Vienna Initiative 2

Credit guarantee schemes in Central, Eastern and South-Eastern Europe - a survey

Áron Gereben
senior economist
European Investment Bank, Economics Department
• **European Bank Coordination ("Vienna 2") Initiative** - a coordination forum for safeguarding financial stability in CESEE.

• A **working group on credit guarantees** was established by the VI2 full forum in November 2013 to explore the possible role of credit guarantee schemes (CGSs) in alleviating the low supply of credit in the CESEE.

• **Main source of information**: 3 dedicated surveys – CGSs, banks, regulators.

• **Main partners**: World Bank, National Bank of Poland, AECM, IIF.

  ----------------------------------------------------------------------------------------------------------------------------------------

• **CESEE survey (2014)**: 13 countries (EU and non-EU), 13 banking groups with 74 subsidiaries, 19 CGSs, 14 supervisory authorities.

• **Follow-up survey for Western Europe (2015-2016, forthcoming)**: 17 countries, 33 banks, 17 CGSs.
1. A quick glance on the credit guarantee landscape in the EU
2. Current issues and challenges
• SME-oriented CGSs exist in many EU member states, including CESEE.
• The largest outstanding volumes in CESEE (1-1.4% of GDP) are observed in Lithuania, Hungary and Romania.
• As to Western Europe, the largest volumes (1.7-2.1% of GDP) are in Portugal and Italy.

Outstanding guarantee volumes of national CGSs, by country, in 2014 (%GDP)

Source: AECM
The ‘typical’ CGS in the CESEE region

General information

- **Established in late 1990s**, does not exclusively provide credit guarantees
- **Publicly owned**, legally established as a corporation, and subject to taxation
- **Capitalized upfront**, no explicit restriction on leverage
- **Non-profit, with an obligation to be self-sustainable**
- Does not own a banking license, and is **regulated by the CB or State**

Outreach

- Targets MSMEs, following the EU definition
- **The primary motivation is to alleviate the lack of collateral** and increase lending
- **Operations increased with the crisis**, with no sunset clauses or additional funds

Services

- **Offers guarantees to all banks**, with borrowers applying directly at banks, where they are informed about the guarantee
- Guarantees are for both new and existing loans, and for **investment capital, working capital, and leasing**
- Guarantees are considered on a loan-by-loan basis, and requests are processed in 20-29 days max

Pricing/Coverage

- Charges only per-loan fees, paid by borrowers
- Fees are risk based and payable in advance
- **Coverage is between 50% and 100% of principal**, not interest, for 5 years
- Allows lenders to require collateral, which can often exceed the loan amount

Claims

- The trigger is non-payment/insolvency, with a single payment upon validation
- **The loss-recovery principle is pari passu**, with recovery pursued by the lender

Risk-management

- **Counter-guarantees provided by the State**
- No risk concentration
IFI presence: the European Investment Fund

• The European Investment Fund is the key multinational guarantee provider in the region. It provides both tranched and non-tranched guarantees to lenders, and also supports the local guarantee institutions with counter-guarantees.

• Besides EIF’s own funds, it also manages EU mandates, such as Structural and Cohesion Funds, COSME or InnovFin as funding source for guarantees – a priority usage in the 2014-2020 programming period.

Outst. leveraged amounts supported by EIF guarantees (excluding ABS, 2015, % GDP)
1. A quick glance on the credit guarantee landscape in the EU

2. Current issues and challenges
The demand for credit guarantees in the CESEE

- **CESEE banks use guarantees actively**: more than 75 percent of the financial institutions had loans guaranteed by CGSs in their portfolios.

- Typically, banks have **guarantee coverage between 1 to 10 percent of their SME lending** (with large variation across countries).

**How important is the use of credit guarantees within your SME lending activity?**

- We use guarantees extensively (for more than 10% of the SME portfolio)
- We have limited use of guarantees (between 1-10% of the SME portfolio)
- We use guarantees scarcely (for less than 1% of the SME portfolio)
About **half of the banks believe that supply is below demand**. Another half believes that the supply meets the demand, with a large heterogeneity across countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>Hungary</th>
<th>Poland</th>
<th>Bosnia-H.</th>
<th>Slovakia</th>
<th>Bulgaria</th>
<th>Romania</th>
<th>Slovenia</th>
<th>Albania</th>
<th>Serbia</th>
<th>Czech republic</th>
<th>Croatia</th>
<th>Kosovo</th>
<th>Macedonia</th>
<th>CESEE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Response</td>
<td>33%</td>
<td>67%</td>
<td>100%</td>
<td>60%</td>
<td>56%</td>
<td>55%</td>
<td>50%</td>
<td>43%</td>
<td>33%</td>
<td>33%</td>
<td>20%</td>
<td>100%</td>
<td>100%</td>
<td>48.6%</td>
</tr>
</tbody>
</table>

- In my view the supply of such guarantees exceeds the demand.
- In my view the supply is about sufficient to satisfy the clients’ demand.
- In my view the supply is well below the demand.
Again, typically, banks have **guarantee coverage between 1 to 10 percent of their SME lending** (with large variation across countries).

- **More than 10%** of the SME portfolio is covered in:
  - Portugal, Italy, Belgium, Greece

- **Between 1 to 10%** of the SME portfolio is covered in:
  - Austria, Spain, Germany, The Netherlands, Luxembourg, France

- **Less than 1%** of the SME portfolio is covered in:
  - Cyprus, Finland, Denmark, Sweden, Ireland and the UK
The demand for credit guarantees in the Western Europe

- Typically, banks believe that the supply of guarantee meets the demand, with a few exceptions

Do you believe that the supply of SME credit guarantees is sufficient in your country?

- The supply of such guarantees exceeds the demand.
- The supply is about sufficient to satisfy the demand.
- The supply is well below the demand.
The role of CGSs in alleviating the impact of the crisis – CESEE

- The number of guarantees issued between 2009 and 2012 in the CESEE has increased by 35 percent, while applications increased by 80 per cent.

- The majority of the banks have increased their guarantee usage as a result of the downturn.

- New demand was mainly due to working capital loans, rather than investment.

---

**Does your bank’s usage of credit guarantees increased after the crisis?**

1. Yes, it increased significantly. 12%
2. Yes, it increased somewhat. 46%
3. No, guarantee usage has not been affected much by the crisis. 34%
4. No, we actually use guarantees less than before. 8%

**What type of loans contributed to the increase of guarantee use post-crisis?**

- Mostly working capital: 30%
- Mostly investment finance: 5%
- Both working capital and investment finance: 21%
- 4. Not applicable: 44%

*Source: Bank survey*
The role of CGSs in alleviating the impact of the crisis – Western Europe

- Half of the banks have increased their guarantee usage as a result of the downturn.
- New demand was observed both due to working capital loans and investment finance.

Has your banks' use of SME credit guarantees increased in the last years? If yes, what type of loans contributed to this increase?

- 31%: We have seen an increase in guarantees on both working capital and investment loans.
- 9%: We have seen an increase in guarantees on investment loans.
- 6%: We have seen an increase in guarantees on working capital loans.
- 53%: No increase in guarantee use.
The key factors constraining the credit guarantee activity in the CESEE

Main constraints identified by CGSs

- Lack of collateral on the borrowers’ side: 39% severe, 11% major, 50% minor-to-moderate
- Low quality of loan applications: 39% severe, 6% major, 56% minor-to-moderate
- Regulatory treatment of guarantees: 33% severe, 11% major, 56% minor-to-moderate
- General lack of credit demand: 28% severe, 11% major, 61% minor-to-moderate
- Risk aversion/ Lack of interest from lending institutions: 39% severe, 61% major, 0% minor-to-moderate

Main constraints identified by banks

- Restrictive conditions to clients: 33% severe, 29% major, 38% minor-to-moderate
- Long administrative process (guarantee execution): 30% severe, 23% major, 47% minor-to-moderate
- Long application process: 14% severe, 34% major, 52% minor-to-moderate
- Guarantees are too expensive: 15% severe, 32% major, 53% minor-to-moderate
- Regulatory treatment: 24% severe, 19% major, 57% minor-to-moderate
- High administrative costs to banks: 17% severe, 23% major, 61% minor-to-moderate

Source: CGS survey
Source: Bank survey
Regulatory issues in the CESEE

• For banks, **obtaining regulatory capital relief on the guaranteed loans** is an important component of credit guarantees.

• Two-thirds of the banks operating in the CESEE have been facing **problems in this respect** at least in certain jurisdictions.

How important is it for you to obtain regulatory capital relief for SME credit guarantees?

1. The key purpose of the credit guarantee is the transfer of credit risk. The regulatory capital relief is an additional benefit. 33%
2. The risk transfer and the regulatory capital relief are equally important factors. 63%
3. The regulatory capital relief is a priority for us. We would not consider using guarantees that do not provide regulatory capital relief. 4%

How uniform is the treatment of guarantees within the EU from the viewpoint of reg. capital relief?

1. Our subsidiaries in different EU countries face mostly similar regulatory and supervisory conditions for capital relief on guarantees. 32%
2. Generally it is uniform, but we had problems in certain jurisdictions with regulatory capital relief. 34%
3. In our experience national regulatory and supervisory bodies apply significantly different rules on capital relief. 34%

Source: Bank survey
• **Obtaining regulatory capital relief on the guaranteed loans** is an important component, but less so than in the CESEE.

• Still, almost half of the banks have been facing problems with obtaining regulatory capital relief.

**How important is it for your bank to obtain capital relief to SME credit guarantees?**

- 50% The key purpose of the credit guarantee is the transfer of credit risk. The regulatory capital relief is just an additional benefit.
- 41% The risk transfer and the regulatory capital relief are equally important factors for us.
- 9% The regulatory capital relief is a priority for us. We would not consider using guarantees that do not provide regulatory capital relief.

**How uniform is the treatment of credit guarantees from the viewpoint of capital relief within the EU?**

- 52% Our bank has been facing transparent and uniform regulatory and supervisory conditions for capital relief on guarantees across the EU.
- 36% The rules are mostly transparent and uniform, but we have or had issues in certain jurisdictions.
- 12% The regulatory treatment of capital relief is often non-transparent and varies significantly across the EU.
Regulatory issues mentioned by commercial banks

• For most guarantee schemes – including EU financial instruments –, beneficiary financial institutions face uncertainty about the expected regulatory treatment the associated capital charges.

• In most cases, certainty about the regulatory treatment is obtained only *ex-post*, and the associated risk often discourage banks from using such instruments.

• Issues that have caused uncertainty of heterogeneous treatment include:
  • Termination clauses;
  • Treatment of guarantees on new portfolios to be ramped up over a specific period;
  • The application of the Supervisory Formula Approach in the absence of external ratings for tranched guarantees.
Some relevant conclusions from the survey

• **A strong demand exists for SME credit guarantees.** This is further increased by the needs arising from the adjustment of the European banking system to the post-crisis environment.

• Credit guarantee schemes should be designed and operated so as to **ensure the prudent and efficient use of public resources**, and mechanisms should be in place to **limit the adverse selection** of high-risk borrowers, and **the moral hazard** associated with existing borrowers.

• Financial institutions report that **excessive administrative requirements** and narrow definitions of eligible clients often discourage them from using credit guarantees.

• Given their policy importance, **a stronger awareness of credit guarantee schemes** by the national financial regulatory and supervisory authorities is desirable.

• **A uniform and predictable treatment of the capital relief** associated with guarantees by national authorities may facilitate the more widespread use of such instruments.