Credit Guarantee Institutions (CGIs)
Sector Study

June 2022

Credit Guarantee Institutions

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Credit Guarantee Institutions

Introduction

- CGIs are non-bank financial institutions (NBFIs) whose main objective involves increasing the access of small and medium-sized enterprises (SMEs) to formal lending through the provision of credit guarantees that mitigate the risk of non-repayment. The guarantee schemes are licensed and supervised by central banks or other financial sector regulators and are subject to minimum capital requirements.
- Penetration of the underserved segments and SMEs in credit markets remains low. CGIs were introduced to support these organizations and help them avail the benefits of financial leverage by giving guarantees for underserved segments in the financial industry.
- CGIs typically provide third-party credit risk protection to the lenders by absorbing a portion of lenders loss, in case of default, on loans given to SMEs and other organizations, in return for a nominal fee.
- They are largely owned and funded by the government of the respective country or by multilateral institutions. Given their developmental role, CGIs generally carry high credit risk against their portfolio. These are usually reliant on their owners' equity and/or grants to run their operations.
- Government commonly use public credit guarantee schemes (PCGSs) to unlock finances for underserved segments, with more than half of all countries having some sort of CGS for them, in particular for SMEs. Unfortunately, despite this 68% of formal SMEs in emerging markets are underserved or unserved by financial institutions, which result in a credit gap of approximately USD~1 trn.

THE WORLD BANK

ADB
ASIAN DEVELOPMENT BANK

IFC
International Finance Corporation
WORLD BANK GROUP

Source: World Bank, ADB

Credit Guarantee Institutions

Services Offered By Credit Guarantee Schemes

Credit Guarantees

- This is the core function of the CGS

Credit Assessment

- If the CGS does credit risk assessment, there are numerous benefits such as the development of a credit risk repository, better risk assessment and greater lender comfort.

Credit Insurance services can take the following two forms:

- Trade credit insurance: provides SMEs protection against default risk of business counterparts.
- Loan portfolio (re-) insurance: CGS can include insurance for the institution providing credit guarantee services.

Credit infrastructure services can take the following two forms:

- Credit database: The unique position of CGIs in the financial ecosystem enables it to possess rich information on SMEs.
- Factoring: This will help alleviate cash flow issues for SMEs by enabling the realization of receivables sooner and help them be on better credit terms.

Source: World Bank, ADB

Credit Guarantee Institutions

Setting Up And Operationalizing The CGS

First Step: Initial Assessment	**Identification of Purpose: Define the CGS's exact economic role or underlying need**	Analyze access to finance issues: higher interest rates, rejection rates, demand for collateral and others
		Analyze underlying causes: Outcome of above should be analyzed to identify core underlying issues
		Analyze overlap of functions: Assess whether existing institutions have addressed the core issues effectively or ineffectively.
		Analyze institutional market failure issues: This involves looking at market failure requiring intervention. CGS should only target those issue for which it can offer sustainable long-term solutions.
	Organizational Setup	Organizational structure for a CGS can be: • Public • Private (mutual fund guarantee schemes) • Public-private partnerships • International organization
Second Step: Recommendations for Operationalizing a CGS	**Principles for Sustainable and Efficient CGS Functioning**	Legal and regulatory setup Capital contribution Ongoing capital contributions Leverage ratio

Source: World Bank, ADB

Credit Guarantee Institutions

Types of CGIs

Type of CGIs	Advantages	Disadvantages
Public	High trust factor, synergy with other government departments	Political influence
Private	Better risk assessment	Regulatory disadvantages, chances of fraud
Public-Private	Diverse source of fund, better governance	Rent-seeking activities may take place
International	International expertise and good corporate governance practices	High admin cost, and limited penetration

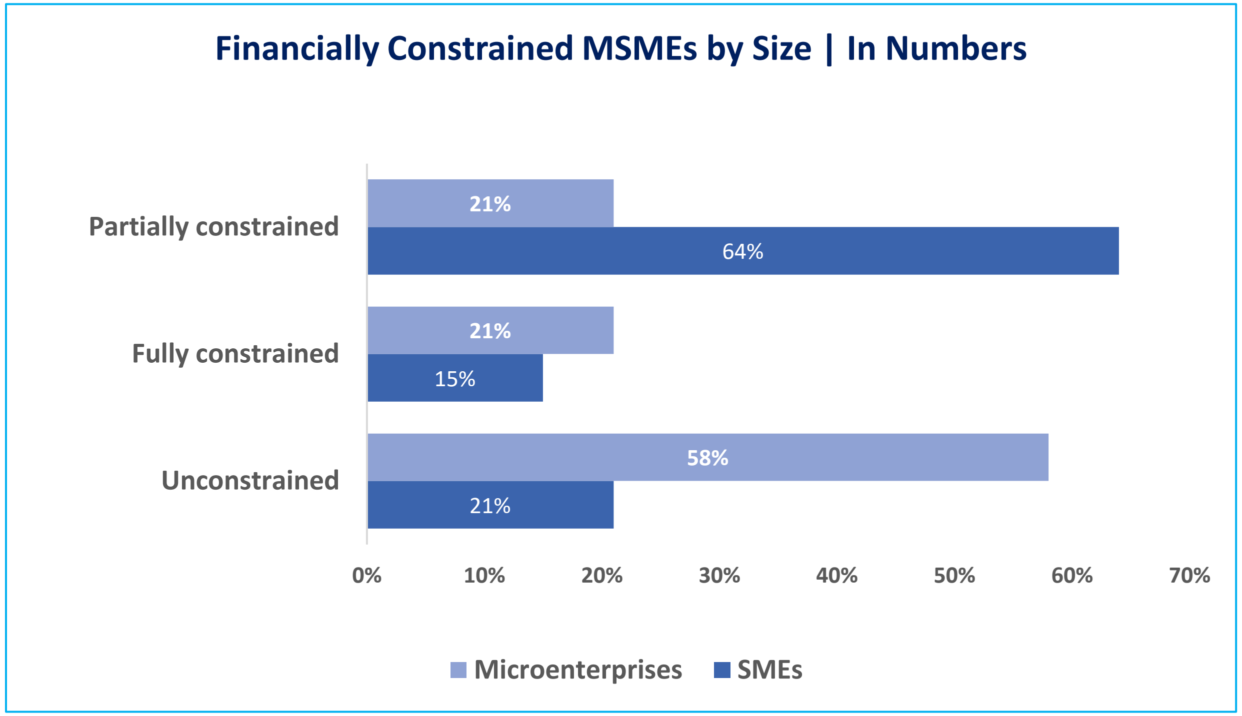
Source: World Bank, ADB

Global Funding Gap

Current Demand for MSME Finance = USD~8,671bln

Current Supply of MSME Finance = USD~3,859bln

MSME Finance Gap= USD~4,812bln

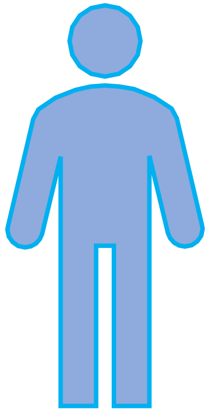


- The current developing world demand for MSME finance outweighs the supply by USD~4,812bln indicating that there are many businesses whose financing needs are yet to be met.
- On a global level ~79% of SMEs are financially constrained, either partially or fully, while ~21% are unconstrained. On the other hand, a majority of microenterprises fall in the unconstrained category (~58%).

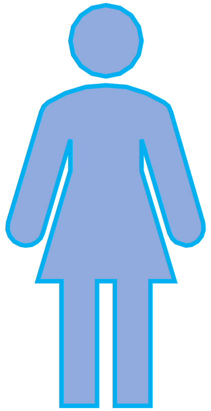
Source: World Bank, OECD, SME Financing Forum

Credit Guarantee Institutions

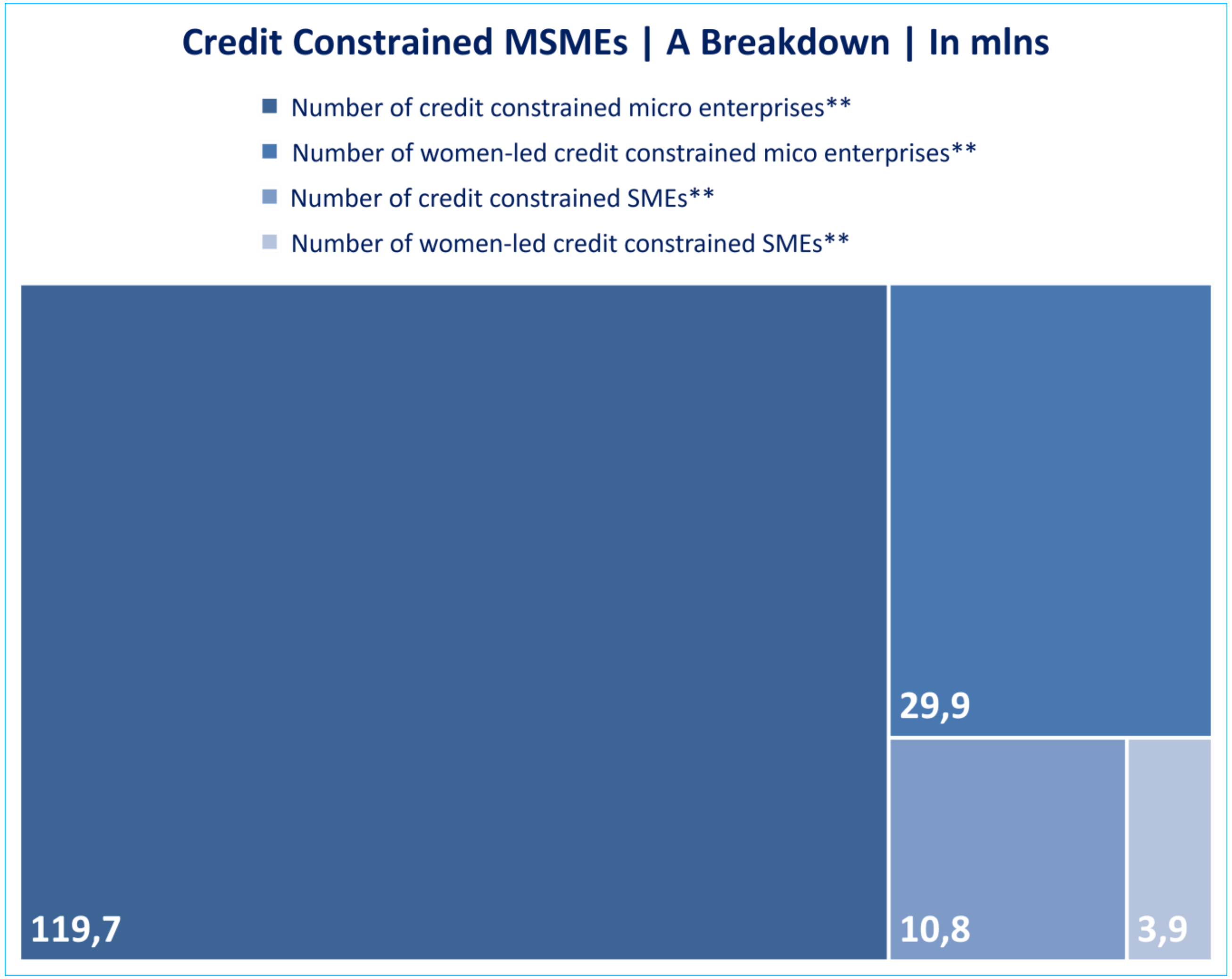
Global Statistics | MSMEs and SMEs



Male-led SMEs*: 64%
Male-led micro enterprises*: 75%



Female-led SMEs*: 36%
Female-led micro enterprises*: 25%

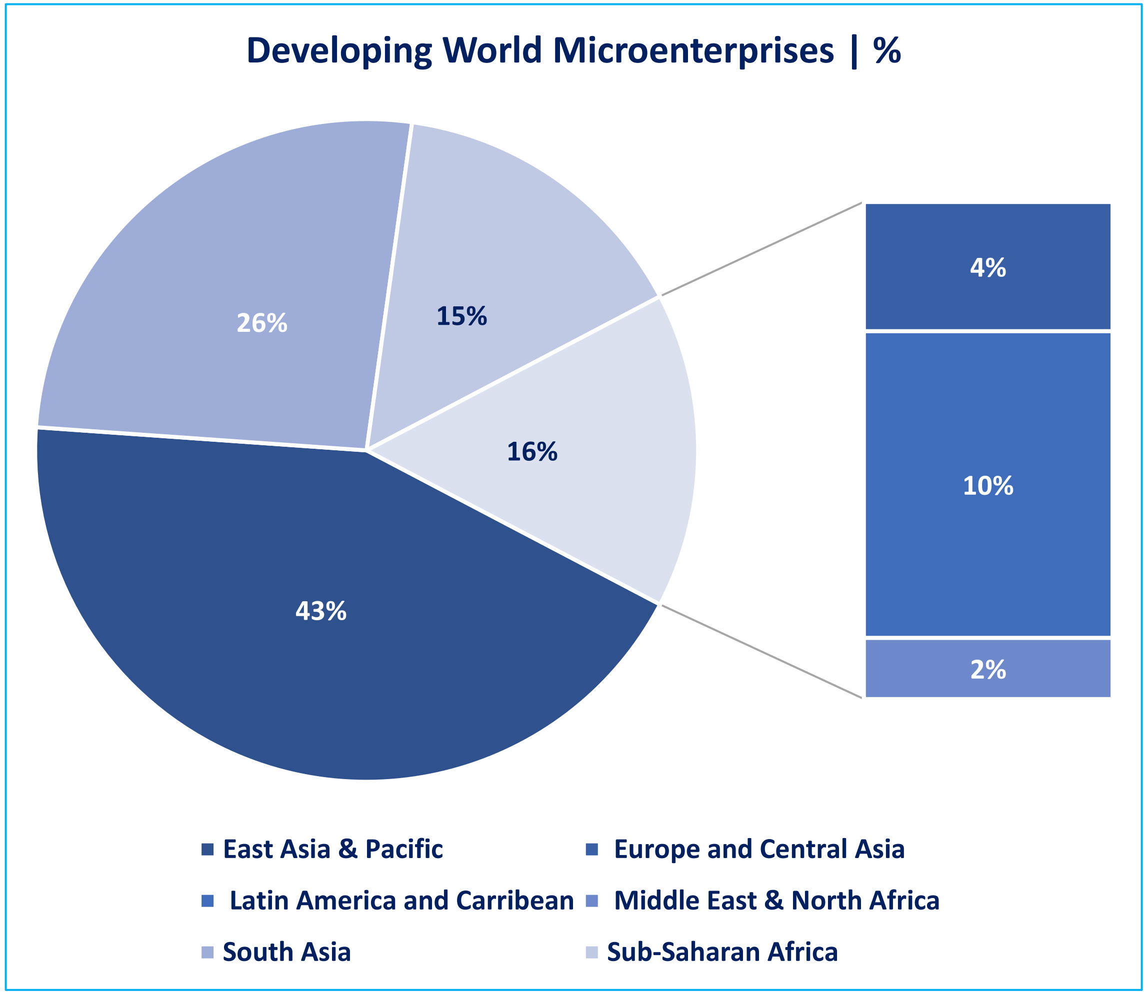


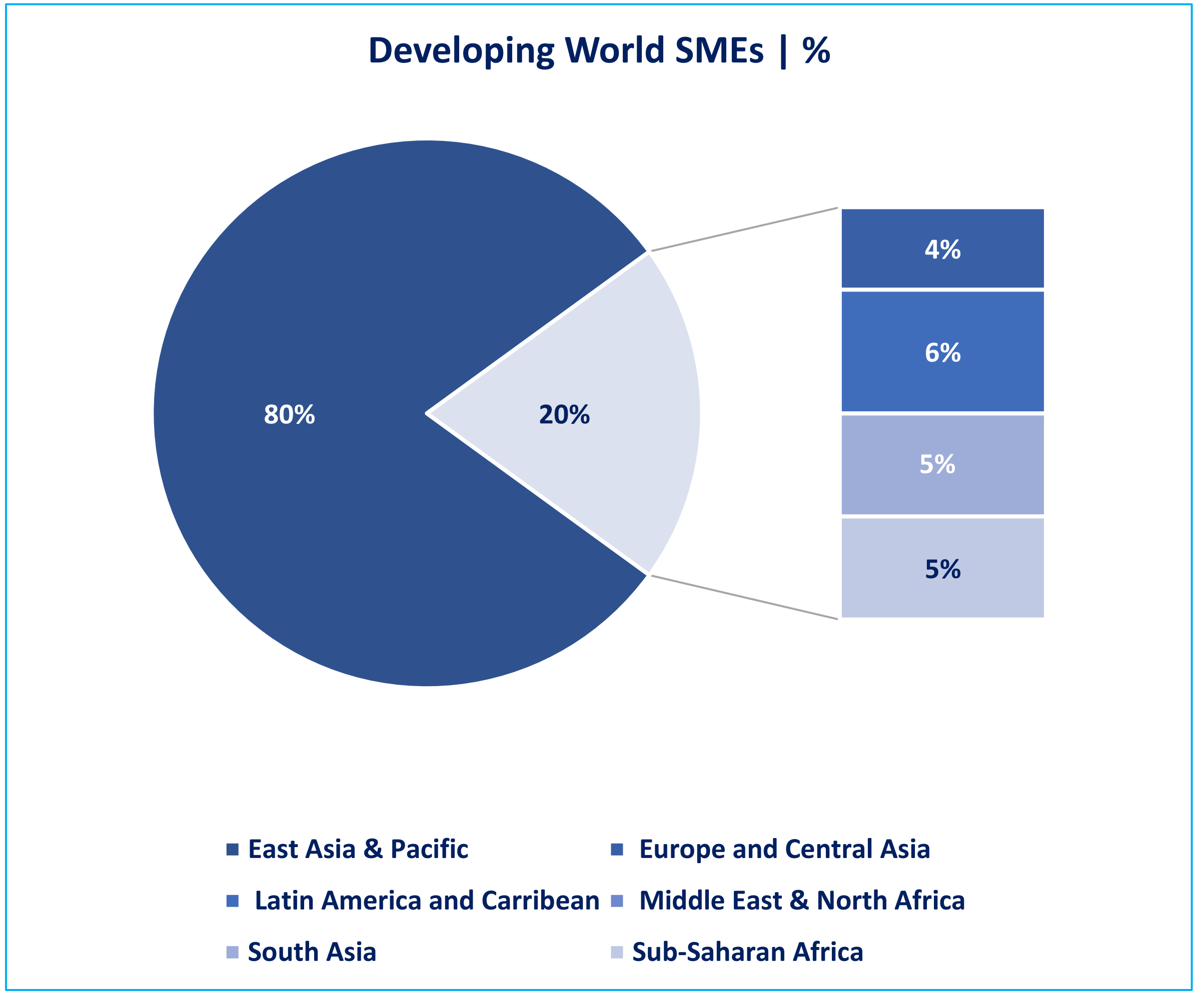
**Percentage of total*
***Credit constrained: Fully and partially constrained*

Source: World Bank, OECD, SME Financing Forum

Credit Guarantee Institutions

Developing World MSMEs





Source: World Bank, OECD, SME Financing Forum

Global Overview | AECM

- The European Association of Guarantee Institutions (AECM) saw an increase of 200% in volumes of guarantees issued in first half of CY20, with guarantees issued worth EUR~300bln, a majority of which are counter-guaranteed by respective governments.
- The number of SMEs supported increased by 80% to ~5.2mln with many counting on the AECM to support them during the pandemic year.
- The significant growth is originating largely from the extensive government programs in the region. The estimated worth of guarantees in Italy, France, Germany, and Spain are EUR~33.6bln, EUR~16.7bln, EUR~5.6bln, and EUR~4.1bln, respectively.
- There are a number of prominent CGIs that operate across the globe. Some of them are discussed in detail in this Sector Study.
- The outreach, which signifies the number of SMEs utilizing CGI facilities, remains low, particularly in Africa at 0.3% which also has the highest default rate of ~17.1%, which signifies the share of non-performing guarantees in total outstanding guarantees.

Source: AECM

Credit Guarantee Institutions

Multilateral Investment Guarantee Agency (MIGA)

- MIGA is part of the World Bank group, and is governed by its member states. It was established in 1948, with the objective to promote foreign direct investment in the developing countries.
- In the last 6 years, MIGA's gross outstanding guarantees have grown by ~29%, while net guarantees have also increased by ~34% to USD~9.1bln.
- In FY21, MIGA issued new guarantees worth nearly USD~5.2bln in support of 40 projects. ~51 percent of these projects address at least one of the three MIGA's strategic priority areas; i.e., International Development Association (IDA) eligible countries, Fragile and Conflict-affected Situations (FCS) or countries, and climate change.

Figures in USD mln	FY17	FY18	FY19	FY20	FY21
Outstanding Guarantees	17,778	21,216	23,300	22,600	23,000
Guarantees Issued (Gross Issuance in FS)	4,842	5,251	5,548	3,961	5,199
Equity	1,213	1,261	1,320	1,335	1,474
Outstanding Guarantees / Equity (X)	14.7	16.8	17.7	16.9	15.6
Net Guarantee Income	93	104	115	117	121
Expenses	(51)	(52)	(58)	(61)	59
Operating Income / (Loss)	42	53	57	56	63
Expense / Guarantee Income	55%	49%	50%	52%	49%

Source: miga.org

Credit Guarantee Institutions

Small & Medium Enterprise Credit Guarantee Fund of Taiwan (SMEG)

- SMEG was established in Taiwan in 1974, after the early 1970s oil crisis in which a large number of SMEs suffered due to recession and high inflation.
- Primary objective of the fund is to provide credit guarantees to SMEs running in normal operations but are short of collateral for external financing.
- Funds for SMEG primarily come from central government, local governments, and contracted FIs. As of 31st December 2020, SMEG's net worth stood at USD~2.7bln*.
- In the 5MCY22 period, a total of 140,254 cases (CY21: 1,140,632) were approved for credit guarantees and the amount guaranteed reached USD~604bln.
- The amount of outstanding guarantee stood at USD~38.9bln at the end of CY20.

Figures in USD mln	CY16	CY17	CY18	CY19	CY20
Outstanding Guarantees	21,815	21,532	21,966	22,886	38,675
Equity	1,906	2,065	2,164	2,566	2,720
Investments	273	342	405	533	802
Outstanding Guarantees / Equity (X)	15.7	15.0	14.9	8.9	14.2
Investments / Outstanding Guarantees	0.9%	1.1%	1.3%	2.3%	2.3%
Investments / Equity	14.3%	16.5%	18.7%	20.8%	20.7%
Default rate	2.0%	1.8%	1.6%	1.5%	1.0%
Guarantee Income	110	112	117	127	114
Investment Income	30	30	30	38	29
Expenses	(280)	(259)	(262)	(266)	(226)
Net Income / (Loss)	(6)	(20)	(23)	51	(83)
Expense / Guarantee Income	254.9%	232.1%	224.7%	209.6%	198.2%

Annual Report available till CY20

*At Dec. 31, CY20: TWD 1 = USD 0.03559 | At Dec. 31, CY21: 1 TWD = USD 0.03608 | At May 31 CY22: TWD 1 = USD 0.034503

Source: smeg.org.tw, exchangerates.org

Credit Guarantee Institutions

Credit Guarantee Corporation of Tokyo (CGCT)

- CGCT was established in 1937 by Tokyo Prefectural Government & Tokyo City Government (together, now the Tokyo Metropolitan Government). CGCT helps SMEs operating in Japan in fund-raising.
- CGCT is engaged in providing services and special credit guarantee programs including Management Support Initiatives, Guarantee System, Entrepreneur Support and International Co-operations.
- CGCT provides medium term guarantees in the form of individual and revolving guarantees with ceiling of JPY~280mln and for up to 10 years.
- As of 31st March 2021, CGCT served 219,511 cases, with outstanding guarantees standing at USD~61.0bln.
- FY20 proved to be an exceptional year in terms of the guarantees issued. Outstanding guarantees increased by ~127.5% from the SPLY and ~109.7% from FY16.
- The number of cases have increased by ~40% to reach 463,039 in FY20 (SPLY: Cases = 329,972).

Figures in USD mln	FY16	FY17	FY18	FY19	FY20
Outstanding Guarantees	29,105	27,322	26,155	26,827	61,036
Guarantees Issued	10,982	9,801	9,875	12,250	56,680
Equity	2,564	2,636	2,734	2,847	2,853
Investments	3,659	3,735	3,808	3,916	4,050
Outstanding Guarantees / Equity (X)	11.4	10.4	9.6	9.4	21.4
Investments / Outstanding Guarantees	12.6%	13.7%	14.6%	14.6%	6.6%
Investments / Equity	142.7%	141.7%	139.3%	137.5%	142.0%
Guarantee Income	292	267	257	254	439
Investment Income	46	42	40	38	34
Expenses	(259)	(250)	(252)	(255)	(338)
Net Income / (Loss)	635	594	85	75	135
Expense / Guarantee Income	88.8%	93.7%	98.0%	100.4%	77.0%

Annual Report available till FY20

*At March 31, CY20: Yen 107.6963 = USD 1 | At March 31, CY21: Yen 110.7728 = USD 1

Source: cgc-tokyo.or.jp, exchangerates.org

Credit Guarantee Institutions

Korea Credit Guarantee Fund (KODIT)

- KODIT was founded in June 1976 and is a public financial institution. Its objective is to enhance an enterprise's financial accessibility and simulate credit based transactions through effective management of credit information for promising SMEs that lack tangible collateral.
- It is engaged in multiple operations including infrastructure credit guarantee, management consulting, credit insurance, credit guarantee, industry start up and, equity aligned guarantees.
- Over the five years, KODIT's average capital fund for guarantees stood at USD~6.2bln. In CY20 KODIT provided new guarantees worth USD~16.3bln.

Figures in USD mln	CY16	CY17	CY18	CY19	CY20
Outstanding Guarantees	42,800	43,900	43,600	45,100	61,722
Guarantees Issued	10,200	10,200	9,700	10,200	16,252
Equity	4,300	4,400	4,400	4,600	7,530
Investments	3,338	3,782	3,550	4,152	4,152*
Outstanding Guarantees / Equity (X)	10.0	10.0	9.9	9.8	8.2
Investments / Outstanding Guarantees	7.8%	8.6%	8.1%	9.2%	9.2%*
Investments / Equity	77.6%	86.0%	80.7%	90.3%	90.3%*
Default rate	3.9%	3.5%	3.6%	3.3%	2.4%

*Based on CY19 figures

Source: kodit.co.kr

Credit Guarantee Institutions

Background

- The State Bank of Pakistan (SBP) introduced its first Credit Guarantee Scheme (CGS) in 2010 particularly targeted towards small and rural enterprises. Pakistan's credit guarantee schemes have been managed by the SBP in collaboration with UK's Department for International Development (DFID) since its inception. The schemes were launched aiming to help micro and small enterprises to easily obtain bank credit.
- The schemes are based on funds provided by DFID and Government of Pakistan (GoP). Participating financial institutions are provided risk coverage against their lending exposure to micro, small and rural enterprises under the schemes.
- Financial institutions that are being provided risk coverage by the SBP include commercial banks, development financial institutions, microfinance banks, leasing companies, and co-operative banks.
- In CY21 SBP launched the SME Aasan Finance Scheme (SAAF) which provides loans up to PKR 10mln for a three year tenure with 40-60 percent credit risk guarantee to SMEs. The mark-up rate for the user under the scheme will be of up to 9 percent per annum (p.a.). SBP will provide refinancing to banks at 1 percent p.a. thereby offering a spread of up to 8 percent p.a.
- In CY19, SBP established the Pakistan Credit Guarantee Company (PCGC) in order to transform the DFID's Financial Inclusion Program (FIP) into an institutional setup and continue its positive effects on promotion of SME lending in Pakistan.
- PCGC was set up as a Partial Risk Sharing Facility by the State Bank of Pakistan to incentivise the FIs to lend more to the collateral deficient SME and agriculture sector. Therefore, its customers consist of commercial banks, DFIs and microfinance institutions.
- The initial investment for PCGC came from UK DFID and GoP. The operations of PCGC are supervised by the SBP. Currently PCGC has a paid up capital of PKR~6bln, and over the time, it has received funding from World Bank as well.
- GuarantCo Limited is the local currency guarantee arm of the Private Infrastructure Development Group (PIDG). It is directly and indirectly owned by five highly rated sovereigns. GuarantCo mainly operates in low income, below investment grade countries as per its mandate, including Pakistan.
- InfraZamin Pakistan Limited (IZP) is a more recent initiative of PIDG with the core objective of encouraging enhanced financial participation in long-term local currency financings of infrastructure assets.

Source: SMEDA, PCGC

Credit Guarantee Institutions

GuarantCo Limited

- GuarantCo was incorporated in 2005 with the aim to i) support infrastructure projects in low income countries via guarantee provisions which in turn, enable the said projects to raise debt financing and, ii) development of local financial debt markets.

- The ultimate ownership of GuarantCo lies with five governments; United Kingdom, Netherlands, Sweden, Switzerland, and Australia. With the exception of the Netherlands Development Finance Company (FMO), which contributes 11% of GuarantCo's total paid-in capital, the agencies act jointly under the umbrella of the Private Infrastructure Development Group (PIDG). However during CY19, FMO also contributed small amount through PIDG.

- In Pakistan, the company has taken a major exposure in infrastructure projects in renewable energy, healthcare, transport, and digital communications in Pakistan

.

Figures in USD mln	CY17	CY18	CY19	CY20	CY21
Outstanding Guarantees	286	265	226	203	267
Equity	273	270	273	280	230
Investments	223	213	120	126	125
Total Earning Assets	272	275	278	295	310
Outstanding Guarantees / Equity (X)	1.0	1.0	1.2	1.4	0.9
Investments / Outstanding Guarantees	78.0%	80.4%	53.1%	62.1%	46.8%
Investments / Equity	81.7%	78.9%	44.0%	45.0%	54.3%
Guarantee Income	11	9	14	15	13
Investment Income	3	4	6	5	3
Expenses	(10)	(14)	(15)	(17)	-18
Net Income / (Loss)	3	(5)	2	2	-55

Source: guarantco.com

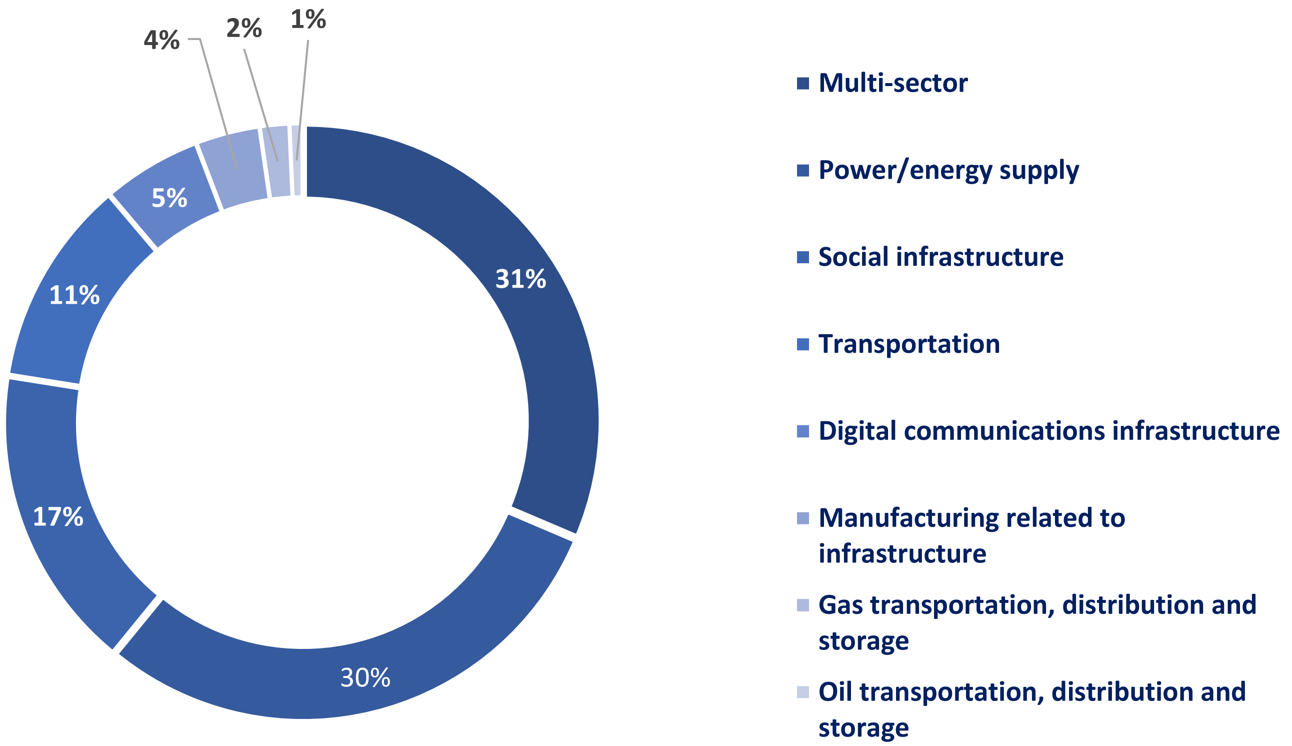
Credit Guarantee Institutions

Background

- Based on the institution's 1QCY22 presentation, GuarantCo Limited has the highest investment commitment in Vietnam (~14.8%) followed by India (~12.7%) and Pakistan (~12.0%).

- The institution provides credit guarantees across Africa and Asia.

Grantco Limited's Sector Portfolio | 1QFY22



Source: guarantco.com

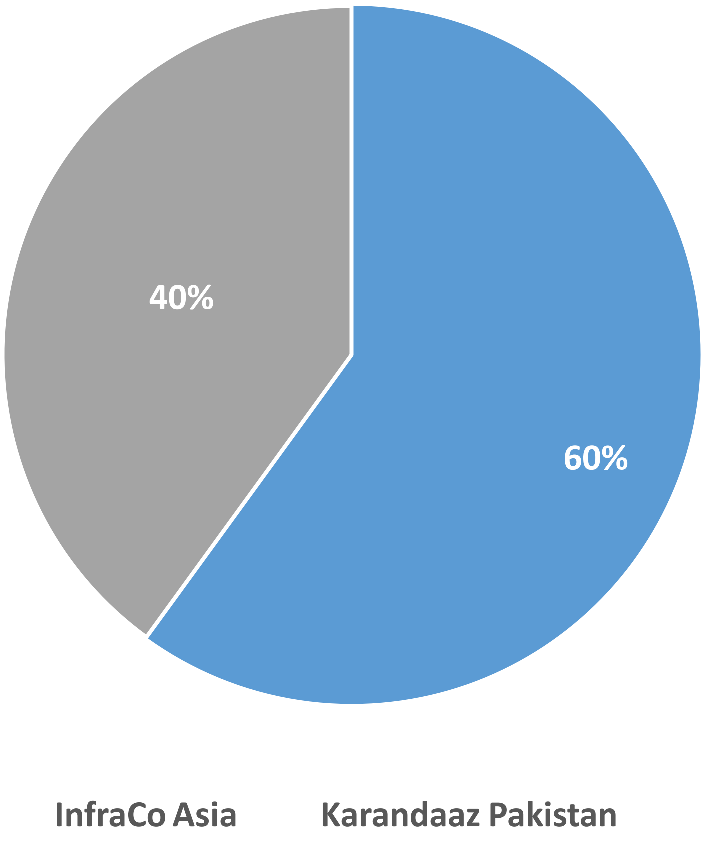
Credit Guarantee Institutions

InfraZamin Pakistan

- InfraZamin Pakistan Limited (IZP) is a recent for-profit initiative of Private Infrastructure Development Group (PIDG).
- The company is a collaboration between InfraCo Asia, GuarantCo, and Karandaaz.
- It is funded with PKR~4.1bln (USD~25mln) equity capital from InfraCo Asia Investments and Karandaaz Pakistan which is provided by the United Kingdom's Foreign, Commonwealth and Development Office (FCDO) and a contingent capital facility of up to PKR~8.25bln (USD~50mln) from GuarantCo.
- The main aim of the company is to catalyze pockets of underused liquidity in Pakistani financial markets to fund infrastructure projects.
- IZP is expected to unlock the hidden potential of the local credit market by way of providing guarantees to reduce the implied credit risk. This will enable greater flow of capital to sectors like renewable energy, digital communication, waste water treatment, social infrastructure and more.

Guaranteeing Infrastructure

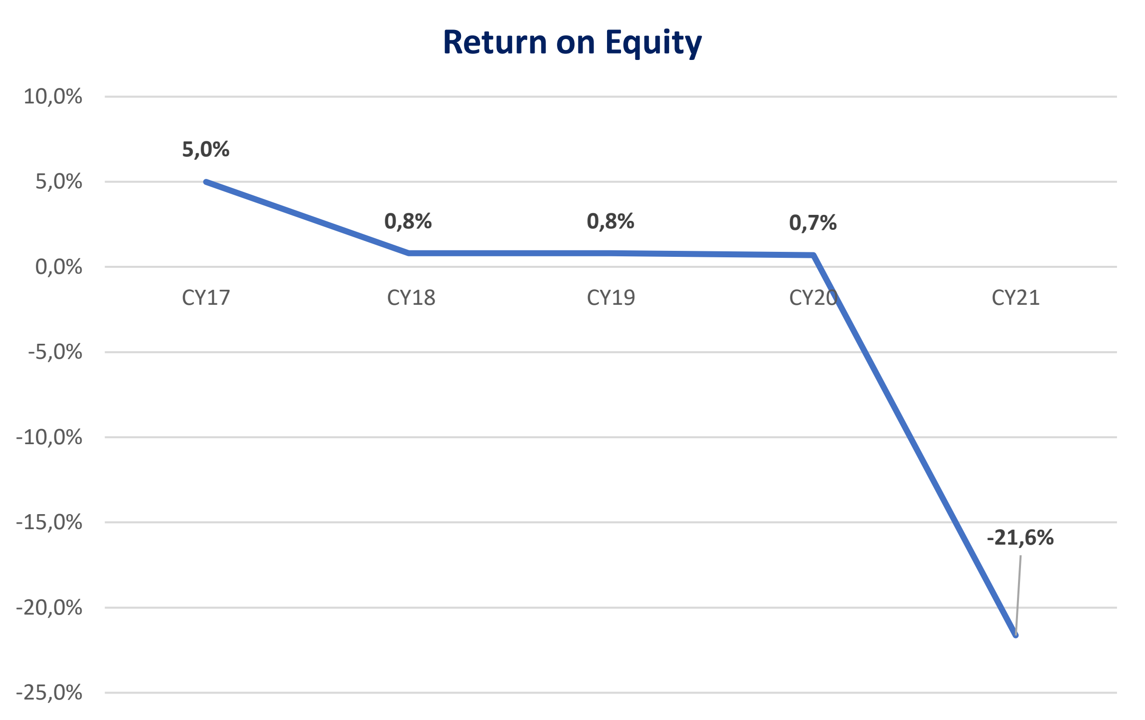
Shareholding Pattern (%) CY21

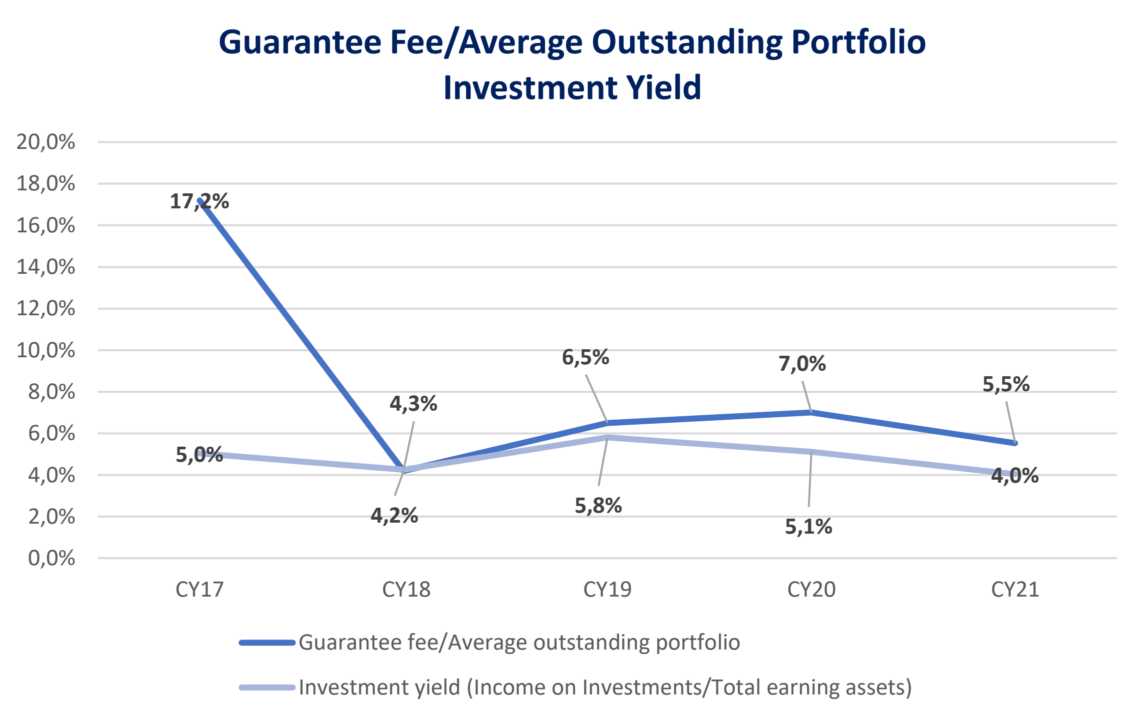


Source: infrazamin.com

Credit Guarantee Institutions

Performance Ratios



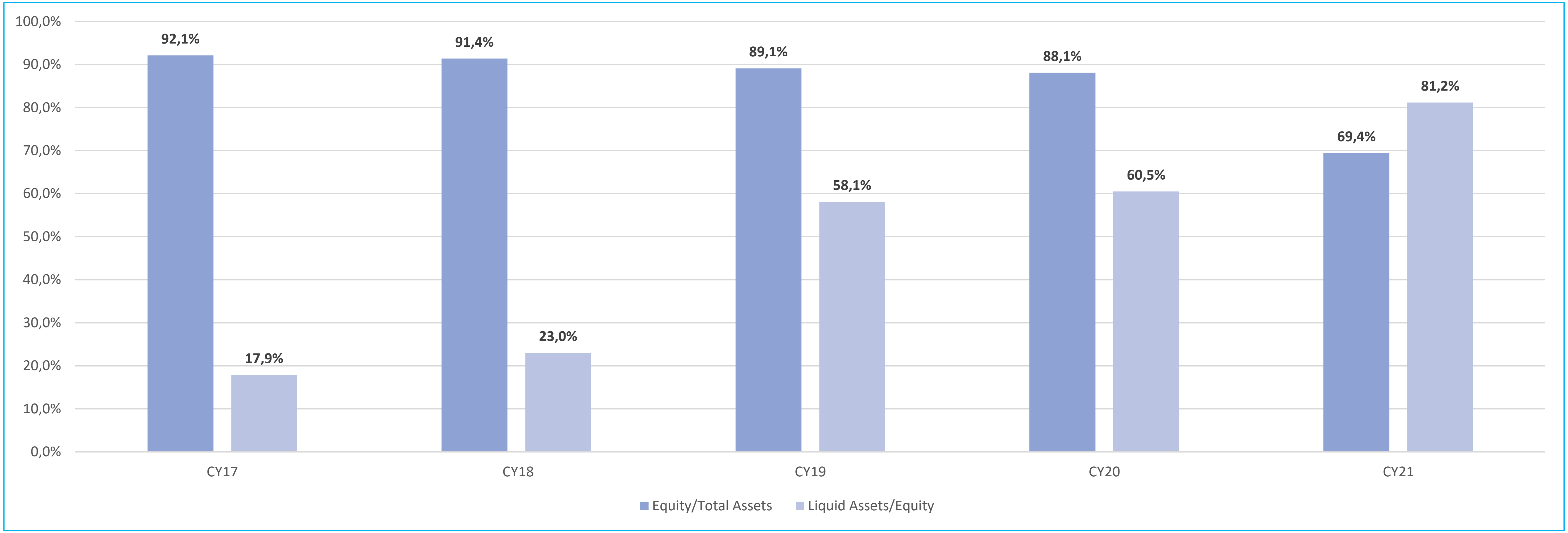


- GuarantCo's Return on Equity (ROE) ratio has been in a declining trend, ~-22% in CY21 as compared to ~1% in CY20. This decline is majorly attributed to the decline in the fair value of financial guarantee contracts and facility arrangements at fair value through profit or loss by ~-513% in CY21, which is indicative of an expected increase in the default of credit obligations.
- Guarantee fee to average outstanding portfolio has exhibited a steady trend between CY19 and CY21 hovering around an average rate of ~6.7%. The decline observed between CY20 and CY21 is due to a decrease in guarantee income by ~17% and increase in the outstanding portfolio by ~10%. Investment yield has shown a declining trend from CY19 onwards to reach a level of ~4% in CY21 and this is because of lower guarantee income in CY21 and a growing total earning assets base (between CY17 and CY21).

Source: guarantco.com

Credit Guarantee Institutions

Capital Adequacy and Liquidity Ratios

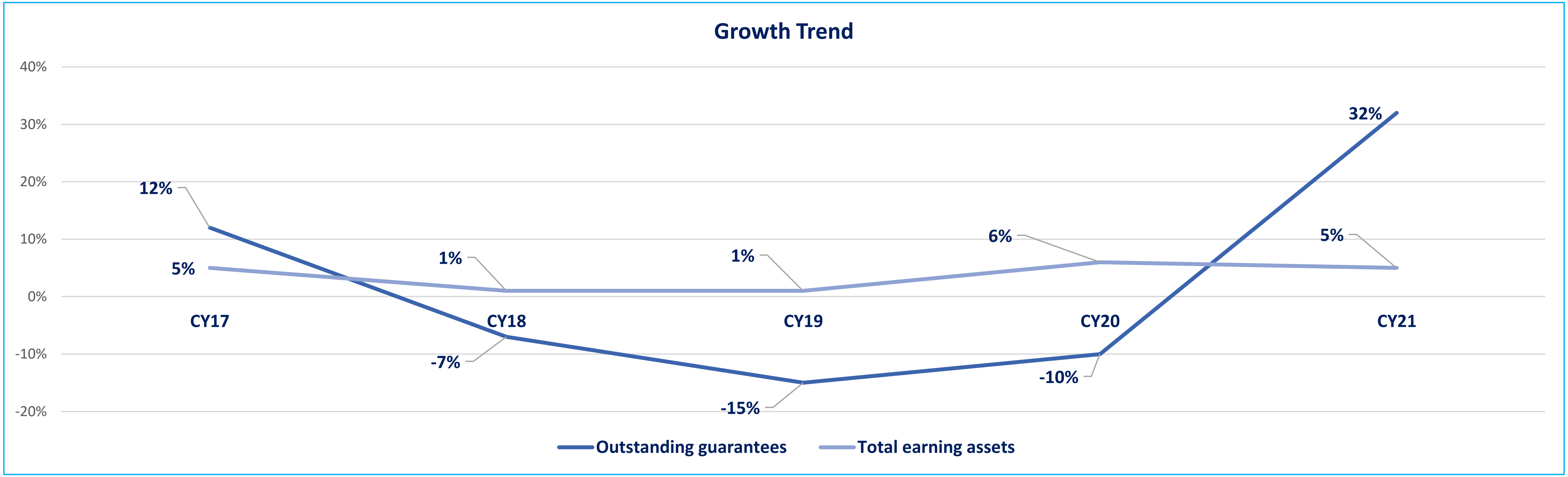


- The Company's Equity to total assets has declined from ~88% to ~69% in CY21 which demonstrates the company's growing reliance on leverage.
- Liquid assets to equity have been on an increasing trend, significantly increasing in CY21 by ~20% to ~81%. This shows the company's improved capability to meet any obligation in case a default occurs.

Source: guarantco.com

Credit Guarantee Institutions

Growth Trend



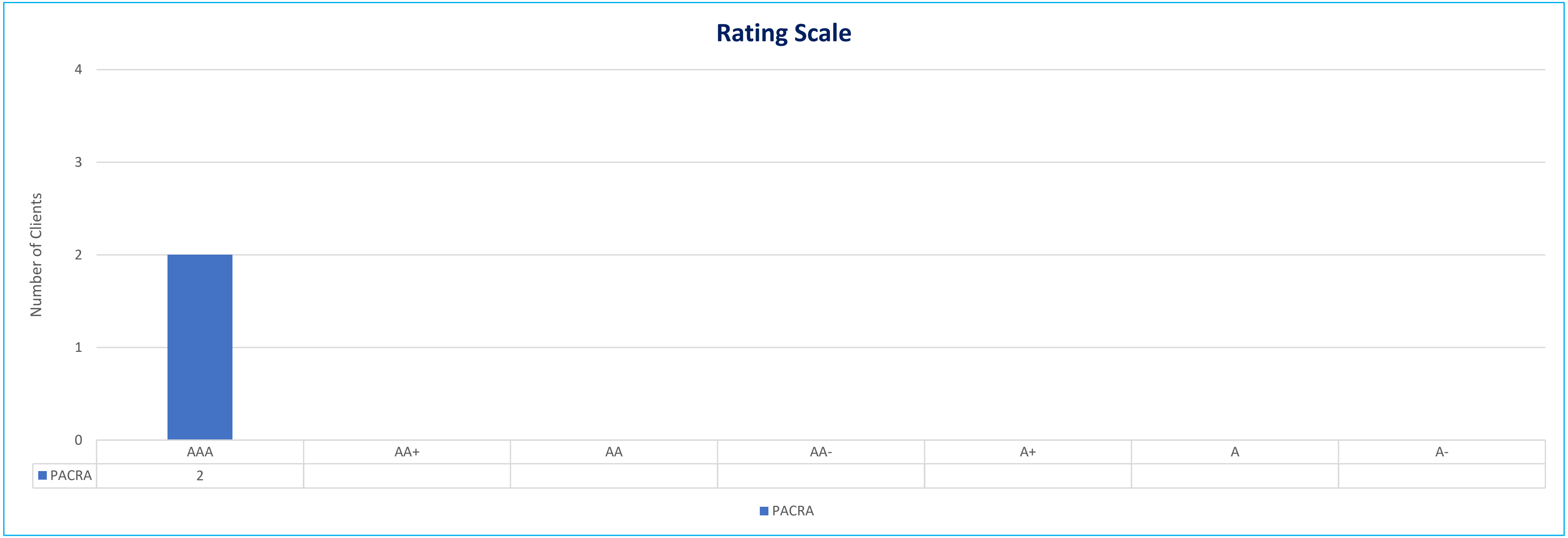
- CY21 is the first year in which the growth rate in outstanding guarantees became positive increasing to ~32% from the SPLY (~-10%). Historically, the observed growth rate between CY17 to CY20 was recorded at ~-5%. Between CY18 and CY21 GuarantCo's portfolio run rate increased from a level exceeding USD 750mln to exceeding USD 885mln. This indicates a growing portfolio base as well as an increased support offered to existing users.
- In the recent years there has been a steady growth in total earning assets. Average growth in earning assets has been ~4% in the five year period.

Source: guarantco.com

Credit Guarantee Institutions

Rating Curves

- PACRA provides rating to 2 Credit Guarantee Institutions – GuarantCo and InfraZamin.
- CGIs have very high ratings because of their underlying sponsor robustness and sovereign ownership.



Credit Guarantee Institutions

SWOT Analysis

Strengths

- Strong regulatory/supervisory role of the State Bank of Pakistan (SBP).
- High level of credit worthiness due to strong financial position of sponsors and government involvement as well.
- Ability to raise large amounts of funds in international capital markets.

Weaknesses

- Conflict of interest between private sponsors and host country's government.
- Tendency to focus on lower risk projects rather than projects that have a more positive effect on development.

Threats

- Uncertainty due to the continuing COVID-19 pandemic and its variants.
- Delay in availability of vaccination could hamper economic recovery.

Opportunities

- Increase in investment opportunities in multiple sectors.
- Development of SEZs and CPEC project, which will give more growth opportunity for SMEs as well.

Credit Guarantee Institutions

Outlook | Stable

- Pakistan's economy grew by ~6.0% *(provisional)* in real terms in FY22 (FY21: ~5.7%). Moving forward, this growth projection is expected to shrink to ~5.0% in FY23 owing to fiscal imbalances, a current account deficit (~USD 13.8bln in 10MFY22 compared to ~USD 0.5bln in the SPLY), exchange rate depreciation, rising fuel prices, and surging international commodity prices.

- As at May CY22, outstanding loan balances to private sector businesses stood at PKR ~7,078bln. Only ~8% of these advances were made to SMEs. This indicates that more effort needs to be done to support SMEs considering their potential to create employment opportunities. The National SME Policy 2021, which has been launched by the government in January CY22 aims to revitalize the SME sector through 'key performance targets' to be achieved by CY25; these include increasing the economic contribution of SMEs by increasing their numbers, simplified taxation regimes, and access to SBP's SME Aasan Finance Scheme (SAAF) scheme. If these targets are met, Pakistan will see a rise in the number of small and medium business registrations over this time horizon.

- The CGIs sector's risks are tied to their exposures in various sectors. GuarantCo has significant exposure in Pakistan's energy sector which is fraught with many problems including rising circular debt (PKR~2,467bln in March'22) and higher international crude oil prices driving energy prices upwards. Circular debt amounts to ~3.8% of Pakistan's GDP.

- Within the industrial sector, the LSM posted a growth of ~10.4% during 9MFY22 (SPLY: 4.2%). The growth rate is expected to slow down in FY23 to ~7.4%).

- Average CPI inflation has increased from 8.9% in FY21 to 11.7% in FY22. In light of this, the SBP increased the policy rate from 12.25% in April'22 to 13.75% in May'22. Although, the projected inflation for FY23 is 11.5%, the short-term horizon does not appear to be favorable given the rising fuel prices and commodity prices. In a heightened inflationary environment, a further hike in policy rate is anticipated. Higher policy rates increase the chance of default.

- The PKR/USD rate has been depreciating and this provides a more risky environment for businesses to operate as the cost of doing business and chances of default can potentially increase. The interbank PKR-USD exchange rate depreciated ~15.1% during July-April FY22. On June 30, 2022, exchange rate stood at PKR~204.73/USD.

- However, the SBP offers credit guarantee schemes at a reduced markup rate of 5% p.a. for women entrepreneurs and special persons as well as other credit friendly schemes with reduced markup rates for SMEs. This indicates a supportive environment for SMEs.

Outlook | Stable

- World Bank
- Asian Development Bank (ADB)
- Organization for Economic Cooperation and Development (OECD)
- Pakistan Bureau of Statistics (PBS)
- State Bank of Pakistan (SBP)
- Pakistan Economic Survey
- https://guarantco.com/
- https://infracoasia.com/
- Small and Medium Enterprise Development Authority (SMEDA)
- Pakistan Credit Guarantee Company (PCGC)
- kodit.co.kr
- cgc-tokyo.or.jp
- smeg.org.tw
- miga.org
- https://www.smefinanceforum.org/post/the-evolving-role- of-credit-guarantees-from-crisis-to-recovery
- exchangerates.org, Economic Survey 2021-22

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