2003 Private Sector Development Policy & Operational Guidelines

CARIBBEAN DEVELOPMENT BANK

PRIVATE SECTOR DEVELOPMENT POLICY AND OPERATIONAL GUIDELINES

MAY 2003

TABLE OF CONTENTS

1. **INTRODUCTION**
Macroeconomic Overview
The Private Sector and Poverty Reduction
Conclusion

2. **CDB'S PRIVATE SECTOR DEVELOPMENT STRATEGY**
General
Private Sector Fund
Areas of Focus in the Medium Term

3. **THE PRIVATE SECTOR DEVELOPMENT POLICY**
General
Principles of Intervention
Micro, Small and Medium-Scale Enterprise Financing
Intermediary Lending
Governance
Investment Products
Procurement
Eligibility
Loan Financing
- Loan Denomination
- Loan Pricing
- Loan Security
- Privatisations
- Appraisal Fees
- Commitment Fees
- Prepayment Fees

Co-Financing Retroactive
Financing Equity
Investments Guarantees
Private Sector Fund
Business Advisory Services and Technical Assistance

4. **OPERATIONAL GUIDELINES**
Introduction
General
Information Requirements
Investment Limits
Exposure
Security
Co-Financing
Equity
- Investments
- Directorship
- Divestment

Private Sector Fund Investment Approval
Guarantees
Project Completion
Business Advisory Services and Technical Assistance

ABBREVIATIONS

BOD	-	Board of Directors
BMCs	-	Borrowing Member Countries
CDB	-	Caribbean Development Bank
DFIs	-	Development Finance Institutions
FIs	-	Financial Institutions
MFI	-	Microfinance Institutions
MSMEs	-	Micro, Small and Medium-Scale Enterprises
OCR	-	Ordinary Capital Resources
PSDS	-	Private Sector Development Strategy
PSF	-	Private Sector Fund
SFR	-	Special Funds Resources
TA	-	Technical Assistance

1. INTRODUCTION

MACROECONOMIC OVERVIEW

1.1 Since the 1990s, economies within the borrowing member countries (BMCs) of the Caribbean Development Bank (CDB) have been challenged to reposition and transform themselves as a direct response to the global integration of markets, financial sector liberalisation and reduction in trade preferences. These economies have traditionally been dependent on market protection for their goods under preferential trading arrangements. However, commitments made in the World Trade Organisation negotiations and the emergence of hemispheric trading blocs and free trade arrangements, such as the Free Trade Area of the Americas, have combined to create greater exposure of BMCs to international competition. As a consequence, BMCs will be required to undergo major political, economic and social transformation to reposition their economies to meet the challenges expected to take full effect by the second half of the decade.

1.2 Agricultural diversification for export markets needs to be pursued with urgency. The manufacturing sector will need to focus on improving its production efficiencies by focusing its efforts on retooling, improving market intelligence, consolidation and rationalisation, skills upgrading and research and development. Prospects for the expansion of trade in services can be improved through advances in information technologies and telecommunications that allow services to be more tradeable across borders. Such a strategy requires further investments in human capital and improvements in international service quality standards.

1.3 There will be a requirement for BMCs to create an enabling environment, which allows factors of production to move uninhibited across geographical boundaries. Greater emphasis will have to be placed on improving production technologies, improving human resource capacity, providing incentives to encourage innovation and ensuring that there is access to cutting edge technology. In addition, strong public/private sector partnerships will need to be developed to harness the resources of the State for the achievement of global competitiveness.

1.4 The private sector represents the part of the economy where economic activity is under the direction and control of non-governmental economic units, and where physical and financial capital are privately owned and controlled. The private sector has the dual role of producing goods and services that are capable of competing internationally but must also fill the investment financing gap through capital accumulation. A vibrant and flexible private sector is therefore critical to the long-term economic development of the Region.

THE PRIVATE SECTOR AND POVERTY REDUCTION

1.5 Development of a vibrant and active private sector is an essential component of long-term economic growth and private enterprise has a key role to play in combating poverty. Private enterprises, which include firms in all sectors of the economy, are the main source of jobs in the BMCs. Although governments may be the single largest employer in most BMCs, the MSME and informal sector represents the largest group both in terms of numbers and share of employment. These sectors play an important role in absorbing labour and generating income for poorer households. Small businesses cover a wide range of economic activities such as agriculture and agro-processing, manufacturing, retail/distribution, tourisms, construction, transportation and other services. Where economic growth occurs, and the number of small and medium enterprise increases, they act as a major source of upward mobility, pulling in people form lower-productivity occupations. It is therefore important to improve the investment climate and open up opportunities, such that these enterprises, as well as people in rural areas, benefit from the development of markets. Policies that impede their growth by increasing the cost of doing business tend to push entrepreneurs into informal sector activities and so reduce economic growth. Access to formal financial and specialised institutions that service the small and informal sectors is facilitated when the legal and governance environment are acceptable. Special attention needs to be given to the specific problems that are faced by women who often have lesser access to productive resources.

1.6 Private-sector development strategies have the potential to help provide access to basic information and social services. Affordability concerns that cannot be addressed by access to better and cheaper services can in principle be addressed by public funding schemes. A range of options is available for combining private provision with public funding to achieve the objectives of greater service delivery *via* provision and support to poor people in order to render the services affordable. The challenge will be in finding the right mix.

1.7 With increasing attention being given to the capacity of the micro, small and medium-scale enterprise (MSME) sector to generate employment, it will be necessary to devise and develop policies for financing that will foster its development in an efficient and sustainable manner. Job creation through the private sector and its direct impact on poverty reduction will assist member governments in addressing grave social problems.

1.8 It is recognised that economic growth is a necessary but not sufficient condition to reducing poverty. The MSMEs as well as start-up firms, which are crucial to long-term economic and social development are especially vulnerable. Discouraging enterprise creation would limit job creation, a major path out of poverty and upward social mobility. Therefore, all policies and proposals to be developed under the PSDS will be examined through a poverty prism to determine the extent to which the poverty reduction objectives will be achieved through any initiative financed with CDB funds. The potential impacts of the PSDS on poverty reduction viewed through CDB's poverty prism, a "lens" through which all private sector development projects will be viewed, is summarised at Table 1.1.

CONCLUSION

1.9 The challenge confronting CDB is to create, in partnership with the public and private sector, an environment that enables the private sector to achieve and sustain international competitiveness. To support this initiative, CDB will have to develop new ways of encouraging productive private enterprise in its BMCs, through strengthening of the private sector and the stimulation of private investment. CDB's policies must, *inter alia:*

(a) be focused on improving private sector operations by enhancing the availability and accessibility of finance to the private sector including MSMEs;

(b) assist in the development of effective operational practices and procedures in private sector enterprises;

(c) assist BMCs in developing appropriate legislative and regulatory frameworks and governance systems that facilitate private sector operations;

(d) foster the development of private sector organisations and capital and financial market institutions which assist private sector development; and

(e) assist BMCs in developing and implementing appropriate policies and strategies, which foster the growth, development and sustainability of the private sector.

TABLE 1.1: POTENTIAL IMPACTS OF PSDS ON POVERTY REDUCTION VIEWED THROUGH CDB'S POVERTY PRISM

Areas of Intervention	Prospective Contributors to Poverty Reduction		
	Capability Enhancement	**Vulnerability Reduction**	**Good Governance**
Business/Product Development	Capacity building for competitiveness Strengthening implementation capability	Fostering diversification Provision of loan guarantees	Improving Corporate Governance Public/private partnerships for development of strategic areas Improvement of monitoring and oversight systems
Catalysing Investment Flows	Financial Intermediation Training to improve services to enterprise groups/sectors Development of Innovative Financial Instruments	Removal of barriers to CARICOM Single Market and Economy Removal of impediments to external trade Enhancing research and representational capabilities	Improving transparency and accountability Development of financial sector
Enabling Environment	Institutional Strengthening of financial institutions (FIs) Capacity building for delivery of technical assistance (TA) by FIs	Financing Investment In Infrastructure and social services Policy dialogue between Social Partners Strengthening participation and benefits from the Regional Negotiating Machinery	Development and integration of capital markets Strengthening legal and regulatory capacity Reduction of transaction costs

2. CDB'S PRIVATE SECTOR DEVELOPMENT STRATEGY

GENERAL

2.1 CDB's strategic objective for private sector development in its BMCs is to support initiatives aimed at improvement in the global competitiveness of the Region's productive sectors on a sustainable basis. Its aim in implementing this strategy is to reposition the economies of its BMCs in the global economy. CDB's emphasis therefore will be on building enterprise and institutional capacity and increasing the flow of investment capital to business enterprises. CDB's strategy will be aimed at supporting the efforts of governments and the private sector. To these, CDB will act as a partner, a client and a resource available to them to improve the effectiveness of the sector and to assist in the reduction of poverty in the Region. CDB's activity will therefore be focused on:

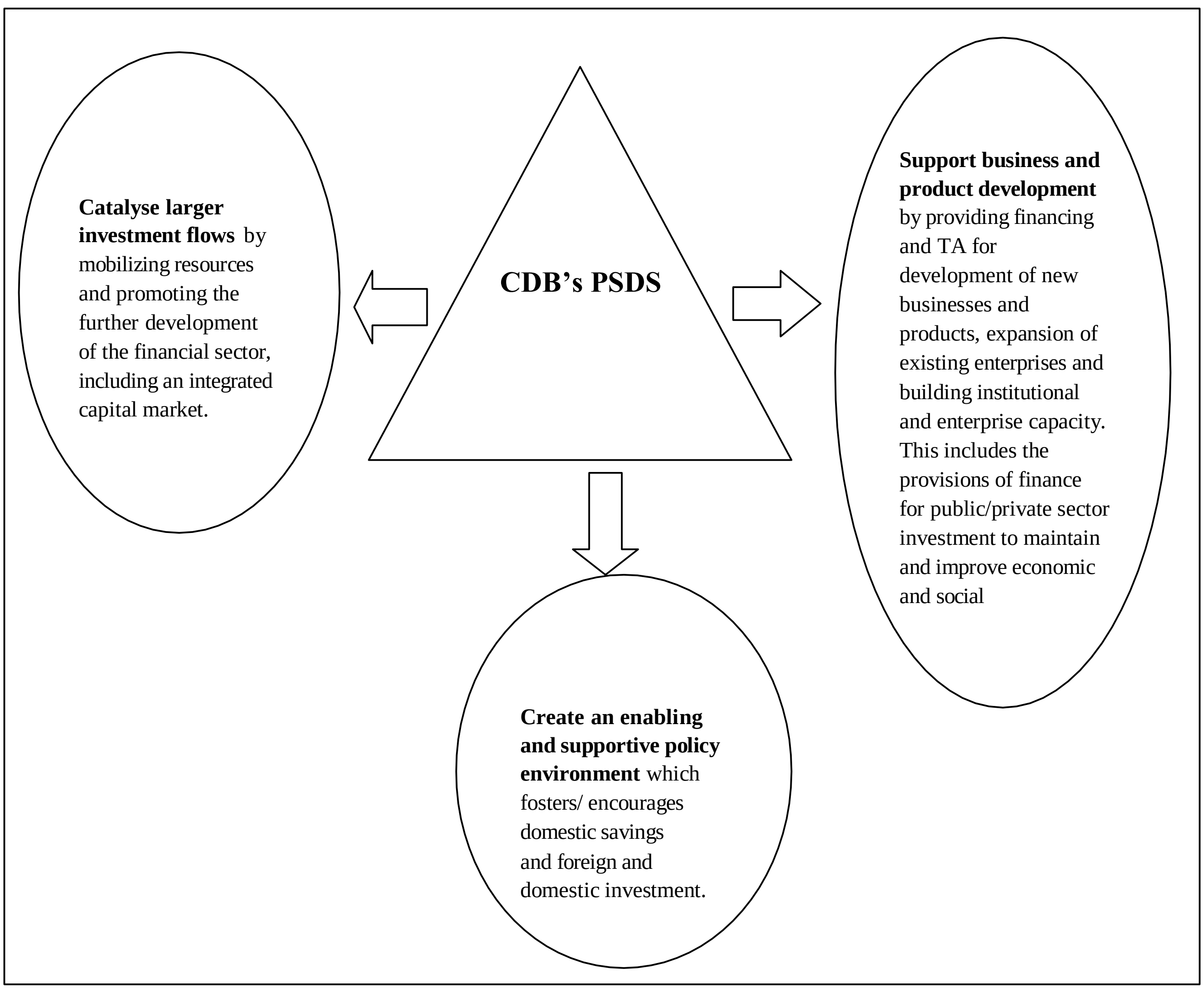
(a) business support and product development;

(b) catalysing larger investment flows; and

(c) creating an enabling and supportive policy environment;

details of which are provided in Box 1 below.

BOX 1: ELEMENTS OF CDB'S PSDS



Capital Resources (OCR) Financial Policies and are intended to provide CDB with the flexibility required to respond effectively to the private sector.

PRIVATE SECTOR FUND (PSF)

2.3 The absence of venture capital as a financing mechanism in the Region forces private sector enterprises to rely mainly on loan financing for projects and operations. This reliance results in many cases in higher than optimal loan leverage with concomitant increases in the cost of production and negatively influencing the competitive position of output. This position is even more acute in cases of new and greenfield projects where there is limited, if any, experience in the process and where reliance on loan financing can adversely affect development. In Paper BD 30/98, CDB established the PSF to assist in addressing some of the perceived weaknesses and deficiencies that are in evidence.

AREAS OF FOCUS IN THE MEDIUM TERM

2.4 CDB's strategy for the medium term recognises the development of the private sector as a critical element of CDB's plan for the development and repositioning of its BMCs in the global environment. For greatest effect in the achievement of this objective in the implementation of the strategy, CDB intends to focus on those areas of intervention that are likely to have major impact on private sector development. The following reflect these areas of strategic priority in the medium term:

(a) Development of an integrated approach to MSME development by:

(i) developing the capacity of private FIs (e.g., commercial banks) to address unmet credit needs, such as MSME lending;

(ii) supporting the development of a regulatory framework to govern the operation of micro-credit institutions;

(iii) supporting the development of mechanisms to mitigate the risks of MSME lending such as the establishment of credit information systems and debt registers;

(iv) supporting the development of alternative financial instruments such as leasing and micro-equity funds as complements to credit where relevant; and

(v) supporting the development of demand driven, commercially oriented business development services that emphasise sustainability, outreach, accessibility and impact.

(b) In financial intermediary lending, emphasising CDB's transformational role as opposed to a "client-parent" role by:

(i) supporting the commercialisation of state-owned development finance institutions (DFIs), including regional/cross-border approaches to strengthening DFIs;

(ii) supporting and building capacity in commercially oriented DFIs so that they become sustainable without continued donor funding;

(iii) where lines of credit are envisaged, ensuring that they are designed to 'raise the bar' on the performance of DFIs; and

(iv) exceptionally, using lines of credit to lend targeted funds or to reach target markets in a manner consistent with the objective of non-dependent DFIs.

(c) Improving the enabling environment and investment climate for private entrepreneurs and foreign investors by:

(i) incorporating Private Sector Development Strategies in Country Strategy Papers and seeking to implement such strategies in CDB's interventions in its BMCs;

(ii) supporting programmes designed to strengthen private sector organisations and institutions to improve their capacity to deliver services to private sector entities;

(iii) supporting initiatives designed to address issues of corporate governance, including strengthening of legislation and the supervisory and regulatory environment;

(iv) participating with member countries in the development of country-specific Investment Climate Surveys in order to inform the design of their reform programmes; and

(v) supporting country-specific reform programmes to improve the enabling environment through TA and lending.

(d) Development of Private Infrastructure: Good infrastructure can reduce costs and improve "time to market", both relevant for the Region and its competitiveness. Economic infrastructure facilities and services play a critical role in underpinning economic development. The private sector and governments are essential players in the provision of these services. Failure to provide adequate facilities and services at affordable prices will affect the quality of life and productivity in BMCs. Special consideration will therefore be given to privately-owned economic infrastructure and utilities for CDB financing, in light of their relatively low-risk profile, due to:

(i) their status as monopolies which is unlikely to change because of the small markets served;

(ii) the existence of secure contractual arrangements to purchase the power generated (off-take agreements); and

(iii) the essential service nature of these facilities and utilities.

2.5 Similarly, investments in environmental mitigation projects usually require long payback periods, partly because they have characteristics of public goods. Investments in these projects are of high development value, CDB will therefore afford these projects the same financing consideration as publicly-owned economic infrastructure facilities and utilities.

3. THE PRIVATE SECTOR DEVELOPMENT POLICY

GENERAL

3.1 CDB will contribute to the financing of private sector projects related directly to economic development in its BMCs. As a regional multilateral development bank, CDB is prepared to finance investments in BMCs where risk perceptions constrain other financial and direct investors. However, CDB will not invest in situations where overall economic conditions and the financial and legal environment are such that the investment is unlikely to succeed. Special attention will be paid to ensure that interventions by CDB promote poverty reduction, social equity and environmental protection.

3.2 In accordance with Article 15(b) of the Charter, CDB may not finance a project if the government of the territory, in which such project is located, raises an objection to it. In some cases, CDB may also require a government undertaking to provide the Borrower with priority access to foreign currency(ies) needed for servicing CDB's loan.

3.3 In making an investment decision, CDB will take into account the economic circumstances in the country concerned and the policies of the member government as they affect private enterprise development. In its evaluation of the projects it finances, CDB gives weight to their anticipated contribution to the general economic activity in the country concerned; the extent to which they would assist in overcoming obstacles to national development; their ability to reduce imports or earn foreign exchange; the introduction of new industries and techniques to raise productivity; the expansion of employment activities; compliance with environmental legislation and guidelines; and the positive contribution of the project to economic cooperation and integration in the member countries.

3.4 CDB will not provide resources to finance speculation in shares or the purchase of land or existing enterprises. In special programmes, and where specific funds have been made available for these purposes, CDB will participate in the equity market through direct purchase, financing of the purchase of equities or by the provision of support guarantees. CDB will finance initial working capital and long-term inventory investments for new enterprises or for existing enterprises to which financing is provided directly or indirectly.

3.5 CDB will permit its resources to be used for restructuring the debt obligations of an existing enterprise where this is deemed necessary for improving the viability and competitiveness of the enterprise as it seeks to expand its operations through diversification of its output, capacity enhancement and efficiency improvement. This support will not be by way of a stand-alone facility but must form part of a broader CDB-financing package.

3.6 CDB provides support directly to private enterprises through loans, investments in equity, co-financing, guarantees and TA and indirectly through lines of credit to public and private financial intermediaries. CDB's assistance may be considered for projects that provide essential services and meet national development objectives. Such projects may, *inter alia*, provide services (such as power, water, roads, ports, airport, telecommunications), assist in the development of capital markets, or assist in facilitating improvements to the environment.

3.7 CDB will support its BMCs in their efforts to create an environment that encourages private sector investment and participation in the provision of economic infrastructure, utilities and communications and to put in place the necessary arrangements to regulate this participation. CDB will provide TA resources to assist BMCs in building institutional capacity for the efficient operation of the supervisory agencies and to undertake sector reform and tariff studies.

<u>PRINCIPLES OF INTERVENTION</u>

3.8 Article 2 of the Agreement Establishing CDB (the Charter) states that in carrying out its purpose, CDB shall, as one of its functions, mobilise additional resources for the development of the Region both within and outside the Region. Additionally, CDB's mandate dictates that any intervention must be justifiable on developmental grounds. Article 15(d) of the Charter also requires that, in considering an application for financing, CDB must pay due regard to the ability of the Borrower to obtain financing elsewhere on terms and conditions that are considered reasonable for the recipient. CDB's private sector operations will be guided by the following general principles:

(a) <u>Additionality</u>: CDB's interventions must bring additionality to medium and long-term funds flowing to the private sector in the Region. This means that CDB's funds must not displace private capital, nor substitute for funds that would otherwise be available on appropriate terms and conditions. Loan maturities, grace periods and pricing are important considerations in determining additionality. The test of additionality will be the ability of CDB to mobilise new resources for private sector development. CDB's participation in private sector projects should therefore enable the leveraging of resources from other lenders. CDB's contribution may take varying forms:

(i) assuming the risk exposure to projects which, though not justified from purely risk/return consideration, merit CDB's participation in order to permit investment by the private sector to allow the socio-economic benefits of the project to be realised;

(ii) offering finance for projects (provided they are sound financially and economically as well as being environmentally and socially sustainable) that would otherwise find difficulty in obtaining financing from other sources in a timely manner;

(iii) offering longer-term maturities for loans; and

(iv) waiting longer if necessary for a return on equity and providing technical advice to ensure that projects are adequately leveraged and that appropriate systems are provided for implementation and management of projects.

(b) <u>Catalytic Role</u>: CDB will serve as a catalyst for the involvement of other FIs. Interventions will contribute to enhanced financial intermediation and capital market development wherever this is feasible. This may include co-financing with other financial intermediaries, direct mobilisation of resources through loan syndication arrangements, including a B-Loan Programme, or enhancement of loans or securities by reducing the risk of a loan or investment from commercial financiers in the form of partial credit or political risk guarantee or asset securitisation.

(c) <u>Partnerships</u>: CDB's relatively small resource base and prudential exposure limits mean that partnerships/alliances with other FIs (including other multilaterals) operating in the Region will be an important component of CDB's private sector operations.

3.9 In accordance with Article 35 of CDB's Charter, only economic considerations relevant to the purpose and functions of CDB will be brought to bear upon decisions of CDB. Projects financed by CDB must generate satisfactory economic rates of return, which are calculated by adjusting for the effects of distortions on market prices and valuing project costs and benefits at their opportunity cost to the economy. CDB's evaluation takes into account factors such as the financial viability and sustainability of the project and whether it will be implemented in an environmentally responsible manner. CDB is willing to assist applicants for loans to carry out necessary feasibility and economic studies, if it considers the project worthy of detailed investigation.

3.10 In its private sector operations, CDB may utilise the Special Funds Resources (SFR) in special circumstances. Particular attention will be given to organizations, the mandates of which focus directly on the social and economic needs of the poor through the provision of opportunities for training and self-development. CDB will direct its efforts on strengthening the capacity of these institutions to be sustainable and to efficiently deliver training and services to MSME and to improve access to finance for the creation of self and other employment.

MICRO, SMALL AND MEDIUM ENTERPRISE FINANCING

3.11 CDB's assistance to micro-enterprises will be two-fold. CDB will finance the provision of TA and advisory services to these entities and provide financial resources to acceptable micro-enterprise financial institutions for onlending to these enterprises. CDB will also assist in the development and provision of programmes aimed at improving the entrepreneurial skills of nationals of its BMCs. CDB will also seek to enhance the capacity of microfinance institutions (MFIs) to develop and deliver appropriate training and business advisory services. CDB will cooperate with supervising institutions in the development of appropriate regulatory frameworks for MFIs.

3.12 CDB will also seek to improve accessibility to financial resources by MSME sponsors directly through the provision of resources to FIs with appropriate guidelines, and indirectly through the provision of guarantees to cover financial exposures to MSMEs by commercial FIs themselves or indirectly through their lending to MFIs.

INTERMEDIARY LENDING

3.13 Financing programmes/projects with private financial intermediaries will be determined in accordance with the fundamental principles, which guide CDB's interventions in the private sector; additionality of resources; CDB's catalytic role in mobilising investment flows; partnerships with other FIs, including other multilaterals; and institutional capacity to deliver the programme/project.

3.14 CDB's lending to private financial intermediaries will normally be limited to institutions that are resident in a BMC. CDB may also consider utilising foreign FIs for delivery of programmes, where greater efficiency can be attained and where an acceptable regulator supervises the proposed institution. CDB's Financial Policies will guide the size of each intervention and exposure to individual FIs.

3.15 CDB will provide financing for privately-owned infrastructure, utilities, telecommunications and environmental projects at lending rates and with loan maturities that are appropriate to the investment. The specific characteristics of the lending, in terms of exposure limits, loan maturities and security, will be determined on a case by case basis and will be guided by CDB's OCR Financial Policies.

GOVERNANCE

3.16 Activities targeted at private sector enterprises and their supporting institutions will be focused on assisting them in meeting the challenges of globalisation, improving capacity, adherence to the regulatory frameworks and for setting and enforcing sound internal financial administration and to adhere to required environmental and social standards.

3.17 CDB will support private sector enterprises, which ensure that sound corporate governance and practices, and the issues arising therefrom are addressed and incorporated into their operating policies. In this regard, CDB will manage its interventions to ensure that the requirements for appropriate accounting and internal controls, as well as internationally accepted best practices, are maintained.

INVESTMENT PRODUCTS

3.18 CDB's private sector operations offer the following broad categories of products:

(a) long-term loans;

(b) equity and quasi-equity investment;

(c) guarantees; and

(d) TA.

3.19 The terms and conditions of CDB's investment in a particular venture will reflect CDB's Financial Policies and Guidelines that are established and approved by CDB's Board of Directors (BOD).

PROCUREMENT

3.20 Article 15(i) of the Charter requires that "in procuring services, and in facilitating financing for entities or enterprises in the private sector, the Bank shall pay due regard to the need to develop and strengthen undertaking, entities and skills of individuals belonging to the Region". Borrowers will be covenanted to respect this obligation, especially in hiring and training staff, and in choosing consultants and contractors.

3.21 In CDB's special operations, the proceeds of loans from the Special Development Fund (SDF) may be spent on goods and services having their source and origin in and procured from member countries and those other countries which have contributed substantially to the SDF and, for loans from other Other Special Funds, from those countries which are designated as eligible countries in the agreement under which the funds are made available to CDB.

3.22 CDB will permit unrestricted competitive procurement methods for all private sector projects financed directly by CDB. Borrowers will be permitted to utilise methods that guarantee that the procurement is achieved at market prices and meet the project requirements but are flexible enough to expedite the procurement, are compatible with market practices and reflect the needs and characteristics of the Borrower. In the case of expansion projects, other methods of procurement may be permitted when compatibility of equipment and the maintenance of established contacts with existing suppliers are considered important for project viability.

ELIGIBILITY

3.23 In its private sector operations, CDB will normally invest in enterprises that are owned and managed by the private sector. Public ownership will not, in itself, disqualify an enterprise from consideration for CDB investment, especially when CDB's involvement serves to foster private sector development. However, in all cases of government ownership, the enterprise must be managed in a way that responds to market signals, enjoys operational autonomy from the government, and is subject to the country's commercial and corporate legislation.

3.24 CDB may consider financing business enterprises with significant ownership participation by a member government that include but are not limited to the following:

(a) FIs that act as channels or vehicles to reach local private entrepreneurs, especially in the MSME sector. In these cases, however, CDB will give particular regard to provisions ensuring sound management, the profit orientation of these institutions and the autonomous character of their management;

(b) enterprises, including parastatals, being privatised in which governments have a policy of private sector ownership and control, but where private investors who are able and willing to participate cannot be found immediately;

(c) enterprises which are wholly owned by governments but which operate with full autonomy; and

(d) joint ventures between governments and foreign investors, located in member countries where one or both of the parties wish to have CDB's presence as a confidence-enhancing factor in the dealings with the other.

LOAN FINANCING

Loan Denomination

3.25 In its operations, CDB's currency of denomination is United States dollars. CDB will determine and specify the currencies of repayment of such loans. These will normally be the currencies that CDB is making available to the Borrower.

Loan Pricing

3.26 In lending to the private sector in CDB's ordinary operations, CDB charges a variable interest rate on amounts outstanding in respect of loans approved after April 1, 1984. The interest rate is reviewed semi-annually to take effect in respect of each such loan on the day following the first due date after June 30 and December 31 in each year for payment of interest or on such other date as CDB may specify. The interest rate for private sector projects will be determined by the calculation and accumulation of premiums added to a base rate, which rate will be determined by CDB's Financial Policies.

3.27 The calculation of the premium will include but not be limited to CDB's estimates of country risk, foreign exchange risk, credit risk and an adequate return on capital. The maturity of loans, inclusive of a grace period not exceeding five years, will be determined on the basis of the project's projected cash flow, the Borrower's ability to repay from other sources, and the terms of the source of funds used to finance the project. Amortisation schedules will be established on the results of realistic cash flow projections, and repayment schedules will be established that take into account the cash flow pattern of the Borrower.

Loan Security

3.28 CDB will require its commitment to be adequately secured. The nature and extent of the security will be determined on a case-by-case basis.

Privatisations

3.29 In recognition of the process of privatisation, CDB will give consideration to the financing of commercially operated and autonomous public sector projects and combinations of public/private sector operations with national or non-national involvement.

3.30 Governments in the BMCs have been reducing their involvement in utilities, commercial enterprises and FIs, both in terms of ownership and operation. Some, however, are still owned by governments. In cases where, at the time of divestment, existing CDB loans to the governments or government-owned entities comprise soft funds or a soft portion (SFR), the following will apply:

(a) the government or the government-owned enterprise will be required to repay the SFR loan or SFR portion of the loan prior to such divestment; or

(b) the SFR loan or portion of the loan will be replaced by a new loan, which will attract the going lending rate.

Appraisal Fees

3.31 In the case of direct loans, CDB will charge a front-end fee equivalent up to 1% on all loans made in its ordinary operations to the private sector. One half of the fee, based on the amount of the loan applied for, will be payable as a deposit prior to project appraisal and the remainder as a condition for submission to the BOD. CDB may, at its discretion, refund any portion of this fee if the loan is not recommended or approved.

Commitment Fees

3.32 CDB will levy an annual commitment fee as determined in CDB's Lending Policies.

Prepayment Fees

3.33 CDB may levy a fee for early repayment of loans disbursed in full or in part.

CO-FINANCING

3.34 CDB will co-finance only in collaboration with approved domestic and international FIs for projects that satisfy CDB's criteria. CDB may participate in or arrange loan syndications, including "A/B" Loan Programmes as considered appropriate.

RETROACTIVE FINANCING

3.35 Retroactive financing is the reimbursement by CDB, after the satisfaction of conditions precedent to first disbursement of a loan, of payments made by a Borrower prior to the approval of the loan. Retroactive financing is permitted for direct capital projects and loans to financial intermediaries.

3.36 Retroactive financing for direct capital projects will be limited to expenses incurred within 12 months of the date of approval of the loan by CDB's BOD. Retroactive financing for loans to financial intermediaries will be limited to subloans approved by the financial intermediaries for funding from CDB's resources 12 months prior to the date of approval of the loan by CDB's BOD. In all cases:

(a) the amount of retroactive financing sought and the period over which retroactive financing is sought must be justified;

(b) retroactive financing is limited to 20% of the amount of the loan; and

(c) expenditure for which retroactive financing is sought must meet all eligibility criteria under the loan agreement.

EQUITY INVESTMENTS

3.37 To the extent that the SFR is made available to CDB for investment in equity, CDB may, in its special operations, take minority equity positions in large national and regional projects in its BMCs.

3.38 In deciding on priorities for equity investments, attention will be paid to the economic and financial situation of the country, the availability locally of other sources of funds for providing equity and the capacity of the enterprise to generate foreign exchange and employment.

3.39 CDB will give consideration to participation in FIs where CDB establishes that such participation will improve the capacity of the FI to raise resources, influence the establishment of special operations targeted at the MSME sector or where such participation assists in improving the governance of the FI.

GUARANTEES

3.40 In instances where projects that have been assessed by CDB to be sound and developmental and which satisfy CDB's lending criteria experience difficulties in obtaining financing, because prospective financiers perceive risks at levels higher than they consider tolerable, CDB will assist in the mitigation of appropriate risks by providing guarantee support, on terms and conditions determined by CDB. Fees associated with the provision of guarantees will be determined by CDB on a case-by-case basis. CDB will also develop and maintain instruments that provide assistance to and satisfy the requirements of funding to the MSME sector.

PRIVATE SECTOR FUND

3.41 The PSF will be used for direct investments in equity funds and greenfield projects with a minimum investment of United States dollars (USD) 100,000 and a maximum of USD 1 million. Equity investments will not normally exceed 33.3% of the investee's total issued share capital. However, given the range of possible interventions, it may prove necessary in some cases to make smaller or larger investments than the recommended guidelines in those BMCs where venture capital financing is not available. The PSF will provide equity, quasi-equity investment - the latter being more appropriate where successful divestiture of equity investments may be limited. The PSF will also be used to facilitate the development of innovative financing vehicles which meet the objectives of the PSDS. Examples of these include:

(a) engagement of the International Finance Corporation to examine the feasibility of securitisation of hotel loans in the Region; and

(b) a "B" Loan to the Inter-American Infrastructure Finance Corporation to finance private infrastructure in CDB's BMCs.

BUSINESS ADVISORY SERVICES AND TECHNICAL ASSISTANCE

3.42 CDB may provide TA resources where, in the opinion of CDB, the benefits that may result will accrue to the benefit of the sector or industry in the BMC. CDB will not provide TA grants to an individual private sector enterprise for the sole benefit of that enterprise. In considering a request for a TA grant to support industry-wide or sector development, including research and market access, CDB will have to be satisfied that the recipient of the resources is sustainable and has the capacity to deliver servic es efficiently to the prospective beneficiaries. Operating or administrative costs will not be eligible for funding from CDB's TA resources. Adequate provision (counterpart financing) must be made in advance for replacing staff upon expiration of contract.

3.43 TA may be provided on a cost-reimbursable basis, except for specific project-related studies that will be contingently recoverable. Innovative project-related studies, the results of which can be applied nationally or regionally, may be grant financed. CDB will not provide TA to fund pre-feasibility studies for private infrastructure projects.

4. OPERATIONAL GUIDELINES

INTRODUCTION

4.1 Implementation of the Private Sector Development Policy will be effected through these guidelines. Limits and ratios presented in the guidelines are provided for guidance only and are subject to the requirements contained in CDB's Financial Policies, as are presently determined and as may be adjusted from time to time.

GENERAL

4.2 CDB will undertake a comprehensive appraisal of the enterprise or project, and must be satisfied that it is financially viable, possesses sufficient competitive advantage and has a good chance of success. In assessing an enterprise or project, CDB will verify the project concept, the technical feasibility, marketing prospects, financial and economic viability, legal structure, management expertise and the sponsor's creditworthiness. The project must have good prospects of meeting all of its financial obligations and generating adequate surpluses to sustain its long-term viability. Financial profitability is not the sole prerequisite for CDB involvement with a private sector investment. Other factors such as the contribution to economic growth and development will be taken into account.

4.3 CDB will be required to examine title deeds, engineering drawings and construction and insurance contracts and may visit sites of proposed projects to assure itself of the soundness of the assets or securities, which are offered as backing for its financial participation.

4.4 CDB will require project entities to adopt appropriate accounting systems, adhering to internationally accepted accounting principles and designed to ensure adequate financial control during project implementation and operation. An independent auditor, acceptable to CDB, must audit accounts and financial statements of the enterprise at least annually. The audited financial statements must be submitted to the Bank together with the auditor's reports to management, directors and shareholders. CDB, however, reserves the right to request special audits and/or specific information to satisfy its requirements for assessment of projects.

4.5 CDB will preserve the confidentiality of all information provided in respect of the project to be financed or the project sponsor.

4.6 In MSMEs, adequate financial data and documented information on operations and markets are generally unavailable due to the cost of preparation and the availability of the required skills. As such, CDB's requirements for appraisal will need to be more flexible and accommodating to this sector than would otherwise hold for larger projects. The appraisal process will therefore need to rely on CDB's assessment of the available data on financial performance, market analysis, the character and commitment of the entrepreneur and the basic business logic of the investment proposal. CDB will streamline the appraisal processes for MSMEs in order to improve delivery and lower the cost, without compromising the integrity of the process.

4.7 In making a direct private sector loan, CDB will give importance to the creditworthiness of the borrower and security. The total debt:equity acceptable in CDB-supported projects will vary according to the circumstances but will not exceed 70:30. The main consideration in determining the debt-carrying capacity of a Borrower will be the adequacy of projected cash flows to meet financial obligations with an acceptable margin of safety. The level of debt in the capitalisation of an enterprise must not exceed its ability to service its loans, after making adequate allowance for cash flow volatility due to normal business risks as well as other variables, such as risk of project cost overruns and implementation delays.

4.8 In its intermediary lending, CDB will be guided by its requirements of sound management, acceptable asset quality, prudent financial and operational policies and adequate capital structure. FIs will be required to adhere to prudential principles, generally accepted accounting principles and regulations established by the appropriate supervisory authority, where applicable.

4.9 In its intermediary lending, CDB may make loans from its SFR to suitable FIs for the purpose of enabling these FIs to make subloans to private sector borrowers. CDB requires these FIs to stringently apply CDB's policies in making subloans out of proceeds of CDB loans.

4.10 CDB will consider financing privately-owned infrastructure, utilities, telecommunications and environmental projects at lending rates appropriate to the investment and with loan maturities, which match the useful life of the assets to be financed, up to a maximum of 20 years. The specific characteristics of the lending, in terms of exposure limits, loan maturities and security, will be determined on a case by case basis and will be guided by CDB's OCR Financial Policies.

4.11 In providing resources to private sector enterprises directly or indirectly through FIs for the purpose of debt restructuring, CDB will limit the use of resources for that purpose to amounts which enhance the viability of the proposed expanded project, improve CDB's security cover and represent a maximum of 40% of the proposed CDB financing.

INFORMATION REQUIREMENTS

4.12 Prospective clients are required to submit full details, including but not limited to:

(a) feasibility studies and information on development incentives and other concessions from government;

(b) a brief history and financial capacity of the sponsor;

(c) market surveys and marketing arrangements;

(d) implementation arrangements;

(e) proposed structure of ownership and management of the project;

(f) operational arrangements for the project;

(g) historical financial data and expected operational and financial performance; and

(h) an analysis of the risks, including social and environmental risks and impacts, in implementing and operating the project with the accompanying mitigation measures showing which party will bear the risk and/or pay for the mitigating measures.

INVESTMENT LIMITS

4.13 CDB's investments by way of loan or equity will be determined on a case by case basis and in line with CDB's OCR Financial Policies. CDB will manage its exposure through appropriate risk analysis. CDB will normally lend in amounts that are considered adequate for the viability of the proposed project and with debt:equity and debt-service ratios that are supported by prudent exposure limits and conservative cash flow calculations. In the case of an existing enterprise, the levels set will depend on its past performance and its current capital structure, with special reference to the retention and use of earnings. CDB will also assist in developing and preparing an appropriate financing package on behalf of the Borrower by seeking co-financiers, and developing mechanisms for financing.

4.14 CDB will not normally provide direct financing in any one project and/or to any one private sector Borrower, other than an approved FI, in amounts that exceed 2.5% of CDB's ordinary capital[1/] or such other limit as may be established from time to time. However, CDB's lending to private financial intermediaries and other suitable FIs for onlending to the private sector will be guided by the requirements of CDB's OCR Financial Policies.

EXPOSURE

4.15 CDB's OCR loans approved net of repayments and cancellations plus equity investments and guarantees provided on direct private sector projects shall not normally exceed 15% of CDB's paid-up capital. This limit will be established by CDB's OCR Financial Policies, as may be determined from time to time and approved by CDB's BOD.

4.16 Loans outstanding to any one private financial intermediary will be restricted to amounts determined and established in CDB's OCR Financial Policies.

4.17 The maximum loan approved in a single private financial intermediary operation or any one private FI will be as set and determined in CDB's OCR Financial Policies.

4.18 OCR loans approved to private financial intermediaries (net of repayments and cancellations) that are not secured by a specific charge on assets shall not exceed limits set in CDB's Financial Policies.

4.19 The lower risk associated with a loan made for privately-owned infrastructure facilities or to privately-owned utilities mitigates CDB's normal exposure limits for private sector projects. Given the capital requirements of private infrastructure, the existing exposure limits would significantly constrain CDB's ability to totally finance these types of projects in most of the BMCs. Therefore, for private economic infrastructure projects, the lending limit for a single project will be determined on a case-by-case basis and will be governed by CDB's Financial Policies.

SECURITY

4.20 Security for loans will normally take the form of a first mortgage on land, but other forms of security without prior claim may be accepted in appropriate cases. CDB may require escrow accounts or guarantees under which third parties would assume responsibility for defaults of the investee company towards CDB and other creditors. Such arrangements would normally cover the construction period through to project completion,

---

[1/] Defined as CDB's paid-up capital, ordinary reserves and unallocated net income plus provisions, less receivables from CDB's member countries.

and may extend longer to cover all or some of CDB's loan exposure term. Project sponsors or corporate parents of project companies may issue guarantees and other forms of security to CDB.

4.21 CDB will be required to examine title deeds, engineering drawings and construction and insurance contracts and may visit sites of proposed projects to assure itself of the soundness of the assets or securities which are offered as security for its financial participation.

CO-FINANCING

4.22 In the "A/B" Loan Programme, CDB will hold a portion of the loan for its own account (the A Loan) and sell participation in the balance (the B Loan) to other established FIs. CDB will be the lender of record for the entire loan (i.e., the A Loan and the B Loan) and would act for itself and the participants in all dealings with the borrower. CDB will perform appropriate due diligence on the project and/or project sponsor to ensure its eligibility criteria are satisfied. Co-financiers participating in the B Loan Programme may benefit from CDB's preferred creditor status and therefore minimise their sovereign risk. However, the risk associated with the B Loan will be passed through to the participants who will have no recourse to CDB for debt servicing.

4.23 Governments in the BMCs have been reducing their involvement in commercial enterprises and FIs, both in terms of ownership and operation. Some, however, are still owned by governments. In cases where, at the time of divestment, existing CDB loans to the governments or government-owned entities comprise soft funds or a soft portion (SFR), the following will apply:

(a) the government or the government-owned enterprise will be required to repay the SFR loan or SFR portion of the loan prior to such divestment; or

(b) the SFR loan or portion of the loan will be replaced by a new loan, which will attract the going lending rate.

EQUITY

Investments

4.24 CDB may make loans to financial intermediaries for the purchase of equity (including preference shares) or convertible debentures and may consider investing in finance corporations whose major function is the purchase of equities. The BOD must specifically approve the terms of such loans or investments in each case.

4.25 CDB may make equity and quasi-equity investments in projects, consistent with its developmental objectives. Special attention will be given to investment opportunities in the BMCs where there is a shortage of risk capital. CDB will require a return on its investment. However, the required rate of return will be determined on a case-by-case basis during appraisal.

4.26 CDB will not be the majority shareholder of an enterprise in which it invests and will normally limit its equity investment to not more than 33.3% of the invested company's total issued share capital. CDB will not normally provide more than 40% of the project's total financial requirements. With the exception of capital market investments, which will promote the development of the domestic and regional capital markets and a high degree of institution building, CDB will agree to act together with co-investors as a "founder" or "sponsor" of a project, provided that it is not the majority shareholder. CDB will require the establishment of appropriate shareholder agreements to insulate CDB against the risk of becoming the majority shareholder.

Directorship

4.27 CDB may nominate a person to the BOD of an investee company. In making appointments to the BOD of the investee company, competent persons from outside CDB may be selected.

Divestment

4.28 CDB will generally seek to sell an equity investment when two conditions are met:

(a) CDB's role in the company is fulfilled; and

(b) the selling price is commensurate with the investment's intrinsic value and the company's prospects.

4.29 In general, CDB will not seek to sell an equity investment before the investment's original purpose has been substantially fulfilled, unless CDB determines that the original objectives are no longer likely to be achieved. In addition, CDB would prefer to sell its shares to nationals of the member country to broaden local ownership and foster development of the capital markets. Should this not be possible, investments will be sold to nationals of Commonwealth Caribbean member states (including companies controlled by such nationals) or to the Governments of those States. To facilitate divestment, the Bank may require eventual listing of the investee company on the stock exchange or may enter into a suitable buy-back agreement with the project sponsors. When disposing of its shares, CDB would, as far as practicable, consult with major investment partners and give due consideration to their views.

4.30 Since equity investments become fungible with respect to the total net worth of an enterprise, normal procurement and disbursement procedures may not be applied formally, but appropriate measures will be taken to ensure economy and efficiency in the use of the funds by the enterprises concerned.

PRIVATE SECTOR FUND INVESTMENT APPROVAL

4.31 In its interventions with the private sector, CDB will be required to expedite decision making, particularly in respect of equity funding and in order to leverage the capacity of the project to obtain financing from other sources. To facilitate this, it is proposed that, following assessment of the investment proposal by CDB and satisfaction with its viability, the President approve the investment in amounts as may be approved by the BOD from time to time. The general principles that underline equity investments will apply.

4.32 PSF activity will be reported to the BOD for each project entering the project cycle with subsequent updates through project approval. The financial information relating to the PSF will be clearly identified and separated from the regular activities of CDB's portfolio.

GUARANTEES

4.33 Guarantees provided by CDB will be in the form and structure determined by CDB and must be in keeping with the objectives of the project as determined during assessment by CDB. CDB will charge an appropriate fee to reflect the level of risk exposure. This will be determined and advised to the client at the time of appraisal of the project.

4.34 Under the Microfinance Guarantee Programme, CDB may provide a guarantee for a line of credit from a commercial lender to a specialised MFI or a loan portfolio of micro and small projects from a FI. This programme will provide 80% coverage to a commercial lender to secure advances, with term duration of three to five years, to an accredited specialised MFI. CDB will charge a guarantee fee of 1.5% of the amount guarantee. The maximum exposure to any single MFI and to a single country will be 20% and 40%, respectively, of the assets in the fund. CDB will perform appropriate due diligence on the operations of the MFI to satisfy eligibility criteria prior to providing the guarantee and will monitor its operation during the life of the guarantee.

PROJECT COMPLETION

4.35 CDB will normally require that the sponsor or other backers of the project agree to provide additional funding, that is outside of the original financial plan, if such funding is necessary to replace shortfalls in financing or to cover an increase in the project's cost above initial projections. Such undertakings are intended to ensure physical completion of a project as well as the availability of sufficient initial working capital.

BUSINESS ADVISORY SERVICES AND TECHNICAL ASSISTANCE

4.36 To be eligible for TA financing, all advisory services and institutional development programmes will require an adequate programme description, approved in advance, setting out the rationale for the programme and the deficiencies to be resolved, the advisory and training services required, a comprehensive scope of work, estimated duration and costs.

4.37 Training will be funded on the basis of an adequate programme description approved in advance.

4.38 As a condition of the provision of TA, all recipients of advisory services shall agree to provide a minimum of 15% of the total TA costs, including adequate counterpart personnel and office space.

4.39 Eligible expenses for business advisory services include, but are not limited to expert salaries and benefits, transportation, per diem and travel, including dependent travel and transportation for long-term personnel. Additionally, a limited amount of commodity support necessary to ensure effective utilisation of TA may be included but shall not exceed 25% of the cost of the assistance.

4.40 Eligible expenses for training include, but are not limited to consultant and lecturer salaries, fees and benefits, travel and per diem, seminar, administrative expenses, materials, books, food and lodging, medical and equipment insurance.

4.41 CDB will use the TA resources to conduct such project studies that it reasonably expects could lead to or serve as a basis for future CDB financing. Resources may be used for promotional studies, i.e., studies for which there are no beneficiaries yet identified.

4.42 Except for innovative project-related studies, the results of which can be applied nationally or regionally, which may be grant financed, specific studies shall be undertaken only on a contingent recovery basis or a reimbursable basis. If a loan is made as a result of a study, the amount spent on the study will be repayable out of the first proceeds of the loan.

4.43 All general studies will be undertaken on a non-reimbursable basis, but not more than 20% of the project preparation resources will be utilised for such studies.

4.44 The following types of studies will be eligible for financing:

(a) general studies and assessments of economic sectors and geographic areas needed to establish the basis for or identify investment opportunities or specific projects;

(b) sector reform and regulatory reform studies;

(c) prefeasibility, except for private infrastructure projects, and feasibility studies of projects including pilot projects;

(d) preliminary and final engineering design studies, including specification, construction plans and cost estimates;

(e) institutional studies;

(f) surveys and assessments of the needs of potential project beneficiaries;

(g) assistance to Borrowers for loan application completion or in providing additional information required by CDB for project appraisal;

(h) post-implementation evaluation; and

(i) impact assessment studies.