4.1 (PARTIAL) GUARANTEE

Brief Description

A (partial) guarantee [28] is the commitment of a guarantor to back up and provide repayment in case of default or non-performance of the enterprise. A (partial) guarantee can have an important role for impact enterprises as it represents a mechanism to increase the security and facilitate the mobilisation of private capital from investors, thus promoting financial access. In fact, the guarantee acts as a sort of insurance, allowing the impact enterprise to lower the relative risk [29] of the organisation, increase access to lending, and obtain exposure to a wider source of funding with improved financial terms and conditions. A partial guarantee does cover only part of the risk (e.g. 80% of a loan) in order to ensure alignment of interest between the guarantor and the investor. A partial guarantee can also cover a portfolio of investments insofar that it provides partially repayment in case of default from any investment in the portfolio (e.g. 80% from any investment) up to a pre-defined cap of the portfolio (e.g. 30% of the portfolio).

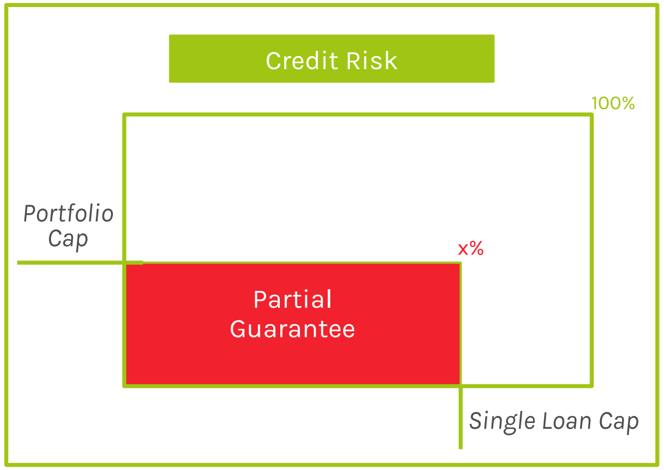

Figure 4.2 – "Partial Guarantees", source: Roots of Impact.

28 A guarantee is considered as partial if the value of the guarantee is less than 100%

29 A guarantee is usually structured to cover credit risk, but other risk categories could be considered (e.g. political risk)

Emergency-Proof: This instrument is particularly relevant in difficult historical moment such as the Covid-19 crisis, when flexibility in repayments is critical to overcoming the severe social, financial, and economic challenges faced by enterprises.

Purpose/Fit	Enabling the impact enterprise to access private risk capital
Can replace	Grants, subordinated loans, and other blended finance instruments
Risk/Return Profile	n/a
Enterprise Lifecyle	All stages
Maturity	Linked to the maturity of an outstanding loan or other financial obligations

Defining Criteria

- **Guarantee level:** It represents the percentage that the guarantor commits to cover in case of default or non-performance.
- **Guarantor:** It is the agent who agrees to be held responsible for the repayment of the guaranteed portion of the financial debt if the receiver defaults. The main provider of guarantees are multilateral agencies or development finance institutions.
- **Front-end fee:** It represents the one-time fee that the borrower has to pay on the guaranteed amount. It is usually required to cover due diligence, processing of the guarantee and other potential up-front costs.
- **Guarantee fee:** It represents a per annum fee on the disbursed and/or outstanding guarantee exposure. It is required in order to cover the guarantor exposure on the guaranteed amount.
- **Commitment fee:** It represents the fee required to be paid on the amount requested, yet not disbursed.

Interesting Variants and Options

- The guarantee or partial guarantee may be structured to partially cover principal repayments and interest, or only a part of the principal repayment, or only the interest payments.
- Guarantees are usually applied to infrastructure and financial services, but other sectors could be considered.
- Linking financial rewards to the achievement of impact, for example increasing the guarantee level or reducing the guarantee fee - see "Examples of relevant terms" and "Examples of partial guarantee structures" below.

Example of relevant terms (as formulated in a contract)

- **Loan Guarantee:** A partial guarantee could be structured to cover the principal amortisation and or interest payments in the lifetime of a loan. The guarantor for instance may take on the credit risk of the borrower for both interest and principal repayments, and in case of a debt service default [30], repay (based on the percentage of the guarantee) the outstanding amount at the time of default.
- **Bullet Loan Guarantee:** In the case of a loan with a bullet maturity[31], a partial guarantee could be structured to repay back a predefined percentage of the debt amount at maturity.
- **Impact-Linked Guarantee:** The amount of investment covered by the guarantee is directly related to the expected impact performance of the enterprise and will be adjusted at pre-defined future dates based on verified outcomes. Thus, the guarantee can be used for targeting and catalysing specific outcomes, and a stronger impact performance will then translate into higher guarantee amounts.
- **Impact-Linked Guarantee on a fund level:** The amount of investment covered is directly related to the impact performance of a portfolio of companies rather than one single enterprise.

Examples of relevant terms (as formulated in a contract):	
Guarantee level	• The Guarantee issued by the Guarantor for the benefit of the Company has a Guarantee Rate of (60%) on the Borrowed Amount. The Guarantee issued by the Guarantor has an uncapped, unconditional and irrevocable financial guarantee in respect of each Eligible Transaction in a set Portfolio up to a Guarantee Rate of (50%) on the Total Invested Capital
Guarantee fee	The Guarantee Fee is (130bps) per annum. The Company shall pay the Guarantee Fee Amount (quarterly) in (arrears) on the aggregated outstanding amount at the end of the calendar quarter.
Optional: Link to Impact Performance	• The partial guarantee of (50%) will be increased by (5%) for each (1,000 units of impact) achieved until reaching full guarantee (100%) in order to facilitate further rounds of funding. • The fee charged for the guarantee will be decreased by (0.15%) for each (1,000 units of impact) achieved until reaching (0.00%)

Main Advantages

- Partial guarantees can help the impact enterprise to obtain more convenient financial terms and conditions as well as to lower the cost of capital.
- They can help the impact enterprise to mobilise additional and more diverse private capital by catalysing more risk-averse sources.
- They can be applied throughout the life of an impact enterprise.
- Investors as well as the markets are familiar with the instrument.

30 By a debt service default, it is intended the situation when a borrower misses a schedule payment.

31 A bullet maturity refers to repayment of the whole amount borrowed (face value) at maturity, as opposed to a traditional amortised repayment schedule. Sometimes the bullet maturity amount can also be comprehensive of interests.

Main Challenges

- They can create moral hazard[32] and disincentivise the investor to carry out a proper due diligence (shall be avoided by providing only partial guarantees where the investor carries part of the risk as well).
- Lack to directly account for impact at the enterprise level if not linked to the achievement of impact.
- The impact enterprise may find itself in the position to use part of the additional capital raised to pay for the fees charged by the guarantor, thus slightly offsetting the overall benefits.

Case studies and additional resources about (Partial) Guarantee can be found here.

32 It is defined as the tendency of deliberately adopting more risk-taking behaviours. It usually happens when a person bears only partially the costs arising from taking greater risk, and they are thus incentivised by the allure of the potential benefits.