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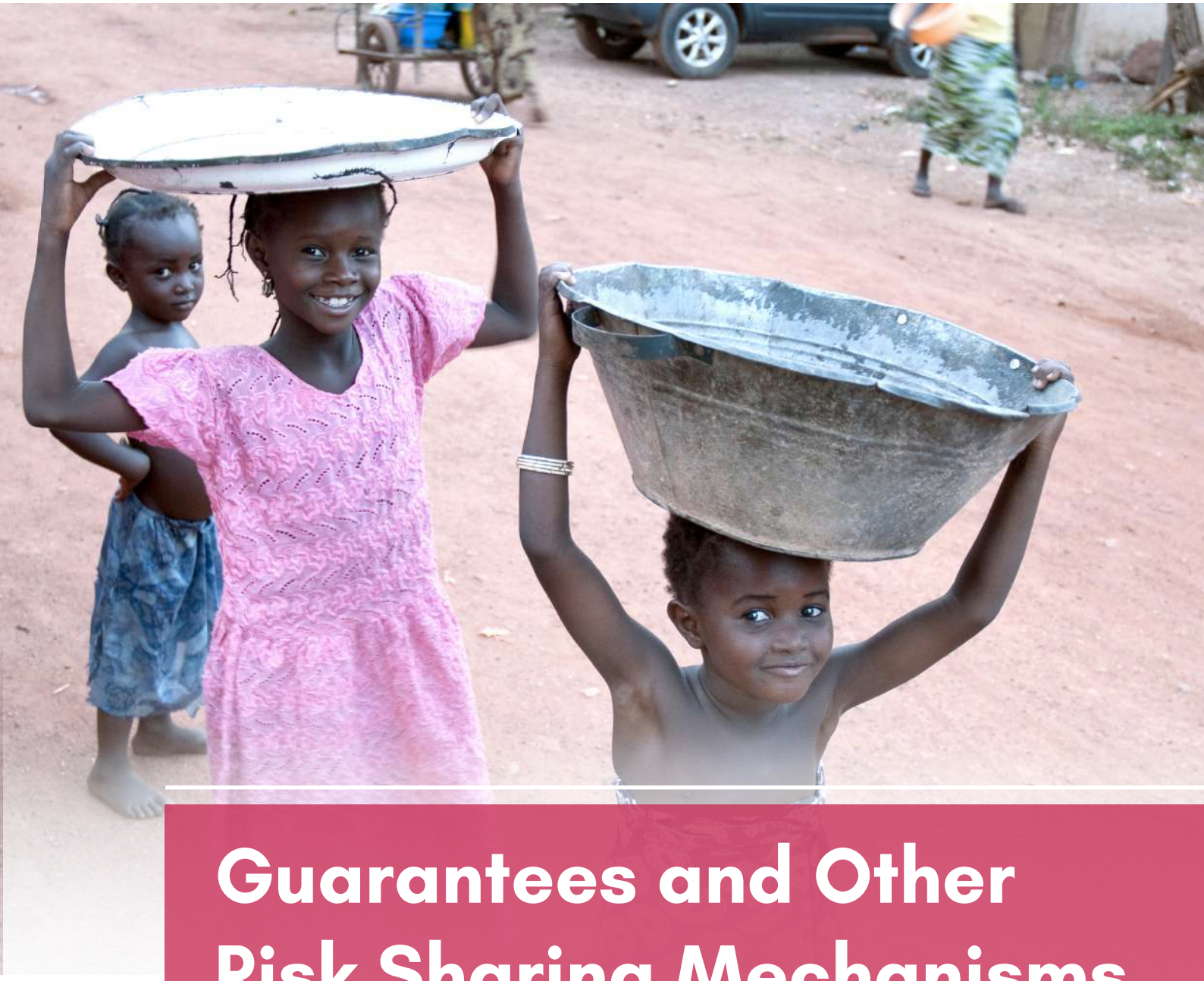

Guarantees and Other Risk Sharing Mechanisms For Nutrition Financing

Public Report

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CONTENTS

ACRONYMS

AfDB	African Development Bank
AGF	Africa Guarantee Fund
AECID	Agency for International Cooperation and Development
AGRA	Alliance for a Green Revolution in Africa
ARIZ	AFD's Risk Sharing Mechanism
AFD	Agence Francaise de Developpement
DANIDA	Danish International Development Agency
DFIs	Development Finance Institutions
FSD	Financial Sector Deepening
FAO	Food and Agriculture Organization
IFU	Investment Fund for Developing Countries
IRDB	International Bank for Reconstruction and Development
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
KCB	Kenya Commercial Bank
MFIs	Microfinance Institutions
MSMEs	Micro, Small and Medium Enterprises
MIGA	Multilateral Investment Guarantee Agency
NFFP	Nutritious Food Financing Program
NGOs	Non-Governmental Organizations
NDF	Nordic Development Fund
OECD	Organisation for Economic Co-operation and Development
OPIC	Overseas Private Investment Corporation
SMEs	Small and Medium Enterprises
SME CGS	Small and Medium Enterprise Credit Guarantee Scheme
SBLC	Standby Letter of Credit
SIDA	Swedish International Development Cooperation Agency
SDC	Swiss Agency for Development and Cooperation
USAID DCA	USAID Development Credit Authority

1 Executive Summary

This paper contributes to the Global Alliance for Improved Nutrition's (GAIN) activities under its Nutritious Food Financing Program (NFFP), an initiative that aims to mobilize private sector financing to enterprises working within or alongside food value chains to make healthier food choices more affordable and accessible. While the work of the NFFP is global in scope, this paper is part of a research series that focuses on the role of small and medium sized enterprises (SMEs) to promote nutritional outcomes in Kenya and Tanzania and the potential of innovative financing mechanisms.

This paper follows an earlier assignment focused on assessing the financial and operational needs of enterprises working within or alongside value chains that could produce or distribute nutritious foods in these target countries, evaluating their investment readiness, and developing a 'deal book' of investable companies.[1] The gathering of this information led to the development of archetypes of different types of enterprises based on the type of capital each archetype requires, as well as informed recommendations for potential structures for a nutritious food-focused financing facility.

Interviews with enterprises in Kenya and Tanzania reinforced findings from experts and other studies found that SMEs in developing countries – including those working within and outside of the agriculture sector – face many constraints when attempting to access finance, including prohibitively high interest rates, lack of adequate collateral, a limited credit history, and lack of reliable financial accounts. All of these factors contribute to the perceived risks by bankers of lending to the SME sector, which has well-documented negative impacts on their growth and economic performance.

At the same time, conversations with stakeholders in the financial sector from this previous work revealed that there are a number of guarantees in place in Kenya to help local financial institutions increase their lending activities to SMEs, including in agriculture value chains, although none of these focus specifically on lending to enterprises in the nutritious foods space. These guarantees were put into place to share part of the default risk of the SME borrowers and thus help catalyze financial institutions lending to the sector. However, some of the guarantees in East Africa reportedly had low utilization rates, which led to this piece of research which focuses on the state of guarantees for agriculture-sector SMEs in Kenya and Tanzania.

Key summaries from this report are:

A Loan guarantees are **innovative financing mechanisms** in which a guarantor (typically the public or non-profit sector) agrees to pay some amount due on a loan instrument in the event of non-payment by the borrower and often take four forms: **loan guarantees, loan portfolio guarantees, portable guarantees, and volume guarantees.**

B The main role of guarantees is to alleviate two conditions: (i) **SME's lack of acceptable collateral for bank lending**, and (ii) **perceived risk on the part of banks to lending to certain market segments**. Evidence from past programs show that while guarantees effectively ease access to finance for a selected group of enterprises, they rarely succeed in lowering borrowing rates or catalyzing long-term bank behavior change toward specific market segments.

C There are no global data sets for loan guarantees, but research indicates that the largest provider of guarantees to financial institutions for commercial risk purposes is **USAID DCA, which has provided over 500 guarantees to unlock USD 4B in capital** since its inception, as well as provides over 60% of the known active guarantees in Kenya and Tanzania.

[1] iGravity, Nutritous Food Financing Program: Investment Opportunities in Nutritous Foods Value Chains in Kenya and Tanzania, 2018.

D Analysis of USAID DCA's dataset of expired **guarantees shows that guarantees targeted for SMEs in Africa have lower utilization rates** – as confirmed by conversations with stakeholders – **and lower leverage rates** than the global data set of guarantees.

E **There are approximately 47 known guarantees in Kenya, 39 of which are believed to currently be active**. Of the active guarantees, the majority (58%) have been provided by USAID DCA, followed by the Africa Guarantee Fund (25%), AGRA (5%), and others (12%). The total value of the active (or presumed active) guarantees' commitments (when the amount of commitment is known) is USD 159M, of which USD 56M have been utilized to date.[2] Analysis of guarantees in Kenya shows that the country benefits from many guarantees and did so historically with at least twice the number of USAID DCA guarantees compared to other countries of comparable populations. **There are approximately 26 known guarantees in Tanzania, of which 16 are believed to be active**. Similar to Kenya, most of the guarantees (68%) are provided by USAID DCA. Collectively, the active or presumed active schemes represent USD 90M in financial guarantee commitments, but the data set is not complete enough to do an analysis of utilization or default rates. Of the 62 active guarantees across Kenya and Tanzania, 70% are serving the general SMEs or those in the agriculture sector as compared to others that are focused on health, women, energy, industry, etc. None of these schemes specifically focus on nutritional quality of food or associated social impacts.

F Kenyan guarantee schemes (as well as those in other comparable countries) appear to be facing a number of similar issues, including: **geographical and sectoral limitations reduce lending options, administrative complexity and hidden costs discourage guarantee utilization, poorly timed fee structures do not reduce risks,** and **perceptions from bankers that guarantees have limited utility**.

G **Best practices for the design and implementation of bank guarantee schemes** highlight the importance of market-research based planning; ensuring full, specialized, and experienced management attention for any guarantee product or program (including creating or working with a specialized, independent organization to manage guarantee loan funds that will operate at a national or regional level); selecting a banking partner that has genuine interest in working in new markets or testing new products; and how critical certain design elements (i.e. risk sharing amounts, fees, reimbursement policies, etc.) are for guarantee utilization.

H Within risk sharing and financing mechanisms, iGravity proposes four different potential options for GAIN in Kenya: (i) **opportunities to impact ongoing guarantees**, (ii) **creating a risk-sharing mechanism with a local bank**, (iii) **creating a standalone portable loan guarantee program**, and (iv) **creating or partnering with a domestic investment facility**. Different aspects against which to assess the viability of these options include minimal capitalization requirements, estimated return on investment, sustainability, scalability, impacts on GAIN target enterprises, and the need to create new legal entities. The proposed options differ in the way they address the challenge, with some aiming at more top-down systemic change (across the market), and others focused on a bottom-up strategy supporting selected nutritional champion enterprises. Further, in order to promote a nutritional agenda, stakeholders need to recognize and value nutritional outcomes. As such, all of these structures could also employ an **interest-rate buy-down linked to nutritional outcomes of loans**, which could provide powerful incentives to companies to reach nutritional goals while lowering the cost of financing, which remains a key barrier to SMEs.

[2] For individual loans, the amount of the portfolio commitment used is the utilization rate. For loan portfolios, however, utilization rates can be calculated overall or with weighted averages. To avoid complications, when available, the amount of capital used will be quoted.

2 Project Scope

iGravity, an advisory firm specialized in impact investment and innovative finance solutions, was mandated by GAIN in August 2018 to expand on the previous assignment where underutilised guarantee funds were identified as both a major constraint and opportunity for mobilising private capital for nutrition outcomes, and look at the following:

- Conduct a **mapping of existing guarantee schemes related to SME agricultural lending available to banks in Kenya and Tanzania** and then – for Kenya only – develop a **diagnostic of the guarantee schemes available to Kenyan banks**. Based on the diagnostic, **meet with selected banks in Kenya to discuss realistic and attractive adaptions** to current guarantees and/or co-design a new guarantee scheme that could unlock significant domestic financing.
- Conduct an assessment of **best-practices in the design and implementation of bank guarantee schemes** (focusing on case studies of both successful and less successful guarantees) with an emphasis on SMEs and agriculture lending and summarize main findings and key success factors.
- Propose different **potential options** related to risk mitigation mechanisms to facilitate increased access to affordable capital for enterprises working in nutritious foods value chains.

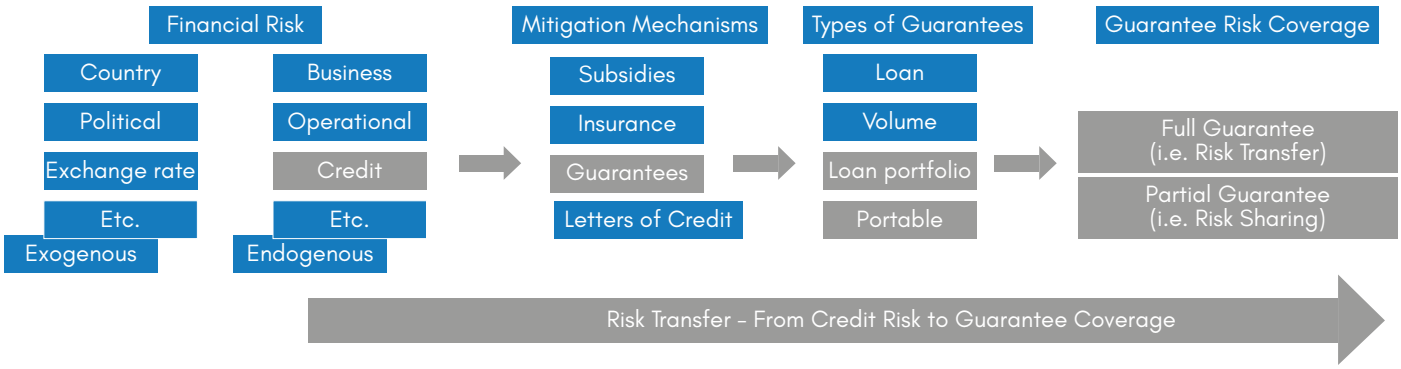
3 Guarantees and Other Risk Sharing Mechanisms

Different Types of Risk

The Oxford English Dictionary cites the earliest use of the word in English (in the spelling of risque from its from French original, 'risque') as of 1621. It defines risk as: *(Exposure to) the possibility of loss, injury, or other adverse or unwelcome circumstance; a chance or situation involving such a possibility.*

The word 'risk' can have different meanings depending on the different contexts. All investments pose **financial risks** given the potential to lose some or all of the invested capital. International investors typically evaluate a variety of risks before making an investment, including more **exogenous risks** such as country risk, political risk, exchange rate risk, interest rate risk, and market risk, as well as more **endogenous risks** such as business risk, operational risk, credit / default risk, and bankruptcy risks. Endogenous risks are directly related to a specific investment opportunity, and can also be referred to more generally as **business risk**, while the overall risk of the investment is sometimes also referred to as **commercial risk**.

Image 1: Risk Transfer Diagram



Banks – as the managers of capital – also have additional risks to manage (notably liquidity and currency risks) but focus mostly on **credit risk**, i.e. the risk that one borrower or a group of borrowers will default on a loan. In order to reduce these risks, banks tend to loan only to enterprises that meet strict criteria or exclude lending to a sector altogether due to a **perceived risk** (which may or may not be factually accurate or supported by viable data) that the credit risk for that sector is too high. Pricing of their loans is also proportional to the perceived risk.

Guarantees are one of numerous tools that are designed to reduce an investors financial risk, by either **risk transfer** in which the potential for the loss of capital is now born by the guarantor, or **risk sharing** in which any potential losses are now split between the investor and the guarantor. The degree to which a guarantee lowers an investor's financial risk depends on the types of **risk coverage** provided (for banks, this is almost always exclusive to credit risk) and the **extent of loss coverage**, which is the amount of risk that is transferred or shared.

Financial Risk Mitigation Mechanisms

Financial risk mitigation mechanisms are instruments that address high (real or perceived) risks to mobilize private finance into investment opportunities. Financial risk mitigation mechanisms that can be applied to capital providers include:

Subsidies

Funds typically provided by the public sector to co-finance part of the investment or business costs. Subsidies typically include both grants as well as concessional funding (i.e. lower than market rate) and can be used either at the fund level (for examples, when DFIs provide low interest loans to large investment funds) or for borrowers (when funds provide discounted rate loans to borrowers). To note, depending on the geography, fund economics typically do not support lending at discounted rates (although there may be discounted lending in the case of shareholder loans), and no examples could be found of discounted lending by Kenyan loan funds.

Guarantees[3]

A financial instrument in which a guarantor (typically the public or non-profit sector) agrees to pay some amount due on a loan instrument in the event of non-payment by the borrower. Guarantees are a specialized form of insurance related to financial transactions, in which the risk of default by one of the two sides in a transaction is taken on by a third party external to the original transaction. Guarantees can be provided for financial institution loan portfolios, financial institution individual loans, or to enterprises seeking a loan (which is referred to as a "portable guarantee").

Letters of credit

A letter of credit issued by a financial institution to serve as a guarantee of payment for an enterprise as part of a contract.

Insurance and options

Funds are paid out only when a certain event occurs, providing instant funds in emergency cases and transferring risk to insurers or investors who earn premiums in return.

Innovative Finance for Development

Risk mitigation mechanisms in impact investment and development finance are part of "innovative finance", **i.e. all mechanisms and initiatives that provide financing to meet the 2030 Agenda for Sustainable Development**. While there is no single agreed definition, innovative finance can broadly be defined as 'a set of financial solutions and mechanisms that create scalable and effective ways of channeling both private money from the global financial markets and public resources towards solving pressing global problems'. This concept incorporates two distinct facets: (i) innovative financing as a complementary source of capital to traditional development finance; (ii) innovative financing as a way of making development projects more effective and efficient by linking financing to results, redistributing risk, improving the availability of working capital, engaging technology, and matching the length, or tenor, of investments with project needs.

Innovative finance mechanisms can be categorized based on key attributes and their main goals, i.e. mobilizing funds from capital markets, mitigating risks, linking payments to results, leveraging technology, etc. It is also important to make a distinction between concessional and non-concessional finance. Concessional finance includes grants and financing that is provided on more generous terms than market rates. The concessionality is achieved, for example, through interest rates below those available on the market or by extended grace periods, or a combination of both.

[3] Other modern risk mitigation instruments include first loss guarantees in equity or debt funds. As an alternative to charging a fee for first loss guarantees, governments or non-profits participate in the "equity tranche" of a product in return for taking the first loss risk. In doing so, they provide a first loss guarantee to private investors, while usually (but not necessarily) participating in potential upside returns associated with the investment. While market practice is that the first-loss takers expect a higher potential financial return than other investors, if and when the fund is successful, there are several cases where the public sector is subsidizing the first-loss and effectively accepting a lower return.

Image 2: Overview of innovative finance mechanisms and goals

1	2	3	4	5	6	7
Financial Products	Risk Mitigation Mechanisms	Result-Based Financing	Technology-Enable Solutions	Taxes & Obligatory Charges	Voluntary Solidarity Contributions	Debt Management
Mobilize and raise funds from capital markets	Aims at reducing (perceived) risks	Payments are linked to certain outcomes being met	Mechanisms that leverage technology	Compulsory contributions to a state's or country's revenue	Voluntary contributions to a social or environmental cause	Reducing or extending a country's debt when certain outcomes are met

Description of Guarantees

There are four types of common guarantees for achieving development impact, with the following definitions being taken directly from the Swedish International Development Cooperation Agency (SIDA)[4], which has employed guarantees since 1996:

- A loan guarantee involves guaranteeing a loan between identified lenders and identified borrowers.

  A loan portfolio guarantee is a guarantee that de-risks several investments or loans in one portfolio.

- A portable guarantee is a letter of commitment which enables a borrower to approach a financial institution and negotiate more favorable terms for a loan.

- A volume guarantee is an agreement that buyers make with suppliers in regards to purchasing a minimum volume of products or services. This is often combined with a supply or offtake contract that determines the prices of future deliveries.

Further, guarantees can generally take two forms – unfunded and funded. Unfunded guarantees are governed by contracts that define and determine payments events, but no capital is provided upfront. Funded guarantees have capital allocated and ring-fenced (for example in a deposit or escrow account) to be utilized in the case of a qualifying event.

"**Developmental guarantees**" are a special category of official guarantees backing projects that promote the development and welfare of lower-income communities and/or developing countries.[5] According to the OECD, "developmental guarantees" are a valuable instrument for mobilizing private resources to improve economic and social conditions in developing countries at a fraction of the potential cost of the risk exposure undertaken. These guarantees can be used in a myriad of ways, such as i) backstopping financing for large-scale, multi- year infrastructure projects, ii) lengthening the maturities of loans to small enterprises, iii) refinancing municipal utilities, iv) enabling local banks to enter new markets such as mortgage or microenterprise lending, or v) deepening capital markets by facilitating local-currency bond issues. In a larger sense, developmental guarantees are uniquely suited to facilitate investment flows to developing countries and high-risk sectors – and they thus mobilize additional resources beyond what financial markets would normally provide.

[4] Evaluation of SIDA's Use of Guarantees to Promote Market Development and Poverty Reduction. Evaluation Brief. SIDA. 2006.
[5] Guarantees for development, Raundi Halvorson-Quevedo and Mariana Mirabile, OECD, 2014.

How Guarantee Mechanisms Work

The guarantee contract specifies the terms and conditions of the guarantee. Key elements include the extent of loss coverage, the types of risks covered, what financial instruments are covered, and the guarantee fee.

- **Risk coverage** may cover all risks — protecting lenders against default regardless of the cause — or partial risk — covering defaults arising from specified events. Guarantees may cover a range of risks including commercial risk (i.e. the risk of default on debt service payment obligations) and political risk.

- The **extent of loss coverage** may be for the full amount of the potential loss (i.e. unlimited) or partial (i.e. limited). Partial credit guarantees cover a specified portion of a loan or portfolio of loans, such as for example only the principal. Full credit (or "wrap") guarantees cover timely payment of scheduled principal and / or interest to creditors for the entire loan period in the event of a default. Guarantees also differ by the way the risk is shared, i.e. ***pari-passu*** (when all parties share risk equally) or ***first-loss*** (when one party accepts all risks to a certain amount, after which risks are shared).

- The **financial instruments** covered can range from individual loans, a portfolio of loans, or a class of investments meeting certain requirements (e.g. home mortgages, car loans, credit card receivables, etc.).

- The **guarantee fee** is paid to the guarantor, and may be: i) a one-time or annual fee, or a blend of both; ii) a percentage of the underlying loan amount; and/or iii) a percentage of the guaranteed portion of the loan. The level of the fee typically depends on the creditworthiness of the creditor, but some public guarantee schemes offer preferential or concessional terms for targeted classes of borrowers.

4 Development Guarantees Worldwide and in East Africa: The Numbers

As the first step of the mapping process, iGravity downloaded the data sets (to the extents available) and reports of all known major development finance institutions (DFIs) with substantial guarantee programs for financial institutions in Sub Saharan Africa, i.e. USAID's Development Credit Authority (USAID DCA), Africa Guarantee Fund (AGF), ARIZ (the guarantor for the Agence Francaise de Developpement (AFD)), International Fund for Agricultural Development (IFAD), SIDA, Danish International Development Agency (DANIDA), Alliance for a Green Revolution in Africa (AGRA), as well as those organizations which focus on providing guarantees for governments, large-scale infrastructure projects, or to individual companies (World Bank via Multilateral Investment Guarantee Agency (MIGA), International Finance Corporation (IFC), International Bank for Reconstruction and Development (IRDB), Overseas Private Investment Corporation (OPIC), etc.) and other industry organizations (i.e. Food and Agriculture Organization (FAO)).

Guarantees Across the Globe

There seem to be rather few international data sources or databases that track guarantees for development. Part of the reason for the lack of information is that guarantees are "unmaterialised" financial flows: as "contingent liabilities"[6] they are registered in the financial statements of the institutions issuing them but they do not actually give rise to official financial flows until a default occurs. Thus, while the OECD Development Assistance Committee (DAC) runs a comprehensive statistical system on financial flows, guarantees in themselves do not appear in it.

The most comprehensive source found during the literature review is the 2013 OECD report "Guarantees for development", which tracks all private sector guarantees from 2009 to 2011.[7] While the data is outdated, it is still revealing in terms of major capital volumes and funders. Per the report, the 26 OECD countries provided USD 11.4B in capital for guarantees that mobilised USD 15.3B in capital from the private sector for development purposes.

Despite these impressive numbers, this represented less than 1% of private capital flows for development purposes in 2011. Further, it is important to note that the vast majority of this capital went towards covering political risk, not commercial risk, with only 6% of mobilized capital being applied solely to commercial risk and 65% being applied to both commercial and political risk. Geographically, Africa was the region most touched by these guarantees, where USD 6.1B in private capital was mobilized. With regards to the sectors, banking and financial services were most favoured with 40% of capital directed to them, with SMEs being the least favoured, absorbing just 5% of the capital.[8]

Looking at the major guarantors in the table below, OPIC guarantees are typically used for larger projects and apply only to US corporations, partnerships, or other associations including non-profits. MIGA provides political risk insurance (guarantees) for projects in a broad range of sectors in developing member countries, covering all regions of the world. The EBRD works with partner financial institutions and uses guarantees to incentivize them to deploy new instruments or develop new market segments in more than 30 countries from central Europe to central Asia.

[6] A contingent liability is an obligation to cover payment that depends on the outcome of a future event: thus, the timing and the amount of any payment cannot be known when the contingent liability is assumed.
[7] Mirabile, M., Benn, J., and Sangaré, C. "Guarantees for Development". Development Co-operation Working Papers, No. 11. OECD. 2013.
[8] Mirabile, M., Benn, J., and Sangaré, C. "Guarantees for Development". Development Co-operation Working Papers, No. 11. OECD. 2013.

Table 1: Top 10 OECD Guarantor Providers per Capital Mobilisation, 2009-2011[9]

Country	Organization	Amount Mobilised 2009-2011 (USD, million)
United States	OPIC	5'561
IO	MIGA	4'467
IO	EBRD/IDA	1'496
IO	IFC	1'199
France	AFD	1'116
IO	Islamic Development Bank	430
Austria	Oesterreichische Entwicklungsbank AG	304
Finland	FINNVERA	209
IO	Private Infrastructure Development Group	144
IO	African Development Bank	139

Further, a 2003 UNIDO study found that there are approximately 2'250 credit guarantee schemes in almost 100 countries, but it also notes that relatively few were designed for agricultural finance in emerging markets (although some are applied to the SME sector in general).[10] Although this may have changed given that 15 years have passed since that study, it was difficult to find exact figures on the number of agricultural-focused guarantee schemes and no known nutrition-focused guarantees currently exist. A 2013 FAO case study of four agricultural credit guarantee schemes that were focused on smallholder farmers (although one focused more broadly on agribusinesses) did not indicate that any of these schemes focused on the nutritional quality of the food as an impact of the guarantee scheme.[11] That said, some of these schemes:

- Had technical impacts on food inputs via loan use that could have an impact on nutrition, including improved seed and livestock varieties, fertilizers, and post-harvest technologies.
- Had windows that focused on specific value chains – such as fisheries – that could increase the availability of a certain nutritious food in the market.

Development Guarantees Worldwide: The Numbers

While there is no global database for loan guarantees – especially in the developing country context – USAID DCA's publicly available data set of its guarantee portfolio is probably the most comprehensive from which data can be analyzed. DCA's dataset is comprised of 562 active and expired loan guarantees from 1999 to 2018.[12] Interesting characteristics about this data set include:

- 59% of the guarantees are currently active;
- The average duration of all guarantees is 7.25 years;
- 52% of the guarantees primarily targeted the SME segment;
- 42% of the guarantees primarily targeted the agriculture sector;
- 76% of the guarantees were to guarantee loan portfolios at financial institutions; and
- Nutrition is not listed as a sector or segment of guarantees.

[9] Mirabile, M., Benn, J., and Sangaré, C. "Guarantees for Development". Development Co-operation Working Papers, No. 11. OECD. 2013.
[10] Credit Guarantee Schemes for Small Enterprises: An Effective Instrument to Promote Private Sector-Led Growth? Austria: UNIDO, 2003.
[11] Miller, C. Four Case Studies on Credit Guarantee Schemes for Agriculture. FAO. 2013.
[12] Data was downloaded as of August 2018 with data as of January 2017. We have assumed that all data included in the data set is full and reported, but this cannot be verified by iGravity, so it is recommended that conclusions are being considered with that fact in mind.

In order to perform a more detailed analysis, iGravity divided the data into several sub-sets:[13]

- All expired guarantees (n=231);
- All expired SME guarantees (n=105);
- All expired guarantees that target agricultural SMEs (n=45);
- All expired guarantees that target general SMEs (n=49);
- All expired guarantees in Sub-Saharan Africa (n=63);
- All expired SME guarantees in Sub-Saharan Africa (n=41);
- All expired guarantees that target agricultural SMEs in Sub-Saharan Africa (n=25); and
- All expired guarantees that target general SMEs in Sub-Saharan Africa (n=17).

These sub-sets were investigated in regards to **guarantee type**, **characteristics of the guarantees** (size, duration, coverage percentage, utilization rates, claims, recoveries, etc.), and **capital efficiency**. The general comparative data of these sub-sets are included in the table below.

Table 2: USAID DCA expired guarantees data set descriptive statistics

	All Expired	Expired SME	Expired Ag SME	Expired General SME	Expired in SSA	Expired SME in SSA	Expired Ag SME in SSA	Expired General SME in SSA
Sample Size	231	105	45	49	63	41	25	17
Average Guarantee Duration	5.7 years	6.1 years	6.1 years	5.9 years	5.6 years	5.9 years	6.0 years	5.7 years
Average Guarantee Coverage	49.17%	49.3%	48.5%	49.8%	50%	48.2%	47.40%	49.41%
Average Cumulative Utilization	69.75%	65.15%	67.2%	66.6%	64.4%	52.6%	51.41%	55.97%
Average Total Maximum Commitment per Guarantee	USD 5.2M	USD 5.7M	USD 6.2M	USD 4.9M	USD 5.7M	USD 5.8M	USD 6.4M	USD 4.7M
Total Maximum Commitment	USD 1.2B	USD 595M	USD 281M	USD 245M	USD 359M	USD 239M	USD 161M	USD 79.8M
Total Cumulative Utilization	USD 880M	USD 420M	USD 183M	USD 209M	USD 226M	USD 119M	USD 83.5M	USD 37.4M
Total Cumulative Nr. of Loans	130,439	13,109	7,816	5,213	8,077	2,285	670	1,629
Claim Rate	1.49%	2.18%	1.73%	2.79%	1.51%	1.93%	0.57%	4.89%
Utilized Commitment Per Loan	USD 6.7K	USD 32K	USD 23K	USD 40K	USD 28K	USD 52K	USD 125K	USD 23K

[13] Only expired guarantees were used, as it was assumed all data for these programs had been collected and reported.

Comparing these data sets reveals some interesting findings:

1. **First, the data largely confirms findings from background interviews that agricultural and general-SME focused guarantees in Africa have lower average utilization rates compared to other data segments**, noting that SME-focused guarantees in Sub-Saharan Africa had lower utilization rates by approximately 10% than SME-targeting guarantees in other countries and all guarantees across Sub-Saharan Africa.

2. In terms of claims, the full data set shows a claims rate of 1.49%, with the guarantees for general SMEs in Africa having a rate of 4.89% and agricultural SME guarantees in Africa having a rate of .57%, which is an interesting finding for further investigation (but could be a result of incomplete data reporting as noted in the caveat).

3. **Further, in terms of capital efficiency, it seems that the capital used in agricultural SME guarantees in Sub-Saharan Africa were less efficient in terms of leveraging lending (assuming constant loan sizes)**. Specifically, on average and very simplistically, for the full data set it took USD 6.7K in utilized guarantee capital to unlock one loan. For agricultural SME guarantees worldwide, guarantee capital per loan was USD 23K, whereas for agricultural SMEs in Sub-Saharan Africa guarantee capital per loan was 124K (or 18x higher than the general data set). This calculation, however, can be largely explained by the lack of any highly productive partners (making 1'000 loans or more) in this data set, while at least one (or more) highly productive partner was included in every other data set.

The statistics above, however, do not take into account some of the factors that could potentially explain the performance differences between different guarantees. One key factor – as noted in background interviews and research reports – is that the type of financial institution selected can play a key role in both utilization and claims rates. Specifically, numerous interviewees indicated that it may be easier to work with a local bank or smaller international bank as these institutions are more likely to have functional SME departments (versus limiting lending mostly to large companies and the purchase of treasury bonds). As utilization rates are partially reflective of bank enthusiasm for using the guarantee, it has been repeatedly mentioned that smaller and medium-sized banks with ambitious growth plans are likely to generate higher utilization rates. Unfortunately, the available dataset does not allow one to draw conclusions with regards to any correlation between bank size or quality and utilization rates.

SIDA's Evaluation of its Loan Guarantee Programs

As of 2016, SIDA's guarantee portfolio contained 29 projects across the globe at a total guarantee value of USD 369M, of which 40% (USD 150M) is committed to market development guarantees for SMEs. In November 2015, SIDA commissioned a case-study based evaluation of its use of guarantees for market development and poverty reduction. This study analyzed the selected guarantees based on relevance, efficiency, effectiveness, and (to a limited extent) impact and sustainability, concluding that the interventions reviewed were relevant and efficient. Without any rigorous impact analysis on outcomes of guarantees, however, the report's conclusion was limited to noting that, overall, guarantees make positive contributions to private sector development and "are a necessary but not a sufficient instrument to bring about private sector development."

The most relevant case study for GAIN that was reviewed in the report was a USD 900K local currency, 7-year joint guarantee with USAID to CRDB in Uganda for a health portfolio. The outcomes of this particular guarantee (as of May 2016, noting it expires in 2019) included:

- 0% claims rate
- 63% utilization rate
- 174% average collateral required for borrowers
- 14% of funds went to first time borrowers (after USAID paused the program due to overuse of lending to existing borrowers)
- Guarantee fees were passed onto the borrower
- The guarantee allowed longer tenors and higher loan amounts that were not sufficiently covered by registered collateral
- No long-term bank behavior changes in regards to providing non-guaranteed loans or lowered collateral requirements observed

Are Guarantees Successful?

Guarantees are financial instruments used to improve the flow of financial resources to targeted enterprises; other potential methods of achieving the same goal include direct lending, interest subsidization, regulatory subsidization, and wholesale credit, among others. **Expert interviews have re-confirmed that the primary role of guarantees is to alleviate two conditions: i) SME's lack of bank acceptable collateral, and ii) perceived risk on the part of banks to lending to certain market segments. When viewed through this lens, many guarantees can be considered successful if structured appropriately for the market.**[14] The AFD, which mostly provides guarantees through its mechanism ARIZ in Francophone Africa, has found that some guarantees have been designed to allow banks to extend loan tenors or reduce collateral requirements when it was clearly tied to the bank's strategic interests, especially when compared to "comfort" guarantees which result in no changes to lending procedures which are unlikely to have any post-expiration impact. They have found that there can be a trade-off between the commercial orientation of the guarantee and experimentation, with below market-priced guarantees giving banks more space to experiment but also potentially having negative externalities.

At the same time, for most guarantee providers who select this tool over others, the ultimate success criterion for credit guarantees (as for other government interventions) is whether they increase access to finance and/or reduce borrowing costs for target enterprises. Methodologically, that is a difficult question, as proper identification of the causality is a challenge. **However, both IFAD and USAID DCA have noted that guarantees most often do not significantly lower the cost of borrowing for companies and can sometimes even increase it as the costs of the guarantee are typically passed directly onto the borrower. SIDA's reviews of its guarantee program have concluded that guarantees are an important tool – but not sufficient in and of themselves – to overcome the weaknesses of the financial markets**.

IFAD's Decision Tools for Rural Finance provides a complete list of when guarantees may be an appropriate instrument.[15] These include: i) a measurable, quantifiable market demand has been demonstrated; ii) the guarantee fund institution is an independent, specialized financial institution and professionally managed; iii) a significant part of the default risk remains with the retail institution to avoid moral hazard and adverse selection, iv) significant technical assistance is available to mitigate the other constraints and risks involved in serving the target group (e.g. appropriate products and delivery mechanisms, trained staff, risk management systems, etc.); and v) international good practices are followed and incentives are set for correct claim and settlement.

Similar concerns have been raised regarding **portable guarantees**, with both IFAD and the FAO noting the high transaction costs (depending on the organizational structure employed) make sustainability difficult. During the course of its research, iGravity found very few examples of portable guarantees and noted that multiple reports highlighted the high costs of administering such initiatives, which mostly depends on the organizational structure required to assess eligibility and select target enterprises.

In conclusion, when viewed through the criteria of lowered collateral requirements, new financial products or policies, lowered rates for borrowers, and financial sustainability, numerous reports reviewed by iGravity revealed that views on guarantees are tempered or mixed in terms of effectiveness. At the same time, the definition of success also depends on the organization, with USAID DCA assessing its programs verbatim along six main dimensions: i) **appropriateness of the design**; ii) **utilization**; iii) **credit additionality** (i.e. the degree to which the program expands access to finance for target borrower groups relative to what one could expect in the absence of the program); iv) **financial sustainability**; v) **program sustainability**; and vi) **impact on the borrowers.**[16]

[14] Conversation with Hamp, Michael. Lead Technical Specialist, Inclusive Rural Financial Services. IFAD. September 24, 2018.
[15] Decision Tools for Rural Finance. IFAD. 2010.
[16] DCA Opening Doors: A Performance Evaluation of the Development Credit Authority (DCA) in Ethiopia. No date.

Key Actors in East Africa

From the data sets identified, it is clear that the most prominent player in guarantees in the development sector (both globally and in East Africa) is USAID DCA, which from 1999 to 2016 made more than 500 guarantees across 76 countries, unlocking USD 4.8B in credit for enterprises.[17] DCA offers a variety of different guarantee options, including guarantees to cover a single loan to a corporate client, for a loan portfolio for a financial institution, and portables guarantees (as well as – in small amounts – guarantees for municipal and regular bonds). It typically provides a 50% pari passu guarantee, as well as provides technical assistance to both banks and end borrowers.

While a more complete analysis is provided in the following sections, **USAID has provided 60% of the active and expired known guarantees in Kenya and Tanzania**. Specifically, in Kenya it has 23 active guarantees and 8 expired guarantees. In Tanzania it has 11 active guarantees and 2 expired guarantees.

The second major actor in this space is the Africa Guarantee Fund (AGF), which is a stand-alone company created in 2012 and financed by DANIDA, the Spanish Agency for International Cooperation and Development (AECID), the African Development Bank (AfDB), AFD, and the Nordic Development Fund (NDF) to assist financial institutions in increasing their financing to African SMEs through the provision of partial financial guarantees and capacity development assistance. The prevalence of funding from DFIs through AGF does explain the relatively small or lack of guarantee programs within these institutions themselves. In terms of guarantees and impact to date, as of December 2017, AGF's guarantee products were implemented by 84 partner financial institutions across 38 countries and allowed 19'000 SMEs to access financing. The organization has cumulatively issued USD 710M of guarantees which enabled its partners to increase the available financing for SMEs to about USD 1.4B (out of which a total of 0.9B has been disbursed), which translates to an approximate 62% utilization rate. Interestingly, AGF highlights a connection between guarantee duration and average SME loan tenor, noting that its own guarantees to banks have expanded from 24 to 60 months and at the same time banks have increased their average loan tenor from 24 to 36 months.[18] In June 2018, AGF announced a capital increase amounting to USD 26M from the Investment Fund for Developing Countries (IFU) and the NDF. The capital increase is part of the first of a three-phase fund raising exercise that will be completed over the next five years, a portion of which will go toward a Green Financing program with the rest to be focused on reducing the SME financing gap by 1% (which per AGF's calculation, is currently USD 155B).[19] AGF also benefits from a grant-funded (by the current shareholders) Capacity Development Facility to assist banks to scale-up and de-risk their SME portfolios.

Other institutions which provide guarantees in East Africa are: AfDB, ARIZ, AGRA, EADB, IFAD, DANIDA, SIDA and the Financial Sector Deepening (FSD). No public figures are available with regards to their exposures. SIDA works in East Africa by co-guaranteeing USAID portfolios. The only known private sector guarantor with exposure in East Africa is Rabobank, through its Sustainable Agriculture Guarantee Fund (see box for more information).

Rabobank's Sustainable Agriculture Guarantee Fund (SAGF)

Founded by the Dutch Ministry for Development Cooperation, Rabobank International, Rabobank Foundation, Cordaid , and Solidaridad, the SAGF provides guarantees to lenders in developing countries at commercial rates with the focus of enhancing portfolios aimed at providing working capital credit (specifically pre-export trade finance) to small and medium sized producers and cooperatives working in sustainable agriculture products. The SAGF currently works in the value chains for cocoa, coffee, cotton, nuts/oils, tea, and fresh fruit.

[17] Putting local wealth to work. Development Credit Authority. 2016. https://www.usaid.gov/sites/default/files/documents/1865/DCA_One-Pager_48.pdf
[18] A Guarantee for African Growth. African Guarantee Fund. 2017 Annual Report & Financial Statements. http://www.africanguaranteefund.com/uploads/pdf/annualreports/AGF%20Annual%20Report%202017.pdf
[19] "African Guarantee Fund receives USD 26 million capital increase for financing SMEs in Africa." AGF News Coverage. June 21, 2018. http://www.africanguaranteefund.com/news/160/160/AFRICAN-GUARANTEE-FUND-RECEIVES-USD-26-Million-CAPITAL-INCREASE-FOR-FINANCING-SMEs-IN-AFRICA/d,secondpage-EN

5 Mapping of Existing Guarantee Schemes in Kenya and Tanzania

Kenya - Overview of Existing Guarantee Schemes

In the past fifteen years, there have been approximately 47 known bank guarantees in Kenya, 39 of which are believed to currently be active. Of the active guarantees, the vast majority (58%) have been provided by USAID DCA, followed by the AGF (25%), AGRA (5%), and others (12%). The total value of the active guarantees' commitments is USD 159.9M, of which USD 50M have been utilized to date. Specifically:

- All of the active guarantees but one provides 50% coverage;
- The active guarantees have an average commitment size of USD 5.1M (with a range of USD 600k-15M) and current utilization rate of 52%;
- These guarantees have an aggregate 2% default rate (per currently available data); and
- 21-33% are focused on agricultural SME lending (depending on definitions).

Tanzania - Overview of Existing Guarantee Schemes

iGravity has collected data on 26 known guarantees in Tanzania, of which 16 are believed to be active. Similar to Kenya, most of the active guarantees (68%) are provided by USAID DCA. Of those active guarantees not coming from USAID, three are provided by AGF, and two are provided by DANIDA. Providers of expired guarantees include AFD and Rabobank. At the sametime, Tanzania also has a number of specialized credit guarantee schemes in agriculture (as well as export schemes not mentioned here) that are ongoing partnerships between multiple organizations, such as the:

- Agricultural Credit Guarantee (est. USD 2.5M), which is a partnership between AGRA, the Kilimo Trust, OFID and Stanbic Bank;
- USAID / AfDB credit guarantee with CRDB (est. USD 20M); and
- PASS program (est. USD 25M), which originated as a scheme between DANIDA and CRDB and has since expanded to 7 other partner financial institutions.

Collectively, the active schemes represent USD 90M in financial guarantee commitments, but unfortunately the data set is not complete enough to do an analysis of utilization or default rates. Interestingly, the Tanzanian guarantees have a slightly higher average coverage percentage than Kenya (53% versus 50%). 46% of these guarantees are targeted toward the agriculture SME sector, which is a significantly higher proportion than in Kenya.

Government Guarantees

Governments across the world have also often engaged in developing and financing loan guarantee programs, especially for small businesses. **As recently as August 2018, the Kenyan government's National Treasury is reportedly working with the Ministry of Industrialization to develop a SME guarantee scheme, partially in response to the reduced lending to the sector resulting from the interest rate cap.**[20] At the same time, this is not the first SME loan guarantee scheme sponsored by the Kenyan government. The Kilimo Biashara loan program which focused on providing credit to farmers resulted in loans of over USD 69M since 2018.

[20] "Treasury to establish credit guarantee scheme for SMEs." KBC News. August 15, 2018. http://www.kbc.co.ke/treasury-to-establish-credit-guarantee-scheme-for-smes/

This program was renewed for a third time by its partners (the Ministry of Agriculture, Livestock and Fisheries and Equity Bank, with the program now being referred to as the Agricultural Credit Guarantee Scheme) in 2017 with a commitment of an additional USD 2.9M in capital.[21] Tanzania has also participated in such schemes, most notably through the creation of the Small and Medium Enterprise Credit Guarantee Scheme (SME – CGS), which was created during a series of financial reforms in 2003 and seems to have been closed in 2008. This program provided a 50% guarantee for SMEs with enforceable collateral and the lending decision being taken by partner financial institutions. The overall program aimed to provide USD 1.3M in guarantees to the entire SME sector, with USD 290K going to agriculture.[22]

A review of Tanzania's SME – CGS program, which had 10 partner banks, found that: i) the program was largely unknown throughout the country (as there was no promotion scheme), ii) it was too expensive for the partner financial institutions customers to borrow through, iii) the program was not adequately included in the policies of the government, and iv) it was not clear which entities were in charge of ensuring program sustainability.[23] Further, the program's overexposure due to low capitalization ultimately led to its suspension.

The Government of Tanzania has also recently considered re-establishing a credit guarantee scheme, with announcements in March 2018 that the Tanzania Agriculture Development Bank is looking for partner financial institutions for a loan guarantee program to cover 50% of the principal loan defaults to smallholder farmers and smallholder farmer organizations.[24] More recent conversations with IFAD indicate that

Agricultural and General SME-Targeting Guarantees

While both of these countries do have fairly active guarantee markets, the number of ongoing, active guarantees in the agricultural and general SME sectors (excluding MSMEs) is more limited, with 19 guarantees that are believed to be active in Kenya and 11 in Tanzania representing USD 96M in guarantee commitments. However, information on all of these guarantees is difficult to come by, and it is not clear if all guarantees are active in the SME sector nor what utilization rates are. That said, per iGravity's data set, over 20% of the commercial banks in Kenya and 11% of commercial banks in Tanzania have a guarantee that is focused on general or agriculture sector SMEs.

[21] "Equity Bank signs Sh300m funding deal for farmers." Business Today News. August 2, 2017. https://businesstoday.co.ke/govt-equity-bank-sign-sh300m-kilimo-biashara-deal/
[22] Small and Medium Enterprise Credit Guarantee Scheme (SME – CGS). Bank of Tanzania. No date.
[23] Tanzania Report on Guarantee Schemes. Development Partners Group Tanzania. Working Group: Private Sector Development and Trade. http://www.tzdpg.or.tz/fileadmin/documents/dpg_internal/dpg_working_groups_clusters/cluster_1/psdtrade/Documents/Draft_report_on_gurantee_schemes.pdf
[24] "Tanzania's agriculture lender mulls guarantee scheme for smallholder farmers." The Citizen. March 1, 2018. http://www.thecitizen.co.tz/News/Tanzania-s-agriculture-lender-mulls-guarantee-/1840340-4324746-qcqvw/index.html

Table 3: List of known, active guarantees targeted at agriculture or general (or unknown sectors) SMEs in Kenya and Tanzania

	Organization	Partner Name	Expiration	Primary Target Segment	Maximum Guarantee Amount
Kenya	USAID	African Guarantee Fund	9/27/19	General	USD 12,000,000
Kenya	USAID	Chase Bank Kenya Limited	9/29/21	Agri	USD 10,000,000
Kenya	USAID	ABC Limited	9/29/23	Agri	USD 6,000,000
Kenya	USAID	Co-operative Bank of Kenya	9/29/23	Agri	USD 9,000,000
Kenya	USAID	Co-operative Bank of Kenya	9/29/23	Agri	USD 2,378,817
Kenya	IIA-Kenya	African Partner Pool	Unknown	Agri	-
Kenya	AGRA/IFAD/ Government to Kenya	Equity Bank	2019	Agri	USD 3,200,000
Kenya	AGRA/IFAD/ Government to Kenya	AFC	2019	Agri	USD 3,700,000
Kenya	Government of Kenya - Ministry of Agriculture, Livestock and Fisheries	Equity Bank	2027	Unknown	USD 2,977,682
Kenya	African Guarantee Fund	Gulf African Bank	Unknown	Unknown	USD 1,200,000
Kenya	African Guarantee Fund	I&M	Unknown	Unknown	USD 600,000
Kenya	African Guarantee Fund	Commercial Bank of Africa	Unknown	Unknown	USD 1,200,000
Kenya	African Guarantee Fund	Jamii Bora Bank	Unknown	Unknown	USD 955,000
Kenya	African Guarantee Fund	Unknown	Unknown	Unknown	-
Kenya	African Guarantee Fund	Unknown	Unknown	Unknown	-
Kenya	African Guarantee Fund	Unknown	Unknown	Unknown	-
Kenya	African Guarantee Fund	Unknown	Unknown	Unknown	-
Kenya	African Guarantee Fund	Unknown	Unknown	Unknown	-
Kenya	African Guarantee Fund	Unknown	Unknown	Unknown	-
Tanzania	USAID	CRDB Bank PLC	9/30/20	Agri	USD 5,000,000
Tanzania	USAID	Akiba Commercial Bank PLC	9/29/23	General	USD 5,000,000
Tanzania	USAID	Covenant Bank for Women Limited	9/29/23	General	USD 5,000,000
Tanzania	USAID	Covenant Bank for Women Limited	9/29/23	General	USD 5,819,071
Tanzania	USAID	CRDB Bank PLC	9/30/20	Agri	USD 5,000,000
Tanzania	USAID	Pride Tanzania, Ltd	9/30/20	Agri	USD 5,000,000
Tanzania	USAID	Equity for Tanzania Limited (EFTA)	9/30/20	Agri	USD 4,726,500
Tanzania	DANIDA	CRDB Bank PLC	Unknown	Unknown	USD 7,000,000
Tanzania	African Guarantee Fund	Unknown	Unknown	Unknown	-
Tanzania	African Guarantee Fund	Unknown	Unknown	Unknown	-
Tanzania	African Guarantee Fund	Unknown	Unknown	Unknown	-
					USD 95,757,070

6 Kenya Guarantee Scheme Diagnostics

In terms of guarantees schemes in Kenya, the initial conversations with banks held in April and May noted a variety of issues that have resulted in low guarantee utilization rates, including the limited scope of certain guarantees (for example, only for female-led SMEs or only for certain crops) as well as concerns over moral hazards.

Generally, the Kenyan market has numerous guarantees. Kenya currently has 47 known guarantees, of which 39 are active or presumed active and focus on either general or agricultural SMEs and in aggregate offer USD 159M in guarantee commitments, of which USD 60M has been utilized. While there are no comparative data sets of numbers of guarantees across countries, the USAID DCA data set reveals that Kenya has more than twice the number of guarantees as countries of comparable populations (i.e. Tanzania, Colombia, and Myanmar) over the same time period.

Guarantee Diagnostics

Conversations with key stakeholders and a literature review further elucidated some of the additional issues that impact the use of guarantee schemes in Kenya, including:

- **Geographical and sectoral limitations prove to be too limiting**: As mentioned in conversations with Kenyan banks, guarantee programs in other countries in Sub-Saharan Africa have also indicated that guarantees had to be re-designed after financial institutions were either not interested or not able to identify businesses that meet geographical or sectoral priorities of the guarantor.[25]
- **Guarantees can be administratively complicated**: Usually guarantees are very complex which, when combined with market forces, can depress utilization rates. Administrative issues cited by bankers include long eligibility processes, excessive due diligence requirements, quarterly reporting, expectations of lender capacity building, and occasional requirements to use alternative information systems. All of these processes are in addition to the bank's own credit approval processes, which also need to be met. Further, the efficiency of reimbursement processes can also impact utilization rates, as banks have noted a tendency to reduce the use of guarantee structures with cumbersome and long reimbursement structures.[26]
- **Moral hazard problem:** Banks fear that guarantee may incentivize poor borrower repayment behavior if they know about the guarantee.
- **Loss sharing:** Banks repeatedly mentioned that - as they need to cover part of any potential losses - they have limited incentives to channel a rejected loan application through the guarantee program (unless the borrower has good credit but is lacking collateral).

[25] "Miamidian, E. Analysis of Credit Lines and Guarantee Facilities: Promoting Access to Finance in Mozambique. FSD Mozambique. 2015.
[26] AFD Working Paper - Assessing Credit Guarantee Schemes for SME Finance in Africa - Evidence from Ghana, Kenya, South Africa and Tanzania. 2012.

Additionally, causes of poor guarantee performance cited in reports include:

- **Banks calculation for the utilization of guarantees is multi-faceted**: Banks typically calculate a full range of costs, including financial (i.e. fees), labor costs, expected value of claims repayment, and expected default rate. Expected value of re-payed claims is a key factor, as there can often be lengthy claim procedures that reduce the real value of the guarantee.[27]

- **High / poorly timed fee structure**: Banks complained about high fees, as well as a guarantee origination fee that becomes a sunk cost that cannot be priced into the loans. So, if a bank ends up using the guarantee, the effective rate for the fee per loan becomes rather low per loan, but the bank does not have certainty at the outset regarding utilization rates.

- **Banks realize they can charge higher interest rates**: As the guarantee fees are passed on to the customers, banks realize that certain customers will be willing to pay higher interest rates, which could incentivize the bank to lend without a guarantee and just charge more to cover the higher borrower risk profile.[28]

- **Guarantees are seen as having limited utility, even for banks**: In response to a question on a 2012 survey of Kenyan bankers on the "Single most important tool to expand bank lending to SMEs", bank managers ranked capacity building / TA support to banks, effective credit scoring systems, credit bureau establishment, and legal and regulatory reform all above credit guarantee schemes.

[27] AFD Working Paper - Assessing Credit Guarantee Schemes for SME Finance in Africa - Evidence from Ghana, Kenya, South Africa and Tanzania. 2012.
[28] AFD Working Paper - Assessing Credit Guarantee Schemes for SME Finance in Africa - Evidence from Ghana, Kenya, South Africa and Tanzania. 2012.

7 Guarantee Case Studies

Case Study: USAID DCA Kenya's KCB Loan Portfolio Guarantee [29]

Relevance

USAID DCA is the largest provider of known guarantees in Kenya and globally. It provided a loan portfolio guarantee to Kenya Commercial Bank (KCB), which is a large local bank with assets of over USD 5B, from 2006 to 2010 to expand the bank's ability to lend to SMEs operating in agribusiness, tourism, commerce, energy, and other sectors. The loan portfolio guarantee was then renewed for 2010 to 2017. This guarantee is included as a study because it is a rather typical loan portfolio guarantee that can be observed in the Kenyan market and thus could aid in understanding common design approaches and challenges.

Design

The 2006-2010 loan portfolio guarantee had a maximum commitment from USAID DCA of USD 3.95M (of which USAID covered 50% of the risk exposure, per its typical policy) and the 2010-2017 loan portfolio guarantee was slightly smaller at USD 2.87M. Notably, the guarantee was specifically designed to reach market segments that were considered "high risk" and target special sectors (such as agricultural production and processing, as well as others), although it seems that lending remained mostly concentrated in the retail and commerce sectors.

Image 3: USAID DCA Kenya's KCB guarantee outcomes

DCA LOAN GUARANTEES TO KENYA COMMERCIAL BANK

Starting Year	Ending Year	Guarantee Ceiling	Number of Loans	Aggregate Loan Amount	Utilization Rate % of Ceiling	Aggregate Loan Amount	Loan Tenor Months	
							Minimum	Maximum
2006	2011	3,950,000	1068	7,821,130	99.03%	7,323	3	48
2010	2017	2,875,000	847	5,716,230	99.410%	6,749	12	45

Source: KCB Transaction Summary Data

Impact

Both the loan portfolio guarantees were seen as successful, leveraging 2x the maximum commitment and having 99% utilization rates. Most obviously, the main impact of the guarantee was to allow KCB to set up a SME venture unit within the bank and grow this market segment. The guarantee also allowed KCB to expand collateral requirements for guaranteed loans to include stocks, motor vehicle logbooks, and personal guarantees. However, its overall high collateral requirements went unchanged and it seems that the bank has decided not to make any collateral adjustments to non-guarantee lending. Further, a majority of the loans went to working capital (versus investment in real assets) so only a limited number of borrowers were able to build their collateral base. Finally, while the loan guarantee program had fairly low additionality (only 12% of borrowers were new customers), these new customers are of a particular interest to GAIN, with KCB expanding its clients to include sole traders, small companies, and SACCOs (Savings and Credit Cooperative Organizations), all of which are typical industries within the value chain of nutritious foods.

[29] KENYA DCA 2006 AND 2010 GUARANTEES EVALUATION. Final Report. June 2013. USAID DCA.

Key Success Elements and Lessons Learned

A key success element for high utilization rates was partner selection, as it was actually KCB that approached USAID DCA after it had already made the strategic decision to focus on the SME market and began developing products to capture the sector. Further, with additional technical assistance support provided by USAID DCA through another capital pool, KCB was able to benefit from internal trainings that accelerated the use the guarantee, with the 2010-2017 guarantee reaching 99% utilization in the first year. At the same time, even though the partner fit between KCB and USAID initially appeared to be very high, it seemed that KCB regressed regarding its SME lending after the expiration of the guarantee, again highlighting that sustainable bank behaviour change regarding markets, products, and collateral requirements is very difficult.

Case Study: Portable Guarantee

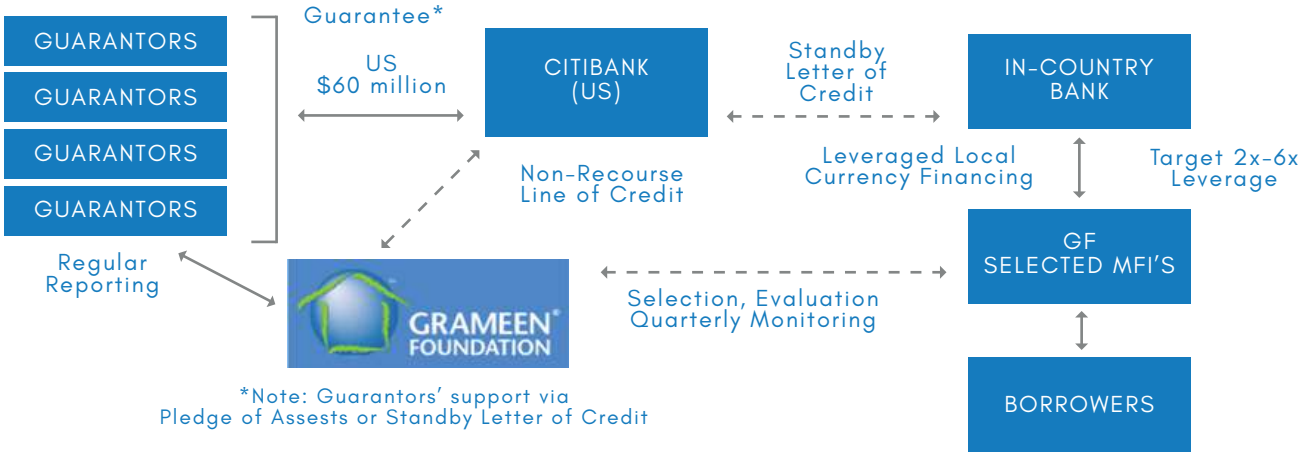
Relevance

The Grameen Foundation (GF) Growth Guarantee (GG) program[30] operated from 2008 to 2015 as a tripartite relationship between USAID DCA (through a USD 32.5M guarantee), GF, individual donors from Schwab Charitable, and Citibank (through a standby letter of credit) to catalyse local currency lending through local financial institutions to qualifying microfinance institutions (MFIs).[31] This study is included as a case study in this report as an example of a portable guarantee program that successfully graduated borrowers from guarantee-based commercial borrowing to borrowing without a guarantee, indicating a sustained behaviour change of banks' risk perception of its MFI borrowers.

Design

Each MFI had to meet minimum criteria (in terms of number of clients, portfolio size, mission, financial sustainability and operational quality as measured by portfolio at risk >30 days) that allowed them to be eligible for a partial, principle guarantee ranging from USD 1-5M and an un-funded[32] standby letter of credit which had a guarantee fee of up to 6% (which was historically issued at between 2-4%) to cover Citibank's issuance costs and GF's team costs.[33] GF chose the standby letter of credit option (which is a tool that USAID has recently started to employ) as it is a rather simple format that allows money to flow directly to the local banks in case of default.

Image 4: GF's Growth Guarantee Program



[30] The Growth Guarantees Program. Grameen Foundation. 2010.
[31] As MFIs typically struggle to raise local currency financing compared to commercial banks that have access to deposits, this feature was especially important to MFIs access to capital at the time.
[32] The SBLC was backed by high net worth donors that were known to Citibank, so no cash was kept at the bank to back the letters of credit.
[33] Grameen Foundation Growth Guarantees. Capital Management and Advisory Center. No date.

Image 6: GG's key terms and conditions

CATEGORY	GUIDELINES
SBLC Amount	Minimum guarantee is USD 100K, maximum is USD 5 million.
SBLC Structure	USD, irrevocable SBLC available upon first demand. The GF guarantee is a partial guarantee covering principal only.
SBLC Tenor	Maximum 5 years.
SBLC Purpose	Used to leverage local currency financing, for loan portfolio expansion, not working capital or capital expenditures.
Target Leverage on SBLC	GF guarantee should be leveraged 5-10x by local commercial banks.
Guarantee Fee to MFI	Up to 6% annually on the SLBC amount. The fee will cover: 1) the cost of the issuances of the SLBC by Citibank to Local Bank, and 2) a portion of GF's costs to provide the guarantee and its value-added services.
Type of Guarantee	Pari passu or first loss guarantee. Guarantee covers principal only.

Impact

Globally, GG was able to leverage USD 32.1M in private financing to catalyse USD 200M in local currency loans for 19 MFIs across 12 countries at ticket sizes between USD 2-20M. In Africa specifically, the GG program provided USD 7M in guarantees to 5 partners which resulted in USD 16.1M in local currency financing to MFIs in Ethiopia and Nigeria. In terms of impact, while initially the program provided 100% guarantees, the coverage percentage was gradually lowered to 50%, then 25%, and then to a first-loss guarantee on 10% of the portfolio, which was still of interest to participating banks. Further, many MFI partners graduated to working with the banks without a guarantee, which indicates long-term bank behaviour change which has been notably difficult to achieve according to evaluations of other guarantee programs. At the same time, interest rates were either unaffected or marginally reduced (i.e. 50 bps) by the guarantee (noting lowering interest rates was not the focus of the program) and it had a 0% default rate on the guarantee pool, which calls into question the additionality of the program.

Key Success Elements and Lessons Learned

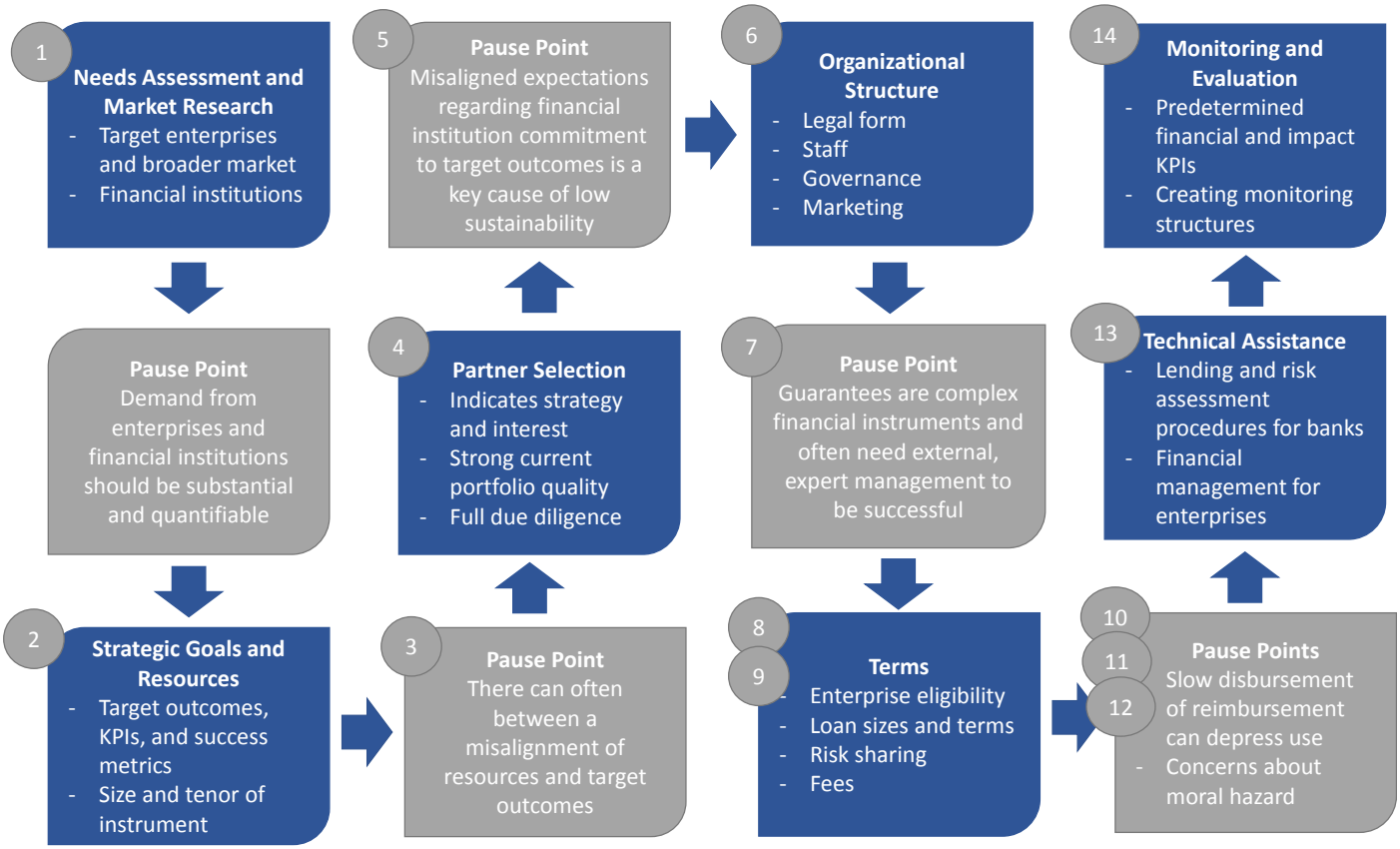
A key element of success was USAID DCA delegating full authority in managing the program to GF (including selecting, evaluating, issuing and monitoring guarantees to MFIs), which was allowed based on its technical track record and qualified team, indicating the need for a highly technical managing partner for such a scheme. In terms of human resources, the guarantee was managed by a team of six (one director, 2-3 analysts, 1-2 associates), but also had global coverage and performed due diligence in person.

8 Bank Guarantee Scheme Best Practices

Best Practices for Development Guarantees

Based on the case studies, other reports and studies, and background interviews, this list is a compilation of best-practices in the design and implementation of bank guarantee schemes, especially for those which focus on the SME market in developing countries.

Image 5: iGravity's framework for structuring credit guarantees



1 Research-based planning

Any guarantee scheme should only be considered once market research has been completed that shows a quantifiable demand exists for both the financial institutions and the SME borrowers.[34]

2 Capitalization and leverage ratio

Undercapitalization is one of the major sustainability concerns associated with guarantee arrangements, with USAID DCA recommending at least USD 1M as the minimum acceptable size of a fund. The minimum capitalization for a guarantee fund depends mainly on the following factors: coverage area, number of loans and average size, loan tenor, maximum guarantee coverage, default rates and operating costs versus fee revenue. Guarantees are leveraged capital (i.e. they are able to catalyze more lending than the amount of capital supplied by the guarantee), with leverage ratios in different markets depending on a variety of factors. For SMEs in emerging markets, ratios can range from 2.5-10x, with an average found of 3.3.[35]

3 Designing with limitations in mind

Guarantee schemes serve very specific purposes to address certain market failures and are not a silver bullet to providing finance to certain groups of target beneficiaries that may not qualify (or be ready) for loan capital. As such, any guarantee scheme should have very clear and strict eligibility criteria for potential borrowers and clear KPIs.

4 Partner selection and due diligence of the partner

The relationship between the guarantor and the financial institution will last between 5-10 years, so it is very important to do a thorough partner due diligence before or during the guarantee design process. Potential partners should be mature banks with high liquidity and low PAR, reflecting functional risk management mechanisms. Further, the banks must be assessed for their governance, their genuine interest in the sector or instruments targeted by the guarantee, and their ability to functionally operate in the geographic areas where target groups are located.

5 Sustainability

Guarantee products are meant to serve as a pilot project of sorts in order to produce demonstration effects which play a catalyst role in transforming the perspective of partner banks to comfortably continue lending to targeted borrowers after the guarantee is no longer in place. Thus, increased exposure of partner banks to the targeted sector or class of borrowers after a guarantee expires is a key outcome indicator that is often difficult to achieve.

[34] Hamp, M., Rispoli, F., Agwe, J., and How to Do Loan Guarantee Funds. IFAD. 2014.
[35] Varangis, P., and Bouri M. Partial Credit Guarantee Schemes to Promote Agricultural Finance. Finance and Market Global Practice. World Bank Group. 2016.

6 Organizational structure

Guarantee schemes can take a variety of structures depending on the complexity of the guarantee proposed. When considering a national or regional-level loan guarantee fund, numerous expert organizations (including IFAD and FAO), note that guarantees that are structured as specialized, independent legal entities managed by professional companies are typically more successful than "multi-purpose" models (where guarantees are one of the organization's many activities). As an independent company, the guarantee manager should have specialized staff with executives with relevant private sector experience, proper legal frameworks, independent supervision, its own corporate governance strategy, internal controls, etc., as well as agreements among partners that clearly delineate the rules and responsibility of the guarantee provider vis-à-vis the financial partners. For more limited guarantee programs, less formal or independent structures could be considered, with the strong caveat that management and monitoring of any guarantee program is very complex and requires full and specialized management attention.[36]

7 Appropriateness of the design

The inherent design of a guarantee scheme is directly or indirectly related to the outcome and impact of the scheme, with the weakness of early guarantee schemes able to be avoided through proper design and institutional arrangement.[37] For example, targeting riskier types of borrowers through strict eligibility criteria may have a positive impact on additionality by discouraging partner banks from using the guarantee for average risk borrowers, but may also reduce utilization and generate adverse selection effects.[38] An effective design needs to strike a balance between the objectives of utilization, additionality, and financial sustainability. Further, the design should include a timeframe for the bank to develop and test its own products for use during and after the guarantee as a potential method to improve sustainability.

8 Risk sharing

There are a variety of risk sharing mechanisms that can be implemented into guarantee designs. It seems that the majority of loan guarantee funds have implemented a policy of *pari passu*[39] sharing of total losses. The second-most-common approach is over 50% sharing of total losses. For both of these, the focus on total losses means the bank may have an incentive to pursue the defaulting borrower in order to try to recover something from the guarantee such as collateral to be resold. Another option is the first loss mechanism, which is easier to implement, but is detrimental to guarantors as it can quickly lead to fund depletion. The four main components of risk sharing are: the percentage of coverage, the capital covered (i.e. principal and / or interest), the type of coverage, and the recovery processes.

A **Coverage percentage** Most guarantees offer 50% coverage, with a typical range of 30-85%.[40]

[36] Hamp, M., Rispoli, F., Agwe, J., and How to Do Loan Guarantee Funds. IFAD. 2014.
[37] Green, A.. Credit Guarantee Schemes for Small Enterprises: An Effective instrument to promote private sector-led growth?, SME Technical Working Paper Series. UNIDO. 2003.
[38] Saadani, Y., ArvaiY, Z., Rocha, R. A review of Credit Guarantee Schemes in the Middle East and North Africa Region. The World Bank. 2010.
[39] Pari-passu (A Latin phrase meaning "equal footing - in finance, pari passu refers to situations where two or more parties have equal rights or obligations) guarantee.
[40] Review of Credit Guarantee Schemes. FSTD. No date.

B **Capital covered** Most guarantee schemes offer coverage of the principal, with others covering the principal and all or part of the interest payments, which increases the risk profile.

C **Type of coverage**

- ***First loss*:** The guarantor agrees to pay out all the initial losses up to a specified limit before other parties participate in risk sharing. Very few guarantors accept first loss guarantees.
- ***Pari passu:*** Both parties share final losses evenly. This is the most popular structure.

D **Recovery processes** Recovery processes should be as swift and efficient as possible, but also incentivize banks to take all steps necessary to make recoveries via loan collection procedures.

9 Fees

Guarantees should not be a subsidization tool and pricing should reflect market rates to ensure the long-term viability of the guarantee. While typical pricing ranges between 1.0 -2.5%[41], there are multiple methods of implementing guarantee fees. USAID DCA - as one of the leading guarantee providers - has a dual fee structure: an origination fee of .5% on the entire maximum portfolio amount and an annual utilization fee (which is an incentive to use the guarantee as agreed upon) of 1.5% on the cumulative outstanding principal loan. Other organizations, such as AGF and SIDA, have the same fee structure as USAID, but with slightly different rates. For example, SIDA offers a .75% origination fee and a .5% utilization fee. Other organizations offer "annual risk sharing fees", which typically range from 1-4%. That said, some reports note that non-profits and NGOs offer even lower fees to incentivize lending to specific target borrowers.

10 Efficient processing and payments of claims

This is one of the greatest determinant of a scheme's impact and sustainability. Partner banks tend to get increasingly frustrated by the slow processing of claims and become reluctant to process new loans under the scheme.[42] While policies depend on the guarantee structure, most schemes in Tanzania (and presumably in Kenya as well) pay 50% of a default claim within 60 days of receivership and the remaining 50% after the loan recovery process has been completed. That said, in agricultural schemes that often have warehoused goods as collateral, many guarantees require the partner banks to go through the entire loan recovery process to settle defaults.[43]

11 Moral hazard

At the borrower level, there is the risk of moral hazard based on the idea that the borrower knowing their loan is guaranteed will reduce their commitment to repay. This risk can be reduced, however, by the creation of credit reference bureaus that would heighten the risk of a default impacting their future access to credit. Further, experience from DCA USAID shows that this can be avoided by explaining to the lender that borrowers should not be aware that their loan is under guarantee, but that can be a violation of client protection principles which call for transparency and fair pricing across the industry.

[41] Varangis, P., and Bouri M. Partial Credit Guarantee Schemes to Promote Agricultural Finance. Finance and Market Global Practice. World Bank Group. 2016.
[42] Review of Guarantee schemes in Tanzania, FSTD.
[43] Review of Credit Guarantee Schemes. FSTD. No date.

12 Utilization

This is the key output indicator for loan portfolio guarantees as it is a measure of the appropriateness of the product for a bank. The most common measurement is the total amount of loans disbursed under the guarantee program as a percentage of the potential maximum coverage amount. DCA has found that the utilization rate is usually a function of various elements including the time since signing the guarantee (utilization is typically low in the first two years of the agreement and then increases), internal preparation of the banks, commitment to and understanding by the senior management, dissemination of the necessary instructions to branches, etc. Further, other guarantors have noted that the efficient processing of payments can have a significant impact on utilization, as some banks get discouraged by slow or arduous reimbursement processes and stop utilizing the guarantee.

13 Technical assistance and technical acuity

Both the borrowers and the partner financial institutions will likely need comprehensive technical assistance packages, which should be designed to be as targeted as possible. Additionally, the guarantor itself needs to have the technical capacity to be able to manage the partner institution, provide additionality in terms of borrower appraisal, and process requests for reimbursement in a timely manner, which requires technical sophistication and specialization.

14 Monitoring

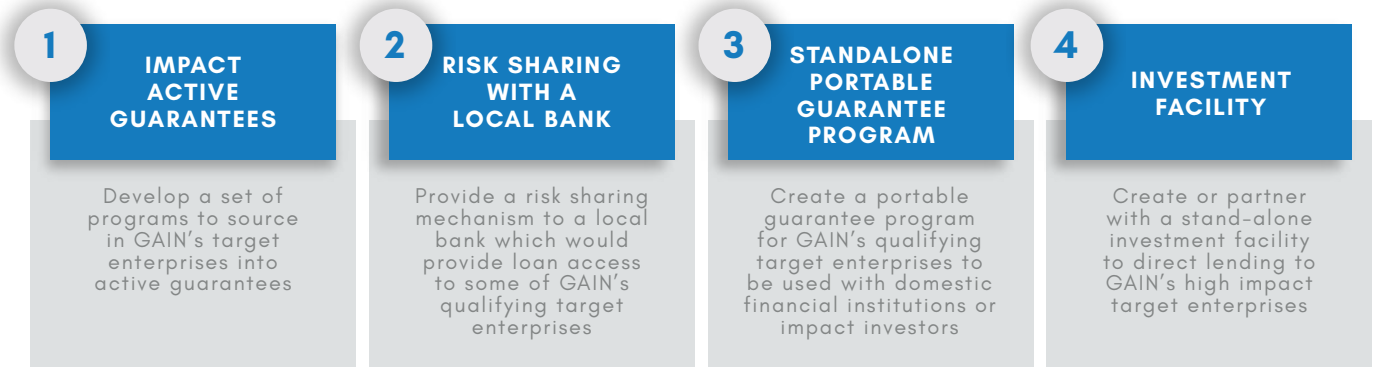
Monitoring is an important component for the guarantee scheme to work well. Reporting schemes should be designed to include reporting on a financial level and impact level (especially for key indicators such as credit additionality), as well as reports in variances against pre-agreed upon product plans and financial models.

9 Strategic Options

Strategic Options

Based on the scope of this project, findings from the literature review, and conversations with experts, iGravity proposes four different options that GAIN or other nutrition investors could pursue as they continue to engage in the field of nutrition finance. None of these options are exclusive, so depending on GAIN's resources and priorities, multiple options could be pursued at the same time. These options differ to the extent they try to work more "top-down" at the systemic level (catalyzing change across the market, but in a much longer timeframe), or bottom-up with an identified portfolio of enterprises (generating immediate impact on a smaller set of companies). All of the proposed mechanisms will need to be assessed to the extent they help to alleviate some of challenges faced by GAIN's target enterprises and help the organization achieve its goals in the nutrition foods finance space.[44]

Image 6: Overview of different risk sharing mechanism options



Assessment and Comparison of Risk Sharing Options

The above options represent a range of potential methods for engaging with the financial and investment sectors to work towards achievement of GAIN's stated goals. As noted, different options require different resources and also have different expected impacts, as captured in the table below.

[44] The original report (non-public veruison) includes a detailed description on the main fetaures of these mechanisms.

Table 4: Comparison of risk sharing mechanisms – investment and return

	Minimal Capitalization	Estimated Leverage	Estimated ROI	Creation of New Entity	Improves Borrowing Terms for Target Enterprises	Most GAIN Enterprises Eligible	Sustainability	Scalability
Option 1: Impact Ongoing Guarantees	USD 0	Low	NA	No	No	No	NA	Low
Option 2: Portfolio Guarantee to a Bank	Fit to demand, likely USD 1M	Medium	1-1.5%	Maybe	No	No	Low potential	Medium potential
Option 3: Standalone Portable Guarantee Program	Fit to demand, likely USD 1M	Medium	1-1.5%	Maybe	Maybe	Yes	Low potential	High potential
Option 4: Creating / Partnering with Investment Facility	Fit to demand, likely USD 5M	Low	5-10%	Maybe	Yes	Maybe	Medium to high potential	High potential

Social metrics for potential outcomes need to be defined as well. Some of them apply for all four options, whilst others are more specific. Examples of outcomes KPIs could be:

- Number of loans and value of loans provided to enterprises in nutritional foods value chains
- Post-program portfolio growth rates (capacity and priority of partner banks for expanding lending to target businesses after the loan portfolio guarantees have expired, ensuring sustainability)
- Cost-effectiveness of the guarantee to partner banks
- Lowered collateral requirements
- Financing approval rates
- Greater product diversity
- Geographical coverage
- Leverage (i.e. value of credit generated per unit value of the guarantee fund)
- Outcomes and impact of guarantees on beneficiaries and their livelihoods
- Borrower repayment rates
- Governance and management
- Enterprise growth rates
- Facility financial returns and exits

In addition to the criteria listed above, GAIN could also consider developing a conceptual or analytical framework to assess and compare the efficiency of the resources deployed, i.e. in which enterprise does one USD spent achieve the greatest nutritional outcomes.

10 Conclusions

Loan guarantee programs are one of many innovative financing mechanisms that GAIN or other nutrition financers could employ in efforts to grow nutrition financing in Kenya and Tanzania. However, these programs are rather complex to put in place and while they ease access to finance for target enterprises there is no evidence of a long-term impact in improving financing terms for enterprises in specific sectors. As this report has noted, there are a relatively high number of guarantees in East Africa (especially Kenya) when compared to other regions, and a number of these guarantees are reportedly flawed, resulting in sub-optimal utilization and no known guarantees that specifically and systemically target GAIN's target beneficiaries.

With this in mind, and drawing from the best practices outlined in this report, GAIN or other nutrition financers could employ a number of different risk sharing mechanisms to support lending to enterprises in nutritional foods value chains, including: i) impacting ongoing guarantees, ii) creating a guarantee with a local bank, iii) creating a standalone portable loan guarantee program, or iv) creating or partnering with a domestic investment facility. While taking into account that next steps are likely to be driven by the availability, ability, and willingness of potential financial institution and investment partners, investors could pursue a multi-fold approach:

1. **Engage with ongoing guarantee programs that focus on general or agriculture SMEs** by working closely with guarantors and making introductions between the financial institutions covered by these guarantees and a portfolio of potentially eligible borrowing enterprises.

2. Mandate targeted market research that shows the potential nutritional impact of a "nutrition-lense" lending approach and **work at the systemic level ('top-down') to push local financial institutions and funds to integrate such an approach in all their agri-business investments.** This will require a framework to guide investors in their appraisals and could include the creation of incentive programs such as interest-rate buy-downs linked to nutritional outcomes of loans.

3. If supported by market demand and if there is a lack of traction with the ongoing guarantee programs, stakeholders could **create a portable guarantee scheme across Kenya and Tanzania to support quality enterprises that are operating in nutritious foods value chains**, including by providing "nutrition-lense" eligibility criteria for companies and financial institutions.

4. Finally, to catalyse non-bank investing into the space, investors could **identify and support the top 10-15 most innovative businesses for nutrition in Kenya and Tanzania through launching a local investment facility**. Such an initiative will take more time to generate, but if done correctly, will likely draw more investment dollars towards nutrition, provide support to the most innovative nutrition companies, and prove the "investability" of the sector.

Any or all of these options have their own benefits and challenges, but would be a great first step in utilizing finance to promote a nutrition agenda and ultimately improve nutritional outcomes in the region.

This public report is a condensed version from the original report.

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