Second Loss Partial Credit Guarantee

Unlocking the potential of small and medium enterprises with an innovative, risk-sharing financing solution

WORLD BANK GROUP

Improving access to finance for small and medium enterprises (SMEs) is crucial to enable this dynamic sector to invest, operate, and grow. The World Bank Group's Second Loss Partial Credit Guarantee structure supports asset-based lending and enables more SMEs to obtain financing, all while lowering the costs and risks to financial institutions.

Solving the Collateral Challenge

SMEs promote economic and social development, especially in developing countries—they boost GDP, exports, and job creation. However, SMEs face a major obstacle to success: access to finance.

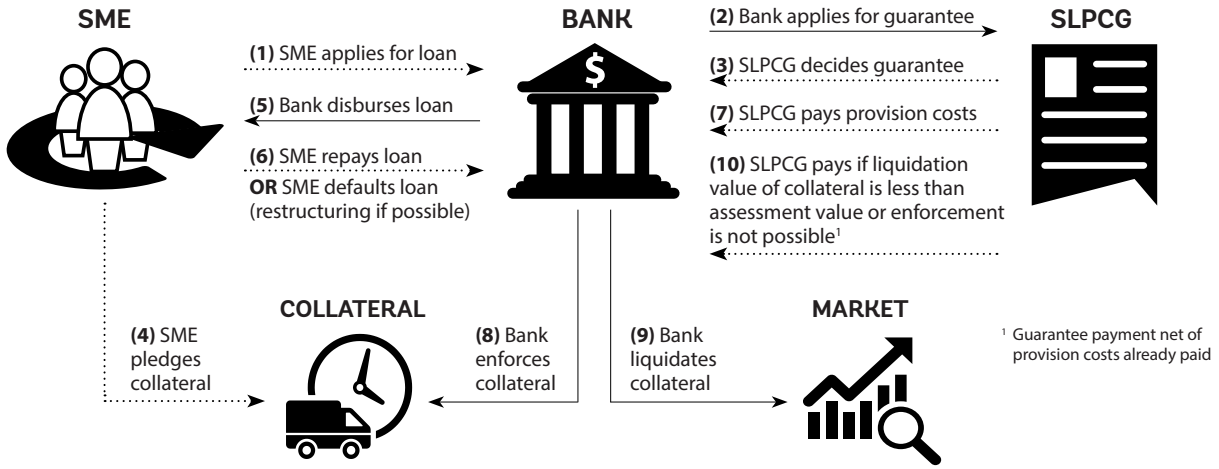
SMEs' access to credit is hindered because they lack fixed assets, such as land and buildings, which could serve as collateral for a loan. Many banks remain reluctant to lend against movable assets, such as inventory, crops, or equipment, due to potential legal challenges to enforce claims or uncertainties about the liquidation value of the collateral. Loans secured with movable assets also have higher capital and provision charges.

Without access to finance, many SMEs stagnate or eventually fail.

Closing the Credit Gap

The World Bank Group works to improve SMEs' access to finance and find innovative solutions to unearth funding sources. The Group assists governments around the world in Global Secured Transactions and Collateral Registries (STR) reforms that make possible the use of movable assets as collateral. The reforms promote secured transaction laws, electronic collateral registries for movable assets, and enforcement mechanisms.

While these reforms are a key step in promoting finance based on movable assets, new, risk-sharing products could counter bankers' and regulators' lack of confidence in using movable assets as security.



Introducing the Second Loss Partial Credit Guarantee (SLPCG)

The World Bank Group is piloting the SLPCG—a product that guarantees the value of movable collateral, tests secured transaction reforms, and equates to the standard public credit guarantee. To implement SLPCG, financial institutions must be willing to lend against movable collateral.

- **SLPCG covers the risk that movable collateral cannot be executed** due to failures in the enforcement system or when other creditors successfully claim the movable collateral pledged. The first loss in the loan is covered by the movable collateral. Banks must execute the collateral first, and the SLPCG covers the remaining losses. However, with a sound STR framework, repossessing and executing the collateral is relatively quick.
- **SLPCG covers the risk of the liquidation value of the movable collateral** falling below the value estimated at the time of loan origination (except in cases of fraud). The SLPCG pays the difference between the assessment and liquidation value of the collateral up to the outstanding loan amount. Losses can be shared with the lender to align incentives.

Expected Impact of SLPCG

- Provides a safe sandbox for financial institutions to test asset-based lending or other loans secured with movable assets against STR reforms.
- Reduces the financial sector's over-reliance on public sector guarantees by creating a viable private sector product that does not use state funds. The proposed structure should have the same prudential treatment as a standard public sector guarantee.
- Frees up public sector guarantees to use with start-up SMEs that have limited movable assets to use as collateral.
- Collects data on borrower and collateral performance that financial institutions can use to reduce provisions for secured loans.

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How can we make it easier and less risky for companies to borrow funds and financial institutions to lend them?

Closing the global credit gap of more than $2 trillion for small and medium enterprises is a pressing issue. But there is a mismatch between what financial institutions require for collateral and what these companies can offer. Our guarantee structure optimizes the use of movable assets as collateral: It covers the risk that movable collateral cannot be enforced and the risk if the liquidation value falls below the assessment value. The product protects financial institutions while giving smaller and younger companies in developing countries the financial access to thrive and expand.

We would be happy to support, through advisory services, partial credit guarantee funds that are interested in implementing this product with their own resources. We would also be happy to explore potential economic support under the context of ongoing or new World Bank Group projects.