EVALUATION OF THE EIB's SPECIAL ACTIVITIES

CONTEXT

Higher risk operations at the EIB are labelled "Special Activities". These Special Activities increased significantly from 2015 to 2020 in absolute and relative terms with respect to the Bank's portfolio. Special Activities include loans and guarantees with a higher credit risk (as measured by a loan grading of D- and below) and all equity-type operations

Loan grading

A loan grading is the Bank's internal assessment of a lending operation's credit risk. It summarizes a large amount of information with the purpose of offering a relative ranking of a loan's credit risk. This ranking ranges from A0 to F and reflects the estimated level of expected loss.

This evaluation seeks to unpack the trade-offs and links between risk, additionality, cost coverage, profitability and capital intensity of Special Activities, with the overall aim of supporting evidence-based decision making regarding the future business mix of the Bank.

KEY FINDINGS

The Special Activities portfolio has some distinctive characteristics.

☞ The Special Activities portfolio includes a larger share of loans to new clients with a high risk profile, shorter tenors and smaller operations than the Standard Operations portfolio. The Special Activities portfolio targets higher value added and/or innovative sectors, and mobilises more complex products such as equity & quasi-equity, mid-cap lending, project finance, risk-sharing instruments.

The evaluation finds that additionality tends to be higher for Special Activities as compared to Standard Operations.

Additionality
Additionality has three dimensions:

1	2	3
Whether the EIB intervention is motivated by the existence of a market failure/investment gap,	**Whether the EIB provided (financial or non-financial) inputs beyond what the market would have provided,**	**Whether the project would have been implemented – to the same extent and within the same timeframe – without the EIB.**

☞ Operations under both the Special Activities and Standard Operations portfolios address market failures and investment gaps.

☞ The EIB contribution to the projects –in terms of inputs that the market would not have provided – tends to be higher for Special Activities as compared to Standard Operations.

☞ The proportion of projects that would not have been implemented without the EIB (or not to the same extent/within the same timeframe) is higher for the Special Activities than for Standard Operations.

☞ Special Activities are more likely than Standard Operations to crowd-in private sector financing.

☞ Beyond the crowding-in effect at the level of individual operations, Special Activities also generate significant market-level "demonstration effects".

Costs and cost coverage

The typical cost (per operation) of Special Activities is higher than that of Standard Operations (factors driving up costs: higher origination and monitoring costs, mandate specific costs), **while the size of the loan/ guarantee per operation is smaller** (which implies a lower revenue generating capacity for a given margin).

On a cumulative basis, Special Activities have not been cost covering (in contrast to Standard Operations) **although the annual cost coverage of Special Activities has improve**d in recent years.

Profitability and capital intensity

Special Activities are of two types: own-risk and under risk-sharing mandates where third parties absorb part of the risk against retrocession of risk pricing revenues.

☞ A much larger share of the revenues for Special Activities comes from the remuneration of risk (i.e. risk pricing revenues), as compared to Standard Operations.

☞ Special Activities under risk-sharing mandates result in lower residual risk for the Bank, but have lower profitability (due to retrocession of risk pricing).

☞ Own-risk Special Activities entail more risk (i.e. more capital intensive), but have higher profitability (as all risk pricing is retained) than Standard Operations. Although higher profitability comes with higher volatility in the profit and loss account.

CONCLUSION

The evaluation finds that there is a rationale for the Bank to engage in higher risk activities going forward.

☞ Special Activities contribute to strengthening the EIB's institutional distinctiveness and competitive position: new clients, new sectors, new activities and new products that respond to shifting dynamics and evolving market needs.

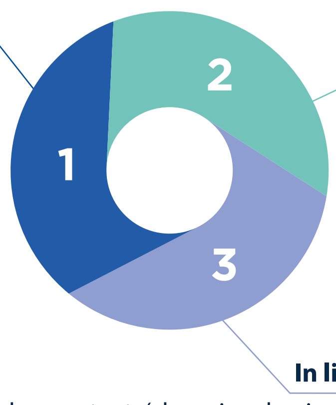
☞ If the EIB wishes to be at the forefront of financing the European Union's transition to a carbon neutral and digital economy, it will need to develop products that respond to market needs and address these gaps. A range of products along the risk spectrum will be required to stimulate/ de-risk private sector investment.

In finding the balance in the business mix, the following trade-offs need to be considered.

1. Special Activities generate higher additionality.
2. Special Activities have lower (statutory) cost coverage, but are more profitable when all risk pricing is retained.
3. Risk-sharing mandate Special Activities have a lower residual risk (i.e. lower capital consumption), but cost coverage is more challenging to achieve and they generate low/no profitability for the EIB (due to retrocession of risk pricing). They also come with further constraints, including governance, eligibility and reporting, etc.
4. Own-risk Special Activities entail more risk (i.e. more capital intensive), but higher profitability for the EIB and greater strategic autonomy.

RECOMMENDATIONS

In finding the balance in the business mix, the following trade-offs need to be considered.



1. **Higher risk products should be** strongly anchored in the expectation of **higher additionality and impact**, while **balancing financial sustainability considerations.** In order to achieve this, the Bank should improve its capacity to understand and analyse the additionality and impact of each product line along with its full lifecycle cost coverage and profitability.

2. **The Bank should explore** and implement specific measures to **improve the cost coverage of Special Activities.**

3. **In light of the evaluation findings** and the broader context (changing business model of the Bank, shifting market dynamics and evolving needs), the Bank should consider re-assessing the suitability of the D- loan grading threshold and/or dropping the (volume based) hard limit on own-risk Special Activities introduced in the EIB's 2021 operational plan and based on the **binary designation of Special Activities**.

PLEASE CLICK HERE TO SEE THE FULL REPORT:

https://www.eib.org/en/publications/evaluation-of-the-eibs-special-activities

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EVALUATION