



*advancing with ESIF financial instruments*



# Financial instruments working with personal loans





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## Introduction

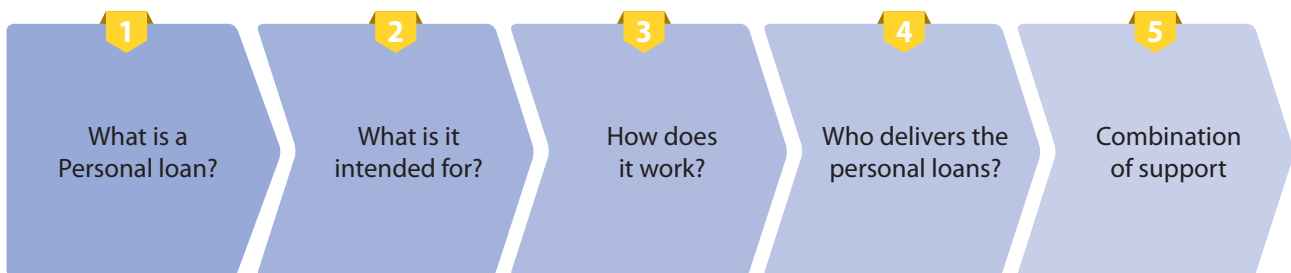
**In the framework of the European Social Fund (ESF) thematic objectives, personal loans refer to finance for individuals that have been excluded from traditional financial services. These are often given for education or training, or to improve their employment prospects or towards reconciliation of work and private life. Personal loans co-financed by the ESF often have better terms than market loans including lower interest rates, longer and more flexible repayment periods, and lower or no collateral requirements. Loans are normally given for non-revenue generating purposes in the short-term, but have a social impact and contribute to the inclusion of disadvantaged and individuals who normally do not have access to the banking system. These personal loans should produce an educated and well-trained workforce, with balanced work-life conditions, contributing to competitiveness and productivity in the European Union (EU) by enhancing social inclusion and reducing poverty.**

This brochure raises awareness and assists in a deeper understanding of the role of personal loans as an additional way for ESF programmes to foster the social and economic inclusion of disadvantaged individuals who are excluded from traditional financial services. The key aspect of a personal loan is that it generates significant social impact by contributing to improved work opportunities and living conditions for individuals.

Personal loans include important characteristics which differentiate them from other financial products. They may represent also a more flexible and sustainable alternative to grants, having lower fundraising costs and ensuring more adaptability to individual needs. Moreover, personal loans are expected to generate leverage effects attracting additional resources, both public and private, so that more resources can be available to reach more individuals. Finally, differently from grants, personal loans are revolving funds: repaid resources can be used again to support additional individuals.

These key features are described in five chapters. Insights from the EU level instrument such as Erasmus+ Master Loans and personal microloans from ADIE, as practical examples, are presented at the end of each chapter, to exemplify the potential use of financial instruments working with personal loans.

The five chapters have the following order:





This document is closely related to topics already covered in other *fi-compass* publications, especially concerning the implementation of ESF-funded financial instruments and the use of ESF resources to address social enterprise needs. General concepts of financial instruments such as the life cycle, financial products, implementation options and governance structures, are detailed in other *fi-compass* advisory products.

<b><i>fi-compass</i> product</b>	<b>Content relevant for personal loans</b>
■ Introducing financial instruments for the European Social Fund	When to use financial instruments in the ESF programme; social impact investment; final recipients and financial intermediaries; how to manage and implement financial instruments; financial products
■ Financial instruments working with microfinance	The microfinance ecosystem and the use of microcredit in the ESF; financial intermediaries and financial products in microfinance; the role of non-financial services
■ Financial instruments working with social entrepreneurship	Characteristics of social enterprises; financial instruments for social entrepreneurship and financial intermediaries; financial products
■ Case studies	Insights from past and current experience in implementing financial instruments under the ESF
■ Developing an action plan – design, set-up, implementation and winding-up of financial instruments	The four phases of the financial instrument life cycle; regulatory provisions; how to design an action plan
■ Financial instruments products – loans, guarantees, equity and quasi-equity	Key features and differences of financial products

Note: ■ ESF related; ■ ESI Funds related.

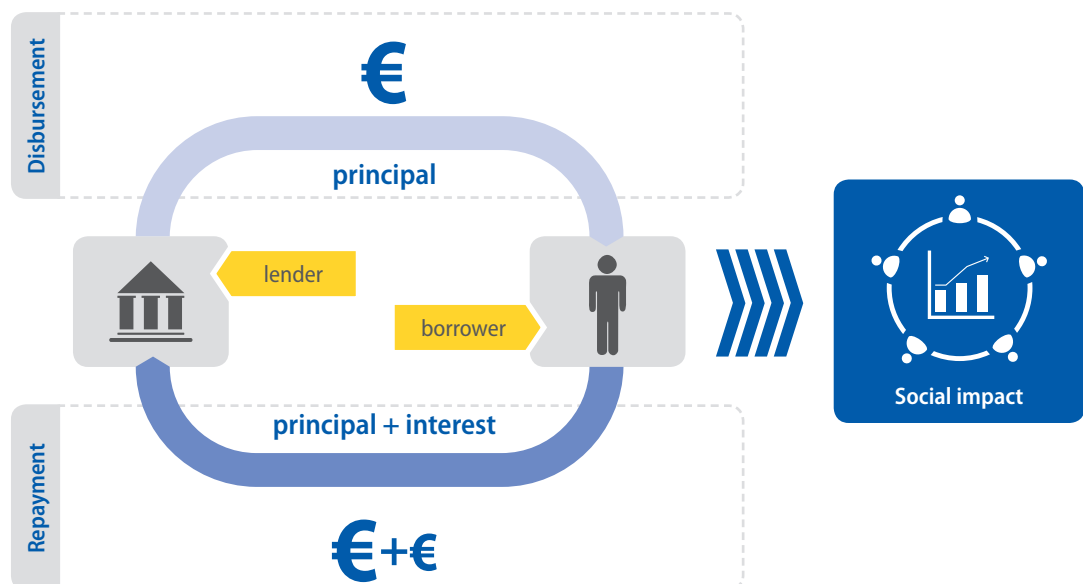
# 1. What is a personal loan?

A personal loan is normally a financial product for individuals addressing a personal need that might not generate revenue directly, but which has a social impact not only on the recipient's life but also on local society. In this case, improved job opportunities or living conditions help the individual to start or improve a revenue-generating activity that leads to repayment of the loan. Therefore, the concept of personal loans under the ESF framework does not cover consumption or leisure activities.

These personal loans usually have:

- reduced or no collateral requirements;
- no limit in size, but are normally microloans (up to EUR 25 000);
- flexible terms, including more generous grace period;
- an investment objective such as education, training, or work-life balance that produces a social impact and generates revenue in the long-run.

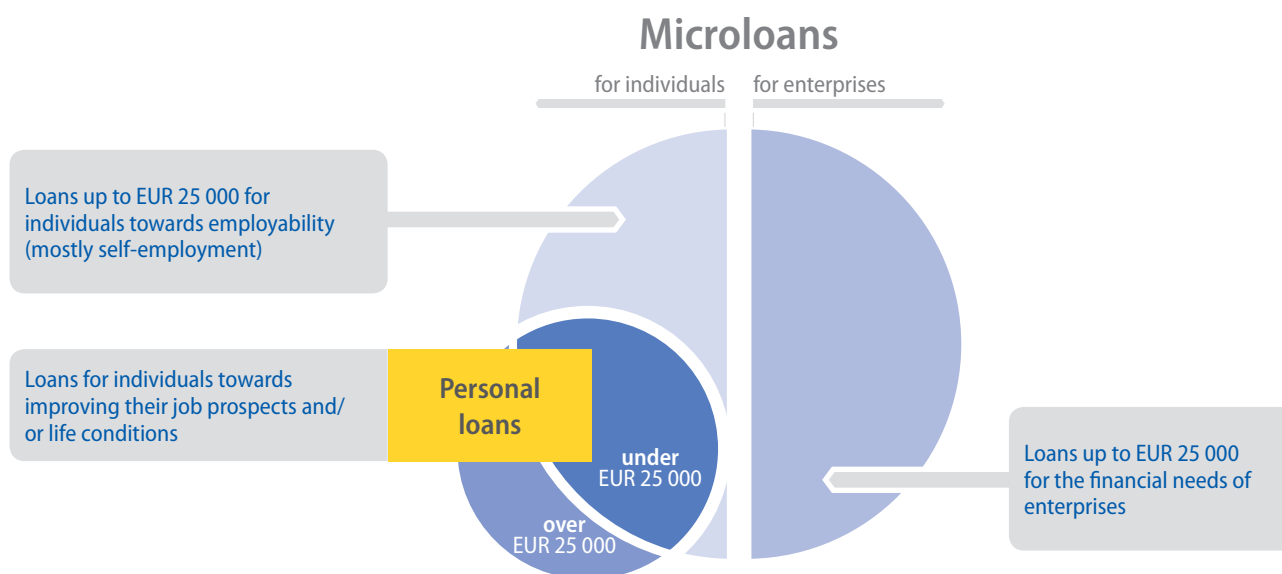
Figure 1.1: The mechanism of a personal loan under the ESF framework



Personal loans can amount to more than EUR 25 000, but they are normally microloans. It is important, however, to specify the difference between a microloan and a personal loan. While microloans can be given to both individuals – for employability purposes (mostly self-employment) – and to enterprises (mostly micro, small and medium-sized enterprises) – for addressing their financial needs – personal loans are only assigned to individuals and they generally target long-term goals like improving labour and life conditions, reducing poverty or easing social integration.



Figure 1.2: Distinguishing between microloans and personal loans



### Erasmus+ Master Student Loan Guarantee Facility – Key features

Managed on the European Commission's (EC) behalf by the European Investment Fund (EIF), the guarantee scheme increases access to finance for students to undertake a Master's Degree abroad, in any of the 33 Erasmus+ participating countries. The new Erasmus+ Master Loan Guarantee Facility (LGF) complements the well-established Erasmus+ study exchange programme and offers graduates an affordable way to finance their studies abroad, regardless of their social background or field of study.

Loans are offered by participating financial intermediaries on favourable conditions (i.e. interest rates below the market level and no collateral or parental guarantee required). Moreover, the repayment terms include hardship provisions such as a 'grace period' of up to one year following the completion of studies and a further one-year 'repayment holiday' which can be requested throughout the duration of the loan. This way, graduates are given up to two years to allow them to enter the labour market before beginning to repay the loan.

The maximum amount of the loan:

- EUR 12 000 for a one-year Master's course (5 years to repay the loan);
- EUR 18 000 for a two-year Master's course (6 years to repay the loan).

### ADIE Personal Microloans – Key features

ADIE (Association pour le droit à l'initiative économique) has acquired extensive experience in microfinance since its creation in 1989. It is a non-profit organisation that covers the whole of France and collaborates with a large network of national and international organisations (especially in Belgium and Greece).

Its purpose is to improve living standards by reducing unemployment and supporting disadvantaged people. In recent years ADIE has also overseen the successful implementation of a revolving fund through an European Regional Development Fund (ERDF) and ESF-funded financial instrument. Support was delivered through financial products and complementary non-financial support (Business Development Services).

One of the facilities offered by ADIE – Personal Microloan – is a personal loan of up to EUR 5 000 that helps individuals to improve their employment conditions. The repayment period is adaptable and differs from case to case.

The maximum amount of the loan:

- EUR 5 000 (6 to 36 months to repay the loan).



## 2. What is it intended for?

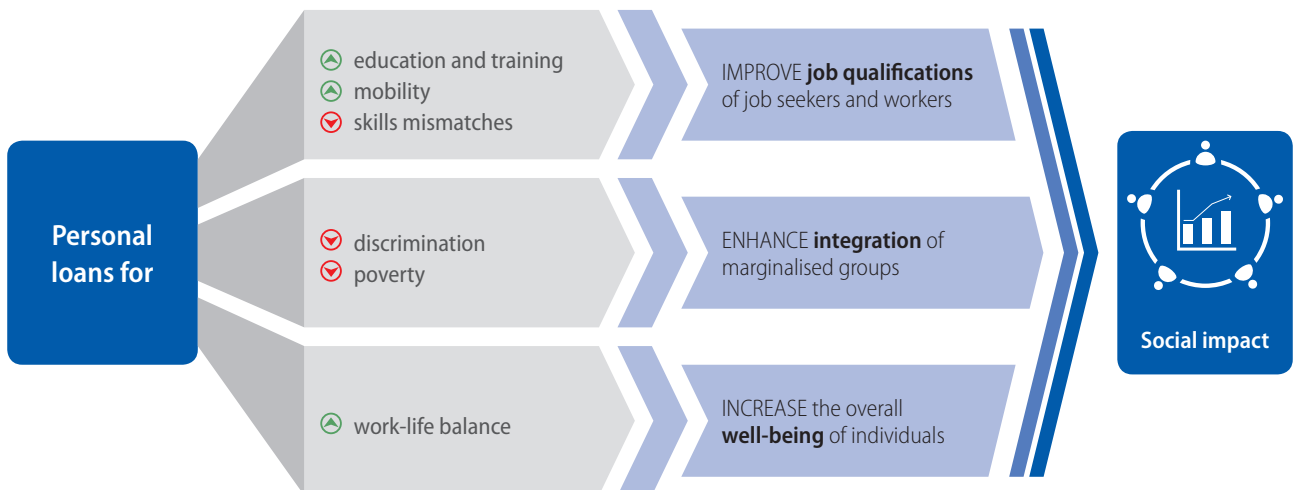
Personal loans are particularly appropriate for education, as in the case of student loans, to acquire new skills and for life-long learning, improving job qualifications. They can be used to improve mobility and working conditions, such as loans for work-life balance, including childcare.<sup>1</sup>

They can also be used to reduce discrimination and poverty among marginalised groups such as minorities and migrants, by offering them financial assistance for skills training, capacity building for income generating activities and functional literacy.

Personal loans could have a positive impact on more than one of these points. For instance, unemployed migrants could use a personal loan to get a driving licence or attend an intensive language course that would subsequently increase their chances of getting a job. At the same time this would help them integrate into society and reduce discrimination resulting from language and cultural barriers, improving their living conditions and reducing poverty.

By improving human capital and contributing to better job opportunities, personal loans lead to increased competitiveness and productivity. By encouraging the social integration of marginalised and disadvantaged individuals and by improving life for individuals, personal loans can help reduce public expenditure for social services. This way, personal loans generate social impact, stimulating social inclusion and cohesion in the EU.

Figure 2.1: How personal loans contribute to social inclusion and cohesion



<sup>1</sup> Other examples include access to social housing (but not acquisition of household appliances); support for relocation; recover of expenses due to injuries or severe illness/diseases.



### Erasmus+ Master Student Loan Guarantee Facility – Scope

Access to higher education is increased by funding students studying for a Master's Degree abroad. This boosts student mobility and tackles skills gaps in Europe. Master's graduates are expected to bring an important contribution to innovation and entrepreneurship in Europe, as the need for higher skills grows.

The initiative targets students who meet the following requirements:

- resident of a participating country;
- accepted for a full Master's study programme;
- the destination country must be different from the country of residence or that of the Bachelor's degree;
- not having already entered a final recipient transaction.

It is estimated that around 200 000 student loans will be supported during the Erasmus+ Programme period (2014-2020), which translates to a total amount of EUR 3 billion available for loans.

### ADIE Personal Microloans – Scope

The scope of the initiative is to support jobseekers to better their employment prospects or preserve their current job. The product is tailored to the needs of disadvantaged or marginalised people that cannot gain access to financing from commercial banks.

Most common needs for a personal microloan are related to mobility, like buying/repairing/leasing a vehicle or obtaining a driving license (Category B, trucks), but also professional formation or any other activity that enables the recipient to find or preserve employment.

According to ADIE, the personal microloan scheme has a significant impact, with 63% of the recipients improving their status subsequent to obtaining the loan, either by finding a job or being promoted from a short-term to a long-term contract.



### 3. How does it work?

A good way to understand how personal loans fit into the ESF ecosystem is through the social impact investment framework. Supported by a growing number of national governments, especially in the EU, and increasingly important in recent years, social impact investment is defined as ‘the provision of finance to organisations addressing social needs with the explicit expectation of a measurable social, as well as financial return<sup>2</sup>’.

Social impact investment can help drive the implementation of personal loans to address specific needs of individuals.

	<p><b>Social:</b> social impact investment’s primary objective and starting point is to tackle social needs which include active ageing, health care, childcare, affordable housing and reduced unemployment. By addressing individual needs and expectations to improve their quality of life personal loans contribute to <b>social inclusion</b>.</p>
	<p><b>Impact:</b> social impact investment looks to produce social change and to improve the quality of people’s lives. To ensure effectiveness, the contribution of personal loans has to be <b>measurable and monitored</b> during the entire life of the investment.</p>
	<p><b>Investment:</b> although personal loans are tailored to assist mainly individuals who are excluded from traditional financial services, final recipients are expected to <b>return the money invested</b>. The uniqueness of providing loans for activities that do not generate immediate financial return implies that, when designing the product to suit individuals, it is very important to ensure that final recipients will be able to repay the loan.</p>

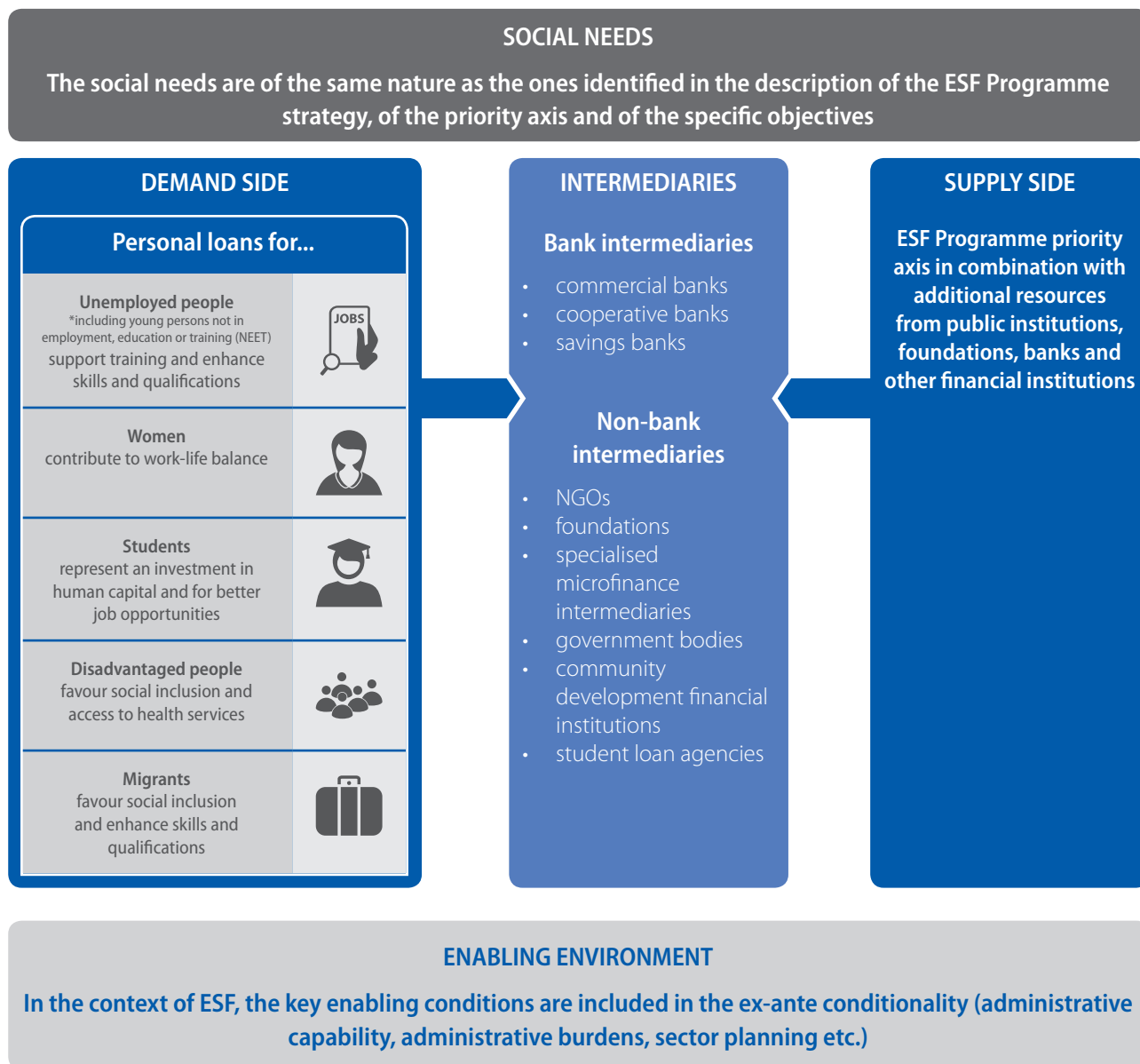
Dimensions of social impact investment are described below and illustrated in Figure 3.1.

<p><b>Social needs</b></p>	<p>Under ESF, the needs of social impact investment are the same as the needs in the programme strategy, the priority axis and the specific objectives tailoring personal needs.</p>
<p><b>Demand side</b></p>	<p>The demand for personal loans comes from the specific individual needs of recipients defined in the ESF investment priorities: the unemployed, women, students, young persons, disadvantaged people and migrants.</p>
<p><b>Supply side</b></p>	<p>Social impact investors working with personal loans include government and public institutions, banks, and foundations. Resources provided through the programme can complement other measures under the ESF, or other EU programmes, as well as national and regional resources.</p>
<p><b>Financial intermediaries</b></p>	<p>Under ESF, financial intermediaries working with personal loans can include commercial banks, cooperative banks and savings banks, or non-bank intermediaries such as non-governmental organisations, specialised microfinance intermediaries, government bodies, community development financial institutions or student loan agencies.</p>
<p><b>Enabling environment</b></p>	<p>Social systems, tax and regulations, administrative capabilities, and administrative burdens all affect the investments.</p>

2 OECD (2015), ‘Social impact investment – Building the evidence base.’



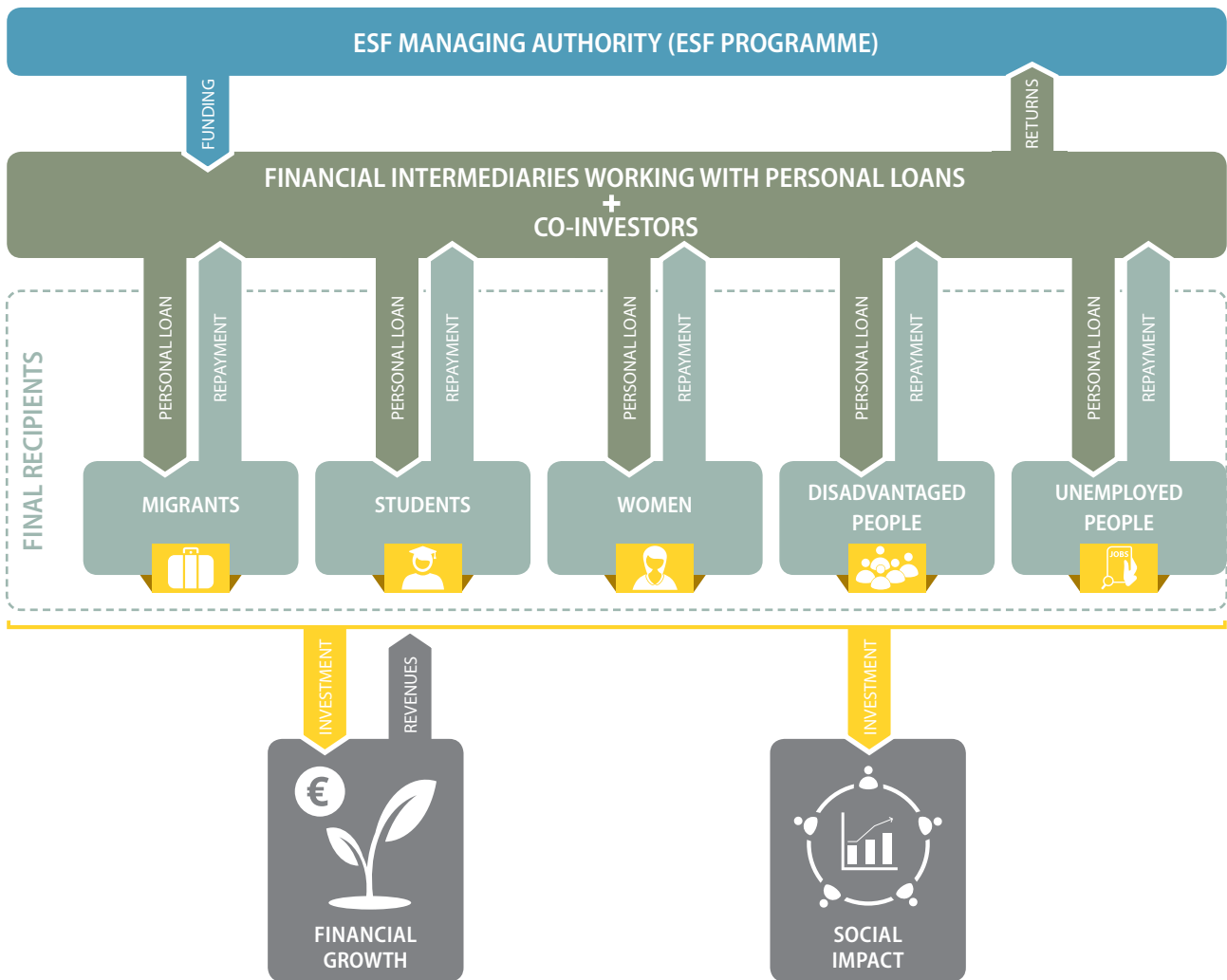
Figure 3.1: Personal loans in the social impact investment context



The successful implementation of a personal loans scheme:

- from a **financial perspective** would create a sustainable revolving fund which reinvests and increases ESF resources;
- from a **social perspective** is an efficient social policy tool that addresses social issues like poor job conditions, disparities in the labour market, skills mismatches, gender inequality and high poverty levels, contributing to the local social impact supported by the ESF.

Figure 3.2: How personal loans work under the ESF framework



### KEY FEATURES

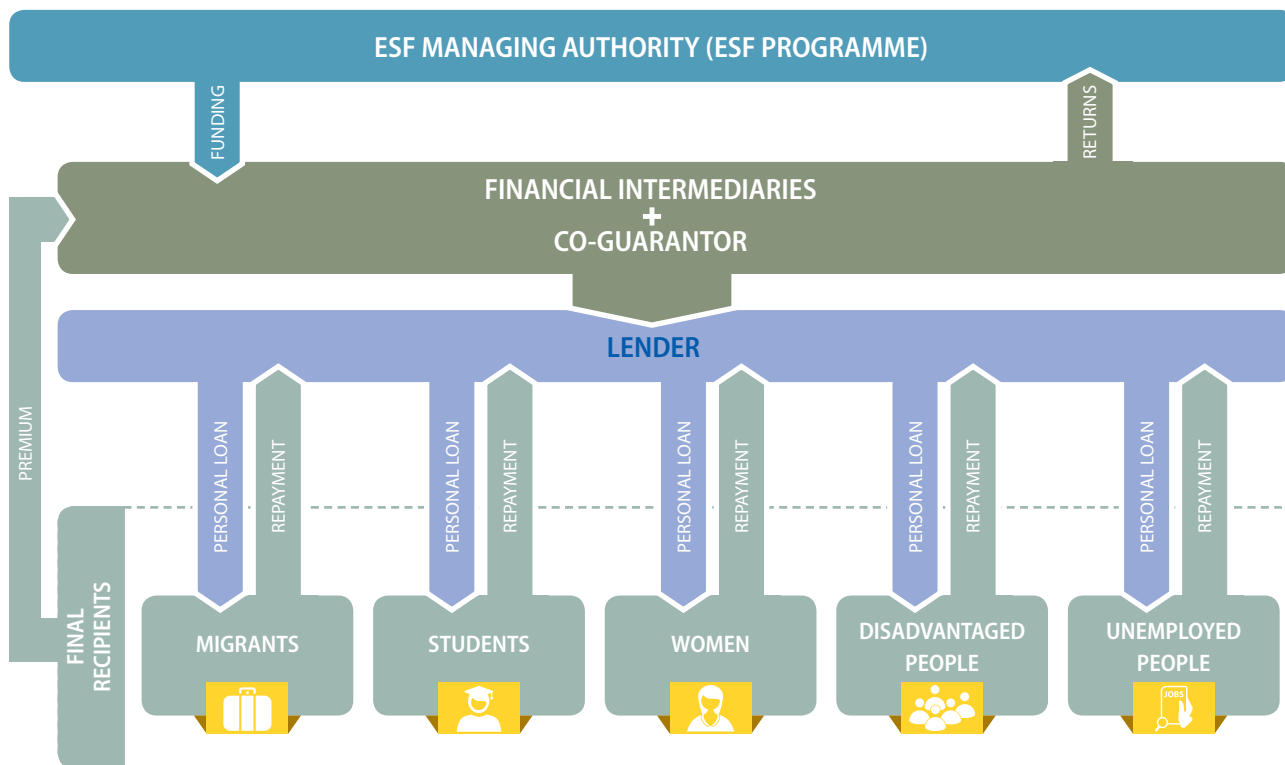
- Not particularly difficult to administer, hence they incur low management costs for financial intermediaries.
- A predefined repayment schedule makes budgeting easy.
- The lending mechanism is well understood, reducing the need for capacity building.
- The involvement of European Structural and Investment (ESI) Funds results in loans that are offered at lower than market interest rates, with longer repayment periods, the possibility of grace periods or with reduced or no collateral requirements.
- Personal loans can also have flexible features like extending the repayment/grace period or provisions to cover part of the loss in the event of a borrower's inability to repay the loan.

An alternative way to implement a personal loan scheme is to use ESF resources to protect financial intermediaries from a borrower's failure to repay the debt, by issuing a **guarantee**<sup>3</sup> for personal loans lenders. Guarantee can protect a portion of the investment until maturity, supporting access to finance by assuming risks that financial institutions are not able or willing to take on. Moreover, by reducing the investment risk for lenders, they may generate a higher leverage effect.

3 'Written commitment to assume responsibility for all or part of a third party's debt or obligation or for the successful performance by that third party of its obligations if an event occurs which triggers such guarantee, such as a loan default', European Commission (2015), 'Guidance for Member States on financial instruments – Glossary'.



Figure 3.3: A guarantee scheme for personal loans



#### KEY FEATURES

- Potential benefits for individuals could include *inter alia*, lower or no guarantee fees, lower or no collateral requirements, as well as, lower risk premiums.
- The investment risk for third party lenders is reduced (they only bear part of the risk of default).
- Since programme contributions cover only certain parts of personal loans (appropriate multiplier ratio), there is a high leverage effect.
- Unfunded products such as guarantees require less initial support than funded products.



### Erasmus+ Master Student Loan Guarantee Facility – How it works

Eligible students can apply to any participating financial intermediary for a loan for their Master's studies abroad. Financial intermediaries are selected by the EIF.

Under the LGF, which began operations in early 2015, the EIF provides credit risk cover on portfolios of student loans to eligible financial intermediaries. Thus, the EIF is sharing the risk with the financial intermediaries, allowing the latter to build up a portfolio of new student loans that would not have been possible otherwise.

Typically, the credit risk protection is provided through a Capped Direct Guarantee by the EIF for the benefit of the selected financial intermediaries. The guarantee is subject to a cap calculated as follows:

*Portfolio volume X Guarantee rate (90%) X Guarantee cap rate (18%)*

The guarantee will cover losses incurred by the financial intermediaries (unpaid principal and interest) of each defaulted loan, and is provided by the EIF free of charge to the financial intermediary.

### ADIE Personal Microloans – How it works

Since ADIE is a non-profit organisation, credit resources are provided by banks and public institutions like the EIF. The risk is also shared between the banks, a public guarantee fund, EIF and ADIE. As an example, Business Development Services are delivered according to the unified model and are financed by subsidies from the government, ESF, ERDF and other foundations or enterprises.

The financial conditions of the loan are:

- fixed interest rate of 7.38%;
- requires a 'solidarity contribution' of 5% of the principal.



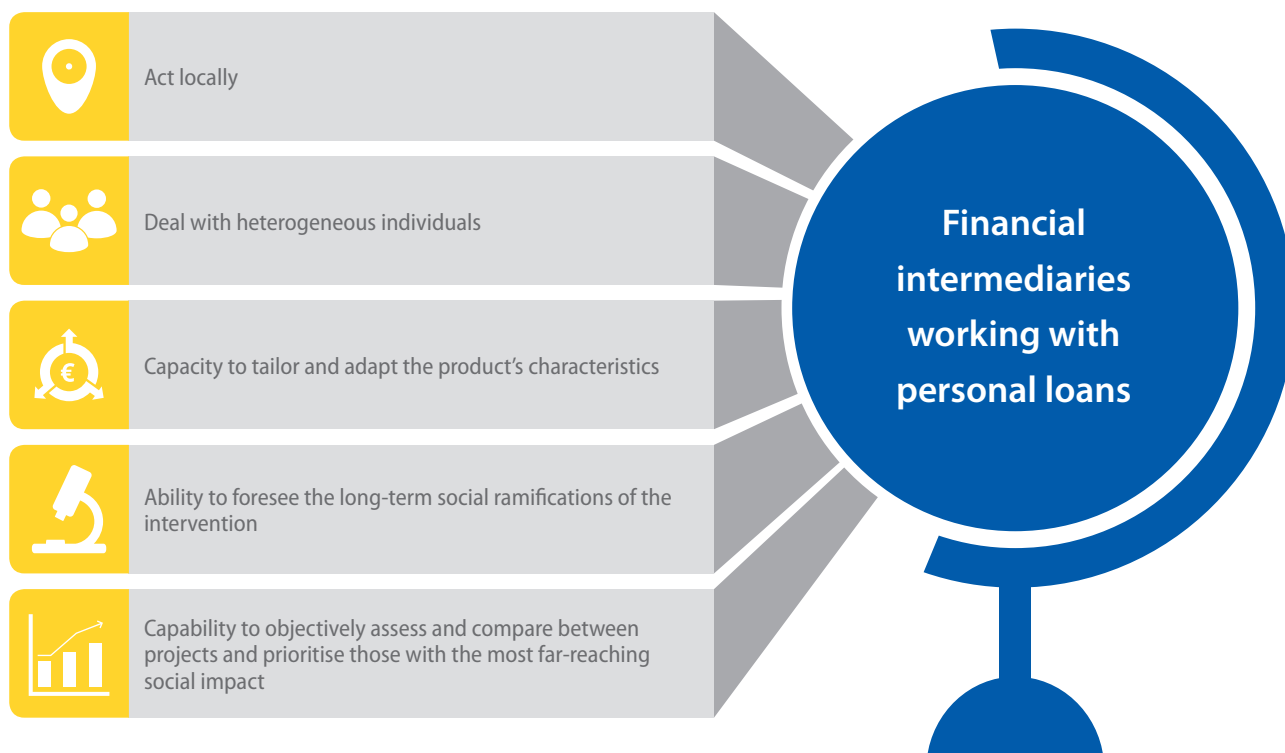
## 4. Who delivers the personal loans?

In the social impact investment ecosystem financial intermediaries can be a variety of financial institutions who can also act as suppliers by providing resources on supply side. They can focus exclusively on the social mission, or combine the social mission with commercial activities.

As with microfinance, personal loans involve high risk and management costs for financial intermediaries. Moreover, final recipients are in vulnerable situations, so most financial intermediaries would either require a high interest rate, or refuse to lend the money.

However, the ESF can be useful in providing financial intermediaries with the necessary resources to service individuals that would otherwise be denied access to credit. Additionally, managing authorities can negotiate funding agreements that require the financial intermediary to co-invest in the initiative, or provide related non-financial services to final recipients, increasing the effectiveness of the financial instrument.

Figure 4.1: The characteristics of financial intermediaries working with personal loans



As with microloans, transparency and mutual trust are key elements for a successful loan scheme, so **local financial intermediaries** are more likely to establish a close relationship with final recipients. Financial intermediaries who act locally, know the clients and understand their needs better, while final recipients are expected to be more receptive to initiatives coming from a local institution.



There is a great variety of people in need of personal loans and each case has its own particularities. Hence, the financial intermediary should have the capacity **to deal with heterogeneous individuals**, where each applicant is motivated by a different need.

Closely related to this, financial intermediaries need to be able to provide **tailored financial products** based on the different needs of applicants. Personal loans need to be adaptable financial products, addressing a wide range of different needs.

Due to the double perspective of personal loans, it is essential that financial intermediaries **foresee the social impact** of the loan, prior to any decision on the application.

Similarly, financial intermediaries are required to make a **fair assessment of different applications** and, if the demand for credit is greater than the available funds, to prioritise the projects that have more, far-reaching social impact and which contribute most to the objectives defined in the ESF programme.

### Erasmus+ Master Student Loan Guarantee Facility – Financial intermediaries

Any public or private bodies that are established and operating in one or more of the eligible countries and are duly authorised to carry out lending to natural persons in accordance with applicable laws and regulations, are eligible to become an EIF financial intermediary under the LGF. Eligible institutions can fill out the official application documents and submit them to the EIF before 30<sup>th</sup> September 2020. The applications are assessed by the EIF on a 'first-come, first-served' basis. The criteria for selection include principles of transparency, equal treatment, proportionality and non-discrimination, the experience and the operational and financial capacity of the financial intermediaries, in compliance with the EIF's statutes, policies, rules and procedures and best business practices.

*The application documents, as well as more detailed instructions can be found on the EIF website:*

[http://www.eif.org/what\\_we\\_do/guarantees/erasmus+master-loan-guarantee-facility/index.htm](http://www.eif.org/what_we_do/guarantees/erasmus+master-loan-guarantee-facility/index.htm)

### ADIE Personal Microloans – Financial intermediaries

ADIE is itself a financial intermediary, managing applications and distributing the loans directly to the final recipients. As a financial intermediary, ADIE possesses professional expertise and extensive access to regional networks. Moreover the organisation has the capability to combine loans with non-financial forms of support – a crucial aspect when supporting individuals.

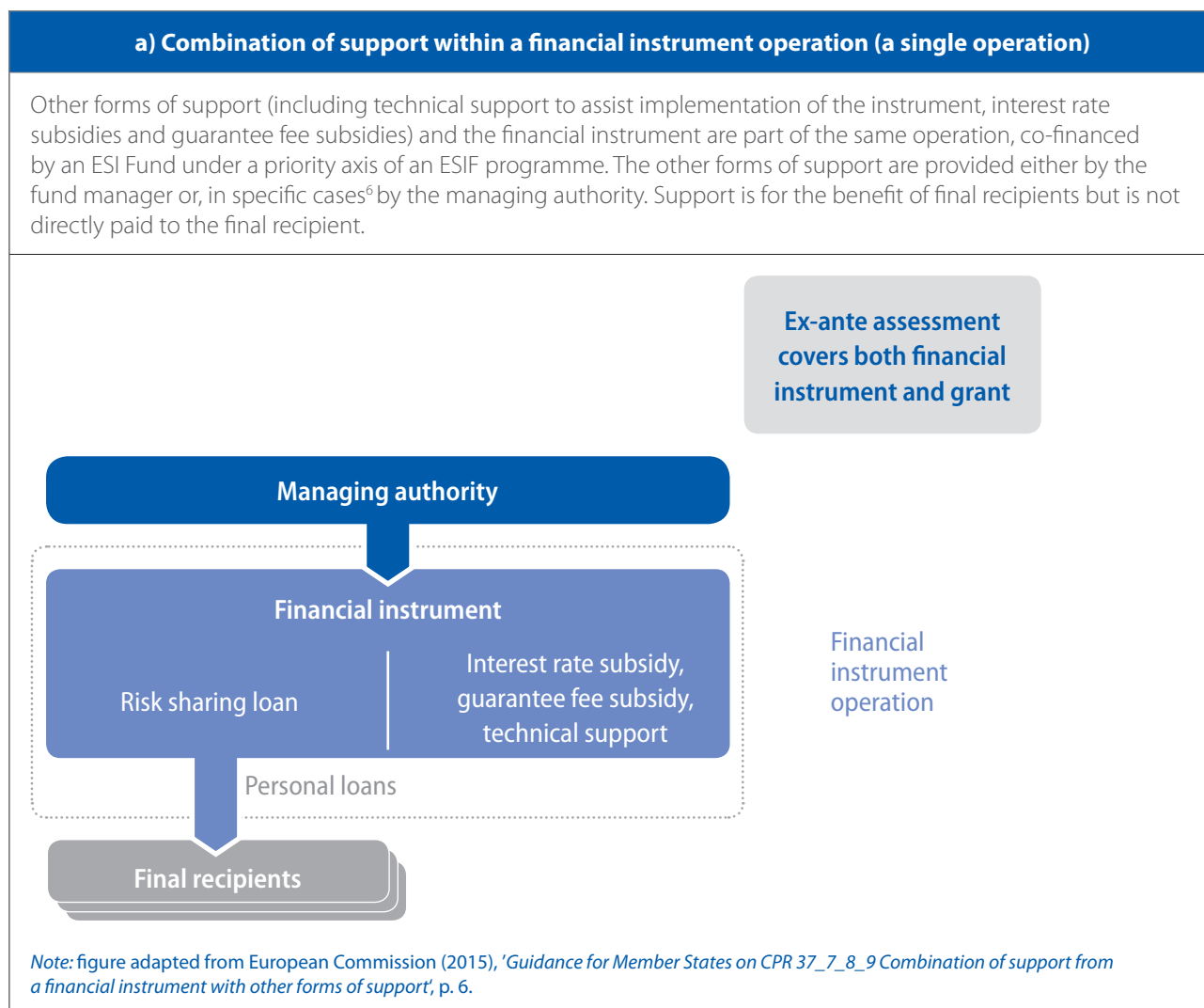
*More detailed information can be found on the official ADIE website (French language):*

<http://www.adieconnect.fr/financements/microcredit-personnel-pour-emploi1>



## 5. Combination of Support

The ESI Funds legislative framework for the 2014-2020 programming period contains conditions for a combination of financial instruments with other forms of support<sup>4</sup> such as grants or other financial instruments in the same programme, or from other EU programmes. Using personal loans together with other forms of financial support may raise the effectiveness of the support and meet the needs of a wider range of final recipients. Two types of combination can be identified<sup>5</sup>:



4 Common Provision Regulation (CPR) Article 37(7), (8), (9), Article 42(1), Article 65(11).

5 European Commission (2015), 'Guidance for Member States on CPR 37\_7\_8\_9 Combination of support from a financial instrument with other forms of support'.

6 Financial instruments implemented pursuant to Article 38(4)(c).

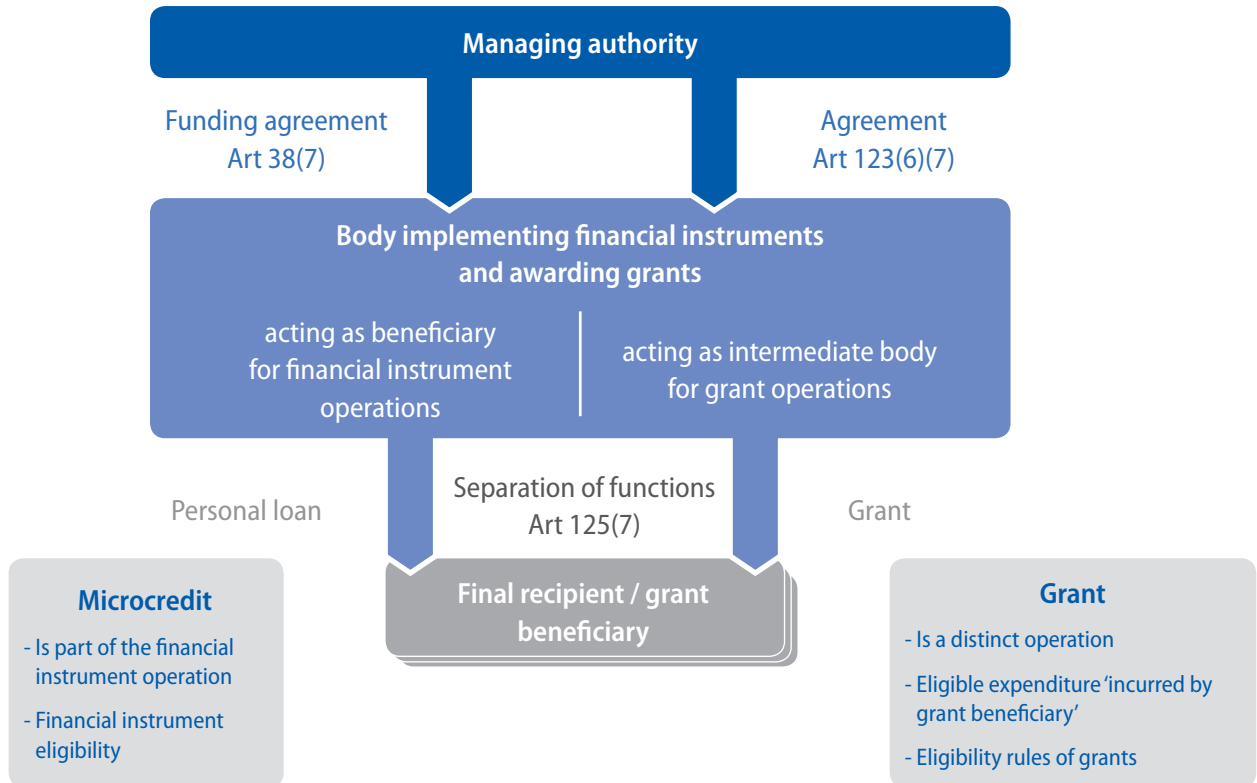




**b) Combination of support at the level of the final recipient (combination of two separate operations)**

Support from a financial instrument may be combined at the level of final recipient with support from another ESI Funds priority or programme or another EU-financed instrument. In this case the grant or other form of assistance does not constitute part of the financial instrument's operation. The combination of financial instrument support and the grant (or other forms of support) coming from another priority, programme or instrument takes place within two separate operations, each having distinct eligible expenditure.

**Ex-ante assessment**



Note: figure adapted from European Commission (2015), 'Guidance for Member States on CPR 37\_7\_8\_9 Combination of support from a financial instrument with other forms of support', p. 11.





