POLICY SPOTLIGHT: KOSOVO CREDIT GUARANTEE FUND

About the Policy Spotlight

In 2016, the American Chamber of Commerce in Kosovo (AmCham Kosovo) has started to publish the ‘Policy Spotlight’ – a publication that aims to bring attention on different economic policies and outline the challenges for the development of such policies, in order to pave the way for addressing them. The Spotlight is published on a bi-monthly basis. While this edition places the spotlight on Kosovo Credit Guarantee Fund the following editions will center on other policy initiatives that are of interest to the private sector. So far, AmCham has published Policy Spotlights on the following topics: Trade, Standardization and Association Agreement, Labor Policies and Contract Enforcement.

Spotlight on the Credit Guarantee Fund

Access to finance has frequently been identified as one of the main challenges facing Micro, Small and Medium Sized Enterprises in the country, haltering the development of the Kosovo private sector. While in the past the majority of concerns related to this topic were about unfavorable financing conditions from institutions involved in this field, we are glad to note that the country has marked significant improvements in this regard the last few years.

The introduction of private bailiffs along with other reforms in the judicial sector and contract enforcement, has contributed to lowering lending risk, thus resulting in lower interest rates. The graph in figure 1 depicts the changes in interest rates over the course of the last two years.

Furthermore, World Bank’s Doing Business Report ranks Kosovo considerably well in the “Getting Credit” indicator, where from 190 countries, Kosovo is ranked 20th in this indicator for the 2017 report (World Bank Group, 2016).

While there is still room for improvement to address the lending risk in banks and other financial institutions, the overall trend is encouraging for the private sector, particularly for companies which can back their borrowing requests with assets of their own.

However, a considerable number of MSME-s in the past had difficulties on obtaining financing due to the lack of assets to provide as a collateral on loan applications. This is particularly applicable in cases of young entrepreneurs and female entrepreneurs, resulting in limited growth opportunities for them. The issue of under-collateralization is not specific to Kosovo however, as numerous
economies around the world face similar issues.

In a study conducted by AmCham Kosovo in 2014 featuring a questionnaire with roughly 650 businesses, the majority of respondents (more than 70%) claimed that they use personal savings and loans from friends and family for financing purposes (American Chamber of Commerce in Kosovo, 2014). While using savings for financing purposes may have its advantages, getting access to capital from financial institutions can certainly facilitate the growth of a company to a greater extent.

In order to address this issue, the government with the assistance of donor organizations, particularly USAID, initiated procedures for creating a credit guarantee fund. This initiative has been implemented this year, and its effects are expected to be noticed in the following years. The purpose of this document is to provide a background on this fund and how businesses will be able to benefit from it.

The Establishment of Kosovo Credit Guarantee Fund

The Assembly of the Republic of Kosovo approved the Law on Establishment of the Kosovo Credit Guarantee Fund (KCGF) on December 2015, which was consequently published in the Official Gazette in January 2016. The law establishes the Fund and sets forth provisions for its functioning, competencies, structure, and the procedure for the issuance of Credit Guarantees. KCGF is supported by USAID EMPOWER Credit Support, a program running through 2014-2017 which aims to address the issue of access to finance for Kosovo MSMEs.

As stipulated in article 10 of the law, KCGF is an independent organization with a full legal personality, which will be reporting to the Central Bank of Kosovo. The two main bodies of the KCGF are the Board of Directors and the Managing Director.

As per article 16 of the law, the Board is composed of 7 members, 3 out of which are appointed on an ex-officio basis, while the remaining 4 are elected by donors. Board members have a 4-year mandate. Among others, the responsibilities of the Board of Directors include the appointment of the Managing Director, the approval of registration of Financial Institutions, and the approval of guarantee agreements with registered financial institutions.

On the other hand, the Managing Director of KCGF, which is also a voting ex-officio member of the board, will be employed as the chief executive officer of the fund on a full-time basis.

KCGF Objectives

Some of the objectives which Kosovo Credit Guarantee Fund aims to reach are:

- Increase lending to MSMEs in Kosovo from the local financial institutions;
- Create jobs, increase local production and value added services, improve the trade balance, broaden the tax base, strengthen the social safety net, and reduce poverty;
- Enhance opportunities for underserved economic sectors and populations including women, minorities, farmers, entrepreneurs, and youth;
- Help unlock and mobilize the roughly 400 million Euros of excess liquidity at
the banks to catalyze business growth and employment; and

- Enable MFIs and NBFIs to reduce their risk and help make more micro and small businesses “bankable.” (Kosovo Credit Guarantee Fund, 2016)

Guarantee coverage
The respective law stipulates that “the percentage of the outstanding principal of the Credit that is covered by the Credit Guarantee, specified by the Registered Financial Institution when submitting that Credit to the KCGF for the Credit Guarantee, shall not exceed fifty percent (50%) of the outstanding amount” (Assembly of the Republic of Kosovo, 2016). This means that if a loan qualifies for coverage under this law, businesses still have to be able to cover 50% of the outstanding principal. Of course this has been done to share the risk with the business as well, in order to avoid reckless borrowing and/or irresponsible behavior from the borrower.

Principle of Additionality
One of the main principles of the Kosovo Credit Guarantee Fund is “additionality”. This means that the Fund will provide coverage for loans which the bank would not have provided otherwise. “The KCGF will achieve additionality by causing new lending to target groups without adding moral hazard via bad loans, resulting in an estimated increased number of new loans, money in economy, and job creation” (Kosovo Credit Guarantee Fund, 2016). In fact, this will be achieved due to the fact that financial institutions will be able to issue loans even to businesses which are under collateralized, which would otherwise not have been given the loan.

Eligible loans & eligible businesses
There are a number of conditions to be fulfilled for a loan to be eligible for coverage through this Fund. These conditions are stipulated in Article 6 of the Law.

One aspect that needs to be emphasized is that renewal or restructuring loans do not qualify for support under the KCGF scheme. The Fund supports only new projects (loan requests) which fulfill the criteria set under Article 6. Additionally, businesses with more than 250 employees shall not be eligible for benefiting from this arrangement. According to the KCGF website, the parameters to get financed through the Fund include but are not limited to:

- MSMEs that are viable but do not have enough collateral and/or credit history;
- MSMEs needing long-term finance;
- MSMEs that can increase local production and reduce imports and/or increase exports;
- Woman, non-majority and entrepreneur-owned MSMEs;
- MSMEs that will create new jobs (Kosovo Credit Guarantee Fund, 2016)
How can businesses benefit?
A very important element to note is that **businesses cannot apply (and do not need to do so)** for a guarantee at KCGF or at the financial institution of their choosing. Instead, if the business submits a loan application, and the financial institution after a due diligence determines that the loan should be issued, but the business itself does not have the collateral needed, than the registered financial institution might submit the loan to KCGF for inclusion in its guarantee scheme, depending on eligibility. Thus, the business cannot initiate any procedure of this kind, but will benefit from it provided that the preconditions explained in this document are met.

**Procedural Aspects**
Financial institutions which are licensed and supervised by the Central Bank of the Republic of Kosovo, that wish to benefit from the Fund, firstly have to **apply for registration with the KCGF**. Upon reviewing their application, the KCGF will make a determination whether that financial institution fulfills the necessary criteria for registration. If the response is positive, KCGF will enter into a **Guarantee Agreement** with that institution “specifying the coverage, limits, policies and procedures for putting Credits under the guarantee into force, paying fees to KCGF and for Registered Financial Institutions, making claims to KCGF in the event of a Guaranteed Event and such other matters as may be established by the Charter and Internal Policies and Procedures” (Assembly of the Republic of Kosovo, 2016). Afterwards, based on the agreement, the KCGF will provide credit guarantees to the specified financial institution. The Central Bank of the Republic of Kosovo has issued a Regulation specifying the information and provisions that a Guarantee Agreement should contain.

Financial institutions which are eligible to be registered with KCGF include banks, non-bank financial institutions, and micro-finance institutions. A significant number of financial institutions have so far concluded their agreements with the Fund. According to the official website of KCGF, 4 commercial banks have completed this procedure so far.

If the guarantee is triggered, KCGF will pay the financial institution the guaranteed amount, after the claims have been approved and validated.

**Financial Aspects and Investments**
In order to ensure financial sustainability, financial institutions are liable to pay the Fund a Guarantee Fee at the time the Credit is put under the Credit Guarantee, and consequently also pay it annually on the outstanding principal amount. As is specified in article 8 of the law, the fees will be used to cover operational expenses and to make up for eventual losses, while the surplus will remain in KCGF to increase its sustainability.
However, the funding of the KCGF itself is a bit broader and includes the following: (1) Capital Fund donated by the Government of the Republic of Kosovo and Donors as a grant, (2) Guarantee Fees paid by Registered Financial Institutions for Credit Guarantees, (3) interest and investment income from deposited and invested Capital Fund and other KCGF Assets, (4) additional capital contributions, (5) borrowings, excluding borrowings from Registered Financial Institutions (Assembly of the Republic of Kosovo, 2016).

In order to increase sustainability and maintain the liquidity of the Fund, the KCGF fund will be invested through an investment policy which will be approved by the Board of Directors. As is stipulated in the law, the funds will be invested only in “safer” instruments, including:

- Euro deposits with CBK,
- Treasury Bills and GoK bonds,
- Euro deposits or instruments with banks that are Registered Financial Institutions, licensed and operating in Kosovo,
- Euro and non-Euro deposits or instruments with the European Central Bank and other European Union Central Banks from member states which, at the time of investment, are rated as Prime or High Grade by the international rating agencies
- Euro and non-Euro deposits or instruments issued by state or commercial banks licensed in such countries as defined in above paragraph and which in addition are individually rated at least as High (a) by Fitch Ratings, or other equivalent rating;

Furthermore, in Article 25 of the Law it is stated that the Fund should comply with reporting and oversight mechanisms provided by the law and other relevant documents. KCGF will be accountable to submit Annual IFRS audit reports to CBK, and will provide periodic reports to CBK with regards to the guarantee portfolio and the risk assessment for that risk portfolio. On the other hand, in accordance with article 25 of the law, CBK is obliged to issue a regulation with regards to the risk-weighting and reserve requirements for the financial institutions with regards to the portion of loans under the guarantee.

**Examples of Credit Guarantee Schemes in the World**

While the Credit Guarantee Scheme is a new mechanism in Kosovo, this certainly is not the case on a number of other countries. Such schemes are substantially used by other countries to address the issue of under-collateralization and limited access to finance, particularly for MSMEs. These credit guarantee schemes differ in terms of their legal status, ownership structure, coverage ratio, decision making structure, types of services rendered and so on. The following paragraphs will provide examples and brief explanations for a number of these aspects.

**Legal Framework**

Given the existence of a large variety of credit guarantee schemes worldwide, the legal framework is bound to be different as well. In the majority of cases, CGFs are not-for-profit organizations, subject to particular regulatory systems/framework (OECD Centre for Entrepreneurship, SMEs and Local Development, 2013). In the majority of cases, the control function over these CGFs is given to the government through the relevant ministry, or to the Central Bank as regulatory body. This is also subject to the type or legal structure of the fund (public, private or a combination of both).

In a number of countries, such as the case in Germany, “a special tax regime is in place to favor the credit guarantee activity” (OECD Centre for Entrepreneurship, SMEs and Local Development, 2013). However, in this case
the credit guarantee facility is a privately held bank which is licensed to operate only as a guarantee bank. Having tax facilitations incentivizes the bank to fully re-invest surpluses resulting from their activities.

Ownership structure
Credit Guarantee Schemes differ in terms of their ownership structure, depending on market needs as well as the regulatory framework of the given country. In general, there are three main types of credit guarantee funds, namely:

- Public Guarantee Schemes;
- Public-Private Guarantee Schemes;
- Private Guarantee Schemes (OECD Centre for Entrepreneurship, SMEs and Local Development, 2013)

Public guarantee schemes are generally founded on government initiative mostly in developing economies to broaden access to finance for local small and medium enterprises. In addition to other countries such as India, Indonesia, Canada etc., examples of such funds can also be seen in many European countries (Austria, Slovenia, Italy, Greece, Belgium etc.). In these sort of schemes, while the government provides the funding for the Fund, in most cases the decision making process with regards to risk-assessment and guarantee approvals is left to the private sector.

In mixed guarantee schemes, there is a combination of funding from the public sector and private sector players. In these cases, a public body (such as the case of Turkey’s SMEs Development and Support Organization) provides the majority of funding (consequently possessing the majority of shares), whereas private sector contributes either through business associations or by the direct involvement of commercial banks. However, there are exceptions, such as the case of Portugal where the Mutual Guarantee System was initiated by the government and gradually the management and the majority of shares were transferred to the private sector (OECD Centre for Entrepreneurship, SMEs and Local Development, 2013).

Among the oldest guarantee schemes are those initiated and operated by the private sector, through the direct involvement of borrowers seeking to create better conditions for their financing. In such cases, the role of the government is limited to a regulatory one, and seldom to a donor one as well. In these “Mutual Guarantee Schemes”, the assessment is done by the Fund itself, given that there is a sufficient in-depth knowledge of the local business environment. Peer review process contributes greatly to conducting proper risk-assessment and to avoiding opportunistic behavior (OECD Centre for Entrepreneurship, SMEs and Local Development, 2013).

Coverage ratio
The coverage ratio is also different from one Credit Guarantee Fund to the other, as a mechanism to mitigate risk. According to the OECD report, the median coverage ratio across 76 countries is 80%, which at the same time is the maximum threshold for guarantee funding by the European Union State Aid Framework. In particular cases, funds use different ratios to target different target audiences. For example, the Costa Rica CGF provides a greater coverage ratio for female entrepreneurs in rural areas, in order to help their development. There are other cases when coverage ratios change depending on the maturity of the loan: short-term vs. long-term (OECD Centre for Entrepreneurship, SMEs and Local Development, 2013).

Services offered
In addition to the traditional credit guarantee service, some Credit Guarantee Schemes offer additional services to the business community of the country in which they operate. While this may become the case in Kosovo as well in the future, given that Article 9 of the Law allows for this, it
would be beneficial to briefly have a look at the examples from other countries.

A number of Credit Guarantee Funds offer assistance on preparing financial statements based on applicable standards, and information on financial markets. Other schemes provide business assistance to help MSMEs increase their productivity and competitiveness in a larger landscape. Remaining funds, such as the ones in Germany and Finland, provide export credit guarantees, to protect borrowers from the default of importers in the foreign market. Schemes such as this not only help the borrower, but improve a country’s prospects in the international trade picture.

Other Aspects
Credit Guarantee Schemes vary in a number of other ways as well. For example, they vary drastically with regards to firm eligibility. While some countries have restrictions in terms of company size (turnover; number of employees etc.), others have restrictions in terms of the industry, geographical location and so on. Some countries pursue policies aimed at developing particular regions of their territories, and credit guarantee schemes can help in this regard as well.

The decision making process and the risk assessment for the credit guarantee differs from one CGF to the other. In the majority of cases, these competencies are transferred to the registered financial institutions, given that often they have the best expertise at conducting such activities. The funding of the Credit Guarantee Schemes is also an element which changes from one case to the other.

Conclusions and way forward
As explained thoroughly in the document, the Credit Guarantee mechanism is very new to Kosovo, and as such it is very early to measure its success. The law and accompanying sub-legal regulations have been adopted only in 2016, and the first agreements between Kosovo Credit Guarantee Fund and Financial Institutions were finalized in the last few months. It remains to be seen whether or not the mechanism will have the desired effects to improve access to finance for micro, small and medium enterprises in Kosovo. Nonetheless, this step has been thoroughly supported by the private sector in the country.

As a summary, businesses must note that they cannot apply for a credit guarantee at KCGF themselves. It is up to the registered financial institution at which they are applying for a loan to do so, if they determine after a due diligence that the applicant deserves the loan, but does not have the necessary collateral to do so.

Last but not least, stakeholders in the process should take note of examples from a number of countries throughout the world in order to analyze the prospects of broadening the range of guarantees to be offered to the private sector. Of particular interest to the manufacturing sector would be the mechanism for export credit guarantees, a scheme used by Finnish and German Credit Support Schemes.

List of Acronyms
CBK – Central Bank of Kosovo
GoK – Government of Kosovo
KCGF - Kosovo Credit Guarantee Fund
MFI – Microfinance Institutions
MSME – Micro, Small, Medium Enterprises
NBFI – Non-bank Financial Institutions
OECD – Organization for Economic Cooperation and Development
References


