

**Virtual Roundtable Series on COVID-19 Mitigation Efforts #5:  
Risk Sharing in the Biggest Crisis Ever  
April 23, 2020**

**Q&A summary**

**Questions around risk, default and credit ramifications**

**1. Have the risk criteria to determine eligibility changed as a result of COVID?**

**AECM** Yes, they have been simplified, enhanced and reduced; to illustrate: for aws / Austria freelance activities are now eligible for guarantees and instead of an additional risk assessment they almost entirely rely on the one of the commercial bank, only verifying themselves that the beneficiary of the guarantee was not in difficulty on 31 December 2019 to comply with the EU state aid provisions; ISMEA / IT suspended the deadlines for the implementation of business plans whose expiry date is between 1 March 2020 and 31 July 2020; BGK / Poland accepts a broader range of eligible costs (resignation from a catalog of eligible costs) and no obligation to submit an investment project plan (in the case of a guarantee constituting de minimis aid); BBB / UK made changes to the scheme operational with lenders from 6 April 2020: the Coronavirus Business Interruption Loan Scheme (CBILS) has been significantly expanded along with changes to the scheme's features and eligibility criteria. For instance, insufficient security is no longer a condition to access the scheme; SEF / SI suspended the deadlines for the implementation of business plans whose expiry date is between 1 March 2020 and 31 July 2020.

**KODIT** Yes, KODIT has expanded scope of business subject to guarantee use, provided priority treatment in the coverage ratio (90~100%) and guarantee fee (0.3~0.5%), and eased the screening criteria for fast distribution.

**CCG Morocco** For the CCG (Morocco), risk criteria for the special products introduced to alleviate the impact of COVID-19 were different from those of the standard offer. We have opted for simplified criteria limited to eligibility conditions check (maximum turnover, verifying that the SME hasn't applied to the same product more than one time, composition of the expenses to be financed and comparison with the standard composition...) without carrying out detailed financial analysis or scoring.

**US SBA** Yes. In the US Paycheck Protection Program (PPP) the eligibility criteria relaxed the "Affiliation Rule". The intention of this change was to qualify a greater number of franchisees, that for the most part are SMEs. However, some parent companies of these franchisees seem to have applied and received funds via the PPP. The USG has appointed an Inspector General, who are traditionally responsible for "waste, fraud and abuse" of government funds.

**FOGAR** At the national level, FOGAR (Argentine Guarantee Fund) increased the offer for guarantees coverages to Banks from 50% to 100% of credit coverage and admit SMEs with up to 90 days of delays in assistances that could be granted before COVID-19 crisis. At the regional level, FOGABA, (Guarantees Fund of Buenos Aires) grants guarantees with a coverage up to a 100%, income requirements were simplified and SMEs up to a Pre-Covid-19 credit obligations in 30 days fulfillment delay, were admitted. On the other hand, refinancing was enhanced with the national level discharging major volume of guarantees at the national entity, depending on the recovery expectation of the sector in which the company's activity is developed and of its credit qualification prior to Covid-19.

**2. How are the schemes balancing the need to respond quickly and accept a greater amount of applicants with keeping the schemes within the risk limits that were set at the onset to ensure that the guarantees scheme losses do not lead to a total collapse of the scheme in the future as more real sector companies undergo huge losses and bankruptcies?**

**AECM** *To lower the default rate,*

- *guarantee institutions also put a strong focus on the existing customer base. For instance, PMV / Belgium is also offering financial assistance to companies in which it has built up a financial exposure, to support those companies with respect to the impact of the corona crisis;*
- *also, for potential new customers, lots of guarantee institutions provide consultancy either being contacted by entrepreneurs e.g. via hotlines / web forms (e.g. SOWALFIN / BE) or by approaching their beneficiaries actively (e.g. SIAGI / FR);*
- *introduction of an overall loss cap per lender (e.g. KredEx / EE);*
- *extension of the maximum duration of revolving credit lines (e.g. CESGAR / ES);*
- *the maximum guarantee amount per beneficiary is increased (e.g. FNGCIMM / RO);*
- *all guarantee institutions have adapted the conditions, e.g. repayment schedule adjustments, lowering or waiver of the charging of handling and guarantee fees (e.g. aws / Austria), sometimes retrospectively reimbursing the fees already charged (e.g. Finnvera / FI) or fees being fully paid by the state (e.g. Nöbeg / Austria) and*
- *as in normal times, not all applications for a guarantee are approved.*

*To cope with defaults, some national and regional governments support the guarantee institutions for instance by providing a 100% state guarantee using only the expertise of the guarantee institutions (e.g. Switzerland) or by increasing the public counter-guarantee rate (e.g. VDB / DE), by backing the newly introduced guarantee products as such (e.g. Altum / LV), by providing specific funds for the new products (e.g. MDB / MT) or by increasing the funds as such (e.g. KGF / TR).*

*During the financial and economic crisis guarantee volumes of AECM's members increased by 25% and the defaults did not bring any of them in difficulties. One reason is also the risk diversification since guarantee institutions cover a large number of different sectors and also the rather low amount of the guarantee: on average, the guarantee amounts to 33,200 EUR (= per 30/06/2019).*

**KODIT** - *Immediately after the Asian economic crisis, the government introduced a partial coverage ratio system from the existing full guarantee (100% coverage ratio), and improved the quality of guarantees and finance, such as improving lending practices of financial institutions and encouraging companies to manage their own credit.*

*- The default rate was 18% in 1998 and 6.1% in 1999, resulting in the largest indemnity since the establishment of the KODIT. Accordingly, the government will carry out special recovery activities for indemnity rights to increase the basic property and secure the foundation for increasing the capacity for guarantee supply.*

*- Since 2001, a credit rating and risk management system has been introduced and established. Immediately after the 2008 global financial crisis, the default rate in 2008 was 5.6% and the default rate in 2009 was 4.8%, maintaining a relatively stable trend.*

*- Through the establishment of an integrated risk management system, it is possible to check the financial model, dynamic model, and representative of the company through the credit risk, liquidity risk, operation risk*

management, and bad sign notification system, and to take follow-up measures for the companies subject to alarm by granting them an alarm rating.

**CCG Morocco** Yes but given the strong political leadership commitment to assist SMEs during this period, the Government will bear all expected losses

**US SBA** One should keep in mind that the risk limits set at the beginning of this draconian government intervention were always expected to be higher than non-crisis credit extended to SMEs. As a result, many governments, including the USG, set aside funding and funding mechanisms that would allow for the transfer of risk from the specific entity or schemes to the central government. In some instances, the final risk would reside within the balance sheet of national central banks.

**FOGAR** In front of risks of such a magnitude, national states are those to have the last word in risk distribution. We understand that to make the distribution of costs and risks more transparent, shall be necessary to differentiate that of credit assistance from that requiring direct subsidies. This will allow to protect credit systems and guarantees, that must remain standing to help finance business balance at least during the first-year post-pandemic. Rescheduling credit obligation payments schemes and that of credits for activity reconversion shall be fundamental steps to minimize companies' bankruptcies that do not overcome the crisis.

**3. The reality is the default rate may be quite high from all these special circumstance loans. Have credit institutions considered the consequences of this?**

**AECM** Cf. answer to question 2

**KODIT** Please refer to the answer to question number 2.

**US SBA** Yes, see my explanation of how the risk is expected to be transferred to and absorbed by central governments.

**4. What is the share of SMEs that failed in paying back, ie what is the value and share of guarantees exercised as compared to overall guarantees? I presume the default rates due to the corona crisis will considerably increase. Is there an idea to forgive the debts of SMEs stressed due to coronavirus?**

**AECM** AECM collects statistical data from its members on a half-yearly basis and the data for the first half 2020 will be available in October 2020. As to the debts of SMEs: in many countries the repayment of loans has been suspended / grace periods have been introduced (e.g. CMZRB / CZ), the percentage of the guarantee has been increased to 90% or even 100% (e.g. KredEx / EE), consultancy services are provided (e.g. Bpifrance / FR) and much more to support SMEs in remaining viable.

**KODIT** For the stable operation of small and medium-sized companies, KODIT currently extends the full maturity of its guaranteed loans, and most of its recent coverage ratios are 95-100 percent, which are supplied as much as possible without the burden of SMEs and financial institutions.

**CCG Morocco** At this time we did not see any increase in default rates and the repayment deadline of special products is December, so it's early to have a clear answer to this question

**US SBA** Yes, the expected SME loan failure rate of COVID-19 credit is expected to be much higher than the non-crisis failure rate. For example, in the US, previous to the COVID-19 Pandemic the failure rate hovered in the 1.25 % to 1.75 range. During the 2008-2009 crisis the failure rate peaked at nearly 4% (see

<https://sbinsights.paynetonline.com/loan-performance/> for details). Yes, the failure rate of the COVID-19 related SME credit is expected to be higher...Higher than the 2008-2009 is the big questions, I suspect that the US Treasury is expecting a 7% or so failure rate for the PPP. Yes, the debt can be converted to a grant if the SME borrower is able to prove that the funds were used in accordance to the specified use of precedes (payment of labor, rent, and utilities).

#### **Questions around how the stimulus be paid for and non-government sponsored guarantees**

- 1. How will these stimulus packages for national economies will be funded? A part will come from an increase in government debt, and another in quantitative easing in hard currency countries. What about developing countries. Will IMF get funds for them?**

**KODIT** *In the case of Korea, some part will secure financial resources through supplementary budget, while some will expand the guarantee supply through adjustment of operating multiple.*

**CCG Morocco** *In Morocco, the Government funded the stimulus package using both contributions from private sector and a loan from the IMF (an existing liquidity and precaution line-LPL)*

- 2. Can you provide some insight into how Guarantee Companies that do not have government's backing/support are responding at this time?**

**AECM** *They strongly focus on their existing customer base, provide more consultancy services, keep on charging fees even if they are reduced, and as last resort have to use their own equity to pay for additional losses. Yet given the albeit reduced but nonetheless remaining risk assessment and the avoidance to promote undertakings which were in difficulty already last year, so not related to the COVID-19 pandemic, the default rate should remain manageable as has been the case in the aftermath of the financial and economic crisis.*

#### **Question about eligibility for COVID guarantees and best practices overall of guarantee schemes**

- 1. In the EU it is a condition for the company applying for a guarantee that the company was not in difficulty on 31 Dec 2019. How is this dealt with in other continents to ensure that you support companies in need because of the pandemic?**

**US SBA** *The same condition applies in the US.*

- 2. Could you please expand on optimal coverage rates, minimum pricing, and other important characteristics for the guarantees being issued for SMEs?**

**AECM** *This depends on regional framework conditions, on sectors to be covered, on the extent of public support provided to the guarantee institution and quite some more factors. Accordingly, AECM's members are very heterogeneous.*

**US SBA** *This is a multi-session topic in and of itself. However, most governments have increased coverage rates (some to 100%), the pricing of government assisted SME credit due to the COVID-19 is not expected to cover all the losses. My read of the pricing is that it is expected to cover some or possibly all the origination and servicing costs, not the capital risk.*

**3. Could you please expand on some of the best practices that you have seen in terms of how to design and structure the guarantee schemes for SMEs?**

**AECM** *Generally speaking, meaning being valid not only during this ongoing crisis, each scheme has its advantages and drawbacks depending strongly on regional conditions (cf. also answer to question 2 above). For the European Union, some conditions are mandatory if state aid rules apply: To illustrate, to mitigate the negative effects of the COVID-19, the European Commission approved the applications filed by the majority of the EU member states under the Temporary Framework to support the economy in the context of the coronavirus outbreak (cf. [https://ec.europa.eu/competition/state\\_aid/what\\_is\\_new/covid\\_19.html](https://ec.europa.eu/competition/state_aid/what_is_new/covid_19.html)) notifying state aid programs. AECM's members apply these programs ensuring that the conditions set by this Temporary Framework are met, i.e. a maximum coverage rate of 90% of the loan principal providing that all the other conditions mentioned in art. 25 are met. The minimum pricing is set per individual loans as mentioned in art. 25 a, and these premiums should increase progressively over time as the duration of the guarantee increases. It is also possible to have 100 % coverage rate provided that the overall aid amount does not exceed 800,000 EUR per undertaking.*

**US SBA** *This is a multi-session topic in and of itself.*