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Credit Guarantee Schemes for SME lending in Western Europe

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EIF Research & Market Analysis

Working Paper **2017/42**

Credit Guarantee Schemes for SME lending in Western Europe

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Executive Summary

Introduction*

This report discusses the activity of credit guarantee schemes (CGSs) in Western Europe and presents an analysis based on a novel survey, conducted by the European Investment Bank (EIB) Group¹, among 18 credit guarantee organisations in 13 countries and 33 banks operating in 17 countries. The report aims at providing a deeper insight into the driving motives and operational mechanisms of CGSs, and the financial intermediaries that use them.

The current publication is a successor of an earlier report, published in 2014 by the European Bank Coordination “Vienna Initiative” Working Group on CGSs (EBCI, 2014), which provides a comprehensive overview on the use of CGSs for Small- and Medium-sized Enterprise (SME) lending in Central, Eastern and South-Eastern Europe (CESEE).

The role of credit guarantee schemes

Credit rationing – induced by information asymmetries – is particularly prevalent in the market for SME and mid-cap lending, a phenomenon often referred to as the SME financing gap. This gap can increase significantly in times of financial downturns.

CGSs are popular public policy instruments to alleviate the credit constraints faced by SMEs. Carefully designed and continuously evaluated guarantee products have the potential to efficiently alleviate those constraints.

SME credit guarantees in Western Europe

In many Western European countries credit guarantees play a key role in supporting SMEs’ access to finance. CGSs are particularly wide-spread in Italy and Portugal, where the outstanding volume of SME credit guarantees stands around 2 per cent of the GDP. In absolute terms, the guarantee sector is largest in Italy (outstanding volume: EUR 33.6bn), France (EUR 16.7bn), Germany (EUR 5.6bn) and Spain (EUR 4.1bn).

Although the national frameworks of CGSs show a large country-by-country heterogeneity, in most of the surveyed countries CGSs are publicly owned, and are active only in their home country.² In most cases

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¹ The EIB Group consists of the European Investment Bank (EIB) and the European Investment Fund (EIF). See www.eib.org and www.eif.org for more information.

² In some cases, the CGS survey covered credit guarantee organisations that are associations or network organisations, which have more than one credit guarantee institute as members. The most prominent example is Italy, where 2 organisations were surveyed, of which one has more than 200 non-public mutual credit guarantee institutions as members. Hence, our statements (including numbers and shares of responses) are typically based on the number of surveyed organisations (including umbrella organisations) rather than on the number of credit guarantee institutions, and we do not apply any weighting. Consequently, even if credit guarantee institutions are publicly owned in most of the surveyed countries, it has to be emphasized that non-publicly owned / mutual credit guarantee institutions play a very important role in the European guarantee market, given the high share of the Italian market in the total European guarantee volume.

they are non-profit, but have an obligation to be self-sustainable, and they are capitalised upfront. Their most important objective is to alleviate the collateral constraints by providing guarantees to both banks and non-bank intermediaries. They manage their risks through government and EU-level counter-guarantees.

The key multinational credit guarantee provider for SMEs and mid-caps in the region is the European Investment Fund (EIF). In addition, the EIB is increasingly deploying new “risk sharing” products.

Providers and users of credit guarantees face a complex regulatory environment. One key aspect of the regulatory framework involves the prudential regulation of financial institutions; the capacity of guarantees to provide capital relief for banks is regulated by the CRDIV/CRR for EU Member States. Another important component is the legal framework of state aid, which governs the provision and pricing of guarantees provided by public entities.

Selected issues faced by CGSs

There is a widespread use of credit guarantees by financial institutions in Western Europe. Local credit guarantee institutions are at the moment the main suppliers of CGSs locally, but multinational providers – the EIB Group, in particular the EIF – also play an important role.

Nearly all national CGSs responded to the crisis by increasing their activity, most notably by increasing the supply of working capital loan guarantees.

Notwithstanding this reaction to the crisis, a majority of both banks and CGSs stated a lack of credit demand by SMEs as a considerable constraining factor to the use of credit guarantees. Restrictive EU state-aid schemes, on the one hand, and cumbersome administrative duties on the other are identified by CGSs and banks respectively as other serious impediments for the credit guarantee activity.

Guarantees may provide capital relief for banks, and nearly half of banks reported this to be an important consideration in their use of CGSs. However, some banks in the survey sample also pointed out that regulation on capital relief related to guarantees is often too complex, non-transparent, and its implementation can differ from one EU jurisdiction to another.

Credit guarantees are able to ease the need for collateral in SME lending. However, they are not always able to perfectly substitute the role of collateral.

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Introduction

A credit guarantee provides risk protection to a lender in case of default by the borrower. The guarantor, typically in return for a fee, commits himself to repay the loan to the lender, in case of the borrower's default. The design of this triangular relationship depends on a number of parameters, the most important being the distribution of risk between guarantor and lender. Credit guarantees are used in many developed and developing economies to alleviate the constraints faced by Small- and Medium-sized Enterprises (SMEs) and mid-caps in accessing finance caused by a lack of collateral and information asymmetries, the so-called SME financing gap.

This report discusses the activity of credit guarantee schemes (CGSs) in Western Europe and presents an analysis based on a novel survey conducted by the European Investment Bank (EIB) Group. The current publication is a successor of an earlier report, published in 2014 by the European Bank Coordination "Vienna Initiative" Working Group on CGSs (EBCI, 2014), which provides a comprehensive overview on the use of CGS for SME lending in Central, Eastern and South-Eastern Europe (CESEE), based on a survey conducted with Eastern European CGSs and banks. The focus on the catalysing role of CGSs in the financing markets of CESEE countries was motivated by the observation that the financing gap for SMEs is typically larger in developing markets, where financial markets remain relatively under-developed.

As the CGS sector in Western Europe was not covered by that earlier survey, the report at hand fills that gap by focussing on CGS activity in Western European countries specifically.³ The extension to Western Europe's markets is motivated by the fact that the causes of the SME financing gap are structurally rooted in the characteristics of SMEs' debt market and hence are not unique to developing economies solely. In addition, also Western European finance markets have been severely hit by the recent financial crisis, and external finance markets for SMEs suffered particularly hard. As will be discussed in this paper, CGSs provide a useful policy tool to address these structural market failures and to mitigate the adverse consequences of the financial crisis on SME finance markets.

To gain a deeper insight in the functioning of the Western European CGS market, the EIB Group conducted a new survey among CGSs and banks operating in 18 countries.³ The current report presents the results of this survey, which will provide a deeper insight into the driving motives and operational mechanisms of CGSs and the financial intermediaries that use them. The survey design builds on the earlier CESEE surveys discussed in EBCI (2014) and contains two parts:

³ The country coverage of the report is going beyond the traditional boundaries of Western Europe. This is due to the fact that the preceding report on CESEE covered mainly the member countries of the Vienna Initiative. Thus in the current report we included all EU member states that were not covered in EBCI (2014). These include the EU15 (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom), and some of those new members states that were not covered by the Vienna Initiative study (Cyprus and Malta). Slovenia was only partially covered by the earlier study; therefore we included it in the current survey, too.

- *CGS survey.* With the support of the European Association of Guarantee Institutions (AECM), a number of national CGSs operating in Western Europe were approached. They were asked to provide information on the scale of their activities, their operational characteristics, their performance indicators and the issues and challenges they currently face.
- *Bank survey.* In collaboration with the Institute of International Finance (IIF), large banking groups operating in Western Europe were asked to participate in a survey on their use of SME CGSs. To obtain country-specific information, the questionnaires were completed by corporate credit risk specialists at the level of local subsidiaries of the banking groups.

Our report fits into a growing line of literature focusing on the institutional characteristics of credit guarantee institutions. Some studies have taken a broad approach and covered many aspects of public CGSs as a policy tool to stimulate SMEs' access to finance, both in terms of topic, as well as from a geographical perspective: Beck et al. (2010), for example, provide a comprehensive overview of CGSs across the world, using data on 76 CGSs from 46 developed and developing countries. The authors focus specifically on the differential role of the government in the provision of the guarantees vis-à-vis the private sector. Another general study by the OECD (2013) examines the role of public CGSs in supporting finance for SMEs for a number of OECD countries. The study covers a wide array of topics, such as the legal framework surrounding CGSs, their financial sustainability and the use of CGSs in the aftermath of the financial crisis. Other studies followed a more focussed approach, targeting a specific geographical area or topic. Of course, most closely related to this report, EBCI (2014) elaborates on the results of a survey that documents the use of CGSs as a policy tool to address the consequences of the financial crisis on SMEs in Central, Eastern and South-Eastern Europe. In addition, Saadani et al. (2011) discuss the use of CGSs in the Middle East and North Africa, Roper (2009) examines how CGSs promoted SME growth and innovation in the MENA region and Ott and Anderson (2014) analyse the role of CGSs in restoring financing to SMEs in the post-crisis era for six Euro Area countries. Finally, a study by the World Bank (2015) discusses the importance of proper scheme design. It outlines 16 principles CGSs should adhere to in order to optimise their effectiveness as a policy tool to enhance credit access for SMEs.

The remainder of this paper is structured as follows. Chapter 1 discusses the role of SME CGSs and the rationale for public intervention. Chapter 2 provides an overview of the use of CGSs in Western Europe by elaborating on the main results of the CGS survey. In Chapter 3 a number of selected topics are discussed in greater detail, such as the demand for CGSs by banks, the role of CGSs in alleviating the impact of the crisis, factors constraining the further development of the CGS sector, the regulatory aspects of capital relief and the use of collateral in combination with guarantees. Chapter 4 concludes with a number of policy recommendations.

1 The role and rationale for SME credit guarantee schemes⁴

- *Credit rationing induced by information asymmetries is particularly prevalent in the market for SME and mid-cap lending, a phenomenon often referred to as the SME financing gap.*
- *Over the course of the survey period (June 2015 – May 2016)⁵, small firms were still experiencing the adverse effects of the crisis on the availability of debt financing.*
- *CGSs are a popular policy tool to alleviate the credit constraints faced by SMEs.*
- *Guarantee products have the potential to efficiently deliver on the policy objectives.*

1.1 The rationale for credit guarantees: information asymmetries in the SME lending market

CGSs operate in many developed and developing economies to alleviate the constraints faced by SMEs and mid-caps in accessing finance, the so-called SME financing gap. Indeed, financial institutions are usually reluctant to extend uncollateralised credit to SMEs, even at high interest rates. This reluctance is in part due to the high costs of obtaining adequate information on the true credit quality of small, possibly young companies. Although to a lesser extent, a similar reluctance in lending by the banks can also be observed towards mid-cap companies. However, many of these firms do not have the necessary amount and type of assets that could serve as collateral for the loan. As a result, many SMEs and mid-sized companies with economically viable projects cannot obtain the necessary financing from the regular system of financial intermediation. This phenomenon is often referred to as the SME financing gap, i.e. an insufficient supply of credit to SMEs (OECD, 2006). The existence of the financing gap is driven by a market failure typical for the credit market: information asymmetries.

Information asymmetries can lead to credit rationing through either moral hazard problems or an adverse selection of low quality borrowers (Akerlof, 1970). Adverse selection occurs when banks cannot sufficiently differentiate between good and bad projects. Higher interest rates will discourage businesses with the least risky projects to apply for a loan. This then implies that, for any given interest rate, inherently riskier projects will be overrepresented in the loan application pool (Jaffee and Russel, 1976; Stiglitz and Weiss, 1981). Moral hazard problems occur when limited liability in the event of default provides borrowers with an incentive to take up excessive risk. This means that in the presence of asymmetric information, banks are reluctant to use higher interest rates, because it reduces their equilibrium profits. As a consequence, the rational response of the banks is to keep the supply of credit below the demand, rather than to increase the interest rate charged on loans.

⁴ This chapter relies heavily on the Chapter 1 of EBCI (2014), and the discussion of market failures in the SME financing market presented in EIF's European Small Business Finance Outlook (Kraemer-Eis et al., 2016a).

⁵ Responses on the CGS survey were received from October 2015 to May 2016. Responses to the bank survey arrived from June to September 2015. See Annex 1: Description of the surveys for further details.

Credit rationing induced by information asymmetry is particularly prevalent in the market for loans to SMEs, for two reasons. The first reason relates to the lack of collateral. Collateral provides a way for borrowers to directly eliminate the asymmetric information problem. Pledging collateral in a loan agreement allows enterprises to bindingly signal their true creditworthiness. However, firms do not always possess the required collateral. This holds especially true for SMEs. Credit rationing can therefore disproportionately affect this specific segment of firms, when failure to meet lenders' collateral requirements aggravates access to finance problems. In addition, the use of collateral comes with a number of drawbacks. For one, the collateral may be worth more to the borrower than to the financial institution providing the loan. Furthermore, the use of collateral usually increases the cost of borrowing, as it generally involves legal and other administrative procedures. The second reason SMEs are more affected by credit rationing than larger companies relates to the fact that credit market information asymmetries are more pronounced for small firms and the cost of monitoring them is higher. Large companies are required to adhere to corporate norms, legal standards, formal reporting requirements etc., whereas business decision making processes, transparency rules, dividing lines between company and personal assets are less defined for SMEs. SMEs are often young companies with a relatively short credit history and operational track record vis-à-vis their older counterparts. Market failures in the bank lending market therefore imply that, without any public or other collective action type intervention, many SMEs with economically viable projects will not be able to obtain the necessary financing from the regular system of financial intermediation.

Certain factors related to the banking system have contributed to a worsening of the SME financing gap during and after the crisis. First, as demonstrated for instance by successive stress tests – see Acharya et al. (2016) –, the European banking system entered into the post-crisis period with less than sufficient equity capital. The scarcity of bank capital is partially resulting from the crisis-related losses and is partially due to the tightened capital standards of the Basel III framework. As shown for example recently by Gambacorta and Shin (2016), low bank capital has negative consequences on the corporate lending activity of the banks. Second, a number of studies have put forward the conclusion that credit constraint issues are further deepened by increasing market concentration in banking sector. Ryan et al. (2014), for example, show how bank market power is associated with an increase in financing constraints, and thus leads to lower SME investment levels. This conclusion is confirmed by Chong et al. (2013) who show that lowering market concentration in the banking sector indeed alleviates financing constraints. Given the pace of consolidation in the European banking sector has been accelerating over the past decade (Uhde and Heimeshoff, 2009), these observations are particularly relevant for SMEs in Europe.

Also, some factors related to the SMEs themselves have contributed to a post-crisis worsening of the credit rationing. The sharp drop in real estate prices negatively impacted the credit availability to SMEs, who often use property assets as collateral (OECD, 2012). Moreover, the uncertainty of the economic outlook exacerbated the information problem, which may have also resulted in the decline in the willingness of lending. Both the tightening of conditions of the credit supply towards the SMEs and evolution of some of the factors behind this tightening have been evidenced by the European Central Bank's survey on the access to finance of enterprises (SAFE) – see ECB (2016).

1.2 The role for public sector involvement

Credit guarantees can help closing the financing gap by substituting collateral provided by a borrower with credit protection provided by an external guarantor. While CGSs do not alleviate information asymmetries directly, and hence do not address the root of the market failure, they can increase the incentives of lenders to supply credit to SMEs by providing a substitute for collateral.

CGSs can operate through private initiatives. Private schemes exist for a number of reasons (Honohan, 2010). First, credit guarantees are conceptually related to credit insurance products, as they allow for a partial transfer of risk stemming from a loan or a portfolio of loans. Guarantee providers can achieve an extent of sectoral or geographical diversification that might be difficult to obtain for a single lender. Second, private sector provision of credit guarantees can be driven by the guarantor's comparative advantage in risk analysis, vis-à-vis traditional lenders. This also explains why private CGSs also exist as mutual guarantee schemes, based on industry associations, where members jointly provide guarantees on the loans taken by the individual members. Arguably, these types of CGSs have better information on the clients' creditworthiness than outside lenders. Third, regulatory arbitrage could also be a driver for private financial markets to offer CGSs, as they allow lenders to comply with regulatory requirements.

However, more often than not, CGSs operate under full or partial public funding. There are arguments supporting the view that on a pure private-sector basis the supply of credit guarantees would be below the socially optimal level. Anginer et al. (2014) argue that when lenders are risk averse, efficient provision of guarantees may not occur on a private sector basis due to collective action problems. Although the stakeholders are all aware of the problem, the lack of action comes from the misalignment of the private interests with those of the society. They also stress that the incentives for collective action are even weaker in economies with less developed financial systems. The state, on the contrary, is able to resolve the collective action frictions that get in the way of risk spreading. However, to achieve this objective, the state has to maintain the incentives for lenders to monitor projects efficiently, and to deter the borrower from excessive risk taking. This can be done by sharing the risk with the private sector.

1.3 Credit guarantees versus alternative forms of public intervention

Loan guarantee programs for SMEs expanded substantially in recent years, as governments responded to the financial crisis. Guarantee policy instruments have the potential to generate positive macroeconomic effects, meaning that the costs for the taxpayers due to default payments are outweighed by the positive stimulating effects of guarantees – such as on employment and tax revenue – for the economy. In addition, “new elements were added to some of these programmes, such as reduced red tape and more rapid provision (i.e. ‘express guarantees’ [in Belgium]), and new instruments were created outside traditional guarantee programmes” (OECD, 2014).

Credit guarantee programs continue to be “the most widely used instrument at governments’ disposal to ease SME access to finance” (OECD, 2015; see also OECD, 2017). Moreover, guarantees are “increasingly targeting young and innovative firms in an effort to boost employment

and value added” (OECD, 2016; see also OECD, 2017). If designed correctly, CGSs can increase overall welfare.

CGSs are preferred over alternative policy instruments, under certain conditions. Some studies have investigated the welfare effects of CGS policies and documented the superiority of CGSs compared to other instruments to alleviate welfare losses associated with credit market failures. Arping et al. (2010) examine the circumstances under which CGSs are socially preferred over government co-funding, using a moral hazard model in the spirit of Holmstrom and Tirole (1997). They conclude that from a welfare-maximising perspective, CGSs up to a certain size are preferred over government co-funding of investment projects. Government involvement in the establishment and funding of CGSs can also be motivated by resolving coordination failure between private-sector entities, which prevents them from pooling their resources.⁶

In addition, CGSs hold other advantages. First, the final lending decision remains with a market-based, private-sector entity –the bank–, which possesses the expertise and the necessary technology to evaluate credit applications and projects. This is likely to ensure a more efficient selection among borrowers than if the task is done by a public agency, since – given that the guarantee is partial – it leaves part of the risk with the privately operating lender. Second, compared to direct lending programmes, CGSs have much lower initial cash flow needs and as such have a leverage (or multiplier) component, which implies a more efficient use of public money.⁷ Therefore, they can also be used when fiscal constraints are tight. However, the small initial cash outlay of credit guarantee schemes also has disadvantages. Honohan (2010) notes that, as a large number of borrowers can be reached with only relatively small initial costs in the short run, political incentives exist for the public sector to supply guarantees generously. This might conceal the true long-term fiscal costs of a programme because of the uncertainty surrounding expected long-term losses on the guarantee portfolio, which can result in unexpected fiscal costs further down the road. Third, the provision of additional guarantees by a CGS increases the risk-taking capacity of the counterpart institutions. Finally, supranational CGSs can contribute to an efficient geographic distribution of credit, if the existence of cross-border information frictions related to national legal frameworks impede CGSs’ cross-border activities.⁸

The assessment of the existence of a causal impact of public CGSs generally proceeds by evaluating the existence of financial and/or economic additionality (OECD, 2013). These encompass the following:

⁶ Credit guarantees have been also successfully used during the crisis in parallel with other policy instruments supporting the financial system – such as targeted funding programs – to achieve synergies in alleviating the decline in credit supply.

⁷ Eslava and Freixas (2016) show that subsidised lending and credit guarantees can be equivalently efficient policy instruments in “normal” times. However, in their modelling approach, the lending instrument is preferred when banks are facing a liquidity shortage, while credit guarantees are more appropriate when banks are undercapitalised.

⁸ Our survey results indeed highlight that all existing CGSs choose to operate within the national borders of the country they are headquartered (see Chapter 2), which is a natural consequence of the public national mandate under which they operate. See chapter 2.3 for an overview of guarantee products provided by multinational sources (EU/EIF facilities).

- **Financial additionality.** This concept captures the incremental credit flow towards eligible SMEs that is attributable to the activity of the given CGS or CGSs. Financial additionality is thus the amount of lending that would not have happened without the guarantee. Establishing the counterfactual baseline is hence a prerequisite of proper measurement, but hard in practice. A number of studies examined the ability of public CGSs to generate financial additionality: Zecchini and Ventura (2009) adopted a difference-in-difference identification strategy to show that government backed guaranteed firms have higher leverage ratios than non-guaranteed, but otherwise similar firms. In addition, they benefit from lower financing costs. D'Ignazio and Menon (2013) illustrate that an Italian regional credit guarantee policy was effective in improving financial conditions for the beneficiary firms.
- **Economic additionality.** An alternative, indirect way to proceed is to assess the outcome of public CGSs on the economic performance of firms, instead of assessing the additionality of the financial flow itself. Economic additionality can be measured through the guarantees' impact on employment, investment, innovation, number of start-ups, etc. The ability of European public CGSs to generate economic additionality has been confirmed by Asdrubali and Signore (2015), among others. Based on an analysis of the Multi-Annual Programme for enterprises and entrepreneurship (MAP) EU SME Guarantee Facility and focussing on Central, Eastern and South Eastern Europe (CESEE) countries, the authors find significantly positive effects of the EU guarantee programme on employment and turnover of the beneficiary firms.

1.4 Design issues and best practices

Carefully designed guarantee products that are continuously evaluated have a greater potential to contribute to the achievement of public policy objectives. To come to an optimal design, several parameters have to be decided on. Mostly, these parameters will impact the prevalence of moral hazard in the relationship between the borrower and the lender on the one hand, or between the lender and the guarantor on the other.

- **Loss-sharing.** An important aspect of the guarantee agreement relates to the arrangements that distribute the losses in case of the borrower's default. Risk sharing arrangements are crucial to adjust incentives to minimise moral hazard from the lenders' side. Loss-sharing arrangement can relate to the principal amount but can also include interests due and/or fees. They can be made at the level of the individual loan, or alternatively, at the level of the portfolio. At the individual loan level, there are two types of loss-sharing arrangements: in case of a *pari passu* guarantee, the guarantee scheme assumes a fixed share of the loss, irrespective of its size. Proceeds of potential subsequent debt recovery are shared according to the agreed loss-sharing ratio. In case of a subordinate guarantee, however, recovered debt is first used to repay the lender. Only after the lender's losses have been fully repaid, the recovered amount will be used to refund the guarantor. At the portfolio-level, one can distinguish between first-loss portfolio guarantees and second-loss portfolio guarantees. In case of a *first loss* guarantee, the burden from defaults is fully assumed up to a predetermined tranche of losses, above which the guarantee scheme has no further

obligation. Under second-loss guarantee arrangements, as the name suggests, the guarantor commits himself to cover a second tranche of losses.

- **Coverage ratio.** The design and pricing of credit guarantee products should also ensure that the transfer of credit risk from the lender to the guarantor does not lead to excessive risk-taking. If the bulk of the credit risk is taken by the CGS, lenders do not have incentives to carry out proper risk screening and credit monitoring (Honohan, 2010). Moral hazard issues between the lender and the guarantor can be minimised by deciding on the appropriate coverage ratio, which determines the share of the loan that is guaranteed. This guarantees that all parties –the lender and the guarantor, as well as the borrower – retain exposure to potential losses to ensure the repayment of the loan. Some programs follow innovative distribution practices in which the available guarantee amount is auctioned with lenders bidding on the coverage rate, where the lowest bid guarantee rates are served first.⁹ This practice reduces moral hazard issues that might arise in the relationship between the lender and the guarantor (Honohan, 2010).
- **Guarantee assignment process.**¹⁰ CGSs can be distinguished according to the role the scheme has in the guarantee assignment process. Three broad types of schemes exist which regulate the relationship between CGSs, banks and SMEs and establish the tasks undertaken by the scheme: retail, portfolio and wholesale guarantee systems. In *retail* guarantee systems, CGSs typically examine the eligibility of firms, assess the risk of credits on a case by case basis, and decide whether the guarantee will be granted. Assessing the credit risk on individual basis typically implies high administrative costs. Retail-type guarantees are more common among mutual schemes. In *portfolio* guarantees, the decision to grant a guarantee is not assessed on an individual basis. Rather, the decision of whether a guarantee is granted is based on some common characteristics such as the volume of the loan, a minimum level of creditworthiness based on financial statistics, the intended use of the funds and the geographic location of the firm or its industrial affiliation. This regime typically entails lower administrative costs. In *wholesale* guarantee systems, there is no direct relationship between the CGS on one side and the borrower and lender on the other. Typically, the role of CGSs is to provide counter-guarantees for nonbanking intermediaries, often micro-credit institutions. In fact, in the case of micro-credit, transactions costs implied by retail or portfolio assessment may be relatively high.
- **Credit appraisal.** Credit appraisal and debt recovery can be assigned to either the guarantor or the lender. In practice, it is the latter party that is usually made responsible for assessing the creditworthiness of the borrowers, as they often have the required infrastructure available (Gozzi and Schmukler, 2015). The same holds true for the debt recovery process. Although it is generally considered the most cost-effective solution, assigning these processes to the lender can be associated with an increase in moral

⁹ The Chilean CGS FOGAPE, for example, determines coverage rates through an auction. During the auction, which occurs several times per year, institutions can acquire guarantee rights. Guarantee rights are assigned to the bid with the lowest coverage rate (OECD, 2012).

¹⁰This paragraph is largely taken from OECD (2013).

hazard. It creates a principal-agency problem in its relationship with the guarantor as it might induce excessive risk-taking, or underinvestment in the credit-appraisal process itself.

- **Pricing.** Public CGSs, just like private CGSs, generate revenue through guarantee fees and administrative fees. In fact, many public CGSs strive for self-sustainability. Pricing is a crucial part of the guarantee design, as it affects the behaviour and incentive of borrowers. OECD (2012) lists two types of fee arrangements: up-front fees and annual fees. Guarantee fees should optimally be a function of the riskiness of the guaranteed project. The CGS should also determine who bears the guarantee fee, which can be either the borrower or lender. In addition, CGSs can charge administrative fees to cover the administrative costs associated with the guarantee activities. Sometimes guarantees are offered that do not carry an explicit fee, but come with the condition that the guaranteed intermediary has to increase lending volumes. Hence, the guarantee carries an implicit price, as the lender is required to carry additional risk. To ensure the public guarantor's efforts reach the final beneficiary, the scheme can contain provisions that the guarantee only kicks in after a predefined threshold is reached. Guarantee fees can moderate excessive use of guarantees on loans that would have been granted even in absence of a guarantee arrangement, and therefore act as a first step towards ensuring additionality.
- **Collateral requirements.** In practice, external guarantees and collateral are often used side-by-side on the same loan, as having some 'skin in the game' through partial collateralisation can reduce the borrower's incentive to default. However, guarantees will not fulfil their policy role in broadening credit supply if they are used excessively as complementary protection on an already collateralised loan. Contractual stipulations containing caps on the level of collateralisation and the cost of taking up a guarantee can contribute to a balanced use of guarantees in combination with existing collateral and ensure that guarantees generate additional lending. Moreover, in the case of a *pari passu* guarantee, recoveries from (additional) collateral need to be shared with the guarantor.
- **Other operational characteristics.** We cannot go into all details of guarantee schemes, but rather mention some additional operational characteristics that are relevant for the efficiency of a CGS. For example, an efficient and transparent claim management process that also provides appropriate incentives for loan loss recovery is important to build and maintain lenders confidence (World Bank, 2015). The precise circumstances under which a claim can be made should be clearly articulated in the contractual agreement between the CGS and the lender. The trigger conditions for claims should, for example, specify the maximum period after a missed payment. Lenders, however, should proactively explore alternative solutions, including rescheduling, to receive payment from the SME borrower.

2 SME credit guarantees in Western Europe: an overview

- In many Western European countries CGSs play an important role in supporting SMEs' access to finance.
- Our survey among 18 CGSs¹¹ in the period October 2015 – May 2016¹² shows that CGSs in Western Europe are typically publicly owned, non-profit, are active only in their home country, aim at alleviating collateral constraints, provide guarantees to banks and non-bank intermediaries, and manage their risks through government and EU counter-guarantees.
- The key multinational credit guarantee provider active in the region is the European Investment Fund (EIF). In addition, the EIB is increasingly deploying new “risk sharing” products.

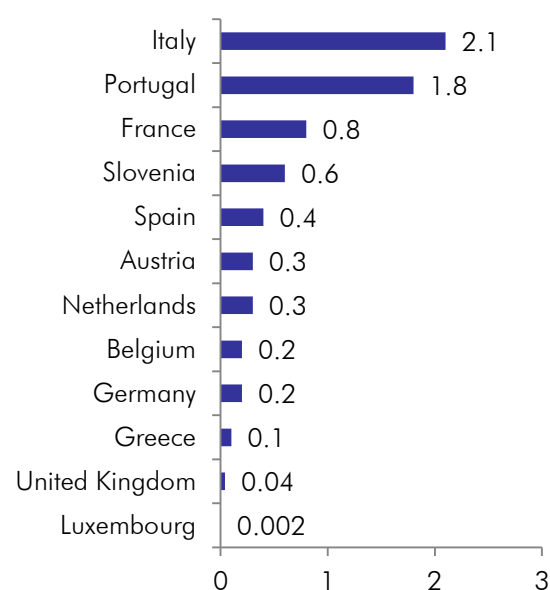
2.1 The size and importance of credit guarantee activity in Western Europe¹³

CGSs are an important pillar of financial intermediation in Western Europe. Credit guarantees are provided by national/local organisations and on a supranational level by the EIB Group, mainly through the EIF.

Aggregate data on the activity of national/regional CGSs is collected by the AECM from their individual member organisation. In the 18 countries covered by the EIB/EIF surveys, AECM has 21 member organisations in 12 countries.¹⁴

In 2015, the outstanding 2.03 million guarantee contracts in Western Europe represented a total value of EUR 68bn. In terms of total amounts of guarantee activities, the core countries are Italy (EUR 33.6bn), France

Figure 1: Outstanding volume of credit guarantees as a percentage of GDP



Source: AECM (provisional statistics), Eurostat

¹¹In some cases, the CGS survey covered credit guarantee organisations that are associations or network organisations, which have more than one credit guarantee institutions as members. The most prominent example is Italy, where 2 organisations were surveyed, of which one has more than 200 guarantee schemes as members. Hence, our statements (including numbers and shares of responses) are typically based on the number of responding organisations (including umbrella organisations) rather than on the number of credit guarantee institutions. We do not apply any weighting.

¹²See Annex 1: Description of the surveys for further details.

¹³This chapter relies heavily on Kraemer-Eis et al. (2016a).

¹⁴Detailed information about AECM members is also available on the AECM website www.aecm.eu, and in particular here: http://aecm.eu/wp-content/uploads/2017/04/AECM_member-fact-sheet_overview_.xlsx

(EUR 16.7bn), Germany (EUR 5.6bn) and Spain (EUR 4.1bn). Italy also accounts for half of the total number of outstanding guarantees (1.05 million), followed by France (705 000) and Portugal (89 000).

Compared to the volume of economic activity, guarantees are the most important in Italy, Portugal and France. Figure 1 shows that in these countries, the guarantee coverage exceeds, or is close to 1 percent of the GDP. According to the OECD (2013), guarantees are most relevant “in those countries where a network of local or sectoral guarantee institutions is well-established”.

In addition to the national institutions, the EIB Group also contributes to the supply of credit guarantees through portfolio guarantees, counter-guarantees to other CGSs and securitisation products. The outstanding volume of EIF’s portfolio guarantees and counter-guarantees in Western Europe for 2016 amounted to EUR 8.5bn. In addition, the outstanding volume of SME-related securitisation activities reached 2.8bn. See 2.3 for further details.

Box 1: A word of caution regarding the interpretation of the results

When interpreting the information and data provided in this report, it has to be kept in mind that the guarantee systems are very different in each country. For example, the Italian mutual guarantee (“confidi”) system, which is the largest in Europe, is formed of more than 200 mutual credit guarantee schemes that differ with respect to their territorial and industry coverage. It is based on a two-layer system, in which the first (local) layer ensures that the system benefits from the specific knowledge of its local members, while the second layer allows for risk sharing across the local CGSs; banks can by-pass this second level by applying directly for a guarantee from a state supported guarantee fund (OECD, 2013). In contrast, there are systems (e.g. in Denmark) that are centralised at the national level and implemented by a public institution, which provides also a broader range of other financing products.

Although our survey provides a lot of information that highlights differences (and similarities) of the different CGSs in Western Europe, we cannot cover all characteristics in this report. As far as AECM member organisations are concerned, detailed overviews are available on the AECM website (www.aecm.be). Moreover, OECD (2013) provides a general overview of guarantee systems around the world. Recent information on guarantee activity is given in OECD (2017) and Kraemer-Eis et al. (2016b).

2.2 Key characteristics of the national credit guarantee institutions

This section provides a detailed characterisation of the CGS sector in Western Europe, based on the outcome of a survey carried out among CGS institutes operating in Western European countries.¹⁵ The descriptive data is categorised along six dimensions: general information, outreach, services, pricing and coverage, claims, and risk management. Where possible, the results are contrasted with the analyses from Beck et al. (2010), and the earlier publication on CGSs in the CESEE region (EBCI, 2014). The key findings are summarised in Box 1, which presents the features of a “typical” CGS in Western Europe.¹⁶

Box 2: Characteristics of a “typical” credit guarantee Scheme in Western Europe	
General information	<ul style="list-style-type: none"> Established in the mid-1990s, it usually provides credit guarantees, often together with other financial services. Publicly owned, legally established as Private Corporation, and is tax exempt. Capitalized upfront, with no explicit restriction on leverage. Non-profit, <i>without</i> an obligation to be self-sustainable. Provides guarantees to domestic markets only, does not own a banking license, and is regulated by national financial authorities or other government agencies.
Outreach	<ul style="list-style-type: none"> Targets SMEs, following the EU definition. The primary motivation is to alleviate lack of collateral and increase lending. Uses guarantees, beneficiaries and jobs created as indicators for the operational performance, and default rates and portfolio at risk as indicators for the financial performance. Conducts economic additionality study on regular basis, but not necessarily a financial additionality study. Operations increased during the crisis, with sunset clauses and additional funds.
Services	<ul style="list-style-type: none"> Offers guarantees to banks, leasing companies and other financial institutions, with borrowers applying directly at the intermediaries, where they are informed about the guarantee. The guarantees are mainly for working capital, investments, and trade finance. Guarantees are considered on a loan-by-loan basis, and there is mandatory time period for processing the requests.
Pricing & Coverage	<ul style="list-style-type: none"> Fees are paid by the borrower and are based on the loan amount. Coverage is between 34% - 81% of principal and for 10-15 years. Allows lenders to require collateral, which can exceed the loan amount. Appraises loans based on the business plan and internal scoring system.
Claims	<ul style="list-style-type: none"> The trigger is non-payment or insolvency, with a single payment upon validation. The loss-recovery principle is <i>pari passu</i>, with recovery pursued by the lender. The lender’s rights are subrogated after payment.
Risk management	<ul style="list-style-type: none"> Counter-guarantees provided by the State or the EU (e.g. through EIF).

¹⁵For a detailed description of the survey, see Annex 2: Survey questions.

¹⁶Note: The box reports the median response of the survey questions, or the mode, where applicable, capturing the notion of the term “typical”.

Most CGSs are either partially or completely tax exempt. Only five CGSs are taxed as normal corporations. This is consistent with the fact that the vast majority of them are publicly owned and serve a public policy objective. The two CGSs that were privately owned are tax exempt (Figure 4). In France and Italy – countries in which several CGSs are present – privately-owned guarantors are operating under preferential tax conditions. With respect to taxation and self-sustainability, Western European CGSs appear to be quite different from the ones in the CESEE region (EBCI, 2014). In the latter study it was reported that two thirds of schemes in CESEE are fully taxed and more than half operate under a self-sustainability requirement. It is also noteworthy that in the CESEE region state-owned guarantors generally enjoyed preferential tax treatments, a finding which does not carry over to the Western European.

None of the CGSs are profit-oriented. All institutes are non-profit, and half of those are not required to be sustainable (Figure 5). About three quarter of the CGSs are capitalised upfront to be able to bear the losses, and a majority of them have not needed their capital to be topped up in the past (Figure 6).

Almost all CGSs limit their activity to the domestic market. All but one institution in the Netherlands exclude firms operating outside of the national borders of the country in which they are headquartered from their scope. According to our survey this is mostly due to legal or statutory reasons. Only one guarantee provider listed business reasons as a limiting factor to constrain their activity to the domestic market.

Figure 4: Ownership and tax status

Ownership	Private			FR, IT
	Mixed	PT	AT, SP	DE
	Public	BE, SI, IT, FR	BE, AT, GR	IE, BE, NL, FI, DK
		Fully taxed	Partially taxed	Exempt
		Tax status		

Source: CGS survey

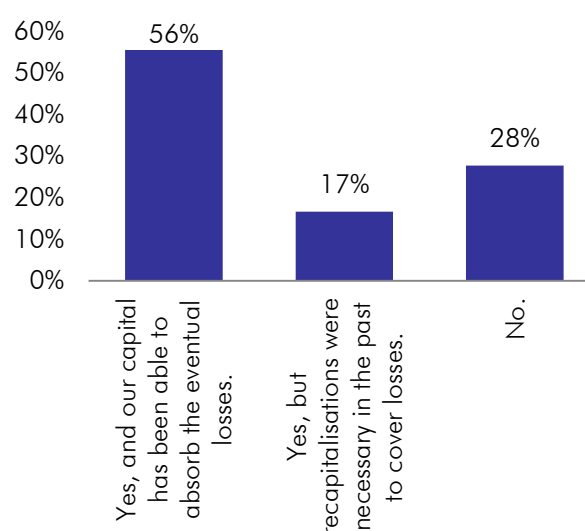
Figure 5: Tax status and profit orientation

Profit orientation	Non-profit	SI, BE	BE, AT, SP, GR	FR, IT DK, BE
	Non-profit sustainable	FR, IT, PT	AT	IE, NL, FI, DE
	For-profit			
		Fully taxed	Partially taxed	Exempt
		Tax status		

Source: CGS survey

Figure 6: Upfront capitalisation

Is your organisation capitalised upfront with respect to its guarantee activity?

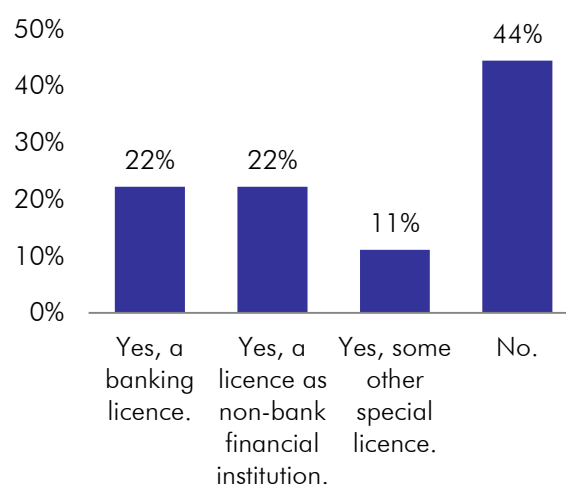


Source: CGS survey

The background of CGSs from the viewpoint of banking regulation shows a very heterogeneous picture. More than half of the entities in the sample operate under some special licence (Figure 7). In some cases, it is a regular banking licence, or a licence for non-bank financial institutions. The allocation of the supervisory authority over CGSs also shows significant variation across CGSs. It can be allocated to the national financial supervisor, to the central bank, but in some other cases it lies with other government agencies.

Figure 7: Operating licence

Is your institution required by law to have banking or other special licence for guarantee operations?



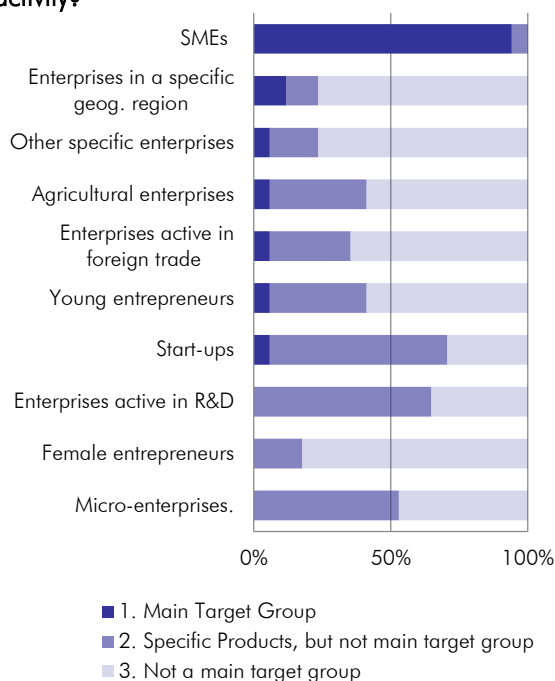
Source: CGS survey

Outreach

CGSs typically tailor their products to SMEs in general. Products targeting specific subsets of SMEs are common, but generally do not constitute the core business. All but one survey participant stated their guarantee activities explicitly target SMEs (Figure 8). While a significant amount of CGSs replied that they also target specific subsets of SMEs as core activity, the different target groups were rather diverse. For example, only two CGS organisations reported that they mainly target local enterprises, e.g. companies established in a specific geographic region. Other SME subgroups that are specifically targeted are agricultural enterprises; enterprises active in foreign trade; young entrepreneurs; and start-ups. All these sub-groups are targeted by at least one CGS. However, many CGSs do offer products specifically tailored to certain types of SMEs, even though they do not consider them as core business. Among the most popular are products tailored to start-

Figure 8: Target groups

Which types of borrowers are targeted specifically by your institutions' guarantee activity?



Source: CGS survey

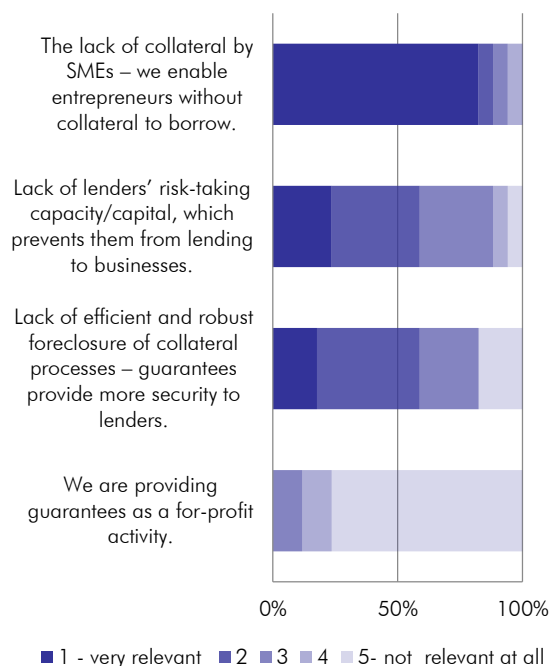
ups (offered by more than 70 percent of CGSs) and enterprises active in R&D (65 percent). Also, micro-enterprises have proven to be a common target group (53 percent).

The key rationale for intervention is to alleviate the collateral constraints faced by SMEs. When asked for the *raison d'être* for their activities, 83 percent of CGSs responded their most important motivation was to alleviate collateral restraints faced by SMEs (Figure 9).¹⁸ In addition, 60 percent of CGSs claimed that increasing lending to businesses by overcoming lenders' risk aversion, or to hedge against the risk of delayed foreclosure on collateral are also important, but secondary reasons behind their activities. Profit does not seem to play an important role as driving motive. By and large these results are in line with the findings in EBCI (2014).

The most important outcome to be achieved, according to the great majority of CGSs, is to increase lending to SMEs. On the one hand, CGSs reported they aim to achieve an increase in SME lending along the extensive margin: 88 percent of respondents replied they want to increase the number of SMEs that have access to external finance. On the other hand, the second most reported answer was an increase in SME lending along the intensive margin: 71 percent of CGS respondents reported they aimed to increase the quantity of credit available to each individual SMEs (Figure 10). Lengthening the maturity structure and/or lowering the financing costs are considered to be secondary objectives, or not considered at all. These results – which are also consistent with the responses on the rationale of activity, illustrated in Figure 9 - are again in line with the EBCI (2014) survey.

Figure 9: Rationale of activity

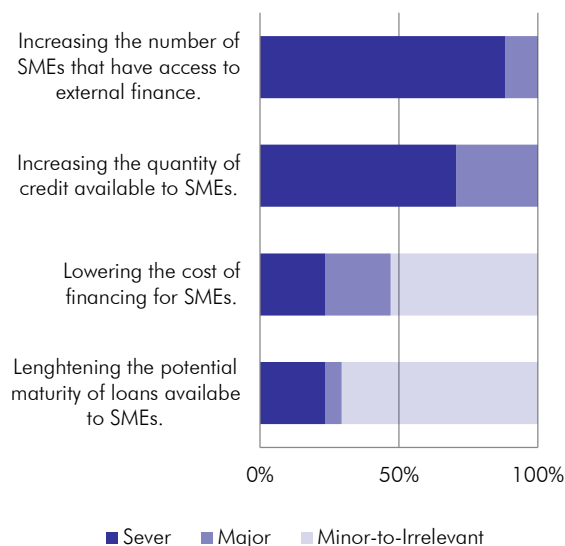
Which of the reasons below describe the rationale(s) of your organisation's activity as a guarantee provider?



Source: CGS survey

Figure 10: Desired outcomes

What are the outcomes that you are aiming to achieve through your activity?



Source: CGS survey

¹⁸ See also section 3.5: The use of collateral in combination with guarantees

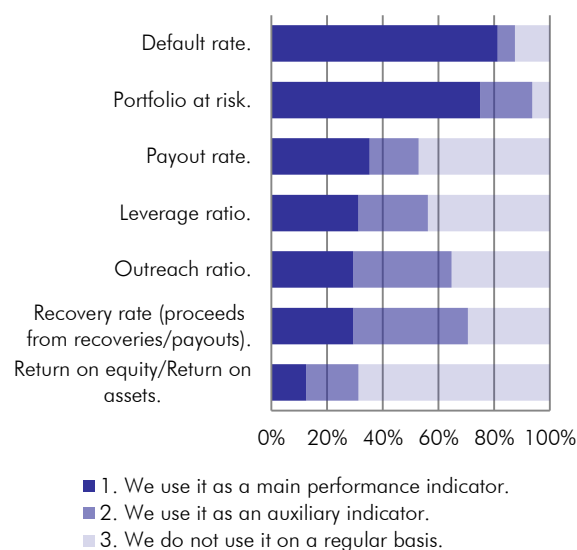
To measure their financial performance, CGSs most often use default rates and portfolio at risk as their main evaluation metrics (Figure 11). Some institutions in the sample preferred to use other indicators such as pay-out rates (value of pay-outs/outstanding guarantee volume). A minority of the survey participants use the leverage ratio (outstanding guarantee volume/equity), the outreach ratio (loans guaranteed/outstanding guarantee volume) or the recovery rate (proceeds from recoveries/payouts) as their main evaluation metric to assess financial performance, and these indicators are also often specified as auxiliary indicators of the financial situation. Return on equity or assets are rarely used as main performance indicators.

CGSs assess their operational performance based on volume metrics. Almost all schemes reported that the number of beneficiaries and the number of guarantees issued are the most often used indicators of performance evaluation (Figure 12). More than half of schemes also track the number of jobs created. However, to assess their impact, CGSs generally assume they generate additional lending, and do not require the lenders to provide supporting evidence to certify the additionality.

Yet, a large number of CGSs claim to assess financial and economic additionality either on an ad-hoc or a regular basis. When asked about how they assess the impact of their activity, about 40 percent of the institutes reported they assess economic additionality on a regular basis (Figure 13). For financial additionality, the results are similar. Little more than 20 percent of the respondents reported to have conducted such exercises only on a one-off basis. These answers are in odds with the results published in EBCI (2014), which suggested that the overwhelming majority of

Figure 11: Measuring financial performance

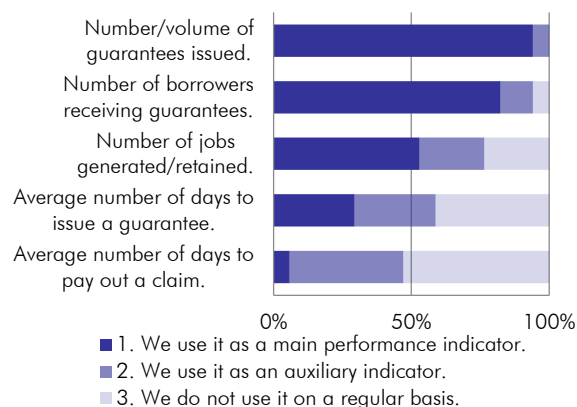
Does your institution use the indicators below to regularly assess the financial performance of its guarantee operations?



Source: CGS survey

Figure 12: Measuring operational performance

Does your institution use the indicators below to assess operational performance?



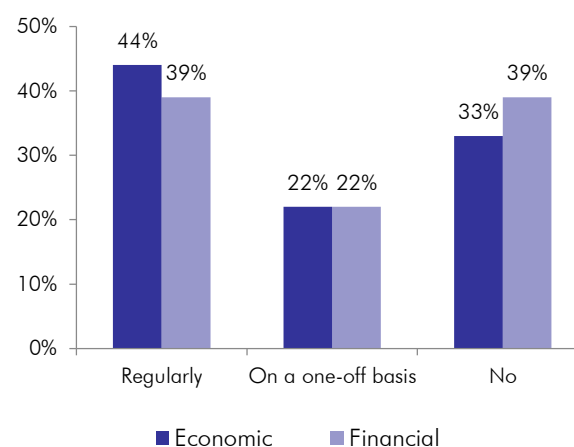
Source: CGS survey

the institutions in the sample did not assess it explicitly. Our survey does not provide us with information on the exact methodology and the overall quality of the additionality assessments carried out by Western European CGSs.

Half of the CGSs require the lenders to provide proof of additionality. A straightforward manner to obtain information on the additionality of credit guarantees is to ask the guaranteed lenders directly. The survey results show that only 50 percent of the surveyed CGSs require the lender to certify the additionality of the guarantees they receive (Figure 14). Given that all CGSs that participated in the survey have some sort of public mandate (Figure 3), this is surprisingly low. Interestingly, the percentage of CGSs that do not require the lender to certify loan additionality exceeds the percentage of CGSs that do not evaluate additionality, implying some CGSs evaluate additionality on an indirect basis, for example through impact assessment analysis. However, such assessments can be rather resource-intensive, which might explain why not all CGSs perform these analyses.

Figure 13: Evaluating additionality

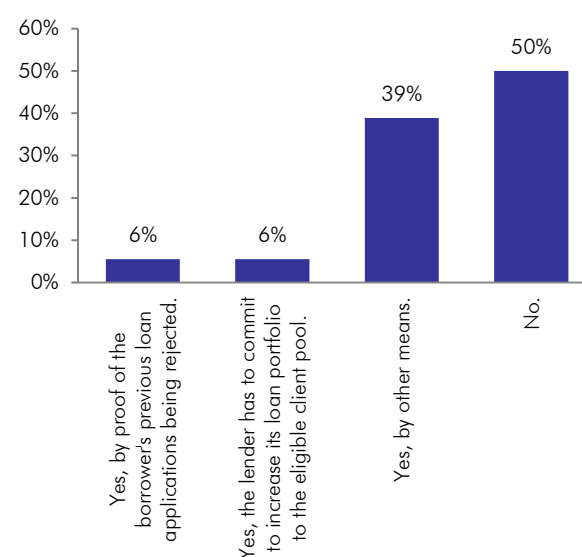
Does your institution measure the economic/financial additionality of its credit guarantee activity?



Source: CGS survey

Figure 14: Ensuring additionality

Does your institution require the lenders to certify somehow the additionality of the guaranteed loan?



Source: CGS survey

Services

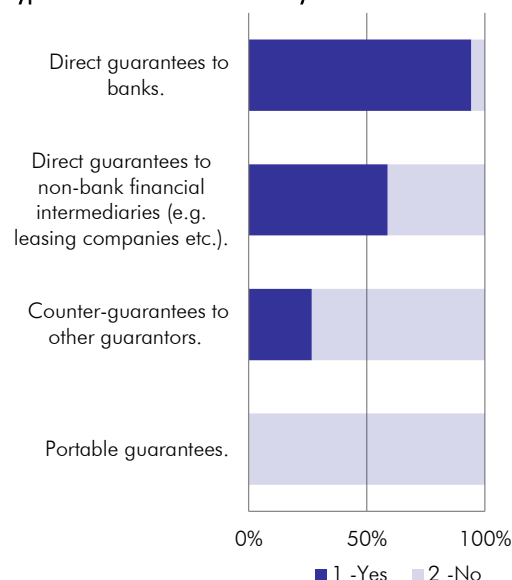
Although the majority of CGSs provide guarantees for bank loans, many institutions also provide guarantees to non-bank intermediaries. More than half of the survey respondents provide direct guarantees to financial intermediaries such as leasing companies (Figure 15). More than a quarter of the CGSs also provide counter-guarantee services to other guarantee providers. None of the CGSs in the survey reported to provide portable guarantees.¹⁹ On the contrary, such guarantees are offered in the CESEE region: according to EBCI (2014), portable guarantees were present in the product palette of 11 percent of the responding CGS organisations.

All CGSs offer guarantee products targeting investment loans, and nearly all offer products for working capital financing (Figure 16). Guarantees for leasing, trade finance or supply chain finance are slightly less popular, but are still available in the portfolio of the majority of the CGSs. Certain institutions also provide guarantees for mezzanine/subordinated financing, or equity, although the survey results do not provide information about the importance of such products in terms of volumes. Interestingly, the survey results suggest that specialisation in a specific type of guarantee products occurs more frequently if more than one CGS is active in a country.

CGSs operating in Western Europe typically provide guarantees on an individual loan basis, and less for a portfolio of loans. More than 50 percent of CGSs reported to offer guarantees on individual loans. About 17 percent of the CGSs provide credit guarantees to portfolios of loans. Another 30 percent of

Figure 15: Final beneficiaries

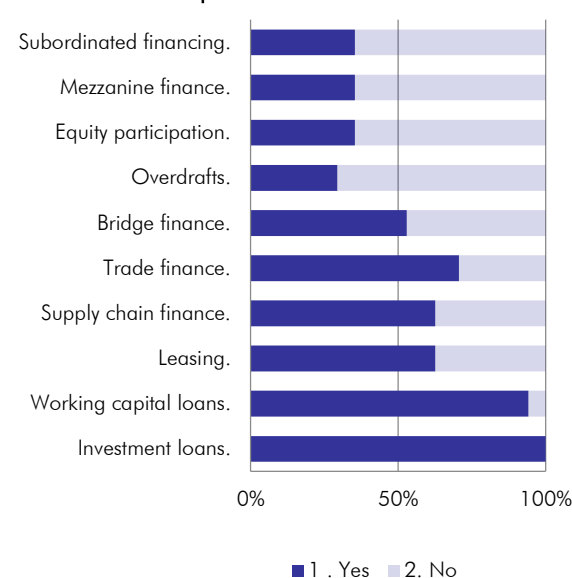
Does your institution offer the following varieties of guarantees, differentiated by the type of the final beneficiary?



Source: CGS survey

Figure 16: Underlying financial products

Does your institution guarantee the following loan or financial products?



Source: CGS survey

¹⁹Portable guarantees are flexible guarantee arrangements that allow the borrower to choose among various possible lenders and in some cases to transfer the guarantee from one lender to another.

the CGSs offer both (Figure 17). These results are in line with the finding reported in Beck et al. (2010) and the EBCI study (2014): in both cases the provision of guarantees on an individual basis was the dominant method. A key difference, however, is that unlike institutes in Western Europe, none of the schemes in the CESEE region provided guarantees exclusively on portfolio basis.

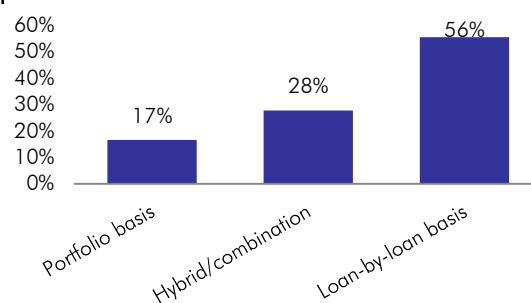
Among all eligibility criteria, the single most important binding condition is the size of the enterprise. Other than this, CGSs use a range of other criteria whose applicability varies according to the guarantee product (Figure 18). As mentioned earlier in the subsection on the CGSs' mission, many CGSs offer products only to local SMEs. This is reflected in the survey results presented in Figure 18, which illustrates that half of the schemes set special eligibility criteria related to geographical limitations. Also the other eligibility requirements contained in the survey appeared to be relatively common.

More often than not, the lending institutions, rather than the CGSs, are the borrower's first point of contact. Only six CGSs reported that borrowers have the option to apply directly to them, as well as to the lender. Cases in which borrowers exclusively contact the CGSs are very rare, and these are typically related to guarantees covering trade finance. All CGSs also reported that borrowers are aware when their loan falls under a guarantee agreement. This is because lending institutes are often legally obliged to report this to borrowers.

Most CGSs have a mandatory time limit to process guarantee requests, with a varying range of processing time. When asked whether they uphold a mandatory time limit to process guarantee applications, almost 60 percent of CGSs provided an affirmative answer, with a typical time period of one to two weeks. For the remaining 40 percent no specific time limit applies (Figure 19).

Figure 17: Portfolio vs individual guarantees

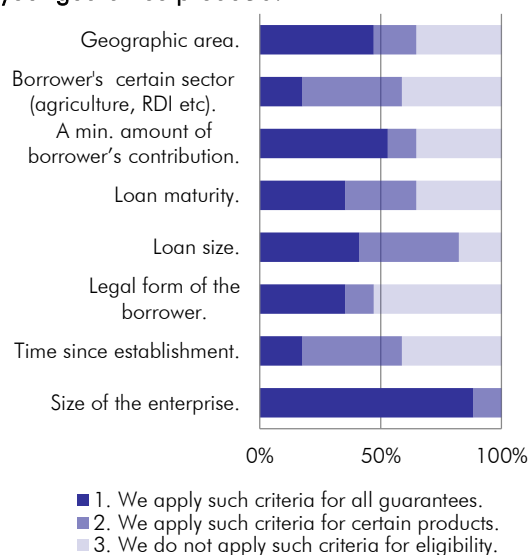
What type of guarantees does your institution provide?



Source: CGS survey

Figure 18: Criteria for eligibility

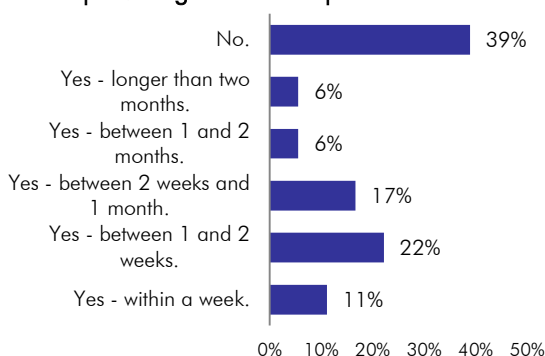
What type of eligibility criteria do you apply for your guarantee products?



Source: CGS survey

Figure 19: Time to process applications

Does your institution have any mandatory time limit to process guarantee requests?



Source: CGS survey

Pricing and coverage

With regards to pricing, guarantee fees almost always depend on the loan size, and more often than not, on the risk profile of the borrower, too. More than half of the schemes reported to take the riskiness of the underlying loan into account in their pricing policy (Figure 20); in other cases, the risk analysis might also determine the guarantee amount. The large majority – about 80 percent – of schemes do not explicitly reward positive repayment history of guaranteed loans with better-priced guarantees in the future. On the other hand, penalty prices for delinquent borrowers are a rather common practice, as many CGSs – 60 per cent – indicated that failure to repay may result in higher guarantee charges, or the rejection of guarantee applications in the future.

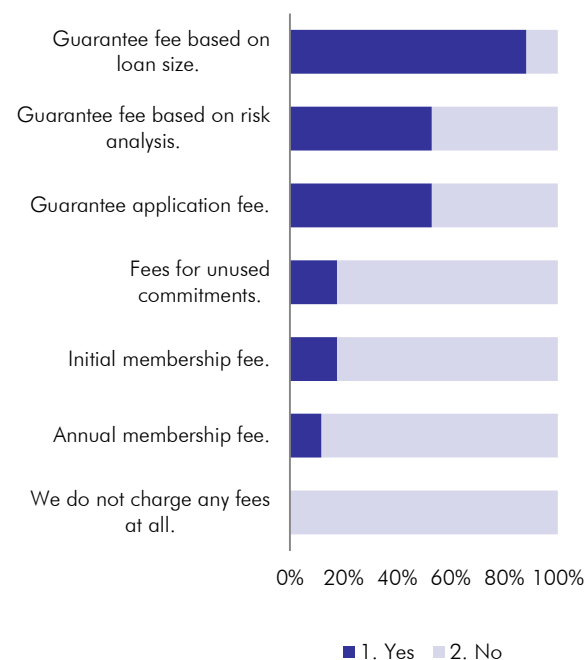
In the majority of the cases the burden of the guarantee fees falls on borrowers. Fees are only rarely paid by the lender and sharing the fee payments between the borrower and the lender is also uncommon (Figure 21). Moreover, the actual burden of the fee payment might still be passed on to the borrower.

The coverage ratios of CGSs offered in Western Europe vary significantly. The average of the minimum coverage ratios in the sample amounts to 34 percent, whereas the average of the reported maximum coverage ratios amounts to 81 percent. The responses vary significantly, from as little as 5 percent of the loan amount, to a full coverage of 100 percent (Figure 22). The heterogeneity among CGSs appears greater than what was found for the CESEE region (EBCI, 2014), but in line with the study of Beck et al. (2010).

There are also large differences in the flexibility CGSs apply to the coverage ratio of

Figure 20: Types of fees

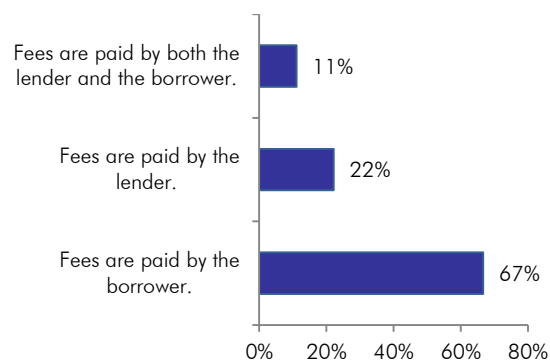
What type of fees does your institution charge to its clients?



Source: CGS survey

Figure 21: Collection of fees

Who pays the fees?



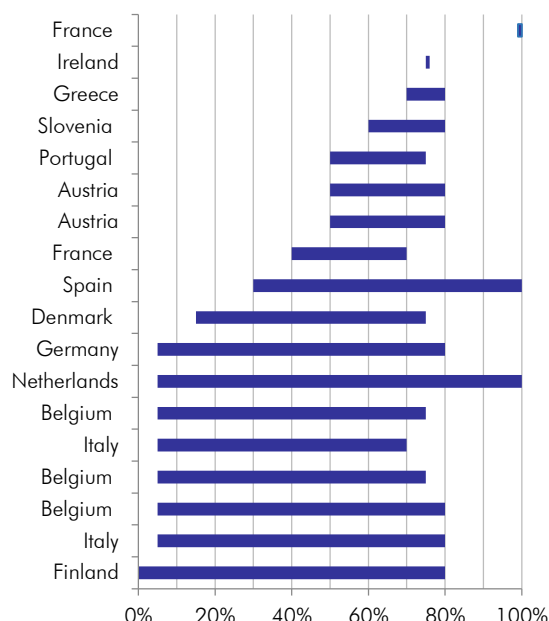
Source: CGS survey

their guarantee products. Certain CGSs are willing to offer any coverage ratio from 5 to 100 percent. Only the Irish and one French CGS in our sample use always the same rate (Figure 22). Three CGSs offer guarantees with full coverage. Such contracts are very rare in the CESEE region (EBCI, 2014). At a global scale they are more prevalent (Beck et al., 2010). The median maximum coverage ratio of 80 percent is in line with the 80 percent reported in Beck et al. (2010) and EBCI (2014).

The typical maturity period of guaranteed loans also exhibits some heterogeneity. The mode of the responses for the minimum maturity of loans eligible for a guarantee was less than a year. The mode of the reported maximum maturities was 10-15 years. Most commonly, CGSs can cover loans with a maturity of less than a year, but loans with very long maturities (15 years or more) are not uncommon as well (Figure 23). Certain CGSs seem to specialise on longer maturities only. Interestingly, the CGSs that reported the longest minimum maturities – 2 years and above – still did claim to provide guarantees for both investment and working capital loans. The heterogeneity in guaranteed loan maturity is in line with the EBCI (2014) report, in which the median maturity of the guarantee product provided for the SMEs was also in the same range.

Figure 22: Coverage

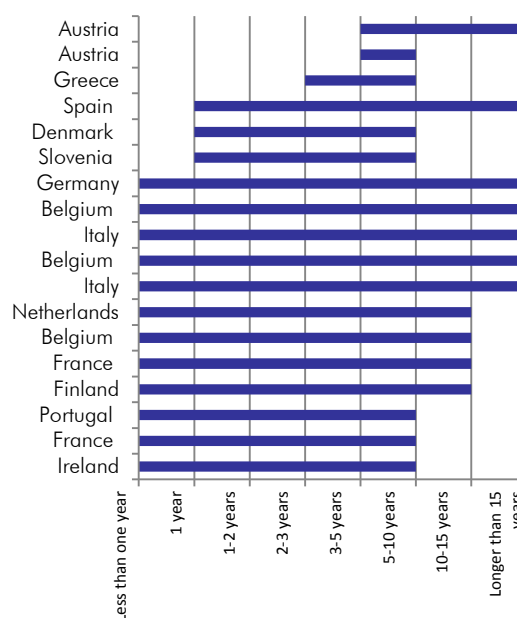
What is the minimum and maximum amount of coverage for your guarantee products?²⁰



Source: CGS survey

Figure 23: Maturity

What is the minimum and maximum eligible maturity of the loans that your guarantees cover?



Source: CGS survey

²⁰Each entry represents one CGS organisation, referred to by the country in which it is located. The Finnish AECM member did not provide a response to the question on the minimum coverage rate.

Claims

In most cases the lender is in charge of loan recovery, but the proceeds are shared with the guarantor. The guarantee is most often called at the time of default or soon thereafter. These are findings which are also common for the CESEE region (EBCI, 2014). The guarantee itself, however, typically does not come into effect unless the disbursements are made, and in some less common cases at the time of signature.

With regards to the repayment of guarantee claims, the most popular arrangement is an uncapped guarantee with *pari passu* (pro rata) sharing of the losses. Many CGSs, however, also offer capped guarantees (Figure 24). A minority of CGSs offer full (100 percent) coverage, and some also provide more complex products such as second-loss guarantees. These findings are in line with the results in EBCI (2014), where most of the schemes follow a *pari passu* principle.

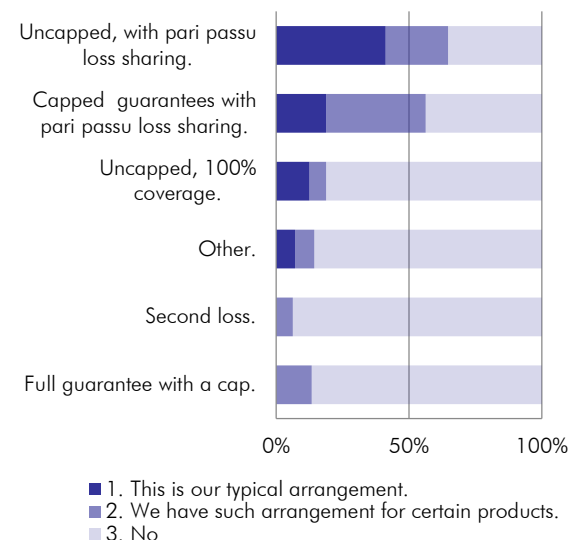
Risk management

When it comes to the appraisal of the guarantee applications, CGSs typically appraise the borrowers' guarantee applications themselves. This usually occurs after an initial credit assessment by the lender (Figure 25). Common sources of information to evaluate guarantee applications include the business plan of the SME, internal credit scoring systems, data from credit registries, and – to a lesser extent – on-site visits. About 70 percent of CGSs also reported having access to a centralised credit reporting system.

All schemes use risk transfer instruments, the most popular being counter-guarantees. The popularity of risk transfer mechanisms is in line with the findings of other studies, such as in Beck et al. (2010). Most of the CGSs in the

Figure 24: Loss sharing arrangements

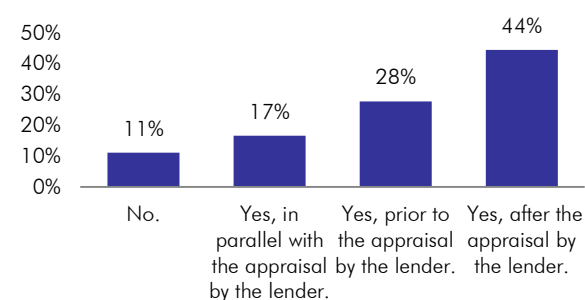
Does your institution offer guarantees with the types of loss sharing arrangements listed below?



Source: CGS survey

Figure 25: Risk appraisal

Does your institution appraise applications individually?

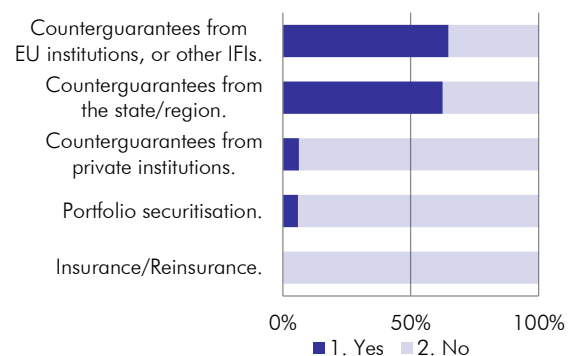


Source: CGS survey

survey, apparently, chose not to use market-based risk diversification instruments, such as portfolio securitizations. Instead, they rely principally on counter-guarantees offered by the state or by EU institutions (Figure 26).

Figure 26: Risk transfer

Does your institution use any of the risk management techniques listed below?



Source: CGS survey

2.3 Guarantee products provided by multinational sources (EU/EIF facilities)

The key multinational provider of credit guarantees is the EIF, which is part of the EIB Group.²¹ EIF provides counter-guarantees to the guarantee portfolio of the local CGSs. EIF also provides credit guarantees to a wide range of financial intermediaries on SME loans and leases. Counterparties include banks, leasing companies, promotional banks, and other financial institutions that provide financing to SMEs. In addition, the EIB is increasingly deploying new “risk sharing” products

The guarantee activity of the EIF encompasses “mandate” and “own risk” transactions or a combination thereof. In the case of mandate transactions the EIF manages and distributes the resources allocated to EIF by, for example, the European Commission, the EIB, countries or regions. In case of “own risk” transactions the EIF deploys its own capital. Most of the transactions fall into the “mandate” category. The EIF’s role is to provide either portfolio guarantees directly to local intermediaries (e.g. banks), or counter-guarantees to guarantee providers. Table 1 shows the volume of EIF’s guarantee business activity (outstanding signatures, and total financing made available to SMEs, i.e. outstanding leveraged volume) in the countries covered in this report.

Other than traditional credit guarantees, the EIF is involved in credit enhancement transactions. These securitisation transactions allow banks and financial institutions to diversify their funding sources, with the aim to providing regulatory capital relief through tranching credit risk transfer. These actions generate additional funding and/or release capital for those institutions that is then

Table 1: EIF’s guarantee and counter-guarantee activity in Western Europe as at end-2016 (EUR bn)*

	Outstanding signatures	Outstanding leveraged volumes
Austria	239	1,568
Belgium	150	1,075
Cyprus	77	159
Denmark	191	802
Finland	10	595
France	1,069	11,101
Germany	887	6,918
Greece	173	579
Ireland	63	230
Italy	1,476	15,030
Luxembourg	60	124
Malta	68	149
Netherlands	60	1,514
Portugal	445	1,193
Slovenia	17	359
Spain	3,093	13,380
Sweden	204	1,021
United Kingdom	101	510
Multi Country	144	291
Total Western Europe	8,527	56,600
<i>Memo: All EU</i>	<i>9,949</i>	<i>63,869</i>

Excludes activity related to ABS/Securitisation.

Source: EIF

*As of 31 December 2016. Figures comprise own risk transactions, activities under current mandates, and business that is related to initiatives under which new commitments can no longer be made (e.g. as it is related to mandates of the previous EU financial framework period).

²¹This section focuses on the EIF activities related to debt financing, and does not cover its other activities, such as equity financing.

redeployed for the provision of additional lending to SMEs. Table 2 shows the volume of the EIF's securitisation activity.

Within the mandates managed by EIF, portfolio guarantees and counter-guarantees for the benefit of SMEs can be provided under the following initiatives:

- Competitiveness of Enterprises and SMEs Loan Guarantee Facility (COSME LGF);
- EU Finance for Innovators SME Guarantee Facility (InnovFin SMEG);
- EU Programme for Employment and Social Innovation Guarantee Financial Instrument (EaSI GFI);
- EIB Group Risk Enhancement Mandate (EREM) Asset-Backed Securities (ABS) Credit Enhancement;
- Cultural and Creative Sectors Guarantee Facility (CCS GF);
- SME Initiative (SMEI); and
- The European Fund for Strategic Investments (EFSI), under COSME LGF, InnovFin SMEG and EaSI – see above.

In addition, EIF manages/coordinates various regional development and sector-specific initiatives, as well as the Deep and Comprehensive Free Trade Area (DCFTA) Initiative East (which is not available for the countries in Western Europe that are in the focus of this report). The details of the individual mandates and products can be found in Annex 3.

In addition, the EIB is increasingly deploying new “risk sharing” products. These are aimed to facilitate with counterparts - such as national and regional promotional banks and other financial intermediaries - financing of EIB eligible projects, such as investments into research, development, energy efficiency and renewable energy. The cornerstone of such products is to provide guarantees on debt financing which is necessary to fund the eligible new investments.

Table 2: EIF's securitisation/ABS activity in Western Europe (EUR bn)*

	Outstanding signatures	Outstanding leveraged volumes
Austria	347	993
France	27	136
Germany	414	5,364
Greece	29	57
Italy	748	2,208
Netherlands	100	300
Portugal	457	957
Spain	350	708
United Kingdom	364	1,252
Total Western Europe	2,835	11,975
<i>Memo: All EU</i>	<i>2,925</i>	<i>12,155</i>

Source: EIF

*As of 31 December 2016. Figures comprise own risk transactions, activities under current mandates, and business that is related to initiatives under which new commitments can no longer be made (e.g. as it is related to mandates of the previous EU financial framework period).

2.4 The regulatory environment

Credit guarantee institutions face a complex, and in many aspects heterogeneous regulatory environment. In the following, key areas of this environment are discussed. An extensive overview is also provided in a publication on CGSs for SME lending in Central, Eastern and South-Eastern Europe (CESEE), which was produced by the EIB Group on behalf of the EBCI Vienna Initiative; see EBCI (2014). Besides the treatment of credit guarantees in bank regulation and the state aid exemptions (as per the *de minimis* rules and the General Block Exemption Regulation) that apply to publicly funded CGSs in the EU, that synopsis also covered an overview of the relatively heterogeneous *national* financial regulation and supervision of CGSs, based on a survey of supervisory authorities and national financial regulators in CESEE countries. A similar survey has not been conducted for the preparation of this report, which is why we do not present related information here. In addition, developments on the treatment of state guarantees in the European System of National and Regional Accounts and its potential impact on CGSs can be found in EBCI (2014).

Credit guarantees in bank regulation.

Guarantees may provide regulatory capital relief for banks. In jurisdictions that follow the Basel III rules, guarantees may be treated as unfunded credit protection. As such, guarantees may allow financial institutions to apply lower risk weights to the covered exposures, and thus to reduce the value of risk-weighted assets used in calculating the capital adequacy ratio.

In the EU, the capacity of guarantees to provide capital relief is regulated by the CRDIV/CRR. EU Member states are subject to Directive 2013/36 (CRD IV) and the Regulation 275/2013 (CRR) which determines, among other issues, the way capital is allocated towards each exposure. In line with the idea of a single rulebook, the CRDIV/CRR rules are unified, and the scope for discretionary local regulations is strictly limited. The capital calculation rules – including the treatment of guarantees for this purpose – are described in a regulation that is directly applicable in all EU countries, resulting in a consistent interpretation across European jurisdictions. The European Banking Authority (EBA) provides useful guidance on the interpretation of CRD/CRR related provisions, contributing to a consistent interpretation of the legislation across the EU.

Credit guarantees are instruments recognized under the CRR as unfunded credit protection. The CRR describes two types of credit protection: *funded* and *unfunded*. Under unfunded credit protection, the reduction of the credit risk of the guaranteed claim is based on the obligation of a third party to pay an amount in the case of default by the borrower. The rationale for unfunded credit protection is based on the assumption that the credit protection provider faces a lower risk-exposure than the borrower, so transferring credit risk from the borrower to the provider of protection diminishes the lender's risk. Unfunded credit protection includes guarantees and credit derivatives: however, not all of them may be used in calculating capital adequacy.

To be eligible as credit protection under the CRR, the credit guarantee should fulfil a set of conditions. These conditions in principle relate to the nature of the issuer of a guarantee and the terms of the relevant guarantee. The CRR specifies who may be a recognized guarantee (or

counter-guarantee) provider of credit protection. These may be governments, central banks, local authorities, multilateral development banks (like EIB and EIF), international organizations, public sector entities, institutions, or rated corporate entities, among others.

Other conditions specified in the CRR relate to the features of the guarantee. In principle, guarantees should fulfil conditions for unfunded credit protection and be legally effective and enforceable in all relevant jurisdictions. The provided protection has to be direct and its scope has to be clearly defined and incontrovertible. The protection contract should not contain any clauses out of the creditor's control and especially cannot allow for the:

- cancellation of the protection unilaterally by the provider;
- increase of the effective cost of protection in if the credit quality of exposure deteriorates;
- non-payment in a timely manner if the borrower fails to make any payments due; and
- shortening of the maturity of the guarantee by the protection provider.

The conditions for credit guarantees should also specify (among other things) that:

- the instrument shall give the documented right to the bank to receive in a timely way payment from the guarantor on the qualifying default or non-payment by the counterparty;
- the payment by the guarantor shall not be subject to the bank's first having to pursue the obligor; and
- the guarantee should cover all types of payments of the obligor in respect of the claim, or if certain types of payment are excluded from the guarantee, the bank has to adjust the value of the guarantee to reflect the limited coverage.

The CRR contains additional provisions related to sovereign and public sector counter-guarantees, as well as guarantees provided by mutual guarantee schemes. Banks shall also introduce arrangements to reduce risk of excessive concentration of collateral in the form of guarantees. Besides, a bank should assure itself (by doing appropriate reviews) that guarantees are enforceable if they are issued by a provider from some other jurisdiction.

The CRR describes two approaches to computing the capital allocated against credit risk: standardised and internal ratings based (IRB). In both methods guarantees may be used to mitigate credit risk, thus allowing regulatory capital relief for a bank.

Banks can modify risk-weighted exposure amounts for credit risk by assigning to the secured part of the underlying exposure the risk weighting of the protection. The extent of reduction can differ by country and instrument. When guarantees are applied as credit risk mitigation, the exposure is typically divided into two parts: the guaranteed and the unguaranteed portion. The risk weight of the former will be equal the risk weight of the guarantor.

According to Art. 117 of the CRR, multilateral development banks confer a 0% risk weight to the guarantee portion. In other words, if a multilateral development bank was to provide an eligible guarantee on an exposure, the bank would not be required to keep any capital against that guaranteed exposure anymore. The risk weight relevant for the unguaranteed portion will be the one normally applying to the exposure, which depends on the asset type and the approach (standardised or IRB) employed by the bank.

The regulatory capital treatment of some guarantee products – such as first loss, capped, guarantees (FLCG) – is not fully homogeneous across Europe. First loss portfolio guarantees provide credit risk coverage up to a certain amount of the reference portfolio (cap amount), typically comprising the portfolio expected loss. The risk transfer benefit of FLCG is assessed by regulated banks by making sure the guarantee complies with articles 194 and 213 of the CRR.

Capital relief can also be achieved by resorting to synthetic securitisation. Art. 4 of the CRR specifies that 'securitisation' means a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranching, having both of the following characteristics: (a) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures; (b) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme. According to Article 242 of CRR, 'Synthetic securitisation' means a securitisation where the transfer of risk is achieved by the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator institution.

EIF is an established provider of guarantees to financial intermediaries in the context of synthetic securitisation of SME loans. Whilst not covering the first loss of the portfolio (i.e. the junior-most tranche), EIF can guarantee mezzanine tranches, allowing the financial intermediary to achieve capital relief.

Capital relief can be achieved if a significant credit risk is transferred to the CGS. Pre-condition for regulatory capital relief under the securitisation framework is that "significant risk transfer" (SRT) is achieved by the beneficiary of the guarantee. The SRT is regulated by Art. 243 and 244 of CRR and guidelines have been provided by the European Banking Authority (EBA) in this respect.

State aid regulation

Credit guarantees provided by public entities may also fall under state aid regulations. In principle, state aid to private companies is prohibited in the EU as it may affect trade between Member States or distort competition. If a Member State provides state aid, it must notify the European Commission so that it can assess whether the aid is compatible with the Single Market.²²

Certain categories of aid can be exempted from the notification requirement. The exemption can be achieved either under the so-called *de minimis* rule, which provide exemption for small amounts of public aid, or under the General Block Exemption Regulation (GBER).²³

The *de minimis* rule is based on the view that small amounts of aid are unlikely to distort competition. Different conditions apply to *de minimis* aid for general sectors ("*de minimis* regulation")²⁴, but also specific sectors (for example, agriculture,²⁵ and fishery and aquaculture²⁶),

²²See Articles 107(1) and 108(3) of the Treaty on the Functioning of the European Union (TFEU).

²³Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

²⁴See Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid.

²⁵Commission Regulation (EU) No 1408/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid in the agriculture sector.

with various thresholds under respective regulations. The general principle reflected by the *de minimis* regulations that aid granted per Member State to a single undertaking shall not exceed EUR 200,000 over any period of three fiscal years, without any specific approval process.

The General Block Exemption Regulation (GBER) exempts aid measures from prior notification if certain conditions are respected. GBER sets out the categories of aid and the conditions under which aid measures can benefit from an exemption from the requirement of prior notification to the European Commission. Consequently, Member States may implement measures which fulfil the conditions of the GBER without European Commission's prior scrutiny. GBER notably provides for exceptions from notification in the case of access to finance of SMEs, where aid is provided under certain types of financial support, including guarantees and loans, within an overall limit of the risk funding aid of EUR 15m per company and subject to certain conditions referred to in the GBER.

To clarify and simplify the state aid rules for state guarantees, the European Commission has adopted a Notice on state aid in the form of guarantees.²⁷ The main aim of the Notice on Guarantees is to provide additional guidance and legal certainty to Member States and stakeholders when assessing whether a guarantee contains an element of state aid or not. This assessment should be based on the Market Economy Investor Principle. According to this principle, a guarantee is free of aid when the state obtains a remuneration equivalent to the premium that a market economy operator would charge for an equivalent guarantee to an equivalent company. In this case, the state would act like any private investor operating on the financial market.

²⁶See Commission Regulation (EU) No 717/2014 of 27 June 2014 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid in the fishery and aquaculture sector.

²⁷See Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (2008/C 155/02).

3 Selected issues

- There is a robust demand for credit guarantees by financial institutions in Western Europe.
- Local CGSs are the main suppliers that satisfy the demand for direct guarantee products.
- Nearly all surveyed CGSs responded to the crisis by increasing their operations, most notably by guaranteeing working capital loans.
- For banks and CGSs alike, the main factor constraining the use of credit guarantees during the survey period (June 2015 – May 2016)²⁸ is the lack of credit demand by SMEs.
- Restrictive EU state-aid laws, on the one hand, and cumbersome administrative duties on the other are identified by CGSs and banks respectively as other serious impediments for the future expansion of their activities.
- Credit guarantees may be able to ease the need for collateral in SME lending, however, they are usually not able to perfectly compensate for the lack of collateral.

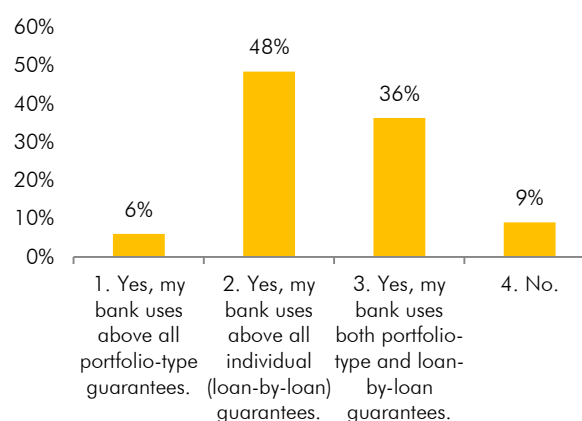
3.1 The use of SME guarantees by banks

According to our survey, most Western European banks have been using credit guarantees to support their SME lending activity, most often in the form of individual (loan-by-loan) guarantees. In total, 91 percent of the banks in the sample of our bank survey reported to have loans in their actual portfolio guaranteed by CGSs (Figure 27). Of these banks, 48 percent use individual guarantees, another 6 percent rely on portfolio guarantees, whereas the remaining 36 percent use both types of guarantee products. Only 9 percent declared not to use credit guarantees at all. The usage of guarantees in Western Europe seems to be more widespread compared to the CESEE region (EBCI, 2014).

While the use of credit guarantees is common practice, the significance of these in banks' overall SME lending activity is rather limited.

Figure 27: The use of guarantees

Does your bank currently use credit guarantees for individual loans or loans portfolios?



Source: Bank survey

²⁸Responses on the CGS survey were received from October 2015 to May 2016. Responses to the bank survey arrived from June to September 2015. See Annex 1: Description of the surveys for further details.

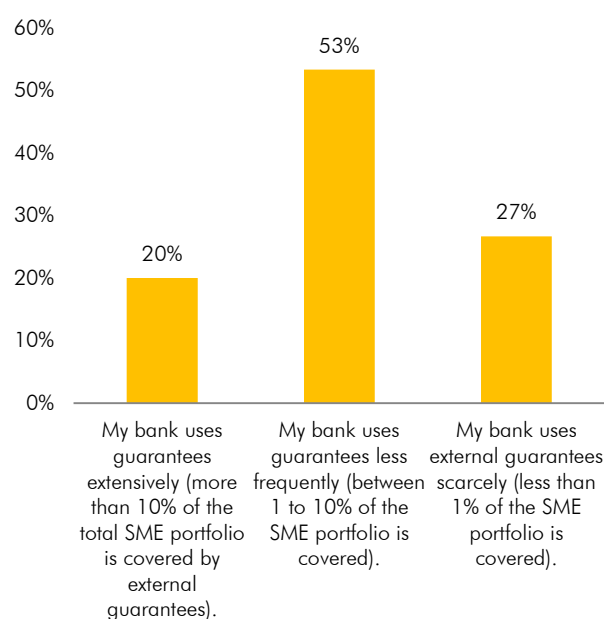
For 80 percent of the surveyed banks, the share of the SME loan portfolio covered by CGSs was below 10 percent (Figure 28). For 27 percent of the surveyed banks, this amounts to less than 1 percent. The latter banks are mostly operating in Nordic countries, Cyprus, UK and Ireland. Only 20 percent of the banks – operating in Portugal and Italy, Belgium and Greece – reported the guaranteed share of their SME loan portfolio exceeds 10 percent. These results are similar with the findings of the CESEE survey (EBCI, 2014), in which the most common guarantee coverage also ranged between 1 and 10 percent of the SME loan portfolio.

Most of the demand for credit guarantees in the Western European region is satisfied by local guarantors. Among the banks that actively use guarantees, more than half of them responded they only use credit guarantees issued by local (national, regional or mutual) institutions (Figure 29). One third of banks also use services by international CGSs, such as those provided by EIF. One bank, located in Cyprus, reported to exclusively use guarantees issued by international CGSs.²⁹ That most of the demand is met by local guarantors is consistent with our earlier finding that CGSs operate almost exclusively within the domestic boundaries of the countries in which they are headquartered (see section 2.2 – General Information).

Banks use credit guarantees mainly to compensate for the SMEs' lack of sufficient collateral, but the guaranteed loans' eligibility for regulatory capital relief is also an important factor. Almost 75 percent of banks reported the lack of sufficient collateral by SMEs to be a relevant driving motive to use CGSs (Figure 30). This is in general consistent with the view

Figure 28: The importance of guarantees

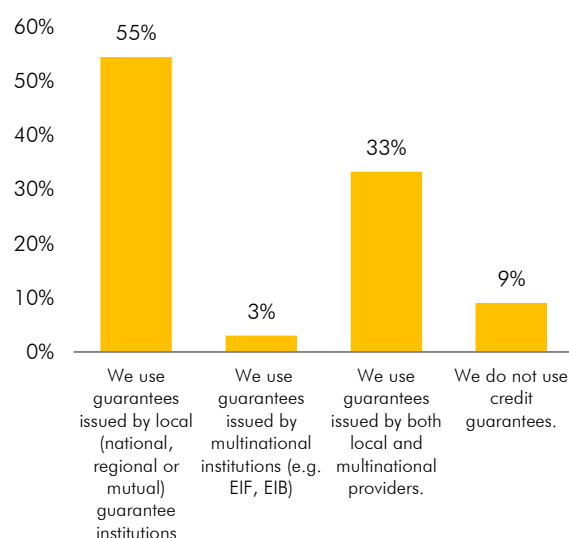
If your bank currently uses SME credit guarantees, how important is it in your SME lending activity?



Source: Bank survey

Figure 29: National vs. multinational guarantors

What types of institutions provide the SME credit guarantees that your bank uses?



Source: Bank survey

²⁹ Driven by the fact that there is no CGS operational in Cyprus.

that credit guarantees can alleviate collateral constraints. It is also in line with the CGSs' self-reported *raison d'être* (Figure 9; see also section 3.5). Around half of the surveyed banks also regard the ability to obtain capital relief as another important reason to guarantee their SME loans. For these banks the ability to obtain capital relief can be a motive as important as compensating for the lack of collateral. Other reasons, such as faster recovery proceeds or the possibility of lending to borrowers above credit limits are considered to be relevant only by a minority of banks.

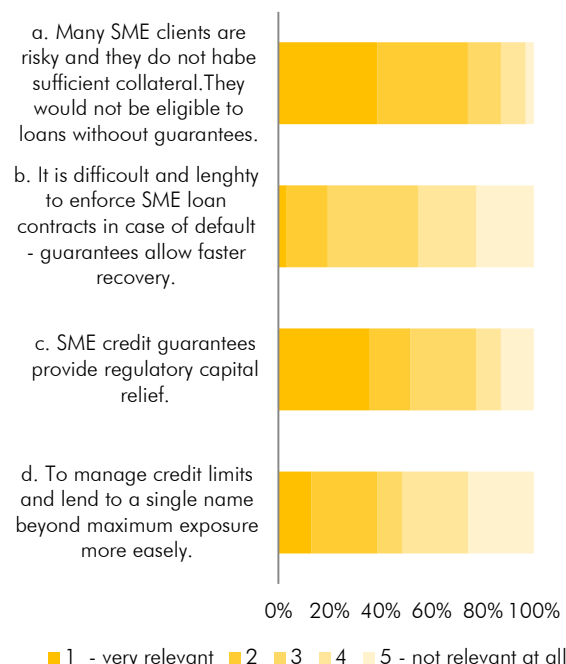
According to banks, there are many benefits that credit guarantees can bring to borrowers, the most important of which is the improvement in access to finance for SMEs with insufficient collateral. This opinion is shared by the CGSs themselves (see section 2.2 – Outreach). Other benefits, such as reducing borrowing costs, the ability of SMEs with risky projects to obtain finance or lower collateral requirements, were also reported to be relevant by a significant number of banks, although to a lesser extent (Figure 31).

According to banks, CGSs should offer a number of auxiliary activities in addition to providing loan guarantees. For example, about 70 percent of banks believe that guarantee providers should be advertising their products to SMEs directly. A similar percentage responded CGSs should offer advisory services (Figure 32). Moreover, 65 percent of the banks encourage CGSs to better inform clients about various financing options and around 40 percent of banks feel CGSs should collect and share credit risk information on SME clients. Relatively few banks (21 percent) believe that credit guarantee institutions should be involved in collateral collection.

Most banks believe that CGSs do not affect the probability of loan default. Close to 60 percent

Figure 30: Reasons for using guarantees

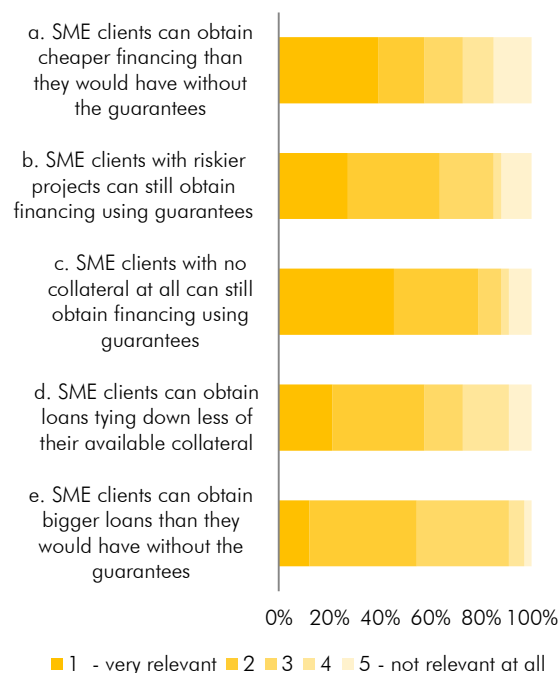
If your bank currently uses SME credit guarantees, what are the main reasons?



Source: Bank survey

Figure 31: Benefits of guarantees to clients

In your experience, what are the key benefits credit guarantees bring to your SME clients?



Source: Bank survey

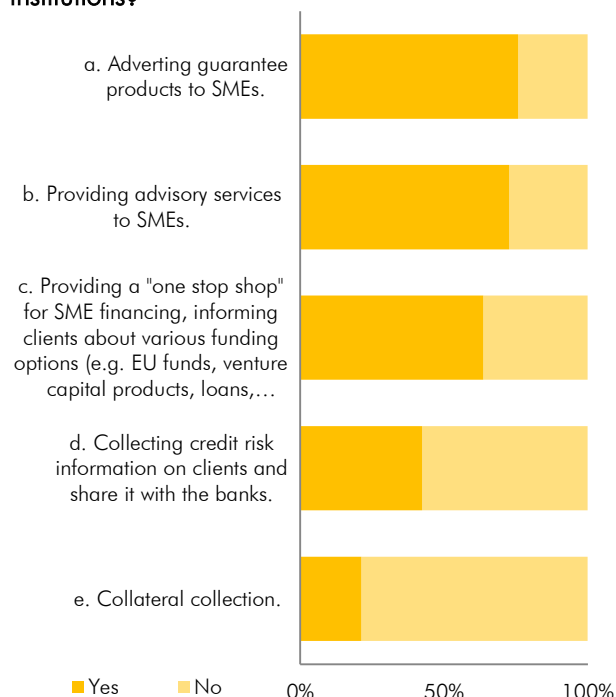
of them report that the default probability of guaranteed loans is no different than that of uncovered loans, which is consistent with the theory underlying the SME financing gap, i.e. that SMEs with economically viable projects do not get sufficient financing (see Chapter 1 for details). However, 35 percent of banks disagree and believe that guarantees do increase the probability of default. This could be explained, inter alia, by guarantees that are provided with the political aim to induce lending to enterprises/projects with a risk level that would not have been targeted before. Those banks that believe that the probability of default of guaranteed loans is actually lower than for uncovered loans are very few: only 6 percent of all respondents.

Financial institutions in Western Europe expect an increase in the popularity of CGSs over the near future. While the great majority of banks – more than 90 percent – has been using this instrument over the past 5 years, Figure 28 revealed that their usage is often limited to a relatively small share of the SME lending portfolio, which might imply that there remains a significant growth potential. Moreover, around 80 percent of the banking groups operating in the region expressed a clear interest to continue to manage or offload credit risk using credit guarantees (Figure 33).

There are frictions, however, that might hamper the effectiveness of credit guarantees and reduce the flow of lending for many SMEs. In section 3.3 we explore the factors constraining the use of credit guarantees in more detail.

Figure 32: Auxiliary activities

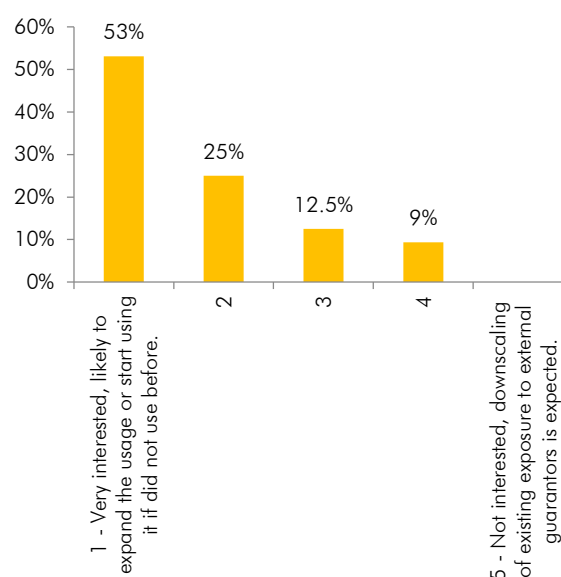
In your view, which of the following auxiliary activities should be done by credit guarantee institutions?



Source: Bank survey

Figure 33: Future demand

Looking into the future, what is your bank's expected interest in the usage of SME credit guarantee products for SME loans?



Source: Bank survey

3.2 The role of CGSs in alleviating the impact of the crisis

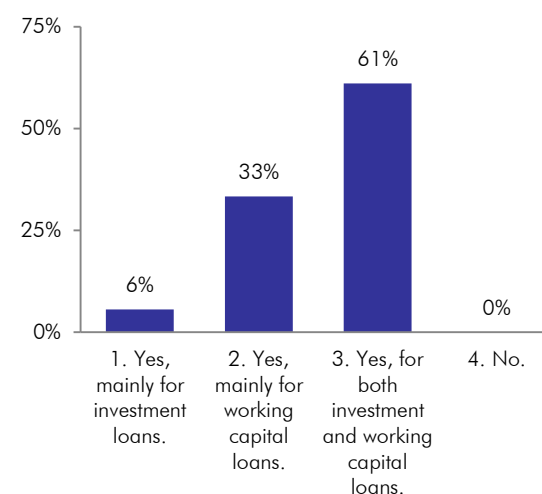
Public CGSs have been actively used to address the adverse effects of the crisis on SME credit availability in many countries (OECD, 2013). All respondents in our CGS survey, irrespective of their ownership or legal status, reported that they reacted to the crisis by increasing the supply of guarantees (Figure 34). Possibly in response to a demand shift, guarantee institutions increased supply more for working capital loans (94 percent of responding credit guarantee organisations), than they did for investment lending (67 percent). Only one CGS expanded its supply for investment loan guarantees only. This is in line with other market information, according to which the demand for guarantees, in particular on working capital loans, increased as a result of the crisis (Kraemer-Eis et al., 2014).

To increase supply in response to the crisis, the vast majority of CGSs needed additional capital. Fifty percent of the schemes acquired this additional budget on a temporary basis, while for 22 percent of CGSs the capital increase was permanent (Figure 35). A quarter of the surveyed CGSs were able to expand their activity with the capital they had available prior to the crisis. However, apart from additional capital, CGSs might also have received other financial means in order to increase the guarantee activity, e.g. in the form of mandates to be implemented on behalf of third parties.

CGSs that received a permanent capital increase mainly focused on expanding guarantees for working capital loans. Figure 36 shows that out of four CGSs whose capital stock increased permanently, three indicated this additional capital would serve primarily to expand guarantees for working capital loans. On the other hand, 7 out of 9 (or 78%) CGSs

Figure 34: Increase of activity as a response to the crisis

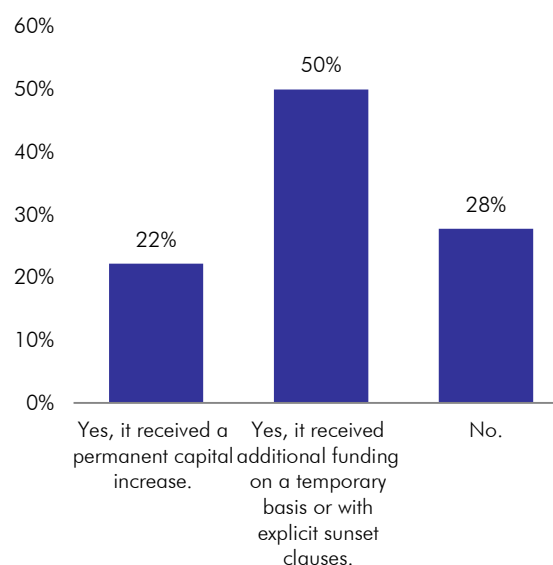
Did your institution's supply of guarantees increase as a response to the financial crisis?



Source: CGS survey

Figure 35: Additional resources

Did your institution receive additional capital during the financial crisis to increase its operations?



Source: CGS survey

Figure 36: Permanent/temporary increase vs

that received the additional funding on a temporary basis targeted both investment and working capital loans.

On aggregate, banks' report only a partial increase in the usage of credit guarantees as part of the response to the crisis. About 50 per cent of the financial institutions in our survey have reported an increase in their credit guarantee-covered lending in the recent years. The majority of these institutions reported a parallel increase in working capital and investment loan guarantees (Figure 37).

Nevertheless, our Bank survey reveals that credit guarantees played a more important role in crisis management in those countries which were affected the most by the financial turmoil. Banks operating in Portugal, Italy, Ireland, Greece and Spain report an increase in guarantee activity much more frequently than those financial institutions that operate in the countries that were affected less by the crisis.

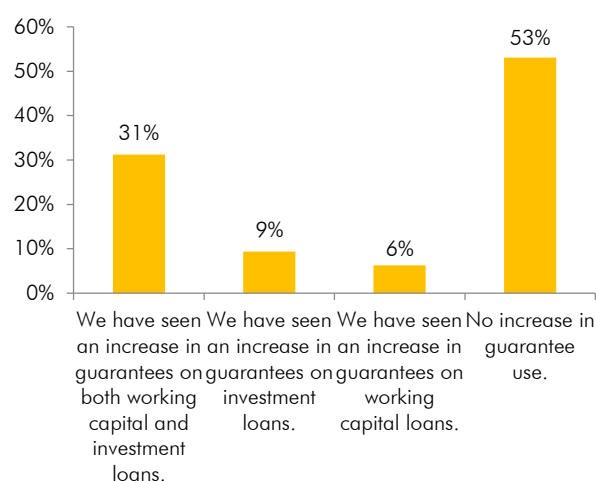
working/investment capital

	Yes, it received a permanent capital increase	Yes, it received temporary additional funding	No	Total
Yes, mainly investment			1	1
Yes, mainly working capital	3	2	1	6
Yes, both	1	7	3	11
No				
Total	4	9	5	

Source: CGS survey

Figure 37: Banks' response to the crisis

Has your banks' use of SME credit guarantees increased in the recent years?



Source: Bank survey

3.3 Factors constraining the credit guarantee activity

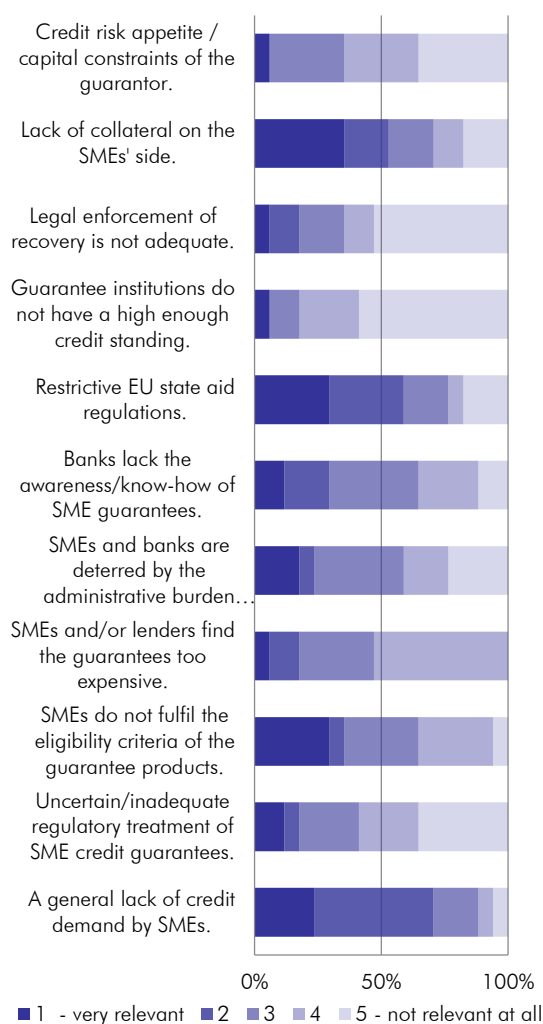
In our respective surveys, banks and CGSs were asked to identify the key constraints for the use of credit guarantees in their country. The general picture that emerged is that a majority of both banks and CGSs perceived a general lack of credit demand as a relevant constraining factor. Besides that, administrative obstacles (including, inter alia, eligibility criteria), EU state aid regulation and a lack of awareness and know-how about SME guarantees were also identified as constraints by a remarkable number of banks and CGSs. The importance of other factors is seen very differently by the banks and by the guarantee providers.

The most important constraint perceived by banks and CGSs alike is the lack of credit demand by SMEs. Looking at Figure 38 and Figure 39, we observe that close to 57 percent of the banks and 71 percent of CGSs, respectively, identified the lack of credit demand by SMEs as a constraint of severe or of major significance. This is consistent with a view that the observed sluggish credit growth in Europe is not only due to the lack of credit supply, but other factors affecting the real economy, manifesting in lower credit demand, are also of key importance.³⁰

Low demand for credit by SMEs is nearly tantamount to a lower credit guarantee activity since the issuance of credit guarantees is conditional on the demand for a loan. This in turn implies that activity by CGSs is in effect determined (or damaged) by any factor affecting the demand for credit by SMEs. Such factors, for example, may rely on purely

Figure 38: Relevant constraints mentioned by CGSs

What are the relevant factors that may constrain the use of credit guarantees in your country?



Source: CGS survey

³⁰The survey did not allow distinguishing between products across the risk spectrum. Hence, it is possible that the lack of demand only pertains to lower risk classes, but does not refer to more challenging projects. Moreover, the responses could also be interpreted as a general structural statement rather than a contemporary situation assessment, that is, stronger credit demand would always lead, ceteris paribus, to stronger guarantee activity. In this case, an interpretation of the current situation would be facilitated by repeating a similar survey in the future, since it would allow tracking the evolution of responses over time.

economic aspects (such as, SMEs' business plan or profitability measures) or on other possible constraints such as the lack of collateral or high borrowing costs.

Moreover, the survey results are in line with market information. According to these, demand for guarantees, in particular on working capital loans and bridge financing, had initially increased after the crisis (Kraemer-Eis et al., 2014), but subsequently weakened in at least some countries, e.g. Germany, partly explained by improved financing conditions and a movement towards the pre-crisis picture (Kraemer-Eis et al., 2015).

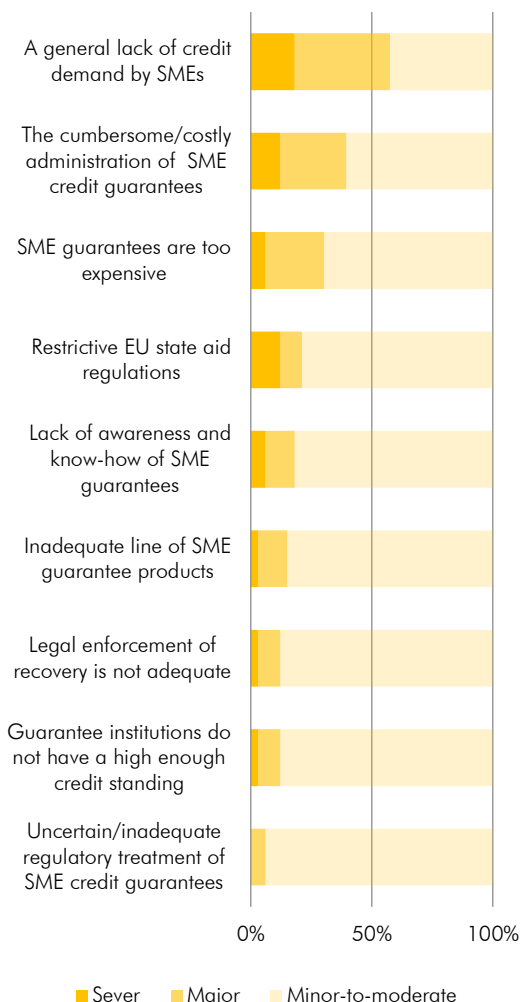
Other constraints – such as uncertainty regarding regulatory issues – were identified by banks and CGSs as less significant. Both surveys reveal that regulatory issues, such as the legal enforcement of recovery proceeds or the uncertain or inadequate regulatory treatment of SME credit guarantees, were considered by both parties as secondary to some of the other constraining factors. Finally, the two surveys show that factors such as the low credit standing of CGSs or the risk appetite of the banks have also minor role to play. Overall, this outcome of our survey goes against the findings in CESEE region: according to the EBCI (2014) report the regulatory treatment of credit guarantees was the most important obstacle for banks and CGSs alike.

Beside the general lack of credit demand, CGSs perceive the EU state aid regulation as a constraint of major importance. In particular, nearly 60 percent of CGSs responded that restrictive EU state regulation is a severe-to-major constraint. We also observed that 21 percent of the banks believe this to be a relevant constraint.

SMEs' lack of collateral is also considered to be an important constraint by many CGSs. Given that the main objective for most CGSs is

Figure 39: Relevant constraints mentioned by banks

What are the relevant factors that may constrain the use of SME credit guarantees in your country?



Source: Bank survey

to alleviate the SMEs' credit constraints that stem from the lack of collateral, it is surprising to see the collateral constraint as a limiting factor for guarantee activity. We look into this particular issue in more detail in section 3.5.

Another constraint that is ranked highly by CGSs is the issue of eligibility. Close to 35 percent of CGSs identified eligibility criteria as a constraint of severe-to-major importance. Guarantee products are accessible only to a narrow range of clients and the product parameters exclude potential clients that do not fit into the specific criteria.

For banks, the administrative procedures related to credit guarantees is a key factor that hinders significantly the use of credit guarantees. Nearly 40 percent of the banks suggested that the cumbersome or costly administrative procedures, which are typically associated with credit guarantees, is the most important constraint after the general lack of credit demand by SMEs. Among the CGSs themselves, 24 percent believe that administrative burden is a relevant factor.

Some banks believe that guarantee products are too expensive and their high costs hinder their development. About 30 percent of the respondents of our Bank survey claimed the cost of credit guarantees is a serious impediment for increasing guarantee-based lending. In contrast, less than 20 percent of the CGS respondents indicated that the cost of guarantee products was a relevant. Relative to the banks, CGSs seem to underestimate the importance of the cost of credit guarantees to the overall cost of financing. A comparable disagreement – both in the role of administrative burden and in the importance of the price of the guarantees – was also found in the EBCI (2014) survey. However, in the current environment of low interest rates other cost elements, such as the guarantee fee, have increased in importance for the borrowing decision.

3.4 Regulatory capital relief

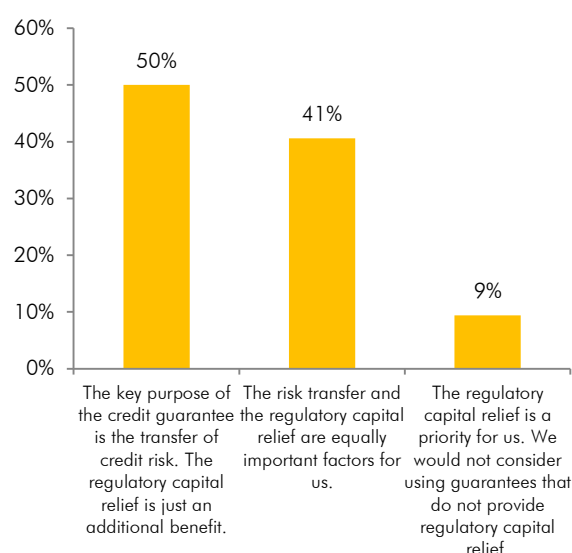
Beyond risk transfer, guarantees are also relevant for beneficiary banks as instruments of capital management. Under the Basel III framework, and its European implementation governed by the Capital Requirements Regulation and Directive (CRR/CRD IV), banks are allowed to diminish the regulatory capital requirements for loans covered by guarantees. The conditions for obtaining capital relief are set out in the CRD/CRR framework and, where applicable, the related technical standards of the European Banking Authority (EBA). The implementation is performed by the relevant banking supervisory authorities. A more detailed description of the prudential rules governing the capital relief associated with guarantees can be found in section 2.4.

This feature of credit guarantees is potentially becoming more important in the post-crisis environment. First, many European banks have been facing significant capital write-offs due to crisis-related losses in the past years. Second, as a result of tighter prudential regulations, capital requirements increased, too. In such an environment characterised by scarcity of bank equity, instruments allowing the lowering of capital needs become increasingly attractive.

Our survey confirms that according to the banks, the capital relief component is an important characteristic of the guarantee products. Figure 40 shows that half of the credit institutions in the sample believe that obtaining regulatory capital relief is as important as the risk transfer. It is somewhat lower than in the case of banks operating in CESEE, as documented by of EBCI (2014), where two-third of the banks answered that the capital relief is at least as important as the risk transfer element. When looking at the answers by country, the regulatory capital relief is particularly important for banks in Belgium, Greece, Portugal and Slovenia, and to a lesser

Figure 40: The importance of regulatory capital relief

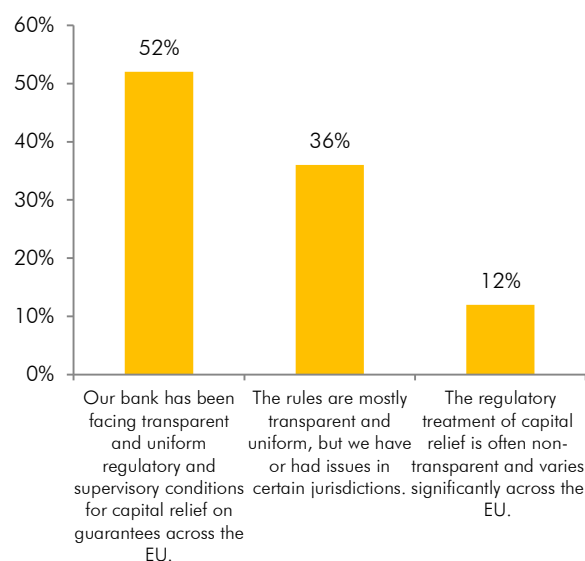
How important is it for your bank to obtain capital relief to SME credit guarantees?



Source: Bank survey

Figure 41: Uniformity of rules governing regulatory capital relief

In your experience, how transparent and uniform is the treatment of SME credit guarantees from the viewpoint of regulatory capital relief within the EU?



Source: Bank survey

extent also in Austria and Italy.

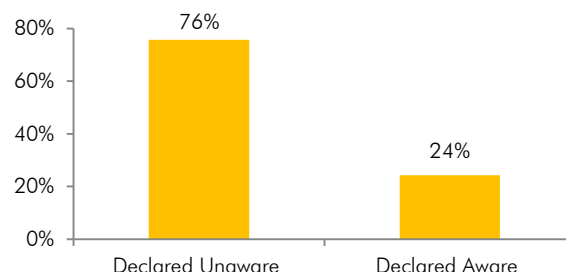
While half of the banks believe that the rules governing capital relief are transparent and uniform, another half report that they have been facing ambiguities in the past in this respect. When Figure 41 is compared to the corresponding data in EBCI (2014), it appears that the banks' perception of the uniformity of the regulatory treatment of guarantees is better in Western Europe than in CESEE.³¹

About a quarter of the institutions reported concrete obstacles that may prevent them to obtain capital relief for certain guarantee products (see Figure 42). Several institutions mentioned that conditions in the guarantee agreement that allow the guarantor to withdraw from the contract under certain circumstances to be an impediment for the guarantee to qualify for capital relief. Also, some banks mentioned ambiguity/complexity with respect to the regulatory treatment of capped (first-loss) portfolio guarantees as a source of uncertainty. Yet another issue, specific to Italy, relates to the mutual guarantee schemes. These are not always recognised as supervised entities, therefore their guarantees may not be eligible for capital relief.

It seems that the national guarantee institutions are also aware of the importance of the capital relief component of their products. According to their survey answers, almost three quarters of the guarantees offered are eligible for providing capital relief to the beneficiary banks (Figure 43).

Figure 42: Obstacles of obtaining capital relief

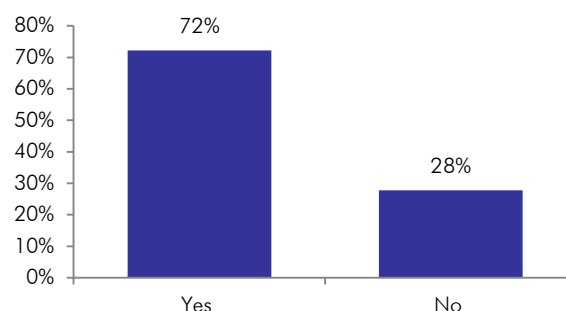
Are you aware of any obstacles - regulatory requirements or other - that have prevented or may prevent your bank from obtaining regulatory capital relief for SME credit guarantees?



Source: Bank survey

Figure 43: Capital relief eligibility

Do your institution's guarantees qualify for regulatory capital relief for the beneficiary banks?



Source: CGS survey

³¹The results of the bank surveys need to be read taking into consideration that the regulatory regime at the time of the survey was new. In 2013, the EU introduced the so-called CRD IV package, comprising the Directive 2013/36/EU (Capital Requirements Directive, CRD) and the Regulation (EU) No 575/2015 (Capital Requirements Regulation, CRR). The survey in the CESEE countries was conducted in the first half of 2014, i.e. at a time at which the surveyed banks might have had only relatively little experience with the use of guarantees under the new regulation. Moreover, CESEE countries outside the EU do not have to apply the CRDIV/CRR. However the results of the CESEE survey indicated that some of them use a similar concept (EBCI, 2014).

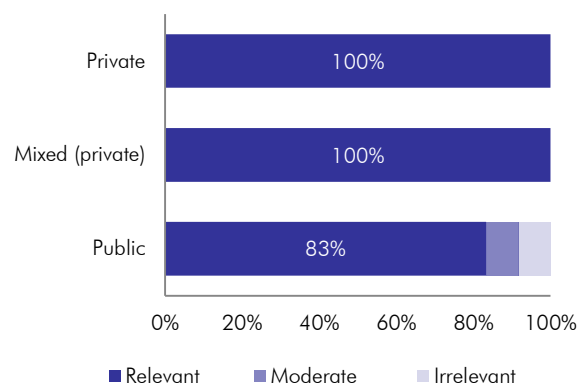
3.5 The use of collateral in combination with guarantees

From a theoretical perspective, the market failure in SMEs' credit market, driven by SMEs' lack of collateral, is an important reason for the existence of public CGSs. This is highlighted³² in the theoretical literature on CGSs (see Chapter 1) and is consistent with the survey results, in which an overwhelming majority of CGSs indicated that enabling collateral-constrained entrepreneurs to borrow was a relevant *raison d'être* for their institution – see Figure 9. This holds true for both public as well as mixed- and privately-run institutions (Figure 44). Nearly all respondents indicated that addressing SMEs' lack of collateral is a relevant driver for their guarantee activities. One single CGS claimed it not to be a relevant driving factor. Surprisingly, this CGS was publically owned.

Also from the banks' side, addressing the lack of collateral among SMEs is an important motivation to use credit guarantees. Seventy-four percent of responding banks indicated it to be the main *raison* to use CGSs – see Figure 30 in Section 3.1. Compensating SMEs' lack of collateral was considered to be more important than regulatory capital relief (51 percent). Banks believe compensating for SMEs' lack of collateral is the most important benefit guarantee provision brings to their clients – see Figure 31 in Section 3.1. Seventy-eight percent of banks reported that enabling SME clients with no available collateral at all to obtain financing is a key reason to offer credit guarantees, while 57 percent of banks responded that credit guarantees allow SMEs to tie down less collateral than they otherwise

Figure 44: Compensate for the lack of SMEs' collateral as a *raison d'être* by ownership type

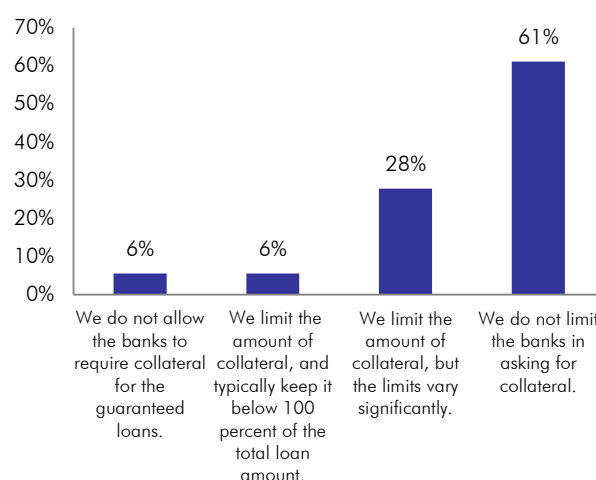
Which of the reasons below describe the rationale(s) of your organisation's activity as a guarantee provider?



Source: CGS survey

Figure 45: Limits to collateral

Does your CGS limit the lenders in asking collateral from the borrowers for the guaranteed loan?



Source: CGS survey

³²The need for alleviating collateral constraints is also confirmed by the 2016 edition of the EIB Investment Survey (EIBIS) of the EU corporate sector. As part of the survey, companies have been asked whether they are satisfied with various aspects of external finance. Among the various dimensions, collateral requirements were attracting the lowest level of satisfaction, with only 72% of the respondents being satisfied with the collateral requirements, followed by the cost of finance (73%), the amount obtained (83%), maturity (86%) and the type of finance (86%). See www.eib.org/eibis for more information.

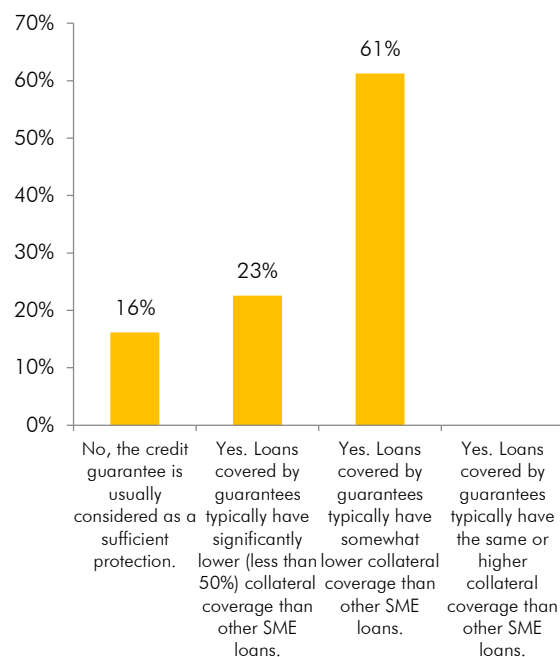
would need to when obtaining a non-guaranteed loan.

While addressing SMEs' lack of collateral clearly is an important *raison d'être* for CGSs, full collateral relief is generally not a binding requirement in the contractual arrangements between the CGS and the banks. The great majority of institutes reported that lenders maintain the freedom whether or not to ask for additional protection in the form of collateral (Figure 45).³³ A coverage rate below 100 percent is often put in place to provide incentive to the lender to conduct sufficient screening activities. Lenders will therefore still require complementary protection and ask borrowers to pledge some collateral to hedge the non-guaranteed part of the loan. In this context, the survey indeed revealed that a number of institutes (34 percent of respondents), while not prohibiting the banks to ask for collateral all together, put limits on the coverage rate of the collateral demanded. This is line with the results from the EBCI (2014) report, where CGS schemes in CESEE region also allow lenders to ask for additional collateral protection.

While CGSs typically do not formally oblige banks to lower collateral demands, the use of guarantees does seem to reduce collateral requirements for SME lending. Regardless of the fact that 61 percent of CGSs do not impose formal obligations to reduce collateral requirements, all banks in the survey report that SMEs with guarantee-covered loans are granted lower collateral coverage requirements (see Figure 46). Twenty-three percent of banks lower collateral coverage demands significantly (<50 percent of loan amount). Sixteen percent of banks consider the guarantee as sufficient protection and do not ask the borrowing SME to pledge additional collateral.

Figure 46: Collateral requirements SMEs

Does your bank typically ask for any collateral for loans covered by SME credit guarantees?



Source: Bank survey

³³Exception to this was an institute in Spain, which explicitly forbids lenders to ask for collateral.

4 Conclusions

Credit guarantee schemes are a widely used public policy instrument in Western Europe to address the SME financing gap. The gap in credit supply for small and medium-sized companies is generally caused by the presence of information asymmetries in external financing markets. Among different policy instruments to mitigate the adverse impact of the recent financial crisis on the supply of external financing to SMEs, CGSs hold a number of advantages and can lead to significant welfare improvements. Several empirical studies have found evidence that the use of CGSs brings about economic and financial additionality.

The Western European credit guarantee sector is well developed, but activity is unevenly distributed across countries. Relative to the size of the economy, credit guarantee activity is strongest in Italy and Portugal. Activity in all other Western European countries lags well behind. Noteworthy is the underdevelopment of the credit guarantee sector in Greece, a country in which SMEs face pronounced difficulties in access to finance (Kraemer-Eis et al., 2016a). In light of our survey results, which highlighted the absence of cross-border CGS-activity, this leaves room for supranational financial institutions to improve the allocative efficiency of SME financing in general, and credit guarantee products in particular. The key multinational credit guarantee provider active for SMEs and mid-caps in the region is the EIF. In addition, the EIB is increasingly deploying new “risk sharing” products.

CGSs in Western Europe are typically publicly owned, non-profit, and are active only in their home country. Their main purpose is to alleviate collateral constraints by providing guarantees to banks and non-bank intermediaries. They manage their risks through government and EU counter-guarantees. They are often tax exempt and are typically capitalized upfront, with no explicit restriction on leverage. They use the number of guarantees/beneficiaries/jobs created as indicators for the operational performance and default rates and portfolio at risk as indicators for the financial performance. Providers and users of credit guarantees face a complex regulatory environment. Two key aspects of the regulatory framework are the prudential regulation of financial institutions and the legal framework of state aid.

According to our survey, most Western European banks have been using credit guarantees to support their SME lending activity. However, the guarantee coverage of the banks’ SME portfolios shows a large variability among the different institutions. Most of the demand for credit guarantees in the Western European region is satisfied by local guarantors.

Although the banks themselves show a strong interest towards guarantee products, it seems that a number of factors have been limiting the further development of credit guarantee usage. Both CGSs and banks agree that the most important of these is the weak demand for loans by SMEs in the survey period (June 2015 – May 2016)³⁴. This is consistent with the view that the observed sluggish credit growth in Europe is not only due to the lack of credit supply, but other factors affecting the real economy, manifesting in lower credit demand, are also of key importance. CGSs perceive the EU state aid regulation and the lack of collateral also as a constraint of major

³⁴See See Annex 1: Description of the surveys for further details.

importance. For banks, the associated administrative procedures and the cost of guarantees are additional relevant factors

CGSs have been used intensively by governments to counteract the adverse consequences of the crisis on the supply of external financing to SMEs. To this end, many CGSs have received a capital increase, be it permanent or temporary, which they used to support lending to finance both investment and working capital. Credit guarantees played a more important role in crisis management in those countries which were the most affected by the financial turmoil.

Credit guarantees bring about capital relief, and nearly 50 percent of banks reported this to be an important consideration in their use of CGSs. However, a similar percentage of banks responded the regulation on CGS capital relief to be complex and non-transparent, overall, or in particular jurisdictions. A limited number of CGSs even reported uncertainty about regulatory treatment of SME credit guarantee to be a constraining factor in the use of guarantees. This suggests that efforts aimed at informing banks about the potential capital relief benefit of CGSs could increase the demand for guarantees.

While addressing SMEs' lack of collateral was indicated to be the primary driving motive of most CGS respondents, SMEs that were granted a guaranteed loan did not receive full collateral relief. Moreover, CGS institutes indicated that lack of collateral was an important limiting factor for the future growth of guarantee activity. This implies that although CGSs might partially alleviate collateral constraints – e.g. allow SMEs to obtain a somewhat larger loan for the same amount of collateral –, they cannot be considered as a perfect substitute. Rather, external guarantees and collateral are often used side-by-side on the same loan. Such a combination ensures that the borrower still has some 'skin in the game', thereby reducing the borrower's incentive to default, which should increase banks' motivation to lend. This is only one example for the need to carefully design guarantee products; we mentioned others throughout this study.

With an appropriate setup and under suitable institutional framework conditions, CGSs can efficiently improve SMEs' access to finance. In addition and complementary to the local guarantee institutions, the EIF, being part of the EIB Group and the key multinational guarantee provider in Europe, contributes to this aim. In doing so, EIF cooperates with a wide range of financial intermediaries, including banks, guarantee funds, mutual guarantee institutions, promotional banks, and other financial institutions that provide finance or financing guarantees to SMEs (Kraemer-Eis et al., 2016b).

Annex 1: Description of the surveys

To support the analysis, two one-off surveys have been carried out. These surveys allowed us to obtain up-to-date information on the key issues discussed in this report. The surveys were conducted using a list of questions for which parties were asked to provide their answers. We applied the same methodology in both surveys, following standard practices of survey design. More specifically, our surveys were based on a questionnaire that parties had to fill in choosing among a menu of suggestive answers. For certain questions, the parties had the option to provide their own answers while for others they were required to provide some key data. Aggregate answers and statistics are reported on an unweighted basis. The next few paragraphs discuss both surveys in greater detail.

CGS Survey

The CGS survey was sent to 21 institutions across Western Europe in September 2015.³⁵ The response rate amounted to 86 percent, with the survey being completed by 18 institutes from 13 countries (see table A.1); answers were received over the period October 2015 to May 2016.³⁶ The survey contains three organisations that are not members of AECM, operating in Ireland, Finland and Denmark. The Italian CGS sector is by far the largest in Europe and constitutes a 65 percent market share.

Table A.1: Geographical distribution of the CGS survey participants

Country	Number of surveyed credit guarantee institutions	Number of institutions that provided feedback	Response rate	Country level shares ³⁷
Austria	2	2	100%	0.37%
Belgium	3	3	100%	0.89%
Denmark	1	1	100%	0.68%
Finland	1	1	100%	0.00%
France	3	2	67%	21.19%
Germany	1	1	100%	3.61%
Greece	1	1	100%	0.01%
Ireland	1	1	100%	0.34%
Italy	2	2	100%	65.12%
Luxembourg	1	0	0%	/
Netherlands	1	1	100%	1.27%
Portugal	1	1	100%	3.41%
Slovenia	2	1	50%	0.03%
Spain	1	1	100%	3.07%
UK	1	0	0%	/
Total	22	18	86%	100%

³⁵We are particularly grateful to Katrin Sturm from AECM, who kindly distributed the survey among its member organisations.

³⁶Luxembourg and UK did not respond to our survey.

³⁷Shares are calculated as the ratio of committed capital of responding CGSs in a given country over total committed capital of all survey participants.

Certain institutions in the sample are not CGSs themselves, but umbrella organisations representing a number of credit guarantee institutions in a given country. In those cases we have instructed the respondents to choose the answer that they believe is the most representative from the viewpoint of a typical individual member of their organisation.

The CGS Survey contained 49 questions categorised into 8 topics:

- Part I: general information about their institute and their main objectives.
- Part II: main characteristics of the guarantee products.
- Part III: appraisal practises.
- Part IV: claim procedures.
- Part V: key performance measures.
- Part VI: operating constraints
- Part VII: regulatory issues.
- Part VIII: operational and financial reporting indicators³⁸

A complete overview of the survey questions can be found in Annex 2.

³⁸For the 8th section, several schemes provided incomplete information which obscured comparability across respondents; therefore this section was omitted from the analysis.

Bank Survey

The bank survey contained 18 questions in total and was sent out in June 2015 to a number of large banking groups operating in Western European countries (table A.2).³⁹ The response rate for the Bank survey is significantly lower compared to the CGS survey. Only half of the 63 surveyed banks returned the questionnaire (responses were received over the period June to September 2015). This resulted in a sample of 33 banks operating in 17 different countries. The survey questioned banks on their use of CGSs. An overview of the questions can be found in Annex 2.

Table A.2: Geographical distribution of the Bank survey participants

Country	Number of Surveyed Banks	Number of Banks Provided their Feedback	Response rate
Austria	3	3	100%
Belgium	3	2	67%
Cyprus	3	1	33%
Denmark	4	1	25%
Finland	3	1	33%
France	4	1	25%
Germany	4	2	50%
Greece	3	3	100%
Ireland	5	3	60%
Italy	6	4	67%
Luxembourg	2	1	50%
Malta	2	0	0%
Netherlands	3	2	67%
Portugal	4	3	75%
Sweden	4	2	50%
Slovenia	2	1	50%
Spain	4	2	50%
United Kingdom	4	1	25%
TOTAL	63	33	52%

³⁹ We are particularly grateful to Jessica Stallings (IIF), who organized the distribution of the survey among IIF member organisations.

Annex 2: Survey questions

Credit guarantee scheme (CGS) survey

- Q.1 – In which year was your institution established?
- Q.2 – Is granting of loan guarantees the main activity of your institution?
- Q.3 – Does your institution have an explicitly stated mission/objective?
- Q.4 – Which of the reasons below describe the rationale(s) behind your organisation's activity as a guarantee provider?
- Q.5 – What are the outcomes that you are aiming to achieve through your activity?
- Q.6 – Does your institution provide credit guarantees also to SMEs in other countries?
- Q.7 – What is the ownership background of your institution?
- Q.8 – What is the legal structure of your organisation?
- Q.9 – What is the tax status of your institution with respect to its credit guarantee activity?
- Q.10 – Is your organisation capitalized upfront with respect to its guarantee activity?
- Q.11 – Is your organisation profit-oriented with respect to its guarantee activity?
- Q.12 – From the list below, which groups are targeted specifically by your institutions' guarantee activity?
- Q.13 – Did your institution's supply of guarantees increase as a response to the financial crisis?
- Q.14 – Did your institution receive additional capital during the financial crisis to increase its operations?
- Q.15 – What type of guarantees does your institution provide (individual/portfolio)?
- Q.16 – Does your institution provide the following varieties of guarantees (differentiated by the type of the final beneficiary)?
- Q.17 – Does your institution guarantee the following types of loans or financial products?
- Q.18 – What type of eligibility criteria do you apply for your guarantee products?
- Q.19 – Does your institution require the lenders to certify somehow the additionality* of the guaranteed loan?
- Q.20 – Are the borrowers informed about the existence of the guarantee on their loan?
- Q.21 – When does the guarantee come into effect?
- Q.22 – What is the minimum and maximum amount of coverage for your guarantee products?
- Q.23 – What is the minimum and maximum eligible maturity of the loans that your guarantees cover?
- Q.24 – What types of fees does your institution charge to its clients?
- Q.25 – Who pays the fees?
- Q.26 – Does success in the repayment of loans lower the fees to future guarantees to the same borrower?

- Q.27 – Does failure to fully repay a guaranteed loan result in higher charges or lower likelihood of future guarantees for the same borrower?
- Q.28 – Does the borrower apply for the guarantee through the lender, or directly to your institution?
- Q.29 – Does your institution appraise the borrowers' guarantee applications individually?
- Q.30 – Does your institution have access to a central credit information agency?
- Q.31 – Does your institution use the following sources of information during the credit assessment of the borrowers?
- Q.32 – Does your institution have any mandatory time limit to process guarantee requests?
- Q.33 – Does your institution offer guarantees with the types of risk sharing arrangements listed below?
- Q.34 – In case of default, who is in charge of loan recovery?
- Q.35 – Are the recovery proceeds shared between the guarantor and the lending institution?
- Q.36 – Does your institution offer incentives for the lenders to intensify recovery proceeds?
- Q.37 – What is the trigger for calling the guarantee?
- Q.38 – Does your institution limit the lenders in asking collateral from the borrowers for the guaranteed loans?
- Q.39 – Does your institution use any of the risk management techniques listed below?
- Q.40 – Does your institution use the indicators below to regularly assess the operational performance of its guarantee operations?
- Q.41 – Does your institution use the indicators below to regularly assess the financial performance of its guarantee operations?
- Q.42 – Does your institution measure the financial additionality* of its credit guarantee activity?
- Q.43 – Does your institution measure the economic additionality* of its credit guarantee activity?
- Q.44 – What are the relevant factors that may constrain the use of SME credit guarantees in your country?
- Q.45 – Is your institution required by law to have a banking license and/or special license for issuing guarantees?
- Q.46 – Do the institutions listed below have supervisory authority over your institution's credit guarantee activity?
- Q.47 – Do your institutions' guarantees qualify for a regulatory capital relief?
- Q.48 – Do lenders complain about difficulties in obtaining regulatory capital relief on loans guaranteed by your institution?
- Q.49 – Please provide the latest annual values for the following operational and financial indicators.

Bank survey

- Q.1 – Does your bank currently use SME* credit guarantees for individual loans or loan portfolios?
- Q.2 – What types of institutions provide the SME credit guarantees that your bank uses?
- Q.3 – If your bank currently uses SME credit guarantees, what are the main reasons?
- Q.4 – What are the relevant factors that may constrain the use of SME credit guarantees in your country?
- Q.5 – In your experience, what are the key benefits credit guarantees bring to your SME clients?
- Q.6 – Do you believe that the supply of SME credit guarantees is sufficient in your country?
- Q.7 – If your bank currently uses SME credit guarantees, how important is it in your overall SME lending activity?
- Q.8 – If your bank currently uses SME credit guarantees, for how long it has been using them?
- Q.9 – In your view, which of the following auxiliary activities should be done by the credit guarantee institutions?
- Q.10 – If you currently use SME credit guarantees, how do you evaluate the affected part of your portfolio from an (ex-ante) probability of default point of view, relative to the rest of the SME portfolio?
- Q.11 – Has your bank's use of SME credit guarantees increased in the last 5 years? If yes, what type of loans contributed to this increase?
- Q.12 – How important is it for your bank to obtain regulatory capital relief for SME credit guarantees?
- Q.13 – In your experience, how transparent and uniform is the treatment of SME credit guarantees from the viewpoint of regulatory capital relief within the EU?
- Q.14 – In your view, should SME credit guarantees be provided by private institutions, public entities, or both?
- Q.15 – Are you aware of any obstacles - regulatory requirements or other - that have prevented or may prevent your bank from obtaining regulatory capital relief for SME credit guarantees?
- Q.16 – Does your bank typically ask for any collateral for loans covered by SME credit guarantees?
- Q.17 – Are your bank's IT systems integrated with the systems of the CGSs, with the aim of facilitating decisions about individual loans?
- Q.18 – Looking into the future, what is your bank's expected interest in the usage of SME credit guarantee products for SME loans?

Annex 3: Details of EIF's guarantee and ABS/securitisation business under mandates⁴⁰

This section elaborates on the mandates implemented by EIF, which were already briefly discussed in chapter 2.3 (sources: EIF, 2017, and the EIF and EIB websites):

Competitiveness of Enterprises and SMEs (COSME) Loan Guarantee Facility (LGF)

COSME LGF was set up in 2014 by the European Commission (EC), Directorate General for Enterprise and Industry, now Internal Market, Industry, Entrepreneurship and SMEs (or DG GROW) to promote competitiveness and entrepreneurship in Europe, improve access to finance for European businesses and provide higher-risk SME loans and finance leases. A significant part of the COSME programme is dedicated to two EU financial instruments managed by EIF: the Loan Guarantee Facility (LGF) and the Equity Facility for Growth (EFG). These financial instruments are foreseen to run in the 2014 to 2020 period with an indicative aggregate budget of EUR 1.4bn.

In addition to the EU-28, the EU enlargement candidate countries Albania, FYROM, Montenegro, Serbia and Turkey, as well as Iceland are eligible for COSME. Additional countries may join at a later stage. The COSME LGF allows EIF to provide guarantees and counter-guarantees to selected financial intermediaries, supporting them in their endeavours to grant loans and leases or issue guarantees to SMEs with limited access to finance. Under the COSME guarantees, EIF provides free-of charge capped guarantees to allow financial institutions to increase the range and volume of SME financing, especially in riskier segments. COSME includes the option of guarantees for the securitisation of SME debt finance portfolios, which enables financial intermediaries to generate new SME debt finance portfolios. By the end of 2016, 41 COSME LGF agreements were signed – of these, 39 EFSI-backed signatures (more on information on EFSI is provided further below), one transaction in Serbia and another in Turkey – representing a guarantee commitment of EUR 337m, which is expected to leverage EUR 7.5bn of financing.

EU Finance for Innovators (InnovFin) SME Guarantee Facility (SMEG)

InnovFin is a joint EIB Group and EC (Directorate-General for Research and Innovation) initiative under Horizon 2020, the EU research programme for 2014-2020. InnovFin consists of a range of tailored products – from guarantees for financial intermediaries and direct loans to enterprises, to equity and advisory services – to support research and development projects in the EU-28 Member States and Horizon 2020 associated countries eligible to benefit from InnovFin (currently including Albania, Bosnia and Herzegovina, Faroe Islands, FYROM, Georgia, Iceland, Israel, Moldova, Montenegro, Norway, Serbia, Switzerland, Tunisia, Turkey and Ukraine). EIF has been implementing the InnovFin SME Guarantee (SMEG) financial product since the programme's launch in June 2014.

⁴⁰See for more detailed information the EIF website, www.eif.org.

The InnovFin SMEG is a 50 percent uncapped guarantee or counter-guarantee that EIF provides to financial intermediaries (and for which a standard guarantee fee is charged), allowing them to provide debt financing on favourable terms to innovative SMEs and small mid-caps in EU Member States and associated countries. With the support of the EUR 1bn EC budget, EIF is expected to enter into guarantee agreements with financial intermediaries for a total amount of around EUR 5bn, which should result in approximately EUR 10bn of debt finance for innovative companies. This is expected to catalyse around EUR 14bn in investments.

In 2016, EIF concluded a record amount of 78 new signatures under InnovFin SMEG – of which 62 transactions leveraging on the EFSI guarantee – reaching an aggregate signature amount of close to EUR 2.34bn, which is expected to leverage EUR 5bn of financing.

EU Programme for Employment and Social Innovation (EaSI) Guarantee Financial Instrument

The financial instruments under EaSI are being set up by the EC (Directorate-General for Employment, Social Affairs and Inclusion, DG EMPL) in co-operation with EIF with the aim of achieving sustainable employment, guarantee adequate social protection and promote the achievement of social goals in line with the Europe 2020 strategy. The EU has indicatively allocated EUR 193m to the EaSI financial instrument for the 2014-2020 programming period. EIF has been entrusted so far with the implementation of two financial instruments in this regard: the EaSI Guarantee and the EaSI Capacity Building Investments Window, launched respectively in June 2015 and December 2016, for a total indicative amount of EUR 112m. In particular, the deployment of these financial instruments aims to increase the availability of financial resources for disadvantaged groups of entrepreneurs as well as social enterprises, and especially for the benefit of those who are typically excluded from the commercial credit markets. In addition to the EU-28, the EaSI instruments are also available in Albania, FYROM, Iceland, Montenegro, Serbia and Turkey. Other countries may join at a later stage.

The EaSI Guarantee provides capped guarantees to portfolios of loans exceeding EUR 25,000 in the field of microfinance, and up to EUR 500,000 for social enterprises, the latter being enterprises whose primary objective is the achievement of measurable, positive social impact rather than having a pure profit-making purpose. Beneficiaries may include underprivileged groups such as the young, the unemployed or migrants who wish to set up their own businesses. A very high market uptake of the EaSI financial instrument led to a frontloading under EFSI in July 2016.

In 2016, EIF signed 29 EaSI guarantee transactions – of which 23 microfinance and six social entrepreneurship agreements – totalling EUR 32.2m, leveraging close to EUR 409m of financing in co-operation with financial intermediaries in Albania, Austria, Belgium, the Czech Republic, Greece, Estonia, Montenegro, Poland, Portugal, Romania, Serbia, Slovakia and Spain.

The European Fund for Strategic Investments (EFSI)

EFSI is an initiative launched jointly by the EC and the EIB Group to assist in overcoming the current investment gap in the EU by mobilising financing for strategic investments. It is the financial

pillar of the Investment Plan for Europe (IPE) which was launched by the EU in July 2015, alongside the implementation of regulatory and structural reforms to ensure an investment-friendly environment in Europe.

EFSI takes the form of a contractual arrangement between the EU and the EIB Group, translating into an EU guarantee to the EIB (initially EUR 16bn) and an EIB capital contribution (initially EUR 5bn). The deployment of the initial EUR 21bn of EFSI funds aims to generate a total of EUR 315bn of investments, as a result of the EIB Group's efforts to crowd-in additional public and private resources.

EFSI has two components to support projects with wide sector eligibility: the Infrastructure and Innovation Window managed by the EIB and the SME Window implemented by EIF. The financial instruments used for the purposes of the EFSI SME Window are mainly guarantees and equity investments.

The initial investment volume expected to be triggered under the EFSI SME Window by mid-2018 was EUR 75bn. However, EIF has effectively responded to the acute market demand for EFSI-backed financial instruments that support innovation and competitiveness, and already within the first year of EFSI's deployment, the agreements signed are expected to mobilise more than two-thirds of the initially foreseen EUR 75bn target. This entails an estimated fifteen-fold leverage, meaning that every EUR 1 guaranteed by EIF generates EUR 15 of investment for the benefit of SMEs and mid-caps. Year-end 2016 results confirmed that EIF had not only achieved, but exceeded this initial estimate.

EIF's outstanding performance in the context of the Investment Plan for Europe was acknowledged by the EC. The EFSI evaluation report from September 2016 highlighted in particular the very fast implementation of the SME Window, due to the reliance on EIF's delivering capacity under existing flagship products and mandates developed and supported by the EC and the EIB Group, notably the InnovFin SME Guarantee Facility (InnovFin SMEG) and the COSME Loan Guarantee Facility (COSME LGF), and on EIF's well-functioning internal processes. In the light of this success, the EC decided on a EUR 500m increase of the EFSI SME Window resources in July 2016, leading to a new investment objective of EUR 82.5bn. The increase was possible thanks to a reallocation from the Investment and Infrastructure Window and EIF is on track to reaching the new investment objective well before the target date in July 2018.

In the first phase of implementation of the SME Window, the following steps were taken:

- EUR 1.25bn was made available to EIF through a guarantee from the EIB (itself backed by the EU guarantee under EFSI) for the frontloading of the InnovFin SMEG and the COSME LGF. Frontloading means that both of these mandates were initially intended for gradual deployment over the period 2016-2020, whilst the EU guarantee under EFSI allowed EIF to deploy the whole investment capacity already as of 2015, hence providing both a quicker access to finance by SMEs and a broader outreach to final beneficiaries.

- EUR 2.5bn was provided to EIF by the EIB, from its own contribution to EFSI, to increase the capacity of the Risk Capital Resources (RCR) mandate managed by EIF on behalf of EIB. This equity mandate supports investments mainly into innovative SMEs and mic-caps.

Hence, EIF has been able to deploy its support at a faster rate than initially anticipated. EIF adapted its response to a strong market demand. By the end of 2016, EIF approved close to EUR 8.2bn of financing in 247 transactions across all instruments. These agreements leveraged on close to EUR 3.9bn of EFSI support, which corresponds to around 70% of the total EFSI contribution under the SME Window resources (EUR 5.5bn). Approvals by year-end 2016 are expected to mobilise investments up to EUR 69.5bn, corresponding to about 84% of the overall target of EUR 82.5bn. The number of signed transactions reached 225, totalling close to EUR 7.3bn of leveraged EIF financing underpinned by more than EUR 3.7bn of EFSI support. Furthermore, EIF achieved a full geographical coverage of all EU-28 Member States under EFSI in December 2016. Under InnovFin SMEG and COSME LGF, 100 new guarantee and counter-guarantee transactions were signed in 2016 with the support of EFSI, expected to mobilise EUR 22.2bn of investments at the level of SMEs. Under the RCR mandate, EIF increased commitments in investment funds that target early to lower mid-market segments, including the provision of equity as well as hybrid debt/equity financing. 30 new EFSI-backed RCR transactions were signed by the end of 2016, leading to an expected EUR 10.9bn of mobilised investments.

Further to the EUR 500m increase in July 2016, the second phase of the EFSI SME Window was launched, encompassing the new EFSI SME Window Equity instrument and a frontloading of the EaSI Guarantee Financial Instrument (EaSI GFI) under the EU Programme for Employment and Social Innovation. The EFSI SME Window Equity instrument has a total investment capacity of EUR 2.068bn. It is an umbrella structure covering early stage investments under the newly launched InnovFin Equity facility including a focus on technology transfer, business angels and venture capital; and growth stage investments and fund of funds, including a focus on social impact investments. In addition, this instrument opens up the possibility for other investors to co-invest alongside EIF in both the early and the growth stage windows. EIF also rolled out a collaborative platform for national promotional banks and institutions (NPIs) in September 2016. The NPI-Equity Platform provides a flexible, nonbinding governance framework enabling EIF and NPIs to establish a closer, more coordinated operational interaction.

To address the high market demand for EaSI guarantees, EIF and the EC signed the frontloading of EFSI budgetary allocations for this initiative in December 2016. Thanks to EFSI, the upfront availability of the EU's budgetary appropriations for the 2017-2020 period accelerates the deployment of resources that can be allocated immediately to final beneficiaries to enhance access to finance in the areas of microfinance and social entrepreneurship. Following the signature of the EaSI frontloading agreement in December 2016, EIF signed two new transactions under EFSI before the year-end, generating a total loan volume of EUR 19m for micro-borrowers. This is expected to mobilise investments of up to EUR 27m at the level of final beneficiaries, empowering small entrepreneurs and contributing to social inclusion.

To this end, additional products will be launched in 2017, aiming to further increase the impact capacity of the EFSI SME Window. Looking ahead, EIF very much welcomes the proposal on the possible extension of the Investment Plan for Europe beyond 2018.

EIB Group Risk Enhancement Mandate (EREM)

The EREM underpins a substantial array of the financial instruments deployed by the EIF. The different windows of EREM comprise the ABS Credit Enhancement initiative, with a primary focus on providing increased cover for mezzanine tranches of SME securitisation transactions, the Social Impact Finance programme, including the Social Impact Accelerator initiative, the Loan Funds instrument launched in 2015 and the Cooperative Banks and Smaller Institutions (CBSI) window that was rolled out in late 2016. The EREM mandate also contributes to the financing of the SME Initiative that is currently deployed in six EU Member States including Bulgaria, Finland, Italy, Malta, Romania and Spain. While the individual focus of the different EREM products varies, they all seek to respond to emerging market needs by offering alternative sources of financing and effectively broadening the long-term financing spectrum available to SMEs. The EREM product windows are to be deployed over a seven-year timeframe in the 2014-2020 period.

Cultural and Creative Sectors Guarantee Facility (CCS GF)

CCS GF was launched in July 2016 in the context of the EU's Creative Europe programme for the budgetary period 2014-2020. The objective of Creative Europe is to promote cultural diversity and Europe's cultural heritage, and to strengthen the competitiveness of the cultural and creative sectors. This new mandate aims to support micro-, small and medium-sized enterprises and organisations in the cultural and creative sectors such as audio-visual, music, fashion architecture, libraries, theatres and museums. These sectors often face difficulties in accessing loans due to the often intangible nature of their assets and a general lack of financial intermediary expertise in addressing the specificities of this sector.

The CCS mandate has an overall envelope of EUR 121m and is expected to support more than EUR 600m in loans and other financial products. The CCS mandate is made up of two pillars. On the one hand, it offers free-of-charge, capped first-loss portfolio guarantees and counter-guarantees to enable selected financial intermediaries to provide loans and leases to relevant entrepreneurs. On the other hand, it will offer an optional capacity-building programme, also free of charge, to help financial intermediaries improve their understanding of the specificities of the cultural and creative sectors.⁴¹

The new programme has been very well received by the market and EIF already signed three CCS transactions, committing EUR 12.7m in France, Romania and Spain. These agreements are expected to generate EUR 86.6m of leveraged financing.

⁴¹ This is expected to be implemented by half 2017.

Deep and Comprehensive Free Trade Area (DCFTA) Initiative East

The DCFTA Initiative East, including its Guarantee Facility pillar (DCFTA GF), was signed in December 2016 between the EC and the EIB Group. It aims to strengthen economic development in EU associated countries (Georgia, Moldova and Ukraine) by providing targeted financial and technical support to SMEs so that they can align to EU standards. DCFTA GF will support economic growth and employment-generating activities and enhance access to finance for SMEs by allowing first loss portfolio guarantees to be provided to financial intermediaries, enabling local intermediary banks to take on more risk and reach out to underserved segments of the economy. A total loan volume of more than EUR 300m is expected to be generated for the benefit of SMEs in these countries. The EU funding for this guarantee facility has been provided by the Neighbouring Investment Facility (NIF) and the programme of EU Support to Ukraine to Relaunch the Economy (EU SURE).

SME Initiative (SMEI)

The SMEI is a joint EIB Group/EC financial instrument, which was launched to address the financial constraints faced by European SMEs as national economies slowly recover from the recent economic turmoil. The programme combines different resources, including ESIF, the EU centralised budget under Horizon 2020 and/or COSME as well as EIB Group's own funds. EIF manages and implements the SMEI within the EIB Group. Two different instruments define the operational framework of the SMEI: an uncapped portfolio guarantee facility, by which financial intermediaries are covered against the credit risk of newly originated SME loans, leases and guarantees; and a securitisation instrument.

The first mandates under the SMEI were signed in Spain (October 2014) and in Malta (July 2015). During 2016, EIF received four new SMEI mandates with activities being extended to Bulgaria, Finland and Romania under the uncapped guarantee pillar; and to Italy under the securitisation component, entrusting in total close to EUR 1.25bn of Member States contributions – European Regional Development Fund (ERDF) resources and, if any, national co-financing – to EIF.

Other National and Regional Mandates

In addition, EIF manages/coordinates various regional development and sector-specific initiatives. In those countries covered by this report, guarantees under such initiatives can be provided, for example, under the CYPEF in Cyprus, as well as under programmes backed by resources from the European Structural and Investment Funds (ESIF).

Cyprus Entrepreneurship Fund (CYPEF)

CYPEF is a fund established by the Republic of Cyprus to support and strengthen entrepreneurship in the country by enhancing access to finance to SMEs. Amounts dedicated from the Cypriot government to CYPEF are made available through financing from the EIB. CYPEF is managed by the EIF.

CYPEF's financial instruments will be deployed by local banks which will be selected by EIF following Calls for Expression of Interest (CEoI) and therefore act as EIF's financial intermediaries. These financial intermediaries will make available CYPEF's financial instruments to eligible SMEs at favourable terms, in the form of reduced interest rates and potentially reduced collateral requirements, extended loan maturities and grace periods.

The EUR 100m of initial capital pulled together under CYPEF by the Cypriot Government will be matched by equal contributions from EIF's selected financial intermediaries, translating into EUR 200m of finance to the benefit of Cypriot SMEs. Additional amounts may become available at a later stage, subject to satisfactory market absorption of the CYPEF funds.

FOSTER TPE-PME Languedoc Roussillon Midi Pyrénées

"FOSTER TPE-PME" is a new generation of Fund-of-Funds to improve access to finance for final recipients (including through guarantee instruments) set up in cooperation with the French Region Occitanie (created following the merger of the Regions of Languedoc-Roussillon and Midi Pyrénées) using its own resources and the European Structural and Investment Funds (ESIF) resources. This initiative is managed by the EIF under the current ESIF programming period 2014-2020 and builds-on the successful implementation of the JEREMIE Initiative in Languedoc-Roussillon.

Annex 4: Country acronyms

Country Code	Country
AT	Austria
BE	Belgium
DE	Germany
DK	Denmark
ES	Spain
FI	Finland
FR	France
GR	Greece
IE	Ireland
IT	Italy
NL	Netherlands
PT	Portugal
SI	Slovenia

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The European Investment Fund (EIF) is Europe's leading risk finance provider for small and medium sized enterprises (SMEs) and mid-caps, with a central mission to facilitate their access to finance. As part of the European Investment Bank (EIB) Group, EIF designs, promotes and implements equity and debt financial instruments which specifically target the needs of these market segments.

In this role, EIF fosters EU objectives in support of innovation, research and development, entrepreneurship, growth, and employment. EIF manages resources on behalf of the EIB, the European Commission, national and regional authorities and other third parties. EIF support to enterprises is provided through a wide range of selected financial intermediaries across Europe. Since its inception in 1994, EIF has supported over 1.8 million SMEs. EIF is a public-private partnership whose tripartite shareholding structure includes the EIB, the European Union represented by the European Commission and various public and private financial institutions from European Union Member States and Turkey. For further information, please visit www.eif.org.

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