DEVELOPMENT CREDIT AUTHORITY

2004 OPERATIONS MANUAL

DCA Operations Manual
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I. Background

A. Introduction to the Operations Manual

This manual provides the USAID Office of Development Credit (EGAT/DC) with guidance on standard operating procedures among its teams – Project Development (PD), Portfolio Management (PM), Risk Management (RM) – and other staff for Development Credit Authority (DCA) guarantees. The *DCA Operations Manual* is not a stand-alone document. The Automated Directive System (ADS) comprises USAID's official, written guidance on policies, operating procedures, and delegations of authority for conducting USAID business. ADS No. 249 (http://www.usaid.gov/pubs/ads/200/249.doc) provides specific guidelines to the policies and procedures of DCA. Based on the policies outlined in the ADS No. 249, two manuals have been produced to further detail internal guidelines for DCA projects. The *DCA Operations Manual* provides EGAT/DC and USAID Missions and Bureaus with a set of standard operating procedures for DCA, while the *USAID Development Credit Risk Assessment Handbook* details how to assess DCA credit risk.

Additional reference materials that guide the EGAT/DC activities will also be referenced in this manual, e.g., Office of Management and Budget (OMB) circulars, other ADS sections.

> This manual focuses primarily on DCA guarantees. However, EGAT/DC also maintains certain responsibilities for the management of the Micro and Small Enterprise Development (MSED), Urban Environment (UE), and Israel credit portfolios. These responsibilities will also be described in this document.

B. DCA Overview

Authorized by Congress in FY1998 and certified by OMB in FY1999, the Development Credit Authority (DCA) provides overseas USAID Missions[1] with a tool by which they may encourage the use of credit and expand financial services in underserved markets. This Authority, supported by the USAID Office of Development Credit, allows USAID Missions to partner with local lending institutions in making resources available for investments that support development objectives. Through DCA, Missions insure a portion of the risk with the lending institutions. As a result, a small amount of USAID development assistance funding facilitates the local banking sector and other sources of private capital to take on projects that otherwise would not be funded.

DCA seeks to provide USAID with the flexibility to make more rational choices about appropriate financing tools - loans, guarantees, grants or a combination - used in project development. DCA is not a separate program, but rather a financing account similar to Development Assistance (DA), Economic Support Fund (ESF), or Support for East European Democracy (SEED).

Credit projects offer several distinct and attractive advantages over other forms of assistance:

[1] Throughout this manual, a "Mission" is identified as the USAID operating unit that can originate and develop a DCA project. Regional and technical USAID Bureaus can also develop DCA projects; Missions are solely identified to simplify this document.

- Access to local private capital – there is a large reserve of untapped capital in the private sector, which presently is not available to certain sectors and markets. The use of credit guarantees can provide the security to make that capital available for projects to develop key sectors and financial markets.
- Risk is shared to encourage lending - DCA guarantees cover up to 50% of a lender's risk in providing financing and are often coupled with training and technical assistance designed to strengthen local financial institution's long term interest in local credit markets, beyond DCA's support.
- Mobilization of local private capital – credit guarantees encourage local market participants to utilize private capital to develop activities that may otherwise be cost-prohibitive or infeasible due to lack of access to financial markets or resistance in lending by financial institutions.
- Benefits of credit demonstrated (the "demonstration effect") - as guaranteed loans demonstrate profitability, benefits of such lending are demonstrated to the guaranteed party and local financial institutions are more likely to expand financial services to traditionally underrepresented economic sectors and social groups that are the beneficiaries of guaranteed loans. Also, the partial credit guarantee leaves the guaranteed lender with real risk and an incentive to undertake thorough due diligence and careful monitoring of the loan. This process enables the guaranteed lender to develop its internal capacity for profitably making similar loans in the future.
- Agency resources are maximized - USAID can leverage up to 25 times the per-dollar-impact by using credit to finance development activities.

C. DCA Products

Private sector resources can be mobilized in many ways through a number of appropriate financial instruments available under DCA. The four DCA credit tools available to Missions are described below. The use of these instruments can be modified and tailored to address a particular project's financing needs.

Loan Guarantee
The typical Loan Guarantee (LG), also referred to as a project-specific guarantee, allows USAID to use DCA for specific credit enhancement purposes in cases where the borrower, lender, and uses of loan proceeds are known.

Loan Portfolio Guarantee
A Loan Portfolio Guarantee (LPG) provides financial institutions with partial coverage on a portfolio of loans that they provide to their customers. In the case of the LPG, USAID agrees to share in the risk of a broadly defined category of bank loans with a view toward inducing local banks to extend credit toward an underserved sector. The individual borrowers under a LPG are not predetermined at the time the Guarantee Agreement is signed, but the borrowers must fall within a pre-agreed definition of "Eligible Borrowers," such as borrowers that are small businesses operating in a specific geographic area.

Bond Guarantee
Bond Guarantees (BG) support the issuance of bonds by financial institutions, private sector corporations, or sub-national entities. The funds generated from the bond issuance can, for example,

assist in raising local funds to initiate municipal infrastructure or utility projects, which require substantial upfront capital investments. The Bond Guarantee or guarantees for other types of debt instruments[2] are typically an option for DCA credit assistance if the capital and financial markets are fairly well advanced in a particular country to support a bond issuance. However, the DCA guarantee can also be used to encourage the development of bond issuances in less sophisticated markets.

Portable Guarantee
Slightly different than the Loan Guarantee, the Portable Guarantee (PG) provides an identified potential borrower with a letter of guarantee commitment through which the borrower may seek the most advantageous terms from the local financial market. Portable Guarantees are appropriate for specific credit enhancement purposes when the borrower is known, but the lender is not yet known. In these cases, a minimum credit rating (e.g., from rating agencies such as Standard & Poor's and Moody's) is established, and the risk calculation and subsidy cost are based on the assumption that the eventual lender will have a rating equal to or above this minimum rating.

D. DCA Guiding Principles

Following is an abridged version of the DCA guiding principles as detailed in the ADS 249. Refer to this section of the ADS for more information.

- DCA is principally intended for credit enhancement purposes and may be used where (a) the Agency's sustainable development objectives may best be achieved effectively using credit, and (b) the risks of default may be reasonably estimated and managed.
- DCA is not a separate program, but rather a financing tool to be used in addition to or in lieu of grant funding where appropriate. Accordingly, the principles and policies applicable to the use of Development Assistance (DA) grant funding are presumed to be equally applicable to DCA funding, unless otherwise indicated.
- DCA loan guarantee agreements will be utilized only when the partner is a non-sovereign entity. For any sub-sovereign government entity involved in a DCA guarantee, e.g., municipalities, the entity must demonstrate strong financial discipline and management.
- DCA shall be a demand-driven initiative, with Operating Units having primary responsibility for designing, authorizing, and implementing activities in support of approved Strategic Objectives and within Administration and Congressional priorities for assistance.
- DCA operations require a clear separation of responsibility for assessing the developmental soundness and the financial soundness of each activity, with the latter responsibilities entrusted to the Credit Review Board (CRB) and the Chief Financial Officer (CFO).
- DCA requires true risk sharing. For loan guarantee transactions, USAID shall not cover more than 50% of a lender's risk unless the CRB otherwise approves.
- DCA financing shall not be used unless it is probable that the transaction would not go forward without it, taking into consideration whether such financing is available for the term needed and at a reasonable cost.
- DCA assistance shall be made at or near market rates. Direct loans shall be made at or above the U.S. Treasury cost of borrowing for comparable maturities.

[2] "Other debt instruments" include (for example): securitizations, structured finance arrangements that involve several tiers or layers of various investment classes.

- DCA fees shall be based on risk with higher risk activities being charged higher fees to the extent feasible, taking into consideration the costs of the development conditionality imposed on the activity.
- Currency mismatches are discouraged. Currencies earned by DCA activities should match the borrowers' liabilities.
- DCA is intended to produce greater development impact and increase Agency performance as reported under the Government Performance and Results Act (GPRA). DCA is not intended for budget support or to increase the nominal assistance levels to specific borrowers.
- DCA is intended to be used in USAID presence countries in support of Agency Strategic Objectives and in support of Mission-financed policy and institutional reforms. DCA is also appropriate for use as part of an exit strategy in countries where USAID assistance is being phased out.
- DCA is intended to address market imperfections. Activities eligible for DCA financing shall have positive financial rates of return.

II. Project Development

A. Overview

The EGAT/DC Project Development (PD) team is responsible for coordinating the development of new DCA guarantees with Missions or other USAID operating units. In many cases, the PD team will respond to Mission ideas on projects that could benefit from a DCA guarantee. In other situations, the PD team can also pursue a more proactive approach by contacting Missions to encourage the development of a DCA guarantee. EGAT/DC PD team support can also include: 1. Meeting with local financial institutions to explore possible links between lending activities and Missions Strategic Objectives (SOs), and 2. Brainstorming with Mission staff about potential ideas of how DCA can help the Mission achieve its SOs. The principal characteristics of this initial idea should be summarized in a "Concept Paper".

Following EGAT/DC review of this Concept Paper to ensure the proposed idea adheres to ADS 249 guidelines (http://inside.usaid.gov/EGAT/off-dc/ads-249_summary_checklist.pdf), the Mission and PD team will develop the Action Package to be presented to the Credit Review Board (CRB). At the same time, the Regional Legal Advisor drafts the basic terms and conditions of the legal agreement based on existing templates from the USAID Office of General Counsel. Upon completion of a significant portion of the Action Package, the EGAT/DC Risk Management (RM) team prepares the risk assessment, which is detailed in Section III of the Operations Manual and results in the calculation of the subsidy cost estimate. The risk assessment is the last section of the Action Package to be completed prior to CRB review. Following the CRB's recommendation for CFO approval of the subsidy cost, funds are transferred to the DCA account according to federal government procedures to be obligated at the Mission level through the signing of a legal agreement.

Further guidance on how a DCA project is developed can also be found in the *10-Step Guide to Preparing a DCA Project* (http://inside.usaid.gov/EGAT/off-dc/index.html). The process, when all relevant parties, e.g, the Mission and the lending institution, are committed to the guarantee, should take no more than four to six months from the Concept Paper stage to the signing of guarantee agreement.

B. Concept Paper

1. Writing a Concept Paper

A Mission identifies an opportunity to use credit to support one or more of its strategic objectives and/or ongoing activities. As the idea is developed, the Mission is encouraged to communicate with the EGAT/DC PD Team to obtain technical guidance related to credit tools/projects. Missions should take advantage of EGAT/DC institutional knowledge to consider lessons learned from previous DCA projects.

To summarize this project idea, the Mission prepares a 2-3 page DCA Concept Paper using the following recommended outline. This step in the process, although not a requirement for ultimate project approval, can be extremely beneficial to the Mission prior to spending significant time and effort on the subsequent steps.

a) Description and Purpose of Project

- Background and Rationale (briefly describe what the Mission proposes to do and why)
- Developmental Importance
- Relationship to Mission Strategy/SOs/Ongoing Activities
- Collaboration with Other Parties, e.g., Donors, NGOs, Contractors, etc.

b) Structure of Project

- Financial Intermediary (provide brief background, if available)
- Borrower (provide brief background, if available)
- Intended Beneficiaries (if different from borrower, if available)
- Type of Credit Facility (loan guarantee, bond guarantee, portfolio guarantee, portable loan guarantee)
- Estimated Amount of Project Financing (maximum portfolio size - US$ amount)
- Guarantee Ceiling (maximum USAID contingent liability -US$ amount)
- Guarantee Percentage (%) (covering principal only [preferred] or principal and interest)
- Term of Guarantee (number of years)
- Currency of Guarantee (US$ or local currency)

c) Funding Source and Amount Available for DCA Credit Subsidy

(Proposed funding transfers from existing budget resources)

d) Management Responsibility

- Initial project monitoring plan
- Clear identification of parties responsible for project development and implementation

e) Proposed Technical Assistance to support the DCA guarantee

f) Estimated Time Frame for Project Implementation

2. Reviewing a Concept Paper

The Mission and EGAT/DC PD team should adhere to the following guidelines to ensure the proposed DCA guarantee adheres to ADS 249 guiding principles: http://inside.usaid.gov/EGAT/off-dc/ads-249_summary_checklist.pdf. If EGAT/DC considers the proposed project extremely risky, it will discuss the Concept Paper and provide technical feedback to the Mission. Consequently, the Mission may engage in efforts to restructure the proposed guarantee to reduce these perceived risks or it may abandon the project at this stage.

The EGAT/DC PD team Relationship Manager may decide to convene a meeting to review the Concept Paper among EGAT/DC staff in order to provide feedback to the Mission as it further develops the idea and begins to prepare the Action Package. The Relationship Manager should summarize the feedback from this meeting in an email to the Mission contact person. Once internal Mission approvals for the Concept Paper are in place, work can begin on the Action Package.

C. Action Package

Unless otherwise noted, the Action Package is the responsibility of the Mission in coordination with the EGAT/DC PD team. This document can also be developed in conjunction with Mission contract support.

1. Action Memorandum

The template of this memorandum is presented in the following diagram and it is available on the USAID intranet – http://inside.usaid.gov/EGAT/off-dc/forms-tools.htm. The EGAT/DC PD team ensures that the memorandum is properly updated with the appropriate names of the USAID CFO and the CRB Chair. Prior to submitting the Action Package to the CFO, signatures of the Mission Director and the CRB Chair are necessary. The Mission should also ensure that its Regional Legal Advisor (RLA) and Controller are aware of the Action Package.

TO: [Name], Chief Financial Officer

FROM: [Name], Chairman of the Credit Review Board

SUBJECT: CRB Recommendation for [Approval] of Development Credit Authority Activity in [Country]

As described in the attached documents, USAID/[Mission] intends to sign a [bond/loan] guarantee agreement with [guaranteed party] in [country] in support of the Mission's [Strategic Objective.] To successfully implement this agreement, USAID/[Mission] agrees to adhere to its Monitoring Plan responsibilities as outlined in this document. The Credit Review Board has reviewed this transaction and found that the risk has been appropriately assessed and that there is reasonable assurance of repayment of the obligations covered by these guarantees. Furthermore, the CRB has approved the subsidy cost to be associated with this activity and believes the Office of Development Credit has adequately provisioned for the risk entailed in this prospective agreement.

RECOMMENDATION
That the CFO sign below and thereby approve the findings of the Credit Review Board and the recommendation of the Chairman of the Credit Review Board with regard to this activity.

(approvals by CFO and Mission Director)

2. **Project Information Sheet**

The Mission with assistance from the EGAT/DC PD team will complete the following Project Information Sheet template, with the exception of risk assessment data, which is an EGAT/DC RM team responsibility.

Project Identifier:	[Shorthand identifier for the activity, e.g., the name of the primary counter-party]

Country		**Mission/Bureau**	
Mission/Bureau Program Officer		**Fin. Viability Analyst**	
ODC Relationship Officer		**Credit Analyst**	
	Concur:	**Chief Risk Officer**	Kathleen Wu

Type		**Guarantee Number**	
Lender(s) /Guaranteed Party			

Borrower(s)	

Mission SO(s) Supported by Activity
Sector
Activity Description

Performance Indicators *(Please provide a list of key measures of the benefits and performance of this activity)*	

Max. Cum. Disbursements ($)		**Guarantee currency**	
Term *(years)*		**Type of Risk sharing**	
Interest Rate (%)		**Guarantee percentage**	
Revolving?		**Guarantee ceiling** ($)	
Initial Disbursement *(year)*		**Payment guaranteed**	

Notes on Transaction Terms	

Commitment Fee ($)					
Utilization Fee (%) **p.a.**		**Util. fee payment Basis**		**NPV** ($)	

For Loan Portfolio Guarantees (LPGs)	
Est. number of sub loans	
Est. avg., sub-loan maturity (years)	
Est. avg. size of sub-loans ($)	
Max. auth. Portfolio Amount ($)	

For Bond Guarantees	
Type	
Coupon (%)	
Trustee	
Investors	
Secondary Investors	

Subsidy Cost	$	%	Net Defaults		Fees		Nom. Defaults	

Funding Source/FY	

WARF Score			
Country (%)		Borrower (%)	
Lender (%)		Transaction (%)	

Key Risk Factors: Brief list of key factors (e.g., nature of the lending activity, specific management concerns, sectoral concerns, etc.)

Special conditions for approval:

3. Activity Description

The Activity Description section outlines the structure of the proposed DCA guarantee. The Mission typically includes a description of the developmental objective of the activity – i.e., how the proposed activity and its expected outcomes will contribute to current or new Strategic Objectives (SOs). New intermediate results and indicators may be developed for the proposed DCA activity, as deemed appropriate and necessary by the Mission.

The Mission writes the Activity Description, borrowing from the Concept Paper. The Activity Description is not submitted to the Credit Review Board for approval; however, it is included in the Action Package for reference purposes.

4. Economic Viability Analysis

The Economic Viability Analysis (EVA) is the assessment of an activity in the context of the host country's economy. In essence, this analysis justifies the utilization of the DCA guarantee in light of the economic and market factors relevant to the proposed activity. In other words, the EVA reviews USAID's role in the DCA transaction and the value added by the guarantee. The analysis should discuss how USAID's proposed guarantee is unique and necessary in this market, why USAID is not "crowding out" the private sector or duplicating the efforts of other donors in this initiative, and why the type of financing to be provided through the guarantee is not otherwise available in the market to the target group of borrowers.

In short, the EVA should determine whether the proposed DCA activity is worthwhile for the country/region, and as appropriate, assess the activity's impact in light of economic costs and benefits to the host country.

In addition to a brief justification of the guarantee with respect to the economic conditions of the host country, two specific points should be addressed in the EVA:

- *Market Imperfections*: The activity will address in-country market imperfections.
- *Additionality*: The DCA credit instrument will not supersede private sources of financing and USAID is a guarantor/lender of last resort in such a way that the activity would not be possible without DCA. This is referred to as "additionality", which implies that the guaranteed party would not extend the loan to the beneficiary without the DCA guarantee.

In-country Market Imperfections

This component of the EVA addresses the overall conditions of the sector impacted by the potential DCA activity. The term "market imperfections" implies that the supply generated by market participants is insufficient to meet the demands of market customers.

Market imperfections may also refer to specific barriers that discourage or prevent the entry of new approaches, e.g., renewable energy, microenterprises, and municipal infrastructure, into an existing market scheme. A common manifestation of these barriers is limited access to capital, represented by a banking sector's unwillingness to lend to a new approach or a new sector. This unwillingness often stems from a lack of historical references for repayment abilities or unavailable or asymmetric information, as well as overly-cautious lending practices. In this regard, the EVA should address how the DCA credit instrument will help overcome some of these barriers, which currently limit market-based lending to the proposed project/sector.

Additionality

The DCA guarantee credit product should not displace the demand for capital and debt financing that could be fulfilled from private sector resources. This can be justified by confirming that the overall commercial banking sector is unwilling or extremely hesitant to lend funds to a particular sector and/or borrower on loan terms and conditions comparable to other borrowers, e.g., loan tenor.

Furthermore, the EVA can indicate if the banking sector charges exorbitant interest rates or requests excessive collateral due to the perception of high risk towards this sector. The EVA highlights how the use of DCA extends credit to a project based on its actual risks, not its perceived risks. In this sense, DCA intends to be a catalyst, providing demonstration effects to more properly align the host country financial sector's perception of risk with actual project risks in a certain sector. For example, the EVA could describe how the DCA guarantee intends to result in a decline in collateral requirements for a particular borrower. The borrower would then be in a position to demonstrate an ability to re-pay its debt and establish a favorable credit history; thereby eventually having the impact of lowering a bank's perception of the borrower's risk.

Discussions with financial institution representatives related to a DCA proposal should confirm that the DCA guarantee provides an increased level of confidence from their perspective to facilitate the credit to the project. Without the DCA guarantee, financial institutions would be unwilling to lend to the borrower. In other words, the EVA must provide evidence that the involved or identified financial institution(s) would not extend credit to the activity if it were not for the DCA guarantee. In the case of a portable guarantee, the potential borrower should confirm that DCA will be the unique factor to enable the project/sector to benefit from fair, market-based debt financing.

5. **Financial Viability Analysis**

The Financial Viability Analysis (FVA) is an assessment of the adequacy of a project's or an activity's financial return for the borrower(s) and/or the lender(s). Generally speaking, DCA assistance (and

USAID economic assistance) should be targeted toward sectors that are competitive or hold the promise of being competitive if the requisite reforms are undertaken. More specifically, as a reflection of the sustainability of economic activity in the sector, an activity should be funded under DCA only if the borrower is able to pay its operating and maintenance costs and financial obligations, including loan principal and interest payments. Likewise, the activity should be sustainable (i.e., capable of generating adequate rate of return) for lenders or investors as well. In the absence of these two conditions, the Mission or Bureau should reconsider the appropriateness of credit as a development tool for this specific project.

The FVA is a quantitative determination of whether the proposed DCA project or activity is likely to yield a positive financial rate of return for borrowers and partner financial institutions (lenders) or investors. In other words, based on expected cash flows, the FVA:

- Assesses the ability of the borrower(s) to meet its financial obligations and service the debt related to the activity, and
- Ensures that the activity is unlikely to generate losses for the lender or investors.

To do this, the FVA thoroughly examines the cash flows of the project or activity over the lifetime of DCA assistance and analyzes rates of return appropriate for the endeavor. Since the project or activity must be examined for both the borrower and the lender, there are in fact *two* analyses. The analyses are summarized at the end through calculation of the net present value (NPV) of the project or activity for both the borrower and the lender, along with calculations of its internal rate of return (IRR) for each.

Although there are two types analyses (borrower or lender), it is necessary to complete only one, depending on the DCA project being considered. As a general rule, the financial viability analysis must be performed for the component of the activity where the developmental benefit of the activity is focused. For example, the developmental purpose behind most loan portfolio guarantees covering small or micro business loans is to increase access to credit for that sector. For the primary developmental effect (increased lending to small businesses) to be sustainable, such lending must be financially viable for the lender. Thus, for such a project, the FVA will cover the financial viability of the project from the lender's perspective. While the Mission will need to gather some information related to the profitability of businesses within the targeted sector (this information will inform estimates of the risk--and thus the returns required by lenders), the primary focus of the FVA will be on the lender. For loan portfolio and lease portfolio guarantees to multiple borrowers, the lender viability analysis is generally more important than the borrower viability analysis. For loan guarantees and bond guarantees to single borrowers where the developmental purpose behind the activity is more closely related to the borrower's activities (e.g., a loan guarantee for a borrower who is introducing new innovative technologies to a market), the borrower viability analysis is substantially more important than the lender viability analysis.

The length and coverage of the financial viability analysis is left to the discretion of the analyst. FVAs can range from two to 20 pages depending on the quantity and quality of information available to the analyst and the complexity of the project and guarantee facility. The analyst should provide a brief discussion of the issues raised below based on the relevancy to the project in question. In many cases, a brief description of the key forecasting assumptions followed by presentation of simple cash flow projections will suffice. Missions should contact EGAT/DC with any questions regarding the scope and necessary level of detail of a FVA. Generally, Missions often find that after preparing an initial outline of the FVA, the EGAT/DC PD Relationship Manager can offer useful guidance that helps focus

the analysis and thus reduce the amount of work involved. As such, we encourage each Mission to contact its Relationship Manager as it begins to work on the FVA.

Note that the focus of the FVA is on the project or activity, as opposed to the overall operations of the borrower(s) or lender(s). This narrow focus provides for a determination as to whether the *direct sources* of repayment for the loan are adequate to cover the borrower's obligations and provide profits for the lender. In other words, the narrow focus assesses whether the project or activity is operationally sustainable on an incremental basis; in economic terms, the project or activity would thus be profitable "at the margin." The credit risk assessment will separately consider other aspects of the overall operations of the borrower(s) and the lender(s), since there are also indirect sources of repayment for the loan (for example, from existing ongoing business activities).

In most instances, however, the new activity is closely related to the existing activities of the borrower(s) and the lender(s). Cash flow projections and calculations of rates of return for the new project or activity would thus be appropriately based on historical cash flows and rates of return for the borrower(s) and lender(s), so careful attention to past years' audited financial statements is required. In instances where the new activity is not similar to the existing activities of the borrower(s) or lender(s), attention must be focused on the assumptions underlying the new activity to generate the cash flows and rates of return. These issues are discussed in more detail in the next three sections on activity viability for the borrower, activity viability for the lender, and discount rates. Additional general guidance for the FVA is provided in the final part of this section or can be obtained from EGAT/DC relationship managers.

a) FVA Part I – Activity Viability for the Borrower

Calculating borrower financial viability involves determining the estimated sources and uses of cash required by the activity. Simply put, viable activities are characterized by projected revenues that exceed projected operating costs and investment expenditures. Once the revenue and cost streams have been estimated for the length or term of the repayment of the borrowed funds, the cash inflows and outflows are compared to determine whether the proposed activity generates adequate income to support anticipated debt service and issuance.

There are two main types of loan guarantee projects – those for single borrowers (e.g., loan guarantees, portable guarantees, and bond guarantees) and those for multiple borrowers (e.g., loan portfolio guarantees and lease portfolio guarantees). The data collection and analysis required will vary significantly between these two categories.

Single Borrowers

In the case of guarantees provided for a single project or company, i.e. loan guarantees, portable guarantees, and most bond guarantees, the financial viability assessment should focus primarily on the borrower's ability to repay and service the debt.

In most circumstances, the focus is on the new activity being financed, and borrower viability should analyze the cash flows associated with the new project. This is clearly the case for "project finance" which has no recourse to cash flows or assets outside the project. (Project finance is addressed in additional detail below.) It is also typically sufficient to examine the cash flows associated with the new activity even when the loan has recourse to cash flows and assets outside the projects, as long as the project cash flows analyzed:

- are based on the historical performance of the borrower's existing projects, under the assumption that the borrower's past performance best represents its future performance, and
- fully consider the impact on the other cash flows of the borrower (which is the issue of incremental cash flows developed below).

Recall that while the credit analysis of the project will take such alternative sources of repayment into account, the project or activity should be sustainable on a stand alone basis. One exception to this rule, for example, is for municipal borrowers, which are often forced to cross-subsidize activities due to market imperfections related to tax authority and customers' willingness to pay for municipal services.

Obtaining project/company information/projections. Prior to conducting the assessment itself, the analyst must obtain project or company information and projections regarding future performance. Most borrowers should be able to present financial statements (balance sheets and income statements) for the past three years as well as financial forecasts during the projected timeframe of the DCA guaranteed credit activity. Ideally, the financial statements will have been audited. At a minimum, most lenders and investors will have required borrowers to produce historical accounts of their performance as well as projections for future growth.[3]

Assessment. With the appropriate financial statements and project information in hand, the analyst is ready to perform the financial viability analysis for the borrower. This assessment can be broken into four main steps.

- **Step 1 – Prepare and Examine Assumptions.** The most important step is to prepare and examine the assumptions which produce the numbers used in the quantitative analysis. After all, these assumptions are what give the numbers meaning. The analyst must consider how reasonable revenue growth and expense assumptions are for the project in terms of recent data and other considerations.

  Generally speaking, the assessment should first examine the core assumptions that underpin growth or contraction of relevant variables (price, sales, cost, etc.) and compare these assumptions to audited historical figures. If revenues are projected to increase, for example, the analyst should examine factors such as market demand, price levels, competition, etc. The analyst should perform a brief review of each of the key variables (e.g., prices, input costs, scalability, competition, regulation). When questions arise, the analyst should provide additional information. For example, if revenues are projected to increase and

OPERATING CASH FLOW COMPONENTS

Net revenue
- Operating expenditures
- Interest expense

= **Free cash flow**

+ Increases in accounts payable
- Increases in accounts receivable and inventories
- Capital expenditures required to offset depreciation

= **Net free cash flow**

- Short-term senior debt and current maturities of senior long-term debt

= **Surplus or deficit**

[3] In some cases, however, particularly for micro- or small enterprises, such statements may not be available. In these instances, the analyst may use previous loan data and peer group analysis complemented by an assessment of the specific strengths and weaknesses of the borrower in question. In the absence of audited financial statements, however, it may not be possible to perform a risk assessment of the activity. Likewise, it is also less likely that the USAID intervention will produce a sustainable effect if it does not address questions related to information asymmetry between lender or investors and borrowers. While the DCA tool can improve problems of information asymmetry between creditors and debtor groups, and is in fact designed to do so, some instances will require upfront technical and/or grant assistance.

operating costs are predicted to remain fairly constant, the borrower will need to justify how it would achieve these efficiencies. Where possible, quantitative information should be used when assessing the assumptions underpinning the activity; however, it should be noted that qualitative assessments are often adequate. For example, if several reputable economic forecasters estimate strong growth in the sector in question, providing this information is sufficient.

Other significant fluctuations in balance sheet and income statement line items should be identified. Again, the FVA should ensure that the projections are "reasonable" and internally consistent; e.g., a ten-fold increase of fixed assets on the balance sheet during a two-year period in the absence of a concurrent increase in depreciation-expenses on the income statement raises questions about the accuracy of the forecast.

- **Step 2 – Project Free Cash Flows.** Once the assumptions underpinning the projections have been vetted, cash flow projections for the project over the life of the DCA assistance can be prepared. These projections should focus on free cash flow (FCF) from operations, and should be denominated in the local currency unless the loan guarantee covers dollar debts. They should also be in nominal terms, or include the local inflation rate (or the dollar inflation rate if being denominated in dollars).

Denominate all cash flows in local currency unless the guarantee covers US dollar debts.

The cash flows of the project need to consider the full impact of the new project on the overall cash flows of the borrower. In other words, they need to represent all **incremental cash flows** to the borrower, for both revenues and costs, associated with undertaking the new activity. For example, if an expansion of an MFI is to be undertaken by opening a new office, some revenues at the new office might actually be siphoned off from established offices; the project cash flows must only consider the truly new revenues.

FCF is typically net revenues minus operating expenditures and interest expense. Operating expenses comprise cost of goods sold, selling and general administrative expenses, and taxes, but particularly exclude depreciation (since it is not a cash flow). Net FCF further adjusts for changes in working capital and capital expenditures required to maintain the firm's projected productive capacity. Hence, the analyst must carefully consider the project's working capital requirements. Working capital is essentially current assets (accounts receivable, inventory) less current liabilities (short-term debt, accounts payable). During periods of high growth, working capital cash flows are frequently negative – current assets increase significantly in comparison to current liabilities. Higher inventories and receivables represent cash outflows, while an additional short-term loan or account payable represents a cash inflow. In other words, as working capital increases, cash is used. A shortfall in cash may lead to a default regardless of the ultimate profitability of the activity. The capital expenditures required to maintain productive capacity essentially offset annual depreciation. This figure should not include cash flow from investing or financing activities (except for those expenditures necessary to maintain or meet the project's projected productive capacity -- i.e., the loan or bond proceeds). The net FCF projections should then be compared to total debt repayment associated with short-term debt and current maturities of long-term debt on a period by period basis.

- **Step 3 – Conduct Sensitivity Analysis.** The sensitivity of the cash flows to changes in key variables, such as price, sales, costs, interest rates, etc. should be tested and any significant

findings presented. This step is typically useful in uncovering a "worst-case scenario" and a "best-case scenario" to supplement the average or expected scenario.

- **Step 4 – Discount Future Cash Flows and Calculate the Internal Rate of Return:** Lastly, the projected, future cash flows should be discounted to a present value using an appropriate "discount rate" or "cost of funds". In addition, the projected cash flows should determine the internal rate of return for the project. The discount rate section below provides more information on determining the appropriate discount rate. This rate should be validated with the participating financial institution and/or other local banks.

Special Considerations for Project Finance: The term "project finance" refers to the raising of funds to finance a capital investment project that is separate and apart from an existing entity. Generally, project finance is limited to large-scale infrastructure projects because of the complexity and cost of structuring a project finance deal. The FVA of project finance is focused exclusively on the ability of the project activity to repay its debt obligations based solely on forecasted project cash flows, independent of whether it is a private or public sector entity. Conservative EBITDA (earnings before interest, taxes, depreciation, and amortization) cash flow projections must be sufficient to service all debt, provide for working capital, pay operating expenses, and still provide an adequate cushion for contingencies.

Special Considerations for Municipalities: For municipal borrowers, the FVA will follow the steps described above with special consideration for credit repayment through "general obligation" funds (taxes and intra-government transfers) versus project-specific funds. First, the repayment history of the municipality should be examined to ensure that there is a positive track record by the municipality to repay its sovereign and non-sovereign debts. The projections collected from the municipality should be assessed with comparisons to its historical financial reports. Stability of central government transfers should also be evaluated in these forecasts. In addition, the ability of the municipality to generate and utilize its own tax and non-tax revenues as well as "unrestricted funds" that are not limited to specific programs will provide insights in the entity's ability to re-pay liabilities. Lastly, administrative and operating budgets and expenditures should be reviewed to assess cost control measures. Much of this information will also be critical for the risk assessment of the project.

Special Considerations for Grant Funding: Certain borrowers -- such as private voluntary organizations (PVOs), non-government organizations (NGOs), and microfinance institutions (MFIs) – receive part of their revenues as grant funds. Under these circumstances, the financial viability analysis must carefully consider the role of grant funding in the new project. Grants associated with the initial investments – such as purchase of real estate or equipment or for other start-up costs – may generally be included in the cash flows of the project insofar as such grants are already secured. These are often known as equity donations, as they contribute to shareholder equity in the balance sheet. However, the project must be subsequently operationally sustainable without ongoing grant funding in order to demonstrate enough financial viability to qualify for a DCA loan guarantee. Uncommitted grant funding associated with operating expenses – such as unrestricted annual donations – should therefore not be included in the cash flows of the project, as such donations are typically volatile and often distort the orientation of the project away from market and competitive analysis.

Multiple Borrowers

For a loan portfolio guarantee supporting many different projects, where the focus of the activity is on the general increase in access to credit for the sector, FVA should be focused on the lender. However, this analysis, as mentioned before, should briefly cover macroeconomic trends, growth estimates,

specific challenges, regulatory environment, management capacity (from a macro perspective), specific strengths or competitive advantages, general creditworthiness, etc. found in the borrower sector. The FVA should thus provide the CRB with an overview of the trends affecting potential borrowers and their prospects for growth. While it is not necessary to produce cash flow projections for specific borrowers in this case, Missions should provide the CRB with an example or two of these borrowers' cash flows and/or debt repayments.

b) FVA Part II – Activity Viability for the Lender

Activity viability for the lender is principally designed to ensure that a loan or lease portfolio guarantee will be applied to loan or lease activities that are profitable for the lender.

The lender viability analysis follows the same principles as the borrower viability analysis. Begin by (1) analyzing the assumptions that underpin the activity, then (2) model the projected cash flows and changes in working capital, (3) evaluate the sensitivity of the project to changes in key variables, and finally (4) discount the cash flows to determine profitability. The Office of Development Credit has developed cash flow model templates for lenders. Please contact EGAT/DC can provide a template for an appropriate model.

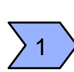
Here are some of the key inputs that should be evaluated and modeled for the purposes of determining the viability of the lending activity.

Definition of Inputs	Notes
Credit "Terms & Conditions" data Loan amount, Coverage percentage, Term of guarantee, Commitment fee percentage and Utilization fee percentage.	All of this information is presented in **Attachment VI: Legal Terms and Conditions** of the DCA Action Memorandum.
Sub-loan Maturity (Loan Portfolio Guarantees [LPGs] only)	The financial institution should verify the term of its typical loan or line-of-credit for the targeted borrower set in order to accurately estimate loan repayment schedules.
Cost of Funds Please see the following section on discount rates.	Average interest rates for deposits, loans and other liabilities should be collected during interviews with the senior management of the financial institution. Next, the weightings (percent of total value) of these debt components should be multiplied by the interest rates and then totaled to calculate a weighted average. This estimated *cost of funds* should be validated with senior management because data on the balance sheet may often not reflect the true current condition of a bank's financial costs.
Client Loan Rate The estimated annual interest rate charged to the borrower(s) identified for this DCA activity.	Gather during interviews with senior management (preferably a chief loan officer) of the financial institution. This should be validated by discussions with a central bank entity and with the potential borrower(s).
Anticipated Defaults The amount of loan principal and interest	Anticipated defaults should be based on a current default rate of loans in the targeted sector multiplied by the estimated principal repayments. An alternative measure

Definition of Inputs	Notes
repayments that are not expected to be repaid.	from recent audited financial statements for the institution as a whole is the **Loan Loss Ratio**: Loan write-offs or losses/ Average gross loan portfolio. This provides an indication of the volume of loan losses in a period relative to the average outstanding portfolio. This ratio, however, does not take into account the targeted borrower(s), which may vary in default patterns from the overall portfolio.
Interest Expenses The additional interest-related costs for the financial institution based on the level of DCA guaranteed loan(s).	Interest expenses are calculated by multiplying the Cost of Funds by the outstanding loan principal amounts.
Tax Rates The tax rates applicable to interest income on the portfolio, and applicable to the deductibility of expenses (especially the cost of funds).	Interest income to the financial institution is generally subject to the local corporate income tax. Similarly, operating expenses are usually deductible from corporate income taxes at the same rate, although this should be verified during interviews with senior management. In particular, deductibility of the cost of funds should be specifically determined.
Overhead Expenses The additional administrative (indirect) costs associated with using the DCA guarantee.	To estimate these costs, start with the most recent Income Statement and calculate the ratio of general & administrative expenses as a percent of the average loan portfolio. This ratio should then be considered on a marginal basis because the additional loans guaranteed by DCA will not necessarily require a 1:1 increase in overhead costs.

c) *FVA Part III – Discount Rates*

With the forecasted cash flows as a basis, the Mission or Bureau should calculate two indicators to complete a Financial Viability Analysis: the Net Present Value (NPV) and the Internal Rate of Return (IRR).

	**Net Present Value (NPV)**: DCA projects must demonstrate a positive NPV, which is the present value of all cash outflows (investments) and inflows (returns) of a project at a given rate of return known as the discount rate. Since the streams of expenditures and receipts occur over a period of time, they are discounted to account for the "time value of money",[4] using the cost of funds to the borrowing or lending entity. When conducting a NPV analysis, the selection criterion is to accept DCA activities with a NPV greater than zero.
	Internal Rate of Return (IRR): Another measure of financial viability is the IRR. IRR is the rate of return or discount rate at which the present value of an investment in a project is zero. When this IRR exceeds the cost of funds, the project is deemed to be an attractive investment. The IRR is somewhat less useful than the NPV calculation, as it is influenced by the profile of cash flows. In particular, IRR cannot be used for paths of cash flows that change sign (negative to positive or vice versa) more than once.

There are many issues to consider in determining the appropriate discount rate to use for calculating NPV. One is whether the discount rate is in local currency or dollars. When cash flows have been denominated in local currency, the discount rate must be a local currency rate. When cash flows have been denominated in dollars, which should be the case when the loan guarantee covers dollar debts, the discount rate must be a dollar rate. In both circumstances, data should be in nominal terms – which include inflation – since cash flows are also expressed in nominal terms.

Whether analyzing the borrower or the lender, the preferred discount rate is the required rate of return on equity given the level of leverage provided by the debt. This is because the projected cash flows in the FVA use available information on the structure of the debt and include interest expenses and principal repayments as cash outflows. With the impact of debt already taken into account in the cash flows, the remaining cash flows (either positive or negative) represent the return to the equity holders. As a result, the remaining cash flows are to be discounted by the required rate of return on equity for the level of leverage provided by the debt.

The required rate of return on equity is difficult to calculate. Using historical financial statements, however, the required rate of return may be approximated by the historical rate of return on equity (ROE). This is calculated by taking the earnings available to the shareholders (i.e., net of interest and taxes) and dividing by the value of equity. Furthermore, the value of equity should be the market value of equity rather than the historical value, which is easily available for publicly traded firms but not for privately held firms. The ROE should be averaged over several years in order to remove year-to-year volatility and move closer to a sustainable market equilibrium. Finally, the calculated ROE must be critically scrutinized to assure its credibility. For example, it must be higher than the interest rate on the firm's debt, as returns to equity must be higher than returns to debt. (For financial institutions, it must be higher than the cost of funds.) It must also be sufficiently higher to compensate for the additional risks associated with equity, although the magnitude of such compensation is unknown.

[4] The basic premise of the "time value of money" is that a dollar today is worth more than a dollar tomorrow due to the interest earned on today's dollar.

It is also worth noting that using the historical ROE as the required return on equity presumes that the new project faces risks similar to those on already existing projects of the same firm. If the project presents wholly different risks than those presented by the borrower's existing business, it is necessary to adjust for this risk by either adding a premium or subtracting a discount. If possible, use financial information for companies that are engaged in the projected type of business.

Similarly, the required rate of return on equity will also depend on the firm's leverage; the more highly leveraged a company, the higher the risk to equity holders and, thus, the higher the required return to equity. If the new project is roughly similar to existing projects with respect to leverage, then the calculated ROE might adequately capture the required rate of return to equity. However, if the new project significantly raises or lowers leverage of the firm, the required rate of return is somewhat higher or lower and the analyst should attempt to incorporate this change in this analysis.

Since the required return on equity is difficult to calculate, some conceptual approaches are useful. The required rate of return on equity must be higher than the interest rate on debt. For financial institutions, it must be higher than the cost of funds. Hence, the simplest discount rate to use is the weighted average interest rate on debt, or, for financial institutions, the cost of funds calculated as the weighted average interest rate for deposits, loans, debt, and other liabilities. Using the weighted interest rate as the discount rate will produce a liberal estimate of the NPV, which must be positive in order for the debt to be fully serviced. This liberal estimate might be satisfactory, as it would indicate that the lenders would be compensated through their senior claims on the project even when shareholders are only minimally compensated. However, the project or activity is truly financially viable only when returns to equity can be sustained at market rates. More conservative estimates of the NPV are thus appropriate, and can be obtained by adding several percentage points to the interest rate on debt. This premium above the interest rate on debt may range from two or three points to nine or ten points, depending on the risk of the project vis-à-vis the existing business and its leverage. The analyst is urged to consider several different discount rates within this range as a way of performing sensitivity analysis on the calculated NPV.

d) FVA Part IV – Guidance for Financial Viability Analysis

Analysts should recognize that this manual is not comprehensive, as FVAs depend on the exact characteristics of the project or activity being studied. If the Mission or Bureau needs assistance with the FVA, it should contact the EGAT/DC PD team. This will most likely be necessary in the case of municipal, project, or bond financing.

Regardless of the level of EGAT/DC support, the Mission will lead efforts to gather information commonly required for DCA supported projects. In the case of a project-specific DCA structure, required inputs for the Financial Viability Analysis will include:

- Project start-up costs
- Future income generated by the project
- Estimated operating and maintenance costs
- Local interest rates (debt servicing costs), tax expenses, etc.

As stated previously, for a portfolio guarantee, illustrative examples of a few borrowers or notional cash flows will be necessary to demonstrate a model for how the debt will be repaid. This model should contain data inputs as just listed for project-specific structures.

If the borrower is an existing organization, the Mission should collect audited financial statements from the last three years, as well as any forecasts the entity has prepared for the near term future. These documents should include:

- Balance Sheet (assets, liabilities and equity components)
- Income Statement (revenues, operating expenses, financing expenses, net income)
- Cash Flow Statement (cash flows from operations, from investing, and from financing)
- Sources and Uses of Funds.
- Detailed estimates of variables such as costs, prices, sales volume, etc.

Similar information about the lender needs to be collected in order to perform the lender viability analysis. These documents should include:

- Balance Sheet (assets, liabilities and equity components)
- Income Statement (revenues, operating expenses, financing expenses, net income)
- Cash Flow Statement (cash flows from operations, from investing, and from financing)
- The inputs detailed in the table under Lender Viability above.

EGAT/DC has developed spreadsheet templates and samples for use in preparing financial viability analyses of loan/bond guarantees and loan/lease portfolio guarantees, which should substantially simplify the execution of the analysis. The EGAT/DC PD team will make these materials available to Missions or contractors as required.

With the appropriate documents and data fully compiled for both the borrower and the lender, EGAT/DC can provide additional guidance.

6. Fee Justification

The EGAT/DC PD team should use the following template for the Fees Justification section of the Action Package and **adjust it accordingly** to reflect the specific characteristics of the guarantee. Any deviations from this justification must comply with ADS 249. In addition, per OMB A-129 guidelines (Sec.II.3), EGAT/DC PM team will annually review the fee structure of DCA guarantees as part of the subsidy re-estimate process.[5] This review will be discussed, documented and filed as part of the November or December Portfolio Review Meetings.

[5] OMB A-129 Circular also states that fees “should be set at levels that minimize default and other subsidy costs while supporting the achievement of the program’s policy objectives. Unless inconsistent with program purposes, riskier borrowers should be charged more than those who pose less risk.” (Sec II.3)

Proposed Fees for this Activity:
Origination Fee: X% *of the guaranteed portion of the authorized amount*

Utilization Fee: X% of the guaranteed portion of the outstanding principal balance per annum

Justification
The fees are consistent with program purposes and were set in consultation with the lending institution so as to maximize utilization of the guarantee facility and not hinder financial viability of the projects.

Since the USAID fees will contribute to the borrower's overall cost of capital and thus the financial viability of the projects, special consideration was given when determining the fee structure. Every effort was made to consult with both the lending institution to ensure that the fee structure would not impede the financial viability of the projects or the utilization of the guarantee facility. The proposed fee structure is essential to accomplish several objectives:

- establish a high rate of utilization for the facility;
- maximize the number of end-borrowers who may benefit from the guarantee;
- ensure that the activity is profitable and capable of demonstrating viability to the market; and; and
- does not put undue stress on the partners USAID is trying to assist.

The proposed fee structure for this guarantee conforms to the guidance set forth in ADS 249.3.4

7. Legal Terms and Conditions

The USAID Office of General Counsel (GC) from Washington or through one of its Regional Legal Advisors should draft, review and approve the guarantee agreement's "term sheet". The Mission or the EGAT/DC PD team will ensure adequate GC involvement in this process. The following is an example term sheet for a loan portfolio guarantee.

THE GUARANTEE. To induce the Guaranteed Party to make "Qualifying Loans" to "Qualifying Borrowers" for "Qualifying Projects," as defined below, the Parties agree to the following terms:

1. **Maximum Authorized Portfolio Amount:** The aggregate principal amount of all Qualifying Loans covered under this Agreement at any one time shall not exceed the local currency equivalent of [numerical words] U.S. Dollars [US$x million].

2. **Maximum Cumulative Disbursements:** The maximum cumulative amount of all loan disbursements made under Qualifying Loans shall not exceed the local currency equivalent of [numerical words] U.S. Dollars [US$x million]. No loan disbursement shall be eligible for coverage under the Guarantee unless the amount of such disbursement, together with all previous disbursements made under Qualifying Loans, does not exceed the local currency equivalent of [numerical words] U.S. Dollars [US$x million].

3. **USAID Guarantee Percentage:** Fifty (50%) percent of the Guaranteed Party's net losses of principal. (See Section 4.01 of the Standard Terms and Conditions for claim requirements).

4. **Guarantee Ceiling (Maximum USAID Liability):** [numerical words] U.S. Dollars [US$x million].

5. **Final Date for Placing Qualifying Loans under Coverage:** December 31, 2009.

6. **Coverage Expiration Date:** June 30, 2010.

7. **Final Date for Submitting Claims:** Six months after the Coverage Expiration Date, except as set forth in Article IV of the Standard Terms and Conditions attached hereto, provided further that no claims may be submitted in connection with any default on a loan that occurs after the Coverage Expiration Date.

8. **Currency of Qualifying Loans Placed Under Guarantee Coverage:** [insert local currency – include US Dollars if applicable as well].

9. **Currency of Guarantee Payment:** Local currency.

10. **USAID Guarantee Fees:**

10(a). **Origination Fee:** [numerical words] (x.x%) of the guaranteed portion of the authorized amount. [US$xx,xxx].

10(b). **Utilization Fee:** [numerical words] (x.xx%) per annum of the guaranteed portion of principal. This amount is to be calculated by taking the USAID guaranteed portion (50%) of the average of the total ending balances of all Qualified Loans at the end of the two most recent Guarantee Periods and then

multiplying such amount by one quarter of one percent (x.xx%) per annum. The fee is payable semi-annually, as billed.

11. **Currency of Fee Payment:** Local currency.

12. **Guarantee Periods:** The first Guarantee Period will commence upon the date of the Agreement and end on September 30, 2003. Subsequent Guarantee Periods will consist of each six-month period, beginning with the six-month period from October 1, 2003 to March 31, 2004, and the final Guarantee Period will commence April 1, 2010 and end on the Coverage Expiration Date.

CRITERIA FOR QUALIFYING LOANS. In addition to the criteria set forth in the Standard Terms and Conditions, Attachment 2, a "Qualifying Loan" is one made to a "Qualifying Borrower" for a "Qualifying Project," each as defined below:

13. **Qualifying Borrowers:** Non-sovereign small and medium-sized hotels and manufacturing firms for productivity improvements that address environmental concerns, reduce environmental impacts and include environmental retrofitting; and small and medium-sized enterprises borrowing money for a variety of needs including business expansion, fixed asset improvement, working capital, and equipment purchase. A Qualifying Borrower includes any Affiliate of that borrower, including parent or subsidiary companies having the same or substantially similar ownership as such borrower. Any question regarding who is a Qualifying Borrower may be resolved in consultation with USAID, and USAID may waive in writing this restriction on loans to Affiliates.

14. **Maximum Cumulative Principal Amount of Qualifying Loans Made To Any One Qualifying Borrower:** The local currency equivalent of Five Hundred Thousand U.S. Dollars [US$500,000], unless otherwise agreed to by USAID in writing.

15. **Qualifying Projects:** Investments designed to encourage growth of Qualifying Borrowers through environmental retrofitting and/or by facilitating business expansion, fixed asset improvement, access to working capital, and equipment purchase.

16. **True Risk Sharing by Guaranteed Party:** To ensure that there will be true risk sharing between USAID and the Guaranteed Party, no Qualifying Loan shall be eligible for coverage under the Agreement if more than fifty percent (50%) of total payments of principal on such Loan is guaranteed by a government or international donor organization, including USAID.

8. Risk Assessment

See Section III for more details. The Action Package includes the full text description of how the EGAT/DC Risk Management (RM) team analyzes the risk associated with the guarantee, summarized quantitatively by the Weighted Average Risk Factor (WARF).

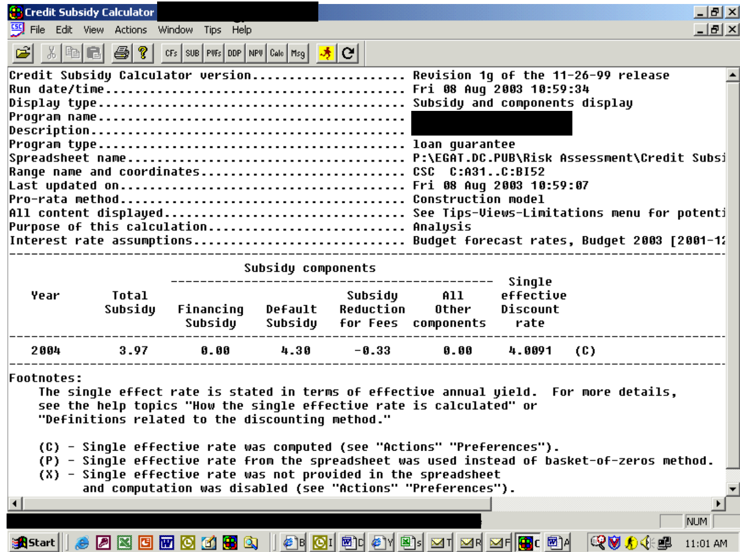
The RM team requires that the Action Package be drafted, with particular emphasis on the financial viability analysis and the term sheet, six weeks prior to the proposed CRB presentation. This allows for sufficient time to conduct the risk assessment, finalize other Action Package sections and distribute to CRB members.

9. Subsidy Cost Calculation

Based on the WARF score and several of the basic terms and conditions of the guarantee (e.g., proposed fees, duration of the guarantee, maximum cumulative disbursements), the EGAT/DC RM team utilizes the Office of Management and Budget (OMB) subsidy risk calculator to calculate the subsidy cost estimate as a percent of the total facility amount, which in the legal agreement's nomenclature is "Maximum Cumulative Disbursements" (MCD). Subsidy, as defined in OMB Circular A-11, is the estimated long-term cost to the government of a loan guarantee, calculated on a net present value basis, excluding administrative costs.

Following is a sample of the output of the OMB Credit Subsidy Calculator. The key fields in this output, which are also summarized in the Project Information Sheet (Attachment 1 of the Action Package), include:

- **Total Subsidy**: This number is expressed as a percent of the MCD. This is equal to the Default Subsidy plus the Subsidy Reduction for Fees.
- **Default Subsidy**: This figure accounts for the estimated cost of defaults (cash outflows) that USAID would pay to the guaranteed party in present value terms. This is also expressed as a percent of MCD. On the Project Information Sheet, Nominal Defaults are presented, which is MCD multiplied by the Default Subsidy rate.
- **Subsidy Reduction for Fees**: This statistic represents the estimate of fees received (cash inflows) from the guaranteed party.



10. **Monitoring Plan**

Monitoring is a coordinated effort between the Mission and the Office of Development Credit (EGAT/DC). Monitoring responsibilities are divided into Development and Financial activities. **The mission is solely responsible for Development Monitoring, while EGAT/DC and the Mission are both responsible for Financial Monitoring.**

DEVELOPMENT MONITORING

The mission must insert a short description on how it plans to monitor the developmental aspects of this activity. This description should include the performance indicators related to Strategic Objective (SO) reporting that this DCA guarantee will support.

FINANCIAL MONITORING

Financial Monitoring activities include ensuring that fees are paid, reporting requirements are met, documenting completion of conditions precedent (when applicable), making site-visits, and closing out the facility upon expiration. The EGAT/DC Portfolio Management (PM) team takes primary responsibility for Financial Monitoring. EGAT/DC will create and manage source files for all DCA facilities and be the primary resource for financial reporting on DCA activities within the Agency.

The coordinated effort in monitoring requires that the Mission and EGAT/DC staff work as a team. The Mission establishes and maintains the primary relationship with the partner financial institution (FI), or guaranteed party, and acts as the liaison between the FI and the EGAT/DC in Washington. The liaison role is supported by the EGAT/DC Project Development (PD) team Relationship Manager who, together with the Mission, ensure:

- Frequent contact with the FI's management.
- Timely and compliant submission of required documents and reports.
- Prompt remittance of USAID origination and utilization fee payments from FIs.
- Communication with EGAT/DC Portfolio Management if problems arise or certain conditions change that either reduce or improve the financial stability of the FI or the Borrowers.

This monitoring plan outlines detailed requirements for Financial Monitoring activities. A monitoring plan may include additional monitoring duties if deemed necessary by the Mission Officer(s) responsible for a DCA activity and/or EGAT/DC Relationship Managers. These additional duties may arise due to the particular structure of the guarantee facility, the status of the guaranteed party or the desired development outcomes. The duties detailed below are performed throughout the life of the guarantee facility. Each monitoring activity must be conducted according to this monitoring plan. The EGAT/DC PM team will ensure that the DCA files in Washington are maintained to document all monitoring activities as outlined in this plan.

i. REPORTING

For examples of any of the following reports, templates should be included as an attachment to the legal agreement signed between USAID and the guaranteed party. Prior to signing this agreement, Missions should contact EGAT/DC for examples/templates.

If the DCA activity is a Portable Guarantee (PG), please disregard this Reporting section. The only monitoring activities related to PGs generally include the identification of a qualified lending institution within a specified timeframe.

a) TRANSACTION REPORT (TR)

This section is applicable only to Loan Portfolio Guarantees (LPG). If this DCA guarantee is not a LPG, skip to Section i.b - Qualifying Loan Schedules (QLS).

Most LPGs require the guaranteed party to submit a Transaction Report (TR) for each loan that is placed under guarantee coverage. A TR contains summarized information about the loan and the borrower. In the case of large volume LPGs, TRs can be structured to be extremely concise with only key data required, such as the loan date, borrower name, loan amount, loan purpose. Guaranteed parties submit TRs to the Mission and to EGAT/DC through an Internet-based system – Credit Management System (CMS). CMS will only track the basic information of a TR. If there is specific performance compliance data to check, e.g. asset size of borrower, the Mission may still require that

the guaranteed party submit paper or electronic TRs. The frequency of submitting TRs varies. They can be entered in CMS in "real time" as the loans are placed under coverage. Alternatively, Missions may decide to allow banks to submit TR data with QLS information on a semiannual basis.

Typically, DCA legal agreements require that the guaranteed party submit loans for guarantee coverage within ten (10) business days of the loan approval or disbursement date to ensure that previous loans or loan renewals that may already be in arrears are not placed under coverage. Missions and EGAT/DC will review CMS data or paper/electronic TRs if required to ensure that the guaranteed party submits TRs that are compliant with the legal agreement. The loan is assumed to be approved for guarantee coverage unless USAID contacts the guaranteed party to further clarify the proper enrollment of loans under coverage.

Missions should contact their EGAT/DC Relationship Managers with any further questions regarding TRs.

b) QUALIFYING LOAN SCHEDULE (QLS)

Most DCA activities require that the guaranteed party submit a Qualifying Loan Schedule (QLS) every six months.[6] Typically, these QLS reports correspond with guarantee periods from October 1 – March 31, and then April 1 through September 30. The QLS is a status report on all new loans placed under coverage, outstanding loans, and loans taken off coverage during the past six months. The summary level figure of each QLS that is most important from the utilization and USAID risk exposure perspective is the ending principal balance. This is relevant for all guarantee types – LPGs, Loan or Bond Guarantees.

EGAT/DC ensures financial compliance of every QLS and it will report any non-compliance to the Mission for resolution or directly discuss these issues with the guaranteed party if previously agreed to by the Mission. QLS non-compliance may occur frequently if the guaranteed party does not fully understand reporting procedures or the legal agreement terms and conditions. In some cases, several email and/or telephone communications may be necessary to resolve non-compliance issues. Furthermore, a Mission or EGAT/DC site visit to or meeting with the guaranteed party may be required if the issues remain unresolved for more than 60 days.

Once in compliance, the QLS serves as a platform to assess appropriate fees, judge the overall risk exposure, document the overall effectiveness of the program, and/or predict future claims.

For LPGs, QLS reports are certified and submitted via the Internet-based Credit Management System (CMS). For other loan and bond guarantees, the guaranteed party will submit either electronic or paper reports, which typically include updated amortization or repayment schedules, as stipulated in the legal agreement. EGAT/DC will ensure those reports are properly entered into CMS for management reporting and utilization fee billing purposes. Missions, guaranteed parties, and EGAT/DC will have simultaneous access to CMS to view data and to identify either compliant or non-compliant issues.

ii. FEES

[6] The current standard for Loan and Bond Guarantee reporting requirements are annual, corresponding with the amortization or repayment of the loan/bond.

Each DCA activity requires that the guaranteed party remit payment of two types of fees. As stated above, it is the responsibility of the Mission and the EGAT/DC PD Relationship Manager with support from the PM team to ensure timely and accurate payment of fees.

a) Origination Fee – One time fee paid upfront. The guaranteed party typically has thirty (30) days to pay this fee as instructed in the legal agreement. A bill will not be submitted to the Mission or to the guaranteed party. Payment must be made as instructed in the legal agreement. See legal agreement for further information. In regards to the majority of PGs, the identified borrower(s) will pay the origination fee as stipulated in its commitment letter, which serves as the obligating document for this type of guarantee.

b) Utilization Fee – Annual fee that is typically paid every six months.[7] The fee is based on an average outstanding principal balance during a semiannual period. This is typically calculated by averaging the ending principal balance of the current and previous QLS reports submitted by the guaranteed party. Once QLS report balances in CMS are confirmed as compliant by EGAT/DC, EGAT/DC will contact the FM/LM contractor to ensure a bill, a "Notice of Payment Due" (NPD), is sent to the guaranteed party with the total amount to be paid. The guaranteed party has thirty (30) days to pay the utilization fee after it receives the NPD. See legal agreement for further information. In regards to PGs, the commitment letter will not entail any utilization fees, which would be paid by the eventual guaranteed party that provides a loan to the borrower. Also, for Bond Guarantees, utilization fees are typically paid upfront in one lump sum at the time of bond disbursement. This fee is calculated as a net present value of future fees based on forecasted outstanding amounts during the Bond Guarantee term.

iii. ANNUAL DATA QUESTIONNAIRE (ADQ)

Through CMS, EGAT/DC will request that guaranteed parties complete an ADQ by June 30 every year. CMS will generate emails to the key contacts of all guaranteed parties on or around June 1 to request that they complete the ADQ before the end of the month.

The purpose of this questionnaire is to obtain further quantitative and qualitative measures of the impact of DCA guarantees. Examples of the questions asked in the ADQ are:

- Percentage of loan(s) disbursed in target sectors(s).
- Aggregate number of employees at the businesses with guaranteed loan(s).
- Examples if the DCA guarantee allowed the guaranteed party to lower collateral requirements to approve the loan.
- Example of a "success story" of the tangible benefits realized by one of the borrowers who productively utilized funds from a DCA guaranteed transaction.

The guaranteed party is requested to use actual data to complete the ADQ, but estimates are acceptable. ADQ guidance in CMS will recommend that the guaranteed party spend no more than 30 minutes on the ADQ to ensure that this request is not overly burdensome.

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[7] In the cases of Loan Guarantees with annual reporting based on its amortization schedule, fees may be billed annually.

iv. CLAIMS

The following list highlights how DCA claims are processed:

- Guaranteed party submits claim(s) for defaulted loan(s) to the Mission and the EGAT/DC PM team.
- EGAT/DC PM team reviews claim for compliance and prepares paperwork for claim approval. Any necessary correspondence with guaranteed party will be cleared by the respective Mission Officer responsible for the DCA activity and the EGAT/DC Relationship Manager.
- EGAT/DC PM team arranges for clearances by the Mission Officer and Relationship Manager prior to submitting to EGAT/DC Director for approval.
- Once approved, EGAT/DC PM team commits and obligates funds from the DCA Financing Account via the Phoenix accounting system.[8] If insufficient funds have been apportioned in the financing account, the EGAT/DC PM team will request an additional apportionment from OMB. This apportionment is in addition to the apportionment request of financing account funds at the start of the fiscal year to cover estimated claims during the year, which is completed with support from the Bureau of Policy and Program Coordination (PPC) Credit Budget Officer and the Office of Financial Management/Loan Management Division (FM/LM). If the financing account still cannot cover the pending claim after complete subsidy outlay/disbursement from the program account, EGAT/DC will arrange for a Treasury borrowing with the assistance of PPC and FM/LM.
- Upon obligation of the claim amount to be paid, the PM team then notifies FM/LM to instruct the Mission Controller to pay the claim.
- The Mission Controller then makes the claim payment, and obtains reimbursement through FM/LM via the Intra-governmental Payment and Collection (IPAC) system.
- EGAT/DC PM team follows up with email/phone contact to Mission Controller to confirm that claim payment has been made available to the guaranteed party.
- FM/LM notifies the EGAT/DC PM team when evidence of the Controller’s transaction has been received. EGAT/DC PM team may then need to adjust the obligation amount due to exchange rate differences.

v. RECOVERIES

The EGAT/DC PM team (with potential field support from the Mission Officer responsible for the DCA activity in case of late responses) will send out annual letters by the first week of June of each year to all FIs that have received a claim payment from USAID.

The letter, signed by the EGAT/DC Director or EGAT/DC PD Relationship Managers, will request that the FI submit a Schedule of Net Recoveries (see template below) by June 30 that identifies all claim payments made to a FI and requests updated data and certification on post-claim recoveries received, if any, by the FI on these defaulted loans.

[8] When a DCA guarantee is initially established, the subsidy funds are transferred to the DCA Program Account. As the guarantee is utilized, the subsidy is disbursed proportionally to the DCA Financing Account, where fee payments from guarantee parties are also applied. The combination of subsidy and fees for guarantees obligated within the same fiscal year is the source of funds for claim payments to guaranteed parties.

SCHEDULE OF NET RECOVERIES								
<Bank Name> <Loan Portfolio Guarantee Number XXX> < as of DATE >								
Defaulted Loan/ Borrowers Name	Date of Qualifying loan	Date of Claim payment	Amount of Claim in USD	Recoveries Received as of <DATE>	Amount of Recoveries Collected by Bank	Date of Recoveries	Amount of Recoveries due to USAID	Expected Date Recoveries to be remitted to USAID

* To be completed by USAID
* To be completed by the financial institution

vi. MISSION SITE VISITS AND EGAT/DC BIENNIAL REVIEWS

Based on OMB Circular A-129 guidance, Mission Officer(s) responsible for a DCA activity are required to conduct and report on site visits to the guaranteed party, while the EGAT/DC PM team must conduct biennial reviews of the guarantee. Structures and guidelines for these visits and reviews are provided in the following two tables. Due to the similar nature of the reports described below, the EGAT/DC PM team will coordinate its biennial review with appropriate Mission staff.

Mission Site Visit	
Frequency:	Annually from date agreement is signed, particularly for guarantees with substantial loan volume, signs of deterioration in guaranteed loan(s), high default rates.
Responsible Entity:	Mission Officer responsible for the DCA activity or designee
Responsibilities:	Meet with partner Financial Institution management, establish status of project and determine compliance and performance issues.
Report Outline:	**Preparation**: Summary of telephone/email communication with PM team prior to site visit to understand unresolved monitoring and compliance issues and to review the most current utilization data. **Unresolved Issues**: Discussion of issues from Section I with FI and clarification of how issues are to be resolved. **Country Status**: Update on any country-wide issues that the FI believes is affecting its loan portfolio and/or DCA utilization – economic changes, exchange rate fluctuations, legal/political changes. **Bank Status**: Update on current situation with the financial institution being guaranteed – e.g., personnel, policy or strategy changes, bank performance, merger & acquisition activities. **Borrower Site-Visit**: If possible, request at least one visit to a borrower that received a DCA-guaranteed loan. Summary of visit should include details of: the loan amount, purpose of the loan, loan term, justification for using the DCA guarantee, how it was repaid, and the resulting benefits for the borrower. **USAID Support**: Discussion with FI if USAID can provide any further guidance or assistance in order to promote utilization of and proper reporting on the guarantee. **Conclusion**: Summary of follow-up action items
Delivery of report:	Mission Officer will send completed report via email to EGAT/DC PM team within 30 days of the anniversary of guarantee and EGAT/DC PM team will review the report and ensure that it is appropriately filed. In lieu of this report, the Mission Officer will send EGAT/DC an email to justify that the visit was not necessary.

	This email will also be filed accordingly.

EGAT/DC Biennial Review	
Minimal Frequency:	Biennially (once every two years) from date agreement is signed or coordinated with a country visit for other purposes
Responsible Entity:	EGAT/DC PM team (with support from Relationship Manager) or designee. If a Mission or its contractor prefers to be responsible for the biennial review, EGAT/DC PM team will review and provide feedback on the biennial report as outlined below.
Responsibilities:	To produce the following report at a minimum of once every two years for a DCA guarantee.
Report Outline: Note: Since the Biennial Report is similar to the Mission On-site Visit Report, EGAT/DC will coordinate its Biennial Review with the Mission to ensure that the FI is not overburdened with similar questions from two different USAID entities.	**Pre-Review Information Gathering**: Review of files to ensure files are current. Analyze recent reporting, fee and claim information to identify any issues that require follow-up with the FI. Data to be summarized and analyzed are: utilization ratios, fees billed and paid, claims net of recoveries as a percent of subsidy + fees, and reporting timeliness. **Unresolved Issues**: Discussion of issues from Section I with FI and clarification of how issues are to be resolved. Also, reminder to FI that have received claim payments of requirement to share recoveries. **Country Status**: Update on any country-wide issues that the FI believes is affecting its loan portfolio and/or DCA utilization – economic changes, exchange rate fluctuations, legal/political changes. **Bank Status**: Update on current situation with the financial institution being guaranteed – e.g., personnel, policy or strategy changes, bank performance, merger & acquisition activities. **Borrower Monitoring**: {if on-site} request to see credit files at the FI on a random selection of at least two borrowers. If possible, request at least one visit to a borrower that received a DCA-guaranteed loan. Summary of visit should include details of: the loan amount, purpose of the loan, the loan term, justification for using the DCA guarantee, how it was repaid, and the resulting benefits for the borrower. **EGAT/DC Support**: Discussion with FI and Mission if EGAT/DC can provide any further guidance or assistance in order to promote utilization of and proper reporting on the guarantee. Conclusion: Summary of follow-up action items
Delivery of report:	EGAT/DC PM team will review this report and ensure that it is appropriately filed. If this report is part of trip report conducted by an EGAT/DC staff member, it will be copied and placed in the appropriate DCA file.

vii. AUDITS

When a guaranteed party submits a claim for payment, the EGAT/DC PM team will monitor the level of claims against the following three criteria:

NOMINAL CHECK	Do cumulative paid and pending claims exceed the equivalent of US$25,000?
PORTFOLIO CHECK	Do cumulative paid and pending claims (converted to total loan values) exceed 10% of Cumulative Utilization?
SUBSIDY CHECK	Are cumulative paid and pending claims as a percent of “subsidy plus fees received” above 50%?

Although this three-tiered criteria checklist is primarily applicable to LPGs, which may receive a series of claim payment requests from the guaranteed party, the same guidelines should be utilized for other forms of DCA guarantees. Data related to these three criteria will be included in the summary page provided in the claim package developed by the EGAT/DC PM team. If at least two out of the three criteria result in positive answers, the EGAT/DC PM team will convene to discuss the possibility of an internal review of the guaranteed party's TRs and QLSs. The PM team will then coordinate next steps with the respective Relationship Manager from the EGAT/DC PD team. The Mission will be contacted as necessary, and additional documentation may be requested from the guaranteed party. The PM team, with guidance from the PD team and the Mission, may request a site visit to inspect the credit files of the guaranteed party.

In the event irregularities are found during the EGAT/DC PM team desk or on-site review, an audit should be conducted by an experienced, independent auditor. The EGAT/DC Risk Management (RM) team will coordinate the planning and review of this auditor's performance. The RM team will also conduct this audit with appropriate Mission guidance. Results of this audit will be disseminated between the PM team and the RM team as well as the Relationship Manager to decide on next steps with this DCA guarantee.

The guaranteed party will be required to repay any amounts deemed to have been paid based on disallowed transactions (e.g., unqualified borrowers). If the guaranteed party is judged to have committed fraud, provided erroneous information, or is perceived as unable to carry out the activities and responsibilities of the guarantee, the USAID Office of General Counsel may advise to terminate the agreement following consultations with the Mission and relevant EGAT/DC staff.

viii. BUDGET

- One (1) US Direct Hire SO Team Leader (or Officer responsible for the DCA activity) monitoring implementation of the DCA agreement: x% of time, $x,xxx annually for each year during which loans may be placed under coverage. This is based on an annual salary of $xx,xxx and a benefits package of $xx,xxx.
- One (1) FSN Project Management Specialist: x% of time, $x,xxx per year for each year during which loans may be placed under coverage. This is based on an annual salary and benefits of xx,xxx.
- One (1) FSN in the Financial Management Office: x% of time, $x,xxx per year for each year during which loans may be placed under coverage. This is based on an annual salary and benefits of $xx,xxx.
- Travel costs to monitor the program overall and conduct random audits of DCA loans, xx site visits per year, all trips out of (Mission location), $x,xxx for each year during which loans may be placed under coverage.

Total Annual Cost for Mission: $xx,xxx per year estimate for xx years (does not include EGAT/DC travel costs).

Total Annual Cost for Mission: $xx,xxx per year estimate for xx years (does not include EGAT/DC travel costs).

USAID/W EGAT/DC travel to COUNTRY: $x,xxx per trip, 1 trip for every two years is $x,xxx per year. Estimated staff time costs for EGAT/DC to monitor this DCA guarantee are:

- EGAT/DC PD and PM team: 7 days per year, $3,500 annually for each year during which loans may be placed under coverage. This is based on an average salary of EGAT/DC personnel of $93,600 and a benefits package of $37,500.
- EGAT/DC PM monitoring contractors: $2,000 annually based on ongoing contract.

ix. ACCOUNTING CODES

Mission Controllers should utilize the following accounting numbering structure to assist in clearly tracking initial subsidies, modifications, reports, claims and fees:
XXX-DCA-XX-XXX. Properly including this code along with the name of the guaranteed party on all relevant documents, such as the original obligation, QLS reports and claim payments will ensure that there is a clear audit trail for accounting purposes. Samples can be provided by the PM team if further clarification is required. This guarantee numbering should be structured as follows:

XXX-DCA-xx-xxx	3-digit country code
xxx-**DCA**-xx-xxx	3-digit guarantee type (DCA)
xxx-DCA-**XX**-xxx	2-digit for fiscal year
xxx-DCA-xx-**XXX**	3-digit loan number = a unique guarantee identifier that is the sequential number of DCA guarantees in a particular country, i.e. 001 for the first guarantee in a country, 002 for the second, etc.

D. Action Package for Multiple Guarantees and Re-Approvals

If a Mission prepares an Action Package that encompasses multiple guarantees, several of the attachments can be consolidated and presented together – Action Memorandum, Activity Description, EVA, FVA, Fees Justification, Legal Terms and Conditions, and the Monitoring Plan. However, the Action Package must present Project Information Sheets, Risk Assessments and Subsidy Calculations separately for each guarantee.

In the case of a CRB re-approval of an existing facility, perhaps if a project is approved but not obligated prior to the end of the fiscal year, or if project was approved and material events have come to pass prior to obligation, the Action Package would require a new Action Memorandum, Project Information Sheet, and a revised Risk Assessment and Subsidy calculation if warranted. The original Action Package would also be attached for reference.

E. CRB Presentation and CFO Approval

Once the risk assessment sections are finalized for the Action Package, the EGAT/DC RM team submits the Action Package to OMB for review. Two weeks thereafter, the PM team distributes the Action Package to all EGAT/DC and CRB members for review, including any comments or changes from OMB. This distribution should occur one to two weeks prior to the CRB meeting.

The PM team will review the Action Package with particular attention to the Monitoring Plan. Members of the PD team who were not involved in the development of this particular project will review the project with particular emphasis on the economic and financial viability analysis sections. Internal feedback from EGAT/DC should be provided to the PD team member prior to the CRB

meeting. This PD team member, in consultation with the Mission, will incorporate these comments into the Action Package before CRB review.

F. Guarantee Agreement (Legal)

Office of General Counsel (GC) maintains templates for guarantee agreements to be utilized by Regional Legal Advisors (RLAs). If the RLA considers a deviation from the template agreement, the RLA should discuss it with GC staff and the PD Relationship Manager prior to finalizing negotiations with the guaranteed party. These discussions may be necessary to ensure that the deviation will not contradict ADS guidance or federal credit program legislation nor inhibit monitoring activities.

Missions are encouraged to engage their RLA in DCA project development as soon as the Concept Paper is drafted and reviewed to ensure adequate lead time to prepare and negotiate the legal agreement. This will avoid unnecessary delays when the legal agreement is expected to be signed after the subsidy funds are committed and available for obligation as described in the subsequent section of this manual.

G. Funds Transfer/Obligation Process

The EGAT/DC PM team will serve as a liaison and guide the process of obligating subsidy funds for a DCA guarantee, especially with regards to other USAID/Washington offices (e.g., PPC, LPA) and other external agencies, such as OMB. However, the EGAT PD team member responsible for the project will maintain responsibility for the steps in this process that concern the Mission and Regional Bureau Program Office.

1. EGAT/DC provides a copy of the Action Package signed by the CFO to the Mission SO Team Leader and to the Mission and/or Regional Controller concerned. The signed Action Memorandum is the basis for subsequently obligating the subsidy amount when the Commitment, or Guarantee Agreement, (obligating document) is finalized and signed.
2. Mission prepares the Congressional Notification (CN), which indicates the subsidy amount of unobligated program funding to be reduced for transfer to DCA funds as well as a description of the DCA activity. Mission sends the CN to Regional Bureau and EGAT/DC for review. Once approved, the Bureau forwards it to the Office of Legislative and Public Affairs (LPA) for final approval and submission to Congress.

    NOTE –In order to expedite the process, the CN should be drafted and presented to the Bureau for clearance at the time the Action Package is presented to the CRB. This is particularly encouraged late in the fiscal year given the Congressional summer recess and the concern to have approved DCA activities obligated prior to the end of the fiscal year. It is not necessary to wait for CRB/CFO approval, unless there is reasonable doubt that the CN would not clear, or that CRB/CFO approval will not be forthcoming. If the final subsidy has not yet been calculated, the EGAT/DC RM team can provide a conservative estimate of subsidy cost prior to completion of the DCA risk assessment, and there would be no need to re-notify if the CN over-notifies the subsidy amount to be transferred to DCA funds.
3. Upon completion of the 15-day CN review period without objection from Congress, the CN expires and Bureau notifies CN approval to Mission and EGAT/DC.
4. Mission SO Team and/or Controller initiates subsidy transfer process in cooperation with the Regional Bureau Budget Office to transfer back to the Bureau the amount of Mission program funds sufficient to cover subsidy.

    NOTE – Step 4 can be initiated as soon as the final subsidy for the DCA activity is calculated without waiting for CRB/CFO approval or CN clearance. In this event, steps 5 through 12 can take place sooner, and will ensure that funds are available to the Mission to obligate upon clearance of the CN and CRB/CFO approval.

5. Regional Bureau Budget Office in turn returns Mission program funds to PPC/B/RA.
6. Bureau drafts and PPC/B sends apportionment letter to OMB requesting transfer of program funds to the DCA funds with a copy sent to M/FM/CAR/FCGL (“Funds Control”) Office.
7. M/FM/CAR/FCGL finalizes SF-132 (Apportionment/Reapportionment Schedule) and submits to OMB for approval.
8. OMB approves SF-132 and returns to M/FM/CAR/FCGL.
9. FM/CAR/FCGL prepares 1151 ("Non-expenditure Transfer of Funds"), and notifies PPC/B/RA of reapportionment of DCA funds and availability of funds in the DCA Program Account in Phoenix Financial System.
10. PPC/RA/PA allots DCA funds amount in Phoenix to Bureaus.
11. Bureau allows DCA funds (in Phoenix) out to the Mission, confirming the allowance to the Mission by email.

    NOTE – If the DCA guarantee is Bureau-funded and managed, the Bureau will hold the DCA funds for subsequent obligation in Phoenix when obligating DCA legal documents are signed.
12. Mission Controller reserves/commits the DCA funds in the Mission Accounting System (MACs) based on copy of the DCA subsidy Action Memo approved and signed by the CRB/CFO, and certifies availability of the DCA funds for obligation.
13. Mission obligates DCA funds after commitment letter or guarantee agreement signed, based on the approved DCA subsidy Action Package.
14. Mission Controller enters funds obligation details (funds cite, obligation date, etc.) on the cover sheet of the signed obligating legal agreement and promptly sends copy of signed legal agreement (by scan or fax) to EGAT/DC, which in turn provides signed copies to the FM/LM contractor (USAID Financial Agent) and FM/LM to set up appropriate servicing and accounting records.
15. EGAT/DC establishes and maintains file for each DCA guarantee obligated (see Filing Procedures in Section IV of this Manual).

III. **Risk Assessment**

Risk assessments are analyses performed on lenders, borrowers, and the structure of a credit activity that determine the creditworthiness of participating institutions and develop an expected cost of the risk. A risk assessment is the process of determining the probability of adverse outcomes, which most likely result in negative cash flows. The higher the level of risk equates to a higher probability of negative cash flows and a resulting loss to the U.S. Government. Risk assessments result in the determination of an ordinal risk score, which is then used to determine the expected cost to USAID of an activity.

A risk assessment involves analyzing all financial aspects of a credit activity to determine the probability of default. Usually, this will include the creditworthiness of the borrower and lender (when applicable), macro- and microeconomic country-related issues, the structure of the credit transaction, and the presence of risk-mitigating factors. In all instances, the structure and location of the activity will have direct bearing on the level of underlying risk.

In order to project the future cash outflows required by the loan guarantees, the EGAT/DC RM team must perform a credit risk assessment on the country, borrower, lender, and structure of the credit activity designed to evaluate the creditworthiness of a particular USAID loan guarantee. It is conducted by the RM team in EGAT/DC, ensuring an independent analysis of project risk related to the possible outflow of U.S. Government funds, and is undertaken in accordance with the procedures established in the *USAID Development Credit Risk Assessment Handbook*. Although EGAT/DC performs the risk assessment, the Mission or Bureau and participating institutions support the risk assessment with information research and collection. Although the required information depends on the credit activity, it typically includes: audited financial statement for three to five years, business/strategic planning documents, CVs of key personnel, financial projections, human resources information, policies/procedures, and organization charts. EGAT/DC conducts the risk assessment once the project development phase is completed, and typically requires a site visit.

The risk assessment utilizes a 10-point scale in which "1" represents low risk and "10" represents high risk. The scale is applied to quantify separate risk scores for the country, the borrower, the lender, and the structure of the transaction, and then a weighted-average risk factor (WARF) score is calculated. This WARF score is used to determine the expected default rates (net of recoveries) on the loans. Higher risk scores are naturally associated with higher default rates. The default rates themselves are provided annually by the OMB based on estimates of defaults on all U.S. Government loan guarantees, and depend on both the WARF score and the maturity (or year in which the repayment of principal is to occur). Once the default rates are determined, they are applied to the specific DCA guarantee being considered to obtain the expected default payments, which represent the future cash outflows required by the loan guarantee commitment. The present value of these default payments is the subsidy cost of the loan guarantee.

Formulating the WARF Score is the main objective of the credit risk assessment, as it is the critical element in projecting future cash outflows. An overview of the factors assessed, along with their assigned weights, is provided in the following table. The country risk score always comprises 40% of the overall WARF score. Weights on the borrower risk and the lender risk may vary in two ways: first, standard weights depend on the particular product being used (as shown in the table), and second, risk analysts have some flexibility to alter the standard weights within the specified ranges. Transaction risk has a standard weight of 20% of the overall WARF score for loan guarantees (but may

vary from 10% to 30%), and has a standard weight of 10% for direct loans (with a range from 5% to 20%).

Risk Factors Assessed in the DC Risk Assessment and Standard Weights

Factor and Weight	Overview
Country Risk 40%	This is determined by a rating system used throughout the U.S. Government, the Inter-Agency Country Risk Assessment System (ICRAS). The ICRAS non-sovereign risk score represents the overall risk of doing business in the country. This score takes into account such factors as the general business climate, banking and legal systems, and foreign exchange conditions.
Borrower Risk Loan Guarantee: 25% Loan or Lease Portfolio Guarantee: 15% Bond Guarantee: 30%	This measures the ability of the borrower to repay the lender. If the borrower is rated by a private rating agency, the rating is converted to a numerical equivalent on the USAID risk scale. If the borrower is not rated, the risk analyst examines a variety of information. Risk components include both borrower-specific factors, such as financial strength and management quality, and external factors, such as industry, market and regulatory conditions. The factors considered vary according to the type of borrower, which may be a private sector business, a financial institution, a leasing company, a microfinance institution, an investment fund, a private voluntary organization, or a utility or sub-national government infrastructure entity. For example, a private sector business is scored based on six factors: industry/market characteristics, the regulatory environment, its legal organization and corporate governance, management, financial assessment, and the nature of the new activity. Other types of borrowers have factors tailored to the nature of their business, as developed in the *USAID Development Credit Risk Assessment Handbook.*
Lender Risk Loan Guarantee: 15% Loan or Lease Portfolio Guarantee: 25% Bond Guarantee: 10%	This assesses the lending institution's experience and ability to originate and monitor loans. If the lender is rated by a private rating agency, the rating is converted to a numerical equivalent on the USAID risk scale. If the lender is an unrated commercial banking institution, USAID utilizes the widely accepted "CAMELS" analysis to evaluate the bank's Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk. Other types of lenders, which may include microfinance institutions, investment funds, and private voluntary organizations, have factors tailored to the nature of their business, as developed in the *USAID Development Credit Risk Assessment Handbook.*
Transaction Risk 20%	This incorporates the legal and financial structure of the activity including: (1) local currency considerations, (2) the legal structure of the guarantee or loan, including protective covenants, and (3) the financial structure of the activity, including the percent guaranteed or USAID's investment (if direct loan) relative to the total funding for the activity. The standard weight on the local currency consideration is 50%, and the benchmark score is the ICRAS score. The standard weight on the legal structure of the guarantee is 25%, and the benchmark is also the ICRAS score. The standard weight on the financial structure of the guarantee is 25%, and the benchmark is either the borrower risk score or the lender risk score, depending on the DCA product being used.

The expected cost to the U.S. Government of a credit transaction is called a ***subsidy***. For all credit activities, USAID sets aside this subsidy in a holding account for the duration of a specific deal (similar to a specific loan loss reserve). The subsidy is the net present value of all credit-related cash outflows and inflows to the U.S. Government. The subsidy concept was introduced in the Federal Credit

Reform Act (FCRA) of 1990. Determination of the subsidy includes (i) assessing the risk of the credit transaction, (ii) estimating scheduled cash flows, and (iii) adjusting the expected cash flows based on credit risk. The system allows the Government to price the expected liability of credit transactions under Federal credit programs.

The primary benefit of the subsidy concept over traditional risk measures is the price determination effect. Traditional risk measures provide ordinal scores of credit risk without providing expected liability estimates. The FCRA subsidy system provides an explicit liability estimate for credit based on risk and cash flow timing. This helps differentiate the price between two transactions with comparable risk scores but substantially different cash flow timing, or vice versa.

In summary, there are two distinct parts to the USAID risk model: risk assessment and subsidy calculation. Risk assessment includes factors that determine the probability of default based on creditworthiness. Calculating the subsidy involves determining the expected cost to the U.S. Government of cash flow implications of risk and financial structure. Complete guidelines to conduct a DCA risk assessment are described in the *USAID Development Credit Risk Assessment Handbook*. For those requesting more information on risk assessments, contact the RM team leader.

IV. Project Monitoring

A. Overview

Following the obligation of a DCA guarantee, the EGAT/DC Portfolio Management (PM) team will be primarily responsible for monitoring activities of DCA guarantees with support from PD Relationship Managers and Mission Officers. The scope of monitoring activities has been clearly identified in the Monitoring Plan, which is included in the Action Package submitted to the CRB (see Section II.C.10).

B. Filing Procedures

The PM Team contractor will be responsible, based on documents provided by EGAT/DC PM team, to create and maintain the DCA project files organized as follows:

- **Yellow** (Project Development) – Action Package, Congressional Notification, audited financial statements, other project development materials, correspondence.
- **Red** (Legal) – Contact information, legal agreement, amendments to legal agreement, commitment letter, evidence of “conditions precedent”, correspondence.
- **Blue** (Financial) – QLS reports, origination fee payment, utilization fee payments, exception reports, QLS late reports notifications, correspondence.
- **Green** (Monitoring) – Mission site-visit reports, biennial reviews, references to trip reports, calling plan schedule and general correspondence.

The PM Team contractor will create these four files for each project within two weeks of receiving the signed legal document. At that time, the PM Team contractor will file all available project development information, including the CN, in the yellow folder from the appropriate PD Team Relationship Manager. The PD team will provide signed copies of the guarantee agreement to the PM Team contractor to be filed in the red folder

The PM Team contractor will maintain the contents of these files on an ongoing basis, filing financial data as they are finalized/received (blue) and any monitoring updates/reviews as they occur (green). EGAT/DC PM team will ensure the monitoring information, as well as any legal amendments/ issues, are provided to the PM Team contractor in a timely manner.

The EGAT/DC PD and PM Team Leader will conduct a spot-check audit of these files on a semiannual basis – by January 31 and June 30 of each year. Reports from these audits will be disseminated at the February and July portfolio review meetings.

C. Initial Mission/Partner contact

Within three weeks of signing the legal agreement, the EGAT/DC PM team will send a letter or email to the guaranteed party with the following content:

- Formal welcome
- Introduction to PM team
- Reminder of "conditions precedent" requirements
- Reminder of origination fee payment with instructions on how to pay the fee
- Explanation of reporting (CMS tutorial in the case of LPGs)

This communiqué will be first sent to the key Mission contact and the PD Relationship Manager for review. EGAT/DC PM will offer to send this on the Mission's behalf or provide the Mission with the option to send it directly to the guaranteed party. EGAT/DC should also encourage the Mission to share this letter/email with its RLA.

D. Monitoring Database – CMS and Reports

The Credit Management System (CMS) is an Internet-based database system for monitoring MSED and DCA guarantees. The primary function of CMS is to collect and monitor data related to guarantees – qualifying loan Transaction Reports, semiannual reports on outstanding balances (i.e. the contingent liability to USAID), fees billed and paid, claims submitted and paid, etc. CMS also provides useful management reports on utilization, cash flows and reporting timeliness.

The CMS web site is hosted externally at https://admin.cms.usaid.org, which requires a username and password. Access can be granted to EGAT/DC, Mission, FM/LM and guaranteed party personnel by the EGAT/DC PM team. For complete guidance on how to use the Credit Management System, see the *CMS Users Guide for USAID Personnel*. There is also a separate Users Guide for financial institutions that describes how a guaranteed party enters its semiannual reports in CMS.

Procedures and responsibilities for CMS are summarized in the following table.

Function	Procedures
Initial CMS data entry (new guarantee agreement)	• Upon filing a new DCA agreement, the PM Team contractor initializes the guarantee in CMS. • EGAT/DC PM team contacts the EGAT/DC PD team Relationship Manager and/or Mission to determine if and how CMS training with guaranteed financial institution

Function	Procedures
	(FI) can proceed.
Reporting and Fees	• Data entry of Transaction Reports and Qualifying Loan Schedules (QLS) – FI or the PM Team contractor. Typically these reports are due semiannually by April 30 and October 31. • The PM Team contractor with EGAT/DC PM support will resolve all outstanding issues in order to finalize QLS data ("approved" status in CMS). • Once finalized, the PM Team contractor will contact The FM/LM contractor in order to develop and send Notice of Payments Due (NPD) for utilization fee payment. • The PM Team contractor will review and then file the NPD after it has been faxed to the FI. • Riggs and the PM Team contractor will provide monthly reports on past-due fee payments. EGAT/DC PM and PD team members will assist with possible guidance from Mission contacts if payments are more than 30 days past due.
Claims	• EGAT/DC PM will forward claim reimbursement requests from FIs to the PM Team contractor for data entry into CMS as "pending claims". • The PM Team contractor will then follow Section IV.F of this Manual to assess and process claims. • Once paid, the PM Team contractor will change the status of claims from "pending" to "paid".

One additional reporting procedure that is included in CMS is the Annual Data Questionnaire (ADQ). The purpose of the ADQ is to collect quantitative and qualitative data on the impact of USAID guarantees once a year from guaranteed FIs. CMS will send out automatic emails on June 1 to request that FIs complete this brief survey.

E. Utilization Targets -- LPGs

For any of the following circumstances, the EGAT/DC PM team, in coordination with the PD team, should contact the respective Mission to discuss how to address the lack of utilization of the guarantee with the financial institution.

- If no loan(s) have been placed under guarantee coverage by the end of first reporting period (typically six months after signing the guarantee agreement).
- If Cumulative Utilization as reported in CMS, which represents the aggregate amount of loans placed under guarantee coverage, is less than 10% of Maximum Cumulative Disbursements by the second reporting period (typically one year after the signing of the guarantee agreement).
- If Cumulative Utilization as reported in CMS, which represents the aggregate amount of loans placed under guarantee coverage, is less than 50% of Maximum Cumulative Disbursements by the midpoint of the guarantee's term.

The EGAT/DC PM team will work with its contractor to ensure these targets are verified on a semiannual basis (following the subsidy outlay process).

F. Utilization Fees Billings and Collections

- The PM Team contractor verifies Qualifying Loan Schedule (QLS) March 31 and September 30 reports as finalized and in compliance with the legal agreement and informs the FM/LM contractor via phone and/or email that the Notice of Payment Due (NPD) can be produced based on CMS data.
- The FM/LM contractor uses CMS ending balance data for each semiannual period to draft the NPD. The PM Team contractor verifies the draft NPD before it is faxed to the guaranteed party.
- The guaranteed party has thirty days to pay the utilization fee upon receipt of the NPD. Through Riggs delinquency reports and CMS reports, the EGAT/DC PM team will monitor overdue fees and involve the PD team if necessary. Payment instructions are as follows:

US Dollar payments
may be wired electronically to Treasury:
ABA#: 021030004, Federal Reserve Bank of NY
To the credit of US Treasury, Type Code: 15 (for banks outside the US)
Acct#: ALC72000001, Ref:: USAID a/c 72X4266
Include the MACS obligation number used for the DCA guarantee at the Mission. This is obtainable from the Mission Controller; e.g., "ref: USAID a/c 72X4266, DCA-201-A01-001". M/FM/LM and Riggs Bank monitor wire activity through Treasury's CashLink system. Riggs Bank will credit the fee payments to the appropriate loan guarantee.

Local currency payments
should be made by the Guaranteed Party via check to the USAID Controller or Cashier, referencing, e.g., "USAID a/c 72X4266, DCA-201-A01-001". The USAID Controller will deposit the funds with the USDO, which will translate and post the funds in US Dollars to the DCA financing account (72X4266). The Mission Controller will provide a copy of the receipt to M/FM/LM. M/FM/LM will notify Riggs Bank of the collection, so that they may credit it to the appropriate loan guarantee.

- Once payment is received and confirmed in Washington by either the EGAT/DC PM team, the PM Team contractor or Riggs, the payment information will be entered in the CMS database by the PM Team contractor or Riggs.

G. Claims

1. Assessment and Payment of Claims

The EGAT/DC PM team oversees all the steps involved to ensure that the claim is paid in a timely manner. Once the claim is received in Washington, and if there are no outstanding unresolved issues regarding the claim, previous reporting, and fees, this process should take no more than thirty (30) days.

Once the Mission receives a claim request from a guaranteed party, the Mission should forward the claim request to the EGAT/DC PM team. The PM Team contractor reviews the claim and performs the following tasks:

- Reconcile principal of claim amount with latest QLS balance.
- Ensure dates fall according to procedures
- Ensure the loan is in default or exhibits lack of repayment in CMS for at least 90 days.
- Review any write-off evidence provided
- Attach copy of latest QLS
- Attach original Transaction Report (if any)
- Check status of utilization fee payments. If outstanding fees, notify bank and wait for verification of payment before proceeding
- Check status of QLS entry and current reporting practices. Resolve any outstanding issues.
- Compile excel spreadsheet, which provides a borrower list of claims and totals the amount of the claim in local currency and US dollars.
- Draft cover memo and financial summary of guarantee to Relationship Manager. This memo will include the three calculations described in the subsequent section, "Trigger for Claim Audits".

Thereafter, the following steps occur:

- EGAT/DC PM team will review claim for compliance and prepare paperwork for claim approval. Any necessary correspondence with guaranteed party will be cleared by the respective EGAT/DC Relationship Manager and the Mission Officer responsible for the DCA activity.
- EGAT/DC PM team arranges for clearances by Mission Officer, Relationship Manager prior to submitting to EGAT/DC Director for approval.
- Once approved, EGAT/DC PM team will commit and obligate funds from the appropriate DCA Financing Account via Phoenix.
- Upon obligation of the claim amount to be paid, the PM team will then notify FM/LM to instruct the Mission Controller to pay the claim.
- The Mission Controller then makes the claim payment in the currency of the guaranteed transaction, and obtains reimbursement through FM/LM via the IPAC system.
- EGAT/DC PM team follows up with email/phone contact to Mission Controller to confirm that claim payment will be made available to guaranteed party.
- FM/LM notifies the EGAT/DC PM team when evidence of the Controller's transaction has been received.
- The PM Team contractor ensures that relevant transaction is removed from coverage in CMS and EGAT/DC PM team updates the claim log, which is used to prepare next year's apportionment request.

This process varies slightly for MSED claims. The primary difference is that Mission clearance is unnecessary. The roles of FM/LM, Mission Controllers do not vary much in the claims process for MSED and DCA claims. Similarly, the PM Team contractor role as it relates to preparing a claims package and CMS data entry does not vary between the two credit authorities.

2. **Trigger for Claim Audits**

See Monitoring Plan (Sec.III.C.10.vii) for details.

H. Recoveries

See Monitoring Plan (Sec.III.C.10.v) for further details. At the May Portfolio Review meeting, the EGAT/DC PM team will remind the PM Team contractor to send out these letters by the first week of June each year. Templates for these letters are stored on the EGAT/DC shared drive.

I. Portfolio Review Meetings

The EGAT/DC PM team will organize and facilitate and the PD team will attend monthly meetings to review pertinent portfolio issues. At a minimum, these meetings will include:

- Review of outstanding follow-up items identified from the previous meeting
- Distribution of updated reports from CMS
- Update on pending and paid claims
- Discussion of portfolio-wide and region-specific issues
- Establish time/date for the next meeting

The PM Team contractor will be responsible for creating meeting minutes and then filing them, along with any handouts from the meeting, in a binder clearly marked in the EGAT/DC office.

J. Relationship Manager Calling Plans

EGAT/DC PD Relationship Managers have created calling plans that represent a planned schedule of phone calls to guaranteed parties and/or the relevant Mission Officer to better understand the current status of the guarantee and to maintain contact with guaranteed parties. These calls are predominantly either semiannual or annual, as decided by the Relationship Manager. The Relationship Manager can substitute in-country meetings or email updates from Mission Officers for the phone calls that cover the necessary topics as outlined below.

Prior to placing a call, the Relationship Manager or Mission designee should request an update from the Portfolio Management team to ascertain if there are unresolved monitoring and compliance issues and to review the most current utilization and contact information.

Topics of discussion during the phone call:

Part I: Information Gathering

- Update on the use of the guarantee, including current utilization, new borrowers, and potential claims.
- Update on bank issues, including personnel changes, policy changes, bank performance, and mergers and acquisitions.
- Update on the issues of the country, including exchange rate fluctuations, economic updates, and legal and political changes.

- Update on contact information, including personnel, email addresses, mailing addresses, phone numbers, and fax numbers of the partner financial institution.

Part II: Customer Service

- Is there any assistance or support that USAID could provide to the guaranteed party to further promote the utilization of the guarantee?
- Is the financial institution in need of any special assistance?
- Is there a strong relationship between the partner financial institution and the Mission? What can be done to promote a strong relationship?
- Is there anything that USAID can do to encourage timely and accurate reporting and fee payments?
- Does the partner financial institution have any special concerns or issues?

Part III: Issue Resolution

- Resolve issues with late reporting and/or fee payments.
- Resolve pending compliancy issues with QLS or other types of reporting.
- Resolve issues with low or no utilization.
- Resolve issue with pending claims.
- Make arrangements to gather missing file components.

Part IV: Conclusions

- Remind the partner financial institution of the due date of the next QLS or financial report, fee payment, audited financial statements, and other stipulations of the legal agreement.
- Update the partner financial institution of the Relationship Manager and Mission's contact information.
- Notify the partner financial institution of the date of the next scheduled phone call or visit.

In preparation for the Portfolio Review monthly meetings for March and September of each year, the PM Team contractor will meet with Relationship Managers to update actual contacts made during the last six months. Reports of calls made during the previous six months will be provided at these two Portfolio Review meetings.

K. Biennial Reviews / Trip Reports

Please refer to the Monitoring Plan section of the Action Package (Sec.II.C.10) for the outline of a biennial review, which is the responsibility of the EGAT/DC PM team or designee.

The PM Team contractor will copy a biennial review report that is included in a broader trip report in the appropriate project file. In contrast, the PM Team contractor will only include a reference for other information from a trip report, excluding biennial reviews, relevant to a particular project in the green project files. EGAT/DC administrative support will maintain originals of all EGAT/DC trip reports.

L. Subsidy Outlays

DCA subsidy involves two accounts, the DCA Program Account (a Mission account) and the DCA Financing Account (a USAID/W account). Both accounts are maintained with U.S. Treasury. The DCA Program Account holds the subsidy transferred to the Mission as DCA funds. As a guarantee is

utilized, the DCA funds are moved (outlaid) from the DCA Program Account to the DCA Financing Account in proportion to the percentage of the facility utilized.

The EGAT/DC PM team will provide information semiannually by November 30 and May 31 of each year to M/FM/LM in order to properly outlay subsidy amounts from the DCA Program Account to the DCA Financing Account. This information will consist of cumulative utilization data from CMS, which will clearly identify the balances that should be outlaid in the Financing Account.

M/FM/LM initiates the transfer from the DCA Program Account (on the books of the Mission) to the DCA Financing Account (on the books of USAID/W). M/FM/LM prepares a disbursement document (SF1081) for each DCA guarantee and submits them to M/FM/CMP for processing through the Treasury Intra-governmental Payment and Collection (IPAC) system. M/FM/LM advises the Mission Controller to liquidate the obligated DCA funds by reducing the DCA Program Account via the U.S. Treasury IPAC electronic funds transfer process. Through IPAC, the Missions Agency Location Code (ALC) is charged directly. M/FM/LM processes a corresponding collection in Phoenix to the DCA Financing Account. Based on the SF1081 received from M/FM/LM indicating the DCA funds transfer, M/FM/CMP prepares the IPAC/ALC report, which completes the DCA subsidy outlay process. The EGAT/PM team will confirm that M/FM processed the outlays as required via Phoenix by December 15 and June 15 of each year.

This semiannual subsidy outlay process will result in the reduction of the DCA Program Account funds that are reflected in Mission accounting records. Missions may ask EGAT/DC for clarification as they prepare quarterly accruals for the Program Account. If there has been a significant amount of loan(s) placed under guarantee coverage, EGAT/DC PM team will provide the Mission with guidance as to how it should update its accrual estimate. Otherwise, the PM team should advise the Mission to leave the Program Account funds unchanged and wait until the next subsidy outlay.

The following table summarizes key Treasury, Phoenix, and a simplified version of Mission Accounting (MACS) codes for reference purposes. The MACS codes listed are merely Mission interpretations of the Phoenix codes. MACS actually uses a different coding system that includes Budget Plan Codes (BPCs).

Appropriation Title	Treasury Symbol	MACS	Fund Code
DCA Financing Account (no year)	72X4266	LFX-FY	BFY LA-X
DCA Program Account (no year)	72X1264	LAX-FY	
DCA Program Account (FY 01/02)	72 1/2 1264	LA-01/02	2001/02 LA
DCA Program Account (FY 02/07)	72 2/7 1264	LA 02/07	2002/2007 LA
DCA Program Account (FY 03/07)	72 3/7 1264	LA 03/07	2003/2007 LA
DCA Program Account (FY 04/07)	72 4/7 1264	LA 04/07	2004/2007 LA

M. Subsidy Reestimates

1. Overview

The subsidy reestimate process is an annual comparison of prior subsidy estimates for each previously disbursed loan/guarantee cohort; and actual loan/guarantee cash flows and updated assumptions about expected performance of the cohort. Cohorts are grouped by the fiscal year in which the subsidy funds were obligated. It is important to note that neither an upward or downward change in the estimated subsidy cost of a DCA guarantee will impact a Mission's budget.

The subsidy reestimate for each account is a two-part calculation:

1. Update for change in interest/discount rate between time of loan obligation (guarantee commitment) and disbursement ("**interest rate reestimate**")
2. Update for changes in technical/default assumptions (e.g., forecast technical assumptions) ("**technical reestimate**").

Interest Rate Reestimate
The purpose of the interest rate reestimate is to replace the OMB-issued economic assumption Treasury interest rates used at execution or calculation of the original subsidy rate with actual Treasury rates. In doing so, the reestimate recalculates the subsidy estimate based on actual interest rates and as a consequence trues up the subsidy balance in the financing account based on the difference between estimated and actual rates. An interest rate reestimate is required to be calculated after a cohort becomes substantially disbursed, which implies that future disbursements, if any, will be minor in comparison to existing disbursements (modified "use 90 percent" method). An interest rate reestimate is only calculated once for a cohort, following the substantial disbursement of loans under coverage.

Technical Reestimate
The purpose of the technical reestimate is to replace the original estimated cash flows (forecast assumptions used to calculate the original subsidy estimate) with actual cash flow data. For example, for loan guarantees this includes default claim payments, recoveries, fees, interest rates, etc. A technical reestimate will also update estimates of future cash flows based upon recent historical (actual) performance as well as revised assessments of risk. Generally, technical reestimates are first calculated after a cohort has substantially disbursed. For example, for most cohorts, USAID will calculate the first interest and technical reestimates at the same time. Once the first technical reestimate has been performed, a technical reestimate must be calculated after the close of each fiscal year.

Closing reestimates
When USAID no longer has any contingent liability associated with any loan guarantees in a cohort, a closing reestimate for that cohort must be performed. A closing reestimate brings the cohort account to zero (0) by either repaying any residual obligations to Treasury or transferring any residual subsidy to Treasury's general receipts account. No further reestimates are required after a closing reestimate has been performed for a particular cohort.

Outcomes
Upon execution, two outcomes are possible, either:

1. An **upward reestimate** when the subsidy cost is higher than previously estimated; or
2. A **downward reestimate** when the subsidy cost is lower than previously estimated.

If an upward reestimate is required, permanent indefinite authority from the U.S. Treasury is available to cover the upward reestimate amount. If a downward reestimate is required, the downward reestimate amount must be returned to the general fund at Treasury via the downward reestimate receipt account.

The process of executing reestimates begins in July of each year and ends in early December. Reestimates are published each January in the President's budget. For example, the FY06 budget reestimates are completed in 1st quarter of FY05.

The process involves participation from Risk Management, Project Development, Loan Management, and PPC. Each of these participants is responsible for completing their assigned tasks on time and in a manner that reflects the Office's commitment to high quality work product and meeting the Agency's and Federal government's standards.

In addition to performing specific tasks, Portfolio Management leads the reestimate process for the Office of Development Credit. In this role, Portfolio Management manages and coordinates the activities of each of the contributors to the process, liaises with the OMB credit team, and ensures that the reestimates are finalized each year in a timely fashion and in accordance with federal credit regulations.

This process must be completed by EGAT/DC for each of the following accounts, for post-credit reform cohorts only, depending upon utilization:

Israel guarantee financing account (72 X 4119)
UE guarantee financing account (72 X 4344)
DCA guarantee financing account (72 X 4266)
MSED guarantee financing account (72 X 4343)
MSED direct loan financing account (72 X 4342)

2. **Process**

The reestimate process is divided into three stages with multiple sub-tasks:

Data collection

Responsibility — Deadline

a. ***Portfolio cash flow data collection*** — ***PM Team – Sept. 6***
   i. Collect all cash flow data for all projects in each cohort
      1. Enter data in Cohort Summaries
      2. FY04 data including projections for final 3 months
      3. FY03 data (confirm accuracy of data for final 3 months)

b. ***Financial statement collection*** — ***PD Team – Aug. 2***
   i. Collect financial statement for partner banks and all borrowers
      1. Update in project files

c. ***Risk re-assessment data*** — ***RM Team – Sept. 13***
   i. Reassess risk of each project using updated financial statements and other information (e.g., project performance, ICRAS updates).
      1. Collect data in Cohort Summaries

d. ***Account balance data collection*** — ***RM Team – Sept. 13***
   i. Run account balance queries for each account as of 8/31
      1. Prepare a summary worksheet with relevant data

Reestimate Calculation

e. ***Reestimate cash flow model approval***
   i. Submit revised cash flow model to OMB if necessary[9]
      1. Approval required by September

f. ***Cash flow modeling*** — ***RM Team – Oct. 4***
   i. Model actual and projected cash flows project-by-project for interest rate and technical reestimates
   ii. Enter results into Cohort Summaries

g. ***Subsidy rate calculation*** — ***RM Team – Oct. 4***
   (Int. rate reestimate rate, technical reestimate rate, etc.)
   i. Calculate revised subsidy rates using updated cash flow actuals and projections
   ii. Enter results into Cohort Summaries and calculate rates on a cohort basis

h. ***Reestimate calculation*** — ***PM Team – Oct. 12***
   i. Enter data from Cohort Summaries into appropriate budget utility
      1. Use balances approach for all pre-FY2003 cohorts
      2. Use CCredit tool for all others

Apportionment (after OMB approval of reestimates)

[9] After the FY06 budget reestimates, Risk Management does not expect the model to change for the foreseeable future.

i. ***Submit apportionment to OMB***
j. ***If necessary, issue warrant for permanent and indefinite authority funds***
k. ***Transfer funds to financing account or to reestimate receipts account***

N. Urban Environmental (UE) and Israel credit programs tracking

1. UE/HG Program (formerly the Housing Guaranty Program)

Authority for the UE guarantee program was provided in Sections 221-223 of the Foreign Assistance Act of 1961. Title 22 U.S.C 2181-2183, as amended, established the Housing Guaranty Program to assist developing countries by promoting basic shelter and related services for low-income families. Title 22 U.S.C. authorized the issuance of 100% guarantees to eligible U.S. investors, in accordance with Standard Terms and Conditions set out in a Final Rule (see Federal Register Vol. 53, No. 170, published September 1, 1988). Since inception of this program, UE guarantees have been issued for loans from U.S. lenders totaling more than $2.8 billion supporting more than 200 projects in more than 40 developing countries. Most of these loans are sovereign loans and have terms of 30 years with a 10-year grace period on principal repayment. Electronic information on the loans is maintained by Bloomberg, a securities marketing information facility for the secondary investors market. Appropriations for this program were discontinued after FY2000.

Consistent with the Federal Credit Reform Act (FCRA), there is an annual budget exercise for three accounts: the Program and Financing Accounts for Post-credit Reform UE loans and the Liquidating Account for Pre-Credit Reform UE loans. In November/December of each year the EGAT/DC PM team collects data from FM/LM and the FM/LM contractor, prepares budgets and provides to PPC/B the budgeting information for these UE accounts. PPC/B submits the budgets to OMB. When finalized with OMB, these UE budgets are incorporated into the President's budget presented to Congress in February of each year.

At the beginning of each fiscal year, the EGAT/DC PM team gathers and provides to PPC/B the relevant information to arrange for the annual apportionments for the three UE accounts. Claims (payments by USAID) and recoveries (collections) information is obtained by the EGAT/DC PM team from the FM/LM contractor and FM/LM. The EGAT/DC PM team follows up to insure that these apportionments are processed by PPC/B and FM. The EGAT/DC PM team will duplicate this process during the year if supplemental apportionments are needed due to unforeseen circumstances.

Subsidies for the disbursed Post-Credit Reform UE loans are maintained in the UE Financing Account, which earns interest at Treasury rates. In addition, the semi-annual USAID fees attributable to these loans are paid into the Financing Account.

The FM/LM contractor performs the role of Paying and Transfer Agent (P&TA) for the UE loan portfolio. As such, the FM/LM contractor bills the UE borrowers and receives payments that are paid by the FM/LM contractor to the existing note-holders. The FM/LM contractor pays the semiannual USAID fees received from the borrowers into USAID's account at Treasury. In addition, the FM/LM contractor maintains a register/list of note-holders for the purpose of recording UE note ownership and transfers related to sales and purchase of UE loan notes on the secondary market.

The FM/LM contractor provides reports to the EGAT/DC PM team and FM/LM on the UE portfolio and individual UE loans, which enables the EGAT/DC PM team to track payment performance and

contingent liability of the portfolio. The principal reports include UE Control Logs (received two to three times per month), detailed monthly reports of pre-credit reform and post-credit reform UE loans (by country, payment status, etc.).

The standard terms and conditions of the UE program detail the claims procedure. The normal conditions provide that the Investor (note-holder) has up to 12 months after a default to submit an Application for Compensation. USAID shall make the required payment no later than 60 days after the filing Date of Application, unless USAID has cured the default. Notwithstanding the standard terms and conditions, USAID, as a matter of practice, has entered into a UE prompt payment arrangement with the FM/LM contractor, whereby USAID provides monthly advances to Riggs Bank to provide funds to make payments on time on the UE loans expected to default. The EGAT/DC PM team receives and reviews these monthly advance requests from the FM/LM contractor, obtains approval of the EGAT/DC Director, and proceeds to commit and obligate the necessary funds. The EGAT/DC PM team then coordinates the payment of the advances to the FM/LM contractor with the Office of Financial Management/Cash Management and Payments Division (FM/CMP), which notifies the EGAT/DC PM team when the payment has been processed through Treasury to the FM/LM contractor. The FM/LM contractor notifies the EGAT/DC PM team when advances are received. The FM/LM contractor provides to the EGAT/DC PM team a monthly reconciliation of the use of these advances, returning any funds to USAID which are not necessary to make payments to UE note-holders.

Annual subsidy reestimates for disbursed post-credit reform UE loans are performed by the EGAT/DC PM team (see Section IV.L.).

Close-out procedures – Upon expiry and final payment of a UE loan, the FM/LM contractor receives the note(s) from note-holder(s) for cancellation and returns them to the borrower(s). For the few remaining UE loans with unfinished underlying programs, the EGAT/DC PM team will assist Missions, if necessary, to help them close the programmatic aspects of these UE loans.

The EGAT/DC PM team maintains UE loan contract/loan amortization/correspondence working files for each UE loan. These files are used to resolve any problems with Borrowers and note-holders, and answer frequent inquiries from secondary market investors. In addition, the FM/LM contractor maintains master loan contract/amortization files.

2. **Special Israel Guarantee Programs**

Two Israel guarantee programs, which were set up by special legislation in 1991 and 2003, are managed by U.S. Department of State. The State Department reports annually to the President and Congress on the status of the programs. In addition, based on these reviews, annual authorized loan amounts are subject to Presidential reductions for activities such as building settlements in Palestinian areas. The guaranteed loan portfolios for these two special Israel programs are administered by USAID, and specifically the EGAT/DC PM team with GC.

A $10 billion loan guarantee program was established October 6, 1992 by special legislation (Title VI of Public Law 102-391, and Section 226 was added to Title III of the Foreign Assistance Act of 1961). The program was established for the purpose of resettling emigrants from the former Soviet Union and certain other countries to Israel. Eleven (11) borrowings took place between 1994 and 1998, totaling $9.2 billion after the annual Presidential deductions.

Given the size of each borrowing, the loans were structured in many pieces, including advances and zero coupon bonds. However, the basic structural guideline (on an equivalent NPV basis) was taken from the UE loan structure, i.e. 30-year term and 10-year grace period on principal repayment with interest payable semi-annually. An originally negotiated USAID fee of 4.5% payable by Government of Israel (GOI) was applied to each borrowing and paid to Treasury for USAID as a "subsidy" fee into a Financing Account.

Bank of New York (formerly U.S. Trust Co.) performs the function of Fiscal Agent, with responsibilities to bill/collect payments and provide loan and portfolio reports to USAID (the EGAT/DC PM team and FM/LM) and the FM/LM contractor (under the Agency's outsourcing contract), which in turn provides reports to USAID (the EGAT/DC PM team and FM/LM) for portfolio tracking and accounting purposes.

A separate $9 billion loan guarantee program, to provide financial assistance to Israel's ailing economy, was established in the Emergency Wartime Supplemental Appropriations Act of 2003, as amended (Title I, Public Law 108-11, April 16, 2003). This Act authorized $3 billion of borrowings each year from 2003-05, with any residual to be borrowed by no later than 2006. These annual borrowing authorizations are also subject to the annual Presidential deduction for prohibited Israeli activities. The August 18, 2003 Commitment Agreement between USAID and GOI provides that all but $450 million (30 years) is subject to a loan term of 20 years. The loans are on "bullet" terms, i.e., no principal is due until the 20-year (or 30-year) maturity. Interest is to be paid semi-annually. A subsidy (USAID "fee") payable by GOI is calculated by OMB at the time of each borrowing, and paid to the USAID account at Treasury for the Israel Financing Account. The FM/LM contractor is the Fiscal Agent for this Program, performing the same activities, including reports to USAID (the EGAT/DC PM team and FM/LM) for this loan guarantee program similar to Bank of New York for the $10 billion program.

Similar to the UE program, the EGAT/DC PM team is responsible for annual budgeting and apportionments for the Israel programs by providing budget data on the portfolios to PPC/B for the President's budget and OMB apportionments. The EGAT/DC PM team, with GC, conducts borrowing preparations (approves underwriters, reviews legal documentation, participates in pricing sessions and loan closings, and insures that the USAID fee (subsidy) has been calculated by OMB and is paid to USAID's account with Treasury (Israel Financing Account) prior to permitting the disbursement of the loans.

The FM/LM contractor tracks billing and receipt of payments, and reports portfolio data to the EGAT/DC PM team and FM/LM for accounting purposes. The EGAT/DC PM team monitors the portfolio utilizing these reports.

As in the UE case, the EGAT/DC PM team receives and processes inquiries from Investors and potential secondary market investors. In addition, prospectuses and market pricing information for each Israeli borrowing are posted on the Bloomberg secondary market facility.

Claims procedures are specified in the terms and conditions of the USAID guarantees, and further enumerated in the respective Fiscal Agency agreements. Upon notification by the Fiscal Agent no later than 2:00 p.m. on the day of a default (payment not received by 12:00 noon on payment date), payment of the claim must be paid by USAID within three days.

The EGAT/DC PM team is responsible for producing the annual subsidy reestimates for the two Israel loan guarantee programs (see Section IV.L.). The EGAT/DC PM team also maintains loan guarantee files for each borrowing, as well as correspondence and background files.

Close-out procedures. In accordance with provisions in the Fiscal Agency agreements, notes for loans that have matured and been repaid are cancelled by the Fiscal Agent and returned to the borrower. These repayments will be reflected in the reports to the EGAT/DC PM team and FM/LM submitted by the FM/LM contractor in accordance with the outsourcing contract.

V. Project Close-Out

Six months prior to the expiration of a guarantee, the EGAT/DC PM team, in coordination with the PD team Relationship Manager, will notify the guaranteed party of the facility expiration. The notification will include the date of termination and reference to termination requirements in the standard terms and conditions of the legal agreement. The EGAT/DC PM team will send a copy of this expiration notice to the Mission and to the FM/LM contractor.

A. Final Reports/Fees

The EGAT/DC/Mission will monitor the collection of final reports and fee payments, especially in regards to processing reports and follow-up on the final Notice of Payments Due (NPD) from the FM/LM contractor. The FM/LM contractor will notify the EGAT/DC/Mission after the final utilization fee payment is received.

B. Claim Payments

EGAT/DC and the Mission will process claims in accordance with Guarantee Agreement standards (see Section IV.F), which typically permit the FI to submit claims until six months after expiration of the DCA guarantee. However, loan default and the lender's demand for full repayment from the borrower must have occurred prior to the expiration of the guarantee facility. Following claim payments, the FI is legally obligated to share any recoveries with USAID. The Mission must take the initiative to remind the lenders that they are obliged to share these recoveries. (See previous section, "Post Claim Recoveries Collection – Section III.C.10).

C. Subsidy De-Obligation

To officially de-obligate the subsidy funds committed to a DCA project, the following steps should be executed:

1. After receipt of expiration notice from EGAT/DC (six months before the expiration of the guarantee), the FM/LM contractor updates the Control Log to reflect upcoming termination.
2. Mission decides if it will de-obligate any unused credit subsidy **prior to** the expiration of the guarantee and notifies EGAT/DC.

For more detailed guidance on de-obligations, see Section VI.B.

D. Project Evaluation

Following project close-out, three levels of DCA project evaluation include:

Mission-level: Development Progress
DCA activities are subject to the same evaluation requirements as grant funded activities. At the Mission level, such requirements include, but are not limited to, the Annual Report and Performance Plan.

EGAT/DC-level: Financial Soundness
The financial soundness of the DCA portfolio will be under continuous evaluation using the financial monitoring systems and annual re-estimates outlined in Project Monitoring. In addition, the CRB will review DCA portfolio financial information annually to evaluate the financial soundness of the DCA portfolio and to identify DCA activities that are developing problems that require management attention. The EGAT/DC PM team will submit a report based on this review to the CFO.

PPC-level: Effective Management of Credit Assistance
The USAID Bureau for Policy and Program Coordination (PPC) and its Center for Development Information and Evaluation are responsible for DCA portfolio-wide evaluations. PPC/CDIE will initiate an evaluation of DCA when significant utilization and potential development impact has been achieved.

VI. Project Adjustments

A. Subsidy Modifications

1. Purpose

From time to time, because of changes in programmatic circumstances, EGAT/DC is required to perform modifications to existing agreements, creating the need for new cash flows covering loans or guarantees under its various credit programs. The purpose of this section is to describe the process of doing so and to serve as a resource for information related to these actions.

A modification occurs when a federal government action changes the underlying assumptions used in the baseline estimate of cash flows and changes the estimated subsidy cost. Examples include changes in terms, such as fees and guarantee maturity. Some legal agreement changes may not warrant a subsidy modification if the inherent risk to the guarantee does not change, such as the widening the target group of borrowers. The FCRA (2 USC 661a(9)) defines modification as "any Government action that alters the estimated cost of an outstanding direct loan (or direct loan obligation) or an outstanding loan guarantee (or loan guarantee commitment) from the current estimate of cash flows."

OMB Circular A-11 Sec. 85(n) states that "modifications would not include routine administrative workouts of troubled loans or loans in imminent default." A modification in sense of DCA is meant to be a discretionary alteration of the financial terms/conditions of a guarantee, motivated by programmatic issues.

The same OMB publication also states “modifications do not include additional disbursements to borrowers that increase the amount of an outstanding loan guarantee. These are treated as new loan guarantees in the amount of the additional disbursement.”

2. **Process**

This process is managed by the EGAT/DC Portfolio Management Team. The EGAT/DC Risk Management Team is responsible for calculating the subsidy cost of the modification. In general, modification cost is the difference between, 1) the net present value of remaining cash flows *prior* to the modifying action, and 2) the net present value of remaining cash flows *after* the modifying action.

The process of executing modifications may begin at any time during the fiscal year, as required. The process is initiated by the Mission making a formal recommendation for a modification to the EGAT/DC Relationship Manager because conditions have changed. The Relationship Manager accountable for the geographic area reviews the request and if warranted, makes a request, including detailed information on the proposed modification, for Portfolio Management to execute the modification. Portfolio Management then requests that Risk Assessment calculate the subsidy cost of the modification. A modification typically takes 15-30 days to complete (not including the time needed by the mission to de-obligate funds if necessary), depending on the work flow on the Portfolio and Risk Management Teams. After the adjustment, if any, has been determined, the modification must be properly recorded and reported.

Modification cost may be positive, negative or zero. Positive indicates an additional subsidy cost and requires a transfer of funds between the program account and financing account. Negative means a saving is achieved and requires a transfer of funds from the financing account to the negative subsidy receipt account. This budget account is a general fund receipt account that is not earmarked for DCA and is available for appropriation only in the sense that all general fund receipts are available for appropriation (see OMB Circular No. A-11 for more details).

The modification process is divided into several stages with multiple sub-tasks:

- **Stage 1**: Mission requests a modification.
- **Stage 2**: At the request of Portfolio Management, Risk Management makes a determination as to the subsidy cost of the modification.
- **Stage 3**: Request CRB approval of the modification. The Action Package for a modification includes: Action Memorandum, Project Information Sheet with revised terms, Subsidy Calculation and the original Action Package for reference. In the case of a facility increase, which as stated previously is treated as a new guarantee and not a modification, the Action Package should also include a new Action Memorandum, Project Information Sheet, Subsidy Calculation and the original Action Package.
- **Stage 4**: Request apportionment from OMB, if necessary. (An apportionment is required if, 1) the current apportionment does not allow the apportioned resources for modifications and, 2) the cost of the modification is higher than the amount apportioned, less amounts already obligated. Otherwise, no apportionment is needed.)
- **Stage 5**: Receive an approved apportionment from OMB, if necessary.
- **Stage 6**. Record the obligation.

The process involves participation by the Mission, Project Development, Risk Management, Loan Management, OMB and PPC. Each of these participants is responsible completing their assigned tasks on time and in a manner that reflects the Office's commitment to high quality work product and meeting the Agency's and Federal government's standards.

There is one exception to the process outlined above – pre-FY1992 USAID loan guarantee or direct loans. These credit instruments precede the requirement to calculate a subsidy cost estimate and USAID utilized liquidating accounts to record all related cash flows to and from the Government. For a better understanding of the difference between a liquidating and a financing account, please see the Glossary of Terms. In cases of pre-FY1992 guarantees or loans, EGAT/DC must transfer the new subsidy cost estimate to the financing account. As stated previously, a proposed loan workout arrangement to avoid loan default does not require a subsidy modification for pre-FY1992 guarantees.

Example:
USAID/Bulgaria sought CRB approval of a proposed facility to increase the size of an existing FY2000 DCA to United Bulgarian Bank (UBB) from $6,250,000 to $10,000,000 and to extend the term from 7 to 10 years. Other terms and conditions remain the same. Below is how we would estimate subsidies.

(1) Treat the net $3.75 million increase of the facility as a new DCA guarantee. As such, it will require separate subsidy calculations. This new facility will also require a separate legal agreement with the DCA guaranteed party. Accounting treatment for this increase will be the same as a new facility, i.e., new facility number and new cohort.
(2) Treat the term change in the existing deal (from seven to ten years) as a modification.
(3) Construct pre-modification cash flows incorporating all actual cash flows (fees, disbursements). In other words, pre-modification cash flows are those assumed in the most recently printed budget, i.e, reestimates. The model used for the most recent budget reestimate should be used.
(4) Construct post-modification cash flows. Post-modification cash flows are the original cash flows, adjusted to reflect the extended maturity on the original amount only. Adjust for future disbursements based on best estimates (it is not necessary to follow the standard disbursement schedule). In the Bulgarian case, the same pre-modification cash flows would be used, but the terms extended to ten years. The file should be saved as post-modification.
(5) Discount both pre and post-modification cash flows using the current year's budget assumption interest rates. The difference in subsidy cost (from the two sets of cash flows) that will result from a longer maturity is the positive subsidy associated with the modification. This additional modification cost can be covered by new subsidy or de-obligated subsidy.
(6) EGAT/DC will also need to compute and record the modification adjustment transfer amount on any amounts that have already been disbursed to the financing account.
(7) For a cost increase, record an obligation in the amount of the estimated increase in subsidy cost against budget authority in the program account. Record an outlay in the amount of increase from the program account to the financing account. At the same time, record an equal amount of offsetting collections in the financing account.
(8) For a cost decrease, at the time the modification is made, record an obligation against unobligated balances for the cohort in the financing account. At the same time, record in the financing account an equal disbursement to the negative subsidy receipt account (a Treasury general fund receipt account).

3. Resources

Modifications are a complicated process. All staff involved in the process should familiarize themselves with the details of the process by reading from the following resources. In addition, EGAT/DC PM and RM staff should attend regularly scheduled OMB training sessions on reestimates.

- OMB Circular A-11, Ch. 185, especially Section 185.7 Note: (Ch. 185 now includes former A-34 Section 70)

- Federal Credit Support Page: http://www.whitehouse.gov/omb/credit
- OMB Credit Subsidy Calculator (CSC page) (on the Federal Credit Support page)
- Consolidated Credit Tool and instructions (Utilities Page of the Federal Credit Support page)

4. Modification Responsibilities

Codes: *RM – Risk Management; PM – Portfolio Management; PD – Project Development; PPC – DCA Budget Officer; FM – Financial Management; MS – Mission; OMB – OMB Approval Authority*

Stage	Task	Inputs	Responsibility
Initial	Collect information pertaining to the requested modification and request execution of a modification	Mission	PD
Initial	Establish timeline for completion	PD; PM; RM; PPC	PM
Calculation	Subsidy cost calculation	PM; PD	RM
Calculation	Approval (if necessary, PM prepares memo to CRB requesting approval of the proposed action	RM; PD	PM
Execution	Apportionment	PPC; OMB	PM
Execution	Record obligation and accounting information	PPC	PM

B. Subsidy Deobligations

When a guarantee agreement is co-signed by USAID and the guaranteed party, or a direct borrower or representative, the initial subsidy calculation will be obligated to the DCA Program Account. As the guarantee is utilized by loan(s) placed under guarantee coverage, EGAT/DC PM team and FM/LM ensure that the appropriate levels of this subsidy are transferred from the Program Account to the Financing Account (see Subsidy Outlays section of this manual).

If it is determined that either all or a portion of the subsidy funds in the Program Account will not be used ('outlaid' to the Financing Account in government accounting nomenclature), then the Mission, specifically the Obligating Official, should consider de-obligating the funds. This de-obligation would allow the Mission to use the subsidy funds for another DCA guarantee. The subsidy amount available for de-obligation is the percentage of unutilized disbursement, i.e. (Maximum Cumulative Disbursements [MCD] – Cumulative Disbursements)/MCD multiplied by the original subsidy amount. If this calculation has not changed since the last subsidy outlay, this calculation should be the same as the amount of subsidy remaining in the Program Account.

To begin the de-obligation process, a Mission must adhere to the appropriation timeframe in which the obligation can be de-obligated and reused for other purposes. The table below summarizes this timeframe since DCA transfer authority was made available in FY 1998.

DCA Transfer Authority	Timeframe for initial obligations
• FY 1998	Unlimited ("No Year" funds)
• FY 1999	Use of carryover funds from FY1998
• FY 2000	Unlimited ("No Year" funds)
• FY 2001 - 2002	Two years
• FY 2002 - 2007	Five years
• FY 2003 - 2007	Four years
• FY 2004 - 2007	Three years

The steps involved in de-obligating Program Account funds are as follows:

1. Mission Officer or Chief Technical Officer (CTO) should contact its EGAT/DC PD team Relationship Manager for guidance on this de-obligation process.
2. The RLA or GC will draft a termination or reduction of coverage letter (hereafter "termination letter") to be presented to the guaranteed party following EGAT/DC PD and PM review.
3. Following confirmation that the guaranteed party does not intend to challenge the termination or reduction outlined in this letter, the Mission Officer prepares an action memorandum for Mission Director approval to de-obligate the DCA funds with a copy of the letter to the guaranteed party acknowledging that the guarantee has been terminated or reduced. The Mission will forward a copy of the final termination letter to the EGAT/DC PM team, which will then distribute copies of the termination letter to FM/LM and its contractor for reference purposes for any outstanding collections or payments.
4. Upon Mission Director's approval, the Mission Controller submits the approved memo and the termination letter to the Bureau and de-obligates the funds in the MACs system.
5. If the Mission intends to use the de-obligated funds for a new DCA guarantee, the Mission Officer prepares a memo to the Bureau to re-obligate these funds for another CRB approved

DCA guarantee. If no other DCA guarantee is planned, the Mission Officer will de-obligate the funds, returning them to the Bureau and requesting to transfer them back to the original fund. The Bureau is required to arrange with PPC to return 100% of the DCA de-obligated funds to the Mission per the Re-obligation Policy of ADS 621 **only if** the intended use of the funds is another DCA guarantee.

6. If the Mission intends to re-use the funds for another DCA guarantee, the funds will be returned to the mission for re-obligation by the end of the next quarter (see general guidelines below). Following confirmation that the funds are available by the M/CFO, a Congressional Notification will be drafted by the Mission to the Bureau for submission to the Legislative Public Affairs. In conjunction with the CN or upon expiry of the CN (2 weeks) the subsidy amount of the new DCA project will need to be re-apportioned by OMB.
7. Please refer to Steps 6-15 of the Funds Obligation Process of this *Operations Manual* for the steps to re-obligate the funds for a DCA guarantee.

General guidelines applicable to this topic provide additional information to take into consideration during this process:

- De-obligated funds from appropriations of FY2002 and beyond will remain available for an **additional four years** from the date on which the availability of such funds would otherwise have expired. For example, a DCA guarantee is obligated with 2003-2007 appropriated funds on January 23, 2004. On September 30, 2007, the obligated funds are still available for an additional four years, i.e. until September 30, 2011. At this point, based on a general rule (31 USC 1552 (a)), a five-year period would commence which states that an obligation must be disbursed within five years after its period of availability ends. Therefore, any unused or un-disbursed subsidy in the Program Account would be canceled on September 30, 2016.
- De-obligations from pre FY2002 appropriations will remain available without a time limit until they are expended.
- Once a de-obligation is recorded (Step #4-5 from above), the USAID Office of the Chief Financial Officer (M/CFO) will provide each Bureau a report detailing all the funds that were de-obligated during the previous quarter. M/CFO will provide this report before the close of the subsequent quarter. For example, if a Mission deobligates subsidy funds by December 31, 2003, the availability of these funds will be confirmed by M/CFO by March 31, 2004. Furthermore, M/CFO will notify PPC that the apportionment of these funds has been completed and that the funds will be available by the same deadline as this report to each Bureau.
- PPC will then issue allotments to the Bureaus within five working days.
- Bureaus will subsequently issue Mission allowances within five working days.

The "**Reobligation Policy**" document of ADS 621 further describes guidelines specific to DCA subsidy de-obligations:

- Funds that are designated for DCA will be returned in full to the originating Bureau.
- At a minimum, the Bureaus will return 50 percent of these funds to the Mission. However, "to encourage Missions to take advantage of the leveraging that DCA activities offer, 100 percent of those funds designated for DCA will remain in the DCA account for the de-obligating Mission's use for other DCA projects."

VII. Acronyms

ADQ	Annual Data Questionnaire
ADS	Automated Directives System
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, (market) Sensitivity
CFO	Chief Financial Officer (within the Management “M” Bureau)
CMS	Credit Management System (https://admin.cms.usaid.org)
CN	Congressional Notification
CRB	Credit Review Board
DCA	Development Credit Authority
EGAT/DC	USAID Office of Development Credit (in the Economic Growth, Agriculture & Trade Bureau)
EVA	Economic Viability Analysis
FCRA	Federal Credit Reform Act (1990)
FI	Financial Institution
FM/CAR	Office of Financial Management / Central Accounting and Reporting Division (in the “M” Bureau)
FM/CMP	Office of Financial Management / Cash Management and Payments Division (in “M” Bureau)
FM/LM	Office of Financial Management / Loan Management Division (in “M” Bureau)
FVA	Financial Viability Analysis
FY	Fiscal Year
GC	USAID Office of General Counsel
ICRAS	Inter-Agency Country Risk Assessment System
IPAC	Intra-governmental Payment and Collection system
IRR	Internal Rate of Return
LG	Loan Guarantee
LPA	USAID Office of Legislative and Public Affairs
LPG	Loan Portfolio Guarantee
MCD	Maximum Cumulative Disbursements
MSED	Micro and Small Enterprise Development program
NPD	Notice of Payment Due (bill for utilization fee)
NPV	Net Present Value
OMB	Office of Management and Budget (White House)
PD	Project Development (EGAT/DC team)
PM	Portfolio Management (EGAT/DC team)
PPC	USAID Bureau of Policy and Program Coordination
QLS	Qualifying Loan Schedule
RLA	Regional Legal Advisor
RM	Risk Assessment (EGAT/DC team)
SO	Strategic Objective
TR	Transaction Report
UE/HG	Urban Environment credit program – also known as Housing Guaranty loans
USAID	United States Agency for International Development
WARF	Weighted Average Risk Factor

VIII. Glossary of Terms

Action Package
The Action Package is the document presented to the CRB for CFO approval of a DCA guarantee. It includes a Memorandum signed by the Mission Director and the CFO. The attachments of various analyses and documents are described in detail in Section II.C of this manual.

Balances Approach Reestimate Calculator (BARC)
The BARC is a budget utility created by OMB to calculate reestimates. The Balances approach can be used for technical reestimates only and is only appropriate for prior year cohorts on which there has already been an interest rate reestimate performed.

Basket-of-zeros discounting
FY2001 and future cohorts are discounted using the basket-of-zeros discounting method. Under this method, each cash flow is discounted using the interest rate on a zero-coupon Treasury security with the same maturity as that cash flow, regardless of the term of the loan. For example, cash flows that would occur exactly at the end of one year are discounted using the interest rate on a Treasury zero that would mature in exactly one year. Cash flows that would occur exactly at the end of five years and one month would be discounted using the interest rate on a Treasury zero that would mature in exactly five years one month. And so on. The basket-of-zeros method, therefore, defines the present value of any collection of future cash flows as the market price of a collection (or "basket") of Treasury zeros that, at maturity, exactly matches the cash flows. Basket-of- zeros cohorts earn and pay financing account interest at the single effective rate; see the description below. FY1992 through FY2000 cohorts are discounted using the similar maturity discounting method, also described below.

Basis Point
Used in the context of interest rates, a basis point is one-hundredth of a percentage point. For example, 50 basis points (bps) = 0.50%.

CAMELS Analysis
A type of credit risk analysis widely accepted by banks and financial institutions to evaluate six traditional factors considered to be most important in the operation of a financial institution – Capital adequacy (C), Asset quality (A), Management (M), Earnings (E), Liquidity (L) and Sensitivity (S).

Cash flow data
Calculated the subsidy reestimates requires collecting a variety of cash flow data related to each project and cohort, including but not limited to:

- Disbursements
- Claims
- Fee earnings
- Subsidy outlays
- Subsidy modifications
- Previous reestimates
- Recoveries
- Lost fees

These data are entered into Cohort Summaries during the first stage of the reestimates.

Cohort
A cohort is comprised of all loan guarantees of a program obligated in a particular fiscal year. A cohort should include all active guarantees or guarantees under which there were cash flows (e.g., fee payments or loan disbursements) prior to those guarantees becoming inactive. These rules apply even if the loan guarantees are disbursed in subsequent years. A Cohort includes all transactions which were obligated in a FY, and are active or disbursed some amount before becoming inactive.

Cohort Summary
Cohort summaries are cohort-specific excel-based databases of information pertaining to particular active cohorts.

Consolidated Credit Tool (CCredit Tool)
The CCredit Tool is a budget utility created by OMB to calculate reestimates. The CCredit Tool should be used for all cohorts on which there has not yet been an interest rate reestimate performed.

Claims
Claim payments represent the FI's request to execute the guarantee for a defaulted loan. Claims represent 50% of the FI's net loss as certified by either a bad debt expense or a loan loss provision for that defaulted loan.

Credit Review Board (CRB)
The CRB includes representatives from EGAT/DC, General Counsel, regional bureaus, PPC and FM/LM. The CRB recommends the subsidy cost of each proposed DCA activity for the USAID CFO's approval. The CRB also recommends policies and procedures designed to assure the financial soundness of all USAID credit activities.

Discount rates
Discount rates are the collection of interest rates that are used to calculate the present value of the cash flows that are estimated over a period of years. The discount rates are based on the Treasury rates in the economic assumptions for the budget year. For loans made, guaranteed, or modified in FY2001 and thereafter, the cash flow estimated for each year (or other time period) is discounted using the interest rate on a marketable zero-coupon Treasury security with the same maturity from the date of disbursement as that cash flow. The discount rate assumptions for the budget will be provided by OMB in a file for use with the OMB Credit Subsidy Calculator. The rate at which interest will be paid on the amounts borrowed or held as an uninvested balance by a financing account for a particular cohort is a weighted average discount rate derived from this collection of interest rates. Electronic spreadsheets are available from OMB to calculate interest income or expense for financing accounts.

Downward Reestimate
A downward reestimate occurs when the reestimated subsidy rate is lower than the original subsidy rate, or most recent reestimated rate, and indicates that the financing account has excess subsidy. In the event of a downward reestimate, USAID's financing account transfers the excess to a receipt account.

Economic assumptions
Economic assumptions include the interest rates used for discounting cash flows, the rate of inflation, and may include other assumptions as applicable to a particular program. They also include the interest rate charged to the borrower on the loan, if the rate is tied to a variable benchmark, such as the rate on specified Treasury securities.

Financing account
Financing account means a non-budgetary account (i.e., its transactions are excluded from the budget totals) that records all of the cash flows resulting from post-1991 direct loans or loan guarantees. It disburses loans, collects repayments and fees, makes claim payments, holds balances, borrows from Treasury, earns or pays interest, and receives the subsidy cost payment from the credit program account. There is at least one financing account associated with each program account. Separate financing accounts are required for direct loan cash flows and for loan guarantee cash flows if the program account receives an appropriation for the subsidy costs of both forms of credit. Financing account schedules are printed in the budget Appendix together with the program account.

Forecast assumptions
Forecast assumptions are factors that affect the expected cash flows of the loan or guarantee. They are factors which are estimated, but not actually observable, at the time of loan origination or modification. They include: default rates, timing of defaults, delinquency rates, late fees, proceeds from the sale of collateral or acquired defaulted loans, income from (and costs of managing) foreclosed collateral and acquired defaulted guaranteed loans, reschedulings, prepayments, loan asset sales proceeds and costs, and disbursement rates.

Guarantee Ceiling
The Guarantee Ceiling, which is on the Guarantee Agreement's term sheet, represents the maximum contingent liability that USAID would pay in claims to a guaranteed party. The Ceiling is equal to the Guarantee Percentage, which is typically 50%, multiplied by the Maximum Authorized Amount.

Inter-Agency Country Risk Assessment System (ICRAS)
ICRAS is a sovereign rating schedule that classifies risk levels, developed by U.S. financial regulatory institutions, the U.S. Export-Import Bank, USAID and the U.S. Department of State.

Interest on the Reestimate
The interest on the reestimate is the additional interest that would have been paid or earned by the financing account if the reestimated subsidy rate had been used as the budget execution subsidy rate.

Interest Rate Reestimate
The interest rate reestimate measures the change in the subsidy rate due to differences between interest rate assumptions (economic assumptions) at the time of budget formulation and execution and the actual interest rate(s) for the year(s) of disbursement.

Internal Rate of Return (IRR)
IRR is the interest (discount) rate at which the present value of an investment in a project is zero. When the IRR exceeds the prevailing interest rate, or the project's "cost of capital", the project is deemed to be an attractive investment.

Liability for Loan Guarantees
The liability for loan guarantees is equal to the net present value of the remaining cash flows, anticipated for a loan guarantee cohort or risk category.

Loan Disbursements
Loan disbursements are the amounts disbursed by commercial lenders to borrowers. The disbursements include the full amount disbursed, not just the federally guaranteed portion.

Maximum (Portfolio) Authorized Amount (MAA)
At any given time during a guarantee, the total amount outstanding under USAID guarantee coverage cannot exceed the MAA. While MCD is a threshold relative to disbursements, MAA is a limit relative to the outstanding balance under guarantee coverage.

Maximum Cumulative Disbursements (MCD)
The aggregate amount of disbursements, i.e. funds disbursed from a financial institution to a borrower or group of borrowers, allowed during the duration of the guarantee. In most LPGs, MCD is equal to the Maximum (Portfolio) Authorized Amount. If MCD exceeds MAA in the guarantee term sheet, this allows the lending institution to revolve funds under guarantee coverage as long as cumulative disbursements do not exceed MCD and the current outstanding balance does not exceed MAA.

Modified Use 90 percent
Modified Use 90 percent is a USAID-specific rule for calculating the disbursement-weighted average discount rate (the financing account earns or pays interest at the disbursement-weighted average discount rate). For budget purposes, a single interest rate reestimate is required for a cohort at the end of the fiscal year if a substantial cumulative amount of loan disbursements have been made for that cohort. Once made, the interest rate reestimate does not need to be performed again. When this rule is used, the rate for calculating interest costs and earnings is either the rate assumed in the budget for that cohort or the rate calculated when the loan is substantially disbursed.

Net Present Value (NPV)
The present value of all cash outflows (investments) and inflows (returns) of a project at a given interest (discount) rate. Since the streams of expenditures and receipts occur over a period of time, they are discounted to account for the time dimension, using the market interest rate or the financial cost of capital to the borrowing entity. When conducting a NPV analysis, the selection criterion is to accept activities with a NPV greater than zero.

Non-sovereign
A non-sovereign loan involves organizations such as private financial institutions, private businesses, municipalities or local authorities whose loans are not explicitly guaranteed by sovereign (state or central) governments. As such, the non-sovereign transaction does not benefit from a host government's full faith pledge of repayment, and therefore, a detailed credit risk assessment of the activity is required.

Pari Passu

The translation of the Latin term *pari passu* is "at an equal rate without preference" or "without partiality". In investment terms, it implies that two securities or obligations have equal rights to payment. With respect to DCA, it typically indicates that in a 50% guarantee scenario, we share losses in the form of claim payments to FIs (net of any recoveries received by the FI from collateral or other guarantees) on a 50/50 basis, and then in turn, FIs are required to share post-claim recoveries with USAID on a 50/50 basis.

Program account
Program account means a budget account that receives and obligates appropriations to cover the subsidy cost of a direct loan or loan guarantee and disburses the subsidy cost to the financing account. Program accounts usually receive a separate appropriation for administrative expenses.

Reestimates
Reestimates are revisions of the subsidy cost estimate of a cohort based on information about the actual performance and/or estimated changes in future cash flows of the cohort.

Recoveries
Following a claim payment from USAID to the FI, EGAT/DC sends the FI annual notices to update a Schedule of Net Recoveries, which includes a payment received from the defaulted borrower, asset liquidation or bankruptcy gains achieved (net of expenses) by the FI following the claim payment.

Similar Maturity Discounting
The FY 1992 through FY 2000 cohorts are discounted under the similar maturity discounting method. Under this discount method, the cash flows are discounted using a single interest rate (more technically called the "yield-to- maturity" rate) on a Treasury security of similar maturity to the direct or guaranteed loans in the cohort. There are five similar maturity bands, with a different discount rate set for each band: less than one year; one to five years; five to ten years; ten to twenty years; and twenty years or more. The FY 2001 and future cohorts are discounted using the "basket-of-zeros" discounting method; see the description above.

Single Effective Rate
The single effective rate is calculated for cohorts discounted using the basket-of-zeros discounting method, the FY 2001 and future cohorts. The single effective rate is the constant discount rate that produces the same subsidy rate as the full basket-of-zeros yield curve. Basket-of-zeros cohorts earn and pay financing account interest at the single effective rate.

Subsidy Cost
Loan guarantee subsidy cost means the estimated long-term cost to the Government of a loan guarantee, calculated on a net present value basis, excluding administrative costs. It is useful to think of the credit subsidy cost as a type of loan loss reserve in the case of default, or as a type of insurance premium that is paid whether or not an event occurs. More specifically, the cost of a loan guarantee is the net present value, at the time when the guaranteed loan is disbursed by the lender, of the following estimated cash flows:

- Payments by the Government to cover defaults and delinquencies, interest subsidies, and other requirements; and
- Payments to the Government, including origination and other fees, penalties, and recoveries.

These estimated cash flows include the effects of expected Government actions and the exercise by the guaranteed lender or the borrower of an option included in the loan guarantee contract.

Obligations for the subsidy cost will be recorded against budget authority in the program account when the loan guarantee commitment is made. The subsidy will be paid to the guaranteed loan financing account when the loan is disbursed by the private lender.

Technical Reestimate
The technical reestimate measures the change in the subsidy rate due to changes in technical assumptions, including actual cash flows and updated future projections. The technical reestimate captures all changes except those captured in the interest rate estimate (described above).

Tenor
Duration or term of a loan.

Upward Reestimate
An upward reestimate occurs when the reestimated subsidy rate is higher than the original subsidy rate, or most recent reestimated rate, and indicates that additional subsidy is needed by the financing account. In the event of an upward reestimate, USAID's program account receives permanent indefinite authority funds and transfers it to the financing account.

USAID Credit Model
The USAID Credit Model is used in the preparation of reestimates to model projected cash flows.

Work-outs
Work-outs mean plans that offer options short of default or foreclosure for resolving troubled loans or loans in imminent default, such as deferring or forgiving principal or interest, reducing the borrower's interest rate, extending the loan maturity, or postponing collection action. Work-outs are expected to minimize the cost to the Government of resolving troubled loans or loans in imminent default. They should only be utilized if it is likely that the borrower will be able to repay under the terms of the work-out and if the cost of the work-out is less than the cost of default or foreclosure. For post-1991 direct loans and loan guarantees, the expected effects of work-outs on cash flow are included in the original estimate of the subsidy cost. Therefore, to the extent that the effects of work-outs on cash flow are the same as originally estimated, they do not alter the subsidy cost. If the effects on cash flow are more or less than the original estimate, the differences are included in reestimates of the subsidy and are not a modification.

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