

Vienna Initiative 2

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

EBA-EIB-EIF seminar on Synthetic Securitisation and Financial Guarantees, 31 May 2016, London

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WORLD BANK GROUP

- **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.
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- **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.

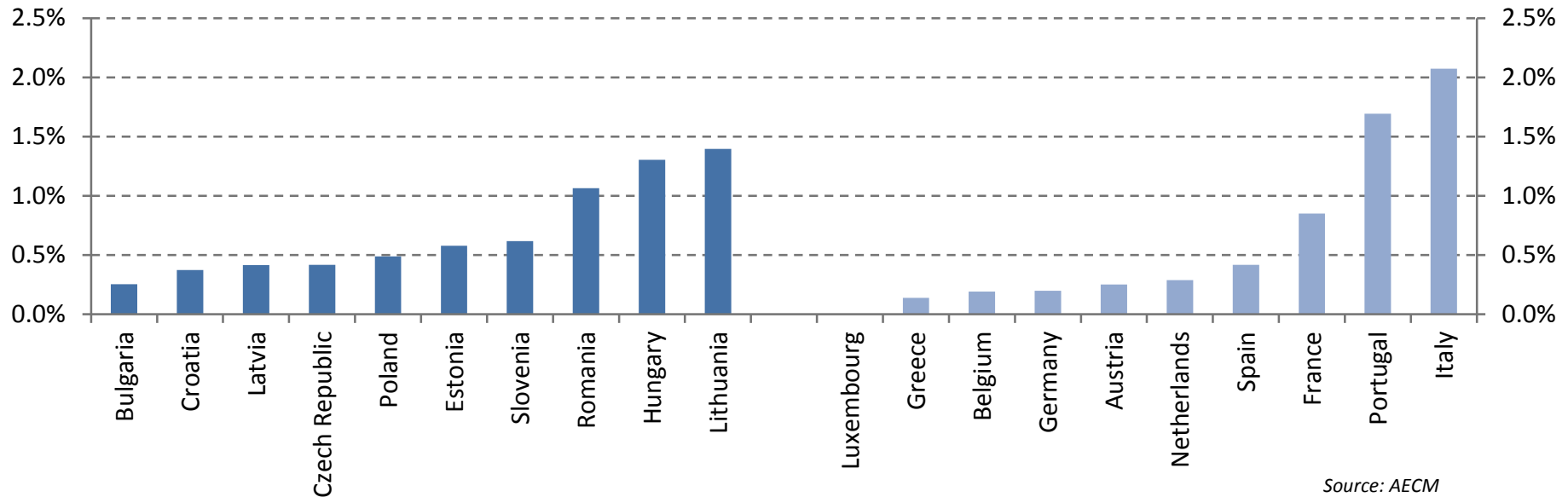
Topics to be covered

1. A quick glance on the credit guarantee landscape in the EU
2. Current issues and challenges

CGS activity

- 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)



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**

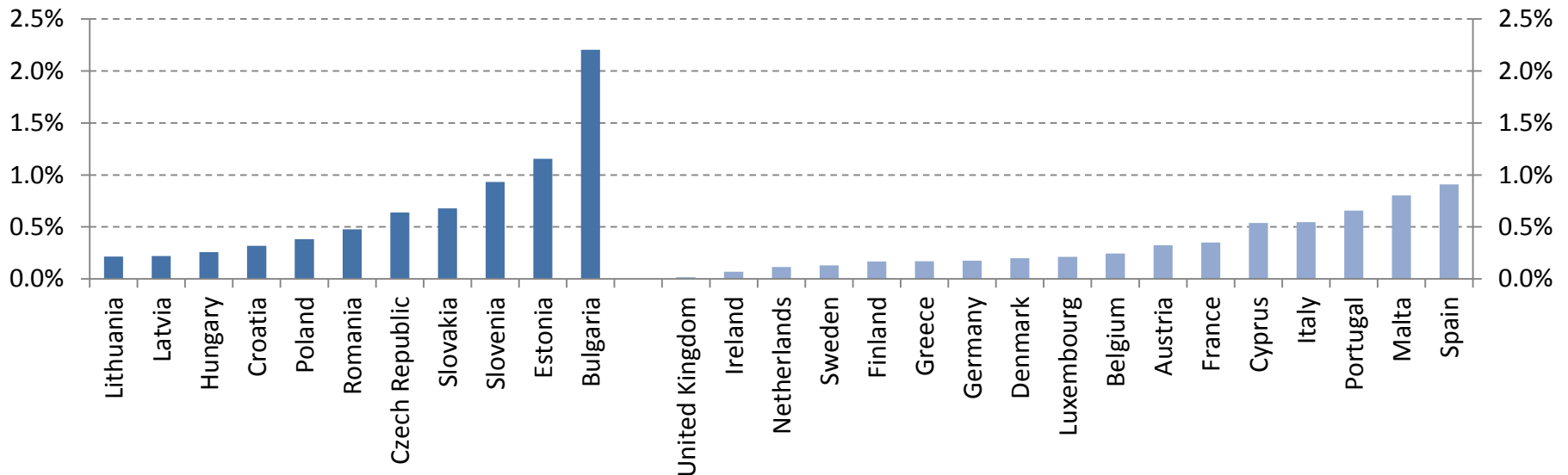
Risk-management

- **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 *tranchéd* and *non-tranchéd* 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)



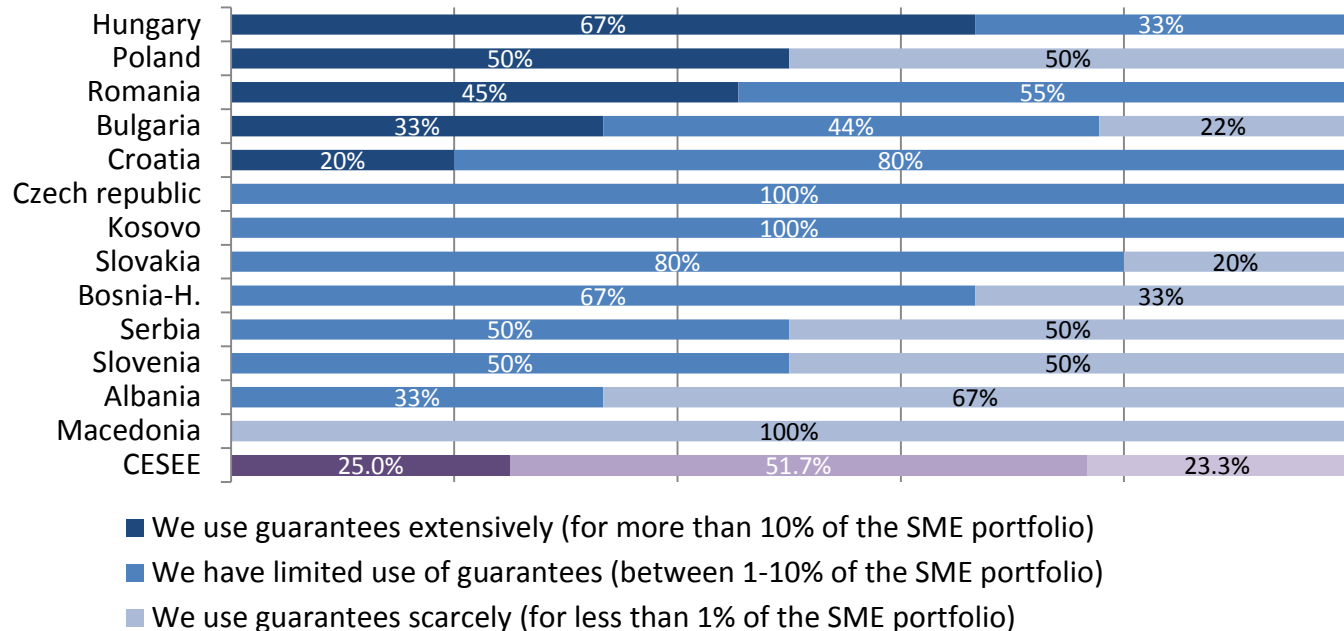
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The demand for credit guarantees in the CESEE

- **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).

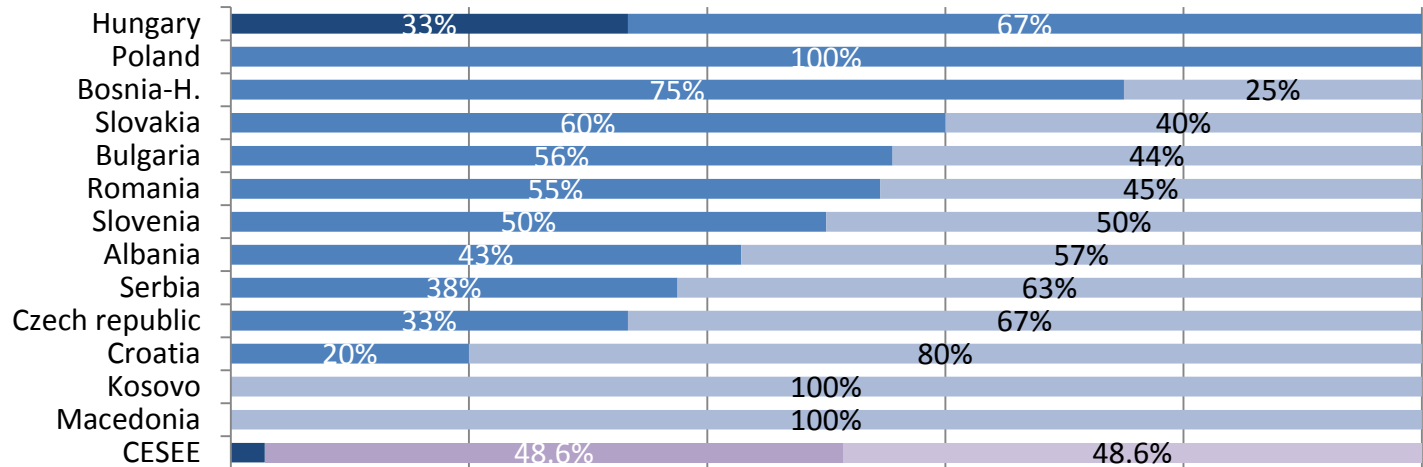
How important is the use of credit guarantees within your SME lending activity?



The demand for credit guarantees in the CESEE

- 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.

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



- 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.

The demand for credit guarantees in the Western Europe

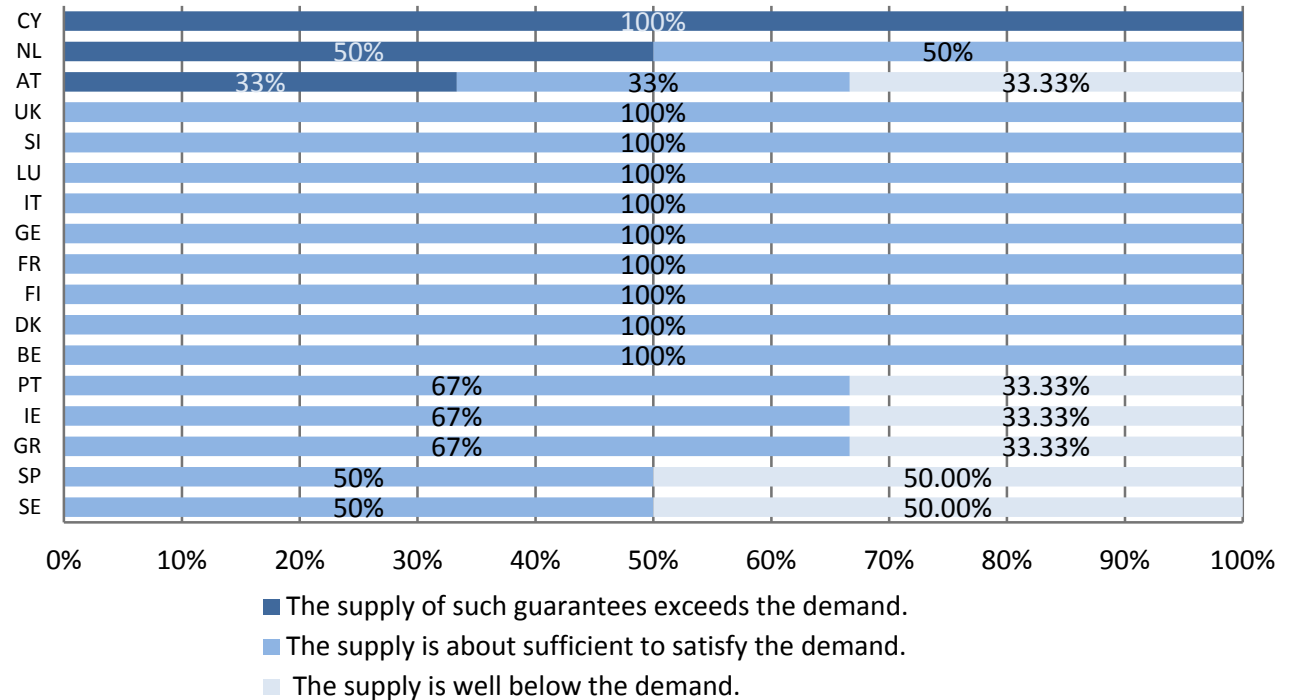
Again, typically, banks have **guarantee coverage between 1 to 10 percent of their SME lending** (with large variation across countries).

- **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

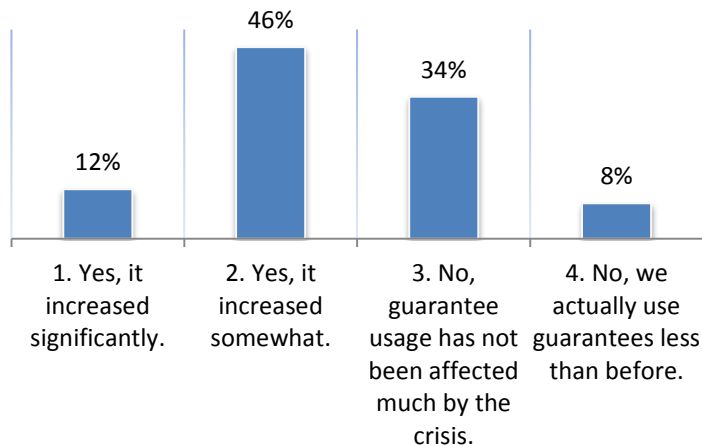
Do you believe that the supply of SME credit guarantees is sufficient in your country?



The role of CGs in alleviating the impact of the crisis – CESEE

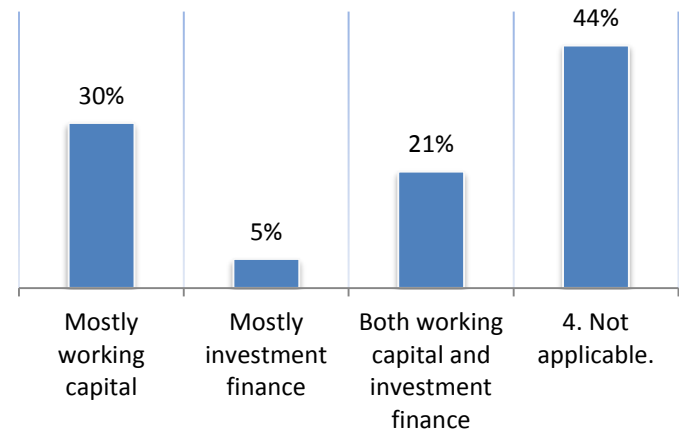
- The number of guarantees issued between 2009 and 2012 in the CESEE has increased by 35 percent, while applications increased by 80 per cent.
- The **majority of the banks have increased their guarantee usage** as a result of the downturn.
- New demand was **mainly due to working capital loans**, rather than investment.

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



Source: Bank survey

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

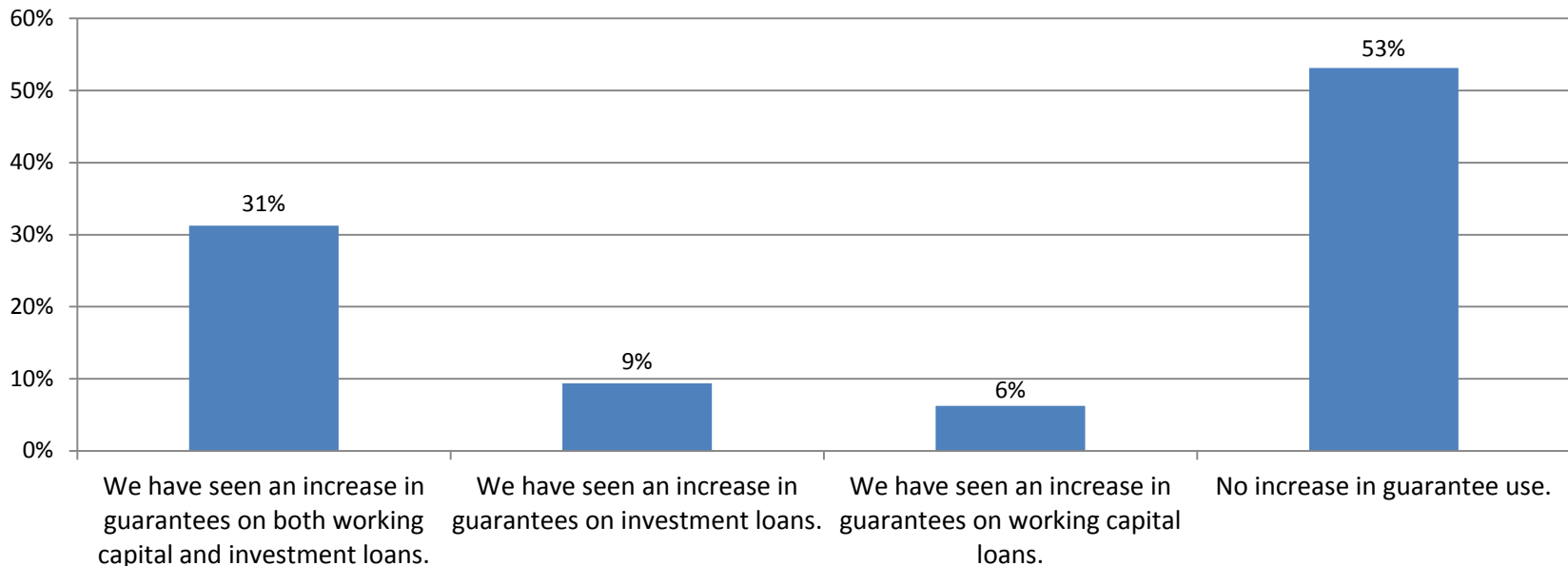


Source: Bank survey

The role of CGSs in alleviating the impact of the crisis – Western Europe

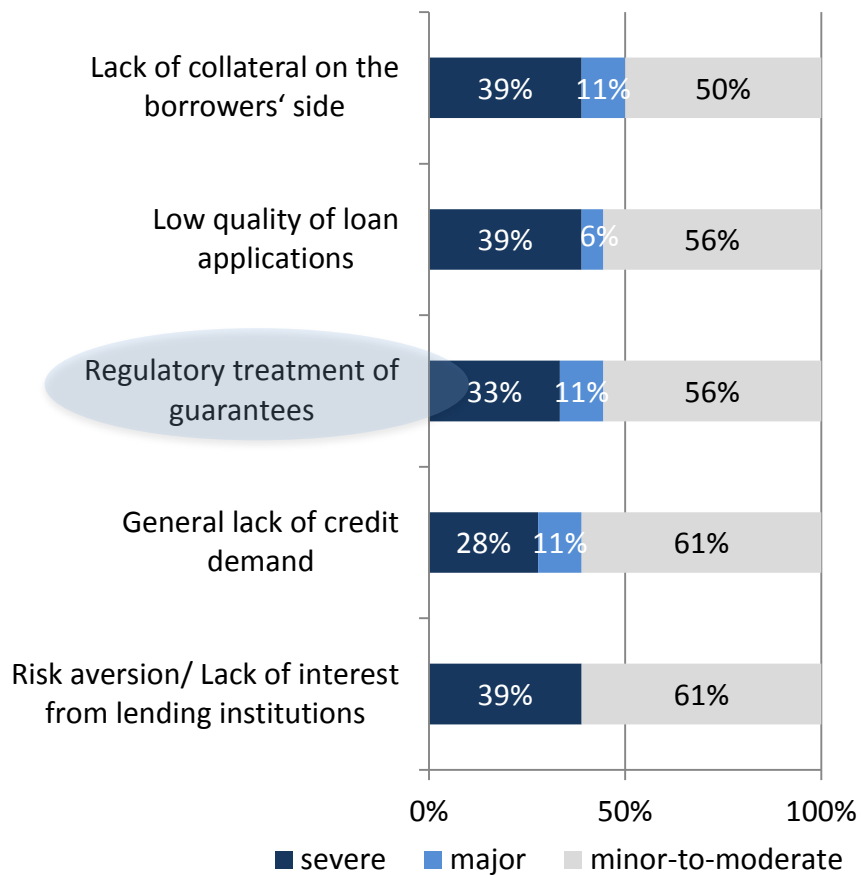
- **Half of the banks have increased their guarantee usage** as a result of the downturn.
- New demand was **observed both due to working capital loans and investment finance.**

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



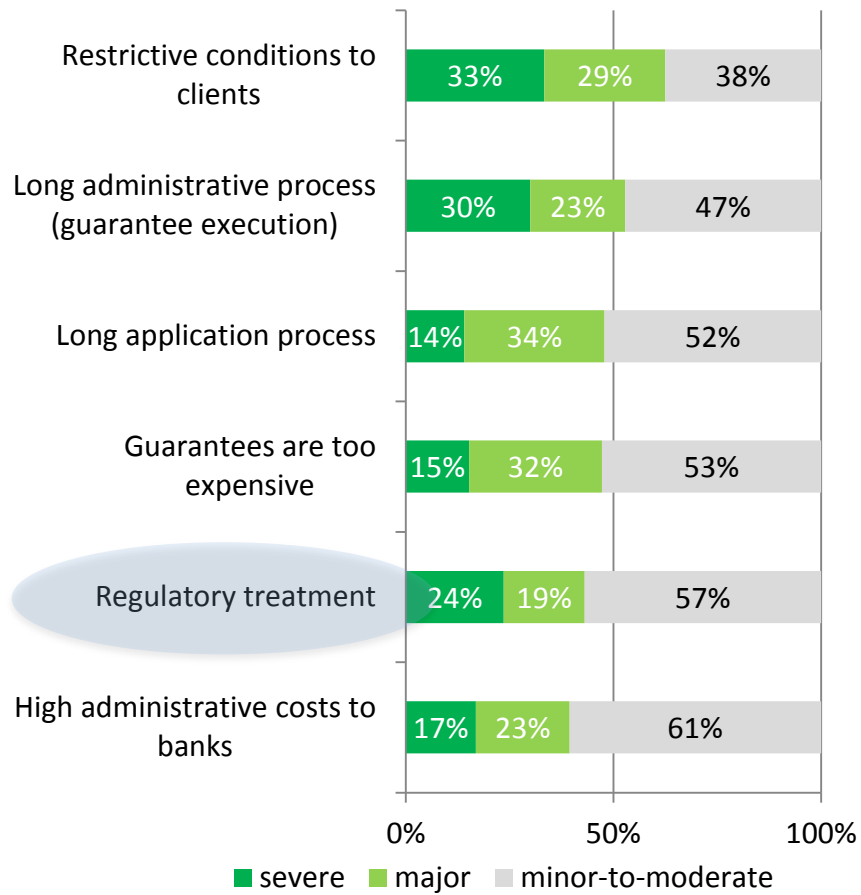
The key factors constraining the credit guarantee activity in the CESEE

Main constraints identified by CGSs



Source: CGS survey

Main constraints identified by banks

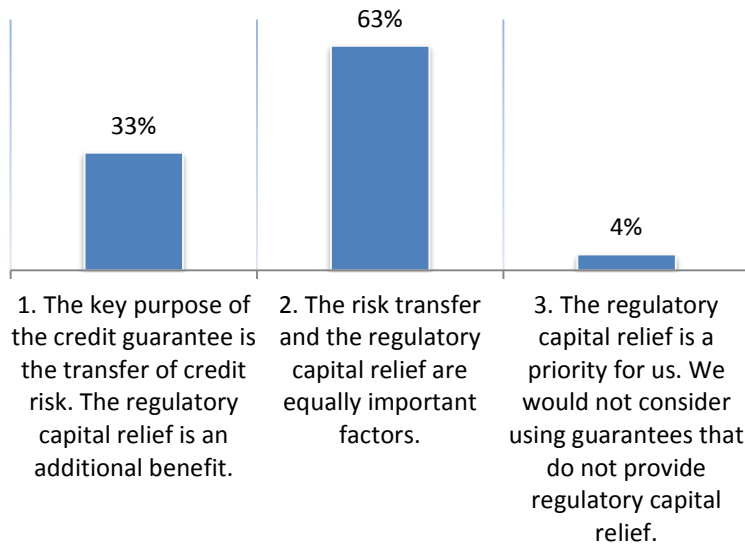


Source: Bank survey

Regulatory issues in the CESEE

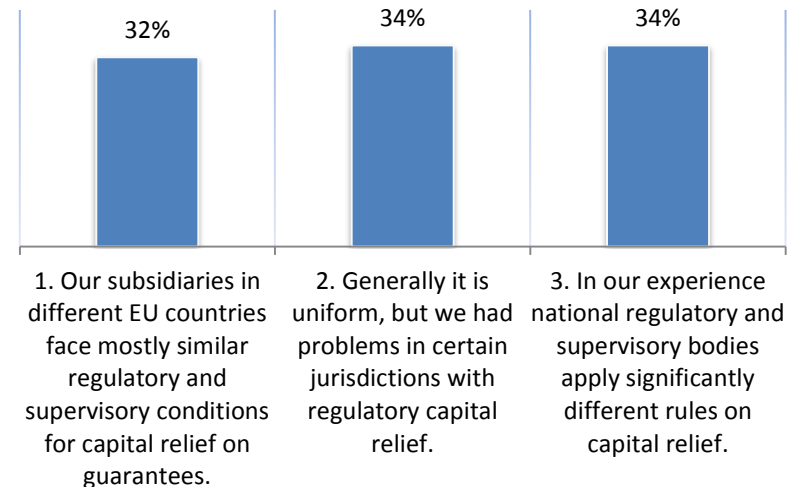
- For banks, **obtaining regulatory capital relief on the guaranteed loans** is an important component of credit guarantees.
- Two-thirds of the banks operating in the CESEE have been facing **problems in this respect** at least in certain jurisdictions.

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



Source: Bank survey

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

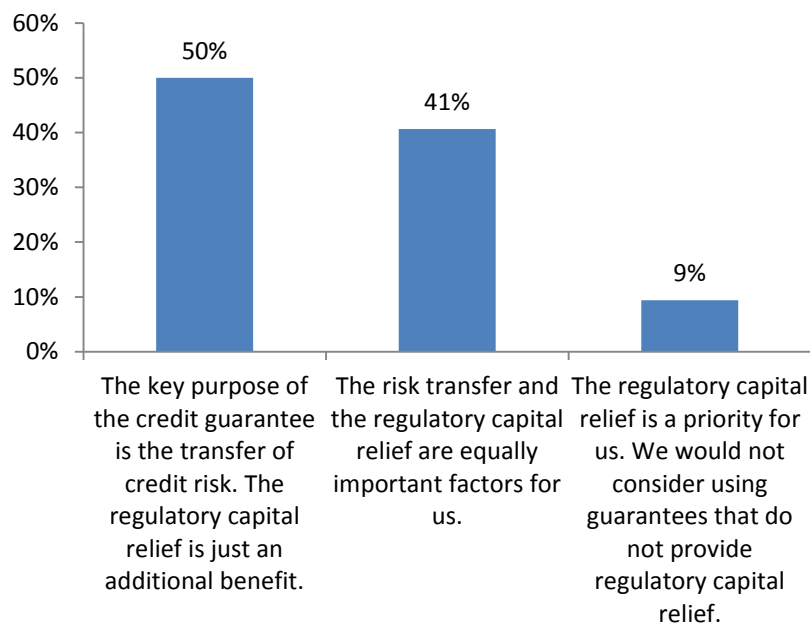


Source: Bank survey

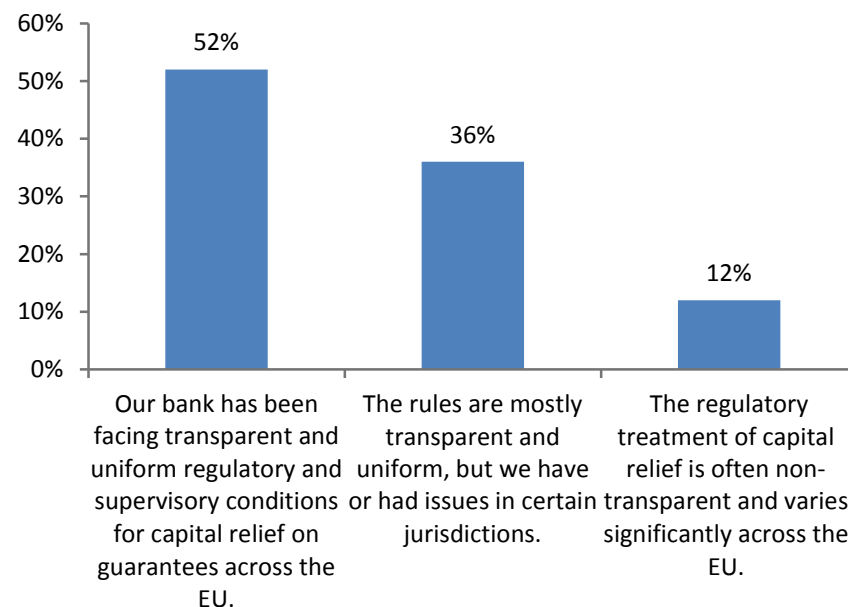
Regulatory issues in the Western Europe

- **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?



How uniform is the treatment of credit guarantees from the viewpoint of capital relief within 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 tranching 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 of 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.