European Investment Bank Group

Support to SMEs 2008-2010

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During the financial crisis, the EIB Group made an exceptional effort to help small and medium-sized enterprises. Some 105 000 SMEs received EIB Group support in 2009 and another 115 000 in 2010.

The EIB Group Strategy for SME support

The EIB Group's strategy for SME support is composed of several layers, from an institutional point of view (EIB and EIF), from the point of view of the goals it addresses (anti-crisis and long term growth), and from the point of view of the instruments that are used (general vs. targeted). The combination of these layers helps the EIB Group to address the very diverse types of financial needs of European SMEs. The products and instruments that fit the specific circumstances are described below.

Two institutions with complementary roles: EIB and EIF

EIB Group support for small and medium-sized enterprises[1] in the EU and Pre-Accession Countries[2] is handled in a complementary fashion by the EIB and EIF acting together:

- the EIB, as the bank of the EU, focuses on access for SMEs to the financial market by providing liquidity at first class interest rates to banks, for long tenors which go beyond those commonly available between banks. Through contractual commitments, the intermediary banks are bound to transfer these favourable conditions to their SME clients.
- the EIF, with the EIB as majority shareholder, focuses on equity support, especially Venture Capital as a Fund of Fund investor, as well as guarantee products for SMEs.

Working together, the EIB and EIF, each with its core competencies and expertise, respond efficiently to market needs in SME finance in Europe.

Two goals: anti-crisis and long-term growth

SME programmes were to be a core part of the Bank's ***anti-crisis*** activities. SMEs form the backbone of the economy and produce a significant volume of positive external effects as regards employment, jobs for young people, training and broad regional impacts. When in Nice in September 2008 the shareholders of the EIB – the 27 Member States of the EU - asked the EIB to increase its SME activities by 50% over 4 years as an anti-crisis measure (to EUR 30bn between 2008-2011), the Bank was ready to answer the challenge. The EUR 30bn objective was already achieved at the end of 2010 – a full year early, thanks to the efforts by the EIB and its partner banks.

In order to grant SMEs access to financial markets in a crisis (i) availability at attractive conditions and (ii) long tenors are of the essence. In addition, anti-crisis activities for SMEs have to be (iii) fast and (iv) give a special emphasis to those countries where a relevant part of the banks have stopped lending or left the country.

The new "Loan for SMEs" product, launched by the EIB in 2008, serves the purposes (i) to (iii). It can also be used to provide working capital and, in addition, it may finance up to 100% of investment costs, instead of the usual maximum of 50%.

Purpose (iv) – special emphasis for countries with a non-functioning banking sector - was catered for by a large-scale IFI initiative for Central and Eastern Europe in which the EIB shouldered the largest share of the lending volume, with approved operations of EUR 13.8bn and signed operations of EUR 11bn in 2009 and 2010.

[1] Small: up to 249 employees, medium: up to 2 999 employees, companies normally have to be independent, i.e. not subsidiaries of large groups.
[2] Pre-Accession Countries are Candidate Countries and Potential Candidate Countries

As the crisis is not over and the recovery pattern is uneven in the different countries there is a strong need for ***support for long-term growth***, beyond the Bank's volume-driven anti-crisis activities. The more the EIB can phase-out the anti-crisis activities, the more the EIB can focus on long-term growth. More weight for long-term growth will imply other product families, usually with lower volumes and higher risk.

Two product families: support for all SMEs, complemented by targeted products

Products for *all* SMEs are mass products, such as the Loan for SMEs (EIB) and the Portfolio Guarantee (EIF). Through these mass products the EIB Group managed to provide support for some 105 000 SMEs in 2009 and 115 000 SMEs in 2010.

SMEs with more than 10 employees fund around a quarter of their financing needs through bank loans. The EIB provides an important element of SME financing in Europe, particularly as Loans for SMEs translate into medium and long term finance rather than overdrafts. Beyond the mass products, other products for equity and mezzanine finance address a smaller number of SMEs as final beneficiaries. As the crisis resulted in a significant shortage of risk capital (which is expected to last for another two or three years), the EIF anti-cyclically increased its activities and temporarily had a market share in that area of up to 20%. After some pilot transactions in 2010, EIF intends to pioneer a redevelopment of the SME securitisation market, with transparent and reliable products.

Targeted products are available for specific regions (e.g. JEREMIE for SMEs in convergence regions), specific sectors (e.g. renewable energy), specific targets (e.g. microfinance and social inclusion) and specific sizes (e.g. the MidCap Initiative for smaller investments of corporates between 250 and 2 999 employees, for which access to bond markets remains very restricted). These targeted products are increasing in number and volume, reflecting the existing and growing diversity of enterprises in EU countries in this fragile recovery phase. Targeted products are aimed at more sustained European economic recovery.

The following sections describe in more detail the two SME product families: general support and targeted products as well as their relative importance in the EIB Group's future strategy.

General support for SMEs

The great majority of funding for the development of SMEs is through loan or lease financing, granted by the banking and leasing sector in Europe. The availability of such financing for this very large and relatively high risk sector of the economy is helped by the EIB providing attractive funding to the banks that are active in SME finance, and monitoring that the funding support for intermediary banks results in enhanced access to attractive finance for SMEs. It is also helped by the EIF offering risk sharing mechanisms which allow the banks to reduce the capital required to extend their SME finance activity.

Loans for SMEs

The "Loans for SMEs" product was launched by the EIB in the second half of 2008, following an extensive consultation with Intermediaries and Final Beneficiaries in 2007/2008. Loans for SMEs are loans granted by the EIB to (private or public) financial institutions (intermediary banks, or "intermediaries") for on-lending to SMEs. In order to allow the maximum number of SMEs to access EIB's funds, the Bank cooperates with more than 170 intermediaries across the European Union.

The main characteristics of a Loan for SMEs are simplicity of access for SMEs and reporting to the EIB for the intermediaries. There is also a strong focus on ensuring that each SME is aware of the fact that the financing it obtained from its banker is supported by the EIB and how much this support has benefitted the SME in financial terms.

For each Loan for SMEs, specific terms are agreed between the EIB and the intermediary. They include amongst others, the minimum financial benefit which is to be granted to each SME compared to a non-EIB supported financing from the respective bank. They also include the time span for disbursement to the intermediary by the EIB and allocation of the funds to SMEs, the criteria describing which SMEs are eligible for the funding, and the reporting requirements. In some cases (limited to the “New” EU Member States and Pre-Accession Countries) Loans for SMEs are combined with subsidies from the European Commission, providing additional support for SME lending activity. Another feature of Loans for SMEs is that the EIB may finance up to 100% of the loan granted by the intermediary. To ensure that EIB lending does not simply substitute for the intermediary lending from own funds, the EIB requires the intermediary to confirm that it has at least matched the EIB funds it received.

Unless otherwise defined between the intermediary and the Bank, a Loan for SMEs allows the intermediary to support SME investments in all EU Member States. To ensure a swift allocation of EIB funds to SMEs, financing requests for SMEs may be presented to the EIB within 12 to 18 months after the date of the signature of the loan agreement between the EIB and the intermediary.

EIB pricing for the Loans for SMEs is based on the EIB’s funding cost on the capital markets, plus an administrative mark-up to cover its operating costs. Since this price is normally lower than the price intermediaries would pay if they were to use alternative funding sources on the capital markets, a pricing advantage is created. The Loan for SMEs documentation includes commitments by the Intermediaries to pass on a pricing advantage to the Final Beneficiaries. This is verified by the EIB.

During the crisis the EIB made considerable efforts to ensure that Loans for SMEs disbursed to its partner banks reached SMEs quickly. For 2008/2009, allocations to SMEs totalled EUR 14bn, a 96% increase compared to 2006/2007. A total of more than EUR 24bn in loans actually granted to SMEs by the intermediaries had been supported by the EIB by the end of 2010. These figures best illustrate the real impact of the EIB’s support to SMEs in the context of the financial crisis. The EIB will continue to closely monitor the allocation activity of its partner banks, to ensure that SMEs benefit from the Bank’s increased support.

The following table summarises the key figures for the EIB’s Loan for SME activity over the last 3 years, across the EU 27. It also shows the 2007 figures for comparison:

	2007	2008	2009	2010
Loans for SMEs signed with banks (EUR bn)	*6*	8	13	10
Amounts allocated to SMEs (EUR bn)	*3*	7	7	10
Number of SMEs supported	*30 000*	50 000	48 000	63 000
Average size per SME allocation (EUR)	*109 000*	139 000	146 000	157 000

The EIB has specifically responded to difficulties for SMEs to access financing in Central and Eastern Europe. In 2009 the participants of the Joint IFI Action Plan (JAP) – the European Bank for Reconstruction and Development, the European Investment Bank Group, and the World Bank Group - decided to launch an action to support the real economy in Central and Eastern Europe, affected by the financial crisis. Support has been provided against the backdrop of a difficult economic environment, with little capital inflows and declining overall lending to the real economy, as well as additional shocks to some regions such as south-eastern Europe. The EIB committed to double its available resources for the region, from EUR 5.5bn to about EUR 11.0bn by end-2010. To date, the EIB has made available 130% of the resources planned for the 2-year period, or over EUR 14bn. Funds have been made available to over 50 financial intermediaries including most of the larger Western European banking groups’ subsidiaries in the region. In terms of geographical distribution, approximately 60% of these resources have been directed to the EU Central and Eastern European Member States, over 15% to the Western Balkans, over 20% to Turkey and the remaining part to Eastern Partner Countries.

SME Loan Portfolio Guarantees and Securitisation

The EIF addresses market gaps in SME debt financing by providing loan portfolio guarantees to banks, as well as credit enhancement in securitisation transactions backed by a portfolio of SME loans.

With first loss portfolio guarantees, the EIF promotes enhanced access to finance for SMEs by reducing the risk taken by banks on new SME loans and thus encouraging banks to grant such loans and to make them available at more favourable conditions compared to their normal credit policy. First loss portfolio guarantees are issued under European Commission mandates (SME Guarantee Facility and JEREMIE).

In its credit enhancement activity, the EIF acts as guarantor of tranches of both synthetic and true sale SME securitisation transactions. With its credit support, the EIF enables banks to obtain liquidity from capital markets, reduce risk and achieve capital relief, thus allowing banks to expand their SME lending activity.

The SME Guarantee Facility under the Competitiveness and Innovation Programme (CIP)[3] provides enhanced access to finance for SMEs throughout the EU, in Iceland, Norway and Liechtenstein, as well as in Croatia, FYROM, Montenegro, Serbia, and Turkey. The SME guarantee is made available to CIP intermediaries as a free of charge guarantee covering part of the first loss (i.e. the expected losses) on a portfolio of new SME loans. To qualify for such a cover, financial institutions commit to offer enhanced access to finance for SMEs by taking SME risk exposure that is additional to what they would usually accept. This can take place through e.g. reduced collateral requirements, increased loan volumes or lending to hitherto excluded SME segments (like, for instance, start-up enterprises). The intermediary typically retains 50% of the first loss in the guaranteed portfolio.

Between 2008 and 2010, the EIF has signed CIP agreements with 27 intermediaries in 15 countries. A total of more than 90 000 SMEs have already benefited from the CIP guarantees. It is expected that a total number of approximately 120 000 SMEs will be supported over time by commitments already made by the EIF. Newly supported SMEs in 2010 totalled 31 310.

At of the end of 2010, the large majority (more than 90%) of the supported SMEs were micro-enterprises and 57% of them were in the start-up phase.

The supported loan volume in the first 3 years of operation of CIP guarantees is as follows (as of 31 December 2010):

Amounts in EUR m	2008	2009	2010
Guarantee commitments	75.3	115.6	96.1
Guaranteed loan volume	1 309	2 339	1 187

The CIP SME Guarantee facility has achieved a substantial leverage of the allocated EC budget of approximately 17 times, i.e. EUR 1 of budget allocation supports EUR 17 of SME loans. Due the financial crisis, the SME Guarantee Facility has played an important role in addressing the difficulties that SMEs faced in obtaining access to debt finance.

As regards the credit enhancement activity, the European securitisation market has gone through an extremely difficult period in the last three years, with very few transactions having been placed with market investors. The EIF, building on its leading position established over the last ten years, has contributed to the gradual reopening of the SME securitisation market in Europe. The second half of 2010 has seen the first SME transactions emerging with actual placement to third party investors and the EIF has played a catalytic role in these transactions.

Despite the market turmoil, the EIF has signed almost EUR 1.1bn of new commitments in the period 2008-2010. The EIF has achieved on average a leverage of 7.5 on its commitments, meaning that its guarantees have translated into the support of approximately EUR 8bn of SME lending and over 40 000 SMEs supported. The new commitments under the

[3] CIP follows two prior EC programmes with similar objectives, the Multiannual Programme (MAP) and Growth & Employment available between 1998 and 2007.

securitisation activity of EIF in 2010 supported approximately 20 000 SMEs and helped to redevelop the SME securisation market after the crisis.

Venture and Growth Capital

In the same way as banks, private sector investors had little appetite to invest in early stage, fast growing and innovative SMEs during the crisis. This shortage of risk capital is expected to last for a further two or three years and the EIF will therefore keep increasing its investment in this sector.

In its Fund-of-Funds activity, the EIF manages a unique portfolio of equity investments. At end-2010, the portfolio comprised net commitments of nearly EUR 4.6bn in over 300 funds. Approximately 92% of the net commitments are written under mandates entrusted to the EIF by external parties of whom the most important is the EIB, followed by the European Commission. The remaining 8% is invested from the EIF's own funds.

The EIF invests in a spectrum starting from Tech Transfer, representing the commercialisation of science being generated in European Universities, through Venture Capital to Growth Capital, the latter complemented by the Mezzanine Facility. Commitments are predominantly made in favour of Fund Managers, who in turn invest into portfolio companies with the aim of building and developing them. The majority of the portfolio companies are European SMEs operating in the technology and generalist sectors.

One of the initiatives which has been developed in 2009 and is since fully operational is the Mezzanine Facility for Growth ("MFG"). The objective of MFG is to provide hybrid financing combining quasi-equity characteristics with limited ownership dilution. This product can be used as a growth expansion or transmission financing tool, as a complement or substitute to banking debt or as a replacement of pure equity investment. It is especially adapted to minority investments alongside individual shareholders who wish to remain majority owners of the company. The EIF will invest EUR 1bn on behalf of the EIB in funds which provide hybrid debt/equity instruments ('mezzanine' investments), with a focus on established, innovative SMEs and smaller MidCap companies. The MFG was put in place for an initial period of three years. By the end of 2010, the MFG was committed by 38%, with a total of EUR 224m commitments signed in 2010 despite relatively weak market conditions. The pipeline of further transactions in 2011 remains very strong.

During 2010, the EIF committed EUR 930m in 42 equity and mezzanine funds across its mandate and own funds capacity, which represents a significant 27% increase on the 2009 outturn. During a year in which fundraising in the EIF investment spectrum remained extremely tight, due to the withdrawal of private investors who perceive the sector as unattractive from a risk/return point of view, this countercyclical effort helped to leverage some EUR 4.5bn of extra financial commitments in favour of EU Equity Funds and ultimately SMEs.

Targeted initiatives for specific SME segments or regions

An increasing number of targeted initiatives have been launched by the EIB and EIF recently to improve access to finance in certain sectors of the SME market. The driver for these initiatives is either to enhance access to classical financial instruments to a very specific target group of companies which face particular difficulties in obtaining such finance, or to enhance the risk-bearing capacity available for SME finance. In all of the initiatives, the EIF and EIB play a joint role, adapted to the competencies they can deliver best. Some of the initiatives are pilot structures, with the intention to repeat them elsewhere or with other participants in the coming years.

JEREMIE

The objective of the Joint European Resources for Micro-to-Medium Enterprises (JEREMIE) initiative is to reach SMEs in convergence regions of the EU and/or market segments for which particular difficulties to access finance have been identified.

The JEREMIE initiative was developed in cooperation with the European Commission. It is implemented by the EIF and offers EU Member States, through their national or regional Managing Authorities, the opportunity to use part of their EU Structural Funds[4] to finance SMEs. The intention is to move away from subsidies and to leverage EU Structural Funds available by means of innovative financial engineering products, such as equity, loans or guarantees, providing a diversified range of financial products for the benefit of SMEs. This will help to create a much improved ratio of investment versus subsidy, i.e. the volume of investments supported will substantially increase in comparison with the “traditional” use of subsidies. Moreover, the equity investments, loans or guarantees will generate revenue which will be available for re-use for investments in SMEs, even beyond the final availability date of the EU Structural Funds (“evergreen concept”).

Working toward achieving this objective, in early 2011 the EIF had set up Holding Funds in twelve countries and regions of Europe providing them with a comprehensive toolbox of financial products for SMEs. As of year-end 2010, the JEREMIE mandates under EIF management amount to a total of EUR 1.18bn.

After a phase of careful preparation and selection of financial intermediaries, resources have started to reach local businesses in 2010. Also in 2010, 17 Calls for Expression of Interest to select Financial Intermediaries for venture capital or risk-sharing instruments in the respective countries and regions have been launched, which resulted in 16 signatures for a total of EUR 311m.

One of the EIF’s significant achievements in 2010 was the set-up of a JEREMIE Holding Fund in the Sicily region under the European Social Fund (ESF), which marked the EIF’s move into a new and challenging territory, adding a social component to the JEREMIE product offering.

The EIB has participated to the JEREMIE initiative in four regions in the UK, by adding EIB funding to the structural funds available for SME investment. Some GBP 275 m of EIB funding has been deployed in such a way in 2009 and 2010. The repayment of the EIB loans depends on the returns on the investments made from the overall amount of money available (Structural Funds plus EIB loan). This is an innovative way for EIB to share some of the risk incurred on SME investments. The EIB expects that the scheme will be expanded to other regions within the EU in the future.

In 2010, the EIF also developed new financial products under JEREMIE in order to leverage EU Structural Funds with the view to enhancing SMEs access to finance in countries less supported by the traditional EIF products: a risk sharing loan scheme and a portfolio guarantee instrument.

Under the JEREMIE risk sharing loan facility, the EIF provides funding to financial institutions for the financing of a new portfolio of SME loans (such loans to be co-financed by the financial institution) and shares part of the credit risk relating to the portfolio. EIF signed six JEREMIE risk sharing loan facilities in 2010. Each risk sharing loan agreement contains specific terms on enhanced access to finance, including the minimum financial benefit to be granted to each SME compared to a non-JEREMIE supported financing from the respective bank.

Under the JEREMIE First Loss Portfolio Guarantee, the EIF covers part of the credit risk relating to a new portfolio of loans and/or leases granted by a financial intermediary to SMEs. Such guarantees provide financial institutions with risk protection for the portfolio expected loss as well as capital relief. The first two JEREMIE portfolio guarantees were signed in Romania in December 2010. Each guarantee agreement provides for a commitment by the intermediary bank to offer its loans on better terms compared to a non-JEREMIE supported financing.

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[4] Structural Funds comprise Cohesion Funds, Regional Funds and Social Funds.

In the coming years, EIB Group will report more in detail on the number of SMEs supported with the help of JEREMIE operations.

European Progress Microfinance Facility

Jointly with the European Commission, the EIB Group is responding to the need to significantly enhance access to finance for micro-entrepreneurs, self-employed or individuals who have difficulties in accessing the traditional banking system. The European Progress Microfinance Facility ('EPMF') was launched in 2010. Through this initiative, the EIF is offering a diversified range of financial instruments to microfinance institutions to extend their capacity to support targeted micro-enterprises and self-employed individuals in the EU, particularly those belonging to vulnerable social groups in the labour market.

This EUR 200 million facility is funded by the European Commission and the EIB and is managed by the EIF. First transactions under Progress Microfinance have already been signed at the end of 2010 and a strong pipeline has been identified for the coming months.

The Greater Anatolia Guarantee Facility (GAGF)

One of the innovative, targeted, joint EIB/EIF operations is the new Greater Anatolia Guarantee Facility (GAGF), which was put in place to support SMEs in Turkey. GAGF was developed by the EIB Group in cooperation with the EU Commission and the Turkish Ministry of Industry and Trade. GAGF provides a combination of portfolio guarantees and funding to Financial Intermediaries, as well as capacity building and promotional activities.

In October 2010, the EIF signed one counter-guarantee agreement for micro-loans and five guarantee agreements with Turkish banks for an aggregate guarantee amount of EUR 27m and a corresponding aggregate loan portfolio volume of EUR 537.5m. As a joint EIB Group operation, the EIB provided Loans for SMEs to these five banks for a total amount of EUR 250m, to finance the GAGF guaranteed portfolios.

The MidCap initiative

The onset of the global financial crisis in autumn 2008 had immediate and significant impacts on the finance available for MidCaps (companies with 250 to 2 999 employees), causing significantly less access to bank finance and to the bond and mezzanine finance markets. This MidCap credit squeeze was seriously limiting the scope for Mid-Caps to invest, and so risked becoming a brake on European economic recovery. The EIB therefore implemented a streamlining of its MidCap lending, drawing on the experience with the new Loan for SMEs product. MidCap Loans are based on the same principle as Loans for SMEs, i.e. EIB provides funding to selected partner banks, which then on-lend these funds to MidCap companies.

The simplifications came into force towards the end of 2010. They will improve EIB lending to intermediate-sized companies through and beyond the immediate crisis period, as part of supporting sustained European economic recovery. The pipeline appears to be strong, and numbers of MidCap companies supported through this initiative will be reported in the coming years.

Future strategy for the EIB Group's support to SMEs

Going forward, and in a context of a fragile and uneven recovery of the European economies, the EIB Group will continue to monitor and further develop its SME strategy and, to maximise its growth support by using the best of the EIB Group's expertise for designing products which respond to particular challenges faced by SMEs. The balance of its SME activities (eg. anti-crisis vs. support for long-term growth) will be regularly adjusted. Access to classical loan or lease finance will remain important in a situation in which SMEs continue to rely heavily on these products to finance their development. The EIB Group will thus continue to play its role in providing liquidity to the banking sector, either through credit lines or through SME loan portfolio guarantees and risk sharing. The EIB Group will closely monitor that this form of support results in improved access to finance for SMEs. Also, the long-term need for risk capital for the development of technology is recognised throughout Europe. The EIB Group will play an active role as the cornerstone investor in early stage innovative SMEs.

The EIB Group's strategy will also focus on market segments with particular needs, in cooperation with the European Commission and other stakeholders. As mentioned above, a number of targeted initiatives, aiming at specific regions or SME market segments, have been created by the EIB Group over the past two years and are now operational. They serve as a solid basis for a shift towards more specific, segment-oriented support to SME finance for growth and jobs.

The relative importance of general versus targeted SME support will depend on the economic development across the EU 27. From today's perspective, with European economies progressively recovering, the EIB Group's support to SMEs through more general products will probably diminish, to the benefit of approaches more focused on long term growth, inclusive growth, innovation, and on enhancing the risk-bearing capacity of SME finance players in Europe.

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