Guarantee Funds of Credits in Romania - Necessity, Features and Networking - II

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Abstract: In the current context, marked by financial crisis, economic recession, lack of liquidity and low capitalization, the access to financing is more difficult, mainly due to the lack, insufficiency or limited availability of guarantees. Guarantee funds represent an innovative solution, proven by the European economies and recently launched in Romania. Taking over the international experience in order to facilitate the SMEs' access to financial resources has become a necessity in Romania, which was reflected by the creation of three specialized financial institutions in granting guarantees domain. These are bodies with private or public capital, which relate, based on agreements with commercial banks. After a period of exposure to major risks from the lack of regulatory activity, the guarantee funds, along with other non-banking financial institutions are absolutely governed by rules of the NRB, according to the banking law and special laws. The analysis in this paper is based on the study of several official documents, reports of specialized bodies, statistics and examples of good practice, summarized and interpreted in through comparison and developments. The aim is to identify a number of issues that may lead to sensitize the responsible factors - public authorities, credit institutions, and specialists - to come up with new practical solutions that would stimulate the financing process of small entrepreneurs.

Keywords: guarantee bodies; guarantee costs; benefits

1. Introduction

Guarantee funds are an active presence in European business environment, while in Romania they have a relatively small but growing activity, which indicates the development potential of this segment in the Romanian financial system.

The role of the financial - banking sector, leasing, factoring, credit guarantee funds, etc. - becomes increasingly important given the need for the development of SMEs through the easier access to bank credit.[3]

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[3] BNR role in Romania in providing non-financial and financial stability, Study Notes, No. 17/2006.

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Despite the positive trends in the recent years, the number and volume of credits from the banking system, SMEs, especially the micro and small enterprises, continue experience difficulties in accessing funds, which actually drifts, not from lack of funds, but because of insufficient size or quality of the presented collateral. Causes such as lack, insufficiency or limited availability of guarantees (assets that represent guarantee cannot be sold easily), the limited experience in business environment, the lack of information, poor managerial efficiency, weak business presentation in the context of the financing demand, limit the funding access of SMEs; it proves the need for enhancing the role of guarantee funds.

2. Responsibilities and Necessities in the Current Context

According to the Romanian National Bank, a credit guarantee fund represent the bank or non-bank financial institutions, whose role is to take the credit risk of a credit entity by guaranteeing a portion of debtor's debt service in the case of incapacity for payment. (Neagu, Mărgărit, & Dimitriu, 2005)

Under the law,[1] the non-bank financial institutions may perform credit activities, including the issuance of guarantees, assuming guarantee commitments, assuming commitments of funding and other forms of financing according to the nature of the credit.

After a period of exposure to major risks from the lack of regulation, the National Bank of Romania (NBR) acting as the guarantee funds activity, along with other non-bank financial institutions (leasing companies, mortgage companies, pawn shops, credit unions, companies of consumer credit, etc.) to be absolutely regulated - both in terms of adequate protection of the population and to ensure equal competitive conditions between these institutions and commercial banks, in the context of substantial expansion of funding provided by this type of non-banking, non-governmental financial institutions.[2] Currently, the regulation and supervision is based on banking law and on special laws and the IFNs are monitored by the NBR, even if the guarantee funds do not attract deposits, but use their own resources for their conducted activity. (Neagu, Mărgărit, & Dimitriu, 2005)

Frequently, especially in adverse conditions at national and international level, the SMEs have difficulties in submitting guarantees at the levels required by the banks (usually located between 150% and 200% of the requested credit), an aspect generated by also the fact that, given that most of the SMEs activate in areas such as trade and other services (over 80%), they have relatively small number of fixed assets, being unable to provide the required guarantees. If a particular enterprise is

[1] Law no. 93 of 8 April 2009 published in Official Monitor, Part I, 21 April 2009, article 14.
[2] NBR, Annual Report, 2005.

at a point in the impossibility of paying the debt to a bank it can resort to such a fund subsequently returning the amount plus a fee.

There are two types of guarantee funds after which it the activity is carried out. The first situation requires that the bank to turns to credit guarantee funds for which it does not have enough guarantees from the company requesting the credit. In the second instance, the demand comes from the investor even before contacting the credit institution.

The Monetary Authority of Romania said that the establishment of credit guarantee funds available to SMEs (National Guarantee Fund for Small and Medium Credits, Credit Guarantee Fund and Romanian Rural Credit Guarantee Fund) is a first step in solving this situation.[1] But there are necessary further measures for this system to become fully functional.

The study achieved by the National Agency for Small and Medium Enterprises regarding the needs of SMEs, has showed that about 40% of companies have said that a real need would be to develop a system of guarantees. (Veselin, 2005)

Especially this need has increased during the crisis, an expert study on the evolution of entrepreneurial SMEs, whose work is well known (suppliers, customers, company of friends, etc.) during October 2008 - March 2011, shows that 39.22% between the companies has reduced their business, 24.02% of companies have gone bankrupt or are in circumstances bankrupt, 27.25% of companies operating at the same parameters, and the 9.51% of economic agents have boosted their economic activity.[2] The biggest problems we have been working in construction companies (59.72%), trade (47.13%), transportation (39.37%) and services (41.34%).

3. The Implementation and Developments

In Romania, taking the international experience to facilitate the SME access to financial resources becoming a necessity, which was reflected by the creation of three specialized financial institutions in granting guarantees:

1. The Romanian Loan Guarantee Fund (FRGC);
2. Rural Credit Guarantee Fund (RCGF);
3. The National Credit Guarantee Fund for Small and Medium Enterprises (FNGCIMM).

[1] NBR, Creating the necessary framework for the Market development of some banking products/services (BNR study) 2003-2004, http://www.bnro.ro/studii-4010.aspx.
[2] National Council of Private Small and Medium Enterprises in Romania, http://www.immromania.ro/impactul-crizei-economice-asupra-activitatii-imm-urilor-3575.htm.

These funds are organized as joint stock companies, which gave them great flexibility in decision making. After the shareholder structures, there are private bodies - RCGF and FRGC (main founders of these organizations are credit institutions and financial companies) or public, such as FNGCIMM's case. It is the sole shareholder FNGCIMM of the Romanian state, represented by the National Agency for Small and Medium.

1. *The Romanian Loan Guarantee Fund* (FRGC) is the first guarantee fund created in Romania, its foundation taking place in 1993, to the World Bank's recommendation, established as joint stock company with 100% Romanian private capital (53.6% participation SIF Muntenia, 23% of SIF Transylvania, 9.5% BCR, 6.23% BRD-GSG, 7.67% other private shareholders)[1], with the mission to facilitate the business financing projects viable to be developed by private entrepreneurs in Romania; the main activity object consists of granting guarantees under the form of letters of bond for credits destined to Romanians private entrepreneurs. The main *guarantee tools* are over 70% of the credit values on medium and long term, including the credit lines), of letters of banking guarantee and leasing operations, and credit destined to purchasing shares; guarantees to the value of 100% mortgage credit.

2. *Rural Credit Guarantee Fund (RCGF),*[2] privately owned company founded in 1994 as an initiative of the Romanian Government, commercial banks and the EU, in order to facilitate the private sector financing of agriculture and food industry. The guaranteed amount of RCGF - IFN SA, in lei or foreign currency, is maximum: 80% of the value of short-term production of credit/bank guarantee agreements; 80% of the values of credits / letters of comfort provided / issued by credit institutions in order to ensure the co-financing investment of projects realized under the National Rural Development Program, that is EAFRD and EAGF respectively. In the case of the public beneficiaries of the EAFRD, the value of guarantee can be up to 100% of the credits' value, and its value may be equal to the amount eligible and ineligible of the project. The private beneficiaries, the maximum amount that can be guaranteed by the RCGF-IFN for each guarantee individual request for coverage shall not exceed the equivalent of 2.5 million Euro.

3. *National Credit Guarantee Fund for Small and Medium Enterprises* (FNGCIMM)[3] was established in 2001, by the Romanian Government through the National Agency for Small and Medium Enterprises and Cooperatives (National Agency), in order to contribute to financing the establishment and development of SMEs by providing financial guarantees, in addition to their material guarantee, necessary to obtain a credit or other financial instruments from commercial banks

[1] http://www.frgc.ro/

[2] http://fgcr.ro/index.php?page=Servicii&lng=ro

[3] http://www.fngcimm.ro/; NBR, Creating the necessary framework for the market development of products / services bank (NBR study), 2003-2004, http://www.bnro.ro/studii-4010.aspx.

and by providing direct financing. As a joint stock company, whose sole shareholder is the Romanian state, FNGCIMM SA - IFN is a tool of the Romanian Government to implement its policies to support the development of this sector which is a priority of economic and social policy of the Romanian Government. FNGCIMM guarantees up to 80% of the credits' value, up to a limit value set differently on this type of guarantee.

The main activity of all guarantee funds in Romania is to grant guarantees domestic to internal entrepreneurs. Except RCGF, which has sole object of activity, the other funds develop related activities as well such as specialized consulting, management of programs which have a connection to SMEs or making any type of activities compatible with the purpose for which they were established. They are allowed to guarantee the new established SMEs.

The main guarantees regard: the medium and long term financings, such as credits for investment in the addition to their own sources (FNGCIMM, RCGF, FRGC); short-term financing for ensuring the working capital (FNGCIMM, RCGF FRGC); letter of banking guarantee (FNGCIMM, RCGF, FRGC); guarantees for co-funded projects associated to the financing programs of European funds and structural instruments (FNGCIMM, RCGF FRGC); bail for credits; letters of guarantee, leasing operations RCGF; credits for purchasing shares (FRGC); consultancy for business plan development; elaborating the credit file; identifying alternative sources of funding; participation in technical assistance projects (FRGC).

The offered products diversify continuously and harmonize with the market needs and government policy in SMEs domain.

Generally, obtaining a guarantee requires the completion of several steps that are clearly defined, namely[1]: the applicant of the credit submits the credit documentation to the financing bank; credit institution, after its analysis process, it considers the project viable, it finds that there is no sufficient material for material guarantees for granting the credit and it asks the Fund to participate in the risk sharing for issuing financial guarantees; the guarantee fund transmits to the Bank, in the shortest time (up to 7 days of receipt from the bank of the complete file) the decision to grant the requested financial guarantees; based on the guarantee fund, the Bank signs the credit agreement with the SME.

The eligible customers must meet the requirements established by the current legal regulations and a series of conditions relating to the repayment ability, credibility and reliability in business, the debt service and others. The credit documentation approved by commercial banks, the guarantee funds carry out their own assessment of the economic agent and decide on the issuing of the guarantee, a decision which it will communicate to the bank.

[1] http://www.fngcimm.ro/

We find that the guarantee funds relate, based on agreements with commercial banks, comparably to the European practice. It has put into practice a more tight system of cooperation with customers and banks, in order to identify at an early stage the possible causes of financial difficulties, so that they could analyze and find the most appropriate solutions.

In terms of SMEs, going for such guarantees involve the increase of the financing costs, under the conditions where the charges for private beneficiaries vary between 1% and 3.8% annually, plus, in some cases, monthly commissions or guarantee bonuses, all depending on the term of repayment of the credit, guaranteed loan type, loan currency, type of guarantee required by the bank, the risk class in which the client fits.

The costs of bank guarantees include usually a flat fee paid periodically by the financial institution issuing on the guarantee period and also additional guarantee fees paid by a Guarantee Fund for a guarantee letter.

On the other hand, there are a series of advantages on the use of the guarantee products offered by credit guarantee funds for all involved stakeholders (Table 1).

Table 1. Advantages on the use of the guarantee products

For SMEs	**For Credit Institution (financer)**	**For Public Administrations**
- Improving access to finance, better access to credit by eliminating the main cause of rejection of credit application (lack of guarantees); - Reduce the uncertainty of granting credit / letter of guarantee; - Reduction of additional costs by reducing / eliminating property guarantees; - Long term to a relatively low rate of commission - Optimization, greater flexibility of funding required to banks without providing additional guarantees; - Time saving compared to mortgage guarantees. - Access to consultancy and	Decrease of risk exposure Sharing the assumed credit risk by taking up to 80% of credit risk by the guarantee fund, through the irrevocable and unconditional guarantee, which is the most liquid guarantee. The guarantee is paid within 90 days of the commencement of the legal proceedings, compared to minimum of 2 years, the duration of a mortgage execution. Coverage with a liquid guarantee Qualified Guarantee The reduction of the amounts for covering the risk Increase the customers Reduction of costs on the analysis Lower costs of monitoring	Promoting SMEs and favoring economic growth throughout the company Increasing investment Creating new working places on specific jobs, reducing unemployment Increasing the collection of taxes degree, increasing revenues Improving the efficiency and transparency

information - Integration into entrepreneurial networks	The increase of credit volume to creditworthy customers but with their own insufficient guarantees Increase of credit volume already granted an to an insolvent client, without being requested additional material guarantees	

From 2010, the Romanian Counter-guarantee Fund[1] (FRC) started its activity, created as a specialized financial institution, joint stock company, having as shareholders the Romanian State through the Ministry of Economy, Trade and Business - 68% , the Foundation Post- Privatization - 32%. The aim is to counter-guarantee all guarantees provided by guarantee funds - Romanian legal entities - for credits and other financial instruments obtained by the small and medium enterprises from the commercial banks and other sources.

FRC acted so as to bring an effective contribution to the improvement of access to financing of SMEs, by assuming a portion of the risk incurred by the guarantee funds and thus supporting the operation of the banking market in particular and of the economy in general. FRC covers up to 80% of the value of guarantees given for loans, letters of banking guarantee and other instruments for investment, working capital, project co-financing projects from structural funds, funding research and development projects of young entrepreneurs and environmental projects.

From the beginning until now, guarantee funds in Romania developed shyly and due to the legislative gap on the quality recognition as guarantor with qualities of diminishing the credit risk. Until 2006 the commercial banks represented the specific risk provisions for guarantees issued by the Guarantee Fund at the level of 100%, NBR regulations recognizing this type of guarantee. Only large banks have allowed such guarantees for some economic agents, of modest amounts, under agreements concluded with the guarantee funds. The recognition of such security by the NBR, entering on the pre-accession funds and the increase of banking competition have paved the premises of the banking products guarantee growth and diversification.

In this context, the developments on the role of guarantee funds are still becoming more and more visible due to the current difficulties that the world-wide economy is facing.

[1] www.frcg.ro/.

Table 2. Aspects on the development of main credit guarantee funds in Romania[1]

	National Guarantee Credit Fund for SMEs (FNGCIMM)			Rural Guarantee of Credit Fund (FGCR)		Romanian Guarantee Credit Fund (FRGC)	
	2005	2010	2011	2005	2010[2]	2005	2010
Own Funds (Bill. lei)	119,9	681,3	931.3	14,8	16,5	13,3	21,5
Granted guarantee (Bill. lei)	128,5	2,000		55.25	-	21,3	26
Leverage[3] (Granted guarantee/own funds)	1.07	2.94		3.73		1.60	1.21

Thus it can be observed a significant improvement in capitalization and a major increase in the volume of activity, primarily at the guarantee fund level, that provides the most direct SME sector. However, overall results are modest, and the effects are relatively little identified at the level of the SME sector developments.

The leverage ratio is an important prudential indicator which is subject to European regulations for credit institutions and investment funds, aimed at limiting excessive accumulation of financial debt.[4] Commission proposes the leverage ratio to be controlled by the supervisory authority. The implications of this ratio will be closely monitored before its inevitable transformation into a requirement on January 1, 2018. In addition, the third Basel Agreement, published in December 2010, introduces a minimum of 3% leverage effect, which would be monitored on the sector of guarantee funds.

[1] Florin Georgescu, Noul regim aplicabil fondurilor de garantare a creditelor și garanțiilor emise de acestea, Studiu BNR, iulie 2006/ The new regime for credit guarantee funds and guarantees issued by them, NBR Survey, July 2006, http://www.sifmuntenia.ro/pdf/670.pdf, raport anual 2010/ Annual Report 2010, Strategia Fondului Român de Contragarantare, 2011-2013, Proiecții strategice 2015/ Romanian Counter-guarantee Strategy Fund, 2011-2013, 2015 Strategic Projections, http://www.frgc.ro/; http://www.fngcimm.ro/index.php?page=rezultate-financiare, http://www.aecm.be/servlet/Repository/description-fgcr.pdf?IDR=85.

[2] The data have not yet been published.

[3] Leverage is a technique of financial management that aims at increasing the returns of its own capital. The multiplier effect of leverage on the returns of its own capitals is known in the specialized literature as the "leverage effect".

[4] COM(2011) 452 final – 2011/0202 (COD); 2012/C 68/07.

4. Conclusions and Challenges

Compensating the lack of guarantees towards the banks, promoting the business initiative especially for newcomers companies, the access to long-term funding and better credit conditions for economic agents, the internationalization, the micro-guarantees are few of the challenges from the national economy which will insure the increase of financial activities in this sector.

Guarantees innovation, diversification of guarantee instruments and harmonization with the European practices in this area are ongoing requirements that represent the targets for specialized institutions in Romania.

It is shown that the safest assets may, in time, be the riskiest guarantees: a collateral deposit may be compromised by its source; an asset accepted into a guarantee is exposed to the tendencies that influence the demand and the supply, a mix or a guarantee package developing exponential risks. No firms of takeover the risks eliminate entirely the banking risks, however, due to the effects of systemic crises there is a regulatory interest in the global decision-makers forces.

But there are necessary measures that regard the increase of the attractiveness for banks of offered guarantees, which is the extension of guarantees and on the interest, the existence of explicit guarantee on behalf of the state, which would have the effect of reducing bank exposure of those credits.

Increases on the value of granted guarantees and the number of benefiting SMEs can be achieved by extending practices according to the model of European Guarantee Fund. The analysis for issuing guarantees would be achieved by the Guarantee Fund, the SME having the freedom of choosing subsequently the lending bank.

It is also required that the public authorities would be more involved, through regulation and facilitating the SMEs access to funds. (Nuta, 2008, p. 65-68)

The strategic guidance in the years marked by the global financial crisis aimed at encouraging the development of SME sector by enhancing the role of guarantee funds under the conditions of continuous increase in demand for security, but taking a prudent policy in risk prevention and management.[1] Among the solutions proposed by the guarantee funds, in the face of global crisis, there are:

- at the level of FNGCIMM, most social capital through new capital contributions, financial fund raising either for capitalizing the Fund, or for co-guarantee some guarantee programs; as prudent management of liquidity and the guarantee activity framing in prudential indicators; diversification of distribution channels, flexibility of credit, etc.

[1] http://www.aecm.be/servlet/Repository/fighting-the-financial-crisis.pdf?IDR=109

- as for FRGC, close monitoring of clients in intervals as short as possible, preferably monthly; the acceptance of credit restructuring; adjustment of guarantee supply in order to ensure the simplification and harmonization of all the tools; reducing the costs of products and services, depending on the type of guarantee and associated risks; renegotiation of credit conditions, etc.
- for RCGF, restructuring and rescheduling of credits; simplifying procedures for granting certain types of guarantees; securing guarantee coverage limits for periods longer than three years; new products of the type of total assurance systems for deposit certificates; the extension of guarantee period.

Romanian Government strategy for SME development[1] retains a series of aspects to improve SME access to finance through: strengthening the guarantee funds for SMEs, mainly by creating a decentralized system of regional support and guarantee funds; increasing the capital social guarantee funds to a level that would allow a better reproduction of capital in conditions of controlled risk; boost the access to European co-guarantee or counter-guarantee; the diversification of financial instruments to support the SME sector development.

On the other hand, the structural funds and the post-accession funding programs create the premises of financial intermediation development, of the innovative instruments and supporting business environment, especially SMEs. Romania has to take manifest more actively at global level, in relation to organizations and projects that promote solutions to support financing small entrepreneurs, to thus take over the research and experience in the field, so that the measures that it promotes would be effective, expressed in a current and organized space at European level.

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[1] Ministry of Economy, Trade and Business, Government Strategy for the development of SMEs sector for the period 2009-2013, http://www.minind.ro/imm/StrIMM_Doc_23022011.pdf.

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