

**FOR
DECISION**

EUROPEAN FUND FOR STRATEGIC INVESTMENTS

STEERING BOARD

EIF SME WINDOW FACILITIES

Questions concerning this note should be referred to
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Each transaction under the SME Window of the EU guarantee (the “EFSI Guarantee”) implemented by the European Investment Fund (“EIF”) is subject to EIF’s governing bodies’ approval. However, SME Window products also have to be approved by the EFSI Steering Board, jointly with the EFSI 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 request approval from the aforementioned governing bodies for an EFSI contribution to the following facilities in the form of:

(i) an increase to:

- InnovFin SME Guarantee Facility (“InnovFin SMEG”)
- COSME Loan Guarantee Facility (“COSME LGF”)
- EaSI Guarantee Financial Instrument (“EaSI GFI”)
- Cultural and Creative Sector Guarantee Facility (“CCS GF”)
- EFSI SMEW Equity Product (“SMEW EP”) Sub Window 1 and Sub Window 2

jointly referred to as “Existing Facilities”; and

(ii) a new contribution to:

- Private Credit Tailored for SMEs (“PC Product”)
- EFSI Combination Product (“EFSI Combination”)

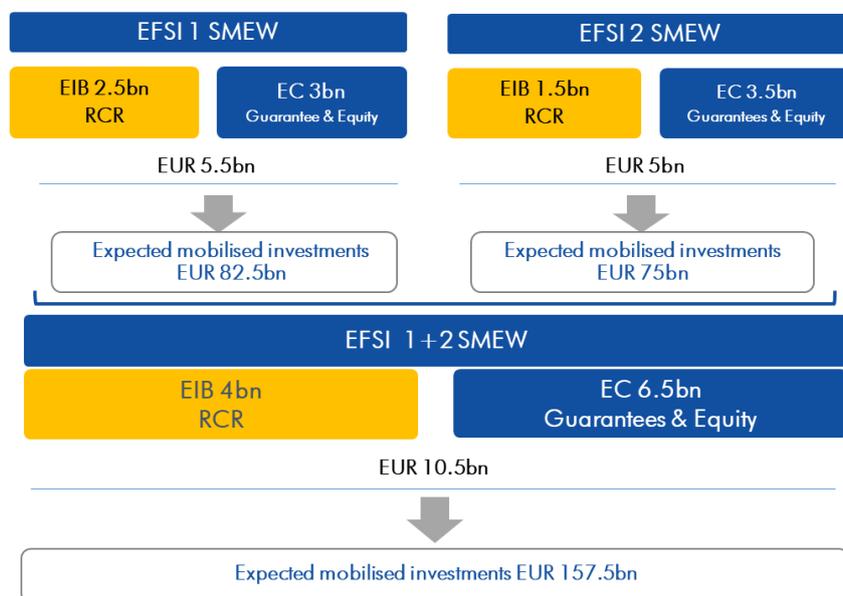
jointly referred to as “New Facilities”,

under the extension of the European Fund for Strategic Investments (“EFSI 2 Increase”).

1. Background

EFSI 2 Increase

Further to the amendment of the EFSI Regulation (“EFSI 2”)¹, the EIF Board of Directors approved on 5 February 2018 the increase of the EFSI SME Window (“EFSI SMEW”) envelope for an amount of EUR 5bn, expected to mobilise an additional EUR 75bn of investments besides the initial target of EUR 82.5bn.



Whilst the EFSI contribution provided by the European Investment Bank (“EIB”) (EUR 4bn) has been fully allocated to the existing equity Risk Capital Resources mandate (“RCR”) (not benefitting from the EFSI Guarantee), the EFSI contribution provided by the European Commission (“EC”) (EUR 6.5bn) has been allocated to the following work streams:

1. **EUR 2.86bn under EFSI 1** to contribute to guarantee facilities active prior to EFSI, namely InnovFin SMEG, COSME LGF, EaSI GFI and CCS GF², and to launch a new instrument in the equity space, namely the SMEW EP³;
2. **EUR 1.76bn under EFSI 2** to increase the above mentioned facilities, referred to as **Existing Facilities** in this document;
3. **EUR 600m under EFSI 2** to allow the set-up of new products referred to as **New Facilities** in this document;
4. **EUR 1.28bn under EFSI 2** to new initiatives and pilots currently under discussion with the EC.

Facilities under item 1 have been approved by the EFSI Steering Board and EFSI Managing Director during the EFSI 1 implementation period. Items 2 and 3 are presented for approval in this note, whilst approval on item 4 will be sought as soon as the underlying product composition will be finalised and related processes concluded.

¹ Regulation (EU) 2017/2396 of the European Parliament and of the Council of 13 December 2017

² Approved by the EFSI governing bodies on 10 July 2017, Document 10-2017

³ Approved by the EFSI governing bodies on 21 July 2016, Document 21-2016

Existing Facilities

In order to address the continuous market demand for SME debt financing, in July 2017, the EFSI Steering Board and EFSI Managing Director approved that the contribution under EFSI 1 to some of the Existing Facilities (i.e. **InnovFin SMEG, COSME LGF and EaSI GFI**) gets converted from a frontloading of each EU contribution into a permanent unfunded second loss piece covered by EFSI, therefore increasing the overall size of those facilities and scaling up the EU support in their policy areas. In a similar manner, the **CCS GF** received for the first time an EFSI contribution, as the existing EU contribution committed to the instrument was insufficient to cater for the cultural and creative sectors (CCS) market demand.

Since then, the demand for these Existing Facilities has kept increasing, revealing that the EFSI contribution granted at that time was insufficient to provide EU support in their respective policy areas beyond 2018.

In the case of the **SMEW EP Sub Window 1 and Sub Window 2**, the latter contributing to the further scaling up of the **InnovFin Facility for Early Stage** ("IFE"), market demand for equity investments for SMEs and small mid-caps, both in their early stage and expansion and growth phases, has remained at a level which requires a further EFSI contribution on top of the initial EFSI budget allocated upon launching the instruments in 2016. A further EFSI contribution will increase the investment capacity and impact of the SMEW EP and ensure the continuity of the related EU support. In addition, such budgetary increase comes with an additional product offering that responds to the need of the EIF to satisfy market demand through new forms of investment and co-investment with selected intermediaries.

New Facilities

The **PC Product** shall contribute to increasing the availability of non-bank financing for businesses from alternative investment funds and other investment vehicles, who provide debt to SMEs and small mid-caps across the EU. To achieve this objective, the PC Product will comprise two distinct, complimentary products: (1) a cash investment product supporting EIF's investments into eligible debt funds and (2) an investor guarantee product helping to mobilise fund commitments from other investors. By combining cash investments together with investor guarantees, the PC Product is expected to support both fund creation and fund scaling, and ultimately support the creation of further alternative funding sources for SMEs and small mid-caps.

The **EFSI Combination** shall facilitate the deployment of new guarantee financial instruments combining national or regional resources together with EFSI resources (with EFSI as a second loss risk taker). The EFSI Combination will address financing gaps and support specific investment objectives where Member State and EU policy objectives align. The agriculture sector experiences a significant financing gap. Therefore, EUR 150m has been allocated under EFSI Combination to combinations creating financial instruments targeting agriculture.

Request

The EFSI Steering Board and the EFSI Managing Director are requested to approve, by means of the extension of EFSI ("EFSI 2"), an increased EFSI contribution to the Existing Facilities and new contributions to the New Facilities as described in section 2.

2. Description and key deliverables

The increase of the EFSI participation in the Existing Facilities and the contribution to the New Facilities through the EFSI SMEW is foreseen to achieve overall levels as follows:

Existing Facilities

- As regards **InnovFin SMEG, COSME LGF, EaSI GFI, CCS GF**, approval is sought for an EFSI 2 Increase of EUR 710m, which, combined with the EFSI 1 allocation of EUR 1.59bn, will lead to an overall EFSI contribution to such facilities of **EUR 2.3bn**. The table below provides for the detailed allocation of the EFSI contribution to the abovementioned Existing Facilities:

<i>Guarantee Facilities</i>	EFSI 1 (EUR m)	EFSI 2 (EUR m)	Total EFSI allocation (EUR m)
InnovFin SMEG	880	220	1,100
COSME LGF	550	220	770
EaSI GFI	100	200	300
CCS GF	60	70	130
Total	1,590	710	2,300

Overall, thanks to the EFSI 2 Increase – together with the total contributions from the relevant Directorate Generals (“DGs”) of the European Commission– the Existing Facilities are expected to trigger approximately EUR 83.3bn of financing and generate up to EUR 116.6bn of mobilised investments at the level of final recipients.

- As regards the **SMEW EP**, approval is sought for an EFSI 2 Increase of EUR 1.050m allocated as follows:

<i>Guarantee Facilities</i>	EFSI 1 (EUR m)	EFSI 2 (EUR m)	Total EFSI allocation (EUR m)
SMEW Sub Window 1	1,000	950	1,950
SMEW Sub Window 2	270	100	370
Total	1,270	1,050	2,320

As regards the **SMEW EP Sub Window 2**, the envisaged EFSI 2 Increase of EUR 100m, together with the contributions provided by DG R&I and EIF own resources, will bring the total investment capacity of the facility to EUR 1,388m.

Thanks to the EFSI 2 Increase of EUR 1.050bn, a total of EUR 35bn is expected to be mobilised under the SMEW EP.

New Facilities

- In respect of the **PC Product**: approval is sought for an amount of up to EUR 300m in the form of a permanent first loss piece (split EUR 200m and EUR 100m between the funded and unfunded products respectively). EIF will contribute up to EUR 700m, resulting in a EUR 1bn facility size, which is expected to generate up to EUR 3.5bn of loan financing for the benefit of eligible SMEs and small mid-caps.

- In respect of the **EFSI Combination**, approval is sought for an amount of up to EUR 300m in the form of permanent, unfunded second loss piece. This will facilitate mandates of at least EUR 600m, and is expected to generate up to EUR 4bn of loan financing for the benefit of eligible SMEs and small mid-caps.

The EIF Board of Directors approved the increase of the Existing Facilities and the New Facilities on 11 June 2018.

3. **Additionality**

Existing Facilities

The additionality of the EFSI contribution lays in the supplementary volume of financing that will be made available to EU policy areas identified as suffering from market failures. In particular, EFSI will enable EU central instruments to scale up their financial support to a wide variety of final beneficiaries, ranging from micro-enterprises to SME, small mid-caps and social enterprises, in a critical post-crisis period.

New Facilities

The **PC Product's** purpose is to enhance access to finance by encouraging institutional investors to increase the volume and diversity of debt financing available to European SMEs and small mid-caps. The PC Product aims to (i) increase the availability of market-based and tailor made funding solutions for European SMEs and small mid-caps, (ii) encourage the development of a pan-European investment focus and (iii) support funds originating opportunities through crowdfunding platforms. This fits well with the joint EIF and EC objective of catalysing SME lending across the EU and contributing to the policy objective of a Capital Markets Union.

The successful implementation of the PC Product should result in businesses having more funding choices and directly facilitate a diversification of funding sources for these businesses (reducing their reliance on bank funding).

EFSI Combination will address financing gaps and support specific investment objectives where Member State and EU policy objectives align. This product will support guarantee financial instruments, which will incentivise new financing in the targeted sectors, with EFSI's risk taking supporting Member State or regional risk taking and facilitating (i) greater risk taking in the financial instruments and (ii) the coverage of larger portfolio volumes.

The first financial instruments under EFSI Combination will focus on supporting financing to SMEs in the EU agricultural sector, where the financing gap is estimated to be between EUR 7bn and EUR 18.6bn. Additional sectors may be included in the future and such inclusions will be subject to approval by the EFSI Steering Board.

4. **Risk sharing mechanism**

Existing Facilities

The respective risk sharing mechanisms for the EFSI 2 Increase will remain unchanged vis a vis the existing provisions:

- As regards **InnovFin SMEG, COSME LGF, EaSI GFI, CCS GF**, the risk sharing mechanism is based on the principle of partial mutualisation of losses between the first loss piece provided by the EC central mandates and EFSI, with a dynamic mechanism which ensures

that the eligibilities set out under the respective legal bases will be respected, while achieving the efficiency of use of underlying resources and facilitating rollout;

- As regards the **SMEW EP**:
 - a. investments under SMEW EP Sub Window 1 shall continue to be funded pari passu by: (i) EFSI, with funding provided by the EIB and coverage under the EFSI Guarantee; and (ii) a systematic 5% co-investment by EIF;
 - b. investments under SMEW EP Sub Window 2 shall continue to be co-financed in accordance with the IFE layered risk-sharing structure entailing: (i) junior tranche (45%) funded by H2020; (ii) senior tranche (26.5%) backed by EFSI with funding provided by the EIB and coverage under the EFSI Guarantee; (ii) senior tranche (28.5%) backed by EIF own resources.

New Facilities

- **PC Product:** EFSI will provide a first loss for 30% of the structure with the balance of risk assumed by EIF under a senior participation using own resources. The junior and senior tranches will build pro-rata as commitments are made to the underlying funds or investor benefitting from the guarantee;
- **EFSI Combination:** EFSI will provide a second loss unfunded cover in new mandates offering guarantee financial instruments subject to following parameters:
 - a. The first loss cover must be the same size, or bigger than, the second loss cover;
 - b. For guarantee products covering both expected and unexpected loss, the first loss cover must cover at least the expected loss;
 - c. The second loss cover must be at least 20% of the first loss cover.

5. Legal Structure

The EFSI 2 Increase will be implemented through:

- the amendments of the respective delegation agreements, if applicable, in the case of the Existing Facilities;
- the amendment of the EFSI Agreement and of the back-to-back agreement between the EIB and the EIF in respect of the EFSI guarantee; and
- be subject to the approval of the EFSI Steering Board and of the EFSI Managing Director (after consultation with the EFSI Investment Committee).

6. Time horizon

Under EFSI 2, the EIF shall be entitled to enter into EFSI operations during the EFSI investment period ending on 31st December 2022, provided that they have been approved by EIF by 31st December 2020.

The increase of the EFSI contribution will become effective for each relevant financial instrument once the relevant delegation agreement, the EFSI agreement and the EIB/EIF guarantee agreement have been amended and the EFSI Steering Board together with the EFSI Managing Director (after consultation with the EFSI Investment Committee) have given approval.

Overview of the sizes of the facilities after the EFSI 2 Increase:

Facilities	Size	Relevant Agreements: EFSI Agreement and the following additional agreements
InnovFin SME Guarantee Facility ("InnovFin SMEG")	up to EUR 2.53bn, out of which EFSI participation of EUR 1.1bn	Delegation agreement entered into between the EU, the EIB and the EIF on 12 June 2014, as amended from time to time (the " Horizon 2020 Delegation Agreement ")
COSME Guarantee Facility ("COSME LGF")	up to EUR 1.77bn, out of which EFSI participation of EUR 770m	Delegation agreement entered into between the EU and the EIF on 22nd July 2014, as amended from time to time (the " COSME Delegation Agreement ")
EaSI Guarantee Financial Instrument ("EaSI GFI")	up to EUR 396m, out of which EFSI participation of EUR 300m	Delegation agreement entered into between the EU and the EIF on 22 June 2015, as amended from time to time (the " EaSI Delegation Agreement ")
Cultural and Creative Sector Guarantee Facility ("CCS GF")	up to EUR 251m, out of which EFSI participation of EUR 130m	Delegation agreement entered into between the EU and the EIF on 30 June 2016 (the " CCS Delegation Agreement ")
SMEW Equity Product Sub Window 1	up to EUR 1.95bn of EFSI participation	N/A
SMEW Equity Product Sub Window 2	up to EUR 1,388m, out of which EFSI participation of EUR 370m	N/A
PC Product	up to EUR 1bn, out of which EFSI participation of EUR 300m	N/A
EFSI Combination	Expected to be ca. EUR 600m, out of which an EFSI participation of EUR 300m is assumed	Mandates signed under EFSI Combination will have individual mandate documentation.