

AECM Operational Training Session

Guarantee products and risk assessments. Evaluating risk for various types of guarantees

Complementary study on the OTS held in Vilnius, 9/10 May 2016

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Preface

The AECM Board of Directors has accepted the principle to add to the contents of Operational Training Sessions an additional document offering practical conclusions and ideas to participants, and attempting to underline the most useful matters for AECM members staff for consideration in their daily activity.

The present document has not the ambition to be a summary or a synthesis of the presentations done in the OTS, held in Vilnius in May 2016.

It stands as a complementary text to these presentations, for the benefit of participants, on main themes and factors developed by speakers, considering common points of importance met by the whole community of AECM's members.

The presentation offers “food for thoughts” to participants, in the logic of contributing to a higher and wider point of view. This integrates also elements of expertise from the Secretariat's experience, which appeared as relevant on the topic of adapting risk assessment to the guarantees on various types of financing.

The comments and recommendations have, of course, to be taken with the adequate adaptation to each reader's country context and financial sector practices, which varies greatly throughout the extent of countries covered by the Association.

Introduction

A serious risk assessment on guarantees delivered is a key principle for most loan guarantee schemes. It is the base of the implementation of the guarantor's risk management, and ensures the scheme' sustainability. This principle is adapted into operational processes, which may vary greatly among guarantee institutions, in order to take into consideration many factors, such as:

- who is the borrower of the loan (size, sector, age, financial profile);
- what project is considered;
- which bank(s) or financial intermediary presents the application for the guarantee;
- What are the characteristics of the financing to be covered;
- Which guarantees on assets, which collaterals give coverage to the risk of lender and guarantor

Some ideas about good practices in risk assessment are common to most presentations at the OTS:

Risk assessment adaptation to different products is needed:

- Intensity of due diligences in risk assessment cannot be uniform;

- A guarantee program addressing a new type of financing (for the guarantor's technical culture) need more control and scrutiny, as its vision on risks is recent, and as no track record exists in the company on such operations;
- Segmentation of customers leads to different processes, guarantee quotas, fee policies and conditions.

Risk assessment is connected to many aspects and features of a loan guarantee scheme. This document presents in the following paragraphs this topic from different angles, for a wider illustration of how it is taken care of, in various AECM members.

The importance of being earnest

“Risk comes from not knowing what you're doing » (Warren Buffett, quoted by INVEGA).)

Considerations on the methods for risk assessment reported in the OTS:

1/ The presentation by INVEGA (Lithuania) is a very clear illustration of the “classic approach” of the risk by the guarantor in the different stages of selection:

- check up of eligibility (size, current financial situation)
- segmenting the purpose of the financing (investment / working capital needs), which leads to different types of risks
- scoring (a minimum value limits acceptance of application; guaranteed quota may vary according to risk level),
- identification of major risk factors and borrower's reputation
- the financial analysis (and the exclusion cases resulting from this profile)
- the coverage of the risk by collaterals (extremely variable)
- the other possible risk reductions
- the observation of risk level according to projects and according to the partner banks (or leaser).
- The four main categories of risk factors: management, activity, financial aspects and project analysis.
- the bank's implication in the final risk.

2 / The scope of financing to be guaranteed has a consequence on the definition of competences to be used, on the definition of the risk policy, and on adaptation to local context.

- The first main constraint is the necessity to have the right skills for each product
- The KYC principle (“Know Your Customer”) has to work both ways :
 - Towards SMEs, as customers which bring risks: moral hazard exists, and entrepreneurs rely sometimes too much on their luck or ...dreams to face the risks in their activity.
 - Towards lenders requesting the guarantee: beyond the usual well deserved image of being risk adverse, lenders can sometimes be “risk-blind, if they follow a “finance fashion”, or commercial objectives. Also, according to their structure, and strategic priorities, they can lack the available staff, experience and available time for appropriate preparation and due diligences for such projects.

Several aspects have to be ensured by the guarantor:

- Can the guarantee company's staff analyze the risk of the enterprises using the financing?
- Can it get a valid expectation of recoveries, if the type of projects have a direct consequence on nature (or absence of) assets taken as guarantees?
- Is the guarantor's network able to get a close enough vision on the risk (to check information, get reliable information on local facts, and use connections with specialists helping in risk assessment?

- Is the Risk Department of the guarantor able to assess risk cost precisely?

This analysis should make it clear whether or not the guarantee scheme should engage in guaranteeing the type of risks to be shared in each specific program.

Is the decision making process using enough (but no excess of) collegial decisions, in order to enter useful subjective opinions on the risks, which should complete the automated rating systems when appropriate?

Without adequate capacities, the guarantee program might turn to be either:

- without outreach, as very few operations will be accepted, due to lack of visibility
- or the source of potential important losses, if too many given guarantees are be called.

3 / Specific factors have influence on the organization of the risk assessment process

Regional risk factors: example of INVEGA's context:

- Attitude of entrepreneurs result in high level of moral hazards in Eastern Europe, and frequent "unaccounted income", reducing visibility and certitudes profit level and expected aptitudes for loan repayment.
- Historical factors caused the private SME sector to lack a long track record. Compared to Western Europe context, private entities are young, commercial conditions can be brutal, and fewer staff with long experience exists within SME and among bankers.
- This "market conditions" leads to higher default, and consequently guarantors tend to lower their risk limits, restricting the incentive outreach of guarantors.
- Also more importance is given to collateral valuation and demands in the decision making process

The population of AECM members can illustrate the diversity of schemes resulting from the above factors:

- Some schemes show a stronger "risk appetite" attitude – for "value bringing" projects (job creation, innovation projects, new entrepreneurs), offering higher risk coverage for those projects
- Other schemes with a necessary risk moderation, with lower guaranteed quota and a higher rejection rate due to a risk probability increase caused by the behavior of some undeserving and unreliable entrepreneurs.

4 / Fulfilling the mission of the LGS

- One of the great differences between a bank and a guarantee company is that the profit objectives comes second for guarantors, after the main objective of granting access to credit to the largest possible population of applicants, in the interest of economic development and job creation.
- Profitability level requested by most guarantee institutions can be reduced to a minimum, ensuring conditions of sustainability.
- This means that even if a selection has to be done between applications, and some of them rejected, the guarantor can accept for some guarantee products a high default rate, as long as it is tolerable in the equation basing their business model with the following variables: [fees collected ; financial proceeds; guarantees paid ; recoveries collected from collaterals; public funding or counter guarantees obtained when they exist]

Risk assessment: a topic too serious to be left (only) to the banks?

Depending on context and historical factors, the guarantor's decision can be bound, or not, to the bank's opinion. Some guarantors delegate decisions totally or partially to lenders; others take all decisions themselves,

in order to avoid adverse selection from the banks, or because the banking sector in their country has not yet reached the level of technicality or organization which would allow such delegation.

The development of staff skills in a guarantee institution through time and experience is a naturally a key element, but this takes time, and in some countries additional, ways have to be found.

The “human factor” of analysts in the risk assessment process is now often complemented by scoring systems, which objective is to add a rational, and “subjectivity free” instrument to the analysis.

Some very different examples have been illustrated in the OTS.

1 / Case one: total delegation to banks

BBB (Great Britain) grants all guarantees through delegation to lenders.

- Its “Enterprise Finance Guarantee” program deals only with accredited partners, according to some operating and risk policy principles:
- Accept market risk arising from the nature of the partner organisations
- The accreditation process and the audit of partners limit the risk of entering in a dangerous relationship
- A balanced Risk sharing is set ; (25% for the lender, 75 % for the guarantor)
- A ceiling limits the maximum amount of payments (20 % gross, 15 % net after recoveries) imposed by the agreements.

The management of the program puts importance on checking that the right target of final beneficiaries is respected: a focus on project objectives have to be done before decisions: do they fit the guarantor’s objectives?

- The cost of the guarantee (2 % annual fee), is also deterrent against possible mislead use of the guarantees, for borrowers which do not need or justify it. Such fee, especially in present conditions, when such a fee is relatively high compared to the interest rate.

The control of the guaranteed operations is a very important factor:

- Regular checks are done on sample of operations from each bank
- A precise follow up is done on each partner default rate
- The agreements with accredited partners make it possible for the guarantor to increase controls and audits if necessary.

2/ case two: a direct decision can be taken by the guarantor, not at the bank request, but by applications direct from the SME

Reliable and appropriate skills in the guarantor’s staff make it possible to make a good self assessment of the risk, totally independent from banker’s opinion.

For most cases in the profession, guarantees are requested from the LGS by the bank, once the bank has set his position on granting the loan to the borrower. The bank sends a copy of its analysis report to the guarantor, with the guarantee application.

- This has specific advantages: the project risk assessment is improved by the bank’s visibility on the borrower’s track record; most due diligences are done by the bank, and help reducing study time and diligences by the guarantor; two opinions on the project are combined for the guarantor’s final decision.

- On the other hand, disadvantages exist in this usual process: risk assessment by the bank may be poor, not deep enough to really screen the project; marginally, in case of adverse selection of risks by the bank, the analysis may be voluntarily hiding negative points, or minimizing them;
- The reverse process can also operate, such as in the example of SIAGI (France) : a Letter of intent to grant the guarantee is issued by the guarantor, from an application made directly by the SME.
- Decision taken upon the borrower's application, after the guarantor's own due diligences
- A letter of intent, stating the details of risks the guarantor is willing to accept, is delivered to the SME, which in turn has to find a bank
- Risk evaluation can be improved by a well set application form allowing collection of all needed data and visibility– sometime more explicit and complete than files from some banks

Some operational requirements exist for such a practice:

- An excellent risk experience and risk appreciation, on the type of borrowers and the type of projects to be guaranteed
- An efficient network, allowing a close vision on the local facts for the guarantor's staff,
- A good knowledge on market gaps existing, in order to supply guarantees where they are really needed
- A good understanding of banks expectations and practiced conditions, on such type of operations, in order to get as often as possible a match of the guarantee offer with a positive decision from a bank.
- Such practice is rare, because it can be riskier than the usual process. It is usually associated with types of projects that have a "complex risk "image within banks (this is the case of SIAGI which make the majority of its activity on transfer financing).

This allows an optimal use of guarantor's commercial network and also, this can build an excellent addition to the guarantor's image as SME support.

3/ Case three: a self made risk assessment model

In the case of insufficient or unreliable risk assessment from the banks, a self made risk assessment model can be developed by the guarantor, to obtain a rating. This type of instrument is used by nearly all actors in the guarantee profession.

One very good example of this is presented by FSECA (Moscow Guarantee Fund) power point.

Lessons of experience must be analysed, learning from the portfolio observed whether partner banks can be trusted:

- Banks over represented in the portfolio of defaulting loans (compared to their part in the production of guarantees) obviously cannot (or will not) segregate properly the risks presented to the LGS.
- A selection of risk factors, covering structure and profitability, project –loan- size
- Mathematical methods have to be used to ensure a scientific correlation between risk factors, available financial data and indicators, and the occurrence of default.

The model of the Moscow Guarantee fund studied for each factor the AUC (Area Under ROC-Curve) and is based on the use of statistical methods: ROC-analysis (receiver operating characteristic analysis), and Bayesian classification methods. Most large LGS use experienced actuaries teams to develop such models; they require, to be efficient, a large enough population (that can be segmented into project type categories, which may contain different risk factors), and long enough testing to assess the efficiency of the rating on the long term.

4) Case four:

Bürgschaftsbank Baden-Württemberg (Germany) is another excellent example of the importance of the use of risk rating, with the use of additional external sources, in an environment richer in possible support for the risk assessment.

- An internal credit rating classifies each application as “credit relevant” or “non-credit relevant” transactions
- Also, an independent national credit report agency, CREDITREFORM, can provide further information on the borrower.
- A market or sector evaluation for the activity of each borrower is given by a research provider (FERI trust)
- The Guarantee bank process also features interesting additional elements to take into consideration:
- Importance of the risk sharing between actors: the percentage of risk taken by the most implicated bank (Hausbank) on the loan has a consequence on the guarantee quota
- Personal impression of scheme local managers on the borrowers, after a visit, comes also in consideration

Portfolio guarantees: a balanced solution to safe risk handling?

Outing the risk assessment process: delegations and portfolio guarantees

1 / Portfolio guarantees can offer advantages when individual risk assessment is difficult, or when the individual transaction cost for the risk study is too high for the guarantor, compared to the size of the loan, and the fee collected.

- Agreements for portfolio guarantees set a ceiling for the amount to be paid by the guarantor, in proportion of the portfolio volume. The system is secured in any case for the guarantor, and the existence of the ceiling ensures a proper care taken by the bank in the risk assessment process.
- Agreements for Portfolio guarantees should be usually come only after a long enough period of observation. It takes time for the guarantor to observe the profile of risk in the population of files presented by a bank, and get a clear judgment on the lender processes.

The following precautions should be taken before signing an agreement:

- Checking on the partner bank understanding of the nature of risks entering the portfolio is a key factor. The lender's logic and vision on its assessment of Probability of Default, and Loss given Default, should be well analyzed.
- Checking that the partner has a risk based fee policy, continual risk management, and a healthy risk repartition in the portfolio.
- Study the concentration by sector, the size of maximum individual loan amount as percentage of total portfolio, and fix limits.

2 / In case of portfolio guarantees, conditions in the agreements with banks must secure the guarantor's position; in the list of best practices, we can mention:

Definition of portfolio:

- When negotiable, and in order to avoid adverse selection of files by the bank, the bank can be requested to accept a principle of entering all the eligible loans in the portfolio (logic of “globality”).
- The principle can have an element of suppleness, allowing the bank to keep all the risk on some of its best clients, which do not make the external guarantee necessary, and would create commercial problems for the bank..

- A minimum population size should be defined, to ensure possible mutualization of risks; failing to do so would result in a higher risk cost for the guarantor.

Limits of the guarantee extent should correspond with the banks' expectations:

- For "classic" types of projects, such as financing investment for growth, and simply lacking collateral: a capped coverage can be acceptable for lenders, expected limited PD on the portfolio.
- For, high risk borrowers (start ups, innovative projects) : the guarantee, to be incentive for banks, should be uncapped. Such offer usually requests public support, with the existence of a national or European counter guarantee program (example: with INNOVFIN program)

The importance of controls

The rhythm of controls fixed in agreements with banks, should be the result of a risk-based audit process, allowing a constant monitoring of risks. Frequency, and sample size of controls should be adapted in case of concern by an increasing default risk; these eventualities should be entered in the agreement.

The specificity of agriculture: quite hard to cultivate

1/ Guarantees on loans to agriculture face specific problems

- Importance of climate factor and market trends on the risk level of borrowers
- A phenomenon of concentration (through the demand for modernization and productivity) affects the sector all over Europe
- A strong negative climatic event can affect the whole portfolio of an agricultural sector
- Turn over for agricultural production is extremely sensitive to market prices, which tend to vary quickly and in a large proportion.
- The financial structure of small actors is usually extremely fragile
- Agricultural borrowers (small farmers mostly) have in general a lower level of understanding or practice on financial aspects
- Reluctance to pay the cost of crop insurance is a very common attitude

Agriculture today means larger investments, and more debts, confronted with fluctuating prices on commodity markets, the schemes have to integrate the logic of associating the insurance element to cover this.

2/ Conditions for a successful activity in this sector can be met

A very good example is represented by Ismea (Italy). Its presentation showed a holistic system combining the action of lending and insurance partners, working in coordination: banks and re- insurers have, through practice, organized an efficient system on a large scale.

- Public but based on self supporting model, risk based fees started in 2005
- Mutual support: use of consortium guarantees (several agricultural SMEs)
- Web based applications
- High risk coverage 70 % (up to 80% for start ups)
- Risk rating model, assessing the PD for the borrower, but taking also into account the track record of default of guarantor, national system, and the loan characteristics
- Fees are calculated for each guarantee according to the risk rating (linked to a probability of default), the purpose of the loan and the nature of financing.

The process leads to a successful business model, based on the mathematical model and the risk cost evaluation. The guarantee scheme is financed by a public resource, but on logic of being a self supporting entity. The state

capital issued for backing the guarantees is not to be paid out to cover defaults, and receives a yearly remuneration.

3/ Guarantors from Eastern Europe, where the agricultural sector is still rather important, have also developed techniques to face the difficulties of this activity. Financial support from national instruments and EU dedicated programs have been presented by SIAULIU BANKA (Lithuania), as a user of ACGF guarantee program. This bank is an active partner of INVEGA. This program integrates a grant element (paying part of interest paid by borrowers). The EU is supporting mechanisms for agriculture (as well as other sectors), as an element of economic growth support.

Common point: using external competences to complete visibility.

Asset protection for guarantors: a constant element, taking more importance for some actors

Context: guarantors are perceived by banks as suppliers of additional guarantees for SMEs missing the necessary collateral requested by lenders. But guarantors have an additional role when loans are requested from borrowers showing an insufficient track record or not enough project visibility: the probability of default becomes the main motivation of the request for the guarantor's coverage. The guarantor, basing his assessment on its experience on similar operations, has to consider how much of its potential risk would be covered by the borrower assets, or by the personal guarantees given by the entrepreneurs.

The value of these guarantees is rarely the main motive for the guarantor agreement to cover the loan, for two main reasons:

- Evaluating collateral offered by the borrowers is usually difficult, and uncertain; the accuracy of estimating how much could be recovered faces too many factors that may reduce the expected recoveries:
 - Obsolescence of equipment, change of market values, difficulties in the legal process, moral hazard play usually a large role.
 - Pre existing mortgage or commercial pledges can reduce the potential value of the guarantee, as detailed in the ALTUM presentation.
 - A table of average recovery rate for each type of collateral, comparing initial value with effective amounts recovered, as illustrated in the INVEGA presentation, is an useful instrument, to avoid excessive optimism.
- Guarantee companies base their decisions mostly on the economic feasibility of the projects that are submitted; the value of collaterals is secondary to the appreciation of future cash flows. Still, as some presentations showed, the element "collateral", can take more importance in the balance of decisions:
 - Guarantees on assets financed by the guaranteed loan are usually taken.
 - Additional guarantees from the borrower, or personal guarantees of entrepreneurs, come into request, as means to set a reasonable and fair sharing of the final risk between the three parties: borrower, lender and guarantor.

The OTS illustrated applications of this logic into two directions: leasing, and innovative guarantee offer.

1 / Leasing guarantees: the experience of Bürgschaftsbank Baden-Württemberg

As the lessors have ownership of the equipment covered by the financing, as well as efficient operational processes (as a rule) for recuperating and selling assets from defaulting customers, the Loss Given Default of their operations is greatly reduced.

Guarantors can consequently operate with lessors under better risk conditions than with bank loans. This is useful for assisting start ups, young SMEs, or enterprises with limited equity of fragile financial structure. It allows a higher leverage between equity and borrowing capacity than traditional loans.

Importance of the equipment valuation from the specialist (who can assess depreciation, conditions and situation of re-selling market),; this factor is basically more reliable, and therefore more important, in some cases, than the opinion on the customers' survival probability. In the German context, the leasing company commits itself on the re- selling value of the equipment financed, in case of default (30 % or 60% of the initial value).

Optimal combination of two complementary skills should be organized ; that of the guarantor, on the viability risk of the lease, and that of the lessor on the estimation of recovery on possible default

Business on leasing guarantees exist mostly on two safe combinations:

- Tolerate riskier SMEs (start ups...), if the equipment is offering a very good protection in case of default
- Keep to good profile SMEs for the equipment with limited market value probability (linked to rapid obsolescence, extreme specialization of the equipment, or assets requiring a high cost for moving it or reselling it).

The success of leasing depends of the existence of adapted conditions in the country's environmental framework, on legal, tax and accounting factors.

- Rent paid to the lessor must be deductible from the user's profit,
- The protection for the lessor must be enforced by favorable operating conditions for seizing the equipment from defaulting leases.
- Court decisions must also enforce a real protection of the lessor's right

2 / Some original guarantee products can be offered, pending minimal asset protection.

This is the case of the "Upfront guarantee" by SOWALFIN (Belgium)

- A statutory payment (maximum of 25% of the initial loan nominal amount) will be paid upfront and unconditionally to the bank by the guarantor, in case of borrower's default, under the condition that the collaterals taken for the common risk of lender and guarantor represent a minimum value of 25 % of the initial loan value.
- Loans must be based on intangible investments, offering a base for valuable collateral. From its evaluation is set the amount of the guarantee, under the respect of the above limit.
- With this guarantee, the bank can avoid the usual long delays that exist when the guarantors payments are done only after the recovery process on pledged borrower's assets
- The guarantor limits its risk to the 25 % of the initial loan; but contrary to main usual practices, if recoveries on collaterals are higher than expected, this will not benefit the guarantor by reducing its risk.
- The Upfront guarantee is limited in any case to 500 000 €. Its term depends on the loan repayment schedule, as it must abide to the EU rule limiting guarantor's coverage to 80% of the outstanding loan.
- The upfront guarantee is consequently more attractive if a possible risk exists in the first years of the loan repayment; due to the above limit, its coverage will reduce as the outstanding loan amount goes down.

- For the guarantor, the defined amount of the payments helps assessing the program risk cost, and allows a better multiplier on its resources; the cost for the borrower is smaller than for a traditional guarantee coverage;

Equity guarantees: the most dangerous game

Equity guarantee is still rare in the product range of most AECM members.

Few guarantee operators manage to tackle this type of activity; risk on equity investments being one of the most difficult to assess, bearing in mind that the request for risk sharing in members of the profession of equity investors addresses mostly the risk capital for the younger, innovative SMEs (seed capital and venture capital), and not the development capital (for corporate customers).

For this activity, it is extremely difficult to find the right balance between financial prudence and the possibility to allow a large outreach of such a guarantee on risk capital actors.

This is still a handicap in most countries for the venture capital firms which should play an essential role in strengthening the financial structure of the most promising SMEs.

The risk assessment of such projects combines several difficulties:

- Need for specialized skills, in financial and economic approach; due to the necessity to assess potential profits from future performance of projects which are, by essence, quite different from passed situations, and often lead by managers on whose attitude success depends.
- The required legal aspects for securing the investments, a clear and precise vision on the SME market, and liquidity for the selling of the equity investment
- For equity guarantees, the specific cultural factor in the population of Venture Capital firms means a need for similar interlocutor in the guarantee company.
- Projects are frequently linked to innovation, making assessment even more difficult.
- High depth in risk analysis necessary, usually out of guarantor's reach
- High expected default rate, difficult to assess upfront.

Two different approaches have illustrated the topic in the OTS:

1 / The German experience: presented by Bürgschaftsbank Baden-Württemberg

- Attentive survey of projects, and decision taken case by case
- Additional high level public counter guarantee, leaving a limited risk portion to the guarantor
- Still, the remaining risk portion for the guarantor is not managed by a subsidy mechanism; therefore, the guarantors keeps its own choice of granting or not the coverage to the VCF.
- Globally, the system has lesser outreach on the population of SMEs looking for financial investors.

2 / Solutions in the Bpifrance guarantee scheme:

The scheme is presented in the Peer Review from the INNO-Partnering Forum (IPF).

The French scheme is based on a principle of creating an incentive for venture capital firms (VCF) to invest in small SMEs carrying attractive perspectives, mostly through innovation projects.

- It does not aim supporting large development projects, but targets rather the young innovative companies.

- It relies, for the risk assessment on the skill of the professionals in the venture capital firms signing an agreement, thus using the capacities of practitioners.
- Operating venture capital firms are selected according to track record, profile of managers, investment committee profile, nature of shareholders, investment strategy adopted), and passes an agreement with each.
- Eligibility limits guarantees to the population of projects fitting well the guarantee scheme's objectives and strategy, sketched by French public authorities.
- Within that frame, the granting of the guarantee comes automatically with the decision to invest, taken by the VCF.

The system carries a risk- limiting mechanism:

A stop loss ceiling is included in each guarantee agreement passed with each equity Venture Capital Firm:

- The potential risk amount to be paid out (in the worst scenario) is pre -determined for the guaranteed VC (volume of eligible portfolio x guarantee quota).
- The whole guarantee scheme, as an addition of individual ceilings, is exposed to a determined and controllable maximum risk.
- This maximum risk, taken yearly on the whole program by the guarantor, is based on the amount of funding allocated for one year by public authorities to cover the risk cost. This adds to income from fixed fees, which is barely covering management expenses of the guarantor.
- The potential of guarantee is shared between eligible and agreed VCFs , normally selected for their contribution to support innovative SMEs, or other SMEs contributing to the national development policy, export, competitiveness...
- The guarantor requires a part of profits done over a 10 years period, as additional income.
- Its share of profit is limited, in order to motivate VCs to request the guarantee.
- This profit sharing is paid only up to a maximum amount, which is the amount of guarantees paid to the VCF during the 10 years period.

Productivity matters: the logic of managing exceptions for the evaluation process

Productivity aspects affecting the type of risk assessment: the risk evaluation processes can be different for categories of files, according to the risk level estimated for each category. Fewer due diligences, reducing allocated staff time, are needed for the less risky operations, leaving more available investigation resources when necessary for the higher risk operations.

Several factors can be used to select beneficiaries of simpler and faster decision making process :

- Size: for Bürgschaftsbank Baden-Württemberg, loans smaller than 200 000 € have a lean and fast assessment is used
- Individual risk rating: Discrimination can be done according to the risk profile.
- Or according to external sources which can provide reliable information – like a credit bureau
- But also according to the quality of the financial partner, based on a sufficient track record
- Segmentation according to sectors, size of borrowers, loan size, types of projects can also help improving the productivity of the risk assessment

Bpifrance offers delegation of its guarantee on smaller loans, to banks signing an agreement.

- Conditions for concluding the agreement include detailed survey of the bank's organization, processes and risk assessment.

- Beneficiaries must be small SMEs (craftsmen, retailers, service providers); The loans must be related to an investment, and be lesser than 150 000 €.

On such populations, the effects of good professional practices in the bank, and the mutualization of small risk in large portfolios lead to a low level of default, making no need for the guarantor' individual assessment.

- No application is sent for individual files; the portfolio is declared monthly or quarterly, with only an identification code for the borrower, and the amount of the outstanding loan.

All controls on eligibility and conditions are made only of files for which the guarantee is called

- All necessary documents for the claimed guarantees are then sent to the guarantor.
- This process avoids all the range of due diligences for the large majority of files entering the portfolio.

The trend towards a wider range of guarantees is a challenge for LGS guarantors

1 / The range of financing covered by the risk sharing offer from guarantors is gradually increasing.

Also, some guarantee Institutions can combine the offer of guarantees with the supply of additional financial instruments (directly, or via companies in the same group).

This is the case for the following institution represented in the OTS, among others, by:

- Burgschafstbanken: gee on loans, leasing, mezzanine capital and on equity; also, guarantees on financing Energy Performance Contracting
- Altum: (as an entity resulting from the merger of several pre-existing institutions) guarantee, direct loans, equity investment.
- Bpifrance: gee on bank financing, provision of loans and leasing, guarantee on equity, plus direct equity investments
- SOWALFIN (guarantees, and at group level, co-financing and risk capital)

This helps to raise higher additionality in the mission of guarantors, to answer the needs of credit-constrained enterprises.

- The outreach of the guarantee instrument meets more beneficiaries,
- Positive synergies between types of financing can be created.

2 / As a consequence of this wider range of products, additional skills needed for the risk assessment of various activities increase the institution value, and its place in the financial landscape.

- A wider range of products add to the attractiveness of its partnership with banks.
- The challenge for existing skills in the guarantor staff gets a greater importance. Default probability can increase on these specific populations of risks, and more competences are required to handle the new guarantee programs safely.

Conclusion: combining factors of risk assessment, in an on-going process

For every guarantee, a risk assessment is needed; but the nature of the assessment, its intensity and the operating agent which is going to make it depends on various factors.

- Whatever the type of guarantee product, the right risk assessment should be chosen in order to fit the target risk limit, the objectives of the guarantee program, the expected quality of risk coverage by collaterals or assets, and the rightful use of competences needed for a good decision making process.
- Solutions for organizing the adapted risk assessment on a definite product should be set by considering the rightful balance between the four groups of factors detailed below.

