CREDIT GUARANTEE
ENABLING GROWTH WITHOUT RISK

PACRA

Credit Guarantee Institutions (CGIs)

Sector Study

June 2021

TABLE OF CONTENTS

CGIs | Introduction

- CGIs are Non-bank Financial Institutions (NBFIs) aimed at facilitating the access of small and medium-sized enterprises (SMEs) and other undeserved segments 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 they 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 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 trillion.
- Advantages provided by CGIs are as following: i) leverage, ii) regulatory capital relief, and iii) countercyclical crises tool.

Type of CGIs	Advantages	Disadvantage
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

CGIs | Global Overview

- The COVID-19 pandemic has led to collapse in free cashflows for SMEs. With millions of businesses in need of cash to support the current lack of revenue, the importance of CGIs has increased with a great significance.
- The European Association of Guarantee Institutions (AECM) saw an increase of 135% in volumes of guarantees issued in first half of 2020, with guarantees issued worth EUR~260bln. 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 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.

Region	Outreach (%)	Default Rate (%)
Global median	1.6	2.5
Africa	0.3	17.1
Asia	2.7	1.2
Europe	0.9	2.9
Middle East and North Africa	2.2	3.8
Western Hemisphere	3.4	2.0

Source: World Bank, OECD, SME Financing Forum

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 5 years MIGA's gross outstanding guarantees have grown by ~59%, while net guarantees have also increased by ~37% to USD~9.2bln.
- In FY20, MIGA has issued new guarantees worth nearly USD~4bln in support of 47 projects. 70 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	FY16	FY17	FY18	FY19	FY20
Outstanding Guarantees	14,200	17,778	21,216	23,300	22,600
Guarantees Issued (Gross Issuance in FS)	4,258	4,842	5,251	5,548	3,961
Equity	989	1,213	1,261	1,320	1,335
Outstanding Guarantees / Equity (X)	14.4	14.7	16.8	17.7	16.9
Net Guarantee Income	86	93	104	115	117
Expenses	(48)	(51)	(52)	(58)	(61)
Operating Income / (Loss)	38	42	53	57	56
Expense / Guarantee Income	56%	55%	49%	50%	52%

Annual Report available till FY20

Source: miga.org

CGIs | Global Overview

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 rate.
- Primary objective of the fund is to provide credit guarantees to SMEs running in normal operation 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 2019, SMEG's net worth stood at USD~2,566mln.
- In CY19, a total of 352,814 cases were approved for credit guarantees, and the amount guaranteed reached USD~36.8bln, while the amount of outstanding guarantee stood at USD~22.9bln.

Figures in USD mln	CY15	CY16	CY17	CY18	CY19
Outstanding Guarantees	22,685	21,815	21,532	21,966	22,886
Equity	1,832	1,906	2,065	2,164	2,566
Investments	157	273	342	405	533
Outstanding Guarantees / Equity (X)	17.3	15.7	15.0	14.9	8.9
Investments / Outstanding Guarantees	0.5%	0.9%	1.1%	1.3%	2.3%
Investments / Equity	8.6%	14.3%	16.5%	18.7%	20.8%
Default rate	1.9%	2.0%	1.8%	1.6%	1.5%
Guarantee Income	113	110	112	117	127
Investment Income	33	30	30	30	38
Expenses	(290)	(280)	(259)	(262)	(266)
Net Income / (Loss)	2	(6)	(20)	(23)	51
Expense / Guarantee Income	256.6%	254.9%	232.1%	224.7%	209.6%

Annual Report available till CY19

Source: smeg.org.tw

CGIs | Global Overview

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 the Small and Medium Enterprises (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 2020 CGCT served 329,972 cases, with outstanding guarantees standing at USD~26.8bln.
- In the last five years, CGCT outstanding guarantees have been on a declining trend. The outstanding guarantees have declined by 14.9%, along with a decline in cases by 17.3%.

Figures in USD mln	FY15	FY16	FY17	FY18	FY19
Outstanding Guarantees	31,515	29,105	27,322	26,155	26,827
Guarantees Issued	9,514	10,982	9,801	9,875	12,250
Equity	2,478	2,564	2,636	2,734	2,847
Investments	3,631	3,659	3,735	3,808	3,916
Outstanding Guarantees / Equity (X)	12.7	11.4	10.4	9.6	9.4
Investments / Outstanding Guarantees	11.5%	12.6%	13.7%	14.6%	14.6%
Investments / Equity	146.5%	142.7%	141.7%	139.3%	137.5%
Guarantee Income	322	292	267	257	254
Investment Income	50	46	42	40	38
Expenses	(270)	(259)	(250)	(252)	(255)
Net Income / (Loss)	682	635	594	85	75
Expense / Guarantee Income	83.8%	88.8%	93.7%	98.0%	100.4%

Annual Report available till FY19

Source: cgc-tokyo.or.jp

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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~4.5bln & average total guarantee supply was recorded at USD~43.6bln. In CY19 new supply of guarantees stood at USD~10.2bln.

Figures in USD mln	CY15	CY16	CY17	CY18	CY19
Outstanding Guarantees	42,500	42,800	43,900	43,600	45,100
Guarantees Issued	9,300	10,200	10,200	9,700	10,200
Equity	4,700	4,300	4,400	4,400	4,600
Investments	3,969	3,338	3,782	3,550	4,152
Outstanding Guarantees / Equity (X)	9.0	10.0	10.0	9.9	9.8
Investments / Outstanding Guarantees	9.3%	7.8%	8.6%	8.1%	9.2%
Investments / Equity	84.4%	77.6%	86.0%	80.7%	90.3%
Default rate	4.0%	3.9%	3.5%	3.6%	3.3%

Source: kodit.co.kr

CGIs | Local Industry

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 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

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.
- As of first quarter 2021 the company's portfolio included guarantees spread in 19 countries. India takes the largest share of exposure with 15.1% of the exposure, followed by Pakistan with 14.7%.
- In Pakistan, the company has taken a major exposure in the Power/ energy supply sector, oil transportation and distribution & storage sector.

Figures in USD mln	CY16	CY17	CY18	CY19	CY20
Outstanding Guarantees	255	286	265	226	203
Equity	256	273	270	273	280
Investments	213	223	213	120	126
Total Earning Assets	259	272	275	278	295
Outstanding Guarantees / Equity (X)	1.0	1.0	1.8	2.2	2.0
Investments / Outstanding Guarantees	83.7%	78.1%	44.2%	20.1%	22.5%
Investments / Equity	83.2%	81.7%	78.9%	44.0%	45.1%
Guarantee Income	7	11	9	14	15
Investment Income	7	3	4	6	5
Expenses	(8)	(10)	(14)	(15)	(17)
Net Income / (Loss)	(3)	3	(5)	2	2

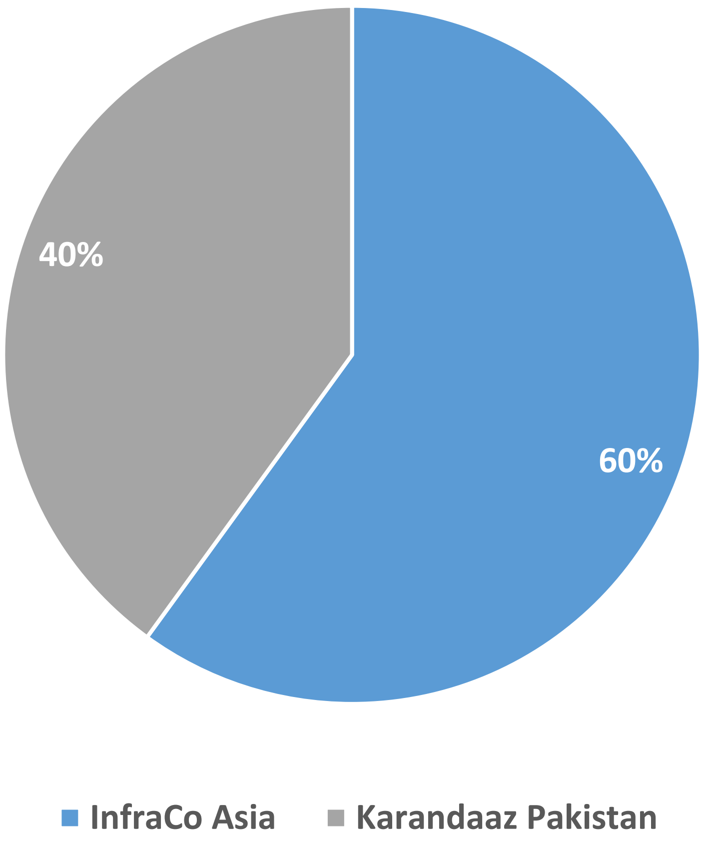
Source: guarantco.com

CGIs | Local Industry

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.

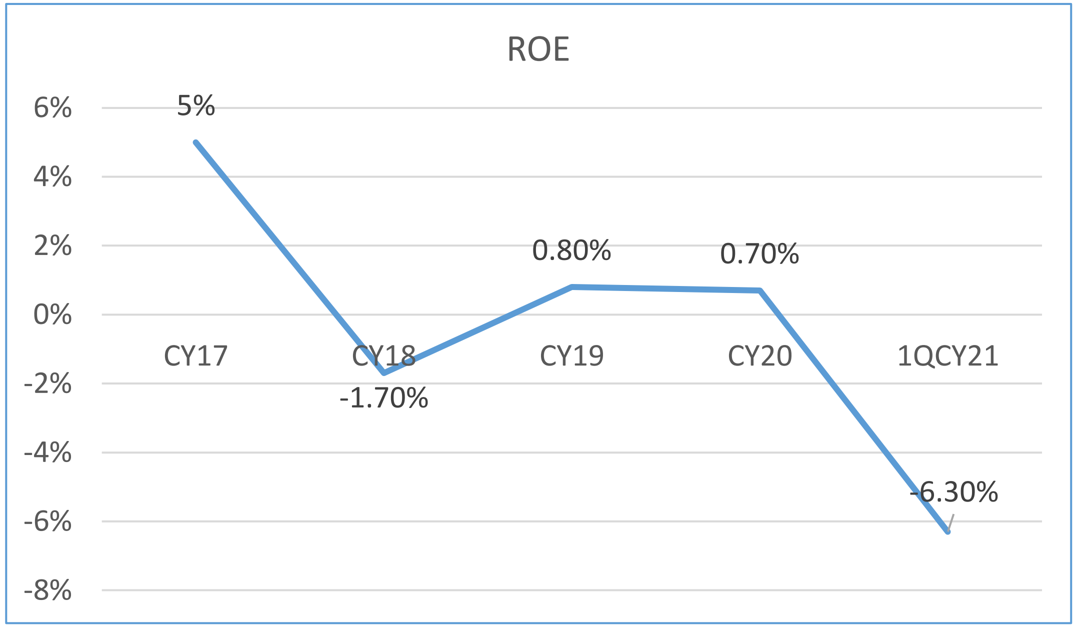
Shareholding Pattern (%) CY20

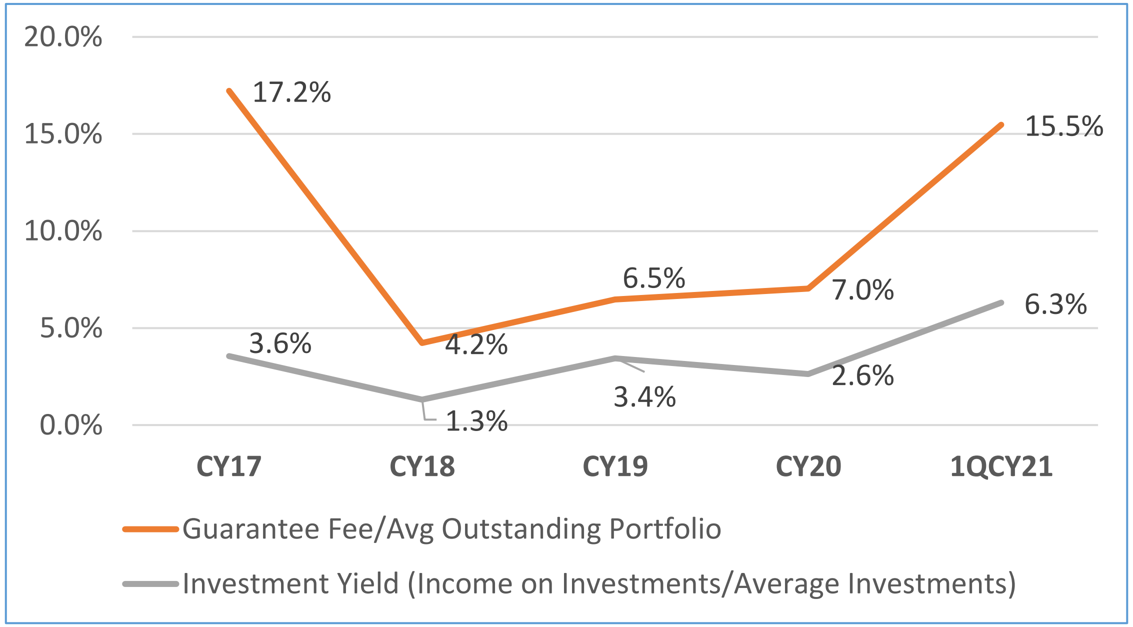


Source: infracoasia.com

Performance Ratios

- GuarantCo's Return on Equity (ROE) ratio has been in a declining trend, 5% in CY17 as compared to 0.8% in CY20. In 1QCY21 it has turned negative to -6.3%. This decline can attributed to higher administrative expenses (fund manager expenses) in the quarter.
- Guarantee Fee to Average Outstanding Portfolio initial declined from 17.2% to 4.2% in CY18. Since then it has been on an increasing trend as it clocked in at 15.5% in 1QCY21. Investment Yield has shown a largely stable trend from CY17 to CY20, but in 1QCY21 it has shot up to 6.3%
- Improvement in both Guarantee Fee to Average Outstanding Portfolio and Investment Yield can be linked to recovery in the economy from the negative impact of COVID-19, which has resulted to much higher returns in 1QCY21.



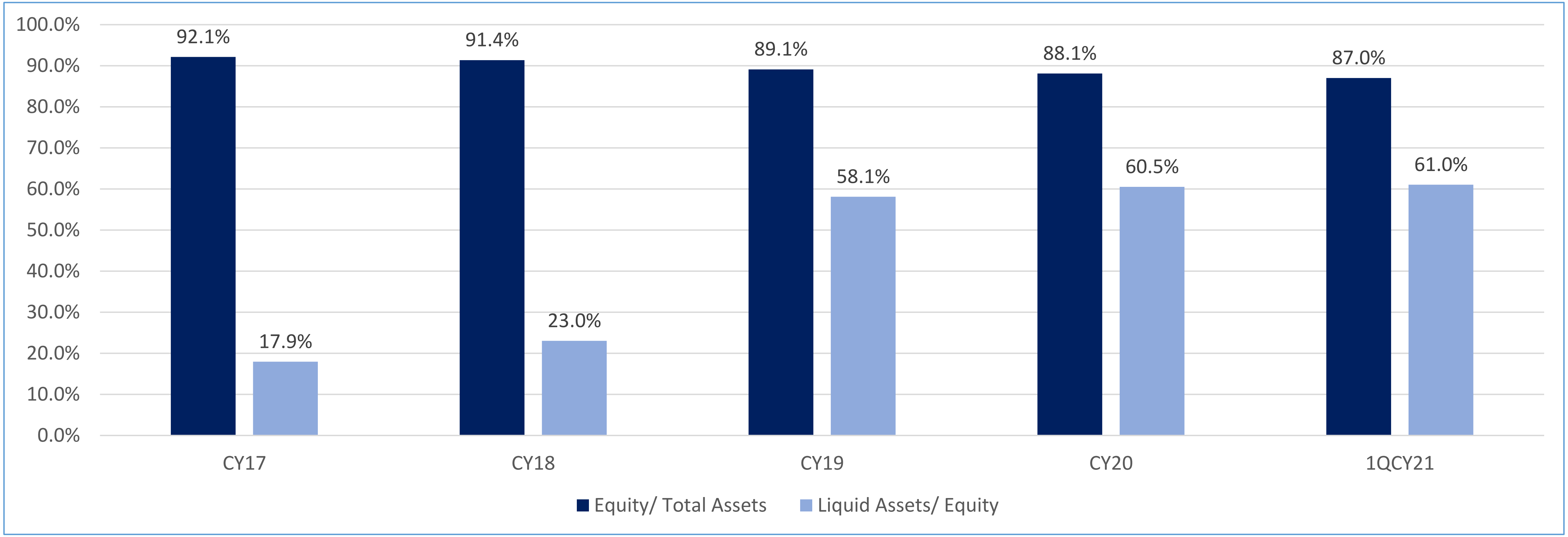


Source: guarantco.com

CGIs | GuarantCo Limited

Capital Adequacy and Liquidity Ratios

- Equity to Total Assets has been declining, though very gradually. It stood at 92.1% in CY17 and has declined to 87% in 1QCY21, thus showing company's growing reliance on leverage.
- Liquid Assets to Equity has been on a increasing trend, it shot up from 23% in CY18 to 58.1% in CY19, and has remained largely stable as it stands at 61% in 1QCY21. This shows company's improved capability to meet any obligation in case a default occurs.

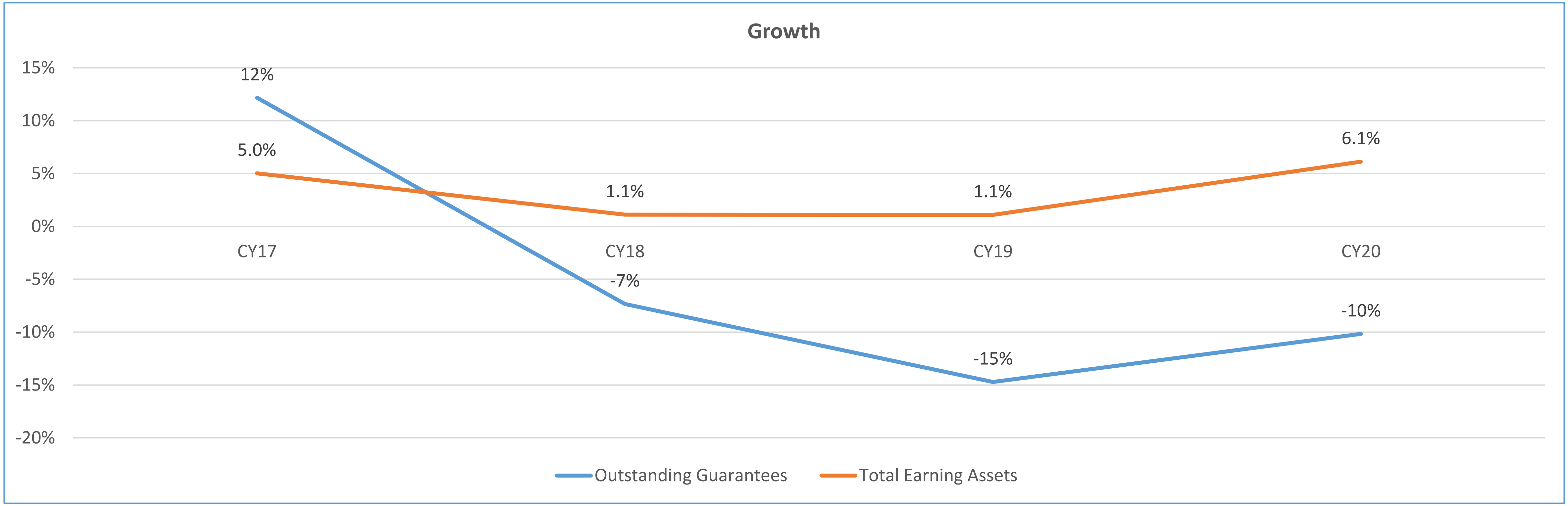


Source: guarantco.com

CGIs | GuarantCo Limited

Growth Ratios

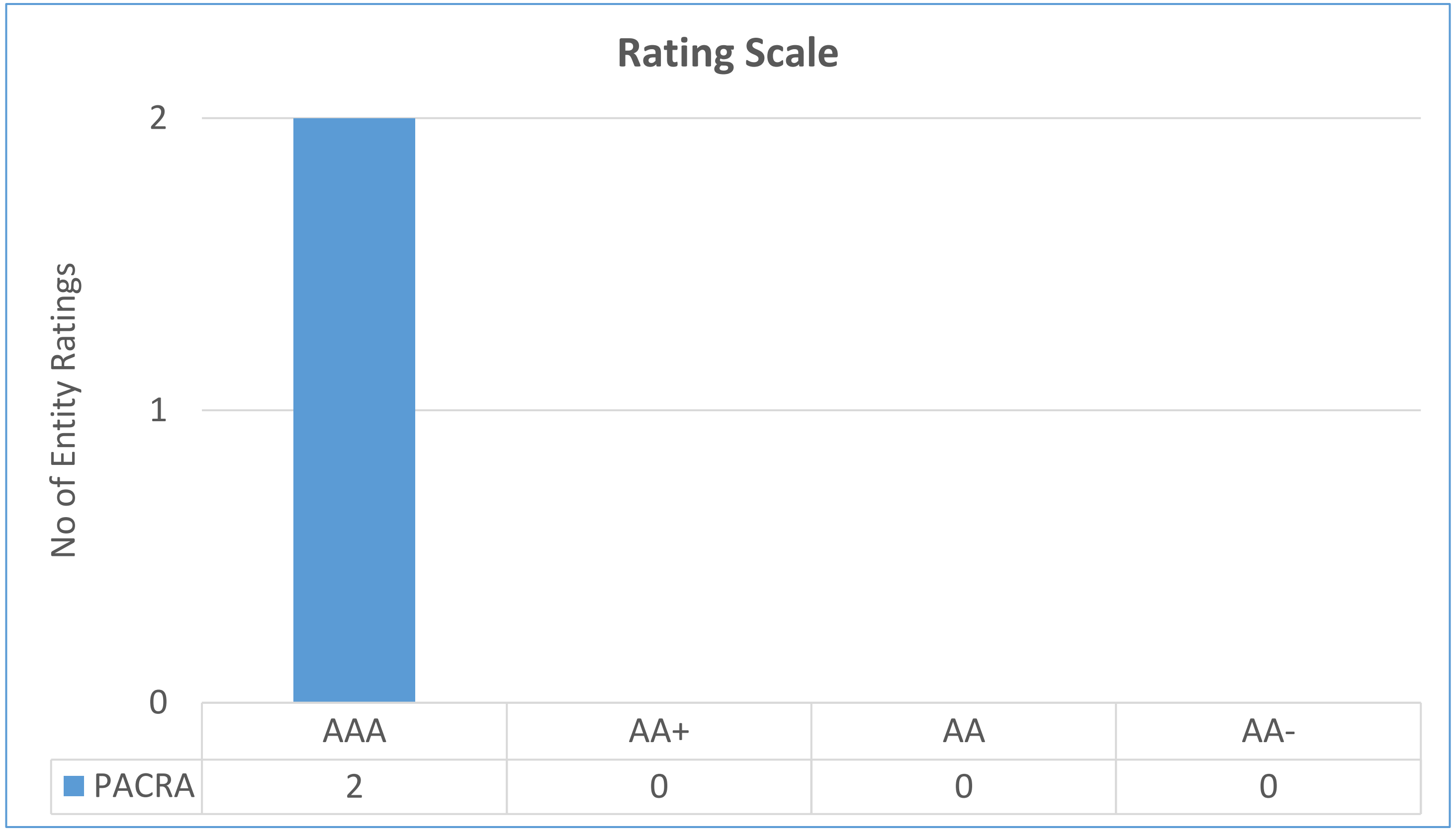
- Growth rate in outstanding guarantees have continuously been negative in recent years where the average growth rate from CY17 to CY20 clocks in at -5%. This decline in Guarantees can be explained by a prolonged period on economic uncertainty in Pakistan, which has resulted in lack of confidence in the local industry.
- Overall, there has been steady growth in earning assets in recent years. Average growth in earning assets has been 3.3% in the 4-year period. Growth rate declined in CY18 to 1.1% but since then it has recovered to 6.1% in CY20.



CGIs

Rating Curves

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



CGIs

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.

CGIs | Outlook

Outlook

- The economy has started to recover after being adversely affected by the COVID-19 pandemic, which forced business closure and resulted in higher rate of unemployment. The latest wave of the virus has subsided, and the government's continuous effort to make vaccine available for the general public, thus reducing chances of any severe impact of the virus on the economy.

- GDP growth in FY21 clocked in at 3.9% against the target of 2.1%. Further private consumption has increase by 17% in FY21, and agriculture sector and large scale manufacturing (LSM) clocked in at 2.8% and 9.9% in 9MFY21. These growth figures paint a very positive outlook for the economy, considering these figures were achieved in the middle of a pandemic.

- The CGIs sector's risks are tied to their exposures in various sectors. GuarantCo has significant exposure in Pakistan's energy sector which has a relatively low infection ratio of 4.8% as at the end of March 2021. However, the infection ratio has a rising trend along with significant circular debt.

- State Bank of Pakistan (SBP) decision to keep the policy rate low at 7% will also help CGIs to offer more guarantees as chance of default decrease due to the low interest rates.

- The PKR/USD rate has also been stabilized, this provides a more suitable condition for businesses to operate and foreign sponsors would also have reduced foreign currency exposure.

- Average CPI inflation has also declined from 10.7% in FY20 to 8.9% in FY21.

Source: PBS, Economic Survey 2020-21, SBP

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