The SME Initiative under the EAFRD

a ready-to-use financial instrument offered to the Member States

The SME Initiative is a new joint financial instrument of the European Union (EU) and the EIB Group (i.e. the European Investment Bank (EIB) and the European Investment Fund (EIF)). It can be targeted to support farmers and/or agribusinesses under the European Agricultural Fund for Rural Development (EAFRD) through separately developed Rural Development Programmes (RDPs), boosting in this way investments in agriculture and forestry as well as in the rural economy.

The SME Initiative is designed to stimulate finance for small and medium-sized enterprises (SMEs) through mechanisms (guarantees and securitisation[1]) allowing for spreading the lending risk across the EU Member States, the EIB Group and the financial intermediaries. Ultimately, it provides for capital relief and loss protection, thereby lowering the credit cost of the financial intermediaries which have to transfer this financial benefit to the final recipients in the form of better financing conditions.

The European Commission's Directorate for Agriculture and Rural Development (DG AGRI) considers financial instruments to be a great opportunity for rural development. They can efficiently contribute to achieve most of the established priorities of the EU:

- fostering knowledge transfer and innovation in agriculture, forestry and rural areas;
- enhancing the competitiveness of all types of agriculture and enhancing farm viability;
- promoting food chain organisation;
- promoting resource efficiency and supporting the shift towards a low-carbon and climate-resilient economy in the agriculture, food and forestry sectors; and
- promoting social inclusion, poverty reduction and economic development in rural areas, in particular through the creation and development of small enterprises.

European Commission

AGRICULTURE AND RURAL DEVELOPMENT

The possible EAFRD contribution from RDPs to the SME Initiative is a further step to reach common objectives:

- **improve access to finance** for farmers and agribusinesses;
- increase the overall volume of available loan financing to SMEs operating in the agricultural sector and **improve the financing conditions** (lower interest rates and/or loan collateral requirements).

The SME Initiative is managed by the EIF in close cooperation with the EIB. In addition to the European Structural and Investment Funds (ESIF) resources (including EAFRD), the SME Initiative uses other EU funding such as under the Programme for Competitiveness of Enterprises and Small and Medium-sized enterprises **COSME** and the Research and Innovation Programme **HORIZON 2020**, as well as resources from the EIB Group. An SME Initiative with EAFRD resources can also be further supported by National Promotional Institutions.

EUROPEAN INVESTMENT FUND

The European Investment Fund specialises in providing risk finance for the benefit of European SMEs. It is a public-private partnership with a unique shareholding structure: the EIB (majority shareholder), the EU, represented by the European Commission (EC) and financial intermediaries from EU Member States and Turkey.

1 For the purpose of SME Initiative, the term ***securitisation*** indicates the pooling of various types of loans into a portfolio. This portfolio is then divided into various tranches of risk and transformed into tradeable securities, hence the expression 'securitisation'. The risk tranches (e.g. Junior, Mezzanine and Senior) are determined by a new capital structure which defines the priority of repayment from the principal and interest cash flows collected from the portfolio.

Who benefits?

Member States and Regions

- National or regional co-financing is not mandatory
- Significant leverage and efficient use of EAFRD resources: Doing more with less resources
- EIF carries out its due diligence procedure to update the findings of the extensive analysis completed at EU level by the EC and the EIB before the launch of the SMEi
- The set-up of the scheme is cleared by the EC from general State aid point of view, but the individual State aid arrangements of a given RDP have to be aligned (e.g. if a financial instruments-relevant measure did not foresee non-Annex activities[2] in the initial RDP, but it is foreseen under the financial instrument under the SMEi, it needs State aid clearance from DG AGRI)
- Possibility to combine resources crowding in participants with high investment potential and leading to a more efficient use of the EAFRD contribution
- Complementing existing financial instruments in the programme area

Financial intermediaries lending to the agricultural sector

- Credit protection and capital relief
- The EAFRD contribution may have zero cost for the financial intermediaries (and consequently for the final recipients) on the junior risk cover depending on the Funding Agreement with the managing authority
- Access to new clients/segments and increased finance to the agricultural sector
- High visibility for support to farmers and agribusiness, rural SMEs

Farmers and agribusiness SMEs

- Easier and better access to financing to enhance competitiveness
- More liquidity for investment projects
- Lower interest rates for loans and leases
- Reduced security/collateral requirements
- Possibility for other favorable conditions, e.g. longer maturity, repayment period, longer grace period

The European economy

- Agricultural SME growth should drive economic growth, also in rural areas
- Complementing grants-based policies with innovative financial instruments
- Financing of economically viable entities and projects
- Job creation
- Support to agriculture SME investment levels

2 Activities falling outside the scope of primary agriculture in accordance with Article 42 of the Treaty on the Functioning of the European Union (TFEU).

What are the steps?

1 Ex-ante assessment

- conducted by the EC and EIB at pan-European level
- revision of the ex-ante assessment to ensure that it is still representative

2 Single Dedicated National Rural Development Programme

- to be submitted by the Member State to the EC
- identifies the priority or measure from which Member State contribution is provided
- requires EC approval

3 Signature of the Funding Agreement

- between the Member State and the EIF
- there is ready-made model of the funding agreement
- ensures uniform conditions and equal treatment for participating Member States

4 Formation of the Investors' Board

- consists of representatives of the managing authority, the EC, EIB and EIF
- reviews and approves the Call for Expression of Interest submitted by the EIF before its publication
- supervises the progress of implementation

5 Publication of the Call for Expression of Interest by the EIF

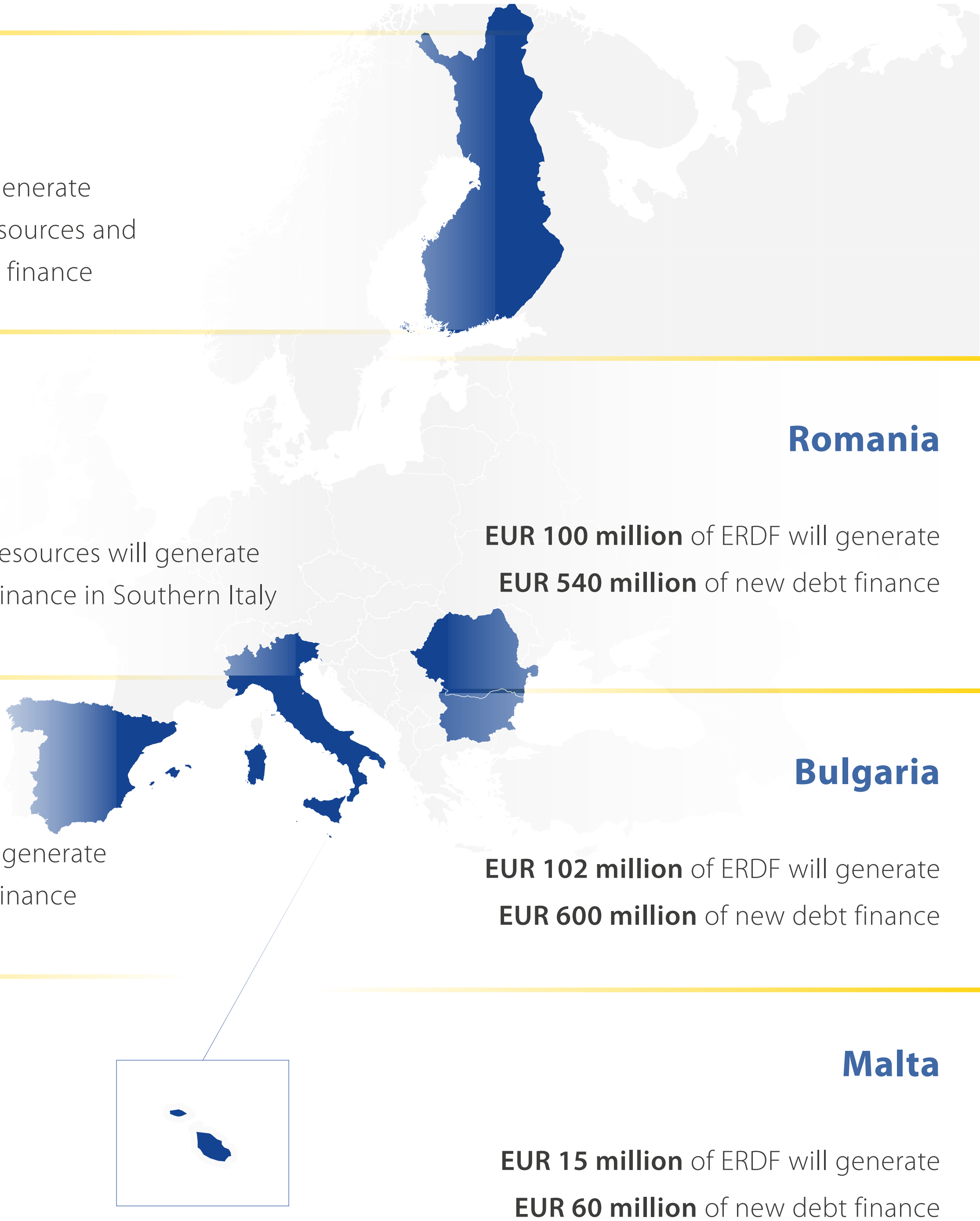
6 Selection of financial intermediaries

- the EIF selects one or more financial intermediaries to implement the financial instrument through an open Call for Expression of Interest
- shall be made on a continuous basis and shall be based on a scoring system
- prioritises financial intermediaries according to a set of criteria such as their experience and financial capacity
- the mechanism to transfer the benefit to final recipients is included in the selection process

7 Disbursement of new loans to final recipients

Where does the SME Initiative already work?

So far, the SME Initiative has been implemented under the European Regional Development Fund (ERDF) in Bulgaria, Finland, Italy, Malta, Romania and Spain.



Finland

EUR 20 million of ERDF will generate
EUR 20 million of national resources and
EUR 400 million of new debt finance

Italy

EUR 102.5 million of ERDF +
EUR 100 million of national resources will generate
EUR 1.2 billion of new debt finance in Southern Italy

Romania

EUR 100 million of ERDF will generate
EUR 540 million of new debt finance

Spain

EUR 800 million of ERDF will generate
EUR 3.2 billion of new debt finance

Bulgaria

EUR 102 million of ERDF will generate
EUR 600 million of new debt finance

Malta

EUR 15 million of ERDF will generate
EUR 60 million of new debt finance

How does a financial instrument under the SME Initiative work in detail?

Joining the SME Initiative requires the programming and EC approval of a separate, single dedicated national RDP supporting the thematic objective enhancing the competitiveness of SMEs and of the agricultural sector. The managing authority has to allocate resources from its EAFRD budget under the running RDP. The set-up of the financial instrument and the allocation of resources can be based on the ex-ante assessment carried out at EU level by the EIB and the EC, and its updated findings. Amendment of the Partnership Agreement may be needed as there will be a new RDP put in place for the relevant programme area.

Similarly to other financial instruments supported by EU resources, the available funds – in that case of EAFRD the RDP's contributions – are exclusively utilised to support the targeted final recipients in accordance with the priority and measure set out in the RDPs.

The funds are utilised to cover credit risk on existing portfolios or new SME loan portfolios of financial intermediaries through forms of guarantee like 'securitisation'. As the financial intermediaries transfer a significant part of their credit risk outside their balance sheet, the capital requirements and hence the credit costs are lowered; this financial benefit is then transferred in the form of advantageous lending conditions to the targeted final recipients.

The managing authority will contribute the dedicated amount from the RDP budget to the financial instrument, managed by the EIF, through a Funding Agreement which includes the investment strategy/selection criteria and the business plan as well as regulates all aspects of the financial instrument. The Funding Agreement tasks also the EIF to select financial intermediaries via a Call for Expression of Interest and on the basis of pre-defined eligibility criteria. The EIF ensures transparency in the continuous management of the financial instrument and provides regular updates on the implementation process.

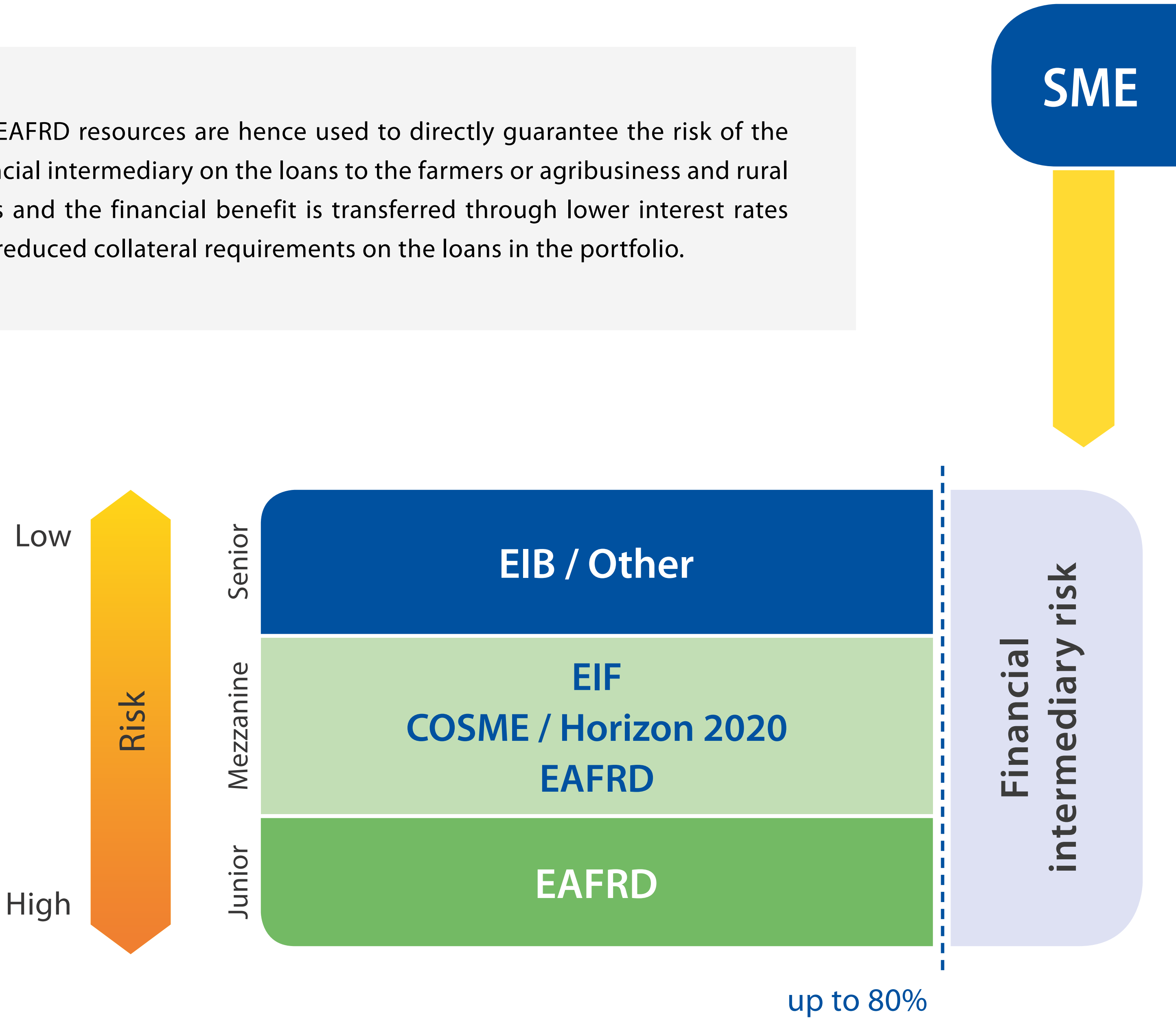
One advantage from this financial instrument is that final recipients such as farmers, agribusiness processors or rural SMEs can take up loans usually at a lower interest rate, together with reduced collateral requirements and/or longer repayment and/or grace periods from the participating financial intermediaries, depending on the design and build-up benefits in the scheme.

Two types of guarantee mechanisms can be used for implementing financial instruments under the SME Initiative with EAFRD funds:

UNCAPPED GUARANTEE INSTRUMENT

- The financial intermediaries gradually build up a portfolio of new loans to final recipients, i.e. farmers or agribusiness SMEs in line with the eligibility criteria.
- The financial intermediary receives a guarantee from the EIF on a loan-by-loan basis for up to 80% of the individual loan amount, there is no cap at portfolio level (uncapped).
- The EIF shares the risk on the guaranteed part of the new portfolio as follows:
  - EAFRD covers the Junior risk;
  - EAFRD, COSME / Horizon 2020 and the EIF cover the Mezzanine risk;
  - EIB and National Promotional Institutions cover the Senior risk.

The EAFRD resources are hence used to directly guarantee the risk of the financial intermediary on the loans to the farmers or agribusiness and rural SMEs and the financial benefit is transferred through lower interest rates and reduced collateral requirements on the loans in the portfolio.

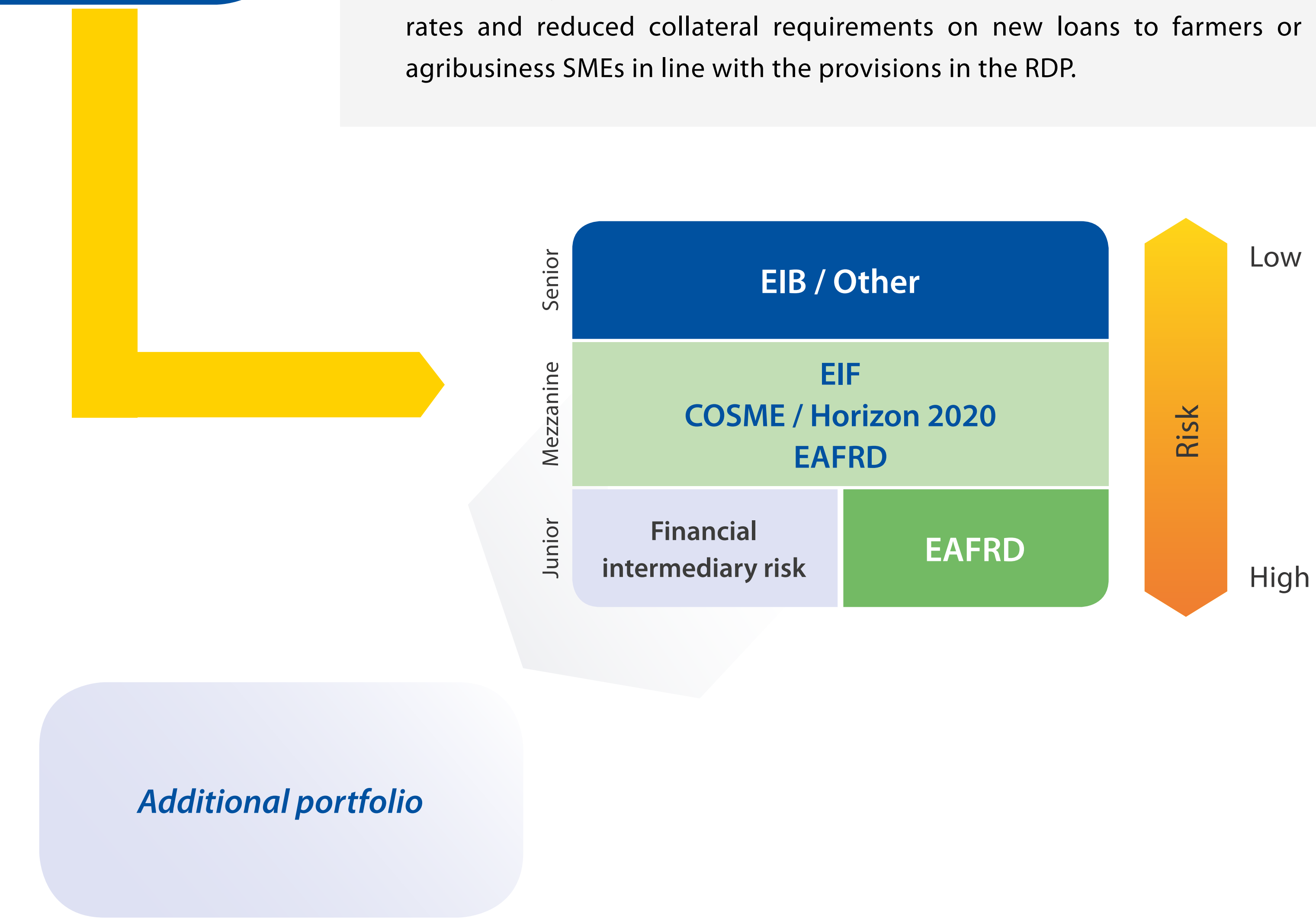


SECURITISATION INSTRUMENT

- A portfolio of existing SME loans is identified or criteria for the build-up of a new portfolio are established with the financial intermediary.
- The financial intermediary transfers the risk of the (existing or new) portfolio into a special purpose vehicle (SPV) and the risk taken on the existing or new portfolio is shared as follows:
  - EAFRD covers or invests in 50% of the Junior risk;
  - EAFRD, COSME / Horizon 2020 and the EIF cover or invest in the Mezzanine risk;
  - EIB and other National Promotional Institutions cover or invest in the Senior risk.

Initiative

The EAFRD resources are hence used to guarantee the risk of the financial intermediary on SME loans, large proportion of which may be unrelated to farmers or agribusiness SMEs. However, the financial intermediaries are contractually obliged to transfer the financial benefit through lower interest rates and reduced collateral requirements on new loans to farmers or agribusiness SMEs in line with the provisions in the RDP.



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OMNIBUS REGULATION

A number of changes to the Common Provisions Regulation are currently contemplated to be changed under the Omnibus Regulation to facilitate the implementation of the SME Initiative with the support of EAFRD funds, including:

- an extension of the SME Initiative over the whole eligibility period;
- the possibility for Member States to rely on an ex-ante assessment carried out at national or regional level[3] to specifically target the needs.

3 At own discretion and recommendable if more recent data is available than in the ex-ante assessment at EU level.

Interested managing authorities can contact their counterparts at the EC – DG AGRI – to discuss how to take up the SME Initiative in their country or region.

Interested financial intermediaries can consult the website of the EIF for open calls under the SME Initiative.

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