EIB non-paper

Contribution to the Eminent Persons Group (EPG)

Key messages

- The EIB, as well as other International Financial Institutions (IFIs), has an enabling role acting as a bridge between public policy goals and private sector discipline, bringing together market orientation, political independence and accountability with the objective to address the financing of global public goods. It allows combining the capacity of the IFIs balance sheets with the ones from their shareholders, in a context of constrained public balance sheets.

- The in-depth technical, environmental and socio-economical assessment of each investment project, in addition to the credit risk analysis and compliance check, is an essential element of the success of both projects financed and of the EIB. Such processes ensure a proper allocation of limited resources and the possibility to monitor the impact and policy performance of EIB. In addition, it acts as a quality label essential to crowd-in private sector investors.

- The EIB capital model has demonstrated its "value added" for public shareholders: with a cash contribution of the EU Member States of around EUR 14bn, the EIB has been able to generate a volume of loans of over EUR 568bn, leveraging a much higher level of total investment. It demonstrates the major multiplier effect of using the EIB capital model as a 'transformation' model compared to traditional subsidies.

- The "value added" of the EIB capital model is magnified for shareholders with lesser or limited access to capital markets or with less developed and mature financial markets.

- Cooperation and sharing of tasks across IFIs based on their complementary comparative advantages should be reinforced by activating different mechanisms for a better alignment of their strategic priorities and subsequent operational implementation. This could be achieved: (i) through better coordination of the shareholders of the same country in different IFIs (for instance, single shareholder across IFIs) and among shareholders across countries; (ii) through investment platform between IFIs targeting specific sectors or areas crowding-in private co-investors; (iii) through exchange of best practices, in order to facilitate mutual reliance across IFIs procedures, as well as knowledge sharing across IFIs, including on investment barriers, and joint initiatives in terms of technical assistance and advisory support.

- Financing is not always the main obstacle. A predictable and stable pipeline of projects, a reliable legal systems and conducive regulatory framework are key components to unlock financing for investment projects and to crowd in private investors. Private investors are prepared to asses and price market and demand risks but should not be asked to mitigate regulatory and political risks. They will have to be addressed by public authorities in a long term perspective.

The EIB Group business model

Throughout its history the Bank's mission has been to support the growth potential of the EU and to address global challenges. The mission of the EIB, an investment promoting Treaty-based EU entity, is to support EU public policies through the provision of finance, usually on a long-term basis, crowding in private and public sector finance. As other public banks, the EIB supports structural policies (e.g. growth through investment) and also operates on a countercyclical basis to be adjusted according to the business cycle. This activity mix derives from the public policy agenda defined by EIB shareholders (EU Member States) as well as EU institutions, and not from profit objectives. The EIB business model is also unique by addressing under the same structure the developed and developing world, which favours cross-fertilisation between these different worlds in terms of the nature of the issues and possible financial and/or non-financial solutions to address them.

The current business model of the Bank is based on a market-driven approach without specific country target. Projects are assessed based on their own merits. The effectiveness of the EIB intervention rests on the simplicity of its business model, passing its attractive funding conditions to the projects promoters combined with the quality of its due diligence process ensuring the selection of economically, technically, environmentally and financially viable investment projects.

The diversity of the new challenges faced by the EIB within and outside the EU is leading to somehow conflicting tasks to be achieved by the same institution. Playing a counter-cyclical role requires achieving high lending volume in a very limited time period which is difficult to reconcile with high impact and additionality of a structural role, while the latter requires targeted investment project with high value added. Purely volume-driven practices based on standard lending require a different culture and logic of intervention than high-impact financing with more riskier counterparts and complex transactions. In addition, the first category of operations is better cost covered and cross-subsidises the more resource intensive and risky business. Maintaining both types of model within the same institution may require developing ring-fenced dedicated entity within the EIB assigned with clear objectives and resources.

The EIB, to achieve its mandates, mobilizes its assets and liabilities side in an integrated fashion. While its favourable borrowing terms is key to provide long-terms financing at attractive conditions generating a significant financial value added for its shareholders, the EIB also mobilizes its funding programme to issue targeted policy-driven bonds such as green bonds allowing to channel savings to investment projects allowing the transition to a low carbon economy.

In terms of enterprise financing, the EIB Group has established a robust policy implementation model through its mother company, the EIB, and its subsidiary the European Investment Fund. The financial products under this model support the development of the companies during their lifecycle, i.e. from seed to early stage over to growth stage financing.

The inclusiveness of the EIB intervention logic

Only financing part of the total investment cost of a project - on average one third of the total project cost - the EIB co-financing share aims at unlocking viable projects and at crowding in co-investors. The EIB has developed various forms of cooperation with National Development Banks and Institutions (NPBIs) within the EU and outside the EU with

International Financial Institutions (IFIs). It is important for the EIB to develop its catalytic role and foster cooperation with other providers of long-term finance (NPBIs, IFIs and sovereign wealth funds, among others). Pooling resources with other financial partners and attracting funding from the capital market will enlarge the means available to support investment in the real economy within and outside the EU.

The collaboration intensifies in the last years with the implementation of the Investment Plan for Europe and with the need to address increasing global challenges such as infrastructure, migration or climate change. The EIB is not only co-financing projects with IFIs but also actively promoting the creation of common platforms in certain regions to facilitate the blending of donor subsidies and IFI loans and the coordination of technical assistance programmes.

While different mandates across IFIs are desirable to achieve different objectives, alignments between due diligence standards, impact measurements and procedures are essential to streamline decision-making process and reduce administrative burden, costly for final beneficiary. The lack of coherence of shareholders, member countries having to balance national interests and public goals of IFIs where there are shareholders, and the difference in internal governance structure does not facilitate convergence across IFIs, ending up with competition between them rather than cooperation leveraging on the respective strength of each institution's business model.

The EIB has a long-standing track record of working with the private sector, supporting the recourse to Public Private Partnerships for infrastructure projects, facilitating access to finance to entrepreneurs, SMEs and mid-caps through a very broad network of private and public financial intermediaries. The implementation by the EIB Group of the Investment Plan for Europe is based on the premise that the stimulation of private investment and the crowding-in of private investors is the optimal policy to accelerate economic recovery.

The dialogue with the private sector – project promoters and co-investors – is negatively affected by the long decision making process of IFIs. The role of IFIs is to combine expert advice to better prepare, finance and monitor projects reducing perceived uncertainty and promoters' limited capability while modulating financial conditions so as the cost of funding is considered sustainable by borrowers. IFIs also ensure a proper dialogue with public authorities. The perceived uncertainty and unpredictability due to frequent changes in the regulatory and legal environment is one of the main impediments for long-term investments. Fixing the regulatory framework and the legal and administrative framework is a prerequisite to facilitate financing. A closer cooperation with public authorities to create a more conducive and predictable investment environment would make the system of IFIs more effective to promote viable investment projects.

The governance structure, reconciling the public policy and financial logic

The governance structure of IFIs aims to balance a strategic orientation role and a control and management function. An enhanced awareness by the governing bodies on these trade-offs between objectives and the focus on the definition of priorities delegating the implementation to the management based on adequate rules and safeguards would smooth decision while ensuring proper accountability.

The mainstay of the business model of these public policy-driven institutions is public trust and an unquestionable financial reputation. The EIB, as the EU Treaty-based bank, should ensure that any projects benefiting from its financing should comply with the EU acquis. Therefore, in practice, these institutions run their finance more conservatively than commercially-run entities.

While abiding to the EU regulatory framework ensures that the EIB will promote EU values within and outside the EU, it may end up having to rigidly enforce principles that may not be adapted to local conditions, especially in developing countries. Its intervention logic might lead to promoting a "compliance" culture. Leading by example to ensure the compliance with the EU acquis might be conflicting with policy orientations, notably in the area of private sector development.

The EIB is not formally subject to standard banking supervision. Instead, its statute defines an internal supervisory and control mechanisms. The EIB has voluntary decided to follow best banking practice principles and to comply with existing banking regulation but its business model differ from that of commercially minded entities. It is important to ensure the recognition of the specifies of EIB and IFIs model ensuring diversity in the business model of financial institutions and hence limiting the contagion effect in time of financial crisis.

The impact of its investment, more than financing

The intervention of the EIB, as other IFIs, is underpinned by the notion of additionality and value added, which has to be reconciled by its intrinsic market-driven nature. As a public institution, the EIB aims as complementing not crowding out the market and is supposed to show the impact of its activities. The decision to finance or not a project is based on the demonstration that it is in an area where there are market distortions and this project would not have materialised or would not have access to reasonable funding terms for a certain risk profile. The recent Investment Plan for Europe has showed the importance of additionality for European institutions to ensure that EU taxpayers' money is used in the most valuable way with the highest impact in terms of growth and jobs.

The value added of the EIB intervention materializes to the quality label attached to its decision to invest in a project or not providing comfort to co-investors based on the high standards of the EIB due diligence process. It allows the EIB to play a catalytic role in accelerating project implementation.

Lack of finance is only one potential barrier to investment in many places in the EU as well as outside the EU. Poor administrative and project management capacity often delay investment implementation. Relaxing these constraints offers potentially large pay-off in terms of project delivery and subsequently employment creation. IFIs generate most of their value by making accessible their knowledge and market experience at project level and structural reforms level to public authorities. The provision of technical assistance and advisory support in addition to the improvement of the projects along its life cycle contributes to improve the business and investment environment where the project is located.

The EIB, in cooperation with IFIs, considers key to further expand the provision of technical and financial advice, an efficient means to help project delivery and speed up disbursements and real investment. Technical assistance and the capacity of the IFIs to act as market sounding board is also crucial to identify the areas where the development of the private sectors is crucial as well as to ensure appropriate project preparation and implementation standards. This represents a significant cost which is often not properly factored in the intervention of IFIs.

The EIB Group versus the EU budget, how to optimize the value added of EU Member States' financial resources

The EU budget and the EIB Group are the two main financing tools that the EU member states could activate to achieve EU policy objectives. They both rely on EU Member States capital, their taxpayer's money and it is key to find the most appropriate mix between how to use these two financing tools for EU investment.

For the EU Member States, as EIB shareholders, a decision to increase the capital of the EIB should be seen from a "value for money" perspective i.e. that the associated additional lending will make a real difference in European economies and contribute to growth and jobs in the EU.

Alternatively they could decide to allocate a similar amount to the EU budget. When channelled to the EU budget, these funds could be either granted as subsidies or combined with resources of the EIB Group and of national public institutions to deliver additional financing to the real economy. This would increase the risk bearing capacity of the EIB, enabling it to provide finance to high value-added projects across all Member States. Compared to EU subsidies, this would allow the EU budget and the EIB to unlock further financial resources in support of investment in the EU and to increase the leverage effect of EU budgetary resources. In parallel, contributions from Member States' programmes co-financed by Structural Funds to joint financial instruments could leverage EIB lending.

While subsidies will remain a major component of the EU budget, there is a room for an enhanced use of financial instruments and budgetary guarantees in the future. From a Member State's perspective, EU grant money should be limited to the financing of non-bankable projects in areas with market failures and with demonstrated EU value added. In other areas, departing from subsidies will allow the Member States and the EU to support a significantly higher volume of investment through the EIB, with built in high leverage effect and EIB quality standards in terms of project selection and implementation.