Guidelines to design a sustainable Credit Guarantee Fund in Belarus

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Structure

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1. Introduction

- Credit guarantee scheme (CGS) can encourage bank lending to viable businesses which cannot meet standard requirements due to lack of collateral and/or a proven track record. It can play a catalysing role in emerging economies where the SME financing gap is particularly wide.
- There is currently no working CGS in Belarus. However, according to the Resolution of the Council of Ministers "About the complex of measures to implement the Programme of social and economic development of Belarus for 2016-2020 years" #18 dated on 12th January 2017 establishment of a specialized guarantee fund is envisaged to improve the access of SMEs to credit resources by 2018. This task is put on Ministry of Economy, Ministry of Finance, National Bank, Development Bank of the Republic of Belarus and other bodies.
- This presentation:
  - Describes main principles for public CGSs
  - Explains structure of a typical CGS
  - Provides detailed recommendations on a design of CGS in Belarus
  - Analyses a relevant case study of Agricultural Credit Guarantee Fund in Lithuania

2. Starting a credit guarantee scheme

- World Bank established 16 main principles for Public Credit Guarantee Schemes for SMEs (2015)*
- They cover the following areas:
  - Legal and regulatory framework
  - Corporate governance and risk management
  - Operational framework
  - Monitoring and evaluation
- Key challenges while establishing a CGS also include:
  - Ensure efficient and sustainable structure
  - Meet CGS's objectives (including additionality and leveraging)
  - Provide efficient guarantee assignment process
  - Avoid duplication of several schemes
  - Prevent fraud and corruption

** Source:* http://documents.worldbank.org/curated/en/576961468197998372/Principles-for-public-credit-guarantee-schemes-for-SMEs

2. Starting a credit guarantee scheme (cont.)

Structure of a typical CGS includes defining of:

1. Mission - a core purpose and long term focus that normally remains unchanged over time
2. Operational characteristics, including:
   - types of services
   - specific objectives (including state policy measures)
   - borrower eligibility
   - maximum amount (preferably avoiding large exposures)
   - maximum tenor
   - pricing of guarantee
   - coverage
   - guarantee assignment process
   - risk management
3. Funding – sources and amount of capital
4. Governance – how the scheme is set up and governed
5. Monitoring and evaluation - issued guarantees should achieve their policy goals. For this purpose a set of clear performance criteria should be established.

3. Recommendations for Belarus

Mission

- Define a core purpose and long term focus that normally remain unchanged over time

Example:

The fund’s main objectives are:

- to help SMEs which do not have sufficient collateral and financial resources to develop by providing favorable borrowing conditions
- to support viable business projects
- to encourage lending
- to ensure that state priorities are implemented
- the fund’s activities are profitable

3. Recommendations for Belarus (cont.)

Operational Characteristics

- Identify detailed structure of guarantees to be issued

Example:

Types of services, specific objectives	credit guarantees for prioritized projects (as per defined eligibility criteria)
Borrower eligibility	SMEs and private entrepreneurs with headcount <250 (as per defined eligibility criteria)
Maximum loan amount	EUR 1 m
Maximum tenor	5 years
Pricing of guarantee	ideally risk-dependent pricing; international benchmark is 0.8 - 2.3% p.a. of guaranteed volume
Coverage	50% of a loan
Guarantee assignment process, risk management	Indirect scheme: through partner banks, which are also recipients of SME funding from IFIs or other sources (as per defined eligibility criteria)
Other	Both local and foreign currency loans can be covered as per NBB rules

3. Recommendations for Belarus (cont.)

Benefits of Indirect Scheme and Functions of Parties

Mutual benefits are:

- Requires less capital
- Increases access to eligible borrowers and projects
- Risk sharing
- Cost saving

Functions	Partner banks	Credit guarantee fund
Promotion of the scheme among SMEs	X	X
Search of eligible borrowers and projects	X	
Search of eligible partner banks		X
Loan risk assessment	X	
Review of guarantee applications		X
Guarantee assignment process	X	X
Monitoring and evaluation	X	X
Recovery	X	X

3. Recommendations for Belarus (cont.)

Guarantee Issuing Procedure

1. Credit guarantee fund (CGF) and selected partner banks sign a guarantee agreement, defining SME and project eligibility and other conditions.
2. Eligible economic entity applies to a partner bank asking for loan and negotiates the terms.
3. A partner bank applies to CGF asking for a guarantee. CGF reviews the application.
4. CGF makes a decision concerning guarantee issuing. Credit beneficiary signs credit and guarantee agreements and pays guarantee fee.
5. CGF issues credit guarantee to partner bank which grants loan to borrower.
6. CGF conducts regular monitoring and evaluation.
7. In case of normal loan repayment amount guarantee decreased and expires.
8. In case of the borrower’s default CGF conducts review of files to ensure that all conditions were fulfilled to exclude any potential fraud.
9. CGF pays out guaranteed amount 30 days after presentation of claim when loan is 90 days past due and with confirmation that the partner bank has initiated legal proceedings.
10. Partner bank will share any recovery with CGF on *pari-passu* basis.

3. Recommendations for Belarus (cont.)

Funding

- Determine sources and amount of funding

Example:

- Funding can be arranged jointly by the government of Belarus and international/bilateral financial institutions such as KfW, EBRD, etc. and/or commercial banks.
- Equity can be invested in (liquid) assets for additional returns
- All earned profits should be reinvested
- As long as old loans are repaid, guarantees are reduced and CGF can issue guarantees for new loans on a roll-over basis
- Capital of the fund of 5 m EUR could generate appx. 25 m EUR of guarantees and 50 m EUR of loans (please see details at next slide)
- Annual revenue of the fund will be 0.5 m EUR (at 2% of 25 m EUR of guarantees)

Sample Financial Model of the Fund (end of Year 1)

Maximum *amount*:		Max loan amount		1 000 000 €
		Covered by guarantee		50%
		Max guarantee amount		500 000 €
Total portfolio:		Total loan portfolio		**50 000 000 €**
		Total issued guarantees		25 000 000 €
Classification of loans/guarantees:	Level of loss provision	Loan portfolio structure	Total guarantee amount for each class	Loss provision
standard	2%	40%	10 000 000 €	200 000 €
under control	5%	25%	6 250 000 €	312 500 €
substandard	20%	15%	3 750 000 €	750 000 €
doubtful	50%	10%	2 500 000 €	1 250 000 €
loss	100%	10%	2 500 000 €	2 500 000 €
Total:		100%	25 000 000 €	
Equity needed:				**5 012 500 €**
Leverage (total loan portfolio to equity needed):				10.0
Leverage (total issued guarantees to equity needed):				5.0

Source: Own calculation

3. Recommendations for Belarus (cont.)

Governance

- Develop how the scheme is set up and governed
- General guidelines are set in G20/OECD Principles of Corporate Governance (September 2015)*

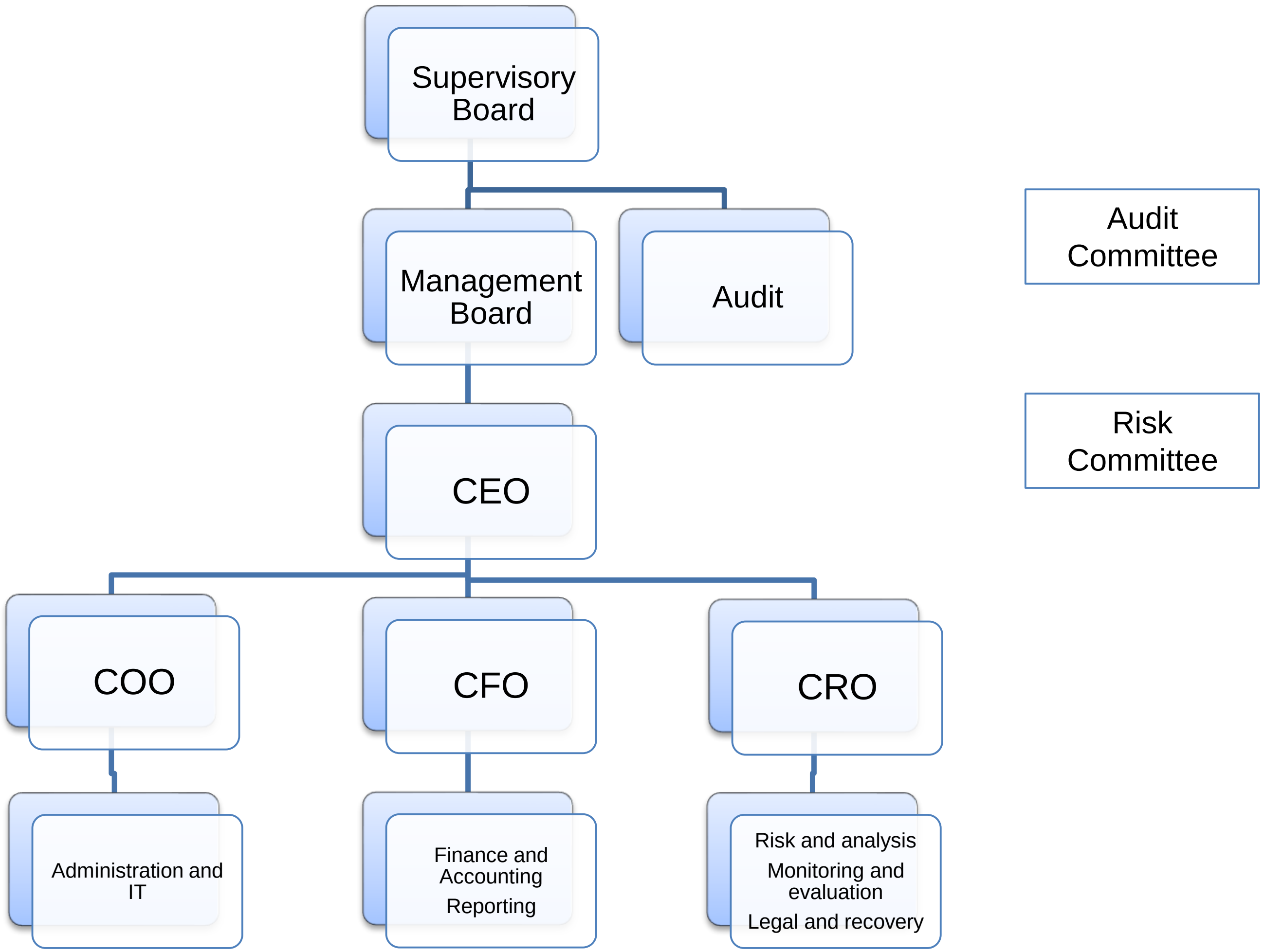
Example:

- For better operational results, accumulation of experience and transparency CGF is to be organised as a self-managed independent legal entity.
- E.g., CGF is to be established as a closed joint stock company with mixed ownership where the state (represented by the Ministry of Finance) owns 50% of the fund's shares.
- CGF is created under the special regulation of the government.
- The general meeting of shareholders, the supervisory board and the management board are the managing bodies of CGF.
- The management board can be composed of up to 5 members (including CEO, COO, CFO and CRO).
- Corporate governance standards require establishment of Audit Committee and Risk Committee.

** Source: https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf*

3. Recommendations for Belarus (cont.)

Sample Organisational Structure



3. Recommendations for Belarus (cont.)

Monitoring and Evaluation

- Identify how the scheme is monitored and evaluated

Example:

- Perform regular independent audit to ensure timely and accurate financial statements
- Publicise quarterly and annual financial reports
- Set up and disclose fund's performance criteria, including non-financial (operational) results
- Show effect of the CGS including:
  - Financial and economic additionality which in broad sense estimates general welfare created by it
  - Leveraging which demonstrates expanding volumes of guaranteed loans over time compared to invested capital
- Announce status/changes in corporate governance structure including ownership, compositions of boards and committees, contents of main policies

4. Case Study: ACGF

Description

- Lithuania's Agricultural Credit Guarantee Fund *Garfondas* (www.garfondas.lt) was established in 1997 to promote the economic development of agricultural sector and creation of alternative businesses in rural areas.
- The Ministry of Agriculture of the Republic of Lithuania holds 100% shares
- The Fund issues guarantees in compliance with Regulations on the Activities of the Private Limited Liability Company Agricultural Credit Guarantee Fund.
- Apart from issuing guarantees to credit institutions and finance lease companies, Garfondas has other functions:
  - Administration of state aid
  - Administration of the Credit Fund established by the government for support of agricultural companies
  - Administration of the Indemnity Fund for Licensed Warehouses

4. Case Study : ACGF (cont.)

Conditions

▪ **Types of services, specific objectives**	▪ credit guarantees for investments ▪ credit guarantees for credits or credit lines intended for the acquisition of current assets
▪ **Borrower eligibility**	▪ Farmers‘ farms, agricultural companies, cooperatives and other agricultural enterprises
▪ **Maximum loan amount**	▪ EUR 1.16 m
▪ **Maximum tenor**	▪ Not limited
▪ **Pricing of guarantee**	▪ the size of guarantee fee varies between 0.5% - 1.8% and depends on project risk, credit purpose, credit maturity and amount, loyalty of the borrower. ▪ the established guarantee fee is reduced for economic entities, which have insured agricultural plants, for economic entities engaged in livestock breeding and for financially sound credit beneficiaries. ▪ 0.3% fee of the guaranteed amount charged for extension of validity period of guarantee multiplied by the number of years.
▪ **Coverage**	▪ Up to 80% of a loan
▪ **Guarantee assignment process, risk management**	▪ Indirect scheme: through partner banks and credit unions
▪ **Other**	▪ Issued in Euro

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4. Case Study: ACGF (cont.)

Guarantee Issuing Procedure

1. Eligible economic entity applies to the credit institution (bank or credit union) asking for credit and negotiates the terms.
2. Credit institution applies to Agricultural Credit Guarantee Fund asking for guarantee. The credit institution shall submit guarantee application and additional documents, indicated in the application.
3. The Board of Agricultural Credit Guarantee Fund makes a decision concerning guarantee issuing and reports it to both credit institution and credit beneficiary. Credit beneficiary pays guarantee fee and signs credit agreement.
4. Agricultural Credit Guarantee Fund issues credit guarantee to credit institution.
5. Credit institution grants the credit to credit beneficiary.

Source: Garfondas

4. Case Study: ACGF (cont.)

History of Transactions

Annex 3. Guarantees Provided and Guarantee Obligations to Credit Institutions Fulfilled

31 December 2013

Year	Provided guarantees, LTL million									Guarantee obligations fulfilled, LTL million		Ratio of fulfilled guarantee obligations and provided guarantees, %
	Farmers, rural entrepreneurs, processing establishments			Lithuanian Agricultural and Food Market Regulation Agency			Total					
	Number	Loans	Guarantees	Number	Loans	Guarantees	Number	Loans	Guarantees	Number	Sum	
1998	230	17.34	15.19	5	240.00	240.00	235	257.34	255.19	0	0.00	0.00
1999	345	25.83	23.04	6	217.56	217.56	351	243.39	240.60	1	1.50	0.30
2000	9	0.57	0.40	3	113.39	113.39	12	113.96	113.79	10	1.24	0.45
2001	10	9.31	6.52	5	117.69	117.69	15	127.01	124.21	34	2.74	0.75
2002	40	18.12	11.79	6	125.50	125.50	46	143.62	137.29	26	1.99	0.86
2003	118	102.82	63.82	5	115.35	115.35	123	218.17	179.16	14	0.49	0.76
2004	162	93.91	58.14	1	42.45	42.45	163	136.37	100.59	3	0.09	0.70
2005	334	180.27	106.45	2	60.93	60.93	336	241.20	167.38	4	0.23	0.63
2006	462	237.39	143.98	2	39.07	39.07	464	276.46	183.04	2	0.03	0.55
2007	523	247.21	142.49	1	8.88	8.88	524	256.09	151.37	0	0.00	0.50
2008	464	246.69	145.19	0	0.00	0.00	464	246.69	145.19	3	2.37	0.59
2009	194	80.28	49.21	8	153.00	153.00	202	233.28	202.21	5	3.79	0.72
2010	415	150.66	92.46	12	46.20	46.20	427	196.85	138.66	1	0.07	0.68
2011	503	203.94	124.81	0	0.00	0.00	503	203.94	124.81	10	1.84	0.72
2012	335	135.17	79.13	0	0.00	0.00	335	135.17	79.13	14	4.16	0.88
2013	242	133.42	81.27	0	0.00	0.00	242	133.42	81.27	14	2.95	0.97
Total	**4,386**	**1,882.94**	**1,143.87**	**56**	**1,280.02**	**1,280.02**	**4,442**	**3,162.97**	**2,423.90**	**141**	**23.49**	**0.97**

Source: Garfondas Annual Report - 2013

4. Case Study: ACGF (cont.)

Achieved Results

- In 1997 - 2016 ACGF issued 5,000+ guarantees amounted to € 830 million and generated € 1.1 billion of loans
- Current volume of outstanding guarantees in portfolio – € 127 million;
- Average amount of granted loan – € 128 th.
- Average amount of granted guarantee – € 78 th.
- Average guarantee coverage ratio – 60%
- Portfolio structure - 80% for investment credits, 20% for working capital
- 50% of covered loans were used to purchase agricultural equipment
- Provided services to 4,500+ farmers and rural entrepreneurs
- Helped to retain and create 3,300+ workplaces
- Fulfilled 167 guarantee liabilities to the banks and paid out € 9.4 million (1% of provided guarantees)

Source: Garfondas

5. Conclusion

- Establishment of the CGF in Belarus requires the following next steps:
  - Decide if the fund is to be established as a new entity or on the basis of the existing one (e.g., the Belarussian Entrepreneurship Support Fund)
  - Approve new/amend existing regulations of the government on the fund's activities
  - In view of rather tight deadline of 2018 it is advised to establish the fund 100%-owned by the state and in parallel start discussions with other potential shareholders
  - Provide adequate funding for starting the fund
  - Nominate and appoint the Supervisory Board and the Management Board
  - Nominate and appoint the Audit Committee and Risk Committee
  - Hire necessary staff
  - Approve eligibility criteria for borrowers, projects and partner banks
  - Elaborate standard operating procedures and regulations
  - Sign agreements with partner banks
  - Design and approve the fund's business plan
  - Set up and disclose the fund's performance criteria
  - Select an external auditor
  - Prepare marketing and awareness strategy Invite donors to participate with grants and/or technical assistance

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