

Countries Continue to Adopt and Update Credit Guarantee Schemes for Small Business Lending

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Original Post [here](#).

In response to the COVID-19 pandemic, many countries quickly announced credit guarantee schemes to support lending to small and medium-sized enterprises (SMEs). Under a credit guarantee scheme, the government fully or partially guarantees the value of a loan to an SME, which minimizes the risk to the lender, incentivizing the lender to provide credit. According to [recent data from the World Bank](#), 41 countries have launched 57 credit guarantee schemes for SMEs this year.

Under normal economic conditions, SMEs are more constrained than larger firms in accessing finance. In the context of the COVID-19 pandemic these constraints are exacerbated and they face severe liquidity shortages. Without support, many SMEs could begin to face a solvency crisis.

Credit guarantee schemes are one tool available to governments to support SME liquidity, but they are not without [design and implementation challenges](#). Guarantees can encourage banks to lend to riskier borrowers by limiting the downside risk, but guarantees will not be as helpful when lenders are limited by balance sheet constraints. Similarly, many SMEs are in a position where any new debt, even inexpensive, fully guaranteed debt, isn't financially feasible. Guarantee programs leverage existing lender-borrower relationships, but the total amount of lending will be influenced by the coverage ratio - the percentage of the loan being guaranteed. If a ratio is set too low, banks may not lend to riskier, high-need borrowers, and the program will not support those it is intended to aid. However, if the coverage ratio is 100% and a program fully protects banks against default risk, banks may lower their lending standards. Other design considerations include size, loan terms, eligible firms and lenders, and duration.

In response to the Global Financial Crisis in 2008-2009, many countries adopted credit guarantee schemes that were never closed. Countries and the responsible authorities that maintained such programs could quickly respond in the face of the pandemic. However, initial responses were often inadequate and have since been expanded. Many other countries have since adopted new programs.

In this post, we provide an update on credit guarantee schemes in response to the COVID-19 crisis. Specifically, we review how governments continue to adapt and expand existing schemes and create new schemes, and how program utilization and demand compare across countries.

Updating and Expanding Existing Credit Guarantee Schemes

Many countries have announced changes to their initial credit guarantee schemes, most of which were introduced in the second half of March and early April.

Coverage Ratio

The coverage ratio is one feature of credit guarantee schemes that can be changed in response to changing economic conditions and demand. Since the beginning of the COVID-19 pandemic, 100% guarantees have increased in prevalence; our [initial analysis](#) of credit guarantees for SMEs noted that only Japan, South Korea, and Hong Kong provided 100% guarantees. Initially, the European Union's [Temporary Framework for State Aid](#) permitted Member States to provide a [guarantee on up to a maximum of 90%](#) of a loan. In an [April 3 update](#) to the Temporary Framework, the limit was loosened, and Member States can now provide a 100% credit guarantee. [Italy](#) [initially](#) announced a tiered credit guarantee system, with decreasing coverage ratios based on loan and company size, but later announced a 100% guarantee. Other countries have increased the coverage ratio to a higher level, though not to a full 100% guarantee. [The Netherlands](#) increased the coverage ratio for SMEs from 50% to 90%, and [Finland](#) increased its coverage ratio from 80% to 90%.

Total Funding

Depending on fiscal availability, countries can increase total funding for guarantee schemes. Often, increases in total funding are multiple times the size of the initial scheme, as evidenced by [Israel](#), which increased funding for its guarantee scheme on several occasions, from NIS 4 billion initially up to 22 billion (USD 6.4 billion or 1.7% of 2018 GDP) in the latest version. On [June 17](#), the European Commission (EC) approved amendments to Italian credit guarantee scheme. The changes include an increase to the budget of the scheme to EUR 25 billion (USD 28.1 billion or 1.2% of 2019 GDP) from EUR 1.7 billion. Other countries have similarly increased total funding for credit guarantee schemes, including Romania, [South Korea](#), and Tunisia, among others.

Maximum Guarantee Amount

Increasing the maximum guarantee amount per beneficiary is another step governments have taken to expand access and increase usage. In Italy, the June 17 amendment increased the [maximum guarantee](#) amount for SMEs from EUR 25,000 to EUR 30,000. The [Peruvian government](#) amended the [Reactiva Peru](#) Program, a tiered guarantee system, to provide a 98% guarantee on loans up to S / 90,000 from S / 30,000.

Duration

Extending the duration of the credit guarantee scheme is another way countries have updated their programs. Countries have both amended the length of the guarantee period and extended the application period. Under the June 17 changes to the Italian guarantee scheme, the loan term is now 10 years, up from the previous 6 years. [Norway](#) has extended its guarantee scheme to include loans made after [June 1](#).

New Zealand extended the term of its [Business Finance Guarantee Scheme](#) from 90 to 180 days.

Eligibility

Other countries have expanded eligibility for credit guarantee schemes. For example, Bpifrance, the French national investment bank, modified eligibility criteria on [May 7](#) to include some companies that were previously excluded. Significantly, it now allows companies that were in bankruptcy proceedings since January 1, 2020, to benefit from the guarantee, and includes some property companies. [Peru expanded](#) eligibility for the MYPE Business Support Fund, which specifically targets microenterprises, to include companies in any sector; the modification also lowered required credit ratings to ensure that more firms would be covered by the scheme.

Phased Approach

Spain has taken a step-by-step approach to its credit guarantee scheme; by releasing funding over an extended duration, it adapts to changes in the macroeconomic conditions in order to better target assistance. The [EUR 100 billion](#) guarantee fund is activated in tranches, and the fifth and final tranche was released on [June 16](#). Of the EUR 15.5 billion of the final tranche, EUR 7.5 billion is allocated for SMEs and the self-employed, EUR 2.5 billion for SMEs in the tourism industry, and EUR 500 million for the automotive industry, with the remaining funding open to all firms.

Creating New Credit Guarantee Schemes

The total number of credit guarantee schemes has grown since the start of the pandemic. The growth can be attributed to countries without such programs announcing the creation of a new scheme and to countries that had schemes but created new, supplementary schemes with different eligibility or a higher coverage ratio.

Eligibility

Switzerland's initial 100% [guarantee scheme for SMEs](#), the "COVID-19 credit" program, served as a model for other countries. However, many startups were ineligible for aid, so the Swiss [government created](#) the "Guarantee Scheme for Startups." The new scheme leveraged the existing process and infrastructure from the initial program, but the terms of the startup scheme are different. The federal government provides 65% of the guarantee while 35% is provided by the canton to jointly guarantee 100% of the loan up to CHF 1 million (USD 1.1 million). The scheme will guarantee up to CHF 154 million total, whereas the COVID-19 credit program can guarantee up to CHF 40 billion (approximately 5.8% of 2019 GDP).

Similarly in South Korea, the government recently [announced](#) a smaller, more targeted credit guarantee scheme, the "Win-Win Special Guarantee to Support Auto Parts Industry." This new, 420 billion won (USD 348 million or 0.02% of 2018 GDP) credit guarantee scheme specifically targets SMEs in the automotive industry. The scheme is

partially funded by the government, which is investing 29.5 billion won, while large automotive companies, such as Hyundai and GM Korea, are together contributing 24 billion won. Beneficiaries are determined based on performance, technological capabilities, and supplier availability, rather than credit rating. The scheme is administered by the national Technology Guarantee Fund.

Coverage Ratio

Other countries have announced new credit guarantee schemes with more favorable terms than their initial schemes. For example, Germany, Italy, and the UK all announced 100% credit guarantee schemes, after initially launching credit guarantee schemes with lower coverage ratios. The creation of new schemes, rather than the modification of an existing scheme, could be due to multiple factors such as the complexity of updating guarantees already made, new eligibility criteria, streamlined application processes, or different infrastructure. Brazil announced a 100% credit guarantee scheme, the [Operations Guarantee Fund](#), on June 10 to guarantee loans for microenterprises and SMEs. Eligible companies must make a commitment to preserve the number of employees at least 2 months after it receives the last instalment.

Demand and Utilization Across Countries

Demand for and utilization of loan guarantees have varied across countries. With many countries increasing funding for guarantee schemes, demand from eligible firms appears to be high. For example, Switzerland doubled the funding for the “COVID-19 credit” program from CHF 20 billion to CHF 40 billion. Despite the increase in funding, the total value of loans guaranteed as of June 18 was CHF 15.2 billion. Of this, CHF 13.3 billion was lent under a 100% guarantee on a loan of less than CHF 500,000. Switzerland’s program also allows for guarantees on loans greater than CHF 500,000, but the government only guarantees 85% of the value while the bank retains the remaining 15% risk.

Media reports indicate that Spain is [considering](#) a EUR 50 billion increase to its [current](#) EUR 100 billion credit guarantee program (approximately 8% of 2019 GDP). As described above, the Instituto de Credito Oficial (ICO) designed the program to release the money in five tranches. The SME loans carry an 80% guarantee and the larger corporation loans carry a 70% guarantee. As of [June 17](#), the ICO had released all five tranches and had made EUR 84.5 billion in guaranteed loans, EUR 60 billion of which had gone to the self-employed and SMEs.

On March 17, the Italian government announced a EUR 100 billion credit guarantee program. It was exhausted within a few weeks and the European Commission [approved](#) a significant increase of EUR 400 billion in the second week of April. However, media reports [indicate](#) that a [small](#) portion of the EUR 400 billion has actually been lent to SMEs. The reports point to bureaucratic infighting, low staff levels at the responsible agencies due to the pandemic, and concerns by banks about receiving

timely reimbursements as causes for the low utilization of the new credit guarantee funds.

The United Kingdom releases [weekly data](#) regarding the utilization of its credit guarantee schemes. Under the Coronavirus Business Interruption Loan Scheme (CBILS), which provides an 80% guarantee, the government has supported 50,482 small businesses with GBP 10.5 billion (USD 13 billion) as of June 21. The [Bounce Back Loans Scheme](#) (BBL) provides a 100% guarantee on loans up to GBP 50,000. This program was launched on April 27 and has guaranteed 921,229 loans worth a total of GBP 28 billion. Applications for the BBL exceed 1 million while applications for the CBILS are less than 100,000. A [recent industry taskforce](#) report includes a projection that one-third of debt under government guarantee schemes will be unsustainable by March 2021. It should be noted that credit guarantee schemes are not without risk to the government, and losses are inevitable, especially given the uncertainty of the duration of the COVID-19 crisis. Credit guarantee schemes and other government-supported lending programs that do not have borrowers that default are likely too narrow. Guarantees are intended to encourage lending to borrowers that are higher-risk, and even during normal economic conditions, borrowers can and will default.

To date in France, approximately one third of the [EUR 300 billion \(USD 336 billion or 10.7% of 2018 GDP\) in guarantees](#) for companies of all sizes have been used. Most of the guaranteed loans have been made to firms with less than 250 employees and less than EUR 50 million in revenue. It is likely that more firms will benefit from the facility as the crisis continues. Bpifrance, which administers the guarantee, [has recommended](#) that firms do not borrow the total entitled amount at once.

Utilization of credit guarantees varies across countries and depends on multiple factors. Utilization is one measure of the success of a credit guarantee scheme, but other measures, such as the increase in lending to borrowers that were unable to access market finance, the default rate, and others should also be used to evaluate if the credit guarantee scheme met the objective of ensuring SMEs had access to finance. Credit guarantee schemes are dependent on broader macroeconomic conditions as well, and if the economy enters another decline or if the recovery is prolonged, governments will face higher losses due to defaults.