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

Credit Guarantee (Amendment) Bill 2014

Regulatory Impact Analysis

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1 Description of Policy Context and Objectives

1.1 Policy Context

The Credit Guarantee Act 2012 and the Credit Guarantee Scheme 2012 (SI No 360 of 2012) involved a new approach by Government to try and increase and support certain bank lending. This was where due to a lack of security or because a bank did not understand adequately the sector, market, business model or technology, and it was not willing to lend to a particular SME. This policy response in relation to bank lending was not taken in isolation of the other policy responses adopted by Government, which are briefly set out below.

The principal response by the Government to the challenge of bank lending to SMEs was the restructuring and recapitalisation of the banks. In this context from 2011 to 2013 both AIB and Bank of Ireland had sanctioned lending targets set by Government under the recapitalisation commitments of 2011. Both banks had targets in 2013 of €4 billion each, compared with €3 billion in 2011 and €3.5 billion in 2012. The imposition of SME lending targets was a key policy intervention not only in addressing the perception that banks were not lending but also in ensuring that the banks produced monthly progress reports which included lending values disaggregated by sector and region, as well as drawdown data and balance sheet volumes. The targets were met by both banks in each of the 3 years 2011-2013.

From a policy perspective, the imperative in 2014 is to ensure that economic recovery is not constrained by a lack of credit from the relevant banking institutions. The Government, in particular through the work of the SME State Bodies Group (chaired by the Department of Finance and drawing its membership from the Department of the Taoiseach, the Department of Jobs, Enterprise and Innovation, the Department of Education and Skills, the Department of Agriculture, Food and the Marine, Forfás, Enterprise Ireland, the National Pension Reserve Fund, the Central Bank of Ireland and Fáilte Ireland) is working on developing and implementing appropriate policy responses in this context.

Having completed a process of deleveraging, both AIB and Bank of Ireland are now concentrating on growing their balance sheets. In this context both banks recognise the need to increase business lending in the period up to 2016, including lending to the SME sector.

Although the targets were a useful policy intervention the focus now needs to shift towards the collation and examination, on a monthly basis, of more granular data from both the AIB and Bank of Ireland and the wider banking sector. This will facilitate the SME State Bodies Group and the Credit Review Office in monitoring progress against agreed annual SME lending plans and in particular ensuring that new lending to SMEs continues to increase as a percentage of total sanctioned lending.

The Medium Term Economic Strategy published in December 2013 recognises the importance of fostering an environment for increased competition in the retail banking sector to address the fact that the global financial crisis has resulted in foreign banks, either scaling back lending activities or exiting the Irish market entirely to focus on their home markets.

This context also serves to reaffirm the importance of Government's strategy of broadening the range of bank and nonbank finance mechanisms available to SMEs in Ireland.

The Credit Guarantee Scheme of 2012 was introduced to deal with an issue that pre-dates the recent banking crisis, whereby new companies or expanding SMEs trying to develop new products or markets struggle to secure finance. This can be due to a lack of familiarity or understanding of the new industry, the new product or the potential of new markets; or the absence of security in the traditional sense.

The Credit Guarantee Scheme provides a level of insurance to banks against losses on qualifying loans to job-creating firms, and was designed to get banks back lending again to viable businesses.

The Regulatory Impact Analysis prepared for the Credit Guarantee Bill 2012 stated that *"Internationally, there are over 2,000 loan guarantee schemes across about 100 countries. Companies operating within and trading from these countries benefit from a range of State supports in accessing capital, in certain cases where risk-sharing is needed to leverage bank lending, including partial loan guarantees and other forms of trade finance. International experience shows such an initiative would involve approximately 2 - 4 percent of total lending to SMEs. However the cohorts of SMEs targeted by this initiative are of strategic importance to national enterprise policy objectives – they are the engines of growth for the future. Therefore, as things stand, Irish SMEs operate at a considerable competitive disadvantage to their competitors across the OECD."*

In the last quarter of 2009, the Department of Jobs, Enterprise and Innovation commissioned Forfás and Enterprise Ireland to prepare a paper with a detailed, robust analysis of the operation of loan guarantee schemes elsewhere with a view to identifying best practice and assessing the extent to which a temporary, partial credit scheme could add value to the measures already taken to address the SME credit supply issue and represent value for money to the State. The Forfás/Enterprise Ireland Report entitled "Small and Medium Enterprise Credit Initiative" was completed in March 2010. This research paper recommends the creation of a carefully targeted SME Credit Initiative on the basis that it would deliver positive returns to the economy and would address the competitive disadvantage being experienced by Irish SMEs. This work is still relevant to any amendment to the existing Credit Guarantee Scheme.

In July 2010, the Department of Enterprise, Trade and Innovation and the Department of Finance engaged with Forfás and Mr John Trethowan, the Credit Reviewer, to seek to develop options for a loan guarantee scheme which would encourage bank lending to specific categories of SMEs in a way which would not reduce the onus on banks to honour their commitments to increase SME lending, with a view to the early discussion of options at the Cabinet Committee on Economic Renewal.

Following this work, the Government decided to develop a targeted temporary partial credit guarantee scheme. This Scheme was designed to support commercially viable SMEs that are at the margins of SME commercial lending decisions because the businesses have insufficient security or the lender does not have the skills to carry out an appropriate assessment of the business proposition. The Scheme operates under the terms of the Commission Regulation (EC) No 1998/2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid.

The take-up of the Scheme has not matched original expectations. Even though the Scheme is sanctioned under the legislation to provide a guarantee on up to €150 million in loans each year the actual up-take to date has been much lower. The Scheme began operating in October 2012 and as at 21 February 2014 there were 83 live scheme facilities amounting to €11,696,500. In view of this performance, the Minister for Jobs, Enterprise and Innovation in Summer 2013 appointed external reviewers to determine what changes could be made to the Scheme to improve its impact and the up-take of the Scheme. The reviewers reported to the Minister in Q3 2013.

The recommendations of the external reviewers were examined by a Steering Group chaired by the Department of Jobs, Enterprise and Innovation, with members from Department of Finance, Credit Review Office, Central Bank of Ireland, Enterprise Ireland, Forfás and the Department of Public Expenditure and Reform. The Group recommended to the Minister that all the review recommendations should be implemented subject to legal and state aid considerations. The Credit Guarantee (Amendment) Bill 2014 that is the subject of this RIA is the outcome of this work.

1.2 Objective of the proposed legislation

The main objective of this new regulatory proposal is to broaden the Minister for Jobs, Enterprise and Innovation's powers in relation to the granting of guarantees for financial products to SMEs. The proposed changes will allow the Minister to make guarantees for a wider range of SME financial products, as well as providing for an accreditation system that will allow the Minister to include providers of financial products who do not have a banking licence. For example companies that provide invoice finance or asset finance are not lending to SMEs and are not licensed by the Central Bank under the Central Bank Act 1971. However, these entities provide key access to finance for SMEs.

The existing legislation empowers the Minister, to give a loan guarantee (within set parameters), and to notify participating lenders that after a specified date he is no longer providing such guarantees; certify and approve a lending institution as a participating lender (and also to withdraw this approval); make a credit guarantee scheme with the consent of the Minister for Finance and the Minister for Public Expenditure and Reform; review the operation of a credit guarantee scheme; withdraw a guarantee (where a lender fails or refuses to comply with the terms of a credit guarantee scheme); and to enter into an agreement with a contractor to perform certain functions under a credit guarantee scheme. This legislation also requires a participating borrower to pay a 2% charge to the Minister.

The legislation as it is proposed to be amended, with the Credit Guarantee Act 2012 will set out the principles and policies, and leaves the details in relation to operational matters to the scheme, which is secondary legislation. The Act gives the Minister the power to make a scheme or schemes and also indicates a number of matters that the Minister may include in a Scheme such as: the payment of the charge or premium in instalments; the preparation and maintenance of records, books of account and other documentation; and audit and examination of accounts.

1.3 Objectives of the Scheme

Under the current legislation it is possible for the Minister, with the consent of the Minster for Finance and the Minister for Public Expenditure and Reform to make a Scheme or Schemes. At present there is only one Scheme in place – the Credit Guarantee Scheme 2012 (SI No 360 of 2012). This Scheme provides a Government guarantee to the lender of 75 per cent on eligible individual loans to viable businesses, which is paid to the lender on the unrecovered outstanding balance on a loan in the event of an SME defaulting on the loan repayments. The purpose of the scheme is to encourage additional lending to SMEs, not to substitute for conventional lending. It is not a grant, nor is it support for ailing businesses. The Scheme addresses specific market failures that prevent bank lending to some commercially viable businesses by providing a level of guarantee to banks against losses on qualifying loans to job-creating firms. All decision making at the level of the individual loan is fully devolved to the participating lenders.

Target groups are commercially viable SME businesses, i.e. SME businesses that can demonstrate repayment capacity for the additional credit facilities, but that do not secure credit facilities due to the following two market failures:

1) Insufficient collateral for the additional facilities, or,

2) Growth / expansionary SMEs which due to their sectors, markets or business model are perceived as a higher risk under current credit risk evaluation practices.

The Scheme facilitates new lending, investment, trade and employment, and enables SMEs to access sufficient credit to maximise growth potential.

A carefully targeted Scheme delivers positive returns to the economy and addresses the competitive disadvantage being experienced by Irish SMEs.

Other Objectives of the Scheme are :

- To encourage additional lending to commercially viable SMEs and to reorient lending to the real economy.
- To encourage banks to lend to commercially viable SMEs engaged in new sectors, technologies and markets. In doing so, place Irish SMEs on a more level footing with international competitors that have access to similar schemes.
- To realign commercial bank lending with national enterprise policy objectives.
- To secure the economic benefits from additional lending, through increasing exports, creating/sustaining jobs and facilitating investment in the real economy.

Based on international experience targeted loan guarantee schemes can support the flow of additional credit, thereby ensuring that these commercially viable businesses are positioned for the economic upturn to deliver the optimal outcome for business and the wider economy - job creation, increased turnover and value added, higher innovation activity and increased taxation receipts.

1.4 Premium Rate

In return for the guarantee, recipient businesses will continue to be required to pay the Department of Jobs, Enterprise and Innovation (the Guarantor) an annual premium on the outstanding balance of the loan. Premium receipts will be treated as income to the State, and will be offset against the cost of settling Guarantee claims.

While the reviewers recommended that the banks be asked to pay half of the premium, the cost model requires the Minister to raise 2% on the principal and then 2% on the annual outstanding balance. The Minister is not proposing changing this cost model, and having considered the suggestion that the bank be asked to pay half, has decided that this would in all likelihood still be passed on to the borrower, and would therefore not achieve a reduction in the cost of the guarantee for the borrower.

It is also intended in this Bill to ensure that any new primary legislation will also allow the Minister to make a scheme or schemes that are not covered by the De Minimis State Aid rules, such as the possibility of making a self-

financing export credit scheme. This will mean that the primary legislation is going to have to allow the Minister to set a rate above 2% in terms of the level of charge he can impose on a borrower.

2 Identification and Description of Options

2.1 Do nothing

This option would perpetuate the identified market failures linked with the existing legislation in ensuring a supply of credit to viable SMEs, as identified under section 1.3 above, and the fact that the Scheme under the current legislative framework has a very low take-up. The external reviewers are clear that in order to improve take-up of the Scheme it is necessary to amend certain parameters set out in the primary legislation and to expand the types of providers of credit to include other financial product providers and to include a wider range of products that SMEs require for working capital and investment.

2.2 Revising the Scheme without amending the primary legislation

This option would not allow the Minister to make the key changes that have been recommended as a result of the review process. In effect this would involve keeping the status quo in relation to the scheme and is akin to the do nothing option. This is only an option if the current level of usage of the Scheme is considered sufficient. As this level of usage is not acceptable it is necessary to amend the Credit Guarantee Act 2012 in order to improve the impact and up-take of the Scheme.

2.3 Revising the primary legislation

The current Credit Guarantee Scheme made under the Credit Guarantee Act 2012 is not performing at a level to make an impact on SMEs, and therefore, employment. The review process, which included a consultation process, has recommended a set of changes the most important of which in terms of impact involve amendments to the primary legislation.

The amending legislation will retain the protections for the State in relation to exposure and the powers of the Minister. Schemes will continue to require the consent of the Ministers for Finance and Public Expenditure and Reform.

In the circumstances, the introduction of a short amendment to the enabling piece of primary legislation is considered to be the best option.

2.4 Conclusion

An amendment to the Credit Guarantee Act 2012 is being pursued to achieve the objectives of the Oireachtas and the Government in terms of providing additional credit for struggling SMEs and jobs.

3 Analysis of Costs, Benefits and Impacts

3.1 Costs to the Exchequer

The actual costs of the scheme arise in relation to the costs on the guarantees paid out (i.e. loans defaulted on) and the cost of operating the scheme. This outflow of funding is partially offset by receipts of premiums paid by borrowers and of any recoveries achieved in respect of loan defaults.

By establishing a number of parameters the level of State exposure is capped. However, as the Scheme is demand led it is not possible to ensure that €150 million is guaranteed each year nor is it possible to be certain that the level of default will actually reach the capped volume. Where there are lower volumes of lending under the guarantee the estimated receipts will be less, as will the amount that can possibly be called under the guarantee.

The net cost to support €150 million of guaranteed lending per annum, with the amendments proposed is approximately €18.376 million over the lifetime of the Scheme.

This cost is broken down as follows:

Cost of Scheme Administration (including additional cost of a new owner/manager)	€4.387m
Gross Cost of Scheme Claims	€64.091m
Premium Receipts	€50.102m
Net Cost of Scheme	€18.376m
Net Cost per €150m Annual Portfolio (based on €10 million lending up to end 2013, €75 million lending in 2014 and followed by 6 years of lending of €150 million)	€2.827m
Net Cost per €100m of Lending	€1.885m

Programme Costs:

Assuming the Scheme is amended as proposed in this report we estimate that the overall cost to the State excluding any tax benefits and Social Welfare savings will be c. €18.376m as follows:

	Actual	Proj	Proj	Proj	Proj	Proj	Proj	Proj	Proj to 2027
Table 1 - No cap / G'tee 10.4%	2012	2013	2014	2015	2016	2017	2018	2019	
	€'m	€'m	€'m	€'m	€'m	€'m	€'m	€'m	€'m
Admin (fixed cost with Capita €199k p.a.)	0.237	0.250	0.250	0.250	0.250	0.250	0.250	0.250	1.750
Scheme Owner / Manager	-	-	0.050	0.050	0.050	0.050	0.050	0.050	0.350
Annual cost	0.237	0.250	0.300	0.300	0.300	0.300	0.300	0.300	2.100
Risk exposure with NO CAP									
Estimate Gross Claims in (Yr 1) 2013 loans	-	-	0.208	0.143	0.074	-	-	-	-
Estimate Gross Claims in (Yr 2) 2014 loans	-	-	-	1.560	1.290	1.000	0.690	0.357	-
Estimate Gross Claims in (Yr 3) 2015 loans	-	-	-	-	3.120	2.580	2.001	1.380	0.714
Estimate Gross Claims in (Yr 4) 2016 loans	-	-	-	-	-	3.120	2.580	2.001	2.094
Estimate Gross Claims in (Yr 5) 2017 loans	-	-	-	-	-	-	3.120	2.580	4.095
Estimate Gross Claims in (Yr 6) 2018 loans		-	-	-	-	-	-	3.120	6.675
Estimate Gross Claims in (Yr 7) 2019 loans	-	-	-	-	-	-	-	-	9.795
Estimate Gross Claims in (Yr 8) 2020 loans	-	-	-	-	-	-	-	-	9.795
Estimate Gross Claims in 2021 - 2027 loans	-	-	-	-	-	-	-	-	
Claims Totals	-	-	0.208	1.703	4.484	6.700	8.391	9.438	33.167
Claims + Admin	0.237	0.250	0.508	2.003	4.784	7.000	8.691	9.738	35.267
Premium Receipts	-	0.163	1.332	3.505	5.238	6.559	7.378	7.657	18.271
Net Cost of Scheme:	(0.237)	(0.087)	0.824	1.502	0.454	(0.441)	(1.313)	(2.081)	(16.996)

Assumptions

- Loan of €150 million per annum from 2015 to 2020, following on from 2014 €75 million)
- Average loan term 5 years (2013 loans of €10 million for 3 years)
- Scheme term of 7 years
- Loan Rate of 7%, inclusive of premia
- No annual portfolio cap
- Guarantee rate increased to 80% and portfolio default increased to 13%, which equates to maximum State risk of 10.4% of exposure
- Default rate of 18.7% ‘flat-line’ (from year 1-5)
- 2% State return on premium income (excluding 18.7% premia defaults).
- Fixed cost of Scheme and administration of €199,000 with a possible cost of a Scheme Manager at €50,000 per annum and provision of €51,000 for other costs (total €300,000)

The cost of administering the Scheme is projected out to 2027, but this requirement will depend upon actual timing of claims and the associated Lender performance.

The relatively low cost (when compared with the costings for the first Scheme) are driven largely by the projected increase in volume, relatively fixed operating costs and the longer term with revenue generated for 7 years as opposed to 3 years under the current Scheme.

3.1.1 Cost of Guarantee Claims

Assuming a Scheme facilitating €150m of lending per annum is introduced, the resulting cost to the Exchequer after premium receipts but before administration costs will be approximately €2.527 million per €150 million of guaranteed lending.

The continued temporary nature of the scheme, even though this is proposed for extension, caps the costs to the Exchequer. The cost of the scheme is a function of four factors –

- the amount of lending covered by the scheme,
- the level of risk assumed by the guarantor(the State)
- the size of the premium charged to borrowers
- the default rate on the guaranteed loans.

The proposed amendment legislation will still provide for all of these to be controlled or capped to limit exposure.

Defaults are more likely to arise in the middle to end of the three year period for loans of this duration. The average loan term for SME is 5/7 years, and therefore while the underlying risk should be lower after 3 years (which was the logic behind the 3 year guarantee), it is difficult for a lender to commit to a 5 or 7 year term loan in the knowledge that part of their security will fall away after 3 years.

By targeting market failure, the scheme seeks to maximise additionality and to limit the impact on the banks' risk profiles and consequential default rates.

Recovery procedures for defaulting loans are required under the current Scheme, and will continue to be required in the future, by participating lenders and defaulting borrowers will be actively pursued. This will have a positive impact on lowering default rates and thus State exposure.

3.1.2 Cost of Administering the Scheme

It is proposed to continue to employ an operator to administer the Scheme. This is estimated to involve an additional annual cost of approximately €0.2 million. The Irish State does not have the existing infrastructure and skills to operate the SME Credit Initiative. While some state entities may have an involvement in certain aspects of the initiative, no existing state entity has the full range of skills, infrastructure and capacity to operate it. Therefore, it has been agreed that the operation of the initiative should be outsourced in order to maximise efficiency, ensure skills capacity and to manage relationships between the State and lenders.

Additional costs of €100,000 per annum are included to 2027 to cover a Scheme manager and other cost such as Scheme audit or review.

Total cost, therefore, is estimated at €4.387 million.

The guarantee is valid for up to seven years (or the term of the loan if shorter) and the maximum lag between a default occurring and a claim against the Guarantee being settled is two years, then a delivery infrastructure will need to be in place for a minimum of nine years. This would mean that new loans in 2015 are guaranteed for 7 years, and then there is a requirement to have an infrastructure for a further 2 years, i.e. to 2023. So if guarantees were made under the Scheme for a further for 5 years 2016-2020 then the infrastructure needs to be in place until 2027, with a possible 2 further years to work out any final claims in relation to loans made in 2020.

3.2 Benefits to the Exchequer

The costs identified for the scheme should be seen in the light of the benefits, in terms of GVA, sales, exports and revenue returns, that will be generated by the additional lending attributable to the scheme. International experience has shown that the positive effects of successful projects in terms of GDP, collected taxes, employment and reduced cost of social benefits represent high multiples of the budgetary cost.

This Scheme will facilitate new lending, encourage investment and company growth (scaling), save jobs and facilitate the creation of new jobs, and will boost trade.

The benefits forecast to arise from this intervention in each year of operation, assuming €150 million of additional lending, include:

- Over 1,000 jobs created
- Over €25m of exchequer benefits in tax revenues and welfare cost savings
- 398% return on the State’s investment

ECONOMIC IMPACTS & BENEFITS – Based on analysis from the RIA for the Credit Guarantee Bill 2012

Quantity/Variable	Value	Assumptions Driving Value
Borrowing Businesses	1,875	Average loan value €76.48k
Defaulted Loans resulting from Failed Businesses	525	
Successful Businesses	1350	
Businesses demonstrating real Additionality	810	
Additional Sales (€m)	81	
GVA (€m)	24.3	GVA 0.329
Additional export sales arising (€m)	21.5-78.2	18
Pillar 1 businesses demonstrating real additionality	648	
Pillar 2 businesses demonstrating real additionality	162	
Pillar 1 direct employment gains	907	2.34 jobs per SME
Pillar 2 direct employment gains	113	2.34 jobs per SME
Total direct employment gains	1020	
Indirect employment gains	324	0.4 per additional business
Total employment gains	1344	
Exchequer Benefits (€m) (Tax revenue receipts and welfare savings)	31.9	€23,741 per employee
Net Cost of Delivery (€m)	6.4	
Net Exchequer Benefit (€m)	25.5	
Return on State Investment (%)	398	Net Benefit/Delivery Cost

3.3 National competitiveness

While the take-up for the Credit Guarantee Scheme 2012 has been disappointing, the jobs estimates have been very positive and encouraging, both in terms of jobs maintained and jobs created.

Loan guarantee schemes are a pervasive public policy instrument globally. Internationally there are over 2,000 loan guarantee schemes in almost 100 countries. Therefore, the further development of this scheme places Irish SMEs on a competitive level-footing relative to other trading competitors, who often avail of a loan guarantee in their own country to support trade and investment. These schemes support the outflow of additional credit,

delivering the optimal outcome for businesses and the wider economy in terms of job creation, and higher innovation activity across knowledge-driven businesses.

The cohorts of SMEs targeted by this initiative are of strategic importance to national enterprise policy objectives. The legislation providing for the Credit Guarantee Scheme therefore supports the realisation of national policy goals, improve the financing environment for SMEs and encourage a banking system that is fit for purpose.

3.4 Industry Costs

Costs arise for industry in terms of the additional annual premium of 2% on the outstanding balance of the loan to be paid by the borrower benefiting from the guarantee to the Guarantor (the State). However, it must be remembered that the borrower would not otherwise have secured the additional credit sought were it not for the guarantee.

Furthermore, it is estimated that all borrowing SMEs which survive to repay their Scheme Facility in full will have experienced an increase in revenues over the term of the Facility of at least 125% of the value of the Facility, i.e. sufficient to service and repay the Facility.

Costs may arise for industry where substitution occurs, that is where companies that would have been funded by banks in any event are brought under the scheme thus increasing their cost of funding. The scheme proposed has been designed to minimise substitution and it is envisaged that the benefits that will accrue from the additionality factor will greatly outweigh the costs of substitution effects.

3.5 Industry Benefits

The Bill will have a positive impact on SMEs as it is a targeted intervention to specifically assist SMEs. It does not extend to large businesses. International experience shows such an initiative would involve approximately 2 - 4 percent of total lending to SMEs.

As stated in paragraph 3.1 above, it is proposed that capacity should be provided to facilitate up to €150 million of additional lending to SMEs per annum through the Scheme.

At this stage an average loan value of €80,000 is assumed, with an estimated 1,875 loans per annum.

The scheme will benefit SMEs by enabling them to access credit that they would not otherwise obtain, for various purposes such as improving cashflow, developing new products and markets, expanding activities, innovation

activities and job creation. Cash-flow is recognised as one of the main constraints on growth by smaller businesses.

The Guarantee Scheme will allow a business to not only acquire a loan it could not otherwise obtain, but also to establish a favourable credit history with a lender so that the business may obtain future financing on its own.

Furthermore, it is recognised that the benefits from small business growth accrue more widely than just to the individual company who has accessed the credit through the Guarantee Scheme. There are positive spill over effects into other businesses, activities, and to society as a whole.

3.6 Lending Institutions Costs

Participating Lending Institutions will have already borne the following costs at the outset:

- setting up systems to record qualifying loans and reporting mechanisms,
- “learning” costs, ensuring the right eligibility procedures are in place for the Scheme.

Any new entity that provides financial products to SMEs will have to bear these costs in order to participate in the Scheme.

3.7 Lending Institutions Benefits

The Lender benefits from having the State underwrite part of the risk in lending to certain SMEs that would not qualify for credit under the Lending Institutions existing credit policies.

For the Lender the successful performance of the guaranteed lending helps develop experience of and confidence in undertaking that type of lending and provides evidence to inform the refinement of policies in respect of lending in cases of inadequate security or to novel propositions which may otherwise be outside the Lender’s existing risk appetite and parameters.

3.8 Employment

The benefits forecast to arise from this intervention in each year of operation include the creation of over 1,000 jobs.

3.9 North/South

Northern Ireland has a guarantee scheme, which has been in place since the 1980s. The establishment of the revised Guarantee Scheme would place Irish SMEs on a competitive level-footing relative to their Northern Irish trading

competitors, who often avail of a loan guarantee (which includes invoice finance and overdrafts) in Northern Ireland to support trade and investment.

3.10 Moral Hazard

The Act provides for safeguards available to the State including the ability to notify a participating lender in writing that as and from a specified date no new loans with be guaranteed by the State, ending the agreement in place in respect of any new loans. The Minister also has the power to withdraw a guarantee given where a participating lender fails or refuses to comply with the terms of a credit guarantee scheme.

The Lender must, as far as is reasonably practicable, treat a Borrower with a Scheme loan in exactly the same way as any other comparable customer. The presence of the Guarantee should not make the Lender either more or less rigorous in their relationship with the Borrower. Applicant SMEs must be commercially viable and must support their application for assessment under the scheme with a business plan demonstrating defined and credible growth targets.

The Lender is entitled to take security in accordance with their normal security policies, including personal guarantees from business owners or others with a beneficial interest in the business.

3.11 Deadweight

Deadweight will be minimised by the charging of the Premium (i.e. making it more expensive than conventional borrowing and therefore only something entered into if there is a very definite need for the finance) and by the Guarantee being in favour of the Lender rather than the Borrower (i.e. meaning that there is not a perverse incentive for the Borrower to behave differently in terms of their degree of commitment to successfully repay the loan).

Additionality, expressed in terms of lending taking place which would not have otherwise occurred, will be maximised by training participating Lenders in the revised scheme criteria at the outset. Specific declarations will be required from the Lenders for each facility guaranteed in terms of loan viability and/or inadequacy of security. Follow-up with appropriate monitoring over the life of the Scheme will ensure that additionality is consistently being monitored and achieved.

3.12 Consumers and Competition

The Scheme is intended to address specific market failures that prevent bank lending to some commercially viable businesses:

1. Insufficient collateral for the additional facilities, or,

2. Lack of knowledge of growth / expansionary SMEs which due to their sectors, markets or business model are perceived as a higher risk under current credit risk evaluation practices.

At present, the significant majority of all lending to SMEs is managed by AIB and BOI in value and volume terms. This concentration of lending amongst a small number of lenders reduces competition but also provides an opportunity for the proposed scheme to support the introduction of new SME lenders to the market or the spreading of SME lending amongst a larger group of banks to the benefit of SMEs.

The Act provides for new entrants to the SME lending market i.e. lenders participating in other guarantee schemes operating in other jurisdictions who are licensed to operate in Ireland but have not traditionally been SME lenders, to apply to the Minister to participate in the Scheme.

The revised Scheme will also cover providers of financial products to SMEs that are not licensed by the Central Bank under section 9 of the Central Bank Act 1971. This means that the full range of actors in the provision of financial products to SMEs will potentially be covered by the scheme (subject to suitable accreditation and approval by the Minister).

3.13 Compliance Burdens

The Bill adds somewhat to the existing compliance burden in lending institutions. However, the compliance burdens on lending institutions with regard to loans having to be registered under the Guarantee Scheme and undergo an inspection regime is not considered onerous when weighed against the benefits of receiving a guarantee from the State.

Every effort is made to integrate the operation and administration into the existing commercial lending decision and appeals processes to streamline delivery. The design of the Scheme achieves this through devolving decision-making to the participating Lenders and providing each Lender with access to a secure on-line administrative tool for recording and tracking all Scheme-specific information.

Other than the above there are no specific impacts for the following: East West; Rural communities; Gender Balance; Quality Regulation, Poverty Proofing (persons experiencing or at risk of poverty or social exclusion; Rights of Citizens; People with disabilities; or Environment.

4 Consultation

There is broad acknowledgement of the challenges facing SMEs in accessing finance from all stakeholders, and the necessity for Government intervention. This has been underlined in the RIA for the Credit Guarantee Bill 2012 which cited the Mazars' Review of Lending to SMEs, the Credit Supply Clearing Group, the establishment of the Credit Review Office and repeated calls from SME representative organisations and individual SMEs for Government action to address the difficulties facing business in accessing credit.

A Steering Group was established and chaired by the Department of Jobs, Enterprise and Innovation to oversee the review process on behalf of the Minister, with representatives from the Department of Finance, the Central Bank, Department of Public Expenditure and Reform, the Credit Review Office, Forfás and Enterprise Ireland. This Group has considered the work of the external reviewers of the Credit Guarantee Scheme and has held detailed discussions with the Irish Banking Federation.

The external reviewers of the Scheme, First Choice financial services and AJS Financial also consulted with various interests in July and August 2013 as follows:

- Allied Irish Banks plc
- Bank of Ireland
- Capita Asset Services (Ireland) Limited (the Scheme operator)
- Capital for Enterprise Limited (the original scheme designer)
- Chambers Ireland
- Department for Business, Innovation and Skills (UK Ministry)
- Dublin Chamer of Commerce
- Chartered Accountants Ireland
- Construction Industry Federation
- Credit Review Office
- Enterprise Ireland
- Forfás
- Hardware Association
- Irish Banking Federation
- Irish Exporters Association
- ISME
- Small Firms Association
- Ulster Bank (Ireland) Limited

All of the views raised from the various parties were taken into consideration in the redesign of the Credit Guarantee Scheme.

5 Enforcement and Compliance

The enforcement and compliance aspects of a Credit Guarantee Scheme are critical to managing the exposure of the State. The Act of 2012 provides for

the Scheme design to make provision in relation to all matters pertaining to enforcement and compliance.

The Act of 2012 sets out the principles and policies in relation to the key aspects such as: the giving of guarantees, the making of schemes, the power to accredit lenders, and the power to appoint a contractor to undertake functions in relation to a Credit Guarantee Scheme. While the Scheme itself then sets out the details in relation to the various such as: conditions that must be satisfied in respect of a loan, accreditation of lenders, eligibility criteria for borrowers and the demand and recoveries process.

The Act of 2012provides for safeguards available to the State including the ability to notify a participating lender in writing that as and from a specified date no new loans with be guaranteed by the State, ending the agreement in place in respect of any new loans. The Minister also has the power to withdraw a guarantee given where a participating lender fails or refuses to comply with the terms of a credit guarantee scheme.

This will continue under the new legislation.

6 Review

The Act of 2012 provides for review of a credit guarantee scheme, and will continue to do so. For any Scheme of this type to be successful there is a need for the Department and lenders to have regular access to data on scheme-related performance and behaviours, and for a regular interpretation of that data and appropriate consideration of the implications of those findings. The operator, Capita, is responsible for this data-gathering, analysis and reporting process.

The operator, Capita, provides the Department with quarterly reports and analysis on the performance of the Scheme. Furthermore the operator has and will continue to keep the Minister informed of the impact of the legislation and both their experience and the experience of the lending institutions regarding operating this regulatory regime.

The Government’s commitment was initially for 3 years of lending of €150 million. As the Scheme has not performed to expectations an early external review was commissioned and this Regulatory Impact Analysis deals with the suggested regulatory changes proposed by the external reviewer.

In addition a process of periodic independent lender audits during which samples of lending decisions and default claims can be examined is provided for in the Scheme, which would provide deeper insights into additionality and lender behaviours.