Combined Project Information Documents / Integrated Safeguards Datasheet (PID/ISDS)

Appraisal Stage | Date Prepared/Updated: 07-Apr-2019 | Report No: PIDISDSA24654
BASIC INFORMATION

A. Basic Project Data

<table>
<thead>
<tr>
<th>Country</th>
<th>Project ID</th>
<th>Project Name</th>
<th>Parent Project ID (if any)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kosovo</td>
<td>P165147</td>
<td>Kosovo Financial Sector Strengthening Project</td>
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<thead>
<tr>
<th>Region</th>
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<th>Estimated Board Date</th>
<th>Practice Area (Lead)</th>
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<table>
<thead>
<tr>
<th>Financing Instrument</th>
<th>Borrower(s)</th>
<th>Implementing Agency</th>
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<tbody>
<tr>
<td>Investment Project Financing</td>
<td>Ministry of Finance</td>
<td>Kosovo Credit Guarantee Fund, Central Bank of Kosovo</td>
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Proposed Development Objective(s)

The objective of the Project is to improve access to finance for Micro, Small and Medium Size Enterprises by strengthening the financial and technical capacity of the Kosovo Credit Guarantee Fund.

Components

Enhancing the Credit Guarantee Framework
Project Implementation and Institutional Strengthening of KCGF

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

<table>
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<tr>
<th>Total Project Cost</th>
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<tr>
<td>Total Financing</td>
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<td>of which IBRD/IDA</td>
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<td>Financing Gap</td>
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DETAILS

World Bank Group Financing

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</thead>
<tbody>
<tr>
<td>IDA Credit</td>
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</table>
B. Introduction and Context

Country Context

1. Kosovo has unique set of challenges and opportunities as one of Europe’s poorest countries and the youngest country in the continent. Kosovo is a landlocked country, with a population of around 1.8 million. Poverty is high with 17.6 percent of the population living below the national poverty line in 2017. At the same time, with its new statehood and majority of its population under the age of 30 Kosovo is the youngest country in Europe. Since independence in 2008, the country has made considerable socioeconomic progress, benefiting from the support of the international community and its diaspora.

2. Despite the achieved progress so far some of Kosovo’s institutions remain weak and underdeveloped. Building strong institutions is a long-term endeavor which requires continuous work and support. Developing the structures, legal frameworks as well as the processes and the capacity within the government institutions is an underlying challenge that cuts across numerous sectors that needs to be addressed by the government, civil society, private sector and international donors. As a young country, and with its socialist legacy, reforms in governance institutions and the regulatory environment have been slow, while insufficient investment in infrastructure particularly in energy supply, regional roads, and ICT is a bottleneck to private sector productivity and competitiveness. Developing strong institutions and legal frameworks is crucial in creating an environment that is conducive to growth and private sector development.

3. Kosovo has enacted several reforms since independence, but barriers to creating a more dynamic, vibrant economy remain. With policies anchored in its overarching political objective of joining the European Union (EU), Kosovo has made progress in promoting growth, reducing poverty, and improving the business climate. Between 2008 and 2016 gross domestic product (GDP) per capita grew an average of 2.9 percent in real terms and reached USD3,647 at end 2016, making Kosovo one of the fastest growing countries in the Western Balkans. However, it has one of the lowest living standards in Europe, with per-capita GDP (PPP terms) of USD10,064 in 2016. Poverty rates are still high with 17.6 percent of the population living under the national poverty line in 2015 despite the considerable reduction of 5.3 percentage points in the poverty rate, measured by the national poverty line, during the period between 2012-2015. Ranked at the 113th place in the Doing Business Report in 2010, by 2019 the

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1 Kosovo Statistics Agency
country had moved to the 44th rank and in 2018 to the 40th, becoming the third top-performer in the lower middle-income category. Yet, serious barriers to greater economic growth remain. These include a narrow base for goods exports, FDI that is mostly concentrated in non-tradable and unproductive sectors and not large enough to transform the Kosovo economy, persistently limited improvement of competitiveness and productivity of the private sector and existing disparities within population along geography, ethnicity, and gender. Kosovo is also prone to natural hazards some of which will be exacerbated by a changing climate including floods, landslides, droughts, earthquakes, and wildfires that could pose damages to the economy, fiscal balance and well-being of vulnerable populations.

4. **Kosovo economy is characterized by low labor force participation and high unemployment, especially for women and youth, limiting the growth potential of the economy.** The country scores particularly low on labor dimensions of gender equality, including from a regional perspective, with a female (male) labor force participation of 20 percent (87 percent among men), employment rate of 12.7 percent (46.6 percent among men) in 2017, and an unemployment rate of 36.6 percent (28.7 percent among men). Youth unemployment is also high at 52.7 percent in 2017. Unemployment rates are persistently high in general with 30.5 percent of the active population unemployed and more than 70 percent unemployed for more than a year.

**Sectoral and Institutional Context**

a. **Overview**

5. **The financial sector in Kosovo is dominated by the banking sector.** As of November 2018, the financial system included 10 private commercial banks, 14 insurance companies, 2 pension funds, and 22 microfinance institutions (MFIs). Banking sector assets represented by far the bulk of the financial system with 65.5 percent of total assets of the financial sector. The banking sector is dominated by foreign banks both in terms of the number of banks (8 out of 10) and total assets (87 percent). The sector is concentrated, with the three largest foreign banks holding 58 percent of total assets in November 2018.

6. **The banking sector remains well-capitalized and profitable.** As of November 2018, ROE and ROA were high at 19.1 percent and 2.3 percent respectively while the capital adequacy ratio reached 16.8 percent, comfortably above the minimum regulatory level of 12 percent. The sector is liquid with liquid assets/short term liabilities amounting to 36.3 percent. Banks’ asset quality is good with the NPL ratio at 2.7 percent in November 2018, which is significantly lower than in neighboring countries. Loan-loss provisions to NPLs were also high at 156.3 percent mitigating relevant risks.

7. **Micro Finance Institutions (MFIs) play an important role in providing lending to underserved segments but their growth potential is constrained.** MFIs represent around 3.5 percent of total financial sector assets. They are licensed, regulated and supervised by Central Bank of Kosovo (CBK). The
majority are registered as non-deposit taking Non-Government Organizations (NGOs), while only 2 have been registered as joint stock companies. The microfinance sector is making significant contributions to the real economy in Kosovo by providing credit to a client base that is approximately half of the client base of the commercial banks. MFIs’ business is limited solely to lending activities and the current regulatory framework for MFIs needs to be revised to encourage the growth and development of the sector. In particular, the impact MFIs make in financing consumers and SMEs could be enhanced if the sector had access to additional capital and if the strongest MFIs could provide deposit services to their clients.

8. **Despite robust credit growth in the last two years, the level of financial intermediation remains low.** Since January 2017, annualized credit growth averaged 10.6 percent thanks to the falling interest rates, good liquidity conditions and reforms to improve contract enforcement. Yet, credit growth has been highest in mortgage and unsecured consumer lending, while lending to productive sectors remains low. Overall, credit penetration remains low in Kosovo compared to its income level with a private sector credit to GDP ratio of 39.6 percent by the end of 2017 (figure 1). The financial sector is also relatively underleveraged with a loan to deposit ratio of 84.9 percent leaving room for further credit expansion (figure 2).

![Figure 1. Credit Penetration vs GDP per capita (2016)](image1)

![Figure 2. Loan to deposit ratios in Western Balkans (% 2017 Q2)](image2)

9. **Authorities acknowledge that further reform progress is needed to support financial intermediation and has started working in this direction with the support of the World Bank.** Reform efforts to support financial intermediation have not been prioritized up until recently. While the establishment of the partial credit guarantee framework and amendments to enforcement procedures were steps in the right direction, more needs to be done. Going forward, authorities should improve the efficiency of the judiciary system, establish a functioning cadaster system, enhance retail payment systems and remove the obstacles against the growth of the MFI sector among others. Authorities have
already started to take actions to address some of these challenges with the support of the World Bank. The World Bank-financed Real Estate Cadaster and Registration Project has helped the authorities to improve the cadaster system both on the municipal and country level. The legislative process for the new MFI law, which was supported by the World Bank technical assistance, is underway. Currently the CBK is working on further development of the retail payment systems with the support of the World Bank through the Swiss State Secretariat for Economic Affairs (SECO) funded technical assistance. In addition, CBK is going under an Financial Sector Stability Review (FSSR) by IMF and in its efforts to further improve financial intermediation has expressed interest to conduct an FSAP developmental module by the World Bank in estimating the dynamics of the financial intermediation for the following areas: i) estimating the financing gap including contextual factors, demand for credit by the real economy, supply of credit by intermediaries, financial infrastructure and ii) assessing the Core Principles for Financial Market Infrastructure.

b. Access to Finance for SMEs and the Credit Guarantee Framework

10. **Based on 2017 Structural Business Survey data, Micro, Small and Medium Size Enterprises (MSMEs) dominate the real sector in Kosovo.** MSMEs are classified by number of employees. Micro firms have 1 to 9 employees while small and medium firms have 10-49 and 50 to 249 employees, respectively. MSMEs compose over 98.7 percent of the private sector in Kosovo with the total number of registered enterprises reaching 49,386\(^2\) in 2016, out of which 34,696 are active. Micro firms dominate the entire spectrum of firms by representing 91 percent of total firms.

11. **MSMEs are concentrated in a few sectors.** 47.7 percent of them are in the trade sector, followed by 13.6 percent in business and other services and 13.5 percent in manufacturing. In terms of the turnover, MSMEs in the trade sector account for 57.7 percent of the total turnover compared to 11.9 percent and 10.5 percent for the ones in manufacturing and construction, respectively. They are also concentrated geographically with approximately 35 percent of firms being located in Pristina.

12. **MSMEs play a critical role in job creation.** According to the World Bank Job Diagnostic Report (2017), Kosovo stands out in international comparisons in terms of the greater contribution of micro firms to employment. MSMEs account for 65 percent of employment while micro enterprises alone provide 36 percent of total employment. In other countries, large firms provide a higher proportion of all jobs because they are proportionally more numerous.

13. **One of the key constraints to growth for MSMEs is access to finance.** According to the World Bank Enterprise Survey (2013), 45 percent of firms identified access to finance as a major constraint compared to 17.2 percent in the ECA region. In particular, micro enterprises are significantly

\(^2\)Results of the Structural Business Survey 2017. Survey does not include agriculture, forestry, fishing, finance, education, health, household activities and public administration.
underserved as banks’ loan portfolios are concentrated in financing SMEs and the corporate sector. IFC MSME Financing Gap Estimates (2017) indicate that 33 percent of MSMEs are financially constrained with an estimated financial gap of at least USD342 million.

14. **Lenders are conservative, interest rates and collateral requirements remain high.** Despite ample liquidity and underleveraged balance sheets, lenders in Kosovo are somewhat risk-averse thanks to stable non-interest income and high margins. At around 5 percent, the interest rate spread is the highest in the region giving rise to competition and efficiency concerns. Although discussions with lenders suggest that the level of collateral is closer to 200 percent of the loan value, the CBK Credit Registry data suggests that the ratio reaches up to 400 percent for non-guaranteed loans in line with the 2013 Enterprise Survey results. Among others, lack of financial reporting, problems with property and land registration and shallow secondary markets are the main reasons behind the high level of collateral requirements.

15. **The Kosovo Credit Guarantee Fund (KCGF) was established in January 2016 to provide guarantees to eligible businesses residing in Kosovo.** The KCGF’s target businesses are MSMEs that are viable but do not have enough collateral and/or credit history; MSMEs needing long-term financing; MSMEs that can increase local production and reduce imports and/or increase exports; women-owned MSMEs; and MSMEs that will create new jobs. Loans to certain sectors are not permitted to be guaranteed\(^3\). The initial capital of the KCGF was USD7 million which was provided by the government, USAID and KFW.

16. **The KCGF’s existing scheme is somewhat conservative.** Currently the KCGF is not used for start-ups, borrowers with a slightly lower debt service coverage ratio or for borrowers in a new line of business. The maximum guaranteed amount is relatively small at EUR250,000 and the Law on the Establishment of the KCGF limits the guaranteed amount to 50 percent of the principal amount. The Law also limits activity to new loans, thus restricting refinancing of existing debts. The scheme is relatively new and has not experienced any losses although the anticipated loss rate is 2 percent. If the scheme continues to operate without losses, this will be further evidence of the conservative approach in place.

17. **The guarantee framework is structured as portfolio based with lenders making the credit decision and the KCGF being responsible for the oversight.** Reasonable due diligence is performed by the KCGF on lenders that apply to use the scheme. This includes an analysis of the SME lending portfolio currently at the bank and a determination that the bank has adequate experience to process and service SME guaranteed loans. Furthermore, the agreement must be renewed every two years. This is considered as good practice as it gives the KCGF a chance to review the lender’s performance and

\(^3\) These include any business connected with the military or weapons production; gaming or gambling activities; illegal activities; nightclubs; production or sale of tobacco or hard liquor, if the production or sale of these products constitutes more than 25 percent of the borrower’s annual turnover (gross revenues); residential mortgage loans; real estate development; municipalities, district or state-owned enterprises; and any businesses that have material negative environmental impacts.
ensure the staff is adequately trained. Once accepted, the lenders submit loans on an individual basis to be added to their portfolio for a guarantee. In addition to randomized checks on individual loans, lenders must report on their portfolio performance monthly to KCGF. KCGF can suspend the ability of a lender to approve loans if there is concern regarding the quality of the portfolio. The final opportunity to ensure compliance with scheme requirements comes when a lender requests the payment on a guarantee. At that time, KCGF has the opportunity to completely review the file to ensure that all requirements were met in 30 days and the ability to refuse payment if the requirements were not met.

18. **Current leverage is just below 2:1 and the KCGF aims to keep it under 3:1 with gradual increase over time against the legal limit of 5:1.** It is appropriate to operate a new Fund with a conservative leverage for two reasons. The first is the need to gain the trust of lenders. If they know that their guarantee is secure, they are more likely to use the scheme. Keeping the leverage ratio below certain level tells them that the guarantee is backed heavily by cash and is therefore very secure. The second reason is to gain experience with how the scheme will operate and see if the actual experience matches projections. Once the initial data is available, projections can be recalibrated to determine an appropriate leverage rate. The current track of losses would suggest that the leverage could be increased if necessary to meet the demand.

19. **Loan level analysis indicate that initial impact of guarantees provided by the KCGF has been positive.** Since its establishment, the KCGF provided guarantees to loans amounting to USD37 million as of end-January 2019. According to the analysis of the project team with the support of the World Bank Development Economics Research Group and Credit Registry of Kosovo, guarantees provided by the KCGF had a positive impact on access to finance both on the intensive and extensive margins. On the extensive margin, more than 25 percent of guarantees were provided to firms with no credit history. On the intensive margin guaranteed loans had better financial terms (maturity, interest rate, amount and collateral value) than non-guaranteed loans (see Table 1.). Although more data points are needed to gauge the economic impacts, initial estimates of the KCGF revealed that credit guarantees contributed to creation of over 1500 jobs since its establishment in two years (2016-2018).

**Table 1. Impact of KCGF guarantees on credit terms**

<table>
<thead>
<tr>
<th></th>
<th>Guaranteed</th>
<th>Non-guaranteed</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average 2016-2018</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Rate</td>
<td>9.2%</td>
<td>11.8%</td>
</tr>
<tr>
<td>Maturity</td>
<td>3 years</td>
<td>1.8 years</td>
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<tr>
<td>Collateral value/Loan</td>
<td>150%</td>
<td>205%</td>
</tr>
<tr>
<td>Loan amount</td>
<td>35503.84</td>
<td>32694.13</td>
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</table>

*Source: Credit Registry of Kosovo, World Bank staff calculations*
20. **Demand is expected to increase over time with wider range of products and delivery channels**

At the moment, the Fund has only two different windows (and products) including the general and agricultural windows. Further product differentiation is expected to make the scheme more attractive without undermining the financial stability of the Fund particularly for the client segments with suffering more from lack of collateral. In this context, there is demand for additional products aimed at women owned businesses, energy efficiency, revolving working capital, contract financing, supply chain financing and startups. On the supply side, expansion of the guarantee scheme to MFI s and NBFI s is being considered in line with the legislation which might be a positive step to increase absorption capacity.

21. **Importantly, the CBK has revised the credit risk regulation that will reduce the risk weight on the guaranteed portion of loans.** This is expected to substantially decrease the capital cost and increase the profitability for banks making loans with a guarantee which in turn will increase the demand for the scheme. The proposed changes will enter into force in 2020. The new regulation is also expected to provide a new opportunity for the KCGF to market the scheme as well.

22. **All in all, there is significant potential for the financial expansion of the KCGF in Kosovo both on the extensive and intensive margin which should be coupled with institutional strengthening.**

Financial gap analysis referred above confirms the potential of the credit guarantees to improve access to finance on the extensive margin. In addition, only less than 16 percent of existing loans are guaranteed as of end-2018 which signals for substantial room for market expansion for PCGs on the intensive margin. Upcoming changes in banking regulations and expected increase in the guarantee coverage limits are likely to boost the demand for guarantees. On the demand side, interviews with MSME representatives suggest that the loan appetite is also increasing. These factors along with the existing financing gap requires enhancement of the KCGF and proposed capital injection of USD24 million. Yet the financial enhancement should be supported by further institutional development of the KCGF which is essential to ensure successful implementation without any risks to financial sustainability of the Fund.

**B. Proposed Development Objective(s)**

23. The objective of the Project is to improve access to finance for MSMEs by strengthening the financial and technical capacity of the Kosovo Credit Guarantee Fund.
D. Project Description

24. The Project has two main components: (i) Enhancing the Credit Guarantee Framework and (ii) Project implementation and institutional strengthening.

25. **Component 1: Enhancing the Credit Guarantee Framework (USD24 million).** Under this component the Project will increase the capital base of the KCGF. Significant part of the project funds will be channeled to the existing guarantee window (general window) of the KCGF. In addition, the KCGF will establish a new window (strategic window) focusing on underserved and strategic segments which will also be capitalized by the project. In line with the KCGF’s current mandate the funds under this component of the Project will be only used for providing financial products, mainly Partial Credit Guarantees, to MSMEs definition and eligibility of which is determined by the KCGF⁴. Accordingly, the component consists of two subcomponents.

26. **Subcomponent 1: Increasing the capital base for KCGF’s general window.** Under this subcomponent, the World Bank will provide USD20 million to expand the capital base for the KCGF’s general window. MoF confirmed that they will be the borrowing party on behalf of KCGF and the funds will be channeled as a grant to KCGF. The additional capital will allow an increase in usage of the Fund and allow the KCGF to address a larger portion of the financing gap for SMEs. Financing gap estimates and the team consultations with financial institutions and other donors indicated that there is enough room in the financial sector to absorb the expansion. The CBK’s planned revision of the risk weightings for guaranteed portfolio is expected to have a positive impact on guarantee demand. The KCGF estimates the leverage ratio to be around 2.5:1 for this subcomponent.

27. **Subcomponent 2: Establishing a window for underserved and strategic segments.** Under this subcomponent, the World Bank will provide USD4 million to be used for the capitalization of a new KCGF window which will provide partial credit guarantees and if necessary other financial products for specific themes/segments/sectors that have strategic importance for supporting the sustainable growth of the economy. These are expected to include young entrepreneurs, women business owners, energy efficiency, waste management and movable collateral. Establishment of the strategic window including the identification process of underserved and strategic segments and product customization will be supported by the institutional strengthening component of the project. The KCGF will develop tailor-made products by altering price, guarantee coverage and type for different segments and pilot those under this window. In line with this, the WB team, KCGF, MoF, the CBK and other donors agreed that existing legislation should be revised to support the effectiveness of the guarantee scheme and the guarantee coverage should be increased. For this subcomponent, the KCGF aims to keep the leverage ratio at around 1.5:1 given the higher risk profile of the segments and possible changes in fee and guarantee structure. World Bank staff have reviewed possible scenarios that included a lower fee on these pilot loans and have concluded that these loans are unlikely to have a substantial negative impact on the financial viability of KCGF. The pilot loans were stress tested by increasing the default rate by 50 percent and by reducing the recovery rate by 50 percent over the estimated default rate for the current portfolio. The model was built with a ratio of 80 percent standard loans and 20 percent pilot loans and used a guarantee fee of 1 percent on the pilot loans. In addition, leverage was raised to five in
the model as a higher leverage will amplify any problems and make them easier to see. While the higher leverage will cause some additional volatility in the account, at the end of 10 years KCGF would be expected to have a slight increase in available capital.

28. **Component 2: Project implementation and institutional strengthening of the KCGF (USD1 million).** Under this component, USD1 million will be provided to the KCGF through MoF for project implementation and institutional strengthening which will be essential to efficiently use the proposed additional capital. Under this subcomponent the KCGF will hire experts to (i) carry out procurement and financial management activities for the project implementation, (ii) to review and reform the legislative framework, (iii) improve information technology, (iv) enhance the risk assessment, (iv) enhance internal control framework, (v) enhance financial reporting process, (vi) improve monitoring and evaluation framework including for environment and social safeguards, (vii) design and develop new products tailored for underserved and strategic segments, and (viii) support marketing and public awareness campaign (detailed list of activities and draft ToRs have been developed and are included in the operations manual). Under Component 2 training will be provided for financial institutions loan officers and for running workshops for MSMEs on how to apply for a bank loan. Workshops will be provided by KCGF to small business owners on how to approach financial institutions. By addressing training specifically to MSMEs, the Project is expecting to increase the demand for guarantee loans by encouraging those MSMEs that have completed training to seek additional financing.

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4 Requirements for MSMEs to qualify for financing under the guarantee include, but not limited to:

- Privately owned MSMEs
- MSMEs that have business registration and fiscal numbers.
- An eligible borrower must be fully (100%) owned by private citizens or permanent residents of Kosovo, with no government ownership during the period of the credit guarantee coverage.
- MSMEs that have less than 250 employees,
- Private MSMEs, as defined in the Law on the Establishment of the KCGF, which are not prohibited by applicable legislation, regulatory provisions, or international treaties to which Kosovo is a party (see Section 3.02 (b) of Standard Terms and Conditions).
- An eligible borrower includes any related party of the borrower in question, as defined in the Law on the Establishment of the KCGF.
E. Implementation

Institutional and Implementation Arrangements

29. **The KCGF will be responsible institution for implementation of the Project.** KCGF is a local independent sustainable credit guarantee facility established in 2016 by the Law on Establishment of KCGF. KCGF enjoys full operational and administrative autonomy and functions outside the framework of the Kosovo governmental structures and the Kosovo Civil Service. Based on the Law on KCGF, the KCGF offers credit guarantees to Registered Financial Institutions on selected loans to MSMEs. The Board of Directors oversees the KCGF and its strategic objectives. Due to limited capacities of KCGF, Component 2 of the project is designed to provide support for project implementation through hiring of experts to carry out procurement, financial management and monitoring and evaluation processes including for environment and social safeguards as well as for reporting on the use of funds and activities. Implementation support will be provided by the WB throughout the Project and will include periodic supervision mission and a midterm review.

30. **The project is designed to provide capital injection to KCGF, support KCGF in designing and piloting new products for underserved markets and support project implementation.** The disbursement schedule will take into account a larger capital injection to the KCGF at the beginning of project implementation. The Ministry of Finance (MoF) is the borrowing institution which will grant funds to KCGF. An interinstitutional agreement between MoF and KCGF will be signed.
F. Project location and Salient physical characteristics relevant to the safeguard analysis (if known)

Geographical scope of the Project is national territory of the Republic of Kosovo. The capital enhancement under the Component 1, entailing environmental due diligence (depending on a scope of supported sub-projects), will be managed by the Kosovo Credit Guarantee Fund (KCGF). The maximum guaranteed single loan under the scheme is 250,000 Euros and maximum exposure of a single Applicant will be 500,000 Euros. The KCGF was established to provide guarantees to eligible MSMEs residing in Kosovo, targeting those that are viable, but did not have enough collateral and/or credit history. Under the Component 1: Enhancing the credit guarantee framework, WB will, within the sub-component 1.1 Increasing the capital base of KCGF, provide funds for increasing capital available to KCGF for addressing a larger portion of the financing gap for SMEs, via commercial FI (banks). Guarantee framework is structured as a loan by loan scheme with lenders making the credit decision. Once the positive decision is made, the lenders (FIs) submit loans on an individual basis for a KCGF guarantee. Upon the positive decision of KCGF (guarantee issuance), the lender releases funds. KCGF structure includes Board of Directors, Managing Director and Credit Risk Management Team. Role and responsibility of the Credit Risk Management include identification and analysis of risks, supervision of risk management framework and implementation as well as ex-ante and ex-post monitoring mechanisms. The location and content of supported investments under the sub-component 1.1 is undetermined. While sectors to be promoted under the sub-component 1.1 are not defined, the piloting program under the sub-component 1.2 will focus on specific themes/sectors that have strategic importance for supporting the sustainable growth, including young and women entrepreneurs, renewable energy, waste management, agriculture, and more. The internal KCGF’s Credit Risk Guarantee Policy sets eligibility limitations partly corresponding to WB general exclusion list that cover, but is not limited to: forced and child labor, alcohol, tobacco, high conservation value areas. Under this policy, the guaranteed loan cannot be used to finance any activities prohibited by regulatory provisions in effect in Kosovo, or any international agreement to which Kosovo is a party. As with sub-component 1.1, the exact locations and investments under the sub-component 1.2 are not defined.

G. Environmental and Social Safeguards Specialists on the Team

Satoshi Ishihara, Social Specialist
Natasa Vetma, Environmental Specialist
Ifeta Smajic, Social Specialist
Ivana Ivicic, Environmental Specialist
## SAFEGUARD POLICIES THAT MIGHT APPLY

<table>
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<tr>
<th>Safeguard Policies</th>
<th>Triggered?</th>
<th>Explanation (Optional)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental Assessment OP/BP 4.01</td>
<td>Yes</td>
<td>In line with the WB OPs, the project design requires FI category. The KCGF, Implementing Agency for the Component 1, is established with the sole purpose to issue guarantees to target businesses - SMEs and does not operate in any other area. As such, and with credit limited to 500,000 Euros, project activities are not expected to produce significant and lasting environmental impacts. The Project will provide general capital injection to KCGF under the component 1, however, the guarantee issuance will be issued on loan-to-loan basis. While sub-component 1.1 has no sector limits or focus, the sub-component 1.2 targeted sectors include some potentially polluting ones such as, but not limited to: agriculture, energy efficiency and waste management. The guarantees can be issued for infrastructure and production deployment loans, but not retroactively. Environmental and Social Management Framework (ESMF) was developed guiding establishment of screening, EA and environmental review procedures for all sub-projects supported by loans guaranteed during the project implementation as well as those supported from the new piloting schemes. ESMF screens out all non-eligible, high-risk and category A activities. It also defines capacity building requirements and Grievance Redress Mechanisms as part of the environmental and social due diligence procedures. ESMF was prepared by the Client and publicly consulted in Albanian, Serbian and English language before the appraisal.</td>
</tr>
<tr>
<td>Performance Standards for Private Sector Activities OP/BP 4.03</td>
<td>No</td>
<td>No investment will be allowed in the Protected Areas. Guarantee eligibility criteria in KCGF’s internal policy excludes wildlife trade regulated under CITES, unsustainable fishing methods and destruction of high conservation value areas.</td>
</tr>
<tr>
<td>Natural Habitats OP/BP 4.04</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Objective</td>
<td>Action</td>
<td>Description</td>
</tr>
<tr>
<td>-----------</td>
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</tr>
<tr>
<td>Forests OP/BP 4.36</td>
<td>No</td>
<td>No commercial or small-scale harvesting will be allowed under the project. The project supports SMEs operations and no significant impacts are expected, however, agricultural practices can impact quantity and health of forests, therefore such projects will be explicitly excluded.</td>
</tr>
<tr>
<td>Pest Management OP 4.09</td>
<td>No</td>
<td>The new financial products target agricultural sector which can support food processing operations, changes in agricultural practices, expanding or diversifying production, however, investments potentially triggering changes in use of pest management agents and practices will not be supported under this Project.</td>
</tr>
<tr>
<td>Physical Cultural Resources OP/BP 4.11</td>
<td>No</td>
<td>No activities that can potentially impact physical cultural resources will be triggered.</td>
</tr>
<tr>
<td>Indigenous Peoples OP/BP 4.10</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Involuntary Resettlement OP/BP 4.12</td>
<td>No</td>
<td>The Project would provide capital injection to the KCGF to enable it to increase its provision of partial credit guarantees and other financial products to be provided by participating financial institutions (PFIs) to MSMEs in Kosovo. The partial credit guarantees will be provided to specific credit applications submitted to PFIs. The ceiling of credit lines eligible for partial guarantees under the project will be EUR500,000. Some of the activities engaged by beneficiary MSMEs may be simple building upgrades, small construction (adding annex to buildings), and rehabilitation of existing buildings for the sake of expanding business activities. Sub-projects that require involuntary land acquisition and/or resettlement will not be eligible for financing under the proposed project and will be explicitly deemed ineligible by means of a screening process defined in the Environmental and Social Management Framework (ESMF). PFIs will verify, using the ESMP checklist, that proposed sub-projects do not include involuntary land acquisition and/or resettlement, nor cause involuntary removal of persons who have no recognizable legal right or claim to the purchased land/property. The KCGF (and PFIs, if necessary) will be provide training on WB Safeguards Policies, including the Bank’s OP 4.12 on Involuntary Resettlement, in order to minimize the risk of non-compliance with OP 4.12. Thus, the</td>
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<tr>
<td>Policy Area</td>
<td>Triggers</td>
<td>Description</td>
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<td>------------------------------------------------</td>
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<tr>
<td>Safety of Dams OP/BP 4.37</td>
<td>No</td>
<td>Guarantees will be issued for SMEs operations, thus investment in large infrastructure, including dams, is not likely. The possibility will be excluded in the Project documents.</td>
</tr>
<tr>
<td>Projects on International Waterways OP/BP 7.50</td>
<td>No</td>
<td>Among other, support to agricultural sector may include enabling investment that may impact quality and abundance of international waters (e.g. irrigation or increased use of pesticides). The Team will discuss this possibility with the Client.</td>
</tr>
<tr>
<td>Projects in Disputed Areas OP/BP 7.60</td>
<td>No</td>
<td></td>
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### KEY SAFEGUARD POLICY ISSUES AND THEIR MANAGEMENT

#### A. Summary of Key Safeguard Issues

1. Describe any safeguard issues and impacts associated with the proposed project. Identify and describe any potential large scale, significant and/or irreversible impacts:

The Project is FI category as the Project will increase the capital base of KCGF (FI) which will issue guarantees for selected sub-projects financed by private banks’ (PFIs) loans. Main environmental risks are stemming from sub-projects guaranteed by the capital base of KCGF that will be increased under the Component 1: Enhancing the Credit Guarantee Framework, Subcomponent 1.1: Increasing the capital base of KCGF and Subcomponent 1.2: Establishing a window for underserved and strategic segments. Under these subcomponents, the Project will support sub-projects without sectoral limitations. However, maximum size of guarantee exposure that KCGF can provide (to a single borrower or a group) will be EUR250,000, meaning that the maximum size loan would be EUR500,000. Given the total size of the loan (EUR20 million) and other financial limitations, significant risks for the environment are not expected and supported sub-projects will be limited to B category. The activities and envisaged impacts are triggering OP/BP 4.01 Environmental Assessment under which the Client developed ESMF that is screening out all category A and projects in protected areas, those potentially impacting forests, physical cultural heritage, pest management practices, international waterways, large greenfield projects and other otherwise high-risk projects. Types of supported activities include (i) simple upgrades, small civil works, small construction, reconstruction, rehabilitation and similar, grouped in B-category for which the ESMP Checklist will be prepared, template for which was developed in the ESMF; (ii) projects included in the Annex II of Kosovo EIA Law that do not require full EIA by the opinion of Kosovo Ministry of Environmental and Spatial Planning. These sub-projects are B+ category for which a Screening Report with an ESMP will be prepared, and (iii) working capital and other C category sub-projects. Related potential impacts expected for the B category projects include air quality issues due to dust from works and transport or materials, noise emissions, waste management, soil and water pollution, traffic disturbance and other typical for construction works.

2. Describe any potential indirect and/or long term impacts due to anticipated future activities in the project area:

The Project rules out high risk and A category sub-projects so no long term significant impacts are expected as a result of Project implementation. The environmental impacts of the project are expected to be of manageable, temporary and of local impact as they are related to the general construction activities on already known and previously used locations. These potential impacts most commonly include: a) dust and noise due to excavation, demolition and
construction; b) management of demolition construction wastes and accidental spillage of machine oil, lubricants, etc., c) encroachment to a private property; d) damage to historical or cultural property or unknown archaeological sites; e) traffic disturbance; f) surface or ground water; and g) soil pollution or erosion.

3. Describe any project alternatives (if relevant) considered to help avoid or minimize adverse impacts.

Involved PFIs have various capacities. Three participating international banks: TEB, Raiffeisen and Procredit Bank have elaborated environmental and social management systems – ESMSs and/or mechanisms for screening the loans and/or loan Applicants and ensuring the national environmental (and other relevant) regulation compliance while other, mostly local, have none. The three international banks with functioning ESMS in place will use their systems in addition to this ESMF for screening the projects and management. Other banks which are lacking the ESMSs might after initial training start by supporting capacity C projects but will be assisted by the KCGF and WB to build and enhance the systems during the project implementation and eventually more to supporting environmentally riskier projects.

4. Describe measures taken by the borrower to address safeguard policy issues. Provide an assessment of borrower capacity to plan and implement the measures described.

Process ESMF is prepared to guide due diligence of Project activities including development of screening procedures, sub-project categorization to which EAs are assigned, environmental review procedures as well as distribution of responsibilities and obligations. ESMP Checklist will be prepared for B- and Screening Report with ESMP for B+ category project in accordance with the Project ESMF.

Environmental capacity of KCGF (FI) is and most of the PFIs, apart of the aforementioned three international banks, is low. To ensure ESMF implementation and Project environmental compliance with WB and national policies and regulation, the KCGF will contract Environmental Expert (as a Project effectiveness condition), a Project Implementation team (PIU) member, on part or full-time bases. The Environmental Expert will be experienced in environmental management, environmental and risk assessment and will be additionally trained in WB Safeguard Policies and procedures (by the WB Environmental Specialist). He/She will be expected to provide training (supported by the WB when necessary) to the PFIs, and supervise their environmental performance during implementation.

In the course of Project implementation, any shortcomings identified on the part of PFIs will be addressed and overcame through (i) training sessions, the content of which will be prepared by KCGF Environmental Expert and approved by WB Environmental Specialist, (ii) guidelines, (iii) building EMS and (vi) other corrective measures. The training program will be optimized based on the existing capacity of PFI, feedback from the PFIs on later stages, and will be presented by KCGF engaged Environmental Expert, supported by WB safeguard specialist as necessary. The Environmental Expert will regularly report to the WB on capacity and performance of PFIs in regular progress reports.

5. Identify the key stakeholders and describe the mechanisms for consultation and disclosure on safeguard policies, with an emphasis on potentially affected people.

ESMF with well elaborated ESMP Checklists for B- sub-projects (small construction) was disclosed on February 12, 2019 for 14 days on KCGF website in English, Albanian and Serbian. Hard copy of the document was also made available to the public at the KCGF’s reception. KCGF launched a call for submission of comments containing postal and email address for sending comments and suggestions as well as call for public consultation meetings that took place on February 22, 2019. All relevant comments and questions raised in/during the public consultations were addressed, then summarized and enclosed to ESMF as Annex 4 which made the document final. meeting. Final ESMF was redisclosed.

PFIs will publish ESMF on their web site to make ESMF and ESMP Checklists for B- sub-categories available to
Applicants and public only after the signing of the agreement for the participation in the project. EAs (ESMP) prepared for individual B+ sub-projects will have to be disclosed in Albanian, Serbian and if needed English and publicly consulted (disclosed for at least 14 days) by applicant, relevant Ministry or Municipality web-site with a call for comments. Hard copy of the document must be available to the public as well. Comments will be requested on the documents disclosed (the call will provide both postal and email address for sending comments and suggestions). Local newspaper advertisements may be used as a means for calling the public to comment on the same documents. All relevant comments and questions raised in/during the public consultations will be addressed, then summarized and enclosed to the EA. Only when the minutes of the consultations are included to the document, it will be considered final.

As consulted within ESMF public consultations, ESMP Checklist for B- individual sub-projects do not have to be publicly reconcensed/ redisclosed (as it was disclosed as part of the ESMF), but it will be recommended to do so to the final users and PFIs as a sign of good practice.

### B. Disclosure Requirements

<table>
<thead>
<tr>
<th>Environmental Assessment/Audit/Management Plan/Other</th>
<th>Date of receipt by the Bank</th>
<th>Date of submission for disclosure</th>
<th>For category A projects, date of distributing the Executive Summary of the EA to the Executive Directors</th>
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<tbody>
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<td></td>
<td>05-Feb-2019</td>
<td>12-Feb-2019</td>
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"In country" Disclosure
Kosovo
12-Feb-2019

Comments

### C. Compliance Monitoring Indicators at the Corporate Level (to be filled in when the ISDS is finalized by the project decision meeting)

**OP/BP/GP 4.01 - Environment Assessment**

Does the project require a stand-alone EA (including EMP) report?
Yes
If yes, then did the Regional Environment Unit or Practice Manager (PM) review and approve the EA report?
Yes
Are the cost and the accountabilities for the EMP incorporated in the credit/loan?
Yes
The World Bank Policy on Disclosure of Information

Have relevant safeguard policies documents been sent to the World Bank for disclosure?
Yes

Have relevant documents been disclosed in-country in a public place in a form and language that are understandable and accessible to project-affected groups and local NGOs?
Yes

All Safeguard Policies

Have satisfactory calendar, budget and clear institutional responsibilities been prepared for the implementation of measures related to safeguard policies?
Yes

Have costs related to safeguard policy measures been included in the project cost?
Yes

Does the Monitoring and Evaluation system of the project include the monitoring of safeguard impacts and measures related to safeguard policies?
Yes

Have satisfactory implementation arrangements been agreed with the borrower and the same been adequately reflected in the project legal documents?
Yes

CONTACT POINT

World Bank

Blerta Qerimi
Private Sector Specialist

Cevdet Cagdas Unal
Special Assistant to Vice President

Borrower/Client/Recipient

Ministry of Finance
Arijeta Neziraj Elshani
Deputy Treasurer for Cash and Debt Management
arijeta.n.elshani@rks-gov.net

Implementing Agencies