

COMMITTEE PAPER
EUROPEAN AND EXTERNAL AFFAIRS COMMITTEE –
NATIONAL ASSEMBLY OF WALES

1. Background

1.1. The European Investment Bank group (EIB) as the policy-driven Bank of the EU is fully committed to supporting EU policy orientations. Investing to ensure economic development and regional integration is at the core of the EIB's activities and both the successor to the Lisbon strategy and the future cohesion policy will remain cornerstones of EU policy and major EIB Group objectives.

The role of the EIB

1.2. The EIB, which is owned by the EU Member States, was established by the Treaty of Rome. The Bank is able to borrow on the finest terms in the capital markets due to its AAA rating. The EIB does not seek to make a profit, and its lending is made on a cost-recovery basis. This means that the Bank can use its lower cost of finance to support investments that are economically and socially profitable and in line with EU policies.

1.3. The EIB has a set of financial and non-financial facilities at its disposal to support EU objectives. In terms of financial instruments, the main categories are:

- Direct Loans: EIB directly lends, on a range of terms and conditions, to private and public promoters for investment projects with a total investment cost about € 100 m upwards. As a rule, the Bank lends up to 50% of the investment costs for a project.
- Intermediated loans: through a delegation model, the EIB makes credit lines available mostly to financial institutions to enable them to on-lend EIB finance to small and medium-sized firms and small projects. The EIB group could also work with other type of intermediaries in order to support small-scale sized projects.
- Guarantees and risk-sharing: The EIB group is developing guarantee instruments to offer monoline guarantee-type services to projects and to share SME credit risks with intermediary banks.
- Venture Capital: The EIB's subsidiary, the European Investment Fund (EIF), operates as a fund of funds, helping provide equity instruments for start-ups, by investing in venture capital funds across the EU.

The value-added of EIB intervention

1.4. To ensure the quality of its funding intervention, each project supported by the EIB should demonstrate its value added (VA) on the basis of three pillars:

- Pillar 1 – consistency of the operation with EU priority objectives.
- Pillar 2 – quality and soundness of the underlying investment.
- Pillar 3 – EIB contribution i.e. financial benefits from the use of EU and other non-financial contribution (strategic technical assistance (TA), advisory).

1.5. Regarding the first pillar, the EIB provides financial supports operations that contribute to specific EU policy objectives, which are identified and translated into the six operational lending priorities in its Corporate Operational Plan. These are :

1. Economic and Social Cohesion and Convergence;
2. Knowledge Economy (Research, Development, and Innovation);
3. Trans-European Networks (TENs) for transport and energy;
4. Protecting and Improving the Environment and Promoting Sustainable Communities;
5. Support for SMEs;
6. Sustainable, Competitive and Secure Energy.

1.6. The second pillar focuses on the quality of the project, i.e. the extent to which the project represents a rational allocation of resources and meets the needs of its beneficiaries and of society at large over its entire life cycle. The quality of a project is assessed on the basis of criteria covering its economic, technical, financial, social and environmental soundness, as well as the promoter's capacity to design, implement and operate the project.

1.7. The third pillar of the value added framework refers to the Bank's contribution in terms of financial value added and complementary contributions such as technical assistance. The EIB's financial value added for a given operation arises from a comparison between the price of (a) an EIB loan and (b) its closest market alternative for the relevant customer. The difference is the financial advantage provided by EIB to the project. In addition, the EIB is also able to offer long maturities and/or grace periods to borrowers. The Bank usually matches the term of the loan to the economic life of the asset being financed. The EIB also offers long-term fixed rate loans and index-linked loans, which are useful for mitigating cash-flow risks for large projects. Lastly, EIB participation in a project often signals to the private market that the investment is sound, since it is well-known for high quality due diligence. This can make it easier for projects to leverage in other sources of finance and on more favourable terms.

1.8. The support provided by the EIB Group through technical assistance (TA) and advisory services to assist weaker promoters to define, prepare and implement their projects has been recognized as enhancing the EIB Group's policy role and bringing significant value added to its customers and shareholders through the improvement of project quality, development impact and in enhanced EIB Group business and disbursement activity. One comparative advantage of the EIB in providing TA is its strong in-house technical expertise based on a large specific staff complement of engineers and economists together with the related capability to manage consultants in its various sectors of intervention. All together, this provides a strong project-related know-how of "best practice" gained from due diligence and monitoring throughout the project cycle. The EIB also has in-depth knowledge of special finance products (including project, structured and other leverage finance-type lending), together with appropriate Basle II compliant credit risk management systems designed to assess the project risks and to manage them.

2. EU-2020 in a nutshell and the role of the EIB

2.1. The Europe 2020 strategy puts forward three mutually reinforcing priorities:

- Smart growth: developing an economy based on knowledge and innovation.
- Sustainable growth: promoting a more resource efficient, greener and more competitive economy.
- Inclusive growth: fostering a high-employment economy delivering social and territorial cohesion.

2.2. To achieve this 2020 objective, the Commission has made some proposals in terms of targets:

- to raise the employment rate of the population aged 20-64 from the current 69% to at least 75%.
- to invest 3% of GDP in R&D in particular by improving the conditions for R&D investment by the private sector.
- to reduce greenhouse gas emissions by at least 20% compared to 1990 levels or by 30% if the conditions are right, increase the share of renewable energy in our final energy consumption to 20%, and achieve a 20% increase in energy efficiency as already defined in the context of the EU energy and climate change policy.
- to reduce school drop-out rates (from 15% to 10% of early school leavers) and to increase the share of the population aged 30-34 completing tertiary education from 31% to at least 40%.
- to reduce the number of European citizens living below national poverty levels by 25%.

The strategy was endorsed by the March European Council. Discussions are still on-going on the choice of indicators, and a final decision is expected at the June European Council.

2.3. As a policy-driven Bank, the EIB Group is already supporting most of the priorities of the Europe 2020 strategy. In addition to the natural fit between EIB lending activities and EU 2020 objectives, joint initiatives developed by the EIB Group and the Commission have demonstrated how loans and grants can be combined to achieve greater leverage, thereby enabling more investment with the same amount of EU Budget funding. The Welsh region is, for instance, a front-runner for the implementation of JEREMIE, demonstrating the value added of financial engineering and of mixing public and private sector contributions for securing key regional investment to support SMEs.

3. The EU 2020 strategy and the future cohesion policy.

3.1 The EU Cohesion policy approach already provides a framework for integrated cross-sectoral approaches adapted to national, regional and local contexts. Indeed, it offers at the same time the right multi-level framework to implement EU-2020 priorities, and the integrated tool to mobilize complementary investment in smart, sustainable and inclusive areas. Since structural funds are managed by regional authorities, these have a key role to play in the effective delivery of Cohesion policy and the further deepening of the integration between EU-2020 priority objectives and regional policy.

3.2 In 2007, EIB financing in support of the EU's Cohesion Policy was translated into a specific EIB Convergence lending objective. Its importance has been reinforced by the current economic and budgetary/financial crisis, requiring an increase in convergence lending to counterbalance the negative impact of the crisis throughout Europe - in particular in disadvantaged regions in the new Member States and at the regional and local level. Signatures under the Convergence objective reached EUR 66 bn between 2007-2009. In Wales, West Wales and the Valleys are both areas under the Convergence Objective, while East Wales is eligible under the Regional Competitiveness and Employment Objective.

3.3 For West Wales and the Valleys, the Operational Programme has a total budget of around €2.7 billion. Community funding through the European Regional Development Fund (ERDF) amounts to some €1.25 billion, which represents approximately 11.8% of the total EU investment earmarked for the United Kingdom under the Cohesion Policy for 2007-2013. The principal objectives are improving knowledge and innovation, encouraging business start-ups and access to finance, developing modern infrastructure and business in future environmental areas and supporting the regeneration and sustainable development of local communities.

3.4 The "East Wales Regional Competitiveness and Employment Programme" has a total budget of around €180 million, with Community assistance through the ERDF amounting to some €72 million (approximately 0.7% of the total EU money invested in the United Kingdom under Cohesion Policy 2007-2013). The main priorities are supporting the strengthening of the knowledge base of the regions, stimulating entrepreneurship and favouring communities regeneration.

3.5 EIB support for Cohesion policies can take different forms, from co-financing of operational programmes to financial engineering. In Wales, the focus has been on financial engineering. In that context, the cooperation between the EIB and the EU structural funds in the JESSICA and JEREMIE programmes is of particular interest.

- Regarding JESSICA, following the establishment of local JESSICA "steering" groups for London, the Northwest of England, and Wales regions, involving the Managing Authorities and other key public sector stakeholders, terms of reference for JESSICA evaluation studies were prepared and respective tenders were launched. Evaluation studies for both London and Wales were completed in late 2008. In Wales, following completion of the evaluation study, the decision was taken to proceed with a single national urban development fund and, to this end, the procurement exercise was launched by the Welsh Assembly Government.
- Regarding JEREMIE, the JEREMIE Finance Wales Fund transaction was signed in April 2009. By supporting the fund, EIB assisted Finance Wales in continuing to bring its expertise in SME finance into the Welsh market and to widen its current activities. The strong and successful relationship with Finance Wales has acted as a catalyst and encouraged further JEREMIE schemes in other UK regions, eg. North East and Yorkshire. The fund totals GBP 150m and invests in SMEs across Wales by providing loans, mezzanine capital and equity. EIB provided a GBP 75m loan to Finance Wales plc. The remainder of the funds was provided by ERDF and Finance Wales. Investment volume between June 2009 and March 2010 has reached more than GBP 30 million, which is substantially higher than expected. Market conditions have resulted in strong demand, with 182 SMEs receiving support.

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