, but also to Governments in the region. Furthermore, guarantees are also required for CBI investors accessing the capital markets in Puerto Rico. For bond issues to be successfully sold in the Puerto Rican market, they must have a rating of AA or better. Credit enhancement is therefore required from either a financial institution or a company with a similar rating for the securities to be purchased by the financial institutions and the 936 companies. This was the case in both the Air Jamaica and AT&T transactions.

o Foreign exchange risk must be reallocated

The cross-border concerns of the CBI financial institutions are limited to the foreign exchange risk associated with foreign currency loans. Most local financial institutions in the Caribbean Basin engage primarily in local currency financing, partly due to the reluctance of local investors to assume the foreign exchange risk. The level of this reluctance, however, varies from country to country.

In Barbados, where the banking system has historically been liquid, the local banks have had little interest in foreign currency lending. However, with recent changes in the Central Bank's policies which have tightened the credit in the system producing a

liquidity crisis for the private commercial banks, the alternative of borrowing on the foreign exchange market is more attractive. Unofficially, the Central Bank moved to guarantee the foreign exchange rate to commercial banks who brought in foreign exchange and had to repay it during the crisis.

Several of the foreign banks such as Canadian Imperial, Royal Bank of Canada and Scotiabank have foreign exchange loans in their portfolio, some--in the case of Canadian Imperial--with tenors of 5 to 7 years. In addition, the banking community in Barbados has been able to access foreign exchange through the Central Bank at a rate that has remained stable over the last decade. A similar situation exists in the Eastern Caribbean.

In other countries, such as Dominican Republic and Jamaica, concern about the foreign exchange risk is more important. The gap between the official and parallel exchange markets is widening in the Dominican Republic, making foreign exchange borrowing unattractive. Not only is there uncertainty about the rate, but there is also a shortage of foreign exchange from official sources since foreign currency coming into the country passes through the parallel market. This is also the case in Jamaica where most of the local commercial banks are concerned about changes in the rate of foreign exchange and the availability of the funds when needed.

Under the current foreign currency regulations in place in Jamaica, the tourism industry is permitted to hold 20% of its foreign exchange earnings in a central account in Miami. This Retained Account allows the tourism industry to meet its foreign currency needs for imported inputs. A similar arrangement has been introduced under the Retained Account Scheme for Exporters which permit exporters to hold 25% of their incremental export earnings in a memorandum account in the Jamaica Central Bank. This scheme covers the exporters of non-traditional products to countries outside of CARICOM and export services for the overseas market such as data entry.

While the amounts permitted are not sufficient to service foreign currency loans, there is evidence that agreements can be made with the Central Bank on a case-by-case basis (primarily for OPIC projects and IFC credit lines to the local commercial banks) to hold additional export earnings off-shore, or negotiate priority access to foreign exchange within the Central

Bank. Similar arrangements exist in Dominican Republic for GTE CODETEL, the country's long-distance carrier, whereby its off-shore export earnings have been assigned directly to its creditor banks, and for the Itabo Free Zone which has received financing from Chase Manhattan with an OPIC guarantee.

o 936 rates must be competitive

The attractiveness of Section 936 loans lies in the fact that rates are below market. These have generally been between 78%-86% of LIBID, based on the 90-day, 936 rate in Puerto Rico. In countries such as Dominican Republic and Jamaica where interest rates range between 30% and 35%, the prospect of lending in local markets at rates that are 12% is very attractive. However, in the case of Barbados, where the rate is 11 1/4%, the attractiveness of 936 loans is limited. Once fees and spreads are included, the 936 rate becomes less competitive for the local investor who also has to assume the foreign currency risk. However, the rates may still be attractive in the Eastern Caribbean where these range between 12% and 15% and can go as high as 17% in some of the islands.

o Accessing the 936 program is confusing

Even though FOMENTO has done an excellent job of promoting the program throughout the Caribbean Basin, there still exists a certain amount of confusion with regard to the program. While some local branch banks such as Citibank, Chase Manhattan and Scotiabank are familiar with the programs, others--especially those without connections in Puerto Rico--are unsure about the procedures for accessing the program and the requirements for obtaining funds. The level of awareness of the program differed from country to country. In Dominican Republic, Scotiabank's knowledge and information about the program was dated while Scotiabank in Barbados was very knowledgeable and actively involved with its Puerto Rican counterpart. This is probably due to the fact that very little foreign currency lending is done in the Dominican Republic. On the other hand, Royal Bank of Canada in Barbados was discouraged from seeking 936 funds from its Puerto Rican counterpart by the guarantee requirement. A table of the commercial banks and their subsidiaries in Puerto Rico and the Caribbean Basin is included in Appendix II.

D. Other Financial Institutions

In addition to the commercial banks in Puerto Rico and the Caribbean Basin, there are other private financial institutions in the beginning stages of development that offer the potential for funding 936 projects and should be considered as offering opportunities for purchasing 936 guarantees. These are the Caribbean Basin Project Financing Authority and the Caribbean Basin Partnership for Progress.

o Caribbean Basin Project Financing Authority

Established by Law No. 9 passed January 24, 1990, the Caribbean Basin Financing Authority was designed to reduce the costs associated with the financing of projects to be carried out in the Caribbean Basin. The Authority will issue bonds and other obligations payable from the income from loans made in the Caribbean Basin. Guaranty for the payment of these obligations will be supplied by the project or other sources acceptable to the purchasers of the bonds. The Authority may also make loans or provide guarantees for loans in CBI countries as it develops. The Authority will be governed by a Board whose membership will include the Administrator of FOMENTO, the Presidents of the GDB and the EDB and two private businessmen to be appointed by the Governor of Puerto Rico.

The bonds issued by the Authority will be limited obligations payable only from the revenues of the Authority or the income derived from it under financing or trust agreements with the investors. They may not exceed 50 years and can have either fixed or floating rates of interest that should not exceed the maximum permitted by law. The bonds will be payable within or outside of Puerto Rico. Bonds issued under this Act may be secured by a trust agreement between the Authority and a U.S. or Puerto Rican bank or trust company although the trust agreement must be valid under Puerto Rican law. A more detailed description of the Law governing the Authority is contained in Appendix III.

o Caribbean Basin Partners for Progress

For the last several years, a group of 936 companies has been working through the Puerto Rico - USA Foundation to establish a private sector financing vehicle. In January 1990, Eli Lilly filed a petition with the IRS for approval of the Caribbean Basin Partners for Progress, a limited partnership established for the purpose of financing projects in the Caribbean Basin from 936 funds in Puerto Rico. It is expected that the Partnership will be organized under the laws of Delaware with the general partner, Caribbean Basin Investments, Inc., organized under Puerto Rican law. It is expected that the total capitalization of the Partnership will be \$100 million.

The Partnership will be funded by staged capital contributions from partners as projects are identified. Investments shall be made in the form of unsecured, unsubordinated loans which shall be between \$1 million and \$10 million. The length of the loans will not exceed 10 years and no loan will exceed 75% of the financing requirements for the project. The remaining 25% of the financing is expected to be in the form of equity.

The Foundation is currently awaiting the decision of the IRS so that the partnership may be a "qualified financial institution" under Section 936(d)(4) and that the investments will qualify as QPSII. Once this approval is obtained, the Partnership will file with the Commissioner of Financial Institutions for recognition under Regulation 3582. A summary of the Partnership Agreement as it currently stands is contained in Appendix IV of this report.

V. CONCLUSIONS AND RECOMMENDATIONS

A. Introduction

Although several factors have restricted the movement of 936 loans into the Caribbean Basin, the most important constraint for which an adequate solution has yet to be identified is the availability of credit enhancement sources. Regardless of the size of projects (most of the commercial banks in Puerto Rico have a preference for large projects) the guarantee requirement for the projects remains a prerequisite for 936 financing. This is especially true of the smaller projects (\$1 million to \$3 million) which are more common in the Caribbean Basin and are perceived to be riskier than larger projects.

Findings under this study did not apply across the board. While both the U.S. and Canadian commercial banks in Puerto Rico were in agreement on the need for guarantees, they differed on issues of guarantee and project size, with the Canadian banks more willing to accept more risk than the U.S. banks. This is due primarily to the differences in the regulatory practices of the U.S. and Canadian banking authorities.

B. Conclusions

Based on the finding of this study, the following conclusions have been drawn:

1. U.S. commercial and investment banks require a full (100%) guarantee for all risks associated with Section 936 loans

Most of the transactions already completed under Section 936 have been financed by U.S. commercial banks such as Chase Manhattan and Citibank who will continue to be the leaders because they are the largest holders of 936 funds in Puerto Rico. Although the savings and loans and savings banks are holders of 936 funds, they have not participated in the program. This is also the case with the Puerto Rican financial institutions such as Banco de Ponce and Banco Popular who have been purchasers of securities issued for CBI projects and participants on syndicates such as the AT&T transaction, but have not been direct lenders to CBI projects. Furthermore, they are reluctant to do so due to regulatory concerns.

In all the transactions in which Chase Manhattan and Citicorp have participated, full (100%) guarantees have been provided by OPIC or by the parent companies for both cross-border and commercial risks. Both banks are reluctant to consider funding either for projects of less than \$3 million or for those projects with a partial (50%) guarantee. This is also the case with the

investment banks such as Paine Webber and BT Securities (formerly Drexel Burnham Lambert, Puerto Rico Inc.)

2. Partial guarantees will not be attractive to U.S. commercial and investment banks but might be to Canadian banks and other selected financial institutions

The availability of credit enhancement programs is crucial to the continued success of the 936 program. However, while all the commercial banks in Puerto Rico agree that they will not fund projects without an off-shore guarantee, the U.S. and Canadian commercial banks differ on the size of the guarantees they will accept.

The guarantee sources available to the Canadian Banks are limited. Because OPIC traces ownership of companies to the beneficial owner, Scotiabank and Royal Bank of Canada in Puerto Rico (although they are incorporated in Puerto Rico and regulated under the FDIC) are considered Canadian companies and not eligible to purchase OPIC guarantees. This, as well as other limitations, makes other available guarantees, regardless of size, attractive to these banks. The extent of the Canadian bank network in the region (See Appendix II) makes it difficult to discount them as providers of 936 loan since the network covers the Eastern Caribbean and most of the current TIEA countries. Furthermore, Scotiabank is among the most financially sound private banks in both Jamaica and Dominican Republic.

It should also be noted that the only 936 project funded to date without a guarantee was a loan by Scotiabank to the long-distance carrier in Barbados. The Canadian banks are willing to consider projects of any size based on their creditworthiness and a decision to fund regardless of the availability of a guarantee. However, the availability of a guarantee, even a partial one, would facilitate the process.

In addition to the Canadian commercial banks, potential clients for a partial guarantee can be found among other financial institutions such as the Caribbean Basin Partners for Progress being developed by the 936 companies themselves. While the partners fully expect to participate in the risk, they are actively seeking sources of guarantees for projects which fall into the size range being contemplated by PRE/I. Assuming that the Partnership is approved by both the IRS and the Commissioner of Financial Institutions in its present form, it should be considered a potential purchaser of the guarantee where the risk can be shared by the partners (936 companies) and with other guarantee sources such as OPIC.

3. Even if full guarantee coverage is available, U.S. commercial and investment banks will only consider projects in excess of \$3 million

The decision to fund a CBI project rests more on the availability of a guarantee than on the size of the project and guarantees are required for all projects regardless of size. However, the U.S. commercial banks are unwilling to consider projects that are less than \$3-\$5 million. This is due to the transaction costs associated with the financing which would be more effectively applied to larger rather than smaller projects. Another reason could be the perceived riskiness of the smaller projects and resulting difficulty in locating guarantee sources.

4. Canadian commercial banks are willing to consider projects in the range of \$1 and \$3 million, with or without a guarantee

While the U.S. commercial and investment banks display an unwillingness to accept any risk associated with 936 loans of any size, the Canadian banks are willing to consider project sizes in the range of \$1 million to \$3 million and to share the risk. This is reflective of the presence of Canadian branch banks in the Eastern Caribbean where these project sizes are common. In addition, the funding decisions of the Canadian banks are based on the creditworthiness of the projects, regardless of project sizes and the availability of a guarantees.

5. CBI private sector and financial institutions are reluctant to engage in foreign currency borrowing or lending.

Although the interest rates available under Puerto Rico's CBI program are attractive, especially in Jamaica and the Dominican Republic, investors in both those countries are as unwilling to seek dollar-denominated loans as the local financial institutions are to make them. The instability of the foreign exchange markets in both those countries (especially in the Dominican Republic) makes the assumption of exchange and transfer risks by private investors and commercial banks unacceptable.

In Barbados, where the banking system is experiencing a situation of tight liquidity at the present time, foreign currency lending is becoming increasingly attractive. However, investors are still unwilling to assume the risks, especially when other sources of financing, such as the Barbados Development Bank, are available and the competitiveness of the rates on 936 loans is limited.

6. CBI financial institutions generally believe that any guarantee fee in excess of 1% would be unattractive

One of the main concerns of the commercial banks in Jamaica and Barbados was the cost of a potential guarantee. The possibility of a guarantee fee reducing the competitiveness of the 936 funds, especially in Barbados where the gap between the current interest rates on 936 loans and the domestic interest rate is already narrow, was uppermost in the minds of the bankers interviewed. Among the bankers interviewed, it was generally believed that a fee in excess of 1% would prove to be unattractive to local investors seeking to use 936 funds.

C. Recommendations

We believe that based on the conclusions discussed above, a 50% guarantee mechanism will be unattractive to the U.S. commercial and investment banks in Puerto Rico, but will be of interest to the Canadian commercial banks. If PRE/I wishes to pursue the development of a guarantee facility on this basis, we recommend the following approaches:

1. Provide Full Guarantee for Levels of Sovereign Risk

Since the crucial issue for most of the commercial banks in Puerto Rico which affects their loan portfolio classification by the ICERC is transfer risk, the banks have shown an interest in having levels of the sovereign (inconvertibility, political violence and expropriation) and exchange risks guaranteed. These can be offered individually or together. The sale of a guarantee of cross-border risk, especially for inconvertibility, would certainly be of interest to the regional commercial banks. This is of particular concern to the banks in the Dominican Republic and Jamaica. However, any kind of product developed along these lines must be accompanied by the negotiation of similar back-up agreements with the Central Banks in Jamaica and Dominican Republic for the protection of the guarantor.

2. Provide Full Guarantees on Transactions up to \$3 million

The sale of a guarantee facility for 936 loans based on a 50% guarantee would find only a limited audience among the commercial and investment banks in Puerto Rico. U.S. regulatory requirements and the inability of bond issues rated below AA to be sold in the Puerto Rican market, would prevent these institutions from considering the purchase of such a guarantee. However, the sale of a facility that was based on the guarantee of a maximum transaction of \$3 million would prove to be more attractive. In the case of a \$6 million project, this would qualify as 50% of the project, but could be considered 100% of the 936 loan to the project.

Such a product could be used in conjunction with the Caribbean Basin Project Financing Authority. The mechanism could be used

to guarantee bonds issued by this Authority which is expected to be functioning by summer 1990. It is currently being implemented and Citibank is exploring its use for projects in Trinidad and Tobago. Since the facility is expected to be structured along the same lines as AFICA, financial institutions in Puerto Rico expect the institutions to be similar. However, if this similarity extends to the transaction costs associated with bringing the issues to market, only projects that are between \$10 million and \$12 million (as is the current case with AFICA) will justify these costs. In this situation, where issues would be limited to \$3 million, the issues can be accumulated and done in a "batches" to justify the transaction costs.

3. Limit guarantees to projects generating foreign exchange

Any sale of guarantees should be limited to projects that generate foreign exchange as in the tourist and data service sectors, free zones developments which have access to foreign exchange leases, telecommunications projects such as the Jamaica Digiport and TRICOM in the Dominican Republic which generate foreign exchange from long-distance services, non-traditional export industries that have government priority, and industries located in free zones. OPIC is currently providing a guarantee to the Itabo Free Zone for financing the construction of manufacturing units. This is based on foreign exchange leases of 5-7 years concluded with the tenants (mostly 936 companies) and reviewed by OPIC.

4. Limit immediate implementation to certain countries

The immediate implementation of this program is more feasible in certain of the countries visited than others. Jamaica, Barbados and the Eastern Caribbean offer better opportunities than the Dominican Republic at the present time. The current state of the Dominican foreign exchange markets does not encourage foreign currency lending and the situation is expected to remain as such until the elections scheduled for May 1990. Furthermore, the ability of the Central Bank to consider any kinds of foreign exchange negotiations will be limited until a new administration and policy is in place.

5. Limit guarantee fee to one percent

In structuring any of the guarantee products destined for the region, careful consideration should be given to the fee that is charged for the service. Commercial banks in the countries visited were concerned about the expense relating to the guarantee. In countries like Jamaica and the Dominican Republic where the interest rates are around 30-35%, the addition of fees would not seriously threaten the competitive advantage of using 936 funds. However, this would not be the case in Barbados where

the gap between the domestic and the 936 rate is small. The commercial banks generally felt that a fee of 1% would be attractive.

APPENDIX I

CARIBBEAN DEVELOPMENT OFFICE
 COMPLEMENTARY OPERATIONS IN THE CARIBBEAN BASIN
 February 1990

<u>COMPANY</u>	<u>COUNTRY</u>	<u>JOBS PR</u>	<u>JOBS CBI</u>	<u>INVEST CBI</u>	<u>936 FUNDS</u>	<u>INDUSTRY</u>
BARBADOS TELEPHONE CO.	BARBADOS			13,000,000	13,000,000	INFRASTRUCTURE
BELTRONICS	BARBADOS	200	200	780,000		ELECTRIC & ELECTRONIC
CAPE RED TEXTILE	BARBADOS	10	9	30,000		APPAREL & TEXTILE PRODUCTS
WACOAL	BARBADOS	5	60	100,000		APPAREL & TEXTILE PRODUCTS
AVON	COSTA RICA	20	100	140,000		FABRICATED METAL PRODUCTS
BAJTER	COSTA RICA		124	2,168,000		CHEMICALS & ALLIED PRODUCTS
CAMPOFRESCO	COSTA RICA	30	360	350,000		FOOD PRODUCTS
CBI UNIFORMS	COSTA RICA	30	200	2,000,000		APPAREL & TEXTILE PRODUCTS
GRUPO BUCH	COSTA RICA	78	98	500,000		WOOD & WOOD PRODUCTS
IES	COSTA RICA	80	70	300,000		APPAREL & TEXTILE PRODUCTS
LENTHERAL	COSTA RICA	4	10	200,000		PAPER & ALLIED PRODUCTS
LENTHERAL & DOHME	COSTA RICA	75	30	1,000,000		CHEMICALS & ALLIED PRODUCTS
LENTHERAL INC	COSTA RICA	0	150	500,000		CHEMICALS & ALLIED PRODUCTS
LENTHERAL PHARMACEUTICAL	COSTA RICA	0	27	2,000,000		CHEMICALS & ALLIED PRODUCTS
LENTHERAL INC.	COSTA RICA	280	150	400,000		ELECTRIC & ELECTRONIC
LABS	DOM REP		200	4,000,000	3,000,000	CHEMICALS & ALLIED PRODUCTS
INTERNATIONAL	DOM REP	10	14	70,000		CHEMICALS & ALLIED PRODUCTS
ANAMID	DOM REP	4	44	30,000		CHEMICALS & ALLIED PRODUCTS
CAN HOME PROD.	DOM REP	6	45	1,600,000		CHEMICALS & ALLIED PRODUCTS
RP.	DOM REP		30	1,000,000		PRINTING & ALLIED INDUSTRIES
INVAI.)	DOM REP		660			CHEMICALS & ALLIED PRODUCTS
GRAIS)	DOM REP		624	5,225,000		CHEMICALS & ALLIED PRODUCTS
MYERS	DOM REP		60	900,000		CHEMICALS & ALLIED PRODUCTS
CHECKPOINT	DOM REP	3	150	350,000		ELECTRIC & ELECTRONIC
CYBELA MFG	DOM REP	30	150	100,000		APPAREL & TEXTILE PRODUCTS
ELJ LILLY	DOM REP	30	80	800,000		CHEMICALS & ALLIED PRODUCTS
F.C INDUSTRIES	DOM REP	12	120	250,000		APPAREL & TEXTILE PRODUCTS
FIVE STAR FASHION, INC.	DOM REP	15	130	400,000		APPAREL & TEXTILE PRODUCTS
FM CARIBBEAN	DOM REP	100	200	200,000		FABRICATED METAL PRODUCTS
G H BASS (XT)	DOM REP		496			LEATHER & LEATHER PRODUCTS
G&G SPORT MANUFACTURING	DOM REP	37				APPAREL & TEXTILE PRODUCTS
GENERAL ELECTRIC	DOM REP		250	3,900,000		ELECTRIC & ELECTRONIC
GTE SYLVANIA	DOM REP	50	200	300,000		ELECTRIC & ELECTRONIC
HANES KNITTING	DOM REP	50	314	2,500,000		APPAREL & TEXTILE PRODUCTS
INFORMATION MAGNETICS	DOM REP	215	300	500,000		ELECTRIC & ELECTRONIC
INTER SPACE	DOM REP	65	150	400,000		FURNITURE
ISABELA SHOE (XT)	DOM REP	0	250	500,000		LEATHER & LEATHER PRODUCTS
JOHNSON & JOHNSON DENTAL	DOM REP	0	180	800,000		CHEMICALS & ALLIED PRODUCTS
JUMPING JACKS	DOM REP	0	170	1,350,000		LEATHER & LEATHER PRODUCTS
J M CARME	DOM REP	100	250	1,000,000		ELECTRIC & ELECTRONIC
LEP	DOM REP	40	203	7,000,000		RUBBER & PLASTICS PRODUCTS
LEP	DOM REP	200	125	1,000,000		LEATHER & LEATHER PRODUCTS
(XT)	DOM REP		375			APPAREL & TEXTILE PRODUCTS
OTWEAR (XT)	DOM REP		300			LEATHER & LEATHER PRODUCTS
TE	DOM REP	42	24	338,000		STONE PRODUCTS
TABLE SAFETYWEAR	DOM REP	0	65	300,000		APPAREL & TEXTILE PRODUCTS
TABLE SAFETYWEAR	DOM REP	42	98	1,000,000		ELECTRIC & ELECTRONIC
BOARD	DOM REP			22,500,000	18,000,000	INFRASTRUCTURE
ATIONAL CARIBE	DOM REP	27	118			ELECTRIC & ELECTRONIC
SRR INC	DOM REP	100	400			LEATHER & LEATHER PRODUCTS
ST. CRISPIN	DOM REP	250	450	1,000,000		LEATHER & LEATHER PRODUCTS
TI INDUSTRIES	DOM REP	400	700	3,000,000		ELECTRIC & ELECTRONIC

<u>COMPANY</u>	<u>COUNTRY</u>	<u>JOBS PER</u>	<u>JOBS CRI</u>	<u>INVEST CRI</u>	<u>936 FUNDS</u>	<u>INDUSTRY</u>
WARNER LAMBERT	DOM REP	0	221	750,000		CHEMICALS & ALLIED PRODUCTS
WESTINGHOUSE(4 PLANTS)	DOM REP	130	1000	10,000,000		ELECTRIC & ELECTRONIC
ABC CONTAINER	DOMINICA	15	50	2,100,000	2,100,000	PAPER & ALLIED PRODUCTS
BACARDI CORP.	DOMINICA	0	5	0		FOOD PRODUCTS
EASTON CHEMICALS	DOMINICA	60	30	500,000		CHEMICALS & ALLIED PRODUCTS
ABBOTT LABS	GRENADA	0	100	1,118,000		CHEMICALS & ALLIED PRODUCTS
JOHNSON & JOHNSON	GRENADA	5	68	484,000		CHEMICALS & ALLIED PRODUCTS
SCHERING PLOUGH	GRENADA	0	50	1,000,000		CHEMICALS & ALLIED PRODUCTS
SMITHKLINE	GRENADA	6	90	600,000		CHEMICALS & ALLIED PRODUCTS
GRUPO BUCH	GUATEMALA	122	152	500,000		WOOD & WOOD PRODUCTS
GUY'S & DOLLS	HAITI		25	500,000		PLASTIC & RUBBER PRODUCTS
STR INC	HAITI	150	450			LEATHER & LEATHER PRODUCTS
TI INDUSTRIES	HAITI	300	516	915,000		ELECTRIC & ELECTRONIC
ADR JAMAICA	JAMAICA	0	30	57,000,000	51,000,000	SERVICES
QUEST	JAMAICA	35	35	85,000		ELECTRIC & ELECTRONIC
ROSEHALL	JAMAICA			10,000,000	4,000,000	TOURISM
SOUTH PACIFIC TEXTILES	JAMAICA	28	350	1,000,000		APPAREL & TEXTILE PRODUCTS
TRANSCARIBBEAN CABLE	JAMAICA	0	0	17,000,000	17,000,000	SERVICES
TRU-CITRUS	JAMAICA	100				FOOD PRODUCTS
U.D.C./TRANSHORE	JAMAICA	0	0	8,700,000	8,700,000	SERVICES
INDAS CORP	PANAMA	25	17	140,000		FABRICATED METAL PRODUCTS
LUTRON	ST. KITTS	65	64	500,000		ELECTRIC & ELECTRONIC
AGOS INC	TRINIDAD	18	15	470,000		ELECTRIC & ELECTRONIC
TT-PD-003	TRINIDAD			79,000,000	79,000,000	PETROLEUM REFINING
TT-PD-007	TRINIDAD			70,000,000	70,000,000	PETROLEUM REFINING
UV-PD-004	U.S.V.I.			9,000,000	9,000,000	TOURISM
TOTAL	78 PROJECTS	3,719	12,981	\$357,363,000	\$274,800,000	

XT= Expansion

ECONOMIC DEVELOPMENT ADMINISTRATION
CARIBBEAN DEVELOPMENT OFFICE

Bank Branches and Subsidiaries in the Caribbean Basin

BANKS	Countries				
	Dominican Republic	Puerto Rico	Barbados	E. Caribbean	Jamaica
Century National Bank		Correspondent			X
Royal Bank Of Canada		X	X	X	
Scotiabank	X	X	X	X	X
Jamaica Citizens Bank		Correspondent			X
Banco de Progreso	X	Correspondent			
Banco del Comercio	X	Correspondent			
Citibank	X	X			X
Chase Manahattan Bank	X	X			
Canadian Imperial Bank		Correspondent	X	X	
Eagle Merchant Bank		Correspondent			X
National Commercial Bank		Correspondent			X
Banco Popular	Correspondent	X			
Workers Bank		Correspondent	X		

Summary of Caribbean Basin Partnership Agreement

The partnership agreement provides that:

1. The partnership will invest up to \$100 million in projects in the Caribbean Basin meeting the investment guidelines contained in the agreement and approved by the Board of Advisors.

2. Initial capital commitments will be based on a ratio determined on the basis of the sum of twice the partner's industrial development income to twice all such income earned by 936 companies, and the ratio of a partner's 2(J) investments to all such investments. Commitments will be increased by the ratio of each partner's initial capital commitment to all other partners' capital commitments until a \$100 million funding level is achieved, subject to the restriction described below.

3. No limited partner shall be required to contribute more than \$5 million. In the event the funding formula contained in the agreement causes any partner's commitment to exceed \$5 million, that partner's commitment will be reduced; the commitments of the other partners will be reduced proportionately.

4. The partnership will be nominally managed by a Puerto Rican corporation owned pro rata by the partners. All significant decisions, including all investment decisions, will be made by a Board of Advisors consisting of 12 members. Each Advisor will represent partners having an approximately 8% interest in the partnership.

5. Investments will take the form of unsecured, unsubordinated loans of between \$1 and \$10 million dollars. These loans shall fund no more than 75% of any one project. At least 25% of a project's financing must consist of equity investments. The partnership will invest only in projects which meet the requirements of the CBI regulations for "qualified investments."

6. The partnership will dissolve in the event of a change in Puerto Rico's political status, or a material adverse change in section 936, or in 2001.

7. Partnership interests are in essence transferable only to other partners at fair market value.

8. The partnership will be formed in Delaware.

9. A ruling as to partnership status and the 936 character of distributions from the partnership has been sought from the I.R.S.

Caribbean Basin Project Financing Authority

Law No. 9

January 24, 1990

27

(H.B.844)
(S.B.673)

(No. 9)

(Approved January 24, 1990)

AN ACT

To create the Caribbean Basin Projects Financing Authority; provide for the organization of the Authority; define its powers, faculties and functions; authorize it to issue bonds and grant it tax exemption.

STATEMENT OF MOTIVES

The development of the Commonwealth of Puerto Rico's economy and the reduction of its high unemployment rate are directly related to the stability of the benefits, related to the stability of the tax advantages provided by Section 936 of the 1986 United States Internal Revenue Code ("IRC") for those industries that are established in Puerto Rico. The tax advantages of Section 936 bring about an intensive capital investment in Puerto Rico which propitiates Puerto Rico's economic development. The stability of Section 936, however, has certain underlying conditions which require Puerto Rico to share the use of the 936 funds (those funds that represent the profits accumulated by the 936 corporations that operate in Puerto Rico) with those Caribbean Basin countries that are authorized to receive investments of said funds under the provisions of Section 936(d)(4) of the IRC.

This Bill has the purpose of creating a Commonwealth of Puerto Rico government entity whose main objective shall be to provide financing of

projects for the development of those Caribbean Basin countries that are authorized to receive investments of 936 funds under the provisions of Section 936(d)(4) of the IRC. This Authority shall operate in the same manner as the Authority for the Financing of Industrial and Medical Facilities, and Education and Environmental Pollution Control of Puerto Rico ("AFICA"). It may issue bonds, and other obligations payable exclusively from the authority's income from the loans that it makes in the Caribbean Basin. Said obligations shall not encumber the Government of Puerto Rico nor the Authority in any way. Guaranty for the payment of said obligations shall rest solely on the project to be financed or in guaranties acceptable to the purchasers of the bonds, provided that no assets of the Commonwealth of Puerto Rico nor any of its instrumentalities are involved. The purpose that this measure promotes is to achieve through this mechanism, a reduction of the costs associated with the financing of projects to be carried out in the Caribbean Basin, since it eliminates the traditional middleman financing costs. The authority may also make loans or provide guaranties for loans in Caribbean Basin countries qualified under the provisions of Section 936(d)(4) of the IRC.

BE IT ENACTED BY THE LEGISLATURE OF PUERTO RICO:

Section 1.- Title

This Act shall be known as the "Caribbean Basin Projects Financing Authority Act".

259'

Section 2.- Purpose

The continuing development of the Commonwealth of Puerto Rico's economy and the reduction of its high unemployment rate are essential for the general welfare. Said public welfare is directly related to the stability of Section 936 of the Internal Revenue Code. It is necessary for a financing vehicle be established immediately so that Puerto Rico can share the use of the benefits accumulated by the 936 corporations. The Legislature of Puerto Rico has the firm intention of adopting whatever measures are necessary and convenient to meet the abovementioned needs and purposes, and to achieve this, it hereby creates the Caribbean Basin Projects Financing Authority as a public corporation and instrumentality of the Commonwealth of Puerto Rico, which is an independent body corporate and politic.

Section 3.- Definitions

The following words and terms, when they are used or are made reference to in this Act, shall have the meaning indicated below, unless some other meaning can be clearly construed from the context:

(a) "Government Agency" shall mean any participating country, or any municipality, political subdivision, agency, department or instrumentality thereof.

(b) "Authority" shall mean the Caribbean Basin Projects Financing Authority established by this Act, or if said Authority is abolished or is otherwise deprived of its functions under this Act, that public body or entity that succeeds it in its main functions or upon which the rights, powers and duties conferred by this Act to the Authority, shall be conferred by law.

40

(c) "Bonds" shall mean the bonds, temporary bonds, refinancing bonds, obligations, receipts, notes, interim receipts or provisional bonds, certificates or other evidence of indebtedness of the Authority issued pursuant to the provisions of this Act.

(d) "IRC" shall mean the Internal Revenue Code of 1986, 26 U.S.C. Sec. 1 et seq. (1989 Supp.) and the Regulations issued thereunder.

(e) "Trust Agreement" shall mean the written document that establishes the rights and responsibilities of the Authority and the corporate trustee, for the security of the holders of the bonds issued to finance a project, including a trust agreement or the resolution authorizing the bond issue.

(f) "Financing Agreement" shall mean the agreement or agreements made between the Authority and any debtor or guarantor with reference to a project, under which the payments to the Authority shall be sufficient to pay the entire principal, interest and any redemption premium, and to provide and maintain any reserves for the bonds issued by the Authority to pay the cost of said project, and to pay the expenses incurred by the Authority with regard thereto, and shall include lease, installment sale, purchase, conditional sale, sale with lease agreement, loan, mortgage, and lease contracts, or any other financing contract or combination of the above, as determined by the Authority.

(g) "Costs" when applied to any project, shall mean all costs incurred in the acquisition, construction or refinancing of any project, or those otherwise incurred to provide any project.

41

including all costs that can be financed under the provisions of Section 936(d)(4) of the IRC. These shall include, but shall not be limited to the: cost of construction; cost of acquisition of all property, real as well as personal, improved or not; cost of demolishing, removing and relocating any buildings or structures on the lands thus acquired, including the cost of acquisition of any land to which said buildings or structures may be transferred or relocated; cost of all machinery, furniture and equipment; financing or any other charges and interest incurred before or during construction, and if deemed acceptable by the Authority and for the term it may determine, after the termination of construction; reserves for debt servicing; cost of studies, market analyses, surveys, plans and specifications; cost of legal consultants, accountants, environmental engineers and other professionals; likewise, it shall include the cost of financial advisors and other special services, and other expenses that are necessary or incidental to determine the viability or practicality of the project; cost of preparation, development and landscaping of the land; initial cost of occupation of the project or any part thereof; administrative expenses, as well as any other expenses that are necessary or incidental to the financing and establishing of the project, including the reimbursement of any expenses made with the prior approval of the Authority, to any government agency or any debtor with regard to said project, which would have been costs of said project if they had been incurred directly by the Authority.

112

(h) "Debtor" shall mean the debtor under a financing contract, whether he be designated as lessee, sublessee, purchaser, borrower or is otherwise designated.

(i) "Caribbean Basin Facilities" shall mean any land, building, structure, equipment, or any improvement thereto, or any combination thereof, whether existing or not or under construction, and any real or personal, tangible or intangible property which is related to an activity, and is in a participating country.

(j) "Guarantor" shall mean any person who is directly or indirectly liable, under the clauses of a financing contract for the unpaid portion of the debtor's obligations, whether he is designated as guarantor, surety, special endorser, accomodation endorser, insurer, or is otherwise designated.

(k) "Board" shall mean the Governing Board of the Authority created hereby, and if it were abolished, whatever board or entity that is its successor in the performance of its main functions.

(l) "Participating Country" shall mean any Caribbean Basin country which qualifies under Section 936 (d)(4)(B) of the IRC.

(m) "Person" shall mean any natural or juridical person, including, but not limited to any government agency, or any individual, firm, partnership, stock company, association or public or private corporation, organized or existing under the laws of the Commonwealth of Puerto Rico, of the United States of America, of any state, of any foreign country, or of any participating country, any agency or instrumentality of the United States, or any combination thereof.

(n) "Project" shall mean those Caribbean Basin facilities which are described as the "Project" in the trust agreement that secures the bonds, the product of which shall be applied to the payment of the costs or to any part of the costs of said project, or to the refinancing thereof.

The words used in the masculine gender shall be understood to implicitly include the feminine and neutral genders, and unless otherwise indicated in the context, the words used in the singular shall be understood to include the plural.

Section 4.- Creation of the Authority

A public corporation and instrumentality of the Commonwealth of Puerto Rico, is hereby created, which constitutes an independent body corporate and politic, which shall be known as the Caribbean Basin Projects Financing Authority. The Authority's governing body shall be the Board, which shall consist of the following members: the Administrator of the Economic Development Administration, the President of the Government Development Bank for Puerto Rico, the President of the Economic Development Bank for Puerto Rico, and two private entrepreneurs to be appointed by the Governor with the advice and consent of the Senate of Puerto Rico.

The Administrator of the Economic Development Administration shall be the Chairman of the Board. The Board shall elect a Vice Chairman annually, from among its members. The Board shall also elect or appoint such other officers as it deems necessary or advisable, including an Executive Director and a Secretary of the Authority, and shall prescribe the duties and fix the compensation of said officers.

The members of the Board of Directors of the Authority shall receive no compensation whatsoever for their services as such, excepting those members who come from the private enterprise sector, who shall receive such per diems as fixed by the Board from time to time taking as a basis the per diems paid to similar instrumentalities, for each Board meeting they attend as certified by the Secretary thereof. The Authority shall reimburse them for the necessary expenses incurred in the performance of their duties.

The Executive Director shall administrate and direct the affairs and business of the Authority, subject to the policies, control and direction of the Board. The former shall be appointed by the Board and shall take office at its volition.

Three members of the Board shall constitute quorum and the affirmative vote of at least three of its members shall be needed for any action taken by the Board, except to adjourn the session. No vacancy on the Board shall prevent it from exercising all its rights and performing all its duties, once a quorum has been established.

Section 5.- General Powers

The Authority shall have all the powers that are necessary and convenient to carry out and perform the purposes and provisions of this Act, including, but which shall not be construed as a limitation, the power to:

(a) Adopt By-laws for the administration of its affairs and business, and prescribe the rules, regulations and norms with regard to the exercise of its functions and duties.

45

(b) Adopt an official seal and alter it at its convenience.

(c) Maintain an office in Puerto Rico.

(d) Sue and be sued under its own name, prosecute and be prosecuted.

(e) Receive, administrate and meet the conditions and requirements regarding any gift, grant or donation of any property or moneys.

(f) Make loans to, and negotiate and grant, or enter into financing agreements with any person in or outside of Puerto Rico, to finance or refinance any project pursuant to the purposes framed in this Act.

(g) Pignorate or assign any moneys, revenues, rights or any other income, as well as the product of the sale of property, and compensations under the provisions of insurance policies or compensation for attachments.

(h) Borrow money and issue bonds of the Authority with the purpose of making funds available to pay all or any part of the cost of any project, or for any other purpose authorized by this Act.

(i) Mortgage or pignorate any property for the payment of the principal, redemption premium, and interest on any bonds issued by the Authority and pignorate all or part of the revenue received by the Authority under the financing agreement related to any project, and assign or give as collateral the financing agreement or contracts related to any portion of, or the entire project, and any

116

type of security, lien or contractual rights given by, or in behalf of the debtor or any guarantor under the financing agreement, during that period that the Authority shall determine, establish reserves to secure said bonds, pay any issuing expenses and pay such other expenses that are incidental, necessary or convenient to carry out its corporate purposes and powers.

(j) Fix, impose and collect fees and other charges for its services.

(k) Contract the services, as needed, of engineers, consultants, architects, lawyers, accountants, financial consultants, appraisers, and other consultants and employees, which in the Authority's judgment may be required, and fix and pay their compensation from the Authority's funds available for such purposes.

(l) Procure insurance against losses in the amounts and with the insurers it deems desirable, which may include, without being understood as a limitation, civil liability insurance for its directors, officers, agents and employees.

(m) Invest its funds as authorized by a Resolution of the Board, subject to any restriction under the trust agreements or resolutions authorizing bond issues.

(n) Guarantee the payment of principal and interest of loans granted by financial institutions to private persons and entities, when said loans are to be used for the purposes promoted by this Act.

(o) Exercise all the powers that have been conferred to it and carry out whatever action or activity is necessary, convenient or desirable to perform its functions.

Section 6.- Bonds of the Authority

The Authority may issue bonds from time to time for such principal sums that are needed in its opinion, to provide sufficient funds to finance or refinance projects, pay interest on its bonds, pay other expenses that are incidental, necessary or convenient to carry out its corporate purposes and powers, pay any issuing expenses, and establish reserves to secure said bonds. It may also issue bonds to make short or long-range investments with the proceeds of said bonds and use the yield of said investments to carry out its corporate purposes.

(a) The bonds issued by the Authority shall be limited obligations payable solely from the total or a part of any revenues derived by the Authority, or the gross or net income derived by it under the financing agreement's clauses regarding the specific project for which the bonds were issued, all as provided in the trust agreement or resolution whereby the bond issue is authorized. The principal and interest on the bonds may be secured by the pignoration or constitution of another lien on the total or part of any revenue of the Authority, or on the income generated by the specific project for which the bonds were issued, and may be secured by the assignment of any financing agreement regarding any project or part thereof, as provided in the trust agreement or resolution under which the bonds are issued. Said pignoration or

constitution of another lien shall be final and binding from the moment it is executed without the need of a public or notarized document. The revenues thus encumbered, including those that the Authority receives subsequently, are immediately subject to said encumbrance without the need of the physical delivery thereof or of any other act, and said encumbrance shall be final and binding and shall prevail against any third party that could have a claim against the Authority for damages, breach of contract or other reason, regardless of whether said third party has been notified or not to such respect. Neither the trust agreement or resolution, nor any collateral agreement whereby the rights of the Authority on any income are pignorated or assigned, shall have to be presented or registered to perfect the lien thereon against any third party. The resolution or resolutions authorizing the bond issue or the trust agreement securing the same, may contain provisions which shall be part of the agreement with the holders of the bonds issued under said resolution or resolutions, with respect to; (i) the guaranty and creation of a lien on the Authority's revenues and assets; (ii) the creation and maintenance of redemption funds and reserves; (iii) limitations related to the purposes for which the proceeds of the bonds may be used; (iv) limitations regarding the issue of additional bonds; (v) limitations regarding the introduction of amendments or supplements to the resolution or resolutions or to the trust agreement; (vi) the granting of rights, powers and privileges and the imposition of

49

obligations and responsibilities on the trustee under any trust agreement; (vii) the operation and maintenance of projects, the fixing of fees, income and other charges for the use and occupancy of any project; (viii) The acquisition of insurance with regard to any project or its operation; (ix) the rights, powers, obligations and responsibilities that may arise in the event of a failure to comply with any obligation under said resolution or resolutions, or the trust agreement; or (x) with regard to any rights, powers, and privileges conferred on the bondholders as security thereof to increase the marketability of the bonds.

(b) The bonds may be authorized by a resolution or resolutions of the Board. They may be in serie or series, bear such date or dates, mature in the term or terms that shall not exceed fifty years from their respective dates of issue, and earn interest, if any, at such rate or rates of interest (that may be fixed or variable) that do not exceed the maximum rate then permitted by law.

(c) The bonds may be payable in the place or places, whether or outside of the Commonwealth of Puerto Rico; may be of that denomination or denominations and shall be represented by such form, whether by coupons or registered; or in form of bonds without certificates; may have those privileges of registration or conversion; may be payable by the means of payment and may be subject to the terms of redemption, with or without premiums; may provide for the replacement of mutilated, destroyed, stolen or lost bonds; may be authenticated in such manner and meet such

conditions, and may contain such terms and conditions that the resolution or resolutions may provide; may be issued temporarily pending the execution and delivery of definite bonds, and may be granted in the manner that the resolution or resolutions or the terms of the trust agreement may provide. The bonds may be sold publicly or privately at the price or prices determined by the Authority, notwithstanding the form and tenor thereof, and in absence of an express admonition on the face of the bond to the effect that it is not negotiable, all the Authority's bonds shall have at all times, and it shall be understood that they have all the characteristics and incidences, including negotiability, of negotiable instruments under the laws of the Commonwealth of Puerto Rico.

(d) The proceeds from the sale of the bonds shall be disbursed in the form and under the restrictions, if any, provided by the Authority in the resolution or resolutions authorizing the bond issue, or in the trust agreement that secures said bonds.

(e) The proceeds of the bond issue shall not be treated as public funds, for the purposes of collateral requirements under Act No. 318 of May 13, 1949.

(f) The Authority's bonds that bear the signatures of the Authority's officers who are in office on the date of the signing thereof, shall constitute valid and unavoidable obligations, even when before the delivery of and payment for said bonds, any or all of the officers whose signatures or facsimiles thereof appear

thereon, have ceased as said officers of the Authority. Any resolution or trust agreement that secures said bonds may provide that any of said bonds may contain a mention to the effect that it was issued in accordance with the provisions of this Act, and any bond that contains said mention under the authority of such trust agreement or resolution, shall be conclusively deemed to be valid and that it was issued pursuant to the provisions of this Act. The validity of the bond authorization and issue shall not depend on, nor shall it be affected in any way by any procedure connected with the construction, acquisition, extension or improvement of the project for which the bonds are issued, or by any agreement signed with regard to said project. Neither the members of the Authority's Board of Directors, nor any person who grants said bonds shall be personally liable for said bonds nor shall they be subject to any civil liability for said bond issue.

(g) At the Authority's discretion, any bonds issued under the provisions of this Act may be secured by a trust agreement by and between the Authority and any bank or trust company described in the next paragraph, which may be a bank or trust company in or outside of the Commonwealth of Puerto Rico. Notwithstanding any legal provision to the contrary, said trust agreement shall not have to be constituted by public deed to constitute a valid trust under the laws of the Commonwealth of Puerto Rico.

It shall be legal for any bank or trust company incorporated under the laws of the Commonwealth of Puerto Rico, the United

States of America or any state of the United States of America, that acts as a depository of the product of the bonds, income or any other type of monies, to grant those indemnity bonds or secure those assets required by the Authority. In addition to the above the trust agreement may include all those provisions that the Authority considers reasonable and appropriate to the security of the bondholders.

Section 7.- Refinancing Bonds

The Authority is hereby authorized to issue refinancing bonds for the purpose of refinancing those bonds that are issued and outstanding at that moment, including payment of any redemption premium with relation thereto and any interest accrued or that is accrued as of the date of redemption or maturity of said bonds, and if deemed advisable by the Authority, for any of the purposes for which the Authority may issue bonds. The issue of such bonds, their maturity and other details with respect thereto, the rights of the bondholders, and the rights, duties and obligations of the Authority with respect thereto, shall be governed by the provisions of this Act related to the issuing of bonds, inasmuch as such provisions are applicable.

The refinancing bonds issued under this Section may be sold or exchanged for bonds in effect issued under this Act, and if they are sold, the yield of said sale may be destined, in addition to any authorized purpose, to the purchase, redemption or payment of those bonds issued and outstanding and may be invested pending such an application. At the Authority's discretion, the refinancing bonds may

be issued at any time prior to their date or dates of maturity, or on the date selected for the redemption of the bonds being refinanced.

Section 8.- Criteria and Requirements

When considering any project under the provisions of this Act, the Authority shall be guided by, and will observe the following criteria and requirements, Provided, that the Authority's determination with regard to its compliance with such criteria and requirements shall be final and binding:

(a) No financing contract shall be signed with relation to a project if the debtor together with his guarantor, is not financially accountable and is not completely qualified and willing to meet his obligations under the financing agreement, including the obligation to make payments in the required amounts and dates, of operating, repairing and maintaining the project on his own account and payment, paying the expenses incurred by the Authority with regard to the project, and to comply with the purposes of this Act and those other responsibilities that may be imposed upon him under the terms of the financing agreement.

(b) Adequate provisions shall be made for the payment of principal and interest on the bonds and to create and maintain the reserves required in that respect, that the Authority may determine if any, and to pay the expenses incurred by the Authority in connection with the project.

Section 9.- The Commonwealth of Puerto Rico and its political subdivisions shall not be liable for the bonds.

The bonds issued by the Authority will not constitute a debt of the Commonwealth of Puerto Rico nor of any of its municipalities or other political subdivisions, nor shall the Commonwealth of Puerto Rico nor any of said municipalities or other political subdivisions be responsible for them, and said bonds shall be payable solely from those funds of the Authority that have been committed for their payment.

Section 10.- Tax Exemption

(a) It is hereby resolved and stated that the purposes for which the Authority is created and for which it will exercise its powers, are public purposes in benefit of the People of Puerto Rico, and the exercise of the powers granted under this Act constitutes compliance with essential government functions.

The Authority shall be exempt from the payment of all taxes, municipal licenses, fees or permits imposed by the Commonwealth or its municipalities on the Authority's properties and its revenues obtained from any of its businesses or activities. The Authority shall pay excise taxes on goods subject to the provisions of Act No. 5 of October 8, 1987, known as the "Excise Act of the Commonwealth of Puerto Rico of 1987".

(b) In order to expedite the obtaining of funds for the Authority to carry out its corporate purposes, the bonds

issued by the Authority under this Act's provisions, their transfer, and the revenue derived from them, including any profits obtained from their sale, shall be, and all times will remain exempted from the payment of all the taxes, municipal licenses or charges imposed by the Commonwealth of Puerto Rico or any of its municipalities.

(c) The Authority shall also be exempted from the payment of all types of charges, stamps and internal revenue receipts, tariffs, taxes or imposts of any kind required by law for the processing of judicial actions, the production of certificates in every Commonwealth office or dependency and the execution of public documents and their recording at any Commonwealth public registry.

Section 11.- Conflict of Interest.- No officer, member, agent, or employee of the Authority, of the Commonwealth of Puerto Rico, or of any local agency shall have a direct or indirect interest in any contract with the Authority related to the purposes for which this Act was created, or in the sale of the real or personal property of the Authority to be used for any project; Provided, however, that this Section shall not be apply to any interest that the Authority deems to be so small that it does not fall within the scope of the purpose of this Section. If said-officer, member, agent or employee should have any interest in the real property acquired prior to the determination of the location of any project, such interest shall be left as evidence thereof in the Minutes of the Board of Directors of the Authority, and

the officer, member, agent or employee with such an interest should not participate in representation of the Authority in the acquisition of said property by the Authority.

Provided, that any officer, member, agent or employee of the Authority who violates the provisions of this Section shall be dismissed from his position, and, in addition, shall be found guilty of a felony, and subject to a fine that shall not exceed \$5,000, or imprisonment for a maximum term of five (5) years, or both penalties, at the discretion of the Court.

Section 12.- Agreement of the Commonwealth of Puerto Rico with the Bondholders.

The Commonwealth of Puerto Rico hereby pledges and agrees with the holders of any bonds issued under this Act, and with the persons or entities who enter into agreements with the Authority in accordance with the provisions of this Act, that it will not limit nor alter the rights granted herein to the Authority until said bonds and interest on them are paid in full and said contracts are fully complied with and executed by the Authority, Provided, however, that none of what is provided herein shall affect and alter such limitation, if adequate measures are provided by law for the protection of said holders of the Authority's bonds, or of those who have entered into such agreements with the Authority. The Authority, as an agent of the Commonwealth of Puerto Rico, is hereby authorized to include this pledge by the Commonwealth of Puerto Rico in said bonds or agreements.

Section 13.- Reports

The Authority shall submit to the Governor and the Legislature after the close of each fiscal year of the Government of the Commonwealth of Puerto Rico, but prior to the end of the calendar year:

(a) A financial statement and a complete report on the Authority's transactions for the previous year, and

(b) A complete report on the status and progress of all its financings and activities since the creation of the Authority, or since the date of its last report.

Section 14.- Constitutional Construction

The provisions of this Act are separable, and if any of its provisions should be declared unconstitutional by any Court of competent jurisdiction, the decision of said court shall not affect nor impair its remaining provisions.

Section 15.- Inconsistent Laws Inapplicable

With regard to the provisions of this Act which are be inconsistent with the provisions of any other law, or parts thereof the provisions of this Act shall prevail.

Section 16.- Liberal Construction

Since it is necessary for the well-being of the Commonwealth of Puerto Rico and its inhabitants, this Act should be liberally construed to achieve its purposes.

Section 17.- Additional Method

It shall be deemed that the previous Sections of this Act shall provide an alternate and additional method for the execution of the

acts authorized thereby and they shall be deemed as supplementary or additional powers to those conferred by other laws; it shall not be construed that said Sections constitute a repeal of any existing power; Provided, however, that for the issuing of bonds or refinancing bonds, as provided by this Act, it shall not be required to comply with the provisions of any other law that applies to the issuing of bonds, other than those contained in Act No. 272 of May 15, 1945 as amended.

Section 18.- Effectiveness

This Act shall take effect immediately after its approval.

Appendix IV

List of Interviews

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