Albania Credit Guarantee Schemes (CGS) Assessment

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1. Introduction

OVERVIEW (1)

- Public CGSs are government-established mechanisms that provide credit risk mitigation to lenders with the objective of increasing access to credit for enterprises (typically MSMEs). Well-designed CGSs facilitate financing to creditworthy customers, which would have been denied credit in the absence of sufficient collateral.
- CGSs are among the most market friendly interventions (minimize market distortions compared to more direct forms of intervention, little competition with genuine market players).
- CGSs are also a useful instrument for crowding in private capital as banks typically share some of the risk. CGSs work particularly well in highly liquid banking systems, which is the case in Albania.
- CGSs help to address market failures, which prevent or constrain enterprises from accessing credit. Hence, they are not an end themselves but rather are a means to solve a problem.

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OVERVIEW (2)

- Compared to direct lending programs, credit guarantee schemes have much lower funding requirements (banks provide the funding), and as such, have a leverage component. As a consequence, they can also be used when fiscal constraints are tight.
- CGSs can also be used to provide countercyclical financing to MSMEs during a downward economic cycle such as the one induced by COVID-19, when financial institutions may become unwilling to lend.
- Worldwide, more than half of all countries have a CGS in place and the number is growing. Many EU countries as well as neighboring countries in the Western Balkans have made CGSs available. Italy, Austria, Switzerland and the UK have expanded and diversified existing CGSs to stimulate bank lending to MSMEs as a response to the crisis. Kosovo and RS Entity in BiH have CGSs' in place while Serbia and BiH are in the process of establishing schemes in response to the crisis.

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2. Access to finance constraints of enterprises

Access to Finance (1)

- The financial sector is dominated by banks which are characterized by high levels of liquidity, strong risk aversion after the financial crisis, increasingly conservative policies from their parents, and lacking proper incentives or capacity to explore new and innovative approaches to finance.
- Albania's financial sector ranks at 102nd place out of 141 countries in the World Economic Forum 2019 Global Competitiveness Report.
- Credit to the domestic private sector represents only 33 percent of GDP compared to above 50 percent in regional peers, reflecting very low levels of financial intermediation in Albania

Access to Finance (2)

- According to the latest Enterprise Survey of Albania in 2019, access to loans has increased and collateral requirements have gone down. At the same time, finance is reported as a bigger obstacle in 2019 and investments are still predominantly financed internally.

	Percent of firms with a bank loan/line of credit		Value of collateral needed for a loan (% of the loan amount)		Percent of firms using banks to finance investments		Proportion of investment financed internally (%)		Proportion of investment financed by banks (%)		Percent of firms identifying access to finance as a major constraint	
	2013	2019	2013	2019	2013	2019	2013	2019	2013	2019	2013	2019
Manufacturing	32	46	262	163	18	33	76	78	12	17	10	29
Services	28	35	270	193	7	16	87	82	2	11	8	19
Small (5-19)	25	30	333	186	6	17	83	79	3	12	8	16
Medium (20-99)	38	56	145	176	28	30	77	82	21	14	10	34
Large (100+)	64	52	N/A	153	N/A	20	N/A	85	N/A	13	13	25
Direct exports are 10% or more of sales	39	60	N/A	167	N/A	38	N/A	69	N/A	18	11	37
Non-exporter	29	34	286	180	13	17	81	84	7	11	9	19
Top manager is female	31	51	n.a.	123	24	37	79	64	18	25	5	20
Top manager is male	30	35	233	194	10	18	82	85	5	9	9	22
Domestic	30	38	269	178	13	22	80	80	7	13	9	21
10% or more foreign ownership	18	41	N/A	N/A	7	17	98	82	2	12	7	21

3. Existing CGS in Albania

Key CGS operating in Albania

Scheme	Institutional set up	Type of guarantee	Beneficiary	Coverage ratio	Size of fund
AASF	Financing framework developed by European Bank for Reconstruction and Development (EBRD) in cooperation and with support from the Government of Albania	- Portfolio based risk-sharing instrument covering up to 50% of the aggregate amount of a portfolio of outstanding eligible agribusiness sub-loans - First loss risk cover provided by the Government of Albania, covering the first 20% of losses of the aggregate amount of sub-loans financed with the proceeds of loans provided under the AASF.	Agribusinesses	-50% for portfolio based pari passu guarantee - 20% first loss guarantee	EUR 36 million
The Italian - Albanian Program for the Developme nt of SMEs	Project Implementation Unit at the Ministry of Finance and Economy	Individual guarantee	Albanian enterprises; at least 70% of the loan amount on goods and services of Italian origin	50 %	EUR 5 million
The KFW RCGF	Not-for-profit foundation	Portfolio guarantee	Farmers and rural entrepreneurs	50%	EUR 33.8 million

- There are a number of guarantee schemes operating in Albania focused on specific sectors which can provide insights for the design of credit guarantee programs going forward.
- Anecdotally, several issues have impacted uptake of existing schemes including the definition of target sectors and other eligibility criteria that were in some instances perceived as too narrow, lengthy administrative procedures in particular as regards to payout, as well as the lack of business advisory services tied to the guarantee program.

Emergency credit guarantee programs

1st guarantee program (ALL 11 billion)	• 2nd guarantee program (ALL 15 billion)
• Portfolio scheme intermediated by banks • Level of coverage 100 percent of the principal • Target are all private companies (no sector specifics) affected by the COVID-19 situation • Purpose of loans covered is payment of employee salaries for up to 3 months (max monthly salaries of ALL 150,000 per employee) • Currency ALL • Maturity up to 2 years • Grace period of 3 months • No administrative costs charged, penalties for early repayment • Interest – 12 months T-Bill rate (3 last auctions average) plus a margin of 0.5 percent, but in total not higher than 2.85 percent. Interest cost fully subsidized by the government. • Banks can claim the guarantee 120 calendar days from the first date of default.	• Portfolio scheme intermediated by banks • Level of coverage 60 percent of the principal • Target are all private companies (no sector specifics) affected by the COVID-19 situation • Purpose of loans covered is working capital or investment • Currency ALL • Maturity up to 5 years • Amount of single loan up to ALL 300 mm • Grace period no less than 6 months, unless the borrower prefers otherwise • No penalties for early repayment • Interest – 12 months T-Bill rate plus a margin up to 3%, but in total not higher than 5% • Banks can claim the guarantee 180 calendar days after the last repayment date from first date of default.

3. How could a public CGS look like in Albania?

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Public CGS in support of economic recovery in ALB

- Following the launch of credit guarantee windows in Phase 1 (salaries) and Phase 2 (working capital), in response to COVID 19 crisis, it is recommended that these schemes be superseded by a CGS to support kick-starting economic recovery.

- The benefits of building full-fledged CGS framework are twofold. First, it allows to better leverage resources to maximize impact including from the private sector and international donors. Secondly, through a sound risk and governance framework, it helps mitigate the risks of possible misallocation of resources, political interference, crowding out as well as long term fiscal costs.

- Because the design of a well-functioning CGS takes time, it is important to start preparing it soon (i.e. during the crisis period) so that it is ready to start operation at the beginning of the recovery period.

- The Principles for the Design, Implementation and Evaluation of Public Credit Guarantee Schemes for SMEs, a set of international best practices developed by the World Bank in 2015, can guide the design of a new CGS.

World Bank Principles for Public CGSs (1)

The 16 principles cover four key areas that are critical for the success of CGSs

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 the operational integrity.
8. Adopt an effective and comprehensive enterprise risk management framework.

World Bank Principles for Public CGSs (2)

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 non-financial information periodically.
16. Systematically evaluate the CGS' performance and publicly disclose the findings.

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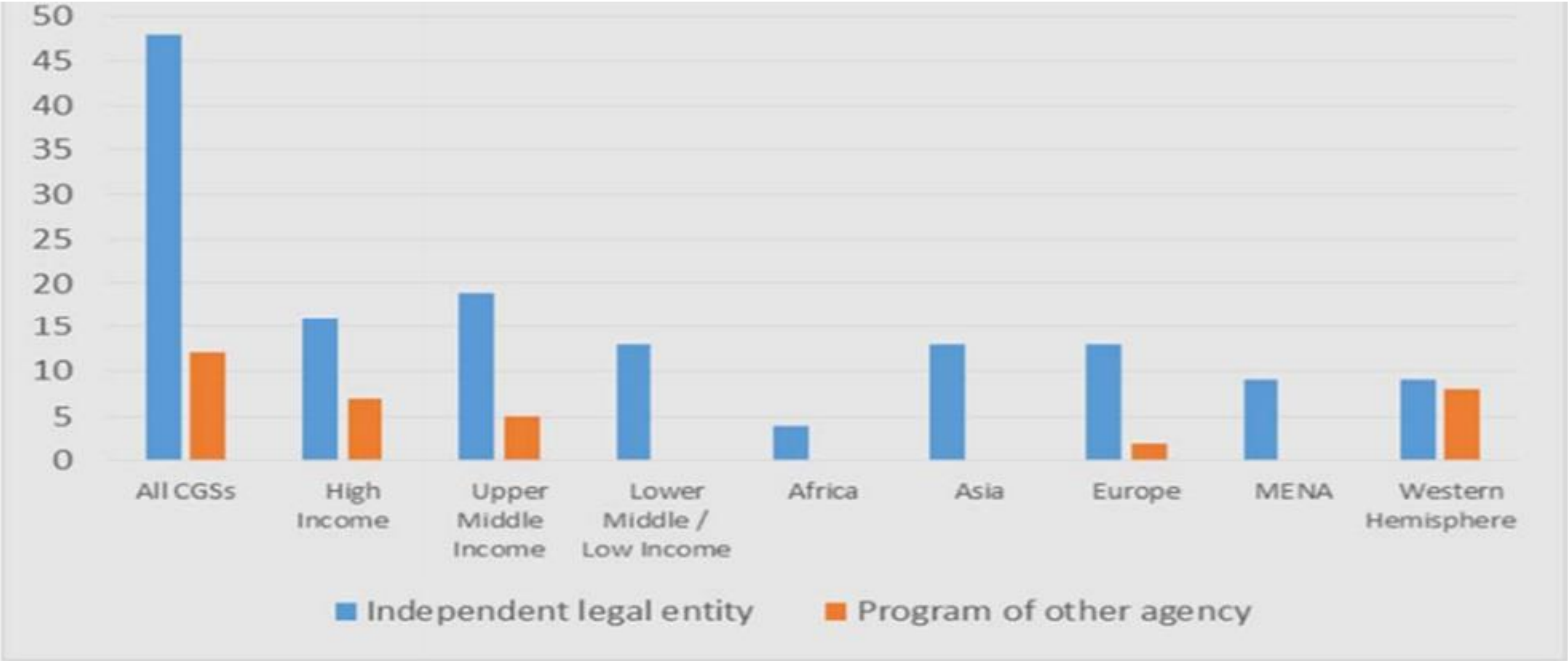
2016 WB CGSs survey - legal framework

Out of 60 public CGSs surveyed 80 percent are established as an independent legal entity and a large majority (87 percent) are established by law, decree or other special legislation.



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Assessing Implementation of the Principles for Public Credit Guarantees for SMEs: A Global Survey, World Bank 2016

Initial overview of what a CGS could look like for ALB (1)

Key Parameters	Credit Guarantee Scheme
Legal, regulatory, and institutional setup	Best set-up will need to be carefully assessed (either building on existing structures/creating a new structure) including potential transitory arrangements. Important to envisage independent and transparent corporate governance and risk management arrangements. Set clear boundaries separating legitimate government control and oversight from day-to-day operations.
Prudential regulation and supervision	Introduce prudential regulation and supervision of the CGS. Carefully assess the regulatory prudential treatment of guarantees and adjust design accordingly.
Funding	Government to provide initial capital, as funded schemes benefit from the security and credibility of the paid-in capital, but international donors and private sector could also be willing to contribute equity if the scheme is designed well.
Leverage	Suggested targeted leverage ratio should be no more than three times in the early years, moving to max of five times in later years when the CGS is well established.
Coverage ratio	The coverage ratio needs careful negotiation with the lenders to provide sufficient protection against credit risk, while also preserving incentives for banks to screen and monitor borrowers. It is recommended to consider 50% plus increased coverage ratios to incentivize certain sectors according to identified market failures or to help with crisis recovery.

Initial overview of what a CGS could look like for ALB (2)

Key Parameters	Credit Guarantee Scheme
Delivery Modality	A portfolio scheme may be most appropriate given efficiency and cost gains.
Fees	To be agreed with government and participating lenders. As a general principle, fees should reflect the cost of risk of the underlying loan portfolio, the cost of capital, and should cover the operating expenses. Fees should be reviewed on an annual basis with full and transparent disclosure and over time move to a risk-based fee system.
Eligibility criteria	To be agreed with government and participating lenders. Most likely with particular emphasis on MSMEs per the national definition.
Minimum and maximum loan amounts	To be agreed with government and participating lenders.
Type of financing	To be agreed with government and participating lenders. The CGS should be designed to be flexible to enable it to cover several loan products (e.g. working capital and investment loans).
Collateral requirements	guarantee schemes should be allowed to require collateral up to reasonable limits. This commits the borrower to an obligation to repay the loan. In many countries, CGSs take personal guarantees, or guarantors, to increase incentives for repayment.

Initial overview of what a CGS could look like for ALB (3)

Key Parameters	Credit Guarantee Scheme
Claim handling	The claim payout should be quick and predictable, in order to build the credibility of the CGS, while encouraging loan collection. Triggers for payout should be clear and the process should be simple. Lenders should continue efforts to recover the collateral through the legal system after pay-out. Successful schemes do not require that legal action is completed before claims are paid out.
Monitoring	Establish a clear division of responsibility between guarantee scheme and lenders, with the main screening and monitoring functions the responsibility of the lenders.
Evaluation	Establish a comprehensive evaluation of the CGS's performance to account for the use of public resources, measure the achievement of CGS policy objectives, and improve its operations.
Capacity Building	Consider providing capacity building programs to MSME borrowers as additional value added (i.e. business development services).
Claim handling	The claim payout should be quick and predictable, in order to build the credibility of the CGS, while encouraging loan collection. Triggers for payout should be clear and the process should be simple. Lenders should continue efforts to recover the collateral through the legal system after pay-out. Successful schemes do not require that legal action is completed before claims are paid out.

Thank you!

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