A Credit Guarantee Scheme for SMEs in Belarus: Overview and Recommendations

- Summary of results -

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Structure

1. Introduction

- Small and medium-sized enterprises (SMEs) can contribute to a more diversified and open economic structure and support employment generation, but lack of access to finance is one of the main problems.
  - In the latest OECD SME Policy Index Eastern Partner Countries (2016), Belarus ranks only 5th (out of 6) in terms of “Access to Finance by SMEs”
- Credit guarantee schemes (CGSs) can encourage bank lending to viable businesses which cannot meet standard requirements due to lack of collateral and/or a proven track record. They can play a catalysing role in emerging economies where the SME financing gap is particularly wide
  - There is currently no working CGS in Belarus – consequently, Belarus ranks last (6th) in the OECD SME Policy Index in the relevant subcategory
  - However, Annex 2 to the State Program “Small and Medium Business in Belarus” for 2016–2020 foresees the creation of a working group devoted to study this topic
- Within the Eastern Partnership region, the c plans to create CGS with respect to the DCFTA countries (Georgia, Moldova and Ukraine)
- This presentation:
  - Analyses rationale for credit guarantee schemes
  - Describes how credit guarantee schemes work
  - Provides an overview of international best practices
  - Suggests how to organise a SME credit guarantee scheme in Belarus

2. Rationale for SMEs credit guarantee schemes

- In emerging economies, both financial institutions and SMEs are not mature: Banks have limited resources and strict credit policies securing loans mostly on a collateralised basis, and SMEs lack collateral, proven track record and experience in raising financing. In addition, options of alternative financing are low.
- During economic and financial crises, emerging economies suffer from a even more constrained supply of credit to SMEs, as deleveraging, low profitability and rising levels of non-performing loans (NPL) limit risk-taking capacity.
- The role of CGSs is to provide guarantees on bank loans to viable borrowers by sharing their risk of default. CGSs are established by public, private or mixed institutions and issue their guarantees for fees. Loans, borrowers and guarantees provided under CGSs should meet certain criteria.

2. Rationale for SMEs credit guarantee schemes (cont.)

- As a policy tool, CGSs help reduce existing financing gaps, make loans cheaper and require less capital. They may have goals such as increase of social standards and employment, support of exports, prioritised industries and young SMEs, etc.
- Ultimately, CGSs can leverage banks' SME lending and may additionally support both banks and SMEs by providing various programmes of technical assistance to transfer skills
- CGS are an important form of non-distortionary/market-friendly financial support to SMEs, as opposed to other instruments (e.g. interest rate subsidies)
- Shifting risks to an external guarantor may result in some future losses. But the actual costs of a well-designed guarantee scheme are significantly lower than the social costs
- At the same time, well-designed CGSs should avoid negligent credit policies and excessive risk-taking
- Proper design of CGSs is important as it should be efficient, sustainable and transparent. They should not be profit-maximisers but rather focused on SME development and promotion.

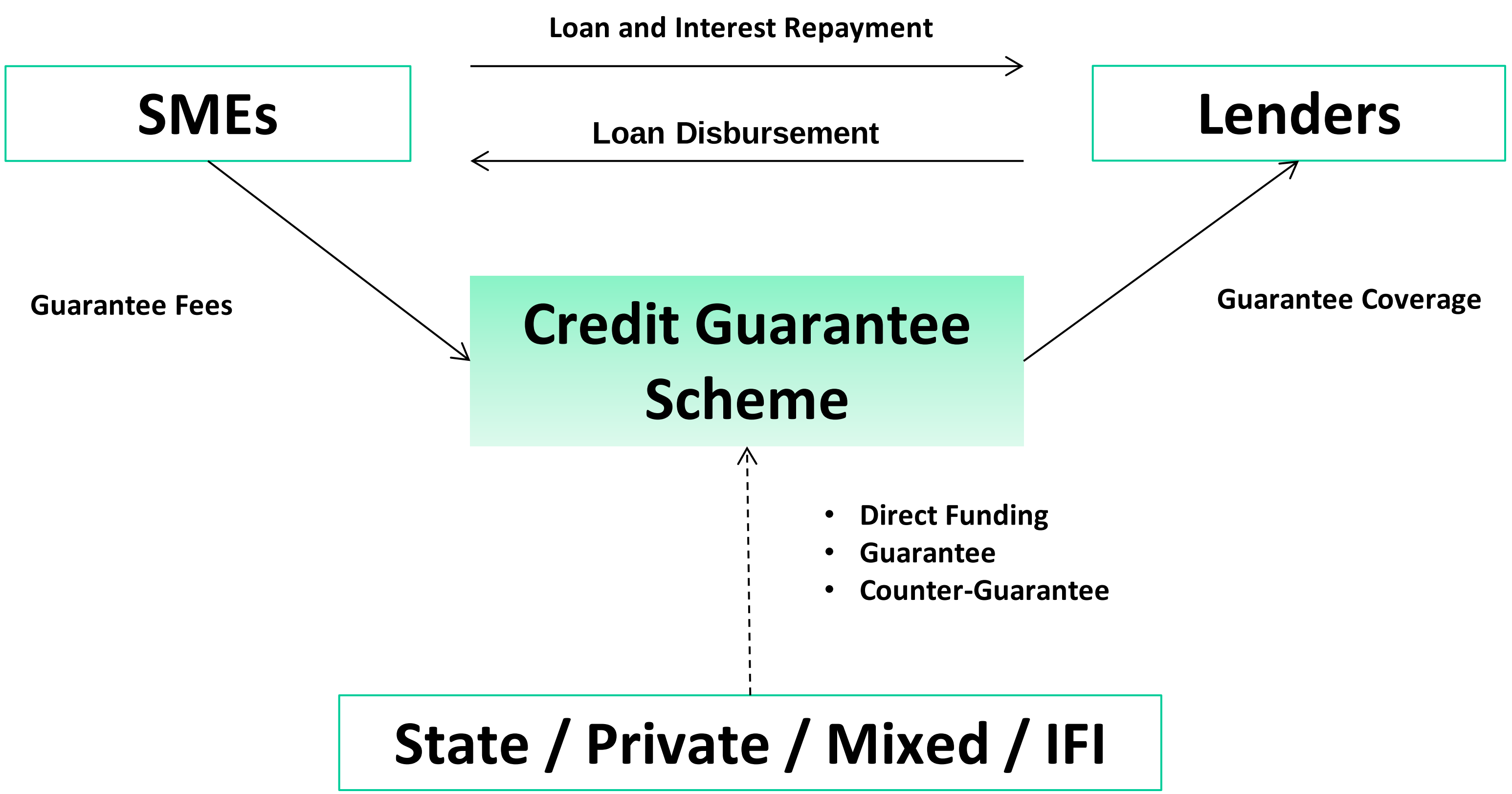
3. How credit guarantee schemes work

CGSs could be grouped as follows:

- Public, private or mixed guarantee schemes – provided by governmental, private or mixed-owned agencies and funds
- Mutual guarantee schemes – arranged by organisations established by borrowers
- Corporate guarantee schemes – provided by companies to boost sales of their products and services
- International schemes – guarantee schemes involving IFIs and other international organisations
- NGO-operated schemes - provided by NGOs to fulfil their tasks

3. How credit guarantee schemes work (cont.)

The functioning of Credit Guarantee Schemes



Remark: Another CGS model, the so-called „portfolio“-model, where refinancing of local banks by international banks is guaranteed is not considered here

3. How credit guarantee schemes work (cont.)

- *Guarantor.* It is generally a state, private or mixed-ownership fund, which is committed to reimburse a lender in case of a borrower's default. IFIs are often involved in CGS in emerging markets
- *Coverage.* CGSs can cover up to 100% of the loan amount, but normally this is limited to 50-80%, to co-share the risk of the borrower's default with the bank in order to set appropriate incentives for project selection and monitoring
  - Guaranteeing a higher share implies a higher guarantee fee to cover the additional risk
- *Individual or portfolio loans.* Guarantees may cover individual loans or a portfolio of loans. Focus is given to new loans, but post-coverage is also possible.
- *Pricing.* Pricing approach includes fees paid by the lender or the borrower and could be one-off or spread over the guarantee period (flat or risk-dependent)
- *Direct or indirect.* Guarantees may be provided directly to SMEs or through banks. This approach also stipulates if credit analysis is done by a guaranteeing institution or by the lender.

3. How credit guarantee schemes work (cont.)

Key challenges while establishing a CGS:

- Efficient and sustainable structure
- Meeting CGS's objectives (including additionality and leveraging)
- Reliable risk management system
- Fit into the country's legal and regulatory framework
- Proper monitoring and evaluation
- Avoiding duplication of several schemes

3. How credit guarantee schemes work (cont.)

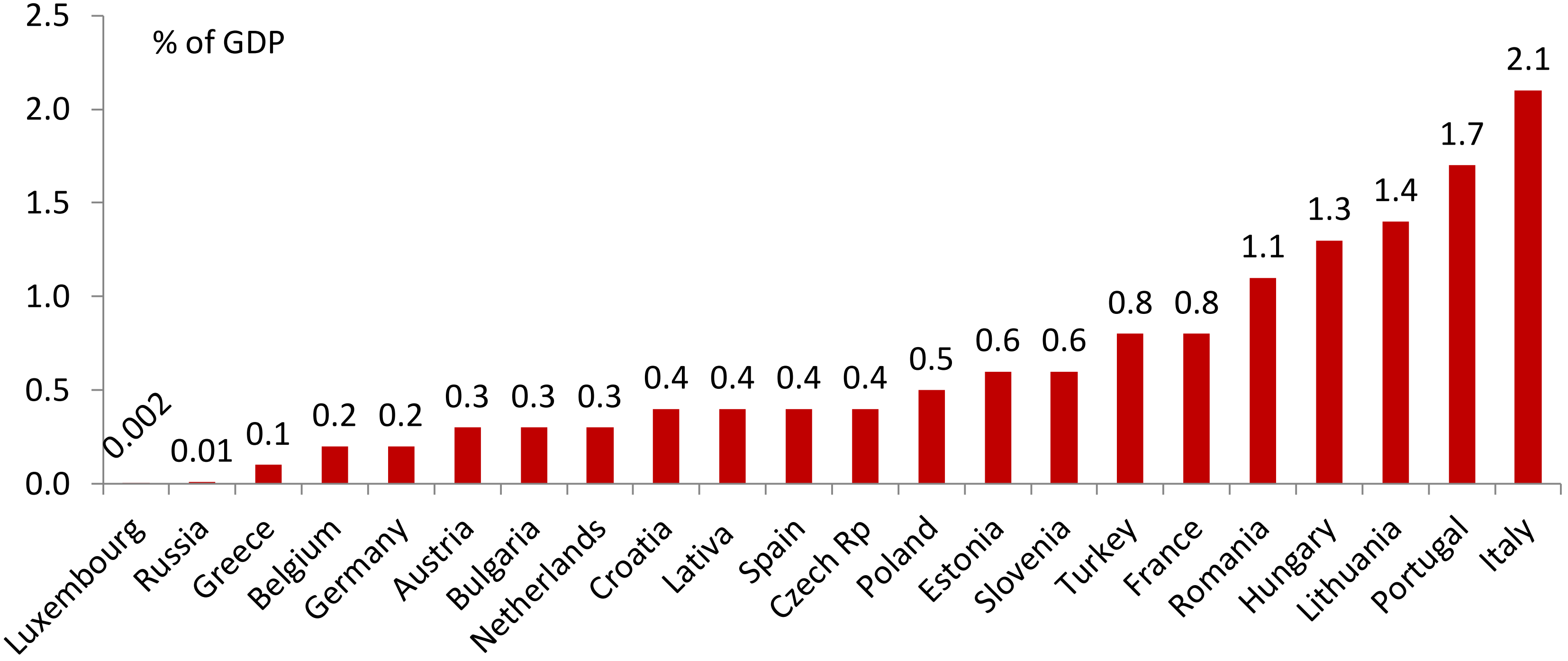
Structure of a typical CGS includes defining of:

1. Mission - a core purpose and long term focus that normally remains unchanged over time
2. Operational characteristics, including:
   - types of services
   - specific objectives (including state policy measures)
   - borrower eligibility
   - maximum amount (preferably avoiding large exposures)
   - maximum tenor
   - pricing of guarantee
   - coverage
   - guarantee assignment process
   - risk management system
3. Funding – sources and amount of finance
4. Governance – how the scheme is set up and governed
5. Monitoring and evaluation - issued guarantees achieve their policy goals. For this purpose a set of clear performance criteria should be established.

4. International Experience

- Global level: Most developed countries have implemented CGSs with various designs and different outcomes
- Europe: CGSs are actively used in Italy, Portugal, Turkey, France and CEE. See detailed example of Irish SBCI in Annex 1

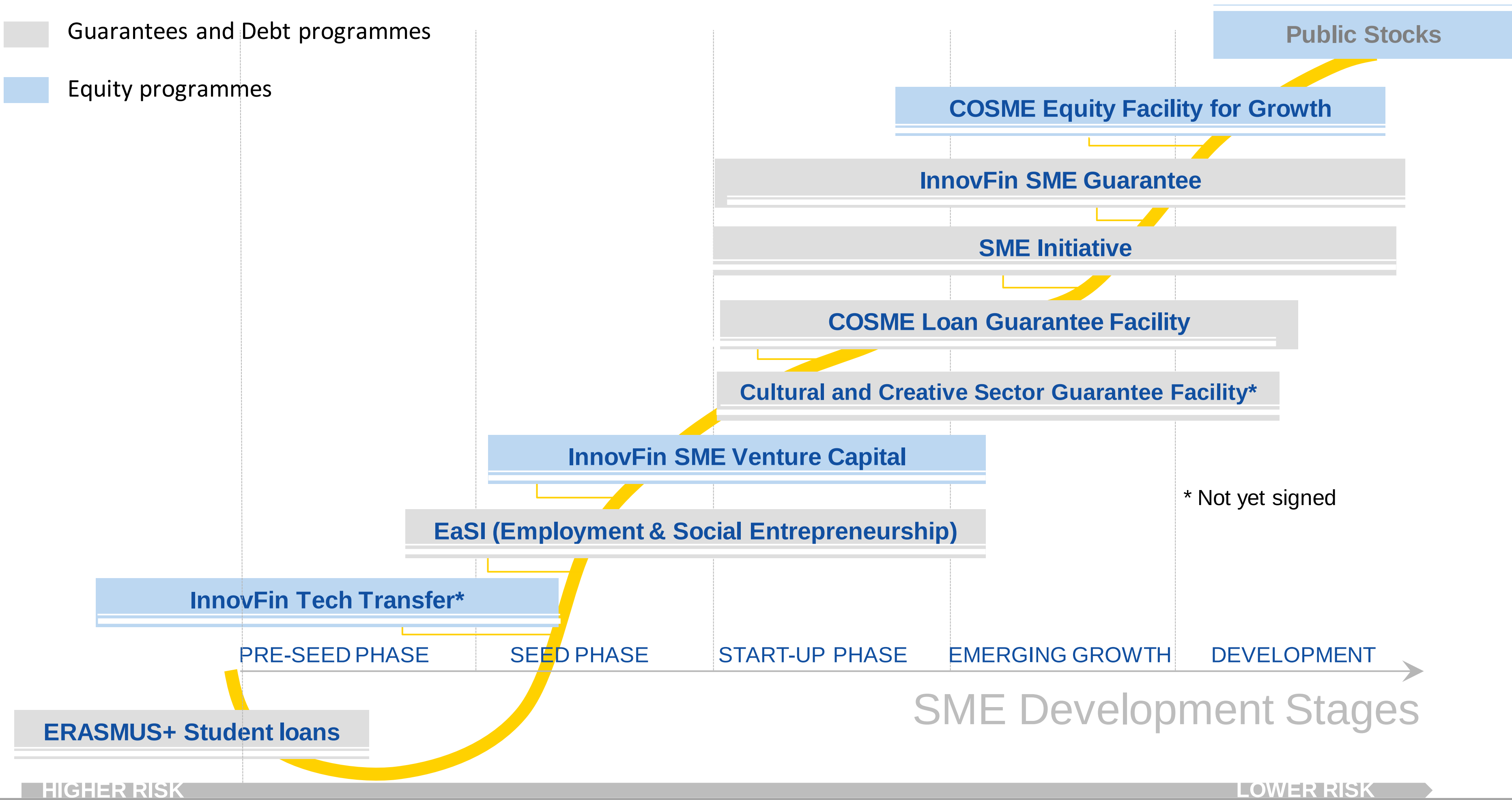
Volume of outstanding guarantees in CGSs (2014)



Source: EIF

4. International Experience: EU

- Depending on risk profiles, the following EIF programmes support SME development over time – some of them are CGSs:



4. International Experience: EU (cont.)

- SME Guarantee (SMEG) facility originated in 1998 on measures of financial assistance for innovative and job-creating SMEs - Growth and Employment (G&E), and was continued as part of the subsequent Multi-Annual Programme for Enterprise and Entrepreneurship (MAP), established from 2001 to 2006.
- Important role is played by the European Investment Fund (EIF). EIF addresses SME's financing needs by providing guarantees and counter- guarantees to lenders to encourage lending to these businesses.
- Guarantees are provided through a wide range of financial intermediaries, such as banks, leasing companies, guarantee funds, mutual guarantee institutions, promotional banks, and other financial intermediaries.
- In 2007-2013 on behalf of the European Commission EIF successfully managed SME Guarantee Facility (SMEG) as a part of the Competitiveness and Innovation Framework Programme (CIP).
- Under CIP SMEG 373,000 SMEs were supported and 72 agreements with 55 intermediaries were signed in 24 countries. The loan amount that CIP SMEG generated for SMEs was at EUR 19.9 bn with only EUR 0.5 bn of capital (40x leverage effect).
- This programme was then succeeded by COSME - the EU programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises - running from 2014 - 2020. It is expected that COSME will enable up to 330,000 SMEs to obtain financing for a total value of up to EUR 21 bn.

4. International Experience: Eastern Europe

- In the region CGSs are proved to be a successful instrument of SME support. See detailed example of Lithuania’s Garfondas in Annex 2.

Selected Eastern European Credit Guarantee Schemes

Country	CGS Provider	Ownership	Max guarantee Limit, EUR m	Max Guarantee Tenor, years	Max Coverage Ratio, %	Guaranteed Loans, EUR m (cum.)
Bulgaria	NGF	Public	0.5	15	50	875.4
Croatia	HAMAG-BICRO	Public	2.4	N/A	50	119.5
Czech Republic	CMZRB	Public	N/A	15	50	546.4
Estonia	KredEx	Public	1.0	N/A	75	200.0
Hungary	Garantiqa	Mixed	8.0	25	80	522.4
Lithuania	Garfondas	Public	1.2	N/A	70	700.0
Poland	NAGF	Mixed	N/A	5	N/A	1320.9
Romania	NCGFSME/FNGCIMM	Public	2.5	N/A	80	718.1
Slovakia	SZRB	Public	0.5	7	60	501.2
Slovenia	SEF	Public	1.2	10	80	192.9

Source: Annex 5, EIF, web-sites of institutions

5. Recommendations for Belarus

#	Subject	Explanation	Example
1	Mission	Define a core purpose and long term focus that normally remain unchanged over time	The fund's main objectives are: ▪ to help SMEs which do not have sufficient collateral and financial resources to develop by providing favorable borrowing conditions ▪ to encourage lending ▪ to seek that state priorities are implemented ▪ the fund's activities are profitable
2	Operational characteristics	Identify the following:	
		▪ types of services, specific objectives	▪ credit and leasing guarantees for prioritized projects
		▪ borrower eligibility	▪ SMEs and private entrepreneurs (headcount <250) with at least 3 years of experience
		▪ maximum loan amount	▪ EUR 1 m
		▪ maximum tenor	▪ 10 years
		▪ pricing of guarantee	▪ ideally risk-dependent pricing; international benchmark is 0.8 -2.3% p.a. of guaranteed volume
		▪ coverage	▪ Initially up to 50% of a loan, later up to 70%
		▪ guarantee assignment process, risk management system	▪ through carefully selected on-lending banks and leasing companies, which are also recipients of SME funding from IFIs or other sources
		▪ other	▪ both local and foreign currency loans can be covered

5. Recommendations for Belarus (cont.)

#	Subject	Explanation	Example
3	Funding	Determine sources and amount of funding	▪ Funding can be arranged jointly by Belarus (e.g. 50%) and international/bilateral financial institutions such as EIB, EBRD, etc. and/or commercial banks. ▪ Equity can be invested in (liquid) assets for additional returns ▪ Statutory capital of the fund of 5 m EUR could generate appx. 25 m EUR of new loans*
4	Governance	Develop how the scheme is set up and governed	▪ The fund is established as a joint stock company. ▪ The state owns 50% of the fund's shares (represented by the Ministry of Finance) ▪ The general meeting of shareholders, the supervisory board and the management board of the fund are the managing bodies of the fund.

Source: Own research

** See Annex 4 for a sample financial fund model*

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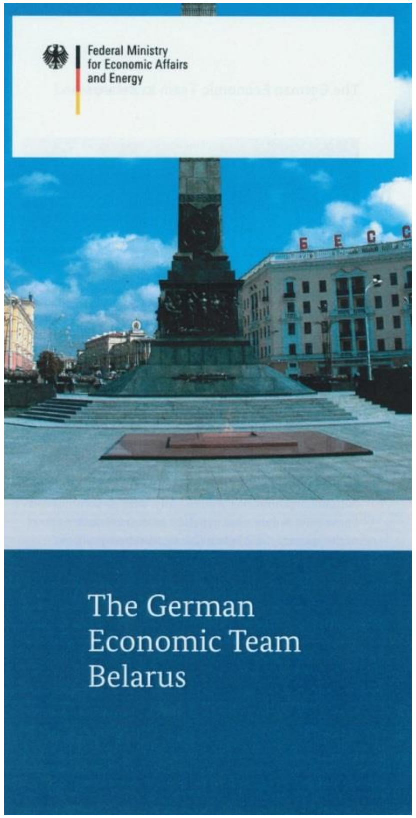


Annex

Annex 1. Strategic Banking Corporation of Ireland

Annex 2. Agricultural Credit Guarantee Fund of Lithuania

Annex 3. EIF DCFTA Facility for Eastern Partnership Countries

Annex 4. Sample Financial Fund Model

Annex 5. References

Annex 1: Strategic Banking Corporation of Ireland

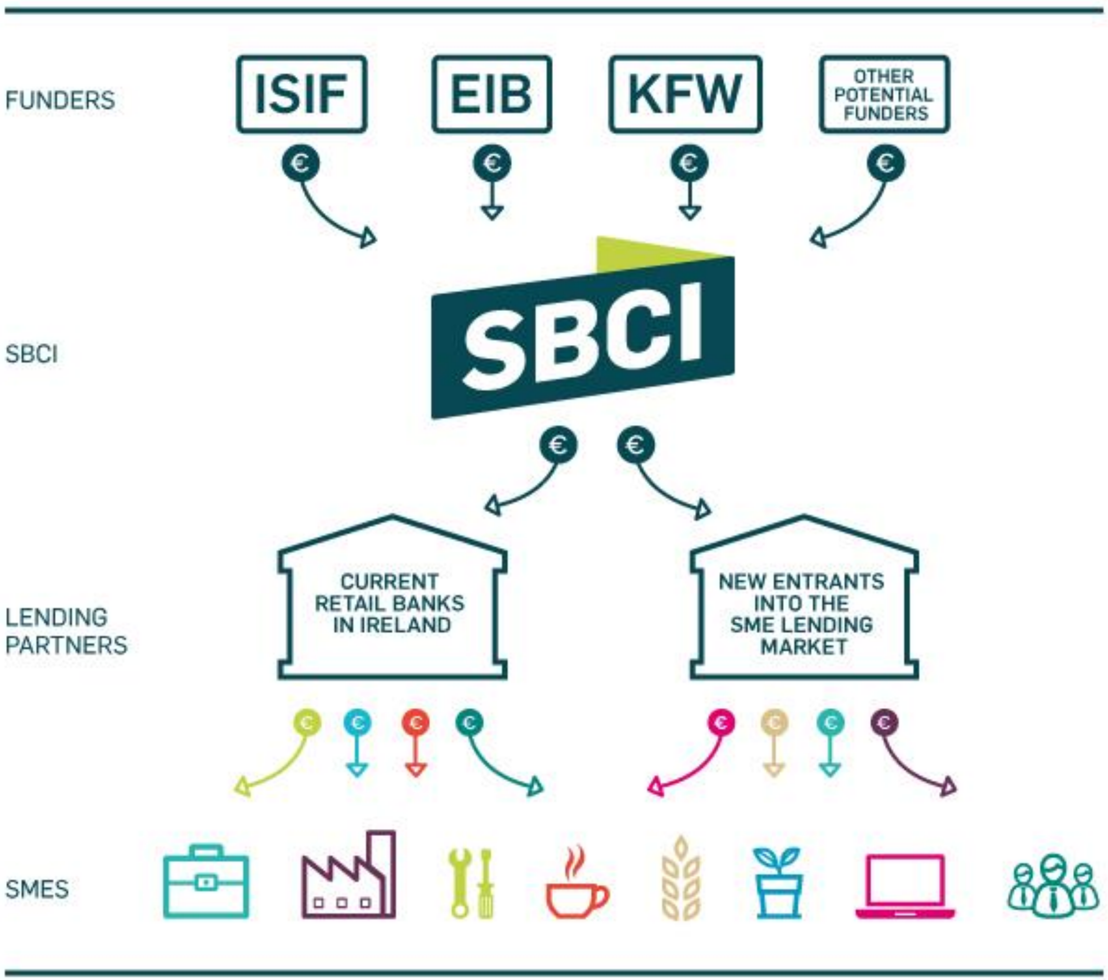
- Unlike many European countries, Ireland did not have a state development bank to channel funding to businesses throughout the financial crisis. During Ireland's exit from the EU/IMF programme in late 2013, it was agreed that the German promotional bank KfW would help financing the Irish SME sector. It led to the creation of the Strategic Banking Corporation of Ireland (SBCI), ensuring that in the future, Irish businesses have access to long-term funding.
- Credit guarantees are provided by Strategic Banking Corporation of Ireland (SBCI) (www.sbci.gov.ie) with the mission to ensure access to flexible funding for Irish SMEs by facilitating the provision of:
  - Flexible products with longer maturity and capital repayment flexibility, subject to credit approval
  - Lower cost funding to financial institutions, the benefit of which is passed on to SMEs
  - Market access for new entrants to the SME lending market, creating real competition
- SBCI offers SMEs loans and agricultural investment finance through its on-lending partners.
- The scheme is intended to address three distinct barriers to lending:
  - Inadequacy of collateral
  - Refinancing due to a lender's exit from the Irish market and insufficient collateral available to support this refinancing
  - Growing or expanding businesses which operate in sectors which are perceived as higher risk under current credit risk evaluation practices
- Governance:
  - The SBCI is a private limited company established under the Strategic Banking Corporation of Ireland Act 2014.
  - The SBCI was formed and registered under the Companies Acts. The issued share capital of the SBCI is owned solely by the Ministry for Finance.
  - The Board of the SBCI may consist of not more than 9 directors.

Annex 1: Strategic Banking Corporation of Ireland (cont.)

- Key features of the CGS:
  - Facilities from EUR 10 thsd. to EUR 1 m
  - Terms of up to 7 years (long-term working capital and capital investment finance)
  - Term loans, demand loans and performance bonds
  - Covers 75% of the facility value. Current participating lenders are AIB, Bank of Ireland and Ulster Bank
- SMEs eligible for the scheme:
  - Involved in a commercial activity
  - A sole trader, partnership, franchise, co-operative or limited company
  - In the lender's opinion have a viable business proposal
  - Able to repay the facility
- Pricing: 2% p.a. premium to the fund in addition to the interest rate/fee charged by the bank
- Credit decision process: the lender is ultimately responsible for the credit decision

Annex 1: Strategic Banking Corporation of Ireland (cont.)

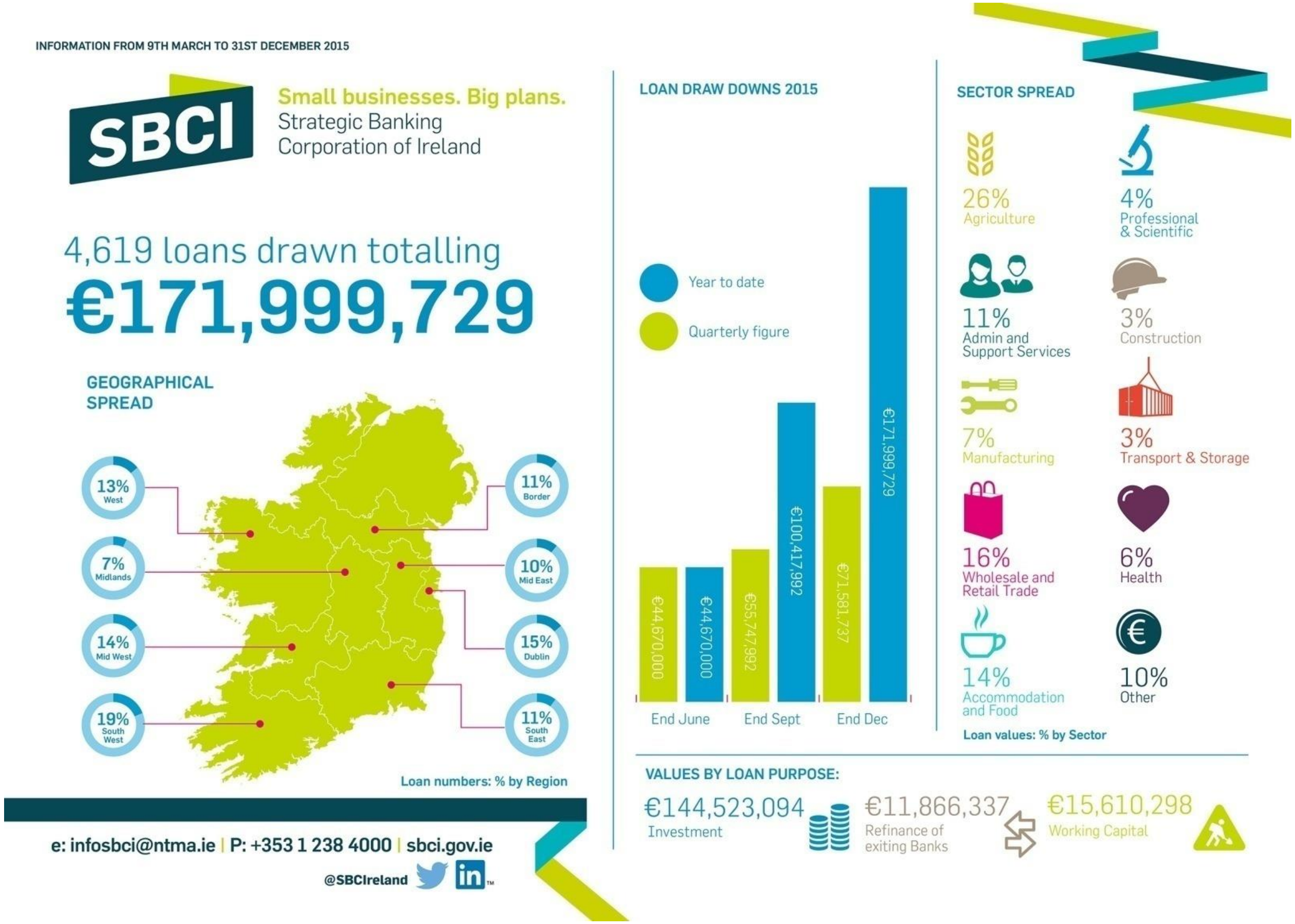
SBCI's scheme of work



Source: Annex 4

Annex 1: Strategic Banking Corporation of Ireland (cont.)

SBCI's operational results in 2015



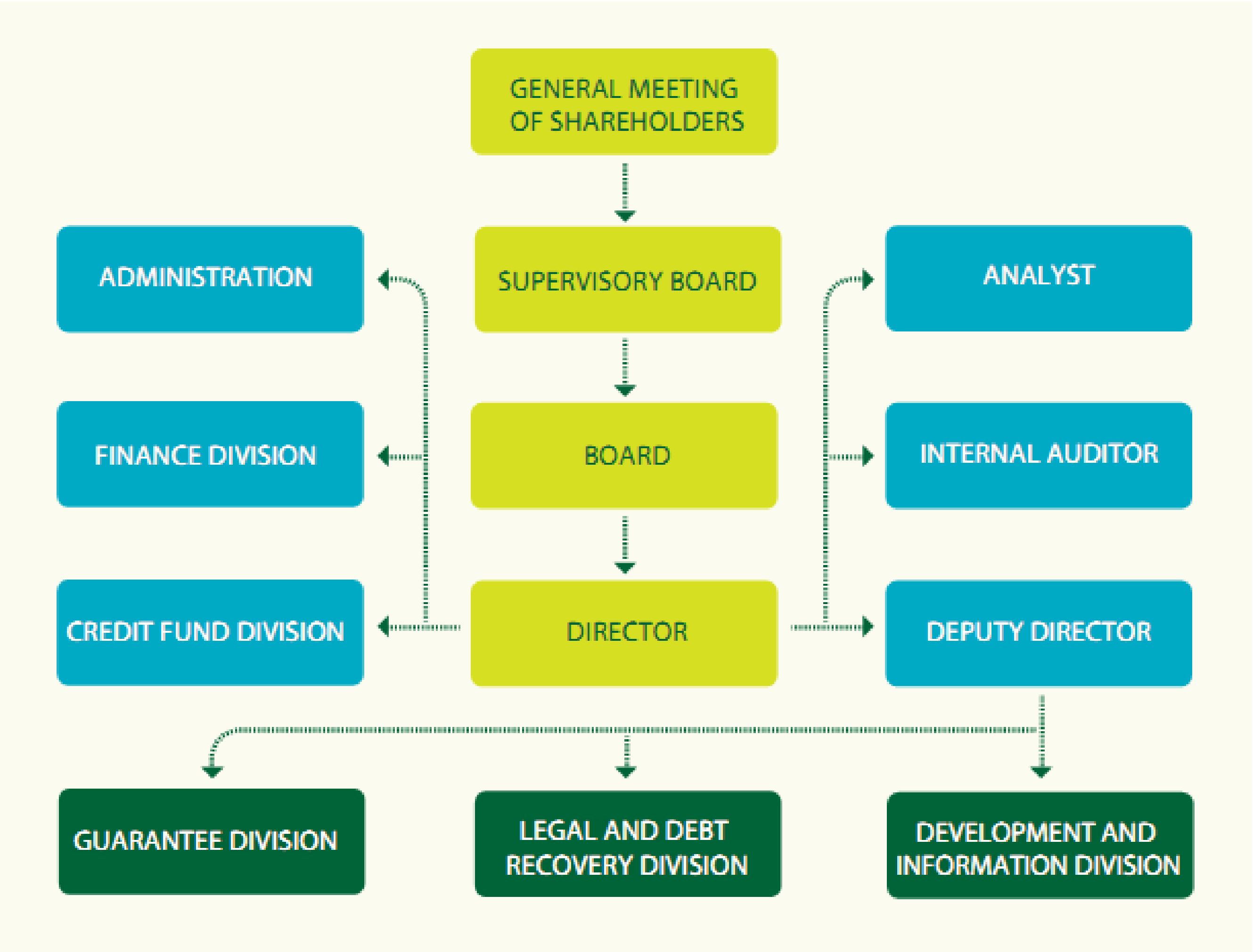
Source: Annex 4

Annex 2. Agricultural Credit Guarantee Fund of Lithuania

- Lithuania's Agricultural Credit Guarantee Fund *Garfondas* (www.garfondas.lt) was established by the Lithuanian Ministry of Agriculture in 1997 with a statutory capital of EUR 6 m
- Target: Farmers, agricultural companies, rural SMEs and processors
- Guarantees to credit institutions amount to 60% of the outstanding credit
- Total amount of issued guarantees exceeded EUR 700 m (cumulative)
- Average amount of guarantee was EUR 100 thsd.
- 50% of covered loans were used to purchase agricultural equipment
- Helped to retain and create 3.3 thsd. workplaces
- Apart from issuing guarantees to credit institutions and finance lease companies, Garfondas has other functions:
  - Administration of state aid
  - Administration of the Credit Fund established by the government for support of agricultural companies
  - Administration of the Indemnity Fund for Licensed Warehouses

Annex 2. Agricultural Credit Guarantee Fund of Lithuania (cont.)

Organisational chart



Source: Annex 4

Annex 2. Agricultural Credit Guarantee Fund of Lithuania (cont.)

Operational results in 2013

Fig 1. *Credits and guarantees per year (excl. the Agency), LTL million*

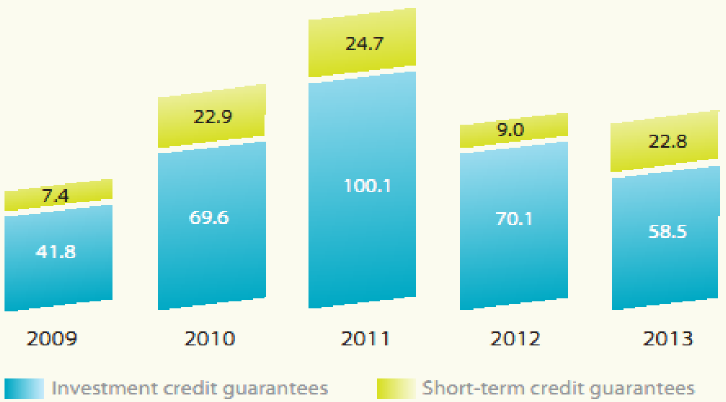


Fig. 3. *Guarantees by type of credit (by year), LTL million*

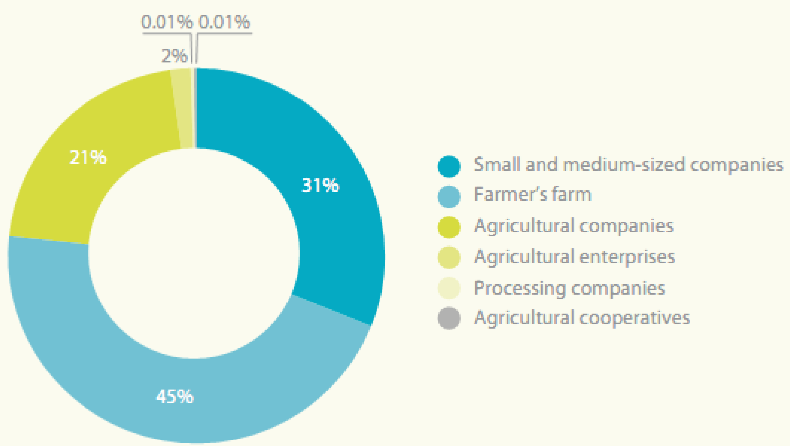


Fig. 5. *Guarantees in 2013 by type of customer (per sum of guarantees), %*

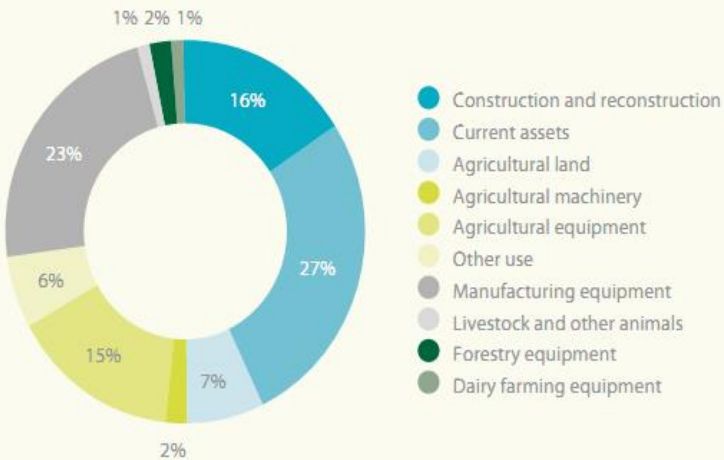
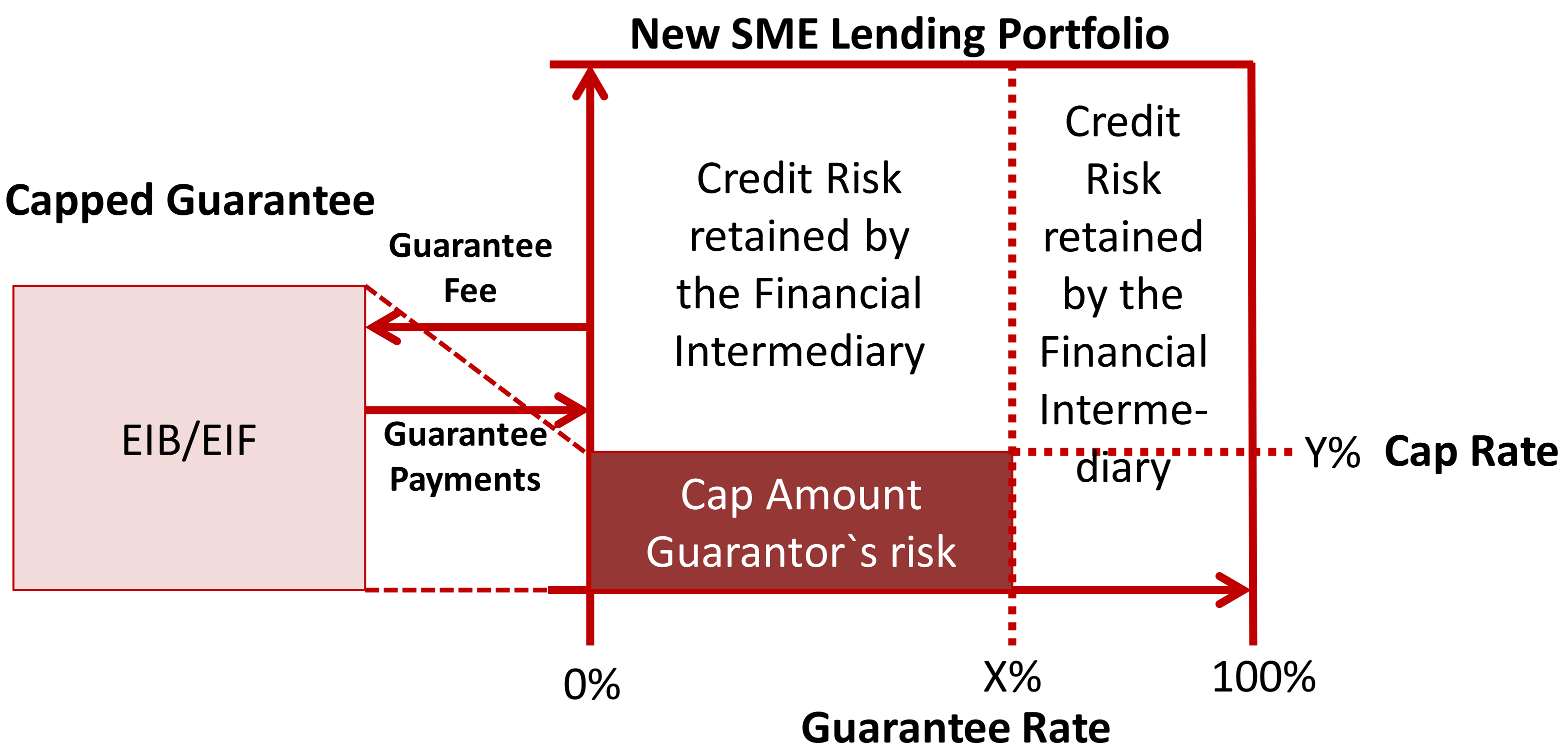


Fig. 8. *Guarantees in 2013 by purpose of the credit and sum of guarantee, %*

Source: Annex 4

Annex 3. EIF DCFTA Facility for Eastern Partnership Countries

- EIF plans DCFTA facility for DCFTA-countries (GEO, MLD, UKR)
- Structure: First Loss SME Portfolio Guarantee
- Based on previous successful example: Guarantee-Programm in Bulgaria (2011-2016)



Annex 4. Sample Financial Fund Model

Maximum *amount*:		Max loan amount		1 000 000 €
		Covered by guarantee		50%
		Max guarantee amount		500 000 €
Total portfolio:		Total loan portfolio		**50 000 000 €**
		Total issued guarantees		25 000 000 €
Classification of loans/guarantees:	Level of loss provision	Loan portfolio structure	Total guarantee amount for each class	Loss provision
standard	2%	40%	10 000 000 €	200 000 €
under control	5%	25%	6 250 000 €	312 500 €
substandard	20%	15%	3 750 000 €	750 000 €
doubtful	50%	10%	2 500 000 €	1 250 000 €
loss	100%	10%	2 500 000 €	2 500 000 €
Total:		100%	25 000 000 €	
Equity needed:				**5 012 500 €**
Leverage (total loan portfolio to equity needed):				10.0
Leverage (total issued guarantees to equity needed):				5.0

Source: Own calculation

Annex 5. References

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