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EBF comments on the Commission's Proposal for a regulation on the European Fund for Strategic Investments [COM\(2015\) 10 Final](#) of 13 January 2015

Key points

- To maximise its impact, EFSI should focus on higher risk projects so that additional private sector financiers will be attracted and ready to contribute. It is also to be noted that it is unlikely that private investors will be willing to take a first-loss risk, unless this is linked to an adequate return.
- Private sector financiers need to know the details of their investment, in particular project types, risk profiles and profitability. Compared to investment opportunities offered by the markets, investors will need transparent information on the EFSI's selection criteria for project support and respective EFSI portfolio guidelines.
- The EBF recommends that EFSI's selection process and criteria seek to avoid complexity and red tape.
- Stability and investment go hand in hand. If investment is to be increased in Europe, a stable regulatory framework must be envisaged for the financial sector.
- The EFSI's multiplier effect will strongly depend on the relief from cumulative regulatory requirements to be provided to banks. In order to further stimulate the private participation of banks in the EFSI, a preferential capital treatment for exposures to the EFSI should be considered.

General comment

In the current economic environment characterised by abundant liquidity and low interest rates, the EBF considers the Investment Plan for Europe as very timely and suitable to address the lack of investment across the economies of the European Union in the aftermath of the economic crisis.

In this regard, the EBF welcomes the European Commission's willingness to speed up investment in Europe and looks forward to working together with the European institutions to promote, unlock and support investment with the aim of boosting economic growth and employment in the European Union.

Notwithstanding this, the Investment Plan falls short of measures needed to reenergize SMEs capacity and propensity to invest, particularly in regard to capitalization levels, which assume a significant importance in the reduction of SMEs' implicit risk in some countries.

The biggest challenge lies in the creation of a better long-term business environment for SMEs and in the improvement of conditions for investments, in general, by means of forward-looking economic policies and structural reforms. In this regard, more should be done to take into account the importance of SMEs for the European economy and the difficulties that they encounter in accessing credit.



Specific comments

Maximising the impact of EFSI

To maximise the impact of EFSI, a differentiated approach is needed: it is well understood that each of the sectors in the economy has a distinctive character. Consequently, **different financing schemes** for each sector are needed, taking into account their respective particularities, such as risk profile, revenue streams, tenors, market competition, etc. In addition, different financing parties will be involved; research projects will require more venture capital and similar structures and less 'traditional' debt, whereas projects with a strong public sector involvement should have no difficulty in attracting even large amounts of bank debt financing.

More specifically, to mobilise private investments and maximise the leverage and impact of EFSI, the European Commission should consider the following issues:

- i. the ability to support **economically viable projects, with high business risk**, linked to the company's operations or project's features;
- ii. from a financing perspective, **the ability to provide additionality**, by addressing sub-optimal investment situations, which could generate cash flows and attractive returns on investment in line with the risk profile;
- iii. in order to make projects more attractive for investors, **additional benefits** should be foreseen, such as tax benefits on the returns associated with EFSI; or alternatively suitable risk-mitigation elements;
- iv. projects should be open to all users, avoiding the creation of barriers to entry and attracting foreign direct investment by:
 - a. **increased integration in financial markets**; in this regard, specific steps on structural reforms for the implementation of the Capital Markets Union are essential;
 - b. **investment in R&D** to benefit from fewer barriers to knowledge transfer, open access to scientific research and greater mobility of researchers;
 - c. the elimination of **regulatory uncertainty**; an unclear regulatory environment does not attract investment but instead lead to the reallocation of investments, to be made elsewhere in a very global competitive environment;
 - d. **restore investor confidence**, regarded as the main reason for weak investment in Europe.



Risk bearing capacity

The EBF considers that the **EIB risk bearing capacity needs to be increased** to avoid a potential risk of crowding-out. To this end, it is expected that EFSI will mainly focus on projects with higher business and financial risk.

The EFSI contribution should affect the project's risk profile positively so that private sector financiers will be attracted and ready to contribute. The focus must be placed on the promotion of overall financing and not in the substitution of funding sources. EFSI will succeed in leveraging bank lending if the promotion of complementary financing options, notably involving long-term investors, such as pension funds, is designed so as to address the financing gap (namely the equity gap in Europe and first stage financing) while simultaneously preventing competitive distortions for the banking sector.

It is expected that EFSI will provide a €21bn risk-bearing capacity in order to attract a large share of private finance to invest in projects which would otherwise not have been funded. EFSI's purpose is to absorb significant losses, but no indications are available so far as to how this mechanism will operate. In this regard, **the EBF suggests providing detailed information on how the risk-bearing capacity will absorb a project's risks.**

The EBF welcomes that the EIB has in the recent years introduced further flexibility in its intermediated lending through banks, including through risk-sharing mechanisms (RSI). A promising example is the EIB Project Bond Credit Enhancement programme which kicks in as a risk buffer in certain circumstances and consequently reduces the risk profile of the project for financiers. In such a way, a new investor class for debt finance, other than traditional project financing banks, could be attracted, i.e. pension funds and insurance companies. **Making intermediated lending more flexible and simple should greatly facilitate the channelling of funds to European businesses.**

Depending on the individual project's nature, EFSI's support can be tailor-made. For example, EFSI could allow for some flexibility on timing, covering (a) a (shorter) ramp-up period and expiring when certain economic parameters are fulfilled or the project is performing, or, (b) the entire lifetime of the project.

EFSI's contributions could significantly enhance project structures if they were to be deeply subordinated and take the risk of not being fully repaid. This feature would allow help to fill funding gaps which could not otherwise be met by private financiers, and so catalyse the entire project, including additional private funding.

Project selection

Nearer-term results may be obtained by focusing on those projects which are theoretically feasible, but currently do not meet the expectations of private equity (inter alia, venture capital) and debt investors. Here, a change of the risk profile of the project by means of EFSI instruments (perhaps only to a marginal extent) may help to achieve project feasibility. In this context, **there is an important equity gap in project funding**, which requires to be filled. For example, if senior debt providers are only willing to leverage up to say 70% and promoters can only invest 15%, then the balance needs to be found elsewhere, usually as subordinated debt



in the capital structure. EFSI could have a useful role in filling this gap by **providing equity or subordinated risk capital** which would improve the likelihood of projects being fully funded.

In order to improve the selection process, **the EBF suggests:**

- Very **simple criteria** that do not become complicated or entangled in red tape;
- Appropriate organisational arrangements to **ensure operational independence of EFSI's Investment Committee**. In this context, the EBF welcomes that the members of the Investment Committee will be appointed following a open and transparent selection procedure and that its Managing Director will be reporting to the European Parliament on the performance of EFSI (Article 11).

Moreover, the EBF welcomes that, according to the proposal, *“the pipeline of projects is without prejudice to the final projects selected for support.”*

Private sector's role and contribution

The EBF acknowledges that EFSI aims at crowding-in private investment by providing risk-bearing capacity in viable projects. Bank financing is one important part of the financing. To achieve this, the EIB and the European Commission will need to ensure that there is **detailed information available on project level**. Private sector financiers would need to know the details of their investment, in particular project types, risk profiles and profitability.

Compared to investment opportunities offered by the markets, investors would need **transparent information on EFSI's selection criteria for project support and respective EFSI portfolio guidelines**. Private investors would naturally tend to compare risk-return conditions of projects supported by the EFSI to those offered in the wider market. Furthermore, **it is unlikely that they will be willing to take a first-loss risk**, unless this is linked to an adequate return.

Banks can play a crucial role in the further increase of the resources of the EFSI, either in the first stage (direct investment in EFSI) or a second stage (on a project-by-project basis or through investment platforms). It will therefore be extremely important to clarify the risk/return allocation among investors (EC/EIB/Banks/Others), in order to promote banks' participation in EFSI.

In addition, the **capital requirements aspect** should be taken into account. Under the Capital Requirements Regulation (Regulation EU No 575/2013), exposures in the form of units or shares in Collective Investment Undertakings (CIUs) are risk weighted 100%, having an exceptional preferential treatment if an external rating exists (article 132 CRR). On the other hand, exposures to certain Multilateral Development Banks and international structures are assigned a 0 % risk weight (articles 117.2 and 118 of the abovementioned regulation).

Since exposures to the EFSI will benefit from public guarantees from the EIB and the EU Budget, **they should benefit from a preferential capital treatment**, when compared with other exposures in the form of unit or shares in CIUs, with a risk weight of 100%. With favorable capital requirements, one can glimpse positive effects for both banks, which would have access to a broadly diversified portfolio of investments (with a lower risk), and the EFSI, whose success will heavily depend on the participation of the private sector.



Governance of the EFSI

Under article 3 of the proposed Regulation, the number of members and votes will be allocated based on the size of contributions (rather than by consensus). This may be unfavourable for parties that access to EFSI by providing a less significant contribution.

Regarding the composition of the Investment Committee, it should be noted that the expertise and independence of this committee will be critical for the choice of the right “additional” projects and to avoid the trap of political capture.

The EBF considers that relevant stakeholders should be taken into account when deciding the criteria to be established by the Steering Board. This will guarantee that the criteria are in line with the real needs of investment projects, private investors and the SMEs.

The EBF would also like to remark that it welcomes that: *“EIB financing and investment operations supported by the EFSI should be managed in accordance with the EIB’s own rules and procedures”* and *“in accordance with the principles of subsidiarity and proportionality”*.

European Investment Advisory Hub (EIAH)

Finally, the proposal also sets up a European Investment Advisory Hub (EIAH) to provide advisory support to project identification, preparation and development across the European Union. It is important to promote technical advisory support for project promoters, **in particular for SME funding**. Technical advisory support is relevant to: (1) enhance organisational and financial corporate systems; (2) support the implementation of changes (e.g. business plans, financial communication practices, corporate governance policy) necessary to attract new investors; and (3) bring enterprises into contact with networks of advisers, professionals, institutions and investors.

For more information

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