

How to Address Unique Risks in Agriculture Credit Guarantee Schemes

Lessons Learned from Credit Guarantees for Agriculture



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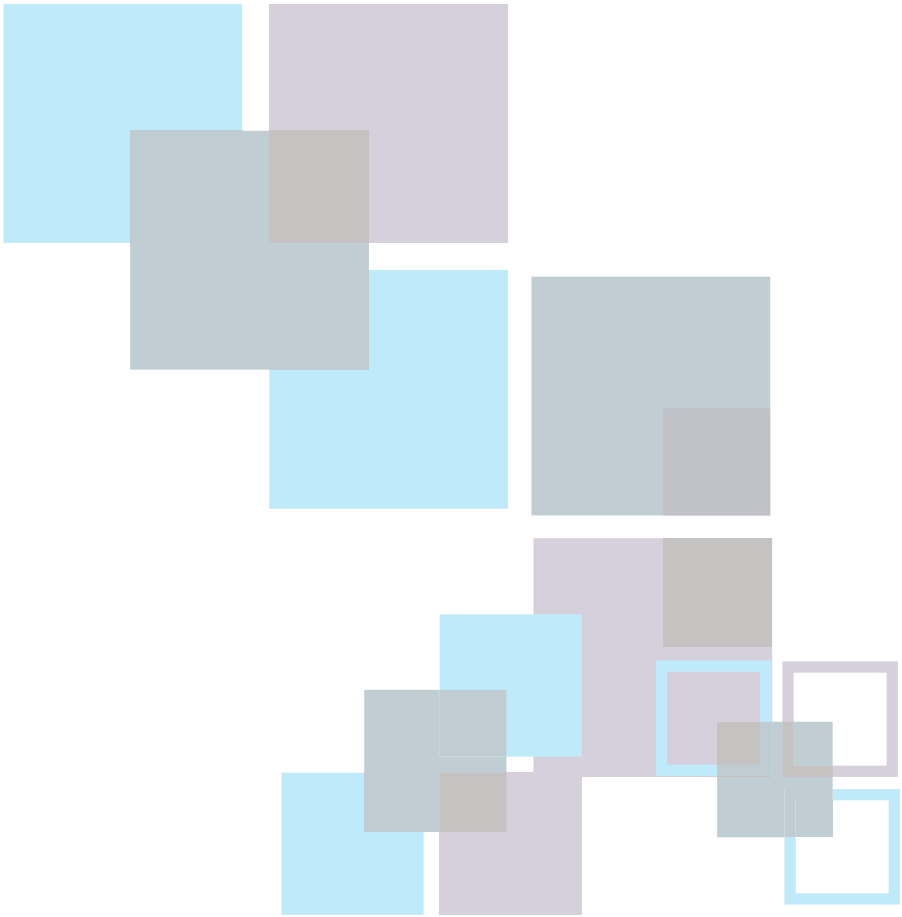






Abbreviations and Acronyms

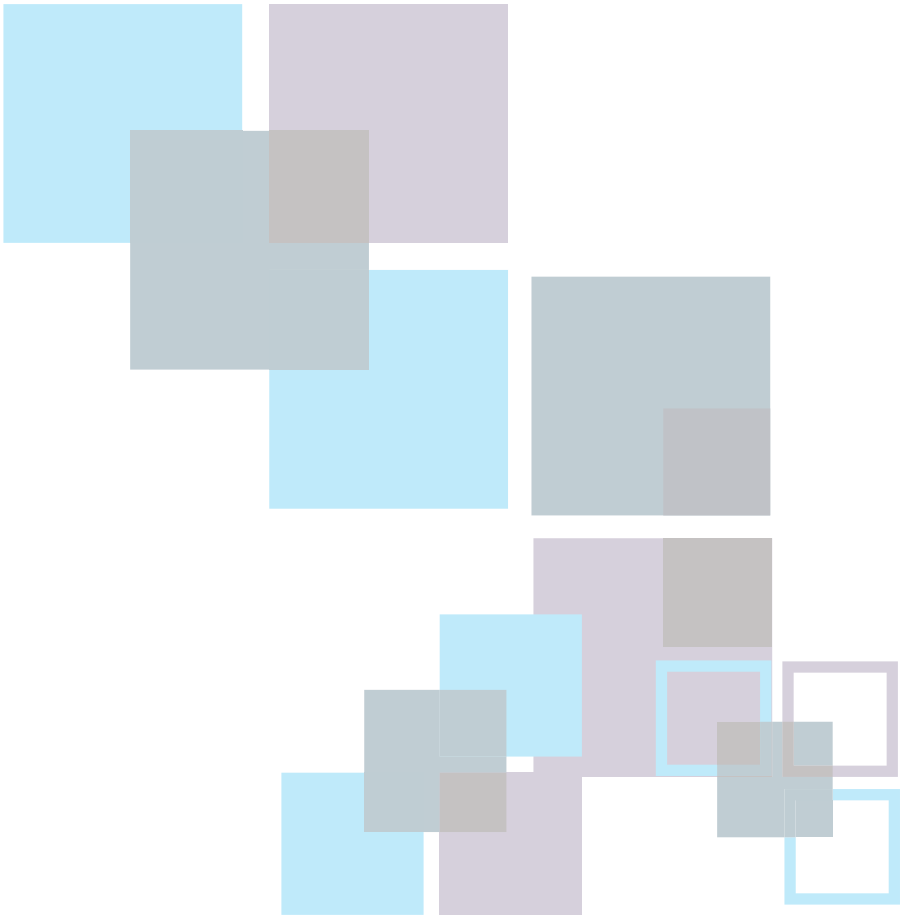
AGFP	Agricultural Guarantee Fund Pool
BAC	Banco Agrario de Colombia (Agricultural Bank of Colombia)
BoK	Bank of Kigali
CGS	Credit Guarantee Scheme
DA	Department of Agriculture
DCA	Development Credit Authority
FAG	Fondo Agropecuario de Garantias
FAO	Food and Agriculture Organization of the United Nations
FINAGRO	Financing Fund for the Agricultural Sector
GB	Governing Board
ILO	International Labour Organization
MFI	Microfinance Institution
MGA	Mutual Guarantee Association
NPL	Non-Performing Loan
PASS	Private Agricultural Sector Support Trust
PFI	Partner Financial Institution
PMO	Program Management Office
RCGF	Rural Credit Guarantee Fund
SMEs	Small and Medium Enterprises
UNIDO	United Nations Industrial Development Organization





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Introduction

Credit guarantee schemes (CGSs) are considered a useful tool to facilitate access to finance in the priority segments of the economy, such as small and medium enterprises (SMEs) and agriculture, which remain largely underfunded. Important knowledge contributions in CGSs have been made on the structure and function of the CGSs through analyses of existing schemes. Among others, the United Nations Industrial Development Organization (UNIDO) and International Labour Organization (ILO) have published practical guides on how CGSs are structured and managed.¹ In 2013, the Food and Agriculture Organization of the United Nations (FAO) analyzed CGSs focusing on rural and agricultural enterprises.² The World Bank and industry experts established a list of principles for public credit guarantees for SMEs.³ The 16 principles cover four important aspects of successful CGSs: (1) legal and regulatory framework; (2) corporate governance and risk management; (3) operational framework; and (4) monitoring and evaluation.

Table 1: The Principles for Public CGSs for SMEs

Legal and Regulatory Framework
1: Establish the CGS as an independent legal entity.
2: Provide adequate funding and keep sources transparent.
3: Promote mixed ownership and treat minority shareholders fairly.
4: Supervise the CGS independently and effectively.
Corporate Governance and Risk Management
5: Clearly define the CGS mandate.
6: Set a sound corporate governance structure with an independent board of directors.
7: Design a sound internal control framework to safeguard operational integrity.
8: Adopt an effective and comprehensive enterprise risk management framework.

Operational Framework

- 9: Clearly define eligibility and qualification criteria for SMEs, lenders, and credit instruments.
- 10: Ensure the guarantee delivery approach balances outreach, additionality, and financial sustainability.
- 11: Issue partial guarantees that comply with prudential regulation and provide capital relief to lenders.
- 12: Set a transparent and consistent risk-based pricing policy.
- 13: Design an efficient, clearly documented, and transparent claim management process.

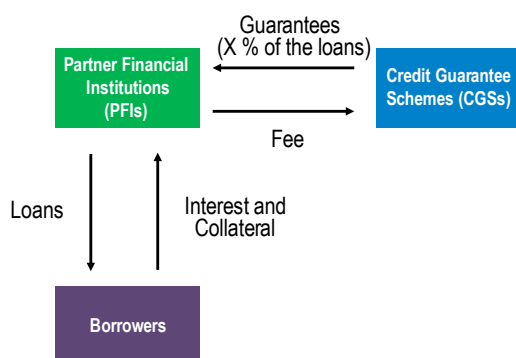
Monitoring and Evaluation

- 14: Set rigorous financial reporting requirements and externally audit financial statements.
- 15: Publicly disclose nonfinancial information periodically.
- 16: Systematically evaluate the CGS's performance and publicly disclose the findings.

Source: World Bank (2015).

The basic structure of CGSs does not seem to be very different regardless of whether they focus on SMEs or agriculture. CGSs share credit risk with their partner financial institutions (PFIs) in exchange for the guarantee fees. PFIs are expected to lend to broad classes of pre-defined target borrowers, and CGSs issue guarantees to cover a pre-determined percentage of the loan value.⁴ The public or donor-initiated CGSs are mostly funded through public funds. In comparison, mutual guarantee associations (MGAs) (also known as reciprocal guarantee companies) are member-funded CGSs. The members, usually a large number of small companies from the same industry and/or geographic location, contribute capital and provide guarantees to borrowing members based on mutual trust.⁵

Figure 1: Core Function of CGSs



While CGSs could partially substitute the limited assets that target borrowers possess against collateral requirements, the interest rate and collateral requirements usually reflect the credit risk of the borrowers and projects, which motivates the borrowers to repay. As the PFIs learn about the target borrowers and recognize new business opportunities through CGSs, additional lending activities are expected to happen even without guarantees.⁶ At the same time, excessive risk mitigation and preventive measures (e.g., excessive interest rates and collateral requirements) could potentially be reduced in future loans. One of the key success factors of CGSs is having clear and mutually accepted risk-sharing agreements among lenders, borrowers, and CGSs to enhance lending, while keeping adequate incentives for proper assessment and loan follow-up to keep default and payouts as low as possible.⁷ Any substantial changes in the risk sharing will alter the incentives of respective players and as a result could weaken the CGSs. For example, guarantees close to 100% by CGSs reduce the incentives for PFIs to properly appraise and monitor the loans. Lenders also need to send the right signal to borrowers by requiring market-based interest rates and collateral to secure the repayment.⁸

Despite the standard function of CGSs, the credit risk they face varies widely by diverse factors, such

as macroeconomic conditions, capacity of PFIs and borrowers, and sector. Agriculture is usually considered highly risky and more difficult to finance/guarantee than other sectors such as manufacturing. The sector-specific risks and challenges in lending stem from various well-known reasons: (1) reliance on climatic conditions, which render the sector prone to natural disasters such as drought and flood; (2) widely dispersed and heterogeneous producers and other value chain actors, including farmer organizations, processors, and traders; (3) seasonal and bulky financial requirements, along with limited physical assets for collateral; and (4) a long history of political interventions that sometimes create a prohibitive environment for financial services. Among other factors, natural disasters in particular make loan portfolio management challenging and have significant implications in the risk management of CGSs.

Due to these challenges, financial institutions in developing countries have traditionally avoided lending to the agriculture sector even in cases where there is ample liquidity. Despite the presence of abundant agriculture-related activities in the economies, financial institutions lean towards lending to other sectors and/or investing in government securities. The agriculture sector is not usually considered a priority sector by many managers at financial institutions, and the loan officers lack sector-specific knowledge required to properly analyze the potential opportunities and risks in the sector. There is a small group of institutions, including microfinance and cooperative financial institutions and some governmental and private banks, that successfully manages risks in agriculture lending through tailored solutions such as value chain financing arrangements and specialized lending products. However, these attempts have not been mainstreamed in many developing countries.

Besides the reluctance in lending among the supply side of agriculture finance, additional difficulties exist on the demand side. Farming activities in many

developing countries remain largely at the subsistence level, especially for food crops. Commercial activities in cash crops are generally not well organized or managed, leaving a limited number of creditworthy projects in the market. As a result of these challenges in both supply and demand sides of the finance as well as the inherent risks in the sector, the agriculture loan portfolio tends to have higher nonperforming loans (NPLs) compared to the overall portfolio. For example, research on CGSs in Tanzania found that default in CGSs for agriculture was almost always over 10% and was as high as 30%, whereas that of CGSs for SMEs remained between 5% and 10%.⁹ According to a recent FAO analysis, the claim rate should be lower than 3% for CGSs to be sustainable and successful.¹⁰ CGSs with high payouts are bound to become unsustainable and eventually fail.¹¹ If the profit margin of the CGS operation is limited or losses are high, CGSs easily become a money-losing operation and start decapitalizing. The lower level of capital to guarantee loans diminishes the confidence among PFIs, leading to a lesser number of guarantees and smaller fee revenues.

Sector-specific CGSs, including agricultural CGSs, have another important disadvantage since they typically have a narrower scope of risk diversification across sectors. This diminishes one of CGSs' critical contributions in the financial market.¹² Targeting that is too specific may also increase the management costs of CGSs and reduce utilization of schemes.¹³

Despite these risks and disadvantages, there have been numerous cases of agriculture-focused CGSs pursuing higher additionality and development impact. For example, many USAID Development Credit Authority (DCA)¹⁴ guarantee programs target the agriculture sector. The Private Agricultural Sector Support Trust (PASS) in Tanzania is another donor-initiated guarantee scheme for the agriculture sector. The cases in this study include public CGSs focused on agriculture to pursue development impact. Moreover, corresponding to the substantive share of agriculture in GDP and large rural

population, CGSs for SMEs in developing countries tend to have a sizable exposure to agriculture-related businesses. Some CGSs possess deep agriculture sector knowledge to identify potential borrowers for PFIs. This value-added function and intelligence improve their capacity to assess the sector, prevent excessive risk taking, and contribute to increased trust of borrowers and lenders in CGSs.¹⁵

What are the key success factors for the agriculture CGSs? Are there any design features/interventions to minimize the above drawbacks? This paper tries to draw some lessons learned specific to agriculture CGSs based on some case studies in developing countries, and aims to provide useful insights for future interventions, including World Bank projects. These lessons learned focus on risk management and operational features of the CGSs serving the agriculture sector. Other critical aspects of CGSs,

such as legal and regulatory framework, corporate governance, and monitoring and evaluation, are largely applicable to any CGSs regardless of the sector focus, and thus will not be covered in this discussion. The impact and additionality of CGSs are also outside of the current focus. This discussion does not intend to override previous efforts, especially the principles for SME CGS, which already provide a standard guideline on designing and managing public CGSs.

The paper consists of four sections. The introduction is followed by a summary of six cases of agriculture CGSs in developing countries. The third section provides a brief analysis and focuses on lessons learned, and the fourth section offers conclusions. A deeper description of the cases is presented in the annexes.



Agricultural CGS Case Summaries

Given agriculture’s unique characteristics and importance in economic development, many CGSs partially or exclusively target borrowers in the agriculture sector. A recent FAO study analyzed 16 such CGSs,¹⁶ and a World Bank survey also covered some agriculture CGSs.¹⁷ The purpose of the case studies in this paper is to extract lessons learned that contribute to the deeper understanding of this special segment of CGSs. The cases focus as much as possible on the agriculture CGSs that disclose information publicly and that were not covered in the preceding studies. A total of 10 CGSs are reviewed (see annex 1), of which six cases with interesting features and detailed information are summarized in this section. The cases include CGSs established by donors and/or governments. The list is by no means comprehensive or exhaustive. The detailed description of these cases is in annex 2.

Fondo Agropecuario de Garantias (FAG) (Colombia)

Target sector	Agriculture (smallholder production)
Guarantee coverage	50–100% depending on the size of the producers
Target loans	Not available
Fee structure	1.5–5.9% (depending on the recipients and term of the loan)
No. of PFIs	Open to all the financial institutions, but mainly used by BAC (Banco Agrario de Colombia - Agricultural Bank of Colombia)
Claim/Loss	6% (in 2014)
<p>Major findings:</p> <ul style="list-style-type: none"> • The guarantees cover the loans from PFIs funded through FINAGRO (Financing Fund for the Agricultural Sector), a second-tier public agriculture development bank, which requires on-lending to small farmers at below-market interest rates. • The annual guarantee fee ranges from 1.5% to 5.9% depending on the loan size and duration. • FAG plays a dominant and important role in financing smallholder farmers in the country. • The default rate is rather high (6% in 2014) and the guarantee fees are not sufficient to cover the costs, leading to capital depletion despite the annual subsidies from FINAGRO’s earnings to FAG. • FAG guarantees are often compensated by other guarantees, which reduces the exposure of BAC and provides weaker incentive for proper risk management. 	

USAID Development Credit Authority (DCA) (Honduras)

Target sector	Agriculture and agribusiness
Guarantee coverage	50%
Target loans	Up to US\$100,000 per borrower (average: US\$2,675)
Fee structure	1% (charged by DCA)
No. of PFIs	One (José María Covelo Foundation)
Claim/Loss	11.9% (entire period of the project)
<p>Major findings:</p> <ul style="list-style-type: none"> • The guarantee scheme was developed and implemented as part of the USAID program in 2003 and 2005. • An accompanying USAID project on rural and agriculture development provided technical assistance support to the PFI as well as farmers and entrepreneurs targeted by the DCA guarantees. • The DCA guarantee boosted agriculture lending of the PFI from HNL 380,000 in 2003 to over HNL 23.5 million (approximately US\$1.25 million) in 2009. This impressive expansion was mainly due to strong commitment by the PFI, which strategically used the DCA guarantees to jumpstart the agriculture lending. • The PFI gradually expanded its lending activities to farmers outside of the target of the guarantees as it accumulated experiences and built a network with various producers' associations. Over 80% of its loans outstanding in the agriculture sector were not guaranteed by DCA in 2009. • As the DCA guarantee was not meant to be sustainable, the PFI seemed to have more freedom to experiment with lending to riskier borrowers, which is reflected in its relatively higher loss rate (11.9%). • The PFI shared credit information with public and private credit bureaus, which allowed other financial institutions to access borrowers' data. 	

USAID DCA (Moldova)

Target sector	Agriculture and agribusiness
Guarantee coverage	50%
Target loans	Up to US\$500,000
Fee structure	1% (charged by DCA)
No. of PFIs	One (FinComBank)
Claim/Loss	1.0% (entire period of the project)
<p>Major findings:</p> <ul style="list-style-type: none"> • The target borrowers are SMEs in agriculture production, agro-industries, and related sectors such as transportation and services. • The PFI had a strong strategic interest in the agriculture sector and expanded its network outside of the capital city while working with the DCA. (The number of staff in its representative office was almost doubled for the five years when the DCA was active). 	

- Both the number and volume of the agriculture loans of the PFI more than doubled from 2004 to 2008. The bank provided a total of 75 loans; 43% of the loans went to first-time borrowers, most of whom had been declined previously due to limited collateral and/or lack of credit history.
- The USAID evaluation concluded that the guarantee did not seem to have lowered interest rates or collateral requirements due to the sector-specific risks, low valuation of the assets, and the regulatory framework (e.g., strict asset classification policies and underdeveloped collateral registries).
- Lending to the agriculture sector continued to increase after 2007, when the funds for the guarantee were almost exhausted. The bank had gained agri-lending experience and expertise, which led to additional lending in the sector.

Agricultural Guarantee Fund Pool (AGFP) (Philippines)

Target sector	Agriculture food production (crop, fishery, poultry, and livestock) by farmers and fisherfolk
Guarantee coverage	Up to 85%
Target loans	Not available
Fee structure	0.25–3.85% of the loan amount depending on the commodities, duration of the loans, insurance coverage, and borrowers
No. of PFIs	101 (banks, cooperatives, NGOs, agribusiness companies, and farmer organizations)
Claim/Loss	2.8% (2008–2015)
<p>Major findings:</p> <ul style="list-style-type: none"> • Cumulative guarantees since inception in 2008 amounted to PHP 31 billion, and the guarantee claims of PHP 895 million were paid, representing 2.8% of the total loans guaranteed in 2008–2015 (the banking sector NPLs in the agriculture and fisheries, 4.9% and 11.1%, respectively in 2011). • The guarantee covers defaults caused by natural disasters and diseases. At the same time, the AGFP encourages borrowers to use the national crop insurance scheme by applying lower guarantee fees to the loans covered by the insurance. • The claim process is clearly explained and allows the PFIs to receive 50% of the claims at the time of the submission, but it also requires the PFIs to continue to recover loans on behalf of the AGFP. • The AGFP is funded through the government budget as well as fines from noncompliant financial institutions under the mandatory lending quotas. 	

USAID DCA (Rwanda)

Target sector	Agribusiness (coffee)
Guarantee coverage	40%
Target loans	US\$75,000–US\$200,000
Fee structure	1% (charged by DCA)
No. of PFIs	One (Bank of Kigali)
Claim/Loss	0% (entire period of the project)

Major findings:

- The guarantee was used to cover loans for working capital and capital investment needs in the coffee sector.
- The PFI had made two loans for coffee prior to the DCA guarantee, and it did not have any strategies to strengthen its lending operation in the sector. Nevertheless, the PFI considered the DCA guarantee as a way to reduce the credit risk while complying with the government request to increase loans to the coffee sector.
- From 2004 to 2007, the PFI made 18 loans totaling US\$1.7 million for coffee washing stations. All the borrowers came from the USAID projects, which provided technical assistance support to the coffee sector.
- The PFI continued to provide working capital loans to a limited number of borrowers without guarantees after the end of the DCA scheme. However, no loans for capital investment were provided, and the lending behavior of the bank was largely unchanged.

Private Agricultural Sector Support (Tanzania)

Target sector	Agriculture and agribusiness in non-tobacco agriculture commodities
Guarantee coverage	Up to 60% (80% for women)
Target loans	Average TSh 197 million
Fee structure	2% (plus 2% of the expected loan amount for business plan development; without the business plan support, linkage fee of 1% is charged)
No. of PFIs	Twelve (started with CRDB, one of the leading commercial banks in the country, and expanded to other financial institutions)
Claim/Loss	2.3% ¹⁸

Major findings:

- PASS was established in 2000 in order to stimulate growth and investment in commercial agriculture through access to finance. It provides technical assistance support to farmers and farmer organizations as well as guarantees when they borrow from the PFIs.
- PASS provides business plan development services to the potential borrowers and charges a service fee of 2% of the expected loan amount. As a result, the guarantees are skewed towards larger and more established farmers.
- Cash used to be deposited to PFIs' accounts to ensure that funds are actually available for guarantees, which restricted the potential leverage of the facility. However, the recent operational change allows the leverage up to 1:3.
- The annual approved guarantees increased to TSh 122.7 billion in 2017 from TSh 3.6 billion in 2001. PASS has generated profits from 2014 through 2017 (the latest year for which data is available).
- The guarantee portfolio seems to be well diversified across business activities (production, processing and trading, etc.), commodities, and regions.
- The organization was initially a part of a Denmark-funded project, but became a trust under Tanzanian law in 2007. It is managed by the Board of Trustees, composed of development/finance specialists, agronomists, accountants, etc.



Lessons Learned for CGSs in the Agriculture Sector

There are six lessons learned that can be extracted from the above case studies and other agriculture CGSs.

Lesson learned 1: Agriculture CGSs should have a clear policy to prevent a sudden capital loss in case of catastrophic events that significantly damage the quality of the overall guarantee portfolio. As noted in the earlier sections, one of the unique characteristics of the agriculture sector is occasional marketwide events, including drought, flood, pests, and diseases. Agriculture sector-focused CGSs could face a sudden capital depletion if a majority of their end borrowers were affected by such disasters. Therefore, agriculture CGSs require preventive policies to maintain their financial soundness.

Diversification of portfolio is clearly one of the possible preventive strategies (see lesson learned 2). Some CGSs take more fundamental measures to prevent catastrophic situations. For example, a CGS in Sri Lanka managed by the government does not allow the triggering of the guarantee in cases of systemic and catastrophic losses caused by climatic events.¹⁹ PFIs are required to restructure the loans without relying on the guarantees. The rationale for this policy is to prevent a sudden increase of claims, which would put the CGSs under tremendous pressure. At the same time, this policy expects PFIs to continue to work with their borrowers rather than letting them default, which would deteriorate their credit records. The assumption in this scenario is that borrowers could rebuild their businesses if the loans are rescheduled and climatic conditions recover. PFIs should also have detailed knowledge of the commodities/value chains and resources to support the borrowers. Such a risk management approach by PFIs is also observed in other cases. For example, in the Moldova case, there were eight NPLs during the operation of the CGS, but only one claim was submitted. The PFI chose to work with borrowers and rescheduled the loans, expecting the recovery of the climatic conditions and agricultural market.

An alternative solution for catastrophic events would be to provide incentives to link the guarantees with insurance. In case of the Philippine AGFP, lower guarantee fees are applied to loans covered by the government crop insurance scheme. This encourages PFIs and borrowers to use insurance at the same time as the guarantee, which strengthens the CGS. Further analysis is required for

deeper understanding of the different risk mitigation strategies for catastrophic events and possible depletion of the guarantee funds.

Lesson learned 2: CGSs should diversify their guarantee portfolios across different commodities, regions, and business activities (production and processing) while achieving development impact through appropriate targeting of underfinanced categories depending on their development goals. Diversification of credit risk across sectors and geographic locations is one of the theoretical justifications of the CGSs. By guaranteeing loans from multiple PFIs, CGSs are usually in a better position to diversify risks beyond the lending portfolio of a PFI. The World Bank's global survey found that three-quarters of 60 CGSs systematically adopt exposure limits in order to prevent concentration in fewer borrowers/segments.²⁰ Although sector-specific schemes like agriculture CGSs inherently have a narrow scope for diversification, it is advisable to broaden their guarantee portfolios as much as possible within the sector. Diversification is a critical risk management strategy in the agriculture sector, which is exposed to systematic risks such as natural disasters. A diversified portfolio would allow losses from one commodity/region to be offset by others. While a specific strategy was not found, PASS in Tanzania has a diversified portfolio across commodities, activities (agriculture production, processing, inputs trading, etc.), and geographic locations. The Philippines' AGFP covers loans for a wide variety of commodities and also applies different guarantee fees by crops and business activities, which can promote a certain level of diversification.

One important caveat for such a diversification strategy is the additional expenses. As demonstrated by the PASS case, establishing six regional branches enabled greater outreach and geographic diversification, but at the same time, it added extra management expenses and increased the break-even point. A diversification strategy may also require

specific programs and products depending on the needs of the borrowers. For example, guarantees for the processing companies may need to cover larger and longer-term loans. In contrast, in order to support lending to smallholder farmers, the guarantee size should be smaller.

For CGSs with a strong emphasis on development goals, diversification cannot be achieved at the expense of the guarantees for the target borrowers. Their guarantee strategy needs to find the right balance between the two. Targeting and diversification has important implications for guarantee products and selection criteria used by the CGSs. Given the heterogeneity of the agriculture sector, slight adjustments in the target loan size, for example, can direct the CGSs to a totally different set of borrowers. Take the case of the Business Development Fund (BDF) in Rwanda: due to its relatively high maximum target loan size, the guarantees are mainly used to cover mid-size to larger farmers, leaving loans for smaller farmers outside of the scope. Thus, the guarantees are not widely used by one of the leading financial institutions in the sector, which actively lends to small farmers. CGSs need to have enough knowledge of the different segments of the agriculture value chains and develop selection criteria for both lenders and borrowers in order to deliver guarantees to the target audience.

Lesson learned 3: Policy makers need to position CGSs in a broader agriculture finance landscape and make an effort to address problems, such as conflicting policies, in order to provide an enabling environment for the CGSs and their partners and beneficiaries. The preceding studies point out that CGSs are usually more effective and less expensive than direct funding in facilitating finance for disadvantaged sectors in the economy.²¹ On the other hand, given the complexity of agriculture finance and acute needs for finance, especially among smallholder farmers, governments are tempted to deploy many other policies and regulations in order to solve the same or wider issues in the agriculture

and financial sectors. These policies sometimes invite unintended consequences and actually limit or even wipe out the positive impact of the CGSs.

For example, the Colombian government requires financial institutions to lend to smallholder production at submarket interest rates. This makes the business unattractive for commercial banks even with guarantees from FAG. As a result, the public agriculture bank (BAC) has become almost the sole player in lending to small producers. Moreover, since other guarantees are also available to complement FAG, the risk exposure of BAC often becomes too low for it to conduct a prudent risk assessment for agriculture lending. The government intended to increase the credit for agriculture production, but the combination of these multiple policy measures hindered private sector banks from lending to small producers, who were the primary target of FAG, and created a disincentive for BAC to strengthen its internal capacity in agriculture finance. This lesson is also applicable to agriculture-related policies, including subsidies, interventions in commodity markets, and trade policies. For example, in Tanzania, introduction of floor prices for certain commodities forced buyers to import the goods due to the price increase of local products. Farmers lost the market and defaulted on guaranteed loans, which resulted in more claims for CGSs.²²

In order to provide fundamental solutions to the access to finance issue, policy makers need to carefully assess the root causes that prevent lending. CGSs may not be the right tool. If the reluctance of financial institutions is due to problems such as the regulatory framework, policy makers should address these issues directly; this will benefit all borrowers, not just target beneficiaries of CGSs.²³ In addition, inconsistent and ad hoc policies and government actions could offset the impact of CGSs and also crowd out private lending in the agriculture sector.

On the other hand, linking CGSs with proper policy tools and infrastructure can facilitate greater

financial inclusion and financial sector development. One example is linking CGSs with credit bureaus as described in the Honduras case. The information sharing between CGSs, PFIs, and credit bureaus provides an additional incentive for the guaranteed borrowers to repay the loans. By using information in the credit bureaus, financial institutions can lower transaction costs for future lending activities. Another potential policy intervention is recognizing the guarantees in loan loss qualification rules and loan loss provision requirements. The absence of such recognition was one of the major impediments in the Moldova case, where the PFI continued to apply excessive collateral requirements on top of the guarantees. If the regulations accept guarantees as proper risk mitigation tools, PFIs may lower collateral requirements and could free up some capital for other activities. This could become an additional incentive for PFIs to participate in CGSs.

Lesson learned 4: CGSs should work with a select number of partner financial institutions that have clear strategic interests in the agriculture sector.

This ensures high and continuous participation in CGSs as well as accumulation of expertise by financial institutions over time, which would lead to expansion of agriculture lending without guarantees. A strong commitment by the PFIs is important for success, as it is critical for creating a good foundation and a partner for product and process innovation in agriculture finance, which could also be supported through technical assistance (TA). For example, the comparison of the Honduras and Rwanda cases clearly highlights the difference in the impact of the CGSs. The PFI in the former case was strongly committed in agriculture lending and continued to expand its agriculture portfolio even without the guarantees. On the other hand, the PFI in the latter case, which used the guarantee to weather the government request, continued to apply its conventional approach to the sector and cut back the lending.

Given the high perceived risks in the agriculture sector, financial institutions in developing countries do not often place a strategic focus on the sector. Clearly defined eligibility and qualification criteria help CGSs identify suitable partners in a transparent manner. In addition, CGSs need to gather qualitative information to verify commitment from the top management of PFIs. The strategic focus and actual lending performance of PFIs should be periodically reviewed to ensure continuous engagement of PFIs.

CGSs should work with multiple PFIs as much as possible in order to have a wider impact in the financial market, since over time some will expand their lending in the sector and some will drop out. As the USAID evaluation suggests, the DCA guarantees in Rwanda, Honduras, and Moldova with a single PFI in each county had a rather limited impact in the market. In contrast, PASS in Tanzania contributed to widening the agriculture finance market by adding new PFIs as the scheme matured. Partnerships with multiple financial institutions bring a higher number of transactions, which allow CGSs to diversify their portfolio (see lesson learned 2) and will certainly contribute to the sustainability of CGSs. In addition, competition among PFIs may ease collateral requirements and lower interest rates for the end-borrowers.

Lesson learned 5: Demand-side support for potential borrowers could strengthen CGSs both in operation and risk management.

Farmers, producer organizations, and SMEs in the agriculture sector often have limited management skills to succeed and grow their operations. The lack of bankable projects is often cited by financial institutions as a deterrent to actively providing loans. Generally speaking, borrowers with strong capacity and credible projects have better prospects and a higher chance to receive loans from PFIs. These are the main reasons for TA support for the potential borrowers. There are many CGSs that provide TA support to the borrowers. The World Bank survey

found that more than half of 60 CGSs provide TA and capacity building support to SMEs.²⁴ Given the heterogeneity of the borrowers and the risks they face in the agriculture sector, the demand-side TA support is equally or arguably more important for CGSs serving the sector. Successful technical support can also strengthen the CGSs themselves. For example, introduction of bankable borrowers will contribute to building confidence among PFIs in CGSs, leading to higher utilization of the guarantees. If the information on the agriculture sector is accumulated within CGSs through TA, as in the case of PASS in Tanzania, it provides additional comfort for PFIs to lend to the target beneficiaries of CGS.

The TA support could be provided through a partnership with other development projects or provided directly by the CGS. In the former scenario, the USAID DCA²⁵ and the Rural Credit Guarantee Fund (RCGF) in Romania²⁶ work closely with technical assistance projects and provide guarantees to common beneficiaries. While this external arrangement supplements CGSs' role to verify loan applications without adding operational costs, CGSs may have a limited opportunity to learn about the potential borrowers and accumulate sector knowledge. If the support is provided internally, the TA support becomes an additional cost to the CGS operation, making financial sustainability harder to achieve. However, as indicated in the PASS case, demand-side support can produce additional income, which contributes to the sustainability of the CGS.

Lesson learned 6: The CGSs should reduce claims as much as possible, but at the same time, very low claim rates should be critically evaluated against the objectives of the CGSs. Some CGSs reviewed in this paper have achieved minimal claim rates as low as 0%, while others suffer from higher claims, making the sustainability of the guarantee schemes questionable. This raises several questions, especially for CGSs with very low claims: what are the truly effective risk mitigation strategies to keep the claims low? Do they truly support intended

beneficiaries with limited access to finance? Since various risk mitigation measures have already been discussed in the previous and current sections, there is merit in focusing on the second question. In this respect, the FAO research pointed out that claim rates close to zero may mean that guarantee policies are too conservative or CGSs suffer from excessive operational costs.²⁷ Generally speaking, PFIs have a natural tendency to lend to less risky borrowers, such as processing companies and larger producers, which may already have borrowed in the past. Therefore, CGSs usually need to establish various measures such as clear eligibility criteria for borrowers in order to encourage PFIs to serve the underfinanced segments of the economy. Otherwise, the guarantees could easily be misused. For example, one USAID DCA in Ghana experienced severe mission drift by allowing PFIs to lend to larger borrowers on an exceptional basis. Although the details of these exceptional decisions are not explained in the evaluation report,²⁸ the data in the below table shows the significant shift of the guarantee resources to the better-off borrowers.

These observations suggest that the governance, policies, and actual management of the CGSs need

Table 2. Ghana USAID DCA Guarantees in 2005—Anticipated vs. Actual Loans

	Anticipated	Actual
No. of loans	35	4
Size of loans	\$200,000	\$1,111,666
Tenure (months)	36	21

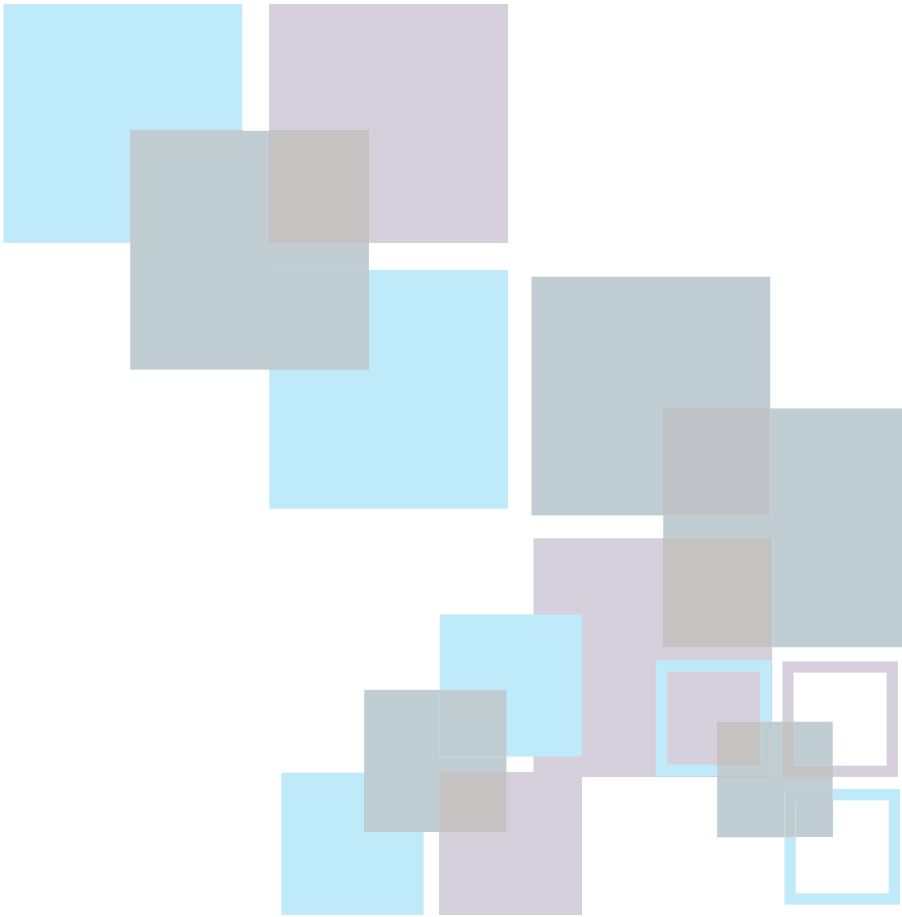
Source: USAID 2008.

to be assessed and closely monitored in case of very low claim rates. This is especially important for CGSs in the agriculture sector, which usually face higher NPLs compared to other sectors.

These six lessons learned point to various potential interventions to influence CGSs in both positive and negative ways, as summarized in the table below. The interventions in the first category can enhance the performance and risk management of CGSs while maintaining or strengthening the risk sharing between CGSs, lenders, and borrowers. Interventions in the second category weaken the CGS. The activities included in this category mainly reduce the risk exposure of PFIs and/or their incentive to continue to serve the target borrowers.

Table 3. Summary of Interventions Extracted from Lessons Learned

Interventions that Strengthen the CGSs	Intervention that Weaken the CGSs
<ul style="list-style-type: none"> • Multiple PFIs committed to agriculture lending • Diversification across commodities, geographic areas, and PFIs • Technical assistance for PFIs and borrowers • Clear strategies for systematic risks • Linkage with credit bureaus 	<ul style="list-style-type: none"> • Additional guarantees to PFIs (reduction of risk exposure of PFIs) • Bank regulation favoring physical collateral (incentive for excessive collateral requirement by PFIs) • Interest rate cap (incentive for PFIs to lend to more secured borrowers)





Conclusion

Although the core structure in providing guarantees remains the same as in other CGSs, CGSs in the agriculture sector are more exposed to the challenges stemming from various sector-specific characteristics, as summarized in the introduction. In this context, this paper has suggested and discussed six lessons learned for the CGSs in the agriculture sector based on the case studies:

- Agriculture CGSs should be protected from systematic risks such as natural disasters (lesson learned 1).
- CGSs should be diversified across commodities, geographic locations, and businesses activities (production and processing) wherever possible (lesson learned 2).
- CGSs should be positioned in a broader agriculture finance landscape, and an effort should be made to provide an enabling environment for the CGSs and their partners and beneficiaries (lesson learned 3).
- CGSs can enhance their impact and achieve better risk management by working with a select number of PFIs with strong commitment in the agriculture sector (lesson learned 4).
- Demand-side technical support could strengthen CGSs (lesson learned 5).
- While it is important to minimize claims as much as possible, CGSs with the claim rate close to zero should be critically evaluated (lesson learned 6).

The analysis presented in this paper was conducted through a desk study of the CGSs that heavily relied on publicly available information. Therefore, the lessons learned should be assessed against a larger number of cases and deeper firsthand field assessment when possible. The lessons learned are also skewed towards the efficiency and sustainability of the CGS operation, thus not covering important issues such as additionality of benefits and intended and unintended effects; this is mainly due to limited availability of documented evidence.

Future research on agriculture CGSs may cover the following subjects:

- Evaluation of additionality and impact of the agriculture CGSs. One of the important questions is whether the agriculture sector-specific CGSs have

clear advantages in this respect by offsetting costs of the sector-specific focus. Other questions of additionality include the effect of CGSs on reducing interest rates and on increasing lending to the specific targets.

- Deeper analysis of specific risk management strategies of CGSs for systematic risks in the agriculture sector.
- The sequencing of financial and agriculture market development as well as a set of policy tools that positively impact the performance of CGSs.
- The relationship between additionality/impact and the risk-sharing structure between CGSs, lenders, and borrowers.



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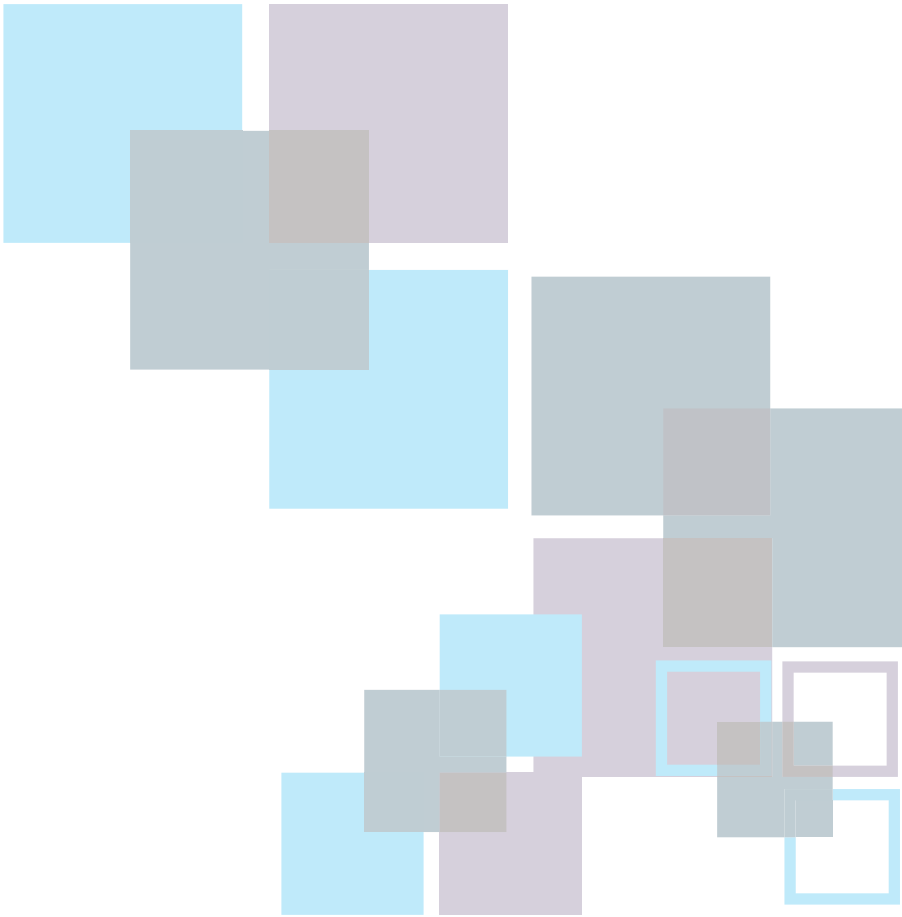
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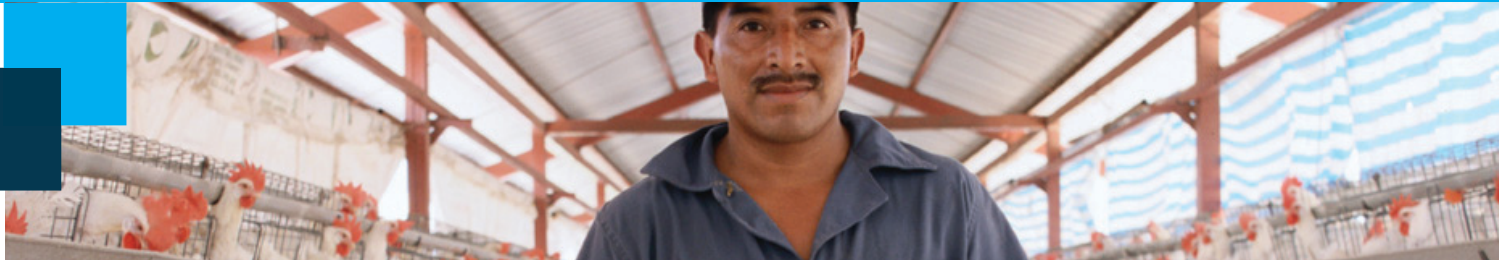


Annex 1. List of Agriculture CGSs

Name	Country	Fondo Agropecuario de Garantías FAG	USAID DCA	Honduras	USAID DCA	Moldova	USAID DCA	Agricultural Guarantee Fund Pool	Philippines	USAID DCA	Rwanda	PASS	Rural Credit Guarantee Fund	Romania	Sri Lanka	Central Bank New Comprehensive Rural Credit Scheme	Agricultural Business Initiative aBi Finance - Agribusiness Loan Guarantee Scheme	Uganda	Rwanda
Management		Colombia FINAGRO	DCA	DCA	DCA	DCA	DCA	Governing board (strategic decisions) and Program Management Office (day-to-day operation). Government has the majority of the members	Board of Trustees (mostly private sector representatives)	Tanzania	DCA		The managing authority (Ministry of Agriculture) makes strategic decisions while RCGF approves guarantees	Central bank	Sri Lanka	Central bank	aBi Finance	BDF	BDF
Ownership		Government	DCA	DCA	DCA	DCA	DCA	Government	Government and DANIDA	Government and DANIDA	DCA		RCGF owned by 3 commercial banks. The guarantee fund is funded by EU (90%) and the government (10%)	Government	Government	Government	Donors (DANIDA etc.) (government is part of the founders)	Government	Government
Target sector		Agriculture (smallholder production)	Agriculture and agribusiness	Agriculture and agribusiness	Agriculture and agribusiness	Agriculture and agribusiness	Agriculture and agribusiness	Agriculture food production (crop, fishery, poultry, and livestock) by farmers and fisherfolk	Agriculture and agribusiness in non-tobacco agriculture commodities	Agriculture and agribusiness in agribusiness	Agribusiness (coffee)		Agriculture and agribusiness	Agriculture and agribusiness	Agriculture production	Agriculture and agribusiness SMEs	Agriculture and agribusiness SMEs	Agriculture production and SMEs (about 70% of the portfolio goes to agriculture)	Agriculture production and SMEs (about 70% of the portfolio goes to agriculture)
Guarantee products		Individual	NA	Portfolio	Portfolio	Portfolio	Portfolio	Portfolio	Individual, portfolio, and portable	Individual, portfolio, and portable	Portfolio		Individual	Individual	Individual	Individual, portfolio, and portable	Individual, portfolio, and portable	Individual and portfolio	Individual and portfolio
Target loan size		NA	Up to US\$100,000 per borrower (average: US\$2,675)	Up to US\$500,000 (average US\$52,000)	NA	NA	US\$75,000 - US\$200,000	NA	TZS 197 million (average in 2017)	Average EUR420,000 (including loans covered by the SME guarantee)	NA	NA	Average EUR420,000 (including loans covered by the SME guarantee)	NA	NA	UGX 5.4 million (average in 2017)	UGX 5.4 million (average in 2017)	Up to Rwf 500 million (agriculture)	Up to Rwf 500 million (agriculture)

Fee structure	1.5 - 5.9% (depending on the recipients and term of the loan)	1% (charged by DCA)	1% (charged by DCA)	1% (charged by DCA)	0.25 - 3.85% of the loan amount depending on the commodities, duration of the loans, insurance coverage, and borrowers	1% (charged by DCA)	2% (plus linkage fee of 1% if business plan is not supported or 2% of the expected loan amount for business plan development) (as of 2012)	1.25%	Up to 2%	NA	1-2%
Guarantee coverage	50 - 100%	50%	50%	40%	Up to 85% of unsecured loans (varies by commodities and borrowers)	40%	Up to 60% (or 80% for women)	80%	60%	50%	30-50% for working capital loans; 50 - 75% for loans for capital investment
Loss	6%	1.0%	11.9%	0%	2.8% (2008 - 2015)	0%	2.3%	10.6%	NA	0.6% (claims)	NA
No. of PFIs	Open to any banks, but mostly used by BAC (public agri-development bank)	1	1	1	101 (banks, cooperatives, NGOs, agribusiness companies, other farmer organizations)	1	12 (started with CRDB and expanded to other FIs)	31	14	14	NA
Other services	NA	Capacity development of FI	NA	NA	NA	NA	Business plan development (charges 2% of the loan amount)	NA	Interest rate subsidy	Capacity development, credit line, value chain development, etc.	Grant, technical assistance, wholesale lending, etc.
Linkage with other activities	Other public policies and schemes (interest rate subsidies, guarantees, etc.)	Donor-funded credit lines for agri-lending	USAID project - TA for borrowers and PFI	USAID project - TA for borrowers in coffee VC (all the borrowers supported)	National insurance program and other development efforts such as Agrarian reform	USAID project - TA for borrowers in coffee VC (all the borrowers supported)	NA	TA for agriculture SMEs financed by various development initiatives	NA	NA	NA





Annex 2. Descriptions of the Cases

Fondo Agropecuario de Garantias (Colombia)

Description

Fondo Agropecuario de Garantias (FAG) has assumed a critical role in agriculture finance in Colombia among other key policy tools, such as lending quotas and direct financing from an agricultural development bank. The FGA aims to facilitate lending to smallholder production. The guarantees are open to any banks; however, BAC (Banco Agrario de Colombia - Agricultural Bank of Colombia) is by far the largest lender through FAG. The guarantees cover the loans from banks funded through FINAGRO (Financing Fund for the Agricultural Sector), a second-tier public agriculture development bank. This wholesale credit from FINAGRO requires borrowing financial institutions to on-lend to small farmers at below-market interest rates, which prevents banks from using the credit line and the guarantees.²⁹ BAC's average interest rate, backed by FINAGRO, is about 5% to 11% for small farmers, while other financial institutions charge much higher rates, from 28% to 49%, in order to cover transaction costs.³⁰

The annual guarantee fee ranges from 1.5% to 4.5% for small farmers and priority medium- to large-scale farmers. The fee for other larger farmers is higher, ranging from 2.6% to 5.9% depending on the size and loan duration (the fee is higher for shorter loans). Under the mandatory lending quotas in the country, banks are required either to lend to the agriculture sector or to purchase certificates for agricultural development, which finance the credit lines and FAG, both managed by FINAGRO.

Performance

Together with FINAGRO's credit line, FAG plays a dominant and important role in financing smallholder farmers. However, the default rate is rather high (6% in 2014) and the guarantee fees are not sufficient to cover the costs, leading to capital depletion despite the annual subsidies from FINAGRO's earnings.³¹ Moreover, the combination of multiple policy tools for smallholder financing has produced several important side effects:

- The guarantees are mainly used by the public agriculture bank (BAC). FAG failed to encourage private banks to lend to small farmers mainly due to the exclusive linkage with FINAGRO's credit, which requires lower lending rates.

In addition, FAG is perceived as complex and slow by banks.³² Thus, private bank finance in agriculture mostly goes to medium- to large-scale producers.

- FAG guarantees are often compensated by other guarantees,³³ which reduces the exposure of BAC and provides weaker incentive for proper risk management.
- Some borrowers misunderstood the guarantee as insurance, as FAG covers defaults caused by natural disasters. This perception has negative implications for the payment culture and also reduces the demand for agricultural insurance.³⁴

USAID DCA (Honduras)³⁵

Description

USAID DCA implemented partial credit guarantee projects in Honduras in 2003 and 2005 through an exclusive partnership with the José María Covelo Foundation, a local microfinance institution (MFI). The DCA allocated a total of US\$1.5 million to cover 50% of the loans for micro and small enterprises and entrepreneurs, mainly in agriculture and agro-industries in certain commodities including wood, specialty coffee, and horticulture. The guarantees were capped at US\$100,000 per borrower, although there were no restrictions on the duration of the loans. DCA charged an origination fee of 1% on the allocated amount and another 0.5% as a utilization fee against the average guaranteed annual principals. An accompanying USAID project on rural and agriculture development provided technical assistance support to farmers and entrepreneurs targeted by the DCA guarantees. Some TA support on agriculture lending was also provided to the Covelo Foundation. The Covelo Foundation made a commitment to expand its exposure to the agriculture sector, mainly due to increasing competition in the urban market. The management of the PFI strategically used the DCA guarantees to gain experience in the sector.

Performance

The DCA guarantee boosted agriculture lending of the Covelo Foundation from HNL 380,000 in 2003 to over HNL 23.5 million (approximately US\$1.25 million) in 2009. This impressive expansion was mainly attributable to strong commitment by the Covelo Foundation, which strategically used the DCA guarantees to jumpstart the agriculture lending. The project provided guarantees to 844 loans with an average size of US\$2,675. The initial borrowers were poorer farmers and entrepreneurs without proper assets for collateral but who were backed by TA from USAID projects. Anecdotal evidence suggests that the loan officers relied on agronomists from the USAID project to identify promising borrowers. Gradually, the focus of the PFI shifted to farmers outside of the project as the PFI accumulated lending experience and built a network with various rural producers' associations. While virtually all the agriculture loans carried the DCA guarantees in 2006, over 80% of the loans outstanding in the agriculture sector were not guaranteed by DCA in 2009.³⁶ This shift suggests that the PFI continued to expand its operation in the agriculture sector based on the DCA guarantees. The evaluation commissioned by the USAID found that the guarantees had also contributed to the facilitation of access to finance beyond the PFI. Some borrowers established their credit history thanks to the guarantees. The credit information was shared with public and private credit bureaus, which allowed farmers and entrepreneurs to borrow from other financial institutions.

The DCA guarantee by nature is a time-bound project activity, and was designed to close after nine years of operation. As the guarantee activity was not meant to be sustainable, the PFI seemed to have more freedom to experiment in lending to riskier borrowers. This is captured in its relatively high claim rate (11.9%), which might not be sustainable for a stand-alone guarantee facility.

USAID DCA (Moldova)³⁷

Description

The USAID DCA guarantee in Moldova aimed at enhancing access to finance in the agriculture sector. The target borrowers were SMEs in agriculture production, agro-industries, and related sectors such as transportation and services. The project allocated US\$226,000 to guarantee a loan portfolio of up to US\$4 million from 2005 to 2010. The guarantees covered 50% of each loan amount. The total lending per borrower was capped at US\$500,000 with a loan tenure of up to three years. The only PFI (FinComBank) had a strong interest in enhancing its agriculture portfolio, and it expanded its network outside of the capital city while working with the DCA. The number of staff in its representative office was almost doubled for the five years when the DCA was active. Like other DCA guarantees, it was meant to be a time-bound structure, but the PFI was still required to pay the origination fee (0.5% of maximum guarantee amount) and the annual utilization fee (1% of annual average of guaranteed loans). FinComBank had previous experience with the USAID guarantee, which was further reinforced through internal training programs. In addition to the DCA guarantees, FinComBank relied on credit lines from donors such as the International Fund for Agricultural Development for agriculture lending, especially with longer-term loans.

Performance

Backed by the DCA guarantees, both the number and volume of the agriculture loans of the PFI more than doubled from 2004 to 2008. FinComBank provided a total of 75 loans. Of these, over 75% primarily covered working capital requirements, and 43% went to first-time borrowers, most of whom had been declined previously due to limited collateral and/or lack of credit history. On the other hand, more than half of the loans were extended to FinComBank's existing borrowers with limited collateral. There was only one minor claim despite unfavorable weather

conditions in the country, especially in 2007, when agricultural production declined by 35%. In fact, there were eight loans past due owing to the drought in 2007, but the bank decided to reschedule the loans, expecting the recovery of the climatic condition in the following year.

Despite the above positive results, the USAID evaluation concluded that the guarantee did not seem to have lowered interest rates or collateral requirements. Although the central bank permitted banks to use the DCA guarantees as a substitute for collateral in 2006, the bank still demanded collateral equal to 100% of the loan value and sometimes required 200–300% due to the sector-specific risks and low valuation of the assets. It seems that the guarantees were mainly used to reinforce the security of loans in addition to the asset collateral. This continuous dependency on the physical collateral could not have been altered only by the guarantees. It was also strongly affected by the lending and risk management skills of the financial institutions, and more importantly by the regulatory framework. For example, strict asset classification policies favor loans secured by physical assets, and underdeveloped collateral registries push down the value of the collateral.

Lending to the agriculture sector continued to increase after 2007, when the funds for the guarantee were almost exhausted. The bank had gained agri-lending experience and expertise, which led to additional lending in the sector. The increase is also attributable to FinComBank's strong commitment in the sector spurred by the DCA guarantee, as well as the global rise in the agriculture market and increased credit line from donors.

Agricultural Guarantee Fund Pool (Philippines)³⁸

Description

The Agricultural Guarantee Fund Pool (AGFP), a public guarantee scheme in the Philippines, covers

up to 85% of unsecured loans for agriculture food production (e.g., crop, fishery, poultry, and livestock) by small farmers and fishers. The guarantees are granted to cover portfolios of the lending institutions (PFIs), including commercial banks, public banks, MFIs, cooperatives, producer organizations, and agribusiness companies. The Governing Board (GB), chaired by the senior official from the Department of Agriculture (DA), makes policy and strategic decisions for the AGFP. The majority of the GB members represent various government agencies, including the Land Bank, a wholly owned government institution and one of the largest lenders for agriculture production; two representatives come from academia and PFIs. The Program Management Office (PMO), headed by a program executive director appointed by the GB, manages the day-to-day operations of the guarantee scheme. The Program Management Committee, chaired by a Land Bank representative and composed of members from the DA and the Land Bank³⁹ clears guarantees and claims approved by the PMO.⁴⁰ The AGFP is funded through the government budget as well as fines from noncompliant financial institutions under the mandatory lending quotas.⁴¹ The guarantee fee ranges from 0.85% to 3.85% of the total guaranteed loans, depending on the commodities, duration of the loan, insurance coverage, and borrowers. The funds for the guarantees are invested in the least risky assets under the classification of the Central Bank. The AGFP is allowed to provide guarantees up to three times the amount of the seed fund. The payout is made for any unwillful defaults, including natural disasters. The claim process is clearly explained and allows the PFIs to receive 50% of the claims at the time of the submission, but it also requires the PFIs to continue to recover loans on behalf of the AGFP.⁴²

Performance

In 2015, the AGFP guaranteed loans of PHP 5.2 billion from 101 lending institutions for about

105,000 beneficiaries.⁴³ Cumulative guarantees since inception in 2008 amounted to PHP 31 billion, and guarantee claims of PHP 895 million were paid, representing 2.8% of the total loans guaranteed in 2008–2015.⁴⁴ This is much lower than the banking sector NPLs in agriculture and fisheries, which were 4.9% and 11.1% respectively in 2011.⁴⁵ During this period, the amount of the guaranteed loans increased steadily; however, the fund pool of PHP 4.5 billion has still not been fully utilized up to the leverage limit of three times.⁴⁶ A recent analysis of the AGFP's performance suggests that claim payments were frequently delayed. In 2012, about 50% of the claim of PHP 886 million had been approved, but only PHP 264 million was actually paid due to lack of required documents. Many PFIs testified that the claim repayment process took up to 13 months, as opposed to the AGFP's policy of repayment within 45 working days.

USAID DCA (Rwanda)⁴⁷

Description

The USAID DCA guarantee in Rwanda was established to expand access to credit to agricultural enterprises assisted by USAID projects in export-oriented sectors. Production of export commodities, including coffee, had already been supported through four USAID technical assistance projects when the DCA guarantee was launched. Under the portfolio guarantee agreement, the Bank of Kigali (BoK) provided loans to cover working capital and capital investment needs in the coffee sector. The guarantee covered 40% of the loans, and the USAID allocated US\$800,000 to guarantee up to US\$2 million for eight years starting in 2004. The target loan size ranged from US\$75,000 to US\$200,000, with the duration of up to one year for the working capital loans and five years for investment loans. The USAID evaluation report found that the BoK had made two loans for coffee prior to the DCA guarantee and that it did not have any strategies to strengthen its lending operation in the sector. However, amid mounting pressure

from the government for commercial banks to support the coffee sector, the BoK considered the DCA guarantee as a way to reduce its risk in coffee sector loans while complying with the government request. The BoK paid the origination fee of 1% of the USAID funds made available and the annual utilization fee of 1% of the outstanding guarantees.

Performance

From 2004 to 2007, BoK made 18 loans totaling US\$1.7 million, comprising 11 investment loans and seven working capital loans for coffee washing stations. The size of investment loans was approximately US\$93,000 for 68 months on average, while the average size of the working capital loans was slightly larger, at US\$101,000 for 10 months. According to the USAID evaluation, the bank used the conventional loan product and procedures. For example, the borrowers covered by the guarantee were still required to provide physical asset collateral covering 100% of the loan amount. The DCA guarantee reduced the risk for the bank by “providing a quicker alternative to the slow court system for collecting at least part of the loan value in case of default.”⁴⁸ All 11 projects guaranteed by the DCA came from the USAID projects. The lending opportunities referred from the USAID projects provided enough creditworthy borrowers to fully utilize the DCA guarantees. By the time of the USAID evaluation in 2009, no claim had been made by the BoK. The DCA guarantee was suspended in 2007, when the government became a majority shareholder of the bank, resulting in a breach of the guarantee agreement.

Although the BoK continued to provide working capital loans to a limited number of borrowers without guarantees, no investment loans had been provided since the end of the DCA guarantee, according to the evaluation in 2009. Some borrowers were able to build relations with the bank and accumulate assets thanks to the DCA guarantee. However, the lending behavior of the bank was largely unchanged.

Private Agricultural Sector Support (Tanzania)

Description

The Private Agricultural Sector Support (PASS) was established in 2000 in order to stimulate growth and investment in commercial agriculture through access to finance. It provides technical assistance support to farmers and farmer organizations as well as guarantees when they borrow from PFIs. From PASS’s inception, the founders of PASS, DANIDA and the Government of Tanzania, aimed to make it a self-sustaining entity; accordingly, the business and organizational structure were gradually developed. The organization was initially a part of a Denmark-funded project, but became a trust under Tanzanian law in 2007. DANIDA continuously provided technical as well as financial support. The number of PFIs increased from one in 2001 to 12 in 2017 as confidence among financial institutions was established. The geographic coverage also expanded, and PASS has six regional branches to cover the entire country in addition to the headquarters. PASS has a team of specialists in all the branches for appraisal of projects as well as business plan development. Since 2007, the Board of Trustees, comprising development/finance specialists, agronomists, accountants, etc., has been responsible for the management, policies, and operational strategies of PASS.⁴⁹

PASS provides business plan development services to potential borrowers and charges a service fee of 2% of the expected loan amount. While this was initially planned as an outsourced service, it became an important value-added service and income stream for the organization in addition to the annual guarantee fee of 2% of the outstanding guarantees. The guarantee covers up to 60% of the individual loans (80% for female borrowers) in various value chains except for tobacco for both working capital and investment requirements. Cash used to be deposited to PFIs’ accounts to ensure that funds were actually available for the guarantees, which restricted the potential leverage of the facility.⁵⁰ However,

leverage of up to 1:3 is now allowed, according to the most recent annual report.⁵¹

Performance

PASS has successfully expanded its operations over the years and gained trust among partner financial institutions. The annual approved guarantees increased to TSh 122.7 billion in 2017 from TSh 3.6 billion in 2001. The income from the guarantee operations has been growing in recent years, and PASS has generated profits from 2014 through 2017, the most recent year for which data is available.⁵²

The claim rate seems to have dropped over the years, and was at 2.3% in 2017. The guarantee portfolio seems to be well diversified across business activities (production, processing and trading, etc.), commodities, and regions. The PFIs in general appreciate PASS's expertise in screening potential borrowers and helping to develop their business plans. Although this additional function contributes to building a solid lending portfolio, 2% fees for the business plan development seem to exclude poorer farmers.⁵³ As a result, the guarantees are skewed towards larger and more established farmers.



Endnote

1. Green (2003) and Deelen and Molenaar (2004).
2. FAO (2013).
3. World Bank (2015).
4. The principles for CGSs for SMEs suggest that the coverage should not be lower than 50% (Principle 11). The average coverage ratio of 60 CGSs was 70% in the survey by the World Bank (Calice 2016). CGSs in developing countries had lower coverage on average than that of the entire sample.
5. For details, see OECD (n.d.); Varangis, Buchenau, and Hernandez (2017); and Green (2003). Mutual guarantee associations utilize industry/company information from the members to evaluate credit risk and rely on peer pressure to ensure timely repayment.
6. However, some of the world's largest CGSs (e.g., in the Republic of Korea, Japan, and the United States.) are some of the oldest. For example, the CGS for SMEs in Japan was established more than 60 years ago and still actively provides guarantees.
7. Calice (2016); Green (2003).
8. Green (2003) argues that CGSs should take collateral as much as possible to incentivize borrowers to repay the loan. Guarantees are not a complete alternative to collateral since guarantees cannot be a threat to borrowers in case of default.
9. Financial Sector Deepening Trust (n.d.).
10. See FAO (2013), which also argues that very low claims may suggest excessive operational costs of CGSs and/or overcautious guarantee practices.
11. This discussion may not be relevant to CGSs with a limited time horizon and/or a clear priority on development impact over financial sustainability.
12. Beck, Klapper, and Mendoza (2008); Honohan (2008).
13. Beck, Klapper, and Mendoza (2008).

14. USAID often implements DCA guarantees as part of its development projects in developing countries. From 1999 to 2016, the DCA provided more than 500 guarantees and facilitated US\$4.8 billion in loans for more than 245,000 entrepreneurs, including farmers, in 76 countries
15. FAO (2013).
16. Ibid.
17. Calice (2016).
18. PASS (2017).
19. Information gathered during the formulation of a World Bank project.
20. Calice (2016).
21. Beck, Klapper, and Mendoza (2008).
22. Financial Sector Deepening Trust (n.d.).
23. Meyer (2011).
24. Calice (2016).
25. USAID DCA guarantees are often designed as part of the wider interventions in the sector, and the lenders and borrower are supported by the TA interventions.
26. Summary is available in annex 1.
27. FAO (2013).
28. USAID (2008).
29. USAID (2014).
30. Ibid.
31. Gutierrez and Reddy (2015).
32. USAID (2014).
33. Gutierrez and Reddy (2015).
34. Ibid.
35. Information on the USAID DCA in Honduras is extracted from USAID (2009a) unless otherwise stated.
36. Although it is not clearly stated, the USAID evaluation suggests that these loans are not covered by any other guarantees.
37. Information on the USAID DCA in Moldova is extracted from USAID (2011) unless otherwise stated.
38. Details on the AGFP are based on the Revised Implementing Rules and Regulations of the AGFP in 2015, available at <http://agfp.ph/Bulletins/>.
39. The Land Bank is also a PFI. The GB approves the guarantees to the Land Bank to avoid conflict of interest.
40. The guarantee lines and claims beyond the Public Management Committee's authority need to be approved by the GB.
41. The Agri-Agra Reform Credit Act of 2009 requires banks to allocate a total of 25% of their loan portfolio to the agricultural sector, of which at least 10% needs to be made available for agrarian reform beneficiaries.
42. Of the recovered amount, 85% will be paid to the AGFP until the total obligation is settled.
43. ACPC (2016).
44. Ibid.
45. Bangko Sentral ng Philipinas (2011).
46. Corpuz (2013).
47. Information on the USAID DCA in Rwanda is extracted from USAID (2009b) unless otherwise stated.
48. USAID (2009b).
49. DANIDA (2009).
50. Financial Sector Deepening Trust (n.d.). Cash cover guarantee is widely used in Tanzania except for several guarantee schemes, including the ones run by the government and USAID.
51. PASS (2017).
52. Ibid.
53. DANIDA (2009).

