PUTTING IN PLACE THE CONDITIONS TO SET UP A CREDIT GUARANTEE SCHEME FOR AGRIBUSINESS SMEs IN UKRAINE

Feasibility Study

Project Summary
March 2016

OECD Eurasia
Competitiveness Programme

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice, and work to co-ordinate domestic and international policies. The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. The European Union takes part in the work of the OECD.
www.oecd.org

OECD EURASIA COMPETITIVENESS PROGRAMME

The OECD Eurasia Competitiveness Programme, launched in 2008, helps accelerate economic reforms and improve the business climate to achieve sustainable economic growth and employment in two regions: Central Asia (Afghanistan, Kazakhstan, Kyrgyzstan, Mongolia, Tajikistan, Turkmenistan, and Uzbekistan), and Eastern Europe and South Caucasus (Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova, and Ukraine). The Programme contributes to the OECD outreach strategy implemented by the Global Relations Secretariat.
www.oecd.org/globalrelations/eurasia.htm

PUTTING IN PLACE THE CONDITIONS TO SET UP A CREDIT GUARANTEE SCHEME FOR AGRIBUSINESS SMEs IN UKRAINE

The project *Putting in Place the Conditions to Set up a Credit Guarantee Scheme for Agribusiness SMEs in Ukraine* (CGS project) emerges out of the OECD Sector Competitiveness Strategy for Ukraine, which identified high-potential sectors in the Ukrainian economy and competency-based barriers that were hindering their development. Agribusiness is a key sector identified in this work, and access to finance for agribusiness SMEs was identified as a major constraint hampering the sector's development. Within the frame of the CGS project, the OECD designed an instrument to guarantee a proportion of loans to agribusiness SMEs of 100-2000 hectares. The scheme was designed on the basis of a pilot covering four Oblasts (Cherkassy, Vinnytsia, Poltava, and Kharkiv), before being scaled up as results are revealed. This project was launched in September 2013 and concluded in February 2016. It was fully **financed by the Government of Sweden**.
www.oecd.org/globalrelations/ukraine-cgs.htm

TABLE OF CONTENTS

GLOSSARY

Agribusiness	Agribusiness represents a comprehensive value chain that covers all aspects of agricultural production (*e.g.* farming, seed and other agricultural inputs, crop production, post-harvest handling, and animal husbandry), processing, and distribution (*e.g.* wholesaling, retail sales to final consumers) (FAO, 2010; OECD, 2008).
Agricultural SMEs	In this report, when referring to the scheme's target group, this refers to enterprises farming 100-2000 hectares of land.
Counter-guarantee	A counter-guarantee is a form of back-to-back guarantee given to a Credit Guarantee Scheme (CGS) by either the state or international organisations, in exchange for a fee, to cover a portion of the potential losses when guarantees are paid out. It is as a supplementary risk-sharing mechanism.
Farmers	In this report, "farmers" refers to land-based agricultural SMEs.
Leverage ratio	Leverage ratio refers to the "multiplier effect" – the size of the scheme's guarantee portfolio relative to the size of its fund.
Moral hazard	Moral hazard describes a situation in which agents do not bear the full cost of their actions and are thus more likely to take such actions. It is particularly an issue when a party undertakes a risky action knowing that it is protected against the risk and that others will share/bear the cost.
Pari passu basis	*Pari passu* refers to loans, bonds or classes of shares that have equal rights of payment, or equal seniority.
Primary features	In this report, primary features are defined as those aspects which constitute the basic concept of the CGS. Broadly, they are the policy decisions – here, they are taken as mission, target and type of CGS.
Secondary features	In this report, secondary features are defined as all other design features of the CGS. These include coverage rate, pricing, legal form and procedures for guarantee application, and claims pay-out. They are defined based on the specific institutional and market environment, international best practice, and projections of the financial model.
Small and medium-sized enterprises (SMEs)	Since 2012, the State Statistics Service of Ukraine has started to classify SMEs largely in-line with the EU definition – the exception being that it excludes a balance-sheet criterion. SMEs are now defined as enterprises with fewer than 250 employees and generating under EUR 50 million in annual turnover.

EXECUTIVE SUMMARY

Building on the conclusions of the project's pre-feasibility study (PFS), the present feasibility study (FS) provides a more detailed set of design features for a Credit Guarantee Scheme (CGS) in Ukraine to maximise the scheme's economic and financial viability, as well as initial recommendations on its formation and framework requirements for its operation. The PFS presents (i) recommendations on primary features for a CGS in Ukraine based on international practice, including mission, targeting, type of CGS, and type of product (ii) the approach to identify potential partner banks, and (iii) project risks, as well as mitigation measures. The PFS defines the CGS mission as an instrument to increase access to finance in Ukraine's agricultural sector, and confirms the target as farms of 100-2000 hectares (ha) in Cherkassy, Vinnytsia, Poltava, and Kharkiv. It suggests that a public/private CGS be established for Ukraine, with international donor participation. The PFS also presents a method for screening potential partner banks.

The present FS provides a more detailed assessment of the scheme's economic and financial viability, as well as its regulatory landscape and the availability of donor funds. The economic and financial assessment was developed principally on the basis of a Financial model (separate file, Annex 1) that forecast the scheme's financial statements under various assumptions. This exercise found that such a scheme could be viable in Ukraine, and that it could increase credit access for approximately 4,600 members[1] of its target group over a five-year period. It found that this would require guarantee fees of at least 1% (on the loan principal) up front and 1% (of the guaranteed amount) annually, capitalisation of EUR 10 million in seed funding and EUR 1.5 million in technical-assistance funds, and a coverage rate of around 50%. These conclusions are presented in Table 1. The assessment also found that the regulatory and legal landscape should be suitable to establish a CGS in Ukraine, but that additional training (particularly for the regulator, the National Commission for the State Regulation of Financial Services Markets, or "*Natskomfinposlug*") may be required to increase capacity.

Table 1. Main conclusions of the feasibility study

Aspect	Conclusion
Guarantee Coverage Rate	The CGS should in general guarantee 50% of the outstanding loan amount from partner banks.
Pricing	The CGS should charge for the guarantee as a flat fee, initially set at 1% on the overall loan amount, and a subsequent 1% annual fee on the outstanding guaranteed amount as it declines. This is in line with international practice and provides sufficient revenue for the CGS to reach sustainability at capitalisation levels of approximately EUR 10 million as forecast in financial projections. This rate may be adjusted in the project's technical report.

[1] Data from 2015 (source: Ministry of Agrarian Policy and Food of Ukraine) found there to be approximately 2,900 land-based agricultural SMEs in the project's four pilot regions, which would mean that the proposed scheme has the capacity to guarantee 100% of these clients (and could provide over 50% with more than one guarantee). However, it has been recommended that the scheme also provide guarantees to non-land-based agricultural SMEs, the number of which cannot be accurately quantified through available data. It is believed that the number of guarantees the scheme can provide relative to the number of land-based agricultural SMEs indicates that the scheme can have an important impact on its pilot regions.

Aspect	Conclusion
Funding	State financing and support is unavailable and inadvisable, and therefore donor support should be sought for around EUR 1.5 million of technical-assistance funds for capacity-building and start-up costs during the first 24 months of operation, as well as EUR 10 million as a capital base for guarantee pay-outs.
Potential donors	The following organisations have been approached to discuss the CGS in Ukraine and potential funding: European Bank for Reconstruction and Development (EBRD), International Finance Cooperation (IFC), KfW Bankengruppe (German Development Bank), European Investment Bank/Fund (EIB/EIF), and United States Agency for International Development (USAID). They have provided useful information to better assess donor needs and maximise the chances of financial support.

Source: OECD analysis and IPC - Internationale Projekt Consult GmbH

The content summarised in this project report was discussed at the Fourth Task Force meeting held in June 2015 in Kyiv. Members of the Task Force, including representatives of the government and the National Bank of Ukraine, provided feedback on the analysis conducted, and raised issues that will be further addressed in the following stages of the project.

1. INTRODUCTION

1.1 Summary of pre-feasibility work

In this project's pre-feasibility study, the rationale for the project was set out and the scheme's primary features proposed.

The justification for such a scheme in Ukraine was based on the low competitiveness of the agricultural sector in the country despite its strategic advantages – a problem that was principally attributed to the poor environment for SMEs operating in the sector. Access to finance was identified as one of the principal constraints for such enterprises: very few bank loans go to the SME segment, whilst public policy has not been successful in addressing market failures. The analysis suggested that a guarantee mechanism could help address some of the issues that make banks wary of lending to agricultural SMEs, incentivising banks to increase the volume of credit flowing to them.

Having provided a rationale for the scheme, the study elaborated its primary features. These are broadly defined as the key policy decisions of the CGS – namely, its mission, target, and type (broadly meaning, the stakeholders governing and owning the scheme). The previous study elaborated and confirmed these features, and its recommendations were presented to, and validated by, Task Force members in February 2015. They are outlined in Table 2 below.

Table 2. Recommendations of primary features for the CGS in Ukraine

Primary feature	Recommendation
Mission	Increase loans to target group
Targeting	Small farmers operating on 100-2000 ha of land in four pilot regions
CGS Type	Public/private internationally funded CGS. The CGS in Ukraine will provide guarantees on an individual basis.

In addition to the definition of primary features, the pre-feasibility study developed a method for screening partner banks. The method aims for the final selection of two or three stable, reliable, competitive bank partners.

1.2 Scope of the feasibility work

After the scheme's primary features have been validated, the next step will be to elaborate its secondary features, which constitute all other design features of the CGS, as well as its risk management and monitoring and evaluation procedures. The majority of these will be developed in this project's technical report, but before they are elaborated it will be necessary to analyse the conditions for a CGS in Ukraine, as well as a projection of its viability.

Thus, the present report will assess the scheme's economic and financial viability through financial-statement forecasting based on various assumptions. In addition, it will assess the availability of potential sources of funding for the scheme and the fit of the supervisory and regulatory landscape. Finally, it will outline a proposed action plan for implementation of the scheme, training needs, and aspects for further analysis.

This analysis will test the viability – particularly the economic and financial viability – of such a scheme in Ukraine, but it will also lead to an initial elaboration of some secondary features. These secondary features noted in this report include the guarantee coverage rate and pricing, as well as the legal form and capitalisation of the scheme. These will be further tested and defined in the upcoming technical report.

2. REGULATORY AND SUPERVISORY FRAMEWORK

It is essential to subject a credit guarantee scheme to a certain degree of regulation, since this signals the safety and liquidity of its guarantees to partner banks (Green, 2003). Guarantee schemes operate either under special legislation (as is the case with FOGAPE in Chile) or under general regulation for financial institutions. For the purposes of this study, an initial assessment was conducted to assess the suitability of the current legal and regulatory framework for the implementation of a CGS for agribusiness SMEs in Ukraine. Using existing regulation would be preferable for this scheme, given the high costs implied for special legislation relative to the small size of the scheme and the fact that it is not a public scheme but rather a donor-funded initiative. However, an initial assessment was necessary to check its fit and suitability.

2.1 Initial assessment of the framework

An initial assessment of the regulatory and legal framework in Ukraine found that the provision of guarantees is governed by the Law of Ukraine "On Financial Services and State Regulation of Financial Markets", which specifies that loan guarantees are considered a financial service.

Under this law, the provision of guarantees is classified as a financial service and the provider is regulated by the National Commission for the State Regulation of Financial Services Markets (*Natskomfinposlug* in common parlance), which conducts both regulation and market surveillance. The law and regulation stipulate certain criteria for financial service providers:

- **Minimum size:** The Financial Services Law stipulates that in order to be registered to provide a financial service, a local entity with no regional branches must possess minimum authorised share capital of UAH 3 million. Slightly more capital is required to provide more than one service, or in case the entity has regional branches.

- **Registration:** Personnel working for *Natskomfinposlug* indicated in June 2015 that they would only recognise an entity registered as a limited liability company (LLC) as fit to provide individual guarantees to agribusiness SMEs in Ukraine that are capitalised through donor funds. This was largely on account of currency issues, and is intended to increase the scheme's operational flexibility.

- **Domicile/Ownership:** During these interviews it was confirmed that a CGS may function as either a resident or a non-resident financial institution. The scheme's founders have the option to register the scheme either as a foreign legal entity with its local representative in Ukraine, as a permanent representative office (without the status of a legal entity), or as a local legal entity (i.e. an LLC) with foreign ownership.

This initial assessment concluded that a CGS should be able to operate within the existing regulatory framework for financial services in Ukraine, and therefore it would not be necessary – or cost-effective – to develop special legislation for the scheme. Given the relative weakness of financial sector regulation in Ukraine, however, it is advisable that strong internal controls – such as robust risk management procedures – be put into place, along with internal and external oversight (monitoring and evaluation, for instance, via strict financial accounting). This will be crucial to secure both investor and partner-bank confidence in the scheme.

However, there is currently (March 2016) a proposal under discussion in the Ukrainian Parliament to dismantle *Natskomfinposlug* and to divide its responsibilities between two entities: the National Bank of Ukraine (NBU) and the State National Securities and Stock Market Commission (NCSSM). If this proposal is implemented, further analysis will be required to ensure that a potential CGS will still meet the requirements set by its regulator.

2.2 Preliminary assessment of supervisory bodies

The initial assessment of the legal and regulatory environment in Ukraine conducted in June 2015 found that currently no entities provide the type of service proposed in this project (that is, an independent legal entity providing individual guarantees) registered with the regulator. Therefore it concluded that, whilst regulation may provide a sufficient framework for oversight, it would be necessary to provide the supervisory body responsible for the regulation and oversight of financial services – namely, *Natskomfinposlug* – with additional training on specific technical elements. Given the novelty of this type of instrument, increased training on best practices for the regulation of risk-sharing mechanisms and assessment of the impact of CGS activities on the country's financial sector would be advisable.

3. FINANCIAL AND ECONOMIC FEASIBILITY

In order to assess the viability of the scheme, a financial model was developed for this report – see separate file, Annex 1 CGS Financial Model. The entire model, from the capital investment for the CGS, to the loan demand by the farmers, to the expenses for the loan guarantees, is expressed in euros (EUR). The model forecasts various financial statements in order to assess the potential quantity and volume of guarantees – as well as the profits – that the scheme could generate. These forecasts are based on assumptions, which themselves rest on an analysis of the Ukrainian context as well as findings from OECD and peer countries. Assumptions are made on features of the scheme such as typical loan amounts, coverage rates, maturities, default rates, collateral recovery rates, and macroeconomic indicators, and are justified further below. It is anticipated that this exercise can furnish the architects of the scheme with more information on the scheme's probable financial structure and cash flow, and thereby on both its feasibility and the fit of specific design features.

The model projected that with funding of EUR 10 million and guarantee fees of 1% (of principal) upfront and 1% of guaranteed amount annually, the scheme could generate over five years:

- **4,620 guarantees**
- An active **loan volume of EUR 160 million** by year 5
- **EUR 371,667 in dividend payments** between year 3 and year 5

Once the scheme's founders have been identified, this exercise should be repeated to adjust its assumptions in line with the prevailing macroeconomic context and specific aspects that the founders will decide (for instance localisation and denomination of funds, eligibility criteria, and risk appetite). A consideration of the scheme's macro- and micro-economic context at the time of foundation will be particularly important, given the high market risk in Ukraine and particularly the targeted sector, and the significant impact that such changes would have on the model's assumptions. Some of these aspects will be explored in section 3.1, followed by a description of and rationale for the scheme's current assumptions in section 3.2.

3.1 Macro and microeconomic context

The stability of a credit guarantee scheme's macroeconomic environment and banking-sector liquidity is an important determinant of its impact (Green, 2003). A scheme operating in an unstable macroeconomic environment will find it difficult (and would be ill-advised) to achieve significant leverage; its profitability (and therefore the capital available to plough back into guarantees) may be adversely affected by high default rates or volatile foreign-currency exchange rates if, for instance, the scheme's funds are denominated in foreign currency.

For the purposes of this exercise, it is important to highlight that Ukraine remains vulnerable to macroeconomic and structural weaknesses hitherto unaddressed. In 2009 and 2014 the country suffered from dramatic slumps in GDP (Figure 1) and banking crises precipitated by a dramatic depreciation of the hryvnia (UAH). These elements led to a steep increase in non-performing loans (NPLs), the almost complete cessation of loan issuance, and substantial deposit outflows. The Ukrainian economy recovered from the 2009 crisis by the first quarter of 2010 thanks to stronger-than-expected growth in the global economy, larger social transfers, and a lower price for imported natural gas. The crisis that began in 2014, however, is ongoing.

Figure 1. Frequency of shocks in Ukraine (1987-2014)

Source: World Bank data

On the microeconomic side, a survey and related research conducted in the scheme's proposed pilot regions produced estimations of credit demand amongst the target group, as well as firm dynamics and creditworthiness. These are computed in the assumptions of the financial model presented below, and will be factored into the deliberation of secondary features for the project's technical report.

3.2 Modelling assumptions

In order to forecast the scheme's various financial statements, assumptions have been based on the typical profile of guarantees, macroeconomic indicators, the nature of the scheme's expenses and revenue, the scheme's risk appetite, and the scheme's capital base.

The assumptions in the financial model – namely, the scheme's capital, expenses, the loans themselves and repayments – are expressed in EUR. The rationale for conducting the financial modelling exercise in EUR is that modelling in UAH can be unreliable given the high macroeconomic volatility in Ukraine. It is also expected that the functional currency of the scheme will be EUR, since it would not have a source of UAH funding in the way that a bank would (i.e. through its deposits) and none of the banks consulted during this stage of the project anticipated a guarantee in UAH. However, this will also depend on where the scheme's funds are located, which will be discussed in the project's technical report but which will be dependent, in the end, on the wishes of the scheme's donors and the Ukrainian government. It is also important to bear in mind that the guarantees will be provided in EUR at the value of the day of the signing of the contract, but the majority of loans would be extended to farmers in UAH (although loans could be provided in EUR if the banks wish); therefore, a scheme using EUR as its functional currency will need to be attentive to exchange-rate fluctuations and the impact of fluctuations on its performance.

3.2.1 Guarantee profile

Average guarantee size

- Based on an analysis of the typical loan amounts requested by the target group in Ukraine, it is anticipated that the average size for a medium-term loan will be around EUR 75,000. Given that the financial model is expressed in EUR (including the expected inflation and loan growth rates), it is anticipated that the average loan size might increase over time to reach EUR 79,602 by year 5. Experience in other CGS suggests that average loan amounts tend to increase over time simply because the creditors' confidence in the ability to take credit risk typically increases – which is reflected in more flexible decision-making on loan amounts, gradually increasing the average loan amounts.

Coverage rate

- Based on international good practices, desk research[2], and the outcomes of the financial model, it is recommended that the scheme guarantee 50% of the outstanding loan amount in EUR from partner banks, which could be up to 60-70% for priority sectors that the CGS founders identify. This rate may be further refined as the scheme is set up.

- The loan risk needs to be shared amongst the lender, the borrower, and the guarantor. The coverage rate should reflect a trade-off between attractiveness and moral hazard. It should sufficiently share credit risk whilst encouraging banks to participate in the scheme. The experience in OECD countries suggests that coverage rates should generally be above 50% but well below than 100%. For schemes operating in the agricultural sector, a rate of 50-60% is typical, reflecting the higher level of credit risk relative to loans in other sectors.

- It should be noted that the guarantee itself would be provided at 50% of the EUR value of the loan on the date that the loan contract is signed, regardless of whether the loan is extended in EUR or UAH. If the bank subscribes the loan in UAH, therefore, it would bear the risk of currency fluctuations and the potential of additional (above 50%) losses if the UAH deteriorates further against the EUR. This arrangement would increase the need for vigilance of bank performance on the part of the CGS – through rules and monitoring – since it may increase the value of the guarantee[3] over repayment if the UAH depreciates, thus decreasing incentives for a bank to conduct proper credit appraisal when disbursing loans or to attempt a resolution in the event that a client is unable to meet his or her repayment obligations.[4]

Average guarantee duration

- Based on an analysis of the typical maturities of loans granted in Ukraine, it is anticipated that the average maturity for a medium-term loan in Ukraine will be 24 months (with 12 months typical for short-term loans and 36 months typical for long-term loans).

---

[2] Desk research was carried out throughout the project by the OECD and Internationale Projekt Consult GmbH (IPC). For further reference, please refer to Task Force meetings presentations and IPC reports.

[3] Specifically, it could mean that the bank will profit more to receive the guarantee (which would now be worth more in UAH) than repayment from the client.

[4] Explicitly, it could increase the incidence of moral hazard.

Collateral requirements

- The CGS will not take additional collateral other than that provided to the partner bank by the guaranteed borrower.

3.2.2 Macroeconomic indicators

Exchange rate

- The UAH/EUR exchange rate in the first year of the scheme's operation is assumed to be 24.23 UAH to 1 EUR, which is the 2015 average level. It is assumed that this will increase by 11.84% year on year, which reflects average exchange-rate fluctuations between 1998 and 2013.[5]

3.2.3 Expenses

Claim rate

- The model assumes a 2% default rate in year 1, increasing to a 2.8% rate by year 5 due to the greater volume of credit being guaranteed and the objective of the CGS to guarantee more "risky" loans as the scheme matures. The default rate is based on the rates of a market leader for SME financing in Ukraine. Levitsky (1998) states that it is not common for a bank that conducts proper client screening to have an SME loan portfolio with a default rate of more than 5%. He suggests that if claim rates surpass 5% of the total volume of guarantees, it is a sign that the CGS should take remedial action.

Administrative costs

- An estimate of administrative requirements, local prices, and salaries in Ukraine suggests that the scheme's initial (year 1) staffing bill will be around EUR 132,250, rising to EUR 545,065 by year 5. The estimates project the initial bill for other operational costs at EUR 21,011 in year 2, rising to EUR 75,234 by year 5.

3.2.4 Income

Upfront guarantee fee

- Based on a review of international practice, desk research[6], and the outcomes of the financial model, it is proposed that the CGS in Ukraine should set its pricing of the guarantee as a flat fee, initially set at 1% on the overall loan amount.

- Given the possibility of moral hazard, it is recommended that the CGS not have a direct relationship with the borrower, with the guarantee being sought by the bank after an eligible client has applied for a loan (known as an *ex post* approach). Thus the initial fee would be paid by the client to the bank, which would transfer this fee to the CGS upon loan closure. This approach contrasts with an *ex ante* guarantee, where the borrower typically seeks a guarantee before applying for a loan.

---

[5] Source: National Bank of Ukraine, official exchange rate of hryvnia versus foreign currencies. The 2014 and 2015 rates are removed from this calculation, due to extraordinary and sharp depreciation experienced during these two years.

[6] Desk research was carried out throughout the project by the OECD and IPC. For more information, please refer to Task Force meetings presentations and other project reports.

Annual guarantee fee

- Based on international practice and discussions with partner banks, an annual fee of 1% of the guaranteed amount has been assumed in the financial model. This rate may be adjusted following the development of a pricing model in the project's technical report, yet a full pricing model can be developed only once the scheme is operational and has begun to generate a sufficient volume of data (on default rates, for instance). It is envisaged that this fee will be paid by banks to the CGS until the loan is completely paid off. It is also expected that this fee will be built into the repayment schedule of the borrower and, as such, will be transferred on a monthly or quarterly basis to the CGS, or otherwise if the loan product of the bank is seasonal.

- Aside from fees (both annual and upfront), and as mentioned previously, the scheme is expected to generate income from investment of its fees and seed capital as well as income from recovery payments following loan default and claim payment. One source of recovery income could be from liquidised collateral.

Recovery income

- In case of a delinquent loan, the CGS will receive income from the recovery of the collateral that the borrower provided to the bank to secure its loan. The bank will be responsible for conducting the recovery proceedings, as well as valuation, based on its specialised knowledge in this area. This information should be provided to the CGS so a sample of recovery outcomes can be checked, for instance by the scheme's lawyer. The CGS will cover only the "net loss" of the bank, after recovery of all the collateral. All recoveries will then be shared *pari passu* between both parties. In the financial model, it is estimated that the CGS will recover 20% of all claims paid out, based on with the experience of local commercial banks. In addition, it is expected that the scheme will subsequently receive 50% of the claim pay-out from a counter-guarantor**,** if a counter-guarantee mechanism is in place. It is anticipated that an institution such as the European Investment Bank/Fund (EIB/EIF) could provide this counter-guarantee.

Investment income

- The CGS will receive investment income on the cash and investment assets serving as collateral. The revenues received will vary based on the interest rates on offer by banks and investment funds for deposits of the excess cash of the CGS. Further information on the pros and cons of the location of the funds either within or outside Ukraine is presented in the project's separate technical report.

3.2.5 Risk appetite

As indicated above, the scheme not only targets a risky sector but will also operate in a rather unstable and vulnerable macroeconomic environment, making the scheme vulnerable to high default rates (particularly in times of economic crises), exchange-rate depreciation, and high inflation. The risk appetite of the scheme's founders will determine, for instance, how far it leverages from its capital base and thus the volume of guarantees provided relative to its assets.

Leverage rate

- This refers to the level of the scheme's outstanding guarantees relative to its capital base. The financial model suggests that the scheme could reach a leverage ratio of 5 times the scheme's capital base by the fifth year of operation. Leverage ratios vary across OECD countries, and can be set only once the scheme is in operation and begins to build up its knowledge base (in order, for instance, to know the rate of guarantee claims against the volume of guarantees outstanding, as well as the level of demand). Levitsky (1998) states that a leverage of 5 times the scheme's capital base by year 5 is acceptable, since a lower ratio raises questions about the value of the scheme and a higher ratio – which should not exceed 10 times the capital base after seven to ten years of operation – may be too risky and advisable only in stable macroeconomic environments, with a well-diversified portfolio and strong bank partners.

3.2.6 Funding modalities

In addition to providing the guarantees, the scheme will require funds to facilitate its operation, particularly in its early stages before it begins to generate substantial income. The scheme's funding needs are estimated at EUR 10 million in seed capital and EUR 1.5 million in technical assistance funds for two years of start-up and administrative costs. The use of a counter-guarantee should also be considered to maximise the effectiveness of the guarantees and the attractiveness of the scheme to partner banks. A description of the scheme's funding needs is provided below.

Seed capital and technical assistance

- Based on market demand in the CGS's target regions, the CGS financial model indicates that EUR 10 million will be needed as seed capital to implement and operate the CGS over 5 years so that it can reach its additionality aims in a sustainable fashion. Furthermore, it is recommended that a technical assistance (TA) component amounting to EUR 1.5 million be made available for the first 24 months of operation. Over half of the TA envelope will be earmarked for the salaries of key personnel, and the remainder is for various costs such as office rental, office equipment and software, and initial legal expenses. Having these funds in place will ensure that the scheme has sufficient capital to launch the company until it begins to generate its own income.

Counter-guarantee

- In order to mitigate SME lending risk, it is proposed that the CGS endeavour to secure a counter-guarantee from multilateral institutions. A counter-guarantee is a form of back-to-back guarantee given to a CGS by a state or an international organisation in exchange for a fee, which should cover a portion of potential losses in the event that the back-to-back guarantee is claimed. In this case, a counter-guarantee is cashed in if the borrower fails to repay his or her loan and the partner bank claims guarantee payment from the CGS.

- A counter-guarantor/guarantee mechanism has been recommended given the risky environment in Ukraine, in order to share risk still further and to boost both the value and the liquidity of the scheme's capital – thus increasing the scheme's attractiveness to potential investors, namely international donors during the inception phase and/or other private investors over the longer term. Such counter-guarantees are offered by international institutions such as EIF and the EIB under their dedicated programmes COSME Loan Guarantee Facility, as well as the Swedish International Development Co-operation (SIDA).

3.3 Projection of key financial accounts

Based on these assumptions, financial-statement forecasting was conducted to anticipate the scheme's future profitability, liquidity, financial structure, and growth. A balance sheet, an income statement, and a portfolio report were elaborated. The forecasts developed in these statements are presented below.

3.3.1 Balance sheet

The scheme's balance sheet will elucidate the financial structure of the fund, its financing method, and its capacity for future growth – which here principally means the scheme's feasible leverage ratio. It will provide an overview of the scheme's assets and liabilities at the time of reporting. The balance sheet is presented in Figure 2.

Figure 2. Financial Model 5-Year Projections: Balance Sheet

Assets	Notes	2016	2017	2018	2019	2020
Current assets						
Cash	1	€ 4,086,750	€ 6,157,953	€ 7,191,499	€ 9,304,521	€ 10,410,943
Receivables	2	€ 165,000	€ 334,950	€ 763,397	€ 1,278,499	€ 2,235,996
Total current assets		**€ 4,251,750**	**€ 6,492,903**	**€ 7,954,896**	**€ 10,583,019**	**€ 12,646,939**
Property, Plant, Equipment						
Buildings + land		€ -	€ -	€ -	€ -	€ -
Equipment		€ 110,000	€ 88,000	€ 66,000	€ 44,000	€ 22,000
Accumulated depreciation		€ 22,000	€ 22,000	€ 22,000	€ 22,000	€ 22,000
Total PPE		**€ 88,000**	**€ 66,000**	**€ 44,000**	**€ 22,000**	**€ -**
Total assets		**€ 4,339,750**	**€ 6,558,903**	**€ 7,998,896**	**€ 10,605,019**	**€ 12,646,939**
Liabilities and equity		**2016**	**2017**	**2018**	**2019**	**2020**
Liabilities						
Borrowings	4	€ 200,000	€ 200,000	€ 200,000	€ 200,000	€ 200,000
Guarantee liability	6	€ 165,000	€ 334,950	€ 763,397	€ 1,278,499	€ 2,235,996
Total liabilities		**€ 365,000**	**€ 534,950**	**€ 963,397**	**€ 1,478,499**	**€ 2,435,996**
Shareholder equity						
Shareholder capital		€ 4,000,000	€ 6,000,000	€ 7,000,000	€ 9,000,000	€ 10,000,000
Retained earnings		€ (25,250)	€ 23,953	€ 35,499	€ 253,041	€ 421,887
Dividends paid	5	€ -	€ -	€ -	€ 126,521	€ 210,943
Total shareholder equity		**€ 3,974,750**	**€ 6,023,953**	**€ 7,035,499**	**€ 9,126,521**	**€ 10,210,943**
Total liabilites and equity		**€ 4,339,750**	**€ 6,558,903**	**€ 7,998,896**	**€ 10,605,019**	**€ 12,646,939**
Check		-	-	-	-	-
Outstanding guarantees (Off-balance)		***5,588,443 €***	***16,549,432 €***	***28,654,545 €***	***46,532,256 €***	***73,540,638 €***

3.3.1.1 Projected liabilities

The scheme's principal liabilities will be its guarantee commitments and any repayment obligations for borrowed funds that were used to cover short-term liquidity gaps. In addition, its equity obligations are counted as liabilities: it is anticipated that shareholder dividends will begin to be paid after year 3. The above projections suggest that assets and liabilities (including shareholder equity) will be roughly balanced throughout the five projected years of operation, with outstanding guarantees remaining off the balance sheet and increasing from EUR 5,588,443 in year 1 to EUR 73,540,638 by year 5 (roughly 1,216% year 1 level – relative to the 191% increase in the scheme's asset base from year 1 to year 5).

3.3.1.2 Projected assets

The scheme's principal current assets will be its cash (both liquid and invested) and receivables, whilst its fixed assets will be its property in the form of buildings, land, and equipment, the accumulated value of which is expected to depreciate over time. The scheme's receivables are estimated based on guarantee disbursement levels.

3.3.2 Income statement

The scheme's income statement, sometimes known as the profit-and-loss statement, will reveal the fund's capacity to cover costs with income, as well as its general profitability. It will provide an overview of the scheme's revenue and expenses, allowing for a real or anticipated calculation of annual turnover and its impact on the value of assets and liabilities entered into the scheme's balance sheet. The income statement is represented in Figure 3.

Figure 3. Financial Model 5-Year Projections: Income Statement

Income statement	2016	2017	2018	2019	2020
Revenue					
Fees on guarantee facility	€ 40,000	€ 20,000	€ 10,000	€ 20,000	€ 10,000
Fees on new guarantees	€ 150,000	€ 304,500	€ 587,228	€ 983,461	€ 1,597,140
Fees on previous loans	€ -	€ 150,000	€ 304,500	€ 587,228	€ 983,461
Deposit interest earned	€ 84,000	€ 124,000	€ 144,000	€ 184,000	€ 204,000
Recoveries	€ 30,000	€ 200,970	€ 458,038	€ 767,099	€ 1,341,597
Other income	€ -	€ -	€ -	€ -	€ -
Total income	**€ 304,000**	**€ 799,470**	**€ 1,503,766**	**€ 2,541,788**	**€ 4,136,198**
Expenses					
Start-up costs	€ 1,500,000				
Salaries	€ 132,250	€ 216,804	€ 342,447	€ 385,228	€ 545,065
Admin costs	€ -	€ 21,011	€ 36,086	€ 72,152	€ 73,234
Claims paid	€ 165,000	€ 334,950	€ 763,397	€ 1,278,499	€ 2,235,996
Depreciation	€ 22,000	€ 22,000	€ 22,000	€ 22,000	€ 22,000
Financing costs	€ 10,000	€ 175,494	€ 296,545	€ 475,323	€ 745,406
Other costs	€ -	€ -	€ -	€ -	€ -
Total expenses	**€ 1,829,250**	**€ 770,259**	**€ 1,460,474**	**€ 2,233,201**	**€ 3,621,702**
Extraordinary income/expenses					
Donor operating grants	€ 1,500,000	€ -	€ -	€ -	€ -
Non-operating expenses	€ -	€ -	€ -	€ -	€ -
Total extraordinary income/expenses	**€ 1,500,000**	**€ -**	**€ -**	**€ -**	**€ -**
Profit before taxes	**€ (25,250)**	**€ 29,211**	**€ 43,292**	**€ 308,587**	**€ 514,496**
Taxes	€ -	€ 5,258	€ 7,793	€ 55,546	€ 92,609
Profit after taxes	**€ (25,250)**	**€ 23,953**	**€ 35,499**	**€ 253,041**	**€ 421,887**
Dividends	**€ -**	**€ -**	**€ -**	**€ 126,521**	**€ 210,943**
Retained earnings	**- 25,250**	**23,953**	**35,499**	**126,521**	**210,943**
Cumulative	- 25,250	- 1,297	34,202	160,723	371,667

3.3.2.1 Projected expenses

The scheme's principal expenses will be operational costs such start-up costs, salaries, and administrative costs; the cost of guarantee claim payments; and depreciation and financing costs. The above projections suggest that expenses can be covered by income after year 1, with dividend payments also made possible after year 3.

3.3.2.2 Projected revenue

The scheme's principal income will originate from guarantee fees (both up-front and annual), income from capital investment, and income from collateral recovery on defaulted loans. The pricing of guarantees is perhaps the most dominant lever the scheme has to increase its income, and should be considered to ensure that the guarantees sufficiently cover the scheme's expenses, particularly operational costs. Fees are generally high for smaller enterprises to ensure that they are risk-adjusted, but also, as is relevant here, to ensure that they account for the higher transaction costs implied when guaranteeing loans to smaller enterprises.

3.3.3 Portfolio report

The portfolio report (Figure 4) serves as an annex to the scheme's balance sheet. This document provides the scheme's founders and management with a full picture of the scheme's receivables, which will appear on its balance sheet only once payments owed to the scheme are written off as unpaid.

3.3.3.1 Guarantee activity

Guarantee activity denotes the real or anticipated growth of the scheme's portfolio over time. It will also indicate the quality of the portfolio, including the volume of claims paid out, the volume of outstanding guarantees, and the volume of new (guaranteed) bank lending.

The model anticipates that the number of guarantees that the scheme provides annually will increase from 200 in year 1 to 1,360 in year 3 (580% year 1 level) and to 4,620 in year 5 (2210% year 1 level). This anticipated growth is projected based on supply-side assumptions of the volume of guarantees that the scheme can realistically cover without exposing itself to an unsustainable level of risk. It is assumed that credit constraints in the pilot regions are sufficiently high to make supply-side rather than demand-side considerations the main driver of growth.[7]

The current financial model assumes a variable annual growth rate. In this project's pre-feasibility study, those eligible for guarantees are defined as agricultural SMEs holding 100-2000 ha of land – initially only those located in four regions of Ukraine: Cherkassy, Kharkiv, Poltava, and Vinnytsia. Based on this targeting, further eligibility criteria should be defined. These criteria will be further defined in the project's technical report, incorporating additional criteria such as annual turnover as a further definition of firm size, the term of the loan, and the purpose of the loan. The scope of firms that are eligible for guarantees, as well as the scheme's capital base, its risk appetite, and the performance of guaranteed loans, will determine the portfolio growth of the scheme. The first three aspects must be fine-tuned upon initial set-up (but can be redefined later); the final aspect will be clarified based on historical data once the scheme is operational.

[7] A definitive figure on the number of underserved agricultural SMEs (100-2000 ha) in the pilot regions is difficult to estimate. As a proxy, 72% of the firms sampled by IPC during the aforementioned study visit claimed to be credit-constrained. Previous OECD analysis (2012) estimated the figure at between 80-90%.

Figure 4. Financial Model 5-Year Projections: Portfolio Report

Guarantee activity	Notes	2016	2017	2018	2019	2020
Desired guarantee capacity in EUR	1	6,262,125	18,671,860	28,941,997	46,632,603	72,876,604
New bank lending (+) in EUR		15,000,000	30,450,000	58,722,825	98,346,051	159,713,987
Amount repaid (-) in EUR	5	3,523,114	13,182,597	33,655,706	61,560,425	103,782,229
Bank loans outstanding (=) in EUR		11,476,886	33,768,764	58,835,883	95,621,508	151,553,267
New guarantees issued (+) in EUR	3	7,500,000	15,225,000	29,361,413	49,173,026	79,856,994
Claims paid (-) in EUR		150,000	334,950	763,397	1,278,499	2,235,996
Outstanding guarantees (=) in EUR		5,588,443	16,549,432	28,654,545	46,532,256	73,540,638
Remaining guarantee capacity in EUR	1	673,682	2,122,428	287,453	100,348	- 664,033
Actual leverage		1.33	2.67	3.98	5.06	7.21
as % of desired leverage		89%	89%	99%	101%	103%

Financing activity	Notes	2016	2017	2018	2019	2020
1. Paid-in capital / donations:	2					
Technical assistance grant in EUR	4	**1,500,000**	N.A.	N.A.	N.A.	N.A.
Donor 1 (TBD) in EUR			2,000,000	N.A.	N.A.	N.A.
Donor 2 (TBD) in EUR	6	4,000,000	N.A.	N.A.	N.A.	N.A.
Donor 3 (TBD) in EUR		N.A.	N.A.	1,000,000	2,000,000	1,000,000
Banks (TBD)		N.A.	N.A.	N.A.	N.A.	N.A.
Private Sector (TBD)		N.A.	N.A.	N.A.	N.A.	N.A.
Subtotal in EUR		4,000,000	2,000,000	1,000,000	2,000,000	1,000,000
Subtotal (Culmulative) in EUR		**4,000,000**	**6,000,000**	**7,000,000**	**9,000,000**	**10,000,000**
2. Borrowing for guarantee activities	3					
Lender 1 (liquidity / bank) in EUR	7	200,000	N.A.	N.A.	N.A.	N.A.
Lender 2 (TBD)		N.A.	N.A.	N.A.	N.A.	N.A.
Lender 3 (TBD)		N.A.	N.A.	N.A.	N.A.	N.A.
Subtotal (Culmulative) in EUR		**200,000**	**200,000**	**200,000**	**200,000**	**200,000**
Total financing base in EUR		**4,200,000**	**6,200,000**	**7,200,000**	**9,200,000**	**10,200,000**
Retained earnings (after dividends) in EUR		**- 25,250**	**23,953**	**35,499**	**253,041**	**421,887**

Assumptions

1 As per desired leverage amounts in assumptions worksheet
2 Financing activity reflects cash needs of the projected guarantee activities in accordance with CGS vision and mission
3 Assumptions to be adjusted when CGS is set up
4 Initial technical assistance / staffing grant from donor for launch of operations, not a basis for income
5 Broken out in more detail in "guarantee products" worksheet
6 Initial capital grant from donor for launch of operations
7 Funding is mainly equity but some debt for liquidity and cash needs

3.4 Conclusions of financial-modelling exercise

The financial-modelling exercise found that 4,620 guarantees can be provided over five years under the assumptions outlined in section 3.2. According to estimates of the Ministry of Agrarian Policy and Food of Ukraine (MoAPF), there are approximately 2,900 land-based agricultural SMEs in the project's four pilot regions, which means that there is sufficient scope to guarantee at least one loan to a large proportion of these SMEs over five years. This should also allow the scheme some scope for flexibility – for instance, to leverage more slowly (*i.e.* guarantee less loans), if conditions are not right. The financial model projects an even distribution in the number of guarantees by maturity (one-third provided for short-term loans, one-third for medium-term loans, and one-third for long-term loans). Given that guarantee levels are 50% of the total loan size for each product, the model anticipates an average guarantee size of EUR 37,500 for short-term working capital loans, EUR 75,000 for mid-term investment loans, and EUR 112,500 for long-term investment loans[8].

These findings suggest that the scheme is financially viable but will require initial seed capital and technical assistance funds to assist with start-up costs before it begins to generate significant independent income. It is proposed that the scheme be set up with EUR 10 million in seed capital and EUR 1.5 million in technical assistance funds to cover its operational costs over the first 24 months. The scheme's seed capital should be invested, and most schemes use income from fees (with the recommendation this be initially substituted with technical assistance funds) to cover operational costs, whilst guarantee claim pay-outs are covered using income from investment. This tends to be best practice on account of liquidity and return-on-investment considerations: operational costs are typically more predictable and regular than guarantee pay-outs, thus the scheme will experience lower transaction costs and less risk of asset/liability mismatches if it directly pays operational costs using income from fees as they arrive rather than unlocking invested funds for the purpose. It is important to invest the maximum volume of funds possible, however, in order to ensure higher returns.

Moreover, this exercise allowed for the modelling of specific features to test their viability as summarised in Figure 5. It suggests, for instance, that the scheme can operate with fees of 1% (up-front on the loan principal and annual on the guaranteed amount) and that a coverage rate of 50% (no higher) is advisable. These features will be further fine-tuned in the subsequent technical report to maximise the additionality and sustainability of the CGS in Ukraine.

Figure 5. Secondary features suggested by financial model and legal analysis

Secondary feature	Description	Design aspect
Coverage rate (%)	50	Guarantee product
Fees (%) *Upfront* *Annual*	 1 1	
Application	*Ex post*	Guarantee processes
Capitalisation	EUR 10 million for seed capital EUR 1.5 million in TA funds	Funding and registration
Legal form	Limited liability corporation (LLC)	

8 Given the relatively low level of long-term financing in Ukraine, "long-term" is taken as having a maturity of 36 months.

4. SCREENING OF POTENTIAL DONORS

4.1 General aspects/classification

This section presents the international financial institutions (IFIs) that are potentially interested and/or could finance the establishment of a CGS in Ukraine. The main objective of this section is to identify suitable institutions that potentially have a strong motivation for supporting the establishment of a CGS in Ukraine. The Task Force and other key stakeholders in Ukraine should gain an understanding of these institutions and thus be better prepared for a targeted and informed dialogue with them once the design of the CGS advances.

Funding for a CGS in Ukraine will be needed in order to increase and diversify its guarantee operations, which are critical to the success of the company. As explained in the previous section covering the financial model and its projections, it is estimated that total funding of at least EUR 11.5 million will be required in order to ensure the CGS's sustainability over a five-year term. The required funding will comprise technical assistance funds of EUR 1.5 million and seed capital to cover guarantee claims amounting to EUR 10 million. Approximately EUR 3 million of the latter will be allocated to cover claims in years 1 and 2 of operation, with an additional 7 million required as the CGS grows until year 5.

It is expected that initial funding for the scheme should come from international development institutions such as IFIs and/or bilateral aid agencies. At least one principal source of funding should be identified and a formal application should be made for funding as soon as possible in order to secure other sources of capital for sustainable operation. It must be taken into account that multilateral development banks and investment vehicles, whilst likely to be the most available sources of funds, do not typically have short approval times.

As part of this study, the OECD and IPC have screened funding sources and approached some institutions for an assessment of their interest in the scheme, as well as their needs/requirements, in order to maximise the chances of securing funding. Funds can be secured only once the CGS is fully designed and the representatives of the public sector are nominated in the supervisory board, however, since the supervisory board should provide strategic support for the scheme and demonstrate the commitment of the government in discussions with donors.

A final point to mention is that as it matures, the scheme will start to generate its own income from guarantee fees and the reinvestment of funds, including return on capital. As the scheme matures it should thus continue to grow and increase its profitability, enhancing its enterprise value for share- and stakeholders. If the scheme wishes to attract private investment or ownership at a later stage, and the primary motivation for private-sector investors will be distributed profits in the form of dividends, it is clear that the CGS's initial supporters should assume that a successful funding strategy in the medium to long term will be linked to eventual dividend payments for investors.

4.2 Type of institutions considered

In order to prioritise potential sources of funding, the project has rated bilateral and multilateral development institutions on the extent to which they fulfil the following requirements:

- Extensive expertise in financial-sector development, ideally through banking-sector support projects
- Proven expertise in Ukraine (or neighbouring countries)

- Strong interest in Ukraine and the country's economic and financial stabilisation (ideally with a project portfolio in Ukraine)
- Strong interest in the agribusiness sector
- Access to financial and/or technical-assistance funds (in terms of available funds and suitable procedures and requirements for funding approval)

Based on these ratings, international development institutions have been separated into two categories: category A, which denotes preferable and potentially leading partners, and category B, which denotes potentially non-leading partners that should be approached at a later stage.

4.2.1 Institutions considered in category A

A number of institutions with potentially strong motivation to support the establishment of the CGS have been identified and classified as category A institutions. These are the European Union (EU), the European Investment Bank (EIB), the European Investment Fund (EIF), the European Bank for Reconstruction and Development (EBRD), the International Finance Corporation (IFC), the US Agency for International Development (USAID), and KfW Bankengruppe (German Development Bank). Preliminary discussions with some of these institutions have taken place in the context of the project, and should be continued by the Task Force leadership once design is completed. The key outcomes of these discussions are presented in Table 3.

Table 3. Outcomes of preliminary discussions with potential funding partners

IFIs (category A)	EIB Group	EBRD	KfW	USAID
General interest in creation of target-group oriented CGS for Ukraine	yes (very high)	yes	yes	yes
Establishment of CGS in line with own strategy for Ukraine	yes	depends on the level of subsidies (potential conflict of interest)	yes	yes
Own experience with CGS (competence)	EIF core competence (EU lead institution for guarantees)	yes (various initiatives)	mixed, recent analysis of lessons learnt	through Development Credit Authority (DCA)
Own partial loan guarantee products/facility planned for Ukraine	yes, one of three pillars for Ukraine	considered, but early introduction unlikely	no	operational EERE financing/few PFIs
Access to grant funds for Ukraine	high (main source: EU)	limited access to grant money for own products	high (main source: Germany)	high (main source: US)
Sovereign guarantee required (Ukrainian government involvement)	very important	only in specific cases	very important	to be clarified
Specific aspects of institutional interest mentioned	SME, agricultural sector	SME, agricultural sector	SME, agricultural sector, Eastern Ukraine, institution-building	SME, agricultural sector

Financial involvement in Ukrainian CGS (main direction)	provision of counter-guarantees	partner (providing on-lending funds to PFIs of CGS	co-investor	not yet discussed
Regular follow-up requested	yes	yes	yes	yes

A description of each of the institutions approached, and their relevance to the CGS, is as follows:

The European Investment Bank Group

The EIB group provides finance and expertise for sound and sustainable investment projects that contribute to furthering EU policy objectives. More than 90% of its activity is focused on Europe, but it also supports the EU's external and development policies, with more than 440 projects each year in 160 countries. One of its focal areas is to facilitate continuous and affordable access to finance for SMEs. In 2014, the total volume of EIB funds allocated to SME-related projects amounted to EUR 25.5 billion.

The EIB Group was formed in 2000, and comprises the EIB and the EIF. The EIB is the EU’s policy-driven, non-profit, long-term lending institution. The EIF is the EIB’s venture-capital arm, tasked with providing risk financing and guarantees for SMEs. In Eastern Partnership countries, the bank invests in activities that promote growth, employment, and intraregional trade, and that help to protect the environment and mitigate climate change.

The EIB’s flagship SME-support programme is the Competitiveness of Enterprises and SMEs programme, or COSME. This programme will run from 2014 to 2020 with a planned budget of EUR 2.3 billion. COSME supports SMEs by promoting better access to finance and markets, supporting entrepreneurs, and promoting business creation and growth.

One of the principal financial instruments of this programme is the Loan Guarantee Facility (LGF). The LGF is managed by the EIF, which uses the instrument to provide guarantees and counter-guarantees -- including securitisation of SME debt-finance portfolios -- to selected financial intermediaries such as guarantee institutions, banks, and leasing companies. Ukraine is interested in joining COSME and negotiations are ongoing. The EIF may be interested in providing counter-guarantees to a CGS in Ukraine using the COSME LGF.

European Bank for Reconstruction and Development

The EBRD is active in more than 30 countries, from Central Europe to Central Asia and the Southern and Eastern Mediterranean. The EBRD serves the interests of all of its shareholders -- 64 countries, plus the European Union (EU) and the European Investment Bank. Ukraine joined the EBRD on 13 April 1992. The main priorities of the EBRD in Ukraine include providing the banking sector with targeted long-term credit and equity funding, as well as technical assistance to strengthen the sector’s future stability, in areas such as governance, diversification of long-term funding sources, and support for local-currency lending to the extent possible. The EBRD works with other IFIs and the NBU to address important issues such as enabling the EBRD to provide loans in local currency. Ukraine is the bank’s second-largest country of operation, and the EBRD is the single largest financial investor in Ukraine. As of October 2015, the EBRD had committed EUR 10.94 billion through 344 projects in the country, of which EUR 5.1 billion are currently active, among them various SME finance projects[9].

[9] European Bank for Reconstruction and Development (EBRD), the EBRD in Ukraine.

International Financial Corporation

The IFC co-ordinates its activities with the other institutions of the World Bank Group but is legally and financially independent. The organisations that make up the World Bank Group are owned by the governments of member nations. Ukraine became a member of IFC on 18 October 1993. IFC is not a bank in the ordinary sense, but is rather a source of finance and technical assistance focusing on the private sector and providing investment, advice, and asset management. IFC began operating in Ukraine through advisory projects on privatisation and land reform and today combines investments and advisory services with a particular focus on agricultural business, infrastructure, energy efficiency/cleaner production, and financial markets. In the 2014 fiscal year, IFC's commitments to Ukraine totalled roughly USD 471 million. IFC has significant expertise in agricultural finance, which could be leveraged in the context of the CGS in Ukraine[10].

US Agency for International Development

USAID is the lead U.S. government agency responsible for administering civilian foreign aid. The USAID's Development Credit Authority (DCA) uses risk-sharing agreements to mobilise local private capital in order to fill financing gaps attributable to a lack of access to loans by SMEs. USAID is increasingly working with banks through a programme that Chemonics International is implementing to provide some support to the banking sector in Ukraine. This project is predominantly working with local credit unions in an effort to unlock their capital to lend to very small (below 100 ha) farmers and to improve the creditworthiness of these farmers through training. At the same time, USAID and the DCA have expressed a strong interest in expanding activities in Ukraine.

German Development Bank (KfW Bankengruppe)

The German Development Bank (KfW Bankengruppe) supports the Ukrainian banking sector via a number of financial-sector development programmes. Most notably, KfW established the German-Ukrainian Fund in 1996 to support a number of Ukrainian banks in developing SME lending activities. Most recently, KfW received a BMZ mandate to manage a newly-established EUR 500 million fund for the reconstruction of the Ukrainian economy. Furthermore, Ukraine and Germany signed a joint statement in January 2015 on the provision of credit guarantees. The CGS may qualify for financial contributions within the framework of this initiative.

4.2.2 Institutions considered in category B

In recent years, specialised firms have emerged for the management of international development funds, such as Finance in Motion, ResponsAbility and Blue Orchard. Their role is not only to manage funds provided by public institutions (such as the EBRD, KfW, and IFC), but also to mobilise private investments that can increasingly leverage initial public grants. To give an example in the area of micro- and SME finance, Finance in Motion has been successfully managing the European Fund for Southeast Europe (EFSE) which provides, amongst other things, funding and technical assistance for investments in agricultural livestock and agricultural processing. The EFSE's outstanding investment portfolio totals more than EUR 1 billion, but only a very small percentage of its funds were provided for investments in Ukraine, where it has a representative office.

In addition, a number of other, more specialised development institutions such as the U.S.-based Overseas Private Investment Corporation (OPIC) or the Netherlands' Development Finance Company

[10] International Finance Cooperation (IFC), World Bank Group, IFC in Ukraine.

(FMO) might be interested in joining the CGS initiative. However, these institutions should be contacted only as the Task Force leadership deems necessary and once the design of the CGS in Ukraine is finalised.

5. NEXT STEPS AND ACTION PLAN

5.1 Proposed action plan for scheme implementation

As elaborated in this project’s pre-feasibility study, caution is advised for implementing a credit guarantee scheme for agricultural SMEs in the current macroeconomic and financial-sector context. Thus, a comprehensive action plan has been developed for implementation of the proposed scheme once conditions are deemed suitable. The action plan is structured in three phases, which are sequenced but specific components of which can be developed simultaneously. Specifically, the three phases comprise the following:

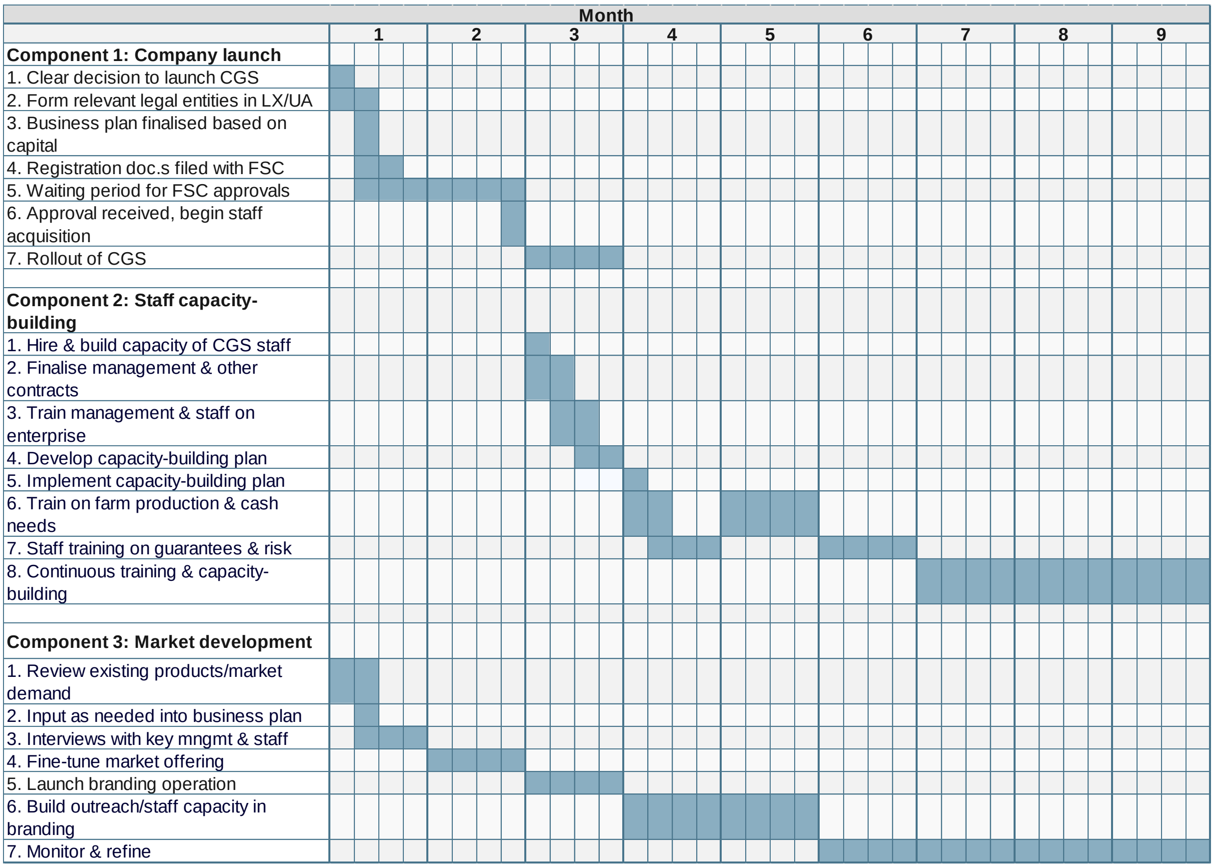
- **The first phase** will involve the mobilisation of seed capital and technical assistance funding as a prerequisite for the launch of the CGS. The launch phase is estimated to last three months and will follow on from a formal decision made by the funding partners and the scheme’s supervisory board, formed by government representatives, to launch the CGS according to a detailed design, which should include a finalised business plan. This phase also includes the creation of the relevant legal entity either in Ukraine or in a foreign jurisdiction, its registration with the financial supervision authority (so far this role has been assumed by *Natskomfinposlug* but this is expected to change if the draft law 2414 is passed), and the waiting period required to obtain *Natskomfinposlug* approval before the scheme is rolled out.

- **The second phase** should last seven months and could start as soon as the *Natskomfinposlug* approval is obtained. It will involve the hiring of CGS staff, the identification of training needs, and the provision of training. Specific training modules are expected to include training on the nature of production and cash needs of target enterprises, as well as on guarantees and risk.

- **The third phase** pertains to market development and will involve the review of existing products and market demand, the collection of inputs to finalise the scheme’s business plan, fine-tuning of the market offering for the scheme’s launch, and branding/marketing as well as building staff capacity in branding and outreach. This phase should last five months but should start at the same time as, and be developed alongside, the launch phase. The final component of this phase will be to monitor and adjust the scheme as it develops; which should be conducted continuously throughout the final months of the scheme set-up that the action plan covers.

These phases, which will be required in order to launch such a CGS in Ukraine, are elaborated in Figure 6. The total activity that the action plan covers is anticipated to take place over nine months, and would be funded through the technical assistance funds outlined in Chapter 2 of this report.

Figure 6. Proposed action plan



5.2 Training needs identified

In order to build capacity to operate a CGS before its implementation, a feasibility analysis has identified several training measures for the project's Task Force members on how a CGS works and how it can achieve its objectives. The content and duration of each module is outlined in Table 4.

Table 4. Training and capacity-building measures for Task Force members

Training Topic	Modality	Duration	Location	Details
CGS mechanisms and risk management	Seminar	3 hours	Kyiv	Training for the task force on how a CGS is established, how it functions, and what factors and risk-sharing requirements are necessary to secure its success
CGS additionality and governance	Seminar	4 hours	Kyiv	Training for the task force on how additionality is calculated for the CGS and what impact this has on its operations
CGS regulation, state support and subsidies	Seminar	4 hours	Kyiv	Training for the task force on how the CGS is supervised and regulated by *Natskomfinposlug*
CGS management and oversight	Seminar	2 hours	Kyiv	Training for the task force on CGS management and oversight

In addition, specific training modules have been identified for the supervisory body *Natskomfinposlug* on how to regulate such a scheme and the guarantees it provides. These have been proposed based on publicly available documents and discussions with the body's senior management. It is proposed that senior management consider who within the institution should be responsible for regulating such a scheme and allocate two or three staff members to attend the training sessions, organised within the framework of this project.

Capacity-building for *Natskomfinposlug* should include a focus on increasing the strength and transparency of the Ukrainian financial sector's regulatory framework as it pertains to the CGS. It is proposed that a small team (two or three *Natskomfinposlug* officials) could be identified to learn from regulators in selected OECD countries about how to develop and implement sound policies and procedures for licensing a CGS, enforcing legislation and prudential standards, and designing and enforcing the scheme's reporting requirements.

Such training would increase the capacity of *Natskomfinposlug*. Increased compliance with international good practice in this area is more likely to convince potential investors of the stability, certainty, and suitability of the regulatory environment and its application to such a scheme in Ukraine – as well as having spill-over effects for investment and the provision of financial services in Ukraine more generally. The training measures are outlined in Table 5.

Table 5. Proposed training and capacity-building measures

Training Topic	Modality	Duration	Location	Details
International Accounting Standards (IAS), International Financial Reporting Standards (IFRS), and international standards for CGS schemes	Seminar	3 hours	Kyiv	Bringing the Financial Services Law into compliance with relevant standards for credit guarantees
CGS prudential standards and guarantee activities	Seminar	4 hours	Kyiv	Supervision by *Natskomfinposlug*
Dispute resolution (complaints)	Seminar	4 hours	Kyiv	Working to resolve potential uncertainty on the repossession of collateral and the sharing of recovery income between the CGS and banks
Anti-money laundering (AML) practices for CGS schemes	Seminar	3 hours	Kyiv	Ensuring that *Natskomfinposlug* and NBU staff are aware of relevant international AML standards

All training modules were designed and provided to Task Force members and relevant stakeholders in February 2016 as part of the project. The materials, including exercises and templates, have been made available to the project's donors and Task Force members. The aim of the training is to ensure that there is a clear understanding of the concept and functioning of a retail[11] CGS for SMEs amongst its relevant counterparts.

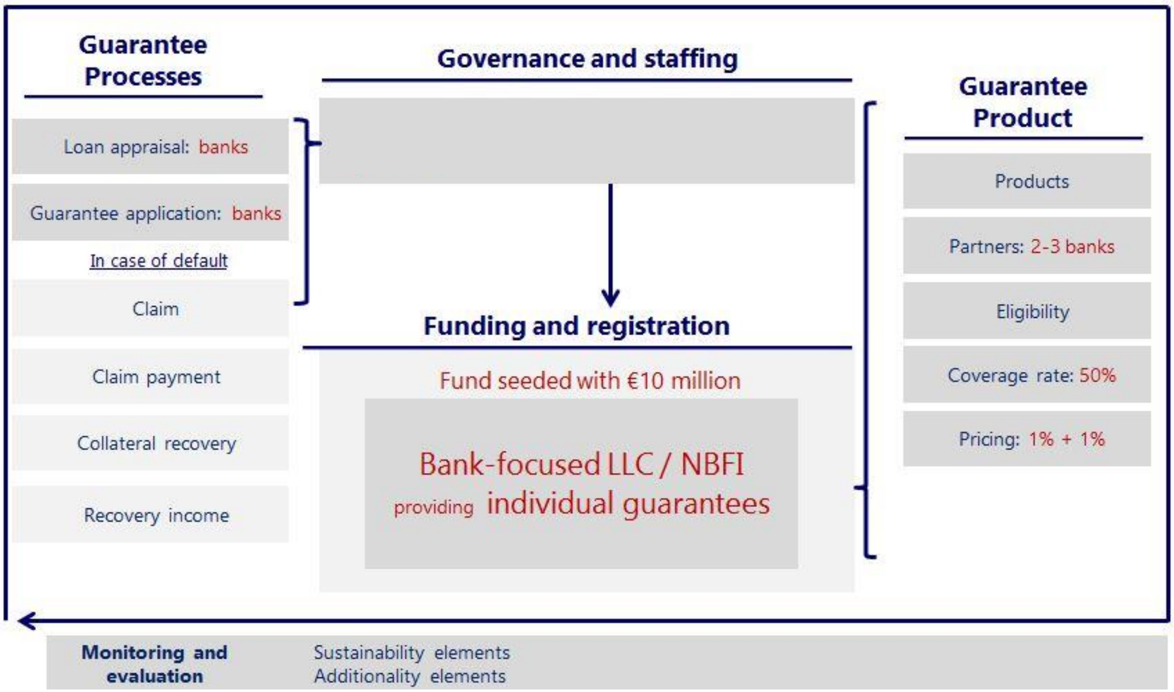
[11] "Retail" is interchangeable with "individual" and refers to a CGS that provides guarantees on an individual basis. It contrasts with a "wholesale," otherwise known as "portfolio," approach.

5.3 Completion of analytical work

Primary features for the scheme have been proposed in this project's pre-feasibility study, and the financial viability of operating a scheme along these lines in Ukraine has been assessed in the present feasibility study. In addition, this report presents an initial assessment of the scheme's regulatory environment and an initial analysis of some suggested secondary features.

The next and final step in this project will be to develop a comprehensive technical report that identifies a full set of recommended features and procedures for a possible CGS in Ukraine. This report will fully delineate scheme's proposed secondary features, in four specific areas: the guarantee product, guarantee processes, the funding and registration of the scheme, and its governance and staffing. It will also propose two sets of procedural aspects: recommendations for risk management, and recommendations for monitoring and evaluation. Some of these elements have already been broadly sketched in this report (Figure 7), and they will be tested and fine-tuned in the project's technical report.

Figure 7. Diagram of design features



All three of project's documents – the pre-feasibility study, the feasibility study, and the technical report – will be distributed to the project's main stakeholders upon project completion. Their findings have been presented to the Ukrainian stakeholders at Task Force meetings. The final Task Force meeting – on 23 February 2016 – presented a full recapitulation and elaboration of the scheme's design and operation. Task Force members have been invited to provide comments on recommendations during and after each Task Force meeting.

BIBLIOGRAPHY

European Bank for Reconstruction and Development (2015), “The EBRD in Ukraine”, available at http://www.ebrd.com/ukraine.html, accessed 18 March 2015.

European Commission (2015), “COSME: The Competitiveness of Enterprises and Small and Medium-sized Enterprises (SMEs)”, available at http://ec.europa.eu/enterprise/initiatives/cosme/index_en.htm, accessed 18 March 2015.

Finance in Motion (2015), “European Fund for Southeast Europe (EFSE)”, available at http://www.finance-in-motion.com/Mandates------_site.index..html_dir._nav.23_likecms.html, accessed 18 March 2015.

Frankfurter Allgemeine Zeitung (2015), “Kiew kündigt EU-Ukraine-Gipfel am 27 April an”, available at http://www.faz.net/agenturmeldungen/dpa/kiew-kuendigt-eu-ukraine-gipfel-am-27-april-an-13506246.html, accessed 18 March 2015.

Green, A. (2003) “Credit Guarantee Schemes for Small Enterprises: An Effective Instrument to Promote Private Sector-led Growth?” UNIDO, *Working Paper no. 10*, Aug. 2003.

International Finance Cooperation (2015), “IFC in Ukraine”, available at http://www.ifc.org/wps/wcm/connect/region__ext_content/regions/europe+middle+east+and+north+africa/ifc+in+europe+and+central+asia/countries/ukraine+country+landing+page, accessed 18 March 2015.

KfW Bankengruppe (2015), “Ukraine – A border country between Russia and Europe”, available at https://www.kfw-entwicklungsbank.de/International-financing/KfW-Development-Bank/Local-presence/Europe/Ukraine/, accessed 18 March 2015.

Levitsky, J. (1997), “Credit Guarantee Schemes for SMEs: an international review”, *Small Enterprise Development*, vol. 8, no. 2.

National Bank of Ukraine (2014), Statistical Bulletin: Monetary and Financial Statistics of Ukraine 2010-2014, available at http://www.bank.gov.ua/files/elbul_2011_xls_archiv.zip, http://www.bank.gov.ua/files/elbul_2012_xls_archiv.zip, http://www.bank.gov.ua/files/elbul_2013_xls_archiv.zip, http://www.bank.gov.ua/files/elbul_2014_xls_archiv.zip, accessed 12 March 2015.

OECD (2012), *Implementing Credit Guarantee Schemes in Ukraine: the Case of Agribusiness*, OECD.

OECD (2015), *Proposal of Ukraine to adhere to the OECD Declaration on International Investment and Multinational Enterprises*, draft background note.

Reuters (2015), “Donors plan Ukraine conference in April to raise USD 15 billion”, available at http://www.reuters.com/article/2015/02/09/us-ukraine-crisis-donors-idUSKBN0LD1NR20150209, accessed 18 March 2015.

State Statistics Service of Ukraine (2014), “Statistical Yearbook: Agriculture of Ukraine 2014”, available at http://ukrstat.gov.ua/druk/publicat/kat_u/2014/zb/09/zb_sg_13.zip, accessed 12 March 2015.

State Statistics Service of Ukraine (2014), “Statistical Bulletin: Agriculture Gross Output of Ukraine”, available at http://ukrstat.gov.ua/druk/publicat/kat_u/2015/bl/01/bl_vpsg2014pdf.zip, accessed 12 March 2015.

United States Agency for International Development (2015), “Ukraine”, available at http://www.usaid.gov/where-we-work/europe-and-eurasia/ukraine, accessed 18 March 2015.

ANNEX

Annex 1: Financial Model (separate file)

ACKNOWLEDGEMENTS

This report summarises the work carried out by the OECD Eurasia Competitiveness Programme as part of the project *Putting in Place the Conditions to Set up a Credit Guarantee Scheme for Agribusiness SMEs in Ukraine* fully financed by the Government of Sweden. The OECD extends its gratitude to Sweden for the financial and political support provided throughout the implementation of the project, in particular to Ms. Sophie Fyrk, First Secretary and Programme Officer for Development Cooperation, and Ms. Christina Danielsson, Head of Cooperation at the Embassy of Sweden in Ukraine.

The OECD is grateful for the leadership of the Ministry of Agrarian Policy and Food throughout this project. Special thanks go to Ms. Vladyslava Rutytska, Deputy Minister for European Integration, for chairing the Task Force meetings and providing relevant feedback and support. The OECD would like to thank the CGS Task Force members for their active participation in the meetings and their feedback on the work, notably representatives of the Ministry of Agrarian Policy and Food (Mr. Vitaliy Sabluk, former Director of Department for the Economic Development and Ms. Olena Kovalova, Deputy Minister), the Ministry of Economic Development and Trade (Mr. Serhiy Shpychenko, Deputy Head of Department for Entrepreneurship Development, Department of Regulatory Policy and Entrepreneurial Development, Mr. Dmytro Boyarchenko, Chief Specialist of the Department for Financial Markets Policy Development, Financial Policy Department, Ms. Tatiana Borisiuk, Head of International Cooperation Sector, Department for Business Climate Development), the Ministry of Finance (Ms. Nataliya Shipilova, Chief Financial Economist of Department for Loan Guarantee and Debt Policy, Department of Financial Policy and International Finance, and Ms. Olena Tepla, Deputy Head of Division on Credit & Guarantee Relations, Debt Policy Unit, Department on Debt and International Financial Policy), and the National Bank of Ukraine (Mr. Oleksandr Kozubenko, Head, and Mr. Oleksandr Voronovych, Deputy Head, Project Monitoring Unit).

In addition to Task Force members, other representatives of the Government, the National Bank of Ukraine, *Natskomfinposlug*, banks, associations and other stakeholders should also be acknowledged for their availability to meet with the OECD team and share valuable insights for the implementation of this project and the development of this report. In particular, the OECD is grateful to Ms. Olena Tregub, Director, and Ms. Iryna Korzh, Senior Expert, in the International Assistance Coordination and Cooperation with IFIs Department, Ministry of Economic Development and Trade. Thanks also to Mr. Igor Pashko, Chairman, *Natskomfinposlug*, Mr. Yuriy Heletiy, Director, and Mr. Pavlo Kartashov, Deputy Head, Department of Cooperation with International Organizations, Ministry of Finance of Ukraine, and Mr. Valeriy Mayboroda, National Bank of Ukraine, for their readiness to meet with the OECD team and share relevant information in preparation of the analysis. The OECD is also grateful for the time and information shared by Mr. Jean-Jacques Hervé, Member of the Board, Credit-Agricole Bank, Mr. Dominique Menu, Head of Representative office in Ukraine, BNP Paribas, and Mr. Roman Shpek, Chairman, Independent Association of Banks of Ukraine (NABU).

A number of international experts based in Ukraine were consulted throughout the project, and provided useful information and insights in preparation of this report, including Mr. Jerome Vacher, (IMF), Mr. Gunnar Wälzholz and Ms. Lyudmyla Gordiyuk (KfW German Development Bank), Mr. Charles Davis, Ms. Anna Bogdanova, Mr. James Borger and Mr. Kenneth Dunn (USAID Ukraine), Mr. Henry Russell, Mr. Nick Tesseyman, Mr. Alexander Pavlov, Mr. Vasyl Hovhera, Ms. Marina Ismaila, Ms. Anna Lebedynets and Ms. Lesya Kuzmenko (EBRD), Ms. Leah Soroka and Mr. Heinz Strubenhoff (IFC), Ms. Nataliya Lischytovych (USAID Agroinvest), Ms. Ricarda Rieger (UNDP Ukraine), Mr. Stephen Potter, Ms. Catherine Pelletier-Hardy and Mr. Zheng Zhang (Canadian Embassy in Ukraine), and Mr. Luca Ponzellini (EIB) and Mr. Yannis Tsakiris (EIF).

The initial draft of this report was written by Ms. Audrey Vergnes. Ms. Annie Norfolk Beadle, Policy Analyst, OECD Eurasia Competitiveness Programme, finalised the text under the guidance of Mr. William Tompson, Head of the Eurasia Division, and Ms. Gabriela Miranda, Project Manager, OECD Eurasia Competitiveness Programme, on the basis of inputs prepared by IPC – Internationale Projekt Consult GmbH. Technical and analytical support was provided by Mr. Dirk Haboeck, IPC Managing Director, Mr. Daniel Gies, IPC International Consultant on Credit Guarantee Schemes, and Ms. Oksana Kozak, IPC Country Director (Ukraine).

The report was based on a project implemented by Ms. Gabriela Miranda, Project Manager, Ms. Yerim Park and Ms. Audrey Vergnes, Project Co-ordinators, and Ms. Annie Norfolk Beadle, Policy Analyst, OECD Eurasia Competitiveness Programme. It was reviewed and benefited from valuable inputs provided by Mr. Antonio Somma, Head of Programme and Ms. Yerim Park, Project Co-ordinator, Eurasia Competitiveness Programme, OECD Global Relations. Mr. Andrzej Kwiecinski, Senior Agricultural Policy Analyst, OECD Trade and Agriculture Directorate, also shared relevant information for the completion of this report. Inputs and relevant material were also shared by Ms. Inga Balzekaite, Manager of Development and International Projects, Agricultural Credit Guarantee Fund of Lithuania, Mr. Áron Gereben, Senior Economist, European Investment Bank, and Ms. Katrin Sturm, Secretary General, European Association of Guarantee Institutions (AECM).

The report was edited by Ms. Therese Eve Hogan. It was translated into Ukrainian by Ms. Lyudmila Strelyanaya-Taranina, who also provided useful support with interpretation. Project implementation was assisted by Mr. Mykhailo Semchuk and Mr. Sergiy Petukhov, local consultants in Kyiv. Primary research support was provided by Mr. Dai Yamawaki. Very valuable administrative support was provided by Ms. Maria Stefanecz, Ms. Kristina Grabovska and Ms. Jolanta Chmielik of the OECD Eurasia Competitiveness Programme.

OECD
GLOBAL RELATIONS
www.oecd.org/globalrelations/eurasia.htm