

The Development Package

Initiatives for promoting the financing of SMEs in particular

An agreement has been concluded between the political parties comprising the Danish government (the Social Democratic Party, the Socialist People's Party and the Social-Liberal Party) and the parties comprising the opposition (the Liberal Party, the Danish People's Party, the Liberal Alliance Party, and the Conservative People's Party) concerning initiatives to promote the financing of small and medium-sized enterprises (the Development Package).

Background

In the last few years, Denmark – like the rest of the world – has been affected by the financial and economic crisis.

This crisis has made it more difficult for small and medium-sized enterprises (SMEs) in particular to obtain financing provided by banks. Two explanations of this are the heavy losses on loans incurred by banks, which has made them more cautious, and the modest equity capital typical of many small enterprises.

The latest Statement on Loans and Advances (udlånsredegørelse) issued by the Ministry of Business and Growth Denmark (December 2011) shows that credit options have been tightened, especially for SMEs. In addition, a number of banks are reducing their exposure to enterprises, particularly in sectors sensitive to market fluctuations, as well as real estate sector and agriculture.

There are many indications that the extent of the financial crisis will impair the ability of small enterprises to qualify for financing for several years to come.

In connection with bank packages and other measures, initiatives have previously been launched to promote enterprises' access to financing. While financing remains in short supply, there is a need to strengthen efforts focused on reversing a downward shutdown trend into an upward growth trend.

Initiatives

Therefore, a major development package is being launched with initiatives to promote the financing of SMEs in particular. The package is aimed at three fields:

1. The demerger of FIH, from which its property activities are to be spun off. This will improve FIH's ability to lend to SMEs in particular.

2. An effort will be made to establish a farm financing institute. The institute is to be instrumental in improving the prospects for viable farms of financing new business development and growth.
3. Strengthening of growth and export financing.

Re 1: FIH

FIH Erhvervsbank A/S faces a substantial funding challenge once the bank's government-backed loans expire. If this is to be resolved by reducing lending, this will drastically trim the bank's balance sheet.

If this type of balance-sheet trimming is even possible, it is unlikely that it could happen without contagion to other banks.

To avoid these negative derivative effects on the financing situation, a solution has been found in which FIH is to be demerged.

The Financial Stability Company (Finansiel Stabilitet A/S) enters into an agreement with FIH whereby the Financial Stability Company takes over FIH's property portfolio of approximately DKK 16 billion. The agreement is contingent on the Finance Committee's approval of a Finance Committee Document authorising this.

The takeover will be effected at estimated market values and pursuant to state-support regulations. The solution will require the phasing out of the individual state guarantees.

For the purpose of identifying the State's risk of loss, the Financial Stability Company will receive an unlimited indemnity bond from FIH Holding A/S. The State receives 25% of any upside, in the event that the liquidation of the property portfolio in the Financial Stability Company goes better than expected.

The agreement increases the likelihood that FIH can be re-established as a specialised commercial bank aimed at financing SME investments.

On a case-by-case basis, it will be possible for other banks in the same situation as FIH, which can meet the requirements for an indemnity bond, etc., to enter into similar agreements.

Re 2: Establishment of a farm financing institute

At present, it is difficult for many farms to obtain financing for new activities. In addition, the Financial Stability Company has been unable to transfer the viable farming exposures it has taken over to other banks.

Although there are signs of improvement of operating economies in the agricultural sector, agriculture's inflexible financial situation prevents structural adjustments and development within the industry.

For this reason, a model is being developed to set up a specialised farm financing institute (LFI).

The purpose of the LFI will be to grant investment capital to farms, led by effective managers and fledgling farmers, in order to re-establish structural adjustments. It is assessed that the LFI should have a capital base of around DKK 300 million to start with. Operations will continue to be financed by the banking sector. The role of the mortgage banking sector will also remain unchanged.

The farm exposures that the LFI receives from the Financial Stability Company and other banks must, in LFI's assessment, be viable. The farm exposures will only be transferred with the agreement of the farmer in question and his bank.

The LFI shall operate on market terms on a par with other financial enterprises. The LFI model will be designed so that it is not anti-competitive in relation to banks or between farmers who obtain financing from the LFI and farmers who obtain financing from other banks.

The establishment of a farm financing institute will not only benefit the individual banks and farms, but will also contribute to stabilising both the agricultural sector and a number of small banks with high agricultural exposure.

Efforts relating to the LFI model will involve the financial sector, Danish Agriculture and Food Council, DLR (Danish Agricultural Mortgage Credit Fund), and the Financial Stability Company.

It is intended that the LFI be established as soon as possible.

Re 3: Growth and export financing

The ability of Vaekstfonden (state investment fund) and the EKF (export credit agency) to grant guarantees and loans for enterprise growth will receive a significant boost. This will be achieved as follows:

- *Boosting the export loan facility with DKK 15 billion*

The export loan facility scheme under the EKF will be boosted by the infusion of an additional DKK 15 billion, thus increasing the total to DKK 35 billion. This will increase exports and create new jobs. The primary users of the export loan facility are large enterprises, but studies show that roughly 4 out of every 10 export *kroner* relating to lending to large exporting enterprises end up at SMEs, as external suppliers, in Denmark. This initiative will be financed by drawing on the government-backed relending scheme. The initiative will be implemented by means of a Finance Committee Document.

- *The EKF's current capital-adequacy band will be extended until the end of 2015. This will enable the EKF to grant export guarantees worth at least an additional DKK 20 billion in the years ahead.*

The EKF's reduced capital-adequacy band can be extended at its present level until the end of 2015 to ensure competitive export financing for Danish enterprises in the years ahead. This will enable the EKF to grant additional export guarantees, and thus support the export orders of many Danish enterprises including many Danish SMEs, for at least DKK 20 billion in the years ahead. This initiative will be implemented by means of a Finance Committee Document, but does not entail additional expenditure.

- *Increasing the credit facility of "Vaekstkaution" loan guarantees by more than DKK 550 million.*

The Vaekstkaution scheme guarantees bank loans granted to SMEs. If an SME cannot repay its loan, Vaekstkaution covers 75% of the loss up to DKK 10 million, and 65% of additional financing up to DKK 25 million. Vaekstkaution can be granted to fund business development, e.g. as part of changes of ownership, investment in plant (commercial construction), the development of new and improved products, and entrepreneurship. All sectors, including agriculture, have access to the Vaekstkaution loan guarantee scheme.

An additional DKK 80 million will be allocated to cover losses on guarantees issued under the Vaekstkaution scheme. These target small loan guarantees where the current need is greatest. These extended loan guarantees will increase support for business-development lending by more than DKK 550 million. The initiative is funded by resetting the priorities at Vaekstfonden and will be implemented by Finance Committee Document. This will enable a flexible application of the combined funds allocated for small and large loan guarantees, according to demand.

- *Vaekstfonden will be given the option of granting subordinated loans in the amount of DKK 500 million. This is expected to increase enterprises' access to bank financing by an additional DKK 1 billion.*

A new scheme will be established to give Vaekstfonden the option of granting subordinated loans to SMEs within a credit facility of DKK 500 million. The subordinated loans will enable growth and change of ownership and contribute to higher solvency ratios that can increase enterprises' prospects of entering into a sustainable growth process. The granting of subordinated loan capital is contingent on the enterprise receiving other loans from lending institutions for at least the same amount. It is estimated, however, that other loan financing – in addition to the subordinated loan capital of DKK 500 million – will account for an additional DKK 1 billion.

By contrast with ordinary loans, no security is required for subordinated loan capital, and for this reason tougher requirements will be imposed on the enterprises and the maturity of their products, as well as on their corporate management. At the same time, the loan interest will be relatively high due to the risk. This scheme will require an amendment of current law. The intention is to try to cover any loss by means of Vaekstfonden's risk premium.

- *Efforts will be made to find alternative sources of funding for SMEs, e.g. the pension sector.*

Efforts will be initiated to find models in which the financing needs of SMEs in particular can match the placement needs of pension funds. In addition, the EKF is continuing its dialogue with other Danish banks in order to give them the option of making financing available to Danish enterprises' exports as well. These discussions take place *inter alia* in connection with meetings of the committee for corporate bonds as a source of funding for small and medium-sized enterprises, whose final report will be issued by autumn 2012 at the latest.

The individual initiatives are described in detail in the enclosed annexes 1–7.