



Leibniz Institute for Financial Research SAFE  
Sustainable Architecture for Finance in Europe (<https://safe-frankfurt.de/>)

## SAFE Finance Blog

### Use banks the right way

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04/21/2020

Thomas F Huertas: How banks can help get money to businesses while it can still do some good



Governments and central banks have announced massive Covid-19 business support programs, including hundreds of billions in loan guarantees. But current guarantee programs require banks to share the risk, and this in turn requires that banks conduct a credit assessment.

That is penny wise but pound foolish. It delays disbursement and creates the risk that companies will lay off workers and possibly fail before assistance arrives.

To avoid this, make banks a conduit for government credit. Make the guarantee 100 per cent, make such debt senior to existing debt, and make such loans eligible as collateral for central bank lending facilities. That way banks face neither credit nor liquidity risk. That will simplify and shorten the loan process. In

particular, it removes the need for banks to conduct a credit assessment of the company and charge a rate that reflects the probability that the company will default. That will accelerate disbursement.

For small to medium-sized enterprises such guaranteed loans could take the form of a one-year revolving line of credit at their "house" bank for up to six months' revenue (as evidenced by their income tax or VAT returns) at a rate of interest of 1 per cent a year. The SME could draw on this line to pay qualified expenses (wages, rent, utilities, suppliers, insurance and interest). Prior to maturity, the bank would transfer the loans to the government at a value equal to the amount outstanding plus accrued interest.

The government would then be the lender of record and have recourse to the borrower. For any amount outstanding at maturity, the government will offer the borrower the opportunity to refinance on commercial terms, provided the borrower can demonstrate that the original loan financed qualified expenses. Any other amount would be immediately due and payable, subject to the same enforcement procedures and penalties as unpaid and overdue tax.

Such a program will get money to companies while it can still do some good. That will sustain suppliers and extend employment. This will make the recession shorter and shallower, as well as help bring about a steeper recovery sooner.

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