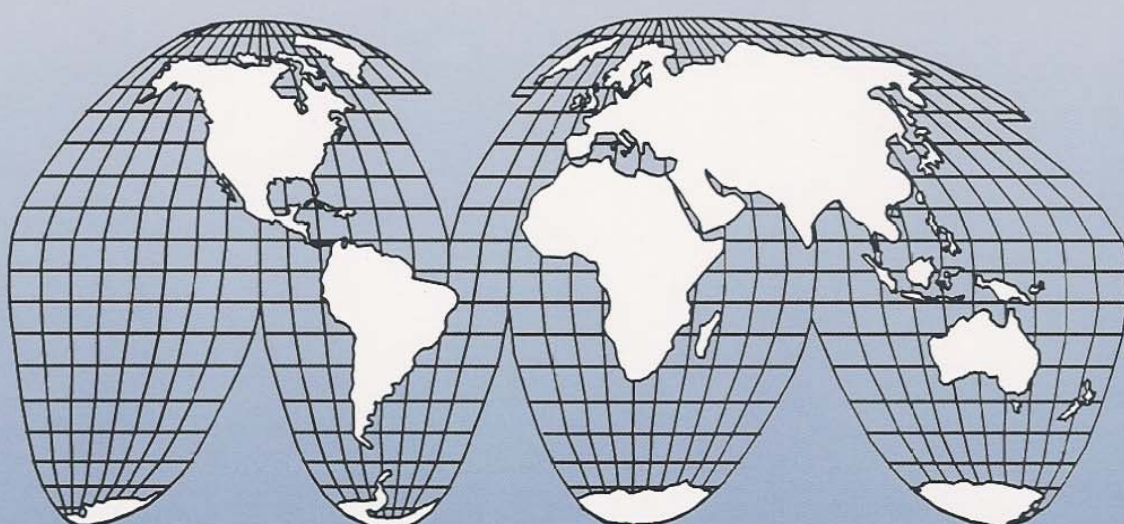
USAID

OFFICE OF INSPECTOR GENERAL

Audit of Selected Micro and Small Enterprise Development Loan Guarantees in the Philippines

Report No. 5-000-03-002-P

August 5, 2003



Manila, Philippines

August 5, 2003

MEMORANDUM

FOR: DAA/EGAT, Jonathan Conly

FROM: AIG/A, Bruce N. Crandlemire /s/

SUBJECT: Audit of Selected Micro and Small Enterprise Development Loan Guarantees in the Philippines, Report No. 5-000-03-002-P

This is our final report on the subject audit. In finalizing this report, we considered your comments to the draft report and included the comments in their entirety as Appendix II.

This report contains two recommendations. In your response to our draft report, you concurred with the recommendations and the potential savings. Therefore, we consider that management decisions have been made on both recommendations. Please coordinate final action for each of these two recommendations with USAID's Office of Management Planning and Innovation.

I appreciate the cooperation and courtesies extended to my staff during the audit.

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Summary of Results

The Regional Inspector General/Manila, audited the Micro and Small Enterprise Development loan guarantee program in the Philippines to determine whether USAID monitored the program to ensure that financial institutions adhered to the requirements of their loan guarantee agreements. The audit focused on three banks in the Philippines to which USAID had paid large amounts for claims on defaulted loans that it had guaranteed.

For the claims audited, USAID monitored the Micro and Small Enterprise Development loan guarantee program (see page 7), but the monitoring did not ensure that financial institutions had adhered to their loan guarantee agreements. The audit identified opportunities for USAID to improve its monitoring of the program (see page 8). Additionally, we recommended that USAID (1) review and recover, as appropriate, $891,813 it paid for claims on defaulted loans which violated the banks' loan guarantee agreements, and (2) implement procedures to regularly monitor banks' efforts to recover funds from borrowers who defaulted on their loans (see page 14).

USAID's Office of Development Credit concurred with both recommendations, and described actions taken and planned to implement the recommendations (see page 14).

Background

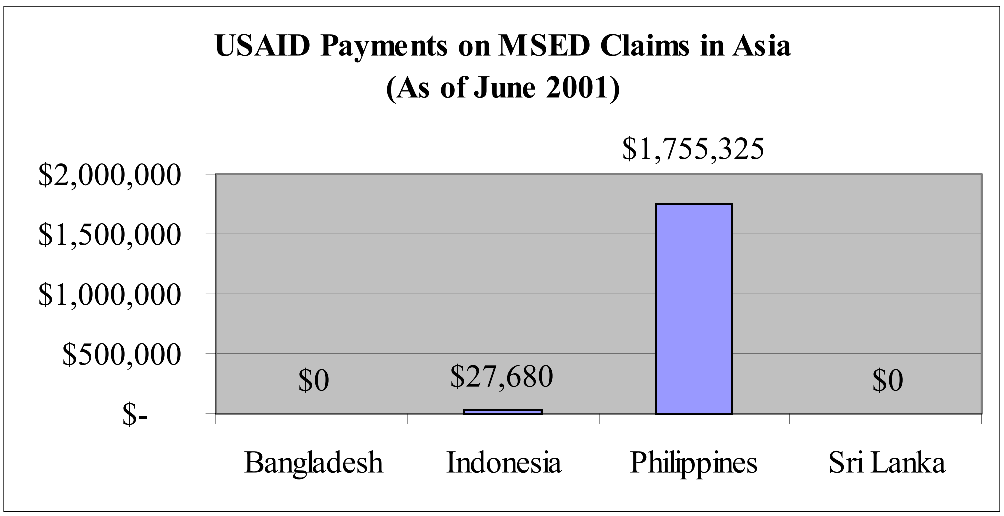
USAID has several loan guarantee programs, including the Micro and Small Enterprise Development (MSED) program, the Urban and Environmental Guarantee program, and the Development Credit Authority program. The Office of Development Credit (ODC) manages these programs, whose purpose is to finance development activities in foreign countries.

The purpose of the MSED program, which ended in the Philippines in September 2000, was to stimulate the growth of privately-owned micro and small enterprises, and/or microfinance institutions by providing credit through host country financial institutions. To encourage financial institutions to provide these loans, USAID shared the risk that the borrowers might default, hence the term, loan guarantee.

Under the MSED program, Loan Portfolio Guarantees were the primary guarantee vehicles. A financial institution participating in the MSED program enrolled qualified loans in its portfolio, and the Loan Portfolio Guarantees provided a loan guarantee of up to 50 percent of the net loss on the principal amount of enrolled loans made by financial institutions to eligible borrowers.

To participate in the MSED program, foreign financial institutions had to submit an application to ODC. Managers of the financial institutions had to sign the application, indicating that they would comply with the standard terms and conditions that are part of the application. Upon USAID's acceptance, the five-part application would become, in effect, the loan guarantee agreement. Additionally, financial institutions had to file claims with USAID to obtain reimbursement for USAID's share of the losses on defaulted loans.

According to the ODC, $32 million was the maximum amount of loans that could be enrolled in Asia under the MSED program in June 2001. This amount was distributed among four participating Asian countries. The graph below shows the distribution by country of the $1,783,005 in claims paid by USAID for its share of the losses on defaulted loans at June 2001, the most recent date for which information was provided.[1]



As the graph shows, the Philippines had by far the largest (about 97 percent) portion of claims paid by USAID on defaulted loans. In addition, a 1999 audit of claims filed by a Philippine bank participating in the MSED program disclosed numerous instances of noncompliance and many invalid claims. Because of its large percentage of claims and the problems noted in the earlier audit, we chose the Philippines to conduct this audit, as discussed in the Scope and Methodology section of this report.

Audit Objectives

As part of its fiscal year 2002 audit plan, the Regional Inspector General/Manila, audited USAID's Office of Development Credit to answer the following audit objective:

Did USAID monitor selected Micro and Small Enterprise Development loan guarantees in the Philippines to ensure that financial institutions adhered to the requirements of the loan guarantee agreements?

[1] Information was provided by USAID and is unaudited.

Appendix I contains a complete discussion of the scope and methodology for this audit.

Audit Findings

Did USAID monitor selected Micro and Small Enterprise Development loan guarantees in the Philippines to ensure that financial institutions adhered to the requirements of the loan guarantee agreements?

For the loans audited, USAID's Office of Development Credit (ODC) had monitored the Micro and Small Enterprise Development (MSED) loan guarantee program, but the monitoring did not ensure that financial institutions (banks) had adhered to the requirements of their loan guarantee agreements. The audit identified certain opportunities to improve monitoring of this program.

On the positive side, ODC had designed and implemented a monitoring system for the MSED program which included:

- Requiring banks to use standard forms for enrolling loans, reporting the status of loan portfolios, and for filing claims on defaulted loans.

- Using "issues letters" to obtain additional information when required forms were inadequately completed or submitted late.

- Contacting banks to resolve issues regarding their payments of fees to participate in the MSED program.

- Conducting field visits to banks and requiring written trip reports. ODC staff visited some participating banks in the Philippines in March 2000 and March 2002.

- Hiring a contractor to help monitor the accuracy and timeliness of information submitted by banks on their portfolios.

- Working with USAID/Philippines to provide training to participating banks on MSED program requirements.

- Hiring auditors to perform on-site reviews when banks' claims were considered excessive. Three such reviews were performed in the Philippines. The Defense Contract Audit Agency performed agreed-upon procedures at one bank in November 1999, and at another bank in August 2000. KPMG performed a review at another bank in June 2002.

However, as discussed below, ODC's monitoring system needs improvement in the areas of loan management by banks and loan default recoveries.

ODC Needs to Better Monitor Loan Management by Banks and Loan Default Recoveries

USAID's ODC is responsible for ensuring that foreign banks participating in the MSED program comply with program requirements.[2] However, none of the three banks covered by this audit complied with MSED program requirements. This noncompliance occurred because ODC did not adequately monitor the banks. As a result, USAID paid $891,813 to the banks for claims on the sample of 32 defaulted loans which did not meet program requirements. USAID has recovered about $6,242—or only 0.7 percent of the $891,813 it paid out.

As noted earlier, a bank signs an MSED loan guarantee agreement acknowledging that it will abide by the agreement's Standard Terms and Conditions. One critical requirement is that banks must maintain books and records to show compliance with the terms and conditions.[3] Testing included whether banks complied with seven loan management terms and conditions relating to: (1) borrower eligibility, (2) loan eligibility, (3) loan renewal, (4) loan enrollment, (5) proof of loan disbursement, (6) loan collection efforts, and (7) loan write-off or loss provisions. The testing of these seven attributes included ascertaining whether adequate books and records were maintained (page 9). Additionally, testing covered recoveries on defaulted loans (page 12). These tests were performed on 32 MSED program loans issued by three banks on which the borrowers had defaulted and for which USAID had paid claims.

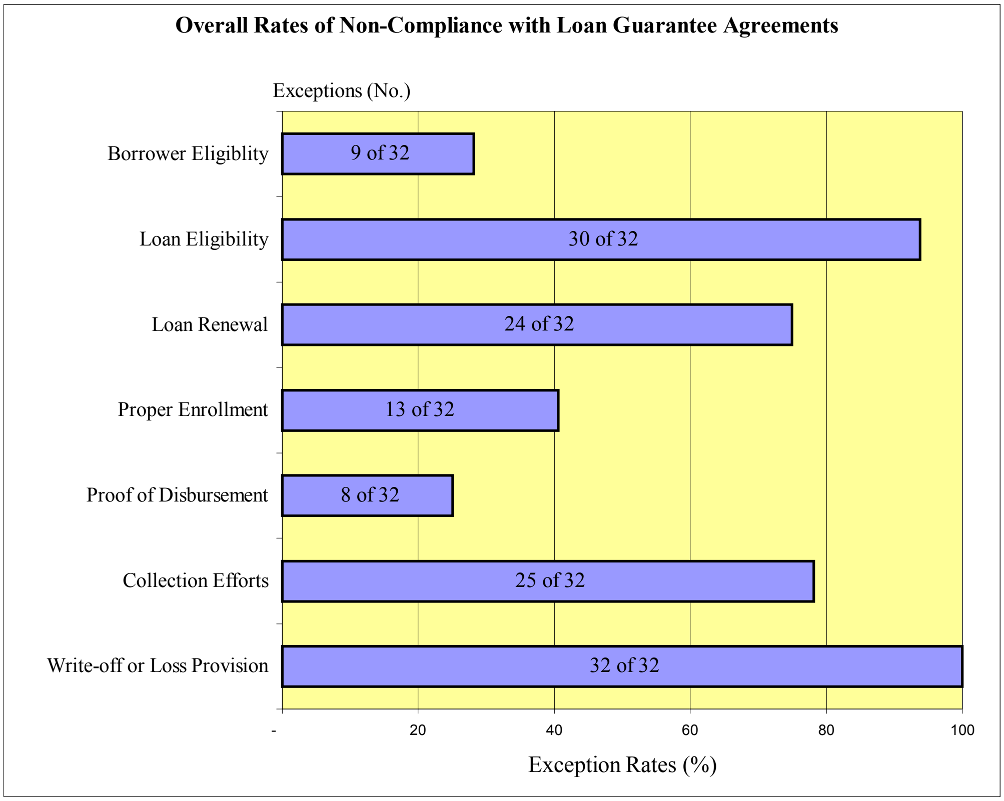
These banks, all located in Manila, Philippines, were Asiatrust Bank (see photo on next page), Far East Bank and Trust (FEB and Trust), and Far East Bank Leasing (FEB Leasing). These latter two banks were acquired by the Bank of the Philippine Islands in calendar year 2000; however, in this report we refer to them as separate banks.

[2] Office of Credit and Investment Manual, Volume 1: Credit Manual for USAID's Micro and Small Enterprise Development (MSED) Program, Section 1.6.1.1, page 22

[3] Application for Microenterprise and Small Business Loan Portfolio Guarantee, Part V (Standard Terms and Conditions), Section 7.06

Photograph shows the main office of Asiatrust Bank, which participated in the MSED program. (Manila, Philippines, November 2002)

Loan Management by the Banks – The audit identified opportunities for ODC to strengthen its monitoring over the way banks manage MSED program loans from the point they are initiated to the point they are written off as uncollectible. As the chart below shows, for each of the seven attributes tested, at least eight of the 32 MSED loans did not comply with the attribute. Noncompliance rates varied from a low of 25 percent (8 of 32 for proof of loan disbursement) to a high of 100 percent (32 of 32 for not having a loan write-off or loss provision). None of the 32 loans reviewed complied with all seven attributes. A detailed discussion of the attributes tested follows, and Appendix III summarizes the results by bank.



Borrower Eligibility – Nine of the 32 loans audited were made to borrowers who, based on the loan files, were not eligible to participate in the MSED program, which was designed to encourage loans to small enterprises. In eight of these nine cases, the borrowers had assets (excluding land and buildings) exceeding the $250,000 limit specified in Annex A of the loan guarantee agreement. In one case, the borrower was a Taiwanese citizen who did not reside in the Philippines. The Standard Terms and Conditions (Section 2.01[a][1]) require the borrower to be a citizen of the country where the MSED program is being carried out.

Loan Eligibility – In 30 of 32 cases, the banks did not provide evidence that the loans met eligibility requirements stipulated in the Standard Terms and Conditions (Sections 2.01 [b], [c] and [d]). Although the Transaction Report (the form used to enroll a loan into the guarantee portfolio) asks the purpose of the loan (followed by the parenthetical request, "please describe in full detail"), the banks generally responded with the words "working capital." Such responses did not enable the ODC to evaluate whether the loan would be used for any one of several prohibited purposes. For example, Sec 2.01[c] states that "The loan may not finance the purchase or lease of motor vehicles manufactured outside the United States." One loan was to a borrower "primarily engaged in the importing, assembling and selling of reconditioned trucks and heavy equipment from Japan." In contrast, the Transaction Report that the bank submitted to ODC described the purpose of the loan as "additional working capital." In this case, ODC did request more information on the loan's purpose. The bank's faxed response led ODC to conclude that the borrower's business was the importing and selling of U.S. manufactured heavy equipment—a conclusion which conflicted with the bank's records.

<u>Loan Renewals</u> – In 24 of 32 cases, the banks did not demonstrate that the loans were not renewals or extensions of pre-existing loans. Such renewals and extensions are prohibited by the Standard Terms and Conditions (Section 2.01[e]). In ten cases, loan approval memoranda in the banks' files actually stated that the loans <u>were</u> renewals, and in all 24 cases, borrowers' files contained evidence of previous loans. The banks did not provide payment histories for the loans, which would have substantiated whether the MSED loans were, in fact, renewals or extensions of the previous loans. In any case, banks are required to maintain books and records to show compliance with the Standard Terms and Conditions (Section 7.06 [A]).

<u>Proper Enrollment</u> – In 13 of 32 cases, the loans were not properly enrolled in the MSED program. Section 2.01[h] of the Standard Terms and Conditions requires that term loans be enrolled within ten business days of disbursement, and that credit lines be enrolled within ten business days of approval. None of the 13 loans were enrolled timely, and one loan was enrolled one year and 261 days late. USAID also specified that, for the Philippines, "… the maximum loan size may not exceed US $150,000." However, one borrower had obtained loans totaling about US $400,000.

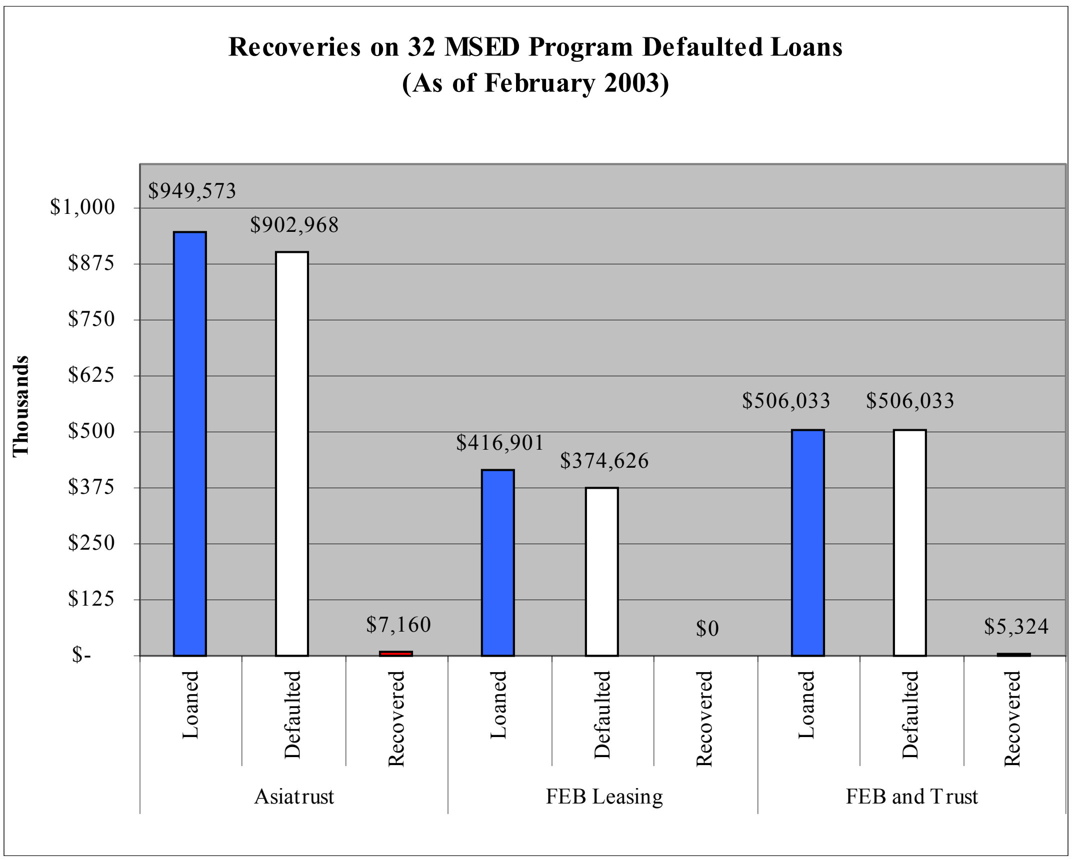
<u>Proof of Disbursement</u> – In 8 of 32 cases, the banks did not provide proof that loan proceeds were actually disbursed. Generally, legal proof of disbursement consists of a promissory note, a document with which the borrower acknowledges the debt to the bank. In other instances, banks discounted checks written by the borrower's customers, and copies of those checks served as the borrower's legal acknowledgement of the debt. Such legal proof of disbursement was lacking for the eight loans.

<u>Collection Efforts</u> – For 25 of the 32 loans audited, the banks did not provide evidence (e.g., telephone call logs, copies of collection letters, and minutes of meetings with borrowers) of diligent collection efforts. Section 5.01[B] requires that a bank pursue all reasonable and diligent collection efforts against the borrower. For 18 of the 32 loans audited, the banks did not provide documentation that they had demanded from the borrower full payment of all amounts due as required by Section 5.01[A] of the Standard Terms and Conditions.

<u>Write-off or Loss Provision</u> – The banks did not substantiate that any of the 32 loans had been written off as a bad debt expense or that in lieu of writing them off, bank management had established a specific provision for possible loan

losses. The Standard Terms and Conditions (Section 5.01[C]) require that banks take one of these two actions before filing an MSED program claim.

Loan Default Recoveries – The audit also identified opportunities for ODC to strengthen its monitoring in order to increase recoveries on MSED program defaulted loans. The Standard Terms and Conditions require banks to (1) pursue collections efforts after an MSED program claim has been filed with USAID, and (2) share any recoveries with USAID. The chart below shows that at February 2003, the total defaulted amount for the 32 loan claims tested totaled $1,783,627. By contrast, recoveries totaled only $12,484 or 0.7 percent of the total defaulted amount. Additionally, although it paid $891,813 (50 percent) of the total defaulted amount, USAID has received only $6,242 in recoveries.



The chart also depicts how virtually all the loans went into default before any significant payments were made. Specifically, of the total loaned amount of $1,872,507, only $88,880 was paid before all 32 loans were declared in default.

The rapid loan defaults, the low recovery rate and the recovery-related problems listed below are reflections of the bank management issues discussed earlier in this report. Other problems with recoveries on MSED program defaulted loans included the following:

- The banks cannot locate 12 borrowers.

- The banks cannot locate assets that four borrowers pledged as collateral.

- Ten borrowers wrote checks to the banks which were later returned because of insufficient funds or because the checks were written on closed accounts.

- In one instance a borrower's property had been confiscated and sold, but the proceeds totaling $76,562 had not been shared with USAID.

- In ten cases, the banks recovered but had not sold pledged properties with a total value of $495,048. These properties have been in the banks' possession for as long as 3 years.

In general, the exceptions relating to loan management were caused by inadequate monitoring of the banks by ODC. ODC did not adequately monitor the banks because it relied on standard forms prepared by the banks for information about the loans and claims. For example, ODC could not determine whether loans enrolled in the MSED program were renewals without reviewing payment histories of prior loans, and ODC did not obtain those payment histories. As another example, ODC could not spot fictitious loans without proof of the loans' disbursement, and ODC did not obtain such proof for some loans.

Problems related to recoveries also were caused by inadequate monitoring of the banks by ODC. For example, in one case where a bank recovered money it over-refunded USAID for its share. However, USAID accepted the refund without question. Further, management at two of the three banks stated that they had obtained mortgages on non-MSED program loans made to borrowers who had defaulted on their MSED loans. They added that they did not intend to share proceeds from foreclosures on the non-MSED loan mortgages with USAID. However, the Standard Terms and Conditions stipulate that such proceeds must be shared with USAID. ODC had no monitoring mechanism in place to detect such foreclosures, and the audit identified one such undisclosed recovery, totaling $2,734. Finally, according to ODC officials, the portion of the Credit Manual which establishes procedures for MSED program recoveries is no longer applicable. No updated procedures were available, and ODC was able to provide information on recoveries for only one of the three banks audited—and that information was dated September 1999.

The inadequate monitoring of the three banks participating in the MSED program resulted in USAID paying $891,813 in claims to the banks for 32 defaulted loans that did not comply with various aspects of the applicable loan guarantee agreements. Inadequate monitoring also contributed to the low level of recoveries on those same defaulted loans.

Because the MSED program is being discontinued, we are not making a recommendation that ODC improve its monitoring over bank management of MSED program loans. However, ODC's replacement program, the Development Credit Authority loan guarantee program, could benefit from careful consideration of the exceptions we noted. We are making a recommendation about recoveries because the banks are still obligated to pursue recoveries on defaulted MSED loans and share any recoveries with USAID. Additionally, if ODC does not have procedures to monitor recoveries in its Development Credit Authority program, the recommendation about recoveries would benefit that program as well.

Recommendation No. 1: We recommend that the Office of Development Credit review and recover, as appropriate, claims totaling $891,813 for loans which violated the loan guarantee agreements, and similarly review all other claims on defaulted loans which were not covered by this audit.

Recommendation No. 2: We recommend that the Office of Development Credit implement procedures to regularly monitor recoveries on the Micro and Small Enterprise Development program claims.

Management Comments and our Evaluation

In response to our draft audit report, the Economic Growth, Agriculture and Trade Bureau's Office of Development Credit (ODC) provided written comments that are included in their entirety as Appendix II. In its written comments, the ODC concurred with both recommendations and the potential savings, and outlined corrective actions taken and to be taken. ODC also stated that it appreciated the insights presented in the report, and that the report's recommendations prompted it to make a number of changes in how it handles portfolio monitoring and post-claim recoveries for loans made not only under the Micro and Small Enterprise Development program, but also under the Development Credit Authority program. Based on ODC's response, management decisions have been reached for both recommendations. USAID's Office of Management Planning and Innovation (M/MPI) will determine final action after ODC provides M/MPI with evidence that the recommendations have been implemented.

Scope and Methodology

Scope

The Regional Inspector General/Manila, conducted this audit in accordance with generally accepted government auditing standards. The purpose of the audit was to determine whether USAID monitored selected Micro and Small Enterprise Development loan guarantees in the Philippines to ensure that financial institutions adhered to the requirements of the loan guarantee agreements.

The audit covered the Micro and Small Enterprise Development (MSED) loan guarantee program which is managed by USAID's Bureau of Economic Growth, Agriculture and Trade, Office of Development Credit (ODC) in Washington, D.C. The audit fieldwork was conducted at ODC, USAID/Philippines, and at the following three banks headquartered in Manila, Philippines:

- Asiatrust Bank.
- Far East Bank Leasing and Finance (acquired by the Bank of the Philippine Islands in 2000).
- Far East Bank and Trust (acquired by the Bank of the Philippine Islands in 2000).

We selected the three Philippine banks because of their large MSED program claims and because a prior MSED program audit performed by the Defense Contract Audit Agency of another bank in the Philippines disclosed significant problems with the way that bank managed its MSED program loans. Based on these and other factors, we assessed overall risk for the MSED program in the Philippines as high. Consequently, we judgmentally selected the 32 largest claims at the three banks for review. These 32 claims made up over 93 percent ($891,813 out of $952,095) of the MSED claims paid by USAID to the banks during the period from September 1998 to September 2000.

We conducted fieldwork at ODC in Washington in June 2002 and continued communicating with ODC throughout the audit. Fieldwork at the three banks began in September 2002 and ended in January 2003. During the audit, we interviewed USAID/Philippines officials to determine their participation, if any, in the MSED program.

In planning and performing the audit we obtained an understanding of management controls related to the MSED program. We interviewed key ODC individuals and reviewed pertinent documentation. Our examination included 1) procedures for enrolling financial institutions and loans, 2) procedures for obtaining, reviewing, and verifying loan and claim information submitted by financial institutions, 3) site visit procedures, 4) coordination and contact procedures with USAID/Philippines and financial institutions, 5) ODC's Fiscal Year 2002 self-assessment under the Federal Managers' Financial Integrity Act of 1992, and 6) prior audit findings.

Methodology

To answer the audit objective, we reviewed applicable laws, regulations, and USAID policy and guidance. We interviewed officials and reviewed documents at ODC and at USAID/Philippines to gain an understanding of the policies and procedures used to monitor the MSED program. These discussions and documents covered such areas as program background, organizational structure, management and staff responsibilities, and records of participating banks, loans enrolled and claims paid.

At the three selected banks, we interviewed officials and reviewed relevant documentation to gain an understanding of their policies and procedures for managing MSED program loans and claims and for complying with their MSED loan guarantee agreements. To determine whether the banks actually complied with the Standard Terms and Conditions contained in their MSED loan guarantee agreements, we reviewed bank records for 32 judgmentally selected claims. The records included claim and loan files, correspondence, and reports submitted to ODC. For the seven loan management attributes tested, the audit established the following materiality thresholds. If 90 percent or more of the sample claims met all seven attributes, then the answer to the audit objective would be positive. If 70 to 90 percent of the sample claims met all seven attributes, the answer would be qualified. If less than 70 percent of the sample claims met all seven attributes, the answer would be negative. A materiality level was not set for loan default recoveries.

Management Comments

TO: AIG/A, Bruce N. Crandlemire

FROM: EGAT/DAA, Jonathan M. Conly

SUBJECT: Audit of Selected Micro and Small Enterprise Development Loan Guarantees in the Philippines

SUMMARY

EGAT's Office of Development Credit (ODC) has carefully reviewed your draft report on the subject audit and appreciates the insights presented in the report. We concur with your recommendations and they have prompted us to make a number of changes in how we handle portfolio monitoring and post-claim recoveries for loans made under both the Micro and Small Enterprise Development Program (MSED) and the Development Credit Authority (DCA). Attached is our detailed response to the report and a description of the actions we have taken or plan to take in light of the findings of the report.

DISCUSSION

A key premise for offering 50% risk-sharing guarantees under the MSED Program and DCA is that it ensures the guaranteed banks have ample incentive to screen potential borrowers and actively monitor their portfolio to minimize defaults. Largely as a result of this true risk-sharing between USAID and the guaranteed banks, the aggregate default rate under the MSED Program has been just 2% (well below an expected default rate for a pool of guaranteed loans). This low default has produced a net gain of $10,657,962 for the MSED Program – the subsidy cost set aside for each guarantee plus the fees exceeds the claims paid by $10,657,962.

Although true risk-sharing has for the most part produced excellent performance by our partner banks, the three banks that were the subject of the audit proved to be poor risk-sharing partners. The many changes in ODC portfolio management and monitoring generated by the audit will ultimately minimize the aggregate losses to USAID and improve the quality of our risk-sharing partners. We are very grateful for your constructive comments.

ATTACHMENTS:

Tab 1: Detailed response to report.
"Management Comments To MSED Audit"

MANAGEMENT COMMENTS TO MSED AUDIT

Recommendation No. 1: We recommend that the Office of Development Credit review and recover, as appropriate, claims totaling $891,813 for loans which violated the loan guarantee agreements, and similarly review all other claims on defaulted loans which were not covered by this audit.

We concur with your recommendation, including the amount of claims identified in the audit. To pursue recoveries we have sent letters to each of the three banks (in the case of Far East Bank and Trust Company and Far East Bank Leasing & Finance Corporation, we have sent letters to the bank that acquired each of them, Bank of the Philippine Islands). In the case of Asia Trust, the letter indicates that USAID refuses to consider pending claims until it receives adequate evidence of compliance with the terms of the Guarantee Agreement. Each letter reminds the bank of its liability to USAID under Section 2.02 of the Guarantee Agreement for claims that were paid for non-complying loans. The letters further underscore USAID's right to reimbursement for such claims under the terms of the Guarantee Agreement and the letters reiterate the banks' obligation to continue to pursue collection activities and reimburse USAID with its share of net recoveries.

After receiving a response from the banks, ODC will consider additional steps and, if appropriate, will discuss with counsel in the Philippines the prospects for achieving recoveries through litigation.

In addition, ODC has undertaken new measures to achieve post-claim recoveries from banks that were not the subject of the audit. ODC has recently sent letters to each bank that was paid claims under the MSED Program. The letters reminded the banks of their ongoing duty to pursue collection and reimburse USAID its share of net recoveries. As a result of such letters, ODC has already received indications from partner Financial Institutions (FIs) that they expect to reimburse USAID $32,000 from post-claim recoveries by July 2003. ODC will continue to pursue post-claim recoveries in accordance with newly implemented procedures discussed in response to Recommendation No. 2 of the audit.

Recommendation No. 2: We recommend that the Office of Development Credit implement procedures to regularly monitor recoveries on the Micro and Small Enterprise Development program claims.

We concur with your recommendation and have implemented several new procedures to monitor recoveries for both the MSED and DCA portfolios. We have taken or plan to take the following measures to improve monitoring of the portfolio and increase the post-claim recoveries to USAID: (*i) monthly portfolio review meetings, (ii) annual certifications by guaranteed banks of net recoveries, (iii) standardized provisions in legal agreements that require an annual certification of net recoveries and prohibit future claims if such certification is inaccurate, (iv) revised monitoring plans for each DCA project, (v) relationship manager calling plan whereby relationship managers are required to regularly call partner banks, (vi) trigger indicators for guarantees with substantial claims – reaching the trigger can prompt a USAID audit or inspection of the bank's records, and (vii) a new database for tracking and monitoring each loan in the portfolio*. Each of these implementation measures are described more fully in the chart below and the succeeding paragraphs.

Improvements Implemented as a Result of IG Audit

Item/ Implementation Date	***Responsible Party***			
	ODC/ Portfolio Management	***ODC/ Relationship Manager***	***General Counsel***	***Mission***
Monthly Portfolio Review Meetings **Status:** Implemented **Date:** 2/20/2003	X	X	X	
Annual Certification and Schedule of Net Recoveries **Status:** Implemented **Date:** 4/30/2003	X	X		X
Standardized Guarantee Agreement Template **Status:** Implemented **Date:** 5/01/2003			X	
Revised Monitoring Plan **Status:** Implemented **Date:** 5/15/2003	X			X
Relationship Manager Calling Plan **Status:** Implemented **Date:** 6/06/2003	X	X		
Trigger Indicators for Guarantees with Substantial Claims **Status:** To be Implemented **Date:** 08/31/03	X			
Credit Monitoring System **Status:** To be Implemented **Date:** 07/31/03	X			X

Brief Explanation of the Above Measures

- **Monthly Portfolio Review Meetings-** The purpose of these meetings is to highlight current portfolio management issues including late or delinquent reporting and fee payments, claims, recoveries, and non-compliance with DCA/MSED requirements. The overall financial performance of the combined MSED/DCA portfolio is also discussed and follow-up actions with respect to the FIs are assigned to individual ODC personnel. These meetings have enabled ODC staff to contact partner banks in a more timely manner to ensure fees are paid, post-claim recoveries are pursued and submitted claims are proper.

- **Annual Certification and Schedule of Net Recoveries-** ODC has been contacting every partner Financial Institution (FI) that has received claim payments from USAID under the MSED Program (to date no claims have been submitted under DCA) in an effort to collect recoveries. ODC will continue to contact the partner FIs once per year to obtain form them a Certification Letter and complete Schedule of Net Recoveries detailing: (i) the Amount of Net Recoveries after reasonable expenses, (ii) the date of such recoveries, (iii) the amount of such recoveries due to USAID and (iv) the expected date such recovery will be remitted to USAID. As a result of this undertaking in 2003, ODC has received indications from partner FIs that they will be remitting $32,000 in post-claim recoveries by July 2003.

- **Standardized Guarantee Agreement Template-** The legal advisors for ODC have revised the Guarantee Agreement Template that is used by USAID lawyers in preparing DCA Guarantee Agreements. The new template requires FIs which have been paid claims to submit annually a "Certificate of Post-Claim Recoveries" in which they certify to the amount, if any, of post-claim recoveries along with a brief description of their collection efforts and the associated costs incurred. The template further states that "USAID may refuse to pay any claims if the Guaranteed Party has failed to submit an accurate Certification of Post Claim-Recoveries". This change provides a powerful incentive for FIs to comply with the post-claim recoveries obligations because they risk having future claims rejected fit USAID determines that they have not adequately shared recoveries.

- **Revised Monitoring Plan-** For each DCA project, a detailed Action Package describing various aspects of the project is submitted to the Credit Review Board. The Action Package includes development analysis, economic viability, financial viability, fee justification and a monitoring plan. A revised monitoring plan will be included as part of the Action Packages that are presented to the Credit Review Board for all new DCA projects. The plan encourages closer coordination between ODC and the Mission and includes guidelines for timely and accurate reporting and fee payments, on-site visits, claims processing, and recoveries procedures.

- **Relationship Manager Calling Plans-** In order to ensure continuous contact with Missions and Partner FIs, ODC has developed regionalized calling plans to stimulate dialogue regarding guarantee utilization, reporting, fee payments, potential claims and recoveries, and economic and political changes that could affect the guarantee. ODC Relationship Managers will be required to call the Partner FIs on at least a semi-annual basis and visit them at least biennially (once every two years) or, in the alternative, they will contact Mission personnel who are in contact with Partner FIs and obtain from them any relevant information about the FIs and the guarantee.

- **Trigger Indicators for Guarantees with Substantial Claims-** ODC's Risk Assessment Team, in conjunction with its Portfolio Management Team, are developing indicators that would place guarantees with substantial claims on a "watch list". Once a guarantee is put on a "watch list", it will receive heightened monitoring and scrutiny from ODC and, if appropriate, ODC may call for an inspection of the books or an audit of the FI.

- **Credit Monitoring System (CMS)-** ODC is developing an on-line monitoring database that will encourage accurate and on-time reporting by partner FI's. The CMS will have automated features to track compliance with some DCA and MSED requirements, such as borrower and loan eligibility.

Additional Improvements

- **Bank training**- In an effort to build the capacity of DCA and MSED partner Financial Institutions, ODC will be hiring a contractor to provide training to selected FIs. ODC plans to have a bank training program in place by January 2004. The bank training improves the capacity of FIs to assess the creditworthiness of borrowers, manage a portfolio of loans and pursue collection against defaulting borrowers. The bank training also helps develop the capacity of FIs to keep adequate books and records in connection with USAID guaranteed loans – something that would have been beneficial for the 3 audited banks since they failed to keep adequate records.

- **Increased ODC Staff for Portfolio Monitoring** – From 1998 to 2000 (the years when the MSED losses in the Philippines occurred), the ODC was staffed by an average of approximately 9 people with no more than 2 people devoted to portfolio monitoring. ODC staff now has authorization to increase to 15 people with up to 4 people for portfolio monitoring.

- **Mission-Driven** – Unlike MSED, under DCA the loan guarantees are primarily identified and designed by Missions rather than AID/W, and Missions also share responsibility with ODC for the monitoring of DCA projects. The heightened role of Missions provides valuable monitoring assistance – there is no substitute for having people on the ground in the country 365 days a year. Mission staff regularly talk to the partner FIs in country.

Appendix III

Summary of Compliance with Loan Guarantee Agreements
For Three Banks in the Philippines

Asiatrust									
			Standard Terms and Conditions Tested						
Claim No.	Date Claim Paid	Claim Amount Paid By USAID	Borrower Eligibility	Loan Eligibility	Loan Renewal	Proper Enrollment	Proof of Disbursement	Collection Efforts	Write-off or Loss Provision
1	8/24/1999	$52,632	Exception	Exception	Exception	Compliant	Compliant	Exception	Exception
2	8/24/1999	$52,632	Compliant	Exception	Exception	Exception	Compliant	Exception	Exception
3	4/14/1999	$50,569	Compliant	Exception	Exception	Exception	Compliant	Exception	Exception
4	8/28/2000	$49,628	Compliant	Exception	Exception	Compliant	Compliant	Exception	Exception
5	4/14/1999	$37,927	Compliant	Exception	Exception	Exception	Compliant	Exception	Exception
6	9/28/1998	$34,839	Exception	Exception	Exception	Compliant	Exception	Exception	Exception
7	4/14/1999	$25,284	Exception	Exception	Exception	Compliant	Compliant	Exception	Exception
8	4/14/1999	$25,284	Exception	Exception	Exception	Compliant	Compliant	Exception	Exception
9	8/28/2000	$19,851	Compliant	Exception	Compliant	Compliant	Compliant	Exception	Exception
10	4/14/1999	$18,963	Compliant	Exception	Exception	Compliant	Exception	Exception	Exception
11	9/28/1998	$16,774	Exception	Exception	Exception	Compliant	Compliant	Exception	Exception
12	4/14/1999	$13,880	Compliant	Exception	Exception	Compliant	Compliant	Exception	Exception
13	9/28/1998	$12,903	Compliant	Exception	Exception	Compliant	Exception	Compliant	Exception
14	8/24/1999	$9,456	Exception	Exception	Exception	Compliant	Compliant	Exception	Exception
15	2/24/2000	$8,148	Compliant	Exception	Exception	Exception	Compliant	Exception	Exception
16	4/14/1999	$7,172	Compliant	Exception	Compliant	Compliant	Compliant	Compliant	Exception
17	8/24/1999	$6,579	Compliant	Exception	Compliant	Exception	Compliant	Exception	Exception
18	4/14/1999	$3,280	Compliant	Exception	Compliant	Compliant	Compliant	Exception	Exception
19	2/24/2000	$3,155	Compliant	Exception	Exception	Compliant	Compliant	Exception	Exception
20	4/14/1999	$2,528	Compliant	Exception	Compliant	Compliant	Exception	Exception	Exception
Exception Rates (%)			30	100	75	25	20	90	100

Exception; Compliant

Appendix III

FEB Leasing									
			Standard Terms and Conditions Tested						
Claim No.	Date Claim Paid	Claim Amount Paid By USAID	Borrower Eligibility	Loan Eligibility	Loan Renewal	Proper Enrollment	Proof of Disbursement	Collection Efforts	Write-off or Loss Provision
1	9/28/2000	$67,788							
2	9/28/2000	$49,802							
3	9/28/2000	$40,807							
4	9/28/2000	$17,126							
5	9/28/2000	$11,790							
Exception Rates (%)			40	60	40	80	20	0	100

FEB and Trust									
			Standard Terms and Conditions Tested						
Claim No.	Date Claim Paid	Claim Amount Paid By USAID	Borrower Eligibility	Loan Eligibility	Loan Renewal	Proper Enrollment	Proof of Disbursement	Collection Efforts	Write-off or Loss Provision
1	2/3/2000	$54,129							
2	8/24/1999	$51,316							
3	8/24/1999	$51,316							
4	8/24/1999	$26,316							
5	5/30/2000	$24,408							
6	12/9/1998	$23,015							
7	5/30/2000	$22,516							
Exception Rates (%)			14	100	100	57	43	100	100

Exception; Compliant