

CREDIT GUARANTEE SCHEME FOR SMALL AND RURAL ENTERPRISES

Background:

Credit Guarantee Schemes are programs that ensure partial repayment of a loan in order to motivate lenders to lend to borrowers which would not have access to credit under normal circumstances. The growth of Small and Rural Businesses is imperative for any developing economy. Access to formal finance for this sector is a major problem hindering the growth of small and micro enterprises, particularly in the rural areas.

Given the impediments in the way of Small and Rural Enterprises in Pakistan to raise capital from the capital markets or financing from the financial institutions, the Credit Guarantee Scheme shall help in resolving severe credit rationing. The major elements of Credit Guarantee Scheme for Small & Rural Enterprises are as given below:

Capital Structure:

The seed money for the Scheme is provided by the UK's Department for International Development (UKAID) under the Financial Inclusion Program (FIP) and Federal Government, with the option of later being bolstered up through further allocation of funds from other sources including international/bilateral agencies.

Target Clients:

- **The Scheme** is to be used for targeting Small Enterprises and Farmers with economic landholding, without any specific regional or cluster restrictions, across the country.
- Preference for use of the Guarantee Fund shall be given to fresh and collateral-deficient borrowers. Participating Financial Institutions (PFIs) will ensure that the guaranteed loans are not used for purposes contradicting the very objective of the Scheme, i.e. the facility will not be used for debt swaps/adjusting an existing loan, buying company shares or member of a partnership, or financing interest payments etc.

Risk Sharing with the Financial Institutions:

The Scheme shall share risk with Participating Financial Institutions (PFIs) by guaranteeing up to 40% of PFIs' fresh portfolio of financing to Small Enterprises & Farmers.

Individual or Portfolio Guarantee:

Instead of evaluation of each and every loan, portfolio (principal amount only) of loans (extended after allocation of Credit Guarantee Limit) of a PFI which meet the given criteria is to be guaranteed under the Scheme to the extent of its allocated Credit Guarantee Limit (CGL). The issuance of Credit Guarantee is subject to compliance with provisions of the Guarantee Scheme and other instructions issued by State Bank from time to time, as deemed necessary. SBP/SBP BSC (Bank) will have right to withdraw its approval of guarantee if it is discovered at

any stage that the borrower was not eligible for financing under the Scheme at the time of extension of the loan facility. In such an event, the PFI will bear 100% of the credit risk of such borrower. The PFIs shall be required to submit monthly or as and when required reports of their financing to Small & Rural Enterprises and compliance with the criteria of the Scheme to 'Credit Guarantee Office (CGO)' in the SBP BSC (Bank) for its evaluation. The CGO is authorized to undertake post-disbursement audit of selected cases to ensure that by and large the criteria has been complied with to acceptable levels by each PFI.

The CGO shall submit a report of performance to TCCG through SME Finance Department, SBP, on a quarterly basis.

Pricing of Loans under the Guarantee Scheme:

Banks may apply market-based mark-up rate under the Scheme, i.e. there will be no cap on pricing of loans under the CGS. However, in cases where the SBP has provided a refinancing facility (such as SME Credit Refinancing Facility), the interest rate cap allowed by SBP to the PFI under a particular facility would prevail.

Selection of PFIs:

State Bank will select 5-7 commercial banks to serve as the Participating Financial Institutions (PFIs) and allocate Credit Guarantee Limits (CGLs) to each PFI. The banks to be considered as PFIs would be in reasonably good financial condition and having considerable share/expertise in small/ agricultural financing, beside sizable branch network across the country.

Guarantee Limits for the PFIs:

Under the Scheme, PFIs will be allocated portfolio guarantee limits for small & rural enterprises on a yearly basis. CGO will monitor the performance of PFIs viz-a-viz their allocated limits on quarterly basis and more frequently if deemed necessary

Management of the Scheme:

The Scheme is managed through high-end **Technical Committee on Credit Guarantee (TCCG)** comprising representatives from Donor Agency, Pakistan Banks Association (PBA), SBP and DFSD (SBP, BSC) to monitor and oversee the performance of the Scheme. Besides TCCG, **'Credit Guarantee Office (CGO)-Unit** is also established at SBP BSC Offices to serve as the operational arm of TCCG for implementation of the Scheme. The TCCG shall arrange for the training of SBP officials in all necessary areas to facilitate effective implementation of the Scheme.

Eligibility of Borrowers:

The borrowers under the scheme will be Small Enterprises and Farmers with economic landholding. The Selection Criteria for Eligible Borrowers will include:

- ⇒ Regular and estimable positive cash flows
- ⇒ Be in conformity with the PRs for SMEs/Agr. Financing
- ⇒ Should have clean e-CIB record
- ⇒ In line with the Credit Policy of Banks.

Loan Limit and Tenure of the Guaranteed Amount:

The loans for short term working capital and medium-term for a period up to 3 (three) years, with maximum amount of Rs.15.0 (fifteen) million for Small Enterprises and Rs 2.0 (two) million for farmers with economic landholding, are to be guaranteed under the Scheme.

Payment of Claims under the Guarantee Scheme:

The Scheme shall pay claim to the lender on 1st loss basis when the loan is categorized as loss. However, this re-imbursalment shall not obviate the lending institutions from the right of recovery of the defaulted amount. The banks shall continue with their regular procedure for recovery of loan and status shall be reported to the CGO on yearly basis. As soon as the loan is recovered, the PFI shall be obliged to return the proportionate share of CGS to the Guarantee Fund. A recovery from a delinquent borrower after reimbursement of guarantee claim by SBP is to be treated as recovery of principal, while the costs incurred on recovery efforts is not to be passed on to the Guarantee Scheme. To ensure that due diligence was carried out by the PFIs at the time of disbursement, all claims qualifying for payment would be inspected by Banking Inspection Department of SBP.

Monitoring of the Guaranteed Portfolio:

To ensure compliance with the objectives of the guarantee fund and avoid adverse selection problems on part of banks, the Banking Inspection Department of State Bank will review the guaranteed loan portfolios of PFIs during their regular and special inspection of the PFIs.

Interpretation:

If any question arises in regard to the interpretation of any of the provisions of the Scheme or of any directions or instructions or clarifications given in connection therewith, the decision of the SBP shall be final.
