AECM position on the need to keep up enhanced guarantee support

CONTEXT

Following the outbreak of the COVID-19 pandemic, the economic activity has been severely hampered due to lockdown and social distancing measures that have been imposed all over Europe since mid-March 2020. Governments from the regional to the European level rolled out extensive support measures for companies that are severely affected by the economic and social consequences of the pandemic. These measures are of a fiscal, monetary and regulatory nature.

Small and medium-sized enterprises (SME) are in this crisis the most vulnerable part of the business structure and at the same time they are vital for a healthy recovery.

The above-mentioned **support measures were key in preventing a complete breakdown of the European economy which would have been the consequence of an insolvency wave and a consecutive credit crunch**. They successfully ensured a relative **continuity in SME lending** allowing small businesses to bridge these difficult times.

At the same time, it is undeniable that the current level of public business support is not sustainable in the medium and long run. That is the reason why an exit from it needs to be well prepared. **It is of utmost importance to design a balanced exit strategy in such a way that it does not endanger the stabilisation of SMEs and of the economic recovery**. We would like to contribute to the debate on an exit strategy and draw the attention on the specific case of SME credit guarantees.

THE COMMITMENT OF GUARANTEE INSTITUTIONS

As most European governments closed down public life (shops, restaurants, cafés, transport, services, etc.) in an attempt to limit the spread of infections, **guarantee institutions all over Europe reacted in no time and set up additional extensive support measures for SMEs** that are strongly hampered in the pursuit of their business activities.

With the support of public counter-guarantees granted by all governmental levels[1] and thanks to an intense use of the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak, credit guarantee schemes substantially expanded their activity. This expansion has both a quantitative and a qualitative character, the latter meaning that conditions were significantly adapted to the changed circumstances and that accompanying measures were set up[2].

The dynamics of developments in the European guarantee sector are impressively mirrored by the statistics that **AECM** collected for the first semester 2020. According to these, the **guarantee activities of AECM members experienced a dramatic increase of 135.2%** with respect to the previous semester **and reached a level of more than bEUR 259**. The **new guarantee production** (in volume) of all **AECM** members over the first semester 2020 was **10.8 times the new production in the previous semester**. The total **number of SMEs supported by guarantees from AECM members jumped up by 56.7% attaining the highest level ever reached, 4.5 million**[3].

Expanded guarantees have been reducing the risk of the banks[4], thereby facilitating the continuation of the lending activity[5] and, consequently, the prevention of mass business insolvencies[6].

Guarantee institutions demonstrated throughout the year 2020 that they are an indispensable part of the policy mix in the fight against the economic and social consequences of the crisis. This is not only due to the **resource-efficient**

[1] According to the OECD publication "COVID-19 Government Financing Support Programmes for Businesses", *"In many countries, Credit Guarantee Schemes (CGSs) represented a key policy tool to address the SME financing gap while limiting the immediate burden on public finances."*
[2] A table in the annex of this position paper gives a non-exhaustive overview of COVID-19 measures adopted by European guarantee institutions. Further details on these measures can be found in our AECM brochure on the covid measures of our members.
[3] The more detailed AECM half-yearly statistical report can be found under this link.
[4] The reason why SME lending could be continued despite a huge increase in risk is that this risk was largely assumed by governments thereby preventing a fast and complete depletion of the banks' lending capacity. According to an EBA assessment using data from June 2020: *"Public guarantees have the potential to significantly reduce banks' RWAs. In June 2020, banks reported RWAs of EUR 29 billion for exposures subject to PGS of EUR 162 billion. This implies an average risk weight of around 18% […], which can be compared with an average risk weight for banks' NFC exposures of 54% […]."*
[5] Unlike the global financial crisis, bank lending to the real sector has even increased during the second quarter of 2020 according to EBA and this thanks to public guarantee schemes.
[6] While the number of registrations of corporate bankruptcies were far below normal in Q2 2020 they picked up during Q3 2020 but remained at a level much lower than in previous "non-crisis" years, see Eurostat.

and risk-mitigating nature of the guarantee instrument but also thanks to the **longstanding intense relation with SMEs** and SME organisations.

This **counter-cyclical role of credit guarantees** is well proven. Already during the financial crisis between 2008 and the early 2010s, guarantee institutions - supported by national governments and EU programmes - filled in where commercial banks were retreating from risk taking. This bold intervention made it possible to **mitigate negative consequences for the European economy**. But whereas the world financial crisis originated in the financial sector and had only second round effects on SMEs, small companies are in the COVID-19 crisis the first in line to suffer from the economic consequences of the health crisis.

THE ROLE OF GUARANTEE INSTITUTIONS IN REGULAR TIMES

In normal times, guarantee institutions support small and medium-sized enterprises with a viable business model but lacking the required collateral to get access to finance. They thereby **solve the problem of information asymmetry** between entrepreneurs and banks and allow to **overcome the market failure** in the area of SME finance[7].

Keeping a functioning guarantee scheme also in regular times has many merits. The positive impact of credit guarantees on the economy, especially on growth, employment, and innovation, is considerable as can be concluded from numerous scientific impact studies. A pan-European assessment undertaken by the European Investment Fund (EIF) for example, finds strongly **positive effects of guarantees on the growth of total assets, on sales/turnover and on the employment level**. Furthermore, it substantiates a **diminishing effect on default rates**[8]. Further studies on the guarantee activity of AECM members in their respective countries find and quantify similarly **positive impact results, including on investment and on macroeconomic indicators such as GDP as well as fiscal cost**[9].

At the outset of the COVID-19 crisis it was an invaluable advantage that a **well established and experienced guarantee sector was standing ready to implement public support schemes swiftly and soundly**.

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[6] OECD (2006). The SME finance gap. Vol. 1. Theory and evidence.
For an overview of market failures in SME lending and mitigation techniques: OECD (2018). Financing SMEs and entrepreneurs 2018. An OECD Scoreboard, OECD Publishing, Paris.
[8] Brault, J. & Signore, S. (2019): The real effects of EU loan guarantee schemes for SMEs.
[9] For an overview of these studies, see here.

IMPLICATIONS AND CONCLUSIONS

As demonstrated above, **credit guarantees play an important role in the area of business promotion both during crisis and in regular times**. Without the extensive public guarantee programmes, the European economy would have experienced mass business bankruptcies, especially of small companies with second round effects on the financial stability, on employment and ultimately on competition and innovation.

A **hasty exit from public support in form of extended guarantees puts in danger the fragile stability that this policy instrument offered during the past year**. The following harmful effects can be expected from such a precipitate retreat:

- Effect on **business structure**: A hasty exit from support measures would first and strongest hit micro and small businesses that are already fragilised by the pandemic. As a consequence, whole sectors and business chains would be put at danger culminating ultimately in high numbers of insolvencies. This would primarily hit rural and structurally weak regions.
- Effect on **employment**: A strong increase in business insolvencies would logically result in a high number of layoffs. Beyond human fate, this would of course on the one hand burden public budgets and on the other hand severely hamper the recovery via negative effects on domestic demand.
- Effect on **financial stability**: An abrupt retreat of governments as risk sharing partner may trigger a wave of corporate defaults that in turn will result into higher non-performing loans (NPLs) threatening banks' stability and putting also more pressure on sovereigns.
- Effect on **public debt**: Governments are currently guaranteeing for a significant share of the European business population. Withdrawing from further support will destabilise many of these businesses causing their defaults and thereby the drawing of guarantees more probable. The fiscal loss of the covid crisis will be sensitively increased.
- Effect on **innovation**: In order to get the recovery off the ground, investments are needed. However, in the current business environment caution is advised and risks are only taken if they can be shared among several partners.

At this point, **AECM** would like to emphasise that due to the reasons laid down in the previous section, **a discussion cannot be held on an exit from public guarantee support as such, but only on an exit from the extension and the adjusted conditions** of public guarantees that were introduced in the frame of the COVID-19 response.

While these points make quite clear that a hasty withdrawal of public guarantee programmes would have severe negative effects on the economy and on the recovery, one also needs to take the risk into account that businesses, that turned permanently unviable during this crisis, are accumulated in the books of banks in Europe and subsidised by the public. In order to avoid that this risk materialises, a lengthy and deliberate withdrawal should start with a more targeted selection of supported companies[10] and a **step-by-step normalisation of conditions with a thorough evaluation of the effects on the economy before every next step**. However, such a process can only start once the health situation allows for a normal and unrestricted business activity. This is all the more true, since the guarantee is a cost-saving instrument.

A sound transition to normal conditions for the public guarantee programmes could ideally be framed with incentives to **complement the outstanding debt measures with equity or quasi-equity support** allowing companies to counteract potential debt overhangs.

Finally, **guarantee institutions need to be strongly involved in any discussion about exit strategies at all political levels**. As the implementors of the extensive government support programmes and at the same time as locally rooted institutions that know the businesses they are supporting very well, they have the required experience and the relevant knowledge to make valuable contributions to these strategies.

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[10] However, a withdrawal from specific sectors (which are less affected by the pandemic) is not advisable. Decisions must be taken on the micro level taking the individual situation of firms into account. Guarantee institutions are well experienced with such assessments on the micro level and are best in place to evaluate in cooperation with the financing bank individual lending requests.

About us

The 47 members of the **European Association of Guarantee Institutions (AECM)** are operating in 30 countries in Europe. They are either private / mutual sector guarantee schemes or public promotional institutions or banks. Their mission is to support SMEs in getting access to finance. They provide guarantees to SMEs that have an economically sound project but do not dispose of sufficient bankable collateral. This so-called SME financing gap is recognised as market failure. By guaranteeing for these enterprises, guarantee institutions help to address this market failure and facilitate SMEs' access to finance. The broader social and economic impact of this activity includes the following:

- Job creation and preservation of jobs by guaranteed companies
- Innovation and competition: crowding-in of new ideas leading to healthy competition with established market participants
- Structure and risk diversification of the European economy
- Regional development since many rural projects are supported
- Counter-cyclical role during crises

SME guarantees generally pursue a long-term objective and our members, if public, private, mutual or with mixed ownership structure, have a promotional mission.

AECM's members operate with counter-guarantees from regional, national and European level. As of mid-2020, **AECM**'s members had about bEUR 259 of guarantee volume in portfolio, thereby granting guarantees to around mEUR 4.5 SMEs. **AECM**'s members are by far the most important counterparts of the EIF concerning EU counter-guarantees, handling EU guarantees from the very beginning in 1998.

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Annex : Overview of measures

Country	Organisation	Support via standard programmes	Support via dedicated covid programmes	Increase of the guarantee capacity	Increase of the maximum and decrease of the minimum guarantee amounts	Increase of the coverage rate	Reduction or waiver of fees and interest	Fast-track procedures and/or reduced documentation requirements	Relaxation of repayment schemes	Extension of the scope of the guarantees	Reduction of collateral requirements	Equity and quasi-equity measures	Offering advisory services (incl. FAQ and hotlines)
Austria	aws	√	√	√	√	√	√	√	√	√	√	√	√
	NÖBEG	√	√	√	√	√	√	√				√	√
Azerbaijan	MCGF	√		√	√	√	√	√	√				
Belgium	PMV/z Waarborgen	√	√	√		√	√		√			√	
	Fonds Bruxellois de Garantie	√	√									√	
	SOWALFIN	√	√	√		√	√	√	√			√	√
Bosnia and Herzegovina	GF Srpska	√			√		√	√	√	√			
Bulgaria	NGF	√							√				
	MGFSME	√	√	√		√	√						
Croatia	HAMAG-BICRO	√	√	√		√				√			
Czechia	CMZRB	√	√	√		√	√	√	√				√
Estonia	KredEx	√	√	√		√	√	√			√		√
Finland	Finnvera	√	√	√		√	√	√	√	√	√		√
France	SOCAMA	√	√						√		√		
	SIAGI	√	√	√		√			√				
	Bpifrance	√	√	√		√		√	√		√	√	√
	EDC	√		√					√				
Germany	VDB	√	√	√	√	√	√	√				√	√
Greece	HDB	√	√	√			√						
	TMEDE	√		√			√			√			
Hungary	Garantiqa	√	√	√	√	√	√						
	AVHGA	√	√	√		√	√	√			√		
	MVA	√											
Ireland	SBCI	√	√	√		√	√		√		√		√
Italy	Assoconfidi	√		√		√	√		√				
	ISMEA	√	√	√		√	√	√	√				
Kosovo	KCGF	√	√	√		√	√						
Latvia	Altum	√	√	√	√			√		√		√	√
Lithuania	Invega	√	√			√	√		√		√		√
	Garfondas	√	√	√		√	√						√
Luxembourg	MC	√	√					√					
	MPME	√											
Malta	MDB	√	√	√	√	√	√	√	√		√		
Netherlands	RVO	√	√	√		√	√	√			√		
Poland	BGK	√	√	√		√	√	√	√	√		√	√
Portugal	BPF	√	√	√		√	√		√		√		
Romania	FGCR	√						√	√				
	FNGCIMM	√	√	√		√	√	√	√				√
	FRC	√					√	√	√	√			
Russia	FSECA	√		√									
Serbia	GF Vojvodina	√		√		√	√			√			
Spain	CESGAR	√	√	√	√	√	√	√	√				
Slovenia	SEF	√	√	√		√	√	√	√		√		√
	SRDF	√	√				√		√		√		√
Turkey	TESKOMB	√					√		√		√		
	KGF	√	√	√			√		√				
UK	BBB	√	√	√	√	√	√	√	√	√	√	√	√
	aecm TOTAL	47/47	34/47	35/47	10/47	30/47	34/47	23/47	28/47	10/47	15/47	10/47	17/47