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# Credit Guarantees

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# MERLIN

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# Knowledge context and expertise of José Fernando Figueiredo

Apart from knowledge and contacts provided by Connectology, this document was produced based on the knowledge of the contributor, **José Figueiredo**, his own experience, and direct contacts with practitioners. The information presented in this report is also supported by the following **publications and sources**:

- **Objectives and measures** contributing to the MERLIN project and its pilot initiatives.
- **Analysis of information and guidelines** from the United Nations (UN), European Union (EU), and other relevant international bodies and institutions, such as the European Commission (EC), about the problematic aspects of climate change, its impacts on ecosystems and effects on life on planet Earth, as well as of the political and policy responses, actions, and measures that international bodies, governments, and institutions take to address the climate change emergency, namely those aimed at supporting the rehabilitation of ecosystems and degraded areas.
- Analysis of publications and existing research about **Partial Credit Guarantee Schemes** (CGS), namely mutual CGS, in sources such as AECM – European Association of Guarantee Institutions, REGAR – Iberoamerican Guarantees Association, ACSIC – Asian Credit Supplementation Institution Confederation, and GNGI – Global Network of Guarantee Institutions, the World Bank Group, OECD, and other international organisations, especially for European-based CGS.
- **Relevant international benchmarks for the sector**, namely on the use of mutual Credit Guarantees, to support the financing of sustainability and climate change transformational projects.

- **Analysis of information on the regulation and supervision** (oversight) of CGS in different European countries, and the mission and objectives, guarantee models, corporate governance models and rules, operational structures, guarantee products, operational workflows, risk management policies and tools, controlling mechanisms, and reporting and impact evaluation frameworks of relevant benchmarked CGSs, and from searching in available public sources, such as websites and annual Activities Reports & Accounts.
- **Analysis of main EU environmental laws and guidelines, banking and financial markets regulations** on ESG and green financing, MSME regulations, and the overall legal and regulatory environment.
- **Statistics and other relevant information on the current status of climate change adaptation**, as well as on the financial sector and the MSMEs, available from the Eurostat and national and international statistics bureaus, the central banks, the ministries of finance, economy and/or industry, and environmental and national promotional agencies.
- On the **Principles<sup>1</sup> for Public Credit Guarantee Schemes for SMEs and the Guidelines<sup>2</sup> for Integrating Climate Changes Mitigation and Adaptation in Public CGS for SMEs**.

The authors could not verify all the sources and data, and thus do not guarantee the full accuracy of the data included in this work. Eventual updates or clarifications in the data used or information included in this work do not change in a relevant way the main proposals and conclusions formulated.



**José Fernando Figueiredo** is the Founding President of GNGI – Global Network of Guarantee Institutions, the network representing the Guarantees Industry worldwide. He is also Special Honorary Chairman of AECM – European Association of Guarantee Institutions, and Chairman at Agrogarante SGM, mutual Credit

Guarantee society for the agriculture, agri-industry, fishery, forestry, and minerals in Portugal. He was a member of the task forces that supported the WB/First Initiative in designing the “Principles for the Public CGS for SME” and the “Guidelines for Integrating Climate Change Mitigation and Adaptation in Public CGSs for SME”, and acts as Advisor and Senior Consultant for institutions such as the European Commission, the World Bank Group, the German GIZ, and Governments and Private Financial Institutions in the fields of Credit Guarantees, MSMEs Financing, Promotional Banking and Financial Inclusion, and Green and Sustainable Financing, as well as being invited as speaker to many international conferences. José is also the founder of Knowledge Factory (consulting), a shareholder of Quadrantis Capital VC, and a member of the Advisory Committee at the European Innovation Council Equity Fund (EIC Fund), as well as of the board or advisory boards of varied companies, from insurance brokerage to biotech, and a member of the General Council of the Portuguese Entrepreneurs Association (AEP). He was the co-founder, general manager, CEO and Chairman of the four Portuguese Mutual Credit Guarantee Societies, which peaked at 10 billion Euros in portfolio, and of the respective counterguarantee mechanism, and was Executive President and Chairman of AECM for four mandates. An economist, he is the author of multiple articles on guarantees and is co-author of the guide “Conceptual Framework for information on the outreach, additionality, and financial sustainability of Public Credit Guarantee Schemes” (2018).

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<sup>1</sup> The World Bank Group (2015), Principles for Public Credit Guarantee Schemes for SMEs. Task Force for the Design, Implementation and Evaluation of Public Credit Guarantee Schemes for Small and Medium Enterprises”, Washington, DC.  
<sup>2</sup> The World Bank Group (2022). Guidelines for Integrating Climate Change Mitigation and Adaptation in Public Credit Guarantee Schemes for Small and Medium Enterprises. Task Force on Greening Public CGS for SMEs. Washington, DC.

# List of acronyms/abbreviations

<b>2030 Agenda</b>	The UN 2030 Agenda for Sustainable Development	<b>IFRS</b>	International Financial Reporting Standards
<b>AECM</b>	European Association of Guarantee Institutions	<b>ILO</b>	International Labour Organisation
<b>CCA</b>	Climate change adaptation	<b>IPCC</b>	Intergovernmental Panel on Climate Change
<b>CGS or PCGS</b>	Credit Guarantee company, entity, society or scheme, or Partial Credit Guarantee company, entity, society or scheme	<b>IWRM</b>	Integrated Water Resources Management
<b>CGF or PCGF</b>	Credit Guarantee Fund or Partial Credit Guarantee Fund	<b>KPI</b>	Key Performance Indicator
<b>CGP or PCGP</b>	Credit Guarantee Program or Partial Credit Guarantee Program	<b>MFI/O</b>	Micro Finance Institution/Organisation
<b>CCA</b>	Climate change adaptation	<b>MIS</b>	Management Information System
<b>COP</b>	Conference of the Parties to the UN Framework Convention on Climate Change	<b>MSME</b>	Micro, Small and Medium Sized Enterprises
<b>COP21</b>	21st UN Climate Change Conference held in Paris, France, in December 2015, that approved the Paris Agreement	<b>NAP</b>	National Adaptation Plan
<b>CSRD</b>	EU Corporate Sustainability Reporting Directive	<b>NBFI</b>	Non-Bank Financial Institution
<b>DRR</b>	Disaster Risk Reduction	<b>Nbs</b>	Nature-based Solutions
<b>EbA</b>	Ecosystem-based Adaptation	<b>NDC</b>	Nationally Determined Contribution
<b>EC</b>	European Commission	<b>NFRD</b>	EU Non-Financial Reporting Directive
<b>EIB</b>	European Investment Bank	<b>NGO</b>	Non-Governmental Organisation
<b>EIF</b>	European Investment Fund	<b>NPL</b>	Non-Performing Loan
<b>ESG</b>	Environmental, Social and Governance	<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>EU</b>	European Union	<b>PFI</b>	Participating/Partner Financing Institution
<b>EU Green Deal</b>	The European Green Deal	<b>PRI</b>	UN Principles for Responsible Investments
<b>EU Taxonomy</b>	European Union Taxonomy	<b>SDG</b>	UN Sustainable Development Goal(s)
<b>EU WFD</b>	European Water Framework Directive	<b>SFDR</b>	EU Sustainable Finance Disclosure Regulation
<b>EUR</b>	Euro (currency)	<b>UN</b>	United Nations
<b>FAO</b>	Food and Agriculture Organisation of the United Nations	<b>UNDP</b>	UNDP United Nations Development Programme
<b>FI</b>	Financial Institution	<b>UNEP</b>	UNEP United Nations Environment Programme
<b>GCF</b>	Green Climate Fund GWP	<b>WASH</b>	Water Supply, Sanitation and Hygiene
<b>GDP</b>	Gross Domestic Product	<b>WB</b>	World Bank Group
<b>GHG</b>	Greenhouse Gas	<b>WB Guidelines</b>	Guidelines for integrating climate change mitigation and adaptation in public Credit Guarantee Schemes for small and medium enterprises. WB task force on greening public CGS for SMEs
<b>GNGI</b>	Global Network of Guarantee Institutions	<b>WB Principles</b>	Principles for public Credit Guarantee Schemes for SMEs. WB and first initiative task force for the design, implementation and evaluation of public credit Guarantee Schemes for Small and Medium Enterprises
<b>GRSF</b>	Green Risk Sharing Facility (Credit Guarantee scheme for green financing)	<b>WEFE</b>	Water–Energy–Food–Ecosystems Nexus
<b>GWP</b>	Global Water Partnership	<b>WMO</b>	World Meteorological Organisation
<b>IFI</b>	International Finance Institutions		

# Executive summary

To address Credit Guarantees in natural ecosystems, there is a need to contextualise for those readers that are not so familiar with nature restoration and its importance for our planet and maintaining our living standards.

The European Union adopted the **EU Green Deal**<sup>1</sup> in 2019, followed by a large set of other (legally and non-legally binding) initiatives, such as the **European Climate Law**,<sup>2</sup> aiming at putting Europe at the forefront of the global fight against climate change with the adoption of a sustainable economy and society. This is very much in line with **UN SDG Agenda 2030**.

The Green Deal also states that the EU must be at the forefront of coordinating international efforts towards building a coherent financial system that supports sustainable solutions, including the **restoration of freshwater ecosystems**.

Public action and support of these massive investments, required to restore natural ecosystems, should attract private investment, namely, by covering part of the implicit risks. **Green technologies are costly and not always commercially viable**, making them more expensive and riskier than existent technologies. It is essential to have alternative sources of funding, as not all organisations are willing to invest in these riskier projects.

**This is where Credit Guarantee Schemes (CGS), namely Mutual CGS, can step in, offering necessary risk coverage and financing of green and sustainable projects and investments.**

**CGS are entities that provide guarantees to cover part of the risks that banks and other Partner Financial Institutions (PFIs) incur** when lending to Micro, Small, and Medium Sized Enterprises (MSMEs) or other stakeholders, and in doing so increase their

willingness to finance projects, entrepreneurs, and enterprises that otherwise would not get access to financing. CGS also provide guarantees for the successful execution of projects and other needs of its final beneficiaries (MSMEs and other accepted segments, such as micro entrepreneurs, NGOs, cooperatives, students, consumers, and special purpose initiatives), and engage in technical assistance activities, namely capacitation, mentoring, and consultation.

**The guarantees can be issued for individual loans or operations, or for a portfolio of loans built by a certain lender and partially covered by the CGS.** The guarantee is provided at a cost, as the CGS charge fees for the issuing, normally related to the risk incurred.

In recent years, CGS in Europe and worldwide started their own wave of adaptations to climate change, not only by greening their own operations and reporting standards, but also by increasingly offering guarantees especially designed to support sustainable and green financing, and by incorporating green, sustainable, and social elements into their risk management frameworks and risk appraising models.

Among the many actions defined at global and EU levels to tackle climate change challenges, as set forth in the UN Paris Agreement and the EU Green Deal and subsequent political and policy decisions, countries are encouraged to **“protect communities and natural habitats... and restore ecosystems.”**

The maintenance and recovery of ecosystems and the ways we deal with water and food production are indeed critical to the future.

Ecosystem restoration means “assisting in the recovery of ecosystems that have been degraded or destroyed.”<sup>3</sup>

Among techniques to restore and rehabilitate ecosystems, so-called Nature-based Solutions (NbS) are increasingly in use. Nature-based solutions are grounded in the notion that when ecosystems are healthy and well-managed, they provide essential benefits and services to people, such as reducing greenhouse gas emissions, securing safe water resources, making air safer to breathe, and providing increased food security.

Through this document, we dive deep into the definition of different types of guarantees, the reasons for their existence, the types of beneficiaries, and the way they work, including CGS main features such as products and costs. We end this section by proposing some KPIs and pointing out, in a simple and graphical way, how to access a Credit Guarantee institution in Europe.

We touch upon the **MERLIN project and, using examples, explain how freshwater ecosystem rehabilitation and restoration projects can successfully make use of CGS to prepare and finance (at least part of) their projects and activities**, followed by listing the main pros and cons of using Credit Guarantees in this area.

An especially relevant takeaway is the fact that freshwater restoration projects, and ecosystem restoration projects in general, must be able to capture the economic value of having healthy ecosystems to also be capable to repay (at least some of) the financing they need.

**We hope you enjoy this reading and have the chance to learn more** about (mutual) Credit Guarantees and the ways they can help finance the rehabilitation/restoration of freshwater ecosystems, and the necessary green transition in general.

<sup>1</sup> COM (2019) 640 Final, Brussels, 11.12.2019. Communication From the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions – (“The European Green Deal”).

<sup>2</sup> REGULATION (EU) 2021/1119 of the European Parliament and of the Council, of 30 June 2021, establishing the framework for achieving climate neutrality and amending regulations (EC) no. 401/2009 and (EU) 2018/1999 (“European Climate Law”).

<sup>3</sup> The UN Decade on Ecosystem Restoration 2021–2030, UNEP and FAO.



## Background

There is a need to adopt bold and determined measures to stop global warming, mass consumption of resources, and ecosystem destruction, and to mitigate climate change effects, including risks arising from natural catastrophes and climate extremes.

Alongside many other measures taken globally to combat the effects of climate change and to adapt companies and societies for the new conditions, it is crucial to apply intensive recovery and restoration policies at the levels of atmosphere, sea, and land, as a way to make life on our planet better and longer.

Aligned with these global objectives, the European Union adopted **the EU Green Deal**,<sup>1</sup>

followed by a large set of other (legally and non-legally binding) initiatives, such as the **European Climate Law**,<sup>2</sup> aimed at putting Europe at the forefront of the global fight against climate change with the adoption of a sustainable economy and society.

**The main goals of the Green Deal are that Europe become climate-neutral (0 net GHG emissions) by 2050 to protect human life, animals, and plants; and to help European companies become world leaders in clean products and technologies, while ensuring a just and inclusive transition, in a way that leaves no one behind.**

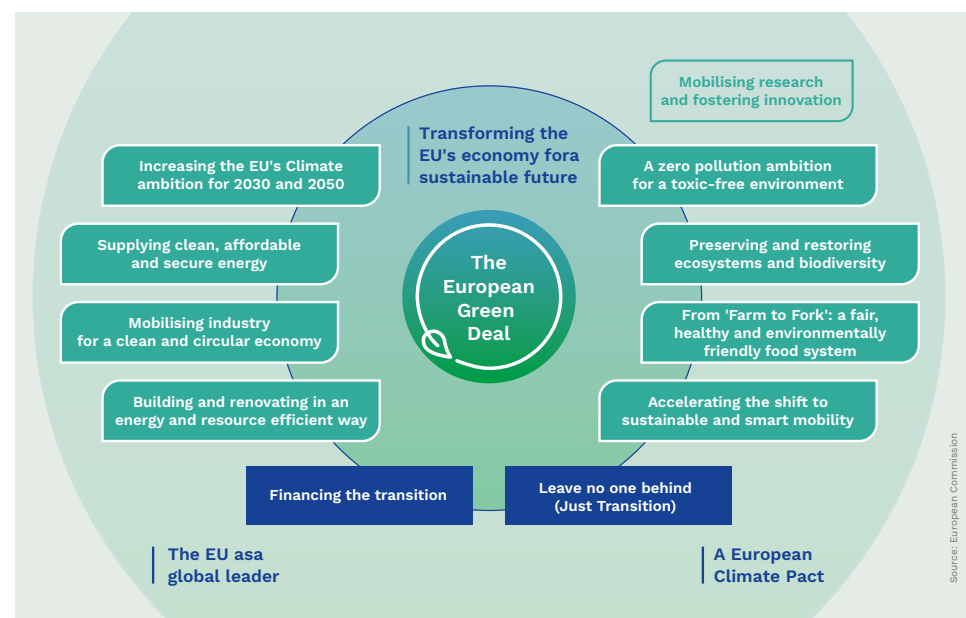


Figure 1: The various elements of the European Green Deal

<sup>1</sup> COM (2019) 640 Final, Brussels, 11.12.2019. Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions – (“The European Green Deal”).

<sup>2</sup> REGULATION (EU) 2021/1119 of the European Parliament and of the Council, of 30 June 2021, establishing the framework for achieving climate neutrality and amending regulations (EC) no 401/2009 and (EU) 2018/1999 (“European Climate Law”).



Public action and support for natural ecosystems restoration should attract private investment, namely, by covering part of the implicit risks and, eventually, of the cost of capital of green projects (green technologies are costly and not always commercially viable, making them more expensive and riskier than existent technologies).

Ecosystem restoration means “assisting in the recovery of ecosystems that have been degraded or destroyed, as well as conserving the ecosystems that are still intact. [...] All kinds of ecosystems can be restored, including forests, farmlands, cities, wetlands and oceans. [...] Between now and 2030, the restoration of 350 million hectares of degraded terrestrial and aquatic ecosystems could generate US\$9 trillion in ecosystem services... The economic benefits of such interventions exceed nine times the cost of investment, whereas inaction is at least three times more costly than ecosystem restoration.”<sup>3</sup>

**Ecosystems with richer biodiversity and unpolluted land and waters yield greater benefits to communities, also from an economic perspective.** They provide bigger crop yields or higher wood production due to more fertile soils, supply higher catches from fisheries, and cache larger stores of greenhouse gases. All of this has an economic value.

Among techniques to restore and rehabilitate ecosystems, so-called **Nature-based Solutions (NbS)** are increasingly in use. Nature-based solutions are grounded in the notion that when ecosystems are healthy and well-managed, they provide essential benefits and services to people, such as reducing greenhouse gas emissions, securing safe water resources, making air safer to breathe, and providing increased food security.

NbS refer to policies or actions that use the power of nature to regenerate itself to address some of the most pressing societal challenges, such as threats to water security, rising risk of disasters, and climate change, while also safeguarding biodiversity and improving human wellbeing.

Cases of the use of NbS in solving real life problems:

- **MERLIN project case 08**,<sup>4</sup> concerning the restoration of a 400 thousand ha agriculture area in the Lower Danube floodplains in the Gârla Mare region, Romania, was selected to demonstrate the benefits of reconnecting former and transformed wetlands back to the natural flood pulse of the Danube, to enhance the benefits provided to natural and local communities. The project also emphasises the benefits of having large partnerships between different interest stakeholders and the local community. **This project involves agricultural and fish-farming sectors, the Ministry of Agriculture and Fishery, Romanian Waters National Administration, National Agency for Environmental Protection, local administration, County Council, nature protection NGOs such as WWF Romania, farmers, landowners, and local community.**
- Another example is **mangrove forests**. Located along coastlines, they are not only important for sustaining fisheries, but also for providing protective natural barriers against erosion and strong storms. They filter water, provide valuable timber and food resources to coastal communities, and can store huge amounts of carbon. **Conserving and restoring these ecosystems benefits people in coastal communities by reducing vulnerabilities and increasing their resilience to the effects of climate change.**<sup>5</sup>

In short, Nature-based Solutions can be a win-win for people and nature. They are different from the notion of conservation, as it relates only to the protection and preservation of the planet’s biological diversity and natural resources so that they exist into the future. NbS include protecting plant and animal species, habitats, ecosystems, and important ecological services against threats. Conservation can involve setting aside parks and preserves, ensuring that species have the habitat they need to survive, or implementing laws to protect endangered plants and animals. Nature-based solutions, on the other hand, encompass a wide range of approaches—from the restoration of habitats to water resource management, disaster risk reduction, and green infrastructure—to address societal problems.

**With the importance of financing for green and sustainable projects growing each year, it is essential to have alternative sources of funding.** And yet, not all organisations are willing to invest in these riskier projects. This is where Credit Guarantee Schemes (CGS), namely Mutual CGS, can step in, offering necessary risk coverage and support to financing of green and sustainable projects and investments.



<sup>3</sup> The UN Decade on Ecosystem Restoration 2021-2030, UNEP and FAO.

<sup>4</sup> See [project-merlin.eu](http://project-merlin.eu)

<sup>5</sup> WWF – World Wildlife Fund website. <https://www.worldwildlife.org>

# Credit Guarantee Schemes (CGS)

## What a guarantee is and how it works

A **guarantee is something given as security**. The so-called “Bank Guarantees”, “Bank-Type Guarantees”, “Financial Guarantees”, and even “Financial Sureties” (all now long called **Guarantees**) are **contracts that serve as a promise from a financial institution**, or a similar entity legally allowed to issue these types of guarantees, **to cover a specified amount of debt or contractual obligations if the principal debtor fails to fulfil them**. These guarantees provide assurance to beneficiaries that they will receive financial compensation in case of default.

Guarantees are very important in the financial industry, as they allow certain financial transactions to proceed that wouldn’t normally take place. **Guarantees make lending more affordable for certain classes of borrowers, and for certain types of operations where the perceived risk is too high and the chances of getting financing or signing a contract are low.**

In the presence of a Guarantee, a risk-sharing and risk-mitigating tool, lenders can not only extend loans to

a wider segment of the market (thus bringing additional and enlarged outreach to the financial markets), but also offer their borrowers better interest rates and credit conditions. Contractors can also provide their counterparts with requested assurance that their obligations will be accomplished.

Most of the time, a financial Guarantee does not cover the entire liability. Particularly in the case of loan guarantees, the Guarantee normally covers a part (a percentage) of the principal of the loan, not the full amount nor interest.

Considering the importance of Guarantees, understanding the details of the way they work is essential for businesses and individuals alike.

Guarantee “Providers” include various financial institutions such as banks, credit unions, insurance companies, and other specialised financial service providers; namely **Credit Guarantee Companies, Entities,**

**Funds and programs, all of which are usually designed as Credit Guarantee Schemes (CGS).** These entities issue Guarantees on behalf of their clients (the final beneficiaries), ensuring fulfilment of their contractual obligations whether that be successful repayment of a loan, effective provision of a service, or good quality of products or goods sold.

Guarantee providers’ services encompass a variety of offerings tailored to meet the diverse needs of clients. **These services can be categorised into secured and unsecured Guarantees.** Backed by collateral or assets, secured Guarantees provide an additional layer of security for the beneficiary. On the contrary, unsecured Bank Guarantees do not require collateral, thus making them more accessible to businesses, projects, and individuals with limited assets.



Guarantees offer multiple advantages to both direct beneficiaries (the ones paid in case of default) and applicants (final or indirect beneficiaries), including:

- **Risk Mitigation:** This is considered to be the main and most relevant feature of a Guarantee. It mitigates the risk of non-payment or default from the principal debtor or servicer, providing assurance to parties involved in a transaction. In case of default the provider of the Guarantee will pay to the beneficiary the amount stipulated, on behalf of the defaulting principal debtor.
- **Enhanced Credibility:** Having a Guarantee enhances the credibility of the applicant, making them more attractive to potential lenders and/or business partners.
- **Facilitated Transactions:** Guarantees facilitate smooth and efficient transactions by providing assurance of payment or performance.

**Obtaining a Guarantee involves several steps, including documentation, assessment of creditworthiness, and agreement on terms and conditions.** This process can be more bureaucratic and imply a lengthier procedure, or simple and smooth, depending on the risk of the underlying main obligation, the creditworthiness of the applicant for the Guarantee, and the operational framework used to support the process. Issuing a Guarantee to cover the full repayment of a loan from a new NGO, or the successful execution of a project from an entity without history or proven expected revenues, will normally require a deeper and lengthier analysis than guaranteeing a loan from a well-established company with known and solid historical cash flow.

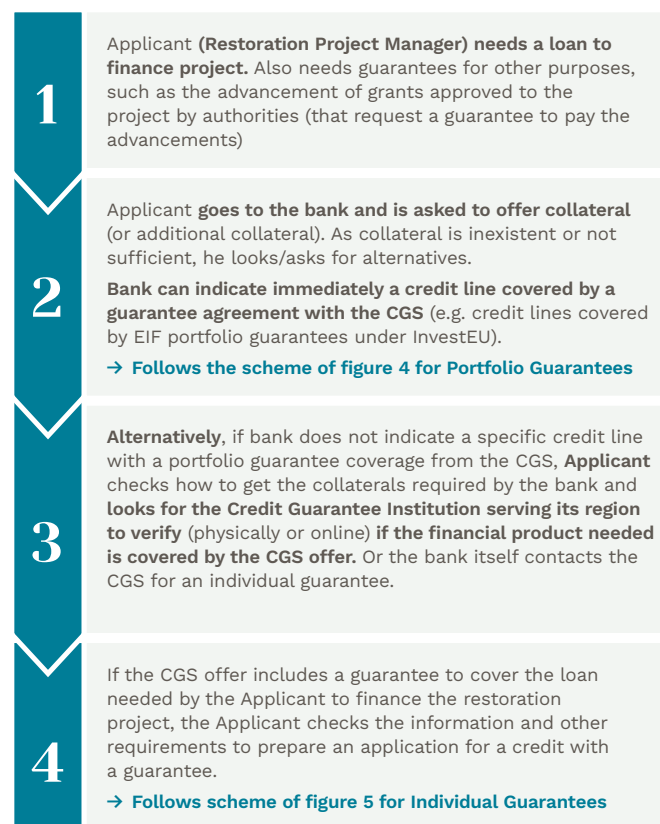
On the other hand, **information requirements are also related to the sophistication of the market in which the applicant moves.** In developed financial markets there are multiple sources of information available that can help the Guarantee providers assessing the application, streamlining the procedures and the paperwork; in other cases the application still relies on lengthier and heavier information requests.

**Applicants typically need to provide the following documents to obtain a Guarantee** (or a loan and respective Guarantee, in the case of credit lines with portfolio guarantees attached): **Fill and application**

**form, financial statements, the business plan or project details, and named collateral (for secured guarantees).** The Guarantee provider will make use of the applicant's credit history to complete the analysis, according to its internal risk appraisal model.

**Factors influencing the approval** and corresponding issuance of a Guarantee are essentially the **financial stability of the applicant, their credit history, the nature of the transaction, and the collateral offered by the applicant** to the provider to cover its risks. These factors determine the creditworthiness of the applicant and the risk profile of the operation. They play a crucial role in obtaining a Guarantee, as it determines the **applicant's ability to fulfil their obligations and not enter default.**

Figure 2: How to apply for a guarantee from a CGS



Source: Own elaboration

**Guarantees offer valuable security, but they also imply certain costs and charges that applicants need to consider, such as:**

- **Analysis and/or Issuance Fees**, charged by the provider for studying and issuing the Guarantee (not always charged; in Europe, in most cases, varies from 0,25% to 2%, paid one time upfront).
- **Commission Fee**, to cover the risk of the operation, normally charged as a percentage (in Europe, in most cases, varies from 0,5% to 4%) of the guaranteed amount and paid periodically to the provider. In the case of CGS, is its main revenue source.
- **Renewal Fee**, charged for renewing the Guarantee upon expiry, in the case of guarantees for revolving credits and similar operations.
- **Handling and other Fees** may also be charged as defined in the pricing policy of the provider.

Despite their benefits, Guarantees carry certain risks, primarily for the issuing entities (the “providers” of the Guarantee) but also for the applicants. The providers essentially face the applicant's risk of default, meaning the risk of the applicant failing to fulfil their obligations vis-à-vis the beneficiary, leading to a coverage liability and correspondent payment obligation(s) to the beneficiary(ies) of the amounts guaranteed. Guarantee issuers also face a risk that debts will be uncollectable, related to difficulties in or the impossibility of receiving the fees from the guarantee applicants. The applicants risk being called for repayment of their debts to Guarantees honoured by the providers. In case of default, the providers pay the guaranteed amounts to the beneficiaries, but go after the principal debtor(s) to claim from them the amounts paid and additional costs incurred in honouring the payment of the Guarantee.

More common types of financial Guarantees include:

- **Loan Guarantee** – Ensures that the principal of a loan is paid on time by the borrower, according to the defined schedule. In exceptional cases, may also cover interest.
- **Payment Guarantee** – Ensures that the delivered goods or rendered services are paid for on time by the buyer of those goods or acquirer of the services (e.g. someone that sells a certain crop and requires



a guarantee from the buyer to be paid within a certain season).

- **Tender Guarantee (Tender Bond)** – Ensures payment requests are met if the subsequent tenderer refuses further cooperation (e.g., cancels application, or does not sign contract).
- **Tax and Customs Guarantee** – Ensures that obligations to the tax and customs authorities are met.
- **Advance Payment Guarantee** – Ensures that a certain advance payment is refunded if the terms of a transaction or the execution of an investment project are not met in terms of time, volume, and quality.
- **Performance Guarantee** – Serves as a guarantee that all services, tasks, or goods deliveries will be completed in full and on time.
- **Technical Guarantee** – Assures that the technical quality or characteristics of a certain service or good delivered are according to the terms of reference and detailed technical requirements, and/or last for a certain period, as defined in the contract.

Every market and every law require a different type of bond. Some are legal obligations, while others are related to business contracts. Some examples include environmental guarantees for the operators of the Establishments Classified for Environmental Protection (French law: ICPE), financial guarantees for government agencies or the food-processing industry, market guarantees for the construction and public works industries, and loan guarantees for local authorities to facilitate the realisation of public interest projects.

The following parties are the participants in a financial Guarantee contract, arrangement, or scheme:

- **Direct Beneficiary** – The natural or legal person guaranteed, allowed to submit a payment request and receive the payment amount from the Guarantee provider in case of default by the principal debtor (is the lender).
- **Principal Debtor or Applicant (Indirect Beneficiary)** – The natural or legal person who (normally) applies for the issuance of a Guarantee by the guarantor and ultimately benefits from its existence (is the borrower). In the case of portfolio guarantees, the principal debtor applies for a loan and the bank decides the approval of the request and inclusion of that loan in the portfolio of credits guaranteed by a certain portfolio guarantee arrangement.
- **Guarantor** – The financial institution (CGS, bank, insurance) that issues the Guarantee and agrees to pay the amounts determined in the conditions set to the beneficiary named in the agreement upon receiving a payment request, and fulfilment of remaining payment requirements as defined.
- **Counterguarantor** – An institution or patrimony that partially covers the guarantor, sharing part of the risk and paying part of the amounts the guarantor pays to the beneficiary in case of default.

**When selecting a Guarantee provider, factors such as reputation and reliability, costs and fees, customer service and technological support, as well as possible regulatory constraints of the provider CGS should be considered.**

Text Box 1 with Example of a CGS intervention in an SME green investment

## Mutual Guarantee and Environmental Sustainability: Collaborative Efforts for a Greener Future

### Mutual Guarantee Societies: example of financing green investments

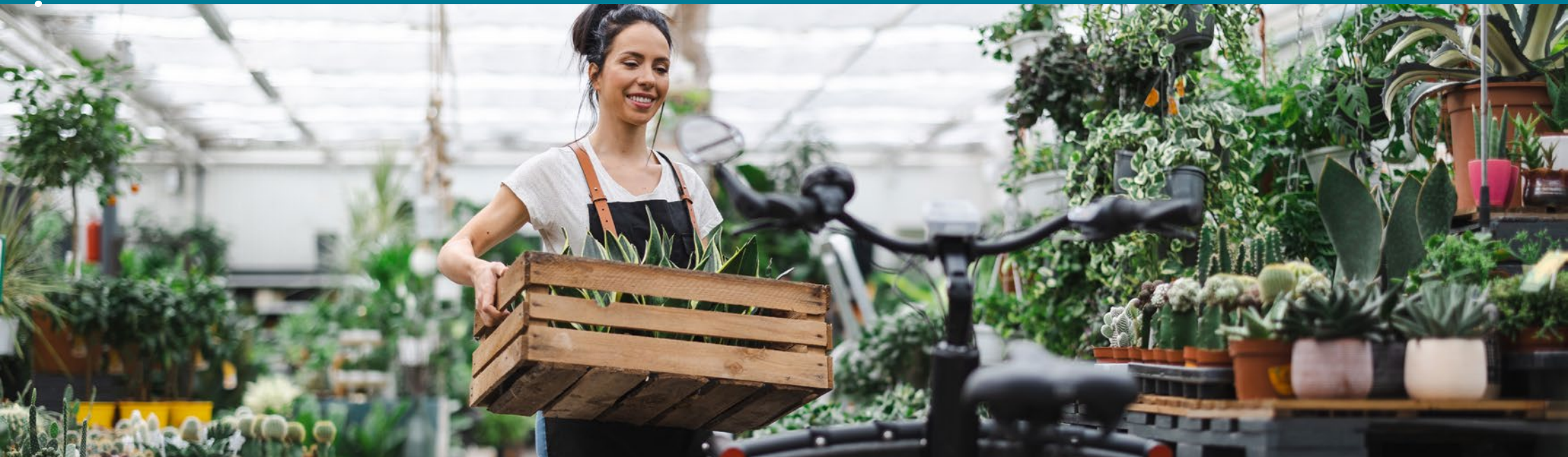
Agriculture Society YYY

#### Investment Description

- The operation was intended to support investment for the implementation of a process for the valorisation of agricultural by-products, such as olive pomace, through composting to produce organic fertilizers.
- YYY, aware of the importance of efficient resource management, but also in the circularity of the economy, intends to move forward with the implementation of a process for valuing agricultural by-products (such as olive pomace), through composting, to produce organic fertilizers, thus contributing to a more efficient management of resources, valuing by-products and replacing the import and application of synthetic fertilizers.
- It is a strategy for sustainable development and circular economy, giving new life to a set of by-products, incorporating them back into its production process. Composting olive pomace is a biological process that transforms organic waste into a nutrient-rich organic compost, which can be used as fertilizer for agricultural plants and crops.
- The circular economy in agriculture is a sustainable approach that seeks to reduce waste and maximize the efficiency of the resources used in agricultural production. This approach is based on three core principles: reduce, reuse, and recycle.
- The process that YYY intends to implement is a sustainable practice that contributes to several sustainable development goals in Portugal and Europe. Some of these goals include:
  - Waste reduction;
  - Protection of the Environment;
  - Promotion of Sustainable Agriculture;
  - Reduction of Dependence on Chemical Fertilizers;
  - Promotion of the Circular Economy.
- In summary, it is understood that YYY's investment/project fits not only into the objectives of the Circular Economy, but also makes an important contribution to national energy and climate objectives.
- This project arises from the need to take advantage of the approximately 10,000 tons of by-products (produced annually by YYY) with very little or almost no commercial value, including lampant oil, olive pomace, olive leaves, almond leaves, almond capote, and grape pomace.
- **In addition, there was a problem (every year) to manage the wastewater from the mill and the winery, which is about 5 million liters.**
- Thus, YYY has the raw material to produce 5 to 10,000 tons of organic compost of very high quality, and it is only necessary to acquire the equipment and adapt the facilities for its production.
- **Wastewater will be used to irrigate compost piles, closing the circle.**

#### Financial Operation

- Amount of loan required to support project: 950,000.00 €
- Bank A open to lend the amount required but asked for a collateral (that company did not have).
- Company reaches Agrogarante that positively appraises the project and approves a guarantee to the loan of 760,000.00 € (80% guarantee coverage).
- Time Frame: 78 months
- Interest rate (paid to the Bank A): Euribor 6m + 1.5% spread
- Fee for the guarantee (paid to Agrogarante): 1.1% per year on the outstanding amount of the guarantee at year-end (that is 80% of the remaining loan unreimbursed yet).



## Why CGS?

**Micro, Small, and Medium-sized Enterprises (MSMEs), including individual entrepreneurs, form the backbone of most of the world's economies. The same applies in Europe.**

Despite their relevance, **MSMEs, as well as many NGOs, face numerous impediments in accessing credit**, among them: lack of sufficient collateral, informality, information asymmetry, stringent loan requirements, capacity challenges on business management, and a relatively high cost of credit.

This difficulty is even more visible for certain segments of the entrepreneurial activity and asset classes, e.g., youth and women entrepreneurship, regional or farmland developments, green and decarbonisation investments, startups, and social or impact investments.

Moreover, **certain specific investment projects in the fields of sustainability and greening**, namely those promoted by a mix of private and public entities or by NGOs and volunteer individuals, **remain far from the traditional forms of financing. They require an innovative approach to access lending** and/or other forms of financing granted by public entities (e.g., the need to provide financial guarantees to access advancement of grants).

## Aim of the instrument

**CGS are among the main policy tools used in almost all parts of the world to address the lack of access to credit finance** by MSMEs, startups, and other targeted economic and social sectors, or by other specifically defined final beneficiary segments. **CGS mitigate the risk of default by borrowers through guaranteeing an agreed portion of the loans** to MSMEs and other beneficiaries, **reducing the lenders' losses in case of default of the original borrower or of non-performance of a contract.**

By providing this partial guarantee, **CGS make lenders more willing to lend** to borrowers that would otherwise have been denied credit, helping the MSMEs and other final beneficiaries in the development of their businesses or projects. **In doing this, CGS contribute to reducing the market gap in the MSMEs financing markets**, and induce a positive externality in the financial markets, as banks must learn how to better evaluate the risks of MSMEs and of the other types of projects

supported, thus becoming better prepared to finance them.

Guarantees are primarily aimed at partially covering the risks incurred by banks when lending to MSMEs and/or other entities. However, they can also be used to cover risks in other situations, such as in the advancement of grants by public authorities (in subsidised projects), or to assure the successful execution of a contract (performance bonds).

**The project managers for restoration/rehabilitation of freshwater ecosystems can access a CGS entity or program to get guarantees to cover their lending needs to finance their investments, to guarantee project performance to lenders/investors, or to provide the guarantees required by public entities.**

**Also, some private members of a project** (entrepreneurs, MSMEs, cooperatives, and even some NGOs) **can get access to financing by using a credit guarantee.**

# Potential beneficiaries

CGS normally work very close with their **beneficiaries**:

- **Direct beneficiaries** – those that receive the guaranteed payment in case of default of the applicants. Includes banks and other PFIs in cases of guarantees to loans, but also public authorities, suppliers, or customers in cases of technical guarantees, guarantees of good payment to suppliers, and performance bonds.
- The indirect, **final beneficiaries** or applicants—those that apply for the guarantee and benefit from the loans and other services due to its existence. They are mainly the MSMEs and entrepreneurs, but also cooperatives, students, households, consumers, and, in some cases, networks or specific projects through an indicated entity.

Alongside the guarantees, the final beneficiaries get technical assistance, mentoring, capacitation, and advice in financial matters. Sometimes banks and PFIs also benefit from capacitation programs from the CGS.

**CGS can be an effective tool to mobilise private resources and increase lending to projects which have a viable business proposition but insufficient collateral.** This applies to projects subject to nature-related risks, such as those for the rehabilitation/restoration of freshwater ecosystems, and that follow under the economic activities covered by the enlarged concept of the “EU taxonomy”.

**The main direct beneficiaries of the CGS guarantees in projects aimed at rehabilitation/restoration of freshwater ecosystems, such as those presented as pilots in the MERLIN project, can be both the banks/PFIs that decide to lend to these projects and will have part of those loans covered by a guarantee, thus reducing their risk, and the public authorities that may ask for guarantees to pay advancements or grants/subsidies to these projects.**

**The main final beneficiaries can be their management entities, if formally endowed to ask for loans or financing, or some of the consortium/project public and/or private members, on behalf of their parts in the project.**





# Why are CGS initiatives established by governments or the private sector?

**CGS are among the most widely-used and market-friendly interventions in the financing markets, as they cause minimal market distortions as compared to more direct forms of intervention, such as subsidised lending or grants, and represent little competition to market players.**

**As mentioned before, a well-designed CGS brings additionality and increases outreach to the MSMEs financing markets**

(and other underserved segments), helping to fill existing gaps, and at the same creates a positive externality, as banks must increase their knowledge about these market segments. Also, from the shareholders' perspective (being public taxpayers' money or private), CGS are a relatively cheaper solution, as they can multiply the capital allocations (their own funds) to reach the final volumes of support (see figure 3).

Figure 3: Examples of multipliers of CGSs in different countries

Organisation	Country	Simple Straight Leverage/ Multiplier 2019 <sup>1</sup>	Risk Decision/ Delivery Model <sup>2</sup>
NÖBEG	Austria	2,0	Individual
NGF	Bulgaria	5,6	Individual
NRB	Czechia	4,9	Individual
CGC	Egypt	> 10	Portfolio (mainly)/Individual
SOCAMA <sup>3</sup>	France	24,7	Portfolio
TMEDE	Greece	3,5	Individual
Garantiqa	Hungary	18,0	Portfolio
AVHGA	Hungary	6,9	Individual (mainly)/Portfolio
ISMEA	Italy	27,5	Portfolio
KCGF	Kosovo	2,6	Portfolio
KODIT <sup>4</sup>	Korea	9,1	Individual (mainly)/Portfolio
SGM <sup>5</sup>	Portugal	11,6	Individual (mainly)/Portfolio
SGR <sup>6</sup>	Spain	5,0	Individual
FGCR	Romania	1,9	Individual
FNGCIMM <sup>7</sup>	Romania	0,7	Individual (mainly)/Portfolio
TESKOMB	Turkey	14,2	Portfolio

Source: AECM Yearbook 2021 and 2022, CGC, KODIT, SGMs, CERSA, CESGAR and SGRs Websites. Own elaboration.

<sup>1</sup> Outstanding Portfolio at year end divided by total Equity at year end (does not consider effects of eventual counter-guarantees). Year 2022 for CGC Egypt, KODIT Korea, SGM Portugal, SGR Spain.

<sup>2</sup> Delivery models change over time and some CGS moved from only individual, or only portfolio to mix.

<sup>3</sup> Benefices from partial counter-guarantee from the EIF-European Investment Fund that reduces effective final leverage.

<sup>4</sup> KODIT has a maximum legal multiplier of 20x its won funds.

<sup>5-6</sup> Benefice from partial counter-guarantee from the national counter-guarantee fund that reduces effective final leverage.



On the other hand, a **badly designed and implemented CGS can be harmful, as its results will be small or even negative** for the amount of public resources involved, and market distortions can occur due to its wrong incentives and malfunctioning.

**There are different legal and organisational structures for the CGS worldwide** (independent ongoing concerns, funds, and programs). Also, the ownership (fully state-owned, fully private, and private-public partnerships) and supervision (from the financial regulator, central bank, or the ministry of finance, economy, or industry) vary.

Despite the absence of a standard legal and operational framework for the establishment and management of a Credit Guarantee scheme, the most common models are as follows:

- **Independent Credit Guarantee Companies or Societies (CGC)** managed as ongoing concerns (corporations, mutuals, or co-operatives)
- **Credit Guarantee Departments (CGD)** of public promotional institutions (promotional banks or development finance institutions)
- **Independent Credit Guarantee Funds (CGF)**, normally with legal personality, under a specific law or regulation published by a government, but managed by a third-party managing entity
- **Credit Guarantee Programs (CGP)**, that concern specific policy measures, sometimes like the PCGFs, managed inside a certain public organisation, such as an SME agency, or even a promotional bank or a CGC, using their internal team; normally with a specific (bounded) budget allocation for a proposed mission, that is time limited, capped in terms of volume, and focused as to delivery conditions.

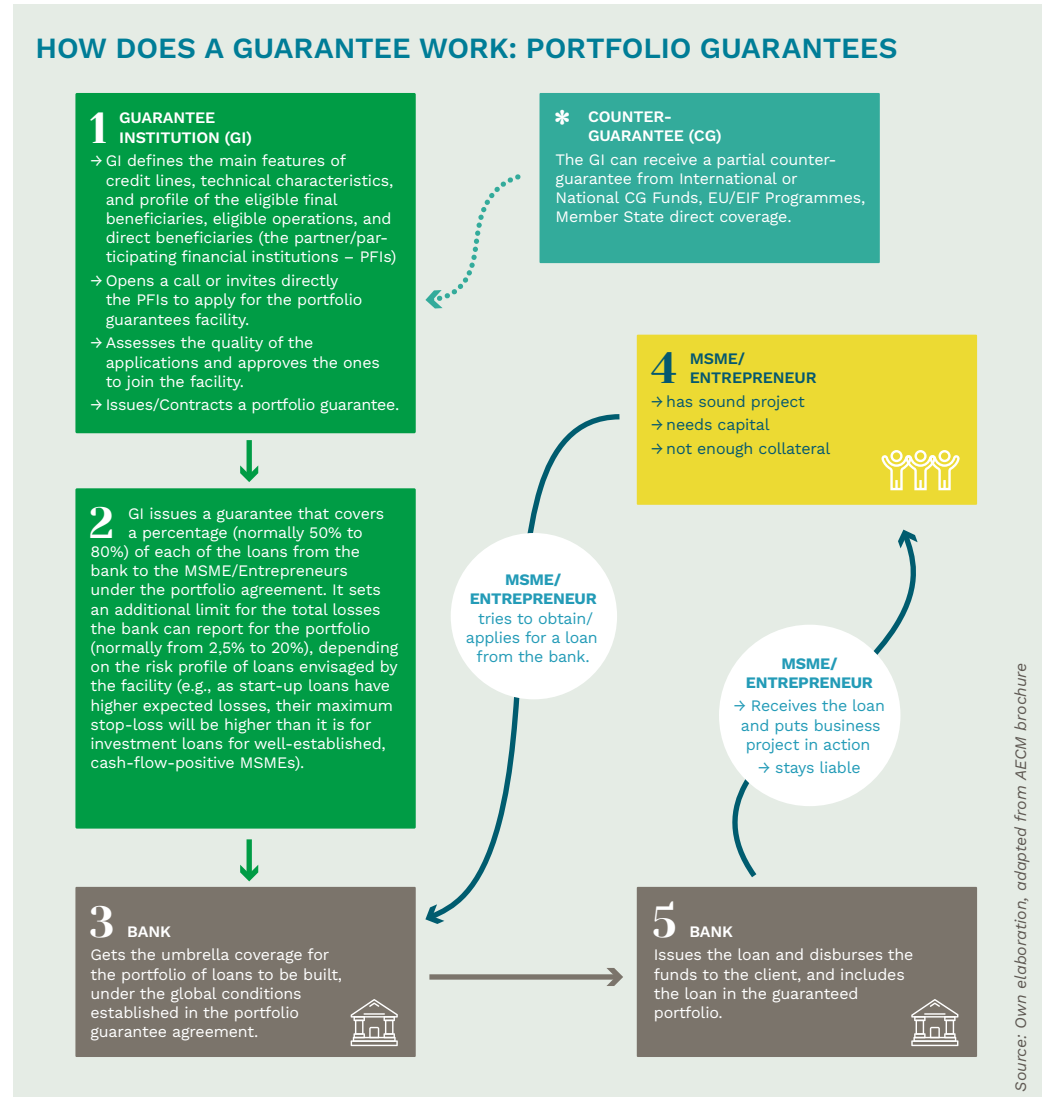
Globally, the majority of the CGS are independent, ongoing, and publicly owned, although some private and even mixed models of property are observed, namely through mutual or co-operative banking structures, especially in the EU (see [www.aecm.eu](http://www.aecm.eu)).

CGSs in Europe are essentially public or private-public partnerships, with the **Mutual Guarantees model (where beneficiary MSMEs participate in the capital, directly or through their organisations) having a certain relevance when in the context of the size (guarantee volumes) of the entities.** Still, in Europe, and unlike in the other parts of the world, the Guarantee Departments of public promotional banks play a relevant role.

**According to the way guarantees are decided, the two prevalent models are Individual Guarantees**, where the CGS issues one guarantee per loan or operation and normally assesses the risk internally, **and the portfolio model**, in which risk analysis is delegated to banks under a certain number of conditions.

→ **Portfolio Guarantees Model – the risk decision is delegated to the beneficiary PFIs, under an umbrella contract** and within certain pre-defined conditions, to be observed by the bank/PFI in terms of eligibility, portfolio building, amounts, pricing, and collaterals required. In this model, the normal situation is to have individual guarantee coverage per loan included in the portfolio (e.g., 60%), but also a stop-loss clause that defines the maximum losses for the total portfolio accepted by CGS (e.g., 10%). Above that limit all the remaining loans lose the CGS individual coverage, unless “coverage returning” clauses are in place.

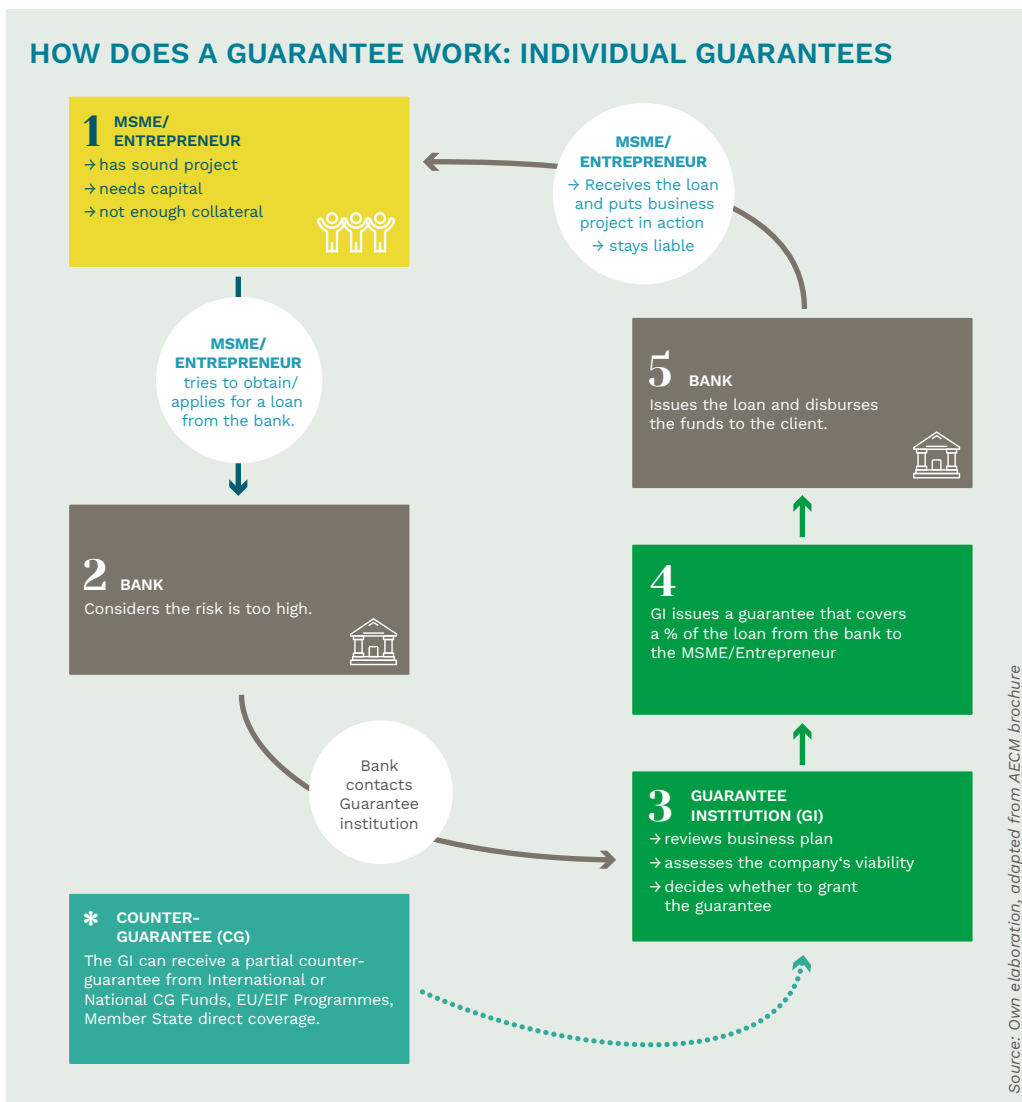
Figure 4: Typical workflow for Portfolio Guarantees



→ **Individual Guarantees Model – the CGS does a (second or parallel) risk analysis of the loan application and decides whether to approve a partial guarantee to that specific operation, issuing an individual guarantee contract or guarantee letter for that specific**

loan. Normally in this model there is an individual maximum guarantee coverage rate (e.g., up to 80% of the loan's principal), and there are no stop-loss clauses, the PCGS bearing the risk of the total outstanding volume of guarantees issued.

Figure 5: Typical workflow for Individual Guarantees



Most innovative CGS have their processes digitalised, and many of these tasks are nowadays done through Apps or web-based IT platforms, making the process essentially paperless, fast, and friendly.

Individual guarantees are widely used for cases of well-established and highly

performing CGSs, with highly skilled teams and sophisticated risk appraisal and management models; for modern IT-supporting platforms, where time for individual analysis, even for smaller files, is very short, and costs very low, so delivery is not delayed due to a double

analysis; and also in situations where financial markets are less developed and not transparent, thus at more risk for moral hazard and adverse selection behaviours by the PFIs; and finally, for the big credit files, where individual risk taken by the PCGS is relevant.

**Both models have pros and cons:**

- **Individual Guarantees** are more accurate in analysing risks, but lengthier and more expensive, as they are obligated to do a double analysis (banks + CGS);
- **Portfolio Guarantees** are faster and more efficient, and thus normally less expensive, as there is no double analysis, but more subject to moral hazard and ineffectiveness, and thus to higher default rates.

The distributions models of CGS also vary from the **fully indirect**, where the MSMEs only make contact with the banks and PFIs; to the fully direct (not so common nowadays), where MSMEs talk first and only with the CGS; to **initially indirect** with the possibility for the MSMEs to start the process at the CGS instead of going to the bank first.

Normally, the guarantees cover a certain percentage of the principal of the loans (typically in the range from 50% in working capital loans to up to 80% for investment loans). Coverages may be even higher or topped-up for certain special purposes, e.g. green financing. All must follow the respective repayment periods.

A fee is charged annually on the outstanding amount of the guarantee (for the individual ones) or on the average outstanding portfolio of guarantees (for the portfolio ones). Frequently, a setup fee is also charged. Fees can vary according to the CGS pricing models, but normally

they relate to the risk of the applicant and respective operation. In Europe, the range currently goes from 0,5% to up to 4%, on average, for the majority of the CGS present in the Eurozone market (see [www.aecm.eu](http://www.aecm.eu)).

CGS can ask for collateral from the borrowers, normally pari passu with the banks and proportional to the risk incurred, especially in the cases of guarantees for investment loans.

Normally the CGS guarantees in Europe are for bank loans, but increasingly the CGS are widening their offer<sup>1</sup> and adding to the typical loan guarantees a provision for performance bonds; guarantees for leasing and factoring; export, technical, equity, advance payments, or green guarantees; and recently also provide technical assistance, capacitation, mentoring and coaching, and even advisory services.

In case of default by the applicant/final beneficiary, paying the guarantee to the direct beneficiary (the banks and other PFIs) is done according to the procedure defined (losses covered can be first losses, second losses, final losses, or pari passu). The guarantee is paid normally within a range of 45 days to 90 days after the claim is received and the payment process is fully and correctly instructed. The recovery processes are normally delegated to the banks, or external parties controlled by the CGS, although the CGS remains in control of the recovery process and is in full capacity to take recovering actions in case the bank/PFI does not do so properly.

<sup>1</sup> AECM (2022). Members' Support Products - Beyond Standard Debt Guarantees. Vienna, Brussels.



## Risk sharing in Credit Guarantee Schemes

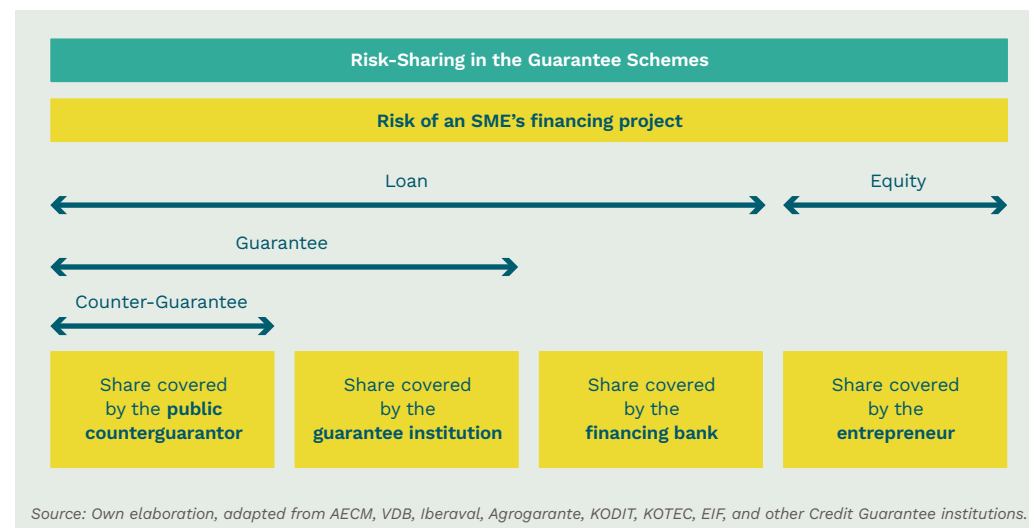
One of the fundamental features of any CGS is the implicit risk-sharing mechanism. Sharing risks with the CGSs permits the banks to increase their exposure to MSMEs credits for the same level of their own funds, reducing the risk when doing businesses and increasing their profitability when lending to the MSMEs sector.

In the same way, for the CGSs, particularly those that are private or mutual, the existence of a risk-sharing mechanism such as a **counterguarantee** (e.g. national mutual counterguarantee fund – FCGM in Portugal, CERSA in Spain, CDP in Italy, and the EU Programs, such as the current InvestEU, managed by European Investment Fund– EIF for all Europe) leverages the guarantees issuing capacities of their own capital base.

The capacity to serve the SMEs market or other, riskier segments (e.g. green financing), is largely influenced by the CGSs capital base.

**Public authorities that support the CGSs** with direct funding in the form of equity or in the form of a **partial counterguarantee**, including the pan-European instruments (such as the EIF counterguarantee), **benefit from a tool that provides a high leverage of public contributions and allows for larger outreach in financing the MSMEs** and other defined segments with a relatively small investment of taxpayer money, as compared with alternatives such as direct subsidies or direct lending from the state.

Figure 6: How the risk-sharing mechanism works, and risks assumed by the parties



# The relevance of CGS for restoration projects

Considering the relevance of CGSs in financing the transition from a grey economy into a new, cleaner and greener one, the approach and perspective towards projects aiming at greening Europe and promoting a better life for European citizens directly influences financial institutions' current strategies and actions.

CGSs in Europe and around the world have already started adapting to progressive public sentiment, defining ESG strategies, creating internal bodies to assure internal transition to green behaviour, introducing green and sustainability elements into their risk-assessment models, and following taxonomies for greener investments and risk-taking activity. Moreover, they have started developing Green Guarantee products aiming at serving different client segments' needs in these transitional times.

Thus, a project such as MERLIN, aiming at investigating and intervening in the restoration of freshwater ecosystems, makes total sense in the context of the new way CGSs must behave.

As examples of how a CGS could act, we provide concrete examples of projects under the MERLIN umbrella, as well as an example taken from a recent World Bank publication, and explain how a local CGS could act and help with financing.

## MERLIN project example 1:

### Mutual Guarantee and Environmental Sustainability: Collaborative Efforts for a Greener Future

Examples on how CGS could intervene in some of the MERLIN's case studies

#### ERVIDEL FLOODPLAIN CASE STUDY 18



**Case study cluster:** small streams and basins

**Country:** Portugal

**Scientific partner:** Instituto Superior de Agronomia, Universidade de Lisboa

**Implementation partner:** Empresa de Desenvolvimento e Infraestruturas do Alqueva, S.A.

**Twinning case study:** CS13 Sorraia floodplain: similar approaches on riparian restoration

#### Demonstration

→ **Type of restoration:** –

→ **Size:** floodplain: 337.71 km<sup>2</sup>; catchment scale: 24.79 km<sup>2</sup>

→ **Location(s):** Barranco do Xacafre

→ **Value of the case:** riparian rehabilitation (underwood clearing), planting of native species, sowing of flowering fields, pollinator hotels

→ **Stakeholders involved:** farmers of the irrigation valley

→ **Sectors involved:** agricultural sector (farmers and land owners)

→ **Innovations being applied:** –

#### Implementation plans

→ **Type of restoration:** riparian rehabilitation (planting of native species and weed control), habitat enhancement with nature-based solution structures for pollinators and key-species predators (bats, birds, spiders, carabids), installation of shelter boxes for bats, sowing flower fields and installation of hotels for insect pollinators

→ **Size:** approx. 30 ha

→ **Scope:** to develop a prototype of ecoscheme contract for irrigation farmland, a monitoring protocol to evaluate restoration efficacy and to propose indicators for agro-environmental certification

→ **Vicinity:** rural (Mediterranean floodplain valleys dominated by intensive agriculture and super-intensive olive groves)

→ **Stakeholders to involve:** agricultural sector (farmers and land owners)

→ **Innovations to be applied:** –

#### How could a Credit Guarantee (Mutual Guarantee) work in the financing of this case (expert recommendations):

1. Agrogarante Mutual Guarantee Society can study and deliver a guarantee to the public authorities to support advance payments of eventual subsidies to the project.
2. Can study and deliver a guarantee of good execution of the project (to support subsidy payments to the project).
3. Can study and deliver a guarantee to farmers involved in the project to get investment loans to acquire the necessary equipment to assure that waters from their agri activities do not pollute the riparian.
4. Agrogarante can support capacitation activities about the (non) use of chemicals and pesticides in their crops.
5. Can support the project financing under its social responsibility activities.

## MERLIN project example 2:

### KVORNING CASE STUDY 1



**Case study cluster:** peatlands and wetlands

**Country:** Denmark

**Scientific partner:** Aarhus University

**Implementation partner:**  
Naturstyrelsen/The Danish Nature Agency

**Twinning case study:** Vosborg Enge, Western Jutland, Denmark

#### Demonstration

- **Type of restoration:** re-wetting/peatland restoration
- **Size:** 450-500 hectares
- **Location:** River valley to Nørreåen situated in Middle Jutland, Denmark
- **Value of the case:** Climate gas emission will be reduced and carbon sequestration will be stimulated by rewetting. The nitrogen content of the water flowing from the area into Randers Fjord will be lowered, benefitting the ecological status of the fjord. The case study area is part of the Natura 2000 network containing habitats such as Alkaline fens (7230) and Petrifying springs with tufa formation (7220), along with a variety of rare and/or endangered species – e.g. Yellow marsh saxifrage, which in Denmark now only exists in around 5 known locations. It is therefore the hope that habitats and species of EU community interest will benefit in addition to species of more local/regional interest. The recreational value will also increase.
- **Stakeholders involved:** farmers/landowners, municipality, different organisations/NGOs with nature- or recreational interests
- **Sectors involved:** agriculture, water resources, municipality/spatial planning

→ **Innovations being applied:** The biomass in parts of the case study area has been harvested since 2018 to lower soil nutrient contents to

- ↳ i) reduce phosphorus loss before rewetting is applied, to reduce mobilisation and loss to the aquatic environment
- ↳ ii) improve conditions for the establishment of habitats and species of EU community interest

Within the framework of MERLIN, the efficiency of harvesting for nutrient removal and net biodiversity gain will be investigated.

#### Implementation plans

- **Type of restoration:** A passage for cattle will be established with MERLIN funds, to support grazing of the restored area after implementation.
- **Size:** up to approximately 500 hectares

→ **Scope:** Approximately 40 landowners. The passage will enable grazing within both the wetted area and in higher (more dry) areas (appropriate e.g. for grazing). Secondary the project also aims to improve the recreational value and access to the area.

→ **Vicinity:** The project area is situated in a rural area, characterised by agriculture and nearby villages.

→ **Stakeholders to involve:** farmers/landowners, municipality, different organisations/NGOs with nature- or recreational interests

→ **Innovations to be applied:** land consolidation – facilitating and supporting landowners in e.g. finding more suitable arable land to compensate for the lowlands being re-wetted

#### Additional information

The project area is part of a Natura 2000 area and a LIFE IP project including 8 municipalities, aiming to make grazing of natural areas profitable. Furthermore, it is part of a multi-functional land consolidation, that also goes beyond the project borders, when e.g. seeking out compensational land for the farmers and various multi-functional considerations such as recreational purposes, drinking water supply etc.

#### How could a Credit Guarantee (Mutual Guarantee) work in the financing of this case (expert recommendations):

1. A CGS can study and deliver a guarantee to the public authorities to support advance payments of eventual subsidies to the project.
2. Can study and deliver a guarantee of good execution of the project (to support subsidy payments to the project), if applicable.
3. Can study and deliver a guarantee to farmers involved in the project to get investment loans to acquire the new lands to substitute the lowlands being re-wetted.
4. Can support financing the project under its social responsibility activities.

**International (World Bank) example:**

## Resource Environmental Solutions

<p> <b>Geography</b></p> <p>North America (USA)</p>	<p> <b>Theme</b></p> <p>Wetlands, streams, protected species habitat</p>	<p> <b>Sources of finance</b></p> <ul style="list-style-type: none"> <li>Private finance (private equity, asset manager)</li> </ul>	<p> <b>Instruments</b></p> <ul style="list-style-type: none"> <li>Regulatory offsets</li> <li>Private equity and debt for project development</li> </ul>
<p> <b>Investment drivers (private finance)</b></p> <ul style="list-style-type: none"> <li>Regulatory obligation (buyer of offsets)</li> <li>Financial returns from sale of environmental offsets (project developer)</li> <li>Financial returns (investors)</li> </ul>	<p> <b>Investment size</b></p> <ul style="list-style-type: none"> <li>\$3 million to \$15 million per wetland mitigation bank</li> <li>\$100 million for client-specific compensation projects</li> </ul>	<p> <b>Financial returns</b></p> <p>Market rate (project developer; investors)</p>	

### Summary

#### Context

Even if development and infrastructure projects stringently follow the mitigation hierarchy—the steps to avoid, minimize and mitigate potential negative impacts on natural ecosystems—some will still have residual unavoidable adverse impacts that need to be offset. Mitigation banking originated in the United States in response to environmental laws (notably the 1972 Clean Water Act, the 1973 Endangered Species Act, and equivalent laws at the state level) requiring public and private projects to offset their unavoidable negative impacts on natural ecosystems, especially the habitats of endangered species and protected wetlands and streams. Environmental offsetting is not intended as a panacea to help countries halt and reverse nature loss. However, it is an entry point for directing private finance to ecosystem restoration, particularly where development impacts are unavoidable.

#### Barriers to investment in restoration

Few public or private infrastructure projects will voluntarily compensate for damage to natural ecosystems, so environmental laws and regulations in the United States create an obligation. Because the obligation can be transferred to a third party, a market for environmental offsets (specifically relating to water and species habitat) has emerged for companies that specialize in nature restoration.

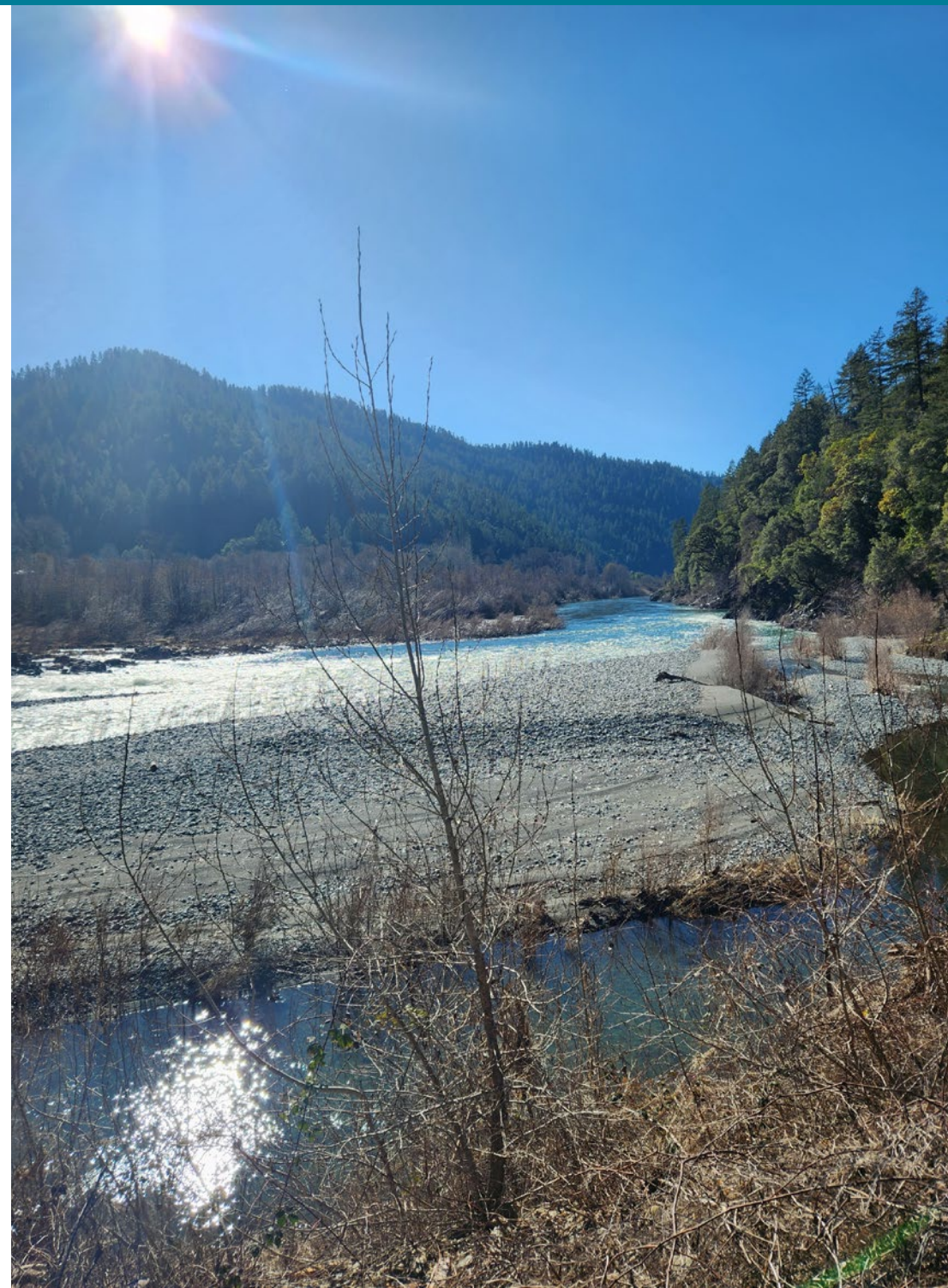
#### The solution

**Resource Environmental Solutions (RES)** is a private company that takes over the obligation for compensation from infrastructure developers. In return, RES develops and manages wetland, stream, and habitat mitigation banks and other compensation projects across the United States. Angel investors provided the company with early-stage risk capital when it was founded in 2007. Since then, RES has secured a series of private equity investments to finance the upfront costs of establishing mitigation banks, which typically require an investment of between \$1 million and \$15 million before mitigation credits can be generated and require at least two to five years before mitigation credits can be sold.

Recent projects RES supports include the Bois D'Arc Lake environmental mitigation project (total cost is estimated at over \$100 million), as well as the restoration of the Klamath river following the removal in January 2024 of four dams (total cost is estimated at \$450 million, with the dam removal accounting for the majority of the expense). In 2022, RES was acquired by two global private equity fund managers, Onex and KKR & Co.

#### Lessons learned and broader relevance

A predictable regulatory environment is a requirement for a well-functioning environmental offsets market. Because standards are clearly defined and demand is more transparent, firms can develop specific expertise, specialize, and invest in nature restoration.



Source: World Bank. 2024 Blueprints for Private Investment in Ecosystem Restoration: Lessons from case Studies. Washington, DC: World Bank.

# Pros and cons of using guarantees

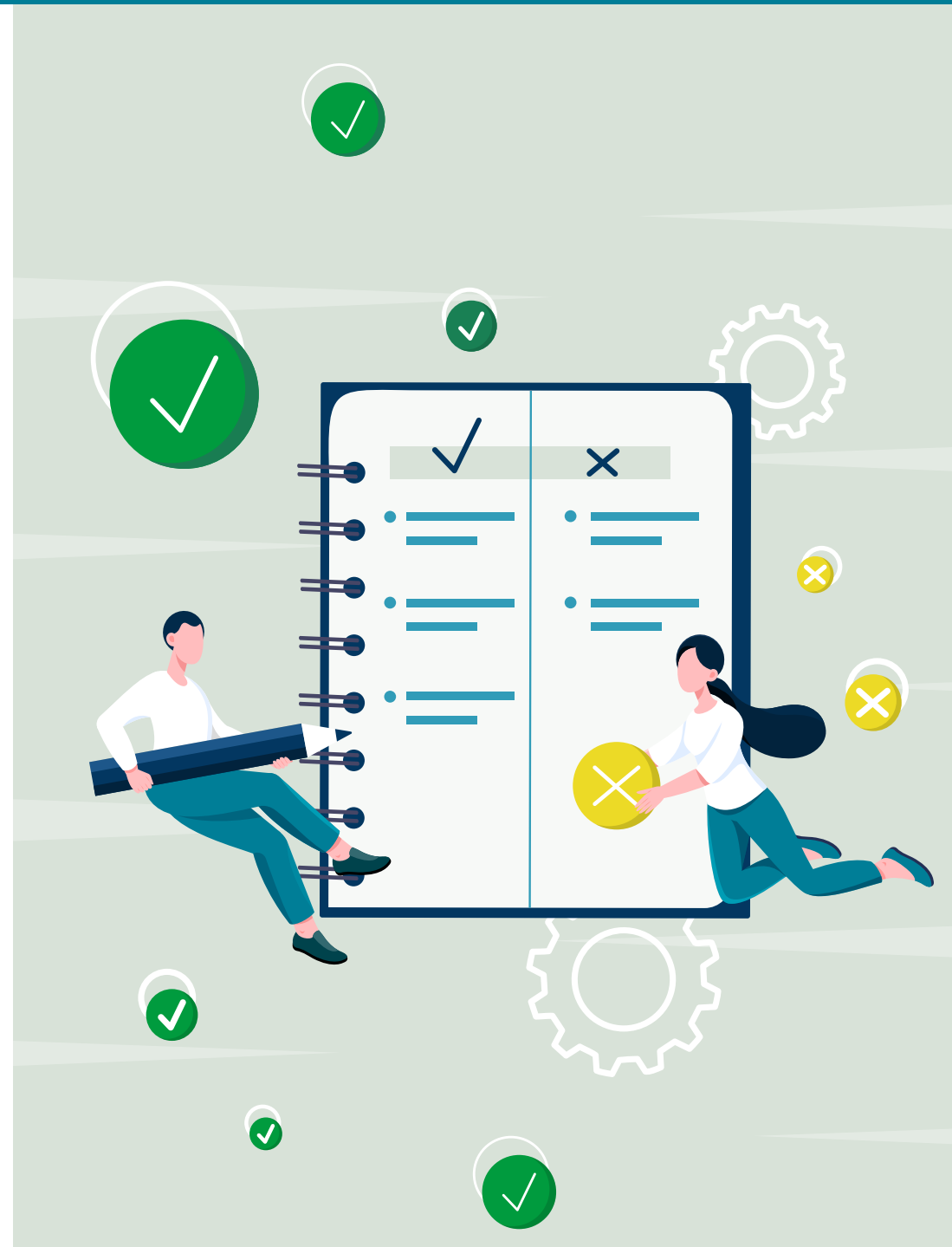
As with all activities, there are pros and cons to consider.

## ✓ Advantages of using guarantees (Pros)

- Guarantee covers **risk to banks** => facilitate the approval of the loans needed to finance the restoration/rehabilitation investments/projects
- The existence of a guarantee **reduces the cost of the loans** => lower interest rates
- Guarantee covers **collateral request from authorities** => allows receiving grant advancements in restoration projects
- Guarantee (performance bond) covers **collateral requests from authorities to assure the successful and timely execution of the restoration projects** => allows receiving grants and 0 interest rate subsidies during the project lifecycle
- CGS can have a pivotal role in **pointing to the economic value of rehabilitation/restoration/rehabilitation projects** => approving a guarantee signals potential financing entities about the financial viability of the project
- CGS can act as a **mentor/counsellor regarding potential “green sources” to finance freshwater restoration/rehabilitation projects**
- CGS brings a **positive reputation** and can even be a partner to implement a project, namely within its corporate responsibility social policy

## ✗ Disadvantages of using guarantees (Cons)

- Loans need to be repaid, and this **may not fit into the schedule and revenues profile of the restoration/rehabilitation project** => loans are not the best way to finance some of these projects
- CGS **may require collaterals that most probably are not available**, as many projects are executed in public areas or privately-owned properties
- CGS **charge fees**, and this is a cost that may not fit into project revenues
- Guarantee **requires project analysis and thorough assessment**, and may become lengthy in the absence of proper information



## Implementation and expected timeline

Most European countries have one or more CGSs (see AECM members at [www.aecm.eu](http://www.aecm.eu)) already active and providing several different types of guarantees, namely green guarantees. In those cases, implementation time is nonexistent, as the facility is already in place to provide the needed guarantee to finance rehabilitation/restoration projects.

In case the CGS operating in a certain region/country does not have an offer that covers the type of financing or guarantees needed to support the rehabilitation/restoration project, the **CGS, banks, governments, or even the European Commission can be challenged to set up specific programs or guarantee lines for the particular purpose of financing ecosystems rehabilitation/restoration** in general, with a particular window for the freshwater ecosystems (namely those of, or similar to, the ones treated by the MERLIN project).

The time required to implement such a financing mechanism can be shorter or longer depending on the national or regional CGS openness and the local, regional, or national government response,

especially its willingness to providing capital or counterguarantee support for the CGS to deliver these types of guarantees.

If public support arrives quickly, the CGS will normally be prepared to set up and design a guarantee product for the specific objective of financing freshwater ecosystems rehabilitation or restoration within a month or less.

**As the representative of the European CGS, AECM is the best contact door to access the different CGS in Europe** (go [www.aecm.eu](http://www.aecm.eu)).

**Commercial banks and similar PFIs are also a potential open door to contact in the process of accessing guarantees to develop a rehabilitation project.**

A guarantee for an NGO can take from 30 days to 3 months to be issued, dependent on the complexity of the project and if it qualifies for an existing **public Guarantee Call**.

## Conclusion

While Credit Guarantee mechanisms are not yet widely adopted in the context of freshwater restoration projects, they represent a **promising financial tool that restoration managers can increasingly rely on to unlock funding and accelerate project implementation**. As these restoration projects often require substantial upfront investments with long-term returns, securing financing can be a significant barrier to progress. Credit Guarantees can bridge this gap by mitigating the financial risks associated with restoration, providing a safety net for lenders or investors, guaranteeing nature-based solution performance, and enabling greater access to capital.

Many governments face budgetary constraints, limiting their ability to finance large-scale restoration efforts. However, **by leveraging counterguarantee mechanisms, governments and multilateral organisations can play a catalytic role in the issuance of Credit Guarantees**. This, in turn, encourages risk-averse financial institutions to support these projects, even in regions where funding has traditionally been scarce. **Such mechanisms can serve as an essential instrument for overcoming the financial obstacles that often delay or derail restoration initiatives**.

Moreover, Credit Guarantees provide flexibility, allowing project managers to pursue funding from a wider array of sources, including private investors. **The ability to diversify funding streams is critical to scaling up restoration efforts and ensuring their sustainability over the long term**. As the global demand for freshwater restoration projects increases, the need for efficient restoration strategies becomes more urgent. **Credit Guarantees can help drive the implementation of these strategies across more countries, contributing to the broader goal of restoring and preserving vital freshwater ecosystems**.

In conclusion, while the use of Credit Guarantees in freshwater restoration projects is still in its early stages, the potential for expansion is significant. As more governments recognise the value of this financial tool, the widespread adoption of Credit Guarantee mechanisms could provide a crucial pathway to overcoming the financial challenges that restoration projects face. **By doing so, it would enable more countries to engage in the necessary work of preserving and restoring freshwater resources for future generations**.



# Frequently Asked Questions (FAQs)

## What is a Credit Guarantee?

A Credit Guarantee (CGS) is a mechanism or scheme where a third party to a loan, the guarantor, agrees to pay back the lender a certain percent of the debt if the borrower defaults. This reduces the lender's expected credit losses and thus increases their willingness to finance certain types of projects that otherwise would not get access to finance. Credit Guarantee Schemes also provide guarantees for other purposes, such as the advancement of grants in subsidised projects. The guarantor may be a Credit Guarantee company or society, or a guarantee fund or program.

## How does a Credit Guarantee help a borrower?

A Credit Guarantee can increase the borrower's bargaining capacity by allowing them to borrow without collateral, or to get a larger loan amount with the same collateral. This is particularly relevant in the case of projects considered "not bankable" due to a lack of historical cash flow or collaterals, and in new areas of economic activity where banks have no experience (e.g. special projects such as freshwater restoration/rehabilitation).

## Who is eligible for a Credit Guarantee?

Eligibility criteria for a Credit Guarantee depend on the specific program, but may include being a registered business, having a social security and a fiscal number, having no debts to public authorities, or being an MSME or an entity legally endowed to borrow money from banks.

## How does a Credit Guarantee scheme work?

The applicants (borrowers) may approach commercial banks and ask if they have credit lines with a guarantee from the CGS through which their projects can be considered eligible for financing. Alternatively, the applicants can approach the local, regional, or national CGS.

In Europe, the best way to establish contact is to check the national or regional CGS at the European Association of Guarantee Institutions (AECM website – [www.aecm.eu](http://www.aecm.eu)).

## What are the typical costs for a Credit Guarantee?

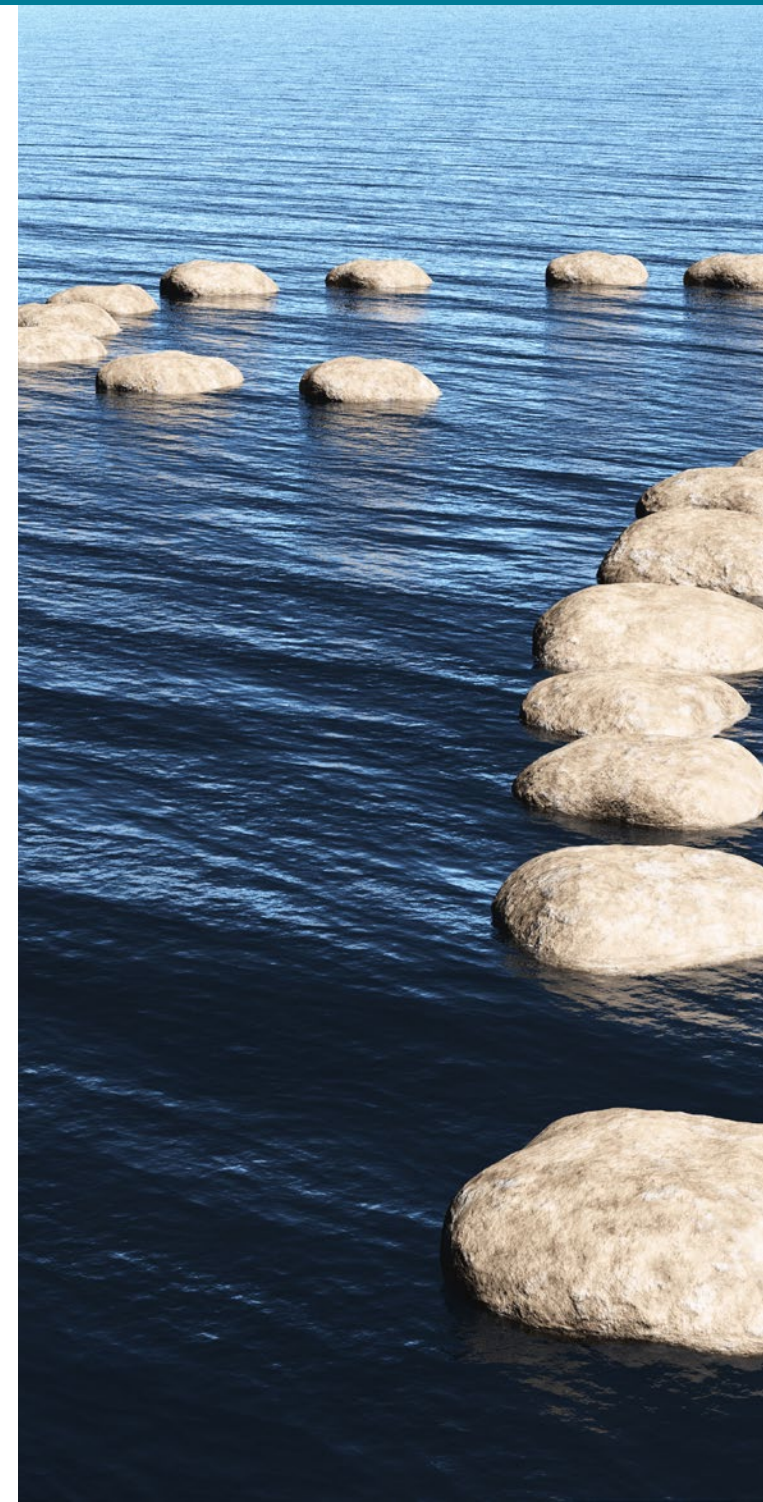
In case of approval of a loan with a Credit Guarantee coverage, applicants are subject to some costs:

- A setup fee may be charged; in Europe it normally ranges from 0,25% to 1,5% of the total amount of the guarantee, and is charged upfront at the signature of the loan (that includes the guarantee).
- An annual fee related to the risk of the company (sometimes a fixed value); in Europe it normally ranges from 0,5% to 3% per annum over the outstanding amount of the guarantee.
- Sometimes "file managing" fees may be charged; these are not very common, nor relevant in terms of percentage.

## Can freshwater restoration/rehabilitation projects be eligible for a Credit Guarantee?

As ESG goals are adopted worldwide, and countries, societies, and organisations recognise and prioritise the need to green and decarbonise the economy, as well as to reuse resources and recover ecosystems, the CGS are offering more and more products that help finance these areas.

Although guaranteeing a loan must always imply an analysis of the capacity of the borrower to repay it, increasing capacity to evaluate new projects and attribute economic value to them helps raise the profile of Credit Guarantee solutions for projects in the restoration/rehabilitation area.



# Glossary

<b>Certification</b>	The action or process of providing a site with an official document attesting to a status or level of achievement	<b>ESMA – European Securities and Markets Authority</b>	Known as the EU Markets’ watchdog, the European Securities and Markets Authority is an independent authority that aims to uphold the stability of the EU’s financial system by protecting investors and encouraging organised financial markets. In doing so, ESMA focuses on four areas: (1) assessing risks to investors, markets, and financial stability, (2) completing a single European rulebook for EU financial markets, (3) supervising credit rating agencies, trade and securitisation repositories, and finally (4) promoting supervisory convergence.
<b>CSRD – Corporate Sustainability Reporting Directive (EU)</b>	The CSRD is a revision and improvement to the Non-Financial Reporting Directive (NFRD) of the EU. Sets specific and detailed structure and content for all companies to disclose, and extends compliance to smaller companies and some classes of SMEs (small and medium sized enterprises). It will also ensure alignment between the Taxonomy and SFDR with respect to how ESG data is defined, measured, and disclosed.	<b>EU Green Deal – European Green Deal</b>	Approved in 2020, the European Green Deal provides a roadmap to transform the EU’s economy by making it more sustainable, resource efficient, and competitive, and in turn meet the EU’s target to become climate neutral by 2050. To enable a just and inclusive transition for all, the European Green Deal aims to ensure that there are no net emissions of greenhouse gases by 2050, that economic growth is decoupled from resource use, and that no person and place is left behind. As part of this effort, the EU Taxonomy was established to give companies and financial institutions a comprehensive sustainability framework and classification system to change and transition and prevent greenwashing. The overarching aim of the European Green Deal is to reach net-zero greenhouse gas emissions within the EU and deliver a pollution-free environment by 2050. Advances in transport, agriculture systems, and ecosystems and biodiversity are all required, as well as efforts to further develop a circular economy that ensures products can be reused and recycled. From 2021 to 2027, 35 percent of the EU’s research funding will be dedicated to developing climate-friendly technologies.
<b>DNSH – Do No Significant Harm</b>	The DNSH principle states that no measure or activities should lead to significant harm to any of the six environmental objectives outlined by the EU Taxonomy.	<b>ECP</b>	The European Climate Pact is a movement of people united around a common cause, each taking steps in their own worlds to build a more sustainable Europe. Launched by the European Commission, the Pact is part of the European Green Deal and is helping the EU to meet its goal to become climate-neutral by 2050.
<b>Feasibility Assessment</b>	A study to determine if the requirements of a project or a program can be met within the cost, schedule, and performance constraints of the project or program	<b>EU Taxonomy – European Union Taxonomy</b>	The EU Taxonomy is a science-based classification system that defines whether an economic activity can be considered environmentally sustainable. By legislating the conditions for claiming that an economic activity is sustainable, the Taxonomy creates a common language that can be used to measure, calculate, and compare sustainable performance. Further, by requiring claims of sustainable activity to be evidenced, the regulation aims to combat greenwashing and incentivise both green activities and green investment.
<b>Impact Assessment</b>	A means of measuring the effectiveness of organisational activities and judging the significance of changes brought about by those activities	<b>GRI – Global Reporting Initiative</b>	The Global Reporting Initiative is an independent organisation that strives to enable decision-makers to act and foster a more sustainable economy and future. The GRI has developed Sustainability Reporting Standards (GRI Standards) that enable organisations to report on its impacts to the economy, environment, and society. All the disclosure requests outlined by the European Directive are also covered by the GRI Standards and Disclosures, and many common themes and areas of alignment exist between the two.
<b>Integrated Reporting</b>	Brings together material information about an organisation’s strategy, governance, performance, and prospects to reflect the commercial, social, and environmental context within which it operates	<b>IFRS – International Financial Reporting Standards</b>	The IFRS Foundation was established to create a single set of clear, quality, enforceable and internationally accepted accounting and sustainability disclosure standards. The IFRS Accounting Standards are developed by the International Accounting Standards Board (IASB) and IFRS Sustainability Disclosure Standards are set by the new International Sustainability Standards Board (ISSB). The Accounting Standards outline how a company prepares its financial statements, whereas the Sustainable Disclosure Standards outline how a company discloses their sustainability-related information.
<b>UN DER</b>	The UN Decade on Ecosystem Restoration 2021–2030, led by the United Nations Environment Programme, the Food and Agriculture Organisation of the United Nations, and their partners, covers terrestrial as well as coastal and marine ecosystems. As a global call to action, it will draw together political support, scientific research and financial muscle to massively scale up restoration.		
<b>EET – European ESG Template</b>	The European ESG Template is a data-exchange template created by FinDatEx that will simplify the ESG data exchange process between financial market participants, as well as facilitate compliance to the delegated acts complementing MiFID II (Markets in Financial Instruments Directive), and IDD (Insurance Distribution Directive).		
<b>CSR – Corporate Social Responsibility</b>	Corporate Social Responsibility is a form of self-regulation whereby companies incorporate social and environmental aspects into their business operations and strategy. It contributes to a company’s reputation, and therefore CSR strategies must align with or be integrated into the company’s business models.		
<b>EFRAG – European Financial Reporting Advisory Group</b>	The European Financial Reporting Advisory Group is an association that was established with the support of the European Commission. EFRAG has two pillars: one is focused on financial reporting, whereby EFRAG works to influence the development of IFRS Standards through the European lens and provide efficiency to capital markets and advice on the IFRS Standards to the European Commission. The other pillar focuses on sustainability reporting, whereby EFRAG helps to develop draft EU Sustainability Reporting Standards and related amendments for the European Commission – a role that was assigned to EFRAG in the CSRD proposal.		
<b>ESG</b>	Environmental, Social, Governance The ESG criteria provide companies with an approach to evaluating and analysing their business operations. The environmental criterion looks at how a company considers and protects the environment, whereas the social aspect evaluates how a company considers its social environment, including employees, communities, clients, and customer relationships. The governance aspect looks at a company’s governance approach and leadership.		

<b>ISSB – International Sustainability Standards Board</b>	The ISSB aims to provide a comprehensive global baseline of sustainability-related disclosure standards and help meet investors’ and financial markets’ demand for high quality, understandable, and reliable ESG information from companies. The ISSB will build on the work of existing reporting initiatives focused on investors, including the Task Force on Climate-related Financial Disclosures (TCFD). The ISSB will first go through public consultations with the aim to eventually develop standards that can be required and linked with jurisdiction-specific requirements.	<b>SFDR – Sustainable Finance Disclosure Regulation</b>	The Sustainable Finance Disclosure Regulation was designed to increase transparency on sustainability among financial institutions and market participants and, subsequently, to encourage capital to flow towards more sustainable investment options. It requires financial market participants to provide standardised disclosures on how ESG factors are integrated at both entity and product levels. In addition, every investment fund marketed in Europe must be labelled as either Article 6: not integrating sustainability into its investment process, Article 8: promoting environmental and/or social characteristics, or Article 9: specifically targeting sustainable investments. The SFDR is one of the pillars of the EU Action Plan on Sustainable Finance, which also includes the EU Taxonomy and the Low Carbon Benchmarks Regulation.
<b>European Climate Law</b>	The European Climate Law codifies the goal set out in the European Green Deal for Europe’s economy and society to become climate-neutral by 2050. The law also sets the intermediate target of reducing net greenhouse gas emissions by at least 55% by 2030, as compared to 1990 levels. Climate neutrality by 2050 means achieving net zero greenhouse gas emissions for EU countries, mainly by cutting emissions, investing in green technologies, and protecting the natural environment. The law aims to ensure that all EU policies contribute to this goal and that all sectors of the economy and society play their part.	<b>UN SDG</b>	Defined within the UN 2030 Agenda for Sustainable Development (2015), the 17 Sustainable Development Goals (SDGs) aim to transform our world in major relevant areas. They are a call to action to end poverty and inequality, protect the planet, and ensure that all people enjoy health, justice, and prosperity. It is critical that no one is left behind.
<b>IWRM – Integrated Water Resources Management</b>	IWRM is a process that promotes the coordinated development and management of water, land, and related resources in order to maximise economic and social welfare in an equitable manner without compromising the sustainability of vital ecosystems.	<b>Paris Agreement</b>	The Paris Agreement is a legally binding international treaty on climate change adopted by 196 Parties at the UN Climate Change Conference (COP21) in Paris, France, on 12 December 2015, entering into force on 4 November 2016. Its overarching goal is to hold “the increase in the global average temperature to well below 2°C above pre-industrial levels” and pursue efforts “to limit the temperature increase to 1.5°C above pre-industrial levels.”
<b>NFRD – Non-Financial Reporting Directive (EU)</b>	The NFRD is an extension to annual financial reporting requirements (Accounting Directive) for large corporations that requires them to publish extra-financial information (here, ESG data). It sets guidelines for companies on how to disclose their approach to managing environmental and social challenges, and requires companies to include environmental and social factors in their annual reports along with their financial reporting. While the NFRD is somewhat beneficial as it provides a loose framework about what non-financial factors can be reported, it only applies to large companies, it does not require a specific structure and content, and it is not fully aligned with the EU Taxonomy and SFDR. The NFRD will be replaced by the CSRD.	<b>TCFD – Task Force on Climate-related Financial Disclosures</b>	The Task Force on Climate-related Financial Disclosures was established in 2015 by the Financial Stability Board (FSB) to provide corporations and finance institutions with recommendations on how to disclose their climate change-related financial risks and opportunities. The recommendations cover four thematic areas that target core elements of companies’ operations: governance, strategy, risk management, and metrics and targets. The Task Force has 31 members and is one of the most widely adopted global standards. TCFD reporting became mandatory for signatories to the UN Principles for Responsible Investment (UN PRI).
<b>PAI – Principal Adverse Impact Indicators</b>	The PAIs are an element of the EU’s SFDR and probably one of its most challenging aspects. Article 4 of the SFDR requires Fixed Maturity Plans (FMPs) to ensure transparency in terms of consideration of principal adverse impacts of investment decisions on sustainability. FMPs need to provide extensive disclosures on various ESG-related matters, including environmental and social indicators. They are subject to two types of disclosures: (1) entity level disclosures (Article 4 SFDR), which are based on a “comply or explain” principle, and urge FMPs to indicate whether they consider the PAIs on sustainability of their investment and to include a statement on their due diligence policies with respect to such impacts, and (2) product level disclosures (Article 7 SFDR), whereby FMPs have to disclose how each of their financial products considers such impacts in their pre-contractual disclosure documents. FMPs which do not consider PAI will be required to explain the reasons for that decision.	<b>TNFD – Task Force on Nature-related Financial Disclosures</b>	The TNFD aims to deliver and establish a risk management and disclosure framework that enables organisations to report on nature-related risks, and in turn shift finance flows away from nature-negative outcomes and toward nature-positive ones. The TNFD is comprised of financial institutions, companies, and market service providers, and aims to provide these players with the information needed to understand how nature impacts their immediate financial performance and long-term financial risks. The TNFD builds upon the work of the TCFD, but while the TCFD focuses on disclosure in relation to climate change, the TNFD instead focuses on the role of nature. Its primary aim is to allow decision makers to incorporate nature-related risks and opportunities into strategic planning.
<b>PRI – Principles for Responsible Investment</b>	The UN-supported Principles for Responsible Investment help to clarify the investment implications of environmental, social, and governance (ESG) factors, and to support its investor signatories to integrate these factors into their investment decisions. Developed by investors, the PRI outlines six principles to integrate ESG into investment strategies.	<b>TSC – Technical Screening Criteria</b>	Set out by the EU Taxonomy, the TSC define the criteria or conditions for meeting the substantial contribution to one or more environmental objectives, such as climate change mitigation or adaptation, while avoiding significant harm to other environmental objectives, including the sustainable use of water and marine resources, transition to a circular economy, pollution prevention control, and the protection and restoration of biodiversity and ecosystems.
<b>SASB – Sustainability Accounting Standards Board</b>	The SASB’s Standards allow companies to ascertain, manage, and convey financially-material sustainability data to their investors. The SASB has created 77 globally applicable Industry Standards, which are designed to be cost-effective and decision-useful for companies and investors.		

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