THE MONTREAL GROUP

A global forum for micro, small and medium-sized enterprise development

Working Document – 2014-2015

Key Topic: CROSS-BORDER GUARANTEES SUPPORTING GLOBAL EXPANSION

Key Topic Group
Cross-border guarantees

Working Group Members 2014-2015

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SMEs' need for cross-border guarantees/loans

- Opportunity to access international markets by **setting up operations abroad**
- Subsidiary treated as new company in foreign country:
  - No track record with foreign bank
  - Limited access to funding
  - Perceived as high risk in the foreign country
  - Little or no collateral in foreign subsidiary
- To help manage currency risk

Objectives of key topic group

- Comparing different options to support SMEs' international strategies
  - Direct/indirect approaches
  - Outward/inward direction (sending/receiving ends)
  - Guarantee/loan products
- Exploring scope for implementing some options between TMG members

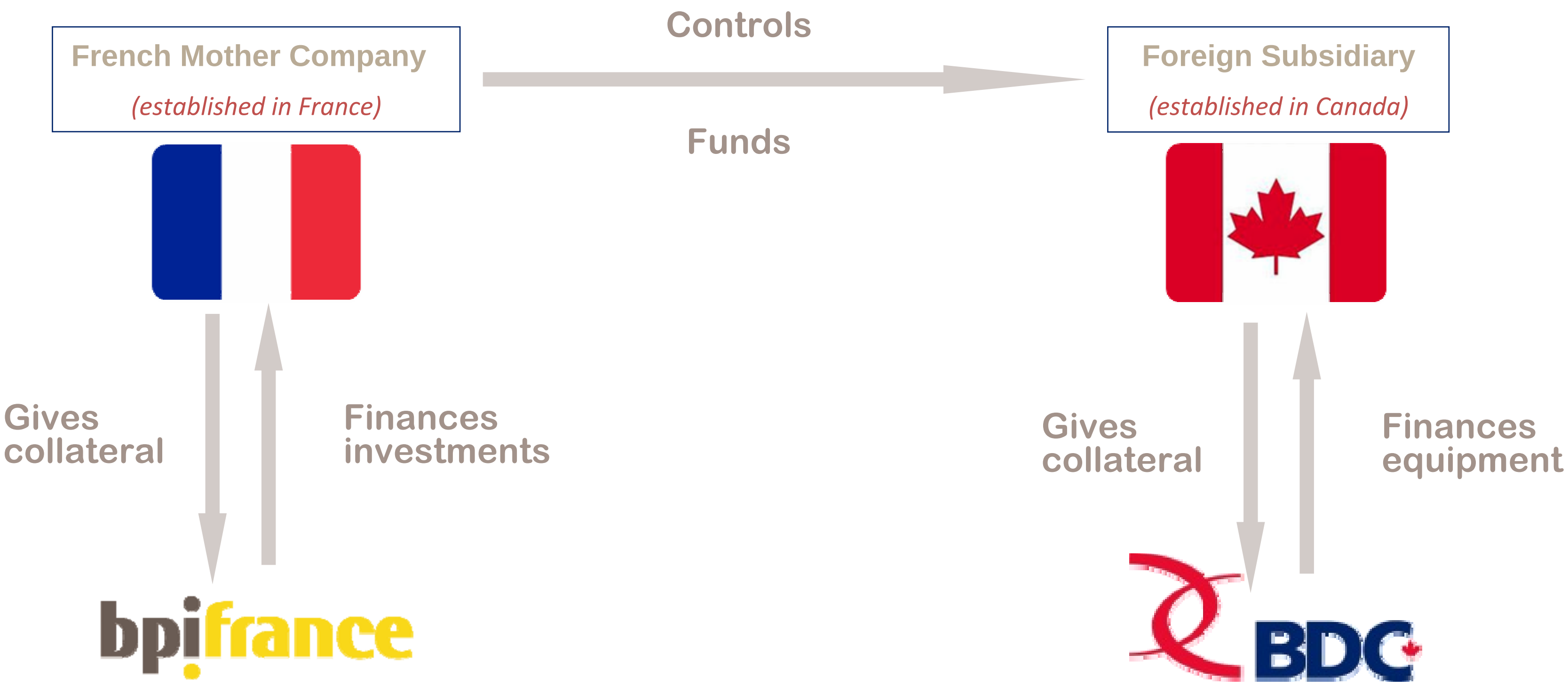
Case study

A well-established French company specializing in 3D impression for the Aerospace Industry wants to implement a subsidiary in Canada with a $1.0M CAD equipment purchase.

- **Bpifrance** understands the client’s financial position, its management capabilities and can easily obtain and provide due diligence information i.e. AML (anti-money laundering) and ATF (fraud)
- **BDC** provides access to local financing & security-taking process according to Canadian regulations

Actual business case conclusion

2 completely separate loans



2 main options discussed by the group

- Loan or guarantee for international investments
- Cross-border counter guarantee

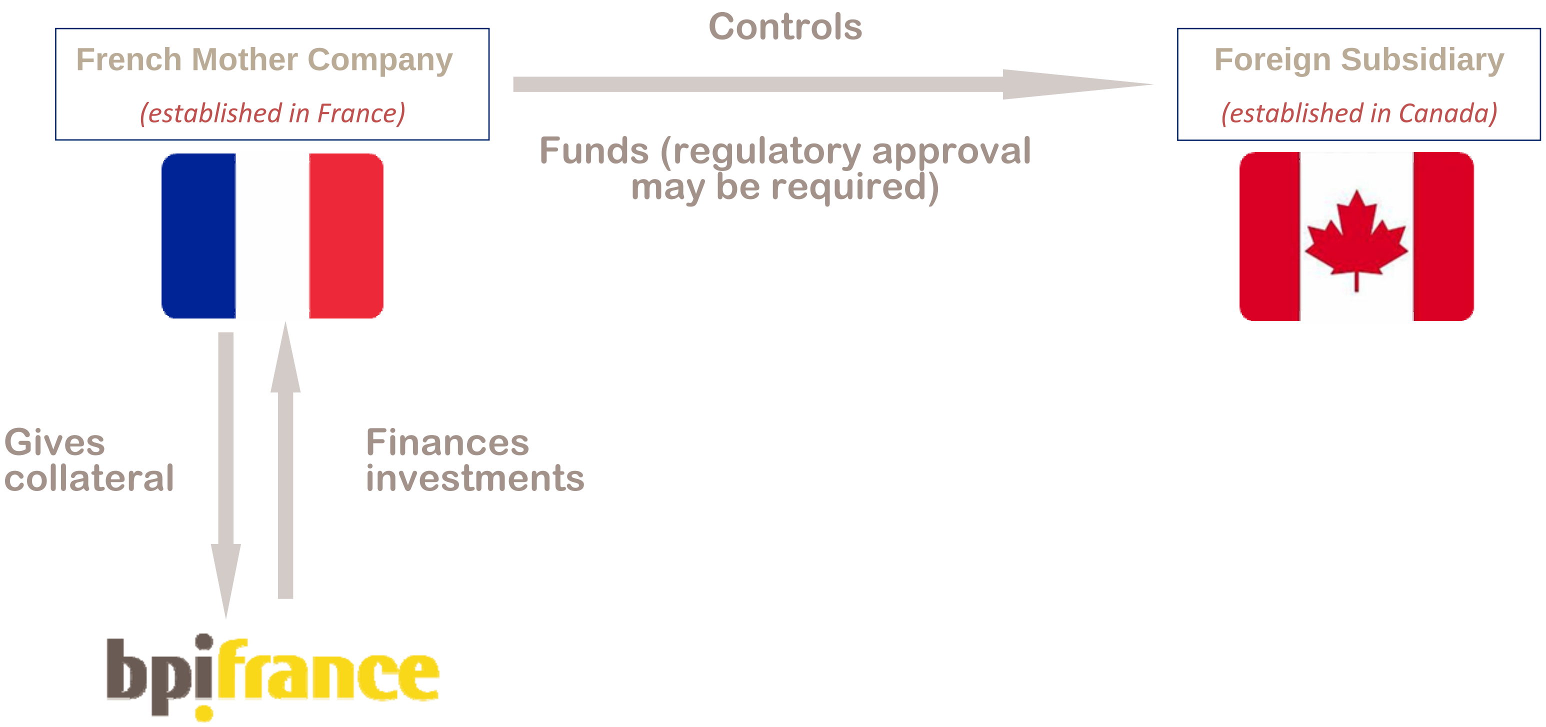
Other options may exist and were not discussed due to lack of time

☐ Guarantee ☑ Direct ☑ Outward
☑ Loan ☐ Indirect ☐ Inward

1. Existing mechanisms

Loan for international investments

Using domestic borrowing leverage, provide financing for investment in subsidiary



☑ Guarantee ☐ Direct ☑ Outward
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1. Existing mechanisms
Guarantee for international investments

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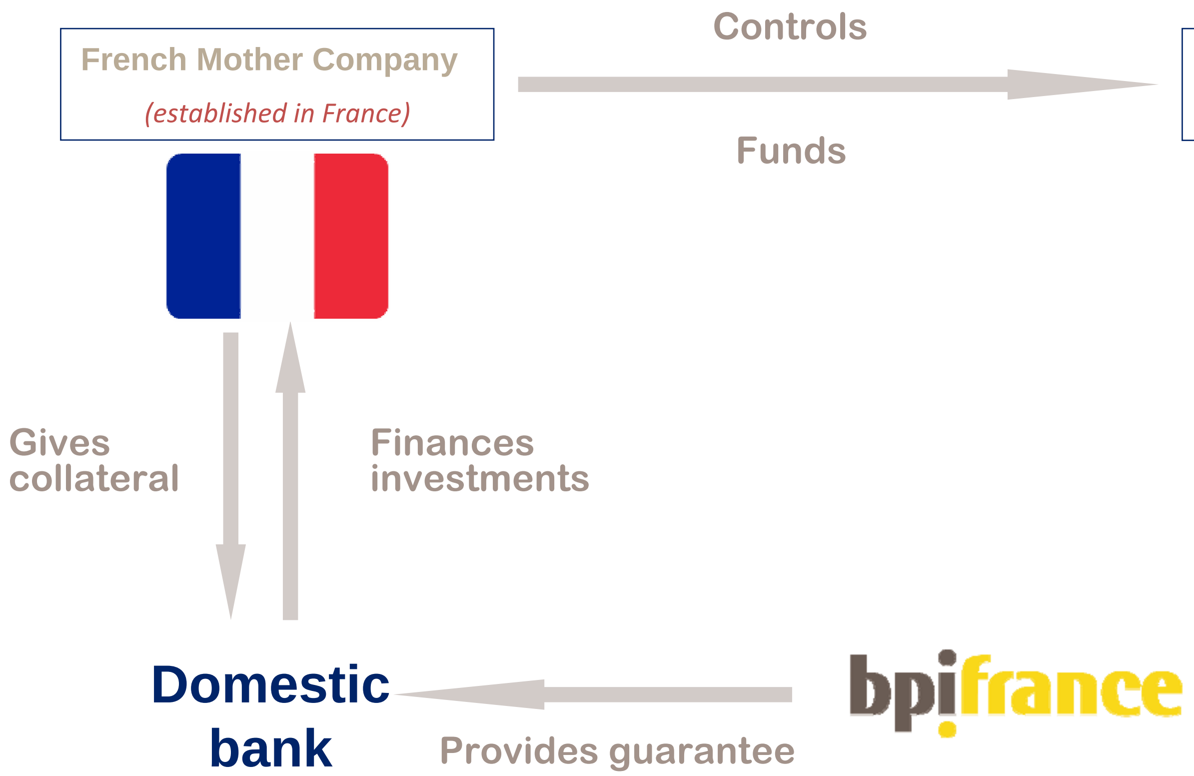


1. Existing mechanisms

Positive aspects

- > Readily **available**
- > Relatively **secure** (domestic Financial Institution takes collateral on mother company)
- > In **domestic currency**: any currency risk is supported by the borrower

1. Existing mechanisms
Negative aspects

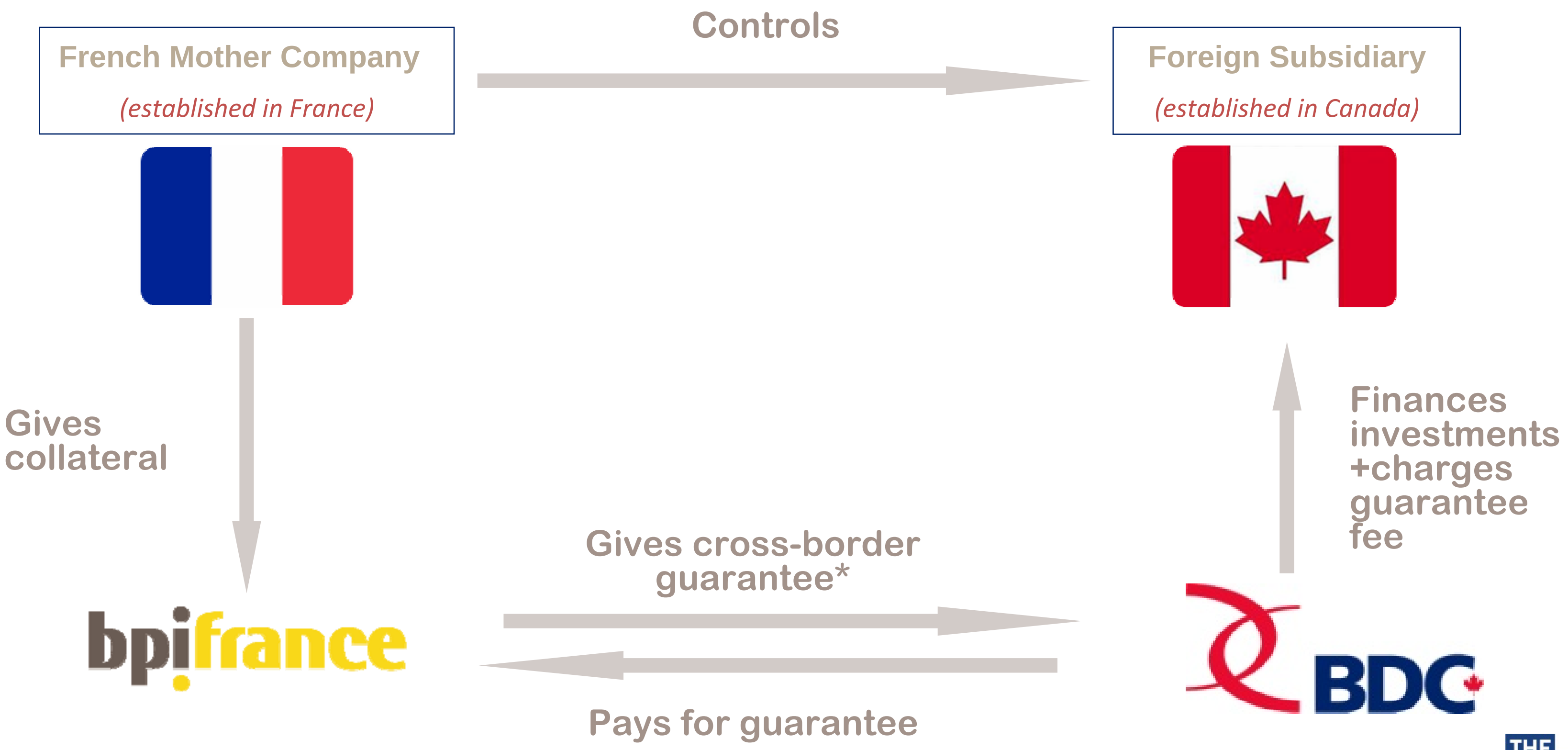
- > Limitations in terms of amounts
- > Investment regulations may limit international movement of funds or require preliminary approval
- > Ownership may differ between parent and subsidiary, limiting capacity to structure financing accordingly
- > Assets in foreign country are free of liens
- > Risks lie with the issuing bank

Involves only one domestic Financial Institution (2 in case of indirect approach) ➔ by coordinating cross-border, through cooperation between TMG members, we can do better for SMEs

☑ Guarantee ☑ Direct ☑ Outward
☐ Loan ☐ Indirect ☐ Inward

2. Cross-border counter guarantee

Agreement between 2 TMG members to provide a subsidiary with access to good financing terms in foreign country.



*Or stand-by letter of credit

2. Cross-border counter guarantee – Guidelines

- Guarantee currency: target country’s
  - where financing is occurring
  - provides greater certainty regarding the risk taken with the subsidiary
  - therefore the issuing bank has the currency risk.
- Guarantee amount: 30% to 70% range
- Ultimate loss guarantee (after recovery process)
- Cost of guarantee based on domestic partner’s model

2. Cross-border counter guarantee – Opportunities

- Capitalizes on both Financial Institutions' knowledge, for the benefit of the client
  - Regulation and security-taking process in the foreign market
  - Financial and historical track record in domestic market
  - Risk sharing between TMG members
  - Simpler for clients, one loan agreement
  - Additional security from the parent company mitigates the currency risk and potentially lowers the guarantee pricing

2. Cross-border counter guarantee – Difficulties

- Participating Financial Institutions need to have the necessary legal constituency and delegation of authority
- Framework agreement needs to be in place
- Risk management:
  - Currency risk needs to be factored in pricing
- Operational issues:
  - Information systems may need to be adapted
- Proposed concept is not compatible with indirect model (via financial intermediaries) because of portfolio approach

2. Cross-border counter guarantee – Conclusions

Makes more sense when the subsidiary is at the start-up phase: among other benefits, limits the investments required from the parent company.

Suitable for +/-1M€ deals?

Increasing globalization: good timing to develop the concept

Next steps

Depending on TMG members' interest:

>Designation of a **contact person** for cross-border set up matters

>Check legal mandate/regulatory implications for implementation of **framework agreements** between TMG members:

- Information sharing and NDA terms
- Counter guarantee (inward + outward)

> Interested members to create a sub-group to take the idea forward and report progress to TMG

> Solution for indirect approach to be developed

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