

European and External Affairs Committee

EUR(3) 04-07 (p1): 27 November 2007

Title: European Investment Bank

22 November 2007

AMcD

Call for evidence - European & External Affairs Committee

National Assembly for Wales

Cardiff, 27 November 2007

Introduction to the European Investment Bank Group

EIB Group is made up of European Investment Bank ("EIB") and European Investment Fund ("EIF").

European Investment Bank

EIB is the European Union's bank, established to finance sound investment contributing to the policy objectives of the European Union. Its overriding objective is to support projects that help the integration, balanced development and economic and social cohesion of the EU Member States. Set up nearly 50 years ago, EIB has grown into one of the world's largest multilateral financing institutions.

To give an idea of the scale of activities - in the last five years (2002-2006), EIB has committed some EUR 220bn (roughly GBP 145bn) for projects mostly located within the EU Member States, particularly in poorer regions and in the new Member States. This finance has supported projects ranging from research, development and innovation, to roads, bridges, urban light railways, large and small-scale industries and businesses, waste treatment, water supplies, renewable energy schemes, housing and hospitals.

In the same period, EIB signed loan contracts for over EUR 17bn (over GBP 12bn) to support key investment in the United Kingdom's economy, of which over EUR 375m (GBP 250m) in Wales.

EIB finances itself by borrowing on capital markets rather than drawing on budgetary resources.

The European Commission manages the EU's grant funds - in particular the Structural Funds. However, EIB and the European Commission have established a number of initiatives such as JEREMIE, and JESSICA, potentially bringing together EIB loans with EU grant aid finance. JEREMIE will create investment funds to finance Small and Medium-sized Enterprises ("SMEs") via equity and loans. Structural funds will be employed in these JEREMIE funds alongside national grant contributions and potentially EIB loan funding and private sector contributions. EIF will act as a holding fund manager for JEREMIE in a number of EU Member States.

JESSICA has a similar format to that of JEREMIE but its objective is to finance sustainable investment that regenerates urban areas. EIB is currently helping Member States and the managing authorities of structural funds to design and set up their JESSICA funds. EIB may also act as holding fund for JESSICA-led investments.

Approach to financing

EIB's primary role is that of long-term lender - up to 20 or more years depending on the investment - in large amounts and in currencies tailored to a project's needs.

The Bank lends to both public and private sector promoters. It provides direct finance to major investment schemes costing over EUR 25m. Smaller-scale investments are generally supported indirectly through financing arrangements (credit lines) with local banks or other financial intermediaries.

Before deciding on financing, EIB carries out a detailed assessment of the economic, technical, environmental and financial viability of each project. This assessment includes an evaluation of a project's contribution to EU policies.

EIB has an excellent credit rating (AAA) and borrows funds on capital markets worldwide at fine rates. Operating on a not-for-profit basis, the Bank passes on this finance at near to the cost of borrowing to project promoters having included only a margin to cover operating expenses and risk.

Lending up to 50% of the cost of projects, the Bank frequently acts as a catalyst, encouraging other financiers to become involved in an investment.

Ownership and governance

EIB was established in 1958 under the Treaty of Rome at the same time as the other institutions of what was then known as the European Economic Community. EIB is an autonomous body of the Union directly owned by the 27 EU Member States, with its mission, governance and supervision clearly defined in the EU Treaty. EIB's Statute is a Protocol annexed to the Treaty.

As EIB shareholders, the Member States subscribe or guarantee to subscribe its capital, which currently stands at some EUR 165bn.

The Bank reports to its Board of Governors, made up of a Government Minister from each EU Member State, usually the Minister of Finance. The Governors appoint the non-resident independent Board of Directors and the full-time Management Committee. The Directors decide on lending and borrowing activities as well as policy issues, proposed to them by the Management Committee.

EIB is subject to the normal controls associated with an international institution and bank, including separate internal audit, financial control and credit risk functions as well as an international external auditor. It is supervised by an independent Audit Committee, appointed by and reporting to the Governors.

The European Court of Auditors reviews all operations where EU budgetary funds and guarantees are involved.

EIB priorities

EIB continuously adapts its activity to developments in EU policies. Its current strategy places the emphasis on qualitative investment and financial innovation. A special focus is being given to economic modernisation of the new Member States, while keeping lending levels broadly stable in the long established Member States such as the UK. In the UK, the Bank's annual lending is expected to continue at the current five year annual average of some GBP 2.5bn (EUR 3.4bn).

EIB's lending is concentrated on six European priorities:

Economic and social cohesion, by supporting investment in the poorer regions, and in particular in "convergence regions".

A competitive and innovative European economy by financing research, innovation, education and information technologies.

Trans European transport and energy networks ("TENs") to ensure efficient and easy access throughout the EU.

Support for the activities of **Small and Medium Sized Enterprises**.

Environmental protection, in particular initiatives to combat climate change, conserving and protecting natural resources and improving the quality of life in urban areas.

Efficient, diversified and secure energy supplies, including investment in renewable energy.

European Investment Fund

Set up in 1994, EIF is the only European Union body with a specialised focus on financing SMEs. EIF's activities centre on venture capital, guarantees and related products. Through the leverage effect of its venture capital and guarantee instruments, EIF contributes to the development of SMEs in the EU Member States and the Candidate Countries. EIF activities for SMEs are complementary to EIB SME credit lines for financial intermediaries. EIF's support is also channelled via financial intermediaries, since it acts as a "fund of funds" financier.

EIF uses its own resources and funds mandated to EIF by its shareholders or third parties. The Fund's counterparties are venture capital funds and banks. EIF's work is implemented on commercial terms.

In the past EIF has been involved in two small funds that have been active in Wales. Currently with EIB, EIF is in discussions with Finance Wales to implement the first JEREMIE investment fund. This is a pioneering transaction and many other Member States are keen to adopt this type of structure if it proceeds to completion.

Venture capital

As a fund of funds, EIB makes equity investments in venture capital funds and business incubators that support SMEs, particularly those that are early stage and technology-oriented entities. In 2006, EIF signed venture capital commitments amounting to EUR 688m. Its total venture capital commitments amounted to some EUR 3.8bn at the end of the year.

With investments in 244 funds, EIF is a leading player in European venture capital in terms of the scale and scope of its investments. It plays a catalytic role by taking minority positions and its presence encourages commitments from other investors, notably from the private sector. As well as focusing on early stage funds, EIF has also, since 2006, targeted mid- and later-stage funds and technology transfer funds to facilitate the commercialisation of research.

SME guarantees

EIF guarantee transactions amounted to EUR 2bn in 2006, while the total guarantee portfolio stood at EUR 11.1bn at the end of the year, comprising 188 transactions.

EIF's counterparties include banks, leasing companies and guarantee institutions. Part of this EIF activity is carried out with European Commission funding under mandate, part of it from the EIF's own funds.

EIF also supports the securitisation of SME loans and leases packaged together by financial institutions in order to sell them on the capital markets. Some 20 new credit enhancement transactions were concluded in 2006. EIF provides added value by using its AAA rating to bring leverage to SME guarantee and securitisation transactions.

Ownership

EIF is a public-private sector institution. EIB is a majority shareholder of the Fund, holding 61.2% of its shares, alongside the European Commission (which holds 30%) and financial institutions in 16 countries (making up the remaining 8.8%). The EIF's authorised capital amounts to EUR 3bn.

What type of investment opportunities and support are offered by EIB for projects in Wales?

EIB operates within the mandates it receives from Member States, and is able to fund investments in a variety of sectors as explained in section 1.3 above.

Within the UK, EIB may lend under the first priority of promoting economic and social cohesion only in convergence areas, of which Wales has one of the two British examples. EIB is able therefore to lend for industrial and other investment projects in the South and West Wales convergence area that create employment and otherwise contribute to local economic development.

EIB's work in pursuing its other priorities translates into funding a wide variety of projects in the UK. Recent examples include: -

Innovation and knowledge economy

- industrial R&D at Ford (including an element in Ford's Bridgend factory), Rolls-Royce;
- lending to a number of English universities including Bristol, Oxford, Imperial College; and
- funding for a large number of school and hospital PPP projects in England and Scotland.

TENs

- National Grid transmission networks (including, in 2007, GBP 180m to finance the Welsh link to LNG facilities);
- a variety of heavy rail projects including the high speed rail link between the UK and the Continent (Channel Tunnel Rail Link) and the west coast main line upgrade; and
- upgrading of the Belfast - Dublin road link.

SMEs - funding of major UK banks with financial advantage passed to individual SMEs. In addition, as previously mentioned EIB is negotiating with Finance Wales to provide a loan to an equity finance vehicle that in turn will finance SMEs throughout Wales as part of the JEREMIE initiative.

Environment

- major lending to water and wastewater sector (including to Glas Cymru);
- financing of domestic waste management projects (e.g. to enable local authorities to comply with the EU landfill directive);
- loans to housing associations for urban renewal projects either via banks or direct;
- funding for urban transport projects (e.g. the Docklands Light Railway in London).

Energy

- funding of a new CCGT power station in Devon; and
- lending to a portfolio of windfarms and other energy projects in Scotland.

EIB's policies mean that it will lend a maximum of 50% of project cost, and will therefore generally work closely with other funders, often commercial banks, to provide a complete funding package.

EIB may finance public sector bodies, corporates, whether major or midmarket companies, and project finance vehicles. Funding may be for new or refurbished assets and associated costs, or for agreed R&D programmes. EIB will not fund purely financial transactions such as management buyouts or debt restructurings.

With the exception of project finance / PPPs, EIB would not require its funding to be formally ring-fenced, allowing borrowers (especially corporates) flexibility in drawdown timetables and treasury management. However, EIB will always be concerned to ensure that the project agreed is indeed implemented. As a result, it does not assess borrowers purely on financial terms as a commercial bank may do, but in addition will investigate how the proposed project fulfils EIB's policy objectives, and whether the risks of implementation are acceptable.

EIB's banking activities are restricted to lending, or closely connected risk-taking such as through guarantees. For many of its public sector projects, it can also provide support to the public sector sponsors through the experience it brings to a transaction, advice on financial structures and the spreading of best practice.

What are the benefits, or otherwise, of working with the Bank?

EIB seeks to work closely with governments so as to employ its resources in governments' priority areas. As explained above, EIB can also provide specific assistance to public sector project sponsors.

As a result of its size, status and carefully judged approach to the markets, EIB's lending is normally at very competitive rates. The benefit of this pricing is available to EIB's borrowers. In the case of lines of credit to banks to support SMEs or other clients, it is a condition of EIB's involvement that tangible benefits flow to the final clients. In PPPs, EIB loans are structured to ensure that financial benefit flows to the public sector.

For the reasons given above, EIB's approach requires scrutiny of policy elements of an investment as well as purely financial matters. This may involve more extensive due diligence and preparatory work for the client than if it engaged a commercial bank funder. In many situations, however, clients welcome the opportunity to involve a funder in the project-related aspects of their investments.

To what extent are public and private organisations in Wales benefiting from funding provided by the Bank?

In the last five years (2002-2006), EIB has lent around GBP 200m directly to projects in Wales, and a further GBP 50m via financial intermediaries. This compares with GBP 12bn lending for the UK as whole in the same period.

All of the recent direct lending in Wales has been to private companies (Ford and Glas Cymru).

To what extent is the Welsh Assembly Government engaging with the Bank, to explore investment opportunities in Wales?

Prior to the current suite of social housing transfer transactions involving Rhondda Cynon Taff, Monmouthshire and Torfaen Councils, Welsh Assembly Government staff and EIB discussed the programme of transfers in Wales, to see whether EIB could assist either in funding larger transfers directly or in funding "grouped" smaller transfers. Partly as a result of those discussions, EIB explored funding for Rhondda Cynon Taff (though this was eventually handled entirely by a commercial lender) and is discussing proposals for Torfaen.

EIB has also kept in touch with the Welsh Assembly government staff in relation to potential PPP projects as well as with advisors on projects in Wales.

How are these opportunities promoted and facilitated in Wales?

EIB has had a programme of meetings with ministers in Wales, as elsewhere in the UK, with the objective of understanding governments' priorities and identifying investments in the public sector where EIB is likely to provide value.

In addition, EIB keeps in touch with agencies and other project promoters to follow market developments. For instance, EIB and EIF have had repeated contacts with the former Welsh Development Agency and now with Finance Wales.

What lessons can Wales learn from other United Kingdom and European regions?

It is helpful for public authorities to have a number of contacts with EIB throughout a region's sectors - e.g. utilities, universities, agencies for private sector investment, public sector departments.

Clearly, success breeds success. EIB often finds that once a project has been funded in a particular region, and the benefits of EIB's involvement are seen in practice, Government or other public sector sponsors provide critical impetus for further transactions.

Other comments and observations

While seeking a balanced portfolio and activity, EIB does not apply any formal lending volume quotas between or within countries. EIB responds to demand from clients and potential clients, as can be expected from a policy-driven institution that must nonetheless remain relevant to the market.

In order to fulfil the potential of providing value in Wales, EIB needs to be involved in a wide range of areas. We are currently working on the Torfaen housing transfer, a Glas Cymru facility, and Finance Wales' JEREMIE Fund. We hope that we can now successfully build on that foundation in Wales.