

EUROPEAN INVESTMENT FUND

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EUROPEAN FUND FOR STRATEGIC INVESTMENTS
STEERING BOARD

EIF – SME Window Equity Product

Adopted by Written Procedure with expiry date 21/07/2016

Joint proposal by EC, EIB and EIF

Questions concerning this note should be referred to
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EIF – SME Window Equity Product

Each transaction under the SME Window of EFSI implemented by the European Investment Fund (“EIF”) is subject to EIF’s governing bodies’ approval. However, SME Window products have to be approved by the EFSI Steering Board, jointly with the Managing Director, after consultation with the EFSI Investment Committee (as these terms are defined in the EFSI Regulation).

The purpose of this note is to describe an additional product to be considered under the SME Window, namely the SME Window Equity Product (“SMEW EP”), and to seek its approval by the EFSI Steering Board, jointly with the EFSI Managing Director, by written procedure expiring the 21st July 2016. In the meantime, the EFSI Secretariat will inform the Steering Board of the outcome of the consultation with the EFSI Investment Committee, following its meeting to be held on 14th July 2016.

1. Background

EIF involvement in the European Fund for Strategic Investments started in early 2015 when EIB and EIF entered into an agreement (“EIB/EIF SMEW Agreement”), entrusting EIF with the implementation of the EFSI SME Window (“EFSI SMEW”), regulated by the Agreement on the Management of the European Fund for Strategic Investments and on the Granting of the EU Guarantee (“EFSI Agreement”), and in particular by its Schedule VII and relevant annexes thereof. The EFSI Agreement also sets out the terms and conditions of the guarantee provided by EU to EIB for the implementation of EFSI (“EU Guarantee”). The deployment of the EFSI SMEW is structured as follows:

Phase 1 approved by the EIF Board of Directors in April 2015 and signed in July 2015, composed of:

- EUR 2.5bn from the EIB to increase the existing equity mandate RCR (without EU Guarantee);
- EUR 750m to enable the frontloading of InnovFin SMEG 2016-2020 budget (“InnovFin SMEG Enhancement”); and
- EUR 500m to allow the frontloading of COSME LGF 2016-2020 budget (“COSME LGF Enhancement”);

Phase 2 composed of new products, including the SME Window Equity Product (“SMEW EP”).

The purpose of this note is to describe the terms of the SMEW EP benefiting from the EU Guarantee, as set out in the amended EFSI Agreement and EIB/EIF SMEW Agreement.

2. SME Window Equity Product

As part of the EFSI SMEW Phase 2, SMEW EP is proposed as a new product targeting equity investments in the early and growth and expansion stages.

The SMEW EP aims at enhancing access to financing for final recipients operating in areas relevant to the achievement of EU policy objectives with respect to operations presenting an EU value-added including through co-investments and increased collaboration and knowledge sharing with national promotional banks or institutions (“NPBs” or “NPIs”).

The expected multiplier of EFSI resources’ participating in the SMEW EP is x12¹.

The SMEW EP consists of:

- the **SMEW EP Sub-Window 1** which is a stand-alone facility for growth and expansion stage equity investments **for an amount of EUR 1 billion**; and
- **SMEW EP Sub-Window 2**, which is a mandate to provide a financial contribution of **EUR 270 million** to the senior tranche of the InnovFin Equity Facility for Early Stage (“**IFE Facility**”) currently implemented by EIF.

in each case as further described below in this note.

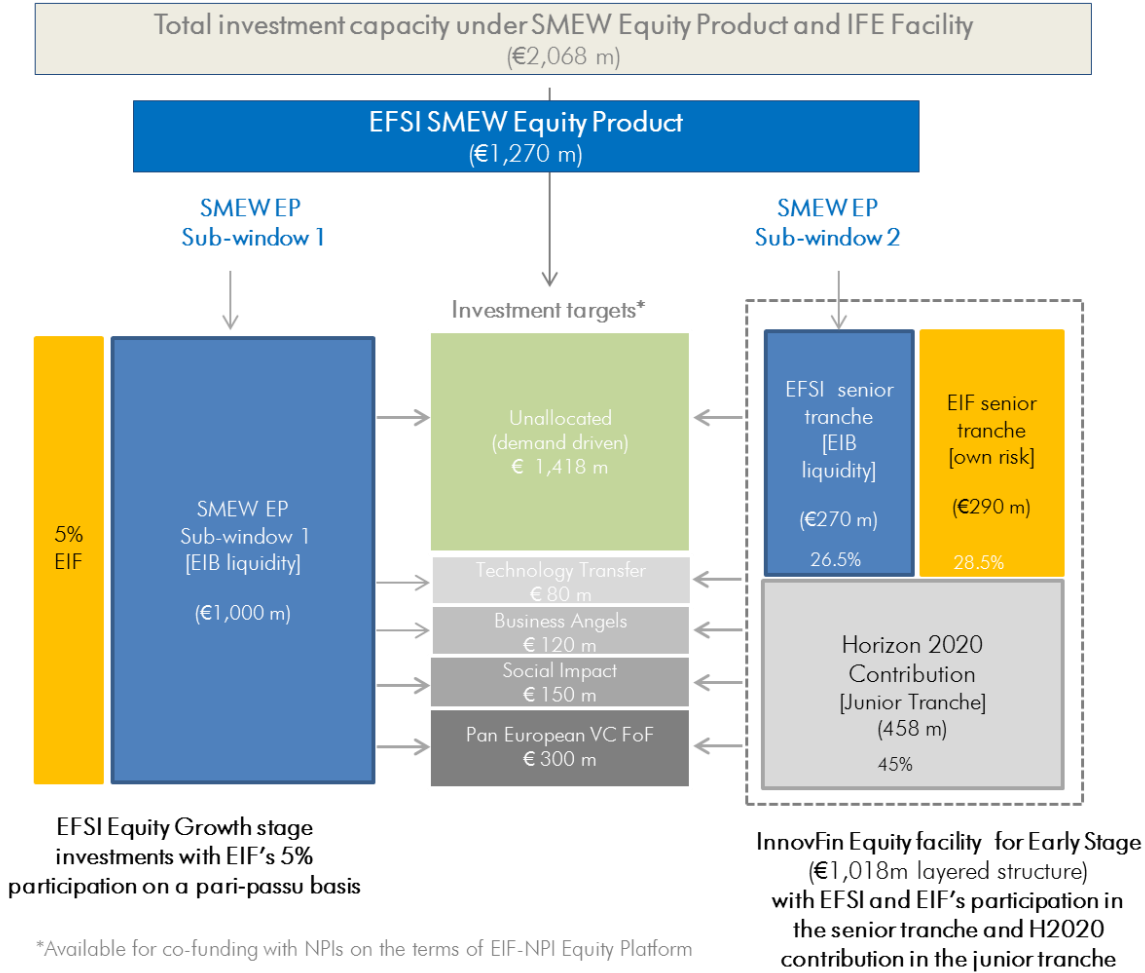


Figure 1 EFSI SMEW Equity Product and its interaction with IFE Facility

¹ Measured as a quotient of the aggregate of mobilised investments at the level of final recipients to the EFSI contribution.

2.1 SMEW EP Sub-Window 1

The SMEW EP Sub-Window 1 is an equity facility pursuant to which EIF shall provide equity type investments and co-investments in or alongside the expansion & growth stage financial intermediaries and multi-stage financial intermediaries (when combining resources with SMEW EP Sub-Window 2) that target SMEs and small mid-caps, as well as social enterprises.

Investments under the SMEW EP Sub-Window 1 shall be funded *pari passu* by:

- i. EFSI with funding provided by the EIB and coverage under EU Guarantee for an amount of up to EUR 1bn (excluding fees and costs); and
- ii. a systematic 5% co-investment by EIF mobilising own resources of up to EUR 50m aiming at achieving alignment of interest.

2.2 EFSI contribution to the IFE Facility (SMEW EP Sub-window 2)

The IFE Facility was created in 2015 as an EU financial instrument implemented by the EIF pursuant to the Horizon 2020 Delegation Agreement.

The IFE Facility is now being transitioned to a new layered risk sharing structure combining the contributions from EFSI (with EIB funding covered by the EU Guarantee), EIF own resources and Horizon 2020.

This new structure containing EFSI resources will allow the EIB Group and the EU to play a more prominent role in supporting underserved, riskier segments as well as further developing the venture capital market whilst achieving increasing leverage and policy objectives for the EU.

Thanks to the SMEW EP Sub-window 2 participation, the IFE Facility scope will be extended allowing covering additional early stage development spectrum by investing in technology transfer (including proof of concept), social enterprises and fund-of funds, while significantly increasing its investments alongside business angels, venture capital funds including the Pan-European VC Fund-of-funds.

The amended EUR 1.018bn IFE Facility will have the following sources of funding:

1. EFSI with funding provided by the EIB and coverage under EFSI's EU Guarantee for an amount of up to **EUR 270m** (excluding fees and costs) **–such contribution being the SMEW EP Sub-Window 2;**
2. EIF own resources for an amount of up to EUR 290m;
3. EU (Horizon 2020 contribution provided from the general budget of the EU) for an aggregate net investable amount of up to EUR 458m.

The IFE Facility will adopt a layered risk-sharing structure whereby:

- all investments made under the IFE Facility will be co-financed by each respective funding source on a proportional basis (as a % of the participation in the IFE Facility resources). All the operations under the IFE Facility shall form a single portfolio (on a fully mutualized basis²), which shall be ramped up over time in line with the availability of Horizon 2020 contribution provided from the general budget of the EU and materialization of the deal flow under IFE Facility;

² Achieving full mutualisation of resources in IFE Facility is critical in the design of the IFE Facility as a scalable and efficient scheme capable of reaching critical investment mass for early stage investments. However, a significant part of transactions under the IFE Facility are expected to meet the EFSI specific criteria, as described in more detail in Point 5 below, under the heading "SMEW EP Implementation Period".

- the Horizon 2020 contribution will constitute a junior tranche which will be subordinated as regards cash reflows (return of commitment) and which shall absorb first losses/impairment allocations (“Junior Tranche”);
- the EFSI and the EIF own resources contribution will have senior ranking as regards cash reflows (return of commitment, preferred return and return of notional funding cost) and shall absorb second losses/impairment allocations (“Senior Tranche”), where the EFSI and the EIF contribution to the Senior Tranche will be *pari passu* between them.

3. EIB funding and EU Guarantee

The EFSI Regulation and the EFSI Agreement foresee that EIB provides liquidity funding to EIF for the purpose of EFSI operations under the SMEW EP with the benefit of the EU Guarantee coverage.

The aggregate SMEW EP Funding made available by EIB to EIF, acting as manager of the SMEW, shall amount to EUR 1.27bn and be used as follows:

- up to EUR 1bn to the SMEW EP Sub-Window 1;
- up to EUR 270m to the SMEW EP Sub-Window 2.

Such amounts are expected to be committed and drawdown on an as-needed basis, towards eligible operations entered into between financial intermediaries and EIF acting in its capacity as the manager of the SMEW EP and of the IFE Facility.

The funding made available by the EIB shall be repaid out of the reflows attributable to SMEW EP. Should such reflows not be available or be insufficient, the EIB shall be entitled to call the EU Guarantee to cover such shortfall. In addition the EIB shall be entitled to call the EU Guarantee for any irrevocable decrease in the value of the EFSI supported investments under SMEW EP calculated by EIF with respect to the SMEW EP and reported to EIB, thereby reducing the outstanding amount of SMEW EP funding made available.

The EU Guarantee shall also cover EIB’s funding costs with respect to such funding.

EIF shall not be required or otherwise liable to pay or repay to EIB the SMEW EP funding and related funding costs other than by applying the reflows attributable to SMEW EP through the relevant order of priority.

4. Legal structure

SMEW EP Sub-Window 1

The terms of the SMEW EP Sub-Window 1, including the terms under which funding will be made available by the EIB under the cover of the EU Guarantee, shall be set out in the EFSI Agreement between the EIB and the EU. The EIB/EIF SMEW Agreement will also be amended accordingly.

SMEW EP Sub-Window 2

The EFSI contribution to the IFE Facility, including the terms under which funding will be made available by the EIB under the cover of the EU Guarantee, shall be set out in the EFSI Agreement between the EIB and the EU. The EIB/EIF SMEW Agreement will also be amended accordingly. In parallel the Horizon2020 Delegation Agreement will be amended to accommodate for SMEW EP Sub-Window 2 contribution into the IFE Facility.

5. Key deliverables and implementation modalities

EU Value-Added

Under the SMEW EP EIF shall target investments, which represent the EU value-added as per EIF's assessment on the basis of whether the investment proposal meets at least one of the predefined indicators. Depending on whether one or more of such indicators are met, the EU value-added of the investment proposal will be assessed by the EIF as "Low", "Medium", "Significant" or "High". Only investments assessed as having "Medium", "Significant" or "High" value-added may be considered for an investment under the SMEW EP. Investments in financial intermediaries already approved by EIF for financing under the IFE (which therefore satisfy relevant Horizon 2020 objectives) shall be deemed to fulfil the EU value-added requirements under EFSI.

SMEW EP Implementation Period

Under the SMEW EP, the EIF shall be entitled to enter into operations during the EFSI investment period ending 30 June 2020, provided that the relevant operations is approved by EIF on or before 5 July 2019³.

Without prejudice to the above, the EIF may commit to financial intermediaries out of the IFE Facility until 30 June 2022, provided that by 5 July 2019 the aggregate amounts of IFE Operations that meet EFSI criteria and approved by EIF on or before 5 July 2019, are not be lower than the amount of SMEW EP Sub-window 2 contribution to IFE Facility. In addition, the EIF will target to achieve that, as of 30 June 2020 (or any later agreed date) the aggregate amount of commitments to operations financed under IFE Facility that meet EFSI criteria is at least two times the SMEW EP Sub-Window 2 amount contributed to the IFE Facility.

Geographical Scope

The financial intermediaries in their investment strategy target final recipients established or operating in the EU⁴ for at least the amount, which is lower of: (i) 2 times the amounts drawn down under an operation for the purpose of investments and (ii) two thirds of the financial intermediary's total amounts drawn down from its investors for the purpose of investments. Moreover, if a financial intermediaries is established in the EU, it shall include in its investment strategy to invest more than 50% of its invested amounts in final recipients established or operating in the EU, while if a financial intermediary is established in a jurisdiction outside of the EU (a list of which, if any, is notified to the EIF by the EC⁵) such percentage shall be higher than 75%.

Without prejudice to the above, under the IFE Facility, the EIF may enter into operations with the wider geographical and eligibility scope set forth in the Horizon 2020 Delegation Agreement, provided that the aggregate committed amount to such operations under the IFE Facility does not

³ However only the commitments signed by 05/07/2018 shall count towards the relevant target under the EFSI SME Window.

⁴ For avoidance of doubt, financial intermediaries' investments in the final recipients established or operating outside the EU will not count towards target of the EFSI SMEW.

⁵ In the absence of any such list, the relevant jurisdictions are determined on the basis of the guidance set forth in the letter dated 14 June 2016 from Commissioner Pierre Moscovici to the President of the EIB or in any other future guidance set forth by the EC and notified to EIF.

exceed at any time the amount of the Horizon 2020 contribution committed to the IFE Facility. Such operations under the IFE Facility will not be counted as EFSI operations. **Investment targets**

Under the SMEW EP Sub-Window 1, the EIF shall target to commit at least EUR 450m to financial intermediaries aiming to invest in SMEs in the expansion and growth stage and which are established in the EU.

Under the SMEW EP Sub-Window 1 and the IFE Facility (in which EFSI will participate in the form of the SMEW EP Sub-Window 2), EIF will aim, in particular, to invest in operations:

- a) at least EUR 80m in the area of Technology Transfer;
- b) at least EUR 120m to, or alongside, Business Angels (including in any new compartments of the European Angels Fund, the EIF flagship product best positioned to effectively deliver on the BA policy targets);
- c) EUR 300m to pan-European VC fund-of-funds, whereby the target commitment under the IFE Facility within this overall amount shall be EUR 200m;
- d) at least EUR 150m in the area of Social Impact investments targeting social enterprises and social sector organisations through the various delivery modes, such as investments in funds linked to incubators/ accelerators, co-investments with business angels and payment-by-result schemes. Depending on market demand and risk profile the implementation of such products will be done either through SMEW EP Sub-Window 1 or through IFE Facility.

EIF may commit to financial intermediaries by combining resources of SMEW EP Sub-window 1 and the IFE facility to effectively target multi-stage financial intermediaries.

In addition NPBs may agree to cooperate *inter alia* within the framework of the EIF-NPB Equity Platform, and they may provide a co-investment alongside the SMEW EP Sub-window 1 and IFE Facility, further increasing the leverage of the EFSI, EU and EIF resources.

6. Specific legal considerations for IFE Facility affecting SMEW EP Sub-window 2

Upon signature of the amendment of the Horizon 2020 Delegation Agreement, the current stock of signed IFE Facility operations will be **grandfathered**, that is transferred under to the new structure by “covering at cost” the existing commitment and any resulting drawdowns thereof, as if these operations have been financed under the new financing structure from its commitment date.

Such grandfathering is necessary to achieve full mutualisation of the IFE Facility portfolio and achieve the target IFE Facility size as well as efficiently use of credit protection provided by the EU (Horizon 2020).

Subject to the relevant provisions of the EFSI Agreement and the confirmation of agreement by the fund managers, such grandfathered IFE Facility operations may be counted as EFSI operations. Side letters or other relevant legal documentation of the relevant fund would be amended to include, *inter alia*, the appropriate EFSI visibility clause or any other provision specified in the EFSI Agreement, as required.