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Responding to the COVID-19 crisis through financial instruments

in the framework of the Coronavirus Response Investment Initiative

SIH Anti-Corona Guarantee

Case study

European Commission

European Investment Bank The EU bank

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Abbreviations

Abbreviation	Full name
CPR	Common Provisions Regulation
CRII/CRII Plus	Coronavirus Response Investment Initiative/Coronavirus Response Investment Initiative Plus
EAFRD	European Agriculture Fund for Regional Development
EC	European Commission
EIB(G)	European Investment Bank (Group)
EIF	European Investment Fund
ERDF	European Regional Development Fund
ESIF	European Structural and Investment Funds
ESF	European Social Fund
EU	European Union
GGE	Gross Grant Equivalent
IFI	International Financial Institution
MA	Managing authority
MFF	Multiannual Financial Framework
NPBIs	National Promotional Banks and Institutions
SIH	Slovak Investment Holding
SMEs	Small and Medium-sized Enterprises
Temporary Framework	Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak

This mini case study focuses on the Financial Instrument 'SIH Anti-Corona Guarantee' recently launched in Slovakia to help alleviate economic hardships faced by SMEs as a result of the measures to contain the spread of COVID-19. It is one of the first products introduced by National Promotional Banks and Institutions (NPBIs) in the EU after the outbreak of COVID-19, which employs European Structural and Investment Funds (ESIF) and may also eventually make use of some of the innovative features enabled by the simplified regulatory framework for financial instruments. As such, it can hopefully serve as inspiration also for managing authorities (MAs) and NPBIs in other Member States too.

1. Introduction

Slovak Investment Holding (SIH) has recently launched a new financial instrument for small and medium-sized enterprises (SMEs), to help support them through the period of difficulties caused by the necessary health and safety measures to contain the spread of the coronavirus. The programme is funded using ESIF, from the Operational Programme 'Integrated Infrastructure' and the national budget of the Slovak Republic.

The purpose of the instrument is to enable financial institutions to extend favourable-term bridging loans to SMEs. The principal objective of the instrument is to help SMEs overcome financial difficulties caused by the COVID-19 crisis and help preserve existing jobs. All the benefits ensuing from this financial instrument (in particular reduced interest rates and reduced collateral requirements) must be fully passed onto the target SMEs.

The financial instrument consists of a portfolio guarantee for financial institutions and an interest subsidy of up to 4% p.a. for those enterprises that manage to preserve existing jobs. By means of said financial instrument, the SIH will shoulder a part of the financial institutions' credit risk resulting from a portfolio of new loans to the SMEs negatively affected by the current situation. The instrument is expected to facilitate the provision of new bridging loans with maturity of no more than four years (including a 12-month grace period on both the principal and interest) and up to almost EUR 1.2 million per loan. Thanks to the SIH Anti-Corona Guarantee, and the combined interest rate subsidy, it is expected that the loans may be provided interest-free to final recipients to cover both their investment and operating costs in order to preserve employment.

The total amount of funds currently allocated to the SIH Anti-Corona Guarantee is EUR 38 million; however, with a view to the ongoing negotiations between the SIH and the Ministry of Economy, as well as the measures recently announced by the Slovak Government, a significant growth in the overall volume of funds allocated to this financial instrument is expected[1]. For this reason, the financial instrument was designed in a way to enable possible increases to the allocation to the participating financial institutions. Draft guarantee agreements contain clauses enabling the participating financial institutions to request a guarantee top-up in the event that 70% of the loan portfolio covered by the guarantee has been created, and subject to SIH having secured additional financial resources.

1 As of the end of April, SIH has secured additional EUR 57 million for this financial instrument and a soft commitment from the relevant managing authority that further resources will be made available if needed.

2. Key parameters of the financial instrument

2.1 Development of the financial instrument

The SIH Anti-Corona Guarantee was rapidly prepared in March 2020 with ESIF from the 2014-2020 programming period. The design of the instrument therefore pre-dated amendments to the Common Provisions Regulation (Regulation (EU) No 1303/2013) that were adopted on 2 April[2]. The need for a formal ex ante assessment was therefore taken into account and the CPR requirements in this respect were met by the ex-ante assessment contracted by the Slovak Ministry of Finance (prepared by EIB in 2014, and updated in 2017). The gap identified at the time was deemed further exacerbated by the economic difficulties resulting from the measures adopted in Q1 2020 to contain the spread of COVID-19.

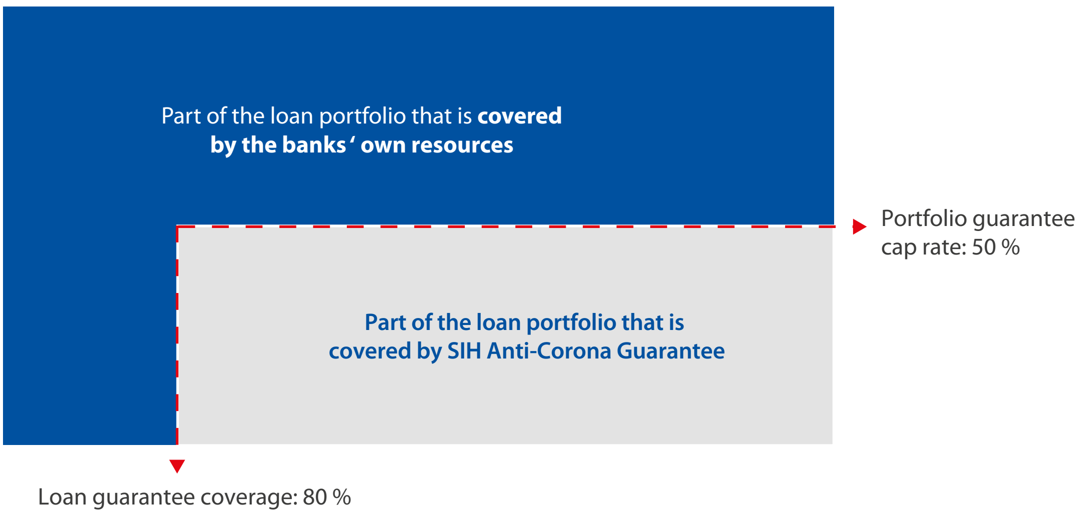
2.2 Description of the financial instrument

The instrument includes two components structured as a single operation:

- SIH Anti-Corona Guarantee (First Loss Portfolio Guarantee); and
- Interest rate subsidy, i.e. partial or full interest refund on loans provided by participating financial institutions.

Guarantee parameters: An 80 % guarantee coverage on individual loans (with maturities between 3 and 4 years) and a 50 % guarantee cap rate on the portfolio of underlying loans.

Figure 2: the SIH Anti-Corona Portfolio Guarantee



2 https://ec.europa.eu/info/sites/info/files/european_structural_and_investments_funds.pdf.

Setup of the guarantee: The SIH provides the guarantee in line with the parameters described above. Based on the guarantee, each financial institution shall create and administer a portfolio of new loans guaranteed by SIH. The guarantee shall cover credit risk at the level of individual loans as well as at the level of the entire loan portfolio. This allows for more favourable financing conditions to be provided by the financial institutions to the target SMEs. Throughout the entire loan period, loans that are covered by the guarantee must comply, *inter alia*, with the following eligibility criteria:

- The loans must be new, i.e. it is not permitted to refinance or restructure existing loans;
- The loans must not be used to finance operations/investments that have been physically completed or fully implemented before submitting a loan application;
- The loans must not be used to finance financial activities, the development of real estate property as a financial investment, or to provide consumer loans.

Funds shall be earmarked and deposited in an escrow account with the State Treasury (Štátna pokladnica), for the sole use of settling guarantee claims from the participating financial institutions. In case of an individual loan default, the participating financial institution shall receive funds in the amount of the guaranteed portion of the defaulted loan, while simultaneously commencing recovery of the defaulted loan from the liable SME. The transfer of the guarantee payment shall be executed by SIH to the financial institution within 30 days of delivering an authorised settlement request.

Interest rate subsidy: Up to 4% p. a.

Setup of the interest rate subsidy: The interest rate subsidy shall reduce the interest paid by SMEs to participating financial institutions. This form of the support is designed for the benefit of SMEs, but it shall not be disbursed to them directly.

The SME's claim to the interest rate subsidy arises after the financial institution verifies that the beneficiary SME has met the following conditions:

- The beneficiary SME's workforce was not reduced, compared to the previous period;
- The beneficiary SME is not or did not fall in arrears on its social and healthcare contributions, or has reduced the arrears as a result of the loan being used for other eligible activities[3].

The conditions must be complied with by the beneficiary SME and verified by the financial institution 12 months after the first drawing of the loan. If the conditions are met, the subsidy applies to the entire loan period, including for the initial 12 months. In such case, SIH makes a payment to the financial institution to cover the interest rate subsidy. If conditions are not met, the interest rate subsidy is not applied to the SME and the financial institution charges the relevant part of the interest rate to the SME, including for the initial 12 months period.

3 For the avoidance of doubt, the guaranteed loans cannot be used directly to settle such arrears.

2.3 Description of the combined financial product for SMEs

Combined financial product: Provision of low- to zero-interest rate loans to SMEs (interest rates between 0% and 2% p.a. are envisaged). The loans shall take the form of a fixed amortisation instalment schedule or a revolving loan. The loans must not take the form of a mezzanine loan, subordinated debt or quasi equity.

Maximum amount of each loan: EUR 1 180 000.
Minimum maturity: 3 years (36 months), including the grace period.[4]
Maximum maturity: 4 years (48 months), including the grace period.
Grace period for the principal and interest payments: 12 months from the date of the loan first being drawn.[5]
Collateral requirements: None.

Interest rate: The financial institutions' loan margins shall be reduced by 50% based on the provided guarantee. Subsequently, the interest rate is reduced by up to 4% p. a. (limited to the interest rate applied taking account of the guarantee). The subsidy is applied only to the extent that a 0% interest rate is achieved. SIH expects that overall, this financial instrument should help bring the final interest rate charged to target SMEs down to between 0% and 2% p. a.

The fees for providing the loan, increases, prepayments and loan guarantee should not be charged. Other fees are to be charged and determined in accordance with the standard fee schedules of the particular financial institution.

Expected leverage effect[6]: Minimum of 2.5 : 1

2.4 Distribution key for allocation to individual financial institution applicants:

The total resources available will be distributed between the participating financial institutions in accordance with the following formula:

(a/b)*c

Where:
a = Outstanding principal balance for SMEs loans of the particular financial institution as at 31 December 2019,
b = Cumulative outstanding principal balance for SMEs loans of all participating financial institutions as at 31 December 2019,
c = Total allocation for the cash collateral to cover losses from defaulted loans, i.e. the guarantee amount.

4 In case of revolving loans, the minimum maturity is 12 months.
5 In case of revolving loans, grace period on principal and interest payments is not applicable. Neither is the interest rate subsidy.
6 Being the ratio between the total amount of newly-extended, guaranteed loans and the amount of the guarantee (which employs both the ESIF and the state budget funds); in other words, every €1 of provided guarantee should lead to the extension of at least €2.5 in new loans.

The minimum possible allocation per individual financial institution is EUR 1 million[7].

Draft guarantee agreements leave room open for additional guarantee allocations to participating financial institutions, in line with the 'distribution key' outlined above.[8]

2.5 Eligible SMEs

- Must be incorporated in the Slovak Republic and pursue their business activities on its territory;
- Must comply with the definition of 'small and medium-sized enterprises' as defined in applicable EU legislation;[9]
- Must pursue their business activities in the territory of the Slovak Republic, in any of its regions;
- Must not belong to the strongest credit risk rating category according to the participating financial institution's internal rating evaluation;[10]
- Must not be subject to any procedure initiated by the European Commission aimed at returning previously provided support on the grounds of irregularities;
- Must not have any history of being convicted for crimes related to their professional conduct, including fraud, corruption, participation in an organised crime group or any other illegal activities that are harmful to EU financial interests;
- Must not be subject to any lawful decision that would sanction them for violating any legal statutes forbidding illegal hiring of third country nationals.

2.6 Eligible use of extended loans

- Procurement of material and non-material property required to maintain or increase the number of jobs, including transfer of ownership rights in SMEs (e.g. purchase of new machinery/technologies/licences, renovation of buildings, etc.) as well as working capital complementary to such procurement;
- Working capital required to preserve or increase the number of jobs and to establish, strengthen or extend business activities of the beneficiary SME (e.g. purchase of supplies/goods/services/utilities, etc.);
- Working capital required to preserve or increase the number of jobs in order to support special treatment of disadvantaged social groups and implement socially oriented measures (e.g. preservation of jobs, etc.);
- Working capital necessary to support SMEs with limited access to capital due to events and developments that are outside of their control.

7 If the formula indicates less than EUR 1 million for financial institution(s), then allocation in a minimum amount of EUR 1 million is made to such institution(s). As a next step, the formula is applied again, this time ignoring the SMEs loan volumes from financial institution(s) with EUR 1 million allocation(s) and the guarantee amount (c) being reduced by the minimum allocation(s) made in the previous step.

8 Once a financial institution absorbs 70% of the initially allocated guarantee, it can request an additional allocation. SIH, subject to having secured additional resources at that point, may allocate additional funding to such a financial institution in the amount, which represents the larger of: 50% of the financial institution's initial allocation; and €1 million.

9 As defined by Commission Recommendation 2003/361/EC on micro, small and medium-sized enterprises.

10 The instrument is not designed to support lower risk/safest SMEs.

2.7 State aid scheme

The aid provided within this financial instrument will be in compliance with *de minimis* conditions as set out in Regulation (EU) No. 1407/2013 and Articles 107 and 108 of the Treaty on the Functioning of the European Union with respect to *de minimis* aid. The *de minimis* aid scheme that governs this financial instrument was published on SIH website[11] after having been approved by the Antimonopoly Office of the Slovak Republic.

This State aid scheme was selected as SIH has implemented a First Loss Portfolio Guarantee instrument in the past and had an existing applicable and approved *de minimis* scheme. As a result, SIH decided to prepare a new *de minimis* scheme, which would be similar to the previously approved one, in order to speed up the process of having the new scheme approved by the Antimonopoly Office.

The scheme was already prepared and under review by the Antimonopoly Office by the time the Communication from the European Commission - Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak - was published. Furthermore, given that the ESIF resources used to implement the SIH Anti-Corona Guarantee were restricted for SMEs, the decision was taken to implement the financial instrument with the *de minimis* scheme under preparation. The Temporary Framework for State Aid was identified as a possible state aid regime to be used in the event SIH receives additional funding and increases the size of the guarantee amount.

2.8 Participation of financial institutions

The SIH Anti-Corona Guarantee is designed to be a remuneration-free financial instrument. This means that SIH will not pay any management or performance fees to the financial institutions that will participate in this instrument. Moreover, the participating financial institutions are not providing a service to the SIH, as the guarantee is used to support SME lending operations in line with standard banking practice. SIH has provided access to this financial instrument to every eligible financial institution and there is no rating of individual applications, nor selection from among them. Every financial institution that submits an expression of interest, which SIH assesses to be in compliance with the Call requirements, including with requirements stipulated in Article 7 of the Commission Delegated Regulation (EU) No. 480/2014, is offered an opportunity to sign the guarantee agreement and participate in the implementation of the financial instrument. No contractual negotiations are to be held before signing of the guarantee agreements. For these reasons, SIH has, with the support of their legal advisers, concluded that the implementation of this financial instrument is not subject to the public procurement rules.

11 https://www.sih.sk/en/aktuality/sih-anti-corona-guarantee-to-help-small-and-medium-sized-businesses.

2.9 SIH verification of the financial institutions' eligibility criteria

SIH checks whether the expressions of interest from financial institutions are compliant with the Call and in line with the requirements stipulated in Commission Delegated Regulation (EU) No. 480/2014 of March 3, 2014. Every financial institution that meets the criteria, receives a portion of the guarantee in line with the distribution methodology for allocation to individual financial institutions described earlier. There is no rating of individual expressions of interest, nor selection of the applicants. Every compliant applicant is offered an opportunity to sign the guarantee agreement and participate in the implementation of the financial instrument. Eligibility criteria against which the expressions of interest from financial institutions are assessed, include:

- Expression of interest is delivered on time, in a prescribed form, with complete documents and declarations, and dully signed;
- The candidate financial institution is in compliance with EU's internationally agreed tax standards;
- The candidate financial institution has no conflict of interest to the object of the financial instrument and has appropriate mechanisms to resolve potential conflicts of interest;
- The candidate financial institution is legally authorised to implement the financial instrument and has an appropriate economic and financial capacity, an efficient and effective internal control system, an appropriate management and system capacity and an appropriate accounting system to implement the financial instrument;
- The candidate financial institution demonstrates preferential financing conditions (e.g. lower interest rate, reduction of collateral requirements) for SMEs as compared to its standard operations and the extension of its basic product line as a result of the guarantee financial instrument;
- The candidate financial institution demonstrates a robust and credible methodology for the identification of the final recipients (SMEs);
- The candidate financial institution makes use of its own resources to implement the financial instrument.

Notes

Notes

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