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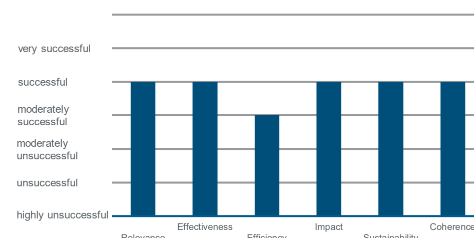
Ex post evaluation EPCGF III, Palestinian Territories

Title	European Palestinian Credit Guarantee Fund EPCGF III		
Sector and CRS code	Formal sector financial intermediaries 24030		
Project number	2012 66 410		
Commissioned by	German Federal Ministry for Economic Cooperation and Development (BMZ)		
Recipient/project-executing agency	Ministry of Finance and Planning		
Project volume/ Financial Instrument (FC)	EUR 2.5 million FC financial contribution (budget funds)		
Project duration	*2012-2017*		
Year of report	2020	Year of random sample	2018

Objectives and project outline

With the evaluated phase III, capital was injected into the EPCGF, which has been providing guarantees for loans to micro-, small- and medium-sized enterprises (MSMEs) since 2006 and has since been expanded to provide guarantees for micro-credit portfolios at banks and for refinancing lines to micro-finance institutions (MFIs). The goal was to contribute to the target-group-oriented expansion and consolidation of the financial sector and, thus, to the promotion of private-sector activities in the Palestinian Territories (PT) and additional income in MSMEs that are viable over the long term. The aim of phase III was to support the growing micro-finance sector in increasing customer numbers and expanding the range of products.

Overall rating: **successful**



Key findings

With DC support, the EPCGF has managed to establish itself as a stand-alone, independent institutionalised credit guarantee fund (CGF) with long-term prospects to promote MSME financing in the PT. The project is rated as successful because:

- With its approach of mobilising existing liquidity in the financial sector by providing guarantees for credit financing, the EPCGF is able to remove any financing obstables for MSMEs.
- The EPCGF is regarded as an independent, established and long-term local partner, giving it a unique selling point that is the result of its establishment as a Dutch trust (2015), its compliance with international good practice for CGFs, the recognition of EPCGF guarantees by the regulator, and its long-standing reliable reputation and cooperation in the financial sector.
- The EPCGF works successfully with the majority of the most important, relevant financiers of MSMEs and other stakeholders in the sector and has helped to develop MSME financing in the financial sector, to improve the range of products on offer, and to improve access – not only through its guarantees but also with complementary measures to reinforce the sector and the professionalism of banks and MFIs in the PT.
- Without EPCGF guarantees, MFIs would effectively have only limited access to refinancing through commercial banks active in the PT and would require another form of security.
- At the same time, the EPCGF has proven to be agile and now has the opportunity to strategically use the fund's current over-capitalisation – separately but in a way that is still coherent with DC funds – for example by working closely with the regulator to offer adequate guarantees during the current COVID-19 pandemic.

Conclusions

The EPCGF was able to establish itself on the market in the PT even though it offers a coverage rate of just 60 %. Similar CGFs cover 80 % on average. It is likely that a reduction in the coverage rate – as originally planned in the objectives – would impair any additional mobilisation of MSME financing. Such a reduction would also not be constructive, particularly in view of the growing risks in an environment of political/economic challenges and problems presented by the pandemic – and also considering the general growth in obstacles for SMEs entering the market (increasing collateral requirements).

- However, the EPCGF should still look for ways to use its capital more efficiently and achieve greater leverage.

1 = very successful, 2 = successful, 3 = moderately successful, 4 = moderately unsuccessful, 5 = unsuccessful, 6 = highly unsuccessful

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Rating according to DAC criteria

Overall rating: 2

Ratings:

Relevance	2
Effectiveness	2
Coherence	2
Efficiency	3
Impact	2
Sustainability	2

General conditions and classification of the project (for complex projects only)

At the time of the evaluation (2020), support for the European Palestinian Credit Guarantee Fund (EPCGF) by German Development Cooperation is in its fourth phase. This evaluation will look at phase III, which was approved in 2012 and disbursed in September 2013. According to the EPCGF, the phase III funds had been revolving since 2017 and – at the time of the final report submitted by KfW to the Federal Ministry for Economic Cooperation and Development (BMZ) in December 2017 – were transferred to the EPCGF's tier 1 capital in 2018.

The purpose of the EPCGF is to promote micro-, small- and medium-sized enterprises (MSMEs) and their access to credit financing via financial institutions active in Palestine with partial guarantees used for risk participation. According to the EPCGF's guarantee criteria, MSMEs are defined as enterprises with no more than 25 employees and with loan amounts of up to USD 200,000. The core product is the provision of partial guarantees for individual loans to MSMEs by commercial banks. In 2012, this work was expanded to include partial guarantees for commercial banks' refinancing lines to micro-finance institutions (MFIs) and portfolio guarantees for banks' micro loans. The scope of the guarantee products provides for partial coverage of 60 % on receivables outstanding at the time of the default, including interest losses for up to three months. Furthermore, a small number of different coverage options are offered, including 65 % coverage for start-ups.

The EPCGF is capitalised by EU funds and German Development Cooperation (DC) funds (budget funds). With the DC funds from phase III, DC funds made up around 30 % of total capital. The cumulative capital through DC funds amounts to EUR 9.55 million with total capital of around EUR 31.5 million (including phase III) – phase III therefore accounts for around 8 % of the subsidised capital resources. Under phase IV in 2018, the EPCGF received a further EUR 9.4 million in DC funds for capitalisation.

In total, almost 95 % of the guarantee volume provided by the EPCGF was used for MSME credit financing via banks. With guarantees totalling USD 191 million, the EPCGF covered 6,659 corporate loans with a total credit volume of USD 319 million (as of 30 June 2020). Over time, individual corporate loans rose from an average of around USD 40,000 (2012) to around USD 75,000 (2019). The remaining roughly 5 % of the guarantee volume provided by the EPCGF was used for refinancing lines to MFIs with a value of USD 10.7 million, whereby the EPCGF covered a credit volume of USD 17.8 million issued by MFIs (as of 30 June 2020).

In recent years, the economic and political situation in the Palestinian Territories (PT) has remained complex and difficult, and increasingly so. This means that banks have to deal with issues including a volatile environment with high risks, particularly for all funding that is directly or indirectly linked to the public sector.[1]

[1] See, for example, PMA AR (Annual Report) 2019, www.pma.ps/Portals/0/Users/002/02/2/Publications/English/Annual%20Reports/PMA%20Annual%20Reports/PMA%20Annual%20Report%202019.pdf

However, banks are still growing, and the total volume of credit issued has also risen. Credit issued to MSMEs has also increased sharply since 2012, rising five-fold, though a slight decline has been recorded since 2018:

(in USD billion – rounded)	2013	2017	2019
Total assets	11.2	15.9	17.9
Credit issued	4.5	8.0	9.0
Credit issued to MSMEs	0.26 (2012)	1.4	1.3
Non-performing loans	3.1 % (2012)	2.3 %	4.1 % (MSMEs: 6.6 %)

In 2019, around 93 % of loans to MSMEs in the PT were financed by banks. However, the annual analyses conducted by the Palestine Monetary Authority (PMA) also highlight that growth rates for MSME loans over the past two years have remained behind overall loan growth rates. In its analysis, the PMA references the difficult economic situation in 2019 and the resulting rise in credit risks for banks, particularly in relation to MSMEs, which often have poor options for collateral. Guarantees therefore continue to play an important role in generally enabling credit worthy MSMEs to access financing from banks.

Liquidity in the sector – measured by the loan-to-deposit ratio (LDR) – is still available. Even though credit portfolios have already been expanded, further growth is still possible (LDR 2012: 56 %; 2019: 67.5 %; 80 to 90 % is regarded as appropriate).

In addition, for several years, micro-finance institutions (MFIs) have been playing an important role as credit financiers, particularly for micro and small-sized enterprises. In 2019, around 6.6 % of MSME loans were financed by MFIs, a figure that was even higher in previous years: around 7 % in 2018 and 9.3 % in 2016. A number of micro-finance providers have been active in the PT since the 1990s, initially as programmes or non-governmental organisations. When licensing options and, as such, market regulation were introduced by the PMA in 2011, the market transformed, and professional standards were established. In 2016, the PMA listed six MFIs (known by the PMA as specialised lending institutions), four of which were commercial (for-profit) MFIs. In 2019, there were eight active licensed MFIs.

Overall, the sector has grown significantly since 2013. The total portfolio belonging to MFIs recognised by the PMA amounted to USD 326 million in 2019 (2013: USD 84 million) and around 75,000 borrowers (2013: around 54,000) with female borrowers making up 36% (2013: 50%). Although liquidity is not necessarily a bottleneck for MFIs, their growth is based on the availability of liquidity and their level of professionalism rises with the diversification of their refinancing and, in particular, with refinancing from commercial sources.

The aim of phase III of the EPCGF was to “support the growing micro-finance sector in increasing customer numbers and expanding the range of products”. A guarantee for the micro-finance portfolio of a Palestinian commercial bank and guarantees for its refinancing lines for two local MFIs are assigned directly to phase III. Since it only makes very limited sense to separate the individual phases for the purposes of the evaluation, the scope is extended to the EPCGF as a credit guarantee fund across phases; if sensible and feasible, phase III is considered separately.

Relevance

In the PT, the private sector is mainly made up of MSMEs (micro and small enterprises with up to 19 employees). They are therefore the main driving force behind economic development. The Palestinian Central Bureau of Statistics (PCBS) estimates that there were around 140,000 companies in the PT in 2019

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(two thirds in the West Bank, one third in Gaza) with a growth rate of 3.8 % compared to the previous year.[2]

The PMA places particular focus on the sector and assumes that 98 % of all privately run enterprises in the PT are small businesses. Its figures show that the volume of lending to small businesses has risen over the years but has stagnated or even declined slightly since 2018, particularly in view of the political instability (see General conditions).

According to enterprise surveys conducted by the World Bank[3], access to financial services is named as the second biggest obstacle (around just 10 % of the small businesses surveyed in 2013, rising to over 17 % in 2019). As such, the PT is above the regional average and only political instability is regarded as a bigger challenge.

While the surveys reveal a slight improvement in access to bank-financed loans on the one hand (2013: 7.3 %; 2019: 13 %), they also flag up the growing requirements for collateral: the proportion of loans requiring collateral rose from almost 65 % (2013) to around 82 % (2019); the collateralisation rate rose from around 150 % (2013) to around 180 % (2019), while small businesses faced rates as high as 190 %. Guarantees therefore continue to keep playing an important role in generally enabling MSMEs with a credit standing to access financing from banks.

The EPCGF is the only provider of guarantees in the MSME segment; it is regarded as a local stakeholder and is institutionalised and independent. The EPCGF's unique position in this regard is the result of its establishment as a Dutch trust (2015), the recognition of EPCGF guarantees by the regulator, a business policy that is geared towards economic sustainability and stability, as well as its long-standing work and solid reputation in the financial sector. While other guarantee providers have since become active in the PT, some of them work only in selected areas such as Gaza or are not limited to or do not specialise in the PT; they are often active for a limited period of time in the form of programmes. By contrast, the EPCGF is regarded as an established and long-term partner in the area.

As the regulator, the PMA accepts the EPCGF as a fully-fledged guarantee provider; in their full amount, its guarantees are recognised as being equivalent to cash-based collateral arrangements. Before the trust was set up, guarantees secured using EPCGF capital were issued by an international commercial bank. Since the trust has been in place, guarantees issued by the EPCGF itself have been recognised by the PMA.

The banking sector has sufficient liquidity to expand the issuance of loans. Guarantees could contribute to commercial banks active in the PT – including MFIs – providing more financing to MSMEs. For foreign – primarily Jordanian – banks active in the territories, the guarantees are an important element for collateralising loans to a sufficient extent and thus being able to approve lending decisions in the region. We regard the fund's original focus of mobilising existing liquidity in the banking sector with the help of guarantees for issuing loans as relevant.

The plan to support the micro-finance sector set out for phase III of the EPCGF aimed to make it easier for MFIs to receive loans from banks to finance their portfolios thanks to the guarantee protection provided by the EPCGF. The diversification of their financing and their involvement in the local financial market achieved through refinancing via local commercial banks make sense and contribute to their ongoing professionalisation and the reduction of their dependence on donations, grants or financing from specialist micro-finance funds. As such, the approach also supports the national strategy and PMA agenda for the MFI sector.

For MFIs, EPCGF-guaranteed refinancing makes up a single-digit percentage of their credit portfolios. They continue to finance their activities mainly through international sources using financial contributions, subsidised loans or even some commercial credit lines from regional or global micro-financiers. A few of the large MFIs refinance themselves via local banks without guarantees. Nevertheless, access to financing via local commercial banks for MFIs – both large and small – is easier thanks to EPCGF guarantees, with some being able to tap into this source for the first time. This applies particularly to access to

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[2] PCBS 2020-10-27: 'The Reality of the Private and Non-government Enterprises in Palestine* 2019' www.pcbs.gov.ps/site/512/default.aspx?tabID=512&lang=en&ItemID=3838&mid=3171&wversion=Staging

[3] www.enterprisesurveys.org/en/custom-query#west-bank-and-gaza

Jordanian banks in the PT. Overall, the refinancing of MFIs via local commercial banks is an important channel and factor in the ongoing professionalisation and the increasing economic efficiency and sustainability of the sector. However, it is also difficult to expand this refinancing for MFIs in the current environment (see Efficiency).

According to the planned results chain, the specially created credit guarantee fund would make the issuance of loans to MSMEs more attractive from the banks' perspective and, in this way, mobilise additional liquidity in the Palestinian banking sector for MSME financing. As a result, private-sector activities in the Palestinian Territories would be promoted and MSMEs with long-term viability would generate additional income. In the context of the PT, this approach appears both plausible and relevant and was applied consistently from the first phase of the project.

We consider the use of credit guarantees to mobilise existing liquidity in the banking sector (both single-loan guarantees and portfolio guarantees) as very helpful in the context of the PT. At the time of phase III and beyond, MSMEs still had a need for financing, even though the bank-financed volume of lending rose slightly but is now stagnating. There was (and is) liquidity in the sector, meaning that guarantees can be a sensible instrument. What is more, if small enterprises have a good credit standing in principle, guarantees offer an opportunity for financing in view of the increasing requirements for collateral. Liquidity and the issuance of loans may suffer – and already have suffered – a downturn as a result of the political and economic situation, particularly its effects on the public sector, and as a result of the pandemic and its effects on the finance sector (e.g. through payment moratoria; see Impact).

The refinancing guarantees for MFIs introduced in phase II make sense – making up a small portion (single-digit percentage) of the EPCGF's volume of business. In general, sufficient access to liquidity is ensured through other refinancing sources. However, access to refinancing through commercial banks active locally serves the purpose of diversification but also contributes to the professionalisation of individual MFIs and the sector and is in compliance with the national and PMA strategy for the sector. In addition to banks, MFIs as credit financiers have been an important player - particularly for small and micro enterprises - for a number of years, including in the Gaza Strip. In the years 2016 to 2019, they financed between roughly 7 % and 9.3 % of MSME loans each year. We therefore rate the relevance of phase III as good.

Relevance rating: 2

Coherence

The design of the EPCGF is broadly coherent; its work and impact are broadly consistent with the partners' national goals in the PT. The EPCGF has established a close and valued working relationship with the PMA and with the financial sector as a whole, including the banks, MFIs and associations and training facilities in the sector. Its design complies with international best practice standards regarding credit guarantee funds, such as fund independence. Capitalisation by German DC complements the EU's financing of the fund.

In terms of both its design and work, the EPCGF complements German Development Cooperation (DC) in the development of the financial sector and MSMEs in the PT, which in turn is closely linked to national objectives. In 2019, for example, the PMA launched (in conjunction with organisations including the GIZ, the Palestinian Network for Small and Microfinance (Sharakeh) and the World Bank), the Palestine Specialized Lending Sector Strategy (2019–2023), which is in line with the National Strategy Action Plan for Financial Inclusion. Overall, the microfinance sector has grown significantly in importance and professionalism thanks to the role and work of the EPCGF, along with other sector-supporting DC projects.

In total, the EPCGF exhibits remarkably good coherence.

Coherence rating: 2

Effectiveness

In 2012, 17 banks were active in the PT, declining to 14 in 2019. The EPCGF worked and continues to work with the majority of them, in particular with the largest and most important MSME financiers in the market. In total, the EPCGF has worked with 12 partner banks, and 11 in 2019. In the case of three of

these banks, the working relationship was related exclusively to their activity as MFI refinanciers. During the period of phase III, the EPCGF worked initially with 9 banks (exclusively on MFI refinancing with one bank), and then with 10 banks from 2015 onwards.

In 2012, the EPCGF granted a local commercial bank an initial guarantee for a refinancing line to an MFI (EPCGF MFI Refi guarantees). Between 2012 and 2019, MFI refinancing lines by local banks accounted for an average of 5 % of the outstanding EPCGF guarantee volume. Through these guarantees, the EPCGF granted the MFIs initial access to refinancing through several Palestinian banks and increasingly through Jordanian banks active in the PT in the past few years. Without EPCGF guarantees, MFIs would have only limited access to refinancing through commercial banks and would require another form of security. This is even more true in the case of Jordanian commercial banks. In the meantime, six commercial banks have concluded refinancing lines with a total of four MFIs. The interviews conducted during the evaluation and feedback from the EPCGF highlight that this would not have been possible without EPCGF guarantees.

The EPCGF has supported the development of the microfinance sector even beyond the granting of guarantees. For instance, it has introduced complementary measures for individual MFIs and at sectoral level in conjunction with and in support of the PMA and other stakeholders (phase II funds).[4] Since 2017, the EPCGF has also issued direct loans to four MFIs, meaning that it has worked with six MFIs in total.[5]

The indicators defined for measuring target achievement at outcome level developed as follows:

[4] For example, by providing support with: the rating of an MFI; the development and professionalisation of operating manuals; degree programmes and other training courses for employees in credit departments at banks and MFIs; the national SME sectoral conference; a study supported by a training programme on the topic of financing farming-related SMEs.

[5] Here, the EPCGF tries to play a complementary role – with its own capital stock (outside of FC financial contributions) – and has directly taken on financial risk since 2017 with credit lines for four MFIs totalling USD 3.36 million (possible and, in principle, set out under the trust's Articles of Association). According to the EPCGF itself, it is not competing with refinancing by banks in this area, but instead plays a complementary role and aims to achieve a spill-over effect. In comparison to the banks, the EPCGF offers a longer duration based on portfolio quality and cash-flow analysis, without any collateral. In terms of the spill-over effect, this approach seems not to be successful or very promising. For banks, this approach is generally difficult to implement, a problem which is only exacerbated by the current growth in risk resulting from a deterioration of MFIs' portfolio quality (even though this is a result of the current political-economic circumstances and the pandemic).

Indicator	Target value PA	Value upon final report (12/2017), additions during the EPE
(1) The average annual growth of the MSME credit portfolio at the respective partner bank or MFI reflects at least the growth of the respective financial institution's balance sheet volume.	Reflection of the growth in balance sheet volume at the very least	Achieved: Achieved at all partner institutions in phases II and III
(2) 3 years after the 1st guarantee, >80 % of the respective partner bank/MFI's credit files contain a cash flow forecast	>80 % of credit files	Achieved: All credit files contain cash flow analyses
(3) The portfolio quality at the partner banks and MFIs is reflected in an average PAR30 <5 % and a default rate <3 % over the term of the project.	PAR30 <5 %, default rate <3 %	Only PAR30 reported and only partially achieved: MFI_1: 4.2 % (2019: 3.36 %) MFI_2: 10.4 % (2019: 19.57 %) MFI_3: 9.9 % (2019: 7.39 %) MFI_4: 6.8 % (2019: 17.35 %) Partner bank_1 MF Ptf: 3.7 %
(4) Financial intermediaries to be promoted should have sustainable operations at the start of the guarantee. Taking into account the long-term distortion of the market environment, gradual target achievement paired with TA support appears adequate for some intermediaries.	OSS at least 75 % at the start, >85 % at the end of year 1 >100 % at the end of year 2;	Partially achieved (OSS) (Status as of report dated 12/2017): MFI_1: 111 % MFI_2: 93 % MFI_3: 59 % MFI_4: 101 % Partner bank_1: >100 %
(5) 3 years after the start of the downscaling[6] activities project, MSME financial services have been sustainably integrated into the organisation of the respective partner bank.	Completed 3 years after the start of the project	Achieved: After a guarantee was provided for downscaling activities at the partner banks, their MF sector grew sharply
(6) The assumption of guarantees by the EPCGF takes place on a diminishing scale over the project term: it falls from 60 % at the start to 50 % after 3 years and <50 % after 5 years	60 % at the start 50 % after 3 years <50 % after 5 years	Not achieved, but regarded as not productive in this case

[6] Downscaling approach: introduction of a micro-credit offering at commercial banks or introduction

The evaluation of the EPCGF's effectiveness as a guarantee fund also involves looking at whether the EPCGF acts in a risk-appropriate manner or whether it could potentially be used more effectively. Overall, the figures indicate that the EPCGF has a strong position on the market and acts in a very conservative and capital-preserving manner. At the same time, use of the fund's capital stock is insufficient and the fund is overcapitalised. Observed from a distance and based purely on figures, the EPCGF acts in an extremely conservative and risk-averse manner. Conversely, the EPCGF and its business conduct convey a stable and reliable impression towards the sector and regulator.

Even though the EPCGF only covered around 4 % of the total MSME credit volume in the PT with guarantees in the period from 2012 to 2019 (and only just below 4 % during phase III), it is worth noting that banks hedged their credit risks, particularly in business with new clients (see Impact). This is another important indication that guarantees contributed to the growth in loan approvals to MSMEs, a figure that increased more than five-fold during the aforementioned period.

However, the EPCGF did not fully exploit the capital available. In the period from 2012 to 2019, the rate of annual outstanding EPCGF guarantee covers to capital stock was around 65 % on average and around 74 % in the years relevant for phase III. With an average of around 90 % (and annual figures from around 83 to 97 %), the period from 2015 to 2017 recorded the highest figures.

In the case of indicator (6), it is worth noting that the EPCGF only offers 60 % coverage in the PT, which enabled it to establish itself on the market. MSME credit guarantee funds, particularly in developing countries, tend to cover up to 80 % of the default risk on average. Reducing the coverage rate to 50 % or even lower is not realistic and, from today's perspective, would not be productive for the EPCGF. It is likely that this would obstruct the additional mobilisation of MSME financing. Particularly in view of the growing risks in an environment of political/economic challenges and problems presented by the pandemic, and also considering the general growth in obstacles for SMEs entering the market (e.g. growth in collateral requirements), a reduction in the coverage rate cannot be implemented.

Even under the circumstances described, the effectiveness is, overall, rated as good.

Effectiveness rating: 2

Efficiency

In the PT, a guarantee can be a sensible instrument because the banking sector is liquid. In terms of providing incentives and generating spill-over effects for MSME financing for banks in the PT, guarantees have proven to be completely effective and appear more efficient than, for example, corresponding direct refinancing lines for banks (allocation efficiency).

However, based on the specific underlying conditions in the PT, it appears difficult to expand refinancing for MFIs via banks – given the MFIs' subsidised and, as a result, distorted financing costs on the one hand and their risk profile on the other. As such, the refinancing lines guaranteed by the EPCGF are at best at a similar level, though most are above the MFIs' average refinancing costs. At the same time, the share of non-performing loans at MFIs (around 5.9 % in 2016; 7.9 % in 2019) is higher than in the banking sector and is slightly higher than the comparable figure for banks' MSME loans.

The EPCGF's operating costs are in the low single-digit range in relation to capital stock (on average around 1.5 %; even in relation to the outstanding guarantee total below 2.5 %) and have been covered by income since 2014 (by guarantees and investment of capital); in the phase III period, guarantee income covered the costs from 2014 onwards; since 2019, some of the return on invested capital has been needed to cover operating costs (however, 'cross-subsidisation' of costs using investment income is common practice for guarantee funds).

Overall, the EPCGF's operating efficiency is rated as good to very good, with a professional approach to fund management, close cooperation with the partner financial institutions, and efficient and effective processes (from the selection of loans to be guaranteed and the monitoring thereof, the division of risk with a

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of SME loans in commercial banks (BMZ 2016: Sector Programme for Financial Strategy Development; BMZ Paper 01 | 2016 Strategy Paper; www.bmz.de/de/mediathek/publikationen/reihen/strategiepapiere/Strategiepapier362_01_2016.pdf)

60 % coverage rate, to the management information systems (MIS)), which also effectively counteract a moral hazard.

The investment of tier 1 capital has grown to become more efficient, thanks to, among others, the establishment of the trust and the investment of tier 1 capital since the shift in the investment strategy. Since 2017, the respective income has corresponded to a return of 1 % p.a. (under a somewhat conservative investment policy) and makes a significant contribution to the covering of costs.

However, the use of capital for guarantees is inefficient with high capitalisation and, at the same time, with a significantly lower outstanding guarantee total on average – particularly in more recent years, after phase III. At this point, there is still potential for more efficient use of capital and greater leverage. In total, the EPCGF is unable to leverage capital in a relevant way, i.e. it does not guarantee credit financing beyond the value of the capital stock. However, this is the basic approach of a guarantee fund: having to hold fewer liquid funds than the value of the guarantees issued, assuming that the default rate is relatively low (true for the EPCGF) and the likelihood of claims from all guarantees arising simultaneously is very low. The over-capitalisation of the EPCGF is explained in detail in the Effectiveness section.

Altogether we assess the efficiency as just about satisfactory.

Efficiency rating: 3

Impact

Target achievement at the impact level is summarised in the table below:

Indicator	Variable: status PA	Ex post evaluation
(1) Increase in the total number of female and male SME credit clients in the sector	Credit clients: 182,954 outstanding loans 67.5 % female credit clients	Achieved: Based on growth figures for the micro-finance sector and the banks' and MFIs' MSME and MF portfolios
(2) Increase in the proportion of new clients in relation to the financial intermediary's total SME credit portfolio.	SME new clients / credit portfolio: N/A	Achieved: 57% of all guaranteed credits from the SME credit portfolio are issued to new clients (No data on the micro-finance product)
(3) Increase in the diversity of the product range for SMEs	Product range: N/A	Achieved: Increased range of SME products for partner banks of the SME guarantee product; introduction of new SME products at two banks

The EPCGF achieves the project's development policy indicators and contributes to the overarching development objective: target-group-oriented expansion and consolidation of the financial sector for promoting private-sector activities in the PT and additional income in MSMEs that are viable over the long term. The fund achieves its intended development policy impact of increasing the range of financial services for MSMEs without taking on excessive losses. The EPCGF works with the majority of banks relevant for MSME finance and has created incentives for credit financing for new clients and MFIs with its guarantees. This has improved access to credit financing for MSMEs. The low number of defaults under the guarantees indicates that customers whose loans were guaranteed were also able to service these loans and that these guarantees supported their existence (ongoing business activities or investments for the purpose of their growth).

The acceptance of the EPCGF among the relevant MSME financiers (banks and MFIs) is high. Portfolio development at the banks, which in 2019 provided around 93 % of MSME loan financing, is still good: credit portfolios are growing – and can still be expanded based on the liquidity available – but their quality is declining (particularly due to the political/economic situation in the PT, even though the proportion of non-performing loans (NPLs) is still under 5 % and therefore has not reached a concerning level).

At the MFIs, the portfolios are developing slowly and some are even declining (shrinking portfolios to adapt to the difficult environment), whereby the portfolio quality has deteriorated significantly since 2018: in 2019, the NPL rate was almost 8 % on average, and the rate was concerningly high at almost 20% at individual MFIs (see Effectiveness). These figures may further deteriorate significantly in 2020 (even at the banks), both due to the political/economic situation, including the effects of the PMA's payment moratorium[7] and, in general, due to the solvency of borrowers being impaired by the pandemic.

Overall, this results in a good impact rating for the EPCGF based on its good acceptance on the market and its contribution to improved access to credit financing for MSMEs via banks and MFIs (see Relevance and Effectiveness). This has coincided with low default rates, which indicates that collateral indeed is a decisive obstacle to credit financing for MSMEs.

Even though the EPCGF requires its partner banks to assume 40 % of the risk, the fund has managed to attract the majority of the PT's banks and MFIs as partner financial institutions. They actively use EPCGF guarantees with a low number of defaults. At the same time, guarantees are only used to a limited extent and on a selective basis in order to expand portfolios to include loans that are accepted into portfolios on the basis of an EPCGF guarantee.[8]

At the same time, the underlying conditions are slowing down the positive effects of the EPCGF. In particular, the increasingly difficult political/economic situation in the PT – which, since 2020, has been coupled with the pandemic-related impacts on credit approval and a payment moratorium/increasingly poor solvency levels – is having a negative impact. However, this is strengthening the EPCGF's role in achieving and protecting results related to development policy – insofar as possible in the context – or at least in partially mitigating any negative developments.

The EPCGF is contributing to the professionalisation of the financial sector in general, both through its guarantees but also through its sector-supporting initiatives and complementary measures (technical assistance). The concept of bringing banks and MFIs together by means of guarantees for refinancing lines and, at the same time, increasing the professionalism of MFIs through cooperation with commercial financiers is coherent in its design. The guarantees play a decisive role in this as the collateralisation otherwise normally required by banks for both MFIs and MSMEs often presents an insurmountable entry barrier. Similar to MSMEs, credit should be awarded to MFIs on the basis of a cash-flow-based analysis as MFIs tend to be able to offer (parts of) portfolios or payments therefrom as collateral as opposed to real estate, for example (see Relevance and Effectiveness).

In terms of development policy, the MFI refinancing guarantees are bringing momentum to the financial sector. Various local banks – and, more recently, a number of Jordanian banks based in the PT – have provided loans to multiple MFIs with the help of EPCGF guarantees. For these MFIs, an introduction to commercial providers by means of guarantees is part of the professionalisation process and a signal to future commercial financiers while banks are starting to consider the MFIs as an additional client segment.

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[7] The PMA has initiated several measures to reduce the negative impacts of the pandemic on the PT, including a payment moratorium, which 'froze' loan instalments for four months (or six months for the tourism industry ("(...) postponing monthly (periodic) instalments for all borrowers for the next four months, and for borrowers from the tourism and hotel sector for the next six months with the possibility of extending them. In addition, credit card ceilings and ceilings granted to individuals and SMEs affected by economic conditions were also extended (...)" (PMA AR 2019, Box 1, page 6)

[8] For the partner banks – and the MFIs – the guarantees appear to only play a supplementary role and therefore make limited sense. At the partner banks, for example, credit conditions for MSMEs tend to be used as a standardised product and are not calculated according to the specific risk. As such, there are no separate individual conditions for guaranteed loans; instead, the interest margins also cover the guarantee costs. Guarantees therefore incur costs for the banks, who appear not to pass these directly on to their clients. As such, the incentive for partner banks to employ a guarantee tends to be present for new clients or for clients who are creditworthy but are unable to offer sufficient collateral.

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However, it is likely that the current situation will negatively impact the MFIs credit standing with local banks as MFIs are reducing their portfolios while the quality of their portfolios is deterioratating.

Despite the adverse underlying conditions, the developmental impact of the MSME guarantees is rated as good. The impact of guarantees for refinancing loans from local banks to MFIs is also rated as good, particularly in view of the aspect of diversification and testing of a new form of product with little 'deployment' of fund capital (slightly over 5 % on average, just under 5 % in phase III). In contrast, further consolidation in relation to MFI refinancing guarantees using other funds or a higher proportion of the EPCGF portfolio appears not to make sense at this time. Thanks to its provision of guarantees – including guarantees for MFI refinancing – and its role and initiatives in the sector, the EPCGF generally enjoys a good reputation and is constructively contributing to the improvement of MSME financing, the professionalisation of the sector, and the significance of MSME financing and MFIs to the regulator, the PMA.

Impact rating: 2

Sustainability

With the institutionalisation of the EPCGF as a Dutch trust in 2015, the credit guarantee fund for promoting MSME financing in the Palestinian Territories has become an established, stand-alone and independent institution. Since early 2016, the EPCGF has been able to issue guarantees directly thanks to regulatory approval by the PMA (previously it had to involve a commercial bank as an intermediary). The fund has gained the trust of the financial sector regulator and other key national bodies as well as those in the financial sector, including commercial banks and micro-finance institutions. Over the years, the EPCGF has worked with the majority of financial institutions relevant to MSME financing on the market and, within this network, has also managed to attract new partners or existing partners with new products. Among these bank and MFI partners, and also in the sector as a whole, the EPCGF has sustainably contributed to professionalisation, acceptance and cooperation in MSME financing and to the growth of MSME credit financing.

The professionalism of the EPCGF's management team and their focus on economic efficiency contribute to the fund's strong position for making a sustainable and long-term impact on the market. Factors including the extremely conservative use of capital with low default rates and the coverage of defaults and operating costs by income have helped to preserve capital. Adjusting the investment strategy for the fund capital improved the position of the EPCGF, even in the ongoing period of low interest rates. Over the medium or longer term, there are no indications that assets will be reduced as a result of mismanagement or the operating approach. In view of the repeated, deepening political escalation and its political/economic setbacks for the PT, now also coupled with the impacts of the COVID-19 pandemic, an increase in the number and scale of defaults will not be surprising and will be unavoidable. However, the extensive capitalisation provides a buffer that will enable the EPCGF to continue to fulfil its role in relation to the partial assumption of risk. In this process, it could and should accept limited temporary losses that do not prohibit it from functioning and that do not impair the sustainability or achievement of the development policy objectives. The increasing separation of capital from commitments by donors and the transfer of funds for the general purpose of achieving the EPCGF's goals also provide the fund with more flexibility in the range and design of its products. The management team can use this flexibility to continue to promote MSME financing and the professionalisation of the financial sector. In general, the fund is able to respond in a relatively agile manner to new or changing market requirements and works together with individual or multiple banks and the PMA when developing new products, such as guarantees for start-up financing, trade finance, taxi financing and, in the current COVID-19 context, 'Estidama' (Sustainability) – the PMA's pandemic programme launched in May 2020.[9] In this work, the EPCGF remains closely tied to its standard product, making very few adjustments. Employing the capital already secured in an agile and flexible way is a sensible approach, at least over the medium term. One aspect could be adjusting the guarantee conditions on a risk basis (term, coverage but also price). This could provide an additional approach and could also contribute to both increased MSME financing and further professionalisation within the sector.

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[9] www.pma.ps/en/Media//Press-Releases/to-help-establishments-affected-by-the-corona-pandemic-palestine-monetary-authority-launches-300-million-sustainability-program-to-provide-financing-for-smes

Updating the EPCGF’s strategic plan appears sensible, including a consideration of the change in the political/economic context. The EPCGF has already taken the first steps towards making these changes, e.g. by testing the market in relation to MSME financing for renewable energy approaches or in the agricultural sector.

The EPCGF is a success story, also in comparison to other MSME credit guarantee funds in underdeveloped or difficult markets. Everything points towards the continuation of EPCGF in its ability to maintain its status and do its work as an independent institution for guarantees to promote MSME financing. Further impetus for growth could stem from new product ideas that are relevant to the environment and that could mobilise financing for new MSME segments or new investments. Overall, we rate the sustainability as good.

Sustainability rating: 2

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Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being **relevance, effectiveness, efficiency** and **overarching developmental impact**. The ratings are also used to arrive at a **final assessment** of a project's overall developmental efficacy. The scale is as follows:

Level 1	Very good result that clearly exceeds expectations
Level 2	Good result, fully in line with expectations and without any significant shortcomings
Level 3	Satisfactory result – project falls short of expectations but the positive results dominate
Level 4	Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results
Level 5	Clearly inadequate result – despite some positive partial results, the negative results clearly dominate
Level 6	The project has no impact or the situation has actually deteriorated

Rating levels 1-3 denote a positive assessment or successful project while rating levels 4-6 denote a negative assessment.

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability): The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The **overall rating** on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Rating levels 1-3 of the overall rating denote a "successful" project while rating levels 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally "successful" only if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are rated at least "satisfactory" (level 3).