Credit Guarantee Bill 2012

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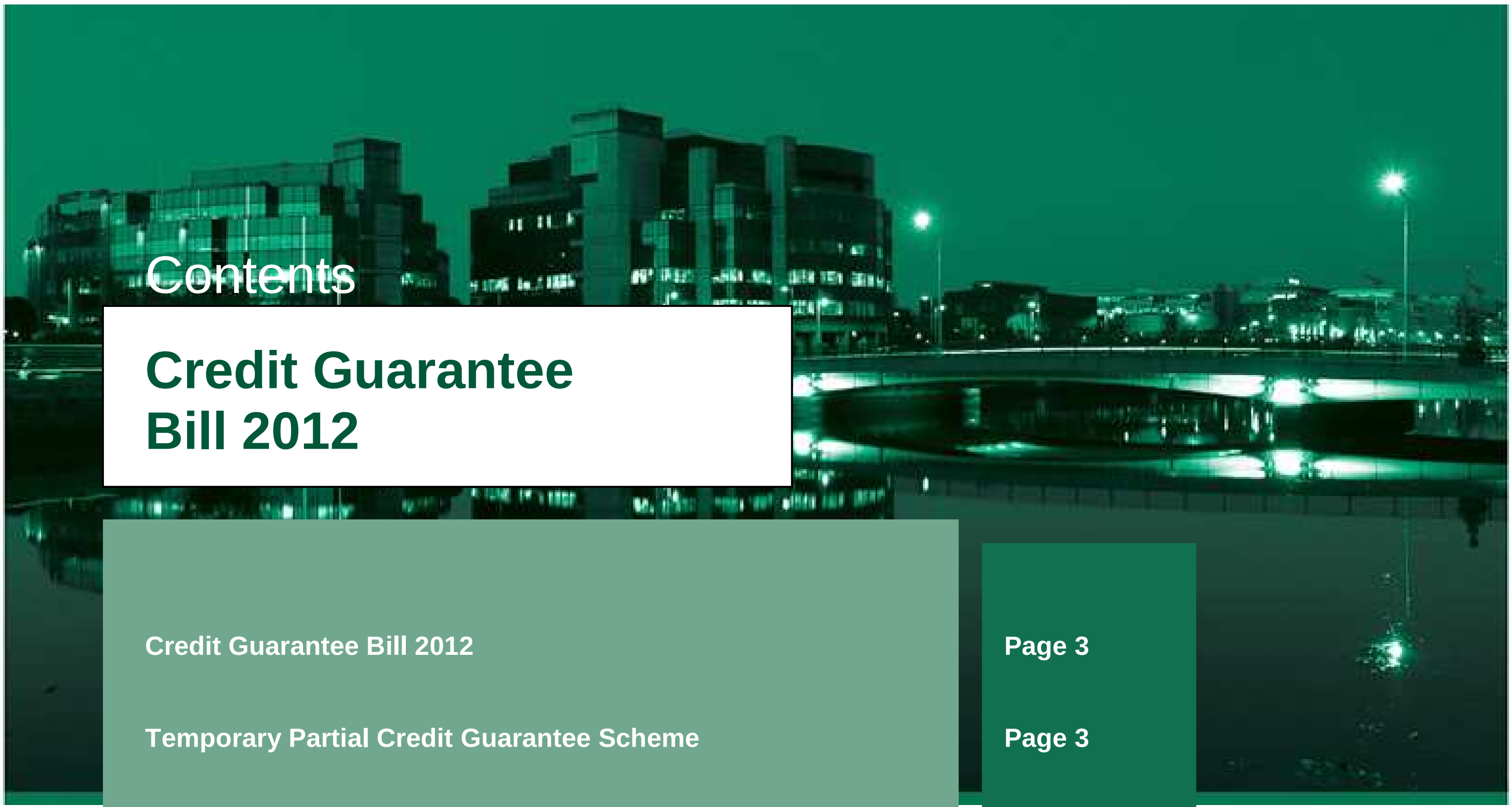

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For the past number of years, Irish small and medium-sized businesses ("SME's") have been lobbying the Government for the introduction of some meaningful initiative to assist cash starved businesses gain access to bank credit. Earlier this year the Government announced (as part of its Action Plan for Jobs 2012 programme) a planned range of new supports for struggling SMEs, including the establishment of a credit guarantee scheme. The Credit Guarantee Bill 2012, published in April of this year, is the draft legal embodiment of the Government's proposals for such a scheme.

Temporary Partial Credit Guarantee Scheme

The Bill provides for the establishment of what the Government refers to as a targeted *Temporary Partial Credit Guarantee Scheme*, the central element of which is a 75% government guarantee on loans granted by participating lenders to qualifying SMEs.

The Bill empowers the Minister for Jobs, Enterprise and Innovation to enter into agreements with 'participating lenders' under which the Minister can guarantee the repayment to that lender of up to 75% of the principal moneys loaned to a 'participating borrower' under a 'loan agreement'.

'Participating borrower' is a defined term in the Bill and falling within its ambit are SMEs employing less than 250 persons and with an annual turnover of not greater than €50million or with an annual balance sheet of not greater than €43million (criteria which are in line with the European Commission definition of an SME).

Importantly, currently excluded from the definition of a 'loan agreement' are overdraft facilities and arrangements for the refinancing of existing debts. The Dáil Committee Amendments to the Bill published at the beginning of June do recommend the inclusion of overdraft facilities (and loans converted from overdrafts) within the ambit of the Scheme, however it is yet to be seen if these recommendations will be taken on board.

Furthermore, it is proposed that primary production in agriculture, horticulture and fisheries will be excluded from the scope of the Scheme, as will property-related activities.

Participating borrowers who enter into loan agreements guaranteed under the Scheme will be subject to a 2% annual premium on the outstanding balance of the loan, payable to the Minister.

The Minister has appointed Capita Assets Services Ltd., a Maynooth based company (and part of the Capital Plc group) to administer the Scheme.

Protections for the State

Guarantees under the Scheme will be given to each participating lender for a collection of loans (a portfolio approach) rather than individually (on a loan-by-loan basis). The participating lender will have the right to determine what loans make up the portfolio, however, the Bill seeks to ensure that the Minister retains high level control over the loans and provides that the Scheme will specify such matters as: the classes of loan agreements (and SMEs) to which the

Scheme will apply; the purposes for which moneys borrowed pursuant to a loan agreement may be applied; and, the maximum amount which a participating lender may lend to a qualifying SME.

The value of the loans which may be guaranteed under the Scheme is capped at aggregate maximum of €150million per annum. The Minister must also ensure that the extent of his/her liability to a single participating lender under the Scheme does not exceed 10% of the aggregate principal of the moneys borrowed under the Scheme from that participating lender in any one year.

Furthermore, the Minister may issue what is effectively a cut-off notice to a participating lender so that as and from the date specified in the notice, the guarantee agreement between the participating lender and the Minister will not apply to new loan agreements.

Benefits of the Scheme

Credit guarantee schemes are widely used initiatives worldwide and are generally considered to have a number of core potential benefits, namely, improving loan terms and facilitating access to formal credit for collateral deficient but otherwise creditworthy SMEs. Potential ancillary benefits are also perceived, including increased credit additionality (i.e. the creation of additional loans which would not have come about without the credit guarantee scheme) and technology / knowledge spill-over and economic additionality, including job creation (the argument being that improved access to formal credit for SMEs facilitates solid investment projects and increases productivity).

The Government seems to be focusing on the traditionally perceived benefits of credit guarantee schemes in its projected analysis of the impact of the Scheme. The Government's stated aim of the Scheme is facilitating up to €150 million of additional lending per annum to eligible SMEs with job creation potential: the implication being that the Scheme will provide access to credit for SMEs, thereby generating job creation. The Government has been keen to emphasise that lending under the Scheme is not to act as a substitute for conventional lending to SMEs that would otherwise have taken place. The Scheme is promoted as designed to enable SMEs to develop a positive track record with the lender with the objective of returning to standard commercial credit facilities in time. Furthermore, rather than representing another drain on the State's resources, the Government estimates that the Scheme will actually return a net gain for the exchequer of over €25 million per €150 million of lending cost (when increased tax receipts and decreased social welfare payments are taken into account).

On a review of credit guarantee schemes established internationally, economic analysts question whether, in practice, such schemes are sustainable and whether they create the financial and economic additionality sought. Furthermore, analysts caution against governments overoptimistically pricing the cost of credit guarantee schemes on the basis of initial relatively small cash outlays. The general consensus seems to be that a successful credit guarantee fund requires as a minimum clear and precise goals, against which performance is regularly monitored, realistic pricing verified by consistent and transparent accounting, and attention to the incentive features of operational design.1

The Government certainly seems cognisant of these prerequisites in its formulation of the Scheme as set out in the Bill, evidenced by such provisions as those which enable the Minister to determine the classes of loan and SMEs

[1] Patrick Honohan: *Partial Credit Guarantees: Principles and Practice (Prepared for the Conference on Partial Credit Guarantees, Washington DC, March 13-14, 2008)*

which will benefit from the Scheme and the Scheme performance review powers afforded to the Minister under the Bill. However, the extent to which such tools will be used effectively by the Minister remain to be seen both in the final design of the Scheme once established and in the governance of the Scheme. An encouraging step in this regard would be for the Bill to include a recommendation made in the Dáil Committee Amendments to the Bill whereby the Minister would be obliged to conduct a review of the operation of the Scheme on at least an annual basis (as opposed to the non-mandatory nature of the review provision currently provided for in the Bill).

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