

## **THE EUROPEAN INVESTMENT FUND (EIF)**

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In 2003, Standard and Poor's, Moody's and Fitch assigned the EIF a AAA/aaa status. Furthermore, its shareholder base widened with inclusion of a Bulgarian, Hungarian and Maltese bank. The EIF, in which the Bank is lead shareholder (almost 60%) alongside the Commission (30%) and a cluster of banks and financial institutions, specialises in venture capital financing and in SME guarantees. The EIF operates through financial intermediaries using its own resources or those entrusted to it by its shareholders (EIB, European Commission) or third parties. Operations are driven by twofold objectives: serving EU policies and trying to generate financial returns. As of today, the total portfolio of EIF venture capital and guarantee operations amounts to about EUR 9 billion.

### **EIF is the “venture capital arm” of the EIB**

- Since 2000 and in the light of the Lisbon Summit conclusions, the EIF has been responsible for all the EIB Group's investment in venture capital funds. The EIF also manages budgetary resources mobilised by the European Commission (MAP: Multi- Annual Programme for Enterprise 2001-2005) for early-stage investments.
- The EIF's total venture capital portfolio amounted to some EUR 2.5 billion at the end of 2003, invested in 190 funds throughout the Union and the Accession Countries. The EIF is Europe's venture capital (VC) leading operator, in particular in the early-stage segment. It is estimated that 15% of VC funded SMEs (around 2000 companies) have benefited from EIF investments since 1998.
- One of the EIF's functions is to play a **catalytic role** during the fund raising stage. Its participation brings in other investors and gives the funds the critical mass they need to launch their investment activity under optimum auspices. Since 2000, the EIF has focused primarily on high technology (biotechnology, convergence, new materials, telecommunications, software, regional funds targeting Southern Europe and pan-European funds).
- Despite a market environment beset by investor wariness, the EIF's investments in 2003 reached EUR 135 million spread over 14 operations. Five out of these 14 venture capital funds are focused exclusively on companies in their seed and start-up phases, with two of these funds targeting new technology-based firms that are either university spin-offs, or benefiting from a strategic partnership with a university. EIF's participation in these funds, which will feed largely off of research conducted at universities, is in accordance with the core drivers of EIF strategy and the EIB's Innovation 2010 Initiative.
- The EIF still plays a leading role in the European venture capital market with a continuous presence achieved through ongoing disbursements, which remain at the same level as in previous years, to its existing funds. Through these disbursements, the EIF attempts to balance its portfolio composition by stage (for example, through second and third round investments) and, where possible, by vintage year (for example, through secondary transactions).
- At the other end of the venture capital market, much further upstream, the EIF is exploring with the European Commission's **DG Research** and certain universities and research centres, how to forge a comprehensive, pan-European approach to financing the link between research and its commercialisation.
- The Acceding and Accession Countries clearly constitute an essential objective of the EIF's future investment policy (to date, seven funds have been backed in this region).

- One development in 2003, that holds significant implications for EIF's venture capital business in 2004 and beyond, has been the launch of a EUR 500 million "**ERP Facility**" for investments in venture capital funds targeting German high-tech companies. The EIF will be responsible for the management of this Facility on a mandate awarded by the German Federal Ministry of Economics and Labour. This mandate is especially significant because it is the first mandate awarded to the EIF by a party that is not an EIF shareholder, and therefore places confidence and gives impetus to EIF's activity.
- Last but not least, the EIF can count on the support of the EIB, its principal shareholder. Over 80% of the resources handled and invested by the EIF in venture capital consist of funds that it manages under mandate from the EIB. This EIB commitment, which dates from 1997 and amounts today to EUR 4 billion, will continue in the coming years and arrangements have already been made to equip the EIF with sufficient financial resources to carry on and expand its activity.

## SME Portfolio guarantees

The second branch of the EIF's activity is the guaranteeing of SME portfolios of financial institutions or public guarantee bodies. Under this heading, the EIF works with over 120 financial intermediaries. The EIF offers two main product lines for its guarantee activity, credit enhancement for *securitisation* and credit insurance/re-insurance. The EIF only covers the operational lending risks. EIF's status as a Multilateral Development Bank (recognition by Basel II Committee) as well as its financial standing (the EIF was rated triple A by Moody's, Standard and Poor's, and Fitch in 2003)

- allows for reduced regulatory capital allocation on assets guaranteed by the EIF thanks to the 20% risk weighting (instead of 100%);
- allows financial institutions to expand their lending capacity and to improve their return on equity in the SME segment;
- facilitates the risk transfer to third party investors;
- facilitates credit risk transfer to the capital markets through bond issuances guaranteed by the EIF.

## Overview Guarantees

- The EIF concluded 30 guarantee transactions in 2003, for a total amount of over EUR 2.2 billion, an increase of 80% compared to last year. The three first EIF guarantees operations were signed in Eastern Europe (in Bulgaria, the Czech Republic and Latvia) for credit insurance operations amounting to EUR 54 million. The total amount of EIF guarantee portfolio amounts to EUR 6.3 billion. Over 250 000 SMEs have so far indirectly benefited from EIF guarantees.
- The credit insurance and re-insurance is mainly funded by the financial resources of the **Multi-annual Programme for Enterprise**, set up by the European Commission and managed by the EIF. Covering the period 2001/2005, this programme includes a "SME Guarantee Facility" with four windows (guarantees for high-growth SMEs, equity participations, ICT investment and micro-credit). In 2003, more than EUR 1.6 billion was committed under this heading.
- The **micro-credit** component of the SME Guarantee Facility provides guarantees for loans of under EUR 25 000, a niche often shunned by the commercial banks on account of the associated high handling costs and risks. Operations concluded by the EIF in this segment have at times been backed up by support measures for mentoring the beneficiary micro-enterprises. They have considerable growth potential, notably in the Acceding and Accession Countries.
- From its own resources (EUR 552 million committed in 2003), the EIF has contributed to the growth of the European banking sector's lending activity by guaranteeing the "junior" *tranches* of SME debts via **securitisation** operations. Enjoying the EIF's guarantee, bonds issued under this technique have enabled the financial intermediaries concerned to reach more SMEs and grant them enhanced credit terms while minimising the risk entailed. This type of guarantee, used in 2002 in Germany ("Promise" Programme), Austria, Italy and Spain and extended to Portugal in 2003, is proving increasingly successful and will be further expanded in the coming years in the context of Basel II and increasing externalisation of the SME risk by banks.

**In response to growing demand, the EIF is strengthening advisory services for structuring guarantee and venture capital funds.**

EIF Advisory Services intends to support the creation, growth and development of SMEs by enhancing its access to finance. This is done through the provision – fee generating - of strategic and technical advice on the design, implementation and evaluation of SME finance policies, projects and structures to a range of counter parties, e.g. governments, local authorities and regional development agencies, as well as the European Commission.

In 2003, three contracts have been signed: the first, with Spain's *Instituto de Fomento de Andalucia* (IFA), was of a more technical nature which included the structuring of seed funds and micro-credit operations; the second assignment, for Belgium's *Gouvernement Wallon* (Ministry of Economic Affairs), dealt with the future SME policy for the region. In both cases, EIF's overview of European best practice was a determinant element of the mission being given to the EIF. A third mission on behalf of DG Energy Transport of the European Commission has also been taken up in 2003. For this case, the EIF is researching the feasibility of a guarantee fund for the enforcement of arbitral awards rendered in energy transactions between Russia and EU Member States.

While remaining a lean organisation, the EIF deploys a wide range of highly specialised financial instruments which are well suited to nurturing European businesses and which perfectly complement those of the EIB. Its activity is destined to grow, because it is a nimble financial agency responsive to market needs. Its role promises to become even more important with the accession of new Member States, which offer vast scope for deploying its services and products. This expanding activity will have the total support of the EIB, through the renewal and development of the existing mandates as well as through the provision of additional capital resources. This proactive approach is fully shared by the European Commission.