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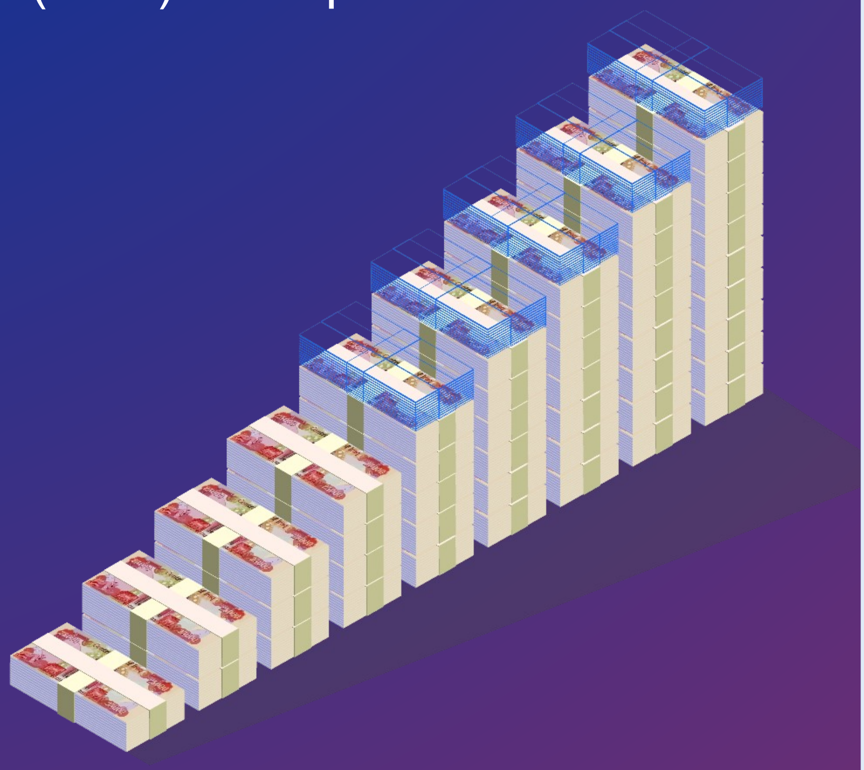
# Guidelines for an Iraqi Credit Guarantee Facility

## Market Reality, Operational Framework and Conditions 2024

Strengthening Public Finances and Financial Markets (FFM) in Iraq



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- Central Bank of Iraq
- Ministry of Finance of Iraq

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# List of abbreviations

| | |
|---|---|
| ADB | Asian Development Bank |
| AFD | French Development Agency |
| BMZ | German Federal Ministry for Economic Cooperation and Development |
| CBI | Central Bank of Iraq |
| CCG | Caisse Centrale de Garantie (Central Guarantee Fund, Morocco) |
| CGC | Credit Guarantee Company Egypt |
| CGF | Credit guarantee facility |
| CGS | Credit guarantee scheme |
| DFI | Development finance institution |
| EGP | Egyptian pound |
| EIB | European Investment Bank |
| EPCGF | European-Palestinian Credit Guarantee Fund |
| ESG | Environmental, social and governance |
| EU | European Union |
| FOGAPE | *Fondo de Garantía para Pequeños Empresarios* (Chilean credit guarantee facility) |
| GDP | Gross domestic product |
| GIZ | *Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH* |
| ICBG | Iraqi Company for Bank Guarantees |
| ICFSME | Iraqi Company for Financing SMEs |
| IFC | International Finance Corporation |
| IGIC | Iraqi General Insurance Company |
| ILO | International Labour Organization |
| IMF | International Monetary Fund |
| IPC | Internationale Projekt Consult GmbH |
| IQD | Iraqi dinar |
| JLGC | Jordan Loan Guarantee Corporation |
| JOD | Jordanian dinar |
| KfW | German development bank |
| KODIT | Korea Credit Guarantee Fund |
| LBP | Lebanese pound |

| | |
|---|---|
| M&E | Monitoring and evaluation |
| MAD | Moroccan dirham |
| MENA | Middle East and North Africa |
| MFI | Microfinance institution |
| MSMEs | Micro, small and medium-sized enterprises |
| NPL | Non-performing loan |
| OECD | Organisation for Economic Co-operation and Development |
| PMA | Palestine Monetary Authority |
| SAL | *Société anonyme libanaise* (Lebanese joint stock company) |
| SFD | Iraq Social Fund for Development |
| SMEs | Small and medium-sized enterprises |
| TA | Technical assistance |
| USAID | United States Agency for International Development |
| USD | United States dollar |

# 1. Executive summary

Small and medium-sized enterprises (SMEs) across the globe play a key role in achieving economic growth, creating competitiveness (leading to improvements in the quality of the services and goods provided) and meeting the needs of local markets, often reducing dependence on external markets for core goods and services. In spite of the globally recognised significance of SMEs to economies, the **business environment for such enterprises in Iraq is challenging**. Iraqi SMEs struggle to gain access to appropriate finance, with the International Finance Corporation (IFC) estimating a **potential SME funding gap of about USD 6 billion in Iraq**. The reasons for this are multiple, and while the government has taken steps to increase financing for SMEs through initiatives such as the One Trillion Dinar Initiative, there remain significant opportunities for additional action to address this market failure, **particularly through the provision of appropriate credit guarantees in Iraq**.

Globally, credit guarantee facilities (CGFs) are recognised as playing a **crucial role in addressing market failures and promoting lending to SMEs**. In Iraq, a core obstacle to increasing funding for SMEs is the lack of suitable credit guarantees for creditworthy SMEs, particularly those with **potential for growth but without the required security in the form of collateral or guarantees**. Currently, the Iraqi Company for Bank Guarantees (ICBG) is the only established CGF in Iraq, but it is limited in the coverage it provides, and it only guarantees loans granted by banks to enterprises that already have suitable security. As a result, the aforementioned finance gap remains for the majority of SMEs, particularly those without suitable security, **leaving significant scope for a CGF in Iraq** that can play a role in addressing this market failure.

While well-designed CGFs can contribute to increasing finance for SMEs, studies have shown that they **may add limited value, prove costly and distort markets *when they are not well designed and maintained***. In light of this, this strategic document provides **operational guidance and advice for the design and creation of an impactful Iraqi CGF** based on market realities and on international and regional experience.

More specifically, **this strategic document includes**:

1. An analysis of the **current Iraqi market context and landscape**, including an analysis of the financing constraints facing SMEs and existing Iraqi financing initiatives and guarantee schemes
2. A presentation of **best practice principles for (public) credit guarantee schemes (CGSs) globally**

3. A **review of and takeaways from CGFs in the Middle East and North Africa (MENA) region** (Egypt, Jordan, Lebanon, Morocco and Palestine) **in terms of regional good practices**

4. Practical recommendations for the potential **design and creation of a CGF** in Iraq, covering multiple aspects including the legal and regulatory framework, mandate and corporate governance, operational framework and guarantee conditions, and monitoring, evaluation and reporting requirements, aimed at supporting stakeholders in considering optimal solutions for the establishment of **a context-appropriate, impact-driven and sustainable CGF**

This document therefore aims to provide **concrete and actionable recommendations and options for the Central Bank of Iraq (CBI)** on establishing a suitable CGF and engaging with Iraqi and international stakeholders. All the recommendations included in this document seek to take into account Iraq's specific circumstances and are based on international and regional best practices for CGFs. In addition, the recommendations also mention and propose options for **more impactful guarantee terms and conditions**, depending on the level of support from the public sector.

This report was prepared as part of Component 4 of Strengthening Public Finances and Financial Markets in Iraq, a project implemented by the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH and co-financed by the German Federal Ministry for Economic Cooperation and Development (BMZ) and the European Union (EU). Working in partnership with the Government of Iraq, the project aims to **increase and facilitate the access of Iraqi SMEs to finance through policy reform, operational support to the CBI and capacity building** for Iraqi banks and financing institutions in critical areas related to lending to SMEs.

# 2. SME financing constraints in Iraq

## 2.1 Challenges in defining SMEs in Iraq

At present, Iraq **lacks a reliable standard national definition** of what constitutes a SME, with different institutions providing different definitions of what micro, small and medium-sized enterprises (MSMEs) are. While most definitions focus on the number of employees (e.g. Iraqi Central Statistical Organization, World Bank), others focus on total assets or turnover (e.g. IFC) or even loan size (e.g. CBI, banks in Iraq).

Guidance provided by the **Iraqi Ministry of Planning** defines SMEs according to the number of employees, as shown in Table 1.

Table 1: Iraqi MSME definitions according to the Iraqi Ministry of Planning

| *Classification* | *Criteria* |
|---|---|
| Micro enterprise | 1-3 employees including owner |
| Small enterprise | 4-9 employees including owner |
| Medium enterprise | 10-29 employees including owner |

Source: Iraqi Ministry of Planning

## 2.2 Characteristics and role of the SME sector in Iraq

The lack of a standard SME definition makes **providing precise statistics about the number and status of SMEs in Iraq challenging**; however, IFC estimates that there are between 377,000 and 840,000 SMEs in Iraq.[1] While the density of SMEs in Iraq appears to be lower than in other countries in the MENA region, they continue to play a significant role in **all sectors of the economy outside of the export-oriented oil and gas sector, generating up to 90% of private sector employment**.

Separate surveys conducted independently by IFC and by GIZ have revealed that Iraqi SMEs are **generally smaller in size and concentrated in the trade and services sector**.[2] Iraq's openness to foreign imports has made the development of an internationally competitive (non-energy) industrial sector challenging. As a result, the **proportion of industrial SMEs in Iraq is very low**, and SMEs tend to **focus on procuring and/or distributing imported goods** (directly or through Iraqi wholesalers), often engaging in retail activities.

SMEs in Iraq play a role in achieving economic growth, creating competitiveness (leading to improvements in the quality of the services and goods provided) and meeting the needs of the local market, thereby reducing dependence on external markets for these goods and services. In spite of this, the **business environment for SMEs in Iraq is challenging**. In terms of regulations, Iraqi SMEs are treated the same as larger enterprises or corporations.

[1] IFC. *Market Bite Iraq: Economic Recovery Creates Opportunity to Invest in Small and Medium Businesses.* November 2022.
[2] GIZ. *Priority financing needs of Iraqi SMEs. Report.* May 2023. online access.

They pay the same tax rate (15%) and do not receive any preferential treatment in the consideration of government contracts and tenders.[3]

According to the *Ease of Doing Business Index*, which evaluates how conducive the regulatory environment is to starting and operating a local firm, Iraq was ranked 172 out of 190 countries by the World Bank in 2020, with key challenges including enforcing contracts, trading across borders and, particularly, **getting credit** (for which Iraq was ranked 186 out of 190 countries).[4]

## 2.3 The formal financial sector in Iraq

The banking sector in Iraq is **dominated by commercial banks, particularly state-owned banks**, with seven public banks holding about 90% of banking sector assets. The majority of Iraqi banks **focus on providing financial services to large corporations and government entities**.

Banks in Iraq earn **considerable profits from currency auctions held by the CBI**, which makes lending to enterprises less attractive for them. These auctions entail purchasing foreign currency from the CBI and reselling it to the private sector at a sizeable spread. Indeed, the simple (relatively low-risk) arbitrage opportunity provided by engaging in currency auctions has, according to GIZ interviews, been a primary reason for financial intermediaries to abstain from 'traditional lending' to the private sector. While foreign exchange spreads have narrowed over the years, they remain a key source of profitability for banks.

As a result of this, Iraqi banks tend to have **relatively small credit portfolios**, as seen below in the summary of the average composition of the banking sector's assets, based on the audited financial statements provided in the annual reports of several banks in Iraq:

- Deposits with the CBI: 40%-60%
- Deposits with other banks: 11%-27%
- Credit facilities: 5%-19%
- Financial assets: 1%-11%[5]

This review of bank financial statements indicates that deposits with the CBI and other banks make up the majority of bank assets in Iraq, followed by **credit facilities, generally less than 20% of bank assets**, and financial assets (primarily investments in government bonds). As a result, **bank lending to enterprises as a whole in Iraq could be described as suboptimal**, due to the relatively high opportunity cost for banks (given the availability of low-risk gains from currency auction activities).

## 2.4 The challenge of financial access for SMEs in Iraq

**Access to finance is a key constraint for SME business growth in Iraq.** The SME sector faces a significant lack of supply of finance from the formal financial sector, with IFC estimating a potential **SME funding gap of about USD 6 billion**, and a very low rate of use

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3 IFC. *Market Bite Iraq: Economic Recovery Creates Opportunity to Invest in Small and Medium Businesses.* November 2022.
4 World Bank. *Ease of Doing Business 2020*. online access.
5 These statistics have been summarised and provided by IPC, based on a review of Iraqi bank audited financials, purely for indicative purposes.

of banking services, with just 8% of Iraqi SMEs having a business bank account (16% have a personal account).[6]

According to a recent May 2023 GIZ survey and report, *Priority financing needs of Iraqi SMEs*, **challenges related to increasing SME financial access in Iraq are numerous and significant**,[7] including:

- **Lack of suitable security**, with banks primarily relying on personal sponsors (*kafeel*, mainly government salary earners) and secondarily on real estate (SME customers often lack acceptable formal titles or documentation for their assets, and 60% of industrial projects are established on sites designated as agricultural land or wetlands – which cover 90% of the country – that cannot be used as collateral)[8]
- **Inability of financial institutions to effectively enforce security rights** in case of default because Iraq lacks suitable legislation on collateral registration and movable collateral control
- **Limited capacity of the credit bureau and poor credit information input from banks into the CBI system**, leading to a lack of available credit-relevant information and greater information asymmetry and preventing Iraqi SMEs from building a positive credit history that would facilitate future financing
- **Relatively higher interest rates and fees at banks for SMEs** (compared with other countries in the region)
- **Long processing times** at banks for loans for SME (and other business) customers
- **Lack of skills (and/or interest) at Iraqi banks to conduct financial analysis of SMEs** focused on profitability and cash flow (rather than just on collateral and personal guarantors)
- **Absence of appropriate Sharia-compliant product offerings** for businesses
- **Absence of specialised leasing companies licensed to finance equipment purchased by enterprises**
- **Widespread mistrust of banks among SMEs** (one third of respondents in an IFC survey had little to no trust in banks, with a further 10% having only a little trust, due to lack of transparency, complexity of processes or services, etc.)
- **Limited financial literacy of SME owners/managers**

Due to these challenges, financial institutions generally impose **strict lending criteria and high interest rates for SMEs** and may even be reluctant to lend to them at all, preferring to lend to larger corporations or engage in retail lending. As a result, in a country where credit is already low compared with gross domestic product (GDP), **only about 9% of Iraqi bank lending reaches the SME sector**. These challenges have led SMEs to seek financing from other sources, including from family and acquaintances. For example, of the

[6] IFC. *Market Bite Iraq: Economic Recovery Creates Opportunity to Invest in Small and Medium Businesses.* November 2022.
[7] GIZ. *Priority financing needs of Iraqi SMEs. Report.* May 2023. online access.
[8] According to a World Bank survey, only 20% of SMEs had collateral that could be used to secure a loan.

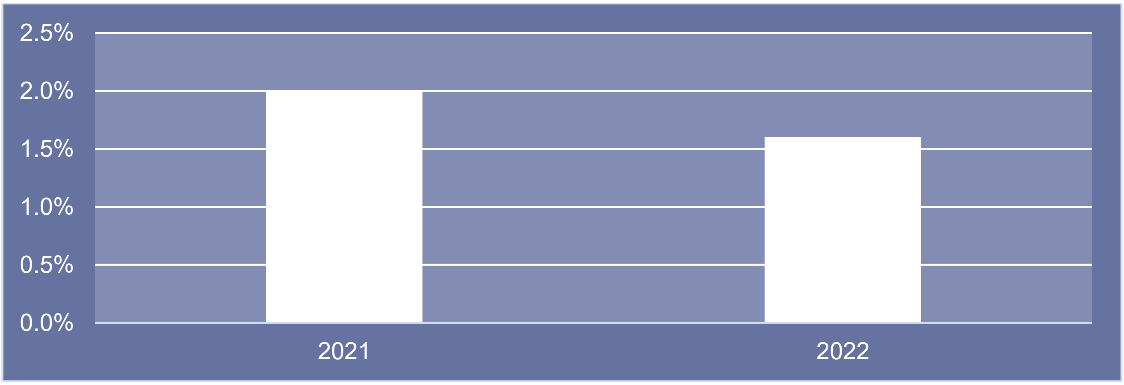
Iraqi SMEs surveyed by IFC that reported using short-term financing (25%), most acquired it from acquaintances.[9]

While acquaintances and money exchange shops are significant sources of short-term financing, long-term financing involving larger amounts (e.g. loans for purchasing fixed assets) is generally provided by banks, due to larger capital requirements, making **lending for business investment significantly less common among SMEs**.

In addition to relatively high interest rates, the credit market in Iraq suffers from **high ratios of non-performing loans (NPLs)** in business lending in general. NPLs at state-owned banks increased to 15.3% in 2021, from roughly 14% in 2020, but these **NPL rates are likely understated, as they do not reflect loans to public entities with uncalled government guarantees**. NPLs at private banks, on the other hand, stood at a **very high 37% in 2021**.[10]

However, an examination of SME portfolio data from a sample of banks conducted by GIZ indicated that **NPLs accounted for 1.6% of total SME loans in 2022 compared to 2% in 2021**.[11]

Figure 1: Share of non-performing SME loans




Data provided by the ICBG shows that it reimbursed only 1.5% of the total amount of loans that it guaranteed to banks due to SME default.

According to IFC, **(the limited) bank lending to SMEs in Iraq generally involves loans of less than USD 50,000** – amounts similar to those provided by microfinance institutions (MFIs). It reports that while there are 'some specialized SME lending institutions in the $500,000 to $1.5 m bracket … with a very small total volume … **[t]here is virtually no financial institution specializing in loans from $45,000 to $500,000**'[12] to finance SME equipment, development and growth.

[9] IFC. *Market Bite Iraq: Economic Recovery Creates Opportunity to Invest in Small and Medium Businesses.* November 2022.
[10] World Bank. *Iraq Economic Monitor: A New Opportunity to Reform.* Fall 2022.
[11] GIZ. *Priority financing needs of Iraqi SMEs. Report.* May 2023. online access.
[12] IFC. *Market Bite Iraq: Economic Recovery Creates Opportunity to Invest in Small and Medium Businesses.* November 2022. Emphasis added by IPC.

## 2.5 Deficiencies in credit registry/history coverage in Iraq

The CBI took a crucial step in 2016 towards creating an enabling environment for business lending by establishing a Credit Information Exchange Division tasked with performing the role of both a credit bureau and a credit registry.

A credit registry's functions are critical in enabling the CBI and the government to shape and implement relevant economic and private sector development policy measures, notably by **monitoring borrowing levels and associated risks in the country**. In addition, the functions performed by a credit bureau are vital in determining and assigning a credit rating to each individual borrowing enterprise/SME. This credit rating can then be used by individual enterprises, including SMEs without collateral, to **build and establish a positive credit history**, based on their previous or current bank loans, which would facilitate future financing.

Despite playing a significant role in facilitating lending and achieving some improvements, the CBI Credit Information Exchange Division remains relatively ineffective in reducing bank concerns over the reliability of customer credit histories, due to issues related to both the **incompleteness of data and the lack of effective processes**. According to IFC, as at 2019, credit registry coverage achieved by the CBI credit bureau in Iraq was just 1.3% of the adult population, and the data was limited to just three types of credit products: consumer loans, credit cards and vehicle loans.[13]

[13] IFC. *Market Bite Iraq: Economic Recovery Creates Opportunity to Invest in Small and Medium Businesses.* November 2022.

# 3. Iraqi SME priority needs and expectations in terms of credit

A recent 2023 GIZ report entitled *Priority financing needs of Iraqi SMEs* compiles and synthesises data from three extensive surveys conducted across Iraq in 2022 and 2023, with a particular focus on **understanding the priorities of Iraqi SMEs in terms of credit**.[14]

A total of 257 enterprises across 10 Iraqi governorates were surveyed, with the following key findings regarding the situation of Iraqi SMEs and their resulting credit needs and expectations.

1. 55% of SMEs in Iraq were established after 2017, and **many close within five years** of opening due to the hostile economic and political environment, including the challenges of competing with cheap imported goods and limited access to finance:

→ Providing access to finance can help SMEs, and credit guarantees can alleviate bank concerns about the creditworthiness of SMEs, but appropriate loan products (and related guarantees) can focus on shorter-term financing to reduce risk.

2. **Most of the equipment and machinery of the majority of Iraqi SMEs is worth less than USD 15,000** – below the amount of their average financing needs – **and does not therefore qualify as credible collateral** (even if it were accepted by Iraqi banks). Additionally, **only 16% of SMEs can provide suitable salary-based guarantees**.

→ Reducing reliance on security may help to unlock finance for SMEs – potentially through appropriate credit guarantee design.

3. The vast majority of SME owners rely on personal and family resources to establish, run and develop their business, with only 6% of those surveyed reporting that they have a bank loan. Businesses are often unwilling to even open bank accounts due to **distrust about the liquidity of banks (particularly private ones) and excessive documentary and procedural requirements**.

→ Documentary and procedural requirements for opening a bank account and applying for a loan must be simplified and streamlined to overcome this reluctance.

4. According to the GIZ survey, when applying for credit '**22% of SME owners/managers indicated that they needed short-term financing to purchase raw materials, 24% short-term financing to increase the quantity of goods they had to sell**, 16% long-term financing to acquire land and real estate for the business and 25% medium-term financing to purchase equipment.'[15]

→ There is significant demand for short- to medium-term loan products for the working capital and equipment purchase needs of SMEs and a general lack of products for shorter-term financing needs in the finance market in Iraq.

5. **Banking literacy among SMEs was relatively low**, with the vast majority of SMEs in Iraq unfamiliar with any financing products other than traditional loans (overdrafts,

[14] The content of this section is largely taken and adapted from: GIZ. *Priority financing needs of Iraqi SMEs. Report.* May 2023. online access.
[15] GIZ. *Priority financing needs of Iraqi SMEs. Report.* May 2023, p. 49. online access. Emphasis added by IPC.

letters of credit or guarantee, working capital financing, etc.). Banks also made little effort to advertise or market their products – in other words, to increase awareness.

→ Improving access to finance for SMEs also requires improved communication and training campaigns, in addition to appropriate products and credit guarantees.

6. The **average financing amount required by SMEs is USD 33,020**, but if requests for outlying amounts are excluded, the **median financing amount is USD 10,000**, reflecting the fact that most SMEs are small businesses. Short-term liquidity financing needs, raw materials and inventory financing needs, and production assets and equipment financing needs all involve relatively small amounts (an average of USD 18,000 or less for all of them). Only vehicle and real estate financing needs involve slightly larger amounts, at an average of around USD 40,000.

→ Appropriate SME loan products could focus on a loan size of less than USD 50,000, which is the range that the limited existing SME bank finance focuses on.

7. **SMEs rely heavily on sales on credit to customers**, with 55% of surveyed SMEs reporting that they sell on credit (one third of them with more than 30% of total sales on credit). Of these, 47% reported that the average length of the credit period was between one and six months, and 50% reported that it was between six and eighteen months.

→ Such enterprises make ideal candidates for revolving credit products which are not currently offered to SMEs by most banks.

8. **SMEs also rely heavily on credit to purchase equipment and materials for their businesses** (47.8% of SMEs purchase materials on credit, of which 33% have more than 30% of their purchases on credit). Of the SMEs that purchase on credit, 39.2% reported that the average length of the credit period was between one and six months, and 53.57% reported that it was between six and eighteen months.

→ As in the case of sales on credit, these enterprises make ideal candidates for revolving credit products which are not offered to SMEs by most banks.

# 4. Existing SME finance initiatives and programmes in Iraq

Due to the reluctance of the financial sector to extend credit to Iraqi SMEs, **the Iraqi Government has sought over time to improve their access to credit**, primarily by creating two cheap refinancing facilities: the One Trillion Dinar Initiative and the Five Trillion Dinar Initiative. In addition, the government has taken **steps to create a healthier and more robust SME finance ecosystem**, including the establishment of collaborative programmes with international partners and funders and the creation of the Iraqi Company for Financing SMEs (ICFSME).

## 4.1 CBI SME lending initiatives

### 4.1.1 The One Trillion Dinar Initiative

The CBI **One Trillion Dinar Initiative** is a government programme announced in June 2015 and intended to boost the Iraqi economy by facilitating lending to SMEs to spur growth and job creation. Under the initiative, the government initially allocated **one trillion Iraqi dinars (roughly USD 760 million at July 2023 rate) of refinancing to Iraqi banks to provide loans to eligible SMEs**, with a focus on businesses involved in manufacturing, agriculture and other sectors that have the potential for growth and reducing export reliance. Under the programme, loans are provided to the over 30 Iraqi participating banks at a low interest rate – a 2.9% refinancing rate – and are intended to be used for investment in equipment, facilities and other resources that will help SMEs expand and create jobs.

*Findings*

The One Trillion Dinar Initiative has been an important step in providing local banks with a refinancing facility with very competitive rates to reduce the cost of funding for SMEs and, according to IFC, **most Iraqi banks that lend to SMEs do so through the initiative**.

However, by the end of 2019, the One Trillion Dinar Initiative had managed to promote lending to 3,235 SMEs – a total of IQD 98 billion – demonstrating that **uptake of funds from the initiative was relatively limited over the first few years of operation**, although it has accelerated significantly since 2020.[16]

One of the controversial steps implemented to increase uptake of the initiative's funds was **lifting the ceiling on housing finance** in August 2020 from IQD 75 million to IQD 100 million, raising concerns that funds were not being optimally channelled to SMEs. This has resulted in greater uptake (mostly in the housing finance area), but has shown that the initiative's impact on SMEs, while significant, **has not reached full potential**. Housing loans are expected to continue to dominate disbursements under the initiative.

Additionally, the One Trillion Dinar Initiative has so far remained **highly dependent on SMEs providing suitable security**, particularly in the form of personal guarantors (*kafeel*). As a result, while the One Trillion Dinar Initiative has played a role in directing financing towards SMEs, those lacking 'suitable' collateral struggle to access funding from the programme and generally remain excluded.

[16] Kapita. The One Trillion Dinar Initiative. July 2021. online access

Therefore, the challenge remains to promote lending to SMEs both *within* this initiative (to ensure full uptake of the available funds by banks) and *outside* it (to promote a sustainable, non-subsidised SME lending market over time, including for SMEs with little or no security).

### 4.1.2 The Five Trillion Dinar Initiative

The Five Trillion Dinar Initiative is a **companion to the One Trillion Dinar Initiative** and was announced simultaneously in 2015. The difference between the two is both the channel used and the target customer niche. The Five Trillion Dinar Initiative aims to **finance larger projects through public banks only**. The initiative's main success has been in **facilitating housing and construction loans**, while loan disbursement via the Iraqi industrial and agricultural public banks was minimal, largely due to inefficiencies in these two banks, which can be attributed to a lack of technical knowledge and infrastructure.[17]

*Finding*

The Five Trillion Dinar Initiative focuses primarily on larger projects and has therefore had a limited impact on SMEs, which are not the initiative's target customers.

### 4.1.3 Remaining funding available under the initiatives

Both the One Trillion Dinar Initiative and the Five Trillion Dinar Initiative have recently received additional funding allocations, with the result that **IQD 1.66 trillion remains to be potentially disbursed to SMEs** under the One Trillion Dinar Initiative (as of 2022), according to the International Monetary Fund (IMF), as highlighted in Table 2.

Table 2: Allocations and disbursements under the CBI lending initiatives (in billions of Iraqi dinars)

| | ***2015 initiative*** | | | | | ***New initiatives*** | | ***Total initiatives*** | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Initial allocation** | **Adjustment** | **Adjusted allocation** | **Disbursm. 2015-2020Q2** | **Remaining** | **New allocation** | **Disbursm. new alloc.** | **Cumulative allocations** | **Cumulative disbursm.** | **Remaining allocations** |
| **Five Trillion Dinar Initiative** | | | | | | | | | | |
| Agriculture | 1,666 | (1,493) | 173 | 57 | 116 | 250 | 0 | 423 | 57 | 366 |
| Industrial | 1,666 | (1,493) | 359 | 161 | 198 | 1,000 | 169 | 1,359 | 330 | 1,029 |
| Real estate | 834 | 0 | 834 | 784 | 50 | 4,666 | 3,965 | 5,500 | 4,749 | 751 |
| Housing fund | 834 | 800 | 1,634 | 1,634 | 0 | 3,366 | 1,850 | 5,000 | 3,484 | 1,516 |
| **Total** | **5,000** | **(2,000)** | **3,000** | **2,636** | **364** | **9,282** | **5,984** | **12,282** | **8,620** | **3,662** |
| **One Trillion Dinar Initiative** | | | | | | | | | | |
| **Total** | **1,000** | **0** | **1,000** | **183** | **817** | **3,000** | **2,161** | **4,000** | **2,344** | **1,656** |

Source: Excerpted from IMF, *Iraq: 2022 Article IV Consultation*, February 2023

[17] Al-Furat Center for Development and Strategic Studies. *The Central Bank Initiative and Economic Performance*. July 2022. online access

## 4.2 Additional SME financing-related activities

International organisations such as the United States Agency for International Development (USAID), the International Labour Organization (ILO) and the World Bank have **provided support through programmes aimed at improving the financial sector and increasing access to financing for SMEs**. These efforts are, however, largely uncoordinated and may even at times compete in terms of technical assistance (TA) offerings, particularly at the policy level.

### 4.2.1 Iraq Social Fund for Development (SFD)

One recent World Bank-funded initiative is the SFD, a programme that 'seeks to improve the living conditions and opportunities for the poor and vulnerable in Iraq by improving their access to basic essential services and generating short-term employment opportunities at the community level'.[18] The SFD, with a total project cost of USD 300 million, includes a component that seeks to strengthen microfinance in Iraq, specifically seeking to enhance MFIs that will be involved with the SFD in the future, reviewing the regulatory environment to allow MFIs to operate without market distortions and developing a framework for structured financing that would allow the flow of funds from the SFD to MFIs in a sustainable manner.

### 4.2.2 Iraqi Company for Financing SMEs (ICFSME)

Originally backed under a USAID initiative, the **ICFSME** was established under the Law of the Ministry of Trade/Companies Registration Department in 2009 and operates under CBI control and supervision. Initially set up with a USD 6 million grant, the ICFSME had a portfolio of USD 90 million focused on SMEs at the end of 2021 and offered loans to businesses in the trade, service, agricultural and industrial sectors. On its website, the ICFSME lists seven shareholder banks and, according to IFC, it has undergone restructuring under the supervision of the CBI.[19, 20]

## 4.3 Existing credit guarantee facilities in Iraq

### 4.3.1 The Iraqi Company for Bank Guarantees (ICBG)

Globally, CGFs are recognised as playing a key role in addressing market failures and promoting lending to SMEs. In spite of the significant potential for credit guarantees in the Iraqi market, at present, the provision of guarantees is **largely limited to the ICBG**.

The ICBG is the **only formally established guarantee facility** in Iraq. The company was founded in March 2006 as a limited liability company owned by 11 private banks licensed by the CBI. The company later received a support grant of USD 5 million from USAID. As of 2020, the ICBG is owned by 16 private financial institutions and several individuals, with an outstanding guarantee portfolio of approximately USD 33 million.

[18] World Bank. *What is the Iraq Social Fund for Development*? February 2018. online access
[19] These include Ashur Bank, North Bank, Mosul Bank, Alkhaleej Bank, Middle East Bank, Alahli Bank and Sumer Bank. online access.
[20] IFC. *Market Bite Iraq: Economic Recovery Creates Opportunity to Invest in Small and Medium Businesses.* November 2022.

The ICBG provides guarantees **on up to 75% of the amount of loans submitted by the participating banks in exchange for a 2% annual guarantee fee**. To apply for and obtain a guarantee, the participating bank must enter into a participating bank agreement with the ICBG, which sets out the institution's operating guidelines. The ICBG's main objective is to enhance the access of eligible Iraqi SMEs to credit from private banks.

*Performance and implications*

The ICBG has played a significant role in promoting SME finance in Iraq – **it has guaranteed over 17,000 loans since its inception**, totalling over IQD 3 trillion in lending. As such, the ICBG is an important institution in the Iraqi financial system, providing critical support to SMEs and helping to drive economic growth and development in the country.

Table 3: ICBG performance since inception

| *Number of loans guaranteed* | *Amount guaranteed (thousands of IQD)* |
|---|---|
| 17,860 loans | 329,257,761 |

Source: GIZ. *Priority financing needs of Iraqi SMEs. Report*. May 2023

Despite its important role in the Iraqi financial system, the company has faced a **number of challenges** in recent years, including complaints from a number of banks about the lack of transparency and accountability and concerns about the quality of its guarantee products. In response, the Iraqi Government has taken steps to **reform the ICBG and improve its operations**, increasing transparency and strengthening risk management practices.

However, the main shortcoming of the ICBG is its limited additionality effect, given that it only guarantees bank loans that are already secured by collateral pledged by the borrowing enterprise/SME and not those of enterprises/SMEs without collateral.

*Market feedback on the ICBG*

IPC conducted a survey with multiple banks and financial institutions in Iraq, in which it asked respondents for their **views on working with the ICBG**. Common responses given by businesses that had dealt with the ICBG in the past included the following:

- As the security requirements of the ICBG are similar to those of banks, the **additional benefit of the guarantee is limited** and **SMEs lacking sufficient security (e.g. *kafeel*) remain generally excluded** from access to finance.
- Several financial institutions were of the view that the ICBG **could or should guarantee 100% of the loan amounts**, perhaps failing to see the benefit provided by the current guarantee coverage (75%).
- Some respondents expressed **scepticism as to whether the guarantee service provided by the ICBG justified the 2% fee**.

### 4.3.2 Commercial guarantees through insurance companies

Despite receiving little attention, an important mechanism for the provision of credit guarantees in Iraq is **insurance companies**.

The Iraqi General Insurance Company (IGIC) has played a significant role in encouraging public banks to increase credit operations. It has a special agreement, for example, with Al-Rafidain Bank, which decided to insure all loans issued to its customers through the IGIC, whether through life insurance or loan repayment delinquency insurance. All automobiles financed by Al-Rafidain Bank are also insured with the IGIC. The general approach adopted by the IGIC in insuring credit is to provide potential partner banks with its requirements for customer compliance with its internal policy, allowing the partner bank to decide which credits to include in this recovery policy submitted on a monthly basis to the IGIC.

In addition to the IGIC, some Iraqi banks have **opened their own insurance companies** in order to obtain guarantees for their lending portfolios (rather than, for example, using the ICBG).

### *Performance and implications*

While Iraqi insurance companies provide credit guarantees that provide reassurance for banks in their lending (potentially including SME lending), anecdotal evidence shows that such credit guarantee provision has **not been entirely effective** in expanding the scope of business lending. Additionally, for banks that have established their own internal insurance companies, credit risk remains entirely within the broader group, even if it is off the bank's balance sheet, and the insurance company **rarely has more specialised expertise than the bank itself in assessing SME credit risk**.

# 5. Credit guarantee facilities: benefits, objectives and principles

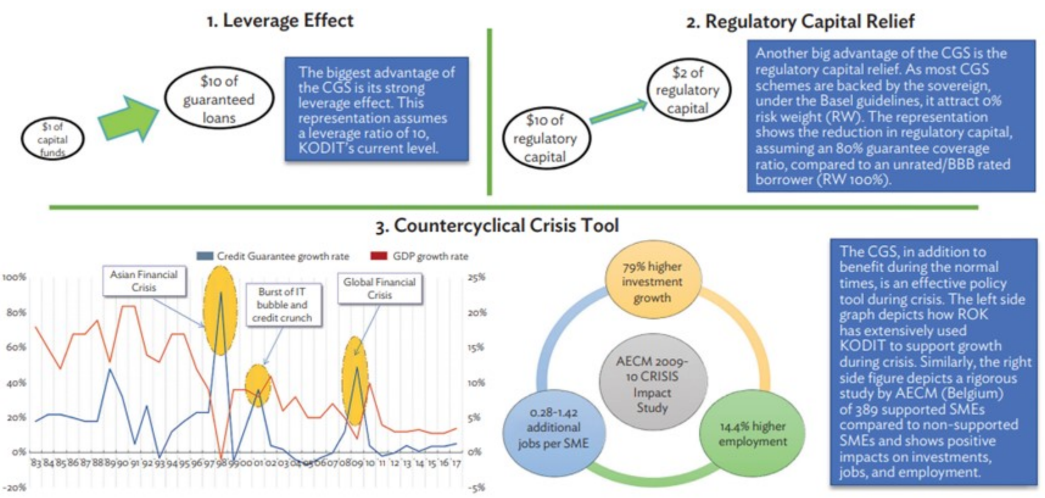
## 5.1 Benefits of effective credit guarantee facilities

CGFs are recognised globally as playing a **key role in addressing market failures and promoting lending to SMEs**. They have a variety of unique attributes, including:

- The ability to **leverage capital** (leverage effect)
- The ability to **provide regulatory capital (and potentially provisioning) relief** to financial institutions
- The ability to be utilised as a **countercyclical platform** (e.g. as a policy response in times of crisis)

These potential benefits are summarised in Figure 2, excerpted from an Asian Development Bank (ADB) report entitled *Policies to Optimize the Performance of Credit Guarantee Schemes During Financial Crises*.

Figure 2: Unique benefits of credit guarantee facilities




CGS = credit guarantee scheme, KODIT = Korea Credit Guarantee Fund, ROK = Republic of Korea, AECM = European Association of Guarantee Institutions.
Source: Authors' compilation.

Source: ADB. *Policies to Optimize the Performance of Credit Guarantee Schemes During Financial Crises*. ADB Briefs No. 167, March 2021, p. 2

As a result of the **increasing recognition of the potential of CGFs to address market failures, such as information asymmetry,**[21] **and enhance financial access for businesses such as SMEs**, there have been a number of studies and analyses on CGFs. While measuring the impact, and particularly the additionality, of CGFs globally has been challenging, a number of interesting studies have found that **well-designed CGFs can contribute to increasing finance for SMEs.** A 2011 World Bank study found that CGFs

[21] 'Information asymmetry' refers to a situation where one (potential) party to a transaction, such as a loan (e.g. a potential borrower or customer), is in possession of more (relevant) information than the other (e.g. a lender).

have contributed to increasing SME lending in the MENA region, and a study in Chile found that its highly regarded CGF – FOGAPE – has increased the probability of small firms getting a loan by 14%.[22, 23]

## 5.2 Core credit guarantee facility objectives

A common finding in research is that CGFs may **add limited value, prove costly and distort markets when they are not well designed and maintained.** In particular**, poor corporate governance, flawed eligibility criteria or inappropriate fees or coverage ratios** may result in ineffective CGFs or in guarantees being issued to businesses that would have obtained credit anyway – essentially providing an implicit subsidy to banks to serve customers they would have served and avoid customers they would have avoided anyway. As a result, the global consensus is that for CGFs to be effective, they must **focus on three** core objectives.

1. To target financially constrained or excluded SMEs (**additionality**)
2. To provide **outreach** to a significant number of these SMEs
3. To remain **financially sustainable**

### Three core objectives of credit guarantee facilities

**1. Outreach** refers to the scale of a CGF, as measured by the *number of guarantees issued to eligible SMEs* or by the *amount of outstanding SME guarantees*.

**2. Additionality** may refer to **financial additionality** – guarantees are mainly extended to SMEs that are credit-constrained either by lack of access or by unfavourable conditions (cost, maturity, security) and that, in principle, would be unable to access appropriate finance without the guarantee – and/or **economic additionality** – an improvement in the overall economy occurring as a result of improved access and availability of appropriate finance for SMEs.

**3. Financial sustainability** refers to the principle that *outreach* and *additionality* should be pursued using a method that is financially sustainable in the long term (although not necessarily profitable), with CGFs able to contain losses and ensure an adequate equity base relative to its expected liabilities.

Source: World Bank and FIRST Initiative. *Principles for Public Credit Guarantee Schemes for SMEs*. 2015

## 5.3 Principles for effective credit guarantee facilities

Recognising the importance of effective CGF design in achieving both outreach and additionality in a financially sustainable way and acknowledging the challenges involved, the World Bank and FIRST Initiative codified a **generally accepted set of international best practices in 2015 – *Principles for the Design, Implementation and Evaluation of Public Credit Guarantee Schemes for Small and Medium Enterprises***.

[22] Y. Saadani, Z. Arvai and R. Rocha. *A Review of Credit Guarantee Schemes in the Middle East and North Africa Region*. Policy Research Working Paper 5612. World Bank. March 2011.
[23] C. Larrain and J. Quiroz. *Estudio para el fondo de garantía de pequenos empresarios*. Banco del Estado. March 2026.

It is a set of 16 individual principles critical to the success of CGFs in **four key areas**:

- **Legal and regulatory framework**
- **Corporate governance**
- **Operational framework**
- **Monitoring and evaluation (M&E)**[24]

**Below is a** detailed breakdown and description of the **16 principles** across these four key areas.

## 16 Principles for SME Public Credit Guarantee Schemes

**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 outcomes.

**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.

**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.

**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.

**Operational framework**

**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.

[24] World Bank and FIRST Initiative. *Principles for Public Credit Guarantee Schemes for SMEs.* 2015.

**Principle 12:** The CGS should adopt a transparent and consistent risk-based pricing policy to ensure that the guarantee programme 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.

**M&E**

**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 non-financial 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.

Source: World Bank and FIRST Initiative. *Principles for Public Credit Guarantee Schemes for SMEs*. 2015

# 6. Credit guarantee facilities in the MENA region: key features, performance and takeaways

**In this section, we analyse various CGFs, comparing the practices and performance of players in the MENA region. In the following section (Section 7), we propose an informed concept for a new SME guarantee mechanism in Iraq, based on international best practices and regional experiences.**

Many countries in the MENA region have established CGFs and funds to promote the development of SME finance. While international best practices, as described, for example, in the Principles for Public Credit Guarantee Schemes for SMEs, are important for the design of an effective CGF, it is also important to understand the strengths and shortcomings of CGF **practices in the MENA region and to highlight effective practices applicable to Iraq and those that have failed in other MENA countries**.

As part of this review, we analysed **various CGFs in the MENA region**, including the following:

- **Egypt:** Credit Guarantee Company (CGC) Egypt
- **Jordan:** Jordan Loan Guarantee Corporation (JLGC)
- **Lebanon:** Kafalat
- **Morocco:** Central Guarantee Fund (CCG)
- **Palestine:** European-Palestinian Credit Guarantee Fund (EPCGF)

In this section, we provide an overview of each scheme individually, concluding with a summary of key takeaways from the analysis of the regional CGFs.

## 6.1 Egypt: Credit Guarantee Company (CGC) Egypt

**Mission:** promote economic and social development by facilitating private sector access to finance, with a main focus on MSMEs

*Overview and organisation*

The Egyptian Credit Guarantee Company (CGC) for small-scale enterprises was established in 1989 as a **private joint stock company** under the provisions of Law 159/1981. It began operations in 1991 and is a **public-private partnership** between the Central Bank of Egypt (holding an equity interest of 20%) and the private sector (eight banks and an insurance company with an equity interest of 80%). The CGC is the primary credit guarantee partner of the Central Bank of Egypt and was **heavily used in this capacity during the COVID-19 pandemic**.

**The stated objectives of the CGC** are to:

- Encourage lending institutions (banks, associations and financial institutions) to increase their efficiency in meeting the financing needs of the target groups which lack sufficient collateral

- Alleviate the burden on the government and the public sector by reducing the dependency on them to generate job opportunities in this large sector
- Transform entrepreneurs in the informal sector into formal economic operators
- Assist enterprises in completing their expansion, development and technical upgrading processes in order to enhance their competitiveness and export capacity

According to its website, the board of the CGC consists of **nine members (two women)**, with the following composition, reflecting its public-private nature:

- Board Chair – Deputy Governor of the Central Bank of Egypt
- Managing Director of CGC (Executive Board Member)
- Central Bank Sub-Governor of Licensing – Banking Supervision
- Chair and Managing Director of the Industrial Development Bank
- Deputy Chair of the National Bank of Egypt
- Chair and Managing Director of Suez Canal Bank
- Chair of Banque du Caire
- Chair and Managing Director of the Arab International Bank
- CEO and Managing Director of Arab Investment Bank

### *Performance to date*

According to the CGC website, as at the first quarter of 2021, the CGC was serving approximately 34,000 beneficiaries, guaranteeing EGP 17 billion (approximately USD 550 million), with a **focus on the industrial sector** (51% of the guarantee portfolio).[25]

Many of the resources that the CGC uses to secure its guarantees come from trust funds from different donors (e.g. USAID). According to the CGC website, women entrepreneurs make up 23% of the CGC portfolio.

The CGC also **collaborates with various partners, networks and stakeholders**. It has 36 bank partners and is a founder of the Euro-Mediterranean Guarantee Network and a member of the SME Finance Forum and the Global Network of Guarantee Institutions. Additionally, the CGC works with various international and bilateral development institutions, including the World Bank, the EU, GIZ, USAID, KfW Development Bank and the French Development Agency (AFD). Finally, the CGC has memorandums of understanding for the exchange of knowledge and best practice with Bpifrance, the Credit Guarantee Corporation Malaysia and the Korea Credit Guarantee Fund (KODIT), providing opportunities to learn from each other and share best practice internationally.

### *Guarantee offering and approach*

The CGC's core target customers are **MSMEs**, reached through the **provision of guarantees to Egyptian financial institutions**.

Through its seven branches, the CGC offers multiple products to partner financial institutions, including **individual guarantees**, **portfolio guarantees** and **wholesale guarantees**. While individual guarantees are examined on a case-by-case basis, the CGC offers portfolio guarantees based on pre-approved criteria. Wholesale guarantees are provided to MFIs to guarantee portfolios of microloans, often complemented by TA covering

[25] Credit Guarantee Company (CGC) Egypt. Programs. link

various topics, including governance, risk/portfolio management, finance and information technology, etc.

In addition, more recently, the CGC established *Engz*, a programme aiming to support the growth and development of SMEs via a **one-stop shop digital platform** allowing CGC products and services to be directly accessed by SMEs, so that they can identify and apply for the most suitable scheme.[26] The schemes target existing registered businesses with inventory or equipment purchase loans from EGP 100,000 to EGP 5 million (roughly USD 3,200 to 162,000) from 12 to 60 months at a 5% interest rate. Loans **continue to be distributed through banks but are guaranteed through the CGC**. The scheme does not yet target tech sectors.

### *Key takeaways from the CGC experience*

- Ensuring **private sector engagement** in public schemes (for example, through a public-private partnership) can increase closeness to the market and the relevance of programme offerings.
- **Gender diversity in board representation should be sought**, particularly if women are target customer segments in the guarantee portfolio.
- **Collaboration and knowledge sharing (e.g. though memorandums of understanding) can be particularly helpful** in developing an institution and sharing best practice. There are a variety of regional and international networks and partners that could also be explored in the Iraqi context, including, for example, the Euro-Mediterranean Guarantee Network.
- An institution can engage in the **provision of multiple guarantee products (e.g. individual guarantees, portfolio guarantees, wholesale guarantees) depending on the actual market situation and the target clientele**. Portfolio/wholesale solutions are most relevant for small-scale and relatively standard (i.e. micro) customers, while more individual guarantees are relevant for larger-scale or more idiosyncratic customers.
- **Utilising digital platforms to provide information directly to potential customers** about available guarantees (and identify the right financial institution if eligible) can drive further uptake of guarantee programmes.

## 6.2 Jordan: Jordan Loan Guarantee Corporation (JLGC)

**Mission:** enhance opportunities for MSMEs to obtain appropriate credit by providing loan guarantees and increase Jordanian exports and domestic sales by providing credit insurance on a sustainable basis

### *Overview and organisation*

The JLGC was established under the Jordanian Companies Law in 1994. It was created in response to a 1993 Cabinet decision approving the establishment of a public limited company to guarantee MSME loans. It operates as a **limited public shareholding company classified as a non-profit development entity**.

[26] Credit Guarantee Company (CGC) Egypt. Engz. link

The subscription of the JLGC's shares was initially limited to the Central Bank of Jordan (on behalf of the Government of Jordan), financial institutions, insurance companies and other related establishments. The JLGC's initial capital amounted to JOD 7 million (USD 10 million in 2023). The Central Bank of Jordan's subscription **came out of a USAID grant** from the agreement on a loan guarantee project signed between the Government of Jordan and USAID in 1988. As of 2011, the JLGC's capital was held by **multiple shareholders**, including the Central Bank (47%), commercial banks (18%), individuals (18%), government and semi-governmental institutions (11%) and private companies (5%).[27]

The board of the JLGC (as at 2023) has eleven members (four women), with the following composition, **reflecting its public-private nature**:

- Chair – Governor of the Central Bank of Jordan
- Vice-Chair – from a commercial bank (Cairo Amman Bank)
- Three additional members representing the Central Bank of Jordan
- Four members representing banks (Bank al Etihad, Jordan Ahli Bank, Arab Bank, Housing Bank for Trade and Finance)
- One board member representing the Social Security Corporation
- One additional independent board member

### *Performance to date*

According to its 2022 annual report, the JLGC **guaranteed 2,293 loans during the year 2022, totalling JOD 185.7 million (approximately USD 262 million)**.[28]

### *Guarantee offering and approach*

According to the Organisation for Economic Co-operation and Development (OECD), the original focus of the JLGC was on reducing unemployment and encouraging bank engagement in the SME sector. Over time, the JLGC has **developed multiple guarantee programmes**, many of which include a focus on SMEs. The OECD also reports that the JLGC has developed an '**extensive database** of information on Jordanian and Egyptian companies **which provides similar services to those of a credit reference bureau**'.[29]

Various guarantee programmes provided by the JLGC are shown in Table 4 below.

With its SME loan guarantee option, the JLGC seeks to encourage financial institutions to support SME businesses with appropriate funding based on the **financial viability and cash flow of the SME** (instead of on the availability of collateral), **along with JLGC financing guarantee coverage**. As can be seen in Table 4, the JLGC covers up to JOD 250,000 (approximately USD 353,000), with payment periods up to 72 months and **coverage of 70%** (which can be bumped to 80% if the project is owned and/or managed by women). Coverage increases further if the credit guarantee is related to exports (i.e. up to 90%).

All JLGC loan guarantee applications must be **submitted through a participating bank** (a list is provided on the JLGC website), which contacts the JLGC for guarantee approval. Once a loan guarantee application form is submitted to the JLGC for consideration,

[27] *Credit Guarantee Schemes: A Tool to Promote SME Growth and Innovation in the MENA Region.* MENA-OECD Investment Programme Working Paper. 2011.
[28] JLGC. *2022 29th Annual Report*. online access.
[29] *Credit Guarantee Schemes: A Tool to Promote SME Growth and Innovation in the MENA Region.* MENA-OECD Investment Programme Working Paper. 2011.

according to its website, the **JLGC will respond to financial institutions with a decision on the guarantee within two business days**.

Table 4: Various JLGC guarantee programmes

| *Name* | *Max. loan amount (JOD)* | *Max. payment period (mo.)* | *Guarantee percentage* |
|---|---|---|---|
| **Productive loans guarantee programmes** | | | |
| SME loan guarantee | 250,000 (USD 353,000) | 72 | 70% |
| Microloan guarantee | 15,000 (USD 21,200) | 36 | 70% |
| Industrial finance guarantee (EJADA) | 1,000,000 (USD 1,413,000) | 96 | 80% |
| Leasing guarantee (EJADA) | 1,000,000 (USD 1,413,000) | 86 | 70% |
| *Kafala* programme – Islamic finance (industries/services) | 1,000,000 (USD 1,413,000) | 96 | 70% |
| *Kafala* programme – Islamic finance (trade) | 250,000 (USD 353,000) | 72 | 70% |
| Entrepreneurial projects guarantee programme | 75,000 (USD 106,000) | 96 | 80% |
| Small start-ups guarantee programme | 250,000 (USD 353,000) | 96 | 85% |
| Renewable energy programme | 500-350,000 (USD 705-494,000) | 36-60 | 70% |
| National programme for facing COVID-19 pandemic | 1,000,000 (USD 1,413,000) | 54 | 85% |
| Central Bank's programme to guarantee the financing of micro and small companies | 25,000 (USD 35,310) | 42 | 85% |
| **Real estate and personal loan guarantees** | | | |
| Real estate loan guarantee | 75,000 (USD 106,000) | 300 | 75% |
| Land purchase loan guarantee | 50,000 (USD 71,000) | 120 | 70% |
| Housing loan guarantee for low- and middle-income people | 35,000 (USD 49,400) | 300 | 90% |
| **Export credit guarantee programmes** | | | |
| Export credit guarantee | 7,500,000 (USD 10.6 million) | 6 | 90% |
| Domestic sales credit guarantee | 4,000,000 (USD 5.65 million) | 4-6 | 80-90% |

Source: JLGC website (link)

Additionally, as of 2011, **participating banks utilising services provided by JLGC benefit from the following privileges from the Central Bank**:

- Loans guaranteed by the JLGC are considered 'good loans' for which **general provisions are waived by the Central Bank throughout the life of the loan**, with default loan provisions waived for the first year of default (but effective from the second year).
- A portion of the participating bank's assets of JLGC-guaranteed loans are considered preferred assets, **decreasing the weighted average of capital adequacy** required from banks.[30]

*Key takeaways from the JLGC experience*

- The JLGC experience demonstrates the value **of engagement with the private sector, particularly at the board level**, while maintaining a development objective.
- Like CGC Egypt, the JLGC demonstrates **gender diversity in board representation**, which should be sought particularly if women are target customer segments in the guarantee portfolio.
- The JLGC experience shows the **value of leveraging initial international grant funding** (in the case of the JLGC from USAID) to establish and build a CGF over time.
- Offering various guarantee programmes and, in particular, **tailoring the coverage ratio (percentage of the loan covered by the guarantee) based on the programme and target segment can be useful in driving uptake and ensuring additionality** by targeting certain segments such as women or exports. However, the JLGC has developed these programmes over the span of 30 years, and less established CGFs may wish to keep things simple at the start.
- When establishing an individual guarantee approach (rather than a portfolio approach), **rapid response and guarantee approval** for financial institutions by the CGF is critical. The JLGC aims to give a response within two business days.
- **Central Bank capital adequacy and provisioning relief for participating financial institutions and banks can significantly increase lending to the private sector**, if possible, and encourage uptake of the use of guarantees from the CGF, as the Jordan experience illustrates.
- As CGFs collect information about various businesses through collaboration with financial institutions, they can also **further drive reporting to credit reference bureaus and enhance credit reporting nationally**.

## 6.3 Lebanon: Kafalat

**Mission:** assist SMEs in accessing commercial bank funding by providing loan guarantees based on business plans/feasibility studies that show the viability of the proposed business activity

*Overview and organisation*

Kafalat SAL is a **Lebanese financial company focused on providing guarantees for SME loans to Lebanese banks in the following economic sectors: industry,**

[30] *Credit Guarantee Schemes: A Tool to Promote SME Growth and Innovation in the MENA Region.* MENA-OECD Investment Programme Working Paper. 2011.

**agriculture, tourism, traditional crafts and high technology.** It is owned by the National Institute for the Guarantee of Deposits (75% equity interest) and 50 Lebanese banks (25% equity interest).[31] The company was founded under Lebanese commercial law, and a **special law was passed to allow the National Institute for the Guarantee of Deposits to subscribe** to the capital of a financial company.[32]

As a private company, Kafalat **has to comply with the decrees of the Central Bank of Lebanon and is regulated by the Banking Control Commission of Lebanon**. The Central Bank requires a monthly report that is drawn up and submitted by Kafalat's finance department.[33]

The Kafalat board, as at 2023, contains six members, **evenly divided** between the National Institute for the Guarantee of Deposits and the banks:

- Chair and General Manager representing the National Institute for the Guarantee of Deposits
- Two additional members representing the National Institute for the Guarantee of Deposits
- Three members representing Lebanese banks (Banque Libano-Française SAL, Fransabank SAL, Bank Audi SAL – Audi Saradar Group)

The Chair of Kafalat also acts as the General Manager of the company.

### *Performance to date*

According to its 2021 audited financial statements, at year-end 2021 Kafalat had an asset base of LBP 106.4 billion (approximately USD 7.1 million at 2023 rate) and **commitments under financial guarantees issued of LBP 70.1 billion (USD 4.7 million) from its own account and LBP 16.6 billion (USD 1.1 million) in co-sharing with third party funds**.

### *Guarantee offering and approach*

Loans guaranteed by Kafalat benefit from **interest rate subsidies** (provided to borrowers, financed by the Lebanese treasury and administered by the Central Bank) introduced to counteract the crowding out effect of high interest rates in Lebanon induced by public sector borrowing. **Some Kafalat guarantees** explicitly **require partner banks not to impose any additional collateral requirements on borrowers**, but the ultimate decision on granting the loan lies with the commercial bank. Kafalat-guaranteed loans (in local currency) also benefit from a Central Bank **exemption from the statutory reserve requirement**, reducing the bank's cost of capital.

Kafalat offers **various programmes**[34] including:

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[31] All the information in this section has been taken from the Kafalat website (https://kafalat.com.lb/) unless otherwise indicated.
[32] *Credit Guarantee Schemes: A Tool to Promote SME Growth and Innovation in the MENA Region.* MENA-OECD Investment Programme Working Paper. 2011.
[33] *Credit Guarantee Schemes: A Tool to Promote SME Growth and Innovation in the MENA Region.* MENA-OECD Investment Programme Working Paper. 2011.
[34] Not included in this list are the Kafalat Innovative and Kafalat Start-Ups and Innovation programmes, which have been suspended according to the website, or the Building Beirut Businesses Back and Better (B5) Fund, which focuses on grant support to micro and small enterprises and MFIs following the Port of Beirut explosion. The Kafalat website also refers to the iSME programme, funded by the Government of Lebanon and the World Bank, which encourages equity investment by increasing early stage investment finance through concept development grants or equity co-investments.

- **Kafalat Basic**: guarantees for the fixed asset and working capital needs of SMEs, with a maximum loan size of LBP 300 million (USD 20,000), a loan term of up to seven years and a coverage ratio of 75%.
- **Kafalat Plus**: focuses on facilitating finance for new production capacity or sustaining current production and employment, with a loan size of LBP 400 to 600 million (USD 26,633 to 39,950), a loan term of up to seven years and a coverage ratio of 85%.
- **Kafalat Agriculture**: provides guarantees for farming and agricultural activities and tree plantation, with a maximum loan amount of LBP 65 million (USD 4,328), increasing to LBP 480 million (USD 31,960) for tree plantation, a loan term of up to seven years (10 years for tree plantation) and a coverage ratio of 85% (75% for tree plantation). The lending bank is not allowed to ask for collateral on top of the Kafalat guarantee.
- **Kafalat Energy**: provides guarantees for eligible SMEs for investments in energy efficiency or renewable energy projects. Maximum amounts and terms vary depending on the investment, and there is a 75% coverage ratio for all investments.

Kafalat fees generally appear to consist of a **2.5% commission** on the outstanding value of the guarantee (but 2% on energy-related guarantees), along with a 0.4% tax stamp on the value of the guarantee.[35]

### *Key takeaways from the Kafalat experience*

- The Kafalat board is **divided between the public sector (National Institute for the Guarantee of Deposits) and private sector representation**, ensuring private sector involvement.
- Some Kafalat guarantees explicitly **require partner banks not to impose any additional collateral requirements on borrowers in order to ensure additionality**, but this is carefully calibrated with financial institutions.
- Kafalat-guaranteed loans (in local currency) also benefit from a Central Bank **exemption from the statutory reserve requirement**, reducing the bank's cost of capital.
- **Coverage ratios at Kafalat range from 75% to 85%**, depending on the type of customer and the programme.
- **Kafalat has a guarantee programme specifically for the agricultural sector**, with a relatively favourable coverage ratio (85%).
- Kafalat provides **regular reporting to the Central Bank of Lebanon**.

## 6.4 Morocco: TAMWILCOM

**Mission:** facilitate access to finance through the sharing of risk with the financial sector and correct market failures for companies and individuals

### *Overview and organisation*

Morocco's *Société Nationale de Garantie et du Financement de l'Entreprise* (SNGFE) or TAMWILCOM, formerly Caisse Centrale de Garantie (CCG), is a **public limited company**

[35] See the Kafalat website for more details: https://kafalat.com.lb/

**governed by banking law**. Founded in 1949, it was transformed under Law 36.20 of July 2020 into a public company and rebranded as TAMWILCOM in 2021. It is the sole provider of public guarantees for MSME financing. **It complements the finance offerings of the private sector, seeking to create additionality and develop the private sector.**

The board of TAMWILCOM comprises **10 members** (four are women, two represent industry associations and three are independent):

- Minister of Economy and Finance – Chair of the Board
- Two representatives from the Ministry of Finance
- Representative from the Ministry of Industry
- Representative from the Ministry of Agriculture
- Representative from the Professional Association of Moroccan Banks
- Representative from the General Confederation of Moroccan Enterprises
- Three independent representatives

### *Performance to date*

According to its 2021 annual report, TAMWILCOM mobilised MAD 62.8 billion (USD 6 billion) in 2021 to support 307,940 different operations/companies. More specifically, **its volume of credit guarantees was MAD 50.6 billion** (USD 4.9 billion), guaranteeing 94,700 loans, of which 75,640 were loans to businesses and 19,060 were loans to individuals.

### *Guarantee offering and approach*

With offices in eight locations across Morocco, TAMWILCOM engages in the following activities, among others:

- **Business guarantees ('Damane' products): facilitate access to credit by viable companies through risk sharing with banks, with coverage ranging from 50% to 80% of the credit**
- Individual guarantees: credit guarantees for individuals with limited or irregular income to promote access to property, education, etc.
- MSME finance: joint financing with banks on favourable terms primarily for investment loans in sectors deemed to be of particular importance to the country
- Start-up equity finance: supports start-ups and innovative projects from the idea stage to fundraising

The **Damane Express guarantee** covers loans to enterprises in all sectors except real estate and deep sea fishing for up to MAD 1 million (USD 98,370), with a **coverage ratio of 70% (80% for women-led enterprises)**. Fees vary, but for short-term loans (less than 12 months) a 0.5% fee is charged when the guarantee is issued and each time the loan is renewed, while for medium- to long-term loans a 1.5% flat rate is charged. **Damane Atassyir and Damane Istitmar guarantees** cover loans to enterprises in all sectors except real estate and deep sea fishing for amounts greater than MAD 1 million (USD 89,370), with coverage ratios from 50% to 70% depending on various factors.

### *Key takeaways from the TAMWILCOM experience*

- A critical aspect of any CGF or related institution should be **ensuring its complementarity with the private sector and crowding in rather than crowding out**

**private sector activity and lending**. The restructuring of the former CCG into TAMWILCOM was in part to ensure its complementarity with the private sector.

- International best practice is to '**ringfence', if not completely separate, credit guarantee activities from lending at public development finance institutions (DFIs)**. It is unclear how TAMWILCOM separates its guarantee activities from its MSME (co)financing or equity start-up financing.
- Offering a **higher coverage ratio for lending to women** or women-led enterprises (80% rather than 70% in the case of TAMWILCOM) can encourage financial institutions to focus lending on women or other target segments.
- **Utilising different fee structures** (upfront issuance fees vs flat rate fees) can be beneficial depending on the tenor of the loan being guaranteed.

## 6.5 Palestine: European-Palestinian Credit Guarantee Fund (EPCGF)

**Mission:** contribute to economic development by stimulating investment in MSMEs through loan guarantees, lending, investment in innovative projects and TA support

*Overview and organisation*

The EPCGF was established as **a development programme for the Palestinian Authority, financed by the European Commission, KfW and the European Investment Bank (EIB), to enhance SME competitiveness and sustainably support income generation, employment creation and poverty reduction**. The EPCGF was incorporated as a not-for-profit foundation under Luxembourg law.

According to the OECD, the fund was initially established to address the business liquidity problems arising from the Israeli-Palestinian conflict, including the strict credit terms (i.e. 100% cash in advance for purchases) imposed on Palestinian merchants.[36]

**Information on the governance structure of the EPCGF was not easily accessible from its website**, possibly demonstrating a lack of transparency compared with other CGFs.

*Performance to date*

Guarantees were approved for 600 SME loans in 2022, with a total guaranteed amount of USD 38,652,525, compared to 411 loans and USD 22,218,336 in 2021.[37] The majority of EPCGF guarantees are for the trading sector. According to the EPCGF website, the credit guarantee fund currently stands at EUR 29 million.

*Guarantee offering and approach*

The EPCGF stimulates bank lending to viable Palestinian SMEs by providing:

- **Individual credit guarantees** for SMEs to financial institutions on a risk-sharing basis

[36] *Credit Guarantee Schemes: A Tool to Promote SME Growth and Innovation in the MENA Region.* MENA-OECD Investment Programme Working Paper. 2011.
[37] EPCGF Quarterly Newsletter December 2020. Issue No. 60.

- **Access to finance by MFIs by issuing guarantees to cover their commercial borrowing**
- **Portfolio guarantees to banks** in Palestine to downscale their operations by covering their microfinance loan portfolios on a risk-sharing basis

With regard to individual credit guarantees, only new loans are eligible for guarantees from the EPCGF, and clearance from the Credit Bureau of the Palestine Monetary Authority (PMA) is required for each loan. Loan maturities are from one year up to five years, the maximum loan amount is USD 100,000 and loans are limited to one every two years.

Eligible borrowers are privately owned SMEs (20 employees or less) with adequate cash flow but lacking sufficient collateral for a bank loan. Start-ups are not eligible, and the **coverage ratio is 60%**.

*Key takeaways from the EPCGF experience*

- Effective CGFs can be set up in **collaboration with international funders**, who can also provide TA for the establishment of the overall framework.
- In such a scenario, **international funders may recommend establishing the CGF as a not-for-profit or other type of institution in another country** (e.g. as a foundation in Luxembourg in the case of the EPCGF). This may be considered **for ease of set-up and placement of funds as well as for monitoring and reporting purposes**.
- The EPCGF demonstrates that, in addition to credit guarantees provided to facilitate MSME lending, CGFs may also **provide guarantees to MFIs to cover their commercial borrowing** (given challenges in refinancing for MFIs in many countries).

# 7. Recommendations for establishing a credit guarantee mechanism or facility in Iraq

It is essential for a new Iraqi CGF to be **properly designed and operated to achieve *outreach* and *additionality*, while striving to achieve *sustainability***, in alignment with the best practices codified in the World Bank's Principles for Public Credit Guarantee Schemes for SMEs.[38]

The general international experience is that CGFs, especially those in higher-risk environments, find it difficult to achieve financial sustainability, particularly in the early years of operation. Therefore, IPC emphasises that the main imperative for any new CGF should be to strive to be **demand-driven and initially opt for a lean (i.e. lightweight) set-up, with a simple structure and product offerings**. The guarantee approach and offerings need to be **based on and responsive to market needs**, providing a strong value proposition to the participating lenders and ensuring sufficient uptake.

As previously stated, ***outreach*** refers to the scale of the CGF, as measured by the number of guarantees issued to eligible SMEs or by the amount of outstanding guarantees. In principle, the greater the outreach, the stronger the effect of the CGF on the SME segment.

The ***additionality* and impact** of the CGF on the supply of credit to the SME segment is dependent on whether guarantees are mainly extended to SMEs that are truly credit-constrained – in other words, those **SMEs without any access to finance, without collateral or with access to finance that is not suited to their needs due to high interest rates, unsuitable maturities or stringent security requirements**. Therefore, in addition to trying to maximise outreach, care should be taken to ensure the CGF is providing additionality and improving SME access to finance by removing credit constraints (rather than subsidising banks in their existing efforts).

**Finally, reaching SMEs that are credit-constrained involves a CGF having a relatively high-risk appetite** – a higher-risk appetite than partner financial institutions have (at least initially) – **to spur and incentivise financial institutions to remove credit constraints**. Ideally, if the guarantee scheme is **professionally managed and has sophisticated risk management** in place, collaborating financial institutions will realise that the risk perceptions they initially had about SMEs may be overly conservative and therefore become more responsive to the needs of the SME sector over time. Consequently, it is **the main task of the guarantee scheme to incentivise its partner lenders to venture into previously under-served target groups by using risk sharing as a means of business development**. While most fully or partially public sector-funded CGFs are **not designed or expected to make a significant profit in the first place,** they should aim to **become *sustainable* after a few years while pursuing their development mandate.**

[38] World Bank and FIRST Initiative. *Principles for Public Credit Guarantee Schemes for SMEs.* 2015. online access.

The following sections detail key challenges and recommendations for a successful new credit guarantee facility or mechanism in Iraq, based on international and regional best practices in all policy and operational areas.

## 7.1 Legal and regulatory framework

As stated under the first of the Principles for Public Credit Guarantee Schemes for SMEs, best practice internationally is **to establish a CGF as an independent legal entity (i.e. with an independent board and management) on the basis of a sound and clearly defined legal and regulatory framework.**

Out of 60 public CGSs globally surveyed in 2016, 78% were independent legal entities established by law, decree or other special legislation.[39] It is vitally important for the CGF to have a **sound legal and regulatory framework to support operational implementation and the achievement of policy goals, optimally through *lex specialis* or institution-specific legislation**. Establishing **a separate legal entity increases the ability of a CGF to effectively leverage capital over time**.

Time constraints. In view of the time required to establish an independent institution, some governments have chosen to operate CGFs through DFIs (e.g. national development banks or funds). In such cases, it is crucial to ensure that the CGF **remains financially and operationally independent**. In particular, boundaries should exist to separate legitimate government control and oversight from daily operations. In some cases, engaging the support of an external party as a fund manager may be beneficial.

Best practice is also to ensure that a CGF has **adequate and transparent funding**, ideally from equity endowments, and that the legal and regulatory framework **promotes mixed ownership**. Private sector participation in the CGF, particularly if related to the potential partner financial institutions, has multiple benefits, including providing an additional source of finance, increasing knowledge of target markets, reducing moral hazard and potentially enhancing governance and transparency.

Government control and protection of private shareholders' minority rights. As the government typically retains control, convincing private shareholders that their rights as minority shareholders are protected and securing their active participation can be challenging. However, the regional experience described in this document demonstrates that **public-private collaboration in the provision of credit guarantees to SMEs is possible and even desirable**, as seen in the cases of Egypt, Jordan and Lebanon (see Table 5 below).

Representativeness of private sector shareholders. Private sector involvement must be carefully considered to ensure that **those involved represent the sector as a whole** (rather than a small number of players) and act in the interests of the CGF and the sector. Naturally, private sector involvement **should not be dominant** because it is essential to maintain a focus on the outreach and additionality (social/developmental objectives) of the CGF and not just on sustainability/profitability, which may limit risk-taking.

[39] Pietro Calice. *Assessing Implementation of the Principles for Public Credit Guarantees for SMEs: A Global Survey.* World Bank Policy Research Working Paper 7753. July 2016.

Table 5: Summary of the ownership structures of key MENA credit guarantee facilities

| ***MENA credit guarantee facility*** | ***Ownership structure*** |
|---|---|
| **Credit Guarantee Company (CGC) Egypt** | Central Bank of Egypt (20%)<br>8 commercial banks and 1 insurance company (80%) |
| **Jordan Loan Guarantee Corporation (JLGC)** | Central Bank of Jordan (47%)<br>Commercial banks (18%)<br>Individuals (18%)<br>Semi-governmental institutions (11%)<br>Private companies (5%) |
| **Kafalat (Lebanon)** | National Institute for the Guarantee of Deposits (75%)<br>50 Lebanese banks (25%) |
| **TAMWILCOM (Morocco)** | Moroccan Government (100% state-owned company) |
| **European-Palestinian Credit Guarantee Fund (EPCGF)** | Foundation started by European Commission, KfW and EIB |

Source: IPC summary based on discussion in this paper and various sources

With regard to CGF **capitalisation**, GIZ understands that KfW has proposed initially capitalising a CGF with EUR 20 million. Assuming that the Iraqi Government and/or other international partners and/or the private sector could match this with another EUR 20 million, the CGF could begin with an initial capitalisation of EUR 40 million (roughly IQD 60 billion at July 2023 rate). **Below is a rough calculation of the potential outstanding guarantee portfolio size and impact, based on a number of assumptions.**

## Potential impact of the CGF with an initial capitalisation of EUR 40 million

| | |
|---|---|
| **Potential initial capitalisation:** | EUR 40 million (EUR 20 million KfW, EUR 20 million other sources) |
| **Assumed leverage:** | 3x |
| **Average coverage ratio:** | 60% (assuming general coverage of 50% and 75% for priority sectors/groups) |
| **Average guarantee:** | EUR 20,000 |
| **Average maturity of loans:** | two years |

***Expected impact:*** *based on the assumptions, it is estimated that the CGF could support an* ***outstanding portfolio of up to EUR 200 million****.*

*With an average maturity of two years for the transactions supported, the scheme is expected to facilitate new transactions* ***amounting to EUR 500 million cumulatively over a five-year period****. This support is expected to* ***benefit approximately 25,000 SMEs****.*

*Considering the underdeveloped state of lending to SMEs, it is anticipated that the* ***scheme's spill-over effects will be even more significant****, amplifying its impact on the broader economy and fostering growth in the SME sector in Iraq.*

Finally, **CGF regulation and supervision is particularly important and should be separated and distinct from CGF ownership and management**. A suitable supervisor, ideally the financial sector supervisor **(i.e. the CBI), should not only review the safety**

**and soundness of operations at the CGF, but also its alignment with government policy objectives, notably in terms of additionality and support to constrained SMEs**. The supervisory approach adopted should clearly define rules related to capital adequacy/leverage, provisioning, risk management and reporting.[40]

**Summary of recommendations for an Iraqi CGF**

- ✓ Establish the CGF as an **independent legal entity** (i.e. with an independent board and management) on the basis of a **sound and clearly defined legal and regulatory framework,** optimally through *lex specialis* or institution-specific legislation
- ✓ Ensure the **financial and operational independence of the CGF** and, if helpful, engage the support of an external party as a fund manager (at least initially)
- ✓ Ensure the CGF has **adequate and transparent funding**, ideally from equity endowments
- ✓ Along with regional best practice, establish **public-private collaboration on the CGF**, ideally through a **mixed ownership structure** (while ensuring the private sector is not dominant)
- ✓ **Clearly separate** CGF regulation and supervision from ownership and management

## 7.2 Mandate, corporate governance and risk management

Best practice is for a CGF to have a **clear mandate, ideally established in institution-specific legislation**, articulating the overall objectives of the CGF (i.e. to address market failures[41] and facilitate SME access to finance) and any more specific objectives (e.g. related to particular target groups, such as women-led businesses, start-ups and production-oriented or export-oriented businesses[42]).

Optimally, the CGF's mandate should explicitly **express the objective of achieving outreach and additionality in a sustainable way**. While CGF strategy may evolve to address changing circumstances, its mandate should be ***'timeless'***, that is, simple and clear and expected not to require substantial changes over time, as changes to the mandate would typically require changes in law (i.e. the *lex specialis*). **See Table 6 for a summary of the mandates/missions of peer MENA CGFs.**

As articulated in the sixth of the Principles for Public Credit Guarantee Schemes for SMEs, the corporate governance framework of any CGF should 'ensure that **operational management is conducted independently**' and that 'business decisions are made on the basis of economic and financial considerations that align with the … mandate and policy objectives and are **free of political influence and interference**'.[43] In particular, an **independent and competent board of directors is a priority**, and it is recommended that the CGF adopt a structured and transparent appointment process, setting minimum

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[40] Note that a key incentive for participation in a CGF by partner financial institutions is being able to reduce risk weightings under the Basel framework and therefore expected credit loss and provisioning because they can substitute customer risk weightings with the CGF's risk weighting.
[41] Market failures must be clearly defined for incorporation or description in future Iraqi legislation; additional primary or secondary research to clearly define and potentially quantify such market failures may be helpful.
[42] It should be noted that specified target groups should reflect the *reality* of the SME sector in Iraq and the market environment. For example, at present, very few Iraqi SMEs are focused on exports, which means that specifying export-oriented SMEs as a target group may lead to a failure to hit targets or frustrated expectations, including for international funders.
[43] World Bank and FIRST Initiative. *Principles for Public Credit Guarantee Schemes for SMEs.* 2015. online access

standards regarding competence, market knowledge and background. It is also recommended that the board include **at least one independent member**, that board members serve a **fixed term** and that **diversity** is considered in board composition.

Table 6: Summary of mandates/missions of key MENA credit guarantee facilities

| ***MENA credit guarantee facility*** | ***Mandate/mission*** |
|---|---|
| **Credit Guarantee Company (CGC) Egypt** | Promote economic and social development by facilitating private sector access to finance, with a main focus on MSMEs |
| **Jordan Loan Guarantee Corporation (JLGC)** | Enhance opportunities for MSMEs to obtain appropriate credit by providing loan guarantees and increase Jordanian exports and domestic sales by providing credit insurance on a sustainable basis |
| **Kafalat (Lebanon)** | Assist SMEs in accessing commercial bank funding by providing loan guarantees based on business plans/feasibility studies that show the viability of the proposed business activity |
| **TAMWILCOM (Morocco)** | Facilitate access to finance through the sharing of risk with the financial sector and correct market failures for companies and individuals |
| **European-Palestinian Credit Guarantee Fund (EPCGF)** | Contribute to economic development by stimulating investment in MSMEs through loan guarantees, lending, investment in innovative projects and TA support |

Source: IPC summary from discussion in this paper and various sources

An appropriate board of directors should include **competent and professional public sector representation** and **additional investor/stakeholder representation** (e.g. DFIs, private sector). **Ideally, independent members with international CGF experience** should be brought in, at least in the early years of the CGF experience. Private sector expertise may include expertise from specific leading financial institutions or from relevant industry associations or groups (e.g. banking associations, business incubators, SME associations and relevant industry groups, etc.). Additionally, **corporate governance principles should be enshrined in the *lex specialis*, as appropriate.**

The CGF should also include an adequate **internal control** and **enterprise risk management** framework. CGF management should establish a strong system of internal controls. This is **critical to protecting the integrity and efficiency of CGF governance and operations**. As part of this, the internal control system should incorporate an **internal audit and compliance function** that reports directly to the board (or a board committee) and has the ability to conduct ad hoc investigations at the board's request. It should have the necessary power to ensure that issues identified through regular work or investigations are addressed or, if needed, escalated to the board level.

As part of internal control, the **CGF's enterprise risk management framework should encompass the identification, assessment and management of all key risks,** particularly credit risk, liquidity and market risk, operational risk and environmental, social and governance (ESG) risks. Enterprise risk management frameworks should be subject to board approval and periodically assessed for relevance.

Figure 3: Best practice aspects of enterprise risk management frameworks for CGFs

**Credit risk**

- Adopt a comprehensive credit risk management framework based on **quantitative and qualitative principles**
- Establish relevant **exposure limits** by sector, geographical area, etc.
- Utilise appropriate **credit risk mitigation techniques** (e.g. counter-guarantees) and adopt sound **guarantee evaluation** policies and practices

**Liquidity and market risk**

- Ensure a sound liquidity and market risk management framework to **meet claims and hedge against market price changes**
- Include **proper governance arrangements**, management information systems, liquidity requirement analysis and contingency planning
- Define a **transparent investment policy** with permissable asset classes and concentration limits

**Operational risk**

- Establish an operational risk framework that clearly identifies **lines of responsibility**, **segregation of duties** and reliable **control mechanisms**
- Establish **codes of conduct**
- Adopt **recruitment policies** that ensure professional and ethical staff behaviour
- Develop a **business continuity plan** to ensure continued operation in case of breakdown or disaster

Source: Adapted from World Bank and FIRST Initiative. *Principles for Public Credit Guarantee Schemes for SMEs*. 2015

**Summary of recommendations for an Iraqi CGF**

- ✓ Define a **clear mandate** that expresses the objective of achieving outreach and additionality in a sustainable way, ideally in the *lex specialis*
- ✓ Establish **principles and guidelines for an independent and competent board of directors**, including clear ('fit and proper') appointment standards, required board competencies, diversity standards (particularly related to gender), committee structure and board terms, ideally enshrined in the *lex specialis*
- ✓ Consider board representation from **both the public and private sectors**, including **independent members**
- ✓ Establish appropriate and adequate **internal control and enterprise risk management systems**

## 7.3 Operational framework and guarantee conditions

The following recommendations for the operational framework and conditions of a potential credit guarantee facility or mechanism cover various critical areas for a successful facility or mechanism:

- Target market and eligibility criteria
- Selection of partner financial institutions
- Guarantee delivery approach
- Coverage
- Leverage
- Pricing and fees
- Segmentation and products
- Claim management and recovery
- TA

### 7.3.1 Target market and eligibility criteria

The recommended target market of the proposed CGF is **SMEs engaged in commercially viable, formal and legal activities in *all* sectors** and in all areas of Iraq that are not subject to international exclusion lists and are in compliance with Iraqi laws and regulations. A clear SME definition should be established, ensuring that it is **broad enough to cover most businesses generally accepted as SMEs in Iraq**. Special windows or approaches may be considered for specific target groups (e.g. women-owned businesses, start-ups).

The following **eligibility criteria** may be considered:

- **SME definition**: according to commonly agreed upon definitions.
- **Formal eligibility of borrowers**: borrowers should be legal entities registered with the tax authorities. As the majority of SMEs are unregistered, the CGF may consider including unregistered entities (i.e. individual loans to the owners themselves), ideally on a temporary basis, coupled with a drive or promotional campaign to encourage SMEs to register.
- **Eligible sectors**: all private sector activities (over 50% privately owned), except those included in applicable exclusion lists.
- **Individual eligibility of borrowers**: borrowers must meet the formal eligibility criteria of participating financial institutions, their business needs must be viable and they must generate sufficient cash flow or income to guarantee their repayment capability. Borrowers need to be creditworthy, both individually (i.e. entrepreneurial ability, management skills, technical know-how and experience) and materially (i.e. financial position).
- **Eligible loan types**: funded and unfunded credit facilities. Where applicable, they must be within the allowable delinquency period, as defined from time to time.
- **Eligible loan purposes**: working capital, fixed assets or a combination of the two; start-ups only if they are for new business lines of existing business entities or if the sponsors have other existing businesses with sufficient repayment capacity.

**Summary of recommendations for an Iraqi CGF**

- ✓ Define the CGF’s target market as **SMEs (or their owners) with legal, commercially viable activities in all sectors and industries**, potentially with special windows for specific target groups such as women
- ✓ **Broadly define eligible loan purposes** to include working capital, fixed assets or any combination of the two

### 7.3.2 Selection of partner financial institutions

The selection of suitable partner financial institutions is critical to the success of a CGF, and the focus should be on **institutions with a proven interest and the capacity to engage in SME finance**.

It is recommended to **limit (at least initially) potential partner financial institutions to banks** in Iraq, given the underdeveloped financial sector and the fact that MFIs in the country tend to be liquidity-constrained rather than risk-averse.[44]

To be **eligible to start cooperation with the CGF**, as initial criteria, a bank should:

- Hold a duly issued and valid licence to carry on business as a bank
- Demonstrate two years of profitable lending operations in the previous three financial years, with effective risk management procedures, controls and acceptable levels of loan portfolio quality and performance
- Ensure that its shareholders and board of directors are qualified persons of proven integrity and knowledgeable in business and financial matters, in accordance with the applicable regulatory guidelines on fit and proper persons
- Show evidence of compliance with all applicable laws and regulations
- Have qualified and experienced management and adequate organisational and institutional capacity for its specific risk profile
- Have well-defined policies and written procedures for management of all types of financial risks (liquidity, credit, currency, interest rate and market risk and risks associated with balance sheet and income statement structures)
- Maintain adequate capital, as prescribed by prudential regulations issued by the CBI
- Maintain adequate liquidity in line with required levels, as prescribed by the CBI
- Have in place adequate procedures for anti-money laundering and combating the financing of terrorism, in line with CBI requirements
- Comply with know-your-customer circulars issued by the CBI
- Have in place an environmental and social risk management system compliant with CBI (and any additional DFI) requirements
- Conduct, maintain and enforce adequate internal audits and controls for its specific risk profile
- Have adequate management information systems
- Demonstrate commitment to serving the SME sector and have in place satisfactory SME loan assessment and approval processes and risk management procedures

In addition to the above qualifying criteria, **strategic alignment of the bank with the CGF's mandate** will also be assessed. This will entail considering the following factors:

- Bank's interest in and ability to enter the SME finance market, if not already active
- Bank's interest in and ability to develop/grow its SME lending activities if it is already a player in the market
- The bank's motivation to work with the CGF

[44] Providing guarantees to MFIs to enable them to access financial sources may be another potential CGF role as MFIs are not currently served by the ICBG.

- The CGF's interest in developing a partnership with the bank
- The bank's interest in and ability to improve SME lending capacities (e.g. potentially absorbing TA)

The CGF could consider starting cooperation with banks that have a clear strategic alignment. **TA could be considered for banks that show gaps** in some of the areas highlighted above to ensure that their SME departments are **ready to utilise the credit guarantees once on-boarded.**

**Summary of recommendations for an Iraqi CGF**

- ✓ Identify and focus on **partner banks with a demonstrated interest in and capacity to engage in SME finance**
- ✓ **Confirm strategic alignment of potential partner banks with the CGF's mandate**
- ✓ **Consider provision of TA to partner banks** to ensure readiness to utilise credit guarantees quickly and correctly once on-boarded

### 7.3.3 Guarantee delivery approach

While in some more advanced economies (e.g. Korea), CGFs might decide to reach out to SME target groups directly, with borrowers applying for a guarantee even prior to requesting a loan, given the moderate level of financial literacy in Iraq and the limited experience of Iraqi SMEs with bank borrowing, it is **recommended that the CGF's operations be based on a secondary business model.**

This approach means that the CGF will **rely on primary lenders (banks)** with which it cooperates as a conduit to pursue its own objectives. While the CGF has legal and operational relationships with the banks, its actual beneficiaries are Iraqi SMEs – the banks are the vehicle for serving this class of borrowers.

The banks will create the business volume and decide whether to apply for guarantees for their SME customers. Banks will also pay the fees on the guarantees, which may be fully or partially passed on to the SME borrowers.

Although SME borrowers are the target group and the ultimate beneficiaries, they should not even know whether part of their loan has been guaranteed by a third party in order to minimise moral hazard. As a result, it is recommended that CGF guarantees be **silent guarantees to avoid any risk of moral hazard** on the borrowers' side – in other words, to reduce the risk of SME customers associating the guarantee with a grant provided either by the government or donors. This approach is used by many guarantee funds in similar economies around the globe and in the region.[45]

Various guarantee options exist, including *pari passu* approaches (in which the CGF assumes a fixed share of losses regardless of loan size, based on the coverage ratio) and first-loss guarantee approaches (in which the CGF bears all losses up to a certain amount).

[45] It should be noted that communicating with SMEs to encourage them to apply for credit in spite of a lack of security (whether a personal guarantor or collateral) may be necessary, as most SMEs believe that bank finance is not an option without such security. This communication, indicating an openness to SME finance without appropriate security, should still occur at the bank level rather than at the CGF level (or at least be 'branded' by the banks).

It is recommended that the new CGF adopt a *pari passu* approach for the first few years as this allows for simplicity.

Three general potential **guarantee delivery approaches** may be considered for a new CGF in Iraq:

- **Individual credit guarantee approach**: the CGF guarantees a single loan made by a bank to a single borrower whose identity is known to the CGF, and the guarantee decision is at the discretion of the CGF after it has conducted an individual appraisal.
- **Blanket credit guarantee approach**: banks evaluate, decide on the guarantee and disburse loans autonomously without CGF involvement in their credit process or the guarantee decision. However, the CGF and the banks agree on specific eligibility criteria for blanket guarantees, which are documented in detail in guarantee framework agreements, defining the specific loan types and conditions, target groups and risk parameters acceptable for blanket guarantees, as the case may be. Blanket guarantees are still individual in nature and legally, but the authority to decide on the guarantee is vested in the banks. The CGF has the right, however, to suspend or withdraw the authorisation for the bank to make the guarantee decision.
- **Portfolio credit guarantee approach**: the CGF guarantees a portfolio of loans made by a bank to qualifying borrowers up to the portfolio ceiling. In this case, the individual borrowers are not known at the time of the guarantee agreement, but eligibility criteria, risk parameters and the loss sharing model (*pari passu*, first loss or second loss) are defined.

In all three cases, the quality and validity of the guarantee, *once issued*, and all the processes related to the outstanding guarantees (guarantee claims, claim refunds, monitoring, auditing, etc.) are **essentially the same**. Blanket and portfolio guarantees should be **audited more intensively** in order to compensate for the higher risk they carry due to the lack of CGF involvement in the guarantee decision. For all products, the CGF should put in place **guarantee agreement measures or criteria** (due diligence, operational and lending strength, random audits, etc.) that will allow monitoring, control and oversight of the portfolio and therefore the risk.

The ICBG has employed a purely **individual credit guarantee approach to date**, which is therefore now familiar in the Iraqi market. At the same time, the need for the ICBG to approve guarantees on each loan individually can be frustrating for SME customers and/or the banks because of the inefficiency of the process, particularly for smaller credits.

Therefore, it is recommended that the CGF ultimately take a **segmented approach, employing a portfolio (or blanket) guarantee for smaller loans or loans with similar characteristics** over time while using an **individual credit guarantee approach for larger, riskier or more idiosyncratic credits**. It may be advisable, however, to **mainly use the individual credit guarantee approach for new banks** as a risk control and training/TA mechanism **for a period of time or until a certain guarantee volume is reached** (i.e. banks can observe how the CGF assesses SME credit risk and potentially adopt similar techniques over time).

**Summary of recommendations for an Iraqi CGF**

- ✓ The CGF should focus on a secondary model that **relies on primary lenders (banks) being the conduits for reaching (SME) customers**
- ✓ It is recommended that CGF guarantees be **silent guarantees to avoid any risk of moral hazard** on the borrowers' side
- ✓ The CGF is recommended to adopt a ***pari passu* approach** for the first few years of operation as this allows for simplicity
- ✓ The CGF is recommended take a **segmented approach with regard to guarantee delivery**, employing a **portfolio guarantee for smaller loans or loans with similar characteristics** while using an **individual credit guarantee approach for larger, riskier or more idiosyncratic credits**
- ✓ Consider **mainly using the individual credit guarantee approach for new banks** as a risk control and training mechanism **for a period of time** or until a certain guarantee volume is reached

### 7.3.4 Coverage

A key factor determining the success and value of a CGF is the coverage ratio offered. As described in the eleventh of the Principles for Public Credit Guarantee Schemes for SMEs, 'guarantees issued … **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'.[46] As a result, best practice is generally to find an **appropriate coverage ratio, no lower than 50% but certainly lower than 100%, although the latter rate is used in some OECD countries, such as Luxembourg, Japan and Canada**.[47]

Additionally, coverage ratios should **generally align with the delivery approach employed**; they are generally lower under portfolio approaches than under individual guarantee approaches.

Coverage should, then, be established based on lender risk appetite, risk of moral hazard, CGF impact targets and the need to ensure that banks are incentivised to perform proper risk assessment and monitoring of borrowing SMEs. The **existing ICBG coverage ratio of 75% could serve as a minimum reference** in the Iraqi market, given the ICBG's limited impact to date on SME access to finance and business development (although not solely attributable to the 75% coverage ratio).

CBI discussions with stakeholders, notably Iraqi banks, will have to take place on this key topic, and market research on this very specific point should be conducted. Ultimately, however, the setting of the CGF coverage ratio remains a sovereign political decision where public policy development objectives should prevail over possibly less generous strictly market and/or moral hazard risk-based approaches.

Given the strong expectations of the CBI and the Iraqi Government in terms of CGF additionality for increased SME access to finance and the leverage effect on SME business development on the one hand, and the development aid role of CGFs in enabling and

[46] World Bank and FIRST Initiative. *Principles for Public Credit Guarantee Schemes for SMEs.* 2015. online access.
[47] OECD. *Facilitating Access to Finance: Discussion Paper on Credit Guarantee Schemes*, p. 12. online access.

boosting private sector development, on the other, an ambitious coverage ratio of 85% to 90% might be considered as a legitimate starting point for CBI internal and external discussions on the matter until and/or unless future market research on this specific point suggests otherwise. This would provide Iraqi banks with a strong incentive to lend to SMEs. It could be counterbalanced over time by a lower coverage ratio for new loans when Iraqi banks become less wary of lending to SMEs, thanks to well-performing SME loan portfolios.

Although some researchers and DFIs recommend using differentiated or risk-based pricing for guarantees, experience in markets similar to Iraq's is that **the focus of new CGFs should, as far as possible, be on simplicity**, with the CGF providing a **simple coverage ratio** (based on loan principal rather than interest) and **potential coverage ratio bumps for target segments** in alignment with policy objectives stated in the CGF mandate (e.g. women, youth, green, start-ups, etc.). This is further in general alignment with the CGFs reviewed in the MENA region (see Table 7).

Table 7: Summary of the coverage approaches of selected MENA credit guarantee facilities

| *MENA credit guarantee facility* | *Coverage ratio range* |
|---|---|
| Iraqi Company for Bank Guarantees (ICBG) | 75% |
| Jordan Loan Guarantee Corporation (JLGC) | 70% to 85% |
| Kafalat (Lebanon) | 75% to 90% |
| TAMWILCOM (Morocco) | 50% to 80% |

Source: IPC summary from discussion in this paper and various sources

While security requirements for SME borrowers should be left to partner banks to arrange without prescriptions from the CGF because a key challenge in the Iraqi market that needs to be addressed is the availability of suitable security, it is recommended **that the general ability or inability of the SME to provide bankable security be taken into account when considering target segments for potential coverage ratio bumps** as a way of indirectly providing incentives to reduce overall security requirements (e.g. moving away from personal salary guarantees). In addition to serving as a tool for promoting lending to target groups, coverage ratio bumps can also promote additionality by indirectly targeting security requirements.

**Summary of recommendations for an Iraqi CGF**

- ✓ Identify an **appropriate coverage ratio (likely between 75% and 90%)** based on lender risk appetite, risk of moral hazard and CGF impact targets determined through market research and discussions with banks
- ✓ Consider starting with a **simple coverage ratio and potential coverage ratio bumps** for target segments or related to availability and type of security

### 7.3.5 Leverage

Leverage can be defined as the **ratio between the CGF's outstanding guarantee exposure and available capital at the CGF**. The assumption underlying the leverage concept is that not all guaranteed loans will default and result in claim pay-out. Using the appropriate leverage mechanism and determining the leverage coefficient is important in attuning the risk accepted by the CGF.

The potential to leverage is **one of the significant advantages of a CGF**. It is, in many ways, similar to a bank's capital adequacy calculation, although leverage is not calculated in a risk-weighted way. At the inception of a CGF, **caution should be exercised regarding leverage in order to build trust in the CGF** and develop capacities over time.

Leverage varies greatly at CGFs globally, with some schemes, for example KODIT, achieving a leverage ratio higher than 10.[48] Many CGFs across the globe **stipulate target or threshold leverage ratios**. The exact leverage could be based on an *ex ante* risk assessment that could be monitored and reviewed during CGF implementation. The leverage ratio reflects the risk; if risk is high, the leverage ratio should be lower. However, as an initial recommendation, the CGF should aim for a leverage ratio of **around three for the first three-year period**, which is typical but on the conservative side compared to funds globally, and then expand this over time to continue to multiply impact and help achieve sustainability.

**Summary of recommendations for an Iraqi CGF**

- ✓ **Exercise caution at the inception of the CGF regarding leverage** in order to build trust in the CGF and develop capacities over time
- ✓ **Stipulate a target leverage ratio** based on an *ex ante* risk assessment revisited over time
- ✓ As an initial recommendation, the CGF should **aim for a leverage ratio of around three** over the first three-year period, in line with international experience for potentially challenging markets

### 7.3.6 Pricing and fees

**Pricing is typically a key factor for participation by financial institutions in credit guarantee schemes or facilities worldwide**. A guarantee perceived as 'expensive' deters financial institutions from engaging with the CGF. Careful pricing is therefore required, along with some education on the additionality of the CGF for the bottom line, where appropriate.

**In many cases, the nominal cost of the guarantees can be partially offset by additionality**. Assuming that the guarantees enable banks to provide larger loans (as loan size can be determined to a much greater extent based on the repayment capacity of the borrower and is less restricted by available security) or loans to borrowers that the bank would not lend to without a guarantee, banks will be able to increase their business volume and thereby increase their interest income, which would partially or even fully offset the cost of the guarantees. This will certainly be influenced by the regulatory recognition of the use of the guarantees by the banks and the incentives it might provide in terms of provisioning relief and risk weights.

**Additionality is a key selling point** and, combined with incentives in terms of capital adequacy relief, can relieve capital constraints and **alleviate the reluctance of banks to pay the cost of the guarantee**.

[48] ADB. *Policies to Optimize the Performance of Credit Guarantee Schemes During Financial Crises.* ADB Briefs No. 167. March 2021.

The guarantee offered by the CGF will be partial, entailing risk sharing with banks. In addition, the CGF has the objective of achieving financial sustainability. As a result, while **pricing may need to primarily take into account demand from banks** (at least initially) to drive uptake and usage, the **CGF's cost structure must be considered over time** and incorporated into pricing as well (operational costs at least).

Two types of price may be considered for CGF guarantees: **upfront (origination) fees** and **utilisation fees**. The **upfront fee is a one-off upfront payment based on the disbursed loan amount** (for loans that are only guaranteed). Upfront fees often range from 0.5% to 3% of the loan amount or up to 5% of the guarantee amount. **Utilisation fees, on the other hand**, are based on the **total guaranteed amount and calculated on a periodic basis** (e.g. quarterly or annually). The advantage of utilisation fees is that they are easy to calculate, and they are particularly suitable for portfolio-based guarantee approaches. Utilisation fees typically range from 0.5% to 5.5% of the outstanding guaranteed amount.

**An origination fee approach may be most useful for credits or portfolios with shorter tenors or smaller amounts.** This may be particularly relevant in Iraq, where meeting SME working capital and shorter-term finance needs is a significant opportunity. At the same time, as a utilisation fee approach allows for greater simplicity, **additional market research and discussions with banks would be required to determine the optimal approach**.

**It is recommended that, for the sake of simplicity**, guarantee pricing be harmonised across all participating banks and **a uniform pricing approach used**. The advantage of harmonised pricing is that it avoids excessive negotiations with individual banks. Over time, depending on the growth of the CGF, risk-based (non-uniform) pricing could be considered.

**Summary of recommendations for an Iraqi CGF**

- ✓ As pricing, along with claim handling, is often *the* key success factor at CGFs, **initially it could primarily take into account demand from banks to drive uptake and usage (additionality)**, with further consideration of the cost structure of the CGF and sustainability incorporated into pricing over time
- ✓ **Additional market research and discussions with banks are recommended prior to deciding whether upfront or origination fees are preferable**
- ✓ A **harmonised pricing approach across participating banks** is recommended, especially at the inception of the CGF

### 7.3.7 Segmentation and products

As detailed above in the presentation of SME credit needs and expectations in Iraq (see Section 3), there is particularly **significant demand among Iraqi SMEs for short- to medium-term loan products for working capital and equipment purchase needs**, with loan amounts requested typically below USD 50,000.

In view of this, **GIZ recommends that the CGF concentrate** on providing guarantees for both **working capital credit and investment/fixed asset loans, but with a particular focus on the short- to medium-term credit for which there is a particular need and demand among SMEs.** Accordingly, the CGF can offer various products with different eligible loan ranges, coverage ratios, fees, etc., although it is highly recommended for the CGF to stick to as simple an approach as possible to begin with to avoid overcomplicating its operation.

In addition, **further segmentation based on other factors, such as region, sector or target group** (e.g. women, start-ups) could be considered, in line with the mandate and objective to promote the additionality of the CGF. **Methods to promote unsecured lending (e.g. through coverage ratio bumps or other benefits) may also be considered**, as the inability to provide appropriate security has been identified as a key financing constraint for SMEs in Iraq.

Other products that could be considered by the CGF that have a potential indirect impact on small businesses in Iraq include **counter-guarantees for the ICBG** and **wholesale guarantees for banks for on-lending to MFIs**, although it is recommended not to make this an initial focus.

**Summary of recommendations for an Iraqi CGF**

- ✓ Consider providing guarantee products for **both working capital and fixed asset lending**, but with a **focus on the short- to medium-term credit for which there is a particular need and demand among SMEs in Iraq**
- ✓ Further product segmentation **based on region, sector, target group or security method** can also be considered, although a simple approach is recommended at CGF inception
- ✓ **Counter-guarantees for the ICBG or wholesale guarantees for banks on-lending to MFIs** may also be considered, although it is recommended not to make this an initial focus of the CGF

### 7.3.8 Claim management and recovery

The **real value of a CGF** and one of the most important issues influencing the perception that partner banks have of cooperation with a guarantee fund **is claim procedures and pay-out stipulations**. Once a guaranteed loan defaults and a partner bank seeks compensation for the loss from the guarantee fund, the claim should be appraised and the pay-out, if approved, made swiftly. The CGF is recommended to **set clear rules for claim decisions, avoiding any ambiguity**. **The Basel principles require guarantees to be unconditional and irrevocable, among other conditions, in order to be considered valid risk mitigation.**

It is crucial to **define clear claim triggers**. In line with best practice, it is proposed to set the claim trigger at **90 or 180 days past due** – subject to negotiations with the prospective banks. Each guarantee claim requires an individual appraisal, carried out by a team that is independent of guarantee operations and the issuance team. Flexibility for longer delays due to 'acts of God' or *force majeure* situations, for example, a pandemic or armed violence, may be considered.

The CGF should **consider the efficiency of the claim appraisal process and the swift and complete payment of guarantee claims as one of the key success factors for its operations**. It is recommended to pay out the claimed amount fully in one instalment and to **not make it dependent on the bank having exhausted all legal remedies** because this would mean a potentially lengthy process of legal action. **The value of having a guarantee in case of default needs to be proven to banks** in order to maintain their interest in cooperation and their willingness to pay the respective fees. As a result, we recommend **strongly pursuing a high claim approval rate –** ***even potentially aiming for a zero claim rejection rate*****.**

The claim appraisal process is carried out in order to **verify the bank's compliance with requirements for approving, disbursing and managing** the respective loan and to **ensure that the delinquency management activities were indeed carried out in line with the bank's credit policy** and that the loan is in default in spite of the collection and recovery efforts the bank is required to make (the bank also shares in recoveries, based on the guarantee coverage ratio).

**Summary of recommendations for an Iraqi CGF**

- ✓ Set **clear rules for claim decisions with clearly defined claim triggers** (90 or 180 days past due) to avoid any ambiguity
- ✓ **Target a high claim approval rate**, potentially aiming for a **zero claim rejection rate**
- ✓ Do not make claim pay-outs dependent on banks having **exhausted all legal remedies**

## 7.4 Monitoring, evaluation and reporting

Due to their unique nature, public CGFs should be subject to **both rigorous financial reporting requirements**, including the external audit of financial statements, and **requirements regarding the disclosure of non-financial information to stakeholders** (if not the public). Such requirements should be explicitly included in the *lex specialis* governing the CGF, if relevant.

Non-financial reporting by the CGF should include provisions relating to:

- **Corporate governance** principles and structure
- **Board** composition, board member backgrounds, board committees, etc.
- Assessment of the **outreach** of the CGF (CGF's ability to meet demand)
- **Impact assessment** (e.g. measurement and evaluation of financial and economic additionality)
- **ESG performance** of the CGF (potentially including an environmental and social management system)

We recommend the establishment of a **M&E framework that seeks to collect, monitor, evaluate and report information specifically related to CGF *outreach*, *additionality* and *sustainability***. Indicators for each of these three dimensions should be established and maintained over time.

**Summary of recommendations for an Iraqi CGF**

- ✓ **Incorporate non-financial reporting and disclosure standards into the *lex specialis* or foundational documents of the CGF**, including provisions related to corporate governance, board composition and structure, outreach, impact assessment, ESG performance, etc.
- ✓ **Consider the establishment of a comprehensive M&E framework** focused on collecting, monitoring and reporting information related to CGF **outreach, additionality and sustainability**

## 7.5 Technical assistance

The CGF could **explore the possibility of receiving funding from donors or international organisations** to deliver TA along with guarantees and promote the outreach, additionality and sustainability of the CGF.

In particular, TA can be provided on three levels:

- **At CGF level**: TA from external parties with CGF expertise can assist with CGF governance, strategy, management and operations, particularly in the early years when staff will benefit significantly from training in view of their lack of previous experience with CGFs.
- **At participating bank level**: TA may be provided to participating banks in order to increase understanding of the benefits of CGFs, improve the credit assessment of SMEs, ensure claims are filed correctly, etc.
- **At individual SME level**: TA at this level may be delivered through industry or sector associations, for example, to raise financial awareness and improve financial education, specifically with regard to applying for and receiving bank finance – potentially in collaboration with the One Trillion Dinar Initiative.

As TA is often provided by an external party (e.g. donor) as a grant or concession, it may be considered 'off-budget' and accounted for separately.

Additionally, depending on bank perceptions of TA value, this can serve as a 'sweetener' to encourage participation in the CGF, particularly at CGF inception.

Donors such as foreign development banks **already in partnership** with development aid organisations for **SME** financial education and **training in making professional applications for loans as well as aid implementers already training Iraqi bank SME lending departments, in particular, could be considered for an extension of their ongoing TA to Iraqi CGF staff and possibly granted observer status on the CGF board for the duration of their TA.**

**Summary of recommendations for an Iraqi CGF**

- ✓ **Explore potential TA options** at the CGF level, participating bank level and individual SME level

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