

MUTUAL GUARANTEE SCHEMES AND SME FINANCE: A CROSS-COUNTRY COMPARISON

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ABSTRACT

The recent financial crisis and the consequent reforms of the regulatory framework are making the Small and Medium Enterprises' (SMEs) access to credit more challenging. In financial systems in which SMEs have no substantial alternatives to bank credit, mutual guarantee schemes and institutions can significantly contribute to facilitate the credit access of such firms, by reducing the information asymmetries between the lender and the borrower and, in some cases, by decreasing the cost of funding. On the other hand, it is known that mutual guarantee schemes vary significantly worldwide, either considering their functioning mechanisms or according to the importance that they have on domestic economy. More specifically, not all the guarantees offered by such institutions are Basel II compliant, and therefore do not allow banks to reduce capital requirement against credit risk.

The goal of the paper is to perform a cross-country comparison of mutual guarantee schemes and institutions in six countries in which such facilities played a significant role in allowing SMEs to obtain better credit conditions from banking system.

The methodology used for the investigation is based on the analysis of aggregate data provided by the domestic supervisory authorities as well as on firm-specific data obtained from annual reports of the top mutual guarantee institutions in the selected countries. The areas of investigation for the cross-country comparison are: the legal and regulatory framework of mutual guarantee schemes and institutions; the structure of supply; the operational features of the guarantees offered; the role of policy makers in promoting such guarantees, with a special focus on post-crisis period.

Starting from a review of the literature on information asymmetries in SME finance (i.e. Leland & Pyle (1977); Stiglitz & Weiss (1981)) and on criticisms in mutual guarantee institutions (i.e. Columba, Gambacorta & Mistrulli (2009); Beck, Klapper & Mendoza (2008)), the critical comparison of the different mutual guarantee schemes adopted in the selected countries aims at identifying whether some operative solutions can be considered more effective and efficient in the perspective of banks - which should consider such guarantees as a value - and borrowers. The expected result of the study is to provide a clear representation of the most significant strengths and weaknesses of mutual guarantee schemes in the selected countries.

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Keywords: *Credit Guarantee Institution, Credit Risk Mitigation, Financial Crisis*

1. Introduction¹

The recent financial crisis and the consequent reforms of the regulatory framework are making the Small and Medium Enterprises' (SMEs) access to credit more challenging. In financial systems in which SMEs have no substantial alternatives to bank credit, mutual guarantee schemes and institutions can significantly contribute to facilitate the credit access of such firms, by reducing the information asymmetries between the lender and the borrower and, in some cases, by decreasing the cost of funding. On the other hand, it is known that mutual guarantee schemes vary significantly worldwide, either considering their functioning mechanisms or according to the importance that they have on domestic economy. More specifically, not all the guarantees offered by such institutions are Basel II compliant, and therefore do not allow banks to reduce capital requirement against credit risk.

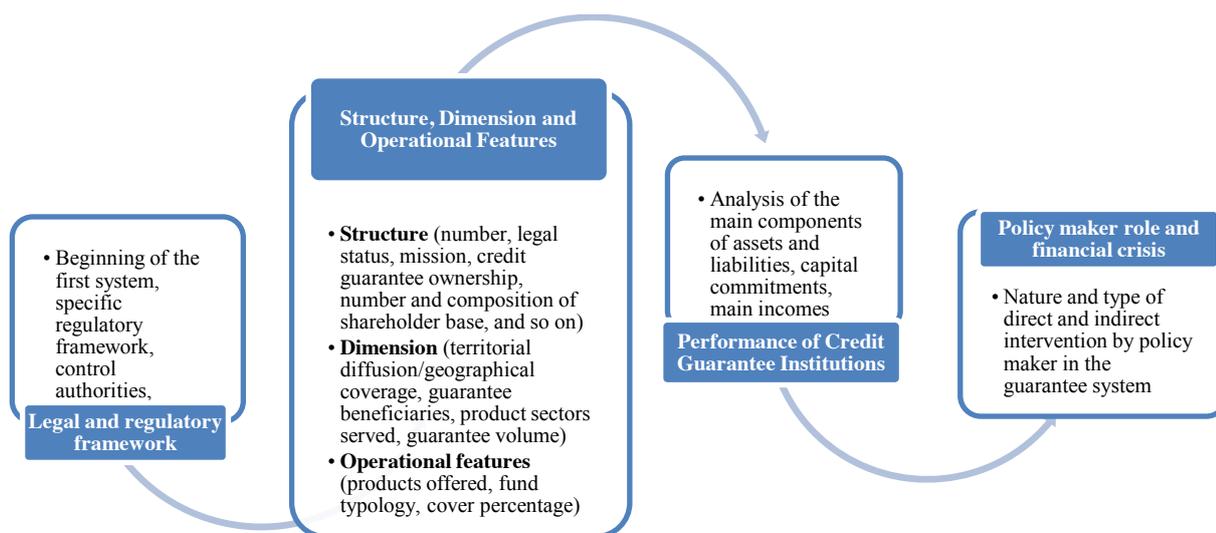
The goal of the paper is to perform a cross-country comparison of mutual guarantee schemes and institutions in six countries in which such facilities played a significant role in allowing SMEs to obtain better credit conditions from banking system. In particular, this paper is aimed at comparing the structure, morphology, characteristics as well as the economic and financial performance of the credit guarantee systems existing in a sample of countries, being aware that they usually lack homogeneity, feature several "contents" and different levels of efficacy. After examining in detail the key features of the credit guarantee systems in these six countries, the paper offers a comparative analysis and highlights some conclusions, which are not, however, meant to be fully comprehensive.

The structure and the organisation of the guarantee scheme sector in the countries analysed are rather heterogeneous as they are the result of growth paths and development models belonging to different social-economic situations (country-specific guarantee systems). Just like banks, guarantee systems are based on a large variety of structures, legal forms and organisational structures (public banks, private commercial banks, savings banks, cooperative networks, micro-finance institutions, and so on); in the countries analysed they vary in practice due to the different economic and historical backgrounds and legal contexts. The main differences between guarantee systems are related to the specific regulatory frameworks, the extent of State intervention in the system, guarantee programs, target market (multi-sectoral, mono-sectoral), guarantee products, guarantee beneficiary (microcredit guarantees, guarantees for growing companies, guarantees for business internationalisations, business start-up guarantees, guarantee for working capital needs, business transfer guarantees, innovation guarantees) leverage ratio, coverage of the loan, the term of the guarantee, extent of coverage and the associated costs, collateral management process, and so on. Behind these

¹ This paper is part of a broader research coordinated by P. Leone, to whom the authors are grateful for the useful comments and suggestions on a preliminary version. Despite the work has been jointly ideated and designed by the two authors, sections 1 and 2 have been written by G. Vento, whereas Sections 3, 4, 5 and 6 belong to P. Porretta. As obvious, the authors are the only responsible of any mistake.

differences there are a common set of objectives: providing loan guarantees and other services complementary and collateral to SMEs. All these factors will be discussed in a comparative analysis below. The cross-country comparison is carried out on the basis of an analysis scheme focussed on four investigation areas: 1) The Legal and Regulatory Framework; 2) Structure, Dimension and Operative Framework; 3) Economic and Financial Performance; 4) Policy Makers Role and Financial Crisis (Chart.1).

Chart 1 - Comparative analysis: logic scheme to read the data analysed



2. Methodology

This paper analyses and compares the credit guarantee systems of some key EU countries in which they are well structured and have a long tradition, such as Italy, France, Spain and other countries such as Hungary, where the credit guarantee system has recently been established, featuring embryonic operative modalities. The analysis framework was widened to include two non-EU countries based in Latin America, that is Chile and Argentina, as they feature well-established and developed credit guarantee schemes, which can provide useful lessons and comparative terms.

The countries that were analysed share an entrepreneurial fabric with widespread small business enterprises (SMEs). The latter cover a significant part of the economy in the countries at stake - in terms of GDP, employment, added value and product export - yet suffer from an intrinsic weakness, as they usually command limited resources, feature a greater risk aversion than large corporate companies and often have insufficient collateral or lack a sufficient track record or credit history. As a consequence, accessing bank credit is objectively more complex for SMEs as for the rationing of volumes and the weighty terms for borrowed money are concerned. Therefore, they are often forced to employ credit risk mitigation tools, specifically *funded* and *unfunded* guarantees given by public or private guarantee or mutual guarantee

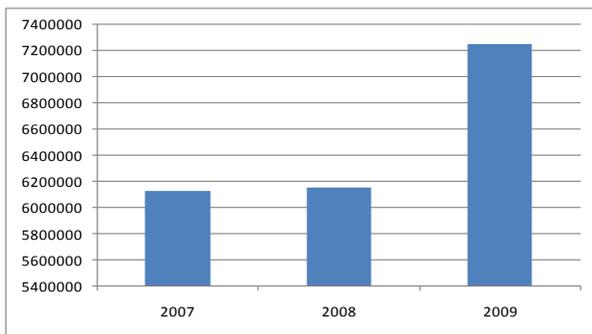
institutions. A very important factor in the growth process and in the shaping of credit guarantee schemes is provided by the presence of small and medium-sized enterprises, which have always found accessing credit difficult. CGIs can be intermediaries of public, private and mixed nature, in line with the characteristics typical of the financial system they belong to. They take part in the bank-company relation in different ways; first of all, they offer unfunded or funded guarantees which usually hedge part of the funds allocated by bank intermediaries and/or the losses borne by the bank in charge for the credit risk of the financed SME. They typically step in when debtors fail to pay (direct debit guarantee) or at the end of the recovery procedures exercised by the bank by paying an amount of money equalling the percentage of cover obtained (subsidiary guarantee). Moreover, credit guarantee schemes usually carry out with banks collective negotiations on interest rates and other terms and conditions for the money borrowed by the SMEs; they also participate in selecting and monitoring the companies applying for guarantees. The above activities, together with the examinations performed by the participating companies (*peer monitoring*), alleviate the effects of information imbalances between banks and small-sized enterprises, which are typically less clear. In this perspective, the credit guarantee system softens the imperfections in the functioning of the credit market, which are expressed in the rationing of funds or the excessive financial burden of the credit as compared to the debtor's credit rating.

For many years now, credit guarantee schemes have played an important part in the financial framework of the European economy. Yet, over the past three years, due to the international financial crisis and the further increase in problem loans in the portfolio of banks, resorting to the credit risk mitigation tools they can provide has become more frequent. The data supplied by the AECM² (European Association of Mutual Guarantee Societies), on the public and private guarantee schemes operating in 21 EU countries, show for the three-year period 2007-09 an increase of about 22 per cent (Figure 1), the same as the increase which leads to the overall number of guarantees in the portfolio (Figure 2). Specifically, in 2009 an increasing number of guarantees were provided everywhere, mainly due to the greater demand for them, to ensure that SMEs could access credit during the most critical stages of the crisis.

In parallel, over the past three years, the leverage ratio increased by about 7 per cent (Figure 3) due to the greater demand for guarantee and less available financial (public) resources for guarantee activities.

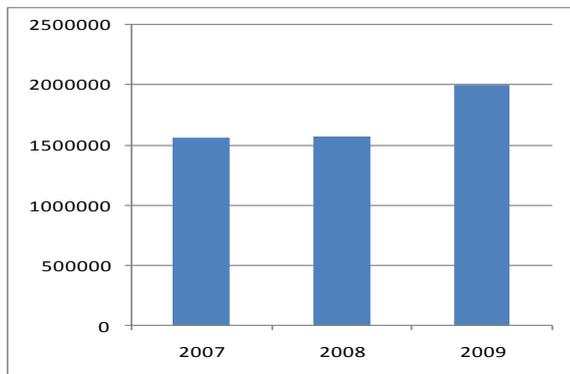
² AECM has 34 member organizations operating in 21 EU countries and Turkey. Its members are mutual, private sector guarantee schemes as well as public institutions, which are either guarantee funds or development banks with a guarantee division. They all have in common the mission of providing loan guarantees for SMEs who have an economically sound project but cannot provide sufficient bankable collateral.

Figure 1-Volume guarantees in portfolio



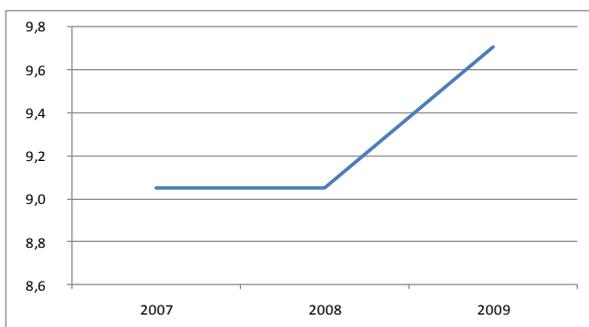
Source: our processing of AECM data (2009).

Figure 2-Total guarantees in portfolio



Source: our processing of AECM data (2009).

Figure 3-Leverage ratio



Source: our processing of AECM data (2009).

In light of this first empirical evidence and of the role which CGIs have always played in supporting SMEs, it becomes essential to understand, in detail, how guarantee systems in EU and non-EU countries work. In this work, they are examined according to a logical scheme involving the following four investigation areas: a) *Legal and Regulatory Framework*; b) *Structure, Dimension and Operational Features*; c) *Economic and Financial Performance*; d) *Policy Makers Role and Financial Crisis*.

Every investigation area includes further sections and items meant to highlight specific structural and operative aspects, which are typical for each credit guarantee system.

The analysis performed started with the investigation area dedicated to the *Legal and Regulatory Framework* as the latter undoubtedly influences the legal and institutional layout of mutual guarantee schemes, and defines both the scope of operation and the technical and legal characteristics of the mitigation tools provided. In fact, the credit Guarantee System requires a legislative and normative framework, which corresponds to the State powers, within which an interaction and alliance process must take place between the public, financial and business sectors. This framework is usually backed by a counter guarantee or a national coverage system and even by a framework of supranational coverage. Interests or objectives of the three agents involved in this “alliance” are not homogeneous. Thus, the public administration has interests such as promoting enterprises, entrepreneurs and wealth, creating jobs and so on (logically this does not agree with financial entities, for example); entrepreneurs want to access financing with competitive conditions (cost, terms); financial institutions require a quality, certified and well weighted (Basel-compliant) guarantees.

Within the regulatory framework, a particularly relevant role is played, for banks in EU Countries, by the regulations for the prudential supervision of banks (Basel II) which define the qualification requirements which the mitigation tool must comply with to reduce the capital appropriation of the funding bank intermediary, against the credit risk, and therefore influence the *modus operandi* of guarantee intermediaries. The influence is stronger where the credit guarantee institutions (CGIs) have acquired the legal and institutional status of supervised intermediaries, while it is weaker where they have not acquired said status. The rules of prudential supervision are different in line with the bank intermediary using the Standard, IRB Foundation or IRB Advanced approach; in any case, they change the possibilities/chances for CGIs to only follow traditional logics and technical modalities. Yet, far from lowering the request for guarantees, Basel II seems to create quite the opposite effect as it offers new and interesting chances to all the guarantors who can adapt to its dictates by putting forward eligible guarantees. Thus, it enhances the operability of CGIs; their guarantees, if in line with the requirements stated, can be used by the funding banks to reduce credit risk, the following capital appropriation, and therefore the same cost of funds allocated to the guaranteed parties. In this context, the guarantees, especially those best certified and Basel-compliant are a scarce resource.

Basel II, somehow, encourages CGIs to undertake reorganization and accreditation plans of different kind and evolution complexity, which will lead to the regulatory acknowledgment of the mitigation activity performed, as well as to the operative enhancement of individual situations and of the system as a whole. Accordingly, this research project starts by analysing the legal and regulatory framework within which credit guarantee schemes operate.

The investigation area called *Structure, Dimension and Operational Features* is aimed at describing the dimension of the operability of CGIs in terms of geographical coverage number, volume of guarantees, amount of guaranteed funds (labelled according to technical form, expiry periods, categories of amount); the

main features of their operability in terms of the product area protected, geographical coverage, type and nature of guarantees offered, average cover percentage of funding, nature of funds used (public/private, real/personal), as well as other collateral services which complement the business of guarantees offered. The Investigation area called *Economic and financial performance* is meant to investigate the structure of the Statement of assets and liabilities and of the Income Statement of credit guarantee schemes, as well as their main income and property performance.

The underlying idea is that credit guarantee schemes perform their institutional mission that is they favour access to credit for SMEs, in compliance with the regulatory framework to different degrees, depths and contents, according to their dimension as well as their operative, economic and financial characteristics. The regulatory framework, the dimensions and the operative, economic and financial characteristics of credit guarantee schemes are all variables which influence the economic and financial additionalities brought about in favour of the guaranteed parties and of the financing banks, which have been greatly affected by the international financial crisis.

The individual investigation areas were examined using accessible information sources; these include the documents created by the individual national supervisory authorities, the reports on the investigation areas examined and literature on the subject.

The analysis scheme was arranged on the basis of the 2005-2009 time frame. Though the lack of data did not always allow for the achievement of a historical depth, as a consequence, it was possible to highlight the main features and similarities among the CGIs of the countries at stake, although no final and universally valid remarks on the topics investigated were made.

For obvious reasons, although a single logical analysis scheme (table 1) was used at the beginning, each of the following sections features a slightly different structure due to the specificity and to the typical *modus operandi* of the financial system of the country examined, to the reference regulatory framework and to the evolution and characteristic features of the economic system. The following table (Table 1) shows the analysis scheme used and its breakdown.

Table 1-Logical analysis scheme

INVESTIGATION AREA	ITEMS
The Legal and Regulatory framework	Specific regulations for credit guarantee schemes;
	Regulatory framework for credit risk mitigation tools (Basel, no-Basel);
	Presence/Absence of a special tax regime for guarantee organizations;
	Presence/existence of controls by national supervisory authorities;
Structure, Dimension and Operational Features	Legal and institutional forms of guarantee intermediaries;
	Legal forms of guarantee organisations;
	Property of credit guarantee schemes (companies, trade associations, public entities and so on);

	Transformation processes developed over the past few years;
	Structure of governing corporate bodies;
	Average and total no. of partners for the years stated;
	Structure of controlling corporate bodies;
	Institutional mission (profit oriented, mission oriented...);
	Number of branches for the different years stated;
	Rates of penetration/ dissemination on the territory
	No. of guarantees granted;
	Total no. of guarantees in portfolio;
	No. of beneficiary enterprises;
	Balance of business demography (setting up – closing down);
	Value of guarantees granted over the year;
	Value of funds granted;
	Value of guarantees in portfolio;
	Overall funds granted;
	Product areas involved;
	Geographical coverage (national, regional, provincial)
	Technical characteristics of guarantees, co-guarantees, counter guarantees;
	Relations with the financial system (banks with an arrangement, other financial intermediaries and so on);
	Beneficiary enterprises (member, non-member too);
	Types of funds used on average;
	Average and total guarantees granted;
	Other collateral and complementary services provided;
	Problem guarantees in portfolio (overdue, difficult receivables, impairment rate);
	Average cover rate for the years stated;
	Percent weight of funds allocated to enterprises of all sizes on the total asset of the banking system for the years stated;
	Percent weight of funds allocated to small-size enterprises on the total asset of the banking system for the years stated;
	Overall funds granted / Funds allocated to SMEs;
	Average interest rate applied by banks for guaranteed credits (on the short, medium and long term);
Economic and Financial Performance	Typical structure of Statement of assets and liabilities and Income Statement (detailed list of the items);
	Income Statement and Statement of assets and liabilities reclassified according to the identified scheme
	Economic and financial performance (indexes of profitability and solvency);
Policy Makers Role and Financial Crisis	Measures taken by policy makers within the guarantee systems (capitalization measures, awarding of funds for guarantee activities, direct guarantee measures and so on)
	Types of funds granted (SPD funds; anti-usury funds and so on);
	Measures carried out to curb the international financial crisis;

3. The legal and regulatory framework: a comparative analysis

The first investigation area of the analysis scheme, which has been adopted in the present survey, is required to analyse the characteristics of the legal and regulatory framework of the guarantee system, the adoption of the regulatory framework on capital (for example, Basel II) and consequently of the regulations on credit risk mitigation by the country analysed, as well as the presence of inspections carried out by the national inspection authorities. All these items put together define the regulatory framework regulating the activity of the CGIs. As known, in the new regulatory framework on capital (for example, Basel II), the role of guarantee societies has grown. The relevance of guarantee societies for banks is to offer mitigation of the risks associated with their SME portfolios. Basel II will qualify most guarantee societies as guarantors provided that their guarantee product is in line with the regulatory requirement. This will allow banks to reduce regulatory capital on their loan portfolio. The adoption of the Basel II framework has had a profound impact on the nature, the type and the characteristics of the mitigation tools offered by the CGIs. For this reason, *credit risk mitigation* provisions modify the possibilities/opportunities for CGIs to continue operating exclusively according to traditional standards and technical methods. Rather than reducing the amount of applications for guarantees, Basel II seems to have caused this amount to increase by offering interesting new opportunities for guarantors who decide to comply with its specifications, proposing eligible guarantees.

France. The present structure of the French guarantee system comes from the bank law of 24 January 1984, which considers CGIs as business companies, including them in the list of financial institutions, setting the goals of their activities as well as the profiles of the subjects who are entitled to carry out such activities. The French guarantee system includes numerous types of guarantee institutions, which are still operative: Oseo Garantie, Siagi and SOCAMAs. Even though they cannot strictly be considered banks, the French CGIs are subject to prudential supervision by the same authority that is in charge of controlling the bank intermediaries: the Banque of France. The supervisory body is in charge of inspecting the intermediaries' internal organisation concerning the internal controls that the guarantee institutions must carry out based on their size and on the complexity of their activities according to the proportionality principle. The overall regulatory framework aims at protecting entrepreneurial initiatives and the contractual autonomy of the economic operators, as well as the stability and efficiency of a business sector (that is the guarantee sector) closely linked to credit intermediation. The present regulatory framework on capital, which was adopted in February 2007, is the same as the Basel II framework.

Spain. In Spain the origins of SGRs date back to 1977, when the decree-law 15 (*Decreto-Ley 15/1977*), concerning the reform of the financial system, authorised the government to manage the creation as well as the legal, fiscal and financial position of the *Reciprocal Guarantee Companies* (SGRs). The following year, the legislative framework of the SGRs was laid down by the Royal Decree 1885/1978. SGRs are members of the *Confederación Española de Garantía Recíproca* (CESGAR), which is in charge of coordinating, cooperating, protecting and representing the interests of its member companies, promoting all types of agreements with public or private institutions both in Spain and abroad, as well as providing advice or

technical assistance to member companies. CESGAR plays a crucial role in the Spanish guarantee system also thanks to the private company *Compañía Española de Reafianzamiento*, S.A. (CERSA), which was established in 1994. CERSA, which is controlled by the SGRs, by the banks and by the State (11.23 per cent, 9.76 per cent and approximately 80 per cent, respectively), is in charge of providing second-level guarantees to SGRs, or rather counter-guarantees for the securities provided to the SMEs. It covers a broad range of risks thanks to the funds of the European Investment Fund (EIF). In certain regions, in addition to the counter-guarantee provided by CERSA, there is also a second-level guarantee managed by the *Comunidades autónomas*. Therefore, even though the Spanish guarantee system is relatively young, it has a clear legislative framework and its activities are constantly inspected by the Central Bank. As known, Spain has adopted the Basel II framework on capital.

Argentina. The Argentinian legislative and regulatory framework on guarantees is rather similar to the Spanish one and features two types of structures: the reciprocal guarantee companies (SGR), which provide guarantees to micro, small and medium enterprises and foster access to credit; the Guarantee Fund of the Province of Buenos Aires (FOGABA), which provides guarantees exclusively to the SMEs operating in the Province of Buenos Aires on a permanent basis. FOGABA was established by a provincial law promulgated in October 1994, whilst SGRs were established with a specific law, which was amended and integrated by other legislative and regulatory interventions. In Argentina, the activity of the SGR is managed and supervised by two inspection bodies: the Sub-Secretariat for Small and Medium Enterprises and Regional Development (SEPyME) and the Central Bank (BCRA). The Sub-Secretariat for Small and Medium Enterprises and Regional Development, which is under the authority of the Ministry of Industry, is in charge of supervising the SGRs' activity. The BCRA plays a dual role: on one hand, it supervises existing relationships among the SGRs, the banks and the other financial intermediaries; on the other hand, it regulates and supervises, together with SEPyME, the SGRs and the regional funds that decide to be voluntarily listed in the registry of the BCRA. Specific regulations provide for fiscal benefits for the activities of the SGRs which are one of the main incentives for the activation of this organisational model.

Chile. The first regulatory framework of the Chilean guarantee system dates back to the beginning of the 1980s, when Law 3472 established FOGAPE (*Fondo de Garantía para Pequeños Empresarios*), a fund with a legal personality based on public law and subject to the prudential supervision of the *Superintendencia de Bancos e Instituciones Financieras* (SBIF), the Chilean bank supervision authority. In 1997 a law was passed making it possible to establish two alternative forms of IGR (*Instituciones de Garantía Recíproca*): *Sociedades Anónimas de Garantía Recíproca* (SAGR) and *Cooperativas de Garantía Recíproca* (CGR). The latter are always subject to the supervision of the *sociedad evaluadora*, which is registered in a specific list deposited at the Chilean Central Bank. A specific law made it possible to set up two public institutions to support the Chilean guarantee system; CORFO (*Corporación de Fomento de la Producción*) and INDAP (*Instituto de Desarrollo Agropecuario*), both supervised and financed by the State, and authorised to help finance the guarantee institutions by means of the *fondos fiduciarios* set up by a specific law. In Chile, banks

and the main financial institutions have adopted the principles of the Basel II agreement. SBIF (*Superintendencia de Bancos e Instituciones Financieras*) plays a crucial role in the supervision of the IGR system and is also in charge of assessing their solvency on a yearly basis. FOGAPE is run by the Banco Estado.

Italy. Established towards the end of the 1950s, the Italian CGIs operated for many years without a specific legislative framework or a univocal legal regime. Starting from the 1970s, a set of provisions were introduced to grant certain benefits to the Confidi provided that they complied with various organisational, dimensional and operational requirements. In the 1990s and in the early 2000s, a set of government bills dealing with Confidi were introduced but failed to be approved. However, in 1993 the introduction of the new Banking Law imposed a series of minimum requirements upon the Confidi relative to the amount of member companies and capitalisation levels as well as compulsory registration in a specific section of the general list of non-bank financial intermediaries causing an ad hoc regulatory framework for the Italian credit guarantee system to gradually start taking shape. In 2003 (in particular thanks to art. 13 of decree-law 269 of 30 September 2003, converted into the Law 326 of 24 November 2003), the Italian regulatory system underwent a general reform of the regulations concerning Confidi (also called “framework law on the Confidi”), according to which such institutions could be subject to the supervision of Banca of Italy. The framework law on Confidi established fundamental principles and laid the foundations for the development of all Italian Confidi, also giving the possibility to the largest ones (adequately recapitalized and fully reorganized) to play the role of financial intermediaries supervised (ex art. 107 or collective guarantee bank for credit lines) by the Central Bank (Bank of Italy). Starting from 2003, numerous regulatory interventions followed with the purpose of providing the sector with coherent legislation and of fostering the development and consolidation of the facilities providing mutual guarantee schemes. The framework law on the Confidi was followed by prudential supervision interventions (circular letter 216 of the Bank of Italy, seventh, eighth, ninth update), by the implementing decrees of the Ministry of Economy and Finance and by the recent reform of Title V of the Banking Law (Legislative Decree 141/2010), whose implementing decrees are still waiting to be issued. The reform of Title V confirms the presence of two different types of Confidi (supervised and non-supervised) in the Italian guarantee system, which will be subject to different inspection regimes that will be both more rigorous and potentially more efficient than in the past. Furthermore, it also introduces inspection systems for the smaller Confidi, as well as minimum regulations and an external Body, (art. 112 bis), also subject to the supervision of *Banca of Italy* and with the power to inform, inspect, sanction and take steps against smaller Confidi. For a long time, due to the lack of a national public regulation system, relationships between CGIs and bank institutes developed thanks to private agreements supporting the growth of the guarantee system, despite the fact that there was no explicit recognition of the value of mutual guarantees.

Hungary. Even though CGIs have been operating since the beginning of the 1990s in Hungary, the legislator has not yet drawn up specific sectorial regulations for guarantee organisations, which are subsequently subject to the same regulatory framework as financial institutions. Law CXII of 1996 on credit institutions

and financial companies provides a reference legislative framework for the establishment of banks and other financial institutions (financial companies). Given that CGIs provide financial services, they are subject, just like the other financial companies, to the supervision of the national credit authorities; there is no specific authority for Hungarian credit guarantee schemes. At the present time, the supervision and the monitoring of the Hungarian banking and financial system are carried out by the Hungarian Central Bank (*Magyar Nemzeti Bank* - MNB) and by the *Financial Inspection Authority of the Hungarian Government* (*Pénzügyi Szervezetek Állami Felügyelete* - PSZÁF). In Hungary there are two State-controlled guarantee organisations that were jointly founded by the State and a number of commercial banks: Rural Credit Guarantee Foundation (*Agrár-Vállalkozási Hitelgarancia Alapítvány* - AVHGA), Garantiqa Creditguarantee Co. Ltd. (Garantiqa).

The comparative analysis between the countries shows that, with the exception of Hungary, guarantee bodies are subject to *ad hoc* legal and tax regulations defining the activities that may be carried out, their legal form, participating firms and minimum share capital. Some of the countries analysed have relatively young credit guarantee systems (Argentina, Hungary, Chile) while others (France, Italy and Spain) have a more long-established guarantee sector (table 2). All countries apart from Hungary have a specific regulatory system for CGIs, and have adopted a new regulatory framework on capital and, therefore, on credit risk mitigation. The existence of specific regulations related to the guarantee system reveals that many countries believe that guarantees require special governmental or State and Supervisory authority attention.

In general, the legal and regulatory framework recognises that guarantee bodies not only provide support to SMEs by facilitating and improving transfer of funds but also produce information that is useful to the banking system as well as channelling public grants. As financial intermediaries the CGIs operating in the various countries are subject to the control of the prudential Supervisory Authority, which tailors its intervention to the operational complexity of these financial companies. In countries with public structures and/or supervised and non-supervised Confidi regulatory activities take place on various levels:

- direct control by the Central Bank;
- controls delegated to ad hoc control structures (like Italy's *Organismo di vigilanza dei confidi minori* and Chile's *Sociedad de Evaluación* which is listed in a register held by the central bank);
- controls carried out by the State (as for CORFO and INDAP in Chile) or by public bodies (like SEPyme - Argentina's Undersecretariat for SMEs and Regional Development, or the Hungarian government's Financial Supervisory Authority).

Table 2 - Legal and regulatory framework

Country	Beginning of the first system	CGIs	Legal and regulatory specific framework	Adoption of Basel II framework	Control authorities
Argentina	1994/1995	SGR (Reciprocal Guarantee Company), FOGABA (Buenos Aires Guarantee Fund)	Yes	Yes	SEPyME (Undersecretariat for SMEs and Local Development) and BCRA (Central Bank of Argentina)
Chile	1980	FOGAPE (Fondo de Garantía para Pequeños Empresarios); IGRs (Instituciones de Garantía Recíproca); CORFO (Corporación de Fomento de la Producción); INDAP (Instituto de Desarrollo Agropecuario).	Yes	Yes	FOGAPE: direct control by Chilean bank supervision authority SBIF (Superintendencia de Bancos e Instituciones Financieras) IGR: control devolved to <i>Sociedad de Evaluación</i> , listed in the SBIF Register; SBIF controls and evaluates IGRs' good standing. CORFO/INDAP: under public control.
France	1917	Oseo garantie; SIAGI; Socama.	Yes	Yes	Banque de France
Italy	1957	Confidi 106, Confidi 107, Guarantee banks.	Yes	Yes	Supervised Confidi (107 and Guarantee Banks): Banca d'Italia Not supervised Confidi: External body controlled by the Banca d'Italia. In the start-up phase.
Spain	1978	SGR (Reciprocal Guarantee Company); CERSA (Compañía Española de Reafianzamiento, S.A.)	Yes	Yes	Banco de España
Hungary	1991	AVHGA (Agrár-Vállalkozási Hitelgarancia Alapítvány - Rural Credit Guarantee Foundation); Garantiqa Creditguarantee Co. (Garantiqa).	No	No	It does not exist a specific Authority. Control is carried out by the Authorities supervising the whole financial system: -MNB (Hungarian Central Bank); -PSZAF (Hungarian Financial Supervisory Authority).

4. Structure, dimension and operative framework: a comparative analysis

In order to assess the role of the guarantee organisations in a certain country, first of all we should analyse their legal-institutional structure, their mission, their ownership aspects, their diffusion and the composition of their membership base. The absolute number of guarantee organisations in a country provides an initial indication as to their diffusion and concentration within its borders. The number of CGIs depends on several factors: the country's size and degree of economic development, the presence of a more or less centralised political and administrative tradition and the extent of government control in the relationship between the public administration and the economic system, the more or less recent recognition of individual economic freedom and other historical and cultural characteristics.

These last two factors also play a role in defining the ownership structures of the credit guarantee schemes as well as their legal structure. All these factors come together in defining *the structure and the morphology of the credit guarantee systems*: one of the survey sub-areas of the logical scheme that was used in this research work.

Structure and morphology of the credit guarantee systems

All the countries analysed have guarantee systems/schemes that can be divided into:

- **Mutual guarantee societies** that develop their activity on the basis of a private legal framework. They are the result of a social agreement among shareholders, under the form of a corporation too. Corporate capital is mixed (public-private, in some case mostly private) and mainly comes from the business sector; they may however request and obtain public aid that is usually destined to the risk funds. They have a non-temporary character and entrepreneurs directly or indirectly participate in the corporate capital, management and decisions through governing bodies. Their philosophy is based on the mutualism of responsibility, decision-making of parties, the fulfilment of competition and market economy rules. Their exclusive corporate activity is to grant guarantees. Entrepreneurs are both clients or users and shareholders. These societies provide share capital directly at an individual level or indirectly through professional or guild chambers, which provide enough “representative” resources to compensate for this business or guild participation. This category includes the French SOCAMA, the Italian Confidi and the Spanish and Argentinian SGRs;
- **Public Funds/National Schemes** that are government initiatives at local, regional, or national level. They are generally established as part of a public policy intended to finance SMEs or specific priority sectors or demographic groups (immigrants). Although publicly funded, they are sometimes managed by private groups. Examples include the FOGABA public credit guarantee schemes in Argentina, the Chilean FOGAPE and the Italian SME Central Guarantee Fund run by Mediocredito Centrale;
- **Commercial/corporate** societies managed by specialised institutions or public administration bodies or departments such as the Hungarian one and the Chilean IGRs. Their resources are mixed and predominantly come from the public and financial sector and rarely from the entrepreneur in a corporate, attesting way, through business chambers or associations. Their aim is to realise profit during their lifecycle³.

In terms of numbers, there are great differences between the guarantee systems in the various countries. The Italian credit guarantee system is clearly unique compared to the other countries analysed (cf. table 2), since it features a high number of CGIs as well as extreme fragmentation and polarisation. However, the number of Confidi actually operating out of a total of 742 Confidi listed in the register held by Bank of Italy (ex art 106 of the Italian Consolidated Banking Law) ranges from 589 (survey carried out by Turin Chamber of Commerce) to the 486 identified by a study by De Vicentis and Marco Nicolai (2010)⁴. The

³ Beck. T., L.. Klapper, J. C. Mendoza, (2008).

⁴ De Vicentis P., Nicolai M. (2010), p. 125.

concentration process started in 2007 and dramatically reduced the number of smaller Confidi operating in Italy; due to the reduction of the “minor” Confidi, 49 supervised Confidi were established. The strengthening process did not take place in a homogeneous way in the different geographical areas. The Italian credit guarantee system is very fragmented, especially in the South, where consortia are smaller (value of guarantees provided) and the business areas are restricted (territorial extension/regions/provinces). After the entry into force of Basel II and the implementation of the regulatory process of the Confidi, Italy has experienced a strengthening process, which enabled many small Confidi, according to art. 106, to reach the critical size and acquire the capital needed to become a supervised intermediary. The registered Confidi have over 2767 shareholders on average; the northern Confidi have the largest average size, also due to the aggregation processes affecting them over the past years. The southern facilities are still rather small, indeed their Confidi (13 per cent) have less than 250 shareholders.

In this perspective, many Italian Confidi tend to be much smaller than similar bodies in the other countries analysed, even though the strengthening process taking place in Italy is redesigning the structure and the morphology of its guarantee system. The Confidi are mission-oriented companies with a predominantly private nature. Furthermore, in Italy there are many second level guarantee institutions and trade associations. The Confidi are organized in five Federations divided by commodity sector with different tasks at national level: representation, assistance and coordination. The national Federations make up the National Coordinating Authority for the Confidi (AssoConfidi), which is in charge of representing the interests of the collective guarantee system both in the political and legislative institutions of the State and abroad, in the European Mutual Guarantee Association (AECM).

The situation of Hungary and Chile is completely different to the Italian one: in Hungary there are two guarantee institutions only (mainly of public nature) and in Chile there are seven recently established IGRs. In the other countries analysed, the number of guarantee organisations is rather limited since they adopted a more centralised administrative approach and the central State plays a more important role in the management of the economic activities (table 9.2). This might also be due to a delay in economic development, in the acquisition of economic democracy models and in the activation of intermediary guarantors.

France. Under the bank law of 1984, French guarantors are considered, in legal terms, as financial companies or specialised financial institutions, both of which belong to the group of credit intermediaries. The origins of the French SME guarantee system are private and based on an entrepreneurial concept, only receiving State support later on. The French credit guarantee system features a State-controlled joint-stock company (Oseo Garantie), a so-called inter-professional company based on indirect mutuality (Siagi) controlled by local bodies (the Chambers of Trade and Crafts) and 27 cooperative companies known as SOCAMA. Even though the three French credit guarantee institutions differ from each other due to their different legal-institutional forms and their ownership structure, they have a common institutional mission, which cannot be defined as profit oriented. This clearly emerges in the mutual and cooperative nature of SOCAMA, but also in Siagi where mutuality is only “indirect”. The ownership structure of Oseo, a joint-

stock company, could mislead us. In actual fact, the controlling shareholder, which is the State, attributes a general mission to Oseo: fostering the development of the country's production sector of the country by supporting SMEs when they need credit. Both Oseo and Siagi have representatives from the public bodies in their corporate structure (nine on average for the years taken into consideration); although this might not seem particularly important, this fact reflects the entrepreneurial-type economic policy adopted by the French State. In the period taken into consideration (2005 and 2009) the number of regional SOCAMAs dropped dramatically (from 34 to 27) due to an aggregation process, which has not yet concluded, reflecting an aggregation process that took place among certain French Industrial Cooperative Banks with which the SOCAMAs have exclusive operational agreements. The SOCAMAs have a corporate base made up of about 250,000 companies on average (in the years analysed).

Spain. The Spanish guarantee system is made up of 19 regional SGRs operating in different sectors and three national SGRs, mainly operating in a single sector, as well as of a counter-guarantee company, named CERSA, and some second-level intermediary guarantors, such as CESGAR. The basic structure of the Spanish guarantee system draws inspiration from the direct mutuality of the French and the Italian experience. Indeed, the SGRs can be considered as intermediaries with mutual purposes; the mutuality consists in the obligation to participate in the capital of the guarantor and in keeping the participating share as long as the guarantee on the loan exists.

Two of the national SGRs stand out from the other SGRs due to the composition of their corporate base: their shares are not held by the public administration, but by the trade associations. For this reason SGRs have a mixed corporate base, whose shareholders are divided into two categories: the protecting shareholders and the participating shareholders. The first ones are mainly local public bodies as well as bank intermediaries and entrepreneurs' associations. Even though the presence of the public sector among the protecting shareholders is predominant, it has been reduced dramatically over the years. The participating shareholders are the customer companies that are required to underwrite share capital in order to benefit from the guarantees and the collateral and complementary services. For this reason the share capital is both mixed, since it is made up of money coming both from the private and the public sector, and variable, as it can be increased or reduced due to the fact that new shareholders might join in, whilst the older ones might leave it. However, in time the public sector has reduced its role as "owner" to the benefit of the private sector, even though it continues to support the system in other ways. The presence of the savings banks (*cajas de ahorros*) in the SGRs' capital has been strengthened over the years. Generally speaking, these banks hold 27 per cent of the investing shares of SGRs (15 per cent of the overall capital) and represent the main beneficiaries of the guarantees provided, both in terms of volume and operations. The savings banks and the SGRs have three main features in common: they share the goal of supporting the local economy; they offer their services to the same kinds of customers; and they often share the public shareholder (the local public institutions).

The number of shareholders of the SGRs rose steadily and sharply in the 2005-09 period, an increase of approximately 26 per cent (from 3667 to 4625) that also affected share capital. The current structure of the

SGRs is the result of a reorganisation process of the mutual guarantee system, which began in 1994 and which was managed and supported by the public sector at national and local level.

Argentina. At the end of 2010, Argentina had 24 SGRs that were authorised to operate by the supervision authority. Similarly to the model developed in Spain, the regulations controlling the SGRs' activity establishes that these companies should have two types of shareholders (the participating shareholders and the investing shareholders) who, generally speaking, have the same composition as those in the Spanish system. SGRs are real financial intermediaries whose legal form is *sociedad anónima* (SA) with a variable capital. They differ from the other SAs because of their mutual character and because of the different requirements for social companies. Private ownership prevails within the SGRs, mainly due to the fiscal benefits, which represent a strong incentive. Therefore, the Argentinean model of guarantees to SMEs has been designed to foster the presence of private capital.

Chile. In Chile, the guarantee system is made up of a guarantee scheme of public origin (FOGAPE), two public bodies (CORFO and INDAP), in charge of providing the funds to support the guarantee institutions by means of the *Fondos fiduciarios*, and several private IGRs. Specific regulations provide for the latter to take two alternative forms: *Sociedades Anónimas de Garantía Recíproca* (SAGR), in which the shareholders (natural or legal persons) participate directly in the ownership of the share capital. They are profit-oriented companies; *Cooperativas de Garantía Recíproca* (CGR), which need the authorisation of the Department of the Cooperatives of the Ministry of Economy to operate in the market of guarantees. They are mission-oriented companies.

FOGAPE is a State fund with a legal personality that is managed by the *Banco Estado*. The Chilean guarantee system is still rather new, indeed, only six SAGRs and one CGR have been created since 2008, therefore, they can be considered as start-up companies.

Generally speaking, in almost all the countries we analysed, the CGIs are grouped into national associations: *AssoConfidi* in Italy, *Fédération Nationale des SOCAMA* in France, CESGAR in Spain. The Associations mainly carry out a representation activity on behalf of the shareholders with regard to national and local institutions, as well as coordinating and organising the joint efforts of the member bodies with regard to certain strategic objectives.

The ownership structure of many guarantee institutions (state funds with a legal status governed by public law) includes the State, which plays a more or less important role depending on the extent of control exercised by the public administration. The constant presence of the State in the guarantee systems, directly or indirectly, highlights the fact that the guarantee sector may not be simply managed in a free market mode because it is mainly mission-oriented and still features low profit margins (as we are going to discover below). Although involved in the ownership of the CGIs, the State has little involvement in management and risk assessment and even less in funding and recovery. Similarly, donors have a limited role in the different aspects of CGIs.

Table 3 - Set-up and structure of credit guarantee systems

Country	CGIs	Number	Legal status/mission	Property of CGIs
Argentina	SGR	24	Open-end stock corporation/Mission oriented	Mainly private
	FOGABA	1	Government fund with legal status	Mainly public
Chile	FOGAPE	1	Government fund with legal status, governed by public law	Public
	IGRs: • CGR • SAGR	CGR: 1 SAGR: 6	CGR: Cooperatives/Mission oriented; SAGR: Sociedades Anónimas de Garantía Reciproca/Profit oriented	Mainly private
	CORFO INDAP	2	Public bodies	Public
France	Oseo garantie	1	Specialist financing company; joint-stock company/Mission oriented	Mainly public
	SIAGI	1	Financing company/Mission oriented;	Mainly private
	SOCAMA	27	Financing companies; Cooperative companies/Mission oriented	Private
Italy	Confidi 106	742	Consortia with external activities -Mission oriented	Mainly private
	Confidi 107	49	Consortia with external activities, cooperative company; joint-stock consortium company (limited liability or cooperative)/Mission oriented	
	Guarantee Banks	0	Limited liability cooperative banks/Profit oriented	
Spain	SGR	22	Open-end stock corporation/Mission oriented	Mainly private
	CERSA	1	Counter guarantee company	Mainly public
Hungary	AVHGA	1	Foundation/Mission oriented	Mainly public
	Garantiqa	24	Joint-stock company/Mission oriented	Mainly public

Operative dimension

As far as the sub-area of inspection dedicated to the *operative dimension* of the guarantee systems is concerned, we analysed the following items for each credit guarantee taken into consideration with the purpose of making some comparative reflections:

- The territorial diffusion / geographical coverage / rate of penetration;
- The utility sectors involved;
- The companies benefiting from the mitigation tools provided;
- The volume of guarantees granted.

These are four qualitative items that jointly define the business area where the guarantee activity of the CGIs takes place. In view of this, we decided to check whether the CGIs operate at national level, at regional level only, or in both areas as well as whether they cover different sectors and whether they offer mitigation tools to their member companies only or to non-member companies too. Indeed, we believe that a substantial presence at local level involving many sectors and companies (members or non-members) represents a factor of flexibility and can facilitate access to this service by SMEs. Many of the items inspected in this sub-area originate in the regulatory framework.

As far as the scope of the CGIs is concerned, most of them do not operate exclusively out of their head office but have a network of local branches operating at regional, provincial or national level. The smaller

CGIs tend to have a more restricted geographic business area as in the case of Italy where the majority of Confidi (63 per cent) do not have their own office; 17 per cent (single-sector Confidi) have only one office. The average number of branches for Confidi overall is one, rising to three (2.4 for Confidi 106 and 6.30 for Confidi 107) if intermediaries without local branches are excluded from the calculation. The smaller Confidi that are not supervised usually operate at provincial level, in some cases at regional level; on the contrary, the larger Confidi that are supervised operate in various sectors and, in certain cases, in more regions. At the present moment, there are no guarantee banks because this type of institution requires huge amounts of capital to comply with capitalisation obligations as well as a complex operative structure. The Confidi provide guarantees to their shareholders only.

In France the three CGIs typologies operate both at national and at regional level. In particular, Siagi and Oseo feature facilities/offices working at interregional level, whilst SOCAMAs mainly operate in their own provinces, even though they achieve a good degree of penetration in the surrounding geographical areas thanks to their partnerships with Industrial Cooperative Banks, as they make use of their offices, thus maintaining close relationships with companies. Oseo's business target reflects the industrial policy objectives of the French Government; its services are mainly aimed at medium enterprises operating in the innovation and internationalisation sectors. Siagi and SOCAMAs are more focused on the Craft, Trade and Industry sectors. SOCAMAs offer their services exclusively to subjects that are financed by cooperative banks; OSEO garantie may only support intermediaries holding a direct interest in the share capital while Siagi may guarantee all types of French credit institutions.

In Spain the 19 SGRs operating at regional level have a multi-sectorial approach, thus providing their services to any sector, as long as the applicants are based in the same region as the SGR. SGRs are located in all the Spanish regions with the exception of "La Rioja". The three national SGRs target companies operating in specific sectors. The beneficiaries of the guarantee provided by SGRs are exclusively the share holding companies (the so-called *Socios partícipes*), even though investing shareholders also exist (the so-called *Socios protectores*). The penetration rates of SGRs constantly increased over the 2007-09 period (the existing guarantees per person increased by about 55 per cent, whilst the guarantees per employed person increased by about 66 per cent). SGRs provide guarantees only to their shareholding companies, which gain access to credit under better conditions.

Argentinian CGIs operate at both national and regional level. The technical-operative facility of SGRs differs according to the public or private nature of the shareholders and whether access to guarantees is open to all applicants (open SGRs) or to certain field/geographical segments of SMEs only (closed SGRs). The closed SGRs are divided into three categories: a) SGR operating on behalf of SMEs located within a certain geographical area; b) SGR specialising in a certain sector of SMEs; c) SGRs providing their services only to companies belonging to a production chain (client/supplier) of a specific corporate group, which participates in the SGR as an investing shareholder. FOGABA operates within a certain territory only.

CGIs in Chile mainly operate at national level with the exception of CORFO which operates regionally and have a large network of offices which increased by 26 per cent (from 51 to 70) in the 2007-09 period.

Generally speaking, the CGIs operate in different sectors, due to the aforementioned features of FOGAPE. CGRs, due to their mutual nature, provide guarantees exclusively to their member companies, whilst CAGR provides them to non-members too. Over the past five years, the core of FOGAPE's work was hedging of long-term traditional credits for SMEs in the start-up phase.

Both these Hungarian guarantee organisations operate at national level and also have local branches, although AVHGA's guarantee activity concentrates on the development of regions with a prevalently agriculturally-based economy. Although both organisations may grant guarantees to SMEs all over the country, they may only offer them to the founding (AVHGA) or shareholding (Garantiqa) banks. A first analysis of the scarce available data reveals that the penetration rate of the guarantee activity increased constantly during the period taken into consideration, with the exception of 2008, which experienced a slight slowdown due to the international financial crisis.

Table 4 shows that each CGI comprises both multi-sectorial and single-sectorial CGIs often dedicated to the industrial sectors playing the most important role in the country's business structure. Most multi-sectorial CGIs diversify their portfolio in order to reduce risks, gradually extending their operations to other sectors in time. This can be seen in France where Socama have gradually opened from the craft sector to commerce and services. In Italy it was only recently that the consolidation process taking place caused the exclusively mono-sectorial business approach to be left behind. The agricultural sector is often served by specialised providers (Hungary, Italy), or by separate CGI guarantee programmes.

Table 4 – The business areas

Country	CGIs	Geographic area	Product sectors	Beneficiaries
Argentina	SGR	Countrywide and regional;	Multi-sectorial SGRs; Mono-sectorial SGRs; SGRs supporting groups of enterprises;	Member companies
	FOGABA	Limited		
Chile	FOGAPE	Countrywide	Multi-sectorial/ Start-up SMEs	Financial institutions
	IGRs	Countrywide	Multi-sectorial	CGR: member companies; SAGR: non-member companies too
	CORFO	Regional		
France	Oseo garantie;	Countrywide and regional	Innovative SMEs and SMEs involved in internationalisation processes	Direct relationship with banks and only indirect relationship with companies
	SIAGI;		Commerce, Crafts, Industry	All companies
	Socama			Member companies
Italy	Confidi 106	Provincial and, in some cases, regional	Mono-sectorial	Member companies
	Confidi 107	Countrywide and regional	Multi-sectorial	
	Guarantee Banks			
	SGR	19 regional SGRs; 3 regional SGRs	19 multi-sectorial SGRs; 3 mono-sectorial SGRs	Member companies
Hungary	AVHGA	Countrywide	Mainly agriculture	Member companies/banks
	Garantiqa	Countrywide	Mainly trade, services and construction	

The analysis of the size and structure of guarantee portfolios is another aspect allowing the operational scope of CGIs to be examined in greater depth. Given that the time frame of the analysis included the most acute phases of the international financial crisis we thought it important to verify whether the CGIs had managed to mitigate rationing of credit to small and medium enterprises during this period. In 2009 there was a sharp increase in guarantee activity due to the greater difficulties being experienced by SMEs in getting access to credit and an increased demand by banking intermediaries for collateral and additional guarantees.

In 2009 France registered 6733 billion Euros of guarantees granted (by Oseo, Siagi SOCAMAs) involving 601,430 operations, 470,499 of which concerning SMEs. Data show that the increase in guarantees in 2007-09 was mainly due to Oseo which holds an 82.97 per cent share of the market and grants guarantees with an average value of 5,515.23 million Euros, amounts in line with its intense activities involving innovation- and internationalisation-oriented firms. Its guarantee portfolio, which covers loans from Business Angels and Private Equity in addition to bank loans, rose steeply in the 2007-09 period – by 112.48 per cent with respect to 11.42 per cent in the 2005-07 period. In the 2007-09 period 11,267 billion Euros of loans were guaranteed - an increase of 92.6 per cent - revealing the support given to the real economy by French CGIs.

In the 2005-09 period Spain registered positive variations in the volume of guarantees granted (+38 per cent) with a total volume of about 2500 billion Euros of guarantees involving a total of 44,047 million operations in 2009. The disaggregation of guarantee variations reveals that the 35.2 per cent increase of 2005-07 was followed by a slowdown in 2007-08 (-8 per cent) followed by a recovery in the guarantee market in 2008-09 (+11.6 per cent). The volume of guarantees granted by the Hungarian CGIs rose considerably during the 2007-09 period, both in absolute terms and in terms of mean values. In 2009 1,499,515 Euros in guarantees were issued for a total of 33,438 million operations.

The disaggregated data for the two guarantee Hungarian intermediaries reveal that 90.94 per cent of guarantees are granted by Garantiqua, which experienced a constant growth trend in the volume of guarantees granted and in the number of guarantee contracts during the observation period. Hungary's entry into the EU in May 2004 drastically reduced the financial resources that been made available to the country for reconstruction and agricultural loans for so many years by the European institutions with an inevitable impact on AVHGA operations in that sector.

At December 31st 2009 the stock of guarantees granted in Italy by its 589 Confidi totalled 24,365 million Euros in 2009. A comparison of the data for guarantee stock in the 2007-09 three-year period shows a positive trend confirming the phase of expansion registered by the guarantee market with an average annual increase of 6 per cent. Moreover, despite only representing 9.34 per cent of all Confidi, the first 55 Confidi to have crossed the 75-million-Euro threshold had a share of the guarantee market amounting to 90.66 per cent at December 2009. Comparing guarantee stock variations for 2007-09 with guaranteed and non-guaranteed performing loans to firms with less than 20 employees in the same period, we can see that a 1.4 per cent drop in loans corresponded to a 2.1 per cent increase in loans guaranteed.

No such extraordinary growth was registered by the guarantee activities in the two Latin American countries in the most intense period of the 2007-09 crisis. In fact, in 2007-08 Argentina experienced a 0.43 per cent drop in the use of this instrument and Chile an about 11per cent drop followed by a considerable request in the following year (27.7 per cent in Argentina and 26.31 per cent in Chile). However we must also consider that guarantees were heavily promoted as free-standing products before the crisis in Argentina, experiencing a 133.33 per cent increase in 2005-07, and to a lesser extent in Chile although it also registered a significant increase of 32.3 per cent.

Although the total number of guarantees granted by FOGAPE in 2005-09 fell by 25 per cent there was an increase in the volume of guarantees granted and loans guaranteed despite a sharp slowdown in the acute stages of the International financial crisis leading to an increase in the average value of guarantees granted.

Operational Characteristics

In order to establish the *Operational Characteristics* of the CGIs analysed, we compared the following items:

- The characteristics of the products offered in terms of: a) type/nature of the mitigation instruments offered and their compliance with Basel II; b) other services that are both complementary or collateral to the guarantee services offered;
- Other characteristics defining the guarantee productive process: the leverage ratio used, the type of funds, the hedging percentage achieved.

These factors help define the scope and technical contents of the relationships between CGIs, enterprises and banks. In fact, relationships with enterprises are based on the contents of the offer in terms of guarantee and other services that can be offered, while relationships with financial intermediaries, which are regulated by specific agreements, contractual schemes and informal negotiation processes, reflect the collateral and credit risk management process implemented by the CGIs, as well as the hedging percentage on the loan granted, the leverage ratio used, the amount and the type of the available funds, the fund provision percentages, and so on. Our difficulties in collecting information on these last three items limited our comparative analysis on the *operational characteristics* of the institutions taken into consideration.

CGIs offer credit risk mitigation instruments guaranteeing loans directly or taking the form of counter- or co-guarantees. The two main mechanisms are⁵:

- *Direct guarantees* to the bank directly cover outstanding loans;
- *Counter-guarantees or co-guarantee* with mutual guarantee institutions provide indirect protection to the lender through a guarantee of the main guarantor. This may take the form of a guarantee in the case of default of the main guarantor or as a percentage of each loss incurred by the main guarantor. Counter-guarantors can be states, public agencies, or international financial institutions.

The exception is FOGAPE's mechanism, which assigns the right to provide guarantees through an institutional offer, addressed to all financial institutes registered in the SBIF list and subject to its supervision, by means of a public adjudication. Once the financial institution has obtained the guarantees

⁵ Beck. T., L.. Klapper, J. C. Mendoza, (2008), p.15.

requested, the beneficiaries who want to benefit from the FOGAPE guarantee will need to go to the approved institutes, which will grant the loan according to their own commercial policies and to the principles set forth by the fund regulations.

As far as compliance with the credit risk mitigation framework is concerned, it should be pointed out that although Basel II extends the range of types of guarantee accepted it also establishes strict subjective and objective eligibility requirements that do not always allow the guarantees issued by CGIs in the countries investigated to be recognised as risk mitigation instruments.

In France, Siagi, Oseo and the SOCAMAs mainly offer personal guarantees, they fully comply with the subjective suitability requirement set forth in Basel II. However, the mitigation instrument that they offer does not comply with all the objective requirements laid down in the regulations as it can be rarely activated upon demand and only intervenes after all bank actions have been taken against the defaulting debtor. The guarantees offered by Oseo are generally for a higher amount and longer maturity than those offered by Siagi and by the SOCAMAs.

The Spanish SGRs offer two types of guarantees: financial guarantees and the *avales técnicos*, which do not involve financing but concern compliance with technical or professional requirements. As the Spanish SGRs are supervised financial intermediaries, they are considered guarantors approved by the Basel II regulations on Credit Risk Mitigation and the financial guarantees that they provide comply with other objective requirements laid down in the regulations. The counter-guarantees offered by CERSA are considered to be compliant with Credit Risk Mitigation, whilst those provided by other local bodies cannot be considered compliant unless they have obtained specific authorisation by the Banco de España with a weighting that is lower than the credit guaranteed.

Like the Spanish SGRs, the Argentinian SGRs usually offer financial guarantees and *avales técnicos* along with commercial guarantees for commercial activities (payment of goods, services and so on). These guarantees are not compliant with Basel II. FOGABA operates with numerous technical forms of guarantees targeting various institutions.

The Hungarian CGIs offer mitigation instruments with the same technical forms as the credit lines: in fact, the Company guarantees that it will repay the loan to the bank under certain jointly agreed conditions. Under certain conditions (consistent with community regulations on State aid), the guarantee can be backed by a State counter-guarantee. There is no information available for the assessment of *compliance* of mitigation instruments with the Basel II Credit Risk Mitigation regulations.

In Italy personal guarantees recognised for the purposes of CRM are only those granted by Confidi 107; personal guarantees granted by Confidi 106, on the other hand, are accepted provided that they meet the objective requirements and have an unlimited counter-guarantee granted by an appropriate body (sovereign states – Central Guarantee Fund and central banks, public bodies, multilateral development banks). The Chilean IGRs offer a *Certificado de Fianza*, which is a personal guarantee. The IGRs that were positively evaluated by an “*Entidad Evaluadora de SGR*” and that are classified in the “A” category by the

SBIF are considered guarantors *complying* with the subjective requirements of the regulations on the *Credit Risk Mitigation* (Basel II).

Most of the credit guarantee systems analysed (Italy, France, Hungary) have a Basel II-compliant counter-guarantee system given that these instruments issued by the sovereign State as well as by local bodies or government-owned corporations cover all credit risk of protected exposure; they meet the objective and subjective requirements for personal guarantees established by law.

In some guarantee systems CGI activities are not limited to guarantees but include complementary and collateral services for their customers. In France, Oseo offers a wide range of services focused on innovation and internationalisation (guidance services, technical partner research, innovation support programmes for other companies belonging to this State group) as well as higher levels of hedging than those offered by Siagi. In fact, Oseo's target company is a medium-sized company that is a bit larger than the target company of Siagi or of the SOCAMAs. At the moment the SOCAMAs do not offer any complementary or collateral guarantee services but they are in the process of evaluating the strategic opportunity of expanding into this field.

The Spanish SGRs implement intensive consulting activities in favour of SMEs, either directly or through third parties. The services provided include: organisational advice, marketing services, training on access to credit and business management, accounting and taxation, advice on applying for aid and benefits. The Argentinian SGRs offer technical, economic and financial assistance to their shareholders, both directly and by means of third parties. In addition to traditional guarantee provision activities, IGRs also provide collateral and complementary services, such as economic, technical and financial advice as well as information on how to obtain counter-guarantees and promote on-line credit for banks. Currently in Italy connected instrumental services are mainly offered by the larger supervised Confidi.

As part of its diversification of traditional business Oseo differs from the CGIs in other countries by offering hedging guarantees for loans disbursed by Business Angels and Private Equity in addition to bank loans.

The analyses carried out during this research shows that the range of products offered by CGIs depends on various factors including the risk assessment procedure used by the CGIs, the legal environment of the country (e.g. length of bankruptcy procedures), the term of the guarantee, extent of coverage and the associated costs. Generally, the CGIs try to adapt the characteristics of the guarantee product to different business situations. This offers the advantage that, if the product is adapted to a particular business situation, it gains better visibility and attractiveness on the part of its potential users. A more sophisticated product may result if the guarantee is accompanied by additional services for beneficiary enterprises. This makes it possible to realise profit margins and to keep business balanced.

The leverage ratio represents the maximum possible expansion of the guarantee activity; it is the factor that links the size of the guarantee fund to the amount of loans grantable by indicating how many times the guarantee fund can be multiplied to reach the maximum amount of credit that may be issued. This mechanism is not suitable for collective guarantee bodies similar to supervised financial intermediaries

which need to identify maximum expansion of credit guaranteed on the basis of the expected and unexpected losses of the guarantee activity. Generally speaking, leverage ratio is the result of agreements between banks and CGIs and is defined according to the size of the fund and only rarely according to the probability of insolvency of beneficiary enterprises.

In practice, it is calculated differently by different CGIs, limiting the comparability of the data concerned. Despite the lack of information on size and characteristics of the leverage ratio applied by the guarantee bodies in the various countries, we found that it fluctuates, ranging from 2.0 applied by AVHGA in Hungary to 9.5 of the Spanish SGRs, 11.1 of Siagi in France, 16.2 of Garantiqa in Hungary, to 24.2 of Siagi and 33.6 of SOCAMA, again in France⁶¹. Under Argentinian law the SGRs can have a leverage ratio up to four times higher than the risk fund; FOGAPE uses a leverage ratio of up to a maximum of ten times the value of the fund.. The data currently available show that although the leverage ratio applied by the Spanish SGRs reveals a growing trend, the Spanish guarantee system is still a long way from reaching the maximum leverage ratio values permitted by law. The SGR therefore have a margin of expansion for their operations. Chile's CORFO, which is responsible for managing the financial support for the IGR guarantee funds, uses a leverage ratio that is three times the value of the fund. In Italy the average leverage ratio lies between 11 and 20, with the exception of only a handful of Confidi which apply leverage ratios with values greater than 31². In recent years the Italian Confidi have tended to gradually reduce the leverage ratio applied due to a more cautious approach recently adopted following the introduction of prudential supervisory regulations (for supervised Confidi).

The level of guarantee coverage should reflect the risk of the underlying loan but it is usually defined in the agreements. In addition to determining *how much* is being guaranteed, it is important to specify *what* is being guaranteed. If the guarantee is issued as a first liability, the bank can call in the guarantee as soon as the borrower is in default and receives the guaranteed portion of the *loan principal*. In the case of a second liability, the bank must sell all the borrower's pledged assets before it can call in the guarantee which only applies to the *actual losses* incurred by the lender. This ensures that the lender has an incentive to pursue the borrower for further collateral collections. Another important issue regarding the guarantee is whether it applies only to the loan principal or also to unpaid interest⁷ (in the latter case the guarantee is more attractive for lenders). In other words it is important not only to know the coverage percentage but also what is being covered (interest cost, administrative costs, and so on).

Data available show that around 30 per cent of all CGIs in our sample offer guarantees of up to 100 cent. In particular: SOCAMA offers approximately 100 per cent coverage, Siagi approximately 40 per cent and Oseo approximately 55 per cent. The Argentinian FOGAPE covers up to 80 per cent of SME loans and 30 per cent of corporate loans. AVHGA covers a percentage ranging from 50 to 80 per cent depending on the

⁶ Data, with the only exclusion of Italy, are taken from AECM statistics concerning 2009 which use equity in the leverage ratio calculation.

⁷ Green A. (2003).

loan amount while Garantiqua covers approximately 80 per cent to which interest and additional expense coverage may be added depending on the type of agreement involved. Italian Confidi cover approximately 50 per cent of definitive losses experienced by the financing bank.

Table 5 - Mitigants and other services offered

Country	CGIs	Principal Offered mitigants	Compliance of mitigants with Basel II	Other services offered
Argentina	SGR	Commercials, Financial and Technical securities	Not determinable	Technical consultancy, economic and financial services
	FOGABA			
Chile	FOGAPE	Guarantee rights	No	
	IGRs	Personal securities	When certain conditions occur	Economic, technical and financial consultancy; consultancy to obtain counter-guarantees; promotion of on-line credit for banks
France	Oseo garantie;	Personal securities	No	Technical consultancy, economic and financial services
	SIAGI;			
	Socama.			
Italy	Confidi 106,	Collateral securities; Personal securities; Tranched cover.	When certain conditions occur	Services relating to and instrumental in the guarantee asset
	Confidi 107			
	Guarantee Banks			
Spain	CERSA	Counter-guarantees	Yes	
	SGR	Financial guarantees; technical guarantees	Yes	Organisational consultancy, marketing services, training for credit access and company management, accounting and taxation, consultancy to obtain support and subsidies
Hungary	AVHGA	Personal securities	Not determinable	Assistance and consultancy services
	Garantiqua			

5. Economic and financial performances

In order to fully evaluate the economic and financial performances of the guarantee system, we decided to analyse its structure, typical contents and main balance sheet aggregates of the CGIs. The differences in allocation and feeding of items and sub-items typical of the guarantee management processes carried out by the various contexts analysed made this analysis particularly complex. Such differences are not only the result of the differing financial reporting standards used to draw up financial statements but also of the variety of *modus operandi* in the various countries. Given the uneven, incomplete and limited body of information supplied by the financial statements, any remarks made with regard to this study area can only have a limited validity. Moreover, for some guarantee systems the analysis was limited to a restricted number of guarantee institutions or a sample group of them.

Despite the differences that emerged, we attempted to draw up a homogeneous reclassification of the main balance sheet items, paying particular attention to the production processes typical of CGIs in order to

develop conclusions concerning their profitability, assets and financial situations. Usually guarantee activities involve the creation of earmarked funds or funds guaranteeing loans to member and non-member enterprises and involves using ad hoc financial statements that differ from those drawn up by other financial intermediaries.

The statement of assets and liabilities was reclassified using different criteria: the assets were listed in decreasing order of liquidity while the liabilities distinguished between liabilities typical of the guarantee activity (how to allocate guarantee funds not included in the statement of assets and liabilities, guarantee deposits, specific funds for hedging of guarantee granting activity) and other financial liabilities (table 6). Only on a few occasions was it possible to establish which funds (whether risk or debt) derived from public sector (national and/or local) resources.

Table 6 - Reclassified statement of assets and liabilities

Available funds	Liabilities
Credits	- Financial liabilities
Financial assets	- Typical (or operating) liabilities
Fixed assets	Other liabilities
Other assets	Capital

The Income statement was reclassified in order to progressively breakdown the composition of the operating result (Table 7):

- *Fee income* (costs and revenues characterising guarantee services);
- *Financial management income* (profits and losses resulting from financial assets);
- *Operating income* (takes into account operating costs and possible depreciations of fixed assets).

Table 7 - Reclassified income statement

+	Fee income
+	Financial management income
=	Annual gross income
+	Other net earnings
-	Operating costs
=	Operating income
-	Adjustments and recoveries of risk funds
=	Operating results
+	Extraordinary operations result
-	Taxes
=	Profits

As for the suspense accounts, guarantees granted and received were shown separately where possible, even in the case of loans classified as substandard by the banks.

Spain. The composition of the assets in the Statement of Assets and Liabilities of the Spanish SGRs reflects the limits imposed by the regulations; in fact financial assets account for most of the assets even though their importance has diminished over the past four years. The volume of guarantees supplied, and therefore the credit risk assumed, has increased over the past four years at an annual rate of 10.57 per cent. In order to limit losses in case of enforcement of guarantees the SGRs have increased the amount of collateral and personal guarantees requested from enterprises and third parties. However, the SGRs have also further reinsured themselves against the risk assumed by making use of the counter-guarantee of CERSA and the Autonomous Communities. In 2009 alone there was an 86 per cent increase in use of counter-guarantees, underlining the public sector's strong commitment to reducing the effects of financial unrest on enterprises. In fact, non-performing loans have doubled during the past two years. These trends have led to a demand for greater coverage against risk with an increase in hedge funds and capitalisation of the CGIs examined. The efforts made in terms of recapitalisation in the period considered made it possible to improve the solvency of the SGRs and therefore to increase support for SMEs even during the period of the crisis. This seems to be confirmed by the analysis of the economic performances which showed the important contribution offered by financial management to the operating results (even though the fee income generally accounts for 68 per cent of the annual gross income), a substantial increase in value adjustments to loans and guarantees and, therefore, an increase of management costs linked to an increase in risk assumed by SGR and a reduced self-funding capacity.

France. Given that the French guarantee institutions are supervised intermediaries their statements of assets and liabilities and income statements are drawn up in accordance with the relative regulations. The statements of assets and liabilities of the French guarantee companies, both public and private, are organised in a similar manner with regard to assets (listed in decreasing order of liquidity) while the structure of the liabilities varies considerably due to the inclusion or exclusion of various items and their differing composition. Siagi liabilities include a source of funding with characteristics and functions similar to those of equity although structured differently: subordinated term debt, represented by additional paid-in capital and delayed redemption bank contributions. Siagi also makes limited use of third-party capital represented by bank debts; moreover, explicit statutory provisions that do not apply to OSEO garantie and SOCAMA establish that profit made during the course of the financial year paid out to shareholders must not exceed 5 per cent of subscribed share capital. The guarantee fund is the main item in the operating liabilities and is made up of additional annual contributions made by policy makers, provisions from investment results (90 per cent) and provisions (50 per cent) from fees paid by guaranteed SMEs. OSEO does not make use of third party capital funding; it has considerably greater capital and guarantee funds than the other two types of CGIs. The SOCAMA liabilities are mainly made up of share capital (owned by the craftsmen members) and the mutual risk fund (similar to the guarantee fund) and retained profits. With regard to credit for guarantee

operations relative to the period examined, Siagi experienced a generally stable trend, Socama experienced a sharp fall and OSEO considerable growth. During the same period there was an increase in troubled loans in the portfolio of French CGIs; the data shows that Siagi has experienced a worse situation of average risk (overdues on the value of guarantee portfolio) than Oseo, with an average overdue rate of 10 per cent compared to 8 per cent for Oseo. Although the impairment rate (ratio between new overdues and total non-overdue loans at the beginning of the year) is showing signs of increasing, it is not yet giving reasons for alarm, also in view of the reassuring solvency situation. Oseo and Siagi have rather different cost and revenue structures. While Oseo has a more evenly balanced fee and financial management incomes, Siagi's revenue structure is totally dependent on fees for guarantee commitments. Moreover, in 2007 and 2008, financial management showed a loss mainly due to the weight of interest payable on subordinated debt. In the years concerned both Oseo and Siagi made an effort to reduce costs even though Oseo proved to be more efficient with a cost-income ratio that fell below 60 per cent in 2009. While personnel costs represented the greatest operating cost for both Siagi and Oseo, the SOCAMAs transferred the entire personnel costs to the *banques populaires* or cooperative banks leading to substantial reductions in administrative expenses. Overall, Oseo not only had greater economic and financial flows than Siagi, it also had more evenly balanced revenues and greater cost efficiency. However the latter was distinguished by more profitable assets.

Argentina. In terms of accounting standards, the Argentinian SGR balance sheet resembles that of an industrial enterprise more than that of a financial intermediary. The performance analysis only examined the financial statements of the Garantizar SGR thus severely limiting the validity of the considerations described below. Over the past two years the assets column in the statement of assets and liabilities of this SGR saw a reduction in credit for guarantee activities and in fixed assets, and an increase in cash on hand and financial assets, along with a minor reduction in operating liabilities and other liabilities and an increase in capital. There seems to have been a reduction in guarantee activities in favour of investment of available funds and improvement of capital. The importance of investment in transferable securities is confirmed by the importance of the financial management income component (approximately 52 per cent) in the annual gross income. In the period analysed, the fee income (approximately 48 per cent) and operating revenue both increased, but operating results fell by approximately 64 per cent due to the major growth in adjustments and recovery of risk funds. The increase in guarantees granted was almost the same as the increase in counter-guarantees received. The increase in requests for counter-guarantees is probably due to the increase in troubled credit in the portfolio, confirmed by the sharp increase in provisions to the risk fund intended to cover both specific and general risks involved in collective guarantee activities and recapitalisation.

Chile. The analysis of the performance of the Chilean credit guarantee system was limited to the 2007-2009 accounting documents of FOGAPE because the IGRs are still in the start-up phase.

Given that in all three years considered approximately 60 per cent of assets in the FOGAPE statement of assets and liabilities comprised assets with immediate liquidity (less than 1 year), it is obvious that FOGAPE's assets portfolio has extremely high levels of liquidity, thus permitting high levels of hedging for

possible payments for insolvent debtors. During the period examined there was a drop in fixed assets (including investments in loan capital mortgages, bonds of the Central Bank of Chile and instruments issued by other entities) while financial assets fell steeply in 2008, increasing to levels higher than in 2007 during 2009. Financial assets in the portfolio are characterised by low risk and return levels. Under the relevant legislative framework, shareholders' equity comprises: government loans, profits/losses of previous year, annual adjustment of Fund on the basis of current inflation values, capital from the *Fondo de Garantía para Exportadores*.

The ratio of share capital, which is the largest funding component, to total liabilities never falls below 80 per cent (minimum value of 2008 was 82.8 per cent). FOGAPE's activities require high levels of capital and a low level of debt for the granting of guarantees meaning that the organisation is distinguished by high levels of capitalisation. Operating financial liabilities comprise guarantee deposits which include *Comisiones por pagar* which are the fees owed to the *Banco de Estado* for the management of the Fund. The fees received from clients contribute to the risk fund, which has a highly cautious provisioning policy aimed at maintaining the stability of the guarantee system.

In the period examined FOGAPE saw a sharp increase in its operativity linked to a rise in the risk of its guarantee portfolio and therefore to the growth in provisions for Risk Fund and proportional new contributions of share capital. The analysis of the reclassified Income Statement reveals that fees for guarantee activities are well in excess of costs borne by the Fund; in fact the fee income has consistently high positive outcomes. The cost of the increased provisions to the Risk Fund, also due to an extremely prudential provisioning policy weighed heavily upon the operating income in 2009.

Italy. Although based on an incomplete body of information, the sampling of the Italian guarantee system revealed that, over the period investigated, the aggregate-level shareholders' equity experienced a 14.4 per cent growth rate similar to that of the invested capital, augmented by shareholders' payments, provisions and external contributions. It also showed limited public participation in the ownership of the Confidi on the one hand and a large state contribution to their risk funds. The invested capital is mainly comprises financial assets, while investments in tangible assets tend to increase along with aggregation processes which obviously require an organised structure and increase in fixed assets. During the period concerned *operating liabilities* has a value fluctuating around 22 per cent of the total liabilities. An important component of this aggregate is represented by the guarantee deposits of shareholders, which account for an average of 42 per cent of operating liabilities and 10 per cent of total liabilities. There were no subordinated loans, not even in the larger Confidi. The analysis of the composition of aggregate assets showed that financial assets accounted for approximately 84 per cent of the total assets. Cash on hand increased while credit for guarantee operations remained generally stable. Taking into account the limits of the available information flow, overdues and difficult guarantees increased sharply (limited to data collected). The analysis of the reclassified aggregate income statement reveals: a reduction in the fee income (which continues to be the main item in the annual gross income), an increase, albeit a small one, in the amount resulting from financial management income; a fall in operating costs, an increase of

approximately 25.25 per cent in loan capital adjustments and losses, a drop in administrative costs and the rapidly diminishing influence of the extraordinary sector on the operating result. A drop in the fee trend was also registered for the period analysed. Given that fees for services are, at least in part, applied as a percentage of loans disbursed, this drop depends on the decrease in loans guaranteed, especially by the larger SGRs. As mentioned above this reduction results from the sharp operational slump that followed the merger process taking place in the Italian guarantee system.

Hungary. The structure of the balance sheet of the Hungarian guarantee organisations is the same as that of the country's other financial enterprises. The Statement of assets (liabilities) distinguishes between receivables (payables) from/to credit institutions and from/to customers (suppliers). The trend of historical data from the reclassified Statement of assets of AVHGA shows: a constant increase in financial assets accompanied by a constant decrease in receivables. This tendency is the result of corporate policies intended to increase investments in government bonds, to reduce receivables from institutions and customer enterprises. AVHAGA's Statement of liabilities contains only typical financial liabilities; in fact, during the period examined, it did not acquire debts to banks or other debtors nor did it issue debt securities. The incidence of typical liabilities on total liabilities has increased slightly but the degree of capitalisation of the organisation has not undergone noteworthy fluctuations, remaining around 90 per cent. There are no financial liabilities. AVHGA's Income Statement shows that the gross annual income fell slightly due to the combined effects of two different trends: on the one hand, the doubling of fee income for guarantee services and, on the other, the sharp drop in financial management income. The dynamics of AVHGA's profitability reveal a strongly declining trend, especially from 2007 onwards, the year in which Hungary's agricultural sector was hard-hit by the international financial crisis, leading to many agricultural enterprises closing and the restriction of criteria for disbursement of guarantees by the Foundation in order to tackle this critical situation. The same dynamics emerged from Garantiqa's return rates even though the declining trend began in 2008. The gross annual income underwent a constant though limited rise due to the steep increase in fee income.

Despite the limitations of the analysis of this survey area, it seems that all the realities investigated experienced a slow deterioration of their guarantee portfolio which began in the acute phase of the crisis and an increase in the reinsurance of credit risk in their portfolio and in capital mainly due to the intervention and major subsidies of the policy-makers. There was also a widespread increase - albeit with varying levels - in the contribution of financial management to the operating result, a considerable rise in value adjustments of loan capital and guarantees, and therefore an increase in management costs linked to the increase in risk assumed and a reduction in the self-funding capacity. This suggests that the continuing economic sustainability of the guarantee business in the various countries studied is mainly due to the intervention of policy-makers in the guarantee system. Nevertheless, while the majority of CGIs examined have the aim of mutuality this does not exempt them from meeting the requirement of profitability; they must still produce adequate operating margins and maintain the necessary level of capitalisation to guarantee management autonomy and sustainable growth in the long term. These aims have proven hard to meet during these years

of financial crisis which led to the deterioration of the guarantee portfolio and thus of the profit margins of the intermediaries examined.

6. Policy Makers' Role and Financial Crisis

At this stage of our analysis we can state that public support is fundamentally necessary for the development or survival of many CGIs, public or mainly public. In this perspective we decided to analyse the role of *policy makers in the guarantee system* also in the aftermath of the financial crisis.

Given that the development of the guarantee systems and public support seem to go hand in hand, we decided to analyse the role of policy makers in the guarantee system also in the aftermath of the financial crisis. Public intervention in the guarantee systems analysed went beyond merely drawing up regulatory frameworks to support CGIs in their journey towards more rational and efficient development; in many countries it extended to offering various types of funding and subsidies (including tax benefits). Local public bodies, chambers of commerce and other trade associations were often the most intensely involved, subscribing shares in the CGIs or allocating funds to hedge the risks assumed by the latter.

This also seems to be the case in Argentina which has a mainly private guarantee system model that does not exclude the active intervention of the State. In fact, the government has set up two public guarantee funds (FOGAPyME and FOGABA).

The degree of intervention of policy makers varies according to the degree of economic democracy in the various countries and the extent of interventionism of the Central Administration. By participating in the share capital public bodies in many countries act as financiers not shareholders or consortium members, and are therefore excluded from benefitting from guarantee activities.

Many of the countries analysed have put into place a series of public measures aimed to increase capital that belong to the following macro-categories:

- Direct intervention designed to increase CGI risk funds;
- Direct intervention designed to increase share capital of CGIs, thus improving their capitalisation;
- Supply of own subsidies or channelling of national and community funds to SMEs supported by a guarantee activity by CGIs.

These two approaches are adopted without distinction by both prevalently public and prevalently private guarantee systems. Establishing the extent of the private component in the share capital is not sufficient in order to identify a guarantee system as public or private, it is necessary to analyse the origin of the system, which also affects the organisation and philosophy of CGIs as well as the nature and composition of risk funds used. In fact, the public contribution to the capital or risk funds of private models can be considerable. In many CGIs, it is the national government which supplies the funds for the guarantee schemes. In some cases, however, funding is provided by a regional government; in the Fondo de Garantías Buenos Aires (FOGABA) of Argentina, for example, the Province of Buenos Aires contributes the complete risk fund and owns 84 per cent of the scheme's shares. Consequently, eligibility to the scheme's services is restricted to firms operating in the province. While governments do have an important role in funding they have a much more limited role in management, risk assessment and recovery. While the private sector shares funding with

governments, it plays a predominant role in management, risk assessment and recovery. In other words, the banks generating the loans being guaranteed are mainly responsible for credit risk assessment and recovery of defaulting loans.

In developing or emerging economies, donors may supply most of the funds to establish a guarantee scheme. If this is the case, they are also likely to provide technical assistance in setting up the scheme. In Argentina, FOGABA is scheduled for privatisation after ten years of operations. By providing guarantees to small businesses which hold invoices issued by contributing firms, FOGABA provides incentives for large corporations to contribute equity capital to the fund.

The financial participation of the private sector and the corresponding influence in the decision-making process of the scheme is especially important in countries where political considerations might tempt the government to extend guarantees to excessively risky borrowers. Evidence from the European guarantee system shows that schemes operating in a decentralised manner - that is, on a local or regional basis - are more successful than those operating at national level (like in Italy and France).

In France, the State currently controls the largest of the three Confidi while the regions offer their support to the two smaller Confidi, appointing them to manage the regional funds for the support of small-business owners or counter-guaranteeing the guarantees granted by Siagi or SOCAMA. There is no direct guarantee intervention either by the Central Administration or by the regional bodies. Their intervention is limited to capitalisation or allocation of the management of entrepreneurial support funds. Given the specific operating profiles of Oseo, on the one hand, and of SOCAMA and Siagi, on the other, one could maintain that government intervention aims to reinforce specialisation of the single CGIs in the guarantee market.

In Spain, the guarantee system is based on the direct or indirect financial support of the central and local administrations. The Spanish State intervenes directly by means of participation in the capital of CERSA (holding 72.2 per cent of the total share capital in 2009) and by means of contributions to the *Fondo de Provisiones Técnicas* created to cover losses for counter-guarantees granted. The State also lays down the criteria for the disbursement of partial or total counter-guarantees on the basis of the characteristics of SMEs belonging to sectors deserving support; CERSA's role has increased in importance during the recent crisis. Public support for the Spanish guarantee system takes place at various levels - state, regional, provincial and community - and according to different procedures.

Chile's government is one of the most active in the leading South American economies in its support for SMEs. It plays an active role in the guarantee system with the support of FOGAPE and CORFO, which counter-guarantee debt lines covered by the IGRs, thus sharing their credit risk. CORFO is a body governed by public law that implements Chile's government policies with the mission to promote the competitiveness and development of SMEs. CORFO's contribution to the Chilean guarantee system takes the following forms: a. financial contribution to IGR "Guarantee Fund" operations (especially during their start-up phase) taking the shape of *cuasicapital* credit lines; b. Granting of subsidies to SMEs to help cover costs borne by small and medium entrepreneurs resulting from the transfer, between different banks, of the guarantee certificate issued by the IGR to the Bank.

The Hungarian policy makers, aware of the importance for the country's development of economic support measures for small and medium enterprises, have adopted different intervention approaches over the years: Guarantee schemes of the Rural Credit Guarantee Foundation; facilities provided by Garantiqa Zrt; Guarantee Cooperatives, Products of Start Equity Guarantee Pte Ltd. (Start), New Hungary Portfolio Guarantee Programme. The two Hungarian guarantee organisations can legitimately be included among the intervention instruments of the policy makers, given that they are State-controlled entities often used as economic policy drivers to promote the growth of SMEs or tackle financial and economic crisis situations. The average size of guarantees granted (and of the relative loans) is rather high and the sectors benefiting from guarantee policies developed by central government are the ones considered to be of national interest (agriculture).

A strong state presence in the credit guarantee system can lead to problems: the lack of closeness between such organisations and firms, information asymmetry and a guarantee demand that tends to remain unsatisfied.

State support was increased after the recent international financial crises. The Chilean government has introduced major anti-crisis measures including the following innovations relative to FOGAPE: the introduction of guarantees into the system on a three-monthly rather than a six-monthly basis; increase in the offer of guarantee rights and in the value of the Fund by means of an extraordinary government contribution of 60 billion Chilean pesos and the temporary extension (from 2009 onwards) of access to guarantees for medium and large enterprises.

In Italy a special anti-crisis decree increased the resources of the SME Central Guarantee Fund run by Medio Credito Centrale, (Law 662/1996) supported by the State guarantee and allowing the bank benefiting from the guarantee to apply a zero weighting to the aliquot part of the guaranteed loan. In 2009, Oseo further increased its additional capital, confirming the support given to the real economy by the policy makers during the acute phase of the international financial crisis.

In Spain, CERSA strongly augmented its guarantee activity during the height of the crisis. The improvement of the SGRs' share capital situation during the international financial crisis is mainly due to the intervention of the policy makers; if we take into account the contribution of financing members, the total contribution of local bodies, chambers of commerce and public administration rose to an average of 72 per cent during the years of the crisis. In Hungary, during the financial crisis, AVHGA used the opportunities offered by the EU State aid regulations to increase guarantee services to SMEs, given that Hungary was given the possibility of exemption from the regulatory constraints due to extraordinary circumstances. Lastly, AVHGA was involved in distributing guarantee information to final beneficiaries. Garantiqa also streamlined the decision-making process, giving SMEs swifter access to loans.

In all countries analysed we saw that public and private, mutualist and for-profit aims, bank interests, needs of SMEs and government economic and industrial policies could overlap and even merge.

Although the presence of public funds in the guarantee systems helps expand guarantee activities, increase credit risk absorption and improve contract relations between guarantors and the banking system, it

may also contribute to augmenting, rather than eliminating, operating inefficiencies by maintaining bodies with doubtful operating capacities that are unable to support themselves. It frequently helps improve access to credit by a particularly weak segment of the entrepreneurial system, and to guarantee the survival of small credit guarantees although it ends up by encouraging CGIs to make suboptimal use of public resources. As in the case of Italy, for example, where major subsidies allocated to Confidi by policy makers have allowed many of them to survive despite extremely narrow profit margins. Public intervention in credit guarantee systems is not necessarily positive or negative; we need to assess their effectiveness and efficiency in terms of volume and number of guarantees granted, economic sectors supported improvement of access to credit and so on. In this perspective it will be very important to measure the financial and economic additionality created by CGIs correctly.

The major changes in the regulatory framework and market demand that CGIs do not oppose the condition of economic equilibrium and that they produce satisfying profit margins also by means of adequate diversification of services and products offered in-house or through outsourcing.

In brief, the results obtained by state intervention in the guarantee system at this stage can be summed up as follows:

- *State-based guarantee system* typical of countries with strongly State-influenced economies where CGIs represent the operational branch of State intervention (Hungary, for example);
- *Decentralised guarantee systems* where economic development is mainly entrusted to the autonomous development of firms although this does not imply an absence of interventionism or initiatives run by central or local administrations in the economic and credit system. Our survey shows that such initiatives tend to prevail during periods of greater economic and financial instability (experienced by all other guarantee systems analysed).

Two general conclusions can be drawn with regard to the role of policy makers in the guarantee system: different solutions are required for different contexts or for the same context in different phases/years of its economic and financial lifecycle. Not all experiences are at the same stage of their life-cycle, some are still in the start-up phase, others in the expansion/rationalisation stage, and yet others in the maturity stage. They are all in search of a new role within the changed legislative framework and market context.

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