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Financial Instruments 2014-2020 under European Structural and Investment Funds (ESIF)

Brussels, 19-20 January 2015

Financial Instruments in Cohesion Policy 2014-2020: The SME Initiative

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SME Initiative: Rationale

- In the aftermath of the economic crisis, European banks have been forced to:
  - Deleverage their risky assets
  - Repair their balance sheets
  - Comply with tight regulatory requirements (Basel III, CRD IV)

- which results in:
  - reduction in the volume of lending
  - market fragmentation
  - impaired money transmission to real economy

- In this context, EU SMEs were particularly hit

- ECB President Draghi, May 2013: "*The key obstacle to a growth recovery seems to be the blocked credit channel to SMEs*."

SME Initiative: Objective

- **Increase the volume** of lending to SMEs in the EU;
- **Pooling resources**: European Structural Investment Funds (ERDF-EAFRD) + COSME and Horizon 2020; + Combine and fully utilise the **EIB and EIF**;
- Providing capital relief to EU banks to make them more robust and to **incentivize them to extend additional loans to SMEs**;
- Achieve significant impact to stimulate SME financing and economic growth:
  - Stimulate SME financing and economic growth;
  - Fight EU fragmentation

Main features:

- **Article 39 CPR**: legal basis;
- **Voluntary** contribution (ERDF – EAFRD) from MS;
- **EU level instrument**: indirectly managed by the Commission and EIB for the implementation;
- **EU-wide ex-ante assessment** already carried out by the EIB and Commission;
- Setting up a **single dedicated OP** at MS level;
- Up to **7% of ERDF – EAFRD** per MS and capped to **EUR8.5bn** from ERDF-EAFRD;
- Maximum contributions from EU's COSME (EUR 175 m) and Horizon 2020 (EUR 175 m);
- Possible contributions from other FIs & national promotional banks and/or private investors

Main results of the ex-ante assessment:

- **At the EU-28 level**, the ex-ante assessment by using a conservative approach estimates that up to 4.1% of all SMEs (i.e. approximately 860,000 SMEs) were not successful in obtaining loan finance even though "financially viable"
- The EU-wide **loan financing gap** for the non-financial sector in the period 2009-2012 is quantified at up to EUR 112 billion
- The future evolution of the SME gap financing in the EU-28 will likely improve, however that **improvement will be far from sufficient to fill the loan financing gap**
- There are **very significant differences between Member States**

SME initiative comprises of two different options:

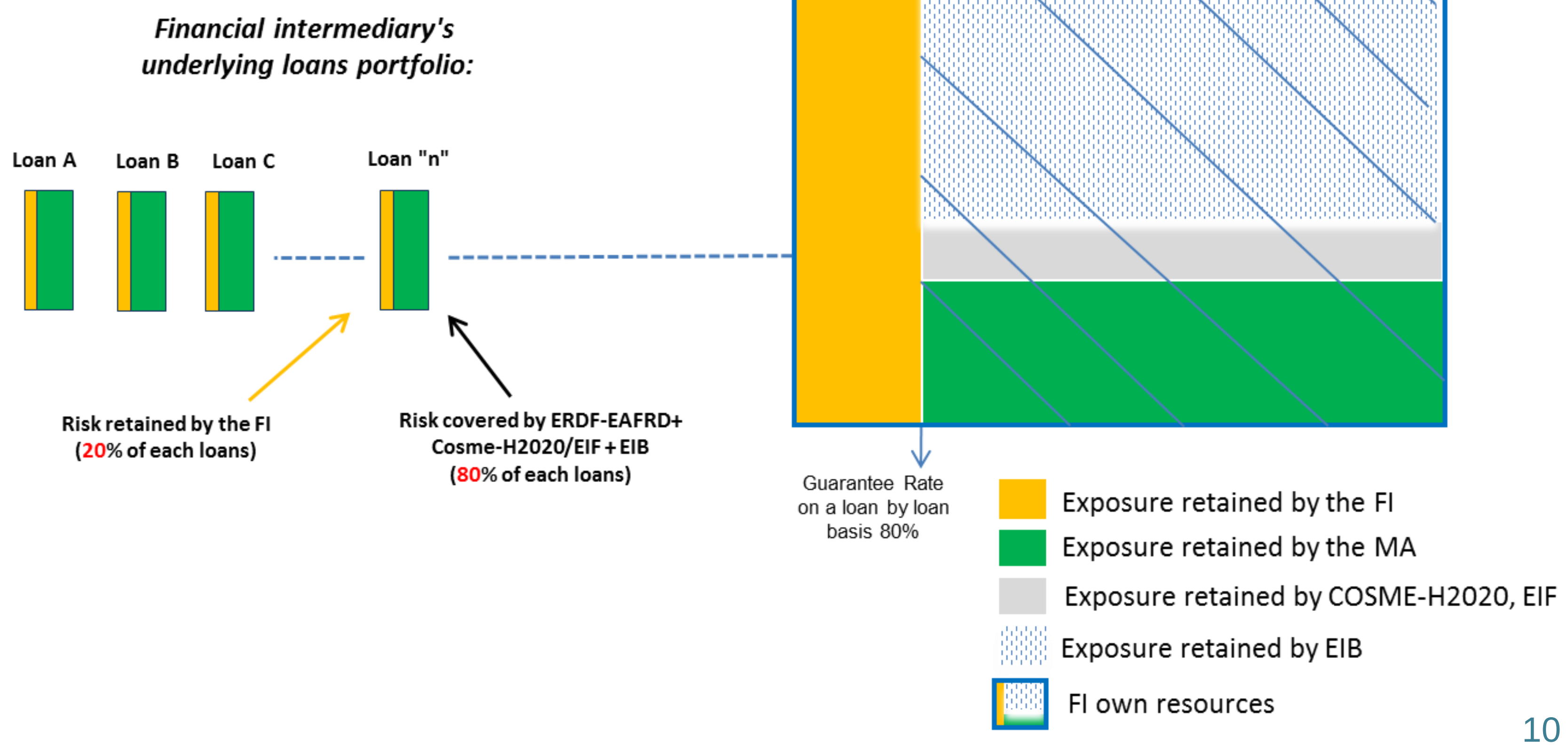
All these options are not mutually exclusive:

- **Option n°1**: Uncapped guarantee instrument;
- **Option n°2:** Joint securitisation instrument for new and existing loans;
- Option n°2 is also possible with **ERFD/EAFRD-EIB/EIF pooling of risks** (not covered by this presentation)
- Option 1 is the one currently most advanced and with highest demand

1. Uncapped Guarantee Instrument

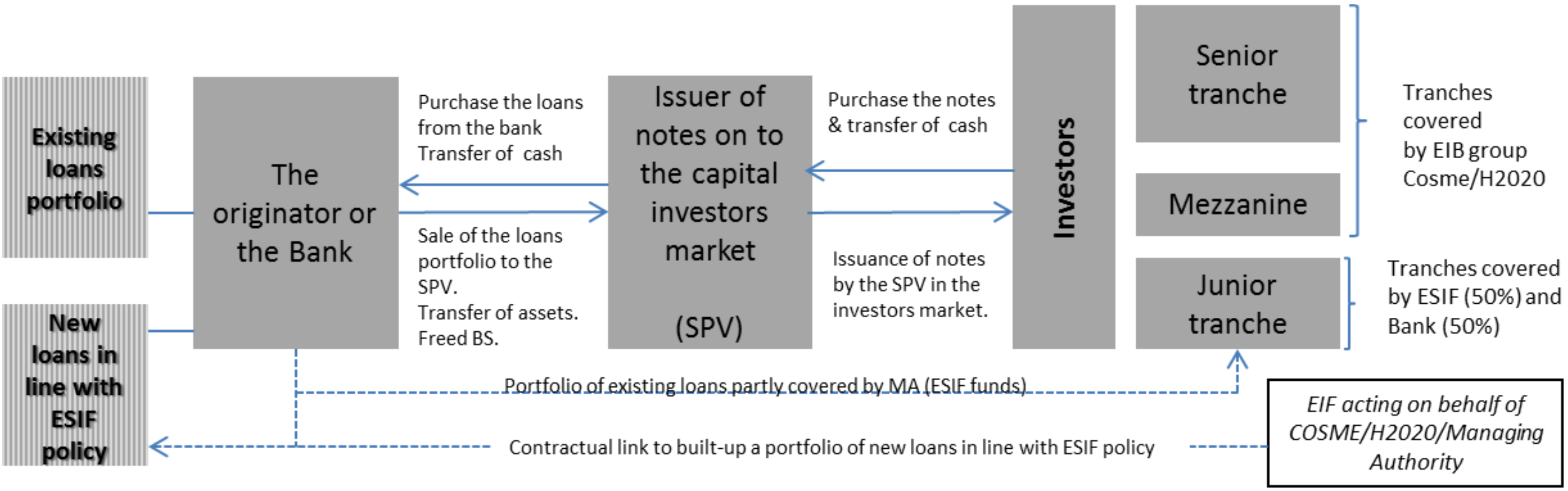
- **Combines** ERDF-EAFRD, COSME, Horizon 2020 in one instrument;
- EIF, EIB share the residual risk;
- The instrument covers **up to 80%** of the losses from the banks' portfolios;
- Alignment of interest with the bank that retains **20% risk exposure**;
- Contributions from MA remain ring-fenced to support SMEs in their respective country;
- Benefit passed onto SMEs:
  - **lending to riskier SMEs (e.g. innovative SMEs, start-ups, etc.);**
  - **reduction of collateral requirements and reduced pricing.**
- Gradual capital relief to financial intermediaries **to support new lending to SMEs**.

Uncapped Guarantee instrument: Option 1



2. Joint securitisation instrument for new and existing loans

- Combining resources from ERDF-EAFRD, COSME, Horizon 2020, EIF, EIB and possibly NPBs in one instrument;
- Two steps: a) securitisation of an existing/new portfolio and b) construction by the bank of a new portfolio;
- Increase lending to SMEs by providing capital relief and/or liquidity to on-lending banks
- ERDF-EAFRD take 50% of the riskier tranche (Junior tranche);
- Bank would retain a material interest in the transaction (adequate portion of the Junior tranche appx. 50%) to help ensuring alignment of interest and good origination standards;
- EU resources together with EIF own resources guarantee the Mezzanine tranche
- EIB and other institutional investors invest in the Senior tranche.


Existing loans portfolio
New loans in line with ESIF policy
The originator or the Bank
Purchase the loans from the bank Transfer of cash
Sale of the loans portfolio to the SPV. Transfer of assets. Freed BS.
Issuer of notes on to the capital investors market (SPV)
Purchase the notes & transfer of cash
Issuance of notes by the SPV in the investors market.
Investors
Senior tranche
Mezzanine
Junior tranche
Tranches covered by EIB group Cosme/H2020
Tranches covered by ESIF (50%) and Bank (50%)
Portfolio of existing loans partly covered by MA (ESIF funds)
Contractual link to built-up a portfolio of new loans in line with ESIF policy
EIF acting on behalf of COSME/H2020/Managing Authority

SME Initiative: key steps

- **Ex-ante assessment already carried out**
- Each participating Member shall provide the COM with a **single dedicated national programme (SDNP)** per financial contribution by ERDF and EAFRD supporting the thematic objective set out in Article 9 (3) i.e. supporting the capacity of SMEs to grow in regional, national and international markets, and in innovation processes;
  - **The resources for implementing the SME Initiative should be provided under the single dedicated national programme**
  - **If contributions at regional level (covering several regions), then the SDNP shall highlight the appropriate amounts by regions; contributing regions shall agree to designate "*single authorities*" as: managing authority, certifying authority (where applicable), audit authority.**
- CPR (Article 97) foresees specific provisions regarding the SDNP programming – it is a much lighter and shorter OP than the mainstream OPs
- Approval of the Single dedicated national programme by the COM

- There is a model Funding Agreement available (COM Implementing Decision 2014/660/EU of 11 September 2014) for interested parties to use
- Negotiation of the funding agreement between the participating MS and the EIB.
  - **Positive: Signature of the Funding Agreement (the signature shall occur within 6 months following the approval of the single dedicated national programme by the COM). If SME Initiative set up at regional level, this should be clearly specified in the SDNP and in the FA;**
  - **Negative: Member State shall submit a request for amendment of the single dedicated national programme and reallocate the contribution to other programmes and priorities in accordance with requirements for thematic concentration.**

- Request for payment from the EIB to the participating MS.

- Transaction approved with the selected financial intermediary (this approval should occur within 3 months following the request for payment from the EIB to the participating MS)

Added value

At the level of participating ***Member States***

- no national co-financing required for the contributions from ERDF-EAFRD
- Leverage effect on the ERDF-EAFRD contribution by a combination of resources (leverage definition in Art. 39(5) of the CPR)
- higher number of SMEs supported and more beneficial terms for SMEs thanks to risk-sharing with the EU and EIB Group
- Complement the existing financial instruments to address market failure

At the level of ***financial intermediaries***

- capital relief enabling new debt finance to SMEs
- additional funding in case of true securitization
- Extend volume of loans without impacting on risk exposure

At the level of ***SMEs***

- more liquidity for investments,
- improved financing conditions and
- better terms of loan contracts with financial intermediaries
- Availability of financing for projects that would otherwise be turned down by banks

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Thank you for your attention!

DG Regional and Urban Policy – Directorate B, Policy

B3: Financial Instruments and International Financial Institutions Relations

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