European Union

Government of Montenegro

WORKSHOP ON
CREDIT GUARANTEE FUNDS

European Agency for Reconstruction

Directorate for SME Development

Dr. Dieter Falk

Senior Partner, Dialog GmbH (Eschborn, Germany)

Economic Impact of Credit Guarantees: The Case of Germany

Advisory Support for Transformation of the Development Fund
An EU funded project managed by the European Agency for Reconstruction

Part I – Main Features of the German Federal Guarantee System

Mission

Support SME & Start-ups in access to finance

Improve their collateral situation and

financial credibility, lower interest rates

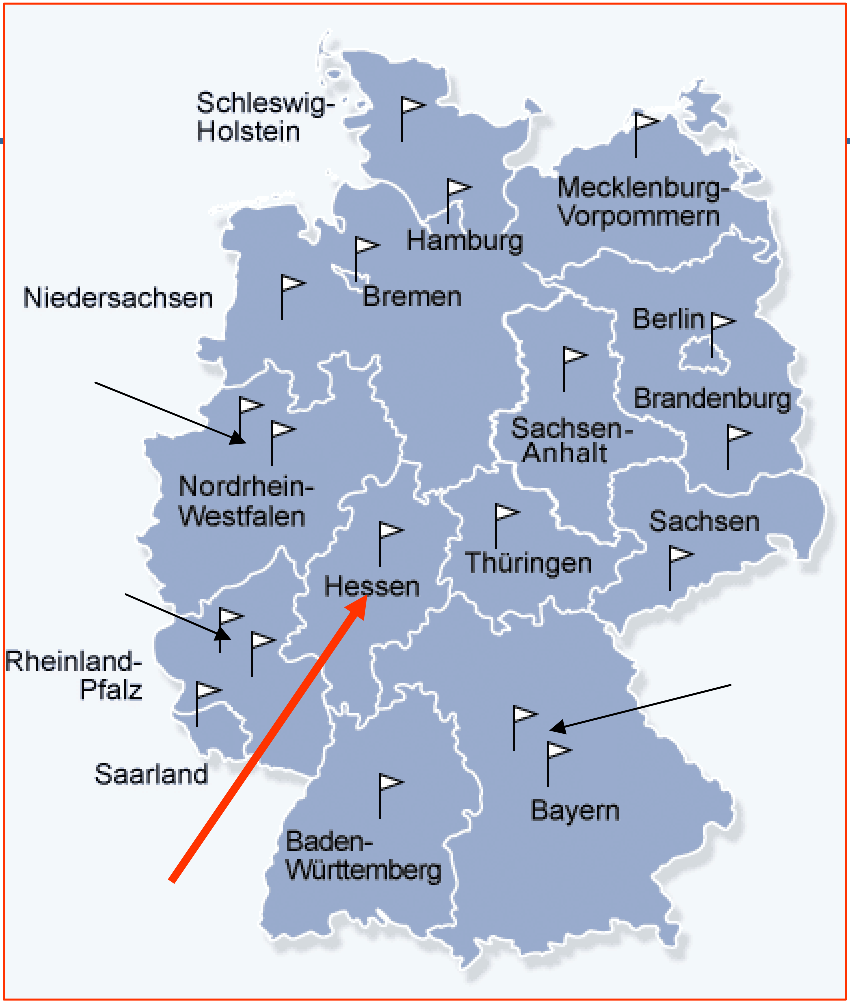
Help banks to lower their credit risk and expand capital adequacy

Contribute to Germany's economic growth

Part I – Main Features

Players

Network of Guarantee Banks



Part I – Main Features

Players - VDB

The Association of Guarantee Banks (VDB) is the voluntary union of the legally and economically independent guarantee banks (formerly known as credit guarantee societies).

The association itself carries out no active business, it is a common interest group.

Part I – Main Features

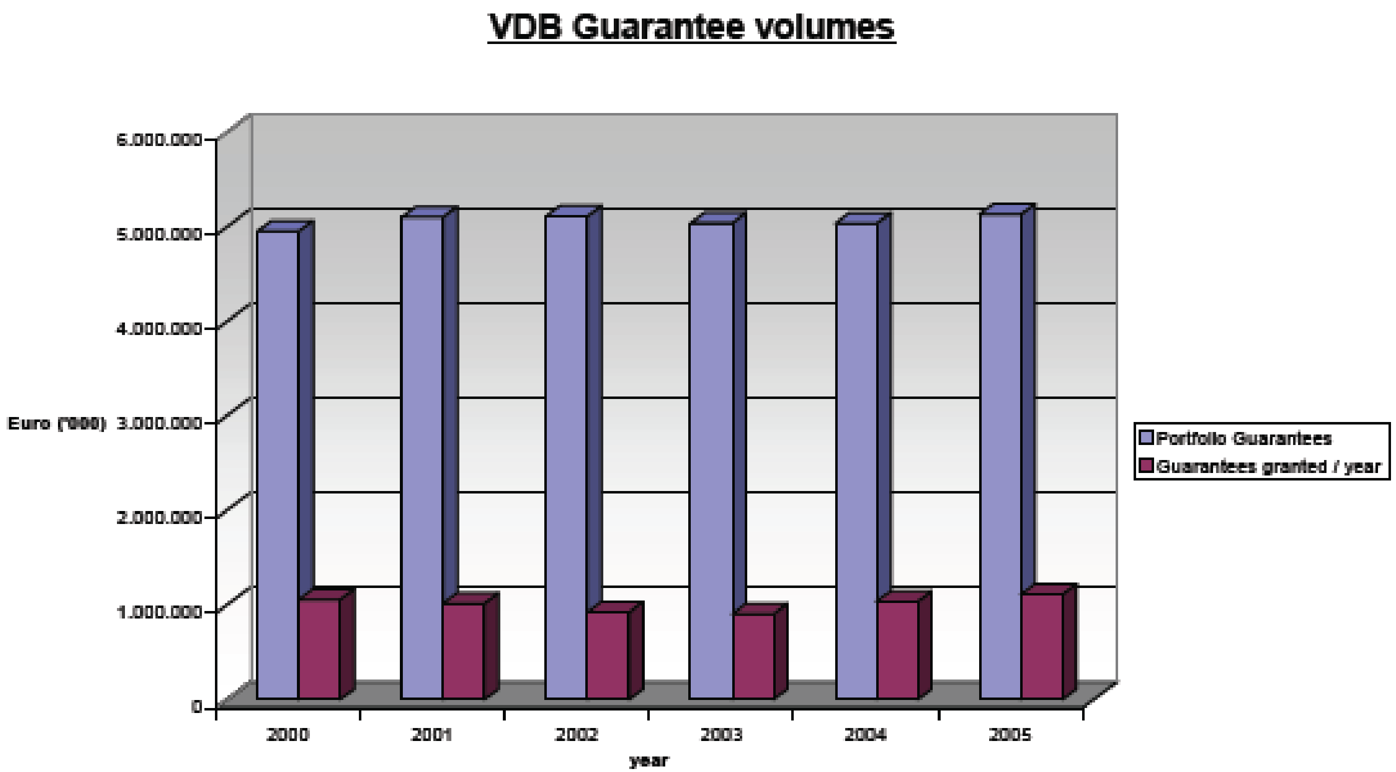
Figures I

Number of sureties and guarantees as of end 2006

BÜRGSCHAFTS- UND GARANTIEBESTAND DER BÜRGSCHAFTSBANKEN ZUM 31.12.2006, ANZAHL BÜRGSCHAFTEN UND GARANTIEN

Part I – Main Features

Figures II - Volumes



Part I – Main Features

Figures III – Size and Performance

Total equity of German GBs: 290 m €

Guarantee portfolio 2006: 5.2 billion €

GDP Montenegro 2007: 2.3 b €

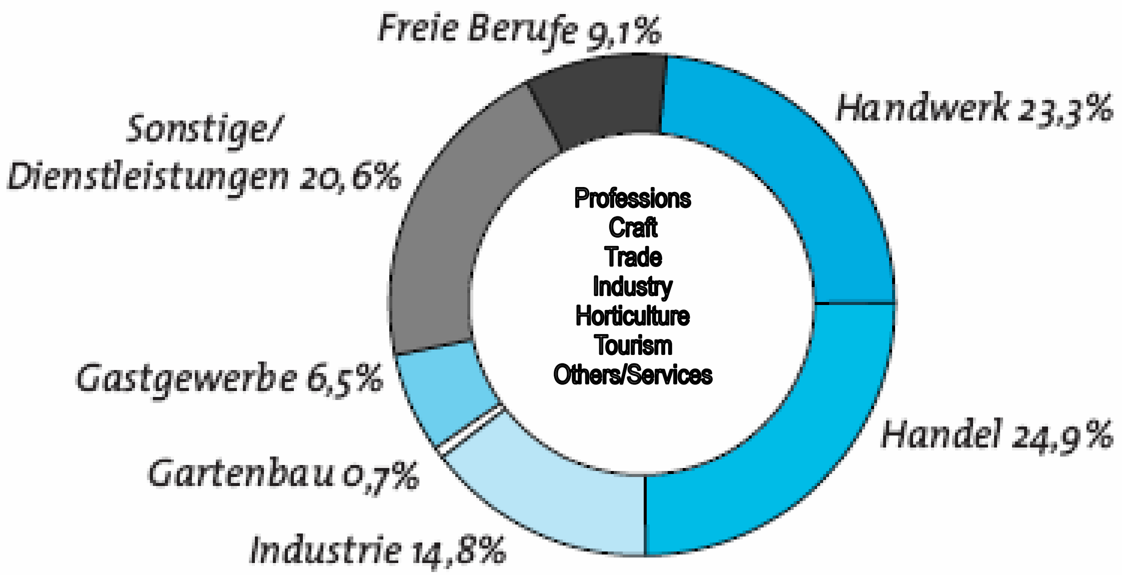
Defaults: 176 m €

< 3.4% (incl. East Germany!)

Reasons for losses: special industry-related problems, too much dependency on certain customers or suppliers, personnel problems or among partners, entrepreneurial mistakes, but especially, regional difficulties: emphasis on start-ups in East Germany

Part I – Main Features

Figures IV – Recipients by Industries



GENEHMIGTE BÜRGSCHAFTEN UND GARANTIEN NACH WIRTSCHAFTSZWEIGEN 2006 – ANZAHL –

Part I – Main Features

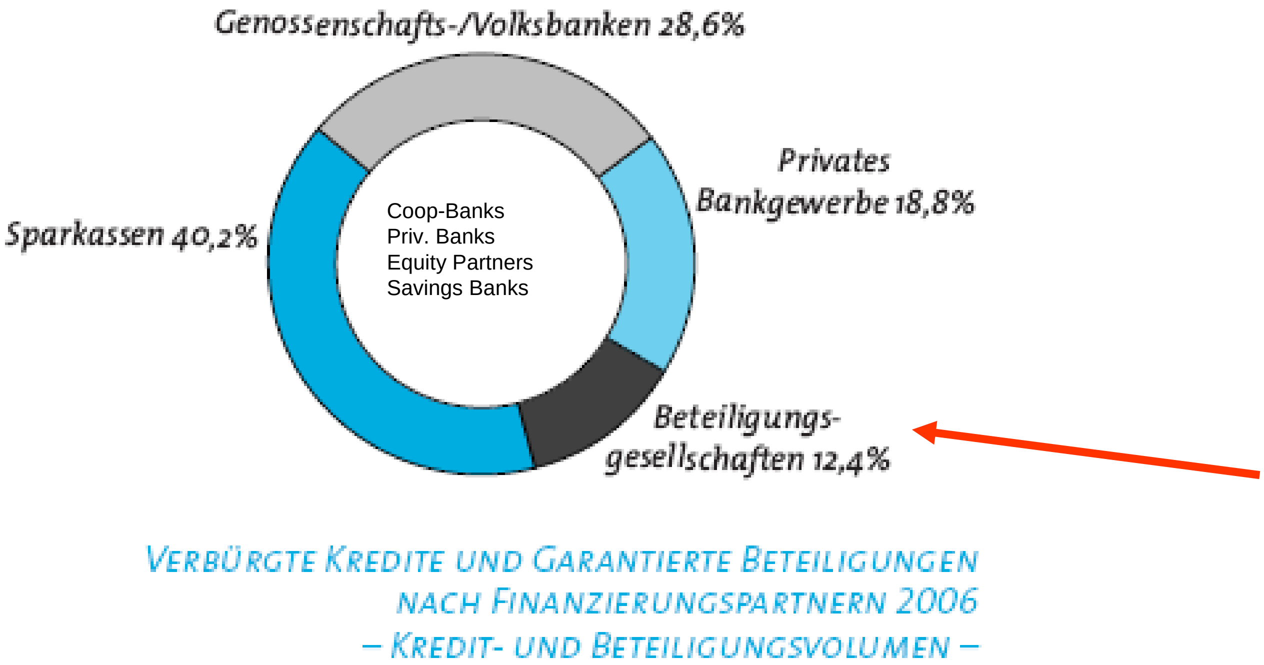
Customer Features / Criteria

- **Start-ups**
- **Equity growth not following company growth**
- **Young industries without history**
- **Dynamic companies in difficult industries**
- **Crisis situation requires venture or equity capital partner** ***(more and more the case – 1 in 8 already)***

  But: no recapitalization or rescheduling of debts

Part I – Main Features

Figures V – Main Partners in Financial Sector



Part I – Main Features

Particular strengths of the system I: Consulting

- SMEs that have been set up with the help of a guarantee have proven to be particularly sustainable. This is in large part due to the support offered by the consulting services of the respective trade organisations (which are also shareholder of the guarantee bank). Also, via the project assessment performed by the Guarantee bank during the application process, potential weaknesses can be eliminated and necessary corrections undertaken to ensure greater viability of the new business.

Part I – Main Features

Particular strengths of the system II: Common Rating System

After Basle II, the German GBs developed a specific joint rating system (1-13) with a common data pool.

Criteria are quantitative, qualitative and external data and information. In each case the phase of the life cycle the individual company is in is considered.

Early warning & risk management systems for credit or address, market, liquidity, and operational risk.

Part I – Main Features

Legal Framework

- **Guarantee Banks are private non-profit supervised credit institutions (§1 KWG) for a special purpose**

  Commercial banks benefit within Basle II rules, guaranteed loan portfolio only requires 20% of normal capital

- **By legal exception, GBs are Limited (GmbH), not Joint Stock (AG) Companies, and tax exempt**

  The **share capital** is mostly held by Associations or holding companies of commercial, savings and co-operative banks, Chambers of Commerce, Craft, and Professions, Federations, and insurance companies.

Part I – Main Features

Legal Framework

Public participation in the scheme:

Federal and State <u>counter guarantee mechanism</u> (80% in 5 “New” East-German states, 65% in West)

“Self-Help with State-Help Character”

State officials are normally <u>not</u> members of supervisory board; only sometimes in Credit Committee

Part I – Main Features

Organisation

Legal Organs of GBs:

- **General Meeting of Shareholders (roles regulated by law)**
- **Supervisory Board (members from shareholders plus state)**
- **Management Board (at least two directors)**
- **Guarantee or Granting Committee (experienced members from the business community, nominated by shareholders; advise the directors). No guarantee without consent of GC!**

Part I – Main Features

Guarantee Arithmetic for Commercial Banks

	Basle I			Basle II	& SolvV
	no guarantee	guarantee		guarantee	(W. Germany: 65% state counter guar.)
Loan	**100**	**100,00**		**100,00**	
Guarantee	**0**	**80,00**		**80,00**	
Uncovered Loan	100	20,00		20,00	
Banks' equity requirements	n.a.	1,60		1,60	
	n.a.	1,28	*0.2*0.08*80*	0,45	*0.2 * 0.08 * 80 * (1-0.65)*
	8,00	**2,88**	(36%)	**2,05**	(26%)
			(East:	*1,86*	*23%)*

Part I – Main Features

Legal Framework – EU

- According to EU *de minimis* regulations (i.e. competition rules), a maximum guarantee of 1.5 m EUR is allowed - German GBs only grant a maximum of 1.0 m EUR

- Prohibition of *cumulation* of grants, subsidies etc. – also relevant for guarantees from GBs!

Could become problematic for East Germany

Part II – The example of Hessen

The Hessian Bürgschaftsbank (BB-H)

Established in 1992 as a Guarantee Bank for many industries, not separated industry-wide Guarantee Cooperatives as before

Main shareholders:

- Chambers of Commerce and Industry
- Chambers of Crafts
- Chambers of Architects, Engineers and Tax Advisors
- Several Industry Associations
- Credit and Insurance Institutes

Part II – The example of Hessen

Special features of the Hessian Bürgschaftsbank I

Guarantee without Bank (BoB)

Start-ups often have difficulties in finding a financing partner for their idea. To avoid these, the initiative "Bürgschaft ohne Bank" (BoB) was launched by BB-H and their partners in the state.

New entrepreneurs who do not have a consolidated banking relationship (i.e. without a "Hausbank") can apply for a guarantee between 50,000* and 300,000 € directly from BB-H. Once approved, promoters of start ups can "shop around" and it is much easier for them to find a bank willing to finance their activities.

: For micro loans up to 50,000 €, KfW Mittelstandsbank offers "StartGeld" – low interest loans. They already contain a guarantee so that the Hausbank needs no further securities. Loan applications must go first via the Hausbank, though.

Part II – The example of Hessen

Special features of the Hessian Bürgschaftsbank II

Guarantees for Equity Participations

SME without access to the capital market often need equity participations to <u>complement bank loans</u>.

Bürgschaftsbank Hessen supports SME in the state of Hessen in obtaining equity by giving <u>guarantees to private equity funds</u> etc. for their share investment capital.

In financing equity capital, BB-H cooperates closely with <u>Mittelständische Beteiligungsgesellschaft</u> Hessen mbH (MBG H), a fund for SME participation owned by the same members as those of BB-H. *(In many cases, directors of BBs are = MBGs)*

For <u>silent partnerships</u>, a guarantee of max. 70% of the capital for max. 10 years, incl. for private equity companies for SMEs.

Part III – Evidence of economic impact

Results of 2006 study (done by the "Institut fur Mittelstandsoconomie") on the macro-economic benefits of the German Guarantee Banks

Contributions to

- **Accomplishing financings and realization of investments**
- **Creating jobs**
- **Improvements in companies' competitiveness**
- **Quantitative macro-economic effects**
- **Safeguarding a functioning competition**
- **Successful structural change**
- **Safeguarding generation change in SMEs**

Part III – Evidence of economic impact

Results of 2006 study

- In 2004, 6,300 sureties (for loans) and guarantees (for equity investments) totaling almost 1 b € were granted
- Nearly half for start-ups and takeovers
- For 1 € guaranteed, 3 € investments
(6.8 for equity, 2.4 for loans!)

Part III – Evidence of economic impact

Results of 2006 study

- GDP + 3.2 b € p.a.
- + 12,900 new jobs p.a.
- - 9,100 unemployed p.a.
- Lower social security contributions, i.e. lower non-wage costs for companies over the long run
- Net state gain 670 m € p.a. from various taxes (VAT, PIT, capital taxes) over counter guarantee payments

Part IV - Conclusions

Conclusions I

For SME:

- **flexible access to finance at low cost levels**
- **Low default rate**
- **Multi-industry coverage in areas known to members – incl. expert advice**

For Banks:

- **lower own fund requirements**
- **lower provisions on credit risks**

Part IV - Conclusions

Conclusions II

- **A prudent risk policy (max. 80% coverage in known fields with expertise from within)**
- **and a reasonable fee policy**

  (1.5% upfront, min. 250 €, and 1.5% p.a. on Jan 1)
- **plus the public counter guarantee coverage**

assure the <u>long-term sustainability</u> of the system

THANK YOU FOR YOUR ATTENTION

Dr. Dieter Falk

www.dialog-international.com