Overview of different structures and characteristics of financial instruments

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Funded Risk Sharing Loan

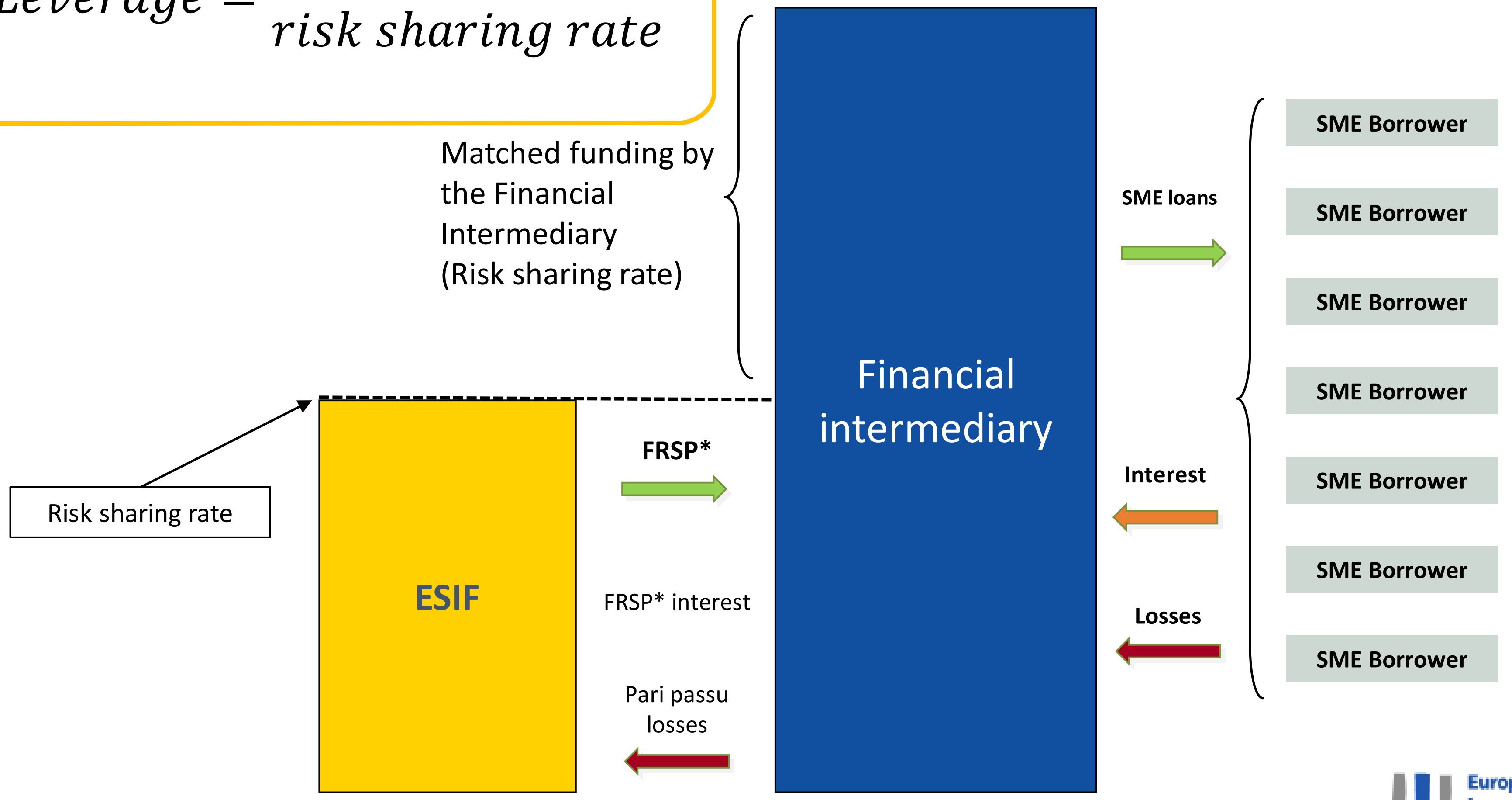
The RS loan is a loan pooling together ESIF funds and funds from the financial intermediary, where the latter shall contribute at least 25% (alignment of interest) – Commission Implementing Regulation (EU) No 964/2014

Goals:

- to provide the better access to finance to targeted SMEs and credit risk sharing to intermediaries.
- to leverage ESIF resources to support financing for SMEs.

Funded Risk Sharing Loan

$$Leverage = \frac{1}{risk\ sharing\ rate}$$



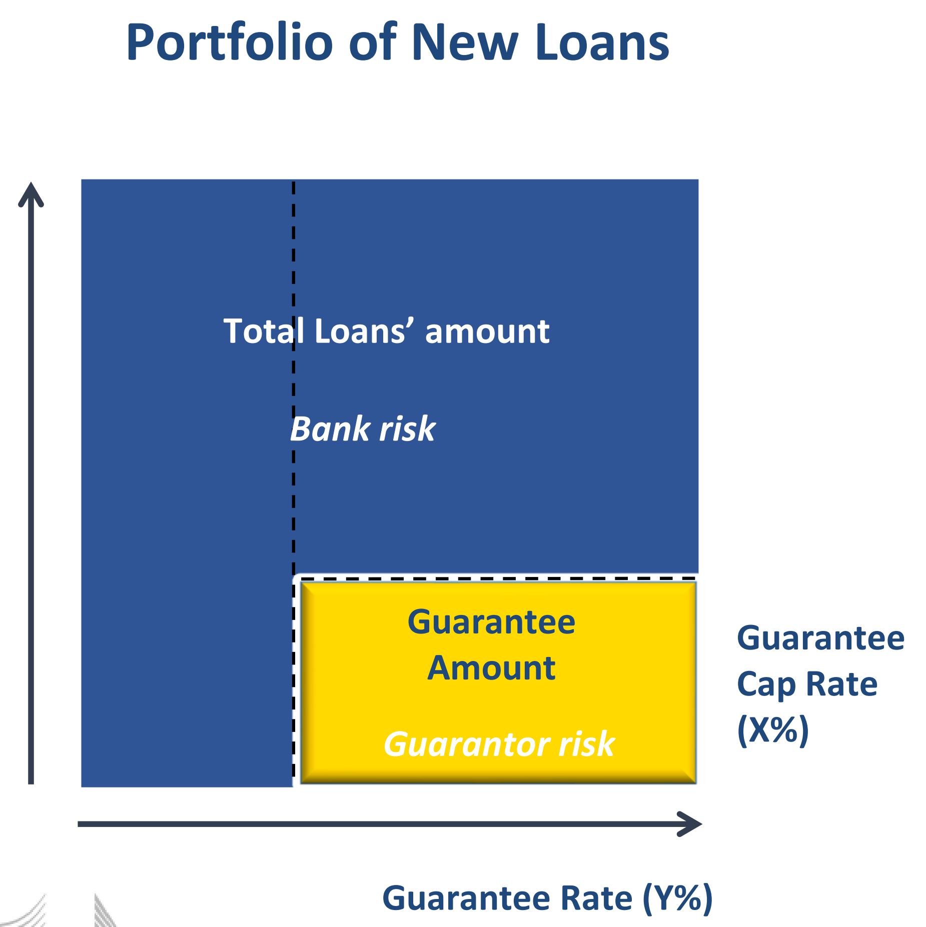
Capped Portfolio Guarantee – what is it?

Objective: provide **better access to finance to targeted Final Recipients** (typically addressing a market failure identified in ex ante assessment)

- Providing better access to finance to targeted SMEs (full advantage passed on to SMEs), addressing concrete and well identified market gaps.
- Leveraging the ESIFs to support financing for SMEs.

The Capped Portfolio Guarantee provides credit risk coverage to intermediaries on a loan by loan basis, **up to a Guarantee Rate**, for the creation of a portfolio of new loans to SMEs **up to a Guarantee Cap Rate**.

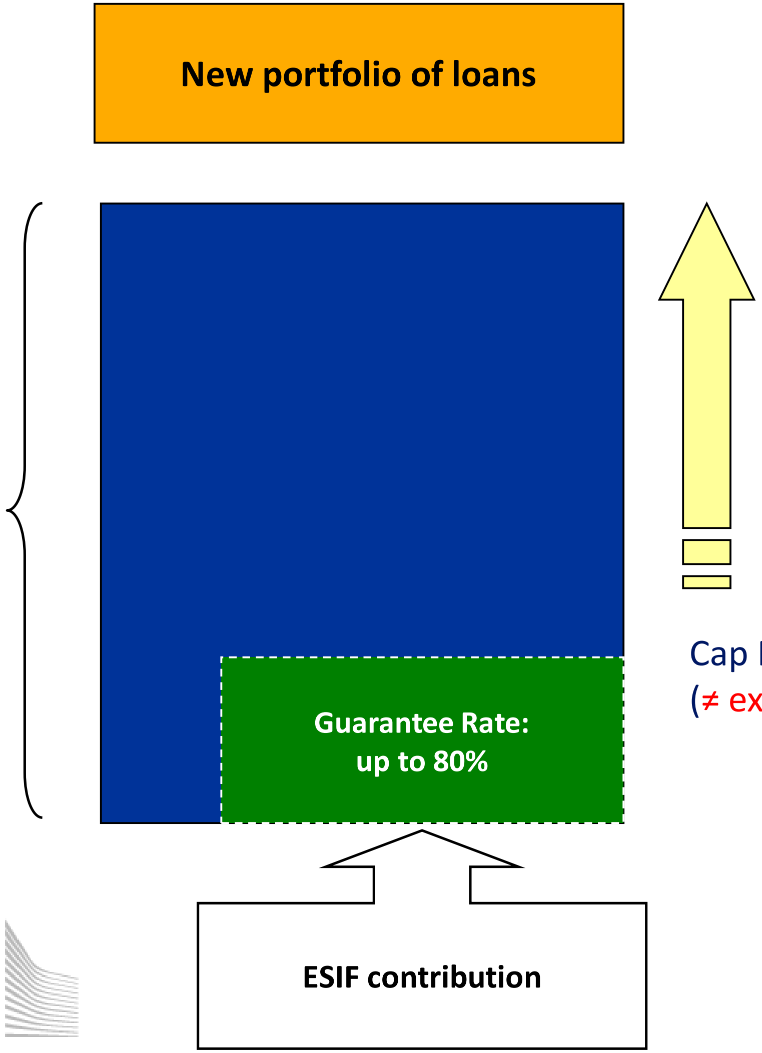
First Loss Portfolio Guarantee – at a glance



Objective: access to finance, with improved lending conditions for Final Recipients (reduced interest rates and/or collateral requirements)

- **Cap Amount available to cover losses in the Final Recipients loan portfolio;**
- **For each loan defaulting, [Y]% (guarantee rate) of the covered loss is paid to the bank;**
- **This holds until [X]% (cap rate) of the portfolio is covered.**

Capped Portfolio Guarantee – scheme



Multiplier:
(1/Guarantee Rate) x (1/Cap Rate)

Minimum:
(1/0.8) x (1/0.25) = 1.25 x 4 = 5

Cap Rate: determined in ex ante risk assessment
(≠ ex ante!) up to 25%

Capped Portfolio Guarantee – key features (1)

Further key features:

- Lending methodology to ensure that the **full financial advantage is passed on to SMEs** – reduction of interest and/or of collateral of each and every loan;

- Portfolio must include new loans (no refinancing!), up to EUR 1.5m each (granularity), for a term of 1 to 10 years (Lending policy – CIR 964/2014);

- Loans for:
  - investments in <u>tangible/intangible assets</u>, including for take over of other enterprises if transfer is between independent investors. But <u>no pure financial activities</u>, <u>real estate</u> development or <u>consumer finance</u> can be supported;
  - working capital related to development or expansion ancillary to investments.

Capped Portfolio Guarantee – key features (2)

Further key features (ctd):

- Eligibility criteria to be aimed at
  (i) reaching a **large number of recipients**, and
  (ii) achieving sufficient **portfolio diversification** ➔ no overspecialisation!

- No revolving credit lines, no equity, no subordinated or mezzanine debt;

- No fees payable by financial intermediary;

- Alignment of interest:
  - Performance fees;
  - FI to always keep at least 20% of risk in its own books.

Capped Portfolio Guarantee – State aid

The set-up of the instrument is State aid cleared:

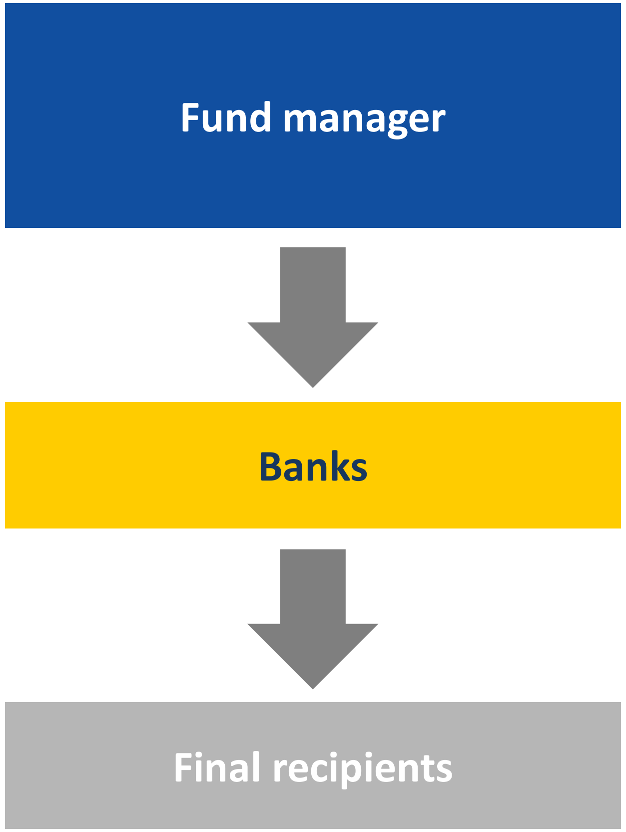
- At FoF and FI level, State aid free as long as:
  - Remuneration in line with Regulations and market – FInt. selected in open call;
  - FInt. covers the remaining 20% of risk with own resources;
  - Financial advantage fully passed on to SMEs.
- At SME level, under *de minimis* as long as:
  - GGE is below EUR 200k (including cumulations);
  - Other general rules regarding *de minimis*.

Guarantee – Transfer of benefit to SMEs

FLPG

- Subsidised guarantee
- Delegation principle: eligibility & risk assessment by banks
- Possible capital relief –reduced regulatory capital charge

- Significantly lower collateral requirement
- Reduction of risk related margin (decrease in the interest rate)
- Decreases in fees (based on call application)



Main advantages of guarantee instruments

For MA:

- Leverage effect (> than for a loan),
- Alignment of interest (FInt. “skin in the game”),
- Finance viable investment.

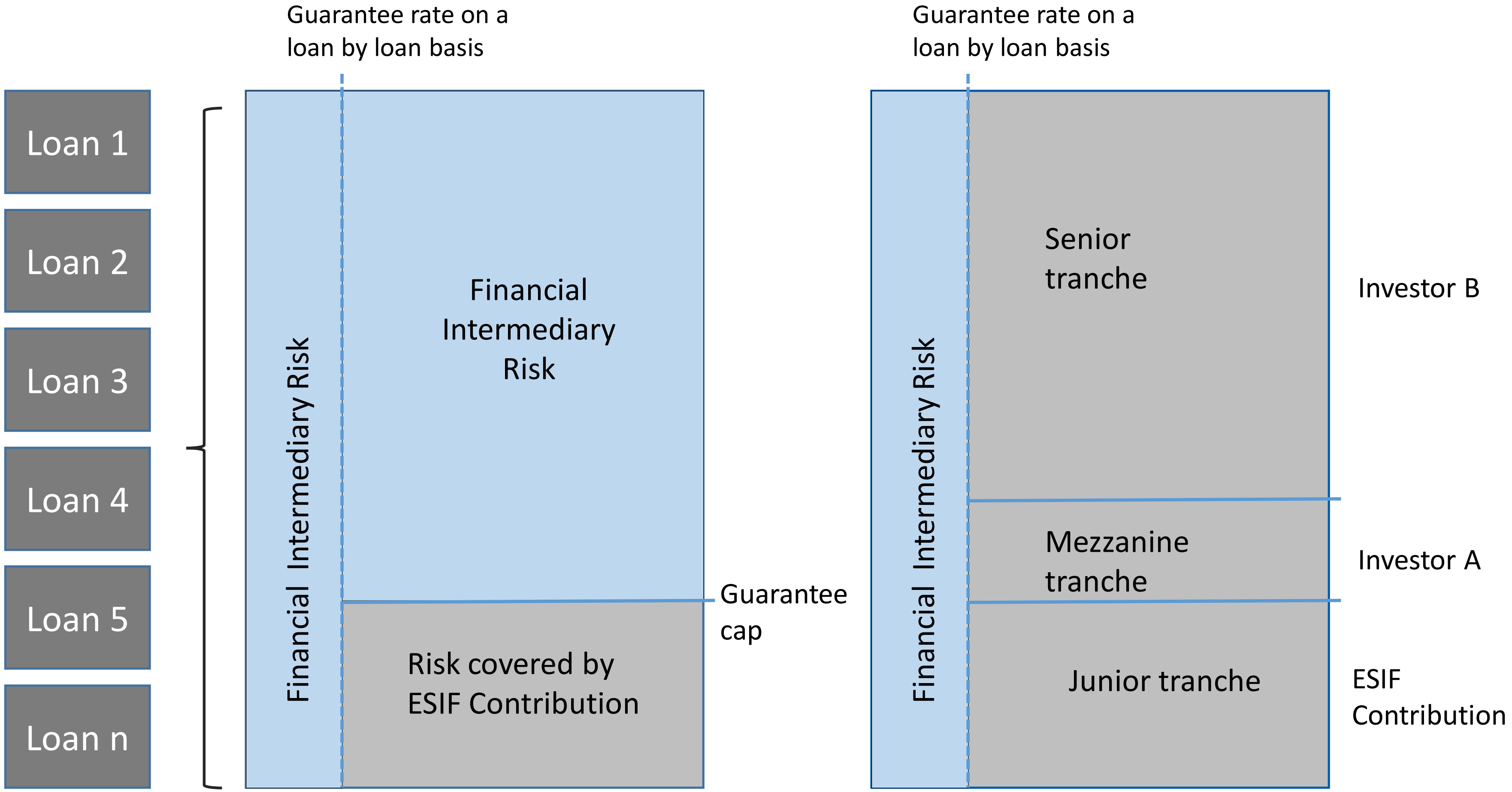
For Banks:

- FInt. risk coverage means reduce the overall exposure of banks (see e.g. following slide),
- Improves bank reputation (more willing to extend loans to SMEs),
- <u>Sometimes</u> allow banks to get capital relief.

For SMEs:

- Easier access to finance, since FInt. risk coverage,
- Collateral reduction,
- Interest rate reduction (cost of risk should be reduced) (< than for a loan).

Capped vs. Uncapped Guarantee



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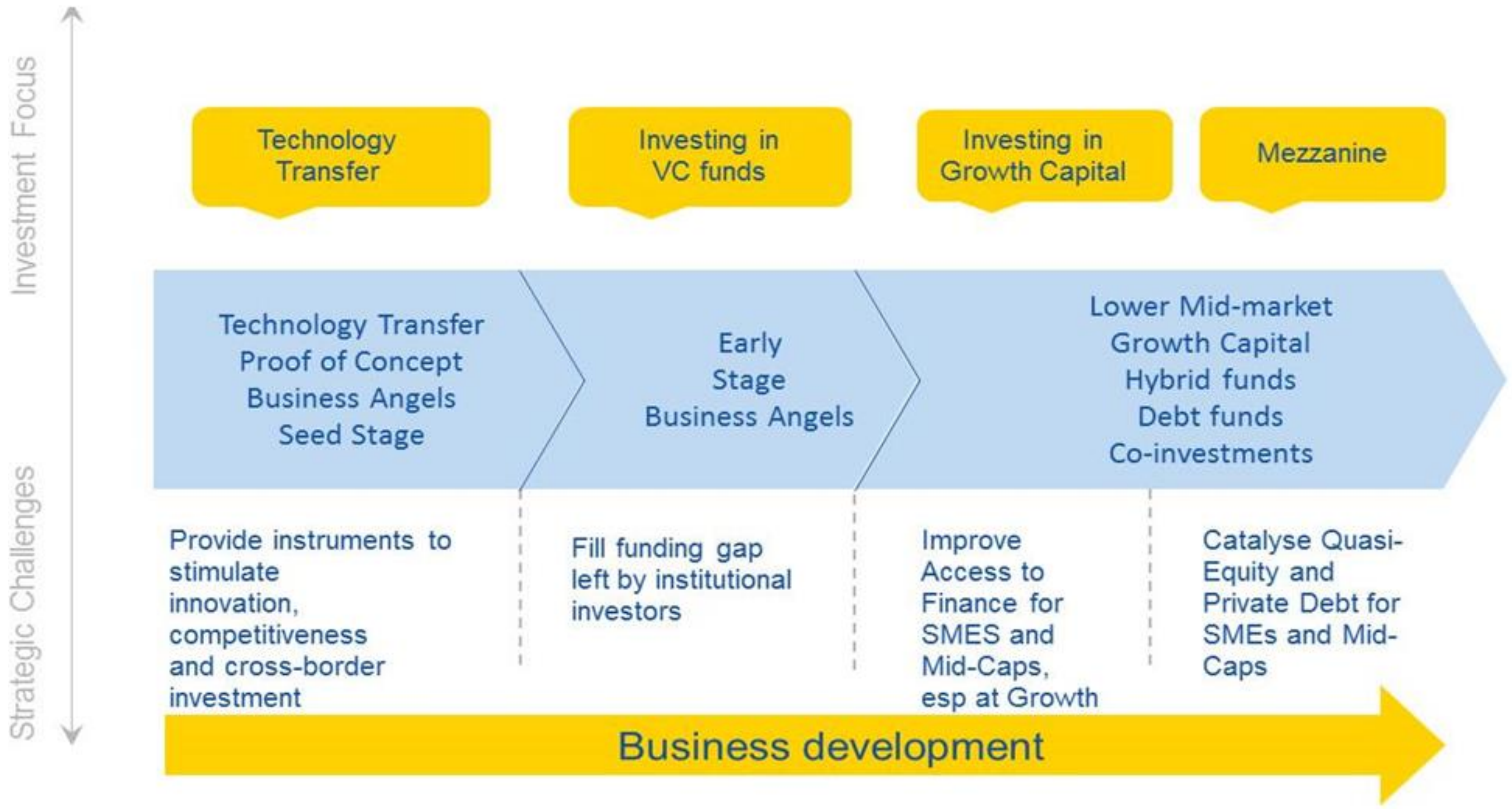
Equity

Main features:

- **Types** of equity investment normally depend on the **development stage** of a company;
- The most appropriate financial products to address the market gaps will be identified in the **ex-ante assessment** (incl. leverage effect and reinvestment):
  - For equity, leverage is measured by the co-investment from public and private resources in the financial vehicle.
- Equity is a longer term investment, normally with minimal dividends in the early life of a company:
  - Funds can revolve once the investment has been sold, which implies this will occur later in the life of the fund than for loans or guarantees;
- Any pay-off from an **'exit'** is very difficult to determine at the time of investment and estimates will be volatile during the life of the fund;
- There is full insolvency risk for the invested capital in the target companies;

Private Equity products

Which product for which SMEs?



Equity – pros and cons

ERDF

For F.Ints and other co-investors

For Final Recipients

PROS

For F.Ints and other co-investors:

- Active role in project management and access to shareholder information
- Managers/owners are motivated

For Final Recipients:

- No collateral to be provided
- Provision of management expertise to FRs
- Can access a wider network through involvement of venture capital investor

CONS

For F.Ints and other co-investors:

- Full insolvency risk when co-investing
- Establishing the price for the investment can be challenging

For Final Recipients:

- FRs can be less attracted by equity due to the obligation to transfer/yield control
- Strong financial discipline required
- Sharing the profits

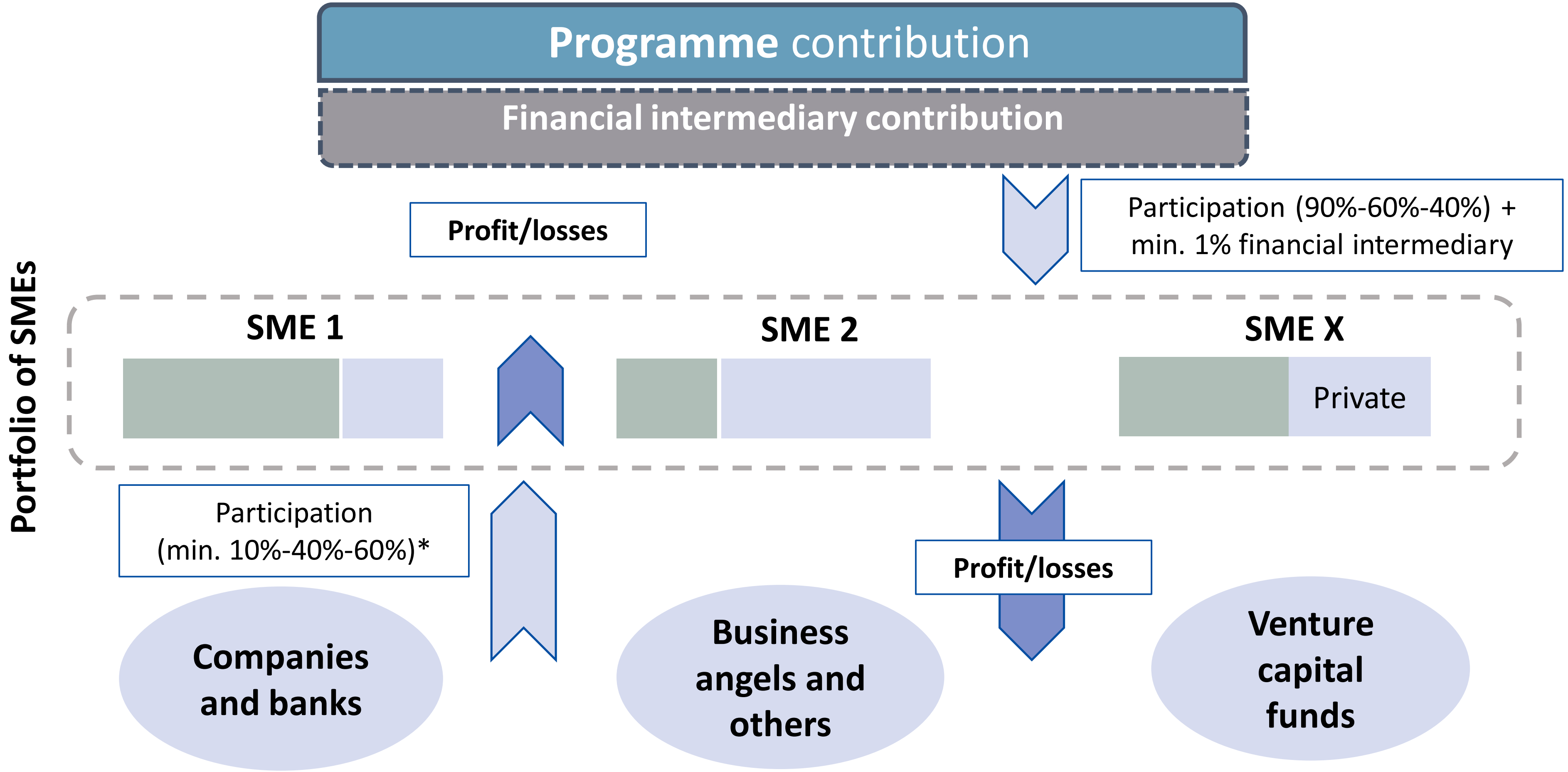
Co-investment facility (1)

The Co-investment is a pooled facility managed by a FInt., economically and legally independent from the MA (or FoF), whereby ESIF funds are invested in equity in SMEs in combination, and pari passu, with third party independent private investors on a deal by deal basis.

Goals:

- Providing equity financing to targeted SMEs, for which the market gap is generally substantial,
- Leveraging the ESIFs to support financing for SMEs,
- Catalysing private investment in the selected geography.

How does a co-investment scheme work?



** % include the minimum 1% financial intermediary contribution*

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