

Sharing credit risks, an incentive for investment and growth

SME's access to financing can be facilitated by guarantees provided by the so called "credit guarantee funds" (CGF). The nature of CGF varies across the countries, but they all share some basic features, i.e. they exert a social function, assisting access to credit for weaker borrowers, dressed in the clothes of commercial companies, and complying with all obligations of such a financial institutions

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The positive role of small and medium-sized enterprise (SME) in the economy is widely recognized: they create value added and jobs, contribute to innovation. To this, one can add the contribution of SME to the emergence of a solid social fabric, their presence in less developed areas, and their democratic spirit.

However, access to bank loans can be particularly difficult for SME in cases where they have insufficient collateral or lack a sufficient track record or credit history. Often, SME are also more sensitive towards changes in the economic climate than larger companies. In many countries, and particularly in Montenegro, the rate of financial intermediation has risen substantially, but still efforts have to be made to direct financing towards productive investments.

Credit guarantees provide cover to lenders - commercial banks - in cases where the borrower defaults on repayments, i.e. when the lender makes a claim on the borrower and the latter is unable to meet its obligations. To be successful, CGF must provide a service to both market partners, the SME and commercial banks.

Regarding SME, CGF have the advantage of facilitating access to external financial resources without diminishing the financial responsibilities of the borrower. This access to finance can prove a catalyst for the launching and expansion of a business. Guarantees are issued on the basis of a sound analysis of quantitative and qualitative pa-

rameters. As a consequence, entrepreneurship is stimulated and SME managers and entrepreneurs also benefit from the financial advice provided by the CGF.

Regarding the relationship with commercial banks, CGF help to reduce the overall risk faced by financial institutions. In this way, CGF contribute to a safer development of SME loan portfolios. In the framework of the Basel 2 accord and of the EU Capital Directive, the credit guarantees issued by CGF are regarded as a useful "risk mitigating" instrument, and allow banks to reduce their provisions.

Nowadays, in the territory of the enlarged EU there are 35 CGF, operating in 19 countries, with a total cumulated capital of about 6 billion euros. This has allowed European CGF to issue credit guarantees for a total amount of 50 billion euros. These are impressive figures, which also highlight one of the most important features of CGF, i.e. their "multiplier effect". In fact, in EU countries, with 1 Euro of own funds, CGF are able to generate about 9 euros of guarantees, or about 15 euros of loans which, in turn, result in about 25 euros of investment. In EU countries, CGF support different credit operations, from working capital loans to long term investment loans. In certain countries, CGF can also provide the so called "technical guarantees", e.g. guarantees for the good performance of public works, guarantees for VAT reimbursement, etc.



Given the above, it is not surprising that in EU countries establishment of CGF has been actively supported by governments, which in many cases have contribute to their capitalization. CGF are also supported by European institutions. A major supporting scheme is represented by the counter guarantees offered by the European Investment Fund to well organized CGF, in order to strengthen the financial solidity and allow a bigger volume of guarantees.

The establishment of a CGF in Montenegro has been under discussion for a long time. However, creating a new credit guarantee institution is not a simple job, as it requires a detailed analysis of the local context. Among the issues to be reviewed are:

- what are the prevailing market conditions between borrowers and lenders? What should be the main target market?

- what is the average probability of default of business loans? At what level should the guarantee premium be set to be affordab-

le by borrowers and at the same time the viability of the CGF?

-what is the desirable amount of capital be mobilized in order to maximize the CGF impact? Who should provide this capital? Is it possible to have, as in a number of EU countries, business associations, banks and government authorities to join forces, in order to capitalize the CGF?

In the case of Montenegro, the above issues were thoroughly revised within the framework of a technical assistance project funded by the European Commission and managed by the European Agency for Reconstruction (EAR). During more than two years, a group of European experts worked closely with Montenegrin institutions, business associations and banks to find a satisfactory solution to the various questions. This work also contributed to raise the awareness regarding the benefits

of CGF among all the stakeholders and eventually succeeded in creating a consensus among the various players, regarding the establishment and initial capitalization of the CGF.

Another essential aspect to be considered is that the CGF must be regarded as a reputable and credible partner by commercial banks. In this respect, a cornerstone is the supervision of CGF operations: if CGF are subject to a serious prudential regulation that makes sure that credit guarantees are issued on the basis of sound principles, then a crucially important step in the good direction has been made.

In our country the role of supervising CGF is entrusted to the Central Bank of Montenegro (CBM). In particular, the CBM:

will be called to issue licenses to new CGF, ensuring that the business plan is re-

alistic and reliable, that managers have the requested qualifications, that a minimum equity has been collected, that the multiplying effect is kept within safe limits;

will determine other requirements to identify, measure, monitor and supervise all kinds of risks met in day to day operations, with special reference to credit risk, liquidity risk and market risks. Furthermore, CGF governing bodies will be required to adopt policies and procedures that are satisfactory to the CBM.

With passing of the new Law on Banks and the ensuing approval of the CBM regulation on the establishment and operations of CGF, all the basic conditions for the effective launch of the first credit guarantee institution will be met, and Montenegro will have accomplished one more step in the direction of approximating conditions present in EU member states ■