Introduction to FIs:

Key features and advantages, different financial products, implementation options

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Definitions and acronyms

FIs	Financial instruments
ESIF	European Structural Investment Funds (ERDF & CF, ESF, EAFRD, Maritime and Fisheries Fund)
MA	Managing authority
Beneficiary	Body that implements the financial instrument or the fund of funds
Final recipient (FR)	A legal or natural person receiving financial support from a financial instrument
Financial intermediary (F.Int)	A specialised financial organisation able to deploy financial resources to target groups of FRs

Source: European Commission (2015). Guidance for Member States on Financial Instruments – Glossary


FINANCIAL
INSTRUMENTS

Financial instruments

- ✓ co-funded by the European Structural Investment Funds (ESIF)
- ✓ a sustainable and efficient way to invest in growth and development
- ✓ can support a broad range of development objectives for the benefit of a wide range of final recipients (FRs)

Revolving effect

Additional flows of money - generated through repayments that can be reused for further investments

Leverage effect

Capacity to attract additional public and private resources.
It is "the sum of ESIF funding and additional public and private resources raised divided by the nominal amount of the ESI Funds contribution"

State aid: FIs must be implemented in accordance with State aid rules

What are the financial products?

Loans

Agreement which obliges the **lender** to make **available** to the **borrower** an agreed sum of money for an **agreed period** of time and under which the borrower is **obliged to repay** that amount with interest within the **agreed time**

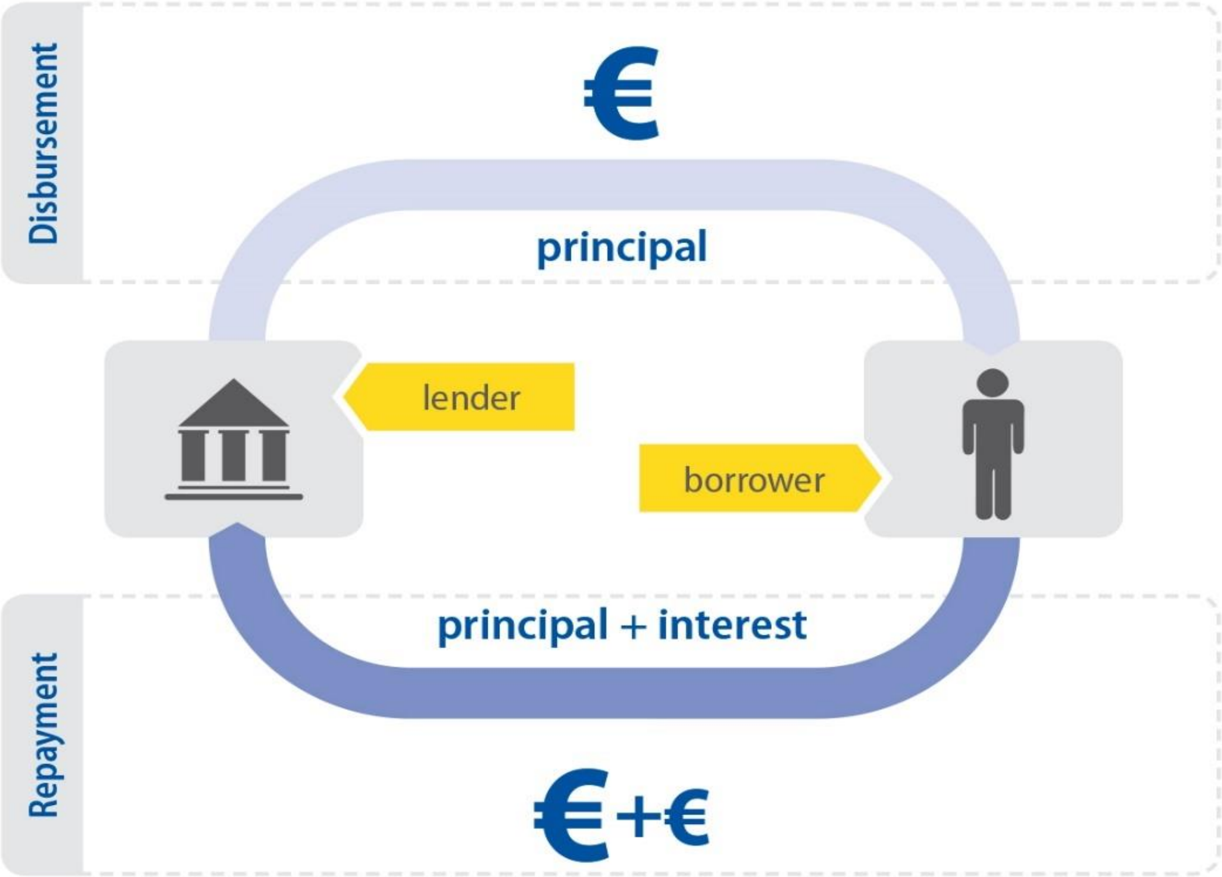
Guarantees

Written commitment to **assume responsibility for** all or part of a **third party's debt** or obligation **if an event occurs** which **triggers** such **guarantee**, such as a loan **default**

Equity

Provision of capital to a firm, invested directly or indirectly **in return** for partial **ownership** of that firm. Equity investor may assume some management control of the firm and may share the firm's profits

How does a loan work?



Key features of loans supported by ESIF:

- **lower** than market **interest** rates
- **longer** repayment **periods** (incl. grace periods)
- **reduced** collateral requirements

=> soft loans

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Loans – pros and cons

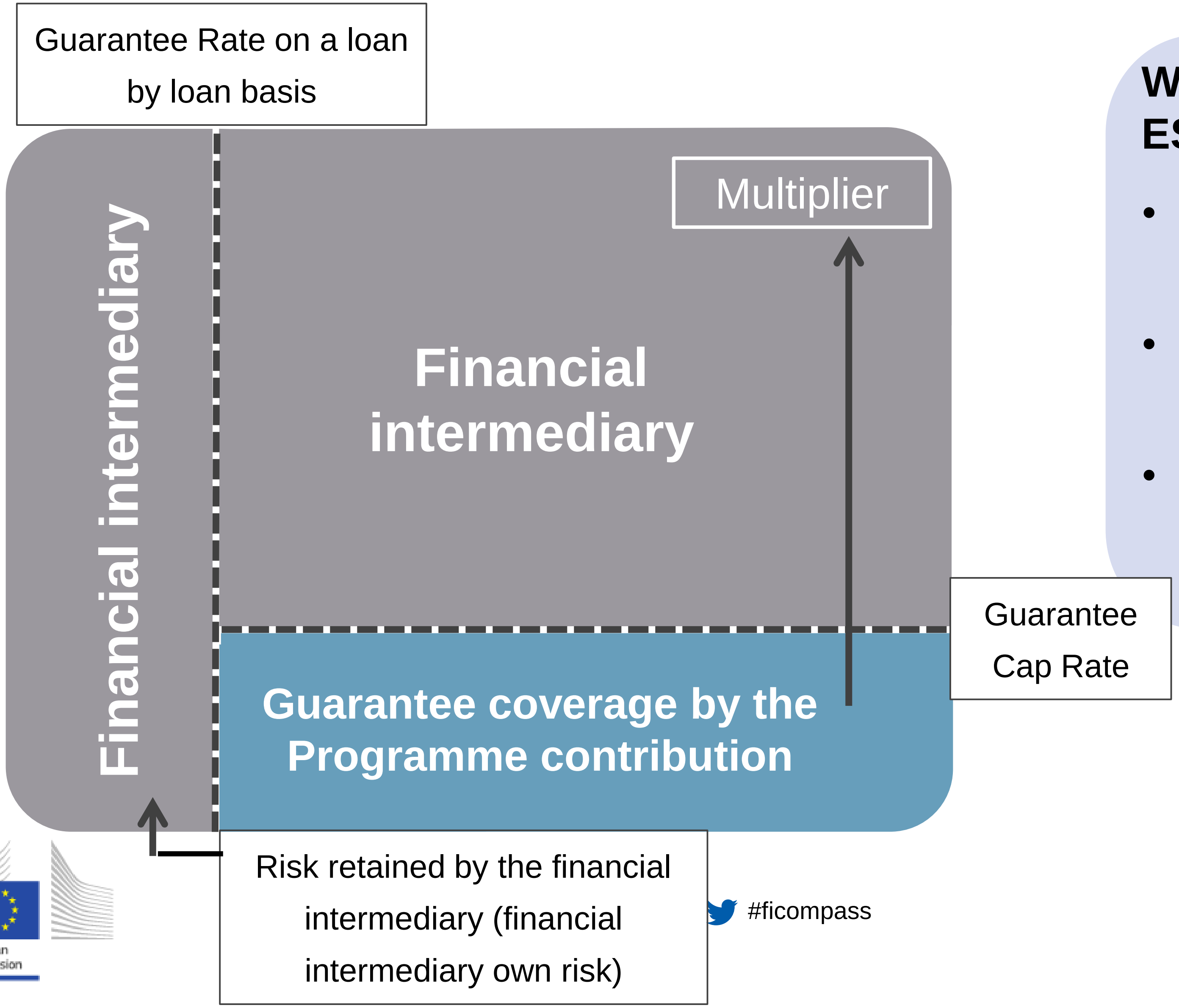
PROS

- **Not** too **difficult** to administer (limited management costs/fees)
- Budgeting easy, due to **defined repayment schedule**
- The **lending mechanism** is **well understood**, need for **capacity building** is **limited**
- Loans **preserve** the **equity** of FRs

CONS

- Funded product: requires **more resources** than unfunded products
- **Limited additional benefits** as know-how of the F.Int is not transferred

How does a portfolio guarantee work?



When it is useful to use ESIF:

- High collateral requirements by banks;
- Risk-aversion of banks to finance riskier projects;
- Tightening of lending conditions stemming from regulatory pressure.

Guarantees – pros and cons

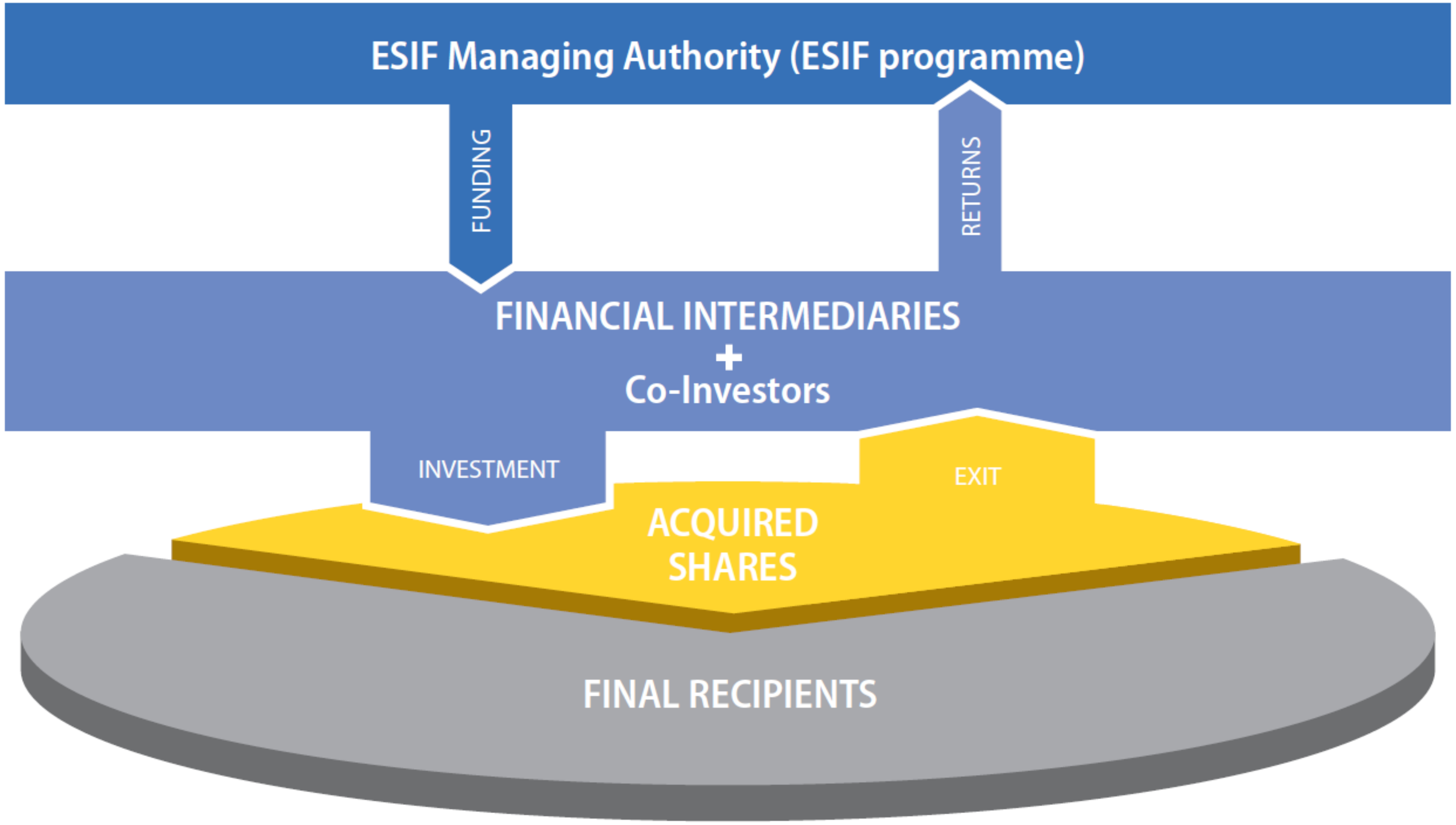
PROS

- Benefits for FRs include, e.g. **lower or no guarantee fees**, lower or no **collateral requirement** and lower **risk premium**
- Can **preserve the equity** of FRs as there is normally no claim on the ownership of the enterprise
- Since contributions cover only a portion of the loans there is a **high leverage effect**
- Unfunded products such as guarantees require **less initial support** than funded products such as loans
- **Possible capital relief** to the lender creates space for more SME lending

CONS

- The guarantee represents a risk reserve for the lender and does **not provide liquidity**
- **Estimating** the appropriate **cap**, or maximum limit, can be **challenging**
- There is **no transfer** of business **expertise** to FRs

Equity
How does it work?



Equity – pros and cons

PROS

- **Higher potential returns** compared to pure debt instruments
- **Active role** in project management and access to shareholder information **for the investor**
- Stimulates **investment by local private equity** industry also **in riskier areas** not previously serviced.
- Company can **benefit from investor's** management **expertise**

CONS

- **Insolvency risk** for all the invested capital
- Time-consuming and cost-intensive investment
- **Complexity** in terms of administering than normal loans (high set-up and operational costs)
- Short-term financing is not possible, since **returns** are expected only in the **long term**
- Establishing the process for the investment can be challenging

Which products to choose?

The choice of the financial products will depend on:

- the market failures
- the suboptimal investment situations and investment needs to be addressed
- the acceptable level of risk, reward and ownership that a MA is willing to consider

tailored financial products

'off-the-shelf' instruments

EU level instruments

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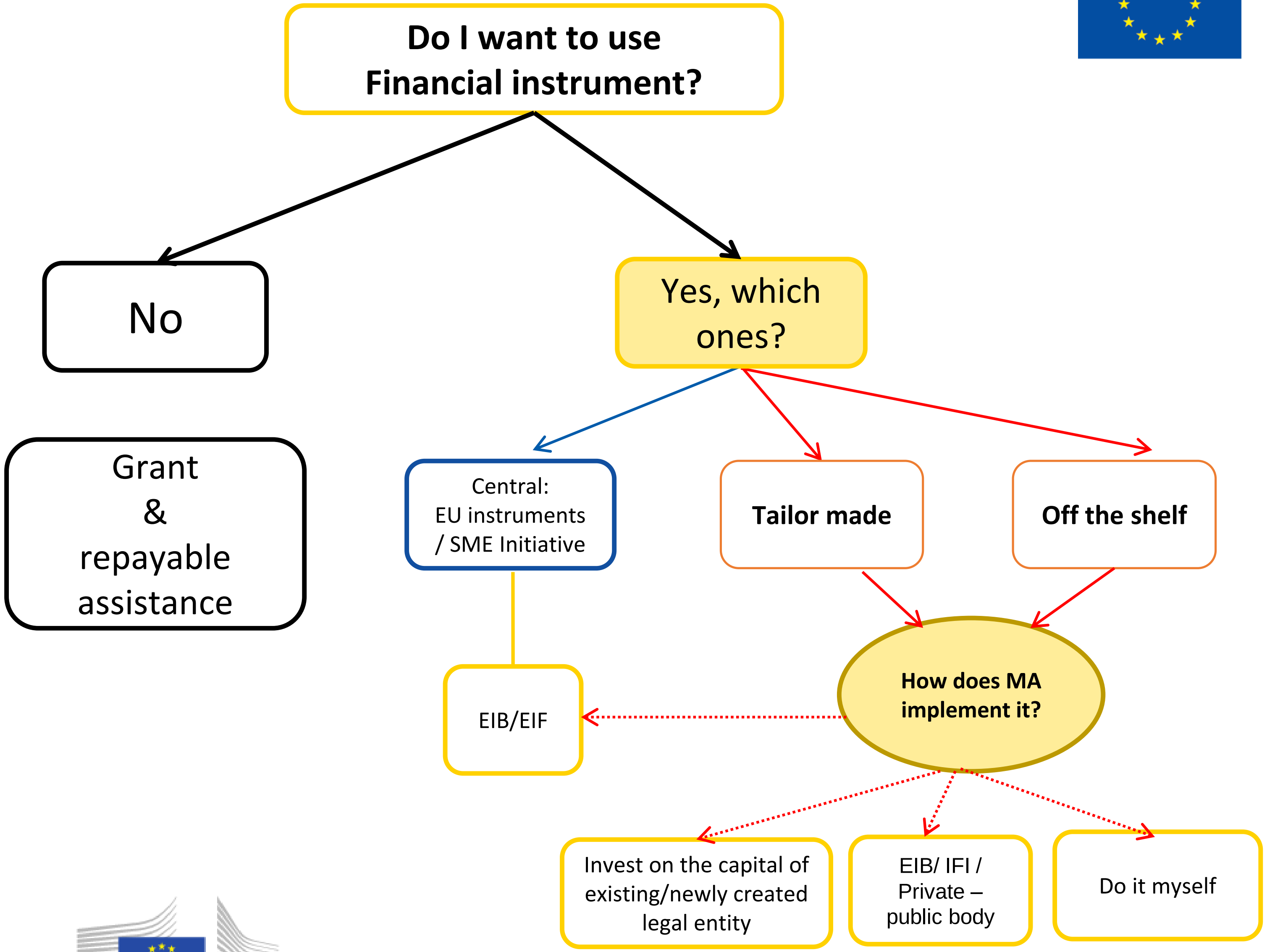
Mode of implementation



Potential options:

Article 38.1.a: MA may provide a financial contribution to FIs set up at Union level and in case of Art. 39 the MA may use the ERDF and EAFRD to contribute to the SME Initiative (specific case);

Article 38.1.b: MA may provide financial contribution to FIs (tailor-made / OSI) set up at national, regional, transnational or cross-border level, managed by or under the responsibility of the MA according to:

- ✓ Article 38.4.a: MA may invest in the capital of existing or newly created legal entities;
- ✓ Article 38.4.b: Entrust implementation task to: EIB/ IFI / Private – public body
- ✓ Article 38.4.c: MA may undertake implementation tasks directly (solely for loans / Guarantees).

Off-the-shelf models

5 Standard products published by Commission

3 x SMEs

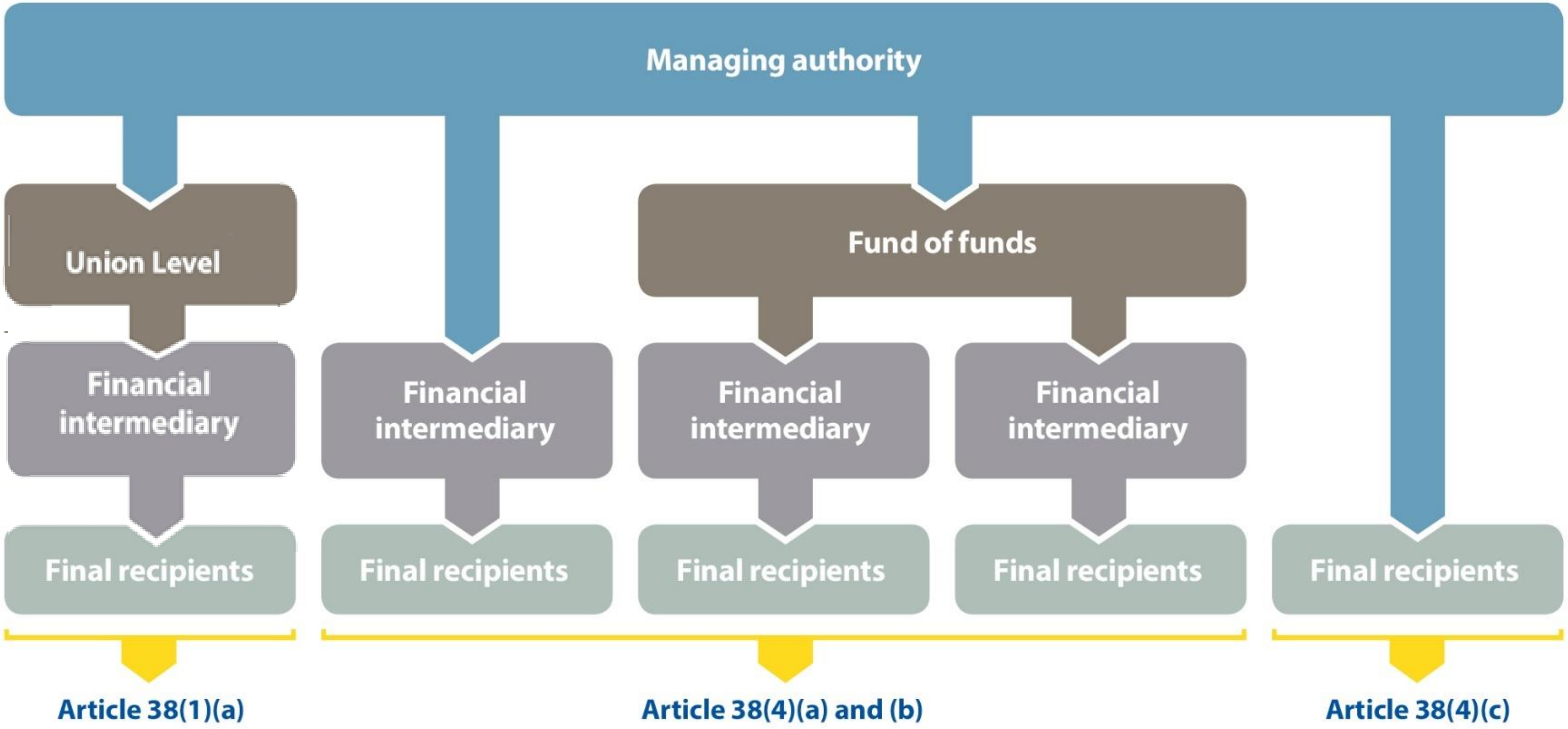
- Portfolio risk sharing loan (RS loan)
- Capped portfolio guarantee
- Co-investment facility

2 x EE and Urban Development

- Renovation loan
- Urban Development Fund

Implementation Options

What are the implementation and governance options?



Article38.1.a:

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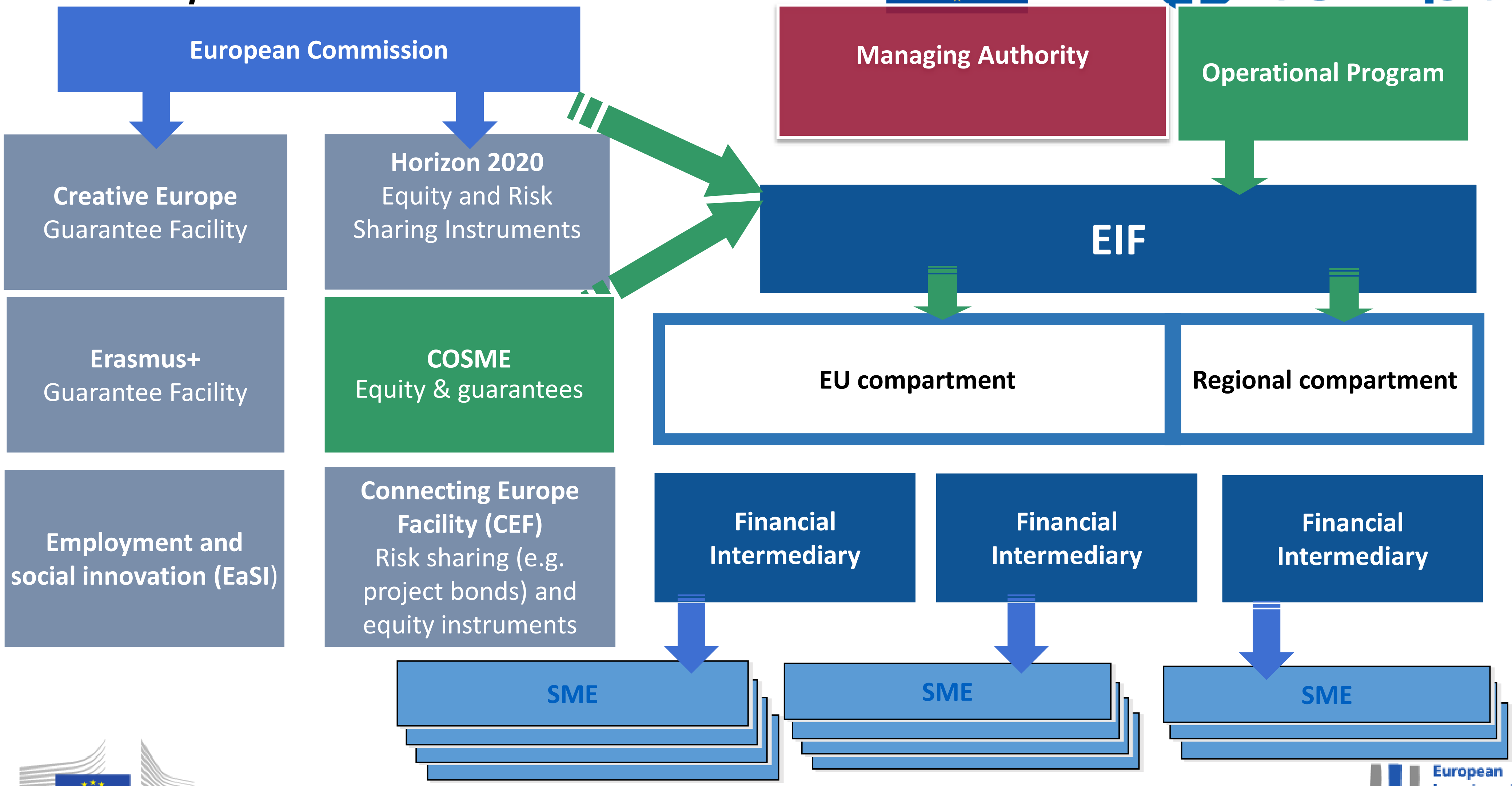
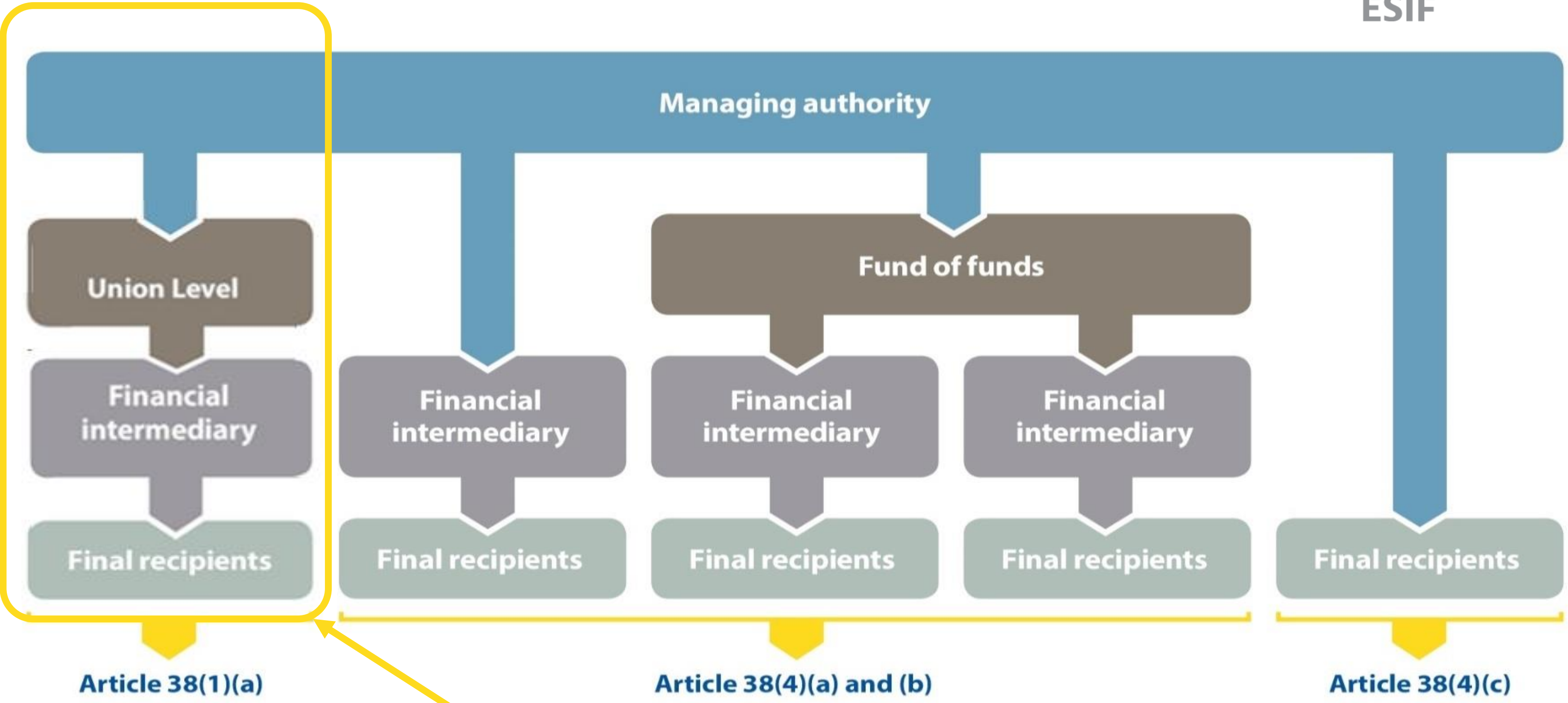


Shared management / central management



- EaSI
- Erasmus+
- Innovfin
- COSME

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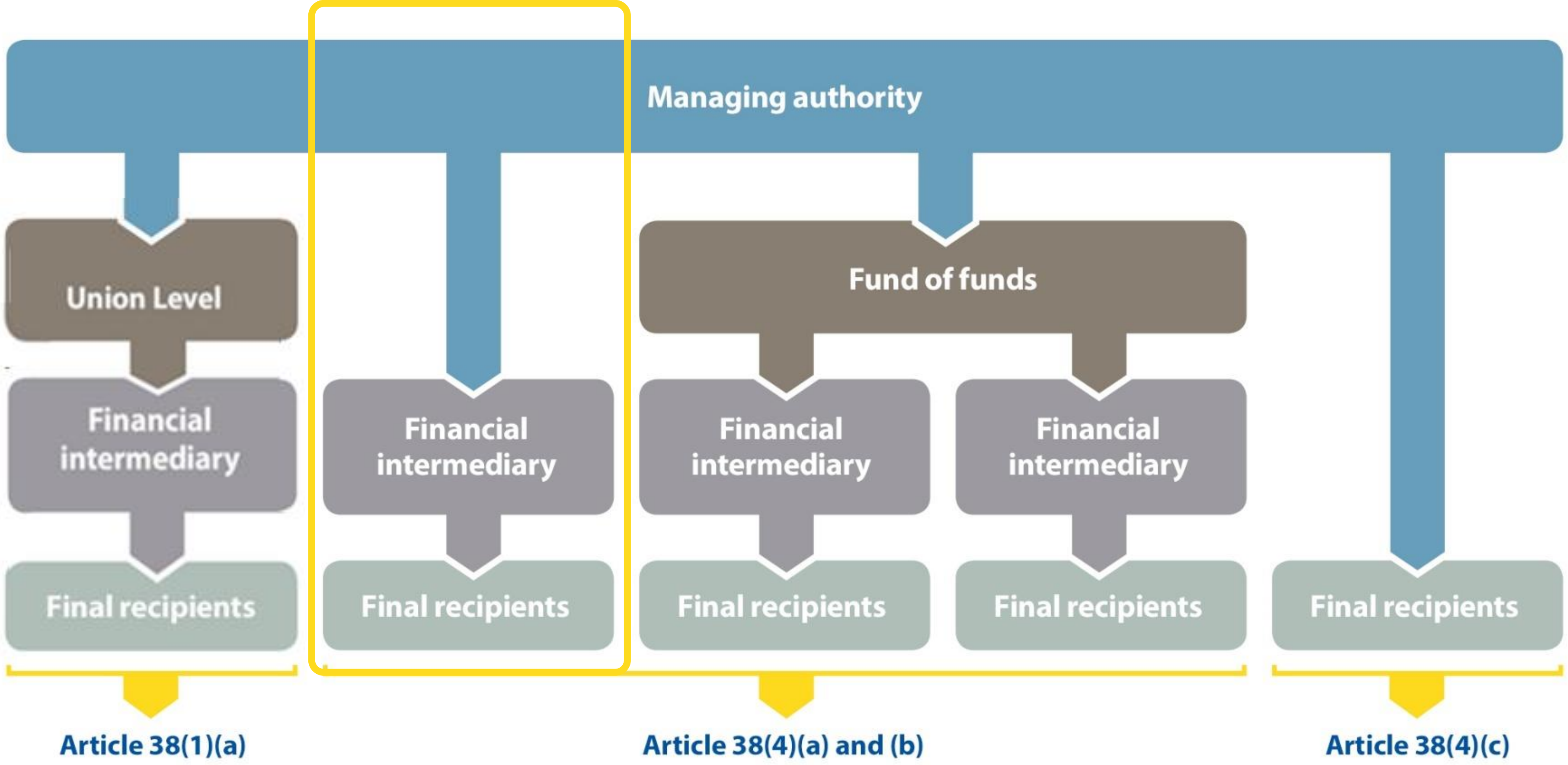
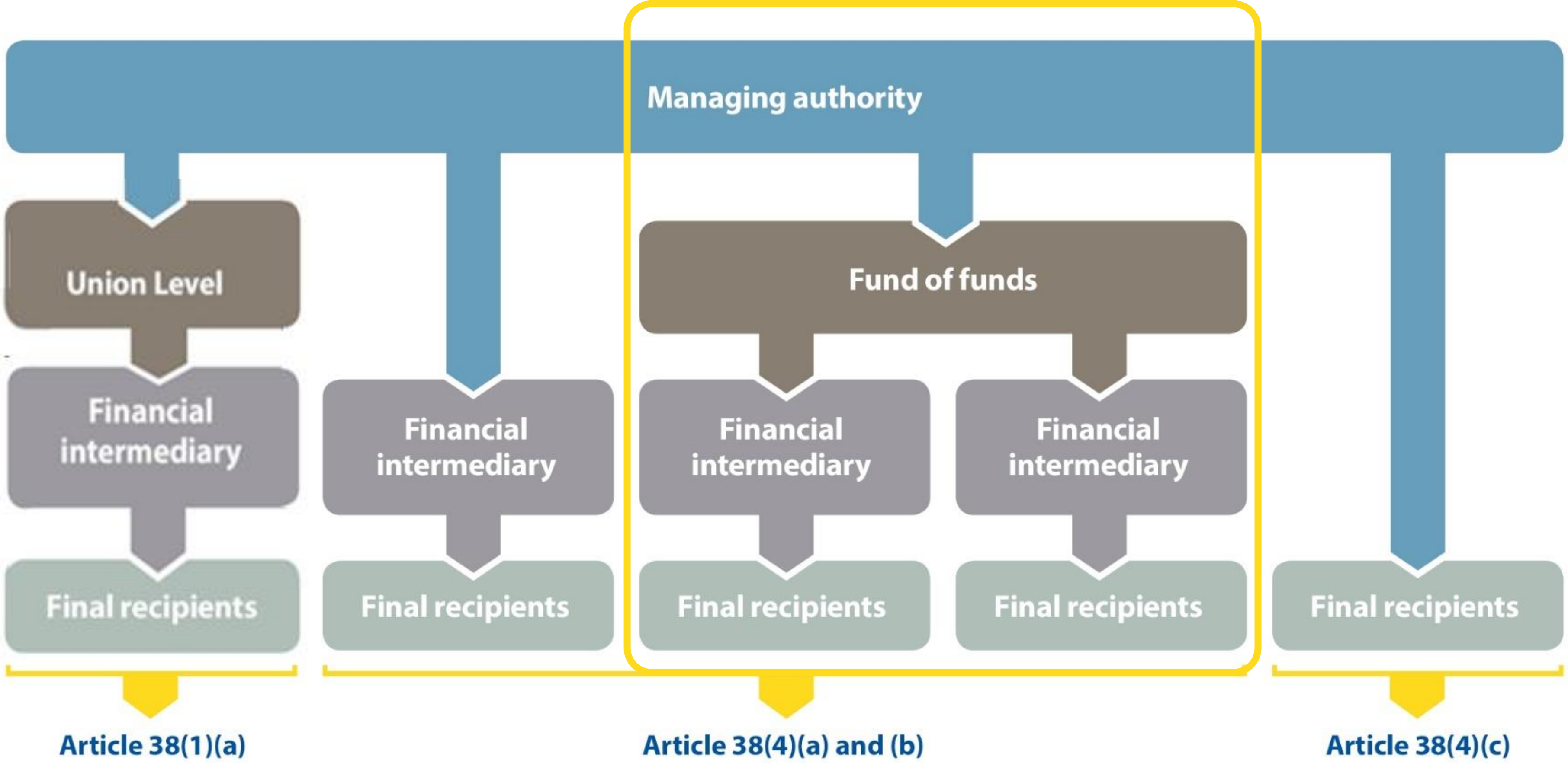
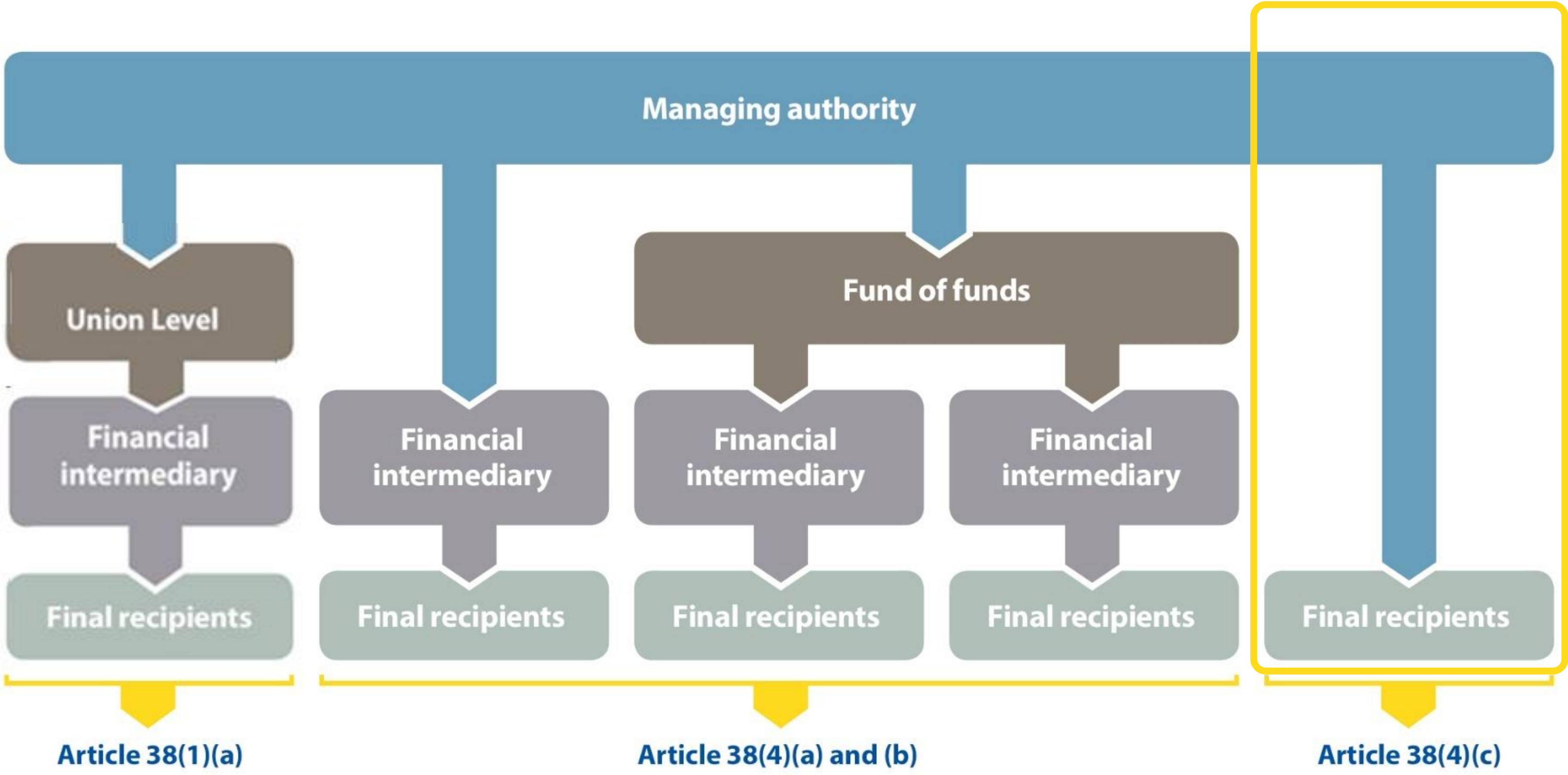
Shared management (financial intermediaries)



Shared management (fund of funds)



Direct management



Funded Risk Sharing

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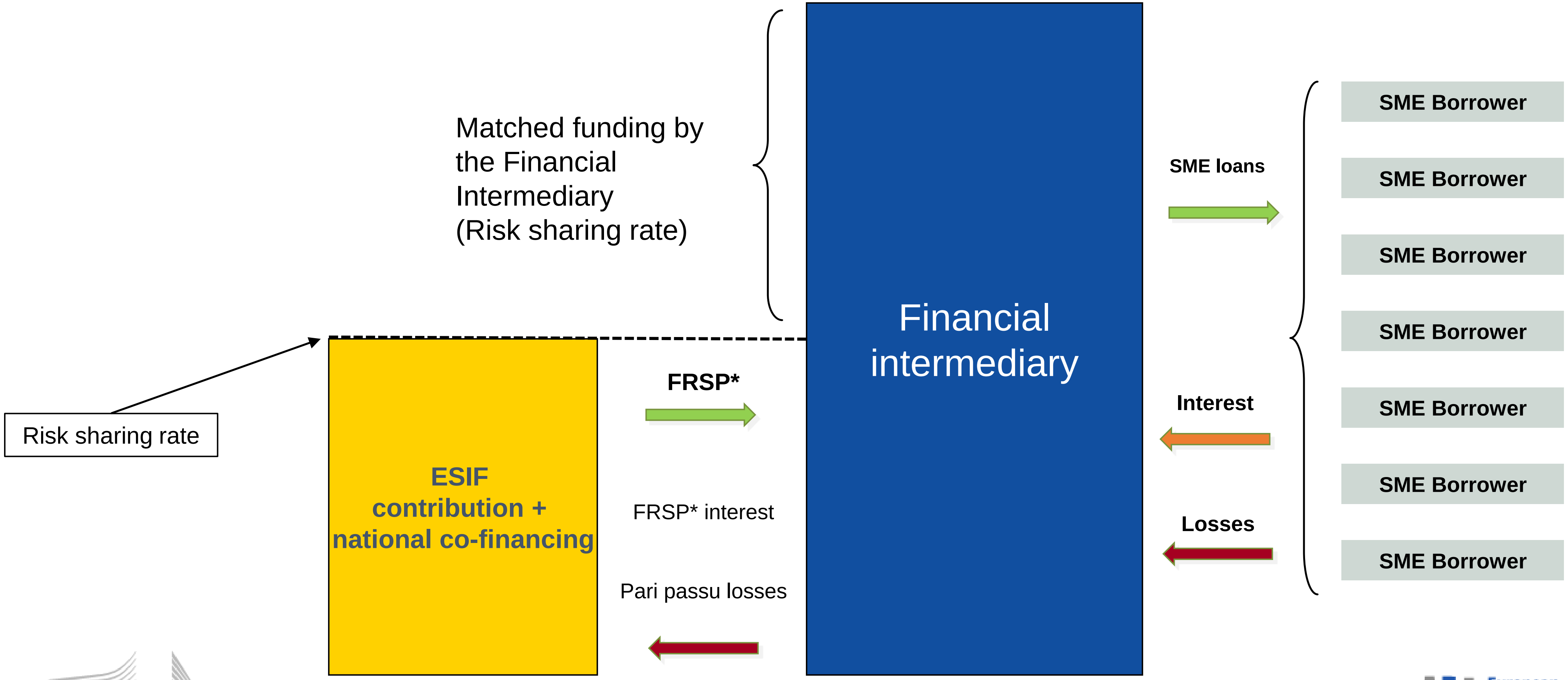
Risk sharing loan

**FRSP – Funded Risk Sharing Product*



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