S P E E D

Support for Private Enterprise Expansion & Development

EXPORT CREDIT GUARANTEE SCHEME

EVALUATION REPORT

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Abbreviations

BOU	Bank of Uganda
EADB	East African Development Bank
DCA	Development Credit Authority (USAID Loan Guarantee Program)
ECGS	Export Credit Guarantee Scheme
PFI	Participating Financial Institution
SPEED	Support for Private Enterprise Expansion and Development (a USAID-funded project)
UGX	Ugandan Shillings (Ugandan currency equal to about 1850 / 1 U.S. $)
USAID	United States Agency for International Development

1. EXECUTIVE SUMMARY AND KEY RECOMMENDATIONS

The development objective of the ECGS - to finance increased volumes of non-traditional exports - is in the process of being realized. This has been especially true of grains, beans, and flowers. In order to build on this success, the program should now be enhanced to broaden and deepen it in order to serve a bigger number of diverse, smaller *individual* exporters, and to include a larger number of banks. It should also be expanded to cover the fish processing industry in particular, whose needs for short-term finance will increase. The enhancements recommended must be considered in the context of BOU's interest in relocating ECGS outside of the central bank. BOU's executive management no longer consider development finance programs of this type as part of the central bank's core activity for the future.

While a future home for the ECGS is being considered outside of BOU[1], the following technical assistance is recommended during this interim period in order to enhance use of the program and to determine the level or resources needed to support it in the medium term. Coordination with current *and potential* stakeholders should be undertaken during this process.

1. Legal documentation should be modified as noted in 5.1 below.

2. An updated operations manual should be drafted incorporating points in 5.2 below.

3. Both the legal document and new operations manual should be sent to PFI's for comment.

4. Financial projections should be prepared to determine the amount of additional capital needed for the capital reserve fund and the projected level of guarantee fees required in order to ensure self-sustainability of the scheme. The projections should incorporate an assumed cost of management and administration and a provision for claims payments, with sensitivity runs performed on claims.

5. Two smaller banks should be added to the program as non-delegated Participating Financial Institutions and assistance should be provided to them and to smaller individual exporters to deepen the reach of the program.

6. Training and promotion should be provided to all PFI's and exporters in the revised program.

For the medium term after the future location of the ECGS is decided, technical assistance should be considered for the following:

1. Program administration should be monitored (especially if the program is assumed by another financial institution or a donor).
2. Continuing assistance for smaller exporters and banks should be provided.
3. Consistent training and promotion should be undertaken.

[1] See Section 7 and Exhibit 2 for details of possible options for the future home of ECGS.

2. BACKGROUND AND SCOPE OF WORK

Access to reasonably priced credit has been a major hurdle to exporters of non-traditional good and services, which are considered high-risk by lenders. Realizing these problems, the Bank of Uganda (BOU) decided to set up a scheme under which it would share the credit risk with financial institutions. In December 2000, BOU accordingly established the Export Credit Guarantee Scheme (ECGS) with the assistance of USAID. This followed a feasibility study conducted by First Washington Associates (FWA), a US consulting firm, which had been contracted by USAID. Initial capital of UGX 2.26 billion was contributed for the scheme, of which 1.26 billion consisted of a "reflow" from a previous USAID program and 1.0 billion was contributed by BOU.

Following the inception of the ECGS, the first loan was placed under the guarantee in April 2001. Since then a total of 78 loans have been guaranteed to 16 exporting companies, some of which represent consortia of smaller companies. Barclays Bank of Uganda Ltd and Stanbic Uganda Ltd are the two banks participating in the scheme. Products exported included grains, fish, flowers, hides and skins, manufactured foods, pharmaceutical products, beans, and export support services.

In the opinion of BOU, an evaluation was needed to determine the extent to which the scheme has achieved its objectives, to review issues raised by exporters and banks about expansion of the program and changes in its *modus operandi*, and to map a way forward.

Statement of work for the consultancy was as follows:

- Review and assess the effectiveness of the performance of the ECGS to date;

- Identify any problems limiting the effectiveness of the scheme;

- Examine the various proposals to expand the scope of the ECGS, including the incorporation of traditional exports and increasing the number of participating banks, and determine their viability;

- Make specific recommendations for the way forward including the need for any training of staff of BOU and the participating banks, marketing the ECGS, modifying the operations manual, and funding and technical assistance.

In carrying out these tasks, the consultant was to examine the operations of the USAID DCA Loan Guarantee Program, which is being promoted and managed by SPEED, to avoid any duplication of resources.

In executing this assignment, participating and selected banks, exporters and export associations, and donors were interviewed (See Exhibit 3 for Contact List). A spot-check of credit files was also undertaken with BOU at Barclays Bank, the program's predominant user.

3. GENERAL REVIEW OF THE ECGS

3.1 Conclusions about Status of Program

The development objective of the ECGS - to finance increased volumes of non-traditional exports - is in the process of being realized. This has been especially true of grains, beans, and flowers. In order to build on this success, the program should now be enhanced to broaden and deepen it in order to serve a bigger number of diverse, smaller *individual* exporters, and to include a larger number of banks. It should also be expanded to cover the fish processing industry in particular, whose needs for short-term finance will increase. The enhancements recommended must be considered in the context of BOU's interest in relocating ECGS outside of the central bank. BOU's executive management no longer consider development finance programs of this type as part of the central bank's core activity for the future.

3.2 Nature of Credit Extended

When the definition of an export credit scheme is considered, it classically refers to a program managed by an export credit agency like the U.S. Export-Import Bank or Hermes (Germany) or COFACE (France), which guarantees or insures commercial and political payment risks related to monies owed by foreign buyers from an export sale. *Despite its name, the ECGS does not refer to an export credit scheme in this sense. It is rather a guarantee fund set up in Ugandan shillings for working capital loans for targeted borrowers in Uganda, who plan to repay these loans from the proceeds of related export sales.* Under the ECGS, the lender (the PFI) and guarantor (BOU) take the credit risk of the exporter in Uganda rather than the importer (buyer) overseas, as would be normal in a so-called "export credit" transaction. [2] Also, export credit schemes tend to cover both short and medium-term loans, whereas the ECGS is geared to short-term loans only with a maximum term of 180 days.

The two active participating banks in the program, Barclays Bank and Stanbic Bank, use the program differently. Barclays, which is by far the largest user of the program (see Table 3 in the text below), has adapted it procedurally with BOU's cooperation, to cover multiple transactions of maize and beans concentrated on a few exporters (one of which is a consortium of 16 smaller companies). Barclays Bank has also financed air freight on a revolving basis. On the other hand, Stanbic Bank has used the ECGS to hedge the resale value of non-traditional goods taken as collateral in a warehouse awaiting export shipment. In this way, Stanbic follows more traditional commodity finance practices, which relate to loans against physical commodities: in the case of non-traditional exports, the ECGS in effect provides additional security for the bank's extension of credit against goods that cannot be hedged and are subject to price fluctuation.

[2] The 15% "down-payment" requirement for borrowers in the ECGS is adapted from export credit programs requiring a buyer contribution to a transaction and very unusual for a working capital facility like ECGS. In order to avoid confusion, it might therefore be beneficial to change the name of ECGS to (for example) "Trade Finance Guarantee Scheme (TFGS)."

3.3 Current Level of the Capital Reserve Fund

As of June 30, 2002, the Capital Reserve Fund for the program was UGX 3.392 billion. This represents an increase of UGX 1.132 billion from 2.260 billion as of the inception date of April 2001. This increase results from credits from interest earned on fund balances, guarantee fees received from operations, and a further transfer to the fund by BOU.[3] The level of capital of 3.392 billion compared to guarantees *outstanding* of UGX 6.255 billion as of September 30, 2002, for a leverage ratio of 1.84:1.[4]

3.4 Appropriate Level for the Capital Reserve Fund

The appropriate level for the Capital Reserve Fund has been suggested by consultants at 2.5 "times" the level of guarantees outstanding. In fact, this guideline is very subjective, as an optimum level of capital will depend upon the level of risk in a business. In the case of the ECGS, the business risk is the risk of loss from guaranteeing loans for non-traditional exports. A useful analogy in this context is the insurance industry, where differing levels of "surplus" (i.e. capital) may be mandated by regulators to support different types of underwriting risk. In the insurance industry, policy risks are "experience-rated" by actuaries, and on this basis an appropriate level of capital is determined to support a given line of business.

As the ECGS is a new program, it is difficult to evaluate the risk of claims. There are two positive aspects that augur well for a favorable "underwriting" experience:" risk-sharing by the banks, and the transactional nature of the loans made (loans to finance specific exports the proceeds of which are used to repay the loans). To the extent that either of these positive factors is changed, a higher level of capital would be required. In any event, until more experience is gained under the program, leverage of 2.5 is recommended for the interim. However, to achieve continued growth in the levels of issued guarantees, an increase in capital is recommended in the short term. The amount of such an increase should be determined after financial projections are put together for the ECGS, which will put the program on an economic basis, i.e., which incorporate projected management costs and assumptions about a provision for claim payments. As a rough estimate, an increase of UGX 3.5 billion might be contemplated, double the current level, to about UGX 7 billion within the interim period to support a doubling of the current level of guarantees.

3.5 MIS and Accounting at Bank of Uganda

BOU maintains detailed records of capital accounts on an annual basis on Excel software and a compilation of guarantees issued by participating banks and borrowers. In order to determine the level of increased capital necessary for growth in the program, detailed financial projections should be done, which incorporate an estimate of management costs (personnel, occupancy expense). There must also be an estimated provision for claims payments, which is a subjective matter at this time. However, sensitivity analysis for claims can be done to judge the effect on capital accounts. An

[3] There has also been no allocation of management cost for the program by BOU, which contributed time and expense during start-up phase to help ensure the program's success.
[4] The level of guarantees outstanding can fluctuate substantially. For example, as of June 30, 2002, outstanding guarantees were UGX 10.027 for a leverage ratio of 2.96:1, in excess of the current guideline of 2.50:1.

appropriate level of guarantee fees can be set based upon what will be needed (conservatively) to ensure that the program can be self-sustainable.

3.6 Claims History

As of September 30, 2002 one claim of UGX 52.2 million had been submitted by Barclays Bank. However, a potential claim of about UGX 1.06 billion ($575,000) may also be filed by Barclays, relating to grain exports to Zambia. With respect to the potential claim, all amounts due from private importers (millers) in Zambia have been paid, but the Government of Zambia, which undertook to pay a premium, owes the balance. BOU is attempting to recover the amount from the Bank of Zambia, and it is considered that the sum will ultimately be paid, albeit with delay. Nonetheless, even a partial loss of principal plus interest covered under the ECGS would cause a reduction of ECGS capital accounts.[5]

4. OVERLAP WITH THE DCA LOAN GUARANTEE PROGRAM

The "DCA" or Development Credit Authority Loan Guarantee Program (funded by USAID and promoted and managed by SPEED), which has been operational in Uganda since April, 2002, provides guarantees from USAID for 50% of bank loan principal up to a term of 5 years for qualifying borrowers in Uganda. In practice, all borrowers under the ECGS would have been eligible for guarantees under the DCA program, so that there is duplication of resources between the two schemes. The DCA program has broader scope and more flexible terms, whereas the ECGS has a higher percentage of guarantee coverage per loan and is more targeted. Operating procedures, especially in the sensitive area of claims, are more flexible for the DCA program than for the ECGS (see below for discussion under "Program Constraints" in Section 5).

Barclays Bank and Stanbic Bank, that participate in both programs, face a choice of which program to use for specific loan requests. Some banks that are qualified under the ECGS (but do not participate like Bank of Baroda and DCFU Ltd.) are not qualified under the DCA program because they have Government ownership. Two banks participating in the DCA program (Nile Bank and Allied Bank) were not approved for the ECGS although they could still be eligible if qualified by BOU. Under the ECGS, banks either have delegated or non-delegated authority. (The difference between delegated and non-delegated authority is whether transactions require the approval of the BOU or not.) In the DCA program, all banks have delegated authority.

Below is a summary of the terms for the two guarantee programs with additional tables that show activity under the ECGS and the DCA. For a detailed listing of differences in program terms see Exhibit 1.

[5] For a discussion of finance for maize and beans under ECGS please see sections below. These loans comprise more than half of the program's utilization and merit separate consideration.

Table 1

ECGS and DCA Programs

Item	ECGS	DCA
Qualifying Borrowers	Non-traditional private exporters.	Private micro and medium sized enterprises, micro-finance institutions
Type of Financing	Working Capital loans for pre-export to 180 days.	Short term and medium term loans to 5 years. May be related to an export or not.
Maximum exposures	UGX 700 million.	US$ 1,000,000. Guarantee in dollars or shillings.
Guarantee Limits	75% of 85% of the lesser of cost or export price, interest on the guaranteed amount.	50% of principal, no interest.
Claims Procedures	Notice 5 days after default. Claim within 120 days, specific collection actions required with timetable.	Claim must be filed before program ends, bank to pursue reasonable collection efforts and write off or reserve 100% of loan.
Reporting requirements	Monthly reporting of defaulted loans, otherwise quarterly reporting.	Summary information on borrowers 30 days from usage, otherwise semi annual reporting. Periodic information about bank.

Table 2

Activity Under ECGS
Total: UGX 23.6 Billion in Loans

Bank	Number of Loans	Total Loans Guaranteed
Barclays Bank	72 (of which 47 for 4 accounts)	UGX 19.2 billion
Stanbic Bank	6	UGX 4.4 billion

Table 3

Activity under DCA
Total: UGX 3.7 Billion in Loans

Bank	Number of Loans	Total Loans Guaranteed
Barclays Bank	8	UGX 2 billion
Nile Bank	2	UGX 720 million
Standard Chartered	2	UGX 225 million
Stanbic Bank	1	UGX 410 million
Centenary Rural Development Bank	1	UGX 310 million
Allied Bank	1	UGX 62 million

The tables show the predominant role of Barclays Bank in both programs. They also show the wider participation by the banks in the DCA program.

In the writer's opinion, there are three valid reasons for continuing the ECGS program as a separate effort from the DCA program:

1. The ECGS gives priority to non-traditional exports and has facilitated loans of UGX 23.6 billion to date.

2. The ECGS has started well and has materially assisted exporters whose access to financing would not otherwise have been possible.

3. As can be noted from the Exhibit 1, the DCA program carries an aggregate limit over a five-year period, whereas the ECGS is renewable annually and does not impose any aggregate limit of loans or guarantees, except to the extent that outstanding guarantees are limited by the leverage of the reserve capital fund. The ECGS is therefore better positioned to deal with the repetitive, higher volume, short-term needs of its constituent exporters.

5. PROGRAM CONSTRAINTS

Based upon interviews conducted in Kampala and an in-depth review of the ECGS program documentation by SPEED, constraints in the ECGS program's operating procedures and practices have been identified. This section of the report discusses these constraints and recommends actions to reduce them, in order to enhance the

effectiveness of the program. It is noteworthy that most loans granted under the program (to grain traders and an air transport company) are not in accordance with the original terms and conditions of the ECGS but were approved as exceptions by BOU in the interest of the program's development objectives. The program has therefore operated largely by exception rather than by rule. While continued flexibility on an industry-by-industry basis is recommended, the operations manual should be re-written to specify what is permitted.

5.1 Legal Documentation

Two of the banks chosen for the ECGS, Citibank and Standard Chartered (both with delegated authority), are reluctant to participate because of concerns that the BOU's guarantee as set forth in the Master Guarantee Agreement imposes too many conditions.

SPEED's review of the documents confirms this view. Obligations for Participating Financial Institutions (PFIs) as set forth in Articles IV and VII of the Agreement require notice periods, the submission of specific form documents within defined periods, even demonstration of specific collection procedures to include notice of a defaulted loan within 5 days of default on loan payment. In other words, the program's operating and reporting procedures, which involve micro-management of problem loans, are incorporated integrally into the Guarantee Agreement. Presumably, if there is even minor, inadvertent delay in compliance with reporting or procedural requirements, an event of default[6] would occur, and BOU would have a basis for refusing payment of a claim[7] under its guarantee.

In addition, should it be desirable to change an operating procedure, the legal agreement would have to be amended. In the case of an international bank, this process can take considerable time in practice, with reviews required by in-house counsel outside of Uganda.

It is recommended that the Master Guarantee Agreement be divorced from the program's operating procedures, specifically that the Agreement refer to a requirement that the PFI follow procedures in an operations manual as updated from time to time between the PFI and BOU. The Agreement should also have normal default provisions[8] as between BOU and the PFI, so that it is clear what the PFI must do to assure the enforceability of a guarantee. Currency risk must also be clarified, so that BOU's obligation to pay is clearly in shillings only. Interest coverage should also be modified (See 5.2.2 and 5.2.3 following for more about these latter two points).

[6] Unusually, there are no default provisions in the Agreement as between the bank and BOU, so that any violation of a PFI of its obligations as set forth in Articles IV and VII must be assumed to constitute an event of default.

[7] Indeed, with respect to the potential claim by Barclays Bank of $575,000 in UGX for grains financing to Zambia, the bank apparently did not provide a required notice of default within 5 days after occurrence, which could be used as an argument to contest the validity of its potential claim on BOU under the Guarantee Agreement.

[8] Such provisions may include a requirement that BOU notify a PFI that it is in default and provide the PFI with a time to cure the default (called a "cure period").

5.2 Operating Procedures

A new operations manual should be drawn up with incorporates many of the provisions of the current system but also adds procedures for revolving and multiple use facilities, modifies claims procedures, and adds industry-by-industry flexibility.

5.2.1 Multiple Use Facilities

Currently Barclays Bank operates these facilities for a large percentage of the program's volume in grains, beans, and airfreight, but the bank documents and reports them as though they are individual transactions. Based upon inspection of credit files at Barclays, this can create administrative problems for the bank and also generate issues with respect to enforceability of BOU's guarantees, as the Master Guarantee Agreement integrates operating procedures that relate to single transactions[9].

5.2.2 Currency Risk

Many of the loans under the program are made in dollars, but the related guarantees are in shillings. The operating procedures should make clear that in such cases the bank, not BOU, will bear any currency risk relating to appreciation of the dollar against the shilling. A provision to this effect should also be put into the Guarantee Agreement, for example to define "Guaranteed Amount" as an amount in shillings, a "Loan Facility Amount" as an amount in shillings, or if the loan is in dollars, the equivalent amount in shillings at the BOU's rate of exchange as of disbursement date, etc. Also, for clarification, the agreement should define BOU's obligation to pay in shillings only.

5.2.3 Interest Coverage

The ECGS currently provides interest coverage on the guaranteed portion of bank loans at the bank's interest rate until a claim is submitted (maximum 120 days after default). Thereafter interest is payable at the Treasury bill rate (which rate is not specified). Also, as many of the loans are made in dollars, should interest accrue for the 120 days at bank dollar interest rates (payable in shillings) or shilling rates if a claim is to be made in shillings? Should the Treasury bill rate used be a U.S. bill rate or a Ugandan bill rate for dollar loans? It is recommended that interest be payable by BOU at the Ugandan 90-day Treasury bill rate if BOU does not pay a claim[10] within 90 days of receipt of a claim from a PFI.

However, it is recommended that the interest coverage currently included in the ECGS be eliminated, as it is not a critical inducement for use of the ECGS program.

5.2.4 Claims Procedures

Current claims procedures for ECGS require PFIs to notify BOU of any obligation more than 5 days past due, to submit a claim no sooner than 90 nor later than 120 days after

[9] This continues to be true despite an amendment permitting multiple transactions, as the main agreement still incorporates procedures that do not relate to the amendment, and it is not clear whether these should still be followed as a legal matter.

[10] The interest would be payable for undisputed claims only. If BOU disputes a claim no interest would be payable unless the dispute is resolved in favor of the PFI, in which case interest would accrue and be paid in that event.

due date of a defaulted loan, to send Form 109, to provide evidence of specific due diligence, and to include two written claims on the borrower, a site visit, service of a 30-day Statutory Notice for a legal mortgage, and subsequent advertisement of collateral for sale.

These procedures are problematic for the two approved banks (Citibank and Standard Chartered) with delegated authority and prevents their participation in the program. The procedures should accordingly be modified to allow all participating banks to follow normal collection practices rather than follow claims procedures that might not fit circumstances and raise issues about the enforceability of a guarantee. For example, often in the area of problem loan management, delinquent borrowers who demonstrate potential viability can be restructured and rehabilitated: In these cases premature collection actions would not be advisable, indeed be counter-productive to ultimate recovery of loan assets.

Specific recommendations in this area are as follows:

1. Notice of borrower default should be required within 30 days rather than 5 days as now.

2. Claims should not be filed until 90 days but may be filed at any time up to one year after the program is terminated.

3. The bank must be able to demonstrate to BOU that reasonable collection efforts are being pursued in accordance with prudential norms.

5.2.5 Requirements for Export Contracts and Financing Term

The ECGS requires an export contract or firm order to be demonstrated as a basis for any covered pre-export financing[11]. The lesser of the contract value or cost content is then determined. The borrower must make a 15% contribution to the lesser of the two values, with BOU guaranteeing 75% of the remaining amount (75% of the 85%). The reason for structuring matters this way is that the program is intended to be transactional and self-liquidating – with repayment tied to proceeds from specific export sale transactions whose production has been financed.

The problem with this approach is that it is not workable for some industries that do not use export orders or contracts in advance, or for which they represent excessive price risk. In the case of non-traditional exports like flowers, grains, and fish, wide fluctuation in prices can be expected during the term of trading cycles, so that buyers and sellers tend to quote and deal on a spot basis as goods are ready for shipment. By the time a price is fixed, no financing is needed. On the other hand, de-linking financing from specific transactions runs the risk of funds being used for other purposes and therefore increases the risk of non-payment to lenders. There is therefore tension between the reality in which many businesses operate and the ECGS's operating procedures. The following are suggestions in this respect for the grains, flowers, and fish sectors:

[11] Exception has been made for Fresh Handling Ltd., an airfreight company owned by flower exporters, which is financed on an exceptional basis under the program.

(i) Grains / Beans

The largest user of the program is Uganda Grain Traders Ltd, which is owned by 16 millers (as of September 30, 2002 total guarantees issued were UGX 7.48 billion or 42% of the program's total). The transactions considerably exceeded the maximum loan limit under the program of UGX 700 million per borrower. This was permitted in order to accommodate the needs of a key new sector. Borrowings are now done on a "multiple" basis, with borrowings and repayments up to an approved limit under one guarantee with loan renewal notices required of the bank.

By way of background, Uganda Grain Traders Ltd had obtained an export contract in 2001 for sales of maize to Zambia at a fixed price, which, according to the company's manager, represented too much price risk, as purchase prices for the grain could have exceeded the committed contract price.

For the coming season, the company has proposed that the Government of Uganda approve financing for accumulation of stocks under a warehouse management program whereby the commodity would be inventoried and controlled by a warehouse management company that would hold the maize it as security for the lender. These stocks would be financed under the ECGS program, and would be available for sale at spot prices in the region. Offers for grains are now reportedly in circulation in the marketplace at a fixed price in anticipation of implementing this program.

The problem with this approach is that there is no assurance that all of the goods will be exported. Also, the lender and guarantor would take the price risk on inventories financed and could get caught in the event of a sharp decline in price, suffering substantial loan losses, as has happened in the coffee trade recently in Uganda and elsewhere in East Africa. Therefore, this scheme is not recommended for ECGS-guaranteed financing. It should also be borne in mind that Uganda Grain Traders will maximize the use of this form of credit.

In order accommodate financing for grains and beans, a sounder approach would be to require that the borrower finance an initial shipment from its own capital, and that the proceeds from the initial shipment be used to retire a loan taken out to finance a subsequent shipment, etc. The bank's disbursed loan amount should not exceed 85% of the value of the *prior unpaid* shipment, which for procedural purposes would be documented and would meet the requirement of an "export contract." In this way, the self-liquidating nature of the lender's credit risk would be preserved.

A problem with this method is that Uganda Grain Traders Ltd. it is under-capitalized and would therefore have to seek funds from its shareholders to finance an initial shipment[12] or shipments.

It is further recommended that the level of guarantee cover for this sector decline over time – from 75% of loan principal now to 50% in three years, then be reviewed for elimination altogether in 5 years, as the sector might then be deemed to be mature. Total amounts of guarantees outstanding under the revolving facility for Uganda Grain

[12] In the writer's opinion, even if the shareholders have the financial means to cover initial shipments, they will be reluctant to use them and contribute as capital to the consortium company if they believe that debt financing is available from a bank that is guaranteed by the BOU or a donor.

Traders Ltd. should be kept to a reasonable limit in relation to the capital reserve fund. A limit of 30% of the fund balance is recommended, or guarantees outstanding of about UGX 1.0 billion covering loan principal of about UGX 1.33 billion. Assuming that the business revolves 3 times per year, total volume of loans possible would be UGX 4.0 billion or about $2.2 million at the current capital reserve fund level[13], which represents substantial assistance on an exceptional basis for this industry. Any financial support above these levels should come from other sources.

(ii) Flowers

60% of the export cost of flower exports comprises airfreight. With the cooperation of BOU, an innovative use of the ECGS was established by Barclays Bank to finance the first operations of Fresh Handling Ltd., a freight handling company owned by a consortium of flower growers. This has succeeded in consolidating and lowering freight costs and allowing smaller growers access to export markets. Although prices are set on a spot basis in Holland for stems ready for shipment and export contracts are therefore not realistic, Fresh Handling Ltd. does require contracts for delivery of flowers to it at a specific price (with a penalty payable for non-delivery).

One idea discussed in Kampala was that these contracts might be financed via Fresh Handling Ltd. as part of an increased revolving loan facility available to it. This idea should be investigated, as it could provide added working capital for smaller growers.

(iii) Fish

Fish processors rarely use the program for two reasons stated by the industry association: 1) the industry does not function with export contracts because of volatility in price, and 2) guarantee fees are too high. With respect to the lack of export contracts, as the entire business is for export, there is little chance of diversion of resources for non-export purposes if working capital credit is extended without contracts. Therefore, SPEED recommends extending the application of the ECGS to this sector, subject to some written evidence of an export order or *pro forma* order to document transactions for the files[14]. Initial amounts guaranteed should be restricted to the current per borrower limit of UGX 700 million or 20% of capital. Because of the rapid business cycle for the export of fresh fish (15 days), there would be need to review the application of the 1.25% fee on each transaction. Our recommendation is that this fee should apply at the rate of 1.25% per 180 days, as is the case with the flowers.

5.2.6 Collateral Issues

Although this has not yet become an issue, in the event of liquidation of collateral to repay a problem loan, the situation could become complicated in the event that a bank lender has other types of non-guaranteed credit facilities for the same borrower and sharing the same security. What would pro-rata sharing mean under those circumstances? Would the proceeds of the sale of the common security be shared across all the loans (on the basis of the size of the loans) or would the proceeds be first

[13] If the reserve fund is doubled, as has been suggested, guarantees outstanding for this company could be increased.
[14] A format for this would have to be worked out with the industry.

(or possibly last) allocated to the ECGS-covered loan? The allocation of the security proceeds has to be finalised before the loss on the ECGS-covered loan can be determined and subsequently allocated on a 75/25 basis.

Also, how would the bank's accrued interest be handled? Normal collection procedures at commercial banks allow for application of liquidated proceeds *first to fees, then loan interest, then loan principal*. If BOU has guaranteed 75% of loan principal and some interest at effectively less than 75%, how should liquidated proceeds be applied "pro-rata" if the bank's total accrued interest is substantial over time? What if the loan is in dollars with a guarantee in shillings and there is substantial appreciation of the dollar against the shilling? What does "pro-rata" application of liquidated proceeds mean in this case? Does BOU get less than 75% because the "pro rata" amount of its guarantee is less 75% of the shilling equivalent value of the dollar loan?

The operations manual should detail these matters. The experiences of problem loan management and the realisation of shared securities demonstrate that serious difficulties can arise. These matters are often material and should be addressed in advance to avoid misunderstanding and disagreement.

5.2.7 Level of the Capital Reserve Fund

The level of the Capital Reserve Fund has been mentioned above in Section 3.4. The current level appears to be a constraint in the expansion of the program and will likely need to be increased to maintain the 2.5 leverage ratio. As mentioned earlier, the exact amount of any increase will depend upon the financial projections done for the ECGS, assuming allocation of management costs and a provision for claims payments. Commercial sources of equity financing from financial institutions are unlikely to be available for the program. Targeted sources should be BOU, grants and counter-part funding that may be available from USAID programs, KfW, the German investment agency, and the Dutch investment agency.

5.2.8 Consistency of Guarantee Fees

Inspection of the files and interviews with borrowers and banks revealed that the 1.25% guarantee fee has not been applied on a consistent basis. For some accounts it is a flat fee (e.g. Uganda Grain Traders), for others a semi-annual fee. There is also discussion about applying it on an annual basis. In order to make this consistent, BOU intends that the fees relate to periods up to 180 days. In other words, all guarantees with a term of up to 180 days would carry a flat fee of 1.25%. Any facilities with a longer term, for example 270 days or a year, would require that an additional 1.25% (total 2.5%) be paid. For a multiple use facility, 0.25% flat for each renewal would also be due. SPEED supports this approach by BOU. The fish processors in particular have requested a maximum of 1.25% per annum, rather than per 180 days, citing the high cost as a barrier to usage of the program. However, when the value of the guarantee is considered, the cost would seem to be reasonable. No exception is recommended.

The ultimate level of fees will depend upon financial projections and the program's financial needs to assure self-sustainability.

5.2.9 BOU Mandate to Place the Program Elsewhere

BOU has decided to place the ECGS along with other activities that are part of its Development Finance Department outside BOU, so that BOU may concentrate on its core central bank businesses. The relocation of the program could represent a major constraint to its development and success depending upon where it is put. Section 7 below and Exhibit 2 attached therefore set forth options for consideration for a "way forward" with advantages and disadvantages for each option.

6. PROPOSALS TO EXPAND THE ECGS

There are two main proposals currently being voiced to expand the ECGS: (i) more banks should participate; and (ii) traditional exports should be included.

6.1 More Banks

SPEED agrees with the goal of achieving a broader bank participation and believes that modification of the program's operating procedures and documentation as recommended in Section 5 above will contribute to this goal for banks with non-delegated authority. A new round of training and promotion of the program is recommended to ensure this as part of any modification. In addition, inclusion of at least two additional smaller banks by BOU in the non-delegated category is recommended to service smaller individual exporters who are under-represented in program activities. Allied Bank and Nile Bank, two smaller banks that are qualified under the DCA program, should be reviewed for consideration under the ECGS. If any deficiency is found in their credit practices by BOU which might impede their qualification for the program, technical assistance might be mandated from SPEED or another donor to assist BOU in evaluating applications and ensure proper handling of ECGS guarantee requests.

6.2 Traditional Exports

Several of the banks interviewed requested that the ECGS be broadened to include "traditional" exports, which are defined as coffee, tea, cotton, and tobacco. In this context it should be noted that the ECGS can cover value-added products from traditional sectors, like specialty coffees, as they represent new areas for development and are in a sense "non-traditional." We considered each of the sectors.

Tobacco is dominated by British American Tobacco, which has captive financing arrangements, so that the ECGS is not needed. Cotton is well organized, as is tea, and both are mature sectors not appropriate for the ECGS. As for coffee, while this sector is depressed, it remains a mature sector and is a hedged commodity with forward prices quoted on exchanges in New York and London. Commodity financing techniques for this sector are well established internationally and have not historically required subvention in other parts of the world. The fact that the banks in Uganda and elsewhere in East Africa have experienced high loan losses in coffee financing recently because of inappropriate credit practices, does not justify expanding the ECGS to cover it.

7. OPTIONS FOR THE WAY FORWARD

As was mentioned in Section 5.2.9 above, BOU has reportedly decided to place the ECGS, along with other activities that are part of its Development Finance Department (DFD), outside of BOU, so that BOU may concentrate on its core central bank businesses. BOU has accordingly been considering options for the future of the program for the past two years. This process will intensify with the hiring of a consultant under the sponsorship of the German Development Corporation (GTZ) for an in-depth review of the ECGS and other DFD programs to be completed by the end of 2002.

As part of this report, SPEED has also discussed possible options for the future with counterparts, which are set forth in this section of the report. These options are preliminary only and should be amplified by the GTZ-sponsored study. In our deliberations about advantages and disadvantages for the options, we were guided first and foremost by the need to ensure that a new guaranteeing entity or scheme for the ECGS can issue a first class guarantee that will be acceptable to participating banks.

7.1 Options

The five options considered are as follows. Exhibit 2 sets forth each option and a summary of the advantages and disadvantages for each.

- ***Transfer of the ECGS to the Uganda Development Bank (UDB).*** This option would involve a transfer of the program to UDB. While there are advantages to this approach, a deciding disadvantage is that UDB's financial standing as guarantor may not be acceptable to participating banks.

- ***Transfer to DCFU Group (DCFU Ltd.).*** This option would allow for transfer to a commercially minded development group, allowing for efficient administration and commercialization of the program. Disadvantages would be that while the group is financially strong, it may not be able to provide a first class guarantee for international banks operating in Kampala. Also the group owns a commercial bank, which could lead to a potential conflict of interest with participating banks. Efforts to reduce these disadvantages, for example by arranging for one of DFCU's international donor-shareholders[15] to act as guarantor, and/or by using confidentiality agreements and arrangements acceptable to participating banks, could make DFCU a prime candidate for the transfer of ECGS.

- ***Set up a quasi-independent or semi-autonomous guarantee fund.*** This option, which has the attraction of providing a distinct identity and focus for the program, would ultimately have the principal disadvantage of not being able to provide a first class guarantee acceptable to participating banks. The same ultimate barrier would be present even if such a fund were considered as an "interim step" under some arrangement where BOU would continue as guarantor for a while. Once BOU's guarantee is no longer available, in the absence of other prime backing for the guarantee, the ECGS would be at risk and likely fail.

[15] For example, the Commonwealth Development Corporation (CDC) or International Finance Corporation (IFC).

- ***Establishment of a deposit guarantee program in parallel with DCA.*** Under this innovative approach, the Capital Reserve Fund at BOU (increased as necessary) would be placed on deposit with selected banks, which would use it as 25% cash collateral for qualifying pre-export loans. The cash would be subject to a pledge agreement whose terms would define the *modus operandi* of the program, in particular the conditions to the banks' right to offset the funds on deposit against a loan in the event of default. If operated with the DCA program, which allows for a 50% guarantee of principal, the total in cash and guarantees would amount to 75%[16]. The disadvantages are that (i) transaction volume would be limited, as the DCA program does not allow for revolving transactions, and (ii) the legal documentation of the DCA program would need to be amended to allow the additional 25% cash collateral. It is unknown whether this would be feasible.

- ***Transfer the ECGS to the East African Development Bank (EADB) as a country-specific fund.*** As noted in Exhibit 2, this option has several advantages, the most important of which are the bank's financial standing and possibility of replication in the region. There would a need to be responsive and efficient in managing the program.

In meetings with senior officials from the EADB and DFCU Ltd, interest was expressed by both organizations in managing the program. If neither of these two alternatives is possible, we recommend maintaining the program at BOU until a solution is found.

7.2 Implementation Steps for Transition Period

As a future home for the ECGS is considered outside BOU, the following technical assistance is recommended during the interim period in order to enhance use of the program. Coordination with current *and potential* stakeholders should be undertaken during this process.

1. Legal documentation should be modified as noted in 5.1 above.

2. An updated operations manual should be drafted incorporating points in 5.2 above.

3. Both the legal document and new operations manual should be sent to PFIs for comment.

4. Financial projections should be prepared to determine the amount of additional capital needed for the Capital Reserve Fund and the projected level of guarantee fees required in order to ensure self-sustainability of the scheme. The projections should incorporate an assumed cost of management and administration and a provision for claims payments, with sensitivity runs performed on claims.

5. Two smaller banks should be added to the program as PFIs as non-delegated PFIs and assistance should be provided to them and to smaller individual exporters to deepen the reach of the program.

[16] There would be no coverage of interest under this scheme.

6. Training and promotion should be provided to all PFIs and exporters in the revised program.

7.3 Implementation Steps for Medium Term

For the medium term (after the future of the program is decided), technical assistance should be considered for the following:

1. Monitoring and program administration (especially if the program is assumed by a financial institution or a donor).

2. Continuing assistance for smaller exporters and banks should be provided.

3. Consistent training and promotion should be undertaken, perhaps with the support of the Export Promotion Board.

Exhibit 1

Comparing ECGS and DCA Programs in Uganda

Item	*ECGS*	*DCA*
Qualifying Borrowers	Non-traditional private exporters (coffee, tea, cotton, and tobacco excluded). Main users are grain, flower, and fish exporters.	Non-sovereign (private) micro and medium sized enterprises, micro-finance institutions, NGOs (USAID written consent required for pharmaceuticals, pesticides, logging equipment, luxury goods (alcohol), enterprises that might damage the environment and / or U.S. economic interests). Eligible borrowers may include both traditional and non-traditional exporters.
Type of Allowed Financing	Working capital loans for pre-export purposes.	Short-term and medium term loans. May be related to an export or not.
Term of Financing	Maximum 180 days	Up to the shorter of 5 years or the termination date of the program (currently January 31, 2007).
Maximum Exposure per Borrower	Ugandan shillings 700 million (approx. $375,000)[17]	$1,000,000
Currency	Loans in Ugandan shillings or foreign exchange. Guarantees in shillings only.	Loans and guarantees in dollars or Ugandan shillings.
Authority Delegated to Banks	Certain banks may obtain delegated authority to approve transactions. Others may be required to submit each guarantee application for approval. Participating banks must be licensed by BOU and may have public ownership.	All participating banks have delegated authority. Participants must be privately owned banks.
Guarantee Limit as a Percent of Loan Principal	63.75%[18] of the lesser of the export price or cost content of an export as defined.	50%

[17] This limit was exceeded with the approval of Bank of Uganda for Uganda Grain Traders Ltd. (total exposure $2.7 million).

[18] 15% cash down payment or contribution toward an export contract is required from the borrower. Of the remaining 85%, 75% may be guaranteed under the ECGS. 0.85 "x" 0.75 = 0.6375 or 63.75%. For two larger borrowers the 15% requirement has been waived.

Item	*ECGS*	*DCA*
Guarantee Fees	1.25% (flat) of guaranteed portion of maximum amount of loan facility payable in advance (period of 1.25% not defined).	Origination Fee of 0.25% of maximum guarantee ceiling available to the bank, which shall be credited to the Utilization Fee. Utilization Fee of 0.50% per annum on the guaranteed portion of outstanding loans, payable semiannually in arrears.
Guarantee Limit as a Percent of Loan Interest	75% of interest at bank rate payable until the earlier of 120 days after default or when a claim is filed.	None
Past due Interest Protection	100% of interest from filing of claim on guaranteed amount until payment at BOU T'bill rate (not clear which bill rate).	None
Bank Administration Issues	Separate loan posting and accounting required to track each advance to a borrower.	Separate loan posting not required.
Collateral Procedures, Including Distribution of Liquidated Proceeds	For unsecured loans, payment by importer for goods financed shall be sent directly to borrower's / exporter's bank and applied to the loan by the bank before net proceeds are remitted to borrower. For secured loans, proceeds from liquidation of collateral and collections to be shared between bank and BOU in proportion to coverage ratio of BOU guarantee.	Additional guarantees from donors or government entities for the uncovered 50% lender risk prohibited. Proceeds from collections from debtor and from liquidation of borrower security to be shared pro-rata between the bank and USAID
Application Conditions for Specific Cover	For banks without delegated authority, a separate application for each loan in accordance with Form 101. For banks with delegated authority, loan authorization form to be submitted with guarantee fee.	None. All banks have delegated authority.

Item	*ECGS*	*DCA*
Claims Procedures	Bank must notify BOU of any obligation more than 5 days past due. Bank to submit a claim no sooner than 90 nor later than 120 days after due date of a defaulted loan. Bank to send Form 109 and provide evidence of specific due diligence, to include two written claims on the borrower, a site visit, service of a 30-day Statutory Notice for a legal mortgage, and subsequent advertisement of collateral for sale.	Bank to submit a claim no sooner than 90 days after demand for payment has been made on a defaulted loan and no later than 6 months *either* 1) after the maturity of the defaulted loan *or* 2) after the final date for submission of claims (July 31, 2007). Demand must have been made for loan principal, reasonable collection efforts undertaken, and 100% of principal and interest written off or reserved.
Reporting Requirements	Monthly reporting of past due loans subject to guarantees, quarterly reporting of activity during the previous quarter and outstanding credits at the end of the period. Other information as reasonably requested by BOU.	Semi-annual portfolio reports in accordance with a table provided together with certification that the loans are qualifying; annual financial statements on the bank within 180 days of FYE; summary information about borrowers within 30 days of bank's notice of utilization to USAID; summary information about the bank's loan portfolio each July 31 and January 31.
Termination of Program	One year, automatic annual renewal if no objection. Guarantees outstanding at termination to remain in force.	January 31, 2007[19]

[19] This means that the loans eligible for guarantee cover must carry shorter repayment terms as the program nears termination, so that final loan payments occur and related guarantees are in force prior to January 31, 2007. A bank might agree to take the risk that final loan maturities beyond January, 2007 are not covered, however.

Exhibit 2

Options for Way Forward
Export Credit Guarantee Scheme

Option	*Advantages*	*Disadvantages*
Transfer to Uganda Development Bank	• Consistency with existing program documentation, procedures, and staff. • Ease of transition.	• Problem of acceptability of Uganda Development Bank as guarantor by PFIs. • Political interference risk and consequent risk of loss of donor support
Assumption of Program by DFCU Group	• Strong commercial and development group. • Efficiency of administration.	• Problem of acceptability of DFCU Ltd as guarantor by PFIs. • Possible perceived conflict of interest with PFIs and therefore problem of PFIs providing information from files to competitor bank. • May increase Guarantee fees to ensure profitability of program.
Establishment of an Independent Guarantee Fund – Transfer Capital and Systems from BOU	• Independent identity for program. • Marketing of program easier. • Management of fund independent. • Possible diversification into other forms of guarantee cover.	• Financial standing of fund and acceptance by banks of guarantees problematic. • Sources of additional capital uncertain (PFIs not interested). • Need to demonstrate sustainability and put program on an economic basis. • Time to establish could be long.

Option	Advantages	Disadvantages
Establishment of a Deposit Guarantee Program in Parallel With DCA	• Easy to establish. • Easy to operate, user-friendly. • Administration efficient. • Reporting and monitoring consistent with DCA Program. • Continuation of BOU involvement in program. • Development objectives met without additional institutional expense or staff.	• Amendment of one or two clauses of DCA Agreement required. • New legal document (pledge agreement) and operating procedures necessary. • Qualifying banks limited to DCA – qualified banks (no banks with public ownership). • Specific sectors only authorized rather than all sectors except for specific exclusions.
Transfer to East African Development Bank as a Country-specific Fund	• Consistency with existing program documentation, procedures, and staff. • Ease of transition. • Good financial standing as guarantor. • Possible replication in East African region	• May have difficulties in being sufficiently responsive to the needs of participating banks

Exhibit 3

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