7 Credit Guarantee Schemes of SBP – Implementation thereof

Credit Guarantee Office (CGO) established as a unit of Development Finance Support Department(DFSD), implements Credit Guarantee Schemes (Microfinance Credit Guarantee Facility & Credit Guarantee Scheme for Small and Rural Enterprises) launched by Agricultural Credit & Microfinance Department and Infrastructure Housing & SME Finance Department of SBP to encourage lending to the priority sectors like SME, Agriculture and Microfinance. These are relatively new schemes and are gaining pace with increasing awareness by stakeholders. Development Finance Support Department (DFSD) is playing a proactive role in implementing these schemes and a number of amendments have been incorporated in schemes by the concerned departments of SBP, on the basis of feedback provided by DFSD.

7.1 Overview

State Bank of Pakistan (SBP) has a special focus on development finance initiatives. Different schemes have been launched by SBP to facilitate lending to priority segments especially to the Micro, SME & Agriculture sectors. SBP is using indirect tool of sharing credit risk with banks for provision of funds to these priority sectors under credit guarantee schemes. Credit Guarantee Schemes are programs that ensure partial repayment of a delinquent loan in order to motivate lenders to lend to borrowers which normally do not have access to credit from formal sector. Banks/ Development Finance Institution (DFIs) are at times reluctant to extend credit to Microfinance Banks (MFBs)/ Microfinance Institutions (MFIs), Small and Medium Enterprises (SMEs) and Agri. sector as they perceive lending to these sectors riskier than other sectors.

Experience of other countries has revealed that financial institutions do extend loans to these sectors as well if the risk is shared, thus enabling the borrowers from these sectors to avail financing from formal sector. Keeping in

Highlights

- Ten guarantees issued under MCGF of Rs. 805 million against the total sanctioned amount of Rs. 2,825 million to commercial banks for varying maturities ranging from 1 to 5 years.
- Out of the allocated limit under CGS there is an exposure of around Rs. 325/- million on CGS funds against the sanctioned amount of Rs. 755 million by 5 Banks for their 1,357 SME/ Agri borrowers.
- A reasonable share of about 12% of overall CGS portfolio has been sanctioned to flood affected borrowers while Bank of Khyber has sanctioned 33% of its cases to flood affected areas.
- Investment of MCGF and CGS funds in risk free govt; securities i.e. TBs and maturity value of these funds has become 1,445 million and 1,949 million, which translates into a profit of Rs. 405/- and Rs.277 million respectively.
- Arranged 5 workshops and one awareness session on SBP guarantees Schemes and facilitated 345 participants from banks and other stakeholders.

view this fact, SBP designed two schemes namely "Microfinance Credit Guarantee Facility (MCGF)" and "Credit Guarantee Scheme (CGS) for Small and Rural Enterprise" to facilitate lending to these priority sectors. Salient features of these schemes are presented in Table 7.1, whereas details of the two schemes with analytical snapshot of guarantees issued are presented in the following sections.

Table 7.1: Salient Features of MCGF and CGS

Features	Microfinance Credit Guarantee Facility (MCGF)	Credit Guarantee Scheme (CGS) for Small and Rural Enterprise
Launched in	Dec-08	March-10
Target Sectors	Microfinance Sector (MFBs/MFIs)	Agriculture and SME Sectors
Funds Providers/Supported by	Department for International Development (DFID), UK.	Department for International Development (DFID), UK.and Government of Pakistan
Fund Manager	DFSD, SBP BSC.	DFSD, SBP BSC.
Seed Money Provided by DFID	GBP 10 million	GBP 10 million
Grant Amount Received	Rs. 1,040 million (GBP 7.5 million received from DFID)	Rs. 1,671 million (including GBP 10 million received from DFID plus Rs. 300 million Government of Pakistan contribution)
Participating Financial Institutions	Commercial Banks/DFIs	PFIs (Selected Banks)*
Guarantor	SBP BSC	SBP BSC
Maturity Period	upto 5 Years	upto 3 Years
Markup Rate Cap (if any)	6 Month KIBOR+ 2%	No Cap
Guarantee Coverage	Two options i-e i) 40% Partial guarantee (Pari passu) on the principal outstanding ii) 25% First Loss Default on the principal disbursed.	40% of outstanding principal
Per Borrower Limit	No limit	Agri- Rs. 2 million, SME Rs.15 million

* PFIs include ABL, BOK, MCB, Askari, HBL, NBP, NIB, FBL, UBL, BAFL & FWBL.

7.2 Microfinance Credit Guarantee Scheme

One of the main reasons for people to remain poor is lack of access to credit. Microfinance Banks (MFBs) have been set up in Pakistan under MFI Ordinance, 2001 from formal sector to ensure that they play their due role in increasing financial inclusion by providing financial services to microfinance borrowers who prior to this set up were being served only by NGOs and MFIs. The empirical evidence suggests that in addition to access to finance, microfinance borrowers also need other financial products especially micro deposit services which MFIs/NGOs being non-regulated institutions were not able to provide. MFBs being the regulated deposit takers can mobilize deposits, provide small loans and extend remittance & insurance services with underlying ability of poverty alleviation. The low income people do not have access to commercial banks as provision of financial services to them is generally discouraged by mainstream banks/DFIs due to unavailability of collateral and high contract, screening & monitoring costs associated with lending to clients from this segment.

As microfinance in general presents a solution for poverty eradication to very poor people by extending financial services including small loans, therefore in order to encourage mainstream commercial banks to provide wholesale lending to MFBs/MFIs who in turn can provide funds to their micro borrowers, the SBP in collaboration with UK Department for International Development (DFID) launched Microfinance Credit Guarantee Facility in December, 2008. For the purpose, DFID provided funds to the extent of GBP 10 million. Under the guarantee, SBP shares the borrower's default risk with banks for their lending to MFBs/MFIs under two different options a). 40% Partial guarantee (Pari passu) on the principal outstanding and b).25% First Loss Default (FLD) on the principal disbursed. The facility is available for commercial banks/DFIs entering into lending arrangements with financially and socially sustainable MFBs/MFIs with significant potential to maximize the outreach to poor and marginalized segments of the society. It is expected that with the passage of time commercial banks will start to feel that lending to MFBs/MFIs is safe. The main features of scheme are given in table 7.1.

Under the facility, responsibility of carrying out diligence in evaluating the borrowers rests with the commercial banks as major portion of default risk is assumed by them. In case of default, responsibility of recovery efforts also lies with banks. After issuance of guarantee, DFSD, SBP Banking Services Corporation (BSC) monitors disbursement and repayment of loans extended under the scheme. In case of default, DFSD will pay amount covered under MCGF to banks. Notably, no default has been reported since the inception of the scheme.

7.2.1 Guarantees Issued under MCGF

DFSD has so far issued ten guarantees with exposure of Rs. 805 million against the total sanctioned amount of Rs. 2,825 million to commercial banks for varying maturities ranging from 1 to 5 years. The profile of the guarantees for Tameer MFB, Kashf Foundation and NRSP are as per details mentioned in Table 7.2.

Table 7.2. Guarantees Issued under MCGF

Amount & Guarantee Cover in million Rupees

MFB/MFI /Lender	Amount sanctioned under MCGF	Tenor in Years	Option	Issuance Date	Total Guarantee Cover
Tameer MFB	**1250**				**355**
BAF	50	5.0	40% Partial	5-Oct-10	20
KASB*	100	3.5	40% Partial	5-Oct-10	40
JS Bank	100	2.0	40% Partial	3-Nov-10	40
ABL	100	5.0	40% Partial	28-Feb-11	40
St.Charted	600	2.0	25% First Loss	17-Mar-11	150
MCB Bank	100	5.0	25% First Loss	26-May-11	25
NBP	200	5.0	40% Partial	17-Aug-11	80
Kashf Foundation	**375**				**150**
MCB Bank	225	2.0	40% Partial	14-Dec-10	90
Silkbank Ltd	150	1.0	40% Partial	5-May-11	60
NRSP	**1,200**				**300**
Consortium**	1,200	3.0	25% First Loss	29-Jun-10	300
Total	**2,825**				**805**

*KASB guarantee Cancelled due to non-disbursement
**Consortium of banks includes (HBL,NBP,ABL,MCB,UBL,AKBL,NIB & FBL)
Source: DFSD, SBPBSC

DFSD closely monitors repayment of principal and mark up of the loans against which guarantees have been issued. The outstanding position of such loans shows that Rs. 2,376 Millions are outstanding against the loans for which guarantees have been issued by DFSD with a guarantee cover exposure of Rs. 666 million. Notably, no default has been reported since the inception of the scheme.

7.3 Credit Guarantee Scheme for Small and Rural Enterprises

The growth of Small and Rural Businesses is imperative for any developing economy. In Pakistan, lack of adequate access to formal finance by this sector has been a major hindrance in the growth of small and micro enterprises, particularly in the rural areas.

To promote access to finance to SMEs and to encourage banks towards cash flow based lending for fulfilling credit requirements of potential businesses that lack collateral, SBP has launched Credit Guarantee Scheme for Small and Rural Enterprises (CGS) on March 19, 2010 with the support of UK's Department for International Development (DFID) under the Financial Inclusion Program (FIP) and Government of Pakistan. Under the facility SBP shares 40 percent of the bonafide losses of banks resulting due to defaults by the SME and Agri. sector borrowers of the banks.

In 2010, SBP's Technical Committee on Credit Guarantee (TCCG) approved Guarantee Limits (CGLs) of Rs. 1,035/- million to 11 selected banks under component 1 (comprising of small and rural enterprises of KPK, FATA and Gilgit-Baltistan) and Rs. 2,035 million to 14 selected banks under component 2 (comprising priority sectors of the rest of the country), for the period up-to December 31, 2010. However, out of 15 banks only three banks availed the facility and sanctioned loans of Rs. 113.07 million to 89 borrowers with a guarantee coverage of Rs. 67.84 (60% as per original scheme) showing a nominal utilization of 2.2 percent. Keeping this low utilization in view, the scheme was revised vide SMEFD Circular No. 02 dated February 14, 2011; where-after, the TCCG approved allocation of Credit Guarantee Limits of Rs. 3,832/- million to 11 banks on April 19, 2011 for the period up-to 31-12-2011. The status of utilization during the months April-July, 2011 is as given in Table 7.3.

Table 7.3: CGS Utilization during April-July, 2011

Amount in million Rupees

PFI	Approved CGL	No of Borrowers.	Sanctioned Amount	Credit Guarantee Liabilities	Limit Utilized by PFI
ABL	325	122	194.4	92.0	28.3%
BOK	300	56	42.3	18.2	6.1%
MCB	77	110	61.8	24.7	32.1%
ASKARI	100	20	43.4	24.4	24.4%
HBL	400	1,049	413.5	165.4	41.3%
Others*	2,630	-	-	-	
Total	**3,832**	**1,357**	**755.4**	**324.7**	**8.5%**

*CGLs assigned to other PFIs i.e. NBP(Rs.800m), NIB(Rs.750m), Faysal (Rs.500m), UBL(Rs.330m) BAFL(Rs.150m)and FWBL(Rs.100m) have not been availed till July 2011.

7.3.1 Loan Size Analysis

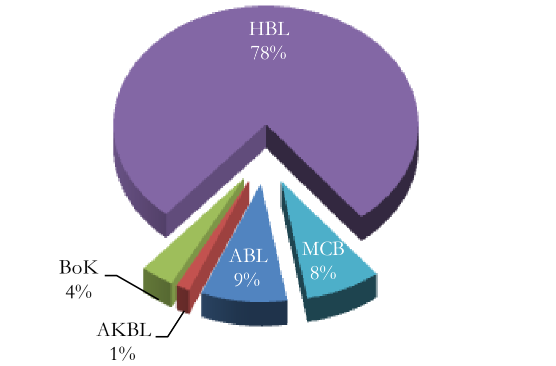
The larger banks with extensive branch network are better placed to reach out to unbanked low end segments of potential borrowers for utilization of their allocated limit. This is evident from increased utilization of the facility by Habib Bank Limited (HBL), MCB Bank Ltd and request of United Bank Limited (UBL) for allocation of limits under the scheme. So far HBL has the largest share of 78% in the Credit Guarantee cases sanctioned during the April-July, 2011. It is also encouraging that the banks which utilized the facility last year have shown more interest in lending facilities on the basis of the guarantee under this scheme. **(Figure 7.1).**

The avreage loan size extended by banks under this Guarantee cover is Rs. 0.56 million whereas around 75% of the all guaranteed cases are equivalent to or less than Rs. 500,000, which clearly suggests that the facility is being utilized by small and rural enterprises. **(Figure 7.2)**.

Figure 7.3 shows that the Banks have mostly provided low range financing, while some instances of small enterprises with good turnover can also be seen. The maximum finance of Rs.10 million provided by Bank of Khyber is within the maximum loan size of Rs. 15 million allowed under the Scheme. HBL, however having more than 75% cases and covering more than half of the total amount financed has a maximum loan size of Rs. 2,000,000.

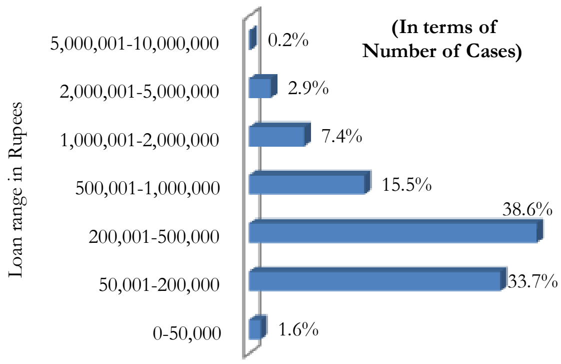
The larger sized loans are sanctioned to small enterprises which have used financing facilities for procuring inventories or building necessary infrastructure. However, consolidated utilization of large quantum loans, being small in number, has remained nominal on an overall basis. Though banks have extended multiple loans of up to Rs. 30,000, Askari and Allied Banks have relatively higher average loan sizes as reflected in their higher upper loan amounts. Their high average loan sizes may be attributed to their focus on Small enterprises with relatively better presence in the urban centers compared with HBL and MCB who have extensive branch network and focus towards Agri-based borrowers in small cities and rural areas **(Figure 7.4)**.

Figure 7.1: Bankwise number of CGF cases processed



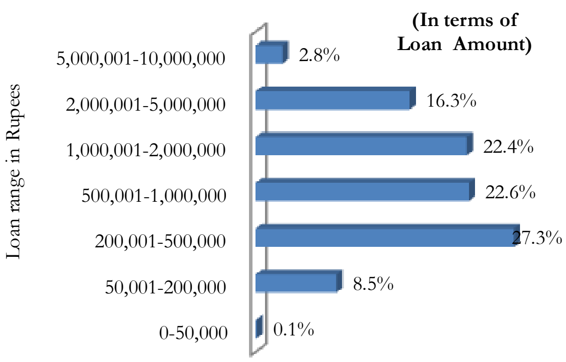
Source: DFSD, SBPBSC

Figure 7.2: Loan-range wise share under CGS



Source: DFSD, SBPBSC

Figure 7.3: Loan-range wise share under CGS



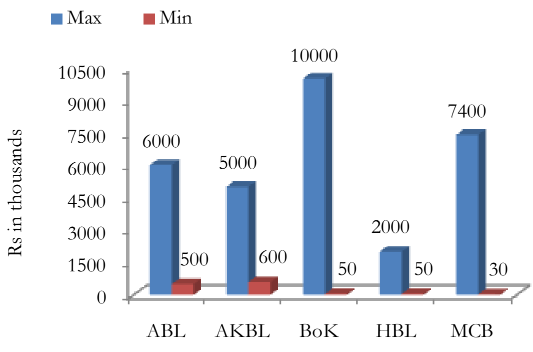
Source: DFSD, SBPBSC

The average loan size among the PFIs ranges from Rs. 2.231 million for the Askari Bank to Rs. 0.4 million for the Habib Bank Ltd. As already stated, the cumulative average loan size is. Rs. 0.56 million which shows that the banks have sanctioned predominantly higher number of loans to low end borrowers - a point emphasized earlier **(Figure 7.5)**.

7.3.2 Sector Analysis

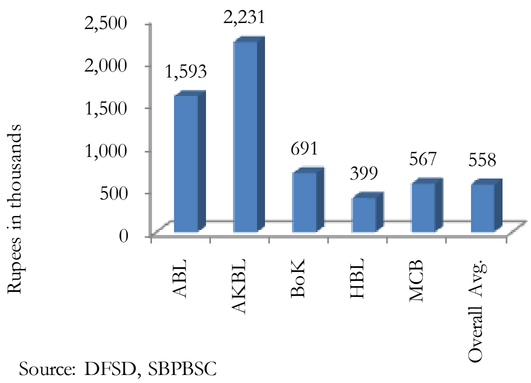
The Guarantee Facility under the Scheme is available for small enterprises and farmers with economic landholding. The Small Enterprises have been specifically defined for the scheme based on their employee strength and sales turnover (The maximum annual sales turnover for a small enterprises is Rs. 75 million). A review of the Small Enterprises availing the facility suggests that most of the financing has been provided to mid range small enterprises having a turnover of Rs.25 million with 30% of financing extended to firms having a turnover of less than Rs. 10 million. MCB Bank Ltd has extended more than 50% of its financing to the firms falling in this range.

Figure 7.4: Bankwise Max and Min loan sizes under CGS



Source: DFSD, SBPBSC

Figure 7.5: Average loan size under CGS



Source: DFSD, SBPBSC

With regard to the Agri-financing, the majority of loans extended are to farmers with meager land holding of up-to subsistence level. The data also reveals that 11% of the Agri financing amount was extended to farmers with no land holding, while most of the cases fall within the mid range land holding of 15 Acres.

7.3.3 Lending Analysis

<u>*Collateral Vs Clean Lending*</u>

The targeted beneficiaries under the Scheme are low end small and agri. borrowers. As such borrowers operate in a competitive environment with turnovers/ profits highly influenced by seasonal fluctuations and economic cycles. Therefore, banks are either reluctant to provide financing facilities to them or are only willing to lend against collaterals. In order to ensure that collateral deficient borrowers also have access to the formal sources of finance, steps have been initiated towards strengthening cash flow based financing with low emphasis on collateral.

<u>*Lending to Flood Affected Borrowers*</u>

A reasonable share of about 12% of overall guarantee portfolio has been sanctioned to flood affected borrowers while Bank of Khyber has sanctioned 33% of its cases to flood affected areas.

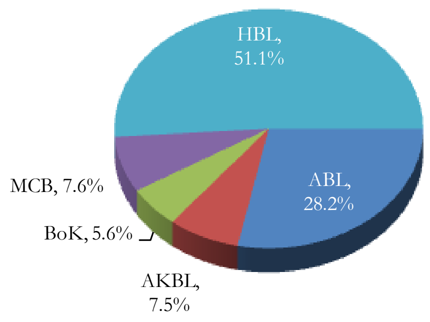
<u>*Lending to Female Population*</u>

The lending portfolio of banks is highly skewed towards male borrowers. In order to bring female entrepreneurs to the main stream, Credit Guarantee Limit of Rs. 100/- million has been allocated to First Women Bank Limited (FWBL) by SBP. This is an example that how Guarantee facility can be potential tool for enhancement in the lending to female population. It is expected that entry of the bank in the arena will improve the mix of lending to male and female borrowers and financial penetration will enhance.

7.3.4 CGS Utilization

The limits under the credit guarantee scheme have been allocated to 11 banks of which only 5 banks have so far used the facility. The utilization of the facility is a function of various elements including internal preparation of PFIs, understanding and commitment at senior management levels of PFIs, dissemination of necessary instructions to branches etc. The fast paced utilization of facility by HBL underscores the importance of commitment at head office level for utilization of the facility. The share of HBL in guaranteed exposure is more than 51% followed by ABL with 28% share. A review of HBL portfolio shows that the Bank is concentrating on lending to Small and agri. borrowers in districts/ regions of relatively low bank penetration **(Figure 7.6).**

Figure 7.6: Bankwise share in total exposure under CGS



Source: DFSD, SBPBSC

The CGS utilization shows that the scheme has picked up momentum after revision. HBL and MCB have started utilization of CGS while UBL has also shown interest in utilization of the scheme. Before revision of the scheme, Rs. 67.84 million guarantee cover was issued in three months. After revision of CGS, the guarantee utilization witnessed a robust growth and guarantees amounting Rs. 257 million were issued in first four months showing a growth of almost 4 times.

7.4 Investments of MCGF & CGS Funds

MCGF and CGS funds contributed by DFID and Government of Pakistan are also managed by the Development Finance Support Department. For prudent management of these funds, DFSD usually keeps these funds in the form of investment in risk free government securities i.e. T-bills (TBs) of varying maturities of 3, 6 and 12 months (Table 7.4).

Table 7.4: MCGF & CGS Funds Management

Amount in million Rupees

Funds	Tenor	Amount Invested
MCGF	3m T-bills	109
MCGF	6m T-bills	494
MCGF	12m T-bills	708
sub-total		**1311**
CGS	6m T-bills	1083
CGS	12m T-bills	697
sub-total		**1780**
Total		**3091**

So far DFSD has received two installments of DFID funds for MCGF. The first tranche of DFID funds amounting to GBP 5.5 million (equivalent to Rs.766 million) was received during October, 2008, whereas the second tranche of GBP 2 million (equivalent to Rs.273 million) was received during March, 2011. The total seed money available for issuing guarantees under MCGF stood at Rs. 1,040 million. Fortunately, no guarantee has been invoked so far.

As the result of MCGF funds investments, the total fund base has increased by around 26 percent to Rs. 1.3 billion, which has further been reinvested in the TBs and it is expected that at the time of maturity, total value of these funds will increase to Rs.1.4 billion which is 38.9 percent higher than the original funding amount **(Table 7.4).**

DFSD received first tranche of DFID funds for CGS in May, 2010 which amounted to GBP.5 million (equivalent to Rs. 687 million). Another tranche was received for CGS in March, 2011 amounting GBP 5 million which was equivalent to Rs. 684 million. Government of Pakistan also provided Rs. 300 million for the scheme. Thus Rs. 1,671 million was provided as total seed money for issuing CGS guarantees by both the sources. The seed capital has been invested in risk free government securities i.e. 6 months and 12 months TBs, and as on end June, 2011, the total value of these funds stood at Rs. 1950 million showing a net addition of Rs. 277 million.

7.5 Awareness and Capacity Building

During the period under review, in order to create adequate capacity in the Commercial Banks to effectively undertake the SBP Credit Guarantee Schemes, five workshops and one awareness session on SBP Credit Guarantee Schemes have been arranged by Access to Finance Units (AFUs) in coordination with DFSD and Infrastructure Housing & SME Finance Department of SBP, at BSC offices i.e., Hyderabad, Multan, Peshawar, Rawalpindi, Sukkur and Faisalabad. A total of 345 participants from the commercial banks and other stakeholders have been facilitated from these programs.

7.6 Likely Benefits of SBP's Credit Guarantee Schemes

Non Availability of timely and adequate credit is one of the most important issues faced by the SME, Agricultural and Microfinance sectors. Amongst others, major cause for low availability of bank finance to these sectors is the high risk perception of the banks in lending to these sectors. SBP's Credit Guarantee schemes are likely to bring following benefits to the economy:

- Providing indigenous long term solution to the liquidity problems of MFBs/MFIs for extending loans to micro borrowers.
- Providing commercial banks a platform for lending arrangements with MFBs/MFIs.
- It is expected that as banks improve their lending skills to MFBs/MFIs with MCGF, they, in future, would develop capacity to lend to microfinance sector without guarantee cover from SBP BSC.
- The role of micro lenders has been very critical in calamity hit areas around the world and same is expected from Pakistan's MFBs/MFIs to play their due role in recently flood hit areas.
- These schemes would be helpful in increasing outreach and financial inclusion in the country.
- Banks' reluctance in extending loans to SMEs due to increasing NPLs can be tackled by sharing risk of commercial banks through CGS.
- By increasing SME borrowers, SMEs contribution in GDP and employment generation will help in revival of the economy.
- Rural enterprises constitute a sizeable portion of rural economy and lending to this sector through CGS may bring prosperity at grass root level.

- Through these schemes a viable avenue for Banks' lending/investment will be available, which may increase flow of funds to the priority sectors like SME, Agriculture and Microfinance.

All these benefits of credit guarantee Schemes will increase private sector credit, encouragement to banks to lend to the lower segments of the society and financial inclusion by making unbankable to bankable.