CREDIT GUARANTEE SYSTEMS FOR AGRICULTURE AND RURAL ENTERPRISE DEVELOPMENT

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Preface

Guarantee funds have been used over the years in many countries, forms and contexts as a way to increase the flow of funds into targeted sectors and groups. Various types of guarantee systems and scheme are used to make lending more attractive by sharing or absorbing the risks associated with lending to the targeted sector or type of enterprise. Such systems can also increase the amount of loan funds available to an enterprise beyond its own collateral limits, because the guarantee is a form of loan collateral. The guarantee manager can assume the additional role of loan assessor and monitor, which can improve the quality of the loans made.

However, guarantee funds have a cost, which is paid through the fees charged and/or subsidized by the government or a donor. Questions arise regarding the cost versus the benefits when a subsidy is needed. What is the value added of guarantee funds in reducing interest rates or the risks to lending, and how much do the funds influence lenders decision-making regarding whether or not to lend?

Guarantee funds have more frequently been used for small enterprise loans in diverse sectors, but they are now quite common in agriculture and agribusiness. There is renewed interest in using them to increase investment into the sector and to ensure that investment is directed towards target groups and agro-industries that are deemed too risky for adequate financing without such risk-sharing incentives. This document takes a fresh and unbiased look at the application and results of guarantee funds for agricultural and rural enterprise development. Through analysis of guarantee funds that have been operational for a long time, the document aims to inform development agencies and policy-makers on current practices and experiences, so that they can apply this information to their decision-making regarding whether or not and/or how best to promote guarantee mechanisms that are effective and sustainable.

This document builds upon four major case studies of guarantee funds and 12 other analyses of such funds. A detailed description of the four cases will also be published and available at http://www.fao.org/ag/ags

Executive summary

Partial credit guarantees are a comparatively new instrument in agricultural development finance. Following the introduction of credit guarantee systems (CGS) in Japan in 1937, their use spread first throughout Europe and the Americas in the 1950s, and then to Africa, Asia and Oceania in the 1960s and 1970s. A recent count found 2 250 CGS in almost 100 countries. Newer forms of CGS cover not only individual end borrowers, but also parts of the entire loan portfolio, with exposures in areas of interest to policy-makers and development banking practitioners. For small and dispersed rural and microfinance institutions, the guarantee cover may be applied to the entire loan portfolio. Other new forms of guarantees include bond guarantees and portable guarantees, which are discussed in detail in this study. Whether the guarantee covers the institution or the loan of the end borrower can make a big difference to the public policy appeal and acceptance of these schemes.

The most frequently raised argument against CGS in the past was that they could not sustain themselves out of guarantee fees and/or investment returns on the underlying capital. CGS are not alone in being vulnerable to failure without subsidy inflows. Even full service banks with individual microenterprise lending technology, and conventional microfinance non-governmental organizations – which are the two most frequently quoted new types of microfinance institution – do not claim to be subsidy-free. These institutions are subsidized for their establishment and initial capitalization. The subsidies are phased out as the institutions grow and secure access to commercial sources of funds.

Large challenges also emanate from the fact that most CGS worldwide are capitalized out of public funds and managed by staff with pay and employment histories that are typical of public sector employees. Political interference and the inability of CGS managers to minimize this interference have brought an end to many CGS, particularly those operating in developing economies.

The general lack of transparency in the presentation of financial results of most CGS is a further weakness that contributes to their fragility and potential misuse by forces other than those with commercial and development objectives. The detailed case study of the large Indian CGS illustrates this point.

This study provides a review of agricultural CGS worldwide. The focus is on testing a few key study hypotheses and examining concrete case examples and empirical field realities. Four case examples from four continents are analysed in detail and referenced throughout the study: the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) in India, the Agricultural Credit Guarantee Scheme Fund (ACGSF) in Nigeria (the oldest CGS in sub-Saharan Africa), the Rural Development Foundation (RDF) in Estonia, and the large and well-established *Fideicomisos Instituidos en Relación con la Agricultura* (FIRA – Trust Funds for Rural Development) set of guarantee funds in Mexico.

Using these and 11 shorter case examples of CGS, which are presented in the form of comparable term sheets in the annexes, the study highlights and analyses the complex nature of many CGS and their sometimes positive, but often also inconclusive or negative, long-term track record. Study results indicate ingredients for good practice in setting up and managing individual or portfolio guarantees. They also identify potential areas of underperformance and eventual failure. The study argues that CGS are neither the panacea nor the preferred option for development finance that bankers tend to portray them as; however, neither are they doomed to fail, as their critics would suggest when referring to the disadvantages of the public funding and start-up subsidies that are usually involved in setting up CGS. Instead, their strengths and weaknesses have to be analysed case by case.

As the FAO Global Expert Roundtable on Agricultural Guarantee Funds has shown, there are positive precedents for operating with different types of guarantee. Success is facilitated by a generally healthy banking sector with generally low levels of impaired assets, transparent accounting accompanied by supervision and evaluations, and professional management that is independent and free from political interference.

Future areas of research concern above all the need for a much stronger empirical and analytical base for discussion of CGS. CGS are under-researched and subject to less rigour and weaker standard practices for institutional assessment than commercial banks or microfinance institutions are.

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Acronyms

aBi	Agribusiness Initiative Trust (Uganda)
ACGSF	Agricultural Credit Guarantee Scheme Fund (Nigeria)
AFD	French Development Agency
AGRA	Alliance for a Green Revolution in Africa
BIS	Bank of International Settlements
CBN	Central Bank of Nigeria
CGS	credit guarantee system
CGTMSE	Credit Guarantee Fund Trust for Micro and Small Enterprises (India)
CIS	Commonwealth of Independent States
DANIDA	Danish International Development Agency
DCA	Development Credit Authority (USAID)
DFID	Department for International Development (UK)
DICGC	Deposit Insurance and Credit Guarantee Corporation (India)
EIF	European Investment Fund
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FAST	Finance Alliance for Sustainable Trade (Canada)
FEGA	Fondo Especial de Asistencia Técnica y Garantía para Créditos Agropecuarios (Mexico)
FIG	Fonds International de Garantie (RAFAD)
FIRA	Fideicomisos Instituidos en Relación con la Agricultura (Mexico)
GF	guarantee fund
gov't	government
IBRD	International Bank for Reconstruction and Development
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IMF	International Monetary Fund
MFI	microfinance institution
MIGA	Multilateral Investment Guarantee Agency (World Bank Group)
MIS	management information system

MLI	member lending institution (CGTMSE, India)
MSMEs	micro-, small and medium enterprises
OECD	Organisation for Economic Co-operation and Development
PASS	Private Agriculture Sector Support (United Republic of Tanzania)
PROPARCO	Promotion et Participation pour la Coopération Economique
RAFAD	Research and Applications for Alternative Financing for Development
RDF	Rural Development Foundation (Estonia)
SBA	Small Business Administration (United States of America)
SBDC	Small Business Development Corporation, now Business Development Company Ltd (Trinidad and Tobago)
SCP	Special Credit Programme (Japan)
SDC	Swiss Agency for Development and Cooperation
SIDBI	Small Industries Development Bank of India
SMEs	small and medium enterprises
UN	United Nations
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development

Chapter 1
Background and introduction

BACKGROUND

The collateral requirements of banks can pose a serious challenge for farmers or rural micro- and small entrepreneurs trying to source funding for business or farming. In many countries around the world, credit guarantees are implemented as a partial substitute to conventional collateral. The design of guarantee systems has evolved to address the new and changing needs of intermediary financial service providers in areas such as portfolio concentration risks and the capital requirements for cushioning against lending risks. At the public policy level, guarantee systems are an instrument for facilitating lending to specific sectors considered to be policy priorities. Taken together, guarantee systems hold promise and provide attractive features for borrowers, financial institutions and policy-makers alike. This explains the current interest in guarantees as an instrument in development finance. However, empirical evidence regarding the performance of different types of guarantee is mixed. In general, newer forms of portfolio guarantee, and guarantees provided to profitable rather than merely promotional sectors appear to fare better than others.

This study builds on a 1998 FAO publication entitled *Credit guarantees – an assessment of the state of knowledge and new avenues for research* (FAO, 1998). The time span of approximately 15 years since then provides an opportunity for assessing observations made in 1998 and comparing them with recent developments in the field. Much has been learned, contexts have changed and new models have been developed. Recent developments include a shift from a simple individual guarantee mechanism towards portfolio and specialized types of guarantee, and a trend for operating guarantee systems through specialized legal entities with limited political influence, although national public and international funds continue to represent the lion's share of guarantee fund (GF) capitalization in development finance.

TARGET AUDIENCE

The study has been compiled primarily for decision-makers at the domestic/national and international levels, in both the public policy and financial sector spheres. Financial service practitioners and other parties involved in rural development finance, such as commercial banks, microfinance institutions and other financial service providers; FAO project office staff, partnering ministry officials, scholars and academics may also find the study useful.

RATIONALE AND PURPOSE

The study takes into account a number of detailed and extensive worldwide stock-taking exercises carried out over the past two decades regarding GFs as an instrument for development finance. It attempts to stratify and focus analysis and findings with regard to: i) credit guarantee arrangements focusing on rural

small and medium enterprises (SME) and micro-, small and medium enterprises (MSMEs) and the agriculture sector; and ii) *a priori* definitions of the internally agreed hypotheses to be tested to avoid providing a mere stock-taking exercise and general policy recommendations.

The *key hypotheses* guiding this study can be summarized as follows:

i. *New and different arguments for CGS:* Risk-sharing mechanisms have regained prominence in development finance because of excess liquidity in the banking system, the emergence of microfinance institutions (MFIs) with refinancing requirements, and internal lending restrictions in the sectors that are prioritized for development finance.
ii. *Improved scope for sustainable GF arrangements:* Over the past two decades, cost-covering GF arrangements with a medium-term sustainability perspective have been established in developing economies because of improved scheme design, incentives (particularly to participating banks) and efficiency gains from linking guarantees to ratings and credit information services. The specific design parameters of these arrangements need to be highlighted and their potential for replication discussed.
iii. *Development goals and specific objectives:* GF arrangements that are governed by considerations other than the prudent and reasonable sharing of financial risk among the different partners in a credit contract are likely to fail.
iv. *Forms of incorporation:* GF arrangements are organized in various corporate or legal forms, ranging from publicly managed financial institutions, State-funded companies and government counter-guaranteed corporations to independently managed and privately owned institutions. Independent private corporate entities, credit guarantee foundations or associations, mutual guarantee associations and specialized single-purpose guarantee corporations operating at the national level are more likely to succeed.
v. *Operating and implementation parameters:* Parameters regarding the percentage of risk shared, the claim procedures and timings of claim submissions, and the fee arrangements have a particularly strong bearing on the market acceptance and eventual success of a scheme.
vi. *Monitoring and supervision:* Proper design and monitoring arrangements, including automated management information systems (MIS) play a key role in the costs of administering credit guarantee systems (CGS), and thus eventually in a system's success or failure.

STRUCTURE OF THE DOCUMENT

This document commences with a definition of GFs. Chapter 2 details what has been learned about this instrument since it first became operational less than eight decades ago, and outlines some major institutional models and current actors. The cases for and against guarantees are made, and the worldwide and regional incidences of guarantee systems past and present are presented in overview.

Chapter 3 introduces four detailed case examples of guarantees for agriculture, agribusiness and rural enterprise development. These are followed by a tabular overview of the main design and implementation benchmarks for each of the case examples. Emerging trends and approaches in the application of GFs are outlined

in chapter 4. The importance of empirical studies and independent evaluations is underscored, and emerging trends in ownership of GF models and governance are outlined. The chapter ends with a summary of future potential growth areas for guarantees and words of caution regarding the challenge of managing the administration costs and claims on GFs in ways that establish sound prospects for sustainability.

The final chapter (5) brings together the issues discussed throughout the rest of the document and makes observations and recommendations from the perspective of the key hypotheses. A detailed table outlines current practice – which is often unsustainable – and provides recommendations for policy-makers and GF managers regarding each of the six underlying research hypotheses.

Chapter 2
Credit guarantees – what we know

OVERVIEW

Credit guarantees are one of a pool of instruments for risk mitigation and credit enhancement measures. These range from very simple to complex arrangements using a blend of structured finance instruments, such as subordination and portfolio concentration limits. Credit enhancement measures mainly include credit derivates of different sorts that are treated in similar ways to credit guarantees in the Basel II and Basel III framework (discussed in the last section of this chapter). Rather than selecting one instrument and rejecting others, corporate finance applies a mix of different instruments, including guarantees from the European Investment Fund (EIF) and other highly rated financial promotion agencies such as Germany's KfW Banking Group and the International Finance Corporation (IFC).[1]

Credit guarantees can operate at different levels, with the top levels in many cases taking the form of investment guarantees rather than loan guarantees. Of the 23 largest microfinance investment funds, three offer investment guarantees on MFI or SME loan portfolios.[2] In other cases, a donor uses a guarantee as an instrument to finance one or more recipient financial service providers. For microfinance alone, it is estimated that the amount of loan guarantees outstanding to support MFIs is at least US$500 million (2007).

Among donors, the guarantee instrument is utilized above all by private sector funding subsidiaries of bi- or multilateral donor agencies. An example is the support of the Swiss Agency for Development and Cooperation (SDC) to the Bangladeshi Shakti Foundation through provision of a guarantee.

At the next level, banks or MFIs seek guarantees for their loans to specific priority target clients. CGS can back transactions between international and local partner banks.

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[1] Glaubitt *et al.* (2008: 358) narrate the complex nature of the sale of part of Procredit Bank Bulgaria's SME and micro-enterprise loan portfolio to a Bulgarian special purpose vehicle for loan proceeds with a revolving promissory note that was adjusted monthly to reflect current portfolio balances. The guarantee was used to provide cover to the portion of senior notes in the special purpose vehicle pool. This raised the notes' rating from BBB to AAA, making possible the participation of Deutsche Bank, which can purchase notes only with the best quality and rating. Through the guarantee, the quality of the pool of investors was thus enhanced.

[2] The Netherlands' Hivos-Triodos Foundation offers 8 percent of its total MFI investment funds as guarantees. The share is smaller for the church-based and very innovative Oikocredit (also Netherlands) investments and the French *Solidarité Internationale pour le Développement et l'Investissements*.

Banks and specialized financial institutions offering guarantees provide guarantees to individual final borrowers. However, most small commodity producers and agribusiness or other rural SMEs are unaware of the existence or functioning of individual credit guarantees. A study undertaken by the Microfinance Center found that in Georgia, approximately 7 percent of entrepreneurs who had never used external financing for their businesses had attempted to obtain credit but failed. The most common reasons were lack of guarantees, an inadequate business plan or an offer from the bank or financial institution that was too expensive. Although lack of collateral is a major concern for entrepreneurs, only 2 percent of them have ever used the services of a GF according to a 2011 Microfinance Center report.

ACTORS

A credit guarantee simply substitutes part of the collateral required from a borrower; if the borrower fails to repay, the lender can resort to partial repayment from the guarantor.

The *guarantor* can be a separate company or other form of distinct legal entity, or part of a multi-purpose service set-up, usually provided by the public sector or development projects.

The *lender* can be any type of financial service provider, or a participant in agricultural value chains as a buyer or seller of agricultural produce and commodities.

The *borrower* profile in this study is mainly farmers, agriculturists and rural-based micro- and small enterprises.

The *guarantee fee* is levied by the GF management from the lending bank. Participating banks usually pass this fee on to the end borrower. The basis of the fee varies. It can be:

- a one-time or annual fee, or a blend of both;
- a percentage of the underlying loan amount;
- a percentage of the guaranteed portion of the loan.

In order to be considered as being in line with market prices, the guarantee fees charged have to cover the normal risks associated with granting the guarantee, the administrative costs of the system, and a yearly remuneration for an adequate capital base, "even if the latter is not at all or only partially constituted" (European Commission, 2008).

TYPES OF GUARANTEE

The four main types of guarantee,[3] which have many variations and overlaps, are as follows:

- *Individual guarantees for loans:* This archetypical form of guarantee provides partial coverage for the underlying principal loan amount, with both parties to the transaction – borrower and lender – clearly identified.
- *Guarantee on an investment facility:* Some guarantee agencies offer a variation of the standard model for partially guaranteeing a bond issue. This type of

[3] Export guarantees are not included in this study.

guarantee is useful when a developing economy already has functioning capital markets in place, and medium- to long-term placements of investment funds are needed. It ultimately results in a lengthening of assets as placements in the money market, thus helping to deepen and stabilize emerging capital markets.

- *Portfolio guarantees:* In this case, lending to a specified priority development sector is supported by providing a partial guarantee for a number of loans – one lender with many borrowers.
- *Portable guarantees:* In some cases, other forms of guarantee are applied that do not have a major impact on agricultural finance at present. Portable guarantees are an example: Potts, Reynolds and Rozendaal (FAST, 2011) define a portable guarantee as one that has a specific and identified borrower who can compare competing loan terms and offers from various lenders. Borrowers become more attractive and, through the guarantee, have enhanced opportunities to create a relationship with lending institutions. The main advantage of the portable guarantee is its ability to link the guarantee process with specific results for a specific actor. However, it is not a common form of guarantee in development finance, and has the disadvantage of comparatively high transaction costs for borrowers and lenders alike (when lenders are dealing with a new and unknown applicant).

Credit guarantee systems (CGS) are any scheme on the basis of which – without requiring further implementing measures – guarantees can be provided to undertakings that satisfy certain conditions of duration, amount, underlying transaction, and type or size of undertakings (such as microenterprises or SMEs).

REGIONAL COVERAGE OF CREDIT GUARANTEE SYSTEMS

Most guarantee systems to date operate at the national level. However, there are increasing instances of regional and/or continent-wide guarantee systems such as *Proyecto Cambio* for Central America, and the *Fonds Africain de Garantie et de Coopération Economique* (African Fund for Guarantee and Economic Cooperation) and the Alliance for a Green Revolution in Africa (AGRA). Global guarantee systems are still rare, but include the United States Agency for International Development (USAID) Development Credit Authority (DCA), the Swiss-based *Fonds International de Garantie* (FIG) and *Promotion et Participation pour la Coopération économique* (PROPARCO).

On the other hand, there are guarantee systems that cover only one region of a national economy, such as the Serbian Vojvodina Development Fund. Some have even smaller regional coverage and are set up by local government to promote micro- and small enterprises and agribusiness at the municipality level, such as the municipal GFs in Bosnia and Herzegovina.

HISTORY AND PREVALENCE OF GUARANTEE SYSTEMS

CGS have been in place for many decades in most Organisation for Economic Co-operation and Development (OECD) countries. Levitsky (1997: 5) lists Japan as the oldest (1937), followed by the United States of America (1953), Germany (1954), Italy (1960) and Canada (1961). At the time of Levitsky's review (1997), CGS had been operating in 13 developing economies for more than ten years.

Market failures in the credit markets for SMEs have led to the formulation of more than 2 250 CGS in almost 100 countries (ADB, 2007). CGS serve the larger public policy objectives of promoting entrepreneurship in the country by providing credit to SMEs – which commonly lack the kind of collateral required by banks – while reducing the credit risk to lenders. It is also argued that well-designed, well-funded and well-implemented CGS can improve SMEs' access to credit and their integration into formal financial markets; assist SMEs in obtaining finance for working capital, fixed assets and investment at reasonable conditions; and enable smaller firms to improve their competitiveness and extend their economic activities. These advantages ultimately translate into improved business performance and job creation. In some countries, a high proportion of SMEs are serviced by guaranteed loans, such as Japan (38 percent), the Republic of Korea (20 percent) and Taiwan Province of China (20 percent). However, most national CGS have little impact on the SME sector at the international level, servicing only 1 to 2 percent of the world's SMEs.

Although CGS are relevant to all business sectors of the economy, many – especially in developing countries – are applied to agriculture and rural MSME development. MSMEs with less probability of securing access to commercial refinancing are targeted, including those with limited operating periods and track records. Publicly owned special CGS frequently include business start-ups.

A recent study from the *Banca d'Italia* (Pozzolo, 2011) provides empirical evidence from the Italian banking system that appears counterintuitive, but that underlines the role and importance of partial credit guarantees in commercial bank financing to micro- and small enterprises. The study confirms that from a lender's perspective, guarantees are required on loans considered *ex-ante* as riskier. In particular, larger loans, those made to smaller borrowers with less capital and to borrowers with multiple banking relationships are more likely to be partially secured by guarantees to meet their collateral requirements. Another important set of characteristics that make it more likely that a bank loan will be secured with guarantees is the availability of assets of the borrower that can be posted as collateral. Moreover, these borrowers may incur a lower cost of borrowing – from using the guarantees as collateral. These lower costs can come from having lower interest rates because of the security of the guarantees and/or the costs associated with other types of collateral.

The ability of banks to screen loan applications, sector concentration and efficiency of credit are important determinates of the use of guarantees, because a stronger capacity of the banks in this can reduce the need for, and consequently the incidence of, guarantees. This ability to assess loan risk efficiently also affects interest rates. Guarantee-secured loans can have a higher average than those on unsecured loans, confirming that guarantees are required to *ex-ante* riskier borrowers and that the presence of guarantees is not sufficient to offset completely the higher credit risk of the loan. Therefore, after controlling for borrowers' riskiness, the direct correlation between the presence of guarantees and the interest rate on bank loans is weak.

Credit guarantees can be used to bridge technology gaps. At the national level, this may include building up specialized rating agencies for SMEs, which can contribute significantly to borrower screening and credit risk assessment. The case of the Small Industries Development Bank of India (SIDBI) (see chapter 3) is relevant. SIDBI has been a pioneer in introducing ratings for many different development

finance sectors. It introduced MSME ratings through its subsidiary SME Rating Agency of India[4] with the specific objective of reducing information asymmetries between lending banks and the MSME sector.[5] SIDBI was also the first wholesale lending agency to MFIs that required an MFI rating as a precondition for wholesaling funds (CRISIL Ratings, 2006), and established its own all-India SME rating system and database. These innovations, its collaboration with the commercial IDBI Bank, and its own data capturing systems position SIDBI well as a partial guarantee provider, because it can process the rating information and analyse it for risk mitigation. This capacity creates an information access and management advantage that SIDBI as the GF manager for Indian micro- and small enterprises may have over partner financial institutions that have been reluctant to lend to non-collateralized businesses, particularly in rural India, and that have therefore not captured relevant information or borrower track records internally in banks.

Many guarantees focus more on SMEs than on agricultural production. Farmers can often use land as collateral, so may have less need for GFs; land is frequently used as loan collateral, so its appraisal is well understood by the commercial banking sector. Credit guarantees therefore target primarily non-landed productive entrepreneurs in rural areas; India's Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) is an example. The detailed case studies in chapter 3 provide examples of GFs that explicitly target farmers, livestock producers and plantation owners – *Fideicomisos Instituidos en Relación con la Agricultura* (FIRA) in Mexico, the Agricultural Credit Guarantee Scheme Fund (ACGSF) in Nigeria and the Rural Development Foundation (RDF) in Estonia. In debating the delineations between rural farm and non-farm borrowers it should be kept in mind that many people operating as farmers apply for loans as rural microentrepreneurs to make ends meet in the lean season.

EARLIER STUDIES AND REFERENCE MATERIAL

FAO's reference study *Credit guarantees – an assessment of knowledge and new avenues for research* (written by M. Gudger) was published in 1998 (FAO, 1998). Several other studies published over the past two decades focus on a comparative assessment of CGS. First, came a global survey of CGS compiled by Graham Bannock and Partners Ltd (1997) and summarized by Jacob Levitsky (1997). Levitsky's study was carried out over the two years from 1995 and 1997 and constitutes the largest comparative study and analysis of CGS undertaken, covering the 85 countries with guarantee systems running in 1996. Of these countries, 70 had operating records to review. The Bannock and Levitsky studies' main contribution is in generating primary data, which are very useful for understanding how credit guarantee funds performed in this period, when many CGS lacked workable performance data.

[4] At the end of the 2007/08 financial year, the agency had conducted 1 800 MSME ratings and established four centres for promoting lending to MSMEs that utilize these rating data to facilitate loans from Indian commercial banks.

[5] As described in the Chief Executive Officer's presentation at the SIDBI annual general meeting in Lucknow, India, 2008.

The Department for International Development (DFID) of the United Kingdom of Great Britain and Northern Ireland commissioned a review of the efficiency and effectiveness of CGS worldwide based on detailed analysis of six case studies (see DFID, 2005 for a synthesis). Study results are mixed and leave room for further analysis, but allow a more comprehensive perspective beyond the focus on financial sustainability.

A similar study was commissioned by SDC (Reichmuth, Flaming and Dominicé, 2006), which examined a GF constituted by the Research and Applications for Alterative Financing for Development (RAFAD) Foundation based in Geneva. This guarantee mechanism involves leading Swiss banks and recipient financial institutions all over the world and has had high visibility over the past 20 years.

There are two more recent comprehensive international overviews. The World Bank's review of 76 partial CGS from 46 developed and developing countries (Beck, Klapper and Mendoza, 2008) generated a detailed data set of these guarantees and stressed CGS' contribution to the start-up and development of micro- and small enterprises. This survey found that commercial bankers view CGS as the most effective way of promoting additional flows of funds to micro- and small entrepreneurs worldwide.[6] A second publication, by the World Bank Independent Evaluation Group (2009), covers guarantees issued by the bank's Multilateral Investment Guarantee Agency (MIGA) subsidiary and also evaluates those issued by IFC and the International Bank for Reconstruction and Development (IBRD). This document sheds interesting light on how the guarantee instrument operates within the different institutions of the World Bank Group. It highlights the multifaceted use of the instrument, mostly for large-sized lending transactions in corporate and industrial finance.

Canada's Finance Alliance for Sustainable Trade (FAST) compiled the most recent comparative overview (FAST, 2011) in which guarantees are sourced specifically for facilitating commodity sectors and assisting primary producers who depend on commodities for their livelihood. This recent study contributes to the current debate on CGS as it takes the rural producer as its starting point and the pivotal beneficiary of any credit guarantee arrangement reviewed.

THE CASE FOR CREDIT GUARANTEES

When asked how to improve the access of farmers and small agribusiness to finance, bankers and practitioners are more likely to opt for introducing guarantees than any other financial instrument – a point that is frequently emphasized in the literature (Pozzolo, 2001). Specifically, for promoting value chain finance, Beggs observes for Zambia that:

[6] Beck, Thorsten, Asli Demirgüç-Kunt, and Maria Soledad Martinez Peria. 2008. Banking Services for Everyone? Barriers to Bank Access and Use around the World. "*The World Bank Economic Review*" 22(3): 397–430.
This is confirmed by findings of Beck, Demirguc-Kunt and Martinez Peria (2008). Banks view CGS as the most common and effective government support programme for SME lending, ahead of directed credit and interest rate or regulatory subsidies.

BOX 1
Top five key factors for MSME growth

- Access to adequate, timely and low-cost credit.
- Collateral requirements for obtaining credit facilities.
- Access to equity capital.
- Access to markets, technology and innovations.
- A business-enabling environment (e.g., taxation, labour laws, rehabilitation).

Source: Government of India, 2010.

> *Because of the difficulty of enforcing contracts and the reported culture of non-repayment, value chain suppliers frequently cited guarantees as the product which would most incentivize them to supply more finance. They stated that if their risk could be reduced, they would happily supply more finance.* (Beggs, 2010)

A similar situation for Asia is captured in a recent demand-side assessment carried out in India (Government of India, 2010). Although MSMEs contribute significantly to the overall economic growth of the country, they suffer from several bottlenecks. Of the top five impediments to growth of this sector (Box 1), access to credit has been identified as the most critical. The major reasons for this have been banks' perception of MSMEs as a high-risk sector and the high transaction costs for loan processing and appraisal. The perceived high risk is a more serious issue for microenterprises that require small loans, and for first-generation entrepreneurs without credit history and collateral.

Banks meet the financing needs of SMEs without having to warehouse excessive credit risks: This is the classical argument that bankers themselves use in favour of instituting or expanding CGS. The banks do not expect lower costs for loan enforcement or final court settlement in case of default.

Reducing the expense of handling collateral lowers financial service providers' administrative costs: Banks see this as a second major advantage, particularly for rural small enterprise loans that are collateralized and require the usual documentation – including, in some countries, entry into a special pledge registry.

Financial service providers' learning about the requirements of new client groups is facilitated: The provision of guarantee cover for loans directed to specific subsegments of a financial service provider's potential market can act as a catalyst not just to the partner bank, but also – through demonstration – to the wider financial sector.

Development finance resources are leveraged through unlocking excess liquidity in the domestic banking sector: Highly distorted loan-to-deposit ratios constitute a

major policy challenge in the financial sectors of many developing economies. The creation of a guarantee system for micro- and small enterprises in India was largely built on the rationale of helping banks to reduce their excessive deposit-to-credit ratios in rural areas. The India case described in chapter 3 illustrates that this has been achieved to some extent, although major sectoral and institutional challenges persist. This argument has somewhat replaced the traditional proposition that CGS produce additionality by channelling resources to finance priority sectors that would otherwise be neglected by financial institutions.

Innovations strengthen the case for CGS: There are two main types of innovation: general institutional, product or process innovations in the financial sector, which have a bearing on the functioning of credit guarantees; and specific innovations in the design and implementation of GFs. Relevant innovations in the broader financial sector focus on the increased automation of rural banks, with connectivity and automated core banking solutions reaching remoter parts of the world. Establishing, or widening the coverage of, credit bureaux also makes it more likely that farmers will repay, regardless of whether their loans are partly covered by guarantees or financed out of the lending bank's resources. The threat of being denied loans in the future because of a negative entry in national credit information databases acts as a serious deterrent to loan default. Some credit bureaux also directly collect information on the guarantees granted (and the guarantors) and store it in their databases. The lead taken by India, specifically by SIDBI, in using enterprise ratings to reduce information asymmetries between banks and MSME clients has been followed by other countries in the Southern Hemisphere and informs the lending decisions of commercial banks with little past exposure to microentrepreneurs and, particularly, rural and agricultural business.

Innovations that specifically target CGS centre on institutional upgrading and an increasing tendency for national and stand-alone facilities; professional management of programme funds, without specified closing timeframes (sunset clauses) and with no or limited scope for political interference; the wide presence of the GF provider through a network of branches (such as Mexico's FIRA); and the direct investment of funds as cash in deposits at partner financial institutions in developing economies, without the involvement of international banking intermediaries. Together with the useful separation of individual loan guarantees (mainly for larger and longer-term loans) from portfolio coverage (for smaller loans of shorter duration and where MIS are insufficiently developed to follow each borrower individually), development finance has imported more complex arrangements from corporate banking, such as portable guarantees and bond guarantees.

Excess liquidity in rural locations is an opportunity for GFs to focus on rural and agricultural borrowers: Meyer (2011: 23) summarizes the main expectation specific to guarantee systems directed to agriculture and rural SME finance: donors and governments expect credit guarantee funds to reduce default risks and induce lenders to serve specific target groups or institutions. It is believed that guarantee subsidies accelerate learning, so lenders improve their credit analysis and are encouraged to lend liquid funds rather than investing in government securities or lending only to highly collateralized borrowers. This point is often made against agricultural

finance institutions and commercial banks, which are accused of consistently producing excess liquidity from small agricultural depositors and siphoning it off for money market placements or urban investments rather than investing it back in the rural economy.

THE PITFALLS OF CREDIT GUARANTEES

There is moral hazard at the borrower and financial service provider levels: The existence of guarantee systems reduces the willingness of end borrowers to service their loan obligations. A similar moral hazard may exist for a financial service provider with guarantee cover for its portfolio, as the existence of a guarantee system may reduce the financial service provider's efforts to supervise and eventually enforce loan repayments from its borrowers. In practice however, lending banks consider the reputational losses that this would bring. From the borrower's point of view, the massive increase in credit information databases makes it increasingly difficult for a loan defaulter to obtain future loans, irrespective of whether or not the defaulted loan has guarantee cover.

The World Bank study of 2008 (Beck, Klapper and Mendoza, 2008) illustrates the challenges brought about by moral hazard: default rates increase with the degree of government involvement and the age of the system (von Pischke, Yaron and Zander, 1998), which averages ten years for the 76 guarantee systems included in the World Bank sample.

Farm and business development is not left to market forces: Any CGS is at first glance considered a demand-side subsidy. In general, such subsidies result in market distortions and less than optimal allocations of the funds employed in financial service providers.

The guarantee mechanism intervenes in free market forces: This is closely related to the supply-side argument: free market proponents consider CGS to be a hidden interest rate subsidy to SMEs that is used for political purposes and is thus not a true component of a market economy. Not surprisingly, this point was emphasized in the first FAO study on credit guarantees from the mid-1990s (FAO, 1998), at the height of the free market mantra and Friedman-type of economic rationales worldwide.

Views of the advantages and disadvantages of subsidies have changed. A recent paper by the Capacity Building in Rural Finance (CABFIN) Donor Group (Meyer, 2011) assesses different types of subsidies and concludes that they are more likely to attract support when they target the meso-level and are institution-neutral. Credit guarantee funds, credit bureaux and similar institutions that service a country's entire financial sector are meso-level institutions. As illustrated in the cases of Mexico, India and Nigeria described in this document, credit guarantee funds are open to any commercial bank and – in Mexico and India – also to other non-bank financial institutions.

Stakeholders in a guarantee system may have unrealistic expectations: Worldwide, many guarantee systems are financed by public resources. As instruments of public and development policy, the expectations placed on GFs are therefore high and

sometimes disproportionate. These include expectations of an improved borrower credit culture with greater willingness and ability to repay, lower processing and appraisal costs for participating banks, and the substitution of liquidity gaps or maturity mismatches within partnering banks.

GFs lose money through inadequate supervision of banks and screening of final borrowers: In their discussion of Japanese CGS, Uesugi, Sakai and Yamashiro (2010) outline the main reasons for the collapse of this massive system after only three years of operation, and conclude that there were two major causes:

> *First, financial institutions had incentives to substitute incumbent and impaired non-guaranteed loans by loans guaranteed by the [Special Credit Guarantee] SCG program. In principle, the credit guarantee corporations prohibited this asset substitution, but since guarantee corporations have no legal right to inspect financial institutions, there are rumours that many financial institutions have engaged in this type of asset substitution. The incentive to substitute was even higher when the incumbent non-guaranteed loans were failing or when the financial institution was short of capital and needed to reduce its holdings of risky assets. Second, there is a concern about moral hazard. A series of media reports have exposed the blatant misuse of funds by some borrowing firms. Some borrowers made stock investments with loans guaranteed for daily company operations (Nikkei Financial Newspaper, February 16, 2000), others filed for bankruptcy less than one month after receiving loans (Nikkei Newspaper, January 11, 1999), and finally some, who were in no need of financing, simply obtained the loans because they could.* (Uesugi, Sakai and Yamashiro, 2010: 6)

Guarantee funds lose money by design: The FAO 1998 study took a largely negative stance on the sustainability of any type of guarantee operation. Based on concrete country case examples from OECD as well as developing economies, it concluded that the two major cost factors – administrative costs and risk costs related to claims from the guaranteed loan portfolio – were too heavy to be included as interest rate components for final borrowers. These rates were found to need increases of between 8 and 15 percent to cover full administrative and claim expenses.

Similar to the subsidy argument, this reflects the thinking at the time (1998); the main tenets of the argument remain valid today. If the objective is to provide financial services and institutional development that cover costs without requiring seed capital or other funding assistance, GFs – and several other meso-level institutions – cannot compete.

However, conventional wisdom on the establishment and start-up of development finance institutions has changed in recent years, largely because of more liberal economic thinking and advances in MFI building. An International Monetary Fund (IMF) publication (Hardy, Holden and Prokopenko, 2002) summarizes the best practice that has emerged with regard to setting up and providing initial support to MFIs from a public policy perspective:

> *There are good reasons to provide support for MFIs.… High administrative costs and an intrinsically risky environment suggest that often some degree of support may be indispensable for MFIs, at least in their start-up period.… The*

> *paper emphasizes the importance of only providing one-time support to cover the start-up costs of MFIs or the initial costs of banks entering the microfinance business. Where on-going support is needed, mechanisms should be designed to limit aid dependence and promote competition.* (Hardy, Holden and Prokopenko, 2002: 20)

The parallel challenges related to setting up guarantees, and developments in the conventional views on institution building in development finance are clear. While start-up subsidies and adequate initial capitalization are certainly required and justified, current views recommend phasing out this support as soon as possible, to avoid a situation in which operating losses have to be offset by repeated fund injections. As subsidies decline over time, publicly funded guarantee systems should start to establish an accounting system for the remuneration of capital invested from the public. The European Commission Notice (European Commission, 2008) proposes that this remuneration should constitute 4 percent of the capital invested or, if the State has made no cash contribution, the yield of the ten-year government bond, as a suitable proxy for an acceptable imputed return on capital invested. Costing the capital in a CGS then acts as a buffer against excessive capitalization, which may at first glance appear to increase sustainability prospects, but – if the costs of capital are properly imputed – does not stand the test of long-term viability.

This view tallies well with the prevailing notion held by policy-makers in many countries who view support and strengthening of the micro- and small enterprise sector, particularly in rural areas, as a prime objective of social and economic policy and who are happy to pay subsidies for setting up a GF, if this fund proves to be less distortive and more acceptable to bankers than subsidy alternatives such as low interest rates. Post-communist experience in Eastern Europe and the Commonwealth of Independent States (CIS) indicates that the considerable economic growth and employment creation potential of micro- and small enterprises requires start-up support and policy promotion.

There are additional threats for GFs that focus on rural and agricultural borrowers. These threats emanate mainly from the very limited data sets of performance data or evaluations related to rural or agricultural guarantee systems of different types. This issue will re-emerge in discussion of the case studies and in the suggestions for key performance indicators related to rural and agricultural credit guarantees in chapter 5.

SELECTED INSTITUTIONAL MODELS

This subsection gives a brief overview of some leading institutional models that apply GFs for extending development finance. The coverage is not exhaustive, and complementary information on other actors and approaches is provided in chapters 3 and 4.

United States Agency for International Development

Credit guarantees support USAID in the provision of credit for any development purpose specified by the Foreign Assistance Act. These guarantees are centrally managed and can support loans or investments globally in developing economies. These partial guarantees generally cover up to 50 percent of the risk in lending to projects that advance USAID objectives and catalyse the private sector in developing

countries in expanding USAID's investment in local development activities. USAID missions are the primary contact for obtaining these loans, and the Development Credit Authority (DCA) – part of USAID Head Office in Washington, DC – provides the authority to issue loan guarantees to private lenders. This model, of a centrally managed facility that guarantees specific types of loan granted by private banks, has proven resilient and has been in operation for more than a decade. It leverages domestic liquidity with different types of guarantee that support different sectors and development purposes. DCA does not have a separate corporate status; instead it operates as a form of financing or financial leverage account and involves the USAID field offices. This makes it difficult to compare with other funds and assess the viability of the approach, considering the different levels of the credit guarantee transaction.

DCA offers three products:

1. the loan guarantee, for project-type enhancements and in cases where the borrower, lender and uses of the loan proceeds are known;
2. the loan portfolio guarantee provides partial coverage on a portfolio of loans, mostly for one recipient financial institution, with DCA taking the risk of a broadly defined category of bank loans to induce local banks to extend credit to an underserved sector; individual borrowers under a loan portfolio guarantee are not predetermined at the time the guarantee agreement is signed, but they must fall within a pre-agreed definition of eligible borrowers, which include small businesses operating in a specific geographic area;
3. bond guarantees, with DCA supporting the issuance of bonds by financial institutions, private sector corporations or sub-national entities; the funds generated from the bond issuance can assist in raising local funds for development finance if domestic financial markets are sufficiently developed to issue domestic bonds (to finance municipal infrastructure, etc.).

The DCA loan guarantee model is the most commonly used and provides a donor-promoted service delivery structure that operates with a single recipient financial institution whose loans are partially guaranteed. This is similar to both the RAFAD model of the 1990s (described later in this subsection) and the United Kingdom of Great Britain and Northern Ireland's Overseas Development Assistance model introduced in 1994, with Barclays Bank Kenya, which met with only limited success.

European Investment Fund

EIF provides guarantees to financial institutions with SME loan portfolios. It has four guarantee products ("windows"): i) the loan guarantee window covers the portfolios of financial intermediaries providing medium- to long-term lending to SMEs, and the portfolios of guarantees issued by intermediaries to cover this financing; ii) the microfinance window covers microfinance portfolios for microenterprises, especially start-ups, and the portfolios of guarantees issued by intermediaries to cover this microfinance; iii) the equity guarantee window covers the portfolios of guarantees issued by intermediaries to cover equity investments in SMEs in the seed and start-up phases; and iv) the securitization window provides guarantees to support securitization structures, with a view to enabling intermediaries to mobilize

additional debt financing for SMEs. The guarantee policy is available to the public and downloadable from EIF's Web site.[7]

In the loan guarantee window, the main product features of both guarantees and counter-guarantees for participating financial intermediaries are based on individual loans that are secured for up to 50 percent of the bank's loan exposure. The policy states that the guarantee cap is a flexible ceiling that is defined by the percentage known as the "cap rate" of the total amount covered by the European Union (EU) microcredit guarantee. The cap rate is based on the expected cumulative net losses incurred by the intermediary on the EU portfolio. EU loan guarantees are provided free of guarantee fees. However, to encourage full use of the available budget, commitment fees may be charged. This means that once drawn, funds for guarantees incur a fee payable to EIF by the participating financial intermediary if the funds are not utilized. Guarantee maturity extends to ten years for each individual financing agreement with an end borrower.

The usual EU definition for SMEs applies to the guarantee instrument and denotes the target group (MSMEs) as enterprises that employ fewer than 250 employees and have an annual turnover not exceeding €50 million, and/or an annual balance sheet total not exceeding €43 million (European Commission, 2003: 36).

Alliance for a Green Revolution in Africa

AGRA was established in 2006 through a partnership between The Rockefeller Foundation and the Bill & Melinda Gates Foundation. AGRA also receives core funding from DFID.

AGRA's Innovative Financing Initiative constitutes one of the thrust areas of this Africa-wide programme. It operates across the agricultural value chain. Its aims are to lessen the risks of lending to agriculture, develop appropriate financial products for farmers, improve the performance of agricultural markets, and improve farmers' financial literacy.

AGRA uses the guarantee mechanism to promote lending by domestic commercial banks to smallholder agriculture. Using US$17 million in loan guarantees to reduce the risks of lending by banks, AGRA and its partners have leveraged US$160 million in affordable loans from commercial banks in five African countries, including Ghana, Kenya and Mozambique. These low-interest loans go to associations of smallholder farmers, to agrodealers and to small- and medium-sized agricultural businesses that support small-scale agriculture. The loans support the entire value chain, from primary farm production, to seed companies, post-harvest handling, storage, processing, transportation, and trade in agricultural inputs and produce.

The RAFAD International Guarantee Fund

This institutional model operates a comparatively small portfolio and has achieved a worldwide reputation as a pioneer in this field. RAFAD and its successor FIG have promoted specific forms of guarantee since the 1980s. At a time when credit guarantees were attracting little policy attention at the international level, RAFAD was

[7] www.eif.org/attachments/guarantees/cip/cip_securitisation_guarantee_policy.pdf

providing them through leading Swiss banks to selected financial service providers in Africa, Latin America and Asia. In the combined history of RAFAD and FIG, a cumulative total of US$53 million of guarantees have been issued, resulting in US$212 million being granted to RAFAD/FIG's partners. In 2010, FIG issued CHF 2.2 million (approximately US$1.83 million) in guarantees to leverage CHF 4.8 million in loans. This leverage is partly the result of appreciation of the Swiss franc in relation to major currencies, and also of increased scepticism towards large international banks. The standard RAFAD model operates with a non-interest-bearing deposit held in a Swiss bank, against which guarantees are issued to local lending banks. The model has been adapted and piloted recently: first through investing some FIG funds directly in local partner financial institutions, and second through FIG's direct issuance of guarantees, without intermediation by a Swiss or international bank.

STOCKTAKING – THE REGIONAL EXPERIENCE

The 1998 FAO study of CGS based on data from 15 to 20 years ago provides the baseline for assessing progress and recent developments related to credit guarantees. This document is therefore mainly an update on the findings and situation assessment contained in the FAO study. There is more experience from sub-Saharan Africa, and the gulf that separates the Western European from the Eastern and Southeastern European banking systems has become significantly smaller. Convergence has mainly been driven by foreign direct investment and the appearance of highly innovative specialized microfinance and microenterprise promotion banks driven by loan technology. Gudger (FAO, 1998) starts with a summary of Eastern and Western European experience, and continues by describing the financial sectors in Asia, Africa and Latin America. This subsection follows the same sequence but does not deal specifically with the developed United States types of guarantee, which are detailed elsewhere in this document. The Canadian experience is also left out, but any noteworthy characteristics or performance parameters of Canadian guarantees highlighted in the 1998 FAO study are referred to.

A recent study (FAST, 2011) presents an up-to-date worldwide inventory of GFs with an agricultural, commodity or agribusiness orientation. The authors identified 119 facilities that service, or could service, agricultural SMEs. Of these, seven operate globally, seven offer services regionally (five in Africa and two in Latin America), and the remaining 105 offer CGS for agriculture at the national level. A slightly earlier study by the Asian Development Bank reported a total of 2 250 guarantee facilities for all sectors and purposes as of 2005 (ADB, 2007).

Globally operating funds

In the 1990s, the best-known globally operating guarantee mechanism was that of RAFAD, but it was small by volume and is not mentioned in the 1998 FAO study. RAFAD then started FIG, and other, much larger GF have since established a global presence, specializing in developing economies and having no primary profit motives.

PROPARCO

This subsidiary of the French Development Agency (AFD) for private sector development was created in 1977 and initially focused on sub-Saharan Africa, which was

the main focus of the banks and other private operators that had acquired shares in PROPARCO. Guarantees have been provided since 1991 when PROPARCO obtained financial company status and furthered its product range from equity and loans to the provision of individual and partial guarantees. With €68.61 million, PROPARCO expanded its operations to the Caribbean, the Pacific, the Maghreb and parts of Southeast Asia. Following steady increases in its capital base, to €142 million, and the signing of cooperation agreements with the World Bank's MIGA and other large-scale international guarantee agencies, PROPARCO launched Averroes Finance, the first "fund of funds" in the Mediterranean, co-managed by PROPARCO, the Commonwealth Development Cooperation and the benefitting small and medium enterprises. With the extension of activities into Brazil, India and Pakistan in 2006, and the opening of regional offices on all continents, PROPARCO became a global player, helped by a tripling of its capital base to €420 million. PROPARCO now transacts business in all the countries eligible for official development assistance. Individual guarantees cover up to 50 percent of loan amounts, and transactions – as defined by OECD – range from US$2.8 million to 130 million. PROPARCO is now active in Africa, the Mediterranean, Asia, Eastern Europe and Latin America.

USAID DCA

These guarantees were established far more recently and finance significantly smaller transactions, from US$1 million to 43 million. Like PROPARCO's, DCA's guarantees typically cover single private sector bank loans to specified counter-parties with higher than commercial risk profiles and proven and established development purposes underlying their loan requests.

MIGA

Established in 1988, MIGA has issued more than US$24 billion in political risk insurance for projects in a wide variety of sectors and all regions of the world. MIGA insures against a tightly defined residual risk profile to mainstream commercial risks: it provides insurance to investors and lenders against losses caused by non-commercial risks. For its main operations of up to US$180 million, MIGA provides 90 to 95 percent risk coverage against currency transfer restrictions for cross-border transactions, expropriation, war and civil conflict, terrorism and breach of contract.

Through this global innovation, MIGA partial credit guarantees have introduced new countries to commercial markets and reintroduced countries that have suffered economic or political upheavals or crises. MIGA's special product for small-scale investments – the Small Investments Program – specifically targets small agribusiness and other small investments of up to US$10 million.[8] While MIGA has full portfolio exposure to guarantees, partial credit risk guarantees account for only

[8] A recent evaluation (carried out in 2009 with evaluation data up to 2007) highlights that other institutions of the World Bank Group also provide guarantees. Since 1990, MIGA has issued 897 guarantees for a total of US$16.7 billion. Its guarantees have supported investment flows across a broad range of high-risk sectors and countries, for small and medium-size investments. The World Bank has issued 25 guarantees for US$3 billion. Although limited in number, its partial risk guarantees have facilitated the flow of investment into large infrastructure projects in high-risk countries. IFC, the private sector investment arm of the World Bank Group, has approved 196 guarantee operations for US$2.8 billion.

1.6 percent of the overall World Bank loan portfolio, and 6 percent of IFC's. An evaluation (World Bank Evaluation Group, 2009) found weaknesses, mainly in product overlap among different subsidiaries of the World Bank Group and in their pricing; marketing and awareness of the MIGA product range among development investors could also be significantly improved. The additionality of guarantees from the World Bank Group was found to be acceptable, although only 45 percent of the MIGA, 46 percent of the IFC and 48 percent of the World Bank guarantees issued were for high-risk country transactions. MIGA's comparatively low share in this is somewhat surprising, given its special mandate and products as an international guaranty agency.

Rabobank

This Netherlands-based bank has emerged as a noteworthy global player in partial loan guarantees. Funds have been merged and renamed over time, but the current product, the Rabo Sustainable Agriculture Guarantee Fund, provides partial individual risk coverage for loan transactions in the US$500 000 to 1 million bracket, with three to four-year duration and – apparently – zero default up to the end of 2010. The borrower must invest in sustainable agriculture. Rabobank reports that this has resulted in borrowers being offered better terms than they would have had without the guarantee cover. Noteworthy is the very high initial partial risk coverage of up to 90 percent, which is gradually scaled back over the duration of the loan. The FAST study (2011) observes that coverage ratios are high and defaults low, so Rabobank's scaling back strategy seems to work. At the end of the guaranteed transaction, Rabo expects to phase out completely while a sustainable lending relationship develops between borrowers and lenders without subsequent guarantees.

Africa

The situation outlined in the 1998 FAO study was quite bleak. Gudger (FAO, 1998) observed that dozens of guarantee systems were in existence in the mid-1990s, most of which had been established relatively recently with donor funds and were operating on a very small scale. Nagarajan and Meyer (2005) provided an inventory of 20 systems in 16 countries but, as the systems had all been operating for only a short time, few conclusions could be drawn. Nagarajan and Meyer concluded that several programmes had issued too few guarantees and were terminated. Terminations occurred primarily because of poor performance and poor implementation, which led to high costs and defaults. Even where guarantee systems were relatively active, they made little impact. There was little additionality in terms of loans made, and almost no borrowers graduated to non-guaranteed lending. Against this background, Nigeria's ACGSF was highlighted as a case study. Between 1978 and 1994, ACGSF wrote 183 875 loan guarantees against loans totalling NGN 1 035.3 million (approximately US$46 million).[9] By June 1994, ACGSF had settled 653 claims for NGN 400 000, amounting to less than 0.4 percent of the value of the loans guaranteed. However, it had NGN 127 million of claims due for settlement, or about

[9] At the 1994 exchange rate of US$1 = NGN 23.

12.3 percent of the total volume of guarantees issued. At the time, the cost of claims was estimated to be roughly 12.3 percent of the loans guaranteed. Together with the high administrative costs of between 13 and 15 percent estimated by Gudger (FAO, 1998), the sustainability of the system was uncertain. The mismatch between high administrative costs and net claims paid out to banks still characterized the system 13 years later, as the case study in chapter 3 indicates. Altogether, the picture for GF arrangements all over Africa was bleak. Their reach and impact was small to non-existent, and the only major system, ACGSF, was in danger of collapse.

Situation to date

GFs operate in many countries of sub-Saharan Africa. Most of these are capitalized and managed by the public sector, but some are under private corporate management (see the term sheet on Burkina Faso in Annex 2.7).

Regional African GFs

Among the GFs with regional coverage, some have been driven by donors and their desire to enhance finance for farmers and the rural sector in Africa. In others, the business objectives are primarily commercial and focus on facilitating large international foreign direct investment inflows. By far the most visible of these is the AGRA GF supported by the Bill & Melinda Gates Foundation. Other regional funds with less visibility and a focus on large commercial lending are the *Fonds Africain de Garantie et de Coopération Economique* (African Fund for Guarantee and Economic Cooperation), with a partial individual guarantee covering up to 80 percent of loans of up to US$120 million. The *Fonds de Garantie des Investissements Privés en Afrique del´Ouest* (Guarantee Fund for Private Investments in West Africa) and the *Fonds de Solidarité Africain* (African Solidarity Fund) are regional African GFs that target far smaller transaction sizes. The *Fonds de Garantie des Investissements Privés en Afrique del´Ouest* requires a minimum transaction size of US$110 000 and provides partial individual guarantees of up to 50 percent of the loan amount in different sectors, including agribusiness. Fees and service charges appear to be comparatively high (FAST, 2011). The *Fonds de Solidarité Africain* operates in French-speaking Africa and covers up to 50 to 65 percent of loans of a maximum of US$43 000. No evaluations or assessment data are available to evaluate the financial and operational performance of these funds, or their sustainability prospects without additional capital infusions.

The most frequently quoted example of a new and innovate credit guarantee system is the AGRA GF facility, which illustrates the enthusiasm for and impacts expected from loan guarantees. AGRA reports using US$17 million in loan guarantee funds to leverage US$160 million through four major lending programmes (Meyer, 2011). This total included a US$10 million line of credit that the National Microfinance Bank in the United Republic of Tanzania agreed to lend to agrodealers at an interest rate of 18 percent, compared with the 46 percent typically charged by MFIs. In Kenya in 2008, AGRA and the International Fund for International Development (IFAD) each provided US$2.5 million as a loan guarantee that leveraged US$50 million from equity banks. By May 2009, this programme had loaned more than KES 679 million (about US$9.8 million) to almost 20 000 small-scale farmers. The bank reportedly hired 100 new staff to expand and improve the

programme's outreach and effectiveness. In March 2009, Standard Bank in Africa agreed to offer US$100 million in loans to smallholder farmers and agricultural businesses; Ghana, Mozambique, the United Republic of Tanzania and Uganda each received US$25 million. With several contributing partners, AGRA developed a loan guarantee fund of US$10 million for these loans (AGRA, 2009). No details are provided on the design of the guarantees or the circumstances of the lenders involved, so it is not clear whether the guarantees alone induced these amounts of additional lending.

National-level GFs for agriculture and rural and other agribusiness

Similar to the situation described by Gudger (FAO, 1998), many different GFs operate within individual African countries. While some of these funds (Tunisia and South Africa) are sophisticated and creative, most operate as straightforward individual guarantee facilities and cover export-oriented business or industrial sectors.

In the United Republic of Tanzania, different GF arrangements are in place, some of them established with technical assistance from the Danish International Development Agency (DANIDA). Nearly all the beneficiaries of the Private Agriculture Sector Support (PASS) guarantee system are farmers. PASS is a multipurpose organization providing business development services on a cost-sharing basis for feasibility studies, contract farming, input finance, hire/purchase of farm equipment, business plan assessments and financial services. Individual farmers account for 41 percent of these guarantees, farmers' groups for 32 percent, businesses/farms for 24 percent and savings and credit cooperatives for 3 percent; 40 percent of beneficiaries are women.

In 2005, initial capitalization was US$12 million; by 2008, US$30 million had been added as PASS upscaled from one office in Morogoro to include regional operations in Mbeya, Iringa, Rukwa, Tabora, Shinyanga, Lindi, Tanga, Dar es Salaam, Kilimanjaro, Arusha, Kagera and Ruvuma; plans for this year are to cover the entire mainland. Latest figures indicate that PASS runs with an operating profit. Examples of this and two other Tanzanian GF arrangements are contained in the United Republic of Tanzania term sheets in Annexes 2.10 to 2.12.

In Uganda, individual and portfolio guarantees for agriculture and agribusiness have recently found new interest through establishment of the Agribusiness Initiative (aBi) Trust capitalized by the governments of Denmark and Uganda. The aBi Trust establishes a permanent legal structure and offers equity financing and guarantees. For individual guarantees, partner financial institutions operate under a general agreement providing loans up to the maximum under guarantee. Each loan application is analysed by the partner financial institution, and vetted by the aBi Trust. In selected sectors (agribusiness), portfolio guarantees permit partner financial institutions to place loans of up to an agreed maximum without individual vetting by aBi. The trust was registered as a corporate body in mid-2010 and its products are still being fine-tuned (Bank of Uganda, 2011; FAO, 2011).

Nigeria's ACGSF is described in chapter 3. Under the leadership of the African Development Bank, FAO and the United Nations Industrial Development Organization (UNIDO) are planning to put in place an equity and guarantee fund for African agribusiness.

Eastern Europe and the CIS

The FAO overview (FAO, 1998) found that CGS in Poland, Hungary and Romania in the mid-1990s were characterized by large-scale installations coupled with little experience and limited track records. Eastern European banking systems, particularly those of the former Yugoslavia, had myriad guarantee arrangements, either as separate funds or as credit substitutes, quasi-insurance or derivative products offered by domestic banking systems. These domestic and international guarantees generally comprised at least (advance) payment guarantees, tender guarantees and performance guarantees. In many cases, they were booked as contingent liabilities outside the main balance sheets, so sometimes received inadequate attention from internal and external auditors and banking supervisors.

Internal bank guarantees can account for a considerable proportion of the overall business of a commercial bank, particularly in banks that are subsidiaries or affiliates of other economic concerns where quasi-insurance products are needed to hedge against specific operational risks. For example, although the Crown Agent Bank is a separate and fully licensed bank, it backs up the business of crown agents when tenders for services are submitted (bid bonds), or when performance guarantees have to be submitted by successful bidders. Close operational ties ensure that the premium for these guarantees adequately reflects the underlying bid- or performance-related risks.

Loan guarantees have a particularly strong history in Eastern Europe, the former Soviet Union and the Yugoslav successor countries, which have a very specific and unusual banking system. In many cases, loan guarantees have substituted for ordinary loans, but have been far less strictly supervised than loans and advances. The origins and different uses of guarantee services by commercial banks in the former Yugoslavia have generally not been analysed separately from the functioning of separate incorporated GFs.

The 1998 FAO study highlighted two large EU-financed guarantee systems in Hungary and Romania, and numerous medium- to very small-sized private and public guarantee systems in Poland. None of these systems produced results that put them on the path to sustainability, even where there was high recovery of the underlying loan portfolio in the early phases. Where administrative costs were reasonable, defaults shot up and total costs to GFs quickly increased to 10 percent or more of the value of the guaranteed portfolio.

Situation to date

Bank guarantees as quasi-insurance or credit substitutes still play a larger role in the financing of medium and large enterprises in this part of the world than elsewhere. However they are now far more strictly regulated and supervised in banks of the former Yugoslavia and the Caucasus. The Agricultural Credit Bank of Armenia still offers the full range of bank guarantees to bidders and executing agencies. Separate GFs do not make up a major part of any financial sector in southeastern Europe to date.

In Ukraine, traditional banking legislation strictly limited loan and advance transactions to licensed banks and credit unions; all other actors in this large agricultural Eastern European market were barred from lending. Consequently, for a long time after independence in the 1990s, none of them formally engaged in lend-

ing. Instead, citizens' associations – which are governed by the Law on Citizens' Associations – provide guarantees. According to the Civil Code, any legal entity may provide guarantees to other legal entities.

In the Republic of Moldova, different types of financial and microfinance institutions emerged out of a microfinance fund for rural savings and credit associations supported by IFAD and the World Bank. The new MFI player MicroInvest – a spin-off of the Moldova Microfinance Alliance – has been innovative in this small and highly regulated market by offering, in addition to micro-loans (up to US$10 000), the first MFI guarantees (US$10 000) and venture capital (US$50 000) in response to rural client demand that other Moldovan MFIs are not yet meeting.

In southeastern Europe, almost identical GF arrangements operate in Croatia and Serbia. In Bosnia and Herzegovina, at least four different guarantee arrangements at different levels were found, but no performance data seem to be available. A GF was started in April 2003, but only in Brcko district. The partial GF managed by the United Nations Development Programme (UNDP) supported agriculture and allowed farmers to obtain loans through the banking system (UniCredit Zagrebacka Bank, ProCredit Bank and Tuzlanska Bank) and one MFI (EKI-MCO). In Mostar in 2004, under a similar arrangement, the Association of Entrepreneurship LINK Mostar signed an agreement with Universal Bank to establish a GF for financing small enterprises and handicrafts in the Herzegovina region. A Deutsche Bank Foundation GF is deposited in local banks that issue loans to the microcredit organizations Mi-Bospo and Mikro Aldi. KfW Banking Group launched credit guarantees for microcredit organizations in September 2007, providing guarantees to commercial banks on the credit lines they extend to microcredit for SMEs. This system amounts to €5.12 million provided by the German Government.

In one of the two territories of Bosnia and Herzegovina, the Republika Srpska, there are high expectations regarding the establishment of an agriculture-based partial individual credit guarantee fund based on the Croatian and Serbian experience, with individual guarantee systems used mainly by medium- to larger-sized farms and agroprocessors. Coverage of these partial guarantees could be up to 50 percent for individual loans, but is projected to average no more than 33 percent for the total guaranteed portfolio. The fund will operate throughout Republika Srpska, and a law instituting the GF as a separate legal entity was passed by Parliament in 2010. The GF will operate as a public enterprise solely owned by the public, with three directors and up to 13 employees for loan monitoring and supervision. It will be audited by the Auditor General and capitalized with initial budget support of BAM 30 million (€15.28 million). It will be managed by professionals from the Republika Srpska's Ministry of Finance. The law specifies that the majority of the funds are to guarantee loans to agriculture of any size. Nine of the republic's ten banks have signed agreements with the GF to operate as lending banks. These agreements specify that banks are obliged to cut their current interest rates for agricultural loans by half. Interest rate reductions are thus incorporated into the GF's arrangements from the outset. As of April 2011, the fund was not yet operational, although budgetary allocations had been made and a management team had been recruited and was in place. Among other factors, this delay was due to the structuring of operational details, including the need to settle claims before finalization of due legal process, so rapidly that operations were compromised.

Asia

Gudger (FAO, 1998) pointed to a dichotomy in the operations of GFs in Asia in the mid-1990s, which also characterized the situation in Europe at the time. In the more developed economies, guarantee systems had market penetration of 7.5 percent (Japan) and 3 percent (Republic of Korea) of all loans to SMEs. In Japan, the aim was to alleviate the effects of a severe credit crunch among SMEs, brought about by a contraction in the financial sector. The Special Credit Guarantee Programme differed from other CGS in that it was accessible to nearly all SMEs as long as they were not in default, were not tax delinquent and did not have a significantly negative net worth. The programme covered 100 percent of the default cost incurred by borrowers. The lever for the 52 guarantee companies operating in Japan in 1998 was a retro-guarantee from a government-owned company for 70 percent of any losses incurred through the total or partial failure of a borrower. No data were available on the financials of this apex GF, which collapsed a few years later. Although key performance data were lacking, estimates at the time indicated that the Japanese system operated efficiently: the cost of operations was only 3.5 percent of the guaranteed loan amount (2.8 percent in administration plus 0.7 percent losses net of recoveries). The Republic of Korea's systems were more expensive to run, with 7 percent on operating costs alone. About US$9.5 billion was guaranteed in 1997, about 13 percent of all loans to SMEs. Default rates on guaranteed loans were 6.8 percent. Of these defaults, only about 23 percent could be recovered later, producing a net loss of about 5 percent of the amount of the guarantees, or about 4 percent after deducting the 1 percent guarantee fee.

Levitsky (1997) covers guarantee systems in India, two of which were introduced in 1981, covering small industries and exporters. The Indian Deposit Insurance and Credit Guarantee Corporation (DICGC) managed the guarantee arrangements for both systems. Claims increased from 45 000 in 1987 to 190 000 in 1994/95. The actual gross paid-out claims rate was 5.8 percent. As 6.8 percent of this amount was later recovered, the net loss rate was 5.4 percent. Typical of subsequent developments in India (see the description of the CGTMSE system in chapter 3), 23 percent of claims were either not claimed by the lending banks or were refused by DICGC. The 1998 FAO study also reports on CGS in Indonesia, where in the mid-1990s they played a similar major role to that of the past, while in Malaysia CGS had been promoted earlier, but were already in decline. The dynamic and private sector-driven banking scene in the Philippines provides an example of private guarantee systems that had made some inroads in the mid-1990s.

Situation to date

GF arrangements in Asia have proliferated over the past 15 years. By far the most visible was launched in India, first as an SME and later specifically as a micro- and small enterprise development system (CGTMSE). This system constitutes one of the four detailed case examples in chapter 3. It is characterized by a more radical pro-poor orientation towards micro- and small enterprises, in line with the central bank's policy of promoting collateral-free loans to these potential borrowers.

A recent review of the effectiveness of the New Principal Guarantee Scheme offered by the Credit Guarantee Corporation in Malaysia came up with mixed results (Boocock and Shariff, 2005). Using a variety of research methods, the

authors investigated whether the Credit Guarantee Corporation had achieved its objectives of generating finance and economic additionality without placing its financial resources under undue strain or jeopardizing its relationships with participating financial institutions. The authors conclude that it is "almost impossible" to establish definitive measures of additionality given the thin data sets available for review, adding that they had collected sufficient evidence to conclude that the corporation had not met all of its stated objectives at the time of the study.

Japan initiated the first reported guarantee system anywhere in the world, dating back to 1937. In the 1998 FAO study, Gudger speaks of only one piece of research and attempts to validate GF performance on the basis of information for the entire Asian continent (Hatakeyama, Yamamori and Nakamura, 1997).

Similar research is reported in the recent article of Uesugi, Sakai and Yamashiro (2010), who provide an update on the large guarantee programme in place during 1998 and explain the financial collapse of the system in 2001 as a consequence of the decreased availability of funds for SME promotion. Through the Special Credit Guarantee Programme for Financial Stability, the Japanese Government guaranteed a total of approximately JPY 30 trillion (US$300 billion) of loans, or about 10 percent of total lending for the four years. The authors' research shows that the availability of loans increased for programme participants, but when loans were provided by undercapitalized banks the increased liquidity persisted for only a few years. Furthermore, the *ex-post* performance of programme participants, other than firms with sizeable net worth, deteriorated relative to their non-participating counterparts. The implication is that quite a few of the borrowers with guarantee cover were not good credit propositions in the first place.

Latin America and the Caribbean

GFs also spread rapidly in this part of the world. A look at the history is instructive because credit guarantee funds are a new type of institution in most parts of the world, dating back no more than two or three decades.

The Bannock study of the mid-1990s (Graham Bannock and Partners Ltd, 1997, summarized in Levitsky, 1997) draws on the example of the Small Business Development Corporation (SBDC) of Trinidad and Tobago. SBDC operated a CGS from 1990 with a GF of US$5.2 million. During the following five years, 1 855 guarantees were issued, for a cumulative value of US$4.93 million. Of these guarantees, 12.6 percent were paid out in claims equivalent to 9.2 percent of the guarantees approved. Added to these risk costs were operational expenses of US$226 000. Set against the US$2.9 million outstanding in the same period (1994), administrative expenditures amounted to more than 10 percent, resulting in total running costs of more than 20 percent. Later in the 1990s, a portfolio guarantee from SBDC was introduced, covering selected SME business of only the largest Trinidad and Tobago banks. No further results of this system are known.

Situation to date

There are two regionally operating GFs for agriculture and rural entrepreneurship development. *Proyecto Cambio* is a loan and guarantee facility set up by the Global Environment Facility and UNDP. It aims to develop MSMEs linked to the conservation and rational use of biodiversity of the Central American region.

Most Latin American and Central American countries operate a range of mainly individual and partial credit guarantee facilities. However, data on past or current performance of these funds are not available or are not accessible to the public. For example, in Brazil three different funds for agriculture and agroprocessing operate under the umbrella of the Brazilian Development Bank. The most important of these funds, the *Fundo Garantidor para Investimentos*, works with 12 intermediary banks and supports investments, mainly in larger-scale agricultural production. Microenterprises form the smallest client bracket and are defined as units with an annual gross profit equivalent to US$1.5 million. Guarantees are individual and range from 20 to 80 percent. The formula for deciding guarantee amounts is posted on the Web site of the Brazilian Development Bank.[10] Enterprise ratings are included in the consideration of loan and guarantee facilities.

In Trinidad and Tobago, the successor to SBDC continues to focus its financial services promotion activities on issuing partial individual guarantees. The Business Development Company provides loan guarantees for commercial banks lending to SMEs, exclusively to finance their working capital requirements. The company guarantees up to 85 percent of loans to a maximum of TT$ 500 000,[11] with the possibility of increasing to TT$ 1.5 million. At the end of 2009, the company had issued 5 190 guarantees valued at TT$ 130 million and covering loans of more than TT$ 250 million (Moya, Mohammed and Sookram, 2010). No further details on technical or financial performance are available.

Near East and North Africa

Historically, this region was not proactive in establishing GFs. However, over the past two decades, funds have been advocated in several countries with advanced and widely present banking industries and high population densities. In the Maghreb, Tunisia has developed a range of sophisticated GFs (see the Tunisia term sheet in Annex 2.15).

Lebanon stands out as an economy with a long-standing GF, and new and innovative approaches for credit guarantees. Kafalat is a self-standing credit guarantee corporation established by the Lebanese Government in 1999 with core capital of US$13.3 million: US$75 percent contributed by the publicly owned *Institut National de Garantie des Dépôts* and 25 percent by the 46 banks that were in operation at the time. Kafalat started operations in June 2000 and has covered 9 600 loans, with agriculture accounting for the largest share, at 45 percent, industry for 40 percent and tourism for 12.5 percent. Technology and traditional crafts account for 3.5 percent of the covered loans. Kafalat is supervised by the central bank as a single-purpose guarantee cooperation.[12]

A notable share of its total portfolio covers agricultural finance loans under individual guarantees. Between 40 and 60 percent of the original Kafalat product portfolio has directly financed agriculture, with industries as the second largest guaranteed loan segment. Kafalat coverage extends to up to 75 percent of the total

[10] www.bndes.gov.br/sitebndes/bndes/bndes_en/

[11] US$1 = TT$ 6.3.

[12] A special law enacted to allow the *Garantie des Dépôts* to invest in Kafalat specifies agriculture, industries, tourism and traditional crafts as investment areas.

principal loan amount; under various EU-funded special products, coverage can increase to 85 percent for loans of up to US$30 000 to small farmers, but most agricultural loans guaranteed by Kafalat are larger than this.

Kafalat grants guarantees for up to seven years with a grace period of six to 12 months. Loans have to be repaid monthly, and the maximum guarantee amount is US$200 000 per beneficiary. Potential borrowers should submit applications with a business plan and a feasibility study. Kafalat operates profitably from a 2.5 percent guarantee fee as its principal source of income.

Also in Lebanon, the Economic and Social Fund for Development planned to extend its conventional credit lines to commercial banks and to offer portfolio guarantees from January 2011, responding to Lebanese banks' demand for these services. However, no further details about these plans are available.

THE REGULATORY FRAMEWORK FOR CREDIT GUARANTEES

The Bank of International Settlements (BIS) provides important reference material on regulatory and supervisory aspects of credit guarantees.[13] The Basel II Capital Framework of 2005 constitutes the reference for developing banking sectors and establishes clear regulations for the treatment of guarantees by banking supervisors. The Basel II Framework evolved into Basel III and the second Solvency Framework Guidelines for the Finance Industry (Solvency II) of 2010.

Basel II Framework with regard to risk classification of guarantees

Over the last decade, international standards for capital measurement have tightened the scope for using credit guarantees and credit derivatives to reduce the capital requirements for bank portfolio exposure. Commercial banks usually book credit guarantees as contingent liabilities, off the main balance sheet. During the 1990s – and occasionally since then – this practice led to significant incidences of fraud and misappropriation, particularly in the banking systems of Eastern Europe and the CIS. International accounting standards have become more rigorous in this area, and now demand disclosure whenever the possibility of outflow in settlement becomes probable.

With regard to capital requirements for guarantees, BIS concluded the following in the Basel II Framework (2005), which did not undergo substantial changes in the post-financial crisis Basel III adjustments of 2010:

> *Where guarantees or credit derivatives are direct, explicit, irrevocable and unconditional, and supervisors are satisfied that banks fulfill certain minimum operational conditions relating to risk management processes they may allow banks to take account of such credit protection in calculating capital requirements.*

Basel III

Basel III and Solvency II sharpen the recognition of credit risk mitigation techniques when determining the required capital under Basel III. These mitigation

[13] www.bis.org

techniques include the use of: i) collateral; ii) guarantees; iii) credit derivatives; and iv) claims netting. Regarding guarantees, the basic guidance to regulators remains unchanged from Basel II. Like credit derivatives, credit guarantees can be used to reduce credit exposure when they are direct, explicit, irrevocable and unconditional. IMF clarifies that under Basel III, supervisors must also be satisfied that banks fulfil certain minimum operational conditions relating to risk management processes, and the guarantors must be recognized by the supervisor. The hedged portion of the exposure is assigned the risk weight of the guarantor or protection provider (Al-Darwish *et al.,* 2011).

Basel-compliant EU guidelines for guarantees

An European Commission Notice of 2008 sets out conditions for CGS and credit guarantee providers under EU coverage. Sections 3.2 to 3.5 – the main body of the notice – stipulate that guarantee arrangements must not be considered as direct State aid and are thus not under the special watch of competition regulations within the EU. For individual guarantees, the notice stipulates that the end borrower must not be in financial difficulty and that the guarantee must not cover more than 80 percent of the outstanding loan or other financial obligation.

Obligations of the lending institution concern mainly the extent to which the lender assumes the risk of the underlying loan. The EU notice specifically discourages first loss guarantees, in which losses are first attributed to the guarantor and then to the lender. These arrangements are regarded as possibly involving aid. The price for the guarantee should not be set uniformly by industry standards. Instead, when determining the corresponding market price, the characteristics of the guarantee and of the underlying loan should be taken into consideration. These characteristics include the amount and duration of the transaction; the security given by the borrower, and other factors affecting evaluation of the recovery rate; the probability of default of the borrower due to its financial position, sector of activity and prospects; and other economic conditions. This analysis should enable classification of the borrower's risk rating.

For valuation of the individual guarantee premium for SMEs that do not have a credit history or a rating based on a balance sheet approach – such as certain special purpose companies or start-up companies – the safe-harbour premium is set at a maximum cap rate of 3.8 percent (to be adjusted from time to time in accordance with market conditions).

Chapter 3
Case examples from developing country experience

This chapter is based on a detailed review and assessment of four CGS in different parts of the world. It provides lessons from experience and global comparisons from cases of FIRA in Mexico, CGTSME in India, ACGSF in Nigeria, and RDF in Estonia. A complete description of these guarantee systems is available in the document *Four case studies on agricultural credit guarantee funds* at http://www.fao.org/ag/ags/ags-division/publications. This work completes and compares with material from other recent studies of GFs (FAST, 2011; World Bank, 2009).

The comparative overview focuses on key design and performance indicators that allow comparison of the different approaches.

The key design indicators are:

1. type of guarantee;
2. leverage;
3. governance and management;
4. geographical coverage;
5. targeted borrowers;
6. eligible financial service providers.

The key GF performance indicators vary widely among the different stakeholders in a guarantee arrangement. For the funders and owners of programme funds, which are often the public sector, the most important key performance indicators of a guarantee arrangement are:

1. accelerated access to loan finance (or investments) for specified development priority groups;
2. reduced interest rates for borrowers because of partial risk coverage.

For lenders the most important indicator is:

3. a recovery performance of the guaranteed portfolio that does not decline in spite of partial risk coverage to avoid reputational risk for the involved banks.

For GF managers it is:

4. a stable programme fund (with low guarantee calls) that is not reduced by loan defaults or high administrative expenditures and associated cost overruns.

There are also wider strategic or sector considerations, which do not figure prominently among the stakeholders but are of interest to policy-makers and financial sector managers:

1. the extent of subsidization and requirements of public funding in relation to loans reaching the developmental target group;
2. the vulnerability to politicization and resulting loan defaults.

LATIN AMERICAN EXPERIENCE – *FIDEICOMISOS INSTITUIDOS EN RELACIÓN CON LA AGRICULTURA*, MEXICO

Introduction

CGS housed in specialized financial institutions and operating as second-tier or apex institutions have a long history in Central and South America. In Mexico, different guarantee systems for industry, export, and agriculture and rural development have been in place for many decades. Even for agriculture and rural development, there are several GFs operating in the Mexican rural and SME sector. Among these funds FONDO PYME was constituted by the Ministry of Industries and supports rural micro- and small enterprises. Another GF provides access to funding administrated by *Financiera Rural*, to cover loan defaults.

FIRA is a group of public trust funds supporting rural development, established in 1954 as a publicly owned and capitalized development financial institution operating as a second-tier development bank. All trust funds operate under a single public administration. Products include loans, guarantees, capacity development, and technical assistance for technology promotion and dissemination. FIRA runs its own network of branches throughout Mexico and operates through specialized trust funds that were established sequentially to meet different policy objectives and client group requirements:

- *FONDO (1954):* The *Fondo de Garantía y Fomento para la Agricultura, Ganadería y Avicultura* is the original fund provided by the Mexican Federal Government to support the financing of agricultural and animal production through short-term funds and working capital financing.
- *FEFA (1965):* The *Fondo Especial para Financiamientos Agropecuarios* provides investment financing and other services for the same client group.
- *FEGA (1972):* The *Fondo Especial de Asistencia Técnica y Garantía para Créditos Agropecuarios* provides technical assistance and guaranties to the agriculture and related sectors.
- *FOPESCA (1989):* The *Fondo de Garantía y Fomento para las Actividades Pesqueras* focuses on supporting the fisheries sector.

FIRA is planning to establish an additional trust, FONAGA for renewable and bioenergy projects, and a special programme for long-term financing and investments in energy efficiency.

A special characteristic of the FIRA set-up is that it runs 136 offices throughout Mexico, focusing on communities with populations of up to 50 000 people. It is a large organization with a total staff of 1 150 specialists.

Table 1 illustrates FIRA's three types of financial product, broken down by term and specific rural or agricultural subsector.

FIRA's trusts target a wide range of rural productive farm, agroprocessing and micro- and small enterprises: any business-related project in the rural sector in communities with fewer than 50 000 inhabitants can apply for FIRA coverage.

Ownership and management

The different trust funds are operated under a single management. Although FIRA is a public sector organization, its board and management have enjoyed considerable continuity of leadership. Board members come from the Federal Government, the

TABLE 1
FIRA and associated trust financial products, by term and sector (millions of pesos)

Type of loan	2010			2011		
	Loans granted	Loans + guarantee	Guarantee without loans	Loans granted	Loans + guarantee	Guarantee without loans
Per term						
Short-term	75 291	51 189	12 964	84 012	50 849	11 035
Long-term	13 336	8 170	1 354	14 027	8 484	1 842
Total	**88 627**	**59 359**	**14 318**	**98 039**	**59 333**	**12 877**
Per sector						
1. Agriculture	59 011	43 786	9 907	63 524	38 448	8 344
2. Livestock	17 538	7 661	2 724	20 614	12 460	2 704
3. Forestry	976	852	478	1 165	712	155
4. Fisheries	2 622	2 260	786	3 190	1 958	425
5. Rural lending	8 480	4 800	423	9 546	5 755	1 249
Total	**88 627**	**59 359**	**14 318**	**98 039**	**59 333**	**12 877**

Source: Compiled by L. Miranda, FIRA, 2011.

central bank, commercial banks, agricultural industries and farmers' organizations representing the different types of agricultural producers in Mexico. A recent report (FAST, 2011) observes that FIRA is considered a highly professional and technical organization with a reputation for independent management and decision-making. This has enabled it to avoid various types of interference.

Guarantee terms and conditions

As Table 1 indicates, guarantees constitute one of three financial products and, as a stand-alone facility, represent only a minor part of FIRA's product mix.

FEGA is the trust with the most direct coverage of agriculture and agribusiness along the commodity value chain. Guarantees are offered by intermediary banks. The guarantee fee payable by the borrower consists of two cost elements: the operating costs of the FEGA specialized trust, and a contribution to cover expected loan defaults.

FEGA guarantees are offered in two currencies – United States dollars and the local currency. FEGA provides partial individual guarantees covering varying percentages of the guaranteed loans, usually depending on the currency of the loan and the type of intermediary involved (bank or non-bank). Typically the percentage is a maximum of 63 percent of the loan.

Financial performance

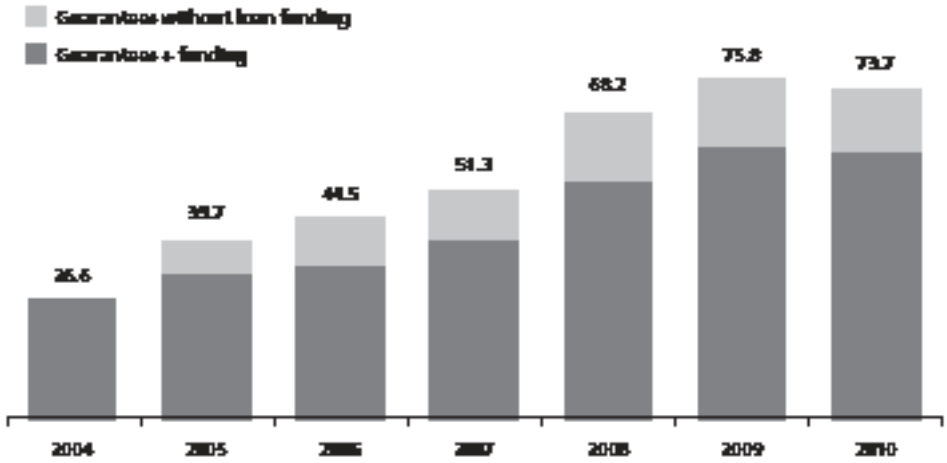
The sum total of FIRA equity amounted to about US$5 202 million at the end of 2010. Of this, FEGA equity amounted to US$990 million.

During 2010, FEGA (the trust fund in charge of the guarantee service) granted MXN 59 359 million in guarantees on FIRA's total loan portfolio (67 percent) and on MXN 12 964 million of loans granted by other financial intermediaries from their own resources (guarantees without loan funding). Figure 1 presents both loan guarantee products – guarantees and loans, and guarantees granted from FEGA resources for agricultural and agribusiness promotion. FEGA granted MXN 73 677 million (US$5 946 million) in guarantees to support 1.08 million producers, an average of US$5 505 per producer. Of this amount, 39.7 percent (MXN 29 300 million) went to small producers and 60.3 percent (MXN 44 377 million) to producers with higher incomes.

The portfolio of credit guaranteed by 31 December 2010 rose to MXN 48 763 million, of which MXN 28 874 million was for short-term credits and MXN 19 889 million for long-term loans.

Income is generated through investments. FIRA and FEGA invest exclusively in the government bonds, bank debt and repurchase agreements with the best ratings (Tables 2 and 3). FIRA's accumulated earnings amount to US$213 million and FEGA's to about US$71 million. There have been no donations or capital infusions. The total volume of guarantees granted amounts to approximately US$5 261 million.

FIGURE 1
FEGA's guaranteed loans (MXN billion, December 2010)



Source: L. Miranda, FIRA, 2011.

TABLE 2
FIRA key design indicators

Type of guarantee	Individual
Coverage	Depending on currency and individually tailored; 63% on average
Governance and management	Central management with subsidiary trusts
Geographical coverage	National
Targeted end borrowers	Agriculture, livestock, agribusiness, fisheries, rural MSMEs
Eligible financial service providers	99 intermediaries, 22 banks, 77 other financial institutions
Claim Settlement Procedures	Fast settlement of claims, with on-site verification in participating banks

TABLE 3
FIRA key performance indicators

Capital of the programme fund	US$5 202 million (FIRA)
Number of borrowers, current	1.08 million producers (FEGA only)
Volume of loans under guarantee	US$5 261 million (FEGA only)
Current default rate on guaranteed loans	0.74–3.2% depending on producer type; 0.11–4.1% depending on intermediary type*
Growth/decrease of capital	September 2009 to September 2010 FIRA achieved 10.15% annual average returns, and FEGA 10.67% on its investment portfolio

* FIRA presentation at the FAO Global Expert Roundtable on Agricultural Guarantee Funds, Yerevan, Armenia, 27 and 28 September, 2011.

Source: Compiled by L. Miranda, FIRA, 2011.

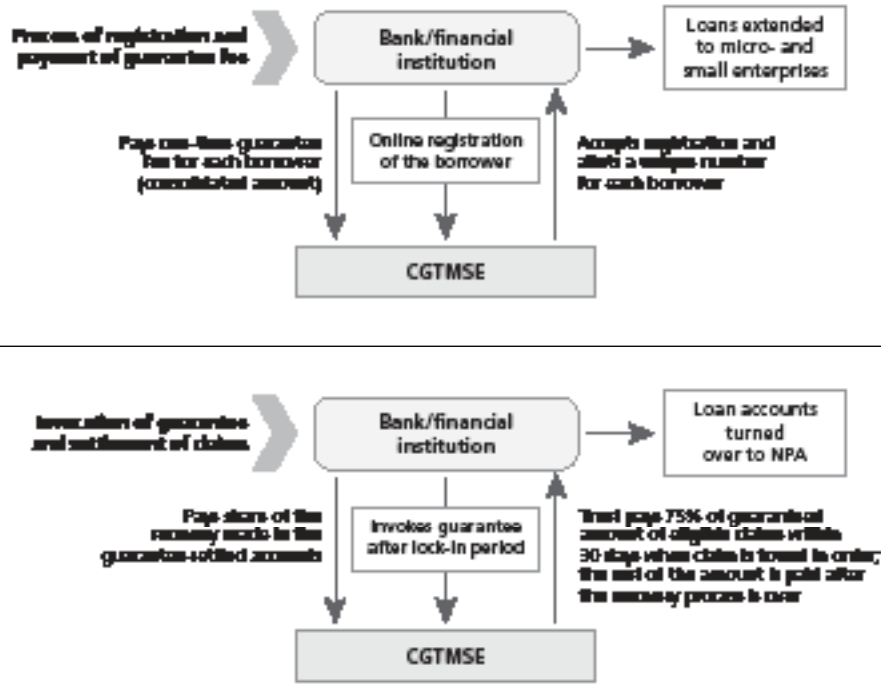
ASIAN EXPERIENCE – CREDIT GUARANTEE FUND TRUST FOR MICRO AND SMALL ENTERPRISES, INDIA

Introduction

In line with the recently increased policy attention to the development of rural micro- and small enterprises, the Small Industries Development Bank of India (SIDBI) designed and piloted a system, which was initially for State-owned commercial banks and expanded in 2007 to cover India's large regional rural banks. This enlarged both the system's volume and its penetration into rural and agricultural areas. As of 31 January 2010, there were 110 member lending institutions (MLIs) registered with CGTMSE: 27 public sector banks, 16 private sector banks, 59 regional rural banks, six financial institutions and two foreign banks.

Start-up and existing micro- and small enterprises that have received loans without any collateral security and/or third-party guarantees are eligible for guarantee cover under the CGTMSE system.

FIGURE 2
CGTMSE system, India



NPA = non-performing asset.

Source: CGTMSE, no date.

Ownership and management

The trust fund was contributed by the Government of India's Ministry of MSME (80 percent) and SIDBI (20 percent). It is managed from SIDBI's corporate office in Mumbai, which also designed and piloted the system. Figure 2 illustrates the basic functioning of this partial individual CGS.

Guarantee terms and conditions

Guarantee coverage

Any collateral and third-party-free loans granted by participating MLIs up to a credit limit of INR 10 million are eligible for CGTMSE cover.[14] The extent of the guarantee cover varies: for microenterprises with loans of up to INR 500 000 and defaults of up to INR 425 000, 85 percent of the default is covered; for loans

[14] US$1 = INR 47.20.

up to INR 5 million coverage is generally up to 75 percent; and for those up to INR 10 million it reaches 50 percent, or a maximum of INR 6.25 million.

Guarantee tenure
Cover commences from the date of payment of the guarantee fee and runs through the agreed tenure of the credit. For working capital, guarantee cover is available for up to five years. Units covered under CGTMSE that suffer defaults because of *force majeure* or other circumstances can be covered for up to the credit cap of the CGTMSE system (INR 10 million).

Guarantee fees
One-time guarantee fees of 1 percent of the credit limit for credit facilities up to INR 500 000 and 1.5 percent for facilities above INR 500 000 are charged.[15] Annual service fees are 0.50 percent for loans up to INR 500 000 and 0.75 percent for larger loans.

Guarantee registration
On approval and disbursal of the loan, the MLI starts the registration process, which is online and generates a unique identity number for each borrower on acceptance by CGTMSE. The MLI then pays the one-time guarantee fee against each borrower, which is transferred online to CGTMSE within 30 days of disbursal of the loan.

Claim settlement
A Reserve Bank of India (2010) report observes that under satisfactory terms and conditions, MLIs may invoke a guarantee within a maximum of one year from the date of an account becoming classified as a non-performing asset, if the date of such classification is after the lock-in period of 18 months from the date of the guarantee, or within one year after the lock-in period, if the date of classification is within the lock-in period.

The claim settlement process of CGTMSE appears to be slow and complicated. According to the available data, the trust had received a total of 4 761 claim applications from MLIs by 31 March 2010, of which 2 506 were settled, giving a success rate of 52.64 percent. Of the cumulative settled account, the share settled during 2009/10 was 68.72 percent (1 722). About 11.20 percent (533) of the claim applications were not eligible, 420 (8.82 percent) were incomplete and 1 302 (27.34 percent) were pending settlement. This demonstrates that both invocation and settlement of guarantees under CGTMSE are slow.

According to the bankers, the causes of this low level of guarantee invocation were the complicated procedures for filing a lawsuit as a precondition for submission of a claim, and the prescribed lock-in period of 18 months. CGTMSE is of the view that most of the applications are not in line with requirements. The average time required to complete the settlement of an account (first instalment) is more than six months, which hinders the smooth functioning of the GF.

[15] There are exceptions to this, and other terms and conditions of the CGTMSE scheme for enterprises in a small group of states in northeastern India that are considered particularly in need of development assistance.

The provision that the final instalment of the claim (25 percent of the total amount) is paid by the trust only after the decree of recovery has become time-barred – approximately 12 years after it has been passed by the courts – causes problems to participating MLIs, leading some of them to book this 25 percent as a loss after receipt of the first instalment of the claim (75 percent of the total eligible).

Financial performance

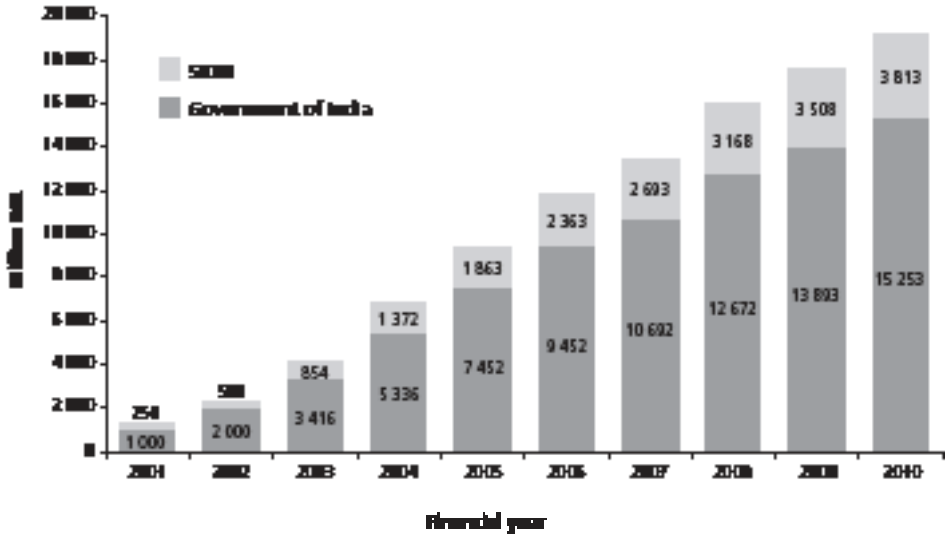
Trust fund size and contributors

The committed corpus of the trust is INR 25 billion divided between the Government of India (INR 20 billion) and SIDBI (INR 5 billion) at the ratio of 4:1. Of the cumulative INR 19 065.6 million received by the trust as a corpus fund by 31 March 2010, the aggregate contributions of the Government of India and SIDBI were INR 15 252.5 million and INR 3 813.1 million respectively. The balance contribution of INR 5 934.4 million from the government and SIDBI was expected to be received over the following two financial years. The year-wise corpus contribution is given in Figure 3.

Recent trends and developments

CGTMSE had received 4 761 claim applications from MLIs by 31 March 2010, of which the trust had settled 2 506 for INR 530.24 million: 533 applications were not eligible, 420 were incomplete and 1 302 were pending settlement. During the 2010 financial year alone, there were 1 722 (68.7 percent) claim settlements for

FIGURE 3
CGTMSE trust fund composition



Source: CGTMSE, no date.

TABLE 4
Claim settlements by the CGTMSE trust, 2005 to 2010

Year	No. of claims settled	Amount of claims settled (million INR)	Average loan size (INR)
2005	47	5.40	114 000
2006	113	11.04	98 000
2007	111	14.46	130 000
2008	238	71.44	300 000
2009	275	85.36	310 000
2010	1 722	342.53	199 000
Total	2 506	530.23	212 000

Source: CGTMSE, no date.

INR 342.53 million (64.6 percent), indicating that there was a steep rise in the invocation of guarantees during the year, which suggests that the trust will face challenges in the years to come (Table 4).

At the end of March 2010, CGTMSE had leveraged itself to more than six times its corpus funds (INR 19 065.6 million) by extending credit guarantee coverage to a loan portfolio of INR 115 600 million. It has now become imperative that the settlers of CGTMSE increase the corpus of the trust so they can increase the volume of credit guarantee approvals and tap the emerging market of micro- and small enterprises. Exploring the possibilities for reinsuring the guarantee coverage extended by CGTMSE in a cost-effective manner could also improve the position.

Tables 5 and 6 outline CGTMSE's key design and performance indicators.

AFRICAN EXPERIENCE – AGRICULTURAL CREDIT GUARANTEE SCHEME FUND, NIGERIA

Introduction

This is one of the oldest operating CGS in the developing economies. It was established in 1977 with 60 percent of its funding from the national government, and the remaining 40 percent sourced from the Central Bank of Nigeria (CBN), which also manages the system. ACGSF provides guarantees for loans to agriculture, including perennial crops such as coffee, tea, cocoa, rubber, oil-palm and cereals, and animal production and processing under certain conditions. The guarantee mechanism has features of a portable guarantee as the farmer applies for the loan guarantee together with the lending bank.

History

After becoming operational in 1978, ACGSF quickly became a major player in Nigerian agricultural finance because of the very favourable terms and conditions the system granted to lending banks: 75 percent coverage of the principal in case of default, plus reimbursement of interest up to a level matching the interest income from non-due loans. However, the settling of claims filed by banks became very slow, which led to a drop in the number of banks participating in the guarantee

TABLE 5
CGTMSE key design indicators

Type of guarantee	Partial individual
Coverage	50–85 percent
Governance and management	State-owned development financial institution (SIDBI)
Geographical coverage	National
Targeted end borrowers	MSMEs (including start-ups)
Eligible financial service providers	110 MLIs (2001 to 2010); 27 State-owned commercial banks; 16 private sector banks; 59 regional rural banks; 6 other FIs; and 2 foreign banks
Procedures for claim settlement	2 tranches – 75% and 25% – of which the latter is payable after more than 10 years

TABLE 6
CGTMSE key performance indicators

Capital of the programme fund	INR 19 065.6 million (US$397.2 million)
Number of borrowers, current	300 105 (cumulative total in 2010)
Volume of loans under guarantee	INR 115 600 million (US$2.41 billion)
Current default rate	2 506 claims settled by 31 March 2010 (52.64%)
Growth/decrease of capital	From INR 125 million (2001) to INR 19 065.6 million (2010). Committed corpus of INR 25 000 million

Source: Compiled by P. Das, 2011.

arrangement. Recent evidence shows that the number of participating banks has begun to increase again.

Financial performance

CBN manages the day-to-day operations of the fund, which at the end of 2009 had a capital base of NGN 1.95 billion. The exclusive source of income is placement of funds in local money markets, with the resulting fluctuations in interest rates explaining the fluctuations in revenue (Table 7).

It is important to note that salaries and wages (52.76 percent) and other administrative expenses (mainly travel, hotel and mobility-related expenditures and those for communications and stationery) together make up more than 90 percent of the system's total expenditure. No separate cost attributions are made for the office space provided by CBN. With its limited field presence and its links to CBN's central and regional offices, ACGSF follows a different strategy from that of FIRA in Mexico with its extensive network of branches.

The performance of ACGSF has been mixed. By 31 December 2009, a total of 442 726 loans, valued at NGN 18.20 billion had been repaid, representing average loan repayment rates of 68.4 percent by number and 52.9 percent by value or amount. Compared with 2007, these figures indicate a decline in performance. The values for 2007 were respectively 69.7 and 58.5 percent. According to CBN (no date), the single factor constraining the repayment of loans under the system was the

TABLE 7
ACGSF income and expenditure statement, 2006 to 2009 (NGN)

Item	2006	2007	2008	2009
Income				
Investment	397 042 104	309 117 350	475 029 155	199 723 265
Operating expenses				
Claims	16 344 487 (7.02%)	23 324 438 (7.96%)	2 033 797 (0.80%)	14 231 700 (4.46%)
Salaries and wages	87 472 253 (37.55%)	111 500 188 (38.06%)	141 426 521 (55.96%)	168 307 912 (52.76%)
Other administrative expenses*	119 339 239 (51.23%)	149 479 708 (51.02%)	104 582 869 (41.38%)	130 399 227 (40.88%)
Uninsured stolen vehicle written off	Nil	Nil	59 461 (0.02%)	Nil
Directors' emolument	4 256 660 (1.83%)	3 691 332 (1.26%)	666 667 (0.26%)	1 583 000 (0.50%)
Audit fees	525 000 (0.23%)	525 000 (0.18%)	525 000 (0.21%)	525 000 (0.16%)
Travels for audit inspection of branches	569 000 (0.24%)	781 000 (0.27%)	1 238 700 (0.49%)	1 998 800 (0.63%)
Depreciation	4 451 371 (1.91%)	3 688 648 (1.26%)	2 179 395 (0.86%)	1 960 595 (0.61%)
Total expenses	232 958 010	292 990 314	252 712 410	319 006 234
Surplus/deficit	**164 084 094**	**16 127 036**	**222 316 745**	**(119 282 969)**
Reserves b/f	1 532 802 604	1 696 886 698	1 713 013 734	1 935 330 734
Reserves c/f	1 696 886 698	1 713 013 734	1 935 330 479	1 816 047 510

Figures in parentheses are percentages of total costs.
* Include hotel and travelling; stationery, postage and communications; conferences and seminars; newspapers and periodicals; entertainment; medical expenses; repairs, maintenance and vehicle running; consultancy; training; advertisement and publicity; and incentives for farmers.

Source: Annual reports and financial statements of ACGSF 2006 to 2009.

bad loans granted in its early years (1978 to 1988). From 1989 to 2009, there was a remarkable improvement in the system's procedures for loan appraisal, monitoring and records of repayment.

Tables 8 and 9 outline ACGSF's key design and performance indicators.

EASTERN EUROPEAN EXPERIENCE – RURAL DEVELOPMENT FOUNDATION, ESTONIA

Introduction

RDF represents a typical case of a State-capitalized GF specifically for agriculture and related investments along different agricultural, animal production and fishery value chains. It operates as an individual loan guarantee system and collaborates

TABLE 8
ACGSF key design indicators

Type of guarantee	Individual
Coverage of principal	75% (plus interest)
Governance and management	CBN
Geographical coverage	National
Targeted end borrowers	Agricultural producers
Eligible financial service providers	Commercial and merchant banks
Procedures for claim settlement	Farmers paying up the credit plus interest on schedule are granted a 40% rebate on the interest. When a farmer fails to do so, ACGSF pays, but it takes a long time. ACGSF always pays 75% of the principal plus interest

TABLE 9
ACGSF key performance indicators, at end of 2009

Capital of the programme fund	NGN 1.95 billion
Number of borrowers, current	52 787
Volume of loans under guarantee	NGN 6.721 billion
Current default rate	Average loan repayment rates of 68.4% by number and 52.9% by value in 2009; 69.7% and 58.5% in 2007
Growth/decrease of capital	Investment return of NGN 199 723 265 in 2009

Source: Compiled by B. Omonona, 2011.

with Estonian commercial banks. RDF operates as a multi-purpose foundation supporting rural and agricultural development. It: i) promotes investments in agricultural and rural areas; ii) provides loans and guarantees as financing support to rural and agricultural entrepreneurs; and iii) offers training and capacity building and other types of technical assistance to end borrowers.

Targeted clients for guarantees include small, medium and large farmers and agro-enterprises owners who require guarantees to meet borrowing needs. Savings and loan associations and some non-profit community association clients also use RDF's services to obtain access to finance. The guarantees mitigate the high loan collateralization demanded by Estonian banks, which often reaches 120 to 150 percent of the principal loan amount.

Table 10 shows the RDF loan guarantee portfolio approved in the first six months of 2011. It illustrates the agricultural focus and the overall leverage between guaranteed obligations and the balance financed by commercial banks. The total combined loan portfolio of banks and RDF was €33.94 million in the first half of 2011, of which 62.93 percent was financed by commercial banks, and the remaining 37.07 percent was covered under partial RDF risk coverage. The average loan per borrower in agriculture is €167 544. For the entire guaranteed portfolio, approved loan principals average €181 594.

TABLE 10
RDF guarantees, by business area, first six months of 2011

Business areas	Number of guarantee agreements	Bank financing (€)	RDF guarantees (€)	% guaranteed
Agriculture	111	11 873 026	6 724 367	53.44
Commerce, storage	11	2 943 626	1 513 309	12.03
Fisheries	7	1 579 431	1 135 313	9.02
Food processing	1	1 340 000	804 000	6.39
Tourism, hotel service	9	1 009 435	630 496	5.01
Forestry	12	634 312	415 215	3.30
Other activities	6	701 710	363 768	2.89
Village development	12	465 428	360 262	2.86
Services	8	398 746	310 715	2.47
Construction	3	184 200	147 360	1.17
Liquid fuel sales	1	100 000	80 000	0.64
Transportation services	3	43 996	35 197	0.28
Medicine	1	50 000	35 000	0.28
Industry	2	35 173	27 338	0.22
Total	187	21 359 083	12 582 340	100.00

Source: compiled by R. Rosenburg, 2011.

History

RDF[16] was established in its present form in 2001 as a merger of two predecessor organizations: the Rural Life Credit Foundation dating back to 1993, and the Rural Credit Guarantee Fund established in 1997. This merger of a credit guarantee with a more general agricultural promotion organization aimed to adapt the work of both to the changing investment environment as Estonia evolved from a Soviet command economy to a market-based one with privately owned and managed farms. The transition incurred large investments in new machinery, equipment and infrastructure as well as in training and capacity building.

Ownership and management

RDF is owned by the Government of Estonia and its equity capital belongs to the government. The government and donor agencies provided funds for the capital.

[16] *Maaelu Edendamise Sihtasutus* in Estonian.

RDF is managed by a 16-member management board of delegates from public sector organizations, banks and ministries. It carries out four types of business activity.

Guarantee terms and conditions

RDF's GF provides guarantees for up to 80 percent of the loan, charging guarantee fees that range from 0.5 to 6 percent and are usually between 3.8 and 4.6 percent, depending on the risks.

Financial performance

In 2010, 302 guarantee agreements (compared with 245 in 2009) worth a total of €19.5 million (€16.6 million in 2009) were concluded, including 98 agreements with a total guarantee obligation of €3.4 million for financing non-profit associations. With the benefit of guarantees, borrowers were able to borrow €30.7 million (€25.8 million in 2009) from credit institutions.

Tables 11 and 12 outline RDF's key design and performance indicators.

In summary, Estonia's RDF continues to grow in terms of the number and volume of loans under guarantee. It has also continued to increase the fund capital through its annual earnings. Prudent management plus the multi-purpose set-up of the fund managing institution adds to its resilience and income.

OTHER CASE EXAMPLES

The annexes to this study include another 11 GFs. Information is presented in a template that allows direct comparisons of key technical or performance criteria.

TABLE 11
RDF key design indicators

Type of guarantee	Individual
Leverage	Varies among sectors
Governance and management	Multi-purpose foundation
Geographical coverage	National
Targeted end borrowers	Agriculture (53.44%)
Eligible financial service providers	Banks and credit unions

TABLE 12
RDF key performance indicators, end 2010

Capital of the programme fund	US$36.3 million
New borrowers, 2011	288 guarantees
Volume of loans under guarantee	US$29.4 million
Number of borrowers, current	593
Growth/decrease of capital	Net profit of US$5 million

Source: Compiled by C. Miller.

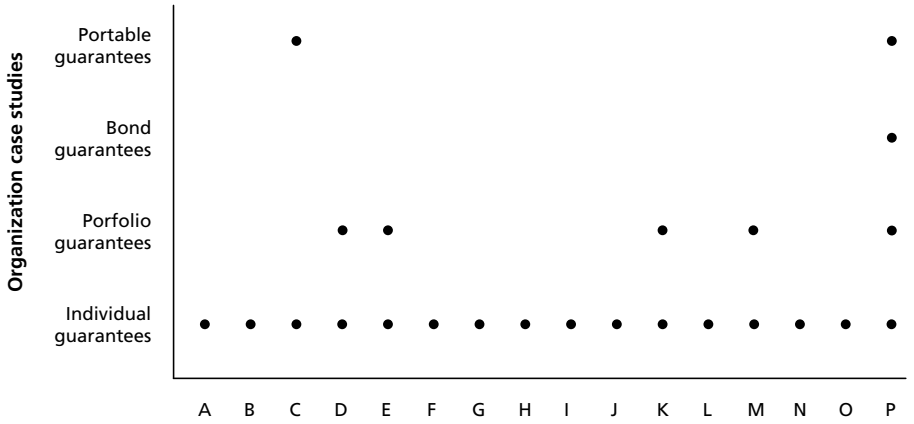
Examples include GFs from Tunisia and the Republika Srpska and a privately owned and managed GF from Burkina Faso. Publicly capitalized GFs focusing on agriculture and related industries or rural micro- and small entrepreneurs are summarized in term sheets from Senegal, Uganda and the United Republic of Tanzania. Examples from Italy and Lithuania complete this additional empirical sample set.

The templates ("term sheets") indicate that GFs, particularly in sub-Saharan Africa, were established comparatively recently. They are generally capitalized out of public budgets and – in the cases and term sheets collected – support different segments of agricultural and related value chains.

COMPARISON OF KEY INDICATORS

Figure 4 illustrates that individual partial CGS far outnumber all other guarantee types combined. Providing partial collateral cover to a clientele of individual end borrowers appears more attractive and politically acceptable than the alternative of

FIGURE 4
Types of guarantee offered



A: *Fideicomisos Instituidos en Relacion con la Agricultura* (FIRA), Mexico
B: Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), India
C: Agricultural Credit Guarantee Scheme Fund (ACGSF), Nigeria
D: Rural Development Foundation (RDF), Estonia
E: Italian State Guarantee Fund for Agricultural Credit (ISMEA), Italy
F: *Société de Cautionnement Mutuel du Sénégal*, Senegal
G: *Société Financière de Garantie Interbancaire du Burkina*, (SOFIGIB), Burkina Faso
H: Rural Credit Guarantee Fund, Lithuania
I: Guarantee Fund Republica Srbska, Republica Srbska
J: Private Agriculture Sector Support (PASS), United Republic of Tanzania
K: Bank of Tanzania (BOT) Small and Medium Enterprise Credit Guarantee Scheme (SME-CGS), United Republic of Tanzania
L: Financial Sector Deepening Trust (FSDT), United Republic of Tanzania
M: Agribusiness Loan Guarantee Company (ALGC), Uganda
N: Sustainable Agricultural Guarantee Fund (SAGF), the Netherlands
O: *Société Tunisienne de Garantie* (SOTUGAR), Tunisie
P: USAID Development Credit Authority (DCA)

Source: Compiled by the authors.

bond or portfolio guarantees. In the eyes of domestic tax-payers, bond guarantees may help "wealthy investors", while portfolio guarantees support first and foremost the financial institution, and the effect on the end borrower is less clearly visible than it is in partial individual guarantees.

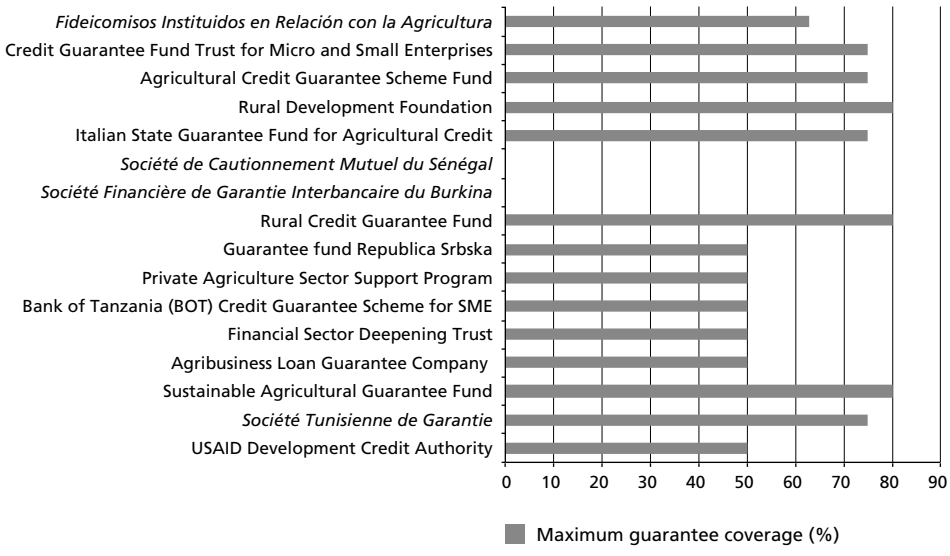
Equally instructive is a comparative overview of the coverage levels of GFs. As Figure 5 illustrates, these vary widely and, in one case (Nigeria's ACGSF), even include interest accrued.

As the discussion of India's CGTMSE highlighted, the coverage level alone does not tell the whole story. If 25 percent of the guarantee claims are paid out only after 12 years, it is more realistic to book the outstanding amounts as a straight loss. Once the distant-future pay-outs from a GF are written off the income statement, the *de facto* coverage levels of CGTMSE operate within widely accepted levels. The discussion of both different arrangements and GF innovations, such as those of Rabobank with declining coverage over time, show that a simple figure should not be used to define maximum "good practice" coverage for GF arrangements if the system's design contains complex features that water down the nominal coverage levels.

An optimum leverage ratio should be based on risk profiles of the specific end borrower group. More applied research is needed in this area to establish benchmarks by borrower profile and lending context.

Table 13 gives an overview of the different types of end borrowers covered under the different systems reviewed in this study.

FIGURE 5
Maximum guarantee coverage (percentages)



Source: Compiled by the authors.

TABLE 13
Categories of end borrower covered by guarantees

	Micro- and small enterprises and farmers	Cooperatives and producer organizations	Small and medium enterprises and medium-sized farmers	Large enterprises and large farmers
Fideicomisos Instituidos en Relación con la Agricultura (FIRA), Mexico	×	×	×	×
Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), India	×	×	×	×
Agricultural Credit Guarantee Scheme Fund (ACGSF), Nigeria	×	×	×	×
Rural Development Foundation (RDF), Estonia	×	×	×	×
Italian State Guarantee Fund for Agricultural Credit (ISMEA), Italy	×	×	×	×
Société de Cautionnement Mutuel du Sénégal, Senegal		×		
Société Financière de Garantie Interbancaire du Burkina (SOFIGIB), Burkina Faso	×		×	
Rural Credit Guarantee Fund, Lithuania	×	×	×	×
Guarantee Fund Republica Srpska, Republica Srpska	×	×	×	×
Private Agriculture Sector Support (PASS), United Republic of Tanzania	×	×	×	
Bank of Tanzania (BOT) Small and Medium Enterprise Credit Guarantee Scheme (SME-CGS), United Republic of Tanzania		×	×	
Financial Sector Deepening Trust (FSDT), United Republic of Tanzania	×	×	×	×
Agribusiness Loan Guarantee Company (ALGC), Uganda			×	
Sustainable Agricultural Guarantee Fund (SAGF), the Netherlands			×	
Société Tunisienne de Garantie (SOTUGAR), Tunisia	×	×	×	
USAID Development Credit Authority (DCA), USA	×		×	

Source: Complied by the authors.

The priority clientele of the GF arrangements covered in this study are those to benefit small and medium enterprises and medium-sized farmers. Taken together with the findings contained in Figures 4 and 5, there is a logic to the design of most systems that evolve out of national public policy interest. Individual clients are viewed as the priority from a policy point of view. This implies partial individual guarantees. Service costs and management considerations for individual guarantee systems naturally tilt the preferred client pool away from small and very small borrowers to the small enterprise segment and medium-sized farmers.

Chapter 4
Emerging trends and approaches

THE VITAL ROLE OF APPLIED RESEARCH AND SCIENTIFIC EMPIRICAL STUDIES

Few areas of debt finance and its promoting instruments have been subject to as little research or analytical analysis as credit guarantees have. The importance of credit guarantees for SME financing in general, and rural enterprise development in particular, is not reflected in the scant coverage of credit guarantees in scholarly research and analytical debate. Only over the past decade have studies on the impact of CGS been conducted in a genuinely scientific manner, beyond the evaluations or research funded by organizations that are themselves assessed, and with adequate control groups and academic rigour. Uesugi, Sakai and Yamashiro (2010) summarize the few studies that have been undertaken, mostly in OECD countries with better data availability and validation options.

Applied research differentiates between firm-level empirical surveys and individual investigations, which are referred to as disaggregated research. Scientists with recent relevant publications include Cowling (2007), who concludes that firms participating in the credit guarantee programme in the United Kingdom of Great Britain and Northern Ireland are less likely to face access barriers and credit rationing in their subsequent dealings with their lending banks. Riding and Haines (2001) and Riding, Madill and Haines, (2006) establish positive correlations between access to guarantee coverage on the one hand, and job creation and increased loan availability on the other (Canadian guarantee programmes). The research of Uesugi, Sakai and Yamashiro (2010) on the impact of CGS in Japan quoted earlier in this study is probably the most comprehensive, covering firm-level surveys of 2 066 guarantee programme users and a control group of 7 980 non-users. For each of the disaggregated borrower cases contained in these authors' research, the analysis includes the borrower's history of lending relations under guarantee. This supply-side information on each firm's financial institutions is another noteworthy feature of this very recent Japanese research. However, distortions and overlapping variables make precise identification of the guarantee systems' effectiveness difficult to establish. Aggregated research captures guarantee systems at the financial institution, GF or financial sector level and attempt to establish impact-level indicators from these. Recent relevant examples of this include Hancock and Wilcox (1998) and Craig, Jackson and Thomson (2005; 2007). Hancock and Wilcox offer a novel positive aspect of the impact of the United States Small Business Administration (SBA) guarantee programme, observing that the volume of loans made under SBA loan guarantee programmes shrank less in response to declines in bank capital during financial crisis than the volume of other loans did.

Neither aggregated primary research nor – particularly – disaggregated research on the impact of CGS at the level of the borrower are cheap as they require an elab-

orate empirical concept, statistically relevant sample sizes and adequately trained data collectors. However, secondary desk research and studies cannot substitute for vital primary research and analysis, particularly given the thin database on the performance of CGS worldwide and the even scarcer information on their technical and financial impacts. In this context, FAO's Rural Finance Learning Centre[17] has evolved as one of the main Web-based platforms for exchanging rural finance publications and thematic research and as a repository for relevant publications.

INDIVIDUAL VERSUS PORTFOLIO GUARANTEES[18]

Individual loan guarantees with identified lenders and borrowers carry high transaction costs per unit, but enable the closest calibration to given development objectives through the direct relationship between the GF staff and the end borrower. Over recent decades, individual guarantees have become a more frequent instrument for higher-volume loans and/or longer repayment periods.

Portfolio guarantees can more efficiently reach a larger group of borrowers to secure access to finance through a single guarantee facility. Because potential borrowers are defined as part of a specific lending subsector, these guarantees usually also serve to demonstrate the profitability of new and innovative lending propositions to the specific partner financial service provider and the broader market.

On account of their suitability for small lot-size transactions, portfolio guarantees have gained particular prominence for microfinance institutional guarantees. Flaming's recent study for USAID and the Consultative Group to Assist the Poor contains a few noteworthy findings (Flaming, 2007). Flaming reviewed 96 individual loan guarantees issued by eight lenders to local MFIs. The MFIs received bank loans, some of them for the first time, but with identical terms and conditions to those offered to non-guaranteed institutional borrowers. In the competitive field of MFI wholesale lending, the annual fees for the guarantees that were fully rolled over to the borrowing MFIs made these loans too costly, but even so the MFIs stuck to their guaranteed loans from local banks largely to preserve and develop their relationships with those banks.

The results of the review were mixed regarding MFIs graduating to unguaranteed borrowing from the same banks. However, guarantees are effective when they are used to structure loans to MFIs under conditions that are more favourable than typical bank loans (loan tenor and collateral cover). Flaming concludes that guarantors realize this potential by focusing on specialized international lenders and on the few markets where local commercial banks make loans to MFIs at lower interest rates than they charge to normal retail business borrowers.

Flaming's review yet again highlights that although there is an element of subsidy in the setting up and running of guarantee systems, few supply the level of financial reporting needed to ensure that subsidy levels are transparent and to allow comparative analysis. In multi-service set-ups, administrative costs are not and cannot be apportioned on the basis of the available information. Fee levels are not set

[17] www.ruralfinance.org/
[18] www.usaid.gov

with cost recovery objectives, but are typically fixed at the maximum amount that designers feel banks and MFIs would be willing to pay (Flaming, 2007).

Three factors contribute to the conclusion that the cost of guaranteeing small bank loans to MFIs would continue to be unsustainable without considerable subsidies: i) the income from small transactions is insufficient to cover the costs; ii) the guarantee agencies incur high costs because of the inexperience of the lenders; and iii) guarantee agency staff incur high costs in appraising small MFIs and assisting them with their guaranteed bank loans. Flaming's review concludes that the benefits of portfolio guarantees to MFIs were generally modest, interest charges for MFIs were not reduced much by the lending banks, and the total costs of borrowing to MFIs – including fees and charges – increased to levels that made borrowing from other domestic or international MFI wholesale lenders or equity funders more competitive.

GF managers and bankers or MFIs lending with an underlying portfolio guarantee add that portfolio guarantees are often seen as politically less desired than individual guarantees as they back up the business of the banks and MFIs. Individual guarantees are seen as direct public policy support to end borrowers.

Of the plethora of other types of guarantee that have been applied in development finance and discussed in this study, one requires a separate mention that it does not get elsewhere in this book: *Credit guarantee facilities* guaranteeing against the default of a partner financial institution became part of the support strategy for development finance and for strengthening the banking sectors of Eastern and southeastern Europe from the mid-1990s onwards. These insurance types of guarantee guarantee against the default of a financial institution, but are not for particular portfolio segments or individual borrowers. With these guarantees in place, financial service providers in Eastern and southeastern Europe could acquire much-needed medium- and long-term funding from international capital markets. On-lending to the final borrower is at the recipient bank's own risk, and the guarantee exclusively covers cases of default of a recipient financial institution servicing its refinancing facility loans to international banks or quasi-commercial development lenders.

When donors' support the start-up of CGS they often do so by absorbing initial losses, with a view to facilitating the eventual path towards self-sustained operations. The most frequent model of this is the first loss arrangement within a pool of funders of a credit guarantee fund. In this model, donor equity completely absorbs losses up to a certain threshold, after which the capital coverage of other funding partners – mostly commercial funders – or the capital of the GF itself, comes in. This is a straightforward subsidy on the part of the donor. It may easily distort management arrangements for the fund, because less emphasis (staff time) is put on keeping claim levels at a lower level. The unintended result of first loss arrangements among funders of CGS therefore is that the GF arrangement suffers from the risk of moral hazard: claim levels are higher than in the without-donor scenario, and staffing and administrative costs are not adequate to maintain claims at a level that promises long-term viability.

COMMERCIALIZATION OF LOAN GUARANTEE FUNDS

For mainstream CGS, the ultimate objectives are to: i) operate sustainably and without the need for repeated infusions of programme funds; and ii) provide added value to the portfolios of rural-based lenders. These objectives should be accompanied

by a reduction in the effective costs of interest on a partly guaranteed loan. If these objectives are reached in the early phase of a publicly funded CGS, the chances for commercialization are higher. However, Meyer (2011) – who has been conducting GF evaluations for USAID and others over recent decades – observes that the methodology used to evaluate guarantees has been weak, so questions about additionality and sustainability remain.

OWNERSHIP AND GOVERNANCE

Today's credit guarantee arrangements focus mainly on covering the portfolio risks of small and microfinance institutions without ready access to guarantees. Different types of portfolio guarantee therefore figure much more prominently than they did in the 1990s. Individual partial credit guarantees tend to be better at addressing borrowers with larger borrowing requirements. This is more in line with international SME standards than with microenterprise characteristics in the less developed economies.

Emerging experience shows that specialized GFs should have priority over multipurpose set-ups and that these GFs should have a clear commercial orientation, even if the initial capitalization is secured by donors. For this reason, the usual dichotomy of public versus private is much less important than is keeping both government and the donors out of the management and day-to-day affairs of GFs.

Donor funding can play a useful role in reinforcing the independent management of CGS, above all if external funders assume a proactive supervisory role with the board. The funding composition of CGS can therefore be usefully diversified by donor equity, particularly if this is made available in accordance with good practices – i.e., not provided as a first loss guarantee – and is accompanied by TA (technical assistance) and a proactive role for the donor in the supervision of the CGS.

A good example that illustrates different aspects of the ownership and management of CGS is Lebanon's Kafalat. In line with characteristics of the wider Lebanese financial sector, there are no State-owned banks among the 68 banks in Lebanon at present. Kafalat is primarily privately owned, with Lebanese banks holding a stake of 25 percent in the fund, and the *Institut National de Garantie des Depôts* (National Deposit Insurance Fund) holding the remaining 75 percent. This insurance fund is itself 50 percent owned by Lebanese banks and 5 percent by the State of Lebanon. This ensures little scope for policy interference in fund management.

INNOVATIONS AND POTENTIAL FUTURE GROWTH AREAS FOR LOAN GUARANTEES

Regionalization and globalization

The increase in risk mitigation and trust-inspiring financial mechanisms that expand beyond national borders has been one of the main areas of discussion in the ongoing crisis of the European Euro-denominated economies. Bold and early examples of mutual guarantees to protect depositors are known from the development history of German and other European thrift and credit cooperative movements. J.D. von Pischke recently proposed assessing the feasibility of a global long-term savings guarantee mechanism that would partially protect poorer people in developing economies who save in local currency instruments with the aim of protecting life savings and micro-pensions (von Pischke, 2008).

The scope for demonstration effects

Recent literature – more than the spate of articles that appeared earlier after the results of the global Bannock review were published in the mid 1990s (Graham Bannock and Partners Ltd, 1997; Levitsky, 1997) – emphasizes the potential for learning from lending under partial guarantee and the quick dissemination of this learning within the lending institution and among other lenders in the vicinity. Particularly for MFIs and their emerging rural and agricultural finance portfolios, this potential seems generally not to have been realized. Research and impact studies need to confirm this learning and to focus on its spill-over effects in future empirical research agendas.

Chapter 5

Recommendations for policy dialogue, formulation and advice

KEY LESSONS ON THE SUSTAINABILITY OF CREDIT GUARANTEE SYSTEMS

Questions and points of view regarding sustainability are at the forefront of the debate on CGS. Can CGS be sustainable without ongoing subsidy? Should they be expected to be sustainable? Under what conditions and modalities can and should they be sustainable?

When considering an economic rather than a development perspective, sustainability is mainly influenced by two variables: i) the level of claims on a credit guarantee fund arising from arrear levels in the partially guaranteed loan portfolio; and ii) the staff and administrative costs incurred while operating a guarantee system. From this perspective, Gudger (FAO, 1998) was pessimistic regarding the long-term viability of CGS. More than a decade later, it is necessary to assess whether this conclusion is still valid and, if so, under what types of assumption.

The experience of guarantee systems in many developing economies was still rather recent at the time of the 1998 FAO study, especially in Asia and Africa. Today the lessons are more extensive and the process of loss indemnification through the GF operators has become more refined. As a consequence, unsustainable losses can be mitigated because unwarranted claims may be rejected or, preferably, the loan guarantee fund is designed to avoid blanket or easy loss indemnification. Experience over the past decade shows that one important criterion is to require that regulation and legal processes be put in place. According to the specific legal environment, many legal processes have been initiated and have come to or close to conclusion. Other areas of recent learning concern the professional management of the fund to limit the impact of the political demands of the day (FIRA Mexico), and the extent to which GF staff have improved access to relevant information for appraising borrowers.

Sustainability prospects are enhanced when efforts are made to recover arrears *after* claim settlement through the GF. In Japan, for example, the differences between gross claims and net claim rates are significant. Recovery efforts continue with the same vigour, regardless of whether or not guarantee claims are being settled.

Deliberations during the 2011 FAO Global Expert Roundtable on Agricultural Guarantee Funds brought additional perspectives to the discussion and helped to substantiate lessons on sustainability in GF design and management: FIRA stressed that sustainability requires a long-term view and an institutional perspective, accompanied by social objectives. Concerning a tighter definition of the institutional sustainability of CGS, FIRA proposed measuring it in terms of maintenance of the real capital value of funds invested in CGS. These funds should be managed without the need for permanent dependence on public budgets and/or annual budget increments from public coffers. Other managers stressed that from their

own day-to-day perspective, sustainability for a GF means having low defaults on the loan portfolio and low overall costs. However, political interference gets in the way of sustainability. Government and political objectives are often different from those of GF managers and bankers.

Some donors have been directing their attention to first loss guarantees. These guarantees are attractive from the lender's perspective because they avail banks with revenue from their potential loss, even though this necessitates a higher financial outlay from the guarantor. The standard approach of a shared guarantee requires a lower "cash engagement" by the guarantor, but also a shared risk agreement from the beginning by the lending banks.

However, IFC advised that guarantors should never agree to accept a first loss, to avoid quick fund depletion. This is in line with good practice and has been singled out in the latest European Commission Notice, which states that this practice is not accepted as market-oriented and thus constitutes a case of improper aid. The 2008 EU Regulation on Guarantees, C155/14 Commission Notice on State Aid in the Form of Guarantees, indicates on page 5 that "First Loss Guarantees, where losses are first attributed to the guarantor and only then to the lender, will be regarded as possibly involving state aid" (Inga Balžekaitė, personal correspondence). Within the logic of the EU directive, this classification of first loss guarantees as possible State aid views them as negative, because of a possible lack of market conformity.

FIRA – with its seasoned (since 1954) and well-established system of credit guarantee funds – highlighted additional issues related to default rates in loan portfolios backed up by guarantees. A common issue is that long-term end clients start to complain to FIRA that they pay their annual guarantee fees for decades but, in their view, never get anything back. For FIRA, the question arises as to how these clients can be kept happy, to maintain sustainability of the service chain. As the expert roundtable proceedings (FAO, 2011) indicate, most of the participants felt that a well-functioning national-level credit reference bureau acts as an effective deterrent against loan defaults, and thus improves the sustainability prospects of bank loan portfolios and GFs.

The expert roundtable agreed on a set of main lessons to be considered for CGS design and implementation:

1. Start with simple guarantee systems.
2. Understand the importance of two levels of client: guarantors are important to financial institutions, and financial institutions are in turn important to farmers.
3. Ensure that money can be "double-used" to increase access to agribusiness finance through both loans to financial institutions and the backing of guarantees (e.g., Estonia's RDF).
4. Understand the context/issue and use the appropriate products for it. Money/guarantees are not always the solution.
5. Set up disaster management systems that can deal with financial and market shocks.
6. Examine guarantees and how they are linked within an array of risks: market, weather, insurance.
7. When a CGS is established, it should be fully funded to ensure sustainability and meet growth requirements.

8. Efficient management of claims and the claim process is key to success.
9. Risk management by the financial institution must include proper research of the value chains involved.

IMPLICATIONS FOR POLICY DEVELOPMENT – THE STUDY HYPOTHESES

There are important implications for the positioning of policy-makers and the allocation of scarce resources for agribusiness and the promotion of rural micro- and small enterprises in general. Table 14 summarizes the findings of this study and outlines action-oriented recommendations on how to proceed in contexts where a GF arrangement is used to promote agribusiness or rural micro- and small enterprises.

The following paragraphs summarize evidence and policy recommendations related to the six study hypotheses.

Hypothesis 1

Risk sharing mechanisms have regained prominence in development finance because of excess liquidity in the banking system and lending restrictions to development sectors through the risk management departments of banks and other financial institutions.

Primary research and evaluations

The importance of studies and independent evaluations is highlighted earlier in this report. A CGS must respond to a specific and well-established demand and pursue clear and measurable objectives that can be monitored. The absence of these features indicates that political considerations are predominating over considerations of professional fund management and viability.

Accessible and transparent financial reporting

Honohan (2010) observes that successful CGS are characterized by consistent and transparent accounting. However, these features are often absent from CGS worldwide.

Hypothesis 2

Over the past two decades, some of the cost-covering GF arrangements established in developing economies have achieved medium-term sustainability through efficiency gains (information technology) and improved system design. The design and implementation parameters of these arrangements should be highlighted and their replication potential discussed.

Flexibility

Setting up a guarantee system requires bringing together at least two contract partners – such as a (group of) lending bank(s), with GF managers as the countersignatory to a guarantee agreement. These parties may not be known to each other and, if the banks have the stronger bargaining position, they may insist on early claim settlement procedures that lead to a depletion of GF capital. Alternatively, the GF managers may have the upper hand in negotiations, resulting in overly cautious leverage ratios, fees and claim procedures that reduce lending under the guarantee cover. In either case, it is important to adjust the system during its implementation,

TABLE 14
Research hypotheses and recommendations

FAO research hypothesis (chapter 1)	Issue	Detrimental practices	Recommendation(s)
GFs' response to excess liquidity and other market failures in financial sectors	Studies	Studies are rare and focus on single aspects or general issues	Carry out system- and country-specific studies to generate assessments based on research and contributing to the international transfer of good practice
Better response to market failures	Evaluations	Evaluations are irregular and not available to the public	Carry out regular, structured evaluations with summaries and recommendations published on the Web
System design	Guarantee coverage – only principal or more	In a few instances (Nigeria and, earlier, Pakistan) guarantee cover extends to unpaid interests	Guarantee coverage should extend to the principal only or to a maximum of 6 months of interest with the same risk-sharing proportion as for the principal
System design	Criteria for approving guarantee claims	Claims can be made too rapidly, before initiating legal process, or too slowly, reducing the value of the system for the banks concerned	Legal process (foreclosure of loan, liquidation of collateral) has to be initiated and borrower reaction awaited Overdue borrowers must be contacted to call in the balance of the outstanding loan Risk classification of arrears should be recorded in bank books
System design	Flexibility and fine-tuning		Good systems have mechanisms for adjusting guarantee agreement components with lenders and fund borrowers
Considerations other than costs and risks	Political interference	Political interests and systems for special lobby groups influence the day-to-day affairs of a GF	Public funding of GFs and publicly deputed management are the norm, but management and supervision must be independent of politics
Considerations other than costs and risks	Building trust among the main contract parties	Banks and GFs are forced to collaborate by the political powers of the day	Building trust in the tripartite relations among the GF, the lending institution and the final borrower reduces risks and appraisal costs
Legal form	Single versus multipurpose service providers	Cost apportioning among separate financial services is difficult	Operating costs can be tracked and benchmarked
Legal form	Appropriate treatment of GFs as small financial institutions	Many GFs are incorporated as societies or trusts without adequate supervision	Ensure that professional GFs are licensed by financial institutions and supervised by the central bank (e.g., EIF)
Legal form	Steep entry barriers discouraging private entrants into the guarantee market	In developing economies, privately owned and managed GFs are rare	Promote flexible access conditionalities for private parties, at least in the establishment and starting phases

(Continued)

TABLE 14
(Continued)

FAO research hypothesis (chapter 1)	Issue	Detrimental practices	Recommendation(s)
Operating and implementing procedures	Fee levels	High fee levels deter both end borrowers and lenders; low fee levels deprive the GF of a principal source of income	Fees should relate to expected defaults and overall interest rate levels in the relevant domestic financial sector
Operating and implementing procedures	Pending claims	Many claims are submitted but are not paid out by the GF system	Design should ensure that claim submission is not premature and that it follows due legal process, etc., but does not delay payments
Operating and implementing procedures	Net claim rates	Incidence from a few countries suggests that net claim rates are up to 15 percent	Claim rates should be no more than 3 percent and claims should be submitted after at least 5 years of system implementation
Operating and implementing procedures	Recovery after settlement of claims	Generally no vigorous attempts are made to recover overdue loans outstanding after payment of claim to lending bank	Particularly in Japan and the Republic of Korea, great efforts are made to recover overdue loans after guarantees are paid out
Monitoring and supervision	Absence of clear objectives	Current arrangements generally specify only fund levels, target claims and operating expenses	The MIS should be based on transparent and comprehensive parameters, and should directly relate to the defined main goal of the CGS
Monitoring and supervision	Advantage of GF managers with data sets on banks and borrowers	GF management has no prior knowledge of the workings of partner lending institutions and/or the technical and financial profiles of end borrowers	CGS work increasingly with established SME ratings (e.g. Mexico, Brazil) and are sometimes also involved as an SME rating agency

Source: Compiled by the authors.

not too early but in time to generate business that lets the GF operate viably beyond the critical first five years.

The initial arrangements of the recently established GF in Republika Srpska provide an example. This GF's initial design foresaw that in the case of defaults, participating banks could settle their claims 90 days after the default incidence, leaving no time to initiate legal process under the specific conditions of the country concerned. This reflects good negotiating on the part of the banks (90 days to ensure their participation), but these claim procedures will have to be adjusted during implementation to make this GF successful. In other cases, flexibility is required in defining the access criteria for guaranteed lending facilities, the percentage of partial guarantee coverage and the one-time and annual fees.

Procedures for claims acceptance and processing

System designers have to tread the fine line between claims procedures that participating banks would view as too slow and cumbersome, and very early pay-outs from GFs invite misuse and inadequate loan follow-up on the part of the lending bank.

Hypothesis 3

GF arrangements that are governed by considerations other than the prudent and reasonable sharing of financial risk among different partners in a credit contract are likely to fail.

Relationships among the institutional contract partners in a credit guarantee arrangement

Levitsky (1997) stresses that efforts have to be invested in building a cooperative relationship between the guarantor and lenders; this has not proved easy. The fear of moral hazard affecting the lenders is always present with the guarantors. For their part, lenders have not trusted government-supported CGS and are not confident that the guarantees will be paid out quickly and without dispute when a claim is made. The more successful systems have developed the necessary collaborative relationships within five to ten years, as the cases of FIRA in Mexico or the German system of guarantee banks (*Buergschaftsbanken*) and their transactions with the ultimate lending banks testify. Long-established guarantee banks provide partial cover for the loans of lending banks. In Germany, the legal construction of bank guarantees as a risk mitigating measure evolved recently (see the paragraph on Flexibility in the discussion of hypothesis 2), and the first loan to an end borrower to be guaranteed directly by one of the German guarantee banks without a commercial lending bank in between has been made.

In general, it is recommended that CGS be managed independently of government involvement and funding donors. CGS managers need to foster proactive policy dialogue with line ministries, monetary authorities and banking supervisors. The *Agriculture investment sourcebook* (World Bank, 2004a) concludes that "such guarantees should decline rapidly over time, and should be designed to develop sustainable business relationships between providers and recipients through building trust and a good credit history".

Hypothesis 4

GF arrangements are organized in various corporate or legal forms, ranging from State-operated financial institutions, State-funded companies, and government-guaranteed arrangements, to independent private corporate entities, credit guarantee foundations and associations, and mutual guarantee associations; specialized single-purpose guarantee corporations operating at the national level are more likely to succeed.

Management for results is easier in a single-purpose set-up

Clear cost-centre accounting and no issues regarding the apportioning of costs or of staff time make it easier to follow a target-driven management approach in a single-purpose corporation dealing exclusively with the provision of guarantees.

GFs are small financial institutions and should be treated as such

The forms of incorporation of GFs are often not adequate (particularly when donors establish a GFs). Societies and trusts, the latter being the preferred form of several donor GFs, are not financial institutions and are not regulated and supervised by the central monetary authority of the country. In many countries, the audits and checks

of GFs' financial statements do not even have to be submitted to a private auditor but can be certified by local government employees (Uganda, India, etc.). Given the complex nature of CGS, a competent audit and transparent accounts are necessary, and legal forms should be selected with this in mind. Issues of liability, supervision and submission to financial institution legislation provide further arguments against incorporation as a trust or a society.

Private entrants into the guarantee market should not be kept away by entry barriers

In developing economies, there are very few examples of private GF corporations. Although most of these operate in environments where the State provides a counter-guarantee, there are also instances of private guarantee corporations without this type of cover. The case of Burkina Faso was highlighted earlier in this study.

Hypothesis 5

The percentage of risk shared, the claim procedures and timing of claim submissions, and the fee arrangements have a bearing on the market acceptance and eventual success of a CGS.

Fee rates

Summarizing the results and recommendations of a comprehensive global study of GFs in the mid-1990s, Levitsky (1997) suggests that one-time registration fees range from 0.25 to no more than 1 percent of the loan. These fees may be partly refundable if there is no claim on the GF. Annual fees vary from 0.5 to 2 percent of the guarantee amount. Exceeding these levels, which are generally considered acceptable, can act as a barrier to use of the system for both end borrowers and lending banks.

GF fee levels have to relate to overall interest rate levels. Quoting the example of Japan, with very low interest rates for the last decade and a half, Levitsky suggests that a 1 percent overall fee is already high when lending rates in the sector do not exceed 2 to 2.5 percent.

Net claim rates

Defaults of the underlying guaranteed loan portfolio tend to be smaller in the initial stages of loan repayment (von Pischke, Yaron and Zander, 1998). Guarantee claims then gradually increase with growing age of the GF system, and a fair assessment of GF operations should not be made until at least five years after commencement of implementation. If at that time or later in system implementation, the claim rate is no higher than 3 percent, the GF system is operating within good sustainability prospects. Very low or zero claims may indicate excessive staff and administrative costs or an overcautious strategy for the guarantee operations.

Hypothesis 6

Proper monitoring and supervision arrangements, including automated MIS, play a key role in the costs of administering the CGS and thus, eventually, in its success or failure.

Goal setting and monitoring of achievements against objectives
Honohan's (2010) comparisons of credit guarantee funds found that clear and precise goals against which to measure performance are absent from almost all the CGS that he analysed. Management for results is not possible if the results themselves are not clearly defined.

Knowledge and experience of all partners in a CGS puts GF managers at an advantage
It is difficult to monitor the data sets submitted by banks without a solid knowledge of the banks' internal reporting formats and requirements. The retroactive booking of defaulting borrowers that were not under guarantee cover represents the most serious moral hazard temptation for intermediary lending institutions. Knowledge and double-checking of the reporting formats submitted by banks constitutes the best buffer against this type of misuse. GF managers' informational advantages over lending banks in assessing the credit-worthiness of potential borrowers under guarantee cover are an important ingredient for success. The recent FAST study goes a step further: "Where a guarantor has better information about the probability of … repayment than the lender, … the information advantages of the guarantor over the lender can help borrowers obtain a loan despite the fact that the lender can not sufficiently estimate the future return of a project" (FAST, 2011: 4). Although it may sound counter-intuitive, particularly given the conventional calls for caution with guarantees because of information asymmetries, the FAST observation is rooted in operational reality. For these reasons, guarantee systems in a value chain, or those where GF managers are under the same roof as major enterprise rating agencies – as in India – demonstrate that CGS can know the final borrower better than the lending bank does.

IMPLICATIONS FOR CAPACITY BUILDING

These implications relate to decision-makers at the policy and institutional levels.

Capacity building to facilitate CGS management

Newly established CGS must have staff who are properly compensated and supervised. This has been one of the most frequent recommendations of comparative studies over the past decade. For example, the *Agriculture investment handbook* states:

> *Market failures that result in poorly functioning and shallow agricultural financial markets may justify carefully designed subsidies, provided they are time-bound and used for overcoming those failures, and do not distort prices or target certain clients. Technical assistance, training, investment in systems, and other capacity building subsidies can support the emergence of strong rural financial service providers.*
>
> *Financial guarantees can be used to attract commercial financial intermediaries into lending to MFIs with an agricultural portfolio, or to develop financial credit within a sector or commodity. Such guarantees should decline rapidly over time, and should be designed to develop sustainable business relationships between providers and recipients through building trust and a good credit history. Guarantees are only useful if a substantial portion of the credit risk remains with the institution, to avoid moral hazard and to allow for the build-up of good credit practices.* (World Bank, 2004a: 308–309).

Capacity building for rural lending bankers instead of credit guarantee arrangements

More recent internal briefs advocate for providing lending bankers with training and technical skills in the demanding field of micro- and small enterprise finance *instead* of facilitating guarantee arrangements. Depending on the circumstances in the specific rural finance market, this recommendation has its merits. A recent nationwide rural bank training and management development project implemented by Germany's KfW Banking Group in India transferred the essentials of modern banking systems and procedures for micro- and small enterprise finance to the Indian context. The project leveraged €55 million in additional lending resources from 11 participating rural-based Indian banks. Three rounds of increasingly complex training and examination of case studies with the banks' credit departments, zonal heads and credit officers established the necessary comfort level among the banks to start or expand lending to a hitherto neglected clientele, using their own funds. The involvement of different national-level bank training institutions has helped to deliver training messages after the project's closure (Zander, 2011). The net additional funding of €55 million mobilized from participating banks to finance microenterprises was generated from a KfW investment in technical assistance of slightly more than €800 000 from 2008 to 2010.

RECOMMENDATIONS

Policy

Policy-makers are recommended to:

- ensure that statutes discourage government interference in GFs – establishing a difference between government ownership and administration of the fund;
- develop policies that guide the management of agricultural crises/disaster situations in a timely manner, especially for developing countries;
- develop a regulatory framework that encourages credit risk mitigation (portfolio guarantees, strongly mutualistic systems).

Research

Applied research and donor activities should be directed towards deepening the most important learning and strong points of automated MIS such as that of USAID/DCA, to enhance management control over CGS operations. Far more research on the Asian systems is also needed, especially on their financial arrangements and the total cost of the guarantees.

Evaluation

One of the most surprising findings of this study is that there is a dearth of technical and financial evaluations, and of large systems with regional coverage and the involvement of donors and international funding agencies with strict supervision and evaluation regimes.

Training and capacity development of bankers

Technical training of loan officers and credit department heads in the specific technologies of individual microenterprise finance and small-scale agribusiness should be encouraged.

REMAINING QUESTIONS AND CHALLENGES

This study has revealed the current status and potential for expansion of CGS. As stated earlier, this financial instrument and its complexities are still underresearched and inadequately analysed. Accounts are not transparent and the way forward is not easily identifiable, despite the rapid circulation of ready-made solutions and quick fixes among both policy-makers and international funders.

The following questions are by no means exhaustive and should probably be adjusted every few years, taking into account new and emerging financial sector environments, banking regulations and policy priorities:

1. What good practices are emerging for the participation of donor capital in multi-funding or syndicated arrangements? How should a donor enter and at what point should exit be envisaged?
2. Rural and agricultural development remains a top policy priority globally. With the relaxation of commodity prices and the positive projections of commodity price levels over the next decade, finance for farmers will become an increasingly important priority. What are the roles of different credit guarantee arrangements in this context, and what roles do commodity value chains and their utilization in lending arrangements play at present and, potentially, in the future? In many developing economies, one possible entry point for CGS would be financing that targets small farmers. Are CGS arrangements in collaboration with large commercial banks the best way of planning development finance support for medium-level and large-scale farmers?
3. What should be the role, adequate level and exit strategy for subsidies connected to credit guarantee arrangements? What would be useful benchmarks in future policy discussions and what do practitioners, bankers, donors and other stakeholders view as appropriate levels and timings of subsidies?

Annex 1

Summary of FAO case studies on guarantee funds

No.	Name of fund	Regional focus	Industry	Type of guarantee	Funding/ ownership	Minimum/ maximum US$ amount guaranteed	% guarantee coverage	Duration minimum/ maximum
1	FIRA	Mexico	Agriculture	Individual credit guarantees via institutions	Gov't	Up to 160 million units of investment (UDIs are established by an index emitted by the Central Bank as a reference to maintain the value of money over time)	63	365 days
2	CGTMSE	India	Manufacture	Individual credit guarantees via institutions	Gov't	INR 0.5 million–10 million	75	5 years
3	ACGSF	Nigeria	Agriculture	Individual credit guarantees via institutions	Gov't	NGN 20 000–10 million	75	Varies
4	RDF	Estonia	Agriculture/ rural businesses	Individual credit guarantees via institutions	Gov't	Up to €2.5 million	80	10 years
5	Italian State Guarantee Fund for Agricultural Credit (ISMEA)	Italy	Agriculture	Individual credit guarantees via institutions	Gov't	With first call guarantee, up to €1 million for micro- and small enterprises and up to €2 million for medium enterprises	55–75% for subsidiary guarantees; 80% for first call guarantees	Loan maturity
6	*Société de Cautionnement Mutuel du Sénégal*	Senegal	Commerce, housing, agriculture	Individual credit guarantees via institutions	Gov't	Varies depending on the value of shares owned by the cooperative member		Unlimited

(Continued)

(Continued)

No.	Name of fund	Regional focus	Industry	Type of guarantee	Funding/ ownership	Minimum/ maximum US$ amount guaranteed	% guarantee coverage	Duration minimum/ maximum
7	*Société Financière de Garantie Interbancaire du Burkina* (SOFIGIB)	Burkina Faso		Individual credit guarantees via institutions	Gov't	Minimum XOF 3 million; no maximum	No fixed limit	5 years
8	Rural Credit Guarantee Fund	Lithuania	Agriculture	Individual credit guarantees via institutions	Gov't	Up to €1.2 million	70–80	Coherent with credit maturity
9	Guarantee Fund Republica Srpska	Republica Srpska	Agriculture	Individual credit guarantees via institutions	Gov't	Up to BAM 1.5 million for start-ups, export enterprises, SMEs and registered farmers	50	15 years
10	Private Agriculture Sector Support (PASS Ltd.)	United Republic of Tanzania	Agriculture	Individual credit guarantees via institutions	Public/ private		50	Life of the loan
11	Bank of Tanzania (BOT) Small and Medium Enterprise Credit Guarantee Scheme (SME-CGS)	United Republic of Tanzania	Agriculture, manufacturing	Individual credit guarantees via institutions	Gov't	Up to TZS 500 million	50	1–5 years
12	Financial Sector Deepening Trust (FSDT)	United Republic of Tanzania	Innovative finance, microfinance	Individual credit guarantees via institutions	Multi-donor trust funds, Gov't		50	Life of the loan
13	Agribusiness Loan Guarantee Company (ALGC)	Uganda	Agriculture	Individual credit guarantees via institutions	Gov't		50	5 years
14	Sustainable Agriculture Guarantee Fund (SAGF)	The Netherlands	Agriculture	Individual credit guarantees via institutions	Public/ private	US$500 000–US$1.5 million	80	3–4 years

(Continued)

(Continued)

No.	Name of fund	Regional focus	Industry	Type of guarantee	Funding/ ownership	Minimum/ maximum US$ amount guaranteed	% guarantee coverage	Duration minimum/ maximum
15	*Société Tunisienne de Garantie* (SOTUGAR)	Tunisia	Agriculture	Individual credit guarantees via institutions	Banks, gov't	Up to TND 5 million	75	2 years
16	USAID/DCA	United States of America	Agriculture	Individual credit guarantees via institutions	Gov't	Unspecified, depends on guarantee agreement	50	Varies

Source: Compiled by the authors.

Annex 2
Case study term sheets of agricultural guarantee funds

2.1 *FIDEICOMISOS INSTITUIDOS EN RELACION CON LA AGRICULTURA* (FIRA), MEXICO

Indicator	Data
Ownership	A group of four public trust funds fully owned by the Mexican Government, with a single administration. The Mexican Central Bank acts as trustee. A Special Fund for Guarantees (FEGA) was constituted to grant partially guaranteed credit loans to financial intermediaries. Operates as a second-tier development bank in support of Mexico's agriculture, livestock, fishing, forestry and agribusiness and of any business-related project in the rural sector (in locations with fewer than 50 000 inhabitants).
Supervisory board	Representatives from the Ministry of Finance, the Central Bank, the Mexican Bank Association, the Ministry of Agriculture and producer associations. The Ministry of Finance has the chair. Board meets at least once a month to discuss strategies and topics and projects related to FIRA's activities.
Management	1 general director, 6 deputy general directors and 1 150 staff in 136 branch offices throughout Mexico, subdivided into 5 regional units. FIRA also has 5 technology development and transfer centres.
Company mission	Contributing to the sustainable and competitive development of the Mexican agriculture, livestock, fishing, forestry and agribusiness sectors with innovative financial and technological services, to improve the population's quality of life.
Company objectives	▪ Granting small farmers access to formal sources of credit. ▪ Strengthening the structure of small producers' investment projects with training and technical assistance. ▪ Increasing credit fund flows through rural private financial intermediates. ▪ Encouraging private financial intermediaries to use their own resources to support producers with existing credit records. ▪ Ensuring the long-term sustainability of FIRA.
Investment strategy	Based on an investment regime established by the committee and authorities, FIRA and FEGA can invest only in government bonds, bank debt and highly rated repurchase agreements. The currency can be either Mexican pesos or US dollars, including nominal and real rates of return.[19]

(Continued)

[19] 30 November 2010: US$1 = MXN 12.489.

(Continued)

Indicator	Data
Investment returns	September 2009 to September 2010, FIRA achieved 10.15% annual average returns, and FEGA 10.67% on its investment portfolio.
Company start-up date	1954
▪ Guarantee conditions	▪ Conditions vary by type
▪ Costs of guarantees	▪ Estimation of the costs of the credit risk taken by FEGA is based on a model approved by the Committee of Risks Administration; FEGA estimates the approximate cost of covering the net estimated guarantee payments (minus recoveries), to cover the credit risk in loan operations. FEGA assigns differentiated to intermediaries (financial institutions) that have sufficient guaranteed operations to estimate their own behaviour. The other intermediaries are grouped and it is estimated and assigned the same cost for this group. The final cost of the guarantee is obtained by adding the operation costs to the cost derived from FEGA's credit risk.
▪ Guarantee period	▪ The guarantee applies while the loan is in force and the intermediary pays the guarantee costs specified by FEGA, for a maximum of 365 days.
▪ Leverage of private capital	▪ FEGA does not use private capital.
▪ Guarantee limit	▪ FEGA guarantees a percentage of each loan, depending on the currency of the loan and the type of intermediary (bank or non-bank) and not usually exceeding 63 percent.
Company orientation and principal activities	Multi-purpose: loan funding, technical assistance and partial credit guarantees.
Company size and operations	
▪ Equity assets	▪ FIRA: about US$5 202 million. FEGA: about US$990 million.
▪ Accumulated earnings and grants donated	▪ FIRA: US$213 million. FEGA: approximately US$71 million. No grants donated.
▪ Guarantees per annum	▪ In 2009, about US$5 261 million.
▪ Accumulative value of guarantees	▪ US$1 900 million.
▪ Loan portfolio outstanding	▪ US$3 783 million.
▪ Loans guaranteed	▪ 62 880.
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ See Exhibit 1.
▪ Increased access	▪ See Exhibit 2.
▪ Guaranteed loan use	▪ See Exhibit 3.

(Continued)

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Indicator	Data
Future outlook and projections	
▪ Diversification of complementary products	▪ Guarantee fund (FONAGA) for renewable and bioenergy projects; a special programme for long-term financing; and investments in electromechanical efficiency.
▪ Possible mergers/acquisitions or other changes	▪ None planned for the short term.

EXHIBIT 1
Spreads of interest rate to the beneficiary

	Agriculture	
	Long-term loans	
	without guarantees	with guarantees
Low-income producers	13.12271841	10.60330826
Others	13.14223173	6.924918862

EXHIBIT 2
Shares of loans granted by FIRA with FEGA guarantees

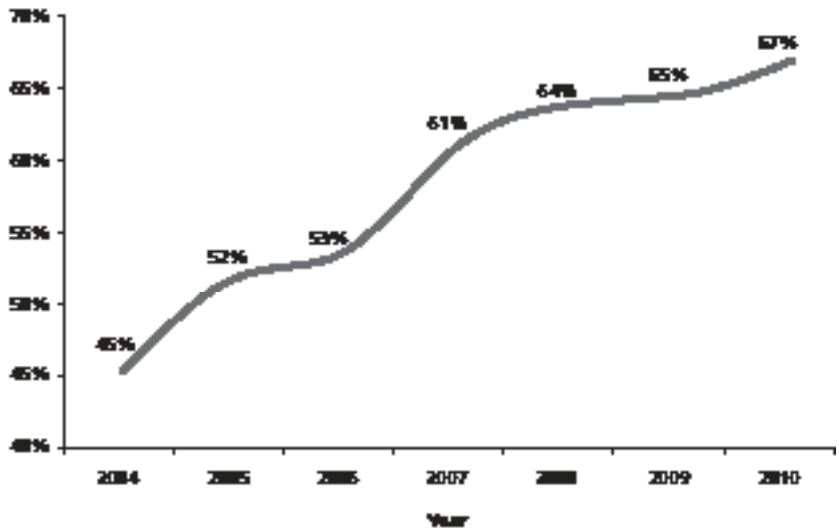

EXHIBIT 3
Loan use

Kind of credit	2010			2011		
	Loans granted	Loans with guarantee	Guarantees without loan	Loans granted	Loans with guarantee	Guarantees without loan
By term						
Short-term	75 291	51 189	12 964	84 012	50 849	11 035
Long-term	13 336	8 170	1 354	14 027	8 484	1 842
Total	**88 627**	**59 359**	**14 318**	**98 039**	**59 333**	**12 877**
By sector						
Agriculture	59 011	43 786	9 907	63 524	38 448	8 344
Livestock	17 538	7 661	2 724	20 614	12 460	2 704
Forestry	976	852	478	1 165	712	155
Fisheries	2 622	2 260	786	3 190	1 958	425
Rural Lending	8 480	4 800	423	9 546	5 755	1 249
Total	**88 627**	**59 359**	**14 318**	**98 039**	**59 333**	**12 877**

Web site: www.fira.gob.mx/nd/index.jsp

2.2 CREDIT GUARANTEE FUND TRUST FOR MICRO AND SMALL ENTERPRISES (CGTMSE), INDIA

Indicator	Data
Ownership	Created jointly by the Government of India and the Small Industries Development Bank of India (SIDBI) – a State-run development bank; 80% of shares owned by the Ministry of MSMEs; and 20% by SIDBI.
Supervisory board	
Management	A chief executive officer supported by executives and staff deputed from SIDBI.
Company mission	Credit guarantees form part of India's public policy to provide an incentive for streamlining MSMEs' production, management, market linkages and access to finance, and to make them more competitive. To achieve balanced, sustainable, more equitable and inclusive growth, the financing of micro- and small enterprises is categorized as a priority.
Company objectives	▪ Lenders should consider project viability and should grant credit based on the primary security of the assets financed. ▪ Lenders using the guarantee facility should give composite credit to borrowers, allowing them to obtain both term loans and working capital facilities from a single agency. ▪ CGS reassures lenders that if a micro- or small enterprise with collateral-free credit fails to discharge its liabilities, the guarantee trust will make good the losses incurred by paying up on 75, 80 or 85 percent of the outstanding loan.
Investment strategy	
Investment returns	▪ 2000–2010: US$41 million. ▪ Turn-over of guarantee units: US$14 720 million.
Company start-up date	August 2000.
Guarantee conditions	
▪ Costs of guarantees	▪ One-time fee of 1.0% for credit facilities up to INR 0.5 million;[20] 1.5% for those of more than INR 0.5 million; and 0.75% for those up to INR 0.5 million in India's northeastern region.[21] Paid up-front by the lending institution to the trust within 30 days of the first disbursement of the credit facility, or 30 days from the date of the demand advice, whichever is later, or on such date as specified by the trust. Annual service fees of 0.50 for credit facilities up to INR 0.5 million, and 0.75% for those of more than INR 0.5 million. Paid by the lending institution by 31 May of every year.
▪ Guarantee period	▪ For term/composite credit, guarantee cover commences from the date of payment of the guarantee fee and runs through the agreed tenure of the term credit. For working capital, guarantee cover is for 5 years or for the period specified by the trust.
▪ Leverage of private capital	▪ Until the date when private capital inflow into the fund is restricted.
▪ Guarantee limit	▪ 85% for loans up to INR 0.5 million; 75% for those of INR 0.5 million–10 million (to a maximum guarantee of INR 3.75 million); and 85% of the default (to a maximum guarantee of INR 4 million) for women entrepreneurs and enterprises in the northeastern region.

(Continued)

[20] 13 September 2011: US$1 = INR 47.

[21] Credit facilities include term loans and/or working capital facilities.

(Continued)

Indicator	Data
Company orientation	▪ Issuing credit guarantees to banks' financing of micro- and small enterprises. ▪ Administering the GF. ▪ Popularizing the system among bankers and entrepreneurs.
Company size and operations	
▪ Equity assets	▪ At 31 March 2011, US$530 million (INR 25 billion): 80% from the government and 20% from SIDBI.
▪ Accumulated earnings and grants donated	▪ For 2008–2010, total receipts of US$29.05 million (INR 1.366 billion), 71% of total receipts since inception.
▪ Guarantees per annum	▪ In 2010, 1 722 (68.7%) guarantee claims settled for US$7.30 million (INR 342 million), 64.6% of total claims settled.
▪ Guarantees outstanding	
▪ Guarantee portfolio	▪ At 31 March 2010, 4 761 claim applications from member lending institutions (MLIs): 2 506 settled for US$11.30 million (INR 530 billion), 533 not eligible, 420 incomplete, and 1 302 pending settlement.
▪ Accumulative value of guarantees	▪ 300 000 guarantee approvals with total coverage of US$2.5 billion (INR.115.6 billion).
▪ Loan portfolio outstanding	
▪ Loans guaranteed	▪ 2 506
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ No.
▪ Increased access	▪ Financial institutions require collateral that micro- and small entrepreneurs are often unable to provide. Banks need an intermediary to share the risks.
▪ Guaranteed loan use	▪ Nearly 70% of guarantees are in the "other manufacturing sector" (208 402 proposals for US$1 594 million), followed by services (industry-related) with 23 859 for US$163 million, metal products with 13 635 for US$107 million, textile products with 12 283 for US$154, and food products with 12 034 for US$110 million.
Future outlook and projections	
Growth	Ensuring fulfilment of MLIs' financial liabilities; improving the project appraisal assessment framework and guarantee fee calculation to arrive at risk-based pricing; and improving the internal control framework and information technology system.

Web site: www.cgtmse.com/

2.3 AGRICULTURAL CREDIT GUARANTEE SCHEME FUND (ACGSF), NIGERIA

Indicator	Data
Ownership	60% Federal Government of Nigeria; 40% Central Bank of Nigeria (CBN)
Supervisory board	The 7-member board, with a chair and a secretary (who was a deputy director in CBN's development finance department), has been replaced by an interim management committee.
Management	Interim management committee of 5 members.
Company mission	Developing and implementing policies, a regulatory framework and programmes for providing effective development finance services in partnership with stakeholders.
Company objectives	▪ Providing guarantees on loans for agricultural production and processing granted by commercial and merchant banks (deposit money banks). ▪ Accelerating the flow of institutional credit to small-scale farmers either individually or in cooperatives. ▪ Cultivating the habit of banking among farmers, to promote the mobilization of savings.
Investment strategy	Investment in government bonds
Investment returns	In 2009, NGN 199 723 265.
Company start-up date	April 1978.
Guarantee conditions	
▪ Costs of guarantees	▪ In 2009, the total cost of guaranteeing loans was NGN 319 006 234.
▪ Guarantee period	▪ Varies according to the gestation period of the commodities concerned.
▪ Leverage of private capital	
▪ Guarantee limit	▪ NGN 20 000 for unsecured loans, NGN 1 million for individual secured loans, and NGN 10 million for secured loans to cooperatives and corporate entities.
Company orientation	Multi-purpose. The GF is one of the duties of a CBN department.
Company size and operations	
▪ Equity assets	▪ NGN 1 816 047 510.
▪ Accumulated earnings and grants donated	▪ NGN 199 723 265.
▪ Guarantees per annum	▪ In 2009, 53 639 loans guaranteed worth NGN 8 349 million.
▪ Guarantees outstanding	▪ 19 339 loans valued at NGN 4 539 million.
▪ Guarantee portfolio	▪ Number and amount of guarantees increase from year to year. In 2008, 52 787 loans worth NGN 6 000 million; in 2009, 53 639 worth NGN 8 349 million.
▪ Accumulative value of guarantees	▪ 647 351 loans worth NGN 34 409 million.

(Continued)

(Continued)

Indicator	Data
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ When interest is paid promptly.
▪ Increased access	▪ Yes.
▪ Guaranteed loan use	
- Agricultural guarantees	- Food = 83.28%, livestock = 7.06%, cash crops = 2.45%, mixed farming = 0.18%.
- Storage and food processing	
- Village development	
- Fisheries	- Fisheries = 6.02%.
- Other rural investments	- Others = 1.0%.
Future outlook and projections	
▪ Growth	▪ Prospects for growth as more banks are sensitized to participating in the system.
▪ Diversification of complementary products	▪ Products include the Interest Drawback Programme, the Trust Fund Model and self-help groups.

Web site: www.cenbank.org/devfin/acgsf.asp

2.4 RURAL DEVELOPMENT FOUNDATION (RDF), ESTONIA

Indicator	Data
Ownership	Government of Estonia.
Management	Autonomous management team under government-appointed board.
Company mission	Improving the livelihoods of rural households in Estonia.
Company objectives	▪ Providing guarantees to enhance rural business investment. ▪ Providing financing to meet the specific needs of community organizations. ▪ Providing technical advisory support and incentives to rural organizations and businesses.
Investment strategy	▪ Enhancing investment by using guarantees to leverage private lending and investments in rural and agricultural businesses. ▪ Providing complementary support services.
Investment returns	Positive return on investment with earnings used to increase the fund and provide targeted incentive grants to rural communities.
Company start-up date	2001 in current form (1993 for predecessors).
Guarantee conditions	
▪ Costs of guarantee	▪ 0.5–6% per annum (usually 3.8–4.6%), depending on risks.
▪ Guarantee period	▪ Up to 10 years (average is 4.4 years).
▪ Leverage of private capital	▪ 1.2–1.5 times.
▪ Guarantee limit	▪ 80% for loans up to €2.5 million (approximately US$3.2 million).
Company size and operations	
▪ Equity assets	▪ US$43 million.
▪ Accumulated earnings and grants donated	▪ US$6 million.
▪ Guarantees per annum	▪ In 2011, 288.
▪ Guarantees outstanding	▪ In 2011, 593.
▪ Guarantee portfolio	▪ US$35.2 million.
▪ Loan portfolio outstanding	▪ US$35.0 million.

(Continued)

(Continued)

Indicator	Data
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ Little evidence of this.
▪ Increased access	▪ Increases in both the number of clients with access to loans and the loan sizes.
▪ Guaranteed loan use	
- Agricultural guarantees	- 51%.
- Storage and food processing	- 11%.
- Village development	- 10%.
- Fisheries	- 10%.
- Other rural investments	- 18%.
Future outlook and projections	
▪ Growth	▪ Some equity growth based on retained earnings and increased leverage as rural investment becomes more attractive for banks and other investors.
▪ Diversification of complementary products	▪ Advisory services and rural community support.

Web site: www.mes.ee/en

2.5 ITALIAN STATE GUARANTEE FUND FOR AGRICULTURAL CREDIT (ISMEA), ITALY

Indicator	**Data**	
Ownership	State entity.	
Supervisory board	Administrator, no board of directors.	
Management	1 director, 13 staff.	
Company mission	Issuing guarantees.	
Company objectives		
Investment strategy	Financial resources invested in Italian Treasury Bonds.	
Investment returns		
Company start-up date	1961, first call guarantee fund in 2008.	
Guarantee conditions	*Subsidiary guarantee*	*First call guarantee*
▪ Cost of guarantee	▪ One-time fee: 0.30% of the loan amount.	▪ Based on risk (portfolio average: 0.40% per annum on guaranteed amount).
▪ Guarantee period	▪ Loan maturity.	▪ Loan maturity (from 18 months).
▪ Leverage of private capital		
▪ Guarantee limit	- 55% for medium-term loans. - 75% for long-term loans.	- Up to 70% of loan amount (80% for young farmers). - Up to €1 million (micro- and small enterprises); up to €2 million (medium enterprises).
Company orientation and principal activities	All loans for agricultural purposes are guaranteed (investments, machinery, working capital, renewable energy, debt consolidation).	
Company size and operations	*Subsidiary guarantee*	*First call guarantee*
▪ Equity assets	▪ No equity.	▪ €50 million.
▪ Accumulated earnings and grants donated	▪ Risk funds of about €500 million.	▪ Risk fund €1.5 million.
▪ Guarantees per annum	▪ In 2009, €3.1 billion.	▪ In 2009, €11 million.
▪ Guarantees outstanding	▪ 36 000.	▪ 34 (started in 2008).
▪ Guarantee portfolio		
▪ Loan portfolio outstanding	▪ In 2010, €11.8 billion.	▪ In 2010, €14 million.
▪ Loans guaranteed	▪ 154 000.	▪ 38.

(Continued)

(Continued)

Indicator	**Data**	
Impact		
▪ Reduced bank interest rate on guaranteed loans to clients ▪ Increased access	▪ Possible but not automatic, depends on the disbursing bank. By 2012 systems will record interest rates with and without guarantee (first call guarantee fund) to quantify the interest rate benefit of the guarantee. ▪ Guarantees make investments possible when farmers lack the collateral requested by the disbursing bank. ▪ All types of agriculture and renewable energy sources (solar plants).	
▪ Guaranteed loan use - Agricultural guarantees - Storage and food processing - Village development - Fisheries - Other rural investments		
Future outlook and projections	*Subsidiary guarantee*	*First call guarantee*
▪ Growth ▪ Diversification of complementary products ▪ Possible mergers/ acquisitions and other changes	Full compliance with the Basel II Framework.	Extend guarantees to short-term loans.

Web site: http://www.ismea.it/flex/cm/pages/serveblob.php/l/it/idpagina/1
E-mail: segreteria.sgfa@ismea.it

2.6 *SOCIÉTÉ DE CAUTIONNEMENT MUTUEL DU SÉNÉGAL*, SENEGAL

Indicators	Data
Ownership	Members of the *Federation des Sociétés de Cautionnement Mutuel* (FSCM), a federation of credit and savings cooperatives operating in Senegal.
Supervisory board	Elected members of FSCM representing borrowers (entrepreneurs working in the textile, leather, handicraft or agriculture sector). Executive board of finance professionals hired with funds from FSCM and donors.
Management	Follows a mutual guarantee association model: FSCM members elect the supervisory board and hire the executive board. FSCM's legal framework is that of a financial non-governmental organization monitored by the Ministry of Finance.
Company mission	FSCM capital from members' shares, matched with funding from a donor-supported project. FSCM does not provide credit directly to members but screens and recommends them to lenders, provides guarantees and conducts loss recovery in cases of default.
Company objectives	Facilitating access to credit to FSCM members without bank accounts through the provision of credit guarantees.
Investment strategy	As well as the shares of all its members, FSCM charges fees to members using the GF and receiving loans. Fees cover screening and loss recovery costs.
Investment returns	No profit sought from guarantee services.
Company start-up date	February 2006.
Guarantee conditions	
▪ Costs of guarantees	▪ Vary, depending on the loan size and duration.
▪ Guarantee period	▪ No limit.
▪ Leverage of private capital	▪ 50% of guarantee capital is privately owned by FSCM members and 50% comes from a donor grant.
▪ Guarantee limit	▪ Varies, depending on the value of shares owned by the member.
Company orientation	FSCM started offering guarantee services in January 2010. Technical assistance services have been provided to member credit and savings cooperatives since 2006, using donor funds.
Company size and operations	
▪ Equity assets ▪ Accumulated earnings and grants donated ▪ Guarantees per annum ▪ Guarantees outstanding ▪ Guarantee portfolio ▪ Accumulative value of guarantees ▪ Loan portfolio outstanding ▪ Loans guaranteed	▪ US$1.2 million.

(Continued)

(Continued)

Indicators	Data
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients ▪ Increased in access ▪ Guaranteed loan use	▪ 60% commerce, 20% housing, 15% agriculture, 5% personal consumption.
Future outlook and projections	
▪ Growth ▪ Diversification of complementary products ▪ Possible mergers/ amalgamations/take-overs	Guarantee services began in January 2010 so it is too early to project the future outlook.

Web site: www.senegal-entreprises.net/guediawaye/cautionnement.htm

2.7 *SOCIÉTÉ FINANCIÈRE DE GARANTIE INTERBANCAIRE DU BURKINA* (SOFIGIB), BURKINA FASO

Indicator	Data
Ownership	Government of Burkina Faso through intermediation of the *Fonds Burkinabé de Développement Economique et Social*, 11 banks, 4 non-bank financing institutions, the National Chamber of Commerce (6%). Plans to enlarge shareholding from microfinance institutions, insurance companies and the *Caisse Nationale de Sécurité Sociale*. Share capital raised to XOF 1.2 billion in accordance with compulsory share capital increases in the Economic and Monetary Union of West Africa.
Supervisory board	
Management	1 chief executive, 2 analysts, 1 controller, 1 accountant and 1 secretary.
Company mission	▪ Supporting SMEs, which play an essential role in the national economy in terms of employment and income generation. ▪ Supporting banks and other financial institutions to cover more extensively the new MSME market.
Company objectives	▪ Facilitating access to finance for SMEs.
Company start-up date	▪ Licensed in December 2007, started operations in October 2008.
Guarantee conditions	
▪ Costs of guarantees	▪ For technically feasible and financially viable ventures of SMEs in the primary, secondary or tertiary sectors. ▪ Fee: 1% of loan amount outstanding, plus 1% handling fee on loan amount requested, plus commission of 0.75% to a maximum of XOF 75 000.
▪ Guarantee period	▪ Up to 5 years.
▪ Leverage of private capital	▪ 50% guarantee and 50% loan plus investor contribution of at least 15%
▪ Guarantee limit	▪ No fixed maximum; minimum XOF 3 million.
Company orientation	Guarantees only

(Continued)

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Indicator	Data
Company size and operations	
▪ Equity assets	▪ XOF 1.2 billion.
▪ Accumulated earnings and grants donated	
▪ Guarantees per annum	▪ 34 in 2009 and 2010.
▪ Guarantees outstanding	▪ 74.
▪ Guarantee portfolio	
▪ Accumulative value of guarantees	
▪ Loan portfolio outstanding	
▪ Loans guaranteed	▪ 74.
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ No; banks pay the interbank guarantee fee, and recover these costs from clients.
▪ Increased access	▪ Too few guarantees to measure this.
▪ Guaranteed loan use	
Future outlook and projections	
▪ Growth	▪ Management expects growth, but no data available.
▪ Diversification of complementary products	▪ Not planned for the near future.
▪ Possible mergers/ amalgamations/take-overs	▪ Take-over of XOF 300 million of a GF for agricultural SMEs initiated under a World Bank-funded project and already managed by SOFIGIB.

Contact: Chief Executive Officer Mr Philippe Consigui, consiguiphi2000@yahoo.fr
E-mail: sofigib@fasonet.bf
Information from: Michael Marx, FAO, michael.marx@fao.org

2.8 RURAL CREDIT GUARANTEE FUND, LITHUANIA

Indicator	Data
Ownership	100% of shares owned by the State and held by the Ministry of Agriculture, which is also in charge of creating and supervising the company.
Supervisory board	Appointed by the general meeting of shareholders within the Ministry of Agriculture. Responsible for supervising company activities. Has three members: one representative each from the Ministry of Agriculture, the Ministry of Finance and the Government of the Republic of Lithuania. Board of directors elected by the supervisory board. Has five members: the Advisor to the Prime Minister, the director of the company, and one representative each from the Ministry of Agriculture, the Ministry of Finance and the Ministry of Justice.
Management	Executive director (head of the company's administration), deputy director and Finance director.
Company mission	Promoting economic development of agriculture, providing opportunities for economic entities lacking the collateral needed to obtain credit, and helping beneficiaries to obtain EU funds.
Company objectives	Issuing guarantees to credit institutions for loans to: ▪ farmers and agricultural entities (farms, cooperatives, agricultural companies, economic communities); ▪ SMEs in rural areas engaged in activities other than agriculture; ▪ processing companies that purchase, process and/or sell agricultural products.
Investment strategy	Invests accumulated reserves (from the fulfilment of financial liabilities) in securities and holds bank deposits.
Investment returns	Interest earned from investments in securities and holdings in deposits is treated as fund income. Investment returns: 5.3 percent. Profitability of equity capital in 2010: 14.2 percent.
Company start-up date	22 August 1997, according to a resolution of the Government of Lithuania.
Guarantee conditions	
▪ Costs of guarantees	▪ One-time fee of 0.7–7.0% of the guaranteed amount, depending on project risk, credit maturity and amount guaranteed.
▪ Guarantee period	▪ Unlimited, based on credit maturity.
▪ Leverage of private capital	▪ Credit beneficiary must self-finance at least 10% of the investment project.
▪ Guarantee limit	▪ Up to 70% (80% for young farmers and agricultural entities that have insured the crop) of outstanding loan, to a maximum of €1.2 million.
Company orientation and principal activities	▪ Issuing credit guarantees. ▪ Administrating State support for credit beneficiaries. ▪ Administrating a credit fund (a measure of financial engineering).

(Continued)

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Indicator	Data
Company size and operations	▪ At 1 January 2011, equity capital of €4.2 million; authorized capital of €2.5 million.
▪ Equity assets	
▪ Accumulated earnings and grants donated	▪ €23 million.
▪ Guarantees per annum	▪ In 2009, 202 guarantees for €58.6 million; in 2010 427 for €40.1 million.
▪ Guarantees outstanding	▪ 1 800.
▪ Guarantee portfolio	▪ €116.7 million.
▪ Accumulative value of guarantees	
▪ Loan portfolio outstanding	▪ €194.5 million.
▪ Loans guaranteed	▪ 1 800; since inception 3 362 have been granted for €619.4 million.
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ No.
▪ Increased access	▪ Increased access to finance. To mitigate risks, financial institutions require collateral, which agricultural and rural entities are often unable to provide. Banks need an intermediary to share the risks.
▪ Guaranteed loans use	
- Agricultural guarantees	- 74%.
- Storage and food processing	- 4%.
- Village development	- 21%.
- Fisheries	- 1%.
Future outlook and projections	
▪ Growth ▪ Diversification of complimentary products ▪ Possible mergers/ acquisitions or other changes	▪ Ensuring fulfilment of the financial liabilities of credit institutions. ▪ Improving project assessment frameworks and the calculation of guarantee fees to meet EU requirements. ▪ Improving the internal control framework and information technology system. ▪ Analysing borrowing tendencies and risk factors, and launching new products in response to credit beneficiaries' demand and the market situtation. ▪ Improving support to clients facing difficulties. ▪ Providing information and training on the company's activities to credit beneficiaries and credit institutions.

Web site: www.garfondas.lt
E-mail: info@garfondas.lt

2.9 GUARANTEE FUND REPUBLICA SRPSKA, REPUBLICA SRPSKA

- The fund's design is based on GF experience in Croatia and Serbia.
- When collateral is available, interest rates are expected to drop from 6.9 to 5.5 percent, which will be fixed in the contract.
- Ten commercial banks, one microcredit organization and two funds participate in the GF. The GF assesses their current exposure to the agriculture sector.
- GFs are only for within the Republica Srpska (RS) and at lower levels in Bosnia and Herzegovina.
- RS has enacted a special law for this GF (Law of the Republica Srpska Guaranty Fund adopted by Parliament on 25 May 2010).
- The fund uses instruments such as mobile or fixed collateral and transferable insurance policies.
- In case of default, the GF pays out when there is a three-party agreement among the bank, the borrower and the GF. Banks can settle their claims 90 days after the incidence; no time is provided for legal process.

Indicators	Data
Ownership	Closed stock company with one founder. Operates as a public enterprise in RS with BAM 30 million[22] founding capital from the RS budget.
Supervisory board	5 members, by public appointment.
Management	1 director, 2 executive directors (one for legal issues and one for finance), and 13 staff, mainly for monitoring and supervision.
Company mission	Increasing production, employment and new products to increase access to credit for SMEs and farmers.
Company objectives	Issuing guarantees, super-guarantees and counter-guarantees.
Investment strategy	Majority of funds deployed for start-ups, agriculture production, women and youth entrepreneurs and export-oriented businesses.
Investment returns	Invested in the capital fund.
Company start-up date	Established 17 September 2010; registered 11 November 2010.
Guarantee conditions	
▪ Costs of guarantees	▪ Risk premium of 2.1–3.2% for guarantees of up to 50% of the outstanding debt, plus 1% on the total loan amount.
▪ Guarantee period	▪ Up to 15 years.
▪ Leverage of private capital	▪ 1:3. BAM 30 million of guarantees for up to BAM 90 million of loans). Borrowers contribute at least 20% of project costs.
▪ Guarantee limit	▪ 50% of the loan.

(Continued)

[22] €1 = BAM 1.9558.

(Continued)

Indicators	Data
Company orientation and principal activities	Target group includes agricultural operations, for loans of up to BAM 1.5 million for start-ups, export enterprises, SMEs and registered farmers. Trade, alcohol and beverage services, financial services and refinancing are excluded.
Company size and operations	
▪ Equity assets	▪ BAM 30 million.
▪ Loan guarantees per annum	▪ 9 in the first year (2010).
▪ Guarantee portfolio	▪ BAM 4 million.
▪ Loan portfolio outstanding	▪ BAM 8 million.
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ Agreements with the GF oblige banks to reduce their interest rates for agricultural loans to the levels for comparable loans.
▪ Increased access	▪ Increased access to loans for farmers and companies with problems providing collateral and other direct guarantees for loan repayment.
▪ Guaranteed loan use	▪ To support businesses that are traditionally less attractive to financial institutions (farming, rural investment, start-ups, women-headed businesses).
Future outlook and projections ▪ Growth ▪ Diversification of complimentary products ▪ Possible mergers/acquisitions or other changes	Plans for expanding the guarantees portfolio and increasing guarantees to up BAM 90 million.

Web site: www.garantnifondrs.org/public/index.php
E-mail: Chief Executive Officer Mladem Kovacevic: mladen.kovacevic@garantnifondrs.org; info@garantnifondrs.org

2.10 PRIVATE AGRICULTURE SECTOR SUPPORT PROGRAM (PASS), UNITED REPUBLIC OF TANZANIA

Indicator	Data
Ownership	Started as a pilot project involving the Ministry of Finance, the Ministry of Agriculture Food Security and Cooperatives, the Danish Embassy and the government. Became a trust in 2007; operates as an autonomous unit with a steering committee of public and private sector members.
Supervisory board	Members include bankers, academics and agricultural finance experts. Trustees are accountable for all financial operations.
Management	Managed by a steering committee; the original project implementers provide guidance and oversight.
Company mission	As a premier commercial entity, assisting primary agricultural producers and agribusinesses in developing their full market potential.
Company objectives	Providing business development advisory and financial services to individuals and companies applying for loans: providing credit guarantees to banks, preparing feasibility studies and/or business counselling and assessing business plans.
Investment strategy	Providing the agriculture sector with supporting services and products on a commercial, demand-driven basis, cost-shared with clients. Services include business development and credit guarantees to give farmers access to credit on more affordable terms for input acquisition, contract farming, irrigation, product price negotiations, crop diversification, purchase/lease of equipment and creation of market linkages.
Investment returns	In 2005, loss of approximately TZS 250 million. In 2008, restructuring and expanding services to 17 of the country's 28 administrative regions led to a surplus of TZS 235 million; this trend has continued.
Company start-up date	Founded in 2000; became a trust in 2007.
Guarantee conditions	
▪ Costs of guarantees	▪ Applicants apply for guarantees at the PASS office or through the bank. Initial fee of TZS 30 000 (about US$24). PASS charges 10% of the loan amount for assistance with business plan preparation, feasibility studies or other business development.
▪ Guarantee period	▪ Life of the loan. In case of default, banks are required to seek recovery of arrears and negotiate a payment schedule.
▪ Leverage of private capital	
▪ Guarantee limit	▪ Up to 50% of the loan value; participating banks charged a risk-bearing fee.
Company orientation	Providing credit guarantees to commercial banks. Providing business development services on a cost-sharing basis.

(Continued)

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Indicator	Data
Company size and operations	
▪ Equity assets	▪ In 2005, initial capitalization of US$12 million. By 2008, US$30 million was added as PASS expanded into other regions. Plans to cover the entire mainland.
▪ Accumulated earnings and grants donated	▪ In 2008, 410 business plans were submitted, worth TZS 18.29 billion, of which 324 were approved for TZS 16.1 billion (79%).
▪ Guarantees per annum	
▪ Guarantees outstanding	
▪ Guarantee portfolio	▪ Beneficiaries include individual farmers (41%), farmers' groups (32%), businesses/farms (24%) and savings and credit associations and cooperatives (3%). 40% of beneficiaries are women.
▪ Accumulative value of guarantees	
▪ Loan portfolio outstanding	
▪ Loans guaranteed	
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ According to the first tractor mechanization system in the Republic of Tanzania, PASS helped to structure loan finance that reduced interest from 18 to 14.5–15%, with farmers depositing only 10% of the tractor cost (TZS 35 million in 2007) plus a 2% fee to PASS and a 1% commitment fee to the bank.
▪ Increased access	▪ Increased quality and volume of production, increased market linkages, better access to finance, creation of more solid value chain linkages through stimulation of agroprocessing and coordination of farmers' groups, buyers, agrodealers, machine operators, etc. Loan beneficiaries include farmers and farmers' groups cultivating, processing and producing paddy, cotton, paprika, cashew, cereals, tea, coffee, horticulture, floriculture and edible oils (especially sunflower). Financial services provided to livestock/poultry keepers and dairy farmers.
▪ Guaranteed loan use	▪ Approximately 97% for agricultural guarantees.

Contact: Iddy Lujina, Managing Director, PASS, Uhuru Street, NMB Building, 1st Floor, P.O. Box 146, Morogoro, United Republic of Tanzania
Tel.: +255 23 260 1765

2.11 BANK OF TANZANIA (BOT) SMALL AND MEDIUM ENTERPRISE CREDIT GUARANTEE SCHEME, UNITED REPUBLIC OF TANZANIA

Indicator	Data
Ownership	Bank of Tanzania Credit Guarantee Scheme for SME
Management	Managed by BOT as an agent of the government. BOT has a department for monitoring and evaluating loan performance at participating banks.
Company mission	Encouraging banks to extend credit to SMEs/farmers without sufficient collateral to obtain lending approval.
Company objectives	Strengthening the access of SMEs/farmers to financial services, to expand their businesses, create employment opportunities and expand value chain linkages in the Tanzanian economy.
Investment strategy	Working with banks (participating financial institutions [PFIs]) in accordance with the SME-CGS Framework Agreement to increase the number of banks using the system. 22 banks have signed the Guarantee Framework Agreement to obtain access to the facility.
Company start-up date	2004.
Guarantee conditions	
▪ Costs of guarantees	
▪ Guarantee period	▪ 1–5 years.
▪ Leverage of private capital	
▪ Guarantee limit	▪ Up to 50% of principal loan value.
Company orientation	Strictly for providing SMEs with guarantees. BOT provides training services to officers in commercial and community banks.
Company size and operations	
▪ Equity assets	
▪ Accumulated earnings and grants donated	▪ Increased from 3 in 2006 to 48 in 2008, valued at TZS 3 135.65 billion.
▪ Guarantees per annum	▪ 35 expired in 2010/2011.
▪ Guarantees outstanding	▪ 12, valued at TZS 1 292.93 billion.
▪ Guarantee portfolio	▪ Total sanctioned loans 2006–2009: TZS 6 505 912 000. Total guaranteed: TZS 3 135 659 876.00.
▪ Accumulative value of guarantees	▪ Guarantees loans of up to TZS 500 million for 1–5 years. Risk shared with the PFI on a pro-rata basis of 50% of the principal amount (i.e., guarantee does not include accrued interest, irrespective of loan tenor).
▪ Loan portfolio outstanding	
▪ Loans guaranteed	▪ Since inception, BOT has received 71 applications for guarantees, of which 48 were approved. SMEs submit loan applications and business plans to the PFI, which conducts credit appraisals based on the project's viability without a guarantee.

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Indicator	Data
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ Some banks reduce interest from an average of 18% to 14.5–15% with lower collateral requirements.
▪ Increased access	▪ More banks using the system. Beneficiaries' capital requirements range from TZS 5 million to 500 million. Generation of 3 358 jobs. SME-CGS has given customers access to credit facilities from other financial institutions, some of which have opened new SME windows providing advisory services to their clients, as well as credit.
▪ Guaranteed loan use - Agricultural guarantees - Storage and food processing - Village development - Fisheries - Other rural investments	▪ Diverse sectors benefit from the system, particularly agriculture, with sanctioned loans totalling TZS 1 489 762 000 and guarantees of TZS 661 334 876. Manufacturing has sanctioned loans of TZS 1 309 940 000 and guarantees of TZS 654 970 000. Other sectors include construction, education, tourism, communication services, mining, fishing and transport. The system was overexposed in 2008 when it exceeded the leverage ratio of 1:3. It was suspended temporarily. In 2010, the government injected new capital of TZ 5 billion to redress capital shortfall, but this step coincided with review of the guarantee system structure, operation and monitoring and evaluation.

Web site: http://www.bot-tz.org/

2.12 FINANCIAL SECTOR DEEPENING TRUST (FSDT), UNITED REPUBLIC OF TANZANIA

Indicator	Data
Ownership	Multi-donor trust funds – Canadian International Development Agency (CIDA), DFID, the Swedish International Development Cooperation Agency (Sida), the Government of the Netherlands, DANIDA, the World Bank, the Government of the United Republic of Tanzania and the Bank of Tanzania (BOT).
Supervisory board	Representatives from each donor country and BOT. An investment committee chaired by financial and banking experts decides which projects to fund.
Management	Sosthenes Kawe is the chief executive officer, with a staff of 8–10.
Company mission	Deepening financial services delivery, mainly to rural populations located in remote areas with no access to financial institutions' products and services. Aligned with the country's poverty reduction strategy and the second-generation financial services sector reform.
Company objectives	▪ Expanding the scale and viability of financial institutions in rural areas, including of the emerging community banks servicing those areas. ▪ Improving financial sector infrastructure by building technical and financial capacity for rural financial institutions.
Investment strategy	Designed to help the rural poor gain access to financial services. Operating since 2006, but less than 10% of the population has access to formal financial services. Has focused mainly on the design of capacity building programmes to strengthen financial institutions in rural areas and to complement other innovative finance systems such as warehouse receipts and mobile banking. Provides loans, grants and guarantees, particularly to the SME loan departments of commercial banks and MFIs.
Investment returns	Not profit-oriented but expects loans to be repaid, including financial institutions' fees for providing credit guarantees. Complements existing financial service providers, especially when risk levels exclude small and medium-sized customers/farmers from equitable access to financial products and services.
Company start-up date	2006.
Guarantee conditions	
▪ Costs of guarantees	▪ At the outset FSDT provided 4 financial modalities: grants, loans, guarantees to support lending to SMEs/farmers, and debt equity such as convertible loans. Interest on the GF is 2–3%.
▪ Guarantee period	▪ The tenor period agreed by the bank.
▪ Leverage of private capital	▪ No.
▪ Guarantee limit	▪ Up to 50% of total loan value for the life of the loan, with first loss to the participating bank receiving the guarantee.
Company orientation	▪ Range of activities to strengthen and deepen financial services delivery in the United Republic of Tanzania. In recent years, FSDT focuses on 3 key modalities for product delivery: micro-level support to rural financial institutions, through capacity building, e.g., assistance with managing transactions; meso-level support to community banks, savings and credit cooperatives and associations, etc., so they can increase lending to SMEs/farmers on reasonable credit terms; and macro-level assistance, through making policy recommendations to the government and BOT on improving the sector's regulatory framework and SME/agribusiness lending practices.

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Indicator	Data
	In 2010, BOT focused on meso-level assistance because rural populations lack access to financial services; training and capacity building are also in high demand.
Company size and operations	
▪ Equity assets ▪ Accumulated earnings and grants donated ▪ Guarantees per annum ▪ Guarantees outstanding ▪ Guarantee portfolio ▪ Accumulative value of guarantees ▪ Loan portfolio outstanding ▪ Loans guaranteed	FSDT's first official report on rural financial activities was expected in 2011. During an interview on 30 January 2012 FSDT emphasized that its guarantee system needs an overhaul given its mixed results from working with commercial banks. FSDT provides guarantees according demand, but is slowing the process down. Recently it assisted BOT in restructuring the terms and conditions of its SME guarantee system.
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ A guarantee system for small and medium-scale agribusinesses on Zanzibar Island led to interest rates being reduced from 18% to about 12%. Loans were primarily to groups (of poultry farmers, fishers, spice growers, processors, etc.).
▪ Increased access	▪ FSDT plans to stop making loans to financial institutions in rural areas and to focus on assisting these institutions by creating new products and financial instruments. It supported the expansion of a local MFI into many new districts. In 2008, FSDT provided 1.1 million GFs in a system with the National Microfinance Bank (NMB), which provided 5.0 million for agrodealer finance in 5 districts. NMB was selected because it has 120 branches covering 80% of the country. Many women benefited from this system. It is unclear whether or not the system was profitable, but it provided support to farmers requiring input finance.
▪ Guaranteed loan use - Agricultural guarantees - Storage and food processing - Village development - Fisheries - Other rural investments	▪ Guaranteed loans are used for input credit, warehouse receipt systems underwritten by commercial banks (NMB), village rural financial services outreach, mobile banking, fisheries and other rural investments.

Web site: www.fsdt.or.tz/
Contact: Mr Mwallu Mwachang, Sasatel House, 251 Toure Drive, Oyster Bay, DSM, United Republic of Tanzania

2.13 AGRIBUSINESS LOAN GUARANTEE COMPANY (ALGC), UGANDA

Indicator	Data
Ownership	Agribusiness Initiative Trust (aBi Trust).
Supervisory board	3-member board of directors with an oversight role. 1 director is a founder of the aBi Trust and 2 are on the board of trustees.
Management	2 managers.
Company mission	Developing the agriculture sector and increasing SMEs' contribution to the agricultural economy.
Company objectives	Promoting financial institutions' provision of credit facilities to agriculture-based SMEs that are generally considered too risky. Attaining yields to sustain investment of funds managed by the company.
Investment strategy	Funds invested in: ▪ government securities; ▪ fixed deposits at financial institutions; ▪ credit lines to financial institutions for lending to the agribusiness sector. A portfolio mix is adhered to and the target yield is set annually.
Investment returns	Yield of 10.48% at 30 June 2011, against target of 6.75%.
Company start-up date	28 July 2006.
Guarantee conditions	
▪ Costs of guarantees	▪ Fees to financial institutions of 0.75–1% of the guarantee limit per annum.
▪ Guarantee period	▪ Up to 5 years.
▪ Leverage of private capital	▪ 41% at 30 June 2011, on account of recent substantial increase in endowment fund.
▪ Guarantee limit	▪ 50% of the loan disbursed.
Company orientation and principal activities	Guarantees, credit lines to agribusiness, investments in various instruments, and technical assistance from aBi Trust.
Company size and operations	*In 2011:*
▪ Equity assets	▪ US$11 945 543.
▪ Accumulated earnings and grants donated	▪ US$11 922 269.
▪ Guarantees per annum	▪ US$5 927 151.
▪ Guarantees outstanding	▪ 7 841.
▪ Guarantee portfolio	▪ US$4 494 161.
▪ Accumulative value of guarantees	▪ US$18 761 549.
▪ Loan portfolio outstanding	▪ US$4 744 058.
▪ Loans guaranteed	▪ 6 732

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Indicator	Data
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ No.
▪ Increase in access	▪ Financial institutions have lent to the agriculture sector where they would not ordinarily have engaged (full additionality), or have disbursed more to an agribusiness than they would have done without the guarantee (partial additionality). The number of loans has grown by 3.670% since 2008.
▪ Guaranteed loan use ▪ Agricultural guarantees ▪ Storage and food processing ▪ Village development ▪ Fisheries ▪ Other rural investments	▪ Guaranteed loans to: - agricultural input dealers; - agricultural marketing enterprises; - agricultural processors; - agribusiness transporters; - farmers' organizations and enterprises; - agricultural produce traders and dealers; - providers of agribusiness support such as veterinary services and agricultural training.
Future outlook and projections	
▪ Growth	▪ Guarantees and credit lines for agribusiness development expected to attain leverage of 1:3, to reach 35 000 beneficiaries and to increase participating institutions from 5 to 8.
▪ Diversification of complementary products	▪ Considering equity investments in financial institutions that finance agribusiness.
▪ Possible mergers/acquisitions or other changes	▪ Possible merger of the trust and ALGC.

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Tel.: +256 312 351600

2.14 SUSTAINABLE AGRICULTURE GUARANTEE FUND (SAGF), THE NETHERLANDS

Indicator	Data
Ownership	Four founding partners. Initiated by Rabobank International (RI) in response to a call for public–private partnerships from the Netherland's Ministry of Foreign Affairs (DGIS). Two additional partners were invited to join because of their specific knowledge and added value: Rabobank Foundation (RF) and *Solidaridad*. In 2006 Cordaid joined.
Supervisory board	Representatives from RI and RF. At present, the board also acts as the credit committee.
Management	RI.
Company mission	Enhancing access to working capital credit (pre-export trade finance) for selected small- and medium-sized producers of sustainable agricultural products in developing countries, on commercial and sustainable terms, by issuing partial and conditional credit guarantees at affordable fees, preferably for local financial intermediaries.
Company objectives	Deepening the local financial sector, by increasing access to financial services for those who previously had restricted or no access.
Investment strategy	▪ Providing credit guarantees to financial intermediaries that support countries' pre-financing of cooperatives and SMEs. Interested in establishing long-term partnerships with participating financial institutions. ▪ Target sectors include agricultural cooperatives and SMEs engaged in the production of coffee, cocoa, cotton, nut/seed oils, tea, fresh fruits and other agricultural products. Cooperatives should be organized as member-based organizations, produce for and export to international markets on a fair trade basis and purchase raw materials from small producers on a fair trade basis. ▪ Fund structure: public–private partnership. ▪ Investment instruments: (partial) credit guarantees.
Investment returns	At 2010, the fund had not experienced any losses or late repayments.
Company start-up date	2008.
Guarantee conditions	
▪ Costs of guarantees	▪ Average 2.5% per year, depending on the risk assessment.
▪ Guarantee period	▪ 3–4 years.
▪ Leverage of private capital	▪ Sales contracts are used as collateral.
▪ Guarantee limit	▪ Up to 80% of the loan principal. Guarantees are for a minimum of US$500 000 up to an indicative maximum of US$1.5 million per transaction. Amounts above US$1.5 million are subject to syndication.

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Indicator	Data
Company size and operations	A separate legal entity has been established – the Stichting Sustainable Agriculture Guarantee Fund – with a board of representatives from RI and RF. A steering committee guides the board on policies, etc. Its members are representatives of the four founding partners. Day-to-day management is by RI's Structured Trade Finance Team under a service-level agreement with SAGF.
▪ Equity assets ▪ Accumulated earnings and grants donated ▪ Guarantees per annum ▪ Guarantees outstanding ▪ Guarantee portfolio	▪ Initial capacity of €10 million.
▪ Accumulative value of guarantees	▪ Operates with 7 banks in 5 partner countries and has issued guarantees for a total of US$5 million.
Impact	
▪ Reduced bank interest rate on guaranteed loans to clients	▪ Short-term, pre-export financing is provided at acceptable commercial rates with less restrictive conditions, e.g., collateral requirements.
▪ Increased access	▪ During its first year of operations, SAGF reached about 27 000 direct beneficiaries (individual producers) and 135 000 indirect beneficiaries (their family members).
▪ Guaranteed loan use	▪ Agricultural investments.
Future outlook and projections	
▪ Growth ▪ Diversification of complementary products	▪ Aims to reach US$30 million in credit guarantees

Web site: www.rabobank.com/content/products_services/business_clients/professionalproducts/raboagrifund/index.jsp?urlkort=guaranteefund
Contact: Ellen Bogers, Rabo Sustainable Agriculture Guarantee Fund, The Netherlands.
Tel.: +31 (0)30 216 23 53.

2.15 *SOCIÉTÉ TUNISIENNE DE GARANTIE* (SOTUGAR), TUNISIA

Indicator	Data
Ownership	37% Tunisian Government; 63% banks, with capital of TND 3 million.[23]
Supervisory board	Representatives from the Ministry of Finance, the Financing Bank of SMEs, the Tunisian Bank Association, the Tunisian Association of Capital Investors and banks. Meets at least four times a year to discuss strategies, and topics and projects related to SOTUGAR's activities.
Management	1 chairperson, 1 deputy general director, 1 director and 8 staff.
Company mission	▪ Managing a CGS granting credits to SMEs and participating in their capital. ▪ Managing the National Guarantee Fund (FNG), which provides guarantees on banks' loans for agricultural production. ▪ Managing GFs or guarantee systems dedicated to credits for SMEs' capital and other financing. ▪ Accelerating the flow of institutional credit to small-scale farmers, either as individuals or as mutual societies.
Company objectives	▪ Ensuring the continuity of financing to SMEs. ▪ Granting access to financing based on project viability. ▪ Sustaining innovative SMEs, the creation of new SMEs and the financial restructuring of SMEs.
FNG objectives	▪ Granting small farmers access to formal sources of credit through rural private financial intermediaries. ▪ Encouraging banks to use their own resources to support producers with credit records. ▪ Ensuring the long-term sustainability of the guarantee system and FNG.
Investment strategy	Established by the Ministry of Finance and the supervisory board.
Investment returns	Grew from TND 2.5 million in 2004 to TND 3.3 million in 2010.
Company start-up date	2003.
Guarantee conditions	
▪ Costs of guarantees	▪ One-time guarantee fee of 0.6% for medium- and long-term loans, 1% for short-term loans, and 3% of the venture capital institution's participation in the SME.
▪ Guarantee period	▪ From the date of approval by the lending company to 2 years after the final judgement in its favour.
▪ Leverage of private capital	▪ Restricted inflow of private capital into the guarantee system.
▪ Guarantee limit	▪ 75% of the total for loans of up to TND 5 million.
Company orientation and principal activities	▪ Issuing credit guarantees for SME financing by banks. ▪ Managing the GFs of FNG. ▪ Popularizing the system among bankers and entrepreneurs.

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[23] €1 = TND 1.9

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Indicator	Data
Company size and operations	
▪ Equity assets	
▪ Accumulated earnings and grants donated	▪ Accumulated earnings of TND 4.9 million; grants of TND 15 million.
▪ Guarantees per annum	▪ In 2010, about TND 131.8 million.
▪ Guarantees outstanding	
▪ Guarantee portfolio	
▪ Accumulative value of guarantees	▪ TND 622.9 million.
▪ Loan portfolio outstanding	
▪ Loans guaranteed	▪ 3 237 in 2010.
Future outlook and projections	
▪ Growth	
▪ Diversification of complementary products	▪ Guarantee line for SMEs facing difficulties in paying off their debts after the Tunisian transition period.
▪ Possible mergers/ acquisitions or other changes	▪ None in the short term. In the long-term, a possible merger with the Financing Bank of SMEs.

Web site: www.sotugar.com.tn/

2.16 DEVELOPMENT CREDIT AUTHORITY (DCA), USAID, UNITED STATES OF AMERICA

Indicator	Data
Ownership	USAID.
Management	Activities designed and managed by USAID's overseas missions, and priced and financially monitored by USAID's Office of Development Credit in Washington, DC. Missions are responsible for identifying, designing, implementing, monitoring and evaluating projects that use guarantees; authorizing projects and funding the costs from their budgets; and ensuring the developmental soundness of projects. In Washington, DC, USAID's Credit Review Board and Chief Financial Officer are responsible for the financial soundness and cost determination of each mission project. On request, the Office of Development Credit assists missions in project identification and design.
Mission	Providing USAID missions with an innovative way to stimulate lending from the private sector for investment in developmentally beneficial activities.
Objectives	A tool that enables USAID missions to provide partial credit guarantees for private-sector investments, to reduce the risk associated with lending to new sectors or new borrowers. Guarantees stimulate development by increasing the flow of credit to areas that need it most.
Investment strategy	▪ Partial guarantees are intended to enhance credit with true risk sharing by private and public sector partners. Loan amounts typically range from US$5 million–10 million, but guarantees have been as low as US$1 million and as high as US$40+ million. ▪ Partial guarantees are primarily for use in countries and regions where USAID has an active presence. Eligible projects must have positive financial rates of return so that the loans can be repaid. USAID may decline to provide credit assistance where risk analysis of a specific project demonstrates that the estimated risk is very high.
Investment returns	
Start-up date	1999.
Guarantee conditions	
▪ Costs of guarantee	▪ ≤Utilization fee averages 0.5% of the outstanding principal amount guaranteed.
▪ Guarantee period	▪ Depends on the date of the guarantee agreement. For bond guarantees, the coverage expires on the date of maturity of the final tranche of the bond, if earlier than the date of the agreement.
▪ Leverage of private capital	▪ US$27 of private sector capital for every US$1 of government resources.
▪ Guarantee limit	▪ 50% of the loan principal (may be more or less in exceptional circumstances).

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Indicator	Data
Company orientation and principal activities	▪ Offering partial loan and bond guarantees to private financial institutions for local currency loans in countries and sectors where access to credit is limited. Based on the premise that there are large reserves of dormant private capital in less-developed countries. ▪ True risk-sharing between USAID and the guaranteed party must be ensured. ▪ Providing 4 types of partial guarantee: - bond guarantees for private sector investors; - loan guarantees for microenterprises and small businesses, with both lenders and borrowers identified up-front and lump sum or multiple disbursements; - loan portfolio guarantees, which are specific to the project concerned and may include the following types of borrower: non-sovereign (country) MSMEs, MFIs, and non-governmental organizations established under (country) law that are private enterprises in relevant sectors – USAID missions decide on the definition of "borrowers"; - portable guarantees, which allow the target institution (borrower) to select the best loan package and which become loan guarantees once the lender is identified.
Company size and operations	
▪ Equity assets	
▪ Accumulated earnings and grants donated	▪ US$193 844 574 mobilized in 2011.
▪ Guarantees per annum	▪ In 2010, new agreements in the agriculture sector were signed in 7 Feed the Future countries, making US$106.8 million available in local credit at a cost of US$8.7 million to United States tax-payers.
▪ Guarantees outstanding	▪ Default rate of 1.75% since inception.
▪ Guarantee portfolio	▪ In 2011, loan guarantees of US$2 500 000 (3%); loan portfolio guarantees of US$76 161 535 (85%); bond guarantees of US$4 331 080 (5%); and portable guarantees of US$5 358 210 (7%).
▪ Accumulative value of guarantees	▪ In 2011, US$89 100 825.
▪ Loan portfolio outstanding	
▪ Loans guaranteed	▪ In 2011, 37 transactions completed in 21 countries, resulting in nearly US$200 million in private capital for local loans.
Impact	
▪ Increased access	▪ Evaluation of USAID's Office of Development Credit found that between 2000 and 2009, USAID guarantees increased the Bank of Abyssinia's lending to the agriculture sector by 102%. Once the bank realized the profitability of this sector, it continued to lend to 20% of the formerly USAID-guaranteed borrowers without guarantees. Total lending from banks within Ethiopia to the agriculture sector increased from 8% of outstanding loans in 2001 to 20% in 2008.
▪ Guaranteed loan use	- Over the past 10 years, DCA has mobilized US$551 million of private sector credit in the agriculture sector at a cost of US$30 million to USAID. - Guarantees for agriculture accounted for 39% of DCA's guarantee portfolio in 2011.

Annex 3

Summary evaluation of UNIDO's experience with guarantee funds

1. UNIDO's experience in supporting CGS is restricted to promotion of the mutual guarantee association model in countries such as Argentina, India and Senegal. Results have been mixed: some of the funds (mostly in India) have been used extensively by members to guarantee loans with a total value exceeding many times the amount of the fund itself, but more rigorous evaluations are needed to verify whether or not these borrowers would have had access to loans without the GF. In other cases, such as in Argentina and recently in Senegal, there has been modest use of GFs by borrowers. The following paragraphs provide insights for developing recommendations that may be of use for future initiatives.
2. Interactions with lenders reveal that guaranteeing a loan is not a substitute for evaluating the feasibility of the investment project or borrowers' willingness to repay. The main interest of profit-oriented lenders is not to recover loan losses through guarantees or collateral and legal action, but rather to fund credit-worthy borrowers. Therefore, if GFs cannot help to address the informational problems faced by lenders (as well as providing guarantees), they only reduce the risk of loan losses and do not influence lenders' capacity to assess credit-worthiness and, consequently, their interest in the targeted segment of borrowers.
3. Because lenders are interested in participating in guarantee systems that open new credit market niches, systems that make efforts to collect and provide lenders with valuable information about targeted customers (such as their financial performance, business models and marketing channels) may enhance lenders' ability to recognize this target group as a new credit-worthy niche, while the lower risk of loan losses due to guarantees may encourage them to provide credit.
4. Experience also shows that GFs cannot affect other very important constraints limiting broad-based access to finance. Even when well-designed GFs are established, access to loans is unlikely to change if: i) existing financial products cannot be adapted to the financing needs of the targeted borrowers; ii) there are problems with enforcing contracts among lenders, guarantors and/or borrowers under the current legal system; iii) the financial regulatory framework makes it unfeasible for lenders to service the poorest potential borrowers; and iv) the targeted groups have no profitable business opportunities because of their low productivity, lack of managerial capacity, inefficient business models, etc. (i.e., the main constraint to access to finance is not financial in nature).

5. These features help to explain why GFs have had mixed results, because important preconditions must exist for this type of intervention to have a significant effect on access to finance. When the critical constraint is related to lenders' inability to determine their loss in case of default, GFs may have a significant effect on access to finance. When the critical constraint is different, another, more focused type of intervention is likely to be more cost-effective (such as the development of new financial products, improvements in the legal system for enforcing contracts, the establishment of market-based interest rates and credit bureaux, and knowledge transfer to increase competitiveness).
6. The mutual guarantee association model is limited by the value of members' contributions. This results in a relatively small fund, which limits the scale of coverage.

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Credit guarantee systems for agriculture and rural enterprise development takes a fresh and unbiased look at the application and results of guarantee funds for agricultural and rural enterprise development. In order to address the need for increased investment in agriculture and agribusiness, there is renewed interest in using guarantee systems investment to attract finance and investment towards target groups and agro-industries, including small and medium enterprises, that are too risky for adequate financing without such risk-sharing incentives.

The document serves to inform development agencies and policy-makers on current practices and experiences, so that they can apply this information to their decision-making regarding whether or not and/or how best to promote guarantee mechanisms that are effective and sustainable.

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