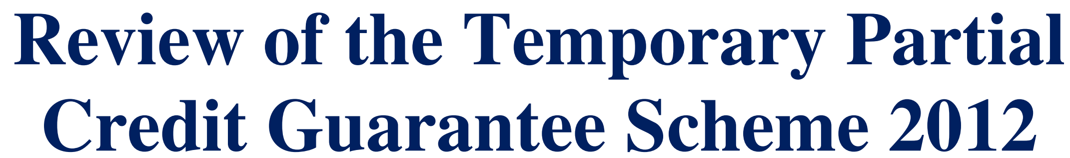

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Recommendations submitted to the Steering Committee appointed by the Department of Jobs, Enterprise & Innovation

By

First Choice Financial Services Ltd
&
AJS Financial Advice Ltd

September 2013

FIRSTCHOICE Financial Services

AJS FINANCIAL

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Glossary:

The following terms, abbreviations and acronyms are used in this document, in which context they have the following meaning:

Accreditation	The process of through which a bank, other financial institution or trade supplier applies and is assessed as suitable to participate as a Lender in the Scheme.
Additionality	New funding advanced as opposed to the restructure of existing lending.
Banks	The banks currently participating in the Scheme, i.e. Allied Irish Banks, (AIB), Bank of Ireland, (BOI), & Ulster Bank Ireland Ltd (UB).
BIS	The UK Department for Business, Innovation & Skills.
Borrower	An SME in the process of applying for or in receipt of a Facility from a participating Lender under the terms of the Scheme.
CfEL	Capital for Enterprise Limited, the SME finance programme development and delivery body owned by BIS.
Credit Review Office	The Credit Review Office established by the Minister for Finance to consider the cases of small and medium-sized enterprises (SMEs), sole traders and farm enterprises that have been refused credit from banks covered under the NAMA Act, and to examine credit policy to assist the Minister for Finance in deciding what further actions may be necessary to increase the flow of credit.
EFG	The Enterprise Finance Guarantee, the current SME loan guarantee Scheme operated by BIS.
EXEFG	The Export Enterprise Finance Guarantee, the Scheme launched in the UK in April 2011 specifically targeted at exporting SMEs looking for short-term trade finance.
Facility	A loan or other form of debt finance instrument provided by a Lender to a Borrower under the terms of the Scheme.
Guarantee	The basis of the Scheme – the entitlement of a Lender to make a claim against the Scheme in the event that a borrower defaults on their obligations to the Lender in respect of a facility provided under the Scheme.
Guarantee Rate	The proportion of the outstanding capital balance of the Lender's loss arising from a Scheme Facility which the Scheme is required to cover. Under the European Commission's De Minimis rules this figure may not exceed 80%.
Guarantor	The Irish State, represented by the Minister for Jobs, Enterprise & Innovation.

Lender A lending institution participating in the Scheme.

Pillar One Classification of trading businesses under the Scheme for which the inadequacy of their collateral is a barrier to their ability to access sufficient debt finance to pursue their objectives in respect of efficient on-going trading and further growth.

Pillar Two Classification of businesses under the Scheme for which, in addition to almost certainly being collateral constrained, bank understanding of the novel aspects of the business environment in which they operate is limited and/or aspects of that environment may restrict the bank's ability to offer certain lending products.

Portfolio A group of Scheme facilities provided within a defined (generally annual) period.

Portfolio Claim Limit The maximum proportion by value of a guaranteed portfolio of lending which can be paid out under the Scheme guarantee.
Portfolio Claim Limit = Guarantee Rate x Portfolio Default Limit.

Portfolio Default Limit The maximum default rate of the portfolio covered by the Scheme guarantee, measured in terms of the outstanding capital balance of defaulting facilities as a percentage of the total drawn value of the portfolio. The actual default rate of the portfolio may be higher than the Portfolio Default Limit. Under the European Commission's De Minimis guidelines the Portfolio Default Limit is capped at 13%.

Premium A payment made by the borrower to the Scheme as a condition of the Lender providing a facility to the borrower under the terms of the Scheme. The premium is, and should be explained as, a form of arrangement fee and NOT equivalent to or conveying the benefits of an insurance premium.

Risk Share Ratio The ratio according to which the overall losses arising from the performance of the portfolio are shared between Scheme and Lender.

Scheme The Temporary Partial Credit Guarantee Scheme which is the subject of this Specification.

Executive Summary:

Introduction:

First Choice Financial Services Limited and AJS Financial Advice Limited (the reviewers) were appointed by the Department of Jobs, Enterprise and Innovation (DJEI) to review the Temporary Partial Credit Guarantee Scheme ("the Scheme") which was launched on 24th October 2012. The review has focused on giving the Scheme the best possible chance of success and the reviewers are confident that an appropriately modified Scheme should be capable of delivering a much improved performance (capped at€150m of new lending per annum) and creating up to 1,000 new jobs per annum.

Scheme performance to date:

The Scheme performance to date has been significantly lower than initially projected with only €5.9m approved and less than €2m drawn under the Scheme against a Year 1 estimate of €150m. Only three banks opted to participate in the Scheme and details of the performance of the participating banks to date are as follows:

Credit Guarantee Scheme (CGS) - Loans Drawn down as at 30th June 2013:

As at 30th June 2013			All participating Institutions
No of Live CGS Facilities.			47
Amount of CGS Lending sanctioned.			€5,936,100
No. of Loans drawn down.			29
Amount of CGS Lending which has been drawn down.			€1,993,100

Not all of the sanctioned loans are progressing to drawdown for various reasons and accordingly the true performance measure should be draw downs and not approvals.

The key purpose of the Scheme is to support employment growth in the SME sector and a target of 1,000 new jobs per annum over the three years of the Scheme was set. As of September 2013, the actual impact on jobs reported is disproportionally high with potentially 273 jobs created and 115 jobs maintained under the €5.9m approvals. Although the numbers are lower than the target, the one encouraging aspect of the performance is that the potential job creation resulting from the Scheme appears to be stronger than expected when the Scheme was first launched.

It should be noted that this performance is against a period where the demand for credit has been low driven partly by weak domestic and international growth. The Red C demand survey for the period October 2012 – March 2013 confirms this low demand but encouragingly pointing to an upward trend from the SME sector. It is vitally important that lack of credit for viable SMEs is not a limiting factor in supporting the upward trend and the Scheme has a part to play in this.

While there is clearly a need for a Scheme to support SME credit at present, this will be even more evident when there is a return to growth resulting in an increased demand for credit. Our review has focussed on removing as many of the barriers (whether real or imaginary) as possible to ensure greater engagement from the stakeholders.

As part of our review we met with key stakeholders and the UK Department for Business Innovation and Skills (BIS) and have reviewed the Scheme design in detail. Our key findings & recommendations following detailed discussions and a review of relevant supporting documentation are as follows:

Summary of Findings & Recommendations:

No.	Key Findings:	Recommendations:
1	The Scheme is seen as being overly complicated and consideration should be given to undertaking a fundamental redesign of the Scheme based on inclusion while remaining within EU restrictions.	Amend the primary legislation to permit the reallocation of overall funding (risk) in response to market and/or stakeholder demands. Expand the covered Scheme products as per point 2 below.
2	The range of financial products to which the Scheme applies is seen as too restrictive.	Extend the Scheme to cover a fuller range of financial products.
3	The Portfolio structure and Cap is a major issue for the banks as is the level of guarantee provided under the Scheme.	Remove the annual portfolio cap and assess the portfolio as a total, rather than an annual portfolio.
4	The 3 year term is seen as too short as most loans are a minimum of 5-7 years.	Extend the term to 7 years.
5	The current level of Scheme Guarantee at 7.5% (75% of 10%) is seen as too low and does not provide an equitable level of risk sharing. The risk / share ratio is imbalanced.	Amend the guarantee to **10.4%** (80% of 13%) to facilitate a more equitable risk share while remaining compliance with De Minimus rules.
6	2% premium is seen as expensive particularly as the use of the Scheme does not command any margin reduction.	On the basis of the Scheme enhancements proposed the banks to be requested to pay 1% of the 2% premium on guaranteed lending to reduce the cost for the borrower.
7	The requirement to issue a formal decline letter, as a prerequisite for being considered for inclusion under the Scheme, is viewed very negatively by borrowers and stakeholders.	Remove the requirement to issue a formal decline letter.
8	There is no dedicated owner/manager of the Scheme.	Appoint a dedicated owner/manager of the Scheme, with responsibility for the general management of the Scheme including driving performance against Scheme objectives.
9	Awareness of the Scheme amongst SMEs and Advisers is exceptionally low.	Re-launch the Scheme to include low cost marketing campaign and stakeholder support / involvement.
10	The ownership of the Scheme within the participating banks differs.	Request that the Scheme is 'managed' by the banks credit function.
11	Low number of participating banks detracts from the potential effectiveness of the Scheme.	As part of the re-launch invite all banks and credit providers operating within the State to participate in the Scheme.

No.	Key Findings:	Recommendations:
12	Exclusion of refinancing, particularly for SMEs trying to 'exit' foreign owned banks that have ceased to support SME activity is an issue.	Allow selective refinancing under the Scheme.
13	The inclusion of 'Temporary Partial' in the Scheme name is seen as a negative.	Rebrand the Scheme the SME Credit Guarantee Scheme (SMECGS).
14	Cost administration of the Scheme is high relative to the level of underlying Scheme activity.	Review the cost of administrating the Scheme with a view to reducing the annual running cost. Future costs to be better aligned with activity.

Other findings & recommendations:

No.	Other Findings:	Other Recommendations:
15	The Scheme is not appropriate for low level credit needs and should be adapted to facilitate the flow of some credit particularly to the construction sector.	A €1m pilot scheme focussed on 'business to business' trade credit is recommended.
16	Scheme provides limited support to SMEs in the export sector.	A self-financing SME Export Guarantee Scheme is recommended to support exporting SMEs.

As part of the review we engaged with a total of 18 stakeholders and other parties details of which are summarised below and listed in ***Appendix 1*** to this report:

Allied Irish Banks plc.	Bank of Ireland.	Capita Asset Services (Ireland) Ltd.
Capital for Enterprise Ltd.	Chambers Ireland.	Department for BIS (UK).
Dublin Chamber of Commerce.	Chartered Accountants Ireland.	Construction Industry Federation (CIF).
Credit Review Office.	Enterprise Ireland.	Forfás.
Hardware Association Ireland.	Irish Banking Federation.	Irish Exporters Association.
ISME.	Small Firms Association.	Ulster Bank Ireland Ltd.

Cost analysis:

If the Scheme was to support lending of €150m per annum for the life of the Scheme, with the amendments proposed, the estimate net cost to the Exchequer is approximately €18.376 million, as detailed in the cost analysis attached at Appendix 5.

Some of the benefits forecasted to arise from this intervention in each year of operation include:

- Over 1,000 jobs created per annum.
- Over €25m of exchequer benefits in tax revenues and welfare cost savings.

The Scheme redesign will operate under the De Minimis State rules, rather than a nominated Scheme. This limits the range of options available in terms of the extent and pricing of the support which can be provided and conflicts with our overall recommendation of 'inclusivity' as it places some limitations

on the business sectors and loan purposes which the Scheme can support, the most significant restrictions applying to export-related transactions. Overall however, there is insufficient evidence to suggest that the benefits of a notified Scheme would significantly outweigh an improved and re-modelled Scheme. Costs and risks are at the forefront of this conclusion.

Recognising the importance of export to the Irish economy, we are seeking greater inclusion through an expansion of products covered by the Scheme. Although technically outside of the scope of our tender/ review, we are also recommending a self-financing SME Export Guarantee Scheme which was already examined by Capital for Enterprise Ltd in their submission to the DJEI in November 2011.

1. Assessment of Current Risk Sharing Arrangements:

There appears to be a fundamental misunderstanding of the Scheme amongst some of the stakeholders and the informed members of the general public with the principal misconception being that the State is guaranteeing 75% of individual loans. As the Scheme is currently structured, this guarantee is actually 7.5% of the annual portfolio as illustrated in the table below:

	Year 1	Year 2	Year 3	Year 4
Portfolio Value	€1,000,000	€3,000,000	€5,000,000	€10,000,000
No. of Loans	10	30	50	100
Portfolio Claim Limit	€100,000	€300,000	€500,000	€1,000,000
Portfolio Default Limit	10%	10%	10%	10%
Guarantee Rate	75%	75%	75%	75%
Bank Value Cover	€75,000	€225,000	€375,000	€750,000

Based on the above scenario the bank will have three separate portfolios of €3m, €5m & €10m. Year 1 portfolio will no longer apply as the Scheme is restricted to the 3 (most recent) years. If the bank has no losses in Years 2 & 3 but has credit losses of in excess of €1m in Year 4 the maximum they can claim under the Scheme is €750,000 or 3.95% of their aggregate portfolios of €19m for the four years. Particularly in the early years, when volume is low, this level of guarantee is seen as insignificant and with minimal, if any, value being placed on it by the banks.

If in the above year 4 scenario the €10m is comprised of 99 loans of €100,000 and 1 loan of €1m the cover level is 75% for any of the loans subject to a maximum of 10% of the portfolio. If one of the €100,000 loans goes bad the bank can claim €75,000 and likewise it can claim €75,000 for a further 9 of the €100,000 loans. However, if the one loan for €1m goes bad this utilises the entire portfolio limit **leaving the remaining 99 loans without cover**.

The view of the banks is that the risk share ratio based on the current Scheme parameters leaves them carrying a disproportionate level of risk for loans they have formally declined and which they are making available solely due the borrower availing of the Scheme. The following analysis demonstrates the risk sharing between the Scheme and the banks and this is based on the following assumptions:

- Average rate of loan loss of 19%.
- Scheme income of 5% for the duration of the Scheme guarantee.
- Net cost of the Scheme being the payout under the guarantee less the income from the Scheme. Administration of the Scheme has not been factored in.
- Borrower's cost share is the value of the premium paid on the guarantee.

	(€m)
Value of Scheme lending.	100
Credit Loss on these loans.	19
Maximum Scheme Liability.	7.5
Scheme Income*.	5
Net Costs to the Scheme.	2.5
Net cost to the bank.	11.5
Lenders Cost Share.	60.5%
Scheme Cost Share.	13.2%
Borrowers' Cost Share.	26.3%

**cumulative income over 3 years amortised at 2% per annum*

Based on the above scenario the banks are carrying a disproportionate (60.5%) share of the risk for loans that they have already, rightly or wrongly, declined based on their current lending policies. It is our view that some greater equalisation of the risk is required to get the banks to fully commit to supporting the Scheme.

The banks in their feedback have cited the lack of borrower demand as a key factor in the performance of the Scheme to date and it is accepted that demand for viable SME credit is currently weak. However, other factors impacting credit demand include the belief amongst many SMEs that banks are not lending and that the absence of collateral is a barrier to gaining approval for an otherwise viable lending proposal. The existence of a Scheme guarantee that carried the support of all stakeholders would in our view assist in stimulating the demand for SME credit and job creation. This is evidenced by our interaction with, and the public commentary of, the key stakeholders and the fact that the UK model (UK Department BIS figures) has proven that access to SME credit has a direct correlation with job creation and retention.

A further important factor to bear in mind is that a properly functioning Scheme will be a vital support for SMEs as confidence returns to the economy. The balance sheets of many SMEs and the value of their collateral has been adversely impacted by the recession and this will inhibit them accessing credit for new viable projects into the future. Accordingly a properly functioning guarantee Scheme will provide valuable support for such borrowers as the economy recovers.

2. Review of Scheme Performance:

As at 30th June 2013 there were 47 live CGS facilities resulting in €5,906,100 being sanctioned through the Scheme by the participating lenders. We set out in the following pages a detailed analysis of approvals and draw downs under the Scheme from inception up to 30th June 2013. This information was provided by Capita Asset Services (Ireland) Limited who manage the Scheme on behalf of the DJEI.

Table 1: Activity Levels:

Dates	No. of Live CGS Facilities	Amount of CGS Lending	Average CGS Loan Amount
From October 2012 to 31st December 2012	6	€ 582,000	€ 97,428.57
From 1st January 2013 to 31st March 2013	18	€ 2,549,600	€ 141,644.44
From 1st April 2013 to 30th June 2013	23	€ 2,774,500	€ 120,630.43
Total as of 30th June 2013	47	€ 5,906,100	€ 130,483.33

Table 2: Activity by Region:

Region	No. of CGS Facilities Granted	CGS Lending Sanctioned
East - (Dublin, Kildare, Meath and Wicklow	18	€ 2,458,000
South West - (Cork and Kerry)	9	€ 1,130,000
South East - (Waterford, Wexford, Carlow, Kilkenny and South Tipperary)	4	€ 950,000
West - (Galway and Mayo)	6	€ 536,100
Midlands - (Laois, Longford, Offaly, Roscommon and Westmeath)	4	€ 482,000
Mid West - (Limerick, Clare and North Tipperary)	4	€ 220,000
North West - (Donegal, Sligo and Leitrim)	1	€ 100,000
North East - (Cavan, Louth & Monaghan)	1	€ 30,000
Total	47	€ 5,906,100

Figure 1: Percentage of CGS Lending Sanctioned by Region (Monetary Value):

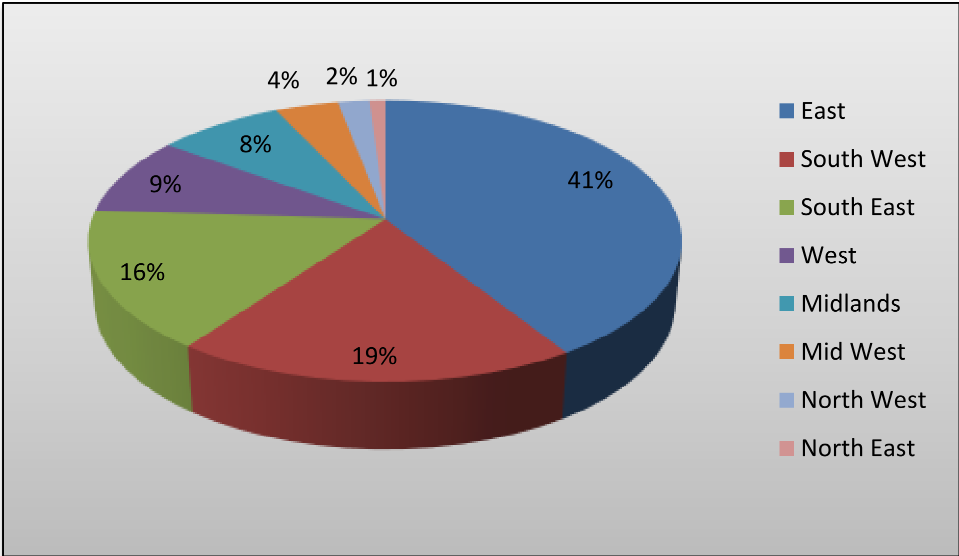

Table 3: Activity by Industry Sector:

Industry Sector	No. of CGS Loans	CGS Lending Sanctioned	
Information & Communications	9	€	1,173,000
Hotels and Restaurants	7	€	1,124,600
Manufacturing	7	€	1,075,000
Wholesale/Retail Trade & Repairs	14	€	777,000
Other Community, Social and Personal Services	3	€	471,500
Financial Intermediation (Excl. Monetary Financial Institutions	1	€	450,000
Contruction	2	€	275,000
Transportation and Storage	1	€	200,000
Business and Administrative Services	2	€	190,000
Human Health and Social Work	1	€	170,000
Total	47	€	5,906,100

Figure 2: Percentage of Lending Sanctioned by Sector (Monetary Value):

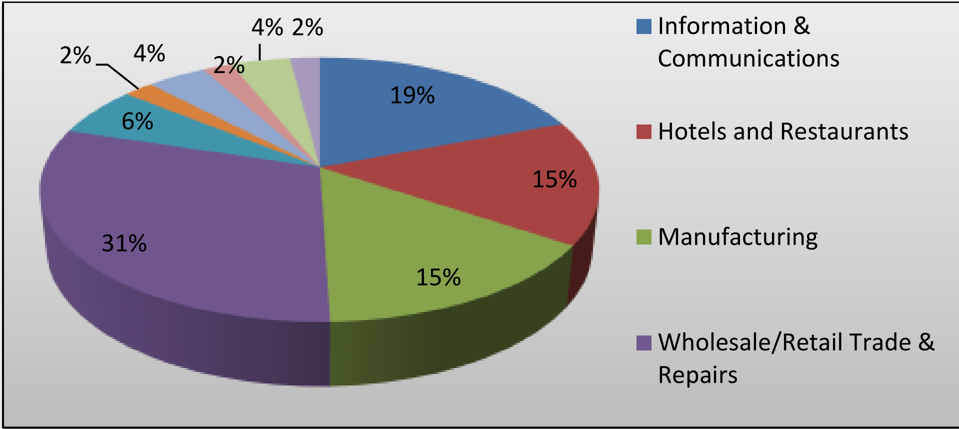

Figure 3: Percentage of Lending Sanctioned by Sector (No. of CGS Loans Sanctioned):

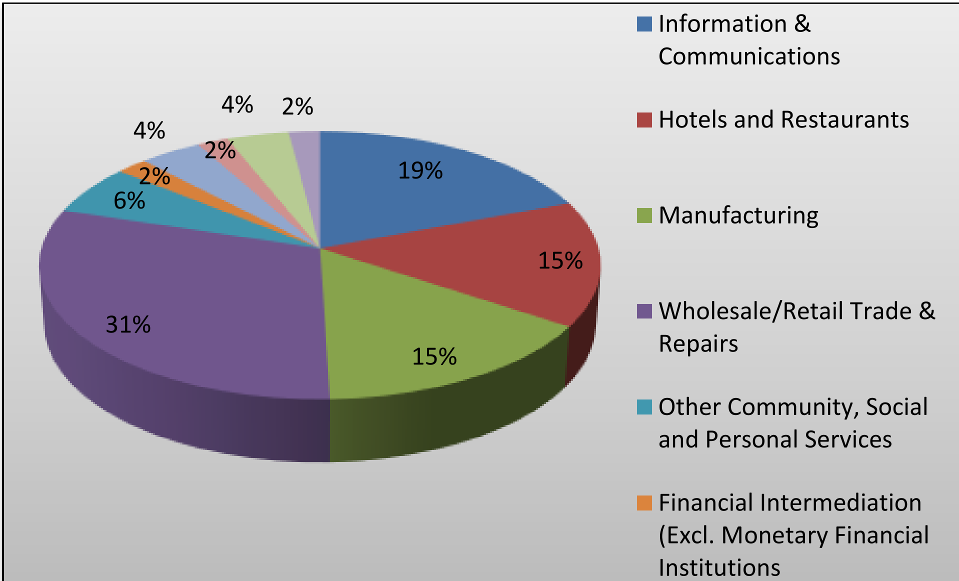

Table 4: Impact on Jobs:

Dates	No. of Job Increased	No. of Job Maintained
From October 2012 to 31st December 2012	33	5
From 1st January 2013 to 31st March 2013	148	20
From 1st April 2013 to 30th June 2013	92	90
Total as of 30th June 2013	273	115

Table 5: Market Inefficiencies:

Dates	Insufficient Collateral	Insufficient Collateral & High Risk Model/Sector/Product	High Risk Model/Sector/ Product
From October 2012 to 31st December 2012	5	0	1
From 1st January 2013 to 31st March 2013	13	2	3
From 1st April 2013 to 30th June 2013	16	4	3
Total as of 30th June 2013	34	6	7

Table 6: Year of SMEs Establishment:

Year of Establishment	Number of CGS Loans as at 30th June 2013
2013	2
2012	8
2011	4
2010	5
2000-2009	22
1987-1999	6
Total	**47**

Table 7: Term of Facility:

Term of Facility	Number of CGS Loans as at 30th June 2013
< 1 Year	6
1 Year	3
2 Year	0
3 Year	13
4 Year	3
5 Year	18
> 5 Years	4
Total	47

Table 8: Purpose off CGS Facility:

Purpose of Credit Guarantee Scheme	Facility Number of CGS Facilities
Working Capital	21
Product or Service Development	2
Renovation/Maintenance of Premises	8
To Fit out Premises	2
Purchase of Equipment	6
IT improvements	1
Cost of Acquisition	2
Develop of visitor centre and retail shop	1
Research and Development	1
Franchise Set up	1
Supplier Guarantee	2
Total	47

Table 9: Profile of SME:

Dates	Micro Enterprise	Small Enterprise	Medium Enterprise
From October 2012 to 31st December 2012	4	2	0
From 1st January 2013 to 31st March 2013	8	9	1
From 1st April 2013 to 30th June 2013	14	8	1
Total as of 30th June 2013	26	19	2
Total Lending Sanctioned as at 30th June 2013	€2,339,100	€3,347,000	€220,000

Table 10: Premium Payments Received:

Dates	Premium Payments Received
From October 2012 to 31st December 2012	€2,410.00
From 1st January 2013 to 31st March 2013	€8,852.00
From 1st April 2013 to 30th June 2013	€14,306.67
Total Premium Payments Received as at 30th June 2013	€25,568.67

2.1 Observations:

- The activity levels are too low to identify any real trends in the data reviewed.
- The regional nature of the lending would be in line with population and activity levels.
- The sectoral break-up is typically aligned with the participating lenders 'normal' lending activities i.e. they appear to be using the Scheme to advance lending into areas which they would be normally comfortable. This trend could have concerns on additionality if it were to continue at scale. This could be sense checked in detail at the end of the 'year 1' audit.
- There is minimal activity for the Scheme in medium sized enterprises with the activity focussed on small and micro enterprise – this could be a result of the banks views on the impact of one large

loan on a portfolio (due to the portfolio cap) but again would require more activity and re-examination at audit for evidence.

- Despite the low take-up, the actual impact on jobs estimated is disproportionally high with potentially 273 jobs created and 115 jobs maintained. We would suggest that a detailed analysis of these figures be undertaken as part of the annual audit to verify their veracity.

2.2 Participating Lenders Barriers & Observations:

The Scheme should be a tool for encouraging greater 'enterprise risk taking' by SMEs and the banks. At its core is job creation by providing credit to two "Pillars" of SMEs categorised as follows:

- **Pillar One** - Trading businesses for which the inadequacy of their collateral is a barrier to their ability to access sufficient debt finance to pursue their objectives in respect of efficient on-going trading and further growth.
- **Pillar Two** - Businesses for which, in addition to almost certainly being collateral constrained, bank understanding of the novel aspects of the business environment in which they operate is limited and/or aspects of that environment may restrict the bank's ability to offer certain lending products.

The core focus of the Scheme is to encourage banks to provide credit that they do not want to provide (declined credit) for reasons of risk criteria and/or for sectoral policy. All of the participating institutions (AIB, BOI and UB) have committed time and resources to the Scheme and have allocated competent senior personnel within the banks to manage the Scheme. The best practice evidenced was within BOI whereby the Scheme is managed within (or close to) the credit function thereby being controlled at source with credits introduced at decline stage by officials who are knowledgeable of the Scheme. The BOI has 15 underwriters in SME lending and 40 underwriters in Business Banking so the catchment of Scheme 'experts' is easily manageable which facilitates the ongoing up-skilling of key personnel in relation to the Scheme.

All of the participating institutions are seeking amendments to the Scheme as articulated at the face to face meetings conducted by the Reviewers and representations from the Irish Bankers Federation (IBF) on behalf of the banks. All of the banks maintain that these restrictions are causing the performance issues. In addition, both AIB and UB cite the portfolio default limit and the portfolio cap as being the single biggest issues relating to support of the Scheme internally.

2.3 Collective views of the participating lenders:

These are summarised under the following headings:

<u>The portfolio default ("PDL"):</u>

- All banks believe increasing the PDL will have a positive impact on volumes as it would increase the realisable value of the security for the loan – they believe that this is only likely to affect marginal cases being considered under Pillar 1.

Level of Guarantee:

- The current level of guarantee is seen as not being equitable from a risk share perspective.

Loan term:

- The ideal maximum guarantee for the Scheme would be 7 years in line with the average loan term for SMEs (5-7 years).

Cost

- The 2% premium is seen as a barrier for borrowers and this is further evidenced by loans approved under the Scheme, but not drawn for pricing reasons. The UK Dept. BIS indicated in May 2013 that their experience indicates that for every 1% increase in premia, demand drops by 25%.

Other factors:

- All participating lenders recommend and support the inclusion of overdrafts and refinancing (removing additionality requirements). Refinancing of existing credit would be particularly helpful in assisting viable SMEs seeking a new banking relationship where their existing bank is exiting the market.
- All participating lenders suggest the inclusion of leasing and invoice discounting.

Summary proposals from the participating lenders:

1. Amend the Portfolio Default Limit.
2. Increase the level of guarantee from the current level of 7.5%.
3. Increase maximum guarantee term to at least 7 years.
4. Include overdrafts, Invoice Discounting, Finance and Leasing, and Foreign Exchange related products as eligible guaranteed products.
5. Allow refinancing of existing credit without additionality requirements.
6. Reduce the guarantee premium.
7. Review the premium calculation methodology for clarity and flexibility for working capital finance.

3. Review the Scheme Design Parameters:

The Scheme was designed for the DJEI by Capital for Enterprise Ltd, (CfEL), the SME finance programme development and delivery body owned by the UK Department BIS, with input from key stakeholders. This was undertaken during a period of significant economic uncertainty and there was always an acceptance that a review of the Scheme would be required based on post launch experience and Scheme performance.

The Scheme is embedded into our primary legislation and the rules are governed by a statutory instrument. As a result it is not possible to make ad hoc amendments to the Scheme and a core of our recommendation is a redesign that will enable the Scheme to be adapted, with the approval of the Minister responsible for the DJEI, as required, in response to market conditions including the facility to operate pilot schemes. We accept that this will involve an amendment to the primary legislation and an expansion of the terms on the statutory instrument to facilitate this in the future.

4. Recommended Changes to the Scheme:

Based on extensive feedback from the key stakeholders, and from other informed parties including the managers of the UK EFG Scheme, we are recommending a total of 16 changes to the Scheme which the evidence indicates will deliver a significant take-up in the Scheme and will help ensure the support of the participating banks and other key influencers for the Scheme. We are also confident that the changes proposed will help encourage SMEs to avail of the Scheme.

The Recommended changes are as follows:

4.1 FINDING NO. 1 - The Scheme is seen as being overly complicated and consideration should be given to undertaking a fundamental redesign of the Scheme based on inclusion while remaining within EU restrictions.

One of the key weaknesses of the current Scheme is its lack of capacity to adapt and re-allocate risk to pilot programmes in response to market or stakeholder demands. The maximum annual lending available under the Scheme is capped at €150m. To accommodate this will require an amendment to the primary legislation and/or the statutory instrument that governs the Scheme. This is seen as an essential requirement to the future success of the Scheme.

Subject to the Scheme being amended we are proposing two initial Pilot Schemes, referred to later in this report, which will involve no additional risk to the State merely the reallocation of the funding limits already approved.

RECOMMENDATION: **Amend the primary legislation to permit the reallocation of overall funding (risk) in response to market and/or stakeholder demands.**

Expand the covered Scheme products as per point 2 below.

4.2 FINDING NO. 2 - The range of financial products to which the Scheme applies is seen as restrictive.

While loan finance can be adapted to facilitate many capital expenditure and working capital related funding requirements the Scheme would benefit for the inclusion of the following additional financial products:

Product	Reason	Factors to consider
Overdrafts.	- Traditional working capital product for SME. - Flexible.	- Potentially higher default rate. - Current 2% fee on full limit would be expensive.
Invoice Finance.	- Invoice finance is difficult to obtain on debtors outside of Ireland & the UK. - It would support sectors where Invoice Finance is not normally provided particularly the service and emerging sectors. - It would facilitate the provision of higher prepayment percentages. - It may attract specialised Invoice/ Debtor Finance providers to enter the Scheme. - It would facilitate the potential inclusion of some software type businesses who currently are excluded from debtor finance due to issues on contingent liabilities on their products which exclude them currently from discounting.	- Primary legislation will need to be amended to cover this type of debt instrument which is deemed to be asset purchase as opposed to credit. - Scheme audit will need to ensure that the Scheme is only used where appropriate.
Asset Finance.	- Demand for Asset Finance is reasonably buoyant and is expected to grow. - A significant number of providers have withdrawn from the market in Ireland. - Investment/Reinvestment in production plant and equipment is a prerequisite to economic growth and recovery.	- Primary legislation will need to be amended to cover this type of debt instrument which is deemed to be asset purchase as opposed to credit. - Scheme audit will need to ensure that the Scheme is only used where appropriate.

Product	Reason	Factors to consider
	- Currently it is very difficult to get Asset Finance on assets with a low resale value. - It may attract specialised Invoice Finance providers to enter the Scheme.	
Forward Foreign Exchange Contracts.	- Forward Foreign Exchange Contracts (FFEC) credit lines are treated as a normal credit line from a risk perspective. - Real risk is minimal.	- Scheme will need to be amended to cover this type of debt instrument. - Care required as Scheme rules specifically exclude export related guarantees (within EU).
Documentary Letters of Credit.	- Documentary Letters of Credit are 100% risk weighted. - Real risk is minimal. - Should assist importers in accessing product at more competitive prices.	- Scheme will need to be amended to cover this type of debt instrument.
Pre-Shipping Finance.	- Provide access to working capital based on an existing order. - Relatively low risk.	- Scheme will need to be amended to cover this type of debt instrument.
Custom & Excise Guarantees.	- As risk is assessed at 200% these use up a lot of available collateral. - Relatively low risk.	- Scheme will need to be amended to cover this type of debt instrument.
Payroll limits.	- As risk is assessed at 200% these use up a lot of available collateral. - Relatively low risk.	- Scheme will need to be amended to cover this type of debt instrument.

RECOMMENDATION: **Extend the Scheme to cover a full range of financial products.**

4.3 FINDING NO. 3 – The Portfolio Cap is a major issue for the banks as is the level of guarantee provided.

The current Portfolio Cap structure is resulting in the banks placing minimal or no value on the Scheme guarantee and this is seen as a major factor in the low take-up under the Scheme to date. The example quoted earlier in this report demonstrates this point and this is repeated below.

	Year 1	Year 2	Year 3	Year 4
Portfolio Value	€1,000,000	€3,000,000	€5,000,000	€10,000,000
No. of Loans	10	30	50	10
Portfolio Claim Limit	€100,000	€300,000	€500,000	€1,000,000
Portfolio Default Limit	10%	10%	10%	10%
Guarantee Rate	75%	75%	75%	75%
Bank Value Cover	€75,000	€225,000	€375,000	€750,000

In the above scenario the level of guarantee could be as low as 3.95% (€750,000 out of a total guaranteed exposure of €18m – using the example where the bank has no losses in Years 2 & 3 but has losses of in excess of €1m in Year 4 the maximum they can claim under the Scheme is €750,000 or 3.95% of their aggregate portfolios of €19m for the four years) and for this reason the attitude of the banks is understandable.

What we are recommending is that the **annual portfolio cap** be removed and that the portfolio be based on the total level of credit outstanding under the Scheme at any point in time. In the above scenario this would be €18m (years 2, 3 & 4) and the potential risk for the Government would remain unchanged at €1.35m whereas the cover for the bank would increase from a potential low of 3.95% to 7.5% i.e. (full cover on portfolio @ 7.5% with no cap).

RECOMMENDATION: **Remove the annual portfolio cap and assess the portfolio as a total, rather than an annual portfolio.**

4.4 FINDING NO. 4 – The 3 year term is seen as too short as most loans are a minimum of 5-7 years.

The current 3 year term coupled with the 'Temporary' nature of the Scheme is seen as a barrier to take-up under the Scheme and to the general commitment to the Scheme by the banks and other stakeholders. As term lending is always likely to be the largest component of Scheme utilisation it is seen as important that the term of any guarantee aligns with the term of the underlying loan. The average loan term is 5/7 years and accordingly it is recommended that the term be extended to 7 years.

While the underlying risk should be lower after 3 years, which was the logic behind the 3 year term, it is difficult for any lender to commit to a 5/7 year term loan in the knowledge that part of

their security will fall away after 3 years. This could actually have a negative effect, resulting in banks making formal demand, to preserve recourse under the Scheme guarantee, where under normal circumstances they might be prepared to restructure or forbear.

A further point we would make is that by restricting the term to 3 years the Scheme is foregoing income.

RECOMMENDATION: **Extend the Scheme for up to 7 years.**

4.5 Finding No. 5 – The current level of Scheme Guarantee at 7.5% (75% of 10%) is seen as too low and does not provide an equitable level of risk sharing. The risk / share ratio is imbalanced.

The current portfolio default limit at 7.5% (75% of 10%) is seen as being too low and inequitable and we would share this view. The UK EFG Scheme guarantee level has recently been increased from 9.75% (75% of 13%) to 15% (75% of 20%) as a stimulus to drive further usage under the Scheme which has peaked in recent years. The UK have a different interpretation of the De Minimus rules.

In view of the fact that the UK EFG limit applied to SMEs in Northern Ireland it is not considered appropriate that there should be such a large disparity in the level of portfolio default limits applicable in the two jurisdictions.

We have undertaken an assessment of the risk sharing at various guarantee levels and this shows that a guarantee level of 12% (75% of 16%) would provide a more equitable risk share as illustrated in the table below:

	Current	Improved	Equalised	De Minimus	UK Model
Guarantee Level	7.5%	9.75%	12%	10.4%	15%
	(€m)	(€m)	(€m)	(€m)	(€m)
Value of Scheme lending	100	100	100	100	100
Loss on these loans (UK Exp.)	19	19	19	19	19
Maximum Scheme Liability	7.5	9.75	12	10.4	15
Scheme Income*	5	5	5	5	5
Net Costs to the Scheme	2.5	4.75	7	5.4	10
Net cost to the bank.	11.5	9.25	7	8.6	4
Lenders Cost Share	60.5%	48.68%	36.84%	45.26%	21.05%
Scheme Cost Share	13.2%	25.0%	36.84%	28.42%	52.63%
Borrowers' Cost Share	26.3%	26.32%	26.32%	26.32%	26.32%

**cumulative income over 3 years amortised at 2% per annum*

In the event that an increase to 16% is not deemed permissible under the De Minimus rules we propose that the level of guarantee be increased to 10.4% (80% of 13%) which is the maximum permissible under the De Minimus rules.

There may be concerns that this increased level of guarantee might encourage banks to take on excessively high risk resulting in a high level of bad debt. It is our view that anything materially short of a full guarantee would not result in the banks taking on risk they would otherwise not take on. It is possible that even at the proposed increased levels the banks will not change their current attitude in relation to Scheme qualifying loans. However, the increased guarantee will address the genuine concerns being expressed by the banks that the current risk sharing is not equitable and will dispel the current view of the banks that the guarantee, as currently structured, has minimal value.

The view has also been expressed by some government stakeholders we have engaged with that a higher level of guarantee might result in the banks applying the Scheme to risk that should not require Scheme support. There are a number of safeguards that will ensure this does not happen including:

- The audit of Scheme loans and rules which should identify any abuse of the Scheme under this audit process.
- There is a cost for the borrower in availing of the Scheme and they are likely to challenge any attempt to include them in the Scheme, if it is deemed inappropriate or unnecessary.
- Our proposal that a Scheme General Manager role be created should ensure any inappropriate behaviour is identified and addressed.

In summary we are of the view that increasing the portfolio default limit will help address one of the major criticisms of the Scheme and will not result in any abuse of the Scheme rules.

RECOMMENDATION: **Amend the guarantee to 10.4% to ensure compliance with De Minimus rules and facilitate a more equitable risk share.**

4.6 FINDING NO. 6 – 2% premium is seen as expensive particularly as the use of the Scheme does not command any margin reduction.

Availing of the Scheme does not reduce the overall cost of credit and there is evidence from the limited approvals to date, and from feedback obtained from the EFG Scheme in the UK, that the 2% premium is a barrier to take-up under the Scheme. The UK experience suggests that a 1% increase in premium results in a 25% fall-off in demand for inclusion in Schemes of this nature.

The De Minimis Regulations provide two alternative approaches to premium pricing, with guarantees able to be priced individually or on Scheme-wide basis. The minimum premium levels related to the credit quality of the Borrower proposed in the Regulations are as follows:

- "Adequate payment capacity" - 0.8%
- "Payment capacity [likely to be]vulnerable to adverse conditions" – 2.0%-3.8%
- "Payment capacity likely to be impaired by adverse conditions" - 3.8%-6.3%

With the proposed recommended extension of the Scheme to include refinance, and/or refinance as a forbearance measure, this effectively dictates that the lowest possible allowable rate of 2% should remain.

However, in view of the significant other enhancements being proposed to the Scheme it is recommended that the premium remain at 2% but that the cost of the Scheme to the borrower be mitigated by the banks. In relation to overdrafts it is proposed that the 2% would apply to the approved limit as applying the premium to utilisation would not be practical. To reduce the cost to the borrower we propose that the banks are requested to pay a premium of 1% for loans & overdrafts guaranteed under the Scheme thus reducing the cost to the borrower by 1%. This is justifiable based on the Scheme enhancements proposed. Payment of the premium by the banks would cease in the event that loan default occurs.

In relation to non-lending facilities, e.g. bonds and guarantees, we would suggest requesting the banks to apply a maximum commission on Scheme guaranteed 'non-lending facilities' of 1% per annum which will result in a not overly excessive overall cost of 3% per annum for the borrower.

RECOMMENDATION: **Given the banks are being offered an improved Scheme request that they pay a 1% premium on guaranteed lending (overdrafts or loans) to reduce the cost to the borrower.**

RECOMMENDATION: **Request agreement from participating lenders on a maximum commission of 1% on Scheme guaranteed non lending facilities**

4.7 FINDING NO. 7 – The requirement to issue a formal decline letter, as a prerequisite for being considered for inclusion under the Scheme, is viewed very negatively by borrowers and stakeholders.

In some participating institutions, it is a requirement of the Scheme that a formal 'decline' letter is issued in respect of the credit application before it can be considered for conclusion under the Scheme. The feedback received in relation to this requirement has been very negative with many borrowers 'put off' by the requirement which they believe impacts on their credit rating and/or long term relationship with their bank. For many of the better performing and larger SMEs this is a major disincentive for seeking to avail of the Scheme. The F.A.Q. on the Irish Credit Bureau website warns borrowers against the implications of multiple credit applications.

It would appear that this requirement was included to ensure that banks did not utilise the guarantee for lending that did not require the support of the guarantee.

It is recommended that where a requirement to issue a formal decline letter existed, it is dispensed with and that instead in every case where a facility is being refused for Pillar 1 or Pillar 2 reasons, that the bank must reassess the proposal on the basis of accessing the Scheme. If the Bank is prepared to approve the request with the support of the Scheme, the customer should be advised accordingly with inclusion in the Scheme treated as an approval condition precedent.

RECOMMENDATION: **Remove the requirement to issue a formal decline letter for eligibility under the Scheme.**

4.8 FINDING NO. 8 – There is no dedicated owner/manager of the Scheme, with a primary/over-riding responsibility for achieving lending and job creation objectives

The failure, to date, of the Scheme in delivering the Scheme expectations is partly due, in our view, to the absence of an owner/manager responsible for ensuring that the Scheme expectations, particularly in the area of job creation, are achieved. Under the current ownership structure the responsibilities are as follows:

- The DJEI has overall responsibility for the Scheme but this does not include (nor should it) the day to day performance management of the Scheme.

- Capita Asset Services (Ireland) Ltd (Capita) are responsible for the administration of the Scheme including the production of quarterly performance reports and the conducting of audits to ensure compliance with Scheme rules. Capita hold quarterly meetings with the participating banks but the agenda for these meetings focuses solely on administrative matters. From our review of the work being undertaken by Capita it is clear that the Scheme is very effectively administered by Capita with excellent systems and procedures in place.

- The banks have approval authority under the Scheme rules and while the performance to date of the various participating banks varies greatly, our experience and observations would indicate that achieving the Scheme targets is not seen as a priority for any of them. This is partially down to the restrictions and the value placed by them on the Scheme as currently structured.

To address this weakness it is proposed that a suitably qualified individual or organisation be appointed to manage the Scheme performance, with the responsibilities of this individual to include:

- The setting of performance objectives with the various participating banks including oversight of how these objectives are rolled out at ground level within the participating institutions.

- Monthly review of performance across a number of key performance indicators including:

  a) performance against plan objectives,
  b) the review of Scheme pipeline, Scheme approvals and Scheme draw downs,
  c) the investigation of all approvals that do not progress to drawdown,
  d) ensuring that all qualifying credits are considered for inclusion in the Scheme,
  e) ensuring that the promotion of the Scheme including bank staff knowledge (both credit and frontline) of the Scheme is maintained at an acceptable level,
  f) quarterly meetings with the CEOs of all participating banks to ensure that the performance of the Scheme is constantly on their radar and,
  g) to ensure adherence to the core objective of the Scheme, monitoring of the actual jobs created and/or maintained once the approved loans move on to drawdown.

It is recommended that this owner/manager responsibility for the performance management of the Scheme is placed with an independent body and the costs for this role have been factored into the cost analysis later in this report.

RECOMMENDATION: **Appoint a dedicated owner/manager of the Scheme, with responsibility for its general management including driving performance against Scheme objectives.**

4.9 FINDING NO. 9 – Awareness of the Scheme amongst SMEs and Advisers is exceptionally low.

It is clear from the research we have undertaken as part of this review that the general level of awareness of the Scheme is extremely low. A recent survey undertaken by the Small Firms Association (SFA) of its 2,500 members revealed virtually no awareness of the Scheme. This result is particularly disappointing as the SFA has undertaken promotional activity of this Scheme and other SME support mechanisms. Similarly, a recent survey by Chambers Ireland revealed that 65% of respondents were not aware of any Government working capital schemes.

Similar feedback in relation to Scheme awareness was provided by other stakeholders including the banks that face the challenge of educating their customer facing staff in relation to what is a relatively complex Scheme.

A key factor in the low level of awareness is the general lack of support for the Scheme, in its current format, across the entire stakeholder base. Redesigning the Scheme to take account of the feedback received from the stakeholders should ensure their support which is seen as vital in raising general awareness of the Scheme.

It is also recommended that some or all of the following promotional activity be undertaken as part of a re-launch of the Scheme:

- Email Marketing – Appropriate lists can be purchased to facilitate a targeted marketing approach.
- Trade Press, particularly construction and manufacturing.
- Promotion by the key stakeholders to the membership base.
- Each of the participating banks to ensure as part of the re-launch that staff knowledge of the Scheme is brought up to an acceptable level and regularly refreshed.
- Regional press.
- Social media.

RECOMMENDATION: **Re-launch the Scheme to include low cost marketing campaign and stakeholder support / involvement.**

4.10 Finding No. 10 – The ownership of the Scheme within the participating banks differs.

The ownership of the Scheme within the three participating banks differs and from our review of the approach taken by all three banks, it is our view that the approach being adopted by BOI

represents best practice and that a similar approach should be considered by the other two existing and any future participating banks. BOI has integrated the Scheme into its credit function and has up-skilled its SME credit underwriters in relation to the Scheme. Where a credit is being declined on Pillar 1 or Pillar 2 grounds it is assessed for inclusion under the Scheme before the formal decline letter is issued and the borrower given the option to reapply under the Scheme. These are all positive steps and provide evidence of the appropriateness of the BOI model.

In AIB and UB the Scheme is owned by the Product Management Divisions of both Banks. In our view the Scheme is not a 'product' per se rather an item of collateral that should be more appropriately owned by the Credit Risk function of the banks.

Based on the performance to date it is clear that the approach being adopted by BOI is 'best practice' and should be replicated in the other participating banks.

RECOMMENDATION: **Based on our assessment of the current ownership structures we recommend that the Scheme is 'managed' by the Credit Functions within all participating banks.**

4.11 Finding No. 11 – Low number of participating banks detracts from the potential effectiveness of the Scheme.

In the UK a total of 43 banks participate in the EFG. It is recognised that the banking landscape in Ireland is very different to that of the UK with most foreign owned banks either withdrawing completely from the market or retrenching their activities to the perceived lower risk sectors of the marketplace. The SME sector is not seen, at present, as an important target sector for these banks.

With the recommended expansion of the products that would qualify for inclusion under the Scheme it is proposed that as part of a re-launch of the Scheme that all banks and finance houses operating in Ireland be invited to participate in the Scheme. This should be backed up by one-to-one meetings between the proposed owner/manager of the Scheme and the CEOs of all banks participating in the marketplace. This should include, but not be limited to:

- KBC Bank.
- ACC/Rabo.
- Danske Bank.
- Barclays Bank PLC.
- HSBC Bank PLC.
- Close Brothers.
- Bibby Financial Services Ireland.

As all banks have moved forward in terms of addressing their legacy credit issues there may now be a greater appetite for participating in the Scheme than existed when the Scheme was first launched.

RECOMMENDATION: **As part of the re-launch all relevant banks and credit providers operating within the State to be invited to participate in the Scheme.**

4.12 Finding No. 12 – Exclusion of refinancing, particularly for SMEs trying to 'exit' foreign owned banks that have ceased to support SME activity is an issue.

The initial Scheme design was quite rightly focussed on additionality i.e. new funding advance as opposed to the restructure of existing funding. However due to the significant changes taking place within the retail and business banking market in Ireland there is a need to reconsider the inclusion of refinancing under the Scheme.

Since the Scheme was launched IBRC has been placed in liquidation and Danske Bank has announced its withdrawal from retail and business banking in Ireland. Coupled with the exit of Bank of Scotland (Ireland) and the activity (or non-activity) of other lenders, it is probable that good SMEs are finding it difficult to access additional credit required for investment. Particularly those that bank with foreign owned banks who are withdrawing from the Irish market. The IBF indicate that the numbers of viable businesses 'trapped' within these institutions is small, but there must be instances of quality businesses requiring investment that cannot expand.

We illustrate the difficulty in the scenario below:

Scenario 1: ***"Viable SME capable of making repayments from cashflow but seeking additional money for expansion"***

	'Exiting' Bank Debt	Security Value	Shortfall
Viable SME	€500,000	€400,000	**(€100,000)**

- SME needs €50,000 to reinvest in new factory equipment for the business.
- Cannot access funds from their own bank as they are no longer lending in Ireland.
- 'Exiting' bank will 'settle' debt to exit, but not for less than their security value – the settlement is agreed at €400,000 and the total funding requirement is therefore €450,000.

Current participating lender position:

- 70% loan to value on the current debt can be refinanced under normal banking policy, i.e. €280,000.
- The 'additional' funds that could be covered under the current Scheme = €50,000
- Total funding available is €330,000 against a required overall funding level of €450,000.

Proposed participating lender position:

- The normal policy rules apply whereby 70% loan to value on the current debt can be refinanced under normal banking policy, i.e. €280,000.
- The remaining funding of €170,000 is covered under the new/amended Scheme.
- Total funding available is now €450,000 and a viable SME with a perfect repayment track record can refinance with a participating bank including investing in their business.

Positives.
- This should attract and facilitate the lower risk refinancing proposals.
- Viable businesses can access funding to invest and expand rather than focusing on paying down debt.
- Positive impact on job creation and retention.

Negatives.
- Could facilitate foreign owned banks exiting the market in Ireland. Rules around the valuing of underlying security would reduce this risk.
- Higher financing cost for the borrower both in terms of interest cost and Scheme cost.
- State taking on additional lending risk that may result in losses for the State.

Scenario 2: ***"Not viable at current debt levels but could be viable in future"***

	'Exiting' Bank Debt	Security Value	Shortfall
Over borrowed but viable SME	€500,000	€400,000	**(€100,000)**

- Company in arrears and foreign owned bank concerned with performance and ability to repay – the SME is over-borrowed but could be viable with a debt write-down / restructure
- 'Exiting' bank will 'settle' debt to exit, but not for less than their security value – the settlement is agreed at €400,000.

Current participating lender position:

- The Scheme currently excludes refinancing and the term at 3 years would be too short to support a restructure proposal.
- In the absence of an acceptable refinance proposal the bank in a situation such as this are likely to foreclose on the business and realise their security resulting in the possible loss of jobs.

Proposed participating lender position:

- An amended Scheme could allow the participating lender additional cover on the negative equity position and facilitate a restructure of the written-down debt that would facilitate keeping the potentially viable company alive.
- Assuming a settlement at a level of €400,000 and a 70% loan to value policy €280,000 can be refinanced with the existing security.
- The remaining settlement funding of €120,000 is covered under the new/amended Scheme.
- Total funding available now €400,000 allowing the settlement and restructure of the reduced debt levels to proceed.

Positives.
- Longer term sustainable forbearance measures are afforded to support the business's chances of returning to a fully viable position.
- Bring the Scheme more in to line with the UK EFG Scheme.
- Retain jobs with the prospect of growing employment over time.

Negatives.
- Could be taken advantage of by exiting lenders.

- State taking on additional lending risk that may result in losses for the State.

It is recommended that the Scheme is amended to facilitate refinancing. This could be done on a pilot Scheme initially and subject to audit and review. Our view is that the market demands this support now, and it will peak in 2013/2014 and subside thereafter once the exiting banks have exhausted their recovery options.

RECOMMENDATION: **Allow selective refinancing / refinancing of other banks under the Scheme.**

4.13 FINDING NO. 13 – The inclusion of 'Temporary Partial' in the Scheme name is seen as a negative.

The name of the Scheme is 'Temporary Partial Credit Guarantee Scheme' and a number of the stakeholders have commented on this name being inappropriate particularly the intended temporary nature of the Scheme.

As referred to earlier in this report most modern economies both in the Euro zone and beyond operate this type of scheme on an ongoing basis and their schemes are constantly being reengineered to take account of changing market conditions. It is our view that when growth and confidence returns to the economy a credit guarantee scheme will be even more a requirement at that stage as demand for credit increases. Bank credit policy is likely to remain very conservative for the foreseeable future and this coupled with the limited number of financial institutions now servicing the SME market will make access to credit, even for viable SMEs, difficult.

The proposed extension of the loan term to 7 years, which is seen as essential, will also prolong the Scheme.

Accordingly it is recommended that the Scheme be appropriately rebranded as the 'SME Credit Guarantee Scheme' (SMECGS) or some similarly worded name.

RECOMMENDATION: **Rebrand the Scheme the SME Credit Guarantee Scheme (SMECGS).**

4.14 Finding No. 14 – Cost administration of the Scheme is high relative to the level of underlying Scheme activity.

The Scheme is administered by Capita and in terms of discharging their responsibilities in this regard they appear to do an excellent job. At the time Capita was contracted to administer the Scheme it was envisaged that take-up under the Scheme would be €150m per annum and a structure to cater for that level of activity was put in place by Capita. Performance to date under the Scheme is exceptionally low but this is not due to any underperformance by Capita.

Capita were paid €237,000 in 2012 under their current contract and as of September 2013, the cost of administering the Scheme is €183,000. Total Scheme income to date is €25,568.

Due to the devolved delivery structure of the Scheme where the participating bank determines access to the Scheme, it is important that a robust administration and oversight process exists and we are satisfied that the current Capita process is fit for purpose. However, at current activity levels the cost is difficult to justify.

Subject to the terms and conditions of the Capita contract it is recommended that a renegotiation of the contract take place with a view to reducing the cost. The proposed extension of the Scheme should justify some reduction as Capita set-up costs can now be accrued over a longer period.

It is recommended that the Capita contract be renegotiated with payment under the contract to be partly linked to the level of Scheme activity. What we would suggest is a fixed base amount plus a variable payment based on draw downs under the Scheme.

RECOMMENDATION: **Review the cost of administrating the Scheme with a view to reducing the annual running cost. Future costs to be better aligned with activity.**

Other Findings & Recommendations:

During the course of our review, we received other representations from stakeholders and observed best practice within the UK EFG Scheme that are worthy of consideration as part of this review. Accordingly we have proposed two additional recommendations based on our findings.

4.15 FINDING NO. 15 – The Scheme is not appropriate for low level credit needs and should be adapted to facilitate the flow of some credit particularly to the construction sector.

What we are proposing is an amendment to the Scheme that would allow Scheme to guarantee B2B (business to business) finance arrangements to be put in place with approved participating trade wholesalers. Under the Scheme normal trade credit would be provided to trades persons who would not otherwise meet the criteria for a trade credit limit. Amendment to the primary legislation will be required to facilitate this proposed change to the Scheme.

The construction industry in Ireland has been particularly hard hit in terms of access to credit. This is having a real impact on the ground particularly in the case of small scale operators in the building and allied trades that cannot secure credit for the supplies needs to undertake work that generally will not be paid for until the work is completed.

This sector has particular relevance to jobs in Ireland as:

- According to the Central Statistics Office in 2011 the construction sector accounted for 20% of enterprises, down from 26% in 2008. This remains, despite the collapse of the building industry, well above the EU average. In 2010, the latest year for which EU-wide figures are available, construction firms accounted for more businesses in Ireland than in any other member state where the average across the EU was 15%.

- 1 in 4 persons on the Live Register are former construction workers (PQ response 28.05.2012 from Minister for Social Protection, Joan Burton TD).

While being mindful of the need to get credit down to where it is perhaps needed most (to the ground level SME), care will be required in the pilot to ensure that:

a) The trade credit guarantee is not utilised where unwarranted – robust rules, good evidence backed credit policy and procedures and a solid audit should minimise this risk. The fact that any guarantee will be excluded should this practice be discovered should be enough to mitigate this risk.

b) The guarantee could inadvertently have a negative impact on other suppliers of building supplies in the country. The pilot would need to be open to all to apply (subject to strict criteria).

c) There is also a growing concern that the shadow or black economy is active and the introduction of any Scheme pilot will need to satisfy certain measurable qualification criteria (such as a tax clearance certificate).

Proposal:

We attach, at ***Appendix 2***, a copy of the EFG participating lender notes on the UK pilot Scheme on trade finance which has been deemed a considerable success by industry and government alike.

In view of the success of the UK Scheme we propose a B2B element modelled on the UK Scheme with the limits covered by a re-allocation of the existing Scheme limits to facilitate. A pilot level of €1m should be sufficient for this requirement. ***Appendix 3*** outlines the detail of this proposed Trade credit 'pilot' Scheme.

We believe this initiative will be well received and will provide a much needed injection of credit at grass root level to small SMEs that cannot access bank or trade credit.

It may be argued that Microfinance Ireland (MFI) could fill this void, however, having an additional local source of credit is seen as appropriate and particularly so in the hard hit construction sector. A key difference also is that this type of facility is like a mini-overdraft or stocking loan which is more suitable for sole-traders working on ad-hoc contracts. While MFI do offer working capital loans, they are structured on a 3 year repayment term and are subject to strict qualifying criteria, a detailed application form and a business plan which may be a barrier to some SMEs.

RECOMMENDATION: **A €1m pilot scheme focussed on 'business to business' trade credit modelled on the UK scheme is recommended.**

4.16 Finding No. 16 – Scheme provides limited support to SMEs in the export sector.

The current Scheme provides minimal support for exporting businesses which face the same credit issues as non-exporting SMEs. In the UK, the Export Enterprise Finance Guarantee Scheme, (ExEFG), was launched in April 2011 specifically to assist exporting SMEs seeking short term trade related financing. ExEFG operates outside of the De Minimis Block Exemption and so in order to avoid any breach of State Aid rules it is configured to operate on an entirely self-financing basis, without any form of public subsidy. In order to achieve this, the guarantee payments to the lenders and the operating costs of the Scheme must be met in full from guarantee premium income from the Borrowers. This is a significant departure from the UK's core Enterprise Finance Guarantee (EFG) in which premium income only partly covers the Scheme funding requirements.

It is proposed that a similar Scheme, an Export SME Finance Guarantee Scheme (ExSMEFGS), be introduced in Ireland. The UK Scheme does have a low take up, so this recommendation is based on our over-riding principle of 'inclusion' rather than 'exclusion' to ensure optimum performance of the Scheme. A comparison of the terms and conditions of the proposed ExSMEFGS with the proposed changes to the existing Scheme is set out in ***Appendix 4,*** and is summarised below:

	Amended Scheme	ExSMEFGS
State Aid Limit	€200,000.	Not applicable.
Sector Restrictions	Restricted to certain sectors.	No restrictions.
Min & Max Term.	3 months to 10 years (Term Loans). 3 months to 2 years (Overdrafts). 3 months to 3 years (Invoice Finance).	3 months up to 2 years.
Min & Max Amount	Minimum - €10,000. Maximum - €1m.	Minimum – €25,001. Maximum - £1m.
Refinancing	Eligible.	Ineligible.
Premium Rate.	2% of outstanding balance.	3% of total limit.
Annual Lending Limit.	Issued on annual basis.	N/A.
Guarantee Rate.	75%.	60%.
Gross Claim Limit.	20%.	4.5%.

RECOMMENDATION: **A self-financing SME Export Guarantee Scheme is recommended to support exporting SMEs.**

5. Scheme Objectives:

It is recommended that despite the low take-up under the Scheme to date that there is real merit in having a Scheme and the performance can be much improved by amending the limitations of the existing Scheme (capped at €150m per annum), which has the potential to create a significant number of jobs (expectation 1,000 per annum @ €150m lending)..

As part of this review we requested the Irish Bankers Federation (IBF) to assess the potential level of annual demand for the Scheme assuming the following changes are made, which they have specifically requested on behalf of their members:

- Inclusion of Overdrafts.
- Extending the term to 7 years.
- Include 'own bank' refinancing.
- Include 'other bank' refinancing.

A summary of their assessment on annual lending based on current demand, is as follows:

Basis	Applications	Declines	Potential CGS
Current.	€23.4bn	€292m (12%)	€45m (15.5% of declines).
Include Overdrafts.	€480m	€48m (10%)	€8.4m (15.5% of declines).
Extend Term.	-	-	€12m
Refinancing.	-	-	€5.6m
			€71m

These appear very conservative estimates given they are based on an overall approval rate of 88%.

It is our view that the re-launch of the Scheme along the lines proposed, with the buy-in of the participating banks and the backing of the key stakeholders will result in an uplift in the demand for credit from viable SMEs wishing to grow their businesses.

The above assessment also does not factor in Invoice Finance, Asset Finance and B2B credit. However, it is not expected that the level of take-up in these areas will be significant in value terms but their inclusion in the Scheme is viewed as important in terms of maximum inclusivity.

As referred to previously the appointment of an owner/manager to drive the Scheme will also result in improved Scheme performance.

6. Cost Analysis:

In 2011, Capital for Enterprise Limited (UK Government Agency) advised the DJEI on the likely Cost-Benefit of the Scheme, informed by UK experience, relevant data from Ireland and the values established in the course of designing the Scheme.

It was noted that a number of the key assumptions, which were included in initial Scheme financial projections, were underestimated. This has impacted on the Scheme performance and altered the cost – benefit position. The key areas at variance, based on the figures from the 3rd quarterly report on the Scheme (to 30th June 2013) are:

No	Initial Assumption	Actual	Revised assumption / comment
1	Lending was projected to be €150m per annum under the Scheme.	The figures for Q3 reflect €5.9m, which represents 47 loans averaging €130,000.	For a variety of reasons outlined the Scheme has underperformed. The amendments proposed should facilitate additional capped to a maximum level of €150m per annum.
2	The cost of administering the Scheme was reflective of a Scheme operating at full capacity.	The Scheme administration costs €199,000 per annum and total costs are c. €250,000 per annum.	At these low levels the costs of administering the Scheme are wholly out of line with the benefits of the Scheme. It is recommended that the cost structure of the Scheme be reviewed to align with the actual performance of the Scheme.
3	Based on lending of €150m, the evidence suggested that up to 1,000 jobs would be created per annum.	The applications on Scheme lending to date suggest that 273 jobs will be created and 115 jobs maintained.	The original assumptions appear sound and were based off UK evidence and consultation with Forfás and other government agencies. The initial performance on job creation and retention is encouraging but as the sample size is small this important aspect of the Scheme will need to be carefully monitored.

No	Initial Assumption	Actual	Revised assumption / comment
4	Default performance is as per current forecast for UK EFG – i.e. 25% by volume of portfolio will have defaulted after 3 year and 31% after 5.	No defaults to date. The actual UK default rate has been 18.7% as confirmed by UK Dept BIS.	It is too early in the Scheme life to have any real-time evidence on this and the UK experience should offer good insight into the likely default rate.
5	Working average €50,000 Pillar 1 loan value.	Average loan for Pillar 1 is €121,000.	It is too early in the Scheme life to amend original assumptions based on evidence to date.
6	Working average Pillar 2 €200,000 loan value.	Average loan for Pillar 2 is €102,000.	It is too early in the Scheme life to amend original assumptions based on evidence to date.
7	Indicative average Scheme Facility Value projected at €80,000.	Actual to date is €130,000. Average loan for combination of Pillar 1 & 2 decline reasons is €181,000.	It is too early in the Scheme life to amend original assumptions based on evidence to date.
8	Split of portfolio between Pillars 1 & 2 by value assumed at 50/50.	**Split of portfolio:** Pillar 1 only €4.1m. Pillar 2 only €0.7m. Combined 1 & 2 €1.1m.	It is too early in the Scheme life to amend original assumptions based on evidence to date.
9	Valuations of unit benefits accruing to the Irish exchequer as a result of the Scheme and accepted level of indirect job creation are as advised by Forfás. Overall benefits of €23,741 per direct job created and 0.4 employees per additional borrowing business have been used.	No change proposed.	No change proposed.

No	Initial Assumption	Actual	Revised assumption / comment
10	Guarantee Rate is 75%, Portfolio Default Limit is 10% (meaning Claim Limit is 7.5%) and Premium Rate is 2%.	This is the current position.	Our recommendations now propose: • Guarantee rate 80% & Portfolio default limit of 13% which equates to a Scheme guarantee rate of 10.4%. • Our recommendations propose no annual portfolio limit. • Our recommendations propose 50% of the cost of the Premium Rate is carried by the participating lenders.

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)**

Summary:

	(€m)
Cost of scheme admin from 2012 - wind-down in 2027	4.387
Gross cost of potential scheme claims (uncapped)	64.091
Premium receipts	50.102
Net cost of Scheme (loss)	**(18.376)**

Assumptions (see appendix 5 attached):

- Loans at €150m per annum – 2014 assumption @ 50% or €75m to ramp up.
- Average loan term 5 years (2013 @ €10m for 3 yrs).
- Scheme term of 7 years.
- Loan rate of 7%, inclusive of premia.
- No annual portfolio cap.
- Guarantee rate increased to 80% and portfolio default limit 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 administration at €199,000 with possible cost of Scheme Manager at €50,000 per annum and provision of €51,000 for other costs (total €300,000).

Administration cost for continuing oversight and loan and premia amortisation is projected out to 2027. Requirement for on-going admin provision will depend upon actual timing of claims and associated Lender performance.

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 fee of 2% is a considered a good return for a partial exposure on viable short to medium term risk with minimal operating costs. On the assumption model used, there is a peak risk at 2019/2020 of €471m, which potentially 10.4% (€49m) would be the maximum state exposure. It is important to note that this would be off-set against income of €32m for the same period (net potential cost before administration @ €17m). It is reasonable to assume that the range of financial products will have some influence on this table as some overdrafts and contingent liabilities would not amortise however this should be off-set by the potential 7 year term allotted. **We suggest that a total Scheme Cap of €450m is set.**

In the event that the claims experience is better than projected, the Scheme could deliver a positive return for the State.

Sense check on the deliverables:

According to the Central Bank, a total of €413m was drawn down relating to new loans to SMEs in the non-property, non-financial sectors during Q2-2013 (i.e. draw downs of new loans, excluding restructuring or renegotiations of existing facilities), equivalent to 1.6 per cent of the previous quarter

stock of lending. The agriculture sector accounted for €144m followed by wholesale/retail trade and repairs at €72m. The sectors with the highest proportions of gross new lending relative to Q1-2013 stocks were agriculture (3.7 per cent), electricity, gas, steam and air conditioning supply (2.5 per cent) and water supply, sewerage, waste management and remediation activities (2.4 per cent).

Annualising this sum is (€413m * 4) – (€144M * 4) = €1,652m - €576m = €1,076M vs. €150M = 13% which would appear high. However the IBF estimate is €71m before refinancing for 2014 – we estimate €75m for 2014 and €150m thereafter. We would also observe that demand is muted currently but showing signs of recovery and this figure excludes a properly inclusive Scheme which carries real value for the lender and covers a full range of financial products.

Taking our calculations – **from a risk perspective** the State should not be additionally exposed if the projections are not achieved. On the assumption of only 50% of the expected lending to take place, the net cost of the scheme is -€11.382m. This is illustrated below and should alleviate concern:

	(€m)	**Less 50%**
Cost of scheme admin from 2012 - wind-down in 2027	4.387	4.387
Gross cost of potential scheme claims (uncapped)	64.091	32.045
Premium receipts	50.102	25.051
Net cost of Scheme (loss)	**(18.376)**	**(11.382)**

7. Summary & Conclusion:

With the small number of banks now providing SME funding a Scheme of this nature is seen as vital to assist SMEs that are having difficulty in accessing funding for viable projects due to the lack of security and/or the sectoral policies of banks. This Scheme if properly marketed and managed will help address the issues arising from the lack of competition in the SME banking sector.

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Appendix 1

Key Stakeholders and Other Parties Consulted as part of Review

- Allied Irish Banks plc.
- Bank of Ireland.
- Capita Asset Services (Ireland) Ltd.
- Capital for Enterprise Ltd.
- Chambers Ireland.
- Department for Business, Innovation & Skills (UK).
- Dublin Chamber of Commerce.
- Chartered Accountants Ireland.
- Construction Industry Federation.
- Credit Review Office.
- Enterprise Ireland.
- Forfás.
- Hardware Association Ireland.
- Irish Banking Federation.
- Irish Exporters Association.
- ISME.
- Small Firms Association.
- Ulster Bank (Ireland) Limited.

Appendix 2

Participating Lender's Notes on UK Trade Finance Pilot Scheme

Introduction

The Government is widening the scope of the existing Enterprise Finance Guarantee Scheme (EFG), which will, for the first time, provide government guarantees to facilitate the provision of additional trade credit through a pilot scheme starting in April 2013.

Trade credit providers who participate in the scheme will be able to provide additional credit facilities to new customers or higher credit limits to existing customers, subject to them satisfying certain criteria.

The scheme will operate as a partnership between the trade credit provider and the Department for Business, Innovation & Skills (BIS). The intention is that, as far as is practically possible, the guaranteed credit line to the small business customer will be provided using your standard commercial processes. The trade credit provider is required to pay a premium to BIS to participate in the scheme. In return BIS will undertake to cover a proportion of the loss incurred in the event that an SME customer fails to repay the credit provided.

Principal Scheme Parameters

Subject to final negotiation it is envisaged that the following scheme parameters will apply:

Duration of scheme:

- Guaranteed trade credit lines may be issued through to 31st March 2014.
- Maximum duration of the guarantee on any individual trade credit line of six months. *(It is envisaged that after this time the SME customer will have demonstrated their creditworthiness and a trade credit line will continue to be provided on normal commercial terms)*
- Subject to alignment with the workings of the trade credit provider's default and debt recovery processes, guarantee claims may be raised against BIS up to 31st March 2015.

Scale of scheme:

- An agreed number and value of new and increased trade credit lines, with expectation of a minimum of £10m of additional lines offered under the scheme. This is a guideline only and trade credit providers offering lower limits will not be excluded from the scheme, although in practice the work involved means that the trade credit provider will wish to ensure sufficient critical mass to make their participation worthwhile.

SME Customer Eligibility *(validation by a combination of SME self-certification and information already considered within the trade credit provider's existing trade credit application process)*:	• Sole trader, partnership or limited company operating in UK. • Turnover of up to £41m. • Most sectors eligible although some limited restrictions. • Not already in receipt of more than a certain level of assistance through other publicly-funded grant and loan schemes.
Categories of SME customers and trade credit lines eligible to be guaranteed *(all to be additional and distribution between type to be subject to negotiation)*:	• New SME customers who would otherwise be denied access to a trade credit line. • New SME customers requiring a larger trade credit line than would otherwise initially be provided. • Existing SME customers requiring an increase in their existing trade credit line beyond that which would normally be provided.
Extent of guarantee cover and entitlement to claim under the scheme:	• The guarantee covers an SME customer's inability to repay credit when due. • The entitlement of the trade credit provider to claim is based on the outstanding balance at default, which may be less than the SME's credit limit. • 75% guarantee cover is provided on each qualifying trade credit line, so each qualifying loss is covered in the ratio 75% BIS : 25% trade credit provider.
Portfolio Claim Limit:	• Whilst individual trade credit lines are guaranteed at 75%, the entitlement of the trade credit provider to claim against the guarantee is capped at 15%, i.e. 75% x 20% of the aggregate utilisation of guaranteed trade credit lines. This is known as the Portfolio Claim Limit.
Calculation of Premium:	• Total value of guaranteed facilities due for payment on the last day of each month of the pilot, at a premium rate of 1%.
State Aid:	• All new and existing SME customers receiving a guaranteed trade credit line are deemed to have received De Minimis State Aid and thus must be advised of the assistance received. • *(A simple mechanism exists for providing this information)*

Guidelines on participation for the trade credit provider

In order to maximise the benefits of the pilot scheme, the following criteria has been set as a guideline for participation. While it is not essential that all are points are satisfied by every potential participating trade credit provider, an organisation falling significantly short of multiple thresholds is unlikely to benefit from participating.

Each request for participation will be considered on its merits and smaller trade credit providers will not be excluded from participating solely on the basis of their size.

Criterion	Suggested Minimum Threshold
Annual turnover of trade credit provider	£50m
Number of existing customers actively using credit lines	10,000
Scope for additional provision of credit lines enabled annually by scheme	2% of existing customer base
Value of additional trade credit lines enabled annually by scheme	£10m
Geographic coverage	National coverage through established branch network and/or evidence of widespread use of on-line or telephone ordering by SMEs from across UK

Application

Trade credit providers wishing to participate will be required to provide information on and be willing to discuss openly:

- their overall business activities, financial strength, organisation structure, key personnel and corporate history;
- the relevance and positioning of trade credit within their overall business model;
- details of their SME customer base, including the products and services offered and those customers' use of trade credit; and
- the operational processes used for initial granting and subsequent management and monitoring of trade credit lines, including arrangements for dealing with defaults and the ability to validate the additionality of guaranteed facilities.

A more comprehensive application form will be available on request.

Appendix 3

Detail of proposed pilot Scheme of €1m for trade credit in Ireland

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Trade credit 'pilot' Scheme outline:

Trade credit providers who participate in the Scheme will be able to provide additional credit facilities to new customers or higher credit limits to existing customers, subject to them satisfying certain criteria.

The Scheme will operate as a partnership between the trade credit provider and the DJEI. The intention is that, as far as is practically possible, the guaranteed credit line to the small business customer will be provided using their standard commercial processes. The trade credit provider will pay a premium to DJEI to participate in the Scheme. In return DJEI will undertake to cover a proportion of the loss incurred in the event that an SME customer fails to repay the credit provided.

Principal Scheme Parameters:

Subject to final negotiation it is envisaged that the following Scheme parameters will apply:

Duration of Scheme:	○ 6 months from launch date – credit can be provided from month 1-6 and the guarantee will remain from the end of month 6 to the end of month 12. ○ Maximum duration of the guarantee on any individual trade credit line of six months. *(It is envisaged that after this time the SME customer will have demonstrated their creditworthiness and a trade credit line will continue to be provided on normal commercial terms)* ○ Subject to alignment with the workings of the trade credit provider's default and debt recovery processes, guarantee claims may be raised against DJEI up to 12 months from launch date.
Scale of Scheme:	○ An agreed number and value of new and increased trade credit lines, with expectation of a maximum of €5m of additional lines offered under the Scheme. This is a guideline only and trade credit providers offering lower limits will not be excluded from the Scheme, although in practice the work involved means that the trade credit provider will wish to ensure sufficient critical mass to make their participation worthwhile.

SME Customer Eligibility *(validation by a combination of SME self-certification and information already considered within the trade credit provider's existing trade credit application process)*:	○ Sole trader, partnership or limited company operating in Ireland. ○ Turnover not exceeding €50m, less than 250 employees and annual balance sheet not exceeding €43m. ○ Most sectors eligible although some limited restrictions. ○ Compliance with State aid DE Minimus rules.
Categories of SME customers and trade credit lines eligible to be guaranteed *(all to be additional and distribution between type to be subject to negotiation)*:	○ New SME customers who would otherwise be denied access to a trade credit line. ○ New SME customers requiring a larger trade credit line than would otherwise initially be provided. ○ Existing SME customers requiring an increase in their existing trade credit line beyond that which would normally be provided.
Extent of guarantee cover and entitlement to claim under the Scheme:	○ The guarantee covers an SME customer's inability to repay credit when due. ○ The entitlement of the trade credit provider to claim is based on the outstanding balance at default, which may be less than the SME's credit limit. ○ 80% guarantee cover is provided on each qualifying trade credit line, so each qualifying loss is covered in the ratio 80% DJEI : 20% trade credit provider.
Portfolio Claim Limit:	○ Whilst individual trade credit lines are guaranteed at 80%, the entitlement of the trade credit provider to claim against the guarantee is capped at 10.4%, i.e. 80% x 13% of the aggregate utilisation of guaranteed trade credit lines. This is known as the Portfolio Claim Limit.
Calculation of Premium:	○ Total value of guaranteed facilities due for payment on the last day of each month of the pilot, at a premium rate of 1% per month. This to be paid for by the credit provider not the customer.

State Aid:	○ All new and existing SME customers receiving a guaranteed trade credit line are deemed to have received De Minimis State Aid and thus must be advised of the assistance received. ○ The applicant will need to certify their position regarding De Minimus State Aid in order to qualify for this support.

Guidelines on participation for the trade credit provider:

In order to maximise the benefits of the pilot Scheme, the following criteria has been set as a guideline for participation. While it is not essential that all are points are satisfied by every potential participating trade credit provider, an organisation falling significantly short of multiple thresholds is unlikely to benefit from participating.

Each request for participation will be considered on its merits and smaller trade credit providers will not be excluded from participating solely on the basis of their size.

Criterion	Suggested Minimum Threshold
Annual turnover of trade credit provider or consortium group.	€10m
Number of existing customers actively using credit lines.	2,000
Scope for additional provision of credit lines enabled annually by Scheme.	2% of existing customer base
Value of additional trade credit lines enabled annually by Scheme.	€1m
Geographic coverage	National coverage through established branch network and/or evidence of widespread use of on-line or telephone ordering by SMEs from across Ireland

Application

Trade credit providers wishing to participate will be required to provide information on and be willing to discuss openly:

- their overall business activities, financial strength, organisation structure, key personnel and corporate history;
- the relevance and positioning of trade credit within their overall business model;

- details of their SME customer base, including the products and services offered and those customers' use of trade credit; and
- The operational processes used for initial granting and subsequent management and monitoring of trade credit lines, including arrangements for dealing with defaults and the ability to validate the additionality of guaranteed facilities.
- The pilot Scheme would be managed by Capita, who would need to design additional systems to accommodate. They have indicated that their current infrastructure to support this project is underutilised and could be adapted to accommodate pilots, such as the one proposed.

Appendix 4

Comparison of Proposed Export Guarantee with Proposed Revised Scheme

Viability	Amended Scheme	ExSMEFGS
Borrower Viability.	Lender to confirm that: - The Borrower is viable and appears able to repay the Scheme facility in full (assessed according to each Lender's normal commercial credit criteria). - The only factor preventing the Lender from lending to the Borrower is the lack of security.	Lender to confirm that: - The Borrower is viable and appears able to repay the ExSMEFGS facility in full (assessed according to each Lender's normal commercial credit criteria). - The only factor preventing the Lender from lending to the Borrower is the lack of security - Additional guidance provided defining SMEs in "financial difficulty".
Available Security.	Lender to confirm that: - All available security has been explored and exhausted. - Even after charging any available security, security is inadequate (according to normal security valuation criteria) to meet Lender's normal requirements and the funding would not be provided but for the backing of the Scheme guarantee.	Lender to confirm that: - All available security has been explored and exhausted. - Even after charging any available security, security is inadequate (according to normal security valuation criteria) to meet Lender's normal requirements and the funding would not be provided but for the backing of the Scheme guarantee.
Permitted Security.	- All business and personal assets, including Personal Guarantees, in accordance with normal commercial security policies.	- All business and personal assets, including Personal Guarantees, in accordance with normal commercial security policies.

Viability	Amended Scheme	ExSMEFGS
"Linked Collateral".	- Any new security charged in support of the Scheme facility. - In the event of a default, any funds realised from this security are used to repay outstanding Scheme debt prior to any other outstanding Lender debt.	- Any new security charged in support of the ExSMEFGS facility. - In the event of a default, any funds realised from this security are used to repay outstanding Scheme debt prior to any other outstanding Lender debt.
"Linked Transaction Proceeds".	- Not Applicable.	- Any funds received by the Lender in relation to the underlying trade transaction being backed with ExSMEFGS are to be used to repay the associated ExSMEFGS exposure.
State Aid De Minimis Block Exemption.	- Applicable.	- Not Applicable.
€200,000 rolling three year De Minimis State Aid limit.	- Applicable.	- Not Applicable.
Sector Restrictions.	- Scheme ineligible or restricted for certain sectors.	- No restrictions.
Minimum and Maximum Facility Term.	- 3 months to 3 years (term loans).	- 3 months up to 2 years (1 year 364 days). - Available in quarterly increments.
Maximum Borrower Turnover.	- €50m (includes group turnover if Borrower is part of a group).	- €50m (includes group turnover if Borrower is part of a group).
Minimum and Maximum Facility Amount.	- Minimum €10,000. - Maximum €1m.	- Minimum €25,000. - Maximum €1m.

Viability	Amended Scheme	ExSMEFGS
Maximum Exposure	- Lifetime Scheme limit of €1m per SME.	- Maximum exposure per SME of €1m at any point in time.
Currency	- Euro only.	- Should the Lender/Borrower wish to utilise the ExSFGS facility to support trade transactions in other currencies, this is permissible. However, any exchange rate risk linked to such transactions is to be borne by the Borrower or Lender and NOT the scheme. Hence, the exchange rate used when the facility limit is initially advised to CfEL must be the same exchange rate used in the event of a subsequent claim on the guarantee. - The ExSFGS facility limit MUST be in Euro only, as notified to CfEL in the scheme worksheets when facilities are first confirmed as guaranteed. - Any subsequent guarantee claim MUST also be in Euro.

Definition of Eligible Exporting Activity.	- Funding of specific export related activity is INELIGIBLE. Funding of non-specific export related activity is ELIGIBLE, for example (i) Generic product development, (ii) Feasibility Studies.	- Funding of specific export related activity is ELIGIBLE, for example:
		  - Working capital to fund export orders.
		  - Short-term trade loans.
		  - Trade bonds, guarantees & indemnities.
		  - Other contingent liabilities (FX hedging) Invoice finance (foreign debtors).
		- Exporting of overseas sourced goods (i.e. goods do not originate from Ireland/direct shipping) is eligible.

Viability	Amended Scheme	ExSMEFGS
		- Importing of overseas goods for subsequent export is eligible. - There is no requirement for the Borrower to be an Irish registered business.
Use of ExSMEFG for Importing SMEs.	- Eligible.	- Import credit with the underlying goods are subject to a subsequent export contract is Eligible.

Eligibility Restrictions.	- N/A.	- Refinance of existing Lender trade finance facilities is not allowed:
		  - For existing export finance facilities, the Lender must not have cancelled or reduced the export finance facility in the previous 3 months unless to do so is in relation to the normal expiry of trade transactions.
		  - The Lender must not cancel or reduce any existing export finance facility during the term of the ExSMEFG facility. Other export finance facilities can only be reduced once the ExSMEFG facility has been repaid in full.

Viability	Amended Scheme	ExSMEFGS
Eligible Debt Instruments.	- Term Loan.	Export related debt instruments, to include: - Trade Loans (including Letters of Credit, Export Collections, pre-export finance/import credit facilities, investment term loans). - Export Bonds, Guarantees & Indemnities. - Other Contingent Liabilities (including FX hedging). - Any combination of the above via Trade Multi-Option Facility.
Underlying Purpose.	- New funding (working capital or investment).	- New funding only. Primarily working capital (though short-term investment is also allowed).
Margin/Fees	- In line with normal commercial terms.	- In line with normal commercial terms.
Repayment.	- Bullet at expiry. - Regular staged repayments.	- Bullet at expiry. - Regular staged repayments.
Acceptance Period.	- Maximum 6 months from Offer date or Lender's maximum availability period if shorter.	- Maximum 3 months from Offer date or Lender's maximum availability period if shorter.
Premium Rate.	- 2% per annum on the outstanding balance (except overdrafts and invoice finance, where the premium is based on the total facility limit).	- 3% per annum (pro-rata) on the total facility limit (regardless of facility utilisation or drawdown profile).

Viability	Amended Scheme	ExSMEFGS
Premium Collections.	- Quarterly, in advance, over the life of the facility.	- Single up-front payment.
Mechanism for Premium Collection.	- Via Direct Debit Collection Agent.	- Electronic Funds Transfer.
Conditions Linked to Premium Payment.	- First scheduled premium payment must have been successfully collected for the guarantee to be valid (though borrower can drawdown funds before first premium is paid). - Failure to pay the premium for any two successful quarters renders the guarantee invalid.	- Single upfront premium payment must have been successfully collected for the guarantee to be valid (though borrowers can drawdown funds before first premium is paid). - The Lender can assume the guarantee is in place and valid on the following basis: - When the Lender forwards to Capita Asset Services (Ireland) Ltd an ExSMEFGS Worksheet, wherein the Lender confirms an ExSMEFGS facility has been drawn and the premium has been credited to the scheme bank account, the Lender can assume the guarantee in relation to that ExSMEFGS facility is in place and valid if the Lender has not received confirmation in writing from Capita Asset Services (Ireland) Ltd within 3 business days of receipt of the worksheet that an error or discrepancy exists. - For the avoidance of doubt, if a Lender has not heard from Capita Asset Services (Ireland) Ltd within 3 business days from submission of a worksheet, the Lender can assume the guarantee is valid and in place. - Premium can be paid by the Lender or the Borrower (at the discretion of the Lender).
Premium Refund for Early Repayment of Facility.	- No.	- No.

Viability	Amended Scheme	ExSMEFGS
Premium can be added to facility.	- Permitted. - Premium payable must be based upon the overall facility limit (core facility limit plus added limit due to premium).	- Permitted. - Premium payable must be based upon the overall facility limit (core facility limit plus added limit due to premium).
Delivery mechanism.	- Via Manual Spreadsheets ("Scheme Worksheets"), to be completed on a weekly basis by each Lender and a summary forwarded to Capita Asset Services (Ireland) Ltd.	Via Manual Spreadsheets ("Scheme Worksheets"), to be completed on a weekly basis by each Lender and a summary forwarded to Capita Asset Services (Ireland) Ltd.
Lender Audit.	- Independent Auditor appointed by Capita Asset Services (Ireland) Ltd.	Independent Auditor appointed by Capita Asset Services (Ireland) Ltd.
Annual Lending Limits.	- Issued on annual basis, determined primarily by previous year's lending.	- N/A.
Annual Scheme Period.	- 1st January to 31st December.	- 1st January to 31st December.
Transferring Guarantee between Lenders when Borrowers switch bank	- Scheme cannot be transferred. However a comparable Scheme facility can be drawn with an alternative Lender without any impact on State Aid limits. - New Lender must re-assess need for Scheme.	- ExSMEFGS can be transferred. - New Lender must re-assess need for ExSMEFGS. - Transferred guarantee to be on same terms and conditions. - Premium and claim limit to also be transferred between Lenders
Altering Facility Terms Once Drawn.	- Permitted except for increases in facility term or amount. Such changes would require a new facility letter plus revised premium schedule.	- Permitted except for increases in term or amount. - Where a new larger facility is issued to replace an existing smaller facility, the Borrower is only required to pay the difference in the premium values.

Viability	Amended Scheme	ExSMEFGS
		- No refund is given if the size of the facility is reduced.
Lenders entering and exiting the scheme.	- Entry: Accreditation of new Lenders subject to assessment and approval by Capita. - Exit: Six months' notice period for Lender and Secretary of State for exit from Scheme.	- Entry: Accreditation of new Lenders subject to assessment and approval by Capita Asset Services (Ireland) Ltd. - Exit: Six months' notice period for Lender and Secretary of State for exit from Scheme.
Guarantee Rate (per individual facility).	- 80%.	- 60%.
Portfolio.	- Total Bank Portfolio.	- A Lender's total ExSMEFGS lending in any annual scheme period, amended to reflect facility amount and term.
Claim Limit on Lender's Total Portfolio.	- Based upon gross drawn lending (irrespective of repayments or transfers) originating in the Scheme period. - All lending under the Scheme up to 13% maximum default rate x guarantee rate of 80% = 10.4%.	- Based upon "annual equivalent gross lending" (including or excluding the value of any ExSMEFGS lending transferred between Lenders) originating during the annual scheme period x 3% Premium Income. - MINUS operating costs (estimated at 0.3% x Lender's Annual Equivalent Portfolio) gives fixed Net Claim Limit of 2.7%.
Frequency of Potential Guarantee Demands by Lenders.	- Guarantee Demands claimed and settled on quarterly basis.	- Guarantee Demands claimed and settled on quarterly basis.
Gross Claim Limit (maximum permitted portfolio default rate covered by the scheme).	- 13%.	- 4.5%.

Viability	Amended Scheme	ExSMEFGS
Interest and Charges to be Added to Guarantee Demands?	- No, outstanding Scheme capital only.	- No, outstanding Scheme capital only.
Realisation of Security.	- Security realisation and/or enforcement/recoveries to be completed before guarantee claim is made.	- Security realisation and/or enforcement/recoveries to be completed before guarantee claim is made.
Backstop Date for Guarantee Claims.	- 18 months from Borrower default (though Lender can claim earlier if all recovery procedures have been completed).	- 18 months from Borrower default (though Lender can claim earlier if all recovery procedures have been completed).

Appendix 5

Cost Analysis

(excel workbook)

	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**	**2020**
	€'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)**

	(€m)	**Less 50%**
Cost of scheme admin from 2012 - wind-down in 2027	4.387	4.387
Gross cost of potential scheme claims (uncapped)	64.091	32.045
Premium receipts	50.102	25.051
Net cost of Scheme (loss)	**(18.376)**	**(11.382)**

Assumptions

- Loans at €150m per annum – 2014 assumption @ 50% or €75m to ramp up
- Average loan term 5 years (2013 @ €10m for 3 yrs)
- Possible loan term of 7 years
- Loan rate of 7%, inclusive of premia
- No annual portfolio cap
- Guarantee rate increased to 80% and portfolio default limit increased to 13%, which equates to maximum State risk of 10.4% of exposure
- Default rate of 18.7% 'flat-line' which is conservative (from year 1 – 5)
- 2% State return on premium income
- Fixed cost of Scheme administration at €199k with possible cost of Scheme Manager at €50k per annum and provision of €51k for other costs (€300k total)

	Loan ASSUMPTIONS	Lending 2012	Lending 2013	Lending 2014	Lending 2015	Lending 2016	Lending 2017	Lending 2018	Lending 2019	Lending 2020	Lending 2021	Lending 2022	Lending 2023	Lending 2024	Lending 2025	
		€'m	€'m	€'m	€'m	€'m	€'m	€'m	€'m	€'m	€'m	€'m	€'m	€'m	€'m	
	2012	-			-	-	-	-	-	-	-	-	-	-	-	
	2013	-	10.000	6.897	3.569	-		-	-	-	-	-	-	-	-	
	2014	-	-	75.000	62.018	48.097	33.170	17.164	-	-	-	-	-	-	-	
	2015	-	-	-	150.000	124.036	96.194	66.340	34.327	-	-	-	-	-	-	
	2016	-	-	-		150.000	124.036	96.194	66.340	34.327	-	-	-	-	-	
	2017	-	-	-			150.000	124.036	96.194	66.340	34.327	-	-	-	-	
	2018	-	-	-				150.000	124.036	96.194	66.340	34.327	-	-	-	
	2019	-	-	-					150.000	124.036	96.194	66.340	34.327	-	-	
	2020									150.000	124.036	96.194	66.340	34.327	-	
	Year end exposure:	**-**	**10.000**	**81.897**	**215.587**	**322.133**	**403.400**	**453.734**	**470.897**	**470.897**	**320.897**	**196.861**	**100.667**	**34.327**	**-**	
	Premium @ 2%	-	0.163	1.332	3.505	5.238	6.559	7.378	7.657	7.657	5.218	3.201	1.637	0.558	-	
				Loss est 2013	**Loss est 2014**	**Loss est 2015**	**Loss est 2016**	**Loss est 2017**	**Loss est 2018**	**Loss est 2019**	**Loss est 2020**	**Loss est 2021**	**Loss est 2022**	**Loss est 2023**	**Loss est 2024**	**Loss est 2025**
2013	Claims @ 18.7% default		-	0.374	0.258	0.133	-	-	-	-	-	-	-	-	-	-
2014	Claims @ 18.7% default			-	2.805	2.319	1.799	1.241	0.642	-	-	-	-	-	-	-
2015	Claims @ 18.7% default			-	-	5.610	4.639	3.598	2.481	1.284	-	-	-	-	-	-
2016	Claims @ 18.7% default			-	-	-	5.610	4.639	3.598	2.481	1.284	-	-	-	-	-
2017	Claims @ 18.7% default			-	-	-	-	5.610	4.639	3.598	2.481	1.284	-	-	-	-
2018	Claims @ 18.7% default			-	-	-	-	-	5.610	4.639	3.598	2.481	1.284	-	-	-
2019	Claims @ 18.7% default			-	-	-	-	-	5.610	4.639	3.598	2.481	1.284	-	-	-
2020	Claims @ 18.7% default			-	-	-	-	-	-	5.610	4.639	3.598	2.481	1.284	-	-
				0.374	**3.063**	**8.063**	**12.048**	**15.087**	**22.580**	**22.250**	**15.599**	**9.844**	**5.049**	**1.284**	**-**	**-**
				Govt Risk 2013	**Govt Risk 2014**	**Govt Risk 2015**	**Govt Risk 2016**	**Govt Risk 2017**	**Govt Risk 2018**	**Govt Risk 2019**	**Govt Risk 2020**	**Govt Risk 2021**	**Govt Risk 2022**	**Govt Risk 2023**	**Govt Risk 2024**	**Govt Risk 2025**
2013	Risk managed @ 10.4%			0.208	0.143	0.074	-	-	-	-	-	-	-	-	-	-
2014	Risk managed @ 10.4%			-	1.560	1.290	1.000	0.690	0.357	-	-	-	-	-	-	-
2015	Risk managed @ 10.4%			-	-	3.120	2.580	2.001	1.380	0.714	-	-	-	-	-	-
2016	Risk managed @ 10.4%			-	-	-	3.120	2.580	2.001	1.380	0.714	-	-	-	-	-
2017	Risk managed @ 10.4%			-	-	-	-	3.120	2.580	2.001	1.380	0.714	-	-	-	-
2018	Risk managed @ 10.4%			-	-	-	-	-	3.120	2.580	2.001	1.380	0.714	-	-	-
2019	Risk managed @ 10.4%			-	-	-	-	-	-	3.120	2.580	2.001	1.380	0.714	-	-
2020	Risk managed @ 10.4%			-	-	-	-	-	-	-	3.120	2.580	2.001	1.380	0.714	-
2021	Risk managed @ 10.4%			-	-	-	-	-		-	-	-	-	-	-	-
2022	Risk managed @ 10.4%			-	-	-	-	-	-	-	-	-	-	-	-	-
2023	Risk managed @ 10.4%			-	-	-	-	-	-	-	-	-	-	-	-	-
2024	Risk managed @ 10.4%			-	-	-	-	-	-	-	-	-	-	-	-	-
				0.208	**1.703**	**4.484**	**6.700**	**8.391**	**9.438**	**9.795**	**9.795**	**6.675**	**4.095**	**2.094**	**0.714**	**-**