



Task Force for the Design,  
Implementation and Evaluation of  
Public Credit Guarantee Schemes  
for Small and Medium Enterprises

# PRINCIPLES

for Public Credit Guarantee  
Schemes for SMEs



Strengthening Financial Sectors



WORLD BANK GROUP

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# Foreword

Access to finance for small and medium enterprises (SMEs) has moved up the global reform agenda and has become a topic of great interest for policy makers, regulators, researchers, market practitioners, and other stakeholders. For the World Bank Group, facilitating access to finance for SMEs is a high priority, given its potential to help achieve the twin goals of eliminating extreme poverty and promoting shared prosperity. It is widely recognized that access to finance for SMEs is associated with innovation, job creation, and economic growth.

The recent global financial crisis has dented confidence that market solutions can be counted on as the primary source of access to finance for SMEs. That change has triggered renewed examination of public initiatives designed to protect or relaunch the flow of credit. A review conducted by the World Bank Group for the Group of Twenty in 2010<sup>1</sup> clearly indicated that credit guarantee schemes (CGSs) have gained prominence as a common form of government intervention in SME credit markets, especially (though not exclusively) in emerging markets and developing economies.

CGSs can contribute to the expansion of SME finance. They may also generate positive externalities by encouraging banks and nonbank financial institutions to get into the SME market, thus improving the institutions' lending technologies and risk management systems. However, CGSs may add limited value and may prove costly when they are not designed and implemented well. There have been efforts in recent years to identify good practices for CGSs, but the international community still lacks a common set of principles or standards that can help governments establish, operate, and evaluate CGSs for SMEs.

Recognizing this knowledge gap, in January 2015 the World Bank Group and the FIRST (Financial Sector Reform and Strengthening) Initiative, in coordination with the SME Finance Forum, convened a global task force to identify and draft principles for the design, implementation, and evaluation of public CGSs to improve access to finance for SMEs. The task force included delegates from the Arab Monetary Fund, the Asian Credit Supplementation Institution Confederation, the Association of African Development Finance Institutions, the European Association of Mutual Guarantee Societies, the Ibero-American Guarantee Network, and the Institute of International Finance.

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<sup>1</sup> World Bank Group, 2010.

The task force developed the CGS principles through consensus and extensive consultations that built on both the literature of good practices for CGSs (including results from global and regional surveys conducted by the World Bank Group) and sound practices successfully implemented in a number of CGSs around the world. The task force's efforts also benefited from a broad public consultation during July and August 2015 with several stakeholders—including CGSs; central banks; and international organizations, such as the African Development Bank, the European Investment Bank Group, and the Organisation for Economic Co-operation and Development.

The task force principles represent an important component of a large number of initiatives aimed at enhancing the stability and inclusiveness of the global financial system. We hope the principles will prove useful to a wide range of stakeholders whose main focus is to provide and facilitate access to finance for SMEs, including governments and CGSs, along with international financial institutions, nongovernmental organizations, think tanks, academics, private sector participants, donors, and members of the wider development community.

A handwritten signature in black ink, reading "Jan Walliser". The signature is written in a cursive, flowing style with a large initial "J".

**Jan Walliser**

Vice President, Equitable Growth, Finance, and Institutions  
World Bank Group



# Task Force Composition

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Co-chair	Pietro Calice, Senior Financial Sector Specialist, World Bank Group Moni Sengupta, Senior Financial Sector Specialist, FIRST Initiative Roya Vakil, Financial Sector Specialist, World Bank Group Roxana Caprosu, Consultant, World Bank Group

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<sup>2</sup> The secretariat is grateful to Rolf Behrndt, Simon Bell, Steen Byskov, Nancy Chen, Aurora Ferrari, Eva Gutierrez, Sebastian Molineus, Cedric Mousset, Consolate Rusagara, Ilias Skamnelos, Peer Stein and Wei Zhang (World Bank Group); Jeffrey Anderson and Matthew Gamser (SME Finance Forum); Christophe Bellinger and Luigi De Pierris (African Development Bank); Aron Gereben, Debora Revoltella and Helmut Kraemer-Eis (European Investment Bank Group); Kris Boschmans, Lucia Cusmano, Miriam Koreen and Sebastian Schich (Organisation for Economic Co-operation and Development); Giuseppe Gramigna (U.S. Small Business Administration); Alan Doran, James Hammersley, Richard Pelly, Roland Siebecke and John Wasielewski (external advisers) for their input and guidance.

# PART 1: Principles for the Design, Implementation and Evaluation of Public Credit Guarantee Schemes for Small and Medium Enterprises

## I. PURPOSE AND OBJECTIVES OF THE PRINCIPLES

Financial inclusion, particularly for small and medium enterprises (SMEs), is widely recognized as a key driver of economic growth and job creation in all economies. SME credit markets are notoriously characterized by market failures and imperfections, including information asymmetries, inadequacy or lack of recognized collateral, high transaction costs for small-scale lending, and perceptions of high risk, all of which lead to suboptimal allocation of credit. For example, in emerging markets, between 55 percent and 68 percent of formal SMEs are either unserved or underserved by financial institutions, with a total credit gap estimated in the range of US\$0.9 trillion to US\$1.1 trillion.<sup>3</sup> To address such market failures and imperfections, many governments intervene in SME credit markets in various ways.

A common form of government intervention is credit guarantee schemes (CGSs). A CGS provides third-party credit risk mitigation to lenders with the objective of increasing access to credit for SMEs. This risk mitigation happens through the absorption of a portion of the lender's losses on the loans made to SMEs in case of default, typically in return for a fee. The popularity of CGSs is partly due to the fact that they commonly combine a subsidy element with market-based arrangements for credit allocation, thereby leaving less room for distortions in credit markets than through more direct forms of intervention, such as state-owned banks.

CGSs can play an even more important role, especially in countries with weak institutional environments, by (a) improving the information available on SME borrowers in coordination with credit registries and (b) building the credit origination and risk management capacity of lenders (for example, through technical assistance for the setup of SME units). Moreover, CGSs can be leveraged to provide countercyclical financing to SMEs during a downward economic cycle when risk aversion may be heightened and a credit crunch is likely to follow.

More than half of all countries in the world have a CGS in place, and that number is growing. Governments have shown renewed interest in CGSs as a result of the global financial crisis, as well as a result of the international community's increasing emphasis on SMEs as engines for growth and employment. A CGS can be a critical policy instrument for easing financing constraints for SMEs, thus contributing to sustainable economic development and job creation.

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<sup>3</sup> See IFC Enterprise Finance Gap Database, International Finance Corporation, Washington, DC. <http://www.smefinanceforum.org/data-sites/ifc-enterprise-finance-gap> (accessed October, 2015).

For that purpose, it is essential that CGSs be properly designed and operated to achieve both outreach and additionality in a way that is financially sustainable. “Outreach” refers to the scale of the CGS, as measured by the number of guarantees issued to eligible SMEs and by the amount of outstanding guarantees. In principle, the greater the outreach, the stronger the effect of the CGS on the SME segment. However, the effect of the CGS on the supply of credit to the SME segment also depends on whether guarantees are solely (or mainly) extended to SMEs that are credit constrained—either by access or by unfavorable conditions, such as cost and maturity (financial additionality). Ultimately, an improvement in the overall economy occurs as a result of increased access and availability of capital for SMEs (economic additionality). Finally, reaching SMEs that are credit constrained involves risk taking and financial losses. Public CGSs are neither designed nor expected to make a profit. However, they should still be financially sustainable in the long term; that is, CGSs should be able to contain losses and ensure an adequate equity base relative to its expected liabilities, as well as through sufficient funding, effective risk management, and sound operational rules.

Against this background, the World Bank Group and the FIRST Initiative convened and provided secretariat support to a task force, which represented international associations of both CGSs and lenders, to develop a set of principles for the design, implementation, and evaluation of public CGSs for SMEs.

## Objective

The objective of the principles is to provide a generally accepted set of good practices, which can serve as a global reference for the design, execution, and evaluation of public CGSs. The principles propose appropriate governance and risk management arrangements, as well as operational conduct rules for CGSs, which can lead to improved outreach and additionality along with financial sustainability. The principles are built on extant literature on good practices for CGSs, including results from global and regional surveys, and draw from sound practices of existing CGSs as they have been implemented in a number of jurisdictions. Distilling these practices into a set of internationally accepted principles is expected to improve CGSs’ performance, while advancing knowledge and awareness of CGSs and their role in the economy. The principles are also expected to guide CGSs, including newly established ones, to develop, review, and strengthen their organizations, operations, and risk management practices.

To ensure a sound application of the principles, a constructive and collaborative response from the recipient countries—especially their financial sectors—is essential. The task force is of the view that the principles, if properly implemented, will help financial sector development and ultimately improve access to credit for SMEs.

## Scope of Application

The principles were developed for their application to public CGSs for SMEs. Public CGSs for SMEs are institutions created by governments, which retain de jure or de facto control as it is defined by relevant home-country laws, to provide credit guarantees to lenders in order to ease access to credit for SMEs operating in the governments' respective jurisdictions. Target SMEs may operate in any sector, including agriculture. Public CGSs can be national, regional, or local. The principles are also intended to apply to (a) two-tier CGSs, in which a system of CGSs operates locally that reinsures part of their risk to a central counter-CGS, and (b) public CGSs managed by third parties. In addition, the principles include a number of good practices that can be applied to other types of CGSs, including international CGSs, cross-border CGSs, donor-funded CGSs, and privately owned CGSs.

## Nature

The principles are a set of good practices that public CGSs either are implementing or intend to implement voluntarily. Given the intended "general" nature of the principles, they are envisioned to be applicable in all jurisdictions, regardless of their relative level of economic and financial sector development.

The principles are expected to guide country authorities in the design, implementation, and evaluation of existing and new CGSs and to help inform any related policy, legal, and institutional reform. At any rate, the principles are subject and subsidiary to existing home-country laws and regulations. The principles complement rather than replace other relevant international standards and codes applicable to CGSs.

## Preconditions for Effective Design, Implementation, and Evaluation of CGSs

CGSs are established to address market failures, which prevent or constrain SMEs from accessing credit. Hence, CGSs are not an end themselves but rather are a means to solve a problem. Therefore, market failures must be comprehensively analyzed to identify and define the problems to be addressed through a CGS and to determine if government intervention through a CGS is justified. Governments are nonetheless encouraged to pursue all necessary legal, regulatory, and institutional reforms to create environments that facilitate access to credit for SMEs.

Even if the analysis of market failures suggests that intervention through a CGS is justified in principle, an effective CGS requires a number of external elements or preconditions that may directly affect the achievement of its policy objectives. These preconditions include the following: (a) a system of business laws, including corporate, bankruptcy, contract, collateral, consumer protection, and private property laws, which provides an acceptable degree of enforcement and a mechanism for the fair resolution of disputes; (b) a sufficiently independent and efficient judiciary; (c) a comprehensive and well-defined set of accounting standards and rules and reasonably well-regulated legal, accounting, and auditing professions; and (d) a sound and liquid financial system able to originate and manage credit effectively.

These preconditions are normally outside the control or influence of CGSs. However, if a CGS is concerned that certain preconditions may actually (or even potentially) diminish its effectiveness, the CGS should make government and relevant stakeholders aware. The CGS should also, as part of its normal business operations, adopt measures to address the influence of such concerns on the effectiveness of its activities.

## Outline

The task force has identified four key areas for the success of public CGSs. Accordingly, the principles cover the following key dimensions:

- Legal and regulatory framework
- Corporate governance and risk management
- Operational framework
- Monitoring and evaluation

Good practices in the first area are intended to provide the foundations for a CGS—that is, its legal basis as well as its regulatory and supervisory framework. Sound corporate governance and sound risk management, as set out in the second area, are critical building blocks for an effectively designed and independently executed strategy aligned with the CGS’s mandate and policy objectives. Corporate governance and risk management also ensure proper monitoring of both financial and nonfinancial risks. A clear operational framework, the subject of the third area covered by the principles, provides CGSs with a course of action comprising essential working parameters. Finally, good practices identified in the fourth area reveal how CGSs must report on their performance and, more importantly, evaluate the achievement of their policy objectives.

## Implementation and Review

The task force acknowledges that implementation of the principles may be challenging for some countries. These countries—especially those with newly established CGSs—may require an appropriate transitional period. Accordingly, the principles are formulated broadly enough to accommodate different legal, regulatory, and institutional settings in various jurisdictions.

The task force also acknowledges that several aspects of the principles could benefit from further study and work. The evolving nature of the financial system, of which CGSs are an important component in many jurisdictions, as well as further experiences of public CGSs, is likely to necessitate the periodic reexamination of some aspects of the principles. Continuing coordination and consultation at the international level are also desirable for other issues of common interest to CGSs.

To facilitate this process, the task force has agreed to consider its evolution into a permanent standing group of CGSs, with terms of reference to be decided on and developed by its members. This standing group would be able to periodically review the principles (as appropriate) as well as provide member organizations with a continuing forum for exchanging ideas and sharing knowledge. The standing group could also examine ways through which aggregated information on CGSs around the world could be periodically collected and disseminated to the public.

## II. THE PRINCIPLES

### **Principle 1**

The CGS should be established as an independent legal entity on the basis of a sound and clearly defined legal and regulatory framework to support the effective implementation of the CGS's operations and the achievement of its policy objectives.

### **Principle 2**

The CGS should have adequate funding to achieve its policy objectives, and the sources of funding, including any reliance on explicit and implicit subsidies, should be transparent and publicly disclosed.

### **Principle 3**

The legal and regulatory framework should promote mixed ownership of the CGS, ensuring equitable treatment of minority shareholders.

### **Principle 4**

The CGS should be independently and effectively supervised on the basis of risk-proportionate regulation scaled by the products and services offered.

### **Principle 5**

The CGS should have a clearly defined mandate supported by strategies and operational goals consistent with policy objectives.

### **Principle 6**

The CGS should have a sound corporate governance structure with an independent and competent board of directors appointed according to clearly defined criteria.

### **Principle 7**

The CGS should have a sound internal control framework to safeguard the integrity and efficiency of its governance and operations.

### **Principle 8**

The CGS should have an effective and comprehensive enterprise risk management framework that identifies, assesses, and manages the risks related to CGS operations.

### **Principle 9**

The CGS should adopt clearly defined and transparent eligibility and qualification criteria for SMEs, lenders, and credit instruments.

### **Principle 10**

The CGS's guarantee delivery approach should appropriately reflect a trade-off between outreach, additionality, and financial sustainability, taking into account the level of financial sector development of the country.

### **Principle 11**

The guarantees issued by the CGS should be partial, thus providing the right incentives for SME borrowers and lenders, and should be designed to ensure compliance with the relevant prudential requirements for lenders, in particular with capital requirements for credit risk.

### **Principle 12**

The CGS should adopt a transparent and consistent risk-based pricing policy to ensure that the guarantee program is financially sustainable and attractive for both SMEs and lenders.

### **Principle 13**

The claim management process should be efficient, clearly documented, and transparent, providing incentives for loan loss recovery, and should align with the home country's legal and regulatory framework.

### **Principle 14**

The CGS should be subject to rigorous financial reporting requirements and should have its financial statements audited externally.

### **Principle 15**

The CGS should periodically and publicly disclose nonfinancial information related to its operations.

### **Principle 16**

The performance of the CGS—in particular its outreach, additionality, and financial sustainability—should be systematically and periodically evaluated, and the findings from the evaluation publicly disclosed.

### III. DISCUSSION OF THE PRINCIPLES

Public CGSs either have implemented or intend to implement the following principles voluntarily. The principles are subject to home-country laws, regulations, requirements, and obligations. This paragraph is an integral part of the principles and should be read in conjunction with the related explanatory notes.

#### *Legal and Regulatory Framework*

**Principle 1: The CGS should be established as an independent legal entity on the basis of a sound and clearly defined legal and regulatory framework to support the effective implementation of the CGS's operations and the achievement of its policy objectives.**

#### EXPLANATORY NOTES

The CGS should be established as an independent legal entity, thereby allowing the government to retain ownership and control and the CGS to operate efficiently and sustainably. A clearly defined legal and regulatory framework for the CGS should have its basis in appropriate and specific legislation. A domestic law or decree should authorize establishment of the CGS, either under corporate or banking legislation or under institution-specific legislation. A sound legal and regulatory framework provides the institutional foundations of the CGS, enhancing its credibility and reputation.

The CGS's legal and regulatory framework should clarify the ownership policy of the government, as well as any general terms and conditions that apply to its investment. The framework should also specify how the government will exercise its ownership, identifying who represents the government and which government body is charged with supervising the CGS. In addition, the legal and regulatory framework should set clear boundaries and should define the relationship between the government-as-shareholder and the CGS's board and management. Such boundaries separate legitimate government control and oversight from day-to-day operations; this in turn ensures the CGS's managerial autonomy and accountability, both of which are necessary for decision making. A sound legal and regulatory framework facilitates the formulation and implementation of an appropriate strategy to achieve the CGS's policy objectives. The framework should also specify the CGS's funding sources.

The task force recognizes that governments may choose to operate CGSs through development finance institutions. In these cases, CGSs should be financially and operationally independent and should apply the principles related to the operational framework (Principles 9 through 13). Moreover, the legal entity operating the CGS should ensure the sustainable functioning of the CGS in accordance with its objectives. Pay-as-you-go CGSs that are based on annual budgetary subventions and run as programs by government agencies should be discouraged.

**Principle 2: The CGS should have adequate funding to achieve its policy objectives, and the sources of funding, including any reliance on explicit and implicit subsidies, should be transparent and publicly disclosed.**

**EXPLANATORY NOTES**

The CGS should have adequate capital and government financial support to ensure effective implementation of its operations and to achieve meaningful outreach and additionality with financial sustainability. Setting up a CGS with inadequate financial resources can result in a limited developmental effect and a lack of financial sustainability, thereby seriously undermining the confidence of lenders and endangering the achievement of the CGS's policy objectives. The adequacy of funding should be determined by (a) the policy objectives that the CGS intends to achieve and (b) the volume of business it must generate to remain current on its financial obligations while ensuring long-term financial sustainability.

Clear and publicly disclosed rules, procedures, or arrangements should clarify the responsibilities of the government or ownership entity to provide the CGS's initial capital, as well as the government or ownership entity's commitment to provide additional capital or subsidies during the course of CGS operations. Sources of funding should be clearly identified. The CGS should be primarily funded out of equity endowments, which can be complemented by long-term concessionary loans either from government sources or from multilateral and bilateral institutions. To prudently manage its capital structure, the CGS should not borrow from public or private debt markets. The legal and regulatory framework establishing the CGS should set minimum capital adequacy standards for the CGS.

To mitigate fiscal risk for the government, the appropriate legislation should put limits on budget appropriations, subsidies, and guarantees. Such limits should accommodate the CGS's policy goals and should be fully consistent with the fiscal resources provided in the government accounts. Funding use and existing limits should be periodically reviewed and revised as appropriate under a fully transparent process and should be audited by a supreme audit institution or any other mandated institution, according to home-country laws.

**Principle 3: The legal and regulatory framework should promote mixed ownership of the CGS, ensuring equitable treatment of minority shareholders.**

**Explanatory notes**

Mixed ownership results when a government or ownership entity either (a) chooses a strategic private sector partner to invest in a CGS to access commercial and industry experience or (b) establishes a new CGS in partnership with the private sector. Voluntary minority participation of lenders or SMEs provides a source of finance for the CGS. Such participation may play an important role in advancing knowledge of target markets, as well as in introducing good governance practices for efficient CGS management. Mixed ownership has the further advantage of reducing moral hazard on the part of the CGS, lenders, and SME borrowers by introducing peer pressure, shared responsibility, and transparency in the decision-making process. The legal and regulatory framework establishing the CGS should encourage but should not force private sector participation in the ownership structure of the CGS.

Mixed ownership, however, poses specific governance challenges. Because the state typically retains a large ownership share, the government or ownership entity can choose all CGS board members and can make major decisions unilaterally. Even when its direct ownership share is smaller, the state may retain a high degree of control through government-linked investors, shares held through other state-owned enterprises, or special legal rights known as “golden shares.” If the government or ownership entity exploits its control rights and pursues its interests to the disadvantage of other CGS shareholders, the potential benefits of bringing in other shareholders will be undermined. Equitable treatment of shareholders is thus crucial to achieving the benefits that mixed ownership can bring. The legal and regulatory framework should assign clear responsibility for protecting the basic rights of minority shareholders and for promoting active shareholder participation in the CGS’s governance and decision-making processes.

**Principle 4: The CGS should be independently and effectively supervised on the basis of risk-proportionate regulation scaled by the products and services offered.**

**EXPLANATORY NOTES**

CGS supervisory accountabilities should be defined in the relevant legal and regulatory framework and should be clearly separated from CGS ownership and management. An effective system of supervision should assign clear responsibilities and objectives for the agency charged with the supervision of the CGS. The supervisor should ensure that the CGS is run as efficiently as possible while also minimizing the risk to taxpayers of any unexpected or unbudgeted losses that may occur in the course of normal business operations. In addition, the supervisor should have the power to evaluate and restrict policy-related activities to those explicitly listed in chartering legislation and fiscal budgets. In this regard, CGS supervision should be extended beyond safety and soundness to the evaluation of suitability and scale of policy operations. The supervisor should be empowered with the legal means to enforce prudential standards and to use corrective measures when necessary. The supervisor should be required to formally raise objections and seek administrative injunctions of inadmissible activities, should such activities be identified. These objections should be made public by the supervisor in annual reports or in a special interim report as appropriate. The legal powers of the supervisor should be reinforced with public disclosure responsibilities.

To benefit from economies of scale and to reduce the overall costs of independent supervision, supervisory powers should be vested in one entity. Normally, the country authorities would choose to empower the financial sector supervisor with responsibility for the supervision of the CGS. If this approach is adopted, the supervisor must have adequate funding and the culture of prudential supervision must be consistent with the supervisory culture of commercial financial institutions.

Supervision should be calibrated according to the nature and risks of the products and services provided by the CGS. The supervisor should have, at minimum, the responsibility to monitor (a) the CGS’s activities on the basis of its mission statement and (b) the specific lines of business its chartering legislation empowers the CGS to conduct through a sound corporate governance framework and adequate risk management systems. Moreover, the supervisor should ensure that

the CGS continuously satisfies minimum prudential capital (or maximum leverage) standards—that is, the ratio of equity to outstanding guarantees, as set either in the CGS’s chartering legislation or by supervisor-issued regulation. The prudential capital standards should be established to provide an adequate buffer to protect against unscheduled needs for fiscal support. Minimum prudential capital standards should be designed to reflect the policy objectives of the CGS and the riskiness of the business environment in which the CGS operates. Finally, the supervisor should ensure that the CGS has adequate policies and processes for the early identification and management of problem assets and for the maintenance of adequate provisions and reserves.

## **Corporate Governance and Risk Management**

### **Principle 5: The CGS should have a clearly defined mandate supported by strategies and operational goals consistent with policy objectives.**

#### **EXPLANATORY NOTES**

Clearly stating and communicating the mandate of the CGS is necessary for defining accountability, determining the scope of CGS activities, and forming the basis for identifying more specific targets for CGS operations. The mandate should be set in the legislation that establishes the CGS and include, at minimum, the target SMEs and the main line(s) of business of the CGS. In addition to the provision of credit guarantees, the mandate may encompass ancillary services, such as technical assistance, provision of information, training, and counseling. The mandate should also specify a desired level of efficiency for the CGS, which defines goals and constraints for financial sustainability. The mandate should be broad enough to ensure take-up and to accommodate cyclical developments in the target SME sectors. However, a CGS that is set up for development purposes should in principle not engage in a countercyclical role with its own resources. The latter would be better achieved through extraordinary measures, such as a counter-CGS or additional funding provided by the government, which may be implemented through the CGS on the basis of specific contractual arrangements. The mandate should be subject to periodic reviews through an explicit and transparent mechanism to assess the mandate’s continuing validity.

In accordance with its mandate, the CGS should develop coherent strategies and specific programs for different target sectors and groups. Acknowledging that different SME target sectors and groups may require different operational support, the CGS should develop tailored strategies, including one for effective communications. Management, the board of directors, and the government or ownership entity should all be involved in the development of the strategy. Management should be responsible for developing and executing the strategy, while the board should be responsible for approving the strategy and monitoring its implementation. The government or ownership entity should be responsible for monitoring the CGS’s performance and its adherence to the strategy and other commitments in line with the general objectives that the government has defined. The strategies should include specific operational goals to ensure the CGS’s performance and financial sustainability and to meet its policy objectives. Operational goals should be clear and realistic and be measured against key performance indicators and targets.

**Principle 6: The CGS should have a sound corporate governance structure with an independent and competent board of directors appointed according to clearly defined criteria.**

**EXPLANATORY NOTES**

The CGS's corporate governance framework should ensure that operational management is conducted independently. Thus business decisions are made on the basis of economic and financial considerations that align with the CGS's mandate and policy objectives and are free of political influence and interference. This framework should be set out in the CGS's legal framework, charter, or other constitutive document. The framework should ensure appropriate division of roles and responsibilities, especially among the government or ownership entity, the supervisor, the board, and the management of the CGS.

Political influence and interference, which typically result from the lack of independence of the board of directors and senior management of the CGS, are major impediments to an effectively functioning CGS. Political intervention can be limited by ensuring a clear process for appointing CGS board members. The government or ownership entity should adopt a structured and transparent appointment process that adheres to explicit policies and procedures and that seeks to ensure the board's ability to exercise its responsibilities in an independent manner. Transparency in the nomination process is necessary to ensure technical expertise consistent with the business operations of the CGS. A clear policy setting minimum standards of competency for board members should be adopted. The process by which people are appointed to the board should be made explicit in the relevant legal and regulatory framework of the CGS.

Board members should serve a fixed term and should act in the best interest of the CGS—without any conflicts of interest. Board members should act with integrity and be held accountable for their actions while being indemnified to minimize potential personal liabilities incurred during the course of normal business operations. More generally, the board should include an independent and unaffiliated member(s) from the private sector. Where a mixed ownership model is adopted, minority shareholders should be adequately empowered either through participation in the nomination process or through the appointment of a representative(s) on the board.

**Principle 7: The CGS should have a sound internal control framework to safeguard the integrity and efficiency of its governance and operations.**

**EXPLANATORY NOTES**

The CGS should have a strong system of internal controls proportionate to its size and complexity. Effective internal controls allow CGS management to know what is happening in the organization and whether instructions are being followed. The CGS's management should design internal control procedures with several purposes in mind: (a) to safeguard assets against unauthorized use or disposition, (b) to maintain proper accounting records, and (c) to ensure the reliability of financial and nonfinancial information. Control procedures should ensure that business processes and other activities are conducted properly, should mitigate the potential for misconduct, and should detect any misconduct that does occur. The board, either directly or through a relevant committee, should assume responsibility for periodically reviewing the internal controls established by the management.

The CGS should have an internal audit and compliance function. To ensure objectivity, the internal audit and compliance function should report either directly to the board or to the audit or compliance committee. The internal audit and compliance function should place particular emphasis on monitoring the CGS's control systems and should evaluate risk exposures related to the CGS's governance, operations, and information systems. In addition, the internal audit and compliance function should be able to carry out ad hoc investigations at the request either of the board or of the audit or compliance committee. The internal audit and compliance function should also have the power necessary to ensure that issues raised in investigations will be addressed, and the board or the audit or compliance committee should ensure that the internal audit and compliance function has adequate resources to carry out its tasks.

**Principle 8: The CGS should have an effective and comprehensive enterprise risk management framework that identifies, assesses, and manages the risks related to CGS operations.**

**EXPLANATORY NOTES**

The ability of a CGS to identify, measure, monitor, and control the risks it faces—as well as to determine that it holds adequate capital against those risks—is a critical component of the overall corporate governance framework. Adherence to high standards of risk management through sound operational controls and systems is an essential determinant of the CGS's performance and of the CGS's ability to execute its mandate. The CGS should adopt a sound enterprise risk management framework as part of the internal control environment. This risk framework should include reliable and accurate information, including that provided by lenders, SME borrowers, and third parties. It should also include timely reporting systems that allow for adequate monitoring and management of relevant risks within acceptable board-adopted parameters. The enterprise risk management framework should be approved by the board and subject to periodic reviews to assess its continuing relevance. At minimum, the enterprise risk management framework should identify, assess, and manage credit risk, liquidity and market risk, and operational risk.

Credit risk is the main risk a CGS faces. Although credit risk management practices may differ depending on the specific nature of the CGS and on its delivery method, all CGSs should nonetheless develop a comprehensive credit risk management that clearly defines responsibilities and accountabilities. The measurement and management of credit risk should rely on appropriate quantitative and qualitative techniques. An effective credit risk management should establish and enforce a set of relevant exposure limits (for example, by subsector, geographical area, and so forth) as well as use any appropriate technique or instrument available, such as counter-guarantees or co-guarantees, to mitigate concentration risk. The framework should also encompass sound guarantee evaluation policies and practices. Finally, the framework should include a system to identify environmental, social, and corporate governance risks associated with the CGS's guarantee business to encourage sustainable and socially responsible business development by both SMEs and lenders.

A second type of risk a CGS confronts is liquidity and market risk. The CGS must develop an effective liquidity and market risk management framework to ensure that it meets claims and hedges against adverse movements in market prices. Reliable governance arrangements, management information

systems, analysis of liquidity requirements, and contingency planning (for example, a concessional standby line of credit from the government) are crucial elements for strong liquidity and market risk management. The CGS should also have a transparent investment policy that establishes an investment framework consistent with the mandate and strategic objectives of the CGS, the approved risk profile, and monitoring procedures. Appropriate portfolio management criteria aimed at minimizing risks should guide the investment policy, which should define permissible asset classes and provide guidance on concentration risk through individual exposures, the liquidity profile, and sectoral and geographical concentration.

A third type of risk a CGS faces is operational risk. This refers to the risk of a loss either from failures in the CGS's systems and procedures or from events outside the control of the organization. Most operational risks arise from incompetence and fraud, business continuity risk, process risk, technology risk, reputational risk, and legal risk. To assess and control operational risks, the CGS should establish and document a framework that identifies lines of responsibility, segregation of duties, and reliable control mechanisms. Codes of conduct and recruitment policies are important to ensure the professional and ethical behavior of staff members involved in the CGS's operations. To ensure that the CGS can operate in the event of a technology breakdown or natural disaster, business resumption planning should be an important part of the operational risk framework.

## **Operational Framework**

### **Principle 9: The CGS should adopt clearly defined and transparent eligibility and qualification criteria for SMEs, lenders, and credit instruments.**

#### **EXPLANATORY NOTES**

The CGS should adopt clear eligibility and qualification criteria to guide operations in line with the CGS's mandate. These criteria should be publicly communicated and periodically reviewed. First, the SME target sectors and groups should be clearly defined in the policies or other relevant operational documents of the CGS. Typical eligibility criteria include firm size, subsector, and age, although in general these criteria are combined. Size is typically defined by maximum number of employees, value of assets, and sales. Many CGSs also have a number of different windows or separately designed programs dedicated to such subclasses of firms as start-ups, exporters, and high-tech firms. Other CGSs either directly or indirectly target specific ethnic groups, women, or youth, the policy aim being to encourage entrepreneurship in these specific segments of the population. A CGS may create a "negative" list of ineligible SMEs (on the basis of their credit profile and repayment reputation, for example) and may even explicitly exclude some subsectors from its scope of operations. Last, the CGS should define qualification criteria for lenders based, for example, on their interest and capacity in serving SMEs, their level of nonperforming SME loans, and their risk management capabilities.

In addition to determining which SMEs are to benefit from guarantees and which lenders qualify to use the guarantees, the CGS should clarify the type of credit instrument targeted. Credit instruments covered by a CGS typically include working capital and investment finance. The CGS should provide guarantees for both purposes. Whereas working capital finance may be important

for sustaining jobs in SMEs that are vulnerable to insolvency because of insufficient short-term credit, investment finance is essential for job creation and long-term economic growth. The CGS should cover the principal loan amount of the underlying credit instrument and, to a limited extent, the unpaid interest. On the one hand, the CGS should not give priority to the refinancing of existing guaranteed loans unless exceptional circumstances spelled out in the CGS's operational documents justify such an intervention. On the other hand, the provision of guarantees for rescheduled or restructured loans may be acceptable if additional funds are being offered on the basis of the SME borrower's prospects, with lenders retaining their share of credit risk.

**Principle 10: The CGS's guarantee delivery approach should appropriately reflect a trade-off between outreach, additionality, and financial sustainability, taking into account the level of financial sector development of the country.**

### EXPLANATORY NOTES

The modalities of extension of guarantees, which determine the relationship between the CGS and the SME borrower, should be driven by the ultimate objectives of the CGS. Two main methods of delivery are generally observed: the individual approach and the portfolio approach.

In the individual approach, guarantees are provided on a loan by loan basis. In most CGSs, the SME borrower approaches a lender, who reviews the project and makes the loan conditional upon a guarantee. Less frequently, the CGS issues an advance guarantee approval to the SME borrower, who can then use that approval to negotiate the loan with the lender. In either case, a direct relationship between the CGS and the SME borrower exists, as the former investigates all loan applications and selects those to guarantee. This relationship should reduce the probability of moral hazard on the part of the lender during the appraisal and should ensure that guaranteed SME borrowers indeed belong to target sectors and groups. However, the individual approach may involve lower outreach and higher operating costs, which may negatively affect the CGS's overall efficiency and financial sustainability.

In the portfolio approach, lenders are entitled to attach guarantees to loans without previous consultation with the CGS—but within eligible categories that have been clearly specified in contractual agreements between the CGS and the lender. In the portfolio approach there is, therefore, no direct relationship between the CGS and the SME borrower. This approach may allow the CGS to reach a larger number of SME borrowers, thereby possibly establishing a good repayment reputation for future lending relationships. Moreover, economies of scale resulting from increased business volumes make more cost-effective operations for the CGS possible. However, financial additionality may be lower than in the individual approach if a large proportion of guarantees are awarded by lenders to SME borrowers who could have qualified for nonguaranteed loans. Finally, default rates may be higher because of the risk of moral hazard on the part of the lender during the appraisal.

The choice of the CGS delivery approach should involve an analysis of the trade-offs among outreach, additionality, and financial sustainability. Whereas the individual approach may imply high costs and low outreach, the portfolio approach may make it harder to ensure that all guaranteed SME borrowers belong to target groups and sectors. Ideally, the CGS should combine both approaches, taking into account the degree of development and sophistication of the overall financial sector and of individual financial institutions. If a certain type of SME—for example, early-stage SMEs or those owned by women—is to be promoted, regardless of the specific project presented, the portfolio approach may be used. Other SMEs would necessitate the individual approach. Alternatively, loans up to a certain amount may qualify for portfolio guarantees, whereas large loans may be assessed by the CGS individually. However, in countries where market failures and imperfections in SME credit markets are pervasive, the focus should be on the individual approach. In such circumstances, the individual approach may reduce information asymmetries and improve lenders' perceptions of high risk in the SME segment, while also helping establish a trusted relationship between the CGS and the lenders.

**Principle 11: The guarantees issued by the CGS should be partial, providing the right incentives for SME borrowers and lenders, and should be designed to ensure compliance with the relevant prudential requirements for lenders, in particular with capital requirements for credit risk.**

#### EXPLANATORY NOTES

To avoid moral hazard on the parts of both lenders and SMEs, credit risk must be shared appropriately among the CGS, lenders, and SMEs. Sharing credit risk ensures that the right incentives are in place so that default and claim rates are kept as low as possible. The CGS can distribute risk to lenders through the guarantee coverage ratio, which is usually expressed as a percentage of the underlying loan exposure. The guarantee coverage ratio should be high enough to induce lenders to participate. At the same time, the ratio should allow lenders to assume a meaningful share of credit risk. In principle, the guarantee coverage ratio should not be lower than 50 percent. The ratio should be clearly indicated in the contractual agreements between the CGS and the lender. These agreements should also clarify whether the losses are shared *pari passu* between the CGS and the lender or whether the CGS covers the first loss.

The appropriate guarantee coverage ratio should be determined by the SME target sectors and groups. For example, higher coverage may be granted to SMEs operating in sectors with higher potential for job creation or job preservation, or to early-stage firms. The appropriate coverage ratio should also be a function of the delivery approach employed by the CGS. Under the portfolio approach, the guarantee coverage ratio should be lower than under the individual approach because, in the former, the lender conducts the appraisal of the SME borrowers. Finally, the appropriate guarantee coverage ratio should reflect the country's level of financial sector development. Higher coverage may be established in less developed jurisdictions. The CGS should be able to adjust its guarantee coverage ratio to reflect the CGS's credit loss history and external market developments.

Risk sharing is also important for preventing moral hazard on the part of SME borrowers, who should, therefore, retain part of the risk and demonstrate their commitment to repayment by supplying adequate collateral, if available. However, excessive collateral requirements can defeat the purpose of the guarantee; hence the CGS should work with the lender to determine appropriate collateral requirements.

The guarantee extended by the CGS should include terms and conditions that are clearly specified through contractual agreements between the CGS and the lender. These terms and conditions should comply with relevant prudential regulation of credit risk mitigation techniques, such as the Basel requirements, as they are applicable to the lender. This ensures that the guarantee issued by the CGS can provide capital relief to the lender for the proportion of the underlying loan exposure covered by the guarantee. In most jurisdictions, the prudential regulatory framework for lenders provides for favorable treatment of exposures to the government for the purpose of calculating prudential capital requirements. This implies that the guaranteed loans will benefit from lower risk weight or equivalent probability of default. However, the guarantee issued by the CGS should meet certain minimum legal requirements in seniority, revocability, and effectiveness as set by the financial regulator. The guarantee issued by the CGS should comply with these minimum requirements to maximize incentives for lenders to participate in the CGS. The guarantee issued by the CGS should also comply with the prudential rules for loan loss classification and loan loss provisioning requirements for collateralized assets, as they are applicable to the lender, thus providing a further incentive for lenders to use the guarantee.

**Principle 12: The CGS should adopt a transparent and consistent risk-based pricing policy to ensure that the guarantee program is financially sustainable and attractive for both SMEs and lenders.**

**EXPLANATORY NOTES**

The CGS should charge fees for the guarantees it provides on the basis of the riskiness of the underlying loan, which is reflected in the combination of guarantee coverage ratio, exposure at default, and loss given default. Such risk-based fees signal that guarantees have a value and also that financial sustainability is a priority for the CGS. The pricing policy should be transparent and codified in the CGS's relevant operational documents.

When determining the size and the structure of the fees, the CGS should strike a balance between the outreach goals of the guarantee program and its financial sustainability. Fees, along with the income that the CGS derives from its investment activities and any agreed-upon level of operational subsidy through government budgetary subventions, should cover the cost of operations and the expected cost of credit risk (or claims). Fees should always be levied on the amount guaranteed. The CGS should be able to adjust its pricing policy on the basis of the CGS's credit loss history and market developments.

**Principle 13: The claim management process should be efficient, clearly documented, and transparent, providing incentives for loan loss recovery, and should align with the home country’s legal and regulatory framework.**

**EXPLANATORY NOTES**

A timely, efficient, and transparent procedure for triggering claims is important to build and maintain lenders confidence. The precise circumstances under which a claim can be made should be clearly articulated in the contractual agreement between the CGS and the lender. Many CGSs have a minimum mandatory waiting period after loan disbursement before a claim can be entered. The trigger conditions for claims should specify the maximum period after a missed payment(s) and should not be conditional on initiating legal action against the SME borrower. Lenders, however, should proactively explore alternative solutions, including rescheduling, to receive payment from the SME borrower.

A clear and transparent process should ensure that guarantee payments are settled in a timely manner to avoid costly disputes. A CGS’s credibility is largely dependent on how claims are handled once they have been submitted. Contractual agreements between the CGS and the lender should clearly state the conditions under which a claim is acceptable, and a detailed written explanation should accompany the refusal of a claim. The maximum amount of unpaid interest covered by the guarantee should also be clearly specified. There should be a time limit for the settlement of claims.

Contractual agreements with the lender should detail an unambiguous and efficient process for post claim loss recovery. Loss-given-default rates for both the CGS and the lender can be reduced by pursuing SME borrowers who have defaulted on the guaranteed loans after claims have been paid. Because there may be economies of scale and scope in concentrating recovery activities in one organization, an ex-ante division of labor must be clear between the CGS and the lender, with responsibilities clearly delineated on the basis of expertise and resources. Should the CGS take over responsibility for debt recovery, the subrogation of the loan must be documented and legally enforceable. The process of debt recovery should be consistent with the home country’s legal and regulatory framework.

## **Monitoring and Evaluation**

**Principle 14: The CGS should be subject to rigorous financial reporting requirements and should have its financial statements audited externally.**

**EXPLANATORY NOTES**

Timely, accurate, and appropriately audited financial statements hold the management of a CGS accountable for the stewardship of the organization. The CGS should produce and disclose financial statements—including a balance sheet, cash flow statement, profit and loss statement, statement of changes to equity, and notes—at least annually. A management commentary should accompany annual financial statements. Financial statements should be prepared in accordance with the

home country's accounting standards for domestic private sector financial enterprises. Using the same reporting standards as private sector enterprises allows the CGS to draw on an established independent body of expertise for organizing and auditing financial statements, as well as for evaluating the statements' significance.

The CGS's financial statements should be audited by a professional, certified audit firm. An independent external audit contributes to the credibility of the CGS's financial reporting and provides reasonable assurance to the government or ownership entity, to other CGS shareholders, and to the general public that the financial statements fairly represent, in all material respects, the financial position and performance of the CGS. An external audit also provides the CGS's management with useful insights into the CGS's main risk areas related to its internal controls and reporting processes.

### **Principle 15: The CGS should periodically and publicly disclose nonfinancial information related to its operations.**

#### **EXPLANATORY NOTES**

The CGS should publicly report nonfinancial information annually, at least. Such disclosure, often qualitative in nature, should give stakeholders key insights into the workings of the CGS, its prospects, and its relationship with the government or ownership entity. Nonfinancial reporting should be linked to the policy objectives of the CGS. At minimum, the following nonfinancial information should be disclosed: (a) social and economic commitments made, (b) social and economic outcomes, and (c) any other material engagement into which the CGS has entered as a result of its status as a government-owned institution.

The CGS should disclose information related to its corporate governance structure, including board committees, if any, and relevant policies. Like private sector companies, the CGS should also disclose the aggregate and individual pay of board members and the chief executive officer, as well as the policy on which the pay is based. Board members' background, current employment, other directorships, and board and committee attendance should also be disclosed. This information should clarify which board members are serving as government officials, which members are primarily from the public sector, and which members are from the private sector. Finally, where a mixed ownership model is adopted, the CGS should disclose ownership structure and rights of minority shareholders, as well as any special right retained by the government or ownership entity. Last, the CGS should make public any agreement, including its terms, between the government and private shareholders.

**Principle 16: The performance of the CGS—in particular its outreach, additionality, and financial sustainability—should be systematically and periodically evaluated, and the findings from the evaluation publicly disclosed.**

**EXPLANATORY NOTES**

A comprehensive evaluation of the CGS's performance is necessary to account for the use of public resources, to measure the achievement of CGS policy objectives, and to improve CGS operations. The CGS should establish a sound mechanism for systematically assessing the performance of its operations. The framework for performance evaluation should be linked with the internal control environment to generate relevant data and information. The performance of the CGS should be evaluated at least every three to five years. The methodology of the performance assessment should be transparent and the findings publicly disclosed.

The performance of the CGS should be measured and evaluated along the dimensions of outreach, additionality, and financial sustainability. "Outreach" refers to the capacity of the CGS to meet the demand for guaranteed loans by SMEs. Outreach should be measured, at minimum, by the number of guarantees issued to eligible SMEs and by the amount of outstanding guarantees. However, the scale of activity of the CGS does not necessarily imply effect of the CGS.

The effect of the CGS should be assessed through measurement and evaluation of the CGS's financial and economic additionality. "Financial additionality" refers to incremental credit volumes granted to eligible SMEs as a result of CGS activities. Financial additionality also includes more favorable conditions for eligible SMEs in loan size, pricing and maturities, reduced amount of collateral required to obtain credit, and faster loan-processing time. "Economic additionality" refers to the economic welfare that the CGS generates as a result of its operations. In particular, economic additionality speaks to the effect of guarantees on employment, investment, and ultimately, economic growth. The task force acknowledges that evaluating the impact of a CGS is technically challenging because of the difficulties in establishing a counterfactual baseline. Nonetheless, the CGS should assess its financial and economic additionality on the basis of existing and widely adopted methodologies, ideally in partnership with academic and research organizations. In any event, the CGS should ensure that it collects and retains relevant data from its operations to facilitate future evaluations.

Finally, the performance evaluation framework of the CGS should include an assessment of its financial sustainability. "Financial sustainability" refers to the CGS's capacity to contain losses while continually maintaining an adequate capital base relative to its liabilities on a going concern basis. Financial sustainability indicates CGS operations' degree of reliance on public support and should, therefore, be assessed from a long-term perspective.

# PART 2: Methodology for Assessing Implementation of the Principles

## I. INTRODUCTION

The principles for the design, implementation, and evaluation of public credit guarantee schemes (CGSs) for small and medium enterprises (SMEs) are intended to become the de facto standard for effectively and efficiently establishing and running public CGSs for SMEs around the world. To fully meet their policy objectives, public CGSs must be designed and operated to achieve both outreach and additionality in a financially sustainable way. The principles are expected (a) to provide guidance to country authorities on the design, execution, and performance assessment of existing and newly established public CGSs for SMEs and (b) to help inform any related policy, legal, and institutional reform.

The principles are a set of good practices that public CGSs either are implementing or intend to implement voluntarily. Given their nature, the principles are envisioned to be applicable in all jurisdictions, regardless of their relative level of economic and financial sector development. The principles cover four key dimensions deemed critical for the success of CGSs: (a) legal and regulatory framework, (b) corporate governance and risk management, (c) operational framework, and (d) monitoring and evaluation.

The principles have been drafted at a broad conceptual level to accommodate different legal, regulatory, and institutional settings in various jurisdictions. In drafting the principles, the task force has attempted to avoid being overly prescriptive while providing sufficient guidance on the core elements of an effective and efficient legal, regulatory, operational, and evaluation framework for public CGSs. Because the principles are broadly stated, they should be complemented with a set of criteria that assesses implementation of the principles at the country level.

For that purpose, and to achieve objectivity and comparability across CGSs in different countries, the task force has developed this methodology for assessing implementation of the principles. Assessing a CGS's implementation of the principles can be considered a useful tool in measuring the CGS's adherence to an effective and efficient legal, regulatory, and operational framework. Such an assessment is expected to identify gaps in the existing framework and form the basis for remedial measures by authorities.

### Application of the Methodology

The methodology can be applied in different ways: (a) self-assessment performed by the CGSs themselves; (b) assessment performed by the government or the regulator of the CGS; (c) World Bank Group diagnostic of CGSs for SMEs—for example, in the context of the Financial Sector Assessment Program or operational work; (d) reviews conducted by third parties, such as consulting firms; or (e) peer reviews conducted, for example, by the international associations of CGSs.

## Scope and Objectives of the Methodology

The primary objective of an assessment should be to identify the nature and extent of any gap in the legal, regulatory, and operational framework governing a public CGS for SMEs. However, the assessment should not be an objective in itself; rather, it represents a means to an end. The assessment is expected to signal to the authorities any relevant area where reforms and actions may be necessary to improve the effectiveness and efficiency of a CGS.

The methodology addresses the preconditions for effective and efficient design, implementation, and evaluation of public CGSs and also addresses each principle in detail. The assessment should start with a review of the preconditions. The review should not evaluate a country's observance of the preconditions, as this is beyond the scope of this methodology. Instead, the objective of the review is to gain information about the legal and financial sector in which the CGS operates. The review should include an opinion on how any weaknesses in the preconditions may hinder an effective and efficient implementation of the CGS, and how the CGS should address those weaknesses.

To assess implementation of the individual principles, the methodology sets out (a) the key issues addressed by the principles and (b) the key questions relevant to assessing how the key issues are addressed. However, the assessment should be seen not as a checklist to be completed but rather as a qualitative and judgmental exercise to be conducted. Any “yes” or “no” (or “not applicable”) answer to a key question should be augmented by commentary that refines and explains the answer in the context of a particular country. An answer that is neither a full “yes” nor a “no” should be qualified with proper explanations. The primary goal of the assessment is not to assign a rating but rather to focus authorities on areas needing attention. This focus will set the stage for development of an action plan that prioritizes the improvements necessary to achieve full implementation of the principles.

## II. REVIEW OF THE PRECONDITIONS

This section offers general guidance on how to review the preconditions for effective design, implementation, and evaluation of public CGSs. The results of this review can provide context to the legal and financial sector environment within which the CGS operates.

The preconditions comprise the following: (a) a system of business laws, including corporate, bankruptcy, contract, collateral, consumer protection, and private property laws, that provides an acceptable degree of enforcement and a mechanism for the fair resolution of disputes; (b) a sufficiently independent and efficient judiciary; (c) a comprehensive and well-defined set of accounting standards and rules and reasonably well-regulated legal, accounting, and auditing professions; and (d) a sound and liquid financial system able to originate and manage credit effectively.

The review should pay close attention to the adequacy of the preconditions and should provide a succinct and structured factual summary that follows the headings indicated in the appendix. The review of the preconditions should be targeted, focusing on essential aspects and based as much as possible on available assessments and indicators to reduce excessive discretion.<sup>4</sup> This review should illustrate the preconditions' interaction with the assessment of implementation of the principles, thus helping to flag any individual principle whose implementation is likely to be affected by any material weakness in the preconditions.

The review of the legal environment, especially those aspects related to insolvency and creditor and debtor rights, could cover the mechanisms that provide methods for recovering debt. These include the seizure and sale of immovable and movable assets and the sale or collection of intangible assets; the legal framework for secured lending, including the existence and the main features of a reliable public registry system; any informal out-of-court process for cases of corporate financial difficulty; and the institutional framework of the insolvency system.

An overview of the independence and efficiency of the judiciary could look at the degree of integrity and impartiality of the courts; the time, cost, and number of procedures involved in a commercial sale dispute; and the main procedural and administrative bottlenecks in the insolvency process.

Review of the accounting and auditing environment could consider the strengths and weaknesses of the institutional frameworks underpinning financial accounting and auditing practices, especially for SMEs; the comparability of national accounting and auditing standards with internationally recognized standards; and the general degree of compliance with national accounting and auditing standards.

The overview of the financial system—particularly the banking sector—intended to determine its soundness and liquidity, as well as its capability to originate and manage credit effectively, could cover the capital adequacy and liquidity profile of the main financial intermediaries, and the main products and services offered to SMEs. The review could also record the track record of lenders, especially in the SME segment, in the size of their aggregate portfolio, asset quality, and profitability.

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<sup>4</sup> Sources may include the World Bank's Doing Business project, Investment Climate Assessments, Business Environment Snapshot, Enterprise Surveys, Accounting and Auditing Reports on the Observance of Standards and Codes, and the International Monetary Fund and World Bank Group's joint Financial Sector Assessment Program.

## III. CRITERIA FOR ASSESSING IMPLEMENTATION OF THE PRINCIPLES

This section lists the assessment criteria for each of the 16 principles. The criteria appear under two separate headings: key issues and key questions. As mentioned previously, the key issues detail those elements that should be present to demonstrate implementation of the principles. The key questions are intended to guide the use of the methodology in how the key issues are addressed.

The Appendix provides a template for conducting comparable and consistent assessments of the state of implementation of the principles in individual countries and for individual CGSs.

### *Legal and Regulatory Framework*

**Principle 1: The CGS should be established as an independent legal entity on the basis of a sound and clearly defined legal and regulatory framework to support the effective implementation of the CGS's operations and the achievement of its policy objectives.**

#### KEY ISSUES

1. The legal and regulatory framework of the CGS should have its basis in appropriate and specific legislation, such as a law or decree.
2. The CGS should be established as an independent legal entity and should have legal personality.
3. The legal and regulatory framework of the CGS should clarify the ownership policy of the government, including who is responsible and accountable for representing the government.
4. The legal and regulatory framework should specify which government body is charged with supervising the CGS.
5. The legal and regulatory framework of the CGS should define the relationship between the government-as-shareholder and the CGS's board and management—separating control from oversight—and should give independence and autonomy to both the board and management.
6. The legal and regulatory framework should indicate the CGS's sources of funding.
7. A CGS operated through a development finance institution should be financially and operationally independent.

#### KEY QUESTIONS

1. Is the CGS established by law, decree, or other relevant source of primary legislation?
2. Is the CGS established as an independent legal entity with legal personality?
3. Does the legal and regulatory framework establishing the CGS indicate which ownership entity (ministry, agency, and so forth) is responsible and accountable for representing the government?
4. Does the legal and regulatory framework indicate which government body is charged with supervising the CGS?
5. In the legal and regulatory framework establishing the CGS,
  - 5.1. Is the separation between government control and oversight and supervision explicitly and clearly specified?
  - 5.2. Are the CGS's board and management explicitly given sufficient independence and autonomy?

6. Does the legal and regulatory framework establishing the CGS indicate its sources of funding?
7. If the CGS is operated as a part of a government-owned development finance institution,
  - 7.1. Does the CGS have financial autonomy in the form of a separate budget and capital?
  - 7.2. Does the CGS have operational autonomy in the form of a dedicated governance body, management, and staff?
  - 7.3. Does the CGS have a specific operational framework that differs from the rest of the development finance institution's business activities?

**Principle 2: The CGS should have adequate funding to achieve its policy objectives, and the sources of funding, including any reliance on explicit and implicit subsidies, should be transparent and publicly disclosed.**

### KEY ISSUES

1. The CGS should have adequate capital and government financial support to ensure effective implementation of CGS operations in line with policy objectives set by the government.
2. The rules, procedures, or arrangements that determine the responsibilities of the ownership entity for providing the CGS's initial capital—as well as any commitment to provide additional capital or subsidies during the course of operations—should be clear and publicly disclosed.
3. The CGS should be primarily funded by equity endowments, which can be complemented by long-term concessionary loans either from government sources or from multilateral and bilateral institutions. The CGS should not borrow from public or private debt markets.
4. Limits on budget appropriations, subsidies, and government guarantees should be spelled out in the appropriate legislation.
5. The CGS should have minimum capital adequacy standards specified in its legal and regulatory framework.
6. Funding use and existing limits should be periodically reviewed and revised, as appropriate, under a fully transparent process, and they should be audited by a supreme audit institution or by any other mandated institution.

### KEY QUESTIONS

1. Does the CGS have sufficient capital and other government financial support to fulfill the CGS's policy mandate in a financially sustainable way?
2. Are the rules, procedures, or arrangements determining the contribution of the CGS's initial capital and other financial commitments, including subsidies, clear and publicly disclosed?
3. Is the CGS primarily funded through equity endowments with no recourse to borrowing from public or private debt markets?
4. Is the CGS subject to minimum capital adequacy standards established by the chartering legislation or regulation?
5. Are limits on budget appropriations, subsidies, and government guarantees clearly indicated in the appropriate legislation, and are they consistent with the fiscal resources provided in the government accounts?
6. Are funding use and existing limits on budget appropriations, subsidies, and government guarantees reviewed periodically and audited by a supreme audit institution or by any other mandated institution in line with the country laws?

### **Principle 3: The legal and regulatory framework should promote mixed ownership of the CGS, ensuring equitable treatment of minority shareholders.**

#### **KEY ISSUES**

1. The legal and regulatory framework establishing the CGS should encourage voluntary private sector minority participation in the CGS's capital.
2. Lenders and SMEs should, in particular, be encouraged to participate in the CGS's capital.
3. The legal and regulatory framework should assign clear responsibility for protecting the basic rights of minority shareholders.
4. The legal and regulatory framework should promote active shareholder participation in the governance and decisions of the CGS, for example, through direct involvement in the nomination or appointment of a representative(s) to the CGS board.

#### **KEY QUESTIONS**

1. Does the legal and regulatory framework promote voluntary minority private sector participation in the ownership of the CGS?
2. Does the CGS have lenders or SMEs among its minority shareholders?
3. Are the basic rights of minority shareholders clearly acknowledged and protected in the legal and regulatory framework?
4. Do minority shareholders actively participate in the governance and decisions of the CGS?

### **Principle 4: The CGS should be independently and effectively supervised on the basis of risk-proportionate regulation scaled by the products and services offered.**

#### **KEY ISSUES**

1. The legal and regulatory framework establishing the CGS should delineate supervisory accountabilities separate from its ownership and management.
2. The supervisor should be given clear responsibilities and objectives under the legal and regulatory framework.
3. Supervisory powers should be vested in one entity, typically the financial sector supervisor.
4. The supervisor should have both legal authority and means to enforce prudential standards and to secure corrective measures when necessary, including the power to formally raise objections and seek administrative injunctions of inadmissible activities (should such activities be identified).
5. The supervisor should have adequate funding, and the culture of prudential supervision should be consistent with the supervisory culture of commercial financial institutions.
6. Supervision should be calibrated according to the nature and risks of the products and services provided by the CGS.
7. The legal and regulatory framework establishing the CGS should set minimum capital adequacy standards for the CGS.
8. The supervisor should have, at minimum, the following responsibilities:
  - 8.1. Determining that the CGS has a sound corporate governance framework in line with international best practices.
  - 8.2. Determining that the CGS has appropriate risk management strategies, policies, processes, and limits.

- 8.3. Determining that the CGS has an internal process for assessing its overall capital adequacy in relation to its risk profile.
- 8.4. Taking necessary measures should the CGS fall below the minimum capital ratio.
- 8.5. Determining that the CGS has adequate policies and processes for identifying, classifying, provisioning, and managing problem assets.
- 8.6. Evaluating and restricting policy-related activities to those explicitly listed in chartering legislation and fiscal budgets.

## KEY QUESTIONS

1. Does the legal and regulatory framework establishing the CGS assign supervisory accountabilities separate from ownership and management?
2. Is the supervisor given clear responsibilities and objectives?
3. Does the supervisor have the legal means to enforce prudential standards and to secure corrective measures when necessary, including formally raising objections and seeking administrative injunctions of inadmissible activities?
4. Is the financial sector supervisor vested with supervisory powers?
5. Does the supervisor have both adequate funding and capacity to carry out supervisory functions?
6. Is supervision according to the nature and risks of the products and services provided by the CGS?
7. Does the legal and regulatory framework establishing the CGS include minimum capital requirements for the CGS?
8. Is the supervisor empowered with the following:
  - 8.1. Determining that the CGS has a sound corporate governance framework in line with international best practices?
  - 8.2. Determining that the CGS has appropriate risk management strategies, policies, processes, and limits?
  - 8.3. Determining that the CGS has an internal process for assessing its overall capital adequacy in relation to its risk profile?
  - 8.4. Taking necessary measures should the CGS fall below the minimum capital ratio?
  - 8.5. Determining that the CGS has adequate policies and processes for identifying, classifying, provisioning, and managing problem assets?
  - 8.6. Ensuring that the CGS performs only those activities that are explicitly listed in chartering legislation and fiscal budgets?

# Corporate Governance and Risk Management

## **Principle 5: The CGS should have a clearly defined mandate supported by strategies and operational goals consistent with policy objectives.**

### KEY ISSUES

1. The legislation establishing the CGS should explicitly state a clear mandate for the CGS.
2. The CGS's mandate should encompass, at minimum, the target SMEs and the CGS's main line(s) of business.
3. There should be an explicitly defined and transparent procedure for periodically reviewing the mandate in order to assess its continuing relevance.
4. In line with its mandate and according to clearly defined policies and processes, the CGS should develop tailored strategies and specific programs for its SME target sectors and groups.
5. The CGS's strategies should include specific and measurable operational goals to ensure that the CGS performs well and is financially sustainable.

### KEY QUESTIONS

1. Does the law or decree establishing the CGS include a clear and explicit mandate for the CGS?
2. Does the CGS's mandate specify, at minimum, the target SMEs and the CGS's main line(s) of business?
3. Is there an explicit and transparent mechanism included in the legal and regulatory framework for periodically assessing the relevance of the CGS's mandate?
4. Does the CGS have clear strategies tailored to and specific programs for its target sectors and groups?
5. Does the CGS have specific and measurable operational goals associated with those strategies?

## **Principle 6: The CGS should have a sound corporate governance structure with an independent and competent board of directors appointed according to clearly defined criteria.**

### KEY ISSUES

1. The legal and regulatory framework, charter, or other constitutive document should delineate the corporate governance framework for the CGS, ensuring appropriate division of roles and responsibilities among the government or ownership entity, the supervisor, the board, and the management of the CGS.
2. The legal and regulatory framework of the CGS should explicitly spell out a structured and transparent board appointment process.
3. There should be a clear policy that sets minimum competency standards for board members.
4. Board members should serve a fixed term and should act in the best interest of the CGS without any conflicts of interest.
5. The board should include an independent and unaffiliated member(s) from the private sector.

## KEY QUESTIONS

1. Does the CGS have an appropriate corporate governance framework spelled out in the appropriate constitutive documents?
2. Does the legal and regulatory framework establishing the CGS include a clear and transparent board appointment process?
3. Is there a policy specifying minimum criteria to ensure that CGS board members are technically capable and act independently?
4. Are CGS board members serving a fixed term?
5. Does the CGS board include an independent and unaffiliated member(s) from the private sector?

## **Principle 7: The CGS should have a sound internal control framework to safeguard the integrity and efficiency of its governance and operations.**

### KEY ISSUES

1. The CGS management should establish a strong system of internal controls to ensure that business processes and other activities are conducted consistently with the CGS's governance structure.
2. Either the board or any relevant board committee should periodically review the internal controls established by management.
3. The CGS should have an internal audit and compliance function.
4. The internal audit and compliance function should report to the board or to the relevant board committee.
5. The internal audit and compliance function should be able to carry out ad hoc investigations at the request of the board or of relevant board committee.
6. The internal audit and compliance function should have the necessary power to ensure that issues raised in investigations will be addressed and, if needed, escalated either to the board or to relevant board committee.

### KEY QUESTIONS

1. Does the CGS have a system of internal controls?
2. Is the system of internal controls established by the management periodically reviewed by the board or the appropriate board committee?
3. Does the CGS have an internal audit and compliance function?
4. Does the internal audit and compliance function report to the board or to the appropriate board committee?
5. Is the internal audit and compliance function empowered to conduct investigations at the request of the board or of the relevant board committee?
6. Does the internal audit and compliance function have the necessary power to ensure that any issue raised during investigations will be formally addressed?

## **Principle 8: The CGS should have an effective and comprehensive enterprise risk management framework that identifies, assesses, and manages the risks related to CGS operations.**

### **KEY ISSUES**

1. The CGS should adopt a sound enterprise risk management framework as part of its internal controls.
2. The board should approve the enterprise risk management framework, which should be periodically reviewed to assess its continuing relevance.
3. Ideally, the CGS should adopt a system to identify environmental, social, and corporate governance risks associated with its guarantee business.

#### *Credit risk*

4. The CGS should adopt a comprehensive credit risk management framework based on quantitative and qualitative techniques.
5. The CGSs' credit risk management framework should establish and enforce a set of relevant exposure limits (by subsector, geographical area, and so on).
6. The CGS should use any appropriate credit risk mitigation technique available, such as counter-guarantees, to manage concentration risk.
7. The CGS should adopt sound guarantee evaluation policies and practices.

#### *Liquidity and market risk*

8. The CGS should have a sound liquidity and market risk management framework to ensure that it is able to meet claims and to hedge against adverse movements in market prices.
9. The liquidity and market risk management framework should include proper governance arrangements, management information systems, analysis of liquidity requirements, and contingency planning.
10. The CGS should have a transparent investment policy that defines permissible asset classes and provides guidance on concentration risk through individual exposures, the liquidity profile, and sectoral and geographical concentration.

#### *Operational risk*

11. The CGS should adopt an operational risk management framework that clearly identifies lines of responsibility, segregation of duties, and reliable control mechanisms.
12. The CGS should have established codes of conduct and recruitment policies that ensure professional and ethical staff behavior.

**The CGS should develop a business resumption or continuity plan to ensure that the CGS can continue operations in case of a technology breakdown or natural disaster.**

## KEY QUESTIONS

1. Does the CGS have an enterprise risk management framework in place?
2. Is the enterprise risk management framework subject to board approval, and is its relevance periodically assessed?
3. Does the CGS have a framework to identify and manage environmental, social, and corporate governance risks associated with its activities?

### *Credit risk*

4. Does the CGS have a credit risk management system in place that relies on quantitative and qualitative methods of analysis?
5. Does the CGS's credit risk management framework include exposure limits by the following:
  - 5.1. Subsector of activity?
  - 5.2. Geographical area?
  - 5.3. Other?
6. Does the CGS use credit risk mitigation techniques to manage concentration risk?
7. Does the CGS have guarantee evaluation policies in place?

### *Liquidity and market risk*

8. Does the CGS have a liquidity and market risk management framework in place?
9. Does the liquidity and market risk management framework include the following:
  - 9.1. Clear governance arrangements, including division of responsibilities among relevant functions?
  - 9.2. Management information systems?
  - 9.3. Analysis of liquidity requirements?
  - 9.4. Contingency planning (for example, a concessional standby line of credit from the government)?
10. Is there an investment policy that provides guidance on permissible investments of the CGS's capital, concentration risk, liquidity profile, and sectoral and geographical concentration?

### *Operational risk*

11. Is there an operational risk management framework in place?
12. Has the CGS established codes of conduct and recruitment policies?
13. Does the CGS have a business resumption or continuity plan?

## Operational Framework

### **Principle 9: The CGS should adopt clearly defined and transparent eligibility and qualification criteria for SMEs, lenders, and credit instruments.**

#### KEY ISSUES

1. The CGS should adopt clear eligibility criteria for target SMEs to guide the CGS's operations in line with its mandate.
2. The eligibility criteria should be publicly communicated.
3. The eligibility criteria should be periodically reviewed.
4. The CGS should adopt qualification rules for partner lenders on the basis of objective criteria.
5. The CGS should clarify the type of credit instrument targeted—that is, investment finance and/or working capital finance.
6. The CGS should provide guarantees for both working capital and investment finance.
7. The CGS should cover the principal loan amount of the underlying credit instrument and, to a limited extent, the unpaid interest.

#### KEY QUESTIONS

1. Does the CGS have clear eligibility criteria for target SMEs?
2. Are eligibility criteria for target SMEs publicly communicated?
3. Are eligibility criteria for target SMEs periodically reviewed to ascertain their relevance?
4. Has the CGS adopted qualification rules for partner lenders on the basis of objective criteria?
5. Is the credit instrument targeted by the CGS—that is, investment finance and/or working capital finance—clearly specified in the appropriate policy and legal documents?
6. Does the CGS extend guarantees for both working capital and investment finance?
7. Does the guarantee issued by the CGS cover the principal loan amount of the underlying credit instrument and part of the unpaid interest?

### **Principle 10: The CGS's guarantee delivery approach should appropriately reflect a trade-off between outreach, additionality, and financial sustainability, taking into account the level of financial sector development of the country.**

#### KEY ISSUES

1. The selection of the delivery approach should involve an analysis of the trade-off between outreach, additionality, and financial sustainability.
2. The individual approach is generally preferable for relatively large loans or when the guarantee is to be used for supporting a specific project submitted by the SME borrower.
3. The portfolio approach is generally preferable for relatively small loans or when a certain type of SME—for example, early-stage SMEs or those owned by women—is to be promoted, regardless of the specific project presented.
4. In countries where market failures and imperfections in SME credit markets are pervasive and the financial sector is either unable or unwilling to engage with SME borrowers on a large scale, the focus should be on the individual approach.

## KEY QUESTIONS

1. Does the choice of the CGS's delivery approach take into account the CGS's policy objectives in outreach, additionality, and financial sustainability?
2. Is the individual approach adopted for relatively large loans or when there is emphasis on a specific project submitted by the SME borrower?
3. Is the portfolio approach adopted for relatively small loans or when there is emphasis on promoting a certain type of SME?
4. Is the individual approach justified by the pervasiveness of market failures and imperfections or by the relatively low degree of sophistication of the financial sector?

**Principle 11: The guarantees issued by the CGS should be partial, thus providing the right incentives for SME borrowers and lenders, and should be designed to ensure compliance with the relevant prudential requirements for lenders, in particular with capital requirements for credit risk.**

## KEY ISSUES

1. The guarantee coverage ratio should not be lower than 50 percent, which allows for appropriate risk sharing among the CGS, the lender, and the SME borrower.
2. The guarantee coverage ratio should be clearly indicated in contractual agreements between the CGS and the lender.
3. Contractual agreements between the CGS and the lender should clarify whether loan losses are shared *pari passu* between the CGS and the lender or whether the CGS covers the first loss.
4. The guarantee coverage ratio should depend on the SME target sectors and groups (for example, higher coverage may be granted to SMEs operating in sectors with higher potential for job creation or preservation or to early-stage firms).
5. The guarantee coverage ratio should be a function of the delivery approach employed by the CGS, with the guarantee coverage ratio lower under the portfolio approach than under the individual approach.
6. The CGS should be able to adjust its guarantee coverage ratio to reflect the CGS's credit loss history and external market developments.
7. The guarantee extended by the CGS should include terms and conditions that are clearly specified in contractual agreements with the lender. These terms and conditions should comply with relevant prudential regulation of credit risk mitigation techniques, as they are applicable to the lender, so as to provide capital relief to the lender.
8. The guarantee issued by the CGS should comply with prudential rules for loan loss classification and with loan loss provisioning requirements for collateralized assets, as they are applicable to the lender.

## KEY QUESTIONS

1. Is the guarantee coverage ratio equal to or greater than 50 percent, allowing for appropriate risk sharing among the CGS, the lender, and the SME borrower?
2. Is the guarantee coverage ratio clearly specified in contractual agreements between the CGS and the lender?
3. Do the contractual agreements specify whether loan losses are shared *pari passu* between the CGS and the lender or whether the CGS covers the first loss?
4. Is the guarantee coverage ratio set based on the SME target sectors and groups so that different coverage ratios apply to different programs?
5. Is the guarantee coverage ratio set determined on the basis of the delivery approach employed by the CGS so that different coverage ratios apply for different delivery methods?
6. Is the CGS able to vary its guarantee coverage ratio to reflect the CGS's credit loss history and external market developments?
7. Does the guarantee extended by the CGS include terms and conditions that comply with relevant prudential regulation of credit risk mitigation techniques so as to provide capital relief to the lender?
8. Does the guarantee extended by the CGS include terms and conditions that comply with prudential rules for loan loss classification and with loan loss provisioning requirements for collateralized assets for the lender?

## **Principle 12: The CGS should adopt a transparent and consistent risk-based pricing policy to ensure that the guarantee program is financially sustainable and attractive for both SMEs and lenders.**

### KEY ISSUES

1. The CGS should charge fees for the guarantees it provides on the basis of the riskiness of the guarantee provided.
2. The pricing policy should be transparent and codified in the CGS's relevant operational documents.
3. The fee amount should be consistent with the financial sustainability objective of the CGS while also attracting the interest of both SME borrowers and lenders.
4. Fees should always be levied on the amount guaranteed.
5. The CGS should be able to adjust its pricing policy on the basis of the CGS's credit loss history and market developments.

### KEY QUESTIONS

1. Does the CGS have a risk-based pricing policy—that is, a fee system calibrated according to the riskiness of the guarantee provided?
2. Is the CGS's pricing policy transparent and clearly specified in the relevant operational documents?
3. Is fee amount sufficient to ensure the financial sustainability of the CGS while also attracting the interest of both SMEs and lenders?
4. Are fees levied on the loan amount guaranteed?
5. Is the pricing policy flexible enough to allow the CGS to adjust its fees on the basis of its credit loss history and market developments?

**Principle 13: The claim management process should be efficient, clearly documented, and transparent, providing incentives for loan loss recovery, and should align with the home country’s legal and regulatory framework.**

**KEY ISSUES**

1. Contractual agreements between the CGS and the lender should indicate the precise circumstances under which the lender can submit a claim in the case of the SME borrower’s default.
2. The trigger conditions for submitting a claim should specify a maximum period after a missed payment(s) from the SME borrower.
3. The submission of a claim by the lender should not be conditional on initiating legal action against the SME borrower.
4. Contractual agreements between the CGS and the lender should describe the conditions under which a claim is acceptable and a payment can be settled.
5. Contractual agreements between the CGS and the lender should specify the amount of unpaid interest covered by the guarantee issued by the CGS.
6. There should be a time limit for the settlement of claims.
7. Contractual agreements between the CGS and the lender should detail the process of post claim loss recovery.
8. The subrogation of the loan should be clearly documented and should be legally enforceable when the CGS takes over responsibility for debt recovery.

**KEY QUESTIONS**

1. Do contractual agreements between the CGS and the lender clearly indicate the precise circumstances under which the lender can submit a claim?
2. Do the trigger conditions for submitting a claim specify a maximum period after a missed payment(s) from the SME borrower?
3. Can the lender submit a claim to the CGS before initiating legal action against the SME borrower?
4. Do contractual agreements between the CGS and the lender clearly describe the conditions under which a claim is acceptable and a payment can be settled?
5. Do contractual agreements between the CGS and the lender specify the amount of unpaid interest covered by the guarantee issued by the CGS?
6. Do contractual agreements between the CGS and the lender establish a time limit for the settlement of claims?
7. Do contractual agreements between the CGS and the lender detail the process of post claim loss recovery?
8. When the CGS takes over from the lender the responsibility for debt recovery, is the subrogation of the loan clearly documented and legally enforceable in the jurisdiction?

## Monitoring and Evaluation

### **Principle 14: The CGS should be subject to rigorous financial reporting requirements and should have its financial statements audited externally.**

#### **KEY ISSUES**

1. The CGS should produce and disclose financial statements at least annually.
2. Financial statements should be prepared in accordance with the home country's accounting standards required for domestic private sector financial enterprises.
3. The CGS should have its financial statements audited externally by a certified audit firm.

#### **KEY QUESTIONS**

1. Does the CGS produce and disclose financial statements at least annually?
2. Are the CGS's financial statements prepared in accordance with the home country's accounting standards required for domestic private sector financial enterprises?
3. Are the CGS's financial statements audited externally by a certified audit firm?

### **Principle 15: The CGS should periodically and publicly disclose nonfinancial information related to its operations.**

#### **KEY ISSUES**

1. The CGS should annually report and publicly disclose nonfinancial information related to its operations.
2. The CGS should disclose information related to its corporate governance structure, including board committees and relevant policies.
3. Like private sector companies, the CGS should disclose the aggregate and individual pay of board members and the chief executive officer, as well as the policy on which the pay is based.
4. The CGS should disclose board members' background, current employment, other directorships, and board and committee attendance.
5. Where a mixed ownership model is adopted, the CGS should disclose ownership structure, rights of minority shareholders, and any special right retained by the government or ownership entity.
6. In the case of a mixed ownership model, the CGS should disclose any agreement between the government and private shareholders.

#### **KEY QUESTIONS**

1. Does the CGS annually report and publicly disclose nonfinancial information, including at minimum, the following:
  - 1.1. Social and economic commitments made?
  - 1.2. Social and economic outcomes?
  - 1.3. Any other material engagement into which the CGS has entered as a result of its status as a government-owned institution?
2. Does the CGS disclose information related to its corporate governance structure?
3. Does the CGS disclose information related to the aggregate and individual pay of board members and the chief executive officer?

4. Does the CGS disclose information related to the board, including the following:
  - 4.1. Composition of the board?
  - 4.2. Background of its members?
  - 4.3. Current employment of its members?
  - 4.4. Other directorships?
  - 4.5. Board and committee attendance?
5. Does the CGS disclose its ownership structure, rights of minority shareholders, and any special right retained by the government?
6. Does the CGS disclose any agreement between the government and private shareholders?

**Principle 16: The performance of the CGS—in particular, its outreach, additionality, and financial sustainability—should be systematically and periodically evaluated, and the findings from the evaluation publicly disclosed.**

### KEY ISSUES

1. The CGS should develop a monitoring and evaluation framework for comprehensively and systematically assessing the performance of its operations.
2. The CGS should comprehensively evaluate its performance at least every three to five years.
3. The CGS should disclose the methodology used for evaluating its performance and the results of the evaluation.
4. The performance evaluation of the CGS should include an assessment of its outreach—that is, the capacity of the CGS to meet the demand for guaranteed loans by SMEs.
5. The impact of the CGS should be assessed through measurement and evaluation of its financial and economic additionality on the basis of existing and widely adopted research methodologies.
6. The performance evaluation framework of the CGS should include an assessment of its financial sustainability.

### KEY QUESTIONS

1. Does the CGS have a framework for comprehensively and systematically assessing the performance of its operations?
2. Does the CGS evaluate the impact of its operations at least every three to five years?
3. Does the CGS publicly disclose both the methodology used for evaluating its performance and the results of the evaluation?
4. Does the performance evaluation of the CGS comprise an assessment of its outreach, including at minimum, the following:
  - 4.1. The number of guarantees issued?
  - 4.2. The amount of outstanding guarantees?
5. Does the impact assessment of the CGS comprise an analysis of its financial and economic additionality, including at minimum, the following:
  - 5.1. Additional credit flows to target SMEs as a result of the CGS's operations?
  - 5.2. Effect of the CGS's operation on job creation in target SMEs?
6. Does the performance evaluation include an assessment of its financial sustainability?

# Appendix: Template for Assessing Implementation of the Principles

This section presents guidance and a format for the organization and methodology of the assessment reports, which the task force recommends for use by assessors in diagnostic work, including country self-assessments. The assessment report should be divided into six sections: (a) a general section providing background information; (b) the information and methodology adopted; (c) an analysis of preconditions for effective design, implementation, and evaluation of public CGSs; (d) a detailed principle-by-principle assessment; (e) a recommended action plan; and (f) authorities' responses and comments.

The following paragraphs provide a brief description of each of the six sections.

## BACKGROUND INFORMATION

This is a general section that describes the CGS being assessed and the context in which the assessment is conducted. This section should include the names and qualifications of the assessors.

## INFORMATION AND METHODOLOGY

This section should mention any self-assessments conducted by the authorities before the assessment along with any questionnaire filled out by the authorities in preparation for the assessment. The section should also mention relevant laws, regulations, and other documentation such as reports, studies, public statements, websites, and directives used for the assessment. In addition, this section should identify counterparty authorities and should mention (in generic terms) the CGS officials with whom interviews were held; other relevant government authorities; private sector counterparties; and industry associations (such as bankers' associations, auditors, and accountants). Last, this section should mention factors that impeded or facilitated the assessment—in particular, information gaps—along with an indication of the extent to which these factors may have affected the assessment.

## ANALYSIS OF THE PRECONDITIONS

This section should provide an overview of the preconditions for effective design, implementation, and evaluation of public CGSs as described in this document as follows:

- A system of business laws, including corporate, bankruptcy, contract, collateral, consumer protection, and private property laws, that provides an acceptable degree of enforcement and a mechanism for the fair resolution of disputes
- A sufficiently independent and efficient judiciary
- A comprehensive and well-defined set of accounting standards and rules, and reasonably well-regulated legal, accounting, and auditing professions
- A sound and liquid financial system able to originate and manage credit effectively

Assessors should pay particular attention to the adequacy of the preconditions. This section requires a succinct and well-structured factual review of the preconditions; experience has shown that insufficient implementation of the preconditions can seriously undermine the CGS's efficiency and effectiveness. The review of the preconditions should strictly follow the bulleted categories indicated above and should provide the information necessary to provide the reader with a clear idea of the assessment.

The assessment of implementation of individual principles should flag those principles likely to be affected by weak preconditions. However, assessors should not undertake assessment of the preconditions themselves, as this is beyond the scope of the assessment. A typical review should devote no more than one or two paragraphs to each type of precondition. The review should rely as much as possible on available assessments and indicators to reduce excessive discretion.

## PRINCIPLE-BY-PRINCIPLE ASSESSMENT

This section should provide a description of the CGS with regard to a particular principle, along with comments discussing the level of principle implementation. The assessment should be prepared according to the simple format that follows. In cases in which the authorities or the CGS are preparing either a self-assessment or an "expert-assisted" self-assessment, they should use the same template.

The template for the detailed assessment is structured as follows:

Principle (x) (repeating principle text)	
Description	
Comments	
Principle (y) (repeating principle text)	
Description	
Comments	

The “description” section of the template should provide observations of the practice as observed in the CGS undergoing assessment. Observations should cite the relevant laws, regulations, operational manuals, and so forth, insofar as it is possible. The description should be structured as follows: (a) laws and supporting regulations, (b) operational manuals and other internal documentation, (c) institutional capacity of the CGS, and (d) evidence or lack of implementation. The description should also highlight when and why assessment of a particular key issue could not be adequately performed (for example, if certain information was not provided or key individuals were unavailable to discuss important issues). If any portion of the key issue is irrelevant or not applicable to the CGS being assessed, this should also be highlighted.

The “comments” section should be used to refine and explain the answers given to the key questions in the context of the specific principle. These comments should be structured as follows: (a) the state of the laws and regulations and their implementation; (b) the state of the operational manuals and other internal documentation; (c) the state of the institutional capacity of the CGS, with particular attention given to organizational setup, staffing, information technology systems, and so forth; and (d) implementation practices.

## RECOMMENDED ACTION PLAN

Because preconditions are not part of the principles, the assessment should not contain recommendations with regard to the preconditions. However, the assessor may point out where weaknesses in the preconditions are likely to hamper effective implementation of the principles. This section should list the suggested steps for improving implementation of the principles. Recommendations should be specific in nature and proposed in the order of priority in every case of deficiency. An explanation could also be provided as to how the recommended action would lead to improving the level of implementation. The institutional responsibility for each suggested action should also be clearly indicated in order to prevent overlap or confusion. Only those principles with specific recommendations should be presented.

The template for the recommended action plan is as follows:

Recommended Action Plan to Improve Implementation of the Principles	
Reference principle	Recommended action
Principle (x)	Description of deficiency; suggested improvement
Principle (y)	Description of deficiency; suggested improvement

## AUTHORITIES' RESPONSES AND COMMENTS

The assessor should provide the authorities and the CGS undergoing assessment with an opportunity to respond to the assessment findings. This would include providing the authorities and the CGS with a full written draft of the assessment. Any differences of opinion on the assessment results should be clearly identified and included in the report. Because the assessment allows for greater dialogue among the parties involved, the assessment team should have had a number of discussions with relevant stakeholders during the assessment, so that the report might reflect the comments, concerns, and factual corrections of the authorities and the CGS. Last, the CGS should prepare a concise written response to the assessment findings. The assessment should not, however, become the object of negotiations, and assessors and authorities should be willing to “agree to disagree,” provided the authorities’ views are represented fairly and accurately.

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