



The use of guarantee instruments by Development Finance Institutions in response to the COVID-19 pandemic

Webinar, 23rd of June 2020

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1. Investment Climate Reform (ICR) Facility

Funding	11th EDF under the ACP-EU Partnership Agreement, together with BMZ and BC
Objective	Support the countries and regional institutions in Africa, Caribbean and Pacific countries in their public-private dialogue process to create a more conducive and sustainable investment climate.

Technical assistance with up to 90 days for interventions:

➤ Business Environment Reform



➤ Business Environment for Sustainability



➤ Public-Private Dialogue (PPD)



Requests must:

- aim at improving the business and investment climate in an ACP country;
- be part of a wider strategy, reform process, or PPD mechanism;
- involve a PPD component;
- handed in by governmental organisations, business associations, development financial institutions (DFIs), and EU delegations in ACP countries.

Agenda

1.	Welcome and Introduction: Support of the ICR Facility for Development Finance Institutions	Yasmine Galloul, ICR Facility
2.	The use of guarantee instruments by Development Finance Institutions in response to the COVID-19 pandemic <ul style="list-style-type: none"> - Impact of COVID-19 on entrepreneurship - Measures implemented - The credit guarantee: how does it work? - How to deploy a guarantee fund? 	Virginie Poncet, Bpifrance Vincent di Betta, Bpifrance
3.	Q&A - Session	
4.	Remote Assistance Application Process (1-on-1-clinics)	Yasmine Galloul, ICR Facility

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2. The use of guarantee instruments by Development Finance Institutions in response to the COVID-19

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WEBINAIRE

**THE USE OF GUARANTEE FUNDS IN RESPONSE TO
THE COVID-19 CRISIS**

23 June 2020

Virginie Poncet

Vincent di Betta

A

Impact of COVID-19 on entrepreneurship

B

Measures implemented

C

The credit guarantee: how does it work?

D

How to deploy a guarantee fund?

A

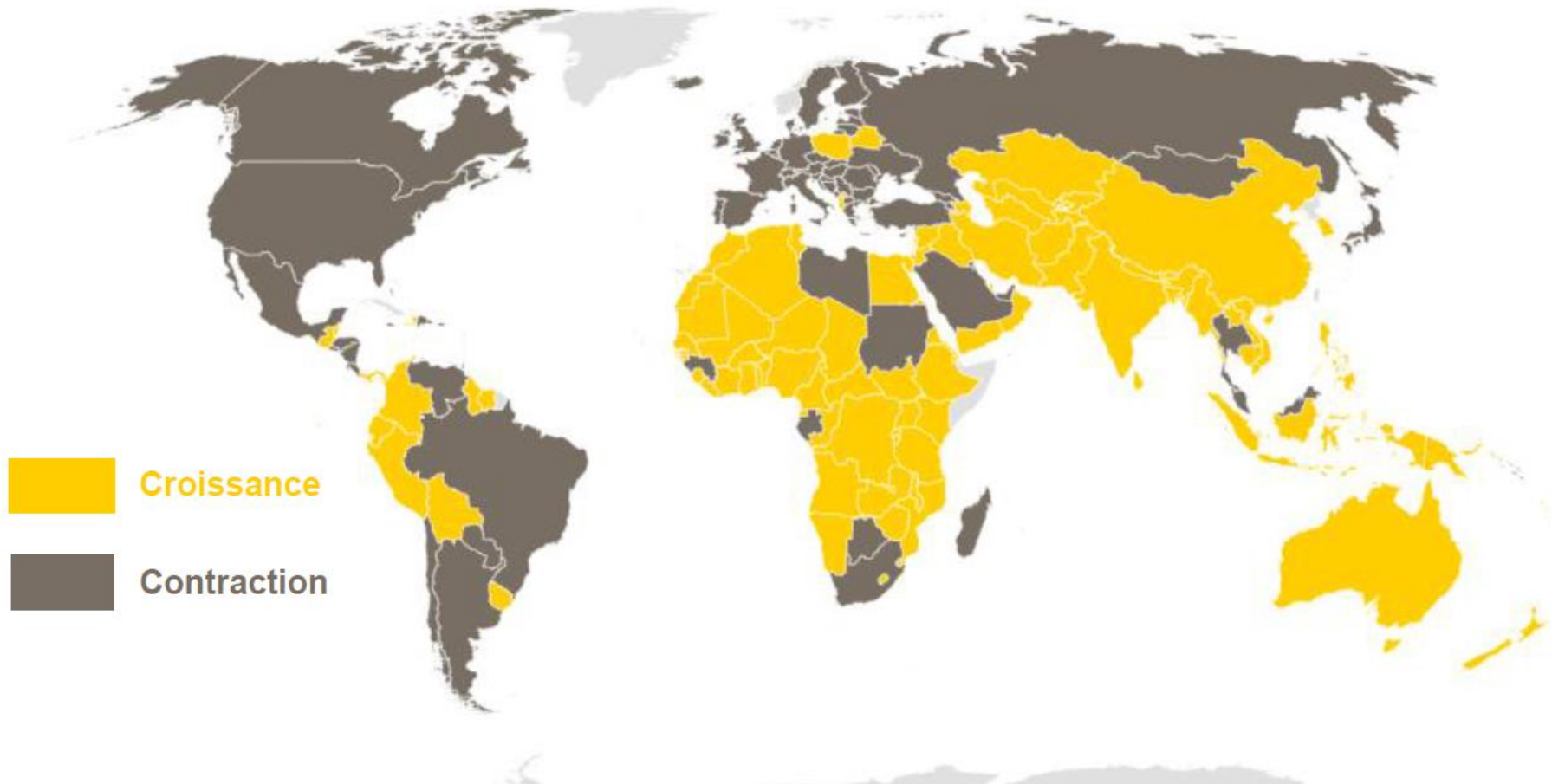
Impact of COVID on entrepreneurship

Introduction: A health crisis that is shaking up globalized societies and economies

- At the end of 2019, in an environment that is certainly under pressure, the growth of international trade is only 1.2%,
- States affected by the crisis had to take unprecedented measures in peacetime to stem the spread of an epidemic that could have been out of control. But these measures have brought entire sectors of the economy to a standstill.
- The Covid crisis19 caught all the world's economies by surprise. What appeared at the end of 2019 to be a distant threat eventually materialized and spread around the world, hitting badly countries, their citizens and businesses.
- Several channels of transmission of the crisis to companies :
 - Global economic slowdown due to declining global demand, oil and raw material exports, services, tourism; project delays (e.g. construction of the oil pipeline in Niger); disruption of supply chains
 - Decrease in domestic activity and demand, particularly because of restrictive health measures and the ban on certain sectors; the informal sector is particularly affected.
 - A strong impact on public finance increases risk and impacts currencies

Introduction: A health crisis that is shaking up globalized societies and economies

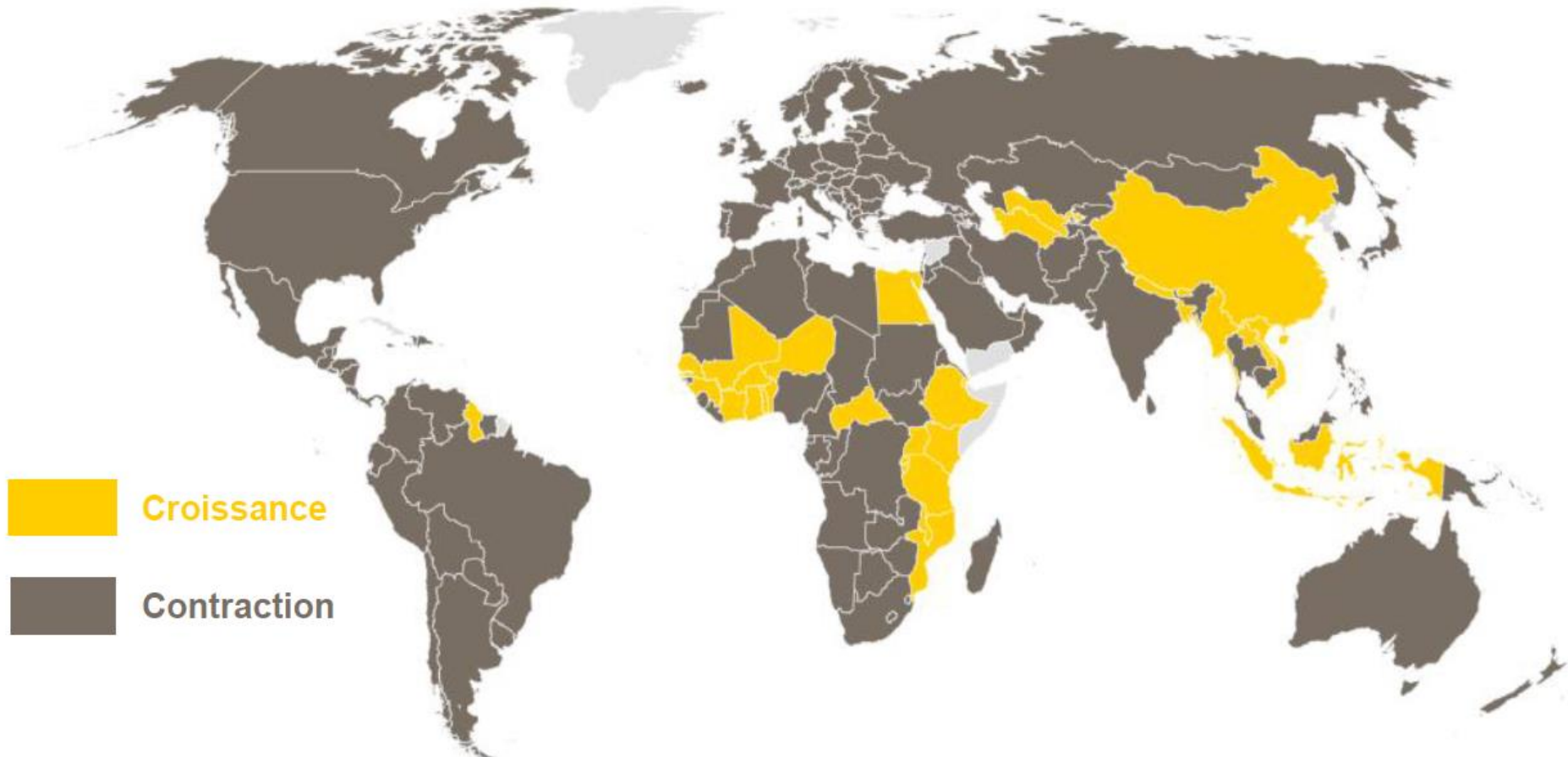
Croissance du PIB réel en 2009



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Introduction: A health crisis that is shaking up globalized societies and economies

Prévisions de croissance du PIB réel en 2020*



*Forecast June 2020 OECD, World Bank

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Themes Key points

Problem of financing VSE/SMEs

- Business environment making VSE/SMEs more vulnerable
 - Structural capital weakness and working capital deficiency
 - Net cash deficit
 - Lack of structuring of governance and activities
 - Lack of guidance on financing circuits and channels
-

COVID-19

- Global Eco Slowdown
- Stop tourism and transport
- 3 months of reduced activity



- Numerous payment defaults
- Cascading bankruptcies
- Major sectoral impacts

Perception of VSE/SME risk by banking partners, accentuated by the Covid-19 crisis

- High collateral requirements in the face of the problems of informal or unreliable financial accounts
 - Risk analysis focusing on the individual
 - Financial analysis of the counterpart relating to the constitution of the turnover, profitability, thus the analysis of flows
 - Unit risk analysis methodology not well developed
-

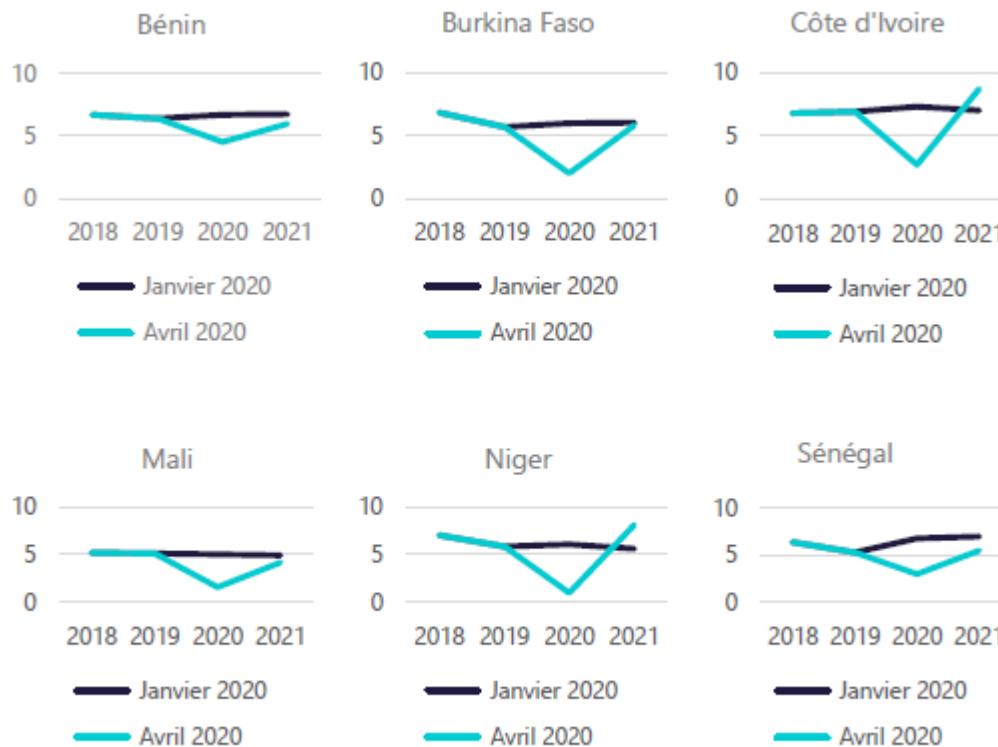
Introduction : Issues in the banking sector

Concerning the banking sector:

- **Overall banks' situation in progress...**
 - Prudential solvency and liquidity ratios well above their 2008 level due to the roll-out of regulatory requirements ;
- **but the banks will have to face up to some big challenges:**
 - The end of containment will massively increase companies' working capital requirements (restarting production facilities, restocking) as well as their cash flow needs. The investment projects that were postponed due to the crisis will also start up again;
 - In this context of recovery, several factors could weigh on banks' credit provisioning (a rationing of cash loans being traditionally observed in economic recovery phases:
 - Accumulated losses by banks and the need to reconstitute capital (Coface forecasts, for example, a 25% increase in corporate failures worldwide and a 15% increase in France);
 - Other structural challenges to be tackled by the banks: the need to reduce operating costs, investments in digital and cybersecurity, future reinforcement of prudential requirements (Basel IV), in a context of persistently very low interest rates...

a recovery to be sustained

- A rapid recovery is expected (hoped for?).
- For example, below, the evolution of IMF growth prospects between January and April 2020 in WAEMU countries. The model for recovery in the examples below is general, but the conditions for recovery are highly dependent on the recovery of global demand and the control of the pandemic.



B.

**Measures implemented
Zoom guaranteed**

Support measures implemented by the authorities

The countries are very diversely impacted and the measures are very different from one country to another, from one continent to another .

- **Sanitary measures**
 - Screening centre, systematic tests
 - Distribution of masks and protective equipment
- **Regulatory measures**
 - Containment.
 - Border closures, travel bans
 - Company closures
- **Social measures**
 - Coverage by the State of all or part of the costs of restrictive measures and relaxation of regulatory requirements.
 - Training of people unemployed due to viruses
 - Subsidy to the poorest, consumer vouchers (China, Japan, Taiwan), childcare vouchers (South Korea)
- **Tax Measures**
 - Relief or even abolition of taxes (on companies but also on income, other).
 - Postponement of tax due dates
- **Financial measures**
 - Measures for companies, solidarity economy, individuals, municipalities and social institutions, measures implemented by development banks and public institutions
 - Increase in the research budget (€5bn over 10 years in France)
 - Asset repurchase programs, reduction in key interest rates, easing of regulatory requirements.
 - Deferral of the payment of charges for companies
 - Acceleration of payment to government suppliers

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Financial measures managed by development banks and public institutions

- **Warranty**
 - Massive public guarantee schemes with higher ratios to encourage commercial banks to finance enterprises, especially SMEs, to grant moratoria and to extend the terms of loans to enterprises.
 - Quota increased from 70% to 100% (KfW & AWS) with higher quotients for VSE/SMEs.
 - Reduced cost of the guarantee (free or 0.25% the first year and possibly increasing thereafter).
- **Support for exporting companies**
 - Increasing export credit insurance (up to 90%) and short-term credit insurance (replacing the private sector).
 - Through credit insurance guarantees to support international supply chains.

Financial measures: examples

Caisse centrale de
garantie (Morocco)



New guarantee mechanism called "Damane Oxygene" with a quota of 95%.

- It covers exceptional overdrafts and loans granted by banks to finance the working capital requirements of VSEs, SMEs and ETIs affected by the crisis.
- In addition, implementation of a zero rate "covid-19 auto-entrepreneurs guarantee" on loans with a maturity of up to 3 years, to finance expenses that cannot be deferred.



Loan and guarantee program of CAD 65 billion (i.e. €43 billion and 2.6% of GDP, in total) :

- "Emergency account" for Canadian companies, loan program without government guarantee up to 40 k (CàD 26K€) and option to reimburse 75% of the amount (under conditions)
- Guarantee on loans to exporting companies up to CAD 6.25 M (€4.1 M)
- Joint BDC - Financial Institution Loan Program (up to CAD 6.25 million) for SMEs with cash flow problems



Guarantee Fund of €140bn (around 10% of GDP) managed by ICO

- Percentage of guarantee (60% to 80%) and variable cost depending on the size of the company and the duration of the loan (0.20% to 1%)



State-guaranteed loan €300bn - guarantee managed by Bpifrance

- Guaranteed share 70% to 90% depending on the size of the company and cost 0.25%.

Upturn plans

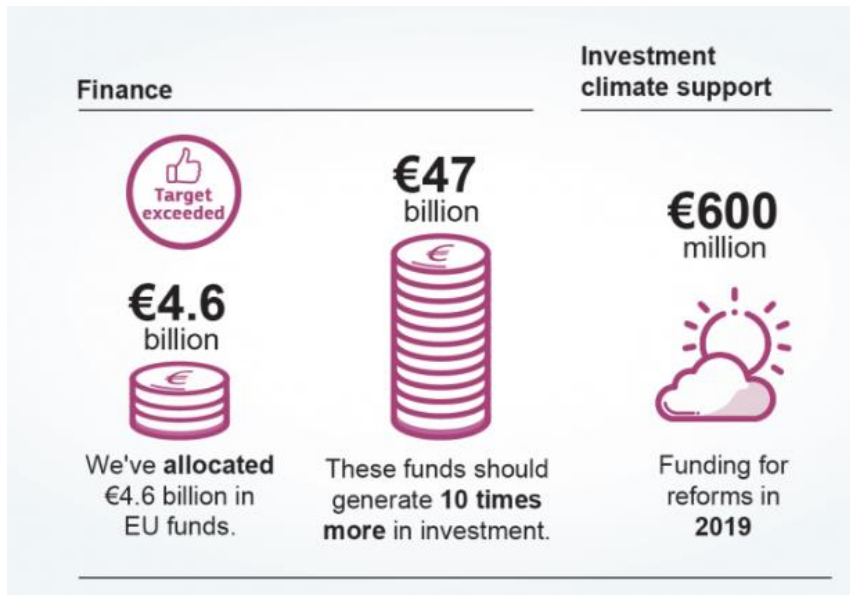
Bpifrance has worked with the State to accompany the recovery: Bpifrance's recovery plan is based on rapid, precise and massive deployment, on a continuum of financing and support. It will be structured around 2 **major ambitions**: (i) to act offensively to support the working capital requirement and accelerate the recovery and (ii) to defend the key sectors of the French economy that have been particularly affected by the crisis.

- **Tourism Plan : A tailor-made offer to finance and accompany the takeover of tourism and leisure businesses** (Ecological and Energy Transition, Digital Transformation, Integration of the next health standards to reassure / protect customers and staff, **Ability to host the** next international sporting events (Paris Olympics, Rugby World Cup))
- **Automotive Plan:** The entire production chain must be supported in order to avoid an interruption and ensure the restart of the activity. **Major efforts to move towards sustainable mobility.** The Corona virus crisis should not mark a halt to this transformation but, on the contrary, act as a catalyst.
- **Plan aero Bpifrance will intervene directly or indirectly, alongside other players, to promote the consolidation movement that** has become inevitable for strong players in the value chain. The challenge will be to create champions in key areas (e.g. materials, structures (components/sub-assemblies), electronics, services, etc.).
- **Plan Touch! (creative industries):** 8 verticals including 4 priority ones (Cinema & Audiovisual, Fashion & Accessories, Beauty, Video Games); The inclusion of Bpifrance's action within a global continuum with its public and private partners; A toolbox and processes being built to amplify Bpifrance's action in the CCIs
- **French tech bridge:** massive support for innovative startups until 2021 to help them through the crisis

Financial measures: EIP (External Investment Plan)

The IEP in its guarantee part is a suitable instrument to support recovery plans in the regions it covers.

The financial part of the IEP, the EFSD (European Fund for Sustainable Development), is 4.6 Billion euros and covers Africa and countries close to the EU.



C.

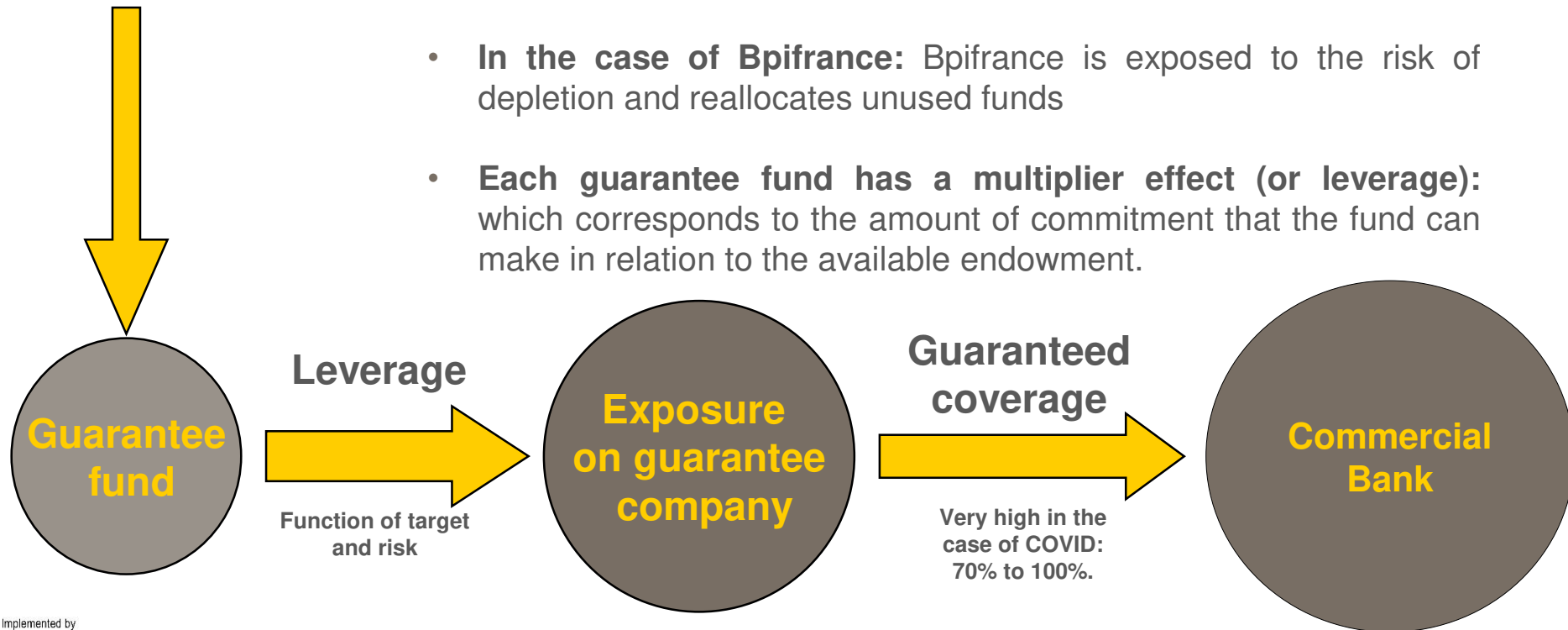
How does the guarantee work?

How does it work? The principle of guarantee funds

Principle of guarantee funds

Donors: State,
Regions
Europe, etc.

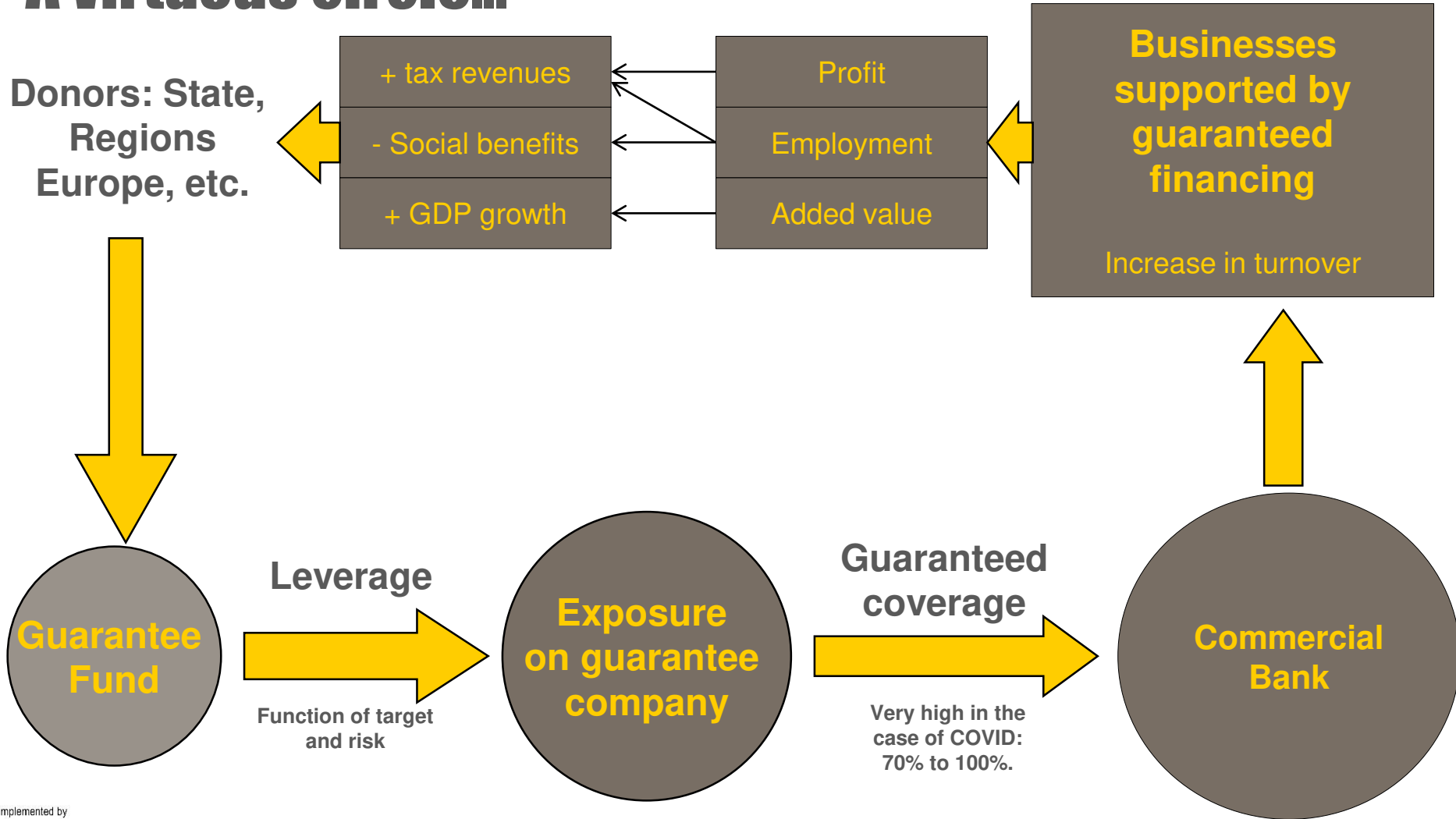
- The guarantee fund is the subject of a contract between the lessor and the manager (guarantee company, development bank, other).
- In the case of Bpifrance: Bpifrance is exposed to the risk of depletion and reallocates unused funds
- Each guarantee fund has a multiplier effect (or leverage): which corresponds to the amount of commitment that the fund can make in relation to the available endowment.



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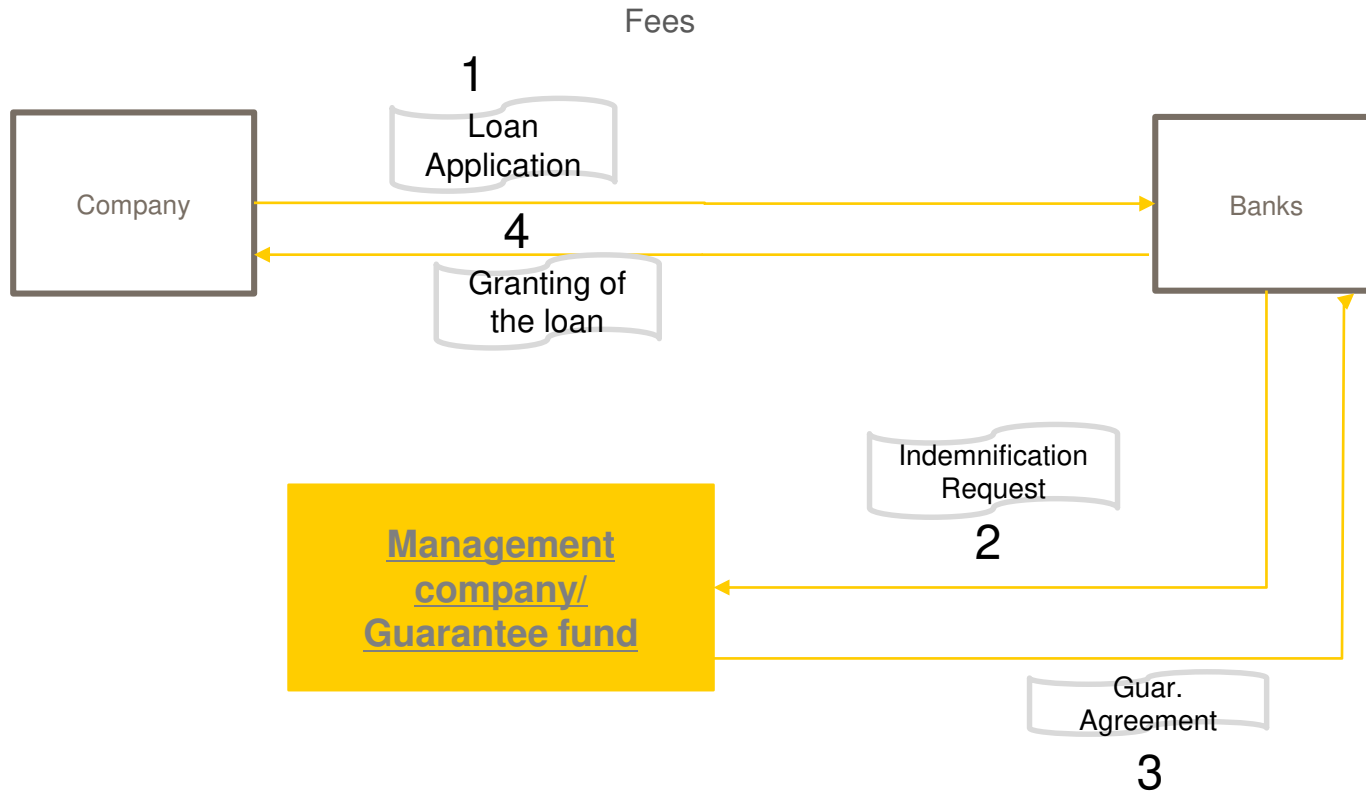
How does it work? The principle of guarantee funds

A virtuous circle...

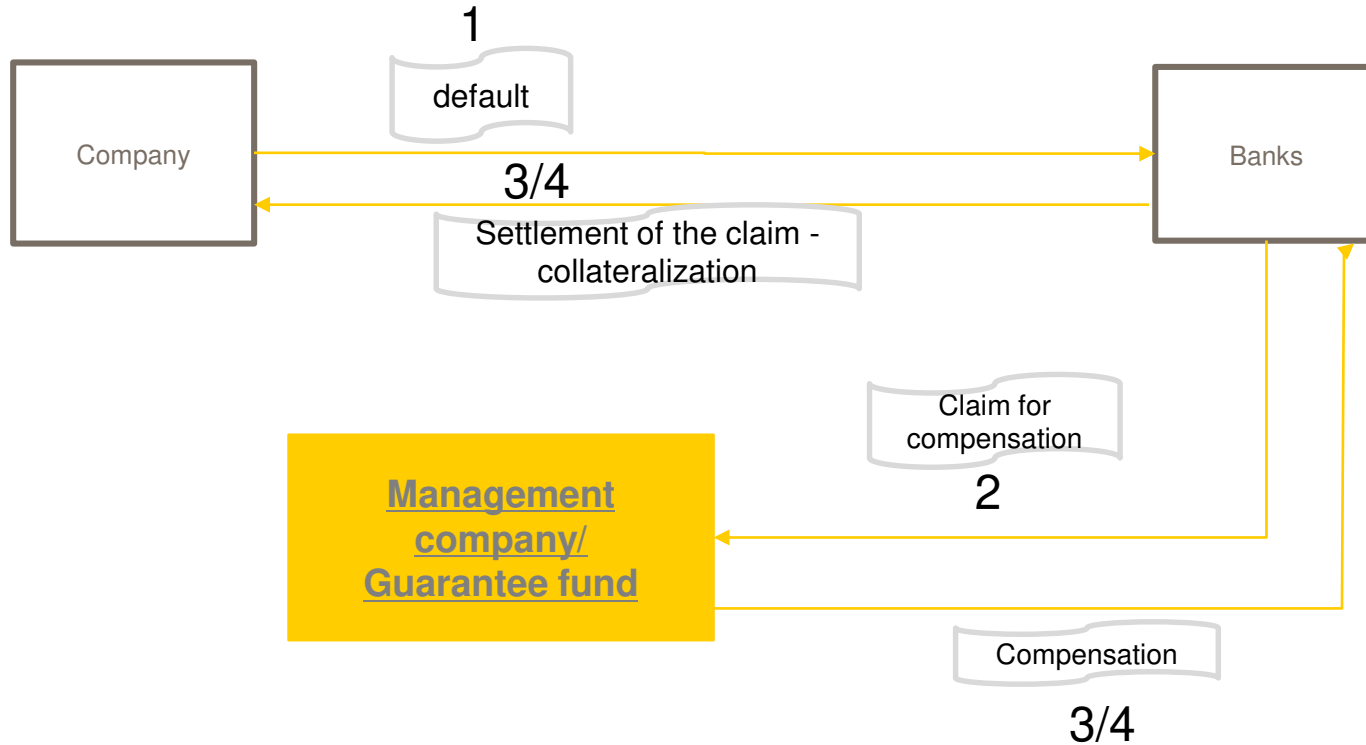


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How does it work? The granting



How does it work? Compensation



Economic model of the **guarantee**

Key points

- **Principles of operation :**
 - In the example of Bpifrance, we guarantee, in final losses, the bank financing and the interventions of the equity capital organizations.
 - The guaranteed activity is organised on the basis of **guarantee funds endowed by the public authorities**¹.
 - Each fund covers a limited scope of intervention corresponding to a phase of the company's life cycle and a risk class (creation, transmission, development, etc.).
- **Resources :**
 - Guarantee fees, charged to credit institutions/capital institutions
 - **Public endowments to guarantee funds :**
 - > Hedging of extreme loss risks
 - Equity :
 - > Risk of depletion of guarantee funds

Contribution to the result

- **GNP :**
 - Commissions paid by the beneficiary of the guarantee (bank or equity institutions)
 - Financial income generated by the investment of the annual endowments

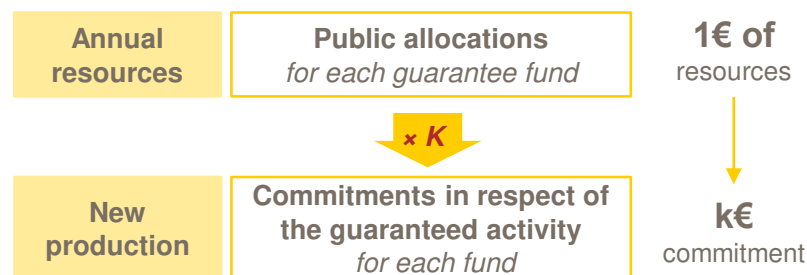
1. Mainly from the State and other public donors (the Regions, Europe)

2. A fund's net worth is its net present value (NPV): the present value of future disbursements and fees to assess the present value of the fund over the time horizon of the extinction of all risks.

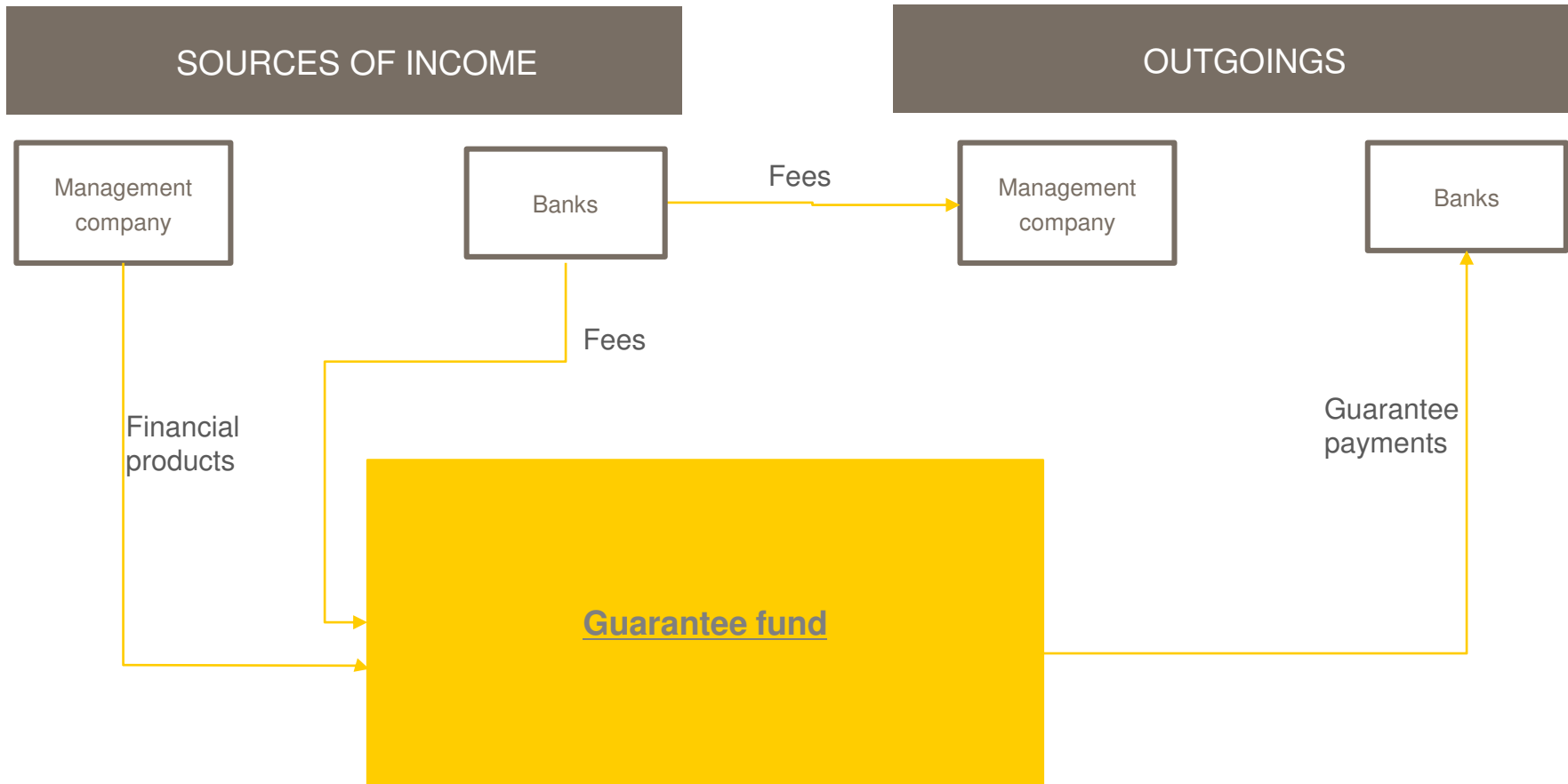
Guarantee Fund

Commitment capacity of guarantee funds :

- The production volumes of the Guarantee business line are determined on the basis of the allocations received per fund using a multiplying coefficient K , depending on the vintage and the type of fund.



How does it work? The business model of a guarantee fund



How does it work? Granting principles

A subtle balance between risk control and banking sector training

- Conditionality: the guarantee is granted where it is needed
- Avoid too high risks
- Limiting capital transactions
- Search for the best collateral (on the investment)
- Optimization - adjustment of the percentage of cover

How does it work? Warranty features (1/2)

- **Portfolio guarantee: delegation of the decision to the bank**
 - Convention establishing the rules
 - Annual overall commitment amount
 - Unit commitment amount
 - Exchange of data
- **Targetting of the beneficiary**
 - Size (SME, VSE, midcap, large)
 - Sector
 - Quality: scoring
- **Credit criteria**
 - Duration
 - Amount
 - Purpose
 - Nature
- **Collateral rules.** The purpose of collateral is to replace unavailable collateral rather than to reinforce the bank's guarantees.
 - In France: credits using the residence of the entrepreneur as collateral are refused.
 - Limit personal collateral to 50% of credit

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How does it work? Credit guarantee features (2/2)

● Safety Period

- Defects during the first x months will void the guarantee,

● Guaranteed coverage

- Ceiling defined by the fund: defines the impact and the leverage
- Adjustable below the ceiling at the request of the bank

● Duration of the guarantee

- Limitation of the guarantee duration
- Relationship between the duration of the guarantee and the duration of the loan

● Exposure limit

- By enterprise
- By bank.

● Method of collecting fees

- Flat, by anticipation, alongside installments
- In the event of early repayment, terms and conditions for the restitution of the fees when flat payment.

How does it work? The principles of compensation

A subtle balance between risk control and banking sector impact

- **First-demand guarantee or final loss?**
- **Risk of depletion** for the management company?
- **Indemnification base:** inclusion of interest ?
- **Information:** the communication of the bank's information must be defined and accompanied by digital tools.
Response to regulatory requirements.
- **Activation period:** from the demand for compensation to the date of the notice of default.

How to deploy a guarantee fund?

D.

- ❑ Whether the sanitary impact of the Covid is high or low, **the economic and social impact will be major.**
- ❑ The answer to Covid is to **create jobs!**
- ❑ And the objective is always to facilitate the access of VSEs / SMEs to bank loans, in a context where private banks and IMFs are still evolving within the framework of new prudential standards.



**Setting up a loan guarantee company is a solution
Here are the modalities of creation**

Conditions for success = credibility & transparency

1. **Close partnership with the ecosystem**, including private banks & IMF
2. **Perfect governance:**
 - responsibility
 - accountability
 - fairness, independence
 - integrity = primacy of the collective interest over individual interest
 - action bias and execution discipline.
3. **Perfect control of SME risk**
4. **Ability to** compensate the bank in the event of borrower default
5. **The success of a guarantee fund goes hand in hand with support for the VSE / SME to make the dossiers presented to the banks "bankable"**

Creation of a guarantee company: Theme 1/3

Optimize public and private resources, in a dynamic of performance and capacity to manage other specialized State funds.

- Initial allocation: Status (X %)
- Other allocations: ADB, WB, insurance companies, banks, MFIs,

GUARANTEE COMPANY under private law

- An approval as a Financial Institution would be requested from the body concerned.
- This fund structuring allows for governance in accordance with international standards with :
 - A Board of Directors representing shareholders and experts
 - An audit committee
 - A risk committee

Key points

- Amount of resources equivalent to at least 10 years of operation
- Promote independence from the state, private banks and the private sector.
- Meeting shareholders' transparency requirements
- Meeting the transparency requirements of banking partners

Creation of a guarantee company: Theme 2/3

Steps in the creation of the Guarantee Company

Key points

1. Market research
2. Financial projections and business plan
3. Legal schemes
4. Request for approval from the institution concerned
5. Recruitment of the CEO of the Guarantee Company
6. Business process: file study, decision, implementation, litigation
7. Risk scoring tools
8. Fundraising
9. Team recruitment and training
10. Launch of the guarantee company



Creation of a guarantee company: Theme 3/3

Typical operation of a Loan Guarantee Corporation Company

Key points

⇒ **2 types of guarantees to make things simple at the start**

- « Unit » or « case-by-case » guarantee
- Portfolio guarantee

⇒ **Coverage rate: 50%**

⇒ **Guarantee payment in 2 steps**

- At the start of litigation: 50% for the bank
- Balance of claim at end of recourse

In conclusion

- ❑ **Allocation of financial resources = at least 10 years of operation.** Sum calculated according to the financial projections made after meeting all the bankers of the place in a given country, their development potential, the probability of future disputes.
- ❑ **Such an action allows to initiate a real dynamic favourable to the country's economy and a spillover effect on the private sector.** The financial endowments of institutions such as the WADB, the ADB, the WB would complement the government's initial endowment.
- ❑ **The economic logic of a private law guarantee fund in a country then takes on its full dimension:** to help develop, thanks to the companies supported, the fabric of the country's small and medium-sized enterprises. This translates into stable jobs, contribution to social protection schemes and strengthening of GDP.
- ❑ **This results in significant financial returns for the State through** taxation (direct taxation, indirect taxation through the expenditure of the employees concerned), social security charges and the stimulation of economic agents.

Study memo on the action of the guarantee deployed by **Bpifrance** between 2007 and 2017 with 470,000 companies (VSEs and SMEs) to generate 64 billion euros of credit

- ❑ **French commercial banks mobilise the Bpifrance guarantee to finance relatively risky projects:**
 - ✓ For start-ups, 40% of the beneficiaries = former jobseekers and 48% were former recipients of social minima.

- ❑ **A very significant impact on investment and employment**
 - ✓ The guarantee schemes have a positive impact in the medium term (3 years) on the economic trajectory of the beneficiary companies, both in terms of survival and growth of the activity.

- ❑ **An effective mechanism in terms of the public resources mobilized**
 - ✓ The study estimates that the amount of funding needed to create or safeguard a job is between EUR 2 800 and EUR 3 500, depending on the profiles of the enterprises supported.
 - ✓ For companies more than 3 years old, one euro of endowment from the "development" fund increases the stock of productive capital by about 26 euros.



3. Questions and Answers



Please type your questions or points for discussion into the chat window.

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4. ICR Facility 1-on-1 Clinics

Virtual, individual targeted support sessions around 1-2 hours

- Eligibility: public or private organization based in ACP country
- Slots will be granted based on availability.
- Support will respect a regional balance across the ACP.



Exchange directly
with us and get
support for your
organisation

- Register your interest until 30th of June 2020 via icrfacility@giz.de
- Indicate your organization and the questions you want to ask

