DIAMNIADIO SMALL AND MEDIUM ENTERPRISE COLLATERALIZED LOAN OBLIGATIONS (SMECLO) AND MCC FINANCIAL FACILITY

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Strengthening Capacity to Implement Public Private Partnerships in Senegal
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DIAMNIADIO SMALL AND MEDIUM ENTERPRISE COLLATERALIZED LOAN OBLIGATIONS (SMECLO) AND MCC FINANCIAL FACILITY[1]

I.- Collateralized loan obligation definition

1.1.- The genesis CLO (collateralized loan obligation) market occurred in the late 1980s with the repackaging of high-yield, speculative loans into highly rated paper. By the late 1990s, the market had expanded into far more diverse product applications, and beyond U.S. borders in terms of issuers and investors alike. Participation by sponsors outside the U.S. increased, most notably, by European and Japanese financial institutions through CLOs. CLOs are securities backed or collateralized by a diversified pool of corporate loans.

1.2.- In particular, a CLO is backed by a portfolio of secured or unsecured loans made to a variety of corporate commercial and industrial loan customers of one or more lending banks. Cash flows from the asset pool plus credit enhancement to cover credit risk in the portfolio provide payment to the CLO investor. Credit enhancement or credit support often comes in the form of excess assets over rated CLO liabilities.

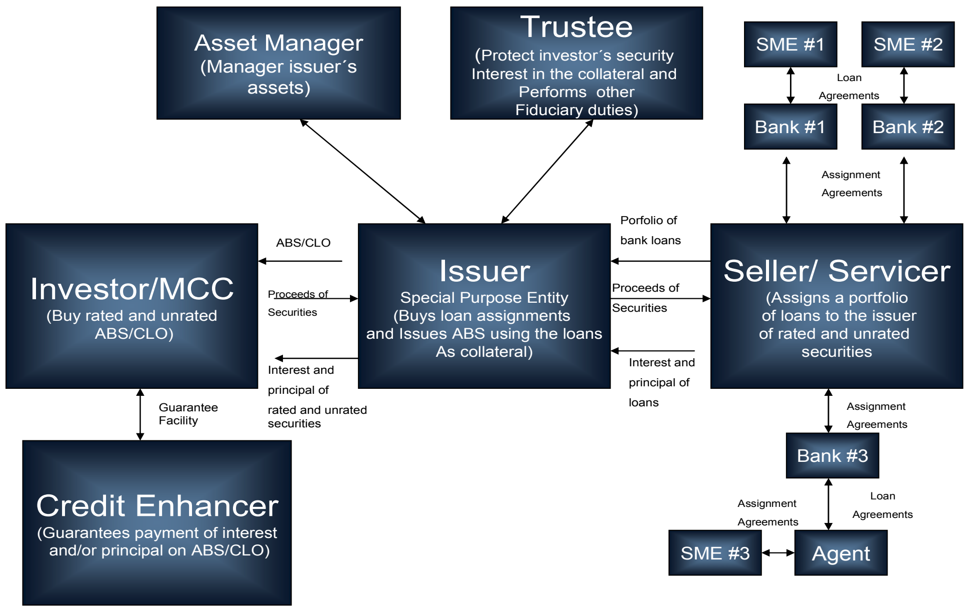
1.3.- This is achieved by subdividing CLO into senior and subordinated tranches or classes, each with different ratings (risk), different loss positions and different levels of excess asset "buffers."

1.4.- For example, depending on an issuer's underlying portfolio characteristics, $40 millions in assets can back $25 million 'BBB-' rated senior notes, and $15 million unrated subordinated and equity classes (BB or B). Arbitrage or "spread" CLO transactions can realize the positive spread between a portfolio of higher-return, higher-risk assets, often rated below 'BBB-', and lower-cost, highly rated CLO securities issued to purchase that portfolio.

1.5.- Another example can be analyzed with an Asset manager-sponsored high-yield CLO. For example the balance sheet CLO transactions can reduce regulatory capital requirements and enhance lending capacity and return on equity by using the proceeds of the CLO securities to "spin off" loans from corporate commercial and industrial lending portfolios.

[1] Prepared by Sergio A. Hinojosa. Dakar , March 21, 2005

1.6.- The following diagram shows a typical CLO transaction:



II.- SME´s Collateralized loan obligation for Diamniadio Platform

2.1.- In a first approach the CLOs asset backed securities methodology can be applied in Senegal in the case of Diamniadio Platform using the MCC financial facility for the amount of $60.1 million according to "Programme d'infrastructure de soutien a l´acceleration de la croissance économique".

2.2.- This it would permit creates benefits for all parties : i) to reduce the interest rate, ii) to extend the maturity and iii) to would allow SMEs the access to the credit capital market. Other positive externalities of the ABS/CLOs are to contribute to the development of the domestic capital market and to leverage the $60.1 million MCC financial facility. As SME borrowers gain increased access to capital they can expand their economic opportunities; and lenders gain a safer entry into a new and potentially profitable market, with a x[2] percent of their risk covered by a solid financial structure.

2.3.- Sustainable economic growth occurs when financial markets mobilize domestic private capital and put it to work. In developed financial markets, lenders provide needed access to credit to help grow private businesses and expand key development projects. However, broad and deep financial intermediation does not occur in many developing countries where access to credit is a key constraint to economic growth.

[2] In the case of DCA X correspond to 50%.

2.4.- The use of MCC funds can be an effective tool to leverage limited donor funds and build local private sector financial institutions in Senegal. However MCC financial facility must be used through a competitive market basis analysis.

2.5.- That means that it is extremely necessary to know the SME borrower risk (creditworthiness) that includes at least SME business plan and financial statements.

2.6.- In addition, also it is important to know the creditworthiness of the lenders (Senegalese Banks) that include to follow a widely CAMELS analysis to evaluate the bank's (Capital adequacy, Asset Quality, Managements, Earnings, Liquidity and Sensitivity to market factors).

III.- General assumptions for the proposed SMECLO Transaction

3.1.- The currency used to securitize the credits is the FCFA in order to avoid FX risk.

3.2.- In average, each credit amounts is for FCFA 50,000,000 (?) and its maturity is 2 years, with interest and principal payable each month. A one month grace period at the beginning of the credit life is considered.

3.3.- The interest rate related to each credit is variable and corresponds to the 6 months Libor Interest Rate Basis (?), plus a spread according to each SMEs credit risk.

3.4.- According to 2.4 and 2.5 SME Projects should demonstrate positive financial rate of returns, indicating that debt can be repaid

3.5.- In all credits, the lending bank counts with a collateral, such as land, equipment, or facilities, provided by the debtor. Alternatively, the lending bank might count with a guarantee supplied by the State and/or Multilateral Donors Agencies.

3.6.- The Special Purpose Securitization Conduit is a SPV company created according to the Senegal Law specially to securitize SME loans.

3.7.- The guarantees can be either full or partial credit guarantees, and ensure the performance in coupon payment of notes or bonds. Partial risk or political risk guarantees can be considered using MCA and/or USAID /DCA Support.

3.8.- As a first approach, the institutions that can provide financial credit guarantees are:

a. The government of Senegal.
b. The World Bank Group, through the IBRD and IFC can provide collateral guarantees.
c. USAID DCA. The Development Credit Authority allows USAID Missions to fund projects that are financially viable through loan guarantees in sectors that meet sustainable development objectives
d. As it was mentioned the Millenium Challenge Corporation is studying to provide a financial facility (facilité de financement) that can be total or

partially in the form of a financial guarantee program. The easy way to do that is doing that MCC be a underwriting of highly debt obligations.

3.9.- The pooled securitized loans generate obligations of three classes:

e. High Class (H): Bonds with investment grade between BBB and BBB+
f. Intermediate Class (I): Bonds with investment grade BBB- and without Bonds with investment grade BB and B-.
g. Low Class (L): Bonds without investment grade moderately speculative CCC, highly speculative CC y and low quality C.

IV.- Diamniadio SMECLO Transaction

4.1.- Under the transaction the loan originators are the commercial Senegalese banks and a SPV specially created issues SME collateralized loan obligations (SMECLO). The obligations are composed of three classes: High, Intermediate and Low. The Intermediate Class can be guaranteed by 7a) b) c) and/or d) and in the Low Class case the MCC acts as an underwriter, this is, is the first buyer of the Low Class bonds: if the MCC or its agents fails to sell the bonds in the market, it is itself obligated to buy them.

4.2.- The liability of the commercial banks as loan originators is to carry out the loan payment collection in order to generate the necessary amounts of principal and interests so that the SPV can manage and securitize them through collateralized obligations. The design of the obligations, as well as the hiring for the rating agency service, follow-up and payment of the coupons is carried out by the SPV. The amount collected through the selling of obligations is passed onto the commercial banks, which provides the SPV with a fee that is paid by the commercial banks.

4.3.- In case of default of the Intermediate Class obligations, guarantors cover the payment of the principal and interests outstanding.

4.4.- The alternative to this scheme is that once the SPV has identified different classes of obligations, the World Bank, by means of the IRBD, provides a partial credit risk guarantee to Intermediate Class bonds, thus automatically increasing its credit rating at least at BBB-.

The advantage of this scheme is that it would be possible to trade BBB bonds in the UMOA and International financial market.

Specific Structure of Domestic SMECL Obligations