



EIB Group Risk
Enhancement
Mandate

**Evaluation of the
Cooperative Banks
and Smaller
Institutions
Instrument**

September 2020

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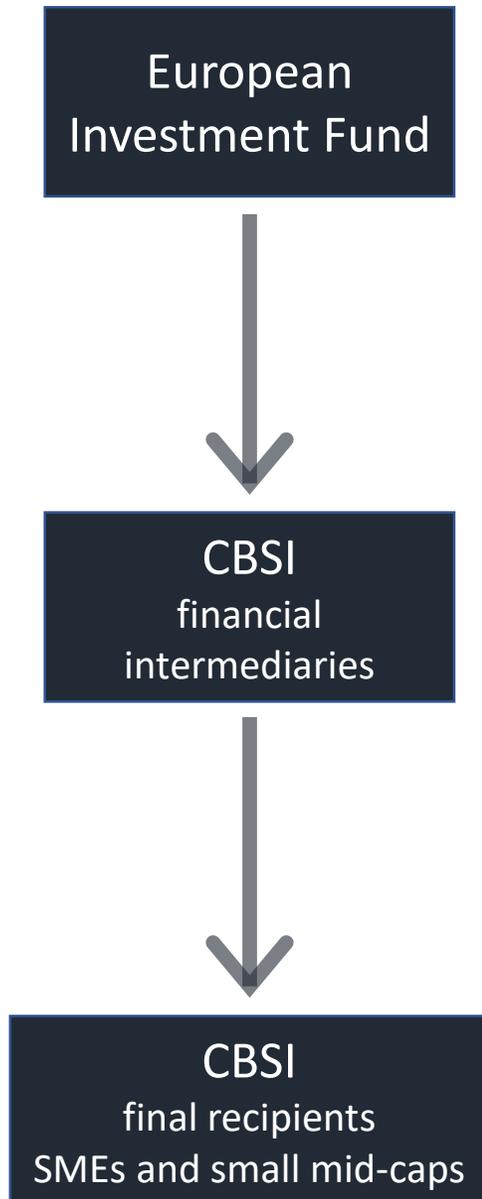
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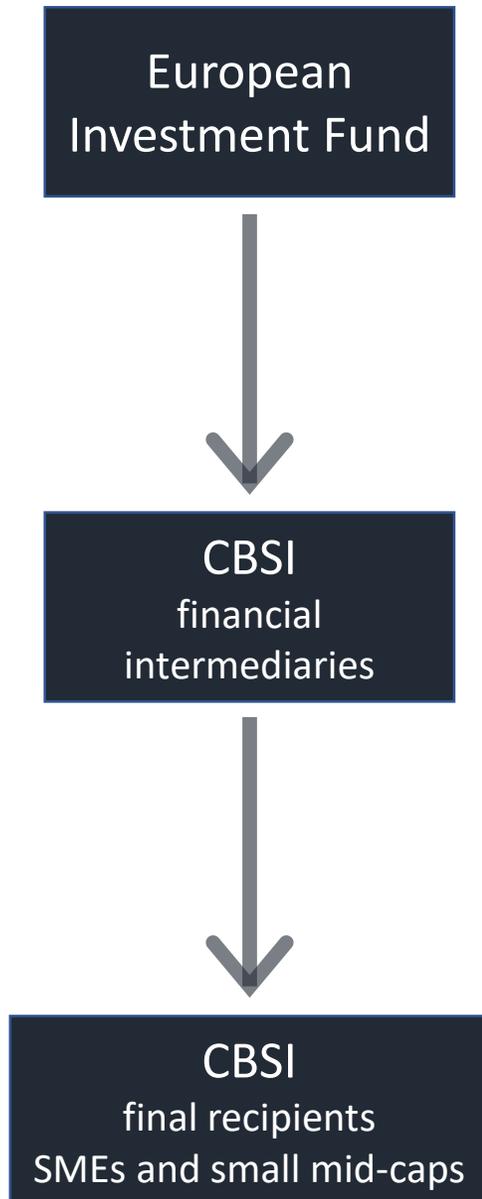
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Introduction



- This document examines the design, implementation and achievements of the Cooperative Banks and Smaller Institutions (CBSI) Instrument.
- The CBSI Instrument was one of six products implemented as part of the EIB Group Risk Enhancement Mandate (EREM). EREM was implemented as a mandate from the European Investment Bank (EIB) to the European Investment Fund (EIF) over the period 2014-2018.
- EREM was approved by the EIB and EIF Boards in December 2013 in response to the European Council's call in June 2013 to mobilise European resources – including those of the EIB Group – to support small and medium enterprises (SMEs) and to get money flowing into the real economy.
- The macroeconomic context at the time was characterised by uncertainty, falling investment levels, worsening labour market conditions and declining volume of credit to non-financial corporations. Against this backdrop, the objectives of EREM were to increase access to finance for European SMEs and small mid-caps, and to support the development of financial markets.
- The CBSI Instrument Agreement was signed in October 2016. The instrument comprised a series of senior unsecured amortising loans provided by the EIF to intermediary cooperative banks and smaller institutions located across the European Union. These intermediaries provided loans and/or leases to eligible SMEs and small mid-caps.

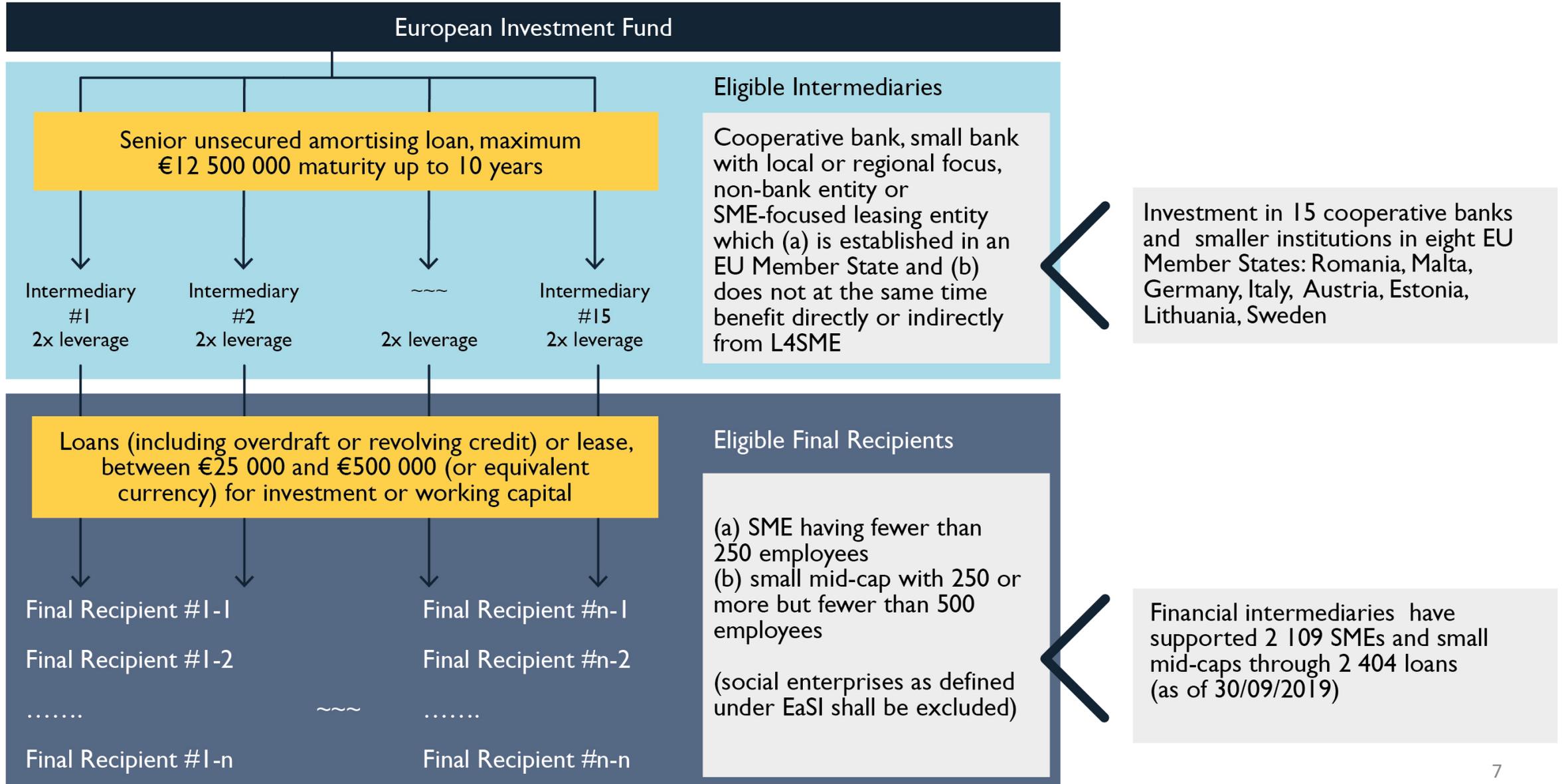


- The main objective of the CBSI Instrument was to “... contribute to widening the availability of small bank and non-bank financing for SMEs and small mid-caps, beyond traditional bank financing”. Furthermore, the product was expected to contribute to broadening the range of financial intermediaries through which the EIB Group provides financing to SMEs and small mid-caps.
- The CBSI Instrument was intended to complement other EIB Group programmes, the EU programme for Employment and Social Innovation (EaSI) and the Loan for SMEs programme (L4SME), targeted at the same or similar final recipients.
- It was initially allocated a budget of €280 million for the first period of EREM (2014-16). Following re-allocations, the budget was eventually reduced to €195 million.
- As of 31 December 2018, the EIF had signed contracts with 16 financial intermediaries (15 after one contract cancellation) in eight EU Member States. Loans provided to financial intermediaries ranged from €3 million to €12.5 million, with maturities ranging between five and ten years.
- On the back of the EIF loan, the assisted financial intermediaries were expected to increase the volume of their lending to SMEs and small mid-caps.
- Financing of SMEs and small mid-caps could take the form of loans (including overdrafts and revolving credits) or leases in the range of €25 000 to €500 000.

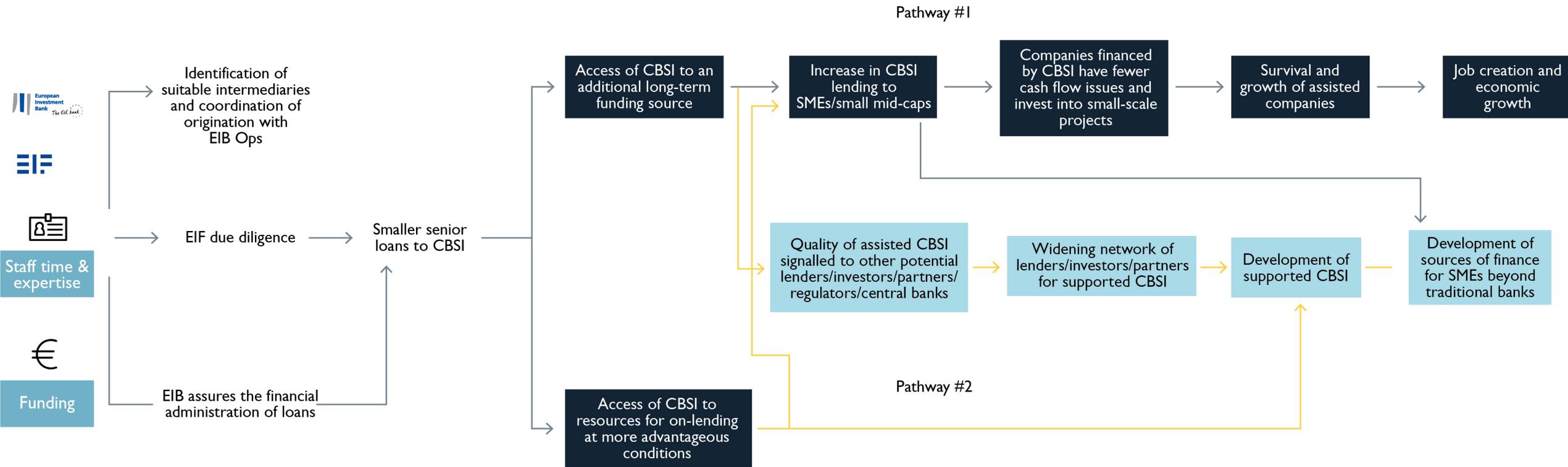
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EIB Group Risk Enhancement Mandate Cooperative Banks and Smaller Institutions Instrument

Overview of CBSI Instrument features



Theory of change for the CBSI Instrument



Assumptions behind the pathways are explained in the next slides.

Pathway **1** CBSI contributes to increased lending to SMEs and small mid-caps

By providing financial intermediaries with access to a longer-term source of funding, the CBSI Instrument enhances their capacity to lend to SMEs and small mid-caps. The EIF loan is used by the assisted financial intermediary for on-lending to SMEs and small mid-caps, while ensuring a certain leverage effect (x2). In turn, SMEs and small mid-caps use the loan to meet their working capital needs and/or make project investments, which contributes to their sustainability and growth.

KEY ASSUMPTIONS

- a) EIF has the capacity to manage the CBSI Instrument.
- b) In the absence of CBSI loans via EREM, lending to SMEs and small mid-caps by assisted financial intermediaries would have been smaller or more costly.
- c) There is a lack of adequate debt finance for SMEs and small mid-caps.
- d) There is demand for debt by SMEs and small mid-caps from CBSI financial intermediaries.

Pathway **2** CBSI Instrument contributes to developing supported financial intermediaries

EIF loans signal the viability of the assisted financial intermediaries, improving their reputation and how they are perceived within their respective markets and among potential investors. Moreover, the CBSI Instrument contributes to diversifying their funding sources. By providing the financial intermediaries with resources on advantageous terms and conditions, EIF loans also contribute to their profitability.

KEY ASSUMPTIONS

- a) Relationship with the EIF has a signalling effect for other lenders/investors/partners of the financial institutions benefiting from the CBSI Instrument.
- b) EIF loans are provided to financial intermediaries on attractive terms and conditions.

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Methodology

The evaluation is based on multiple sources of evidence



Desk research

- **High-level documents:** EREM Framework Agreement and CBSI Instrument Agreement (including amendment note).
- **Transaction documentation for all 15 CBSI financial intermediaries:** 1) Facility agreement, 2) EIF's request for approval note, 3) EIF's due diligence report, 4) EIF's appraisal authorisation, 5) EIF's credit risk management opinion, 6) results of monitoring reports submitted by the intermediaries to the EIF, and 7) documentation available on the financial intermediaries' websites as well as other publicly available data.



Literature review covering available reports/studies on the role of CBSI in the European Union

- Reports by the EIF market research team
- Reports and statistics produced by the European Association of Cooperative Banks (EACB)
- Academic literature.



Online survey of financial intermediaries

- 14 of the 15 financial intermediaries supported through the CBSI Instrument responded



In-depth case studies of five transactions with CBSI intermediaries

- Case studies were based on a wide range of sources including: (a) documentation relating to the intermediaries, (b) in-depth face-to-face interviews with the intermediaries (at their premises), (c) interviews with the respective EIF relationship managers and (d) survey responses from the respective intermediaries.

Note: For a number of practical reasons (lack of contacts database, language barrier, evaluation schedule, large number of final recipients), the evaluation did not survey the final recipients of CBSI loans. The evaluation, therefore, lacks their perspective on issues such as the relative advantages of CBSI financing over alternative loans and the additionality of the financing received by SMEs and small mid-caps from EREM-backed financial intermediaries.

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Key findings

There was a strong rationale for the CBSI Instrument

CBSI are an important source of financing for SMEs

CBSI have a relatively strong focus on SMEs. They tend to lend proportionally more to SMEs as compared to larger commercial banks. The CBSI business model relies on features particularly well suited to these clients, as it is characterised by strong relationship banking, local embeddedness, relatively dense branch networks and a decentralised nature.

The funding model of CBSI restricts their capacity to lend

For many cooperative banks or smaller institutions, the main funding sources are deposits and/or retained profits. Similarly, for small banks, retail deposits account for a considerably larger share of overall funding than wholesale sources, while the lending capacity of leasing companies is often constrained by their small equity base. Overall, CBSI have limited access to external borrowing and equity raising, which limits their ability to increase or sustain lending, including to SMEs and small mid-caps.

Broadening the range of the EIB Group's options for finance delivery

Financial intermediaries, such as CBSI, offer the EIB Group the opportunity to reach SMEs (particularly smaller ones) and small mid-caps which are underserved by large commercial banks. This is because such financial intermediaries already have an established loan portfolio and local presence in various domestic markets.

Despite a strong rationale, the take-up of the CBSI Instrument was lower than expected



Market interest in the CBSI Instrument was lower than expected, as reflected in the reduced budget for the product (from €280 million to €195 million) and its relatively low absorption rate as compared to other EREM products such as the Loan Funds Instrument and the Social Impact Accelerator. As of 31 December 2018, only 80% (€153 million) of the budget had been committed. However, due to the cancellation of one contract, the final budget commitment was even lower (€143 million).

The following factors constrained the take-up of the instrument:



- **Eligibility criteria:** general eligibility constraints imposed on the financial intermediaries such as (a) minimum credit risk rating assigned by the EIB Group to the financial intermediary, (b) exclusion of financial intermediaries already benefiting from L4SME, and (c) specific risk-related issues raised by the EIB and relating to certain types of potential financial intermediaries (e.g. German leasing entities).
- **Timing of marketing:** the relatively long delay (around 2.5 years post EREM launch) before the CBSI Agreement between the EIB and EIF was signed adversely affected the marketing of the CBSI Instrument, as it created uncertainty over the timing of approval and implementation of the instrument.

The long time to market reduced the relevance of the CBSI Instrument as a tool to disburse funding quickly



- The CBSI Agreement between the EIB and EIF was signed in 10/2016, more than 2.5 years after the EREM was launched. Individual contracts between the EIF and the financial intermediaries were signed between 12/2016 and 03/2018, while disbursements to final recipients began in 01/2017 and are still ongoing (until 11/2020). The CBSI Instrument had the potential to be delivered relatively quickly considering **(a)** the plain vanilla nature of the instrument (i.e. senior unsecured loan) and **(b)** the prior experience of the EIB Group (EIB and EIF) with intermediated lending to SMEs.

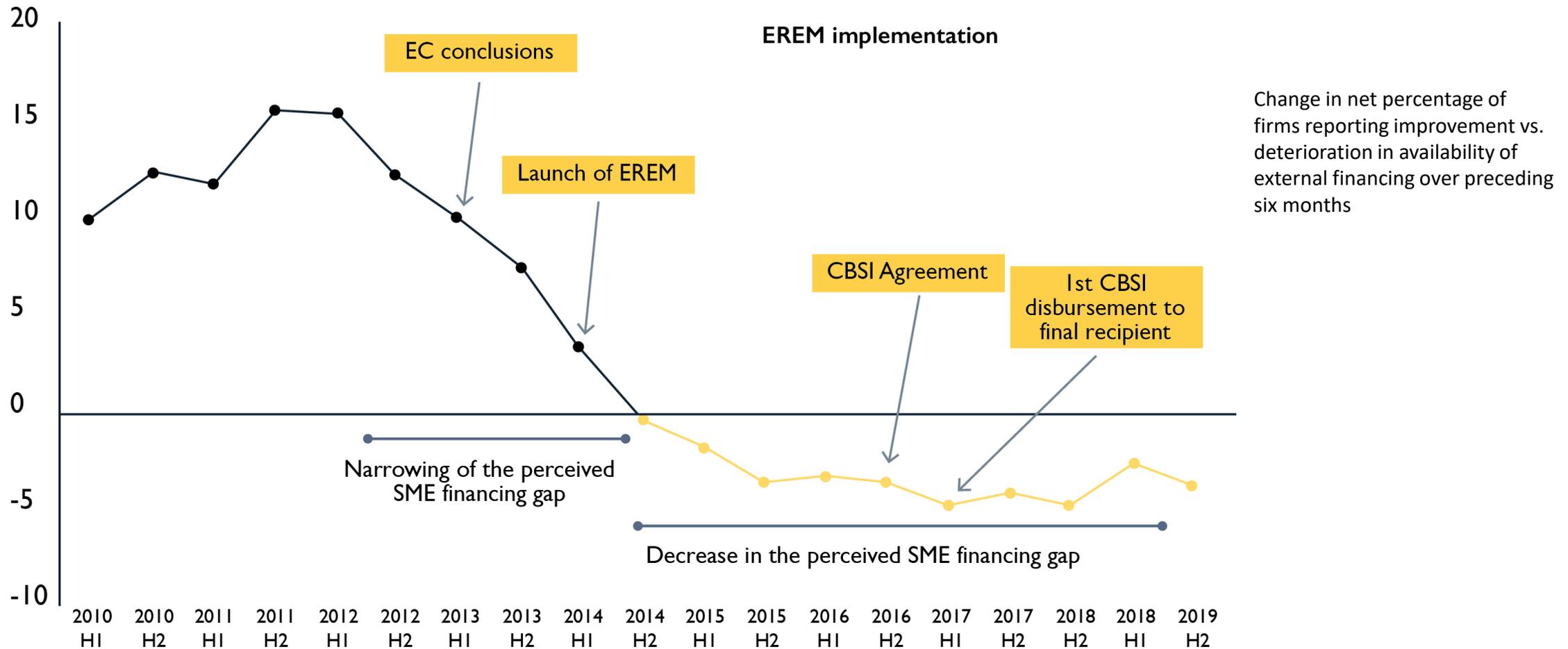


- The delay in signing the CBSI Agreement was caused by:
 - Long discussions between the EIF and EIB around the delivery model to be adopted – partial versus full delegation – and a change in the originally intended approach around midway through the instrument set-up process.
 - Request from the EIB to the EIF to stagger the launch of EREM instruments.



Financing conditions had significantly improved by the time CBSI financing reached the market

Change in the external financing gap perceived by SMEs across euro area countries (Source: ECB SAFE survey)



The CBSI Instrument has increased the availability of finance for SMEs and small mid-caps beyond the amount of EIF loans



The CBSI Instrument is expected to leverage €284.5 million of financing for SMEs and small mid-caps. The prior contractual expectation was that the financial intermediaries would provide additional finance to SMEs and small mid-caps equal to the size of the CBSI loan, resulting in a leverage of x2. However, one financial intermediary was granted a contract amendment reducing its leverage requirement to x1.5. Consequently, the overall leverage effect of the instrument is marginally lower than expected.

The actual financing provided to SMEs and small mid-caps under the CBSI Instrument will be known in November 2020 when the portfolio inclusion period for all financial intermediaries ends.

Contracted and potentially eligible for disbursement

€143m

+

Funding mobilised by financial intermediaries

€141.5m

=

Total available for SMEs and small mid-caps

€284.5m

Leverage x2

Absence of CBSI loans would have affected the lending activities of half the financial intermediaries (FIs)



What would have happened if you had not received the EIF loan? (N=14)

9 FIs	Would have accessed alternative sources of funding, but smaller in size and/or on less favourable terms..	...and SMEs would have been affected (lower lending levels and/or less favourable terms and conditions)	7 FIs
		...but SMEs would not have been affected	2 FIs
5 FIs	Would have accessed alternative financing of similar size on similar terms. Neither the intermediary nor the SMEs would have been affected		

The EIF's presence has a signalling effect



Results of the survey of financial intermediaries show that the EIF's seal of quality was among the main reasons to apply for an EIF loan under the CBSI Instrument.

- Seven out of 14 financial intermediaries stated **reputational benefits** as one of the main reasons for obtaining a loan from the EIF
- Eleven out of 14 financial intermediaries “agree” or “strongly agree” that the EIF's added value “**signalled the organisation's quality to other potential lenders/investors**”



All interviewed CBSI intermediaries stated that the expected reputational benefits of the EIF loan had materialised, providing anecdotal evidence of how the EIF's presence had helped them in discussions with regulators, credit rating agencies and bond investors.

One intermediary explained that the first thing a potential investor looks at is “who else is already financing the institution”. In such a context, the EIF's presence is **reassuring** for other investors (given the EIF's **high standards and strict due diligence**) as it signals the health of the institution.

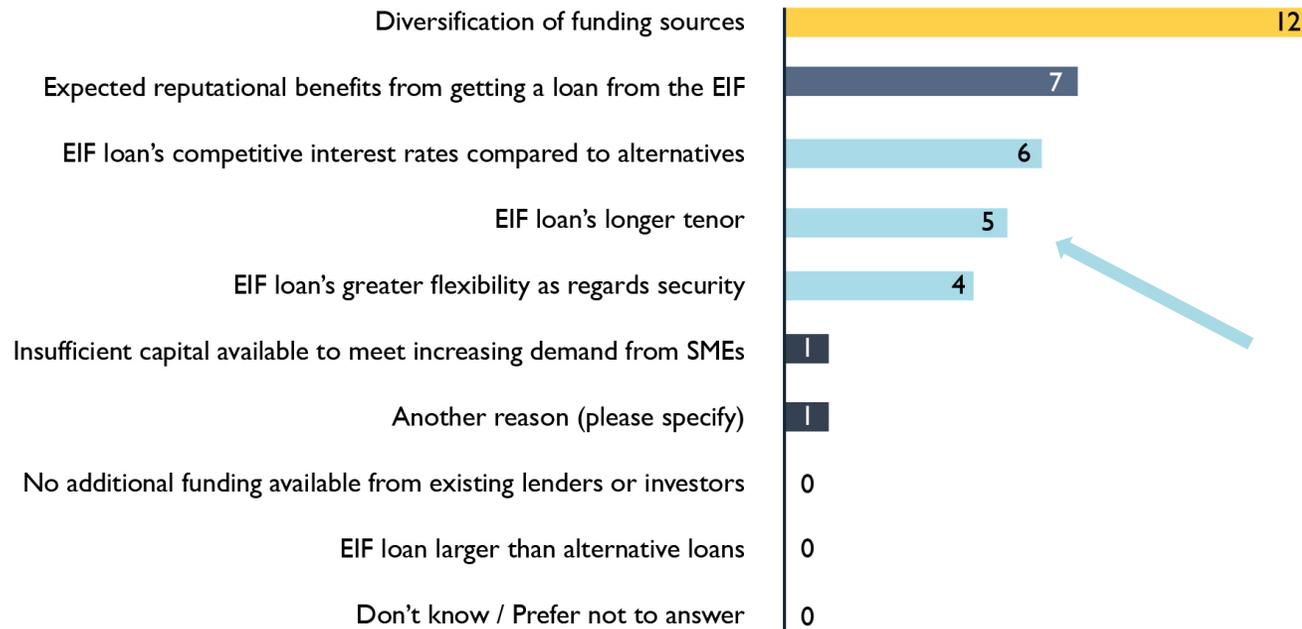
Another intermediary explained how the **EIF's participation played an important role in getting another international financial institution on board.**

EREM has contributed to developing supported CBSIs by diversifying funding sources and providing attractive conditions



The EIF loan enables intermediaries to broaden and diversify their sources of funding.

Financial intermediaries' main reasons to apply for an EIF loan



Diversification of funding sources, beyond deposits

The need to diversify funding sources is important for CBSI

Attractiveness of the EIF loan

8/14 financial intermediaries highlighted at least one aspect linked to the attractiveness of terms and conditions as a reason for seeking to obtain an EIF loan. Several aspects were typically mentioned (duration, pricing and/or flexibility as regards security).

EIF loans are provided on attractive terms and conditions. Similar or more attractive offers are available only in some markets (e.g. available from national promotional banks in two of the five case studies). Access to attractive funding sources contributes to developing supported financial intermediaries.

Most assisted CBSI reported an increase in their SME lending volumes during 2014-18



To what extent did the following factors influence these trends in SME and small mid-cap lending by your organisation during 2014-2018?

● To a large extent ● To a moderate extent ● To a small extent ● Not at all ● Don't know / prefer not to answer

- **Twelve out of 14 FIs** reported an increase in both the volume and the total value of their SME and small mid-cap lending during 2014-2018.
- **Nine out of 14 FIs** reported an increase in the relative share of SME and small mid-cap lending within their total loan portfolio (by value).

▪ The availability of EIF loans is one factor influencing this trend.

Demand for loans from SMEs / small mid-caps

Your mission and lending strategy

Availability of bankable SMEs / small mid-caps

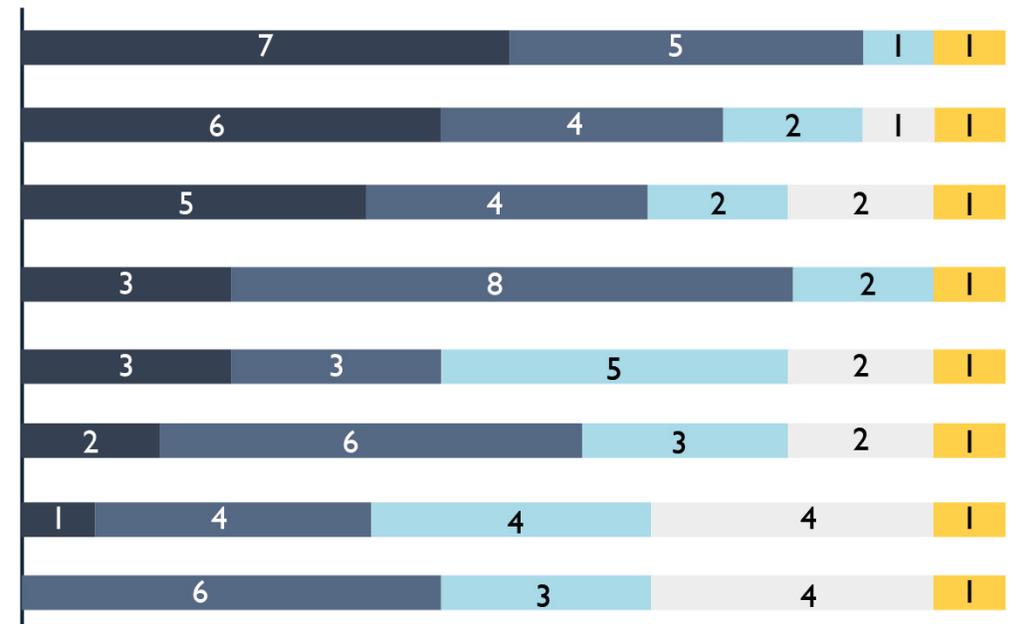
Economic conditions

Availability of lending capital from other sources

The loan provided by the EIF

EU policy for SMEs / small mid-caps

National or sub-national policy for SMEs/small mid-caps

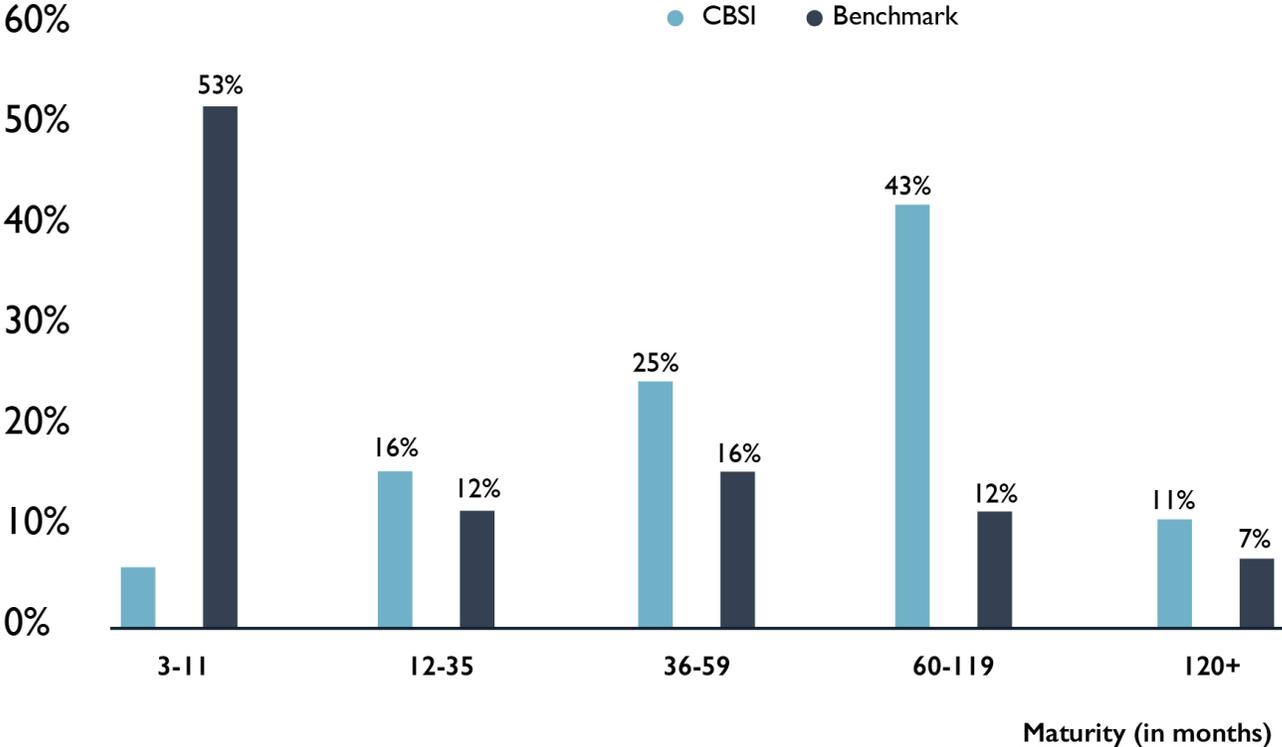


No automatic passing on of benefits to SMEs, but longer loan maturities



Unlike other programmes such as the L4SME, CBSI Instrument contractual documents contained no specific criteria requiring the intermediaries to pass on advantageous terms and conditions of the EIF loan to the final beneficiaries.

Distribution of maturity of loans: CBSI-supported SME portfolio vs. ECB benchmark



Analysis of the maturities of CBSI loans extended to final recipients (as of 30/06/2019) shows that the median maturity in the CBSI-supported SME portfolio is five years.

Comparison with a benchmark based on ECB data (volumes of new euro-denominated loans to euro area non-financial corporations – Nov 2019, only including loans of up to €0.25 million) shows that CBSI loans tend to have longer maturities.

Partial coverage of EU Member States with SMEs reporting the highest access-to-finance needs

CBSI Instrument contracts were signed with financial intermediaries in eight EU Member States. Comparison of the EIF's SME Access to Finance (ESAF) index (a composite indicator that summarises the state of SME external financing markets for the EU-28 countries¹) with the geographic distribution of the financial intermediaries shows only partial alignment of the CBSI Instrument with the highest SME needs for access to finance.

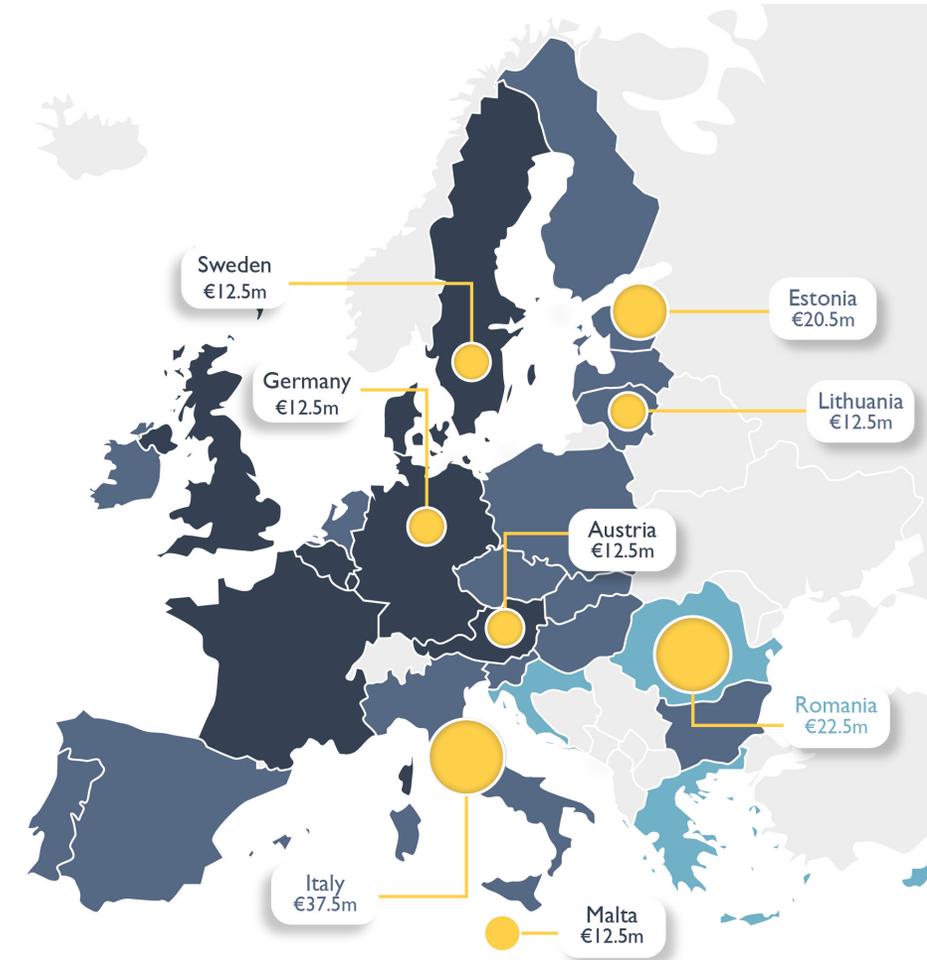
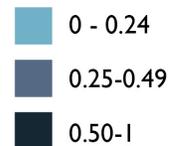
It is understood that the geographical placement of the CBSI Instrument was demand-driven and subject to various constraints (discussed in slide 15).

Three CBSI financial intermediaries are located in EU Member States (Sweden, Germany and Austria) that score very high for SME satisfaction with access to external finance, while only one CBSI financial intermediary is located in an EU Member State (Romania) that scores low on this indicator.

No CBSI loans were made in EU Member States where SMEs have persistent needs for external finance (Greece, Cyprus, Croatia and Hungary).



EIF ESAF, Composite index value, 2014



¹ The EIF SME Access to Finance Index, Working Papers 2018/49 and 2019/58 by the EIF Research & Market Analysis.

Deployment of the CBSI Instrument partly helped to build relationships with new EIB Group clients



Of the 16* signed financial intermediaries:

- seven are new clients of the EIB Group;
- nine have already benefited from other EIB Group loans or programmes, including [JEREMIE](#), [EaSI](#), [EPMF](#), [COSME](#), [InnovFin](#) and direct loans from the EIB.

There is evidence that the relationships developed with new intermediaries under the CBSI Instrument have the potential to be long-lasting. Two of the three new counterparties interviewed during the case studies mentioned that they had either applied for other EIB Group programmes or were considering doing so.



#	COUNTRY	NEW EIB GROUP RELATIONSHIP?	OTHER EIB GROUP PROGRAMMES/MANDATES
1	Romania	No	(1) Loan from EIB
2	Germany	Yes	---
3	Malta	Yes	---
4	Italy	No	(1) JEREMIE, (2) EaSI
5	Italy	Yes	---
6	Italy	No	(1) EPMF, (2) applied for EaSI and COSME
7	Italy	No	(1) JEREMIE, (2) applied for EaSI and COSME
8	Austria	Yes	---
9	Italy	No	(1) EPMF
10	Romania	Yes	---
11	Estonia	Yes	---
12	Estonia	No	(1) InnovFin, (2) EaSI
13	Romania	No	(1) EPMF, (2) EaSI, (3) COSME
14	Sweden	Yes	---
15	Lithuania		1) EPMF, (2) JEREMIE
16	Romania	No	(1) EPMF, (2) EaSI

* before one contract cancellation

Varying performance of CBSI financial intermediaries in creating specific SME and small mid-cap portfolios under the CBSI Instrument



- The progress of financial intermediaries with portfolio inclusions (i.e. disbursements of finance to final recipients) varies. The most recently analysed data (up to 30/09/2019) show that:
 - three intermediaries **exceeded** the expected size of their portfolios within their pre-determined portfolio inclusion periods;
 - a few intermediaries **appear to be on track to achieve** the expected portfolio size by the time their portfolio inclusion periods end;
 - three other intermediaries **experienced challenges** in reaching the expected portfolio size and were granted an extension to the portfolio inclusion period by the EIF in March 2019;
 - two intermediaries **did not reach** the expected portfolio size by the time their portfolio inclusion periods had ended.



- As of 30/09/2019, the portfolio inclusion period had ended for five financial intermediaries, which achieved the following percentages of their expected portfolio sizes:

○ Intermediary A:	83.4%
○ Intermediary B:	110.0%
○ Intermediary C:	39.1%
○ Intermediary D:	44.2%
○ Intermediary E:	153.7%

(The portfolio inclusion period for the remaining ten intermediaries either ended after 30/09/2019 or will continue until 30/11/2020.)

But overall progress has been good



- Two intermediaries were only able to create SME/small mid-cap portfolios that are less than half of the expected amount. For one of them, this comes on top of the reduction of their leverage requirement from 200% to 150%. It is noted that this intermediary's main business is mutual guarantees and direct lending to SMEs, which is a relatively new business line for them. A similar explanation applies for the other intermediary.

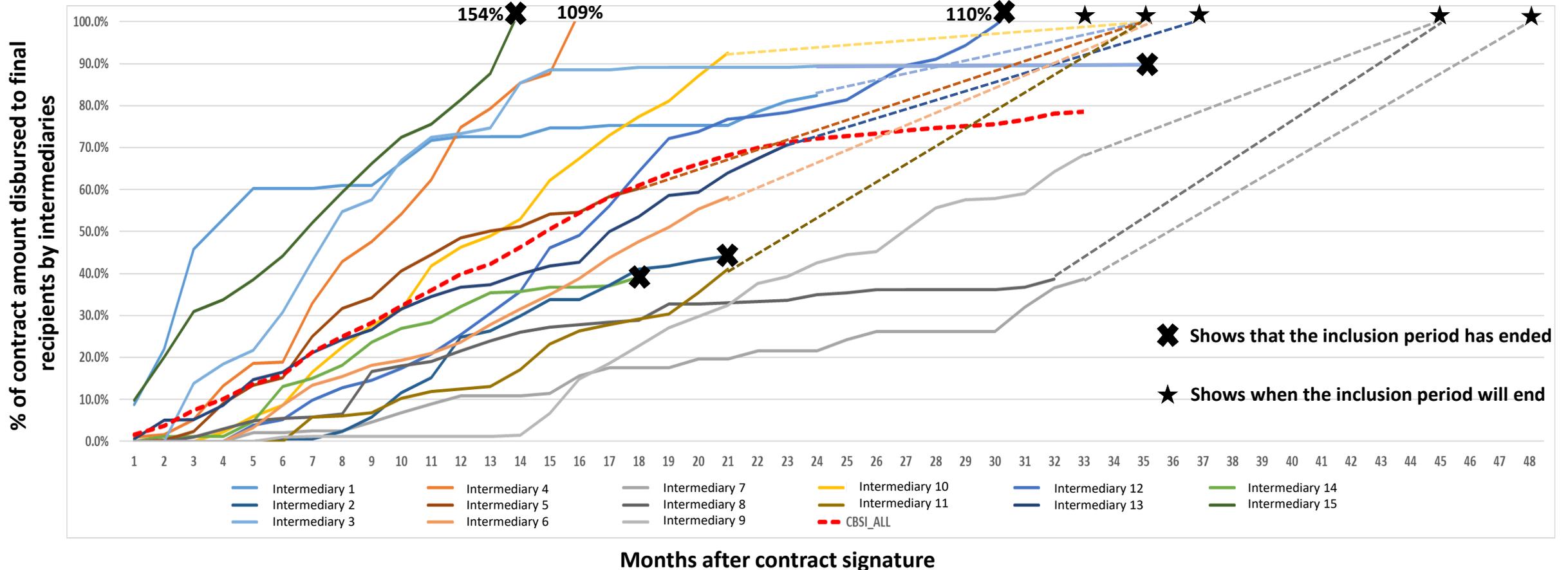


- The sizes of portfolio inclusions need to be interpreted in light of the rates usually achieved; according to the EIF, around 75% overall would be a good achievement. It should also be recognised that about half of the intermediaries had no prior experience of working with the EIF. Robust benchmarks for intermediated loans to SMEs and small mid-caps are not available. The cumulative disbursements by all CBSI financial intermediaries amount to around 79%, which is in line with the EIF's expectation. The percentage is expected to improve with further portfolio inclusions up to 30/11/2020.

Details of the progress on portfolio inclusions by each financial intermediary are presented on the next slide.

Cumulative disbursements to final recipients by month

The chart shows cumulative percentages of disbursements to final recipients per month since contract signature for each intermediary. Dotted lines show the expected paths to the end of portfolio inclusion (assuming 100% of the expected portfolio size is reached). The red dotted line shows the aggregate for all CBSI intermediaries.



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Items for consideration

What worked well?

1. The CBSI Instrument was successful in expanding the number and range of formal relationships with CBSI. This has the following benefits:
 - A diversified range of financial intermediaries that provided increased funding to SMEs;
 - A wider and diversified pool of counterparts for the EIB Group's SME lending activities.
2. Providing CBSI with an alternative funding source at times of funding constraints, i.e. limited capital available in the market (although the delay in CBSI Instrument implementation reduced its relevance).

What could have been done differently?

1. Improved collaboration within the EIB Group to reduce the time required to finalise and agree the CBSI (or similar) Instrument by improving decision-making frameworks and understanding of relative core competencies between the EIB and the EIF.
2. Analyse and revise the CBSI Instrument constraints (specifically eligibility, risk and marketing), where appropriate, to increase the pool of potential financial intermediaries.
3. Design contractual elements to ensure that desirable features, i.e. longer loan maturities, are passed through to final recipients, where appropriate, for the financial intermediaries' credit risk frameworks.
4. Explicitly assess the credit portfolio, systems and processes of financial intermediaries with respect to their ability to disburse loans to final recipients up to the expected amount and within the expected timeframe.

Items for consideration

#1: Shorten the time period for agreement of intra-Group instruments between the EIF and the EIB.

A more efficient Group-wide decision-making process is needed when both the EIB and the EIF are involved, so as to significantly shorten the period for introducing and implementing financial instruments of the same or similar nature to the CBSI Instrument. The objectives of the instrument and the overall mandate should be prioritised to ensure the quickest possible delivery of lending to the target group.

#2: Consider the impact of the CBSI Instrument eligibility criteria, pricing and terms on the pool of financial intermediaries.

Consideration should be given to analysing and revising the financing eligibility criteria, pricing and terms (where appropriate and within the risk appetite of the EIB Group) to ensure that the pool of potential financial intermediaries is maximised. This will help the EIB Group to target financial intermediaries and final beneficiaries in EU Member States with the greatest needs for external funding.

#3: Analyse financial intermediaries in terms of their ability to deliver finance in the required volumes and timeframe.

To deliver finance to final beneficiaries in the most efficient manner, there is a need to explicitly assess the ability of financial intermediaries to deliver the expected amount of finance within the specified time period to the target group.

Evaluation of the Cooperative Banks and Smaller Institutions Instrument

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The evaluation of the Loan Funds Instrument was undertaken as part of a broader evaluation of the [EIB Group Risk Enhancement Mandate \(EREM\)](#) carried out by the Operations Evaluation Division of the European Investment Bank (EIB), under the supervision of Sabine Bernabè, head of evaluation. Charu Wilkinson (external consultant) led the team responsible for evaluating the Cooperative Banks and Smaller Institutions Instrument, composed of Boris Benko (senior evaluator) and consultants from ICF.

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