An Roinn Post, Fiontar agus Nuálaíochta
Department of Jobs, Enterprise and Innovation

Findings and conclusions of the Minister for Jobs, Enterprise and Innovation on the review of the Credit Guarantee Scheme for the purposes of Section 10 of the Credit Guarantee Act 2012

1. Background

The SME Credit Guarantee Scheme was established under the Credit Guarantee Act 2012, to address specific market inefficiencies that prevent bank lending to some commercially viable businesses by providing a 75% guarantee to banks against losses on qualifying facilities. The Scheme is in place to facilitate additional commercial lending to Ireland based or Irish owned SMEs, that can demonstrate commercial viability (i.e. repayment capacity for additional credit facilities), but have been refused conventional bank credit facilities due to:

- inadequacy of collateral (Pillar 1) and / or
- inadequacy of understanding of the novelty of a business model, market, sector or technology (Pillar 2).

It was also developed in response to calls from business interests and recognising that Irish companies were relatively disadvantaged vis-à-vis the UK and other competitor economies. The Scheme provides a Government guarantee to the lender of 75 % on individual loans to viable businesses, which is paid to the lender on the unrecovered outstanding balance on a loan in the event of a participating SME defaulting on the loan repayments. Bank of Ireland, AIB and Ulster Bank are participating lenders. A portfolio approach is applied to the Scheme, and is subject to a portfolio cap of 10% per bank. It is a novel Scheme in an Irish context, in that it sees the State acting as a guarantor in relation to SME loans between €10,000 and €1 million. The borrower pays a 2% annual premium which partially covers the cost of providing the guarantee. The approach adopted in 2012 was a relatively conservative first step into the area of the Government acting as guarantor to certain credit facilities to SMEs and covered term loans and bonds. It was introduced at a time of significant dislocation in the public finances and in the wake of sizeable Exchequer funds transferring to the pillar banks. The Scheme launched on 24 October 2012.

To date the Department of Jobs, Enterprise and Innovation, along with the operator, Capita Asset Services (Ireland) Limited, and the participating lenders have committed significant time and resources to the establishment and operation of this Scheme. While demand for the scheme has been lower than anticipated, it has, nonetheless at 6 June 2014 supported additional lending of some €12 million to 93 companies and supported 478 new jobs, while maintaining 286 jobs. (Take-up in 2013 was just less than €10 million).

Section 10 of the Credit Guarantee Act 2012 provides that the Minister for Jobs, Enterprise and Innovation may, at any time, conduct a review of the operation of a credit guarantee scheme and, not later than 2 months after completing such a review make a report in writing to each House of the Oireachtas of his or her findings and conclusions resulting from that review.

The original Scheme was designed to facilitate lending of up to an additional €150 million per annum for 3 years. Taking into account income from the 2% premium charged, and the maximum 3 year guarantee terms, the net cost of the scheme was estimated at €6.38 million per €150 million in lending, giving a total lifetime estimated net Scheme cost of €19.1 million.

However, the early operation of the Scheme saw the level of sanctioned loans that were guaranteed running at less than €6 million by mid-year 2013, which would have resulted in no more than €10 million per annum in additional lending. This was despite a relatively high estimate of a positive jobs impact and with no loans defaulting at that time. The Minister for Jobs, Enterprise and Innovation decided to conduct an early review of the Scheme in mid-2013.

2. Review

The Minister began the review process in 2013 by engaging consultants following a competitive tendering process to conduct an external review. First Choice Financial Services and AJS Financial were appointed and they conducted a detailed analysis and broad stakeholder engagement in order to develop findings and recommendations. This external review is being presented in conjunction with this report of the Minister's findings and conclusions and is now being submitted to the Houses of the Oireachtas in line with the provisions of section 10 of the 2012 Act.

The Credit Guarantee Steering Committee (chaired by the Department of Jobs, Enterprise and Innovation and drawing its membership from the Department of Finance, Central Bank of Ireland, Credit Review Office, Enterprise Ireland, Forfás and the Department of Public Expenditure and Reform) considered the external review in detail.

The Department of Jobs, Enterprise and Innovation also undertook consultations with the banks and their representative organisations to ascertain the likely level of take-up of any amended Scheme, and this was discussed by the Steering Group.

The overall review process adopted by the Minister was broader than the terms of section 10 of the Act in that it included a review of the operation and parameters within the Credit Guarantee Act 2012 and not just the Credit Guarantee Scheme 2012 (SI No 360 of 2012).

3. Findings

The external review concluded that, while the Scheme had real merit, its complexity, the narrow range of products covered and the apparent disproportionate skewing of risk distribution in favour of the State as guarantor made it unattractive to the banks to operate. It proposed changes in respect of procedures simplification, term of the guarantee, risk sharing and product range. In light of these findings and recommendations and prevailing credit difficulties for SMEs, the Minister and the Credit Guarantee Steering Committee consider that there is merit in continuing with an amended Scheme and the Minister has reported to Government accordingly.

The proposed primary legislative amendments will address:

- A wider range of financial products to be covered not just traditional credit products (e.g. invoice finance, factoring, leasing, overdrafts).
- A wider range of providers of financial product providers to be eligible, i.e. not just banks who hold a licence under the Central Bank Act 1971.
- An increase in the level of guarantee on individual loans from 75% to the maximum permissible under State Aid rules of 80%.
- An increase in the portfolio cap, i.e. the maximum a bank can claim in respect of its portfolio from 10% to 13% which is the maximum permissible under State Aid rules.
- The removal of the annual portfolio cap and instead each bank will run a single Credit Guarantee Scheme portfolio.

The proposed Scheme and other non-legislative amendments which will be effected speedily on foot of the revised primary legislation are broadly technical in nature and are designed to simplify operation and introduce guarantees which are aligned with normal lending durations and practices.

These changes will:

- Extend the maximum length of the guarantee from 3 to 7 years
- Remove the requirement for a formal decline letter.
- Appoint a dedicated owner/manager of the Scheme to drive performance.
- Re-launch and rebrand the Scheme to raise awareness, including a marketing campaign and an invitation to all actors in the SME financing market to actively engage with the Scheme.
- Require the Scheme to be managed within the Credit function of each bank.

While refinancing of lending within the same bank is not permitted in the guarantee (the guarantee as currently constituted is to support *additional* lending). A revised scheme under the current Act is currently being finalised with the Attorney General's Office will allow refinancing in respect of SMEs who have loans with banks who are exiting the Irish market. This has been flagged by both SMEs and the banks as the most pressing issue for SMEs at this time. Following the enactment of the amended legislation as indicated above a new Scheme will be made which will also include this type of refinancing.

This work is being completed urgently and will be followed by the new legislation and a comprehensive new Scheme addressing the issues mentioned above.

4. Outcome

The Minister's findings and conclusions and the external review were brought before the Government on 17 June 2014, where the Minister sought permission to draft the Credit Guarantee (Amendment) Bill 2014, which will take into account and deliver on the required amendments to the Credit Guarantee Act 2012.

When the Credit Guarantee Act 2012 is amended the Minister for Jobs, Enterprise and Innovation, with the consent of the Minister for Finance and the Minister for Public Expenditure and Reform, will make a new Credit Guarantee Scheme, which will be laid before both Houses of the Oireachtas. This Scheme will as indicated above include a number of new provisions including providing for a longer term guarantee and for refinancing where banks are exiting the Irish SME credit market.

The overall cost of the proposed scheme will be less than the cost originally estimated for the Scheme in 2012. However, the profile of the spending will be different and the level of receipts will increase. The relatively low cost of the Scheme proposal is driven largely by the projected increased volume, relatively fixed operating costs and the longer term with revenue generated for 7 years as opposed to 3 years under the current Scheme.

The revision of the Act and the Scheme is in line with Government policy to support access to finance for SMEs.

5. Conclusion

I. The Minister for Jobs, Enterprise and Innovation intends to prioritise work on drafting the Credit Guarantee (Amendment) Bill 2014 and to ensure it is enacted as swiftly as possible.

II. The Minister also intends to deal urgently with the issue of refinancing for SMEs where banks are exiting the SME lending market by means of an interim Scheme and with the consent of the Minister for Finance and Minister for Public Expenditure as required by the Credit Guarantee Act 2012.

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