Evaluation Report

Operations Evaluation (EV)

Evaluation of EIB financing through global loans under the Lomé IV Convention

Synthesis Report

European
Investment
Bank

EIB financing through global loans under the Lomé IV Convention

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Introduction

This evaluation covers EIB financing with own resources and risk capital through global loans (GL) in ACP countries under the Lomé IV convention (1990-2003). It forms part of a broader evaluation of EIB operations in the ACP and follows the report on financing through individual loans which was published earlier.

The above-mentioned report on individual loans has already provided an overview of EIB financing to the ACP Region during this period. Global loans have been an important instrument for the provision of EIB financing to investment projects below its normal threshold for direct lending both inside and outside the European Union during the past decades. Under the two Lomé IV protocols GL operations accounted for 20% of own resource lending operations and increased from 29% of risk capital operations under Lomé IV to 39% under Lomé IV bis (rising to 46% on the supplementary amount). They thus represented an important component of the total financing the Bank has provided to the region during this period.

For this evaluation EV selected a sample of 15 global loans located in Africa (9), the Caribbean (4), Pacific (1) and one multi-regional operation. The operations comprised 7 GLs to individual financial institutions (FIs) and 8 Apex operations under which two or more FIs were selected to participate. In three instances the loan comprised both loans from own resources and from risk capital, and in two cases the risk capital component was specifically targeted at the financing of equity and quasi-equity investments.

Global loan relevance

All the GLs were considered to have been relevant in terms of their objectives, which were consistent with those of the Lomé IV Convention, and in conformity with the lending policies of the Bank and the EU's policies and strategies. These GLs all targeted eligible sectors that were included in the National Indicative Programmes of the countries concerned.

Their specific objective was primarily to channel EIB funding through selected financial intermediaries to small investment projects, primarily to private sector SMEs in the industrial, agro-industrial and services sectors of the recipient countries. Therefore both implicitly and explicitly, through the selection of sub-borrowers, GL operations have helped underpin private sector development by providing financial support to small and medium sized enterprises thereby contributing to economic development.

Independent studies have indicated a positive relationship between financial sector development and GDP growth rates, and between the size of the SME sector and economic growth. Although not a primary objective, a number of the GLs were found to have contributed to financial sector development through the deepening of domestic markets and strengthening of financial institutions through technical assistance linked to the operation and thus to the broader development objectives of the Bank in the region. These aspects could be further reinforced in order to increase the impact on the development of the financial sector.

Performance of the financial institutions

The performance of the operations was first evaluated at the level of the financial institution against the internationally accepted evaluation criteria of effectiveness, efficiency, and sustainability. The evaluation has reviewed their organisation and management and their financial situation, especially portfolio quality. For Apex operations, the performance of a limited number of FIs was evaluated in detail, being those which had most actively utilised the GL, but the rating given is an evaluation of overall performance.

From the 23 financial institutions evaluated, and based on a 4-level rating scale, 10 were rated **good**, 9 were rated **satisfactory,** 1 **unsatisfactory**, and 3 were rated **poor**.

The low ratings were given in cases where the FI's financial situation underwent a severe deterioration subsequent to the GL operation. There was no linkage between this situation and the financing that had been provided by the EIB. Of the four FIs with low ratings, two development banks were concerned.

The selection of the financial intermediaries followed a process which can be considered as satisfactory. The quality of the FIs could be reinforced by increased support either to the development of DBs or to financial sector reforms.

Performance of the global loans

The evaluation of the performance of the Global Loans has analysed amounts disbursed against initial expectations (effectiveness), on-lending conditions (efficiency) and the project and credit quality of the sub-projects financed (sustainability), in particular of a sample of 45 sub-projects which were visited during the evaluation.

Only 5 of the GLs (all risk capital) were fully allocated and disbursed within the initial contractual period and 2 (own resources) following extensions. This outcome was seen partly as a reflection of the ability of FIs to manage the GLs but also as the result of over –optimism on the part of the EIB, and possibly the FIs themselves, in determining the amount of the GL in relation to potential demand at the time of appraisal.

Improved utilisation could be achieved through more thorough screening of FIs at the identification phase, especially for Apex GLs, and the introduction of appraisal and commitment fees.

The conditions set for sub-loans were generally deemed to be appropriate. In accordance with Bank policy, on-lending rates on own resource and risk loans were set at levels which would not result in distortions in the domestic market, the subsidy element being taken out and often utilised for purposes such as the setting up of foreign exchange risk cover schemes and training of bank staff.

GL financing generally reached the targeted sub-sectors, although not always to the smaller projects that might experience the greatest difficulty in accessing term financing. The quality of the sub-projects financed was assessed first through discussions with the financial intermediaries, and second through discussions with the financial beneficiaries evaluated. 92% of the final beneficiaries visited were operating well, leaving only 8% which were experiencing difficulties at the time of the evaluation. It was also observed that, with two exceptions, the quality of projects financed was similar to that of the total portfolio of the FI. The performance of the risk capital operations designed for equity financing was mixed and highlights the need to carefully assess both the capability and interest of the FI to handle such operations at the time of appraisal. More specifically, GLs to a financial intermediary who would allocate the funds to local banks for their on-lending to FBs has not proved successful and should be avoided in future. Although not always quantifiable, a number of positive development impacts were observed, such as employment creation and safeguarding, indirect employment creation, transfer of new technologies, increased export earnings, and increased revenues to government through taxes and other contributions.

The ratings attributed to GL performance were lower overall than those for FI performance: 3 were rated **good**, 8 were rated **satisfactory,** and 4 were considered **unsatisfactory.**

EIB contribution

The Bank' financial and non-financial contribution in the Global Loans financed was evaluated for both the FIs and the final beneficiaries.

The principal financial value added for FIs resides in the longer tenor provided under the GL and on foreign currency resources which are often scarce in the domestic market. A distinction may be drawn between development banks (6 in the sample) that are often dependent on EIB and other donors providing similar financing for the continuity of their lending operations, and commercial banks, for whom the availability of such finance represents an opportunity to launch new products. For FBs the financial added value stems from the additional availability of term finance in the local market.

The sample only included one successful risk capital loan for equity and quasi equity participations. The main value added for this FI was in terms of the flexibility of the instrument. However despite the opportunities the risk capital instrument offers to FIs to diversify both their financial products and risk, the low take up of risk capital available for this purpose under other GLs suggests a more careful selection of specialised financial institutions through which to mount such operations.

In order to contribute to the strengthening of the financial sector, the Bank might consider taking further equity participations in selected FIs as a strategic investor. The likely impact of such participations will be enhanced when the Bank participates as an active member of the FI's Board.

Other contributions granted to FIs depended on the utilisation of the interest subsidy. Where this was retained by the FI, direct benefits resulted in terms of training and, in some instances, technical assistance, although with weak outcomes. One GL required the establishment of a PMU to screen allocations prior to submission to the EIB and to carry out monitoring and reporting functions.

Certain FIs specifically cited benefits resulting from their inter-action with EIB operational and technical staff both during appraisal and implementation of the GLs. Specific mention was also made to increasing awareness of the importance of ensuring compliance with environmental standards and to the higher risks for import substitution projects in economies where large price distortions remain. Commercial banks pointed to the benefit that accreditation by EIB might have on their ability to raise funds from other sources.

EIB management of the project cycle

The Bank's management of the project cycle was rated as being **good** or **satisfactory** during the identification and appraisal phase. In only one instance was it considered to have been unsatisfactory – a first operation through a development bank for which it was considered that the serious challenges in terms of management and portfolio quality facing the bank at the time of appraisal were under-estimated. These ratings also reflect the fact that, in many cases, these were repeater operations with FIs already known to the EIB and who were familiar with the Bank's procedures.

However, the evaluation found that the monitoring and follow-up on GLs was rarely satisfactory. In particular, the management of the special purpose funds created for the use of interest subsidies was weak, often because their setting was too complex. Few FIs provided regular reports on the performance of sub-projects or of their own financial situation. Although the EIB was entitled to request such information, this right was rarely exercised. Consequently, the Bank receives very little information from which to assess the development impacts of its GL operations ex-post.

Recommendations on how to address these points are provided in the following section.

Table of Recommendations

	EV Recommendation	Services' Comments
1.	In order to increase the development impact of GLs at the financial sector level consideration should be given to including conditions aimed at improving the environment in which the GLs will be implemented in areas such as strengthening of supervision capabilities of the central bank or regulatory reform in co-ordination with other major donors. (§ 1.3 and 3.4)	Agreed. However, at the sectoral / policy level, the European Commission is often in a better position to influence the environment in which GLs are implemented. Also, GLs are generally made directly to FIs, not to the Central Bank or government authorities - so the mechanics of addressing sectoral issues are not straightforward. Close coordination with the EC is foreseen on this matter; if required, funds for TA could be made available by the Bank under Cotonou II using part of the interest subsidy endowment.
2.	Greater attention needs to be paid during the selection and appraisal of FIs for inclusion under Apex operations in order to gauge their real interest in participation. To ensure their commitment, consideration should be given to the introduction of appraisal fees and commitment fees. The latter would help reduce cancellations, and both fees would improve IF financial results. (§ 3.1)	Under Cotonou, appraisal fees are generally charged to commercial FIs, but not to public owned FIs or development banks due to their limited capacity to pay such fees. A flexible policy ("menu" approach) on charging appraisal fees is therefore recommended, with exemptions only granted in well justified cases. With regard to commitment fees, clear guidelines need to be established, bearing in mind that this would technically not be feasible in the case of APEX loans with no predetermined amount allocated to individual FIs. One of the objectives of APEX facilities is to open up the facilities to as wide a range of banks as possible - to encourage competition.
3	Consider the inclusion of sub-limits for lending to small enterprises, as was experimented with some success in two operations evaluated, to ensure that part of the GL funding goes to the smaller businesses that often have the greatest difficulty in accessing term finance. (§ 3.1)	This is an interesting recommendation and could indeed be considered more often.
4	Tailor the tenor of GLs more closely to that agreed for sub-loans allowing for sufficient grace periods to enable allocation and disbursement to sub-loans. A report should be provided by the FI at the end of the disbursement period which would confirm that funds rolled over continue to be used for financing activities which are in line with the original objectives of the GL. (§ 3.2.2)	Recommendation agreed; provided that the tenors can be set to allow sufficient time for allocation, disbursement and repayment, not excluding eventual restructuring of sub-loan allocations. Under Cotonou, for GLs denominated in local currencies, it is recommended to avoid roll-over by allowing individual allocations that are just marginally longer than the underlying sub-loan(s) by the FI.

5.	Adapt allocation procedures according to the characteristics of the FIs. - For development banks when concerns persist as to appraisal methodology, continue with fiche procedure. Regular feedback through questions on allocations or on the reasons for rejection of allocation would contribute to transfer of know-how from EIB to the FI. Regular monitoring of sub-projects is recommended to validate information provided in the appraisal reports received and quality of sub-projects. - For commercial banks with well established risk assessment methodologies and procedures, a list procedure whereby sufficient key data is provided to check compliance with eligibility and environmental guidelines for approval prior to release of next tranche. Monitoring of the operation would include physical ex-post checks on sub-projects to validate information provided by the FIs. (§ 5.3)	The general principle of modulating the ex-ante review of allocation requests by the EIB is accepted and is already in practice – it is a very lightweight procedure for experienced commercial or development bank FIs, or in the case of repeat operations with FIs well known to the Bank, but is a heavier procedure for smaller or less experienced FIs. Any further adaptation or relaxation of the allocation procedures should however be considered carefully in the light of anti-money laundering issues, which are being given greater attention. This may also require some trade-off with recommendation nr. 8 concerning the ex-ante definition of development impact indicators for GL operations. Ex-post checks on sub-projects to verify information supplied is accepted as a principle, bearing in mind the need to balance the relative importance of individual allocations vs. the FIs themselves (EIB is the wholesaler, the FI the retailer).
6.	Where there is a commitment of Government to reform existing development banks, institutional development through TA should be included as a stand-alone component in the financial package and not financed from interest subsidies. (§ 3.2.1)	The proposal is agreed, although this is subject to adequate funding being available. This is recognised in the revised Cotonou Agreement (Cotonou II), which has introduced more flexibility, as 10% of the budget for interest rate subsidies may be used to support project related TA.
7.	The utilisation of GLs to finance lines of credit by a FI to local banks has not proved successful. It potentially adds to the cost of funding both for the FI and the FB. Furthermore the Bank has little or no information on the basis of which to assess the quality or development impact of the GL at the FB level. The evaluation concluded that such operations should be excluded from future GLs. (§3.3 and 5.3)	The point is taken. The case in question was an exception. Any new similar proposal would be subject to close scrutiny.

8.	Consider the introduction of a limited number of development impact indicators ex-ante as part of the information requirements provided by FIs at the time requesting approval of allocations (§ 3.4). This would facilitate the ex-post evaluation of development impacts during monitoring of these operations. Following full disbursement of the GL, the FI should include such information ex-post in a completion report which would form the basis of the Report on Allocations which should be provided for each GL once closed. (§ 5.3)	The Bank's standard requirements include information on a number of indicators - number of jobs created, etc., related to development impact. It is agreed that this list could be expanded. This should be dealt with in the framework of development impact / value added assessment of GL operations, both at macro-economic level and at the level of the FIs themselves, and at the level of the FBs; a process which is ongoing. Besides, some trade off is needed between this recommendation and the proposed streamlining of the allocation process (recommendation nr. 5)
9.	Recognise that for most FIs in the region equity and quasi equity investments are a different type of business to term lending and one with which they are often unfamiliar. Therefore the EIB should provide guidance and technical assistance to encourage such operations or channel them through specialised FIs. Simply allowing for the use of the GL for this purpose alongside term lending has shown not to be a sufficient incentive for FIs to develop this product. (§ 4.1.3)	Agreed. Commercial banks typically do not have the vocation to make equity investments, and development banks have a patchy record at it. The growth of specialised equity investment funds in Africa has been seen more recently than the time when most of the GLs evaluated in this report were put in place. The Bank has developed specific guidelines for equity investments and is participating in a number of equity funds as an alternative to support SME investments in ACP countries.
10.	Consider further direct equity participations in selected Fis, which can be beneficial both for the EIB and serve to underpin longer term strategic relationship with benefits for both the FI and the financial sector in which it operates. These will have greater impact and added value if the Bank were to be represented on the Board of the selected FIs. This is particularly justified for DBs in small countries. (§ 4.1.4)	The recommendation is accepted; this issue is being discussed with the Investment Facility (IF) Committee. Board representation etc. has however legal and human resources consequences, which need to be taken into account. It is recalled that for Investment Funds (not covered by this evaluation), the Bank usually insists on the right to a seat on the Investment Committee.

Introduction

Portfolio Presentation

This evaluation covers fifteen Global Loan operations (GL) financed by the European Investment Bank on own resources and risk capital during the past thirteen years in the ACP and OCT countries under the Lomé IV Convention (1990 – 2003). Two were signed under the first financial protocol and the remainder under the second financial protocol (Lomé IV bis). The evaluation forms part of EV's ongoing two-year rolling programme 2005-2006, and complements an evaluation that has recently been carried out on individual projects in the ACP region[1].

The operations evaluated were selected from the GL signed after 1995 and fully implemented before 2003[2]. During this period GLs represented some 30% of lending to the region. As the operations considered have been fully implemented, it can be assumed that most of the sub-projects financed have reached their early operational phase. All operations have been evaluated in depth with 9 field missions to meet Financial Institutions (FIs) in the countries concerned and 10 out of the 15 evaluations included site visits to final beneficiaries (FBs). Three GLs evaluated were operations in which loans were granted in tandem combining own resources and risk capital, one of which to a regional MFI.

In selecting this sample account was taken of the need to ensure a reasonable spread of the operations evaluated, across all types of GL operations (*own resources* for loans to private and public sector borrowers *and risk capital* for loans and/or equity/quasi-equity financing), the countries of the region and the size of the operations (larger and smaller). The following table provides a summary of the sample:

OPERATIONS				FINANCIAL INSTITUTIONS	
	Total number	of which		DB Development bank	CB Commercial bank
		Single FI	Apex		
Own resources (OR)	3	1	2	1	7
Risk capital (RC)	9	4	5	5	22
OR plus RC	3	2	1	2	3
Total	15	7	8	8	32

A brief description of the mechanism of Global Loans is provided in Appendix 1.

Methodology

The evaluation methodology has focused on both the performance of the GL operations and that of the EIB during the preparation, appraisal and implementation of the Global Loans. The evaluation of the GLs takes into account the expectations and objectives of the GL as defined during appraisal and compares these with the ex-post results. A four level rating on an increasing scale has been used (poor, unsatisfactory, satisfactory, and good). An operation that has achieved or surpassed all its objectives will be rated "good", while failure to achieve some or all of key objectives results in lower ratings.

Performance of the GL operation

The performance of an operation has been analysed from three aspects:

[1] EIB Financing through Individual Loans under the Lomé IV Convention (EV Synthesis Report reference CA/396/06 dated 3 May 2006).
[2] Either fully disbursed or in some cases partially disbursed with the balance cancelled due to non-utilisation within the contractual deadline.

- Relevance of the operation: in relation to the objectives of the EU mandates and EIB decisions, and on the other hand, in relation to the national policies and beneficiaries' requirements (*relevance*).
- Evaluation of the FI (only for domestic banks[3]) organisation, financial situation (mainly portfolio quality) and sustainability (*efficacy, efficiency and sustainability*).
- Evaluation of the EIB GL: Amounts disbursed versus initial expectations, achievement of the specific objectives of the GL; on-lending conditions and sustainability of the projects financed including environmental impact. Particular emphasis has been given to the analysis of a sample of projects financed in order to assess whether or not they are sound investments (project quality and credit quality). A total of 45 sub-projects were visited during this evaluation. In addition their development impact has been assessed.

The evaluation of the FI compares its current situation with the situation at the time of appraisal. For Apex GLs in which a number of FIs have participated, at least two FIs (generally those which have been the most active) have been evaluated. The evaluation looks at the evolution of the financial situation and organisation of the FI, its ability to manage sub-loans granted under the GL, and portfolio risk.

Performance of the EIB

The evaluation of the EIB's performance has focused on two aspects of the operations:

- contribution, assessed in terms of financial value added to the FI and FB and other non-financial contributions; and,
- management of the project cycle from identification to monitoring and follow up

For risk capital operations to support equity or quasi equity investments, the evaluation has specifically tried to analyse some indicators of investment profitability for the EIB (on behalf of the EU). Although the main aim of risk capital under Lomé IV was to maximise development impacts, it was deemed useful to analyse profitability indicators to try to identify relevant conclusions for new GLs to be implemented in the framework of the Cotonou Agreement.

In addition, the evaluation has considered:

- The overall contribution of global loans to the development of the private sector and to the development of the financial sector.
- EIB coordination and cooperation with the EU Commission and with Multilateral and Bilateral Development Banks.

Additional objectives (such as the Millennium Development Goals) or priorities introduced after the approval of the operation have also been taken into account, but have not been rated.

[3] For the two operations where the FI was a MDB or bilateral development agencies, their financial situation has not been analysed. Instead the evaluation has focused on the FI procedures to manage the GL and the value added provided. .

1 Policies and strategy

1.1 EU and EIB Objectives and strategies

A Review of Bank Strategies and Policies under the Lomé IV Convention is provided in the Special EV Report, which formed an appendix to the Report on Individual Operations in ACP countries.

1.2 The EIB mandates

As further described in the above-referenced Report, the Lomé IV Convention comprised two Financial Protocols, the first signed in December 1989, and the second in November 1995. Projects could be financed through the EIB by risk capital from the European Development Fund (EDF), or by loans from the Bank's own resources - or jointly by both of these financial instruments. Risk capital could be provided in the form of loans (subordinated, or conditional) or equity or quasi-equity participations (temporary acquisition of minority holdings).

<u>Resources</u>

Under Lomé IV, the resources assigned to the EIB for the ACP countries was as follows (in million EUR):

Lomé IV	Protocol 1	Protocol 2	Total
Own Resources	1200	1658	2858
Risk capital	825	1000	1825
Total	**2025**	**2658**	**4683**

In November 2000 the EIB was allocated an additional 300 M EUR for risk capital operations to cover the transitory period until the Cotonou agreement entered into force in 2003.

As a general principle (Article 238 of the Convention) priority allocation of risk capital resources was given to the least developed ACP countries, with particular account being taken of the difficulties of the land-locked or island ACP states. In practice the social and economic conditions of each country were analysed before indicative programmes were drafted and resources allocated, taking account of these factors. Thus a large number of ACP countries are considered not creditworthy for the Bank's own resources and benefited uniquely from risk capital operations.

In the more developed economies, the Convention required the Bank to utilise risk capital resources to support private sector development. To this end Article 268 provides for the allocation of risk capital to finance direct and indirect investments and to participate in the equity of financial institutions and ACP – EEC joint ventures. Thus in a lesser number of ACP countries risk capital resources have been used in parallel with own resources to finance *inter alia* global loans.

<u>Financial Products</u>

Under Lomé IV, the financial products available for sub-loans via selected Financial Intermediaries (FI) to Final Beneficiaries (FB) through global loans (GLs) comprised of own resource and risk capital GLs. Risk capital GLs were also granted for equity and quasi–equity finance with various risk sharing formulae and studies. In practice the flexible nature of the risk capital (RC) instrument has allowed the Bank to offer different combinations of these products, for example a GL principally for on-lending, but with an option for using part of the loan for financing equity and quasi equity investments, or a GL principally for equity and quasi–equity operations, part of which could be used for the financing of studies.

Private Sector Support

The specific sectors agreed for EIB financing were detailed in the Annexes to the Indicative Programmes that have been drawn up for each ACP by the EC and the respective recipient country, together with an indication of the total assistance envisaged. The Indicative Programme does not specifically identify individual projects and still less borrowers or financial intermediaries, even if some initial contacts may have taken place during the programming exercise. Typically, support through GLs falls under the broader objective of providing assistance to private sector development, with a particular emphasis on the development of small and medium scale investments in productive sectors, and diversifying and strengthening export capacity. This approach has served the Bank well in the past through ensuring that the country's development needs are scrutinised at the outset of implementation of the agreement, but allowing maximum flexibility of choice of investments to be financed as the lending programme moves forward.

Moving Forward

During the late 1990's the development paradigm began to change; a new approach gave greater prominence to the role of the private sector[4] as opposed to public sector investment. It also emphasised the role of undistorted market forces in allocating resources including financial resources. As a consequence, EIB finance was to be provided to final beneficiaries at "market interest rates" that do not distort local financial markets. This new approach was again reflected in the Cotonou Agreement signed on 23rd June 2000 and effective from 1st April 2003. Under this new agreement the Bank continues to grant loans from its own resources guaranteed by Member States[5] and on risk capital resources; the latter are now managed through the Investment Facility (IF) which has a number of innovative aspects. The overarching objective of the IF is to promote the development of the private sector and commercially run public enterprises in ACP and OCT. It broadens the range of financial instruments available to the Bank to achieve this objective. Furthermore the IF is structured as a revolving fund whose aim is to be financially sustainable. Interest and repayments on conditional loans and dividends are repaid to the IF which is managed by the Bank as a self-sustaining facility.

Given the enhanced role of the Bank in the region, it is likely to be increasingly held to account by its shareholders the EU Member Countries, the European Commission and the international community at large to demonstrate the developmental impact of the projects it finances directly and also indirectly through Global Loans. It may also be called upon to provide more support to the development of the financial sectors in the countries in which it operates.

In this new context for operations in the ACP/OCT the evaluation has sought to draw relevant lessons for the Bank's management of its Cotonou mandate based on the past experience of Global Loan operations in the region. Given the quantitative increase in its mandate and the additional developmental objectives in terms of private sector development as well as additional objectives such as the Millennium Development Goals[6], it is likely that GLs will remain an important instrument for the Bank's activities in the region.

[4] EIB, Investment Facility Annual Report 2003.
[5] The guarantee is restricted to 75% of the total amount of the credit opened by the Bank under all the loan contracts and shall be applied to cover all risks.
[6] These eight "goals" are: eradication of extreme poverty and hunger, achievement of universal primary education, promotion of gender equality and empowerment, reduction of child mortality, improvements in maternal health, combating of HIV/AIDS, malaria and other diseases, environmental sustainability and developing a global partnership for development.

1.3 Country Reviews

Although a global picture of ACP economies is difficult to draw, given their different sizes and geographical diversity, a few comments may be made on the overall context. During the period observed, economic growth in *Africa* has been patchy and insufficient to meet the needs of growing and predominantly young populations and severely constrained in many sub-Saharan African countries by the spread of HIV-Aids and a number of local or sub-regional conflicts as well as political instability. The public sector has generally under-performed and private sector development has been affected by all these factors and the fact that most countries are constrained by weak regulatory and legal support infrastructures. Since 2000 some positive tendencies could however be observed - a decline in sub-regional instability and a return to positive economic rates of growth and a degree of financial stability in a number of countries.

The *Caribbean region* also encompasses a wide array of countries and island states, with per capita incomes varying considerably between them. The region has been regularly subject to exogenous shocks (e.g. hurricanes and flooding). Development in the Caribbean region has been hampered by constraints inherent to small and open island economies, mostly heavily dependent on one or two sectors, notably agriculture and tourism, although some have made progress in diversifying their economic bases into other sectors - notably financial services, telecommunications, and oil and gas.

1.4 Relevance of Global Loan Operations

Global Loans have for many years constituted an important financing activity of the Bank in the ACP countries. Initially these were mainly channelled through publicly owned development banks (DB), many established with the support of the multilateral development banks (MDB) as a means of financing smaller investments which would otherwise have been below their thresholds for direct lending operations[7]. Since the early eighties many DBs have faced problems due mainly to weak management, politically directed lending and the impact of local currency devaluations on the ability of their clients to service loans if these are denominated in foreign exchange. This has led to a restructuring and partial or full privatisation of many DBs and a redirection of EIB lending towards commercial financial institutions, often using the Apex structure to diversify risk and achieve a broader distribution of credit through the financial sector.

During the period covered by this evaluation the significance of GL operations in the ACPs, in terms of their volume, is demonstrated in the following table:

Mandate	Signed	Cancelled		Net commitments	Disbursements	
	M €	M €	%	M €	M €	% of comm.
Own Resources						
Lomé IV	313	98	31	215	215	100
Lomé IV bis	248	43	17	205	112	55
s/total	561	141		420		
Risk Capital						
Lomé IV	267	30	11	237	232	93
Lomé IV bis	393	50	13	343	310	90
Lomé IV supl.	108	0		108	24	22
s/total	768	80		688	566	

** % of global amount in total signed amounts under each convention*

In terms of commitments GL operations accounted for a noticeably constant - 20% of OR lending operations. However, the level of cancellation post signature is high (31% under Lomé IV; given the low level of disbursements under Lomé IV bis, one can assume a similar level of cancellation when all operations are closed), suggesting an overall tendency to over-estimate demand at the

[7] The dividing line between smaller projects to be financed indirectly through FIs and larger projects to be handled directly by the Bank takes account of the varying size of the economies of the recipient countries and has evolved over time. In the ACP countries, it varies between EUR 2 and 5 million. By comparison, in the EU the threshold is EUR 25 m.

time of appraisal so that GLs were signed for amounts which were unattainable during implementation.

Risk Capital GL operations account for a larger portion of overall RC lending activity: from about 29% under Lomé IV to 39% under Lomé IV bis and over 46% in the supplementary amount. This reflects the significant share of smaller countries funded through RC, and also possibly suggests greater difficulties in identifying viable projects for direct lending during the latter period. The level of cancellation after signature, although significant, is limited to 11 - 13%, demonstrating better control of limited resources.

As mentioned above, the specific objective of a GL is to channel EIB funding through selected financial intermediaries to investments that are below the threshold for EIB direct lending - primarily to private sector SMEs in the industrial, agro-industrial and tourism sectors[8]. Besides addressing the general objective of promoting the development of mature financial sectors in ACPs, GLs are therefore also a means through which objectives for the productive sectors of the economy as defined in the Indicative Programme can be achieved.

Sub-loans to SMEs have generally excluded public sector enterprises. Therefore both implicitly and explicitly through the selection of sub-borrowers, GL operations have had a second objective which is to support economic and social development by providing financial support to small and medium sized enterprises in the private sector not least in view of their contribution to employment creation[9]. SME access to term finance from commercial banks has been constrained by their reluctance to lend to SMEs or limited by market conditions in which term finance was scarce or allocated mainly to larger corporates, often public sector firms. Therefore, if well designed and targeted, the GL can make an important contribution to improving this situation.

For risk capital operations financing equity and quasi-equity participations the principal operational objectives are similar to those of credit lines – on the one hand to support private sector development through the SME sector, and additionally to contribute to financial sector deepening through the availability of other instruments than conventional term loans. However the interest from FIs in such operations has been low, and even the objective of a regional facility to finance direct investment was not achieved.

In conclusion, the relevance of 14 GLs was rated as "good" and one operation as "satisfactory".

[8] One operation included in the sample also included the financing of small infrastructure projects.
[9] The number of jobs created or safeguarded is detailed in the Final Allocation Report and cumulative figures for employment generation always features in articles and reports on the Bank's activities in SME financing

2 Financial Intermediaries

2.1 Financial Intermediaries population

The selection of sound financial intermediaries is an important operational objective since the FI is the Bank's direct borrower and because the appraisal of sub-projects financed is *de facto* delegated by the EIB to the financial intermediary (also see appendix 3). An essential aspect of the evaluation has been to analyse for each operation the extent to which these operational targets have been met both in terms of their financial and developmental impacts.

Of the Global Loans evaluated, seven operations were Apex loans involving two or more FIs, seven were loans to single FIs and one operation was the grouped loan to European development agencies active in the region. The Apex loans were extended mainly to commercial banks. The loans to single FIs were granted in three cases to government controlled development banks, one to a majority government controlled development bank[10], and one to a former public sector bank which was privatised in the late eighties although the government still retains a minority holding[11]. One global loan was granted to a leasing company and one to a regional development bank whose shareholders include both regional and non-regional countries. Seven were first time operations and eight operations were wholly repeater operations or partially repeater operations in the sense that they were Apex operations in which additional FIs were included in the subsequent operation.

2.2 FI assessment

A total of 23 FIs have been evaluated, including 2-3 FIs for each apex GL, being those FIs that were the most active.

The ratings given to the FIs are summarised in the following table.

FI Rating	Good	Satis.	Unsatis.	Poor
Development banks (6)				
Experience	3	2	1	
Organisation & management	3	2	1	
Sustainability	1	3		2
Overall	**2**	**2**		**2**
Commercial banks (17)				
Experience	7	10		
Organisation & management	7	8	2	
Sustainability	8	6	2	1
Overall	**8**	**7**	**1**	**1**

2.2.1 Experience, organisation & management

The experience of the FIs has been evaluated good or satisfactory in all cases except one, which was rated unsatisfactory. The management of the GLs by the FIs (organisation & management) has been rated good or satisfactory in 20 cases and unsatisfactory in 3 cases (criteria for efficacy and efficiency). This is a measure of reasonable success both in the identification and selection of FIs. The reason for the unsatisfactory rating was that weaknesses were identified at the time of appraisal, and although measures to address these had been identified these took longer to implement than was anticipated. The evaluation concluded that EIB did not fully appreciate the challenges in turning around this institution. The technical assistance provided was too narrowly focused and did not set out precisely what was required to improve the ability of the FI to manage this type of facility.

2.2.2 Financial performance

[10] Other shareholders are IFIs
[11] The only FI in the sample in which EIB is also a minority shareholder

The performance of FIs has been assessed through an analysis of their current financial situation and the use of widely accepted financial ratios to benchmark and compare performance[12].

Returns on equity are generally higher for commercial banks than for development banks; this result is logical and the lowest returns are observed for development banks in difficulty. Three commercial banks could not be rated due to financial difficulties or large reorganization.

The level of non-performing loans is uneven throughout the sample, varying from 2.2% of the total portfolio in one commercial bank to 56% for a development bank.

In terms of **sustainability**, the financial situations of the FIs evaluated ranged from good to poor. Of the development banks in the sample, four were rated good or satisfactory and two were rated poor. For the latter the rating reflects the current portfolio quality and concerns about their ability to properly manage credit risk. In one country the development bank embarked on an ill-conceived expansion and diversification of its lending activities (into housing loans) during the period following appraisal of the GL which resulted in a sharp decline in the quality of its loan portfolio. Some of the problems of another development bank, including poor management and increasing competition from commercial banks, were identified at the time of appraisal but have still to be addressed in the form of a long-term strategy to ensure the sustainability of this FI. It should be noted that three of the development banks rated positively are based in small countries where, obviously, their role can be more significant (less interest for commercial banks).

Eight of the 17 operations through commercial banks were rated good and 6 satisfactory; a rather positive result given the generally perceived level of banking sector risk in many of the countries in which the Global Loans were implemented. It should be pointed out that these ratings mainly related to Apex operations where, for practical reasons, only a limited sample of the participating FIs were analysed. But it is also a reflection of the efforts made in the last few years to strengthen banking supervision and regulation in a number of the countries concerned. Two of the commercial banks that were facing difficulties are based in one country experiencing extreme socio-economic difficulties during the period concerned. International banks have recently acquired these two banks and sustainability should no longer be a problem.

Overall, more than 80% of the FIs analysed are rated satisfactory or good.

These outcomes suggest the need for the Bank to be more proactive in terms of supporting the institutional development of development banks to ensure their sustainability and in terms of providing support for financial sector reform in those countries where its principal financial partners are commercial banks to ensure their sustainability

[12] Operational performance (e.g. return on equity), financial situation (e.g. financial market liabilities/equity for DBs and capital adequacy for commercial banks) and portfolio quality (e.g. non-performing loans / total portfolio). A broad spectrum of other ratios was used in the individual analysis of FIs.

3 Global Loan Performance

Global loan performance has been assessed on three main aspects:

- A quantitive measure of disbursements vs signed amounts, taking into consideration the effective allocation period.
- On-lending conditions, i.e. interest rates (and/or margins) and duration
- Quality of the final beneficiaries (or projects) financed.

The results can be summarised as follows:

	Good	Satisfactory	Unsat.	Poor
Quantitative assessment	5	6	4	0
On-lending conditions	5	9	1	0
Quality of FB	0	10	4	0
Overall rating	3	8	4	0

In addition (§ 3.4), a comprehensive assessment of the development impacts of the global loans has been developed.

3.1 Amounts disbursed/allocation period

The following table compares the amounts signed with the amounts disbursed in the sample evaluated.

Disbursement rate	Number of contracts		Total amounts as % of signatures		Allocation period
	OR	RC	OR	RC	
100%	2	5	17	40	Extended for OR Normal for RC
90-100%	1	3	31	27	Always extended
50-75%	2	2	44	10	Always extended
0-20%	1	1	8	4	Always extended
Not completed		1		18	Extended
	6	12			

Under the 15 global loans considered, 18 contracts[13] were signed (6 own resources and 12 risk capital). Most loans were the subject of extensions to their initial commitment and disbursement periods, which is considered acceptable given their objective of ensuring that, once granted, the funding provided is fully utilised to finance the targeted sub-sectors. However only 5 loans were fully allocated and disbursed within the initial contractual period (all RC loans) and only two further operations following extensions of the allocation and disbursement periods. This outcome is partly a reflection of the ability of the FIs to manage the GLs (see 2.2 above) but also reflects over-optimism on the part of the EIB, and possibly FIs, in determining the amounts of the operations in relation to demand at the time of appraisal. This sample confirms the observation made in § 1.4, on the high level cancellation of OR global loans. Due to their structure the Apex loans might have ensured that the take up of more active FIs compensated for those included but less committed. Nevertheless, against expectation, individual GLs have tended to perform better than

[13] Three GL operations included OR and RC, each requiring separate finance contracts.

Apex loans. On the other hand smaller GLs have outperformed larger ones confirming that it is easier to tailor the loan amount to absorptive capacity for smaller GLs.

In order to improve the disbursement rate on both individual and Apex GLs, the introduction of appraisal fees and commitment fees might be considered.

OR and CR GLs for on-lending activity

A number of specific reasons were identified for the sub-optimal utilisation of GLs. In three instances these stemmed from exogenous factors which impacted the economy as a whole during the implementation of the GL, none of which could have been anticipated at the time of appraisal. In one country, the RC loan denominated in local currency "competed" with the OR loan offered in foreign currency with no foreign exchange risk cover foreseen, which was consequently not utilised. Efforts to improve utilisation of one regional GL by allowing the FI to grant credit lines to local banks did not produce the hoped for results, and it was furthermore ascertained during the evaluation that part of the funds disbursed were not fully utilised - although the EIB had not been previously informed of this situation. Under one ApexGL about EUR 1.6 m (representing 20% of loan amount) were disbursed to the Central Bank but were not on-lent to FIs and only repaid to the EIB with a substantial time lag. This is mainly due to the tranche method of disbursement, as well as the fact that the Bank's Finance Contract did not foresee a time limit for the re-employment of the funds.

As mentioned in 1.4 above, the specific objective of most Global Loans was the financing of SMEs in the private sector, mainly in the industrial, agro-industrial and tourism sectors[14]. Whilst there is no generally accepted definition of SMEs for the ACP region, in terms of size most allocations appear to have complied with this objective. Commercial banks have tended to target medium to larger borrowers within their market, as they represent a lower credit risk and are less costly to manage. However, the maximum ceiling for sub-loans was usually respected. When financing of smaller projects is an objective the inclusion of sub-limits might be considered to ensure that part of the loan reaches smaller sub-borrowers, who often have the greatest difficulty in accessing credit. This option was successfully employed in two of the GLs in the sample.

RC loans for equity and quasi equity investments

A number of GLs on risk capital resources had a provision that part of the credit could be used for equity and quasi equity investments but in only one instance was this used. This outcome suggests that, in future, RC operations with this specific objective should be channelled through specialised institutions or VC companies to be effective.

The two risk capital loans that specifically targeted equity and quasi-equity investments in tandem with OR produced very different results (one fully disbursed - the second only 20% disbursed). The difference can be explained by the experience of the two FIs with this type of instrument– for one FI this was the second RC operation of this type, whilst for the second, it became apparent during the evaluation that the FI had little experience or appetite for making equity and quasi-equity investments - therefore the operation was handicapped from the outset.

Finally, the regional facility, which had the specific objective of financing equity and quasi equity investments through development agencies of EU member countries, failed to meet its objective of allocating most of the amounts to direct investments. Of the 13 allocations made, only 3 went to finance direct investments (representing only 3% of the funds disbursed through this facility) whilst 4 allocations were investments in the financial sector and 6 were venture capital funds (75% of the facility; these amounts are not fully disbursed or fully allocated by the funds).

3.2 On-lending conditions

The following table provides a summary of the ratings given to the on-lending conditions for each GL operation (interest rate margins and durations) as further analysed in the following sections (3.2.1 and 3.2.2 below)

[14] One regional GL also included mining and small infrastructures as eligible sectors

Ratings	Good	Satisfactory	Unsat.	Poor
Interest Margins				
Development Banks	0	6	0	0
Commercial Banks	4	3	1	0
Durations				
Development Banks	3	3	0	0
Commercial Banks	3	5	0	0

(One regional facility not rated)

3.2.1 Interest rates

As mentioned in 1.2 and 1.4 above during the reference period for this evaluation it has been general EIB policy to ensure that interest rates on its GL operations do not introduce distortions in the local financial market. In the case of OR loans for which an interest rate subsidy was foreseen under the Convention, this has usually led to the "stripping out" of the interest subsidy at the FI level so that the on-lending rate to the FB is commercially based. For risk capital operations a more complex build up of the interest rates have been used in order to arrive at a market rate compatible with local market conditions[15].

Different approaches were used for the utilisation of the interest margins:

- Set up a training programme (5 cases)
- Create a fund for forex risk cover (4 cases)
- Specific action directed to institutional development (2 cases)
- Provision of technical assistance (1 case)

The evaluation has found that the EIB has gone to considerable efforts to meet the past EIB policy objective of "non-distortion" and to adapt on-lending conditions accordingly. In four cases this was rated as good and in the remainder satisfactory with one being judged unsatisfactory. However it was noted during the evaluation that their monitoring was difficult and the question arises, particularly when the subsidy was allocated for TA or training, whether such funding which is derived from a cash flow received over the life of the loan can be effectively earmarked for such purposes. A better approach would appear to be to clearly separate the grant and credit components of the GL as distinct components in the loan package.

3.2.2 Duration

OR and RC Credit lines
The duration of the Global Loans for credit lines in the sample mainly ranged from 10 to 15 years, with grace periods on repayment of 3-4 years. In most cases the minimum duration for sub-loans was specified in the legal documents, which was usually 5 years. In most cases the minimum duration was reflected in the on-lending agreements with the FBs. An exception was noticed in an Apex GL under which one of the participating FIs mainly lent for 3 year terms claiming that this

[15] This general policy of avoiding the introduction of market distortions contrasts with the more recent policy discussion within the Bank that mainly relates to EIB global loan operations within the EU, and that stipulates that the financial value added intermediary banks may gain from relatively cheap EIB funding should be passed on to the final beneficiaries. The counter – argument for this in ACP countries (being mostly imperfect financial markets) is that it may be more appropriate to pass on the benefit at the FI level rather than privilege those FBs who borrow under the GL for whom in many cases, the principal benefit is access to term finance rather than the cost of that finance.

reflected local market conditions for term finance. No difference was observed between OR and RC GLs in respect of the durations granted.

The implication of this finding of the evaluation is that most FIs had the opportunity to roll over credits when the sub-loans are repaid. Whilst the EIB finance contract usually stipulates that redeployment of funds should continue to benefit the sub-sectors targeted by the GL there is no provision for ex-post verification that this has in fact taken place.

On the other hand, as shown in the “base case” study carried out during the evaluation of one GL granted to a DB, the shorter durations of sub-loans relative to repayments on the EIB GL clearly provide positive cash flows to the FI, at least during the early life of the loan. It could be demonstrated that the longer duration of the Bank’s loan has helped this FI to leverage the benefits of the terms provided, mainly allowing it to increase its volume of lending by 10% per annum and, as a development bank, its market closely corresponds to the sectors targeted by the GL.

In other GLs there was no evidence that the longer duration of the EIB loan has triggered longer duration of sub loans. Differences in duration could be reduced in the future; in any case, following full disbursement of the loan, the Bank could require a statement from the FI that it is continuing to develop its term lending in the sector(s) targeted by the GL which would provide a proxy assurance that funds rolled over will continue to support the sector objectives of the GL.

RC for equity and quasi equity investments

The duration of risk capital operations to finance equity and quasi-equity depends on the decisions taken by the FI regarding the exiting of investments financed. The finance contract stipulates a final date by which the FI will repay any outstanding loan amount.

3.3 Quality of final beneficiaries/projects financed

OR and RC credit lines

As has been pointed out in previous evaluations of Global Loans, the Bank has very little ex-post information on the quality of sub-projects financed. The EIB does not always require FIs to send regular reports on sub-projects financed or information on the ex-post results of sub-projects when completed. The Reports on Allocation contain information that is largely based on the ex-ante information contained in the allocation fiche at the time of approval.

For the sample of GLs selected for this evaluation, ex-post information on sub-project quality was available for those for which visits were made to sub-projects during the evaluation.

The following table summaries the number of allocations approved under the GLs, the number of sub-projects visited (15% of the allocations financed), and the overall rating given based on the quality of the sub-projects financed under the GL (where this information was available).

Region	Number of GLs	Number of allocations disbursed	Number of projects visited	GL rating	
				Sat	Unsat
Caribbean & Pacific	5	89	11	2	3
West & Central Africa	3	67	12	3	
East Africa	2	79	8	1	1
Southern Africa	4	52	14	4	
Regional	1	13		N/A	
	15	300	45	10	4

Of the sub-projects visited during the evaluation only 8% were facing difficulties at the time of the mission. No sub-projects visited were found to have problems relating to environmental impacts.

During the discussions with the FIs additional information was collected on problem loans in the EIB financed portfolios, which in most instances had not been communicated to the Bank. This information is particularly relevant when the Bank (or the IF) is at risk on an allocation-by-allocation basis, and should be regularly provided by the FI to the Bank.

From this sample and analysis of the EIB financed portfolio, the finding of the evaluation was that the credit quality of the sub-loans granted was generally similar to that of the total loan portfolio of the FIs concerned.

There are two exceptions to this general observation. The first exception is a regional GL, where non-performing sub-loans represent 36% of the EIB portfolio, against 22% for the FI as a whole. This situation was predicated by one major problem loan, which also happened to be the largest sub-project financed under the EIB GL. In another GL, the non-performing sub-loans represented 25% of the EIB financed portfolio, whereas its level of NPL loans to total portfolio was 56% at end 2004.

The overall result suggests that the screening of allocations by EIB has not resulted in most cases in better credit quality than that achieved by the FI overall. On the other hand, it may also be taken to suggest that expected credit quality is not a criterion for deciding which projects to propose for EIB refinancing.

In one instance, the evaluation ascertained that the FI had used a sizeable (53%) proportion of the Own Resources for the financing of credit lines to local banks. This was not initially envisaged at the time of appraisal, although approval was subsequently given at management level. The EIB received no information on the sub-projects financed under these operations, two of which were later prepaid. In this case it is impossible to form an opinion on the credit quality of the sub-projects financed other than in one case where it was ascertained during the evaluation that the local credit line had been fully allocated to a project currently in receivership.

These findings point to the necessity for the Bank to enforce more systematic reporting requirements on sub-loans following full disbursement of the GL.

Although the economic environments in which the sub-projects operate vary significantly, it can be observed that most sub-Saharan countries, with one exception, are moving towards becoming competitive and market driven. In the Caribbean region the transition process is much further advanced. Thus, overall, the credit quality of the sub-loans may be considered to be a reasonable proxy for project quality. This finding was confirmed by the in-depth evaluations. In most instances the problems facing non-performing sub-loans were management-related, in particular due to cost overruns or delays in implementation.

RC for equity and quasi equity finance

For risk capital operations to finance equity and quasi equity contributions the findings were similar. In other words the lack of profitability of the investment, and hence failure to produce a return for the Bank, was linked to project quality. Excluding a regional facility (see below) 14 operations were financed in the Caribbean region and one in the Pacific region. Of the three operations facing difficulties at the time of the evaluation, one was visited. In each case RC allocation had been made in tandem with an OR allocation. The two projects facing difficulty in the Caribbean region were in the tourism sector and the one in the Pacific in the fisheries sector.

Of the 7 direct investments financed under a regional risk capital operation, one was cancelled following default of the promoter and two have been sold. There was insufficient information available to be able to assess the quality of the remaining operations. 75% of the Facility was allocated for investments in Venture Capital Funds (VCF), of which only 38% has been disbursed. An analysis of investments funded by the VCFs was not part of this evaluation.

3.4 Development impacts

This evaluation has also sought to evaluate the development impact of each GL. In accordance with evaluation best practice, the development impact of credit lines has been assessed at five levels -macro-economic, financial sector development, institutional development of the FI, sub-sector development and at the FB level. However we make the observation that it is one of the principles of evaluation that it is difficult to achieve or measure ex-post objectives that are not set ex-ante and up until now the Bank has not included development impact indicators as a measure for GL performance.

At the macro-economic level the GLs have increased medium and long -term capital flows in to the country thereby contributing to some strengthening of local financial markets and to private sector development. At this level the development impact of the GLs is considered satisfactory albeit marginal in relation to overall FDI flows in to the countries concerned.

At the financial sector level contributions have been made to the broadening and deepening of the financial sector through enhancement of financial intermediation, funds mobilisation through the multiplier effect and, to a limited extent, encouraging the use of risk capital for equity and quasi-equity investments. Within some Apex loans there is evidence that the availability of EIB funding has encouraged commercial banks to extend loan durations. However, unlike some other IFIs, the Bank has eschewed the possibility of attaching conditionalities to its GLs which might have enhanced the regulatory environment in the financial sectors concerned.

At the FI level the impact has been through the availability of additional long-term resources and risk capital for equity and quasi equity operations. This impact is considered to have been significant for those operations where full utilisation of the available funding has been achieved and this funding has been well distributed across the sectors targeted by the GL. Institutional development has not been a primary objective of the GLs evaluated although more might have been achieved in certain cases through closer monitoring of the use of the Special Funds financed from the interest subsidies when these were intended for training or other types of institutional support.

At the sub-sector level the GLs have mainly targeted the industrial, agro-industrial, tourism and service sectors. From the information available, the GLs will have contributed directly to the creation or safeguarding of more than 7150 jobs. This figure is probably conservative since, as previously mentioned, it does not include additional direct employment creation when the proceeds of sub-loans prepaid or repaid are re-lent for further projects in the targeted sectors. Nor does it take account of indirect employment creation/safeguarding which take a number of forms – for example in agriculture through the increased production of inputs for agro-industrial projects, or in tourism through the local production of fittings and fixtures, uniforms for staff, consumables, and the provision of services (drivers, guides or diving and fishing boats (to name but a few). For industrial projects these may include both the production of local inputs and services such as catering which may develop around clusters of manufacturing units.

In terms of environmental protection most FIs adhere to appropriate guidelines which are integrated in their appraisal processes. The findings of the field missions suggest that these have been applied in the case of all the sub-projects which were visited by the evaluation team.

At the level of individual FBs, the evaluation has found that, with some exceptions many have positioned themselves well in their respective market segments and have been able to take advantage of an improved economic outlook to expand successfully in the past four years. Through the investments financed, companies have acquired new technologies, increased export earnings and through corporate taxes contributed to an increase in tax revenues for the Government. Several companies interviewed were currently considering further expansion and /or diversification. A dynamic and diverse private SME sector is essential for a more balanced growth of the economy.

In order to be able to measure the development impacts of future GL operations, it is recommended that development indicators are defined ex-ante at the inception phase and included in reporting requirements from the FI. Depending on the objectives of the GL, these might include direct and indirect employment created/safe guarded, number of jobs created for women, use of local inputs, skills and technology transfers, increased enterprise competitiveness, generation of foreign currency earnings (exports) and contribution to increased government revenues (taxes).

Taking all the above factors into consideration the overall development impact of the ACP GLs has been assessed as being of significance.

4 EIB financial and non-financial contribution

4.1 Financial value added for FIs and FBs

In evaluating the financial value added of the GLs the distinction must be drawn between loans on Own Resources, loans on Risk Capital resources for on-lending and loans on Risk Capital resources for equity and quasi equity investments. However a common factor for each type of operation is the value added of the long tenors that all the EIB GLs offer which are available to only a limited extent or not at all in the local financial markets.

Using a scale: high – significant – medium – low, the evaluation rated the financial value added for FIs and FBs as follows (comparing interest rates paid by FI/FB with their alternative cost of funding but not considering other factors such as foreign exchange risk). The ratings are summarised in the following table.

	High	Significant	Medium	Low
FI	5	7	3	0
FB	4	9	1	1

4.1.1 GLs on own resources

When the interest rate subsidy was taken out, FIs received funds at close to EIB standard lending rates which nevertheless are attractive to FI borrowers in countries with lower grade investment ratings and thus provides a further significant value added to the loan tenors offered. By definition own resource loans were deployed in the stronger ACP economies where the risk of substantial exchange rate movements was lower. However the offer of a foreign currency denominated facility in one country, with no exchange risk cover scheme proposed, proved to be of little interest to FIs that could also access a GL in local currency financed from risk capital resources.

A further value added is provided by the characteristic of the strategic framework under which EIB operates. Since the Conventions are renewed regularly, longer-term relations have developed between the EIB and certain FIs which have consistently performed well as demonstrated by the number of repeater operations in the sample.

4.1.2 GLs on risk capital resources for on-lending

The added value of relationship continuity was also evidenced in RC operations such as those in two small economies. Furthermore the flexibility of the risk capital instrument enables the Bank to lend in local currency and on-lending rates to be aligned to local market conditions to the extent that a long-term market exists. In many countries the Bank and other donors are effectively creating that market since long-term resources in local currency have not been available domestically. This provides financial value added in itself, but there is a risk of creating donor dependency especially among DBs. Only a few cases were found where the EIB GL encouraged the FIs to expand their own portfolios by developing more long-term products themselves. Further financial value added also came in other forms. For example, in one country the Government agreed that sub-loans would not be counted against the credit ceiling imposed by the Central Bank. On the other hand there was little evidence to indicate that the Apex structure increased competition between FIs as is sometimes claimed.

4.1.3 GLs on risk capital resources for equity and quasi equity investments

The sample only included one successful risk capital loan for equity and quasi equity participations. The value added for this FI was found to be again in terms of the flexibility of the instrument (the EIB agreed with retroactive effect to change the terms and remuneration of previous operations to match a more market oriented approach developed subsequently). However despite the opportunities the risk capital instrument offers to FIs to diversify their financial products, the low take up of risk capital available for this purpose under other GLs suggests a need for a more hands on approach through TA in order to assist FIs in the development and marketing of this product or to only channel such operations to specialised FIs with a previous track record.

4.1.4 Direct and indirect equity participations in FIs

There was only one instance of a direct equity participation in the sample. The presence of the Bank as an institutional investor was considered by the FI to have added considerable value to EIB's ongoing support through GL operations, although the Bank has not been an active member of the Board[16]. Over time, this investment has furthermore proved to be quite profitable for the Bank. This type of value added would be enhanced if the Bank were to become an active member of the Board of this FI, or indeed under future operations of this nature. In one instance the Bank had financed an increase in the Government's shareholding in the DB under a previous GL. However in this case there was no value added since the Government had allowed the DB to expand its lending into a new sector (residential housing) with adverse consequences for the sustainability of this FI.

4.1.5 To the final beneficiaries

For the final beneficiaries the GLs value added was through increased access to longer-term finance in the form of loans and, to a limited extent, equity and mezzanine finance. With one possible exception, it is unlikely that FBs received loans at below market rates where a true market can be said to exist. Although a standard Bank requirement, and one which is sometimes, but not systematically, included in the finance contract or side letter, few FB's are informed or aware of the use of EIB funding for their loans, which in turn gives the right of visit to the Bank (or Court of Auditors). The experience of this evaluation was that the absence of such a contractual undertaking was not an obstacle to site visits taking place. However since it remains an institutional requirement to enable visits by the Court of Auditors, the contractual undertaking should not only be maintained, but compliance enforced.

The overall slightly lower ratings for value added to FBs is also a factor of the lack of information on the outcome of sub-projects and the arms length relationship between the Bank and FBs. For one GL the value added to FBs was rated low. This reflected the previously mentioned allocations for credit lines to local banks where little information is available to determine their value added to FBs.

4.2 Other Contribution

Institutional development was not a primary objective of the GLs, however four finance contracts included provisions for TA. One GL included a EUR 200,000 capacity building component to cover for staff training and the purchase of computers. This was considered to have been of some benefit to the FI but was, as previously mentioned, of little relevance to addressing the underlying problems within the bank. Another GL included as a condition TA to be financed from grant resources, which was implemented and was found to have made a positive contribution to development of this FI.

[16] Instead the EIB has the right to designate a Board member to represent its interests.

An Apex GL required the establishment of a PMU to screen allocations prior to submission to the EIB, and to carry out monitoring and reporting functions. This was found to have been successful and might have been usefully replicated in other Apex operations.

Five GLs had provisions for part of the interest subsidy to be utilised for training purposes. The evaluation found that the objectives set for such utilisation were insufficiently focused and, because of lack of reporting/ monitoring, there was little awareness inside the Bank as to how effectively the funds had been utilised.

On the other hand, four development banks specifically mentioned during the evaluation benefits resulting from their inter-action with EIB operational and technical staff, both during appraisal and implementation of the GLs. Acknowledgement was also made to increasing awareness within the FI of the importance of ensuring compliance with environmental standards and to the higher risks for import substitution projects in economies where large distortions in pricing of inputs remain. Commercial banks participating in Apex GLs tended to attach greater importance to the impact that accreditation by EIB might have on their ability to borrow from other commercial or official sources of funding.

5 EIB Management of the Project Cycle

5.1 Identification and selection

The identification and selection of the FIs is a relatively straightforward process in the ACP region due to the often limited number of suitably experienced FIs in the domestic financial market. Nine of the GLs in the sample were repeater operations and therefore selection of the FIs was based on the past performance. In the case of Apex loans where, after initial screening, additional FIs were included who had expressed interest in being considered for participation in the new operation. However, as previously noted, this has not always led to broader take up by participating FIs. There has been a shift in focus from the traditional state-owned development bank towards commercial banks, except where the former have been reformed and partially or wholly privatised.

5.2 Appraisal

Ratings	Good	Satisfactory	Unsatisfactory	Poor
Development Banks	3	2	1	0
Commercial Banks	3	5	0	0
Regional	1	0	0	0

As shown in the above table, the EIB two stage appraisal process has, with one exception, generally worked effectively for the GLs covered by the Evaluation. The issues requiring special attention during appraisal were clearly identified in the Proposal to Appraise, and appraisal missions were well prepared even if the time usually allowed for such missions is shorter than is the case for other MDBs. Consequently the main strength of the EIB appraisal process, as perceived by many FI clients, is the capacity to complete the appraisal cycle quickly by comparison to other MDBs, despite the complications that are often involved in the setting up of a GL. However the downside of this approach is that less attention is given to macro-economic and sector issues. The unsatisfactory ratings were given for a GL where it was considered that ongoing management and organisational issues were insufficiently addressed during the Bank's appraisal. Although these weaknesses were identified during appraisal and technical assistance was included, this should have been of greater scope and the Board Report should have set out more precisely what was required to support the major improvements needed to improve the operating performance of this DB (backed up by conditionalities in the finance contract).

While this approach leads to some lack of depth in analysis, the Evaluation found that, with the above-mentioned exception, the Board Reports and Financial Notes provided sufficient information on FIs organisation, management, processes and recent financial performance. The two main shortcomings were however noted: firstly, insufficient analysis of the demand side (needs of targeted sectors) and secondly, in the case of repeater operations, a lack of information on previous operations was observed, in some cases due to the fact that the GL had not been fully allocated at that time.

5.3 Monitoring and follow up

Ratings	Good	Satisfactory	Unsatisfactory	Poor
Development Banks	0	3	2	1
Commercial Banks	1	4	3	0
Regional	0	0	1	0

Under this heading both the allocation of funds under the GLs and subsequent follow up and reporting has been considered. It is worth noting that the one good rating went to an Apex GL, for which, as previously mentioned, the Bank's finance contract provided for the the establishment of a PMU to which screening of allocations and post-disbursement monitoring and reporting were derogated. The unsatisfactory ratings relate to GLs for which information available in the Banks' files was found to be inadequate for proper monitoring of the GL. The poor rating was given to a regional GL where both monitoring of allocations and use of funds disbursed was inadequate.

Under most GLs in the sample the EIB has approved allocations on a case by case basis based on the appraisal report prepared by the FI. Procedures for processing allocations should differentiate between those FIs with weaker appraisal capacity where review of allocations by the Bank can add value and those, mainly commercial banks, where the vetting of allocations can be limited to checking compliance with GL objectives, and the credit decision is fully delegated to the FI.

The Evaluation found that the monitoring and follow-up on GLs was rarely satisfactory. Few FIs provided regular reports on the status of their EIB financed portfolio or of their own financial situation and, although the EIB was entitled to request such information, this right was rarely exercised. The Bank's finance contract usually required the FI to provide its report and accounts annually, but compliance with this requirement was also uneven and the financial situation of borrowing FIs is not regularly reviewed.

Another area in which monitoring and reporting was found to be weak was in the utilisation of the interest subsidy in accordance with the terms of the finance contract, which sometimes themselves lacked clarity and compound the problem (see also 4.2 above). Monitoring of dividends/interest due on equity and quasi-equity operations was also found to have been unsatisfactory. Agreements should avoid the setting of complex formulas, which are difficult, if not impossible, to monitor.

In order to close financially the contract (and ensure full disbursement to the FB), and assess the development impact of GL operations it is recommended that a Report on Allocations, based (as much as possible) on ex-post information provided by the FI should be prepared for all GLs once fully disbursed. For repeater operations this allocation report can be integrated into the appraisal report of the new operation.

5.4 Environmental impact

At the time the GLs were appraised, the EIB approach was that the FI is responsible for checking the environmental impacts of the sub-projects as well as compliance issues, and that the EIB validates the assessment carried out by the FI on the basis of a dossier or a fiche. This approach became more formalised with the introduction of an environmental fiche. During the EIB appraisal, the capability of the FI to carry out environmental due diligence was assessed.

It must be observed that, since the Bank rarely physically monitors sub-projects, there is no ex-post verification that the FI is ensuring application of the Bank's guidelines in this area. The information presented in the project fiche is usually too limited for the Bank to form an independent ex-post view of the adequacy of the systems put in place by the FI to monitor environmental impacts.

The evaluation showed that most FIs had integrated environmental impact verification into their appraisal procedures in response to EIB environmental policy objectives or, in some instances, those of other donors, with only two exceptions. No cases of non-compliance were found in the sample of final beneficiaries visited during the evaluation. The Bank's procedures appear to have a satisfactory outcome.

However, it is recommended that ex-post monitoring of environmental impacts of sub-loans should be reinforced when particular problems are identified at approval.

5.5 Procurement

Except for GLs for the financing of infrastructures, of which there was one (partial) case in the sample, the Bank's rules on procurement in the context of SME financing are rather pragmatic. The Bank's "Guide to procurement", outside the European Union requires FIs to ensure that procurement is carried out following procedures which will ensure the most economically advantageous outcome for the sub-project. FIs subject to the in-depth evaluations were well aware of the risks which could arise from flawed procurement and were fully compliant with the Bank's contractual requirements in this respect.

5.6 Co-operation with other IFIs

5.6.1 European Commission

Coordination between the EIB and the European Commission (mainly DG DEV and AIDCO) operates at two levels: institutional and operational, namely:

- At the general institutional level through discussions concerning the conventions and protocols and their annexes (financial regulations, Member States' guarantees etc.) and horizontal issues such as debt restructuring and structural adjustment issues;
- Institutionally, at the country level, regarding programming, with discussions on the economic situation and joint field missions or discussions on eligibility to mechanisms such as the Heavily Indebted Poor Countries initiative (HIPC);
- Operationally for projects it is at the institutional level quite limited (participation of Commission representatives in the Committee of Member States at the Board, and of the Bank at the EDF Committee).

During appraisal missions where a visit to the EC Delegation is usually foreseen to inform the Delegation of the operation being considered and to obtain intelligence on recent event in the country which may have a bearing on the risk being considered. Copies of Board Reports are also normally sent to the Heads of Delegation for information. Several Delegations visited during the evaluation appreciated the initiatives of Heads of Division and loan officers to maintain regular contact at the operational level although not specifically in relation to GL operations.

5.6.2 World Bank

OpsB staff regularly meet with their World Bank counterparts both at the institutional and operational level:

At the senior management level, the EIB participates at the annual general meeting of the World Bank Group (WB) and takes part in the discussions of the various development groups.
At the country level, the Bank is an active participant at the consultative groups organised by the WB in Paris. During field missions meetings are organised with the WB's country representative offices albeit less systematically than with the EC Delegations.

5.6.3 Other multilateral and bilateral donors

Other principal agencies active in the region include the African Development Bank (AfDB) and European bilaterals - notably Proparco/AFD (France), KfW/DEG (Germany), FMO (Netherlands) and DFID/CDC (United Kingdom). Contacts with bilateral aid agencies appears is also maintained at management level through the Bank's participation in various donor groups, but appears to be less systematic at the operational level.

Regular meetings with the African Development Bank (AfDB) take place at senior management level. Contacts at operational level have been less frequent and have been constrained by the AfDB's decision to close all its regional offices following the 1995 restructuring exercise, and the more recent move of its headquarters from Abidjan to Tunis. However, since 2000, the AfDB has begun to reopen representation offices in its key borrowing countries which should provide opportunities for better co-ordination at staff level in the future. The EIB is also an observer at the annual meetings of the Caribbean Development Bank with which it co-finances projects, as it does with the Inter-American Development bank in the Caribbean and the Asian Development Bank in the Pacific.

The Bank’s recent decision to open regional representation offices in ACP countries will undoubtedly enhance cooperation with other donors going forward with implementation of the Cotonou Agreement. Offices have been opened in Dakar (Senegal) covering West Africa, Nairobi (Kenya) covering East and Central Africa and Pretoria (RSA) covering Southern Africa. Further regional offices in the Caribbean and Pacific regions will be opened in due course.

Appendix 1

Mechanism and structuring of Global Loans

The structure driving the GL mechanism is quite straightforward. A finance contract is signed between the EIB and a selected financial intermediary (FI), or a number of FIs under an Apex loan. The EIB agrees to lend a "global" amount to the FI on certain terms and conditions and the FI agrees to repay the loan, having made sub-loans up to that global ceiling to final beneficiaries (FB) to finance their capital investments which meet the eligibility criteria agreed for the operation and represent an acceptable credit risk for the FI. Under finance contracts for Global Loans the FI undertakes:

- operational responsibility for the identification, appraisal, approval and monitoring of sub-projects meeting the objectives of the GL;
- full credit risk subject to the FB complying with its normal security requirements (although this risk may be shared between the FI and the EIB for GLs from risk capital);
- to inform the FB that part of its sub-loan has been funded using EIB finance,
- to report regularly to the Bank on the use of funds and implementation of the sub-projects; and
- to repay the Bank's loan in accordance with the terms of the loan agreement.

Since the early nineties the Bank has had a policy of non-distortion of local financial markets. However the Lomé Convention provided for final interest rates charged to borrowers to be administratively determined as follows:

- Loans from own resources bear an interest rate of at least 3% but not more than 6% - an adjustable subsidy of up to 4% is available from the grant element of the Lomé Convention (EDF funds) to pay for the subsidy.

- Loans from risk capital (EDF funds) have to bear an interest rate of below 3%. Concerning equity investments from risk capital the EIB is allowed to factor in performance related remuneration that also considers risks and other commercial considerations.

The tenor of the sub-loan will normally be shorter than that of the Bank's loan to the FI in order for cash flow from sub-loan repayments to match repayments due to the Bank. The Bank's loan contract or side-letter usually stipulates a minimum tenor for sub-loans to ensure that the benefits of the longer tenor of the EIB loan is passed on to the FB. Similar conditions apply to credit lines financed from risk capital resources.

The sub-loans proposed for refinancing by the FI are usually subject to approval on a case by case basis and the FI is informed by means of an allocation letter which is a contractual document indicating that a specified amount has been allocated to a given project from the ceiling available under the GL loan. If an allocation is rejected because of non-eligibility or concerns as to the viability of the investment, the FI is also informed. Since funding is generally fungible, this does not necessarily ensure that the FI will not finance the sub-project using other resources available to it. Disbursement takes place, either in tranches, the maximum amounts of which are usually agreed at the time of negotiation of the finance contract, or aggregating individually approved allocations to reach a minimum amount for disbursement established in the finance contract, upon demand by the FI and confirmation that there are no obstacles to disbursement of funds to the FB.

In addition to the above the loan agreement generally includes a number of further undertakings to ensure that EIB funding is properly utilised, namely:

- The FI should ensure that sub-projects financed meet with EIB guidelines on limiting environmental impacts;
- Where applicable, the FI should ensure that the FB complies with EIB procurement rules;
- The FI should inform the FB that the funding has come from the EIB. This may be incorporated in the on-lending contract or the FI may launch a special product; and,
- The EIB has the right of visit to sub-projects financed also accompanied by representatives of the European Court of Auditors.

Appendix 2

EVALUATION CRITERIA

Project performance is assessed using the core evaluation criteria as defined by the Evaluation Cooperation Group (ECG), which brings together the operations evaluation units of the multilateral development banks (World Bank group, regional development banks, and EIB), in line with the work of the OECD- DAC Working Party on Aid Evaluation, and adapted to meet the particular operating needs of the EIB. Evaluations take due account of the analytical criteria used in the ex-ante project appraisal and the strategy, policies and procedures that relate to the operations evaluated. Changes in EIB policies or procedures following project appraisal, which are relevant to the assessment of the project, will also be taken into account.

- Relevance is the extent to which the objectives of a project are consistent with the relevant EU policies (the Treaty, Directives, Council Decisions, Mandates, etc.) and the decisions of the EIB Governors, as well as the beneficiaries' requirements, country needs, global priorities and partners' policies. In the EU, reference is made to the relevant EU policies in the context of the Article 267 of the Treaty that defines the mission of the Bank and the EIB related policies. Outside the Union, the main reference are the Community's relevant external policy objectives considered in the specific mandates given to the EIB by the Council of the European Union and the EIB interpretation of them.

- Efficacy (or effectiveness) relates to the extent to which the objectives of the project have been achieved, or are expected to be achieved, taking into account their relative importance, while recognizing any change introduced in the project since loan approval.

- Efficiency is the measure to which project benefits/outputs are commensurate with resources/inputs. For the ex-ante appraisal, a project's efficiency is normally measured through the economic and financial rate of returns. In public sector projects the economic and financial rate of returns often are not calculated ex-ante. In those cases the efficiency of the project is estimated by a cost effectiveness analysis.

- Sustainability relates to the likelihood of continued long-term benefits and the resilience to risk over the intended useful project life. The assessment of the project's sustainability varies substantially from one case to another depending on circumstances and takes into account the issues identified in the ex-ante due-diligence carried out by the Bank. Among the issues reviewed in the assessment are:

- Technical and management issues, mainly willingness, capacity and funding to carry out the necessary maintenance of the project in order that it can reach its useful life;
- Government commitment, regulatory environment and socio-political support (this is particularly important in weak institutional context such as in some developing countries);
- Financial sustainability for revenue generating projects, whether there is a significant risk that those revenues become unacceptably low, e.g. that they cannot cover at least the operating and maintenance costs;
- Environmental sustainability, whether there are environmental risks that might be a significant threat to the future operation of the project.
- Others issues that might affect the continued long-term benefits during the useful project life.

EUROPEAN INVESTMENT BANK
OPERATIONS EVALUATION (EV)

In 1995, Operations Evaluation (EV) was established with the aim of undertaking ex-post evaluations both inside and outside the Union.

Within EV, evaluation is carried out according to established international practice, and takes account of the generally accepted criteria of relevance, efficacy, efficiency and sustainability. EV makes recommendations based on its findings from ex-post evaluation. The lessons learned should improve operational performance, accountability and transparency.

Each evaluation involves an in-depth evaluation of selected investments, the findings of which are then summarized in a synthesis report.

The following thematic ex-post evaluations are published on the EIB Website :

1. Performance of a Sample of Nine Sewage Treatment Plants in European Union Member Countries (1996 - available in English, French and German)
2. Evaluation of 10 Operations in the Telecommunications Sector in EU Member States (1998 - available in English, French and German)
3. Contribution of Large Rail and Road Infrastructure to Regional Development (1998 - available in English, French and German)
4. Evaluation of Industrial Projects Financed by the European Investment Bank under the Objective of Regional Development (1998 - available in English, French and German)
5. An Evaluation Study of 17 Water Projects located around the Mediterranean (1999 - available in English, French, German, Italian and Spanish).
6. The impact of EIB Borrowing Operations on the Integration of New Capital Markets. (1999 – available in English, French and German).
7. EIB Contribution to Regional Development A synthesis report on the regional development impact of EIB funding on 17 projects in Portugal and Italy (2001 – available in English (original version), French, German, Italian and Portuguese (translations from the original version)).
8. Evaluation of the risk capital operations carried out by the EIB in four ACP countries 1989-1999 (2001 - available in English (original version), French and German (translations from the original version)).
9. EIB financing of energy projects in the European Union and Central and Eastern Europe (2001- available in English (original version), French and German (translations from the original version))
10. Review of the Current Portfolio Approach for SME Global Loans (2002 – available in English (original version), French and German (translations from the original version)).
11. EIB Financing of Solid Waste Management Projects (2002 – available in English (original version), French and German (translations from the original version)).
12. Evaluation of the impact of EIB financing on Regional Development in Greece (2003 – available in English (original version) and French (translation from the original version)).

13. Evaluation of Transport Projects in Central and Eastern Europe (2003 – available in English (original version).
14. EIB Financing of Urban Development Projects in the EU (2003 – available in English (original version), French and German (translations from the original version)).
15. Evaluation of the Projects Financed by the EIB under the Asia and Latin America Mandates (2004 – available in English (original version), French, German and Spanish).
16. Evaluation of EIB Financing of Airlines (2004 – available in English (original version) French and German)
17. Evaluation of EIB Financing of Air Infrastructure (2005 - available in English (original version))
18. EIB financing with own resources through global loans under Mediterranean mandates (2005 - available in English (original version) German and French.)
19. Evaluation of EIB Financing of Railway Projects in the European Union (2005 - available in English (original version) and French.)
20. Evaluation of PPP projects financed by the EIB (2005 - available in English (original version).
21. Evaluation of SME Global Loans in the Enlarged Union (2005 - available in English (original version) and German.)
22. EIB financing with own resources through individual loans under Mediterranean mandates (2005 - available in English (original version) and German.)
23. Evaluation of EIB financing through individual loans under the Lomé IV Convention (2006 - available in English (original version) and French)
24. Evaluation of EIB financing through global loans under the Lomé IV Convention (2006 - available in English)

These reports are available from: EIB website: http://www.eib.org/publications/eval/.
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