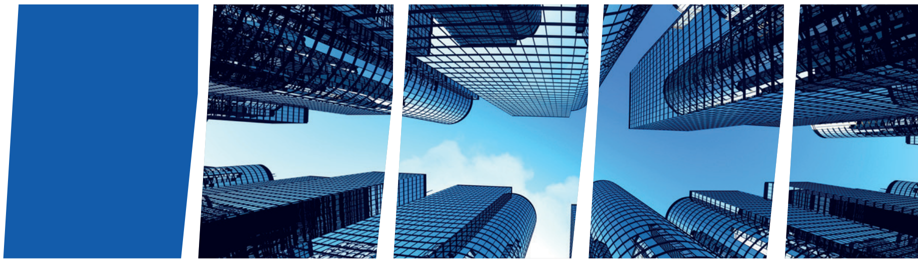
European Investment Bank
The EU bank



Operations Evaluation

Evaluation of the EIF's SME Securitisation Activities, 2004-2015

March 2017

OPERATIONS EVALUATION

EUROPEAN INVESTMENT FUND

Synthesis Evaluation Report

March 2017

EIF's SME Securitisation Activities, 2004-2015

Operations Evaluation, EV

This evaluation was carried out by the EIB's Operations Evaluation Division (EV), under the supervision of Ivory Yong-Prötzel, Head of Evaluation. The team, led by Kirstin Lang (Evaluation Expert), included Sonia Vega Vega (Senior Evaluator), Marie Egret, Marco Mota, Daniela Stoicescu (Evaluators) and Ulrike van Geleuken (Assistant). Bastiaan de Laat (Evaluation Expert) also provided valuable support. The final report was prepared by Sonia Vega Vega and Marco Mota. The team was assisted by consultants from Frontier Economics and PricewaterhouseCoopers.

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List of Acronyms

ABS	Asset-backed securities
ALM	Asset/liability management
BIS	Bank for International Settlements
CEE	Central and Eastern Europe
CIP-SMEG	Competitiveness and Innovation Programme – EU Guarantees
CLN	Credit Linked Notes
COP	Corporate Operational Plan
COSME	Competitiveness of Enterprises and Small and Medium-sized Enterprises
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DG ECFIN	Directorate-General for Economic and Financial Affairs
EBA	European Banking Authority
EC	European Commission
ECG	Evaluation Cooperation Group
ECB	European Central Bank
EFSI	European Fund for Strategic Investment
EIB	European Investment Bank
EIF	European Investment Fund
EMEA	Europe, Middle East and Africa
EREM	EIB Group Risk Enhancement Mandate
ESIF	European Structural and Investment Funds
EU	European Union
EV	Evaluation Division
FTPYME	*Fondos de Titulación para Financiación de Pequeñas y Medianas Empresas*
HQS	High-quality securitisation
ICO	*Instituto de Crédito Oficial*
IOSCO	International Organization of Securities Commissions
KfW	*Kreditanstalt für Wiederaufbau*
MAP	Multiannual Programme for Enterprises and Entrepreneurship
MDB	Multilateral Development Bank
PCM	Project cycle management
PCS	Prime Collateralised Securities
PwC	PricewaterhouseCoopers
RMA	EIF's SME Research and Market Analysis Division
RMBS	Residential mortgage-backed securities
SLA	Service Level Agreement
SMEs	Small and medium-sized enterprises
SMEG	SME Guarantee Facility
SMESec	SME loan securitisation
SPV	Special purpose vehicle
TENs	Trans-European Networks
US	United States of America
VAM	Value Added Methodology
WAL	Weighted Average Life

KEY TERMS

Originator	Originator is an entity which: (a) itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised; or (b) purchases a third party's exposures for its own account and then securitises them.
Special Purpose Vehicle ("SPV")	SPV is a corporation trust or other entity, other than an institution, organised for carrying out a securitisation or securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SPV from those of the originator institution, and in which the holders of the beneficial interests have the right to pledge or exchange those interests without restriction.
Investors	Institutions holding a securitisation position in relation to the purchase of a tranche (or several tranches) of the notes typically on a floating-rate basis. Investors often hold the notes/securities placed in capital markets until maturity, while the most junior tranche is retained in full or in part by the originating bank.
Credit rating agency	Credit rating agency is the external credit assessment institution that is registered or certified in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies or a central bank issuing credit ratings which are exempt from the application of Regulation (EC) No 1060/2009.
Tranche	Tranche means a contractually established segment of the credit risk associated with an exposure or a number of exposures, where a position in the segment entails a risk of credit loss greater than or less than a position of the same amount in each other such segment, without taking account of credit protection provided by third parties directly to the holders of positions in the segment or in other segments.
Credit enhancement	Credit enhancement means a contractual arrangement whereby the credit quality of a position in a securitisation is improved in relation to what it would have been if the enhancement had not been provided, including the enhancement provided by more junior tranches in the securitisation and other types of credit protection (such as financial guarantees).
Deals	Deals refer to EIF's SMESec transactions in which the EIF guarantees at least one tranche. In some deals, EIF guarantees more than one tranche.

Executive Summary

Context, aims and methodology

Since the 1990s, the European Investment Fund (EIF) has provided guarantees to small and medium enterprises' (SMEs) loan securitisation (SMESec) transactions. The key rationale behind the EIF's support to SMESec is that originators will carry out new SME lending as a result of the released capital resources and additional funding following the SMESec transactions.

This evaluation assesses the EIF's contribution to (i) increasing SMEs' access to finance through SMESec and (ii) stimulating the development of SMESec's market over the period 2004-2015. It also proposes recommendations to improve the EIF's contribution to revitalise the SMESec market, a role attributed following the economic and financial crisis of 2008.

Activities and Instruments

From 2004 to 2015, the EIF has supported a total of 109 EIF SMESec transactions for almost EUR 8.2 bn, mainly from EIF own resources, and to a more limited extent from mandates (principally through the EIB Group Risk Enhancement Mandate – EREM – and the Competitiveness and Innovation Framework Programme – CIP-SMEG). Over this period, the EIF diversified its SMESec activities in order to play a more active role in the field and to better address market failures on SME financing. It developed EIB Group-wide instruments topping up EIF's own resources and know-how, managed new Mandates on behalf of the EC or other third parties, and shifted its initial focus on guarantees of senior tranches to mezzanine tranches in order to respond to the changing market demand.

In terms of meeting its COP targets, the EIF has followed the ups and downs of the SMESec market: the EIF achieved annual COP targets to a larger extent in the pre-crisis period (2004-2008) compared to the post-crisis (2009-2015) period, as a consequence of the sudden and dramatic market changes. There has been, however, a positive trend in terms of the volume of operations, from 2013 onwards: the COP targets for 2014 and 2015 were almost reached and exceeded, respectively.

Moreover, the EIF has carried out several non-transactional activities, including *inter alia* market research, production of working papers, dialogue with regulators and market participants on policy issues, with the view to build-up know-how and spread best practices. EIF's expertise in structuring SMESec transactions has been highly regarded, particularly for new market participants and in new markets. In this context, the EIF has also facilitated SMESec transactions with EIB investment within the Service Level Agreement (SLA) signed by the EIB and the EIF under the EIB Group Asset-backed Securities Initiative for SMEs (ABS-SLA). This joint cooperation has been positively valued by originators, and has enabled the EIB to invest high volumes into SMESec relying on EIF's expertise and advisory services (i.e. due diligence, etc.).

Means and organisation

For most of the period under evaluation, the EIF's SMESec business has performed in a cost-efficient manner: below or within the 40-60% overall EIF cost-to-income range. In 2010 and 2011 the EIF's SMESec business registered historically high cost-to-income ratios above the 60% upper threshold, due to provisions for guarantees of an exceptional size. Other more recent factors contributing negatively to the cost-to-income ratio are both the low financial interest rate environment felt since 2009 and, more recently (2014-15), the expenses linked to the increasing number of staff working on the EIF's securitisation business, linked to new activities (mandates and advisory services) and the requirements of the Investment Plan for Europe.

The average annual return on the investment for the EIF's SMESec business over its lifetime respects and even slightly exceeds the overall COP target of a ROE within the 4%-5% range. The financial sustainability of this business line for the years to come depends *inter alia* on significant expenses on guarantees, as those experienced in 2009-2011, not happening again.

Overall Conclusions

In light of its objective to support SMESec market development across the EU-28 and Acceding and Candidate Countries where it operated, the EIF has contributed to expanding SMESec into new markets (e.g. Central and Eastern Europe - CEE). Expansion in some of these markets, however, was not sustained after the crisis (due to *inter alia* the lack of an adequate regulatory framework). It has also contributed to making SMESec more attractive before the crisis, especially for small banks and in CEE. Moreover, the EIF also initiated the first "multi-country" transactions in Europe.

After 2010, the EIF concentrated on large originators in "active" and well-developed markets (i.e. Italy, Germany, Spain and the UK) and on large originators. The EIF has also supported the reopening of some SMESec national markets by facilitating deal execution in a difficult post-crisis market environment.

A key assumption behind the EIF's SMESec instrument is that released capital resources and additional funding generated through a SMESec transaction increases the originators' capacity to lend to SMEs and ultimately results in additional SME lending. Regarding the EIF's objective to contribute to increasing SME's access to finance, for most of the years under review (2004-2012), there has not been a standardized method to verify the extent to which the enhanced originators' capacity translated into additional SME lending in practice. With the introduction of the ex-ante added value and ex-post impact assessments in 2010 and 2013 respectively, there is evidence of the EIF's SMESec contribution to additional SME lending, though mainly based on originator's own reporting, relying to a large extent on their good faith.

Furthermore, the expectations on the EIF's SMESec instrument delivering on SMEs' increased access to finance ought to be considered in the context of external factors beyond EIF's control, which have also influenced the market players' motivation to participate in EIF's SMESec transactions. These external factors include:

- First and foremost, the stigmatisation placed on the entire investment class following the high losses experienced by US sub-prime real mortgage backed securities – RMBS during the crisis in 2008;
- The changes in rating agencies' methodologies and policies, which affected all securitisation asset classes;
- The low interest rates environment and availability of the ECB "repo-facility", making it more attractive for banks to access ECB funds than to participate in SMESec transactions;
- The general trend for many banks to pull out of SME lending, particularly in countries most affected by the crisis;
- The lack of adequate legal frameworks (impacting cash securitisations mostly) to promote SMESec in some countries;
- The significant regulatory changes under way at European level (i.e. Basel III), the effects of which are expected to further restrain the banks' capacity and willingness to lend to SMEs (although balanced by an emerging alternative SME financing market, such as insurance and leasing companies, fintechs and peer-to-peer financing).

The assessment of the EIF's SMESec activity during 2004-2015 leads the evaluation to conclude that stakeholders have placed high expectations on the EIF's SMESec instrument to deliver on increasing SMEs' access to finance and reviving the SMESec market, in particular in the post-crisis market environment. The SMESec instrument alone is not the panacea to solve all market failures for increasing SME lending given that:

- The market needs to be sufficiently active for the SMESec instrument to be in demand. Since the volumes of underlying SME loans available to be securitised after the 2008 crisis are lower, the potential for originators to undertake more SMESec transactions has been diminished;
- SMESec can only deliver its policy objectives as part of a broader public policy effort, together with other instruments (such as intermediated lending, risk-sharing and equity), which the EIB Group is already offering to meet the financing needs in the various stages of an SME's lifecycle;
- The scope of the EIF's own-resources securitisation activities covers one of the most difficult asset classes to securitise (SME loans), which also

represent a relatively small share of the total securitisation market. This scope also limits the potential impact of the EIF's SMEsec instrument. By covering other asset classes (such as Residential mortgage-backed securities - RMBS) and capitalising on the expertise acquired through supporting non-SME securitisation (under the EIB ABS-SLA, for example), the EIF could aim at attaining greater impact through its support to securitisation transactions.

In light of the main findings and conclusions drawn by the evaluation, six recommendations are put forward with a view to enhancing the EIF's policy impact, whilst retaining a "reasonable rate of return". These recommendations are further detailed in the main section of the report.

Box 1. Recommendations

1. Clarify the EIF's policy objectives and set more specific targets in the SMESec market segment.
2. Adjust the EIF's SMESec instrument to enhance its impact.
3. Introduce additional mechanisms to ensure support to SMESec results in increased SME lending.
4. Expand the EIF's advisory and technical assistance for stakeholders and market players.

Organisational recommendation

5. Undertake regular analysis of costs and profitability of the EIF's SMESec business line.

Operational Recommendation

6. Review the EIF's Value Added Methodology to ensure the EIF's SMESec instrument remains fit for purpose.

MANAGEMENT RESPONSE

The Management of EIF welcomes the independent Evaluation of the EIF's SME Securitisation Activity, 2004-2015 conducted by the Evaluation Division.

SMEs are the backbone of the European economy. The financing situation for European SMEs is slightly improving, but also differs very much from country to country. In Europe, SMEs' financing strongly depends on banks and also after the crisis banks will remain the main external financing source for SMEs. A well-functioning securitisation market is a way to ease the supply problems by helping banks diversify their funding and achieve capital relief.

Against this background SME securitisation (SMESec) can form an important element in the efforts to enhance access to finance for SMEs in Europe. It can be essential in helping financial intermediaries broaden their funding base, achieve capital relief and ultimately, increase their SME financing.

In such context, SMESec can only be viewed as a component of a broader public effort to improve access to finance for SMEs, alongside intermediated lending, risk-sharing instruments and equity, which the EIB Group is already offering to meet the financing needs in the various stages of an SME's lifecycle.

The full set of recommendations and EIF's Management responses can be found in Section 6.2 Recommendations and Management Responses.

1. INTRODUCTION

1.1 Evaluation Rationale

Since the 1990s the EIF has provided debt service guarantees for small and medium enterprises' securitisation (SMESec) transactions to originators promoting and enabling the securitisation of SME loans/leases to investors. A total of EUR 9.8 bn from EIF's own resources and third party mandates (mainly EREM) were committed to 147 SMESec transactions from 1996 until December 2015 representing one of the EIF's core business lines. Over time, and in particular after the 2008 financial and economic crisis, the EIF has been asked to manage third-party mandates supporting SMESec on behalf of the European Commission (EC) and/or EU Member States.

The EIF SME support via securitisation has never been evaluated by EV. Consequently, the Operations Evaluation (EV) Work Programme 2015–2017 included an evaluation on EIF Credit Enhancements for SMESec. The evaluation comes at the time when the EIF has been requested by the European Commission (EC) and the European Council to play a key role in revitalising the SMESec market after the crisis.

1.2 Evaluation Objectives

The present evaluation aims at assessing the EIF's contribution (i) to increasing access to SME finance and (ii) to SMESec market development in Europe[1] in the period 2004-2015; that is, before, during, and after the 2008 financial and economic crisis. This evaluation of the EIF's SMESec activities has two main objectives:

- **Accountability:** to assess the influence that the EIF's SMESec activities have had on improving SMEs' access to finance, and on the development of SMESec markets in Europe between 2004 and 2015;
- **Lessons learned**: to draw lessons from the EIF's experience to improve, where necessary, the EIF's role in the SMESec markets across the EU and non-EU countries where it operates, and the functioning of recent initiatives (i.e. EIB Group Risk Enhancement Mandate - EREM).

The evaluation aims to provide well-grounded answers to the following evaluation questions:

Box 2. Evaluation Questions	
Q1:	How relevant were the EIF's SMESec activities vis-à-vis identified SME finance needs and existing policies?
Q2:	To what extent did the EIF's support to SMESec succeed in increasing SME's access to finance?
Q3:	To what extent did the EIF achieve its objectives timely and cost-effectively?
Q4:	How sustainable are the EIF's activities in the field of SMESec and the outcomes that it seeks to achieve?
Q5:	How important were the EIF's financial and non-financial contributions to the expansion of SMESec?

1.3 Scope of the Evaluation

EIF SME Activities covered: This evaluation covers all SMESec activities undertaken by the EIF, either transactional (e.g. the provision of SMESec guarantees) and non-transactional activities (e.g. research, market analysis and policy dialogue), as explained in Section 3.2.3 below.

Chronological scope: The evaluation covers the period between 2004 and 2015.

[1] EU-28 and Acceding & Candidate Countries where the EIF operated.

Geographical scope: All countries inside and outside the EU where the EIF participated in SMESec transactions during the evaluation period[1]. SMESec deals normally take place in a given country because the originator and, more importantly, the obligors of the loans to be securitised are subject to the legal framework of that country. In the absence of an integrated capital market union in Europe, there is no "European SMESec market" *per se*. "European SMESec" market is a term used to mean an aggregation of separate national markets in Europe.

SMESec market characteristics in individual countries are important because they influence what the EIF can do. The types, amounts and timing of SMESec deals depend on national factors (i.e. legal framework; tax; financial market regulations; currency; sovereign rating; size and sophistication of originators; public sector support, etc.). The present report takes into account the following clusters of national SMESec markets both inside and outside the EU identified by the "Background Study" undertaken for the purpose of this evaluation[2].

Box 3. National market clusters inside and outside the EU

The Background Study identifies three distinctive clusters of national markets based on their pre- and post-crisis general SMESec activity levels (sometimes referred to as the level of "market maturity").

Table 1. National SMESec markets in EU, Acceding and Candidate Countries.

Cluster	Definition	Countries
Active markets	Markets with 8 or more SMESec transactions since inception of the SME loan securitisation market and with transactions taking place after the 2008 crisis.	Belgium, France, Germany, Italy, Netherlands, Portugal, Spain, United Kingdom (8 countries)
Less active markets	Markets that recorded between 2 and 8 SMESec transactions, mostly before the 2008 crisis	Austria, Bulgaria, Czech Republic, Denmark, Finland, Greece[3], Ireland, Poland, Serbia (9 countries)
Minimally active markets	Markets with (i) fewer transactions or no SMESec transactions before and after the crisis; or (ii) transactions arriving to maturity before 2015. Except for Turkey, these are in general small countries in terms of GDP and number of SMEs.	Croatia, Cyprus, Estonia, Hungary, Latvia, Lithuania, Luxembourg, Malta, Romania, Slovak Republic, Slovenia, Sweden, Turkey (13 countries)

Source: EV's Background Study (2015).

1.4 Key evaluation steps

The evaluation has relied on several tools to gather and examine relevant information and, ultimately triangulate these findings and incorporate the results in the present report:

1. *Desk research and Literature Review* of key documentation on the European SMESec market trends, the EIF's SMESec policy framework, etc..
2. *Interviews and stakeholder feedback:* with past and present EIF and EIB staff, with a selection of originators, leasing companies; national promotional banks, and the European Central Bank (ECB) in late 2015.
3. *Survey with originators:* Following the interviews, a survey was carried out targeting 11 originator banks and leasing companies interviewed to seek additional feedback about the EIF's SMESec activities[4].

2 In 2015 EV commissioned PwC to undertake a study on "SME Securitisation in EU Member States" in preparation of this evaluation exercise. The study contains an overview of the SMESec markets across Europe, including country profiles for all EU Member States, Acceding and Candidate countries, intended to cluster countries and identify trends regarding SMESec activity since 2000.

3 In the Background Study, Greece was considered an active market. Given that since 2009 there was no new securitisation activity, apart from the SMESec non-public arrangements for ECB funding purposes, the Evaluation decided it would be more appropriate to classify it as a "less active" market.

4 Given the low coverage of the survey, the evidence from the survey results is therefore more indicative than statistical.

4. *Case Studies*: a total of six case studies was carried out, which together account for 57 deals, which represent over 50% of all EIF's SMESec deals during the study period:
   - *Four Country case studies:* Italy, Germany, Spain and Poland;
   - *Two Thematic Case Studies:* one study covering all called guarantees, and another on those instances in which the EIF was a "first mover" in SMESec national markets.
5. *Workshop*: A workshop to discuss preliminary findings with relevant EIF services in early 2016.
6. *Synthesis*: Analysis and synthesis of the outcomes of preceding steps, yielding this report.
7. *Consultation*: Consultation with the EIF services and DG of the draft of the present report.

1.5 Report structure

The report provides the main evaluation findings, their analysis, as well as the conclusions drawn from the evaluation process. A set of recommendations are presented at the end of this report following the main conclusions. The present report is structured as follows:

- Chapter 2 presents the definition of SMESec and the evolution of the European market for SMESec over the period under evaluation;
- Chapter 3 summarises the policy context, objectives and typology of the EIF's SMESec activities;
- Chapter 4 provides the portfolio analysis of the EIF's SMESec activities;
- Chapter 5 presents the main findings from the evaluation exercise around the key evaluation questions;
- Chapter 6 contains the conclusions and recommendations of the evaluation, as well as the management responses.

2. What is SMESec and Evolution of EU Market for SMESec

2.1 What is "SME Securitisation"?

Securitisation is a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranched, having both of the following characteristics:

a) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures;
b) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.

The main stakeholders in the securitisation process are originators (often banks and leasing companies), the Special Purpose Vehicle (SPV), investors and credit rating agencies (see Key Terms).

Box 4 presents a typology of securitisation transactions.

Box 4. Types of Securitisation Transactions

- *Depending on the ownership of the underlying* assets, there are two different types of securitisation transactions:
    - ***True Sale securitisation***, which means that full legal ownership of the assets (i.e. SME loans) are transferred from the originator (i.e. bank) to the SPV; and
    - ***Synthetic securitisation***, which does not involve the transfer of legal ownership of the SME loans, but only the risk associated with these loans is transferred to the investor by way of derivative contracts (for instance, credit-linked notes or credit default swaps) or financial guarantees. Since the assets remain on the balance sheets of the originator, the motivation for synthetic transactions revolves around risk mitigation.
- *Depending on the nature of the underlying pool of assets and the resulting securitised cash flows of the portfolio*, securitised transactions can be categorised into broad groups of structures, which are mostly defined by the nature of the collateral provided for these loans:
    - ***Residential mortgage-backed securities (RMBS)***, backed by commercial or residential loans;
    - ***Collateralised Debt Obligations (CDO)***, backed by debt instruments;
    - ***Asset-backed commercial papers (ABPC)***, backed by short-term consumer/commercial receivables;
    - ***Asset-backed Securities (ABS)***, which is very diverse (i.e. credit card receivables, car loans, etc. and - more interestingly for the purpose of the present evaluation - ***SME loans***, leases, receivables, etc.).
    - Finally, ***Covered Bonds***, which are on-balance sheet instruments with similarities to ABS (as they are collateralised by a dedicated portfolio of assets).

In SME securitisation (SMESec), originators take advantage of the securitisation process, on the one hand, by transferring the credit risk of the securitised assets away from their balance sheets to the purchasers of the securities and, one the other hand, by reducing their funding requirements. In practice, this results in originator banks' capital resources being released, fostering their capacity to lend more to SMEs. SMESec could thus stimulate SME lending by increasing the lending capacity of originators (i.e. by providing access to term funding, by potentially lowering the cost of funding or by providing capital relief). This can be enhanced, for instance with a guarantee provided from a third party (such as the EIF) on one or some of the tranches in exchange for a guarantee fee, which can help reducing their credit risk, lowering its funding cost, ultimately allowing for the placement of a higher amount of other tranches.

Hence, Securitisation of SME loans has the potential to bridge the gap between SME funding needs (demand-side) and the availability of SME loans (supply-side). Moreover, securitisation also provides institutional investors with liquid investment opportunities in types of assets in which they do not traditionally invest, such as SMEs loans, hence providing for diversification of their portfolios.

2.2 The European Market for SMESec

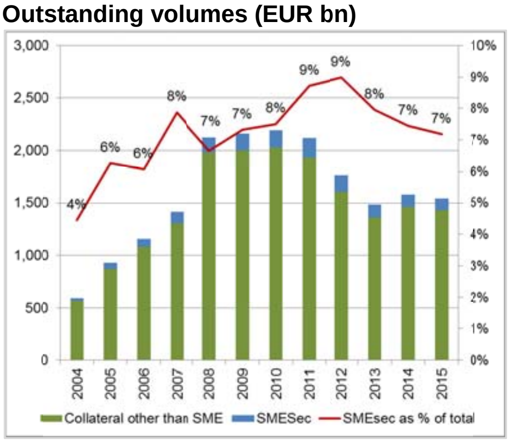
The SMESec market in Europe shows a distinctive evolution before and after the financial and economic crisis in 2008. The main characteristics of this evolution are briefly explained below.

Before the 2008 crisis

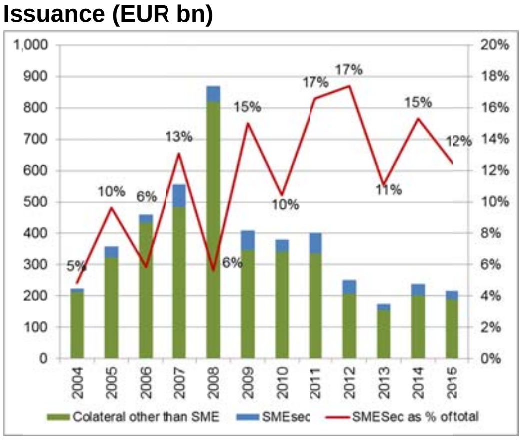
- The securitisation market in Europe took off in earnest after 2000. The market was led by the UK (35% of total securitisation issuance), followed by Spain (15%), the Netherlands (11%) and Italy (9%).
- SMESec, as a share of total securitisation issuance, was generally small[5] (on average 8% of total issuance during the pre-crisis years with a peak at 13% in 2007; see Figure 1, right hand graphic). The reasons behind are varied, including:
  - o Unclear and complex regulatory frameworks (i.e. multiple regulations across EU and non-EU countries) and regulatory discrepancies that act as disincentives;
  - o Limited transparency and information available on the details of the securitisation products and structures;
  - o SME loans are more difficult to securitise and to sell to investors than other asset classes (i.e. residential mortgage): (i) SME loans are not homogeneous, which add to the transaction costs; and (ii) high perceived risks for SME loans largely explained by a high degree of information asymmetry between investors and originators.

Figure 1. Total securitisation in Europe and % of SMESec

Outstanding volumes (EUR bn)



Issuance (EUR bn)



Source: SIFMA (based on AFME Data), adapted by EV.

- Public support intervention programmes played an important role in deepening or jumpstarting the SMESec market in countries like Germany (KfW Promise programme) and Spain (FTPYME)[6].
- Securitisation became a growing funding source and a means for capital relief, especially for larger banks with more than 50% of the SMESec issued placed with market investors (see Figure 1, right hand graphic). In parallel, SMESec products became increasingly complex in terms of tranching (risk layering), SPV vehicle structures and nature of the underlying securities and their cash flows.

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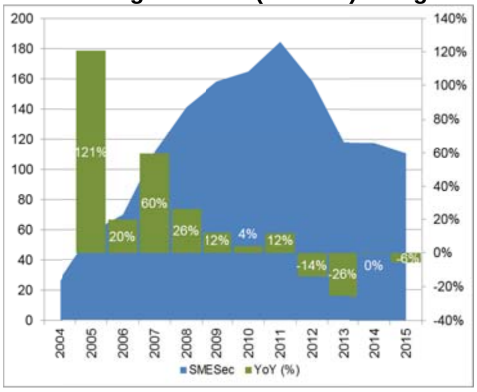
5 However it should be noted that AFME data used across the report classifies only lending-based transaction in the SME category, while a large portion of leasing-based transactions, which are de-facto SME transactions, are classified by AFME under the category ABS-leases. Moreover, synthetic transactions do not appear in the statistics. Therefore the numbers shown in this report are an underestimation of the SMESec market size that can be considered as a "*de minimis*".

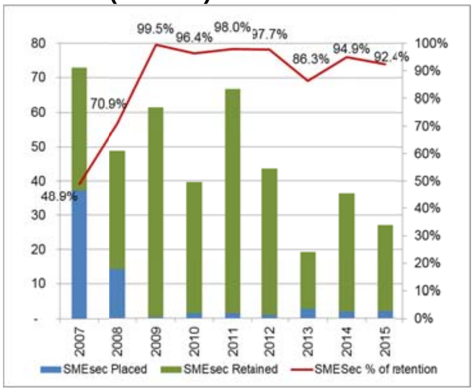
6 The KfW Promise Programme in Germany has also been active outside of Germany. FTPYME Programme in Spain stands for "*Fondos de Titulización de Pequeñas y Medianas Empresas*".

Figure 2. SMESec in Europe

Outstanding volumes (EUR bn) and growth (%)



Issuance (EUR bn) and % of retention



Source: SIFMA (based on AFME Data), adapted by EV.

After the 2008 crisis

- Following the collapse of the real estate market and the loss of credibility of the banking system in many countries, the total European securitisation market issuance halved in 2009 (Figure 1, right hand graphic). All kinds of asset backed securities (including SMESec) suffered from contagion effects of subprime mortgages, which were considered as toxic assets by investors that withdrew from the market.
- The aftermath of the financial crisis in Europe has severely changed the landscape for SMESec: almost none of the issuance was actually placed on the market, but rather retained by originators (see Figure 2, right hand graphic). The reason behind was that the various public sector interventions tried to stabilise financial intermediation. The European Central Bank (ECB) began to accept asset-backed paper in its liquidity support operations, allowing ABS and Covered Bonds to be eligible as collaterals for refinancing operations. ECB intervention largely explains why SMESec outstanding volumes still grew after 2008, peaking exceptionally in 2011 (see Figure 2, left hand graphic), after which it started declining until 2015.
- The share of SMESec over the total securitisation issuance has remained in the range of 10%-17%, evidencing the originators' capacity to take advantage of the conditions of ECB schemes to increase the use of SME collateral in simple issue-to-retain structures.
- Together with the pre-crisis factors mentioned above, some post-crisis factors further shape the SMESec market segment:
  - The current interest rates for SME loans and comparatively low refinancing costs act as disincentives to originators, given the high transaction costs involved in SMESec;
  - It is often more attractive for an originator to access ECB liquidity than to sell securities to investors. Originators retain a large share of their SMESec issuance - above 90% on average since 2009 (see Figure 2, right hand graphic) – in order to use it as collateral with the ECB in refinancing operations.
- Looking forward, some key regulatory changes (see Section 3.1) will likely impact the securitisation market, including SMESec.

3. EU POLICY CONTEXT AND EIF'S SME SUPPORT VIA SMESEC

3.1 EU Policy supporting SME between 2004-2015

Given SME's key role in Europe's employment and economic growth, SMEs support has been a constant on EU's agenda. The role played by the EIF to foster SME's access to finance, in particular through SMESec, has been shaped by some key policy initiatives at EU level, including the ***Lisbon Strategy for "Growth and Jobs"*** (2000)[7].

The challenges posed by the 2008 crisis triggered some EU crisis-response measures to tackle increasing social exclusion levels, high unemployment and worsened accessibility of SMEs finance, including the ***Europe 2020 Strategy for Jobs and smart, sustainable and inclusive growth ("Europe 2020")***[8] and the ***Action Plan to improve access to finance for SMEs***[9] (2011). More recently, the **European Fund for Strategic Investment (EFSI)** Initiative was launched in 2015 jointly by the EC and the EIB Group (EIB and EIF) as part of the Investment Plan for Europe to mobilise around EUR 315 bn from public and private sources for strategic investments over a 3-year period (2015 to 2018). A total of EUR 5 bn is earmarked to support SME risk finance, including SMESec. It envisages the purchases of junior tranches and guarantees on high-quality securitisation (HQS).

Some key regulatory changes relevant for SMESec at European level have occurred during the period covered by this evaluation:

- The ***"Securitisation Framework"*** package launched in 2015 in the context of the EC's Action Plan for the Capital Markets Union aiming at removing current hurdles and revitalising high-quality securitisation. This package included:
  - A proposal for a ***Securitisation Regulation***, to cover all securitisation and include due diligence, risk retention and transparency rules together with criteria to identify Simple, Transparent and Standardised ("STS") securitisations; and
  - A proposal to amend the ***Capital Requirements Regulation (CRR)*** to make the capital treatment of securitisation by banks and investment firms more risk-sensitive and able to properly reflect the specific features of STS securitisations.

- The ***Basel II Framework*** adopted by the EU in 2008 revising the banks' capital framework building on the lessons learned from the crisis. These rules tightened the conditions under which institutions could benefit from lower capital requirements following a securitisation.

- The ***Basel III Framework*** issued by the Basel Committee in December 2010 including detailed rules of new global regulatory standards on bank capital adequacy and liquidity. These new Basel rules have also been taken on board on the recent EU legislative reforms noted above[10]. Planned to be adopted by 2019, this regulation is expected, however to continue putting pressures on bank's capital structure and discourage investment in securitisation instruments by restraining their eligibility for liquidity purposes and rendering too expensive in terms of capital charges compared to other funding instruments. Under the current Basel III proposal, it will be more beneficial for originators to hold SME loans to invest on SMESec, given that the latter can absorb up to 5-7 times more capital than the former[11].

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7 Lisbon European Council, 23-24 March 2000, Presidency Conclusions. Report by the ECOFIN Council to the Nice European Council on the review of Community Financial Instruments for Enterprises: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/misc/13056.en0.html

8 EC Communication, "Europe 2020 - A strategy for smart, sustainable and inclusive growth", COM(2010) 2020 final, 3.3.2010.

9 COM/2011/0870 final.

10 For instance, the Capital Requirements Directive - CRD IV - and the Capital Requirements Regulation – CRR. Official Journal of the European Union, L 176, 27 June 2013.

11 EIF WP 2015/31, page 34.

3.2 Policy context, Objectives and Type of Activities

3.2.1 Policy context of the EIF's SME support via SMESec (2004-2015)

From the standpoint of the EIF's mandate, securitisation is a means to an end: to improve access to finance for SMEs. EIF was set up in 1994 as a self-sustaining and policy-driven institution with two main statutory objectives:

a) Supporting EU policies, by taking investment risks for supporting SMEs and Trans-European Networks (TENs) (the later only until 2000); and

b) Generating an appropriate "return" for its shareholders, through a commercial pricing policy and a balance of fee and risk-based income.

In line with its mandate, the EIF has developed over time a "product mix" including: (a) equity, (b) guarantees and credit enhancement/securitisation, (c) venture capital, (d) microfinance and (e) regional development and partnerships.

The EIF's first securitisation transaction dates back to 1996. Up to 2008, SMESec was a rapidly growing EIF business activity in line with SMESec market development in Europe. In 2009, the EIF faced a drastic drop in securitisation transactions, having supported no transaction that year (see Chapter 4 below). Subsequently, following the changing market environment, the EIF worked on mainstream SMESec transactions with large market players committed to SME financing, and with second-tier banks. Following the 2007-2008 EU-wide SME consultation exercise, the EIF decided to reach out to smaller/regional banks given their focus on lending to SMEs. Moreover a 50% capital increase was approved by the EIF shareholders in 2007 and again in 2014[12] for the EIF to support further the delivery of EU policies, in particular increasing SMEs' access to finance at difficult times.

The EIF has been managing a number of mandates on behalf of the EC and Member States to make more SME finance available, including through SMESec. Due to the worsening of SMEs' access to finance after the 2008 crisis, the EIF has been asked to play a more prominent role in revitalising SMESec Market in Europe (see Section 3.2.3. below).

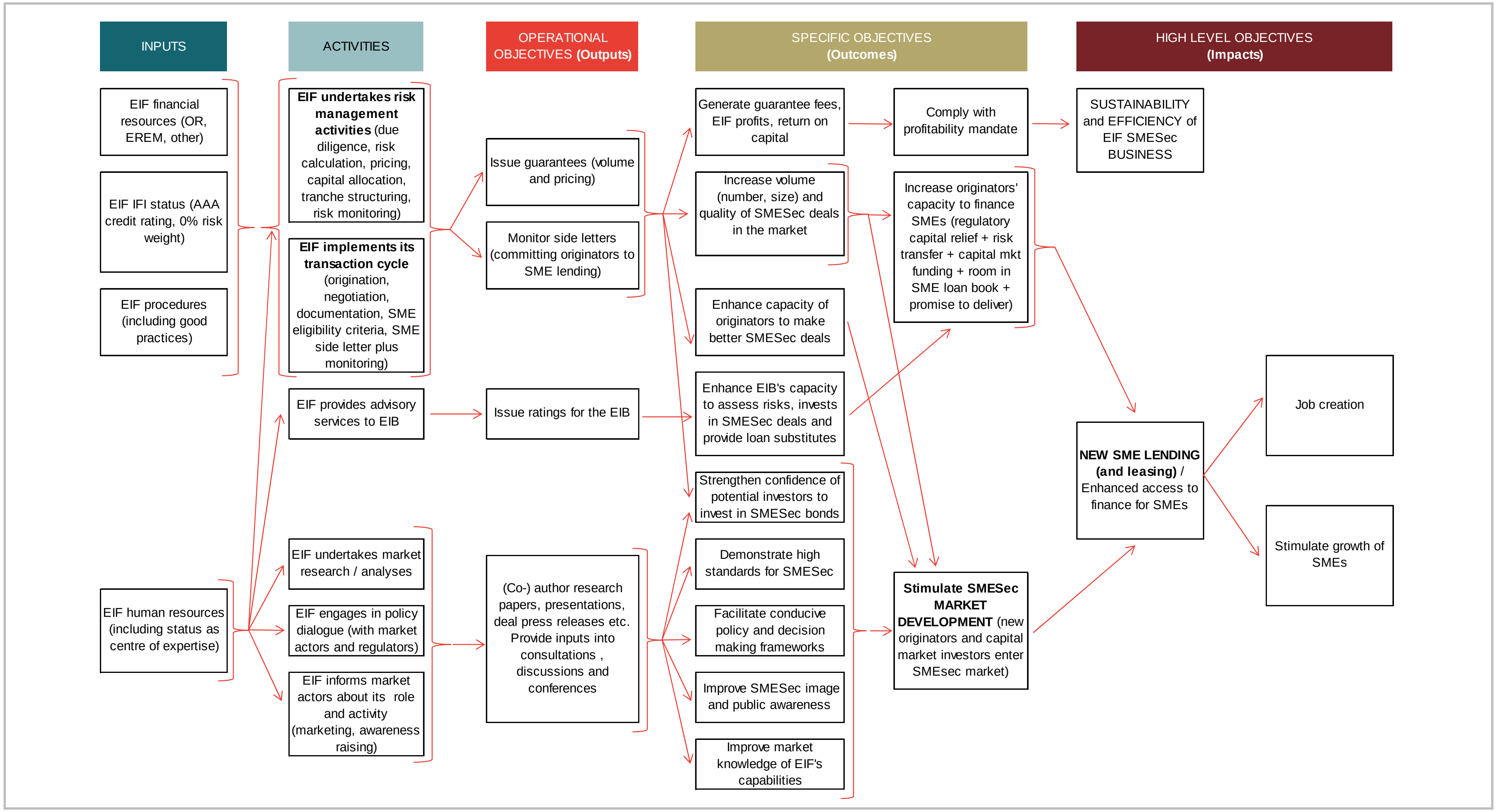
3.2.2 Objectives of the EIF SMESec and Intervention logic

A representation of how the EIF's SMESec activities aim at achieving EIF's objective of improving SME access to finance is provided in the intervention logic depicted in Figure 3 below. Reconstructed by EV and discussed with the EIF, the intervention logic makes explicit the "theory of change" regarding the EIF's SMESec activity.

The diagram in Figure 3 below captures the key transmission channels that link the EIF's SMESec activities to its intended objectives and ultimate impacts. The intervention logic covers both the EIF transaction activities (e.g. the provision of SMESec guarantees) and non-transaction activities (e.g. research, market analysis and policy dialogue). It summarises key causal links between the following interrelated EIF's SMESec dimensions: (a) *inputs* (financial, human and material resources available); (b) *activities* undertaken by the EIF, (c) *outputs* (what is expected to be directly delivered by the EIF's activities, and are the direct result of the EIF's decisions); (d) *outcomes* (or specific objectives; effects attributable to the EIF's SMESec transactions) and (e) *impacts* (or high level objectives; indirect and/or long-term effects to which the operation contributes along with other actors and factors and to which the EIF only has indirect influence). A key assumption in the intervention logic is the expectation that originators carry out new SME lending following the SMESec transaction. This commitment is reflected in side letters signed with the originators. *This increased commitment to SME finance is EIF's overarching policy objective that justifies its involvement in SMESec*.

[12] SEC (2006) 1347 - Annex to the Proposal for a Council Decision on the Community participation in the capital increase of the European Investment Fund; http://www.eif.org/who_we_are/news/2014/capital-increase.htm.

Figure 3. Intervention Logic

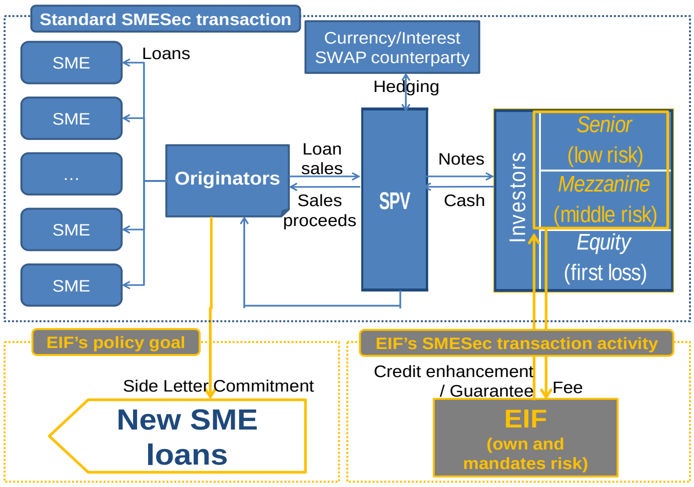


3.2.3 Type of Activities

(a) EIF's SMESec transaction activity

The EIF's SMESec true sale transaction activities refer to the EIF's bilateral guarantees provided to investors or guarantees embedded in the ABS transaction structure ("wrap") and hence provided to the SPV directly, whereas the EIF's SMESec synthetic transaction activities, consist of sale of protection (through financial guarantees) on the underlying portfolio itself (which is not transferred to an SPV), directly to the benefit of the originator (protection buyer).

Figure 4. Basic structure of an SME Securitisation and EIF's intervention



Source: EIF Presentation (2009), adapted by EV.

On Figure 4, the upper part shows the standard structure of a SMESec true sale transaction, whereas the lower part illustrates how the EIF can facilitate the execution of SMESec transactions by providing guarantees to investors buying the senior or mezzanine tranches in exchange of a guarantee fee. In return for its support, the EIF requires originators to commit to reuse part of the additional funding or capital released into new SME loans within a certain timeframe.

True sale transactions are sometimes carried out alongside EIB's investment where, for example, the EIF provides a guarantee to the investors underwriting the mezzanine notes, while EIB purchases senior tranches. Since the EIF usually does not take first-loss risk, the junior tranche is generally retained by the originator (or sold to a third-party protection seller)[13].

In a SMESec transaction where the EIF provides a guarantee, according to the EIF the participating financial institutions benefits from the following advantages [14]:

- ABS backed by an EIF (embedded) guarantee enjoy (explicitly or implicitly) an AAA rating;
- Credit risk transfer and capital relief - through the placement of notes with cash investors or otherwise - are further facilitated by the 0-risk-weighting assigned to the assets EIF guarantees, thanks to its Multilateral Development Bank status;
- The EIF charges a risk-premium for its guarantees which is generally in line with market rates, after a detailed analysis of the transaction and of the originator;
- The EIF can sell protection on the underlying portfolio itself, e.g. directly to the benefit of the originator in synthetic deals.

Depending on their source of funding, the EIF SMESec transactions can be:

i. ***Own risk transactions***, those funded by the EIF's own balance sheet (also known as "*own resources*"), whereby the EIF employs its own capital to credit enhance tranches of SME loan or lease securitisation transactions, and to provide guarantee cover for SME loan and lease portfolios to financial institutions on a bilateral basis. Since 2004 the EIF's own risk guarantee operations have focused largely on credit enhancement of SMESec operations[15]. In 2015, the EIF also started participating as a cash investor.

[13] See EIF WP2015 (pp 24).
[14] See EIF WP2015 (pp 23).
[15] Source: EIF Annual Reports (2004-2014).

ii. ***Mandate transactions*** (also known as *"trust activity*"), whereby the EIF manages a number of mandates on behalf of the EC, the EIB, Member States or Regions intended to promote a variety of public policy objectives while keeping its focus on enhancing SME access to finance, also through SMESec transactions. Box 5 below shows an overview of the EIF's mandates which provide for SMESec.

Box 5. Mandates with SMESec options managed by the EIF.

Some of the EIF's mandates, most of them recent, envisage a securitisation option:

- *Competitiveness and Innovation Framework Programme (CIP)* (2007-2013) launched by EC, which included a SME guarantee window (CIP-SMEG), that was expanded substantially to focus on mezzanine finance.
- *Loan Guarantee Facility (LGF)* under *COSME* (Competitiveness of Small and Medium-sized Enterprises) (2014-2020), which replaced *CIP-SMEG (2007-2013)*: With a planned budget of EUR 1.3bn, EIF offers guarantees and counter-guarantees, including SMESec, to selected financial intermediaries (e.g. guarantee institutions, banks, leasing companies, etc.) to enable them to generate new SME loans.
- The *EIB Group ABS Initiative for SMEs*, launched in 2013 following the signature of the Service Level Agreement (SLA) in relation to ABS SME-based transactions between the EIB and the EIF for a 3-year period with a total of EUR 3bn. It combines EIB investments in senior SME-backed ABS notes at favourable conditions, with on the EIF's expertise for due diligence and monitoring of ABS transactions in exchange for a fee. SLA also covers the EIF services to ABS related to other asset classes and in countries where EIF has experience. Late 2016 this initiative was extended to cover not only cash but also synthetic securitisation of SME loans and other asset classes (such as RMBS, consumer loans and diversified payment rights). EIB Group investment is earmarked not only for senior tranches (for funding purposes), but also for higher risk senior tranches and mezzanine (capital relief). In addition, the EIF will also be fronting certain transactions (for synthetic deals) whilst receiving a back-to-back guarantee from the EIB.
- *EREM Asset-Backed Securities (ABS) Credit Enhancement*: following a request by the European Council in 2014, the EIB Board of Directors approved a debt financial product to be managed by the EIF under the EIB Group Risk Enhancement Mandate (EREM). Up to EUR 6bn have been earmarked for the period 2014-2020.The target for 2014-2020 is EUR 890m of mezzanine tranches guaranteed by the EIF or invested in by the EIF with a risk split between the EIB (2/3) and the EIF (1/3). The renewal of EREM is expected to be approved early 2017 with additional EUR 900n of EIB resources for investments to be rolled out in the period 2017-2020.
- The *SME Initiative*: Co-funded by the EU through EFSI, COSME and/or Horizon 2020 resources and EIB Group resources, this joint EC-EIB Group financial instrument aims at stimulating SME financing by providing partial risk cover for SME loan portfolios of originating financial institutions. Member States can opt-in to the Initiative until the end of 2016, by expressing their interest to the EC. The initiative contains a specific securitisation window.
- *European Fund for Strategic Investment (EFSI):* EUR 5 bn is earmarked to support SME risk finance, including SMESec. SMEs and mid-cap companies will be eligible.
- *EIF-NPI Securitisation Initiative (ENSI):* With EUR 100m entrusted by the EC, EIF launched in 2016 a cooperation and risk sharing platform, together with several National Promotional Institutions (NPIs), to stimulate SMEs' access to finance in Europe by revitalizing the SMESec market catalysing private sector resources.

Source: EV own elaboration from EIF data, EIF WP 2010/007, 2015/31, Debt products page on eif.org.

(b) SMESec non-transactional activity

SMESec non-transactional activities include SMESec activities unrelated to specific transactions, including the EIF's research, market research and analysis (e.g. working papers), policy dialogue with relevant stakeholders (e.g. regulators) and market participants on policy issues related to SMESec inside and outside the EU, best practice design (i.e. high quality securitisation) and regulation; marketing and awareness-raising activities about the EIF's role in SMESec, etc. These activities aim to build up SMESec "*know-how*" and spreading best market practices (i.e. transaction structuring, etc.). Non-transactional activities are thus meant to stimulate the development of SMESec markets (eventually resulting in new SME lending) by demonstrating high standards for SMESec and improving SMESec image and public awareness, for example.

Moreover, the EIF also provides advisory services (i.e. due diligence, risk rating and monitoring services) to EIB, for instance under the SLA signed in the framework of the EIB Group ABS Initiative for SMEs. Finally, in case of unexperienced originators, the EIF provides a great deal of advice to spread best practice and support market development.

4. Portfolio Review

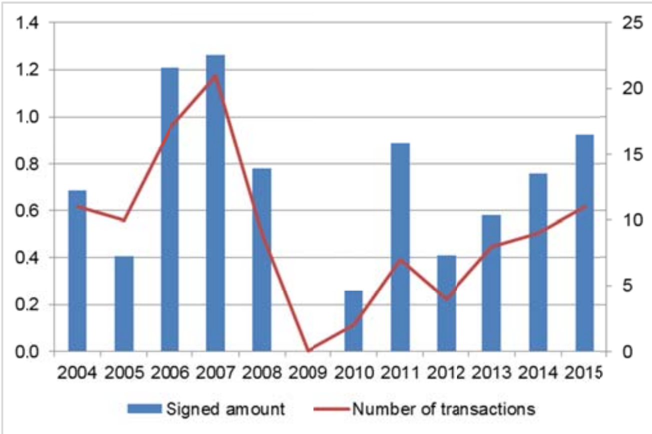
This chapter assesses the scope and evolution of the EIF's SMESec portfolio in the period 2004-2015, as well as of the EIF's non-transaction SMESec activities.

4.1 Transactional activity (2004-2015)

Number of deals and signed amounts: During the period 2004-2015 covered by this evaluation, the EIF participated in 109 SMESec deals accounting for a total signed amount of EUR 8.2 bn funded by the EIF own resources and mandates.

As Figure 5 illustrates, the EIF's SMESec activity during the period 2004-2015 followed closely the ups and downs of the securitisation market. Before 2008, SMESec became one of the EIF's core business activities in support of SMEs financing focussing on risk transfer from banks to the EIF and other investors. Prior to the crisis, the number of SMESec deals signed by the EIF peaked with 21 transactions in 2007. Over time, the EIF also varied transaction types to include credit derivatives for both synthetic structures and true sale securitisations; and innovative collateral types, for example subordinated loans to banks in Denmark, and loan guarantees and leasing receivables in Italy. The EIF's appetite for risk also increased taking on a wider variety of tranches, including many mezzanine, while maintaining a balanced portfolio approach and a fair risk return coverage.

Figure 5. EIF SMESec deals and signed amount (#, EURbn)



Source: EV based on EIF data.

However, the EIF securitisation activity came to a halt in 2009 with no transaction that year. This reflected the situation in the market, where eight ABS deals were executed in the fourth quarter of 2009, but no public SMESec transactions. After that year the EIF supported the re-opening of the SMESec markets by participating in most of the transactions originated in Europe. In 2010, the EIF invested in Europe's two largest SMESec transactions in Germany and the UK (amounting to EUR 200m and EUR 60m respectively). Since 2013, originators have continued mainly to retain newly-issued SMESec tranches to collateralise financing from central banks and create liquidity buffers. In 2013 the proportion retained was 86.3%, growing to 94.9% in 2014 and 92.4% in 2015 (see Section 2.2 before).

The period 2004-2008 (5 years) accounts for EUR 4.4 bn or 53% of the EIF's SMESec total signed volume. The period 2009-2015 (8 years) accounts for EUR 3.8 bn or 47% of the EIF's SMESec total signed volume. During 2004-2008, 155 EIF-guaranteed tranches supported 68 SMESec deals[16], while during 2009-2015, 60 EIF- guaranteed tranches supported 41 SMESec deals.

Table 2. EIF SMESec deals (2004–2015)

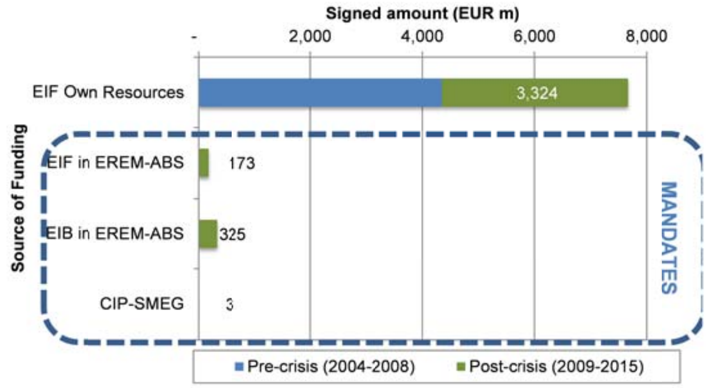
Period	Market cluster	Deals (#)	Tranches (#)
2004-2008	Active Less active Minimally active Multi Country	47 9 1 11	109 12 1 33

16 "Deals" refer to SMESec transactions in which the EIF guarantees at least one tranche. In some deals, the EIF issues more than one guarantee.

Period	Market cluster	Deals (#)	Tranches (#)
2009-2015	Active Less active Minimally active	35 4 2	52 4 4
Total		**109**	**215**
Source: *EIF data, adapted by EV.*			

Source of funding: During the pre-crisis period, the EIF SMESec activity was funded largely by its own resources (OR), whereas during the post-crisis period, funding was came also from EIB group or third-party mandates. However, overall during the period covered by this evaluation, the majority of the EIF SMESec transactions have been funded by EIF own-resources (87% of total), with much lower contributions from EREM-ABS (13% of total signed amount; and CIP-SMEG (0.07% of total signed amount)[17] as shown in Figure 5.

Figure 6. EIF SMESec signed amount by source of funding (EURm)



Source EV based on EIF data.

Although other mandates managed by the EIF had resources available for SMESec (see Box 5 in Section 3.2.1 above: COSME, SME Initiative[18], etc.), no SMESec transactions have been signed by the EIF under such mandates as of end 2015.

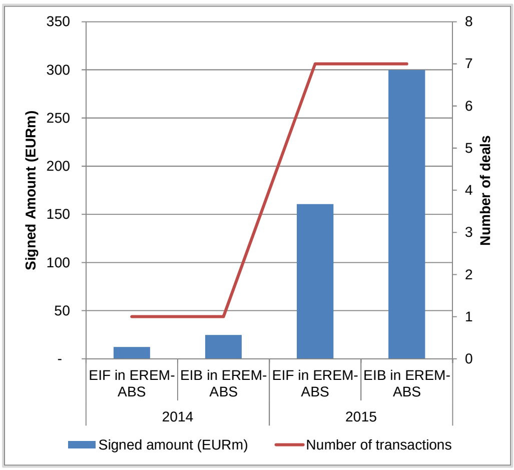
Box 6. The EIB Group Risk Enhancement Mandate (EREM)

EREM has been signed between the EIB and the EIF in March 2014 to support the impaired financing of European businesses. With a total of up to EUR 6bn earmarked, up to EUR 4bn contributed by the EIB and complemented by up to EUR 2bn by the EIF, EREM aims at supporting additional guarantees, debt and equity instruments.

EREM includes a number of different products/windows either reinforcing existing activities or strengthening EIB Group positions using alternative financing tools to respond to concrete new market needs.

Under EREM, the following financial product, inter alia, is made available: Asset-Backed Securities (ABS) Credit Enhancement. Figure 7 displays the overall EREM signed amounts and number of deals, providing also information on the EIF and the EIB's share in EREM.

Figure 7. EREM deals (#, EURm)



Source: EIF data, adapted by EV.

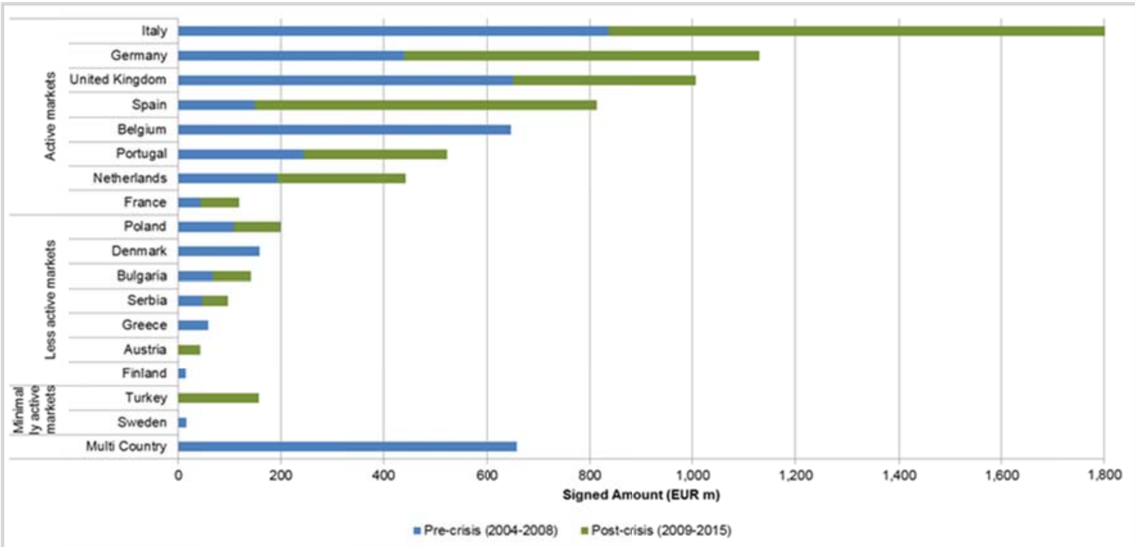
17 Only two transactions in Italy were signed in 2013 under CIP-SMEG.

18 The SME Initiative is currently operational in Bulgaria, Finland, Italy, Malta, Spain and Romania. Italy was the only country opting for the securitisation window whereas the remaining countries opted for the capped portfolio guarantee window.

Geographical distribution: The EIF has transacted in a total of 17 countries, both inside (15 countries) and outside of the EU (2 countries)[19]. The EIF was also involved with pan-EU and multi-country transactions before 2009 but none afterwards, as depicted in Figure 8 below. Before the crisis, the EIF concentrated its SMESec business in developed markets (UK, Italy, Germany and Spain) while adding new markets (Belgium, Bulgaria, Czech Republic, Denmark, Portugal, France, Greece, the Netherlands, Serbia, and Sweden). The EIF has participated in SMESec transactions in "active" and the "less active" market clusters; focusing on fewer "active markets" after the crisis[20].

In the context of the uncertain landscape and volatile credit environment after the crisis, the EIF's SMESec activity concentrated by large in four active national markets: Italy, Germany, UK and Spain, accounting for 74% of the EIF's SMESec volume from 2009 to 2015 (nearly 50% in the period 2004-2008).

Figure 8. EIF's SMESec signed amounts (EURm) by market cluster (2004-2015) before and after the 2008 crisis.



Source: EV based on EIF data.

In 2012, the EIF added Turkey to its list of beneficiary countries, where the first project launched under the EIB ABS initiative took place in 2013. Activity in Turkey concentrated that year with four deals, of which two of considerable volumes (EUR 35 m and EUR 22 m).

Originator size: Table 3 provides a summary of the distribution of EIF SMESec deals in terms of originator size and national market cluster. This evaluation defines "large banks" as those listed by the ECB as "significant banks"[21] and defines as "small banks" all other banks, as well as independent leasing firms not linked to large banks. For the purpose of the present evaluation, non-Euro area banks have been classified by EV under both categories on the basis of the first ECB criterion only (total assets > EUR 30 bn).

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[19] The EIF signed SMESec transactions in 15 EU countries (Italy, Germany, Spain, UK, France, Netherlands, Belgium, Portugal, Greece, Poland, Bulgaria, Austria, Denmark, Finland and Sweden) and outside the EU (Turkey and Serbia).

[20] The categories '*active'* and *'less active'* markets are based on the analysis in the Background Study for this evaluation (2015) – see Box 4 for definitions.

[21] Full list of supervised entities as of 31 May 2016, European Central Bank: https://www.bankingsupervision.europa.eu/banking/list/who/html/index.en.html

Table 3. Number of EIF SMESec deals by originator size per market cluster (2004-2015)

Period	Market cluster	Large	Small
2004-2008	Active	35	12
	Less active	3	6
	Minimally active	1	-
	Multi country	4	7
2009-2015	Active	22	13
	Less active	2	2
	Minimally active	2	-
Total		**69**	**40**

Source: *EIF data and EV (2015).*

This shows that the EIF worked both with small and large banks over the entire period, but worked more often with large banks in the active markets.

4.2 Non-transactional activity (2004-2015)

The EIF's non-transactional activities mentioned in Section 3.2.3 aim to support developing SMESec markets, as well as spreading SMESec "know-how" and best market practices (i.e. transaction structuring, etc.). Some highlights include:

- The different research and communication activities carried out by the EIF's SME Research and Market Analysis (RMA) Division. This Department is responsible for publishing Working Papers (WP)[22], communicating with academia and SMESec stakeholders and representing the EIF in several professional and public forums. The WP series cover a wide array of topics related to SME finance, including a regular series on European Small Business Finance Outlook. Some of them focussed precisely on the evolution of the SMESec market in Europe before and after the 2008 crisis and capture the key issues facing the intended revitalisation of the SMESec market activity in the EU;
- The EIF's relations with European financial regulators, including the ECB, the Bank of England, Bank for International Settlements (BIS), International Organization of Securities Commissions (IOSCO); and the European Banking Authority (EBA);
- Inputs to relevant consultations, typically in the form of an EIB Group response, or the EIF specific depending on the nature of the enquiry and the areas of expertise. Examples of such consultations are:
    - o The EC's consultation on the Capital Markets Union covering the proposal for the Securitisation and Capital requirements Regulations and directive CRR/CRD IV and the creation of a type of securitisation transactions that would be simple, transparent and standardised ("STS");
    - o Input to the work of the High Level Expert Group on SME and infrastructure financing.

In addition, the EIF provides advisory services on SMESec within the EIB Group. A good example is the EIB-EIF cooperation under the ABS Service Level Agreement (SLA) signed in 2013[23] including *inter alia* ABS SME-based transactions. Under the SLA, the EIB relies on the EIF's expertise for defined initial due diligence, risk assessment and monitoring services, against a fee. Under this initiative the EIB has invested a total amount of EUR 5.7 bn in 21 transactions since inception until 31 December 2015, almost half of them signed in 2014. Most EIB-SLA transactions have taken place in Spain and Italy, both active SMESec markets in the EU (with 52% and 26% of total signed volume respectively).

22 See http://www.eif.org/news_centre/research/index.htm.
23 The SLA stemmed from the EIB Group ABS Initiative for SMEs, described in Box 5 in this report.

5. EVALUATION FINDINGS

This section of the report presents the findings of the evaluation articulated around the five key questions the evaluation sought to answer (see Box 2).

5.1 Relevance

How relevant were the EIF's SMESec activities vis-à-vis identified SME finance needs and existing policies? To answer this question, the evaluation sought evidence about the consistency of the EIF's activities with EU and EIB Group policies; how the EIF's SMESec guarantee instrument addresses the perceived market failure in SME finance; the comparative advantage of the EIF; and whether the EIF's SMESec activities – as captured in its intervention logic - remain valid today.

5.1.1 Consistency of the EIF's activities with EU and EIB Group policies

From the standpoint of the EIF's mandate, SMESec is a means to an end. Enhancing SME access to finance is a fundamental public policy goal at the core of the EIB Group activities, typically around a third of overall EIB annual signature volume and the entirety of the EIF activities[24]. The EIF's SMESec activities (both transaction and non-transactional related) aiming at attaining its statutory objective to improve access to finance are strongly aligned with the high level EU objectives of enhancing SME access to finance, entrepreneurship and supporting SME competitiveness and innovation.

In the post-crisis context where supply of risk capital and debt finance to SMEs are scarce and fiscal austerity policies are implemented across Europe, the relevance of the EIF SMESec activities has been reinforced. This is evidenced by the calls from the European Council and the EC - one of the EIF's shareholders - for the EIF to support the delivery of EU policies (e.g. SMEs' access to finance, innovation, etc.). For instance, the EIF capital increases in 2007 and in 2012 aimed at increasing the debt finance available to SMEs, among others. In parallel to the capital increases, the EIF has been requested to implement several financial instruments on behalf of the EC and Member States to promote the above mentioned EU's public policy objectives[25].

5.1.2 The EIF's SME guarantee instrument and the perceived market failures in SME finance

The main underlying assumption in the intervention logic for this evaluation (see Section 3.2.2) is that SMESec increases the originators' capacity to lend to SMEs and ultimately results in additional SME lending. A key element in the design of the EIF SMESec instrument to ensure the causality link between SMESec and additional SME lending is the materialisation of the commitment laid down in the side letters signed with originators. The EIF requests originators to sign side letters committing to reuse the additional funding or released capital for more SME lending. The EIF generally requests an amount at least equal to 100% (for synthetic deals, a higher multiplier is requested) of the volume of the SMESec guarantee commitment within (typically) one year from the issue date to be reused for SME lending. This requirement has been recently reinforced with the introduction of the EIF's Value Added Methodology (VAM), which on a first stage assesses the ex-ante catalytic effect of the supported transaction and on a later stage compares the ex-ante with the ex-post impact assessment, on the basis of reporting provided by the originators. The extent to which these tools have helped the EIF to attain the expected SMESec instrument's policy impact is assessed in Chapter 5.2 on Effectiveness below.

24 Report on EIB group activities in support of SMEs and midcaps in 2015.

25 Before the crisis the SME Guarantee Facility (SMEG) under the Competitiveness and Innovation Programme (CIP) 2007-2013, and after the crisis: the SME Initiative, COSME (2014-2020) (See Box 5).

As such, increased SME lending does not appear to be a primary purpose for originators to undertake SMESec transactions as evidenced by interviews, surveys carried out and literature reviewed in the context of the evaluation. Instead, the originators' motivation to use SMESec has been to meet other needs, for instance (i) to raise long-term funding at a lower cost, (ii) to improve short-term liquidity and (iii) to obtain regulatory capital relief, independent of the type of loans (e.g. SME loans, mortgage loans, car loans etc.) used for securitisation. Originators do not measure the benefits of SMESec in terms of capacity to lend, but rather in terms of cost of funding and cost of capital.

In addition, the current availability of ECB funding at relatively low cost, decreases the incentives originators once had to securitise, rendering securitisation an uneconomical funding option for institutions which have access to such funding facilities. On one hand, the fact ECB started allowing the posting of SME securitisation as collateral for Eurosystem credit operations, undoubtedly led to numerous new issues of SME securitisation; on the other hand, the key benefits of securitisation were not achieved, as the issues were mainly retained by originators rather than placed in the market, therefore not providing for the necessary capital relief to allow for further on-lending through redeployment of funds to the SME sector. This analysis implies that the design of the EIF SMESec instrument needs to be enhanced with a view to include additional measures to ensure that the capital released and additional funding provided by SMESec transactions are directed towards the real economy; hence that originators increase lending to SMEs. Originators need more incentives to use the capital released and the additional funding from SMESec to lend more to SMEs. Other external factors, such us the new banking regulations may affect the relevance of the EIF SMESec instrument, as they are expected to make further investment on SMESec more difficult.

As stated by the EIF in several publications, "*securitisation per se is not good or bad – it is a toolbox, an instrument, a technique. As such, it is value-free (…)*"[26]. Moreover, SMESec can only be a component of a broader public effort to improve access to finance for SMEs, alongside intermediated lending, risk-sharing instruments and equity, which the EIB Group is already offering to meet the financing needs in the various stages of an SME's lifecycle.

5.1.3 The EIF's comparative advantages to address the perceived market failures in SME finance

Even though public support schemes, either at European level (EIF) or at national level, were considered essential to start and maintain SMESec markets across EU-28, the EIF's value added was regarded by stakeholders interviewed more limited (a "*nice to have*") in the case of countries with mature SMESec markets and with strong public support schemes (such as Spain and Germany with the FTPYME and KfW Promise programmes respectively). Both programmes were launched in the pre-crisis years in countries where securitisation was most developed in Europe. In these countries, the main comparative advantage of the EIF involvement was to provide critical mass or support increasing the transaction size. Given that synthetic securitisation (the focus of the KfW Promise programme) has nearly disappeared in the post-crisis context, the Spanish FTPYME programme remains as the most relevant national programme in the EU market.

5.1.4 The current validity of the EIF's SMESec activities

Given its policy mandate to support SMEs' access to finance, the EIF is expected to respond to market developments encouraging investment at times when other market participants pull out from such market. To this end, the EIF's intervention has evolved over time with the aim to respond to evolving market needs and to deliver the expected policy outcomes, as follows:

- In terms of means deployed, both the scale of resources and type of instruments have diversified: from guaranteeing SMESec transactions exclusively with the EIF own resources to combining them with a variety of other funding sources, either from the EIB (under EREM

[26] EIF WP 2015/31, page 13; EIF WP 2010/007, page 14.

Mandate), from third parties (EC's mandates such as CIP, COSME, etc.) and with from other National Promotional Banks (e.g. NPI's Platform); the deployment of advisory services under the EIB SLA agreement;

- In terms of the scope and type of the EIF's SMESec support, for instance by providing a higher risk-coverage for SME loan portfolios of originators, focusing not only on guarantees of senior tranches but also on mezzanine tranches, as noted in the EIF's COP 2015-2017;
- In terms of the originator's outreach, the EIF's focus on reaching out to smaller/regional banks with a view to target more SMEs, alongside its activity with large market players committed to SME financing.

Yet, the question whether the EIF SMESec activities are still "*fit for purpose*" cannot be answered by analysing solely the EIF's product offer and its evolution over the period under evaluation. A combination of several key external factors plays a key role in the current validity of the EIF SMESec product offer:

- Some national regulatory frameworks unfit to promote SMESec, as well as the significant regulatory changes under way at European level (e.g. to apply Basel III). The latter are expected to further restrain the banks' capacity to lend to SMEs, though it has been balanced by an emerging alternative SME financing market (such as insurance and leasing companies, fintechs and peer-to-peer financing, which are subject to less regulation than banks);
- The low interest rates context and the ability of the ECB to continue to inject large-scale liquidity into banks via its "repo-facility", making more attractive for originators participating in SMESec transactions, to retain the securities issued. Then originators use those retained securities as collateral to access ECB funds, rather than placing them on the market and obtaining in return the capital relief necessary to deploy additional SME lending;
- The general trend for many banks to pull out of SME lending in EU countries more affected by the crisis, whereas in countries less affected (i.e. the Netherlands, Germany, etc.), the supply of SME lending and competition in the banking sector remains strong.

An OECD report[27], referred that "*SME securitisation support as currently extended by the European Investment Bank and European Investment Fund were acknowledged as highly professional and well-intentioned, but public support, in particular eligibility of such instruments for ECB collateral, was seen to potentially carry counterproductive effects, blocking the revitalisation of a market-based SME securitisation. Supported deals end up in a similar way as collateral for repurchase agreements by European banks seeking cheap funding from the ECB. Further development of current schemes should preferably allow market-based perceptions and pricing of risk, once the current regulatory inconsistencies are overcome. (…)*

Although allowing the posting of SME securitisation as collateral with the ECB was viewed as undoubtedly beneficial given the collapse of the interbank market, it was highlighted that such policy had a detrimental effect to the revitalisation of the real securitisation market, with most issuances being retained rather than placed in the market (Figure 4 above). As noted in the OECD report referred above, "t*he key benefits of securitisation were not achieved through these funding operations, as they provide no capital relief and therefore do not allow for further on-lending through redeployment of funds to the real economy and to the SME sector. At the same time, the absence of a capital relief does not assist in the deleveraging effort of the banks*."

5.1.5 Conclusion on Relevance

The EU objectives to support SME access to finance, entrepreneurship and SME innovation are strongly aligned with the EIF's overall objectives to increase debt finance to SMEs, among others, through SMESec. The 2008 financial and economic crisis has increased the importance of financial instruments, including SMESec, as a means to achieve these EU objectives.

The main underlying assumption behind the EIF's SMESec is that SMESec increases the originators' capacity to lend to SMEs and originators ultimately make more lending available to

[27] Non-bank debt financing for SMEs: The role of securitisation, private placements and bonds, OECD, 2014.

SMEs. A key element in the design of the EIF SMESec instrument to ensure such assumption materialises is the fulfilment of the originators' commitment laid down on the side letter to extend a multiple of the EIF guarantee as additional lending to SMEs within a certain timeframe. The follow-up of this commitment has been recently reinforced by the introduction of the ex-ante and ex-post impact assessments within the EIF's VAM. Despite these measures, the combination of some external factors, including other central policy interventions (ECB), rendered securitisation for funding purposes uneconomical and reduced the key benefit of securitisation - capital relief. Additional measures might be needed to strengthen the design of the instrument, particularly linked to the fulfilment of originators' commitment laid down in the side letters (e.g. by providing originators with additional incentives to use the released capital for additional SME lending), with a view to ensure the EIF's SMESec activity remains fit for purpose.

The assessment of the relevance of the EIF's SMESec needs to be done within the context of some key external factors beyond the EIF's remit, such as the absence of adequate national legal frameworks, the ongoing regulatory reforms at European level, the ECB "repo" facility and the outlook of banks' lending to SMEs in some countries, which alter the securitisation landscape. The EIF's guarantees to SMESec could only deliver its policy objectives as part of a broader public effort to improve access to finance for SMEs alongside, for instance, other financial instruments (i.e. intermediated lending, risk sharing instruments and equity support).

5.2 Effectiveness

To what extent did the EIF's support to SMESec succeed in increasing SMEs' access to finance? To answer this question the evaluation sought evidence about the extent to which the EIF met its objectives as defined in the reconstructed intervention logic (see Section 3.2.2 above), namely: (1) its operational targets and objectives set in the EIF's three year rolling Corporate Operational Plans; (2) the contribution of the EIF's SMESec activities to enhanced access to finance for SMEs (specific and high-level objective); and (3) the contribution of the EIF's SMESec activities to stimulate SMESec market development (specific objective). The assessment of the high-level objective on "sustainability and efficiency of the EIF SMESec business" depicted in the intervention logic for this evaluation is dealt with in the Chapters of Efficiency (Chapter 5.3) and Sustainability (Chapter 5.4) below.

5.2.1 The EIF's SMESec deals and business targets (Operational Objectives)

Out of the 12 years covered by the evaluation (2004-2015), Figure 9 below shows that the signed volumes of the EIF SMESec activities:

- Either exceeded expectations or remained within the range estimated in the respective COPs in 6 years (all pre-crisis except 2011 and 2015);
- Fell short of the expectations in 6 years (all "post-crisis" years but one, 2005).

Figure 9. Achievement of the EIF's COPs targets in SMESec business (signed vs expected)

	Expected volumes of EIF's SMESec (EURm)												
Source	**Forecast Date**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
COP 2003-2005	Jan-03	385	385										
COP 2004-2006	Dec-03	600 - 690	645 - 755	710 - 790									
EIF Operating Outlook 2005	Nov-04	880	850										
COP 2006-2009	Jan-06			600 - 800	635 - 840	635 - 890							
COP 2008-2010	Feb-08				750 - 1050	675 - 825	700 - 850	700 - 850					
COP 2009-2011	Dec-08						700	700	700				
COP 2010-2012	Dec-09						230	400	500	500			
COP 2011-2013	Jan-11								700 - 750	800	900		
COP 2012-2013	Jan-12									750	750		
COP 2013-2015	Jan-13										750	800	900
COP 2014-2016	Dec-13											770	865
COP 2015-2017	Apr-15												800
	Actual Volumes	**687**	**406**	**1,207**	**1,263**	**781**	**0**	**260**	**891**	**411**	**581**	**757**	**924**
	Performance	**Within the expected volumes**	**Lower**	**Higher**	**Higher**	**Within the expected volumes**	**Lower**	**Lower**	**Higher**	**Lower**	**Lower**	**Lower**	**Higher**
	(*) When a range is indicated, the difference is calculated on the basis of the upper figure.												
	Source: EV with EIF data and EIF COPs												

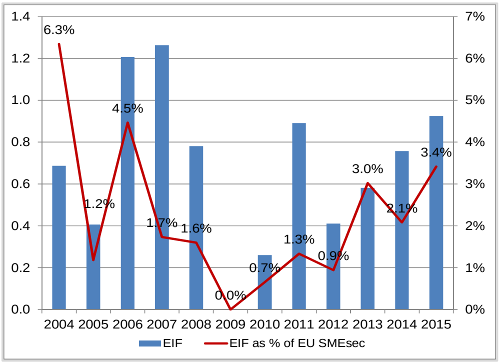
Source: EV based on the EIF COPs and the EIF Annual Reports.

This evolution shows that the EIF has followed the ups and downs of the SMESec market, particularly in a context of very difficult market conditions after the crisis. Given that the EIF SMESec business depends on the appetite of originators to issue transactions which themselves depend on market investors' appetite for this asset class, the difference between the planned and actual volumes supports the argument that the EIF acts as a "*market-driven*" institution, as echoed in interviews carried out for the purpose of this evaluation.

The EIF Annual Reports provide details on the general market evolution over the past year and the actual commitments per business line without comparing them with the planned commitments laid down on the EIF COPs. The EIF operational targets and indicators used by the EIF are more adequate to track and report on the EIF's performance regarding its financial statutory objective to "*generate an appropriate return for its shareholders*", but they offer little insight in the achievement of policy goals, namely increase effective SME lending. As an example of that lack of insight, target leveraged volumes are shown at service line level (for instance securitisation is part of the Guarantees, securitisation and microfinance service line) but are not displayed by single line of product/mandate. Moreover they are based on ex-ante leveraged volumes and not based on ex-post. Looking ahead, the EIF intends to report more regularly on ex-post impact, across its different service lines in a more systematic and consistent manner.

The comparison between the share of total SMESec issuance guaranteed by the EIF (own resources and mandates) compared to the total EU SMESec issuance over the period under evaluation (Figure 10) further supports the conclusion that the EIF's SMESec activity has followed the evolution of the SMESec market. During the pre-crisis period the EIF's total SMESec issuance represented on average 2.2% against 1.3% during the post-crisis period. However, it should be noted that over the last triennium (2013-2015) the EIF's share is more significant between 2.1% and 3.4%.

Figure 10. Share (%) of EU SMESec (EURbn) guaranteed by the EIF (OR+mandates)



Source: AFME and EIF data, adapted by EV.

Activity under mandates managed by the EIF has rather been limited until EREM was launched. As highlighted in the portfolio analysis (Chapter 4 above), SMESec deals under mandates have been signed under CIP-SMEG (2 deals for a total of EUR 2.5 m) and under EREM-ABS (8 SMESec deals by the EIF for a total of EUR 498 m). The achievement of EREM's targets during its first two years of implementation (2014-2015) has exceeded the expectations: EUR 498 m has been invested in SMESec tranches under EREM together by the EIB (around 65% of total) and by the EIF (35%), representing more than 50% of the target set for 2014-2020 (EUR 890 m of mezzanine tranches with a risk split the EIB 2/3 and the EIF 1/3). No other SMESec deals have been signed under other mandates as of end 2015.

5.2.2 The contribution of the EIF's SMESec activities to enhanced access to finance for SMEs

The evaluation sought evidence on whether the EIF's SMESec activities contributed to enhanced access to finance for SMEs by assessing whether (i) the EIF's SMESec transactions increased the originators' capacity to extend loans to SMEs; and whether (ii) the EIF's SMESec deals made more attractive for originators and investors (e.g. lower cost, credibility, rating stability, improved conditions: volume, tenor).

(i) Increased capacity for originators to extend loans to SMEs: Evidence gathered by the evaluation shows that SMESec has actually benefitted originators in terms of access to term funding, capital relief, etc. Yet, it is unclear to what extent the enhanced originators' capacity has been translated into additional SME lending for most of the period under evaluation. As mentioned before (see Chapter 5.1), the main tool put in place by the EIF to influence originators to lend more to SMEs is the commitment expressed in the side letters. The VAM and its ex-ante value-added and ex-post impact assessment are the EIF's internal tools to estimate (ex-ante) and verify (ex-post) the materialisation of such commitment.

Following the start of the implementation of the VAM's ex-post impact assessment in 2013, originators are requested to provide quantitative and qualitative evidence on an annual basis of their new lending/leasing made available to SMEs following the closing of the deal, in line with their side letters commitments, as well as on the number of SMEs that have obtained financing. This reporting is currently taking place following the closing of the transactions and the period requested by the EIF to reuse that additional SME finance on the side-letters (mostly one year but it can be longer in some cases). By the time the present report was finalised, the EIF has issued only two VAM Reports including an ex-post impact assessment: by the end of 2014 covering the EIF's SMESec activity closed in 2013 and in November 2016 covering transactions signed in 2013, 2014 and 2015.

The introduction of the ex-post impact assessment into the VAM and its regular reporting represents a good step forward, as it generates aggregated information to gain insight in the EIF activities' real effects. Following the introduction of the ex-post impact assessment, the EIF's SMESec instrument includes some key elements for better tracking the fulfilment of the ex-ante commitments in side letters and the instrument's relevance for addressing market gaps. Yet, for the most part of the period covered by the evaluation (2004-2012) the EIF did not have a procedure in place to systematically track data demonstrating the originators' fulfilment of the ex-ante commitment in the side letters and the extent to which the additional funding and capital released through the EIF's SMESec guarantee transactions have been actually used for new SME lending by originators. It therefore remains unclear whether the expected increased originators' capacity to extent additional SME loans has been effectively translated into increased SME lending or not before 2013.

Available data from the ex-post impact assessment in VAM report (2014) suggests that almost six originators (out of seven in total) have exceeded their ex-ante leverage commitment, even within the first 12 months of the closing of those transactions. Only one originator deployed additional lending as required on their side letter.

While collecting the ex-post impact assessment reports from the originators, the EIF exercises some quality controls and a plausibility check over the data reported and engages in discussions with originators that might lead to correction of the amounts initially reported. Nevertheless, the evaluation attempted to gain assurance on the achieved leverage reported by originators on SMESec transactions closed in 2013 by computing the growth in the SME lending portfolio of the originator banks, over the relevant period (portfolio approach), given that:

- First, money is fungible on the originator side, and hence is very difficult to establish a causality link between the additional lending reported by originators (in the current ex-post impact assessment quantitative reports) and the support provided through the EIF transaction; and
- Second, originators might have incentives to report positively on the achievement of the side-letter commitment in order not to jeopardise further EIF supported transactions.

Most of the originator banks' financial statements do not disclose the sector of the borrowers. Hence this evaluation used as an example the EIF's transaction with one originator in Spain that reported specifically on SME lending on its financial statements. The transaction between the EIF and this Spanish originator was signed in 2013. According to this originator's financial statements, SME lending grew considerably a year after signing with the EIF pointing at an exceptional leverage of x19.6 in 2014. This is merely a rough indicator that the EIF supported transaction had an impact on this originator's SME lending growth. Yet, it cannot be used as an exact leverage computation given that (i) the SME lending growth has also probably been funded other sources of financing; and (ii) the outstanding volume of loans to SMEs, as shown in the financial statements, are net of repayments, whereas the leverage should be computed solely on the newly disbursed loans to SMEs.

This notwithstanding, most other evidence provides a mixed picture about the effects of SMESec transactions on originators' lending behaviour to provide more SME lending. Large originators interviewed generally did not recognise a strong link between SMESec and their lending behaviour. Half of large originators and only a minority of small originators agreed that before the crisis the EIF SMESec deal helped them to increase their SME lending.

In the cases of banks with SME lending as a core business area (for instance, the case of above-mentioned Originator in Spain), the evaluation considers that it is highly likely that the additional funding and/or released capital provided through the SMESec transaction has been reused for additional SME lending but for the bank's existing client base rather than for new clients, who might have difficulties to access finance[28]. In the cases of large banks, where SME financing comprises a fraction of the bank's overall lending portfolio, the policy impact of SMESec is particularly difficult to verify[29].

(ii) More attractive SMESec deals for originators and investors: The EIF involvement has been regarded as critical for small banks, particularly in Central and Eastern European countries (CEE countries) before the crisis. Feedback from small banks surveyed underlined that the EIF made SMESec deals more attractive, especially for investors into the non-guaranteed tranches, allowing other tranches to receive a higher credit rating and allowing the whole deal to be larger with the EIF than without. The literature reviewed suggests that, after the crisis, the EIF involvement has made SMESec more attractive to investors as notes would not have been placed to investors without an EIF guarantee.

The evaluation also sought feedback from originators about the impact of the EIF's involvement on the amount of collateral required for a deal. Survey opinions were divided between large and small banks regarding collateral requirements. Interviews also confirmed that smaller banks more often believed that the EIF either required more collateral than expected, or excluded more available collateral than expected (e.g. from the real estate and construction sector).

In addition, the case studies suggest that the EIF's intervention in the deal made it more attractive for:

- Originators: by allowing either one or a combination of any the following benefits: (i) lowering the overall cost of funding; (ii) providing capital relief (deals signed before the crisis); (iii) attracting further investors, and (iv) allowing the transaction to reach a meaningful size
- Investors: by allowing either one or both benefits: (i) granting their investment a better rating and (ii) granting more security with regards to the debt service payment of the notes they hold.

Overall, the EIF's involvement has contributed to increase the attractiveness of SMESec for originators, in particular the difficult post-crisis context characterised by a diminished investor base, lower risk appetite and higher market uncertainty. For investors, the EIF's involvement helped them to granting their investment a better rating and more security.

5.2.3 The contribution of the EIF's SMESec activities on stimulating SMESec market development

The evaluation sought evidence about how the EIF's SMESec activities contributed to stimulate SMESec market development by (i) expanding SMESec into new markets (e.g. initiating the market, extending it, or re-vitalizing impaired SMESec intermediation) and to new originators; (ii) attracting new/additional investors; and (iii) enhancing the capacity of originators to make (better) SMESec deals.

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[28] It should be referred, however, that in exchange for its support, there is no commitment requested by the EIF, that the supported originator directs its additional SME lending solely to new clients.

[29] Banks are not obliged to provide, on their financial statements, a breakdown of their loan portfolio by borrower size, which if available, is useful to identify SME lending.

(i) Expanding SMESec into new markets and to new originators: As corroborated by the First-Mover case studies, the EIF was instrumental "to initiate" transactions in both "active markets" and "less active markets", including Belgium, Bulgaria, Czech Republic, Denmark, France, Germany, Greece, Italy, the Netherlands, Portugal, Poland, Serbia and Turkey. It was also involved in facilitating the first multi-country SMESec transaction and the first SME covered bond transaction (Turkey).

Below the evolution of some national SMESec markets, where the EIF supported the first ever SMESec deal, is analysed:

- Successful cases: Belgium and Portugal. The EIF supported the very first SME securitisation deals in these two countries still prior to the crisis. These markets have remained active in the post-crisis period as other deals, both EIF and non-EIF supported, have followed since then. The two markets were the third and fourth, respectively, most active in the post crisis period (Q3 2010-Q4 2015) in terms of new SMESec issuances (see Figure 11[30]);
- Less successful cases: Bulgaria, Greece, Poland, Serbia and Turkey. The EIF also supported the first SME securitisation deals in these countries prior to the crisis, with the exception of Turkey (2013). In Bulgaria, Greece, Poland and Serbia, the markets have not remained very active in the post-crisis period. Few deals have followed and these were always supported by EIF or other IFIs. The lack of specific legislation and regulatory framework in Serbia and Poland and the lack of market transparency in Bulgaria were identified as major hurdles to the future development of those markets. The main barriers for securitisation in Greece are mostly related to bad quality of loan portfolios and the instability of the banking sector rather than to the transparency of the market. Turkey was even one of the first countries to allow the option of SME-backed covered bonds issuance through specific legislation, and EIF invested in the first SME-backed covered bond, but the market demand for these types of transactions seems to have diminished.

Figure 11. Securitisation issuance Q3 2010-Q4 2015

Country	EUR bn	Weight
Spain	73.3	42%
Italy	38.9	22%
Belgium	17.0	10%
Portugal	14.5	8%
Netherlands	10.3	6%
UK	10.1	6%
Germany	6.4	4%
France	3.4	2%
PanEurope	1.7	1%
Greece	0.6	0%
Other Europe	0.3	0%
Total	176.5	100%

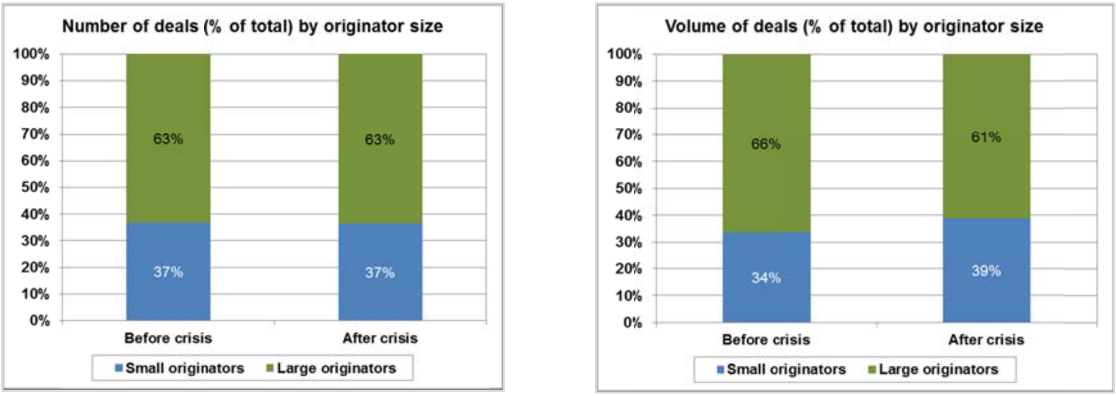
Source: AFME, adapted by EV.

Before the crisis, the EIF was active and diversified across the EU-28. For instance, the EIF concluded SMESec transactions in 11 jurisdictions in 2006 and 9 in 2007 (plus multi-country transactions in both years). After the crisis, however, the EIF's SMESec deal activity largely concentrated on the active markets of Italy, Germany, UK and Spain. Only in 2015 the EIF SMESec activities became more diversified by country as transactions were signed in 8 countries that year.

In relation to expanding SMESec to new originators, the EIF has engaged with small originators to the same extent before and after the crisis, in terms of volumes signed (37% of total signed volumes with small originators before and after the crisis, see Figure 12). However the number of deals signed with small originators was higher before (25) than after the crisis (15), which means that transactions with small originators after the crisis have on average larger sizes than before the crisis.

30 Only from Q3 2010, AFME started compiling securitisation information from SME as separate asset class, distinct from parent category CDOs. No data could be retrieved for Q4 2011, hence amounts are excluded from total.

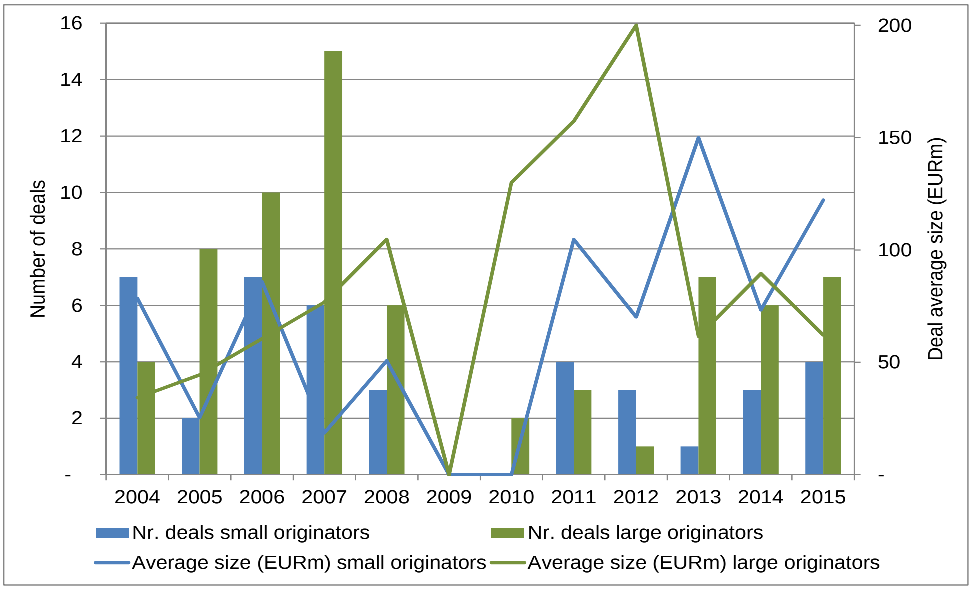
Figure 12. Percentage of deals and volume by originator size



Source: EIF data, adapted by EV.

The EIF has signed deals with large and small sized originators throughout the period covered for this evaluation, with the exception of 2009 (for large and small originators) and 2010 (for small originators).

Figure 13. The EIF's SMESec Activity: Number and average deal size, by of originator size



Source: EIF data, adapted by EV.

Average deal size has increased from EUR 58 m before the crisis to EUR 106 m after the crisis. Throughout most of the period under evaluation, the average deal size of operations signed with large originators was higher than that signed with small originators, with the exceptions of 2004, 2006, 2013 and 2015.

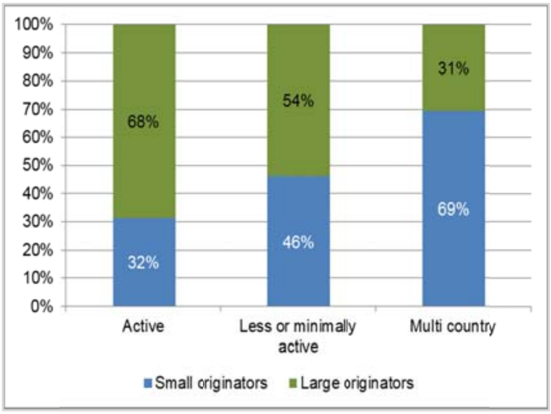
The analysis of volumes signed per cluster of SMESec national markets (Figure 14), evidences that the EIF has worked relatively more with larger originators in both "active markets" (68%) and "less or minimally active markets" (54%). Figure 15 further reinforces that picture given that in countries where SMESec markets are active, a large volume of deals were signed with large originators: Belgium (100%), the Netherlands (100%), Spain (>90%) and the UK (>80%).

Overall, banks from 8 countries are ranked among the top 20 originators of SMESec in EU-28, of which 7 Spanish banks are among the top 11 originators[31]. Evidence suggests, however, that most of these banks are also active in several markets (not only their national markets). The EIF has been active with some top originators, which has proved to be crucial for the development

[31] The other countries are Italy (2 banks), the Netherlands (3 banks), Belgium (1 bank), Germany (3 banks), Greece (1 bank), the UK (2 banks) and Portugal (1 bank).

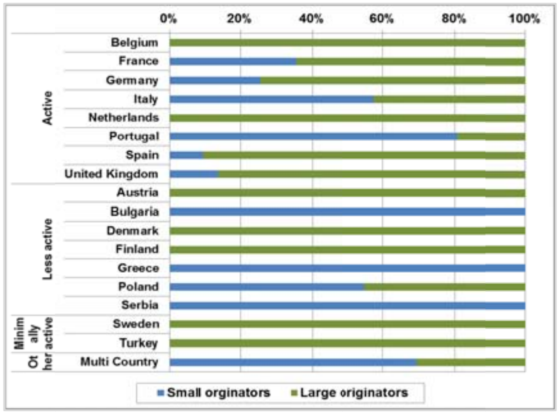
of the markets in the respective countries, since they reported transactions before and after the crisis.

Figure 14. Volume of operations signed by type of market



Source: EIF data, adapted by EV.

Figure 15. Volume of operations signed by type of market and per country



Source: EIF data, adapted by EV.

Finally, through the advisory services provided by the EIF to the EIB under the ABS-SLA, the EIF has also facilitated loan substitute transactions with the EIB. Originators interviewed were willing to accept EIF's guarantee price in joint EIB-EIF transactions if it meant that EIB would purchase a senior tranche of the securitisation as a loan substitute.

(ii) Attracting new/additional investors: The EIF can attract two types of new investors: (i) investors that hold notes that are guaranteed by the EIF, and (ii) investors that invest in other tranches of the deal that are not guaranteed by the EIF. There is no list from the EIF of new investors that the EIF introduced to SMESec deals and the evaluation could add no direct evidence about the degree that new investors were attracted. The interviews and survey provided some insights about the effects of the EIF on attracting new investors into other tranches of a deal. Half of surveyed originators believe that the presence of an EIF guarantee attracted investors to the non-guaranteed tranches. In contrast with ex-ante value added assessment remarks mentioned on the case-studies, the ex-post impact assessment questionnaire results reveal that around ¾ of the originators deem that some investors committed to the transaction due to the EIF's investment.

The EIF involvement in 2 large transactions in 2010 (in the UK and Germany) and 7 in 2011 highlighted the key role played by the EIF in bringing investors back to market and re-starting a market that was "almost dead". After the crisis, however, the focus on more mature markets evidence that the EIF has not managed to reactivate difficult markets at such complex times where market participants have stepped back.

(iii) Enhanced capacity of originators to make better SMESec deals: The EIF's involvement in SMESec transactions was seen as crucial in the first-mover case studies, as it has facilitated:

- Structuring the deal taking in consideration the specificities of the local market and originator capacity;
- Leading the process in terms of risk analysis and tranching of the transaction for other investors;
- Transfer of knowledge to the originators.

Whilst the originators surveyed were broadly aware of the EIF's non-transactional activities (i.e. research, policy dialogue, dissemination of best practice, etc.), their opinion on their value varies by the type of outcome, as shown in the survey responses. The EIF expertise in structuring SMESec transactions, particularly for new market participants and in new markets, has been highly regarded by key stakeholders consulted for the purpose of this evaluation. The opinion of the small banks and leasing companies consulted are more positive than that from large banks. For instance, they argue that the EIF helped them by promoting high quality securitisation, acquiring new skills to better structure securitisation deals, as well as by attracting new investors to the deals (among which sometimes the EIB). For large banks, the

EIF's involvement in public debates and other non-transaction activities have contributed to improving the public image of SMESec.

Given the catalytic role that the EIF plays in the markets and its important signalling effect to market participants, the evaluation found that the EIF's communication activities on its SMESec activities and on the performance of its SMESec transactions (subject to confidentiality rules) have been of paramount importance. Many stakeholders consulted for the purpose of the evaluation highlighted the need for more and more detailed information to be disclosed by the EIF to increase transparency and set a benchmark for other market participants.

In sum, the EIF's participation is appreciated in particular by small or less experienced originators and/or in new markets, as a way to enhance their capacity to improve the structuring of their SMESec deals.

5.2.4 Conclusion

In terms of meeting its COP targets, the EIF has followed the ups and downs of the SMESec market, particularly in the difficult post-crisis context. Before the crisis the EIF achieved its annual COPs targets (except in 2005), but it did not in most of the post-crisis years (except 2011 and 2015). Whilst the performance of EREM has exceeded the expectations, the market uptake of SMESec under other mandates, however, fell below expectations (only 2 SMESec transactions were signed under CIP-SMEG and no other transactions have been signed under other mandates as of end 2015).

The EIF's focus on quantitative performance targets and operational indicators is appropriate to report on the EIF's financial statutory objectives, but less so on its policy goal to increase access to SME finance. The absence of linkage between the ex-post impact assessment information from VAM and the EIF Annual reporting cycle is a missed opportunity for the EIF to show its real contribution to attaining its policy goals of increasing access to SMEs' finance through SMESec. Reporting on additional indicators (both quantitative and qualitative) in its Annual Report (and other external publications) would contribute to stronger signalling effects in the market.

Regarding the degree of achievement of its policy objectives:

- Evidence provides a mixed picture about the effects of the EIF's SMESec activities in enhancing access to SME finance. The VAM report (2014) suggested that the originators generated a multiple of their targeted leverage figures agreed in the ex-ante commitments laid down in side letters within the first 12 months of the closing of those transactions. Yet, it remains to be verified how much of the released capital has been reused for additional SME lending for most of the period under evaluation (for instance the period from 2004-2012). The ex-post impact assessment was introduced only in 2013 and solely two reports on the EIF's SMESec transactions closed in 2013 and signed in 2014 and 2015 have been issued to date. Moreover, it was not always clear from the interviews, surveys and literature review that those capital resources released by the transaction EIF supported have been reused by originators to provide additional lending to SMEs.
- There is however plenty of evidence to demonstrate the EIF's SMESec activities have contributed to stimulating SMESec market development in Europe:
  - o The EIF has contributed to the expansion of SMESec into new markets, (i.e. Portugal, Greece, etc.) and in CEE, though some did not remain active after the crisis. Factors such as legislative and regulatory inadequacies and lack of market transparency, which are out of reach for the EIF's direct intervention, explain the limited activity in these markets;
  - o The EIF has made SMESec more attractive for originators (particularly small/less experienced originators and in new markets like CEE) and investors (better rated and more secure investment), especially after 2009. Furthermore, originators have valued greatly the EIF's facilitation of SMESec transactions with the EIB under the ABS-SLA;
  - o The EIF's expertise in structuring SMESec transactions was of great value in new markets and for less experienced market participants.

5.3 Efficiency

To what extent did the EIF achieve its objectives timely and cost-effectively? To answer this question the evaluation sought evidence about the income and cost of the EIF's SMESec guarantee transactions and the timeliness of these transactions.

5.3.1 Cost-effective delivery of the EIF's SMESec guarantees: Ratio of cost-to-income

One of the EIF's two statutory objectives is *"generating an appropriate "return" for its shareholders, through a commercial pricing policy and a balance of fee and risk based income".* Therefore, the EIF has long targeted an overall cost-to-income ratio of 40% to 60%[32]. In its quarterly reports, the EIF computes its overall cost-to-income ratio but not per business line. For each year in scope for this evaluation, EV attempted to do an approximate computation of what would have been the cost-to-income ratio of the securitisation business and assess its efficiency by comparing it to the benchmark of 40-60%. The following sources of information and estimates were used to assess the level of:

- Income: securitisation risk, mandate management and SLA revenues as provided by the EIF;
- Cost: total EIF staff and other administrative expenses, as disclosed on the EIF's financial statements, pro-rated by the share of staff working for securitisation (front office, risk and monitoring, middle office and legal) on the total non-management staff of the EIF;
- Provisions for guarantees (net of recoveries): excess of provisions which have been subsequently reversed, have been excluded, as provided by the EIF.

The evaluation assessed the evolution of cost-to-income ratio of the EIF's SMESec activities during the period covered by this evaluation. Two ratios have been computed, excluding and including, the impact of provisions for guarantees (net of recoveries). As a result, the evaluation found that the cost-to-income ratio, excluding provisions for guarantees (net of recoveries) were estimated to stand comfortably below the 40% threshold, throughout the whole period under evaluation. The ratio has however deteriorated during the last years, in particular between 2012 and 2013, where it doubled from 6% to 12%. The explanation for this increase is twofold:

- On the income side, the low financial interest rate environment, which is expected to prevail, has eroded the revenues from the securitisation activities[33], that have recorded negative annual growth rates, practically every year between 2010/2009 until 2015/2014;
- On the expense side, the securitisation FTE staff has nearly doubled in 2013, due to new third party mandates and advisory services provided to the EIB, as well as coping with the requirements of the "Investment Plan for Europe".

The cost-to-income, including provisions for guarantees (net of recoveries), portrays a different picture: in the post-crisis period and particularly for 2010 and 2011, when the ratio recorded levels above the targeted higher threshold (60%) and in 2009 and 2014, when the ratio was within the tolerance threshold (40-60%) due to significant provisions for guarantees.

5.3.2 The EIF's timely delivery of its SMESec guarantees

The average time from appraisal to signature date, as calculated based on the case studies (Figure 16):

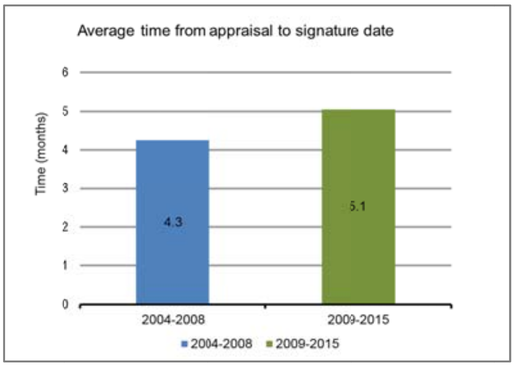
- Increased on average by nearly 1 month, from an average of 4.3 months in the pre-crisis period (2004-2008) to 5.1 months in the post crisis period (2009-2015), following the implementation of a more thorough appraisal and approval process and linked to the fact that the amounts involved are higher (two fold increase in the average deal size, between the two periods);

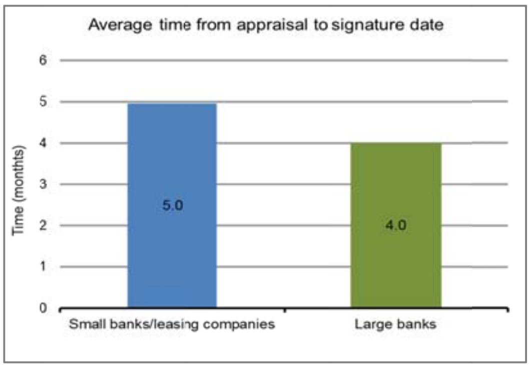
[32] Annual EIF's COP series starting 2010-2012 (December 2009) up to 2016-2018 (January 2016). To note however that within the latest COP (2016-2018) such range is set at 55-60%, due to the recruitment necessary to implement the Investment Plan for Europe ("Juncker Plan").

[33] As noted on EIF's 2016-2018 COP, Page 4.

- Is one month longer for small banks (5 months) when compared to larger banks (4 months). Such difference could be partly explained by the need of providing higher deal structuring support to smaller originators, which might not have a large and dedicated securitisation team as compared to large originators.

Figure 16. Case-study deals – average time from appraisal to signature date





Source: Case-studies data.

5.3.3 Conclusions

For most of the period under evaluation (8 out of 12 years evaluated), the EIF's SMESec business has performed in a cost-efficient manner: below or within the 40-60% overall EIF cost-to-income range. In 2010 and 2011 the EIF's SMESec business registered historical high cost-to-income ratios above the 60% upper threshold, due to provisions for guarantees of an exceptional size. Other more recent factors contributing negatively to the cost-to-income ratio are first, the low financial interest rate environment felt since 2009 and second, the expenses linked to the increasing number of staff working on the EIF's securitisation business, since 2013 due to new activities (third party mandates and advisory services) as well as coping with the requirements of the Investment Plan for Europe.

A lengthier transaction approval process has been recorded for deals signed in the post-crisis period compared to the pre-crisis period and for deals signed with small originators compared to large originators. The reasons behind, are linked to the increase in the average deal size and the lack of dedicated securitisation team for small originators, respectively.

5.4 Sustainability

How sustainable are the EIF's activities in the field of SMESec and the outcomes that it has achieved? To answer this question the evaluation sought evidence about the net profit of the EIF's SMESec transaction activity and its return on investment; and market perceptions about the future of SMESec in the absence of the EIF's support.

5.4.1 The net profit of the EIF's SMESec business and its return on investment

A measure of sustainability is to assess whether the revenues from the SMESec more than compensated its related expenses. On the basis of the EIF's data on net revenues from the securitisation business since inception of the EIF in 1996 until 31 December 2015, the evaluation found that the difference between the EIF's revenues and expenses shows a net cumulated revenue of EUR 162 m from the EIF securitisation activity. If solely business revenues and expenses are taken in consideration, this suggests a two-to-one earnings coverage, which points towards sustainability.

However such analysis does not take in consideration the revenues from managing securitisation mandates, the EIB SLA revenues, the overhead costs (staff and administrative expenses) required to deliver such net business revenues, neither does it provide sufficient information with regards to the profitability of the business. The EIF's financial statements do not present segment reporting, i.e. disclosures accompanying the financial statements, about the EIF's operating segments. If available, operating segment financial data could have been used to compare with other securitisation market players and overall COP objectives, hence providing the means to draw conclusions on the sustainability of the securitisation business.

Therefore, this evaluation on the basis of certain assumptions and estimates attempted to:

- Perform an approximate computation of the overhead costs for the securitisation business, capitalising on data already gathered for the cost-to-income analysis and applying it backwards to the years not covered by this evaluation, since the inception of the EIF's SMESec activities in 1996;
- Benchmark the profitability of the securitisation business, by computing its annual average return on investment and comparing it to the overall COP objective. Such investment, or in other words equity earmarked for the securitisation business, was estimated as being the average net equity of the EIF for the period 1996-2015, pro-rated by the share of securitisation over the EIF's overall business volume. Such share was estimated by assuming that the three major business lines of the EIF (guarantees and securitisation, equity, and microfinance) each have similar volumes and that securitisation represents half of the volume of the guarantee and securitisation business, thus reaching a 16.6%[34] estimate.

On the basis of the analysis of the combined results of the EIF data and our assumption, the evaluation concludes that the return on investment of the securitisation activity respects, and even slightly exceeds, the target set for the EIF long term overall return on equity of 4% to 5%, in the COP 2016-2018.

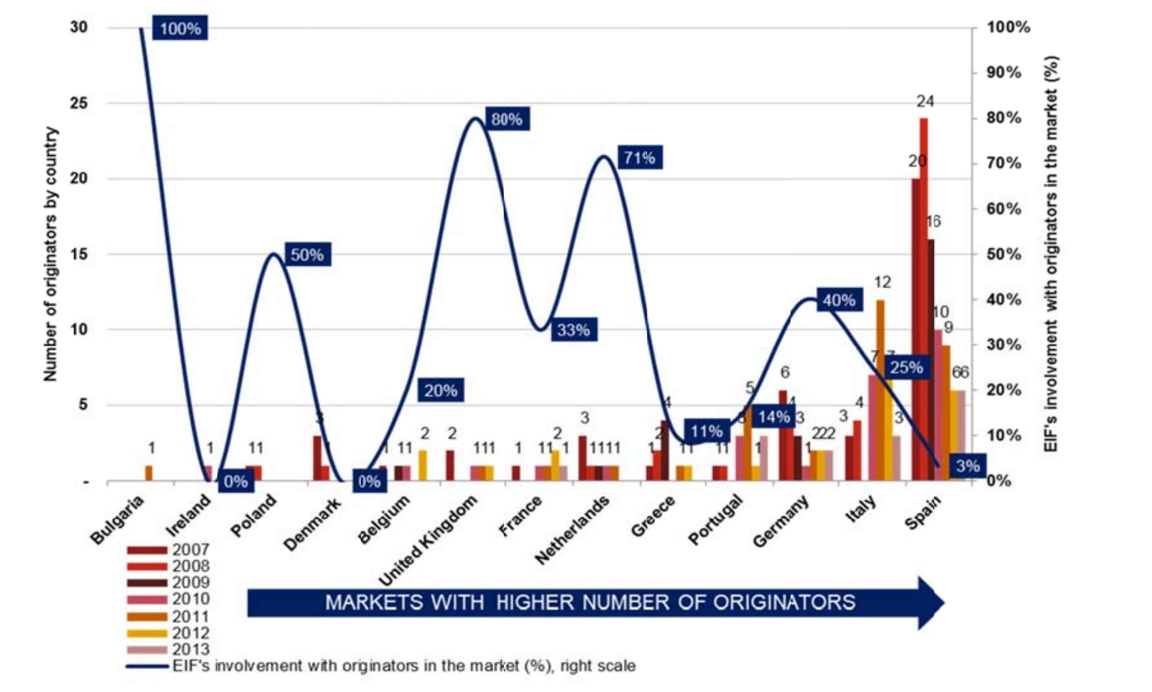
5.4.2 Sustainability of SMESec market activity in the absence of the EIF's support

The evaluation assessed whether the EIF's SMESec activity contributed to secure the future of the SMESec market without the need for future EIF involvement.

Figure 17 shows on the left scale the SMESec markets organised in an ascending order of number of originators, which can be used as a proxy for the level of sustainability of the market, i.e., a high number of originators implies that the market is active and that it has a higher likelihood of surviving without the need of public intervention. The right scale, displays the share of the EIF's involvement with the originators in those markets, measured by the number of originators with which the EIF engaged over the total number of originators active within the period 2007-2013.

[34] The estimate is within the range of values observed for the securitisation's share on the total economic capital of the EIF, over the last four years.

Figure 17. The EIF's involvement with originators in SMESec markets



Source: PwC Background Study, EIF data, adapted by EV.

As derived from the figure above, the EIF intervened to a great extent when markets are in their initial phase, with a few number of originators. Once they become more active, the EIF's level of intervention reduced or diluted as other participants came into the market. There are a few exceptions:

- Developed and active markets such as Germany and Italy, where the share of the EIF intervention is still high (40% and 25% respectively). One explanation might be that, after the crisis started and to date, the EIF strategically concentrated its efforts in the most developed SMESec markets, attempting to sustain those markets and to engage lower tiered banks, which are usually more SME focused.
- Non-developed markets, such as Ireland and Denmark, where the share of the EIF intervention was nil during the period, but explained by the very low level of originators and activity within those markets.

Despite the exceptions mentioned above, the trend suggests that the EIF definitely has a crucial role in the development stage of the SMESec markets.

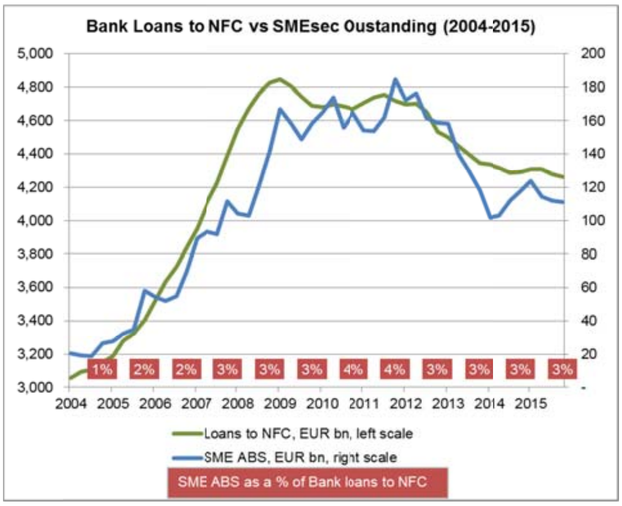
The ECB statistical data warehouse provides market data on the volume of bank loans to non-financial corporations (NFCs). There is no data available specifically on bank lending to SMEs, which constitute the collateral for SMESec operations. Given that most EU corporates are SMEs, this evaluation considers the volume of loans to NFCs as a good proxy for the scale and evolution of bank lending to SMEs[35].

Figure 20 shows that loans to NFCs in the Euro area have increased steadily since 2004 and reached a peak of EUR 4,800 bn in the first quarter of 2009; having declined since then to EUR 4,200 bn by the end of 2015 (i.e., a contraction of 12.5% on lending volumes). Figure 20 also compares the trend in the NFC bank lending market to the SMESec market, which shows a high correlation (95%) between both variables for the period under review (2004-2015). There was strong increase in lending to NFC in the period preceding the crisis and a deleveraging process in the period subsequent to the crisis, which is foreseeable to continue in the coming years, leading to a further reduction on the availability of credit to SMEs. The same behaviour

[35] European Banking Sector - Facts and Figures 2012, European Banking Federation, Page 24, *The SME data challenge.*

has been replicated in the SMESec market. As evidenced by the European Banking Authority (EBA) in one of its reports: *"the macro-economic environment that unfolded since the financial crisis and, more recently, the sovereign debt crisis (affecting some EU jurisdictions more than others) is also partly responsible for preventing the securitisation market from reverting to its pre-crisis volumes. The volumes of underlying assets available to be securitised are lower with respect to pre-crisis years due to: lower demand for loans (…); [banks']]deleveraging process (…) in order to decrease their level of leverage and to prepare for compliance with upcoming prudential regulation, and a de-risking process, i.e. the process by which banks dismiss more risky assets."*[36]

Figure 18. Correlation loans to NFC and SMESec



Source: Source: ECB, SIFMA (based on AFME data), adapted by EV.

Some limitations of the current design of the SMESec instrument are described below:

- SMESec is itself dependent on the volume of non-securitised SME loans available. During periods of strong credit contraction, as that experienced in the last years under review, there are less bank SME loans available for structuring news SMESec transactions, which cap, in a sort of spiral depression, the instrument's ability to revitalize the bank SME lending. A re-design of the instrument - targeting securitisation of assets other than solely SME loans (for instance real mortgaged-backed securitisation, RMBS) and using additional undertakings to ensure additional funding and/or released capital is reused for additional SME lending - could enable the EIF to have a broader impact in increasing SME finance. RMBS are by far and large the most representative type of collateral in securitisation transactions[37], hence having the potential to generate a larger impact in terms of originators' capital relief, compared to SMESec;
- There is no obligation/commitment for originators undergoing SMESec deals to further grant loans to SMEs (apart from those supported by the EIF or similar national programmes). Moreover other incentives, such as the acceptance of ABS shares for refinancing operations with ECB, had perverse effects on the levels of SMESec retained by originators, which recorded historical high values, in the years after the crisis;
- As noted on the Background Study, *"Investment decisions are based on the overall framework affecting the respective instrument. Most of the current country specific legal frameworks are an obstacle to the market. Uncertain future regulatory reforms further undermine originators' and investors' planning (…)*" limiting the potential for growth of the SMESec markets.

5.4.3 Conclusion

Financial data suggests that over the lifetime of the securitisation business the annual return on the investment respects and even slightly exceeds the overall COP target of a ROE within the 4%-5% range. However, such return targets cannot be maintained if in the coming years provisions for guarantees of the same magnitude as those registered in 2009-2011, happen again.

Moreover, throughout the period 2007-2013, a pattern was observed whereby the EIF's share of guaranteed deals is significant in markets still in their embryonic period and progressively

[36] EBA report on qualifying securitisation, January 2014.

[37] According to SIFMA (based on AFME data), as of 31 December 2015, total outstanding securitization in Europe amounts to EUR 1.543 billion, of which 59% were RMBS, followed by 8% credit default obligations (CDOs) and 7% SMESec.

dilutes once the markets become more active with a large number of other players stepping in the market. This trend suggests an important role played by the EIF in the development of the markets.

Market data suggests that banks are undergoing a severe deleveraging process and that SME lending is particularly impacted. A stronger SMESec market in Europe could be used as a means to further deleveraging banks' balance sheets without reducing SME lending volumes, provided that the released capital is utilised for new SME lending. However, SMESec depends itself on the volume of SME loans available for securitisation, therefore its growth is capped under periods of significant credit contraction. The possibility to consider broadening the EIF's securitisation activities to assets other than solely SME loans (and using additional undertakings to ensure enhanced capacity is reused for additional SME lending) could enable the EIF to have a broader impact in increasing SME's access to finance.

Attention should be paid at national and supranational levels on the regulatory and legislative framework, the stability and consistency of which is key for originators' and investors' decisions. EIF could provide more technical assistance to policy makers that help revitalizing the market, notwithstanding its high involvement to date, in particular through the STS process.

5.5 EIF's contribution

How important was the EIF's financial and non-financial contribution to the expansion of SMESec? To answer this question the evaluation sought evidence about (1) the ex-ante value added of the EIF, according to its own methodology; (2) the ex-post impact assessment in terms of additional SME lending/leasing, risk capital relief, and lower cost for originators; and (3) the support of the EIF for the "best practice" structuring of SMESec transactions.

5.5.1 The EIF's ex-ante value added according to its VAM

Since its introduction in 2010, the Value Added Methodology (VAM) has undergone a series of modifications and additions, such as the integration of the leverage methodology to try to assess ex-ante the "catalytic effect" of the EIF's SMESec deals.

Table 4. Evolution of the EIF's Value Added Methodology

Date	Landmark
February 2010	Value Added Methodology (VAM) introduced
January 2011	VAM integrated with EIF Leverage Methodology
April 2012	VAM integrated with Impact Assessment Methodology (IA)
April 2013	VAM and IA: Update on Guarantees and Securitisation Methodology issued
December 2014	Securitisation - Value Added Assessment: Update (1^{st} VAM report)
November 2016	Securitisation – EIF Ex-post Value Added Assessment (2^{nd} VAM report)

Source: Several EIF documents.

Key features of the ex-ante impact assessment's methodology include:

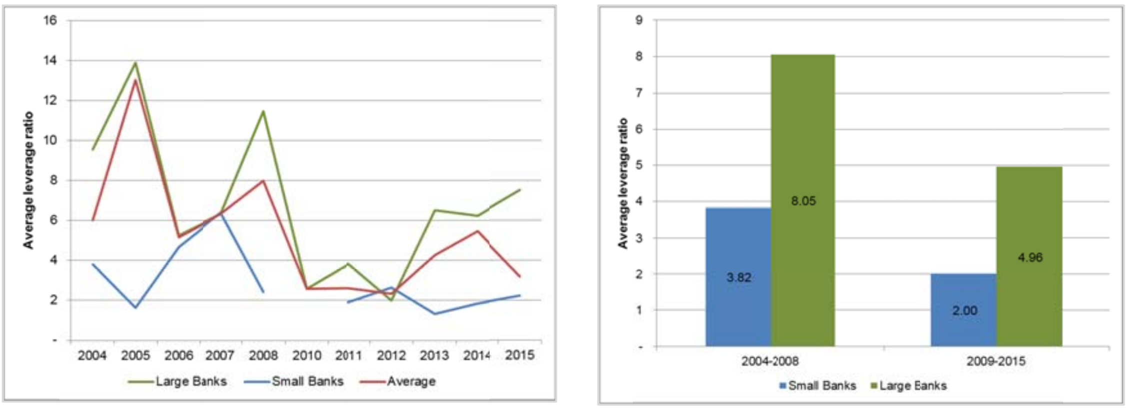
- The EIF's ex-ante impact assessment is based on the analysis of 3 dimensions: (i) market level value added, (ii) transactional level value added and (iii) ex-ante leverage effect, which measures the benefits for the originator of the securitisation deal in terms of risk transfer (capital relief) and the funding provided by the investors;
- The methodology attributes the EIF the outcomes that are directly derived from the EIF's guarantee/investment. Also, it attributes other indirect outcomes to the EIF (e.g. other investors acquiring tranches not guaranteed by the EIF);
- The proportion of funding and capital relief directly/indirectly attributable to the EIF changes from deal to deal, according to the seniority of the tranche guaranteed by the EIF, to the number of other private investors attracted and, in general, to how the transaction has been structured;

- A great degree of professional judgement and estimates are used on the discussions between the EIF and the originators which end up reflected in the leverage figure the EIF expects the deal to generate in terms of additional SME lending;
- Impact performance indicators are identified with a view to assess ex-post the value added effectively triggered by the EIF's participation in a transaction systematic approach to tracing such impacts over the lifetime of an EIF transaction (ex-post);
- The results of the value added assessment are not to be taken as a compliance/eligibility check and are rather to be considered as qualitative profiling of the transaction in terms of its value added characteristics.

According to the EIF, in true sale transactions, where the EIF participates in the senior tranche, it is difficult to justify a leverage ratio higher than 1. In synthetic deals done for regulatory capital relief purposes, however, the leverage ratio can vary between 4 and 10. Thus the EIF itself exercises a degree of judgement for every transaction which is a combination of the EIF's knowledge of the originator, market conditions, other investor participation, etc.

The evolution of the EIF's ex-ante leverage ratio is displayed in Figure 19. Apart from a few exceptional years, the ratio has dropped over the period covered by this evaluation. The average ex-ante leverage ratio peaked in 2005 recording an extraordinary value of 13, and over the last three years covered by this evaluation it was within the range of 4 to 5.

Figure 19. Evolution of ex-ante leverage ratio by originator size

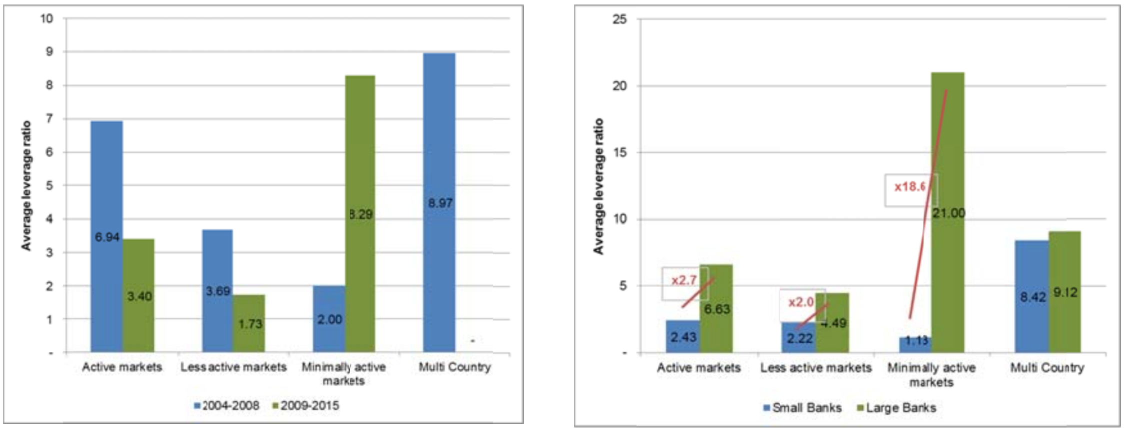


Source: EIF data, adapted by EV.

In general, SMESec deals with large originators, present higher ex-ante leverage ratios when compared with smaller originators. The ex-ante leverage ratio of SMESec deals with both small and large originators, has nearly halved in the post crisis (2009-2015) compared to the pre-crisis period (2004-2008). The fall in the share of synthetic transactions, between those two periods, may be an explanatory factor.

Figure 20 displays the ex-ante leverage ratio by type of market. In the post crisis period (2009-20015), the ex-ante leverage ratio has halved, in both active and less active markets, when compared with the pre-crisis period (2004-2008). However the opposite has happened for minimally active markets, where the ratio has risen more than fourfold between the two periods.

Figure 20. Ex-ante leverage ratio by type of market



Source: EIF, adapted by EV.

On all different types of markets, these being active, less active or minimally active, the ex-ante leverage ratio of SMESec deals done with large originators is a multiple of that done with small originators: x2.7, x2 and x18.6, respectively.

5.5.2 The EIF's ex-post impact assessment

A further improvement made to the EIF's VAM (first introduced in 2010) was its integration with the Impact Assessment (IA) methodology in 2012 and 2013, which is based on two strands:

1) The first strand of the value added ex-post impact assessment relies on qualitative questionnaires which the originators are asked to complete. These questionnaires may be subject to biased answers given the incentives that originators/arrangers have when answering questions related to the role of the EIF and/or potential impact of the deals they just signed. Moreover, these questionnaires are not collected on a regular basis.
2) The second strand lies on quantitative reports that originators have to produce on an annual basis about SME lending volumes and the characteristics of the final beneficiaries. Ideally, this information would shed light on the extent to which the additional funding and/or released capital resources have been used for new lending/leasing. However, there was no data collected from originators about the incremental amount of SME lending/leasing facilitated through the EIF support to SMESec transactions for the period preceding 2013. For securitisation deals closed during 2013 and signed in 2014 and 2015, the EIF has collected qualitative and quantitative data on the additional lending facilitated through the EIF's SMESec guarantee deals and compared such data to the initial commitment as per the side letter. Two reports covering the SMESec deals closed during 2013 and during 2014-2015 have been issued by the EIF during the course of this evaluation. As mentioned in Section 5.2.1 above, the data collected from originators for operations closed in 2013 suggest the Financial Intermediaries have always exceeded or at least delivered on their agreed targeted leverage figures of additional financing, as imposed by the side letter. Nevertheless, the data reported by originators has not been be independently verified (other than some internal checks and controls), so the EIF considers them to have been produced in good faith, mainly relying on the undertakings of originators laid down on the side letter agreements.

Below the evaluation findings on the EIF's contribution on risk-capital relief and cost reduction for SMESec for originators are presented:

(i) Risk capital relief: The capacity of the EIF to engage in lower rated risk transactions at a time when private markets would not accept such risk, or would only do so at high cost, was acknowledged in interviews as a key strength of the EIF's SMESec offer. Large banks surveyed stated that the "EIF 0% Basel capital weighting" and "EIF's guaranteeing of junior and mezzanine tranches" were features of the EIF's SMESec offer that contributed the most to originate SMESec deals (60% of surveyed large banks). For small banks, however, the "EIF guaranteeing senior tranches" was valued the most (67% of total surveyed small banks), followed by far by other attributes like "EIF's facilitating EIB's investment in the deal", "EIF 0% Basel capital weighting" and "EIF's guaranteeing of junior and mezzanine tranches" (each 33% of respondents).

From the case studies only a few (five) pre-crisis deals, with originators from Germany, Spain and Belgium, mention that the aim of the transaction was the provision of risk capital relief for the originator. Among the case studies, there was no post-crisis deal set-up with the logic of providing risk capital relief to the originator, given that ABS notes issued were retained to a large extent by the originators, to serve as collateral in liquidity transactions with the ECB.

(ii) Cost reduction of SMESec for originators: The EIF is well known for setting its prices close to market levels, according to its mandate to make an appropriate return on resources[38]. The case studies suggest that EIF's contribution to reduce the overall funding costs was more often praised by originators than the EIF's guarantees' pricing being competitive than other market players. This demonstrate that choosing the EIF as the guarantee provider does not relate solely to price, but also to: (i) the provision of AAA rating to the (portion) of the share class(es) guaranteed by the EIF; and (ii) the capacity to attract other investors to the deal, including the EIB.

About half of surveyed banks as part of this evaluation believe that the EIF's support was cost-effective for them and that the EIF's pricing works for the economics of their deals.

5.5.3 The EIF's support for SMESec deal structuring according to best practice

Regarding the EIF's contribution to deal structuring according to best practice, the evaluation found evidence that the deals supported by the EIF were by far and large aligned with best practice on several aspects:

(i) Portfolio granularity as per Prime Collateralised Securities (PCS[39]) eligibility rules: Among the case study deals, 77% had an underlying collateralised loan portfolio composed of at least 500 obligors. The case studies reveal a trend of increasing granularity of the underlying loan portfolios in the aftermath of the crisis: prior to the crisis only 66% of the deals had at least 500 obligors compared to 95% after the crisis.

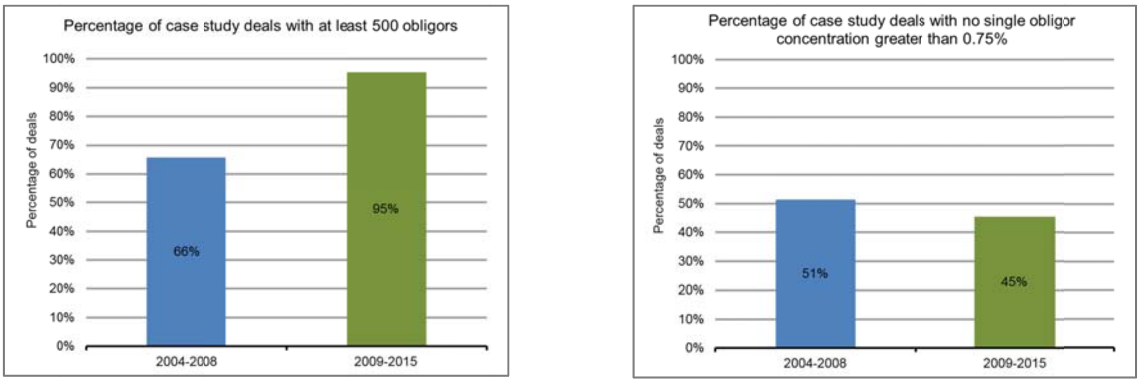
While looking at large exposures in the underlying collateralised loan portfolio, the evaluation observed that 49% of the case-study deals had no exposure towards a single obligor greater than 0.75% of the loan pool. Such percentage was 51% among the deals signed in the pre-crisis period and slightly decreased to 45% on those signed in the post crisis period.

The above-mentioned patterns suggest that the EIF's advice to originators has contributed, throughout time, to an increase in the granularity and reduction of large exposures, among the collateralised loan portfolios.

[38] EIF 2012 Statutes, Article 24: "*The level of remuneration or other income sought by the Fund in connection with its activities pursuant to these Statutes shall be determined in such a way so as to reflect the risks incurred, to cover the operating expenses, to establish reserves commensurate with the said risks and to generate an appropriate return on its resources*."

[39] Prime Collateralised Securities (PCS), an industry body launched in 2012. PCS labels individual securities that conform to its High Quality Securitisation (HQS) standards.

Figure 21. Case-study deals – granularity and large exposures (% of total #)



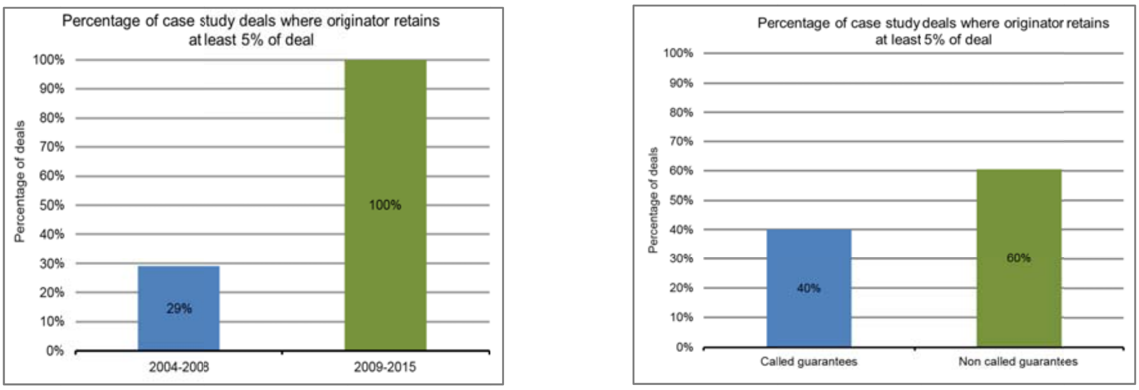
Source: Case studies data.

(ii) Re-securitisation: None of the case studies transactions had as underlying collateral assets which had already been subject to prior securitisation.

(iii) Minimum retention: Post crisis, a key issue for regulators has been the introduction of risk retention rules ("skin in the game") that require banks to maintain an interest in their own securitisations, for example, in the EU, Article 122a of the Capital Requirements Directive (CRDII) and in the US, Section 941 of the Dodd-Frank Act[40].

Among the case-study deals, 54% had the originator retaining at least 5% of the deal. However there are some important variations between deals signed before and after the crisis; and between those which had and those that did not have a guarantee call:

Figure 22. Case-study deals – retention (% of total #)



Source: Case studies data.

It is difficult to establish a causality link between the EIF's advice on the 5% minimum retention and the high retention rates verified in the aftermath of the 2008 crisis. The increased level of compliance is potentially mostly linked to heavier regulation and also the possibility of using the ABS notes as collateral for ECB refinancing.

The case studies where there was a subsequent call of the EIF guarantee had a lower percentage of originators retaining at least 5% of the deal compared to those deals where there were no guarantee calls. A plausible explanation could be a causality between low retention levels and the exercise of the guarantee calls by the beneficiaries based on the following arguments: lower retention levels for originators could give originators room for lowering the quality of their screening, monitoring and selection process for potential borrowers, as a large portion of the deal issue will be placed with investors and hence credit risk will be transferred to the market. If that is the case, it increases the likelihood of having problematic loans among the asset pool collateralising the notes issued by the SPV. When such loans become non-

40 Retained interests in securitisation and implications for Bank Solvency, ECB, 2013.

performing, the SPV might start facing problems servicing its debt to the noteholders and hence the latter might ultimately execute and call the guarantee which is attached to the notes.

5.5.4 Conclusion

Towards the end of the period under evaluation, the EIF has set up a methodology (VAM) to assess the valued added of its interventions both ex-ante and ex-post. The ex-ante assessment is particularly valuable to rank operations in a systematic way, to ensure the approval of those with the highest potential to generate impact. However ex-ante leverage ratios are highly subjective, relying on several estimates and professional judgement.

It is of paramount importance that for each single supported transaction, the EIF gathers sufficient and reliable evidence of their ex-post impact assessment. Throughout most of the period covered by this evaluation (2004-2012), the EIF did not have a system in place to gather data systematically on the additional SME lending generated as a result of its SMESec transactions. Only for 2013 and subsequent years, the EIF has collected evidence of their fulfilment and reported about their ex-post impact. Despite this improvement, the EIF still relies to a great extent on the good faith of originators when reporting back to the EIF on their ex-post impact. Given the fungibility of money, it is difficult for the EIF to independently verify the materialisation of the originators' commitment expressed in the side letters. Moreover, the reliability and robustness of originators' reporting could also be strengthened if the current reporting is complemented, for instance, by a reporting on a portfolio basis.

This evaluation has also found evidence that the EIF has been supporting transactions that are broadly in line with the PCS High Quality Securitisation standards, which has led to an improvement in granularity and retention rates, following the crisis.

6. Conclusions, Recommendations and Management Responses

6.1 Conclusions

This evaluation aims to answer five key questions in relation to EIF's SMESec activity in the period 2004-2015. This section presents the main conclusions derived from the evaluation's findings.

a) **The EIF has acted through the economic cycles following the ups and downs of the SMESec market before and after the crisis:**

- Over the period under evaluation, the EIF has followed the market acting through the economic cycles within the SMESec markets inside and outside the EU where it has operated. Whilst the EIF was active and diversified across Europe before the crisis, the EIF's SMESec activity came to a halt in 2009 with no SMESec deals that year. After 2010, the EIF concentrated on large originators in "active" and well-developed markets: Germany, Italy, Spain and the UK. The geographical diversification of the EIF's SMESec activity then increased in 2015, with deals across eight different countries.
- Before the crisis, the EIF achieved its annual COPs targets (except in 2005) to a large extent, when compared to the post-crisis years (COP not achieved in 2011 and 2015). However, the share of total SMESec issuance guaranteed by the EIF compared to the total EU SMESec issuance, over the last three years (2013-2015) covered by this evaluation, displays a more positive picture in terms of the EIF's achievement of objectives in terms of volumes.
- There has been little activity under Mandates managed by the EIF providing support for SMESec (only 2 SMESec transactions have been signed under CIP-SMEG and no other transactions signed under other mandates as of end 2015), with the exception of EREM, which has exceeded expectations.

b) **For most of the years under review (2004-2012), there has not been a standardized method to verify the extent to which the enhanced originators' capacity effectively translated into additional SME lending:**

- The key rationale to support SMESec is the assumed direct causal link between SMESec and new lending or leasing to SMEs. This is done by the fulfilment of the commitment to reuse the capital released / additional funding through the SMESec transactions for more SME lending laid down in the side letters that the EIF requests originators to sign. Normally the EIF requests originators to commit reusing an amount at least equal to 100% of the volume of the SMESec guarantee committed within (typically) one year from the issue date.
- While such a causal link is plausible in theory, for most of the years under review (2004-2012), there has not been a standardized method to verify the extent to which the enhanced originators' capacity translated into additional SME lending. Moreover, the evaluation found some evidence of the high correlation between the volume of SMESec activities and SME lending, leading us to question how the former can have a role on stimulating the latter, for instance in times of strong credit contraction. The evaluation found also some evidence that originators use SMESec for different purposes other than increased SME lending (i.e. to raise long-term funding at a lower cost, to improve short-term liquidity, etc.). Other external factors, such as the ECB 'repo facility", the changes in the rating agencies' methodologies and policies, the lack of adequate legal frameworks in some countries and the ongoing regulatory changes at European level, have also influenced the originators' motivation to use the SMESec instrument. In light of this evidence, the evaluation questions the extent to which the additional funding/capital released following a SMESec transactions supported by EIF has been translated into additional SME lending.
- The side letters, as they currently stand, are not sufficient to ensure that originators effectively increase SME lending. There is a need to strengthen the undertakings for originators to ensure they reuse the additional funding/capital released generated by the SMESec transactions to issue additional SME loans and to duly report back on their commitments, whilst ensuring that these additional undertakings do not jeopardise the unconditional and irrevocable characteristics of the EIF guarantee.

- The commitment laid down in side letters has been reinforced with the introduction of the EIF's Value Added Methodology (VAM) in 2010, which first of all assesses the ex-ante catalytic effect of the supported transaction and at a later stage compares the ex-ante with the ex-post impact assessment, on the basis of reporting provided by the originators.
- The EIF's ex-post impact assessment reports provide evidence that the EIF's SMESec transactions have generated some additional SME lending. Before the introduction of the VAM in 2010, the evaluation found no evidence of the EIF monitoring the level of additional funding/capital released generated as a result of the EIF's supported transaction and originators reusing such capital for additional SME lending. Since 2010, the ex-ante value added assessment and ex-post impact assessment within the VAM has thus enabled the EIF to track and report on originators' enhanced capacity for extending SME loans as reported by them. By the time the present evaluation report has been completed, the EIF will have issued two ex-post impact assessment reports by covering transactions closed in 2013 and signed in 2014 and 2015.

c) **Yet, there is plenty of evidence on the EIF's contribution to stimulating SMESec market development within and outside the EU:**

- The EIF has contributed to expanding SMESec into new market countries (e.g. Central and Eastern Europe before the crisis), as well as for initiating the first "multi-country" transactions in Europe. Whereas some of these markets remained active after the crisis (Belgium, Greece and Portugal), others (such as Bulgaria, Poland and Serbia) did not. The EIF had a crucial role in the development stage of the SMESec markets where its share of guaranteed deals is significant during the embryonic stage, progressively diluting as markets mature and other players step in, hence contributing to the early development of markets.
- The EIF managed to make SMESec more attractive for originators, especially small banks and in CEE countries. It has contributed to enhancing the originator's capacity to make better deals, in particular by small or less experienced originators and in new markets. EIF has helped some of them to do their first SMESec deals. The extent to which the impact has been sustained is uncertain.
- Although the EIF has played a crucial role in bringing investors back to the markets and re-starting some markets that were "*almost dead*", the tendency to work more on mature markets and with larger originators after the crisis means that the EIF has not managed to reactivate difficult markets from which participants had stepped back.
- The EIF's non transactional activities have also contributed to supporting SMESec market development. Furthermore, originators have valued greatly the EIF's advisory services provided to the EIB under the ABS-SLA as a way to facilitate considerable EIB investment into SMESec transactions.
- Given the EIF's catalytic role in the SMESec markets inside and outside the EU, there is a need for more expertise and information to be shared by the EIF to increase transparency and to set a benchmark for other market participants and policy makers. Additional advisory services and technical assistance by the EIF could be useful for key stakeholders to address regulatory constraints and revitalise the SMESec markets. Likewise, more technical assistance support from the EIF would be advisable for less developed markets in Europe and with small originators or those with little or no experience who are more in need of SMESec skills transfer from the EIF.

d) **The SMESec instrument is per se not the panacea to solve all market failures hindering SME's access to finance. Hence expectations on the EIF's SMESec activities as a means to deliver policy goals in a post-crisis context needs to be put in context:**

- A combination of external factors play a key role in determining whether the EIF SMESec instrument is still fit for purpose, namely: (i) the lack of adequate national regulatory frameworks to promote SMESec (impacting predominantly cash securitisations) and the ongoing regulatory reforms at European level, (ii) the severe deleveraging on banks' balance sheets and the increasingly constrained SME lending by banks in some countries, (iii) the low interest rates and the ECB "repo" facility, and (iv) the changes in the rating agencies' methodologies and policies.

- The evaluation suggests that rather than acting counter- or pro-cyclically, the EIF has acted through the economic cycles, which needs to be sufficiently active for the SMESec instrument to be in demand. It is acknowledged that the EIF's SMESec instrument alone cannot address the existing market failures in SME finance. Hence, the EIF's guarantees to SMESec can only be a component of a broader public effort to improve SMEs' access to finance alongside, for instance, other financial instruments, such as intermediated lending, risk sharing instruments and equity support. Moreover, the effects of the abovementioned external factors on SME lending – which are well beyond the EIF's control – evidence that high expectations have been placed on the EIF SMESec instrument's delivering on policy goals in a post-crisis context. This also relates to the EIF's role in revitalising the market after the 2008 crisis.
- This notwithstanding, within the limits imposed by the demand driven nature of its business model, the EIF can focus its business development and execution efforts. This evaluation has highlighted how the EIF's SMESec instrument has evolved over time with the aim of ensuring that the EIF responds to market developments and addresses market failures in SME financing. It is advisable to focus more on its SMESec activities where it can add more value and enhance its policy impact (for instance, working more with small or less experienced originators and new markets).
- Furthermore, it is worth noting that the EIF focusses on the most difficult assets to securitise (SME loans), which overall represent a relatively small share of the total securitisation market. The evaluation questions whether the EIF could have greater impact if it capitalised on the expertise acquired in supporting securitisation of other asset classes (under the ABS-SLA) and by broadening the scope of its securitisation activities to non-SME assets (including real mortgage backed securities, RMBS). A greater impact, however, could only be achieved by ensuring originators' generate additional SME lending with the capital released from securitisation transactions.

e) **The EIF's processes and tools to take stock of progress towards achieving policy objectives, in light of evolving market failures, needs to be strengthened:**

- The EIF's policy objectives in the SMESec business line are specified as quantitative performance indicators (i.e. commitment volumes and ex-ante leverage volumes per year). The evaluation found that the EIF uses limited operational targets and indicators for monitoring and reporting on progress against the EIF's objectives (SMESec expected commitments and actual, or ex-post, financing catalysed per year). Using additional operational targets and indicators would enable the EIF to provide a more complete picture of its effective contribution to policy objectives in this market segment (i.e. the effective increase of SME lending).
- The absence of tools until 2010 did not enable the EIF to track adequately whether the EIF supported SMESec transactions resulted in originators increasing SME finance during most of the period covered by this evaluation. The introduction of an ex-ante value added assessment in 2010 and an ex-post impact assessment within the VAM from 2012 onwards are positive steps that have enhanced the relevance and effectiveness of the EIF's SMESec instrument. Yet the evaluation found areas of improvement both in the ex-ante value added (i.e. highly subjective, reliability of estimates and professional judgement) and ex-post impact assessments (i.e. absence of verification of originators' reporting). In view of these evaluation findings, it would be advisable to review the design of the instrument to assess whether further assurances and undertakings for the reuse of additional funding and capital relief through SMESec are needed, including incentives for originators, as well as additional monitoring and reporting requirements. Moreover, these measures could provide stronger signalling effects on the EIF's SMESec activities to other market participants.

f) **Aside from the post-crisis years of 2010 and 2011, the EIF has delivered its SMESec activities in a cost-efficient manner. Nevertheless attention should be paid to recent factors negatively impacting the cost-to-income ratio:**

- Overall, the EIF SMESec transactions have a positive yield in line with the operational goals of the EIF. The EIF's SMESec business has performed in line with its 40-60% cost-to-income target, if one does not take into consideration the impact of provisions for guarantees. If provisions are however taken into consideration, the years 2010 and 2011 have registered historically high cost-to-income ratios, due to provisions on a few transactions. The EIF's SMESec activity has been highly sensitive to the underperformance of a few deals, where the large expenses of a small number of transactions absorbed a large portion of those years' revenues.

- The cost-to-income ratio has recently been negatively impacted by, on the one hand, a decline of the securitisation revenues (caused by the low interest rate environment), and on the other hand an increase in staff costs (i.e. hiring of new staff). Both factors are expected to persist, continuing to have negative repercussions on the ratio. On the other hand, the increasing third party mandate management and SLA advisory services fees have managed to balance the decreasing risk revenues.
- Although time needed for the EIF to deliver its SMESec transactions was in line with the requirements of the market, the time needed for transactions on average is increasing. This trend may be explained by the application of quality and transparency requirements for the securitisation market undertaken by the EIF in line with a number of initiatives, such as the HQS and STS labels, and the increased complexity of a number of transactions.
- The evaluation estimated that the return on investment of the securitisation activity respects and even slightly exceeds the target set for the long term overall return on equity of 4% to 5%. Such return targets can only be maintained if provisions for guarantees of significant amounts as those registered in 2009-2011 do not occur again in the coming years.

6.2 Recommendations and Management Responses

Based on the main findings and conclusions of the report, EV makes the following six recommendations. They are categorised according to the latest typology adopted by EV for the follow-up of recommendations, i.e. in terms of strategy and policies, organisation and operations.

6.2.1 Strategy and policy recommendations

Recommendation #1. Clarify the EIF's policy objectives and set more specific targets in the SMESec market segment.

Background and benefits: The EIF policy objectives in the SMESec market segment are translated into a limited number of quantitative indicators. As these indicators do not fully reflect the policy objectives, reporting on them was also weak. It is thus important that the the EIF's policy targets are specified in terms of improved SMEs' access to finance and that additional targets and indicators are set. This will reinforce the EIF's focus on evolving EU policy objectives and at the same time enable the EIF to better assess whether its SMESec instrument is contributing to addressing specific market failures and financing gaps and whether the economic rationale and policy outcomes that justify EIF's intervention in this market segment still apply.

Clarifying policy objectives and setting more specific targets will also enable the EIF to better take stock of the progress towards achieving policy objectives in light of evolving market failures and report on them at the EIF-level, for instance, in its Annual Reports. The evaluation found that the absence of linkage between the ex-post impact assessment information from VAM and the EIF Annual reporting cycle is a missed opportunity for the EIF to highlight its contribution to attain its policy goals. Reporting on additional indicators (both quantitative and qualitative) in its Annual Report could also contribute to stronger signalling effects in the market. The VAM could provide valuable information to develop additional performance targets and indicators and feed into the EIF's annual reporting to enrich the information provided on the EIF's achievement of objectives in this market segment.

Hence the evaluation recommends that the EIF:

a) Clarifies its policy targets in terms of SME access to finance and SMESec market development, and better reflects them in the EIF's Corporate Dashboards;

EIF's Management response: Partially Agreed

EIF agrees that there is a need for a prompt follow-up of set targets. Dashboards are not produced by EIF at product level but at a mandate level and are used as a tool to monitor efficient deployment of the mandate. SMESec activity in itself is monitored on a monthly basis when achieve figures are compared with COP targets.

With regard to policy objectives, the ultimate objective of EIF is to enhance access to finance for SMEs in Europe. With this regard, SMESec forms an important element as it allows Financial Intermediaries to broaden their funding base, achieve capital release and increase SME lending.

b) Sets additional (quantitative and qualitative) performance targets and indicators to better track the EIF's achievement of those objectives;

EIF's Management response: Partially Agreed

Since 2013 and the development of the VAM, the requirements raised by the evaluation are now reflected as part of its impact assessment. Originators are now required to provide both quantitative and qualitative evidence of the volume of lending made available to SMEs on an annual basis on which ex-post evaluation is performed.

In addition, EIF has initiated a review process that will assess the efficiency current process. Following this exercise, EIF will form an opinion on whether revisions are necessary to improve the VAM.

c) Enhances links between its objective setting and reporting. This could be done, for instance, by linking ex-post impact assessment information resulting from VAM to the EIF Annual reporting cycle.

EIF's Management response: Agreed

EIF would like to point out that ex-post impact assessment is now conducted annually.

Following the development of the VAM in 2013 and as acknowledged by the evaluation, the first ex-post assessment was performed in 2014 and covered SMESec activities closed in 2013. A second assessment was made in 2016 covering all transactions that were signed in 2013, 2014 and 2015.

Recommendation #2. Adjust the EIF's SMESec instrument to enhance its impact.

Background and benefits: The evaluation found that the EIF has been active in supporting SMESec market development across Europe by initiating the SMESec market in several countries, of which some did not remain sustained after the crisis for reasons beyond the EIF's direct control.

As there is no European SMESec market *per se*, national legal frameworks and national market-level factors strongly shape the SMESec markets. To ensure the EIF's SMESec instrument is conducive to achieving the highest policy impact possible in each of those markets, it is advisable that the EIF tailors its SMESec instrument to the respective national market contexts.

The evaluation also found that after the crisis the EIF has been mainly supporting SMESec transactions with large originators and in mature/active markets, which is explained to a large extent by the EIF's activities being market based. However, it was the EIF's support to smaller banks/new originators, those lacking experience and to new markets that has been mostly valued over the period under evaluation.

Given the difficulties to securitise SME loans and the relatively small share of SMESec in total securitisation market, the evaluation wonders whether the impact of the EIF's SMESec activities in increasing SMEs' access to finance could be higher by broadening the scope of its own-resources' activities to cover guarantees on securitisation transactions with collateral other than SME loans (such as real mortgage backed securities). Similar to the current design of the instrument, the originators would still have to commit to deploying a multiple of the EIF support into new SME lending. Moreover, the EIF could capitalise on the expertise acquired from analysing securitisation of other asset classes, given that it already provides advice to the EIB on such transactions under an EIB group service level agreement.

In this context, the evaluation recommends:

a) Carrying out periodic national market assessments to determine how the EIF's SMESec can best achieve its objectives across the national markets where it operates;

EIF's Management response: Agreed

EIF welcomes this recommendation to carry out periodic reviews and will study the feasibility of conducting such assessments (frequency of the assessment, geographical focus, etc.).

However, EIF would like to remind that EIF is acting as a facilitator in SMESec transaction and that consequently, other investors are required for a transaction to occur. EIF is consequently not in a position to operate in national market with no securitization activity.

b) Studying the feasibility of broadening the EIF's securitisation activities to other asset classes.

EIF's Management response: Agreed

The EIF welcomes this recommendation from EV. EIF would like to highlight that such study should be conducted at the EIB group level to assess the opportunity of extending activity to other asset classes.

Recommendation #3. Introduce additional mechanisms to ensure the EIF's support to SMESec results in increased SME lending.

Background and benefits: One of the underlying assumptions for the EIF's intervention in SMESec is that SMESec increases the originators' capacity to lend to SMEs. The EIF introduced an ex-post impact assessment on the SMESec business activities in 2012 and therefore the extent to which such impact was attained could be verified through data reported from originators only after this date. Yet the evaluation also found mixed evidence on the impact of the EIF's SMESec transactions on the additional volume of finance made available to SMEs by originators. As money is fungible, it is very difficult to ascertain that additional lending reported by originators was derived from the capital resources released by the transaction the EIF supported. Moreover, increasing SME lending capacity does not always appear to be a primary purpose for originators to undertake SMESec transactions. Hence revamping the ex-post impact reports delivered by the originators, as recommended below under c), could provide more detailed information on the reuse of the released capital/additional funding by originators, as well as enhance the signalling effects of the EIF's SMESec activities *vis-à-vis* other stakeholders and market players.

EV thus recommends that the EIF:

a) Introduces additional assurances and undertakings into the design of the EIF's SMESec instrument with a view to provide originators with adequate incentives to effectively generate additional SME lending.

EIF's Management response: Not Agreed

EIF would like to remind that it adopts a market-based approach for SMESec activities. In this context, EIF would like to point out that the proposed recommendation is not suitable to such approach. Strong contractual undertakings are already in place with originator and EIF does not consider that adding additional burden would increase the efficiency of SMESec transactions. Strengthening legal undertakings could, on the contrary, be non-beneficial for the program if they make EIF's current product offer unmarketable.

b) Undertakes a review of the underlying principles behind the side letter and following that, a revision of the reporting obligations for the originators.

EIF's Management response: Not Agreed

EIF would like to insist that, following the latest development from 2013, the content of the side letters has been modified. EIF is satisfied with this current version and believes it allow to deploy SMESec transactions in a cost-efficient manner.

c) Requests the originator to report on a portfolio approach, in addition to the current reporting, thus mitigating the implication of the fungibility of money on the originator side. The portfolio approach could revolve around three measures:
    a. SME portfolio increase (whether SMEs have received more funding from the supported originating bank);
    b. Increase of the share of SME lending over total loan portfolio (originator's commitment to that segment that could help signalling whether the EIF's support may have helped increase the focus on SME lending); and
    c. Increase of the share of SME lending compared to the market (whether the SME lending portfolio outgrew the competition, which would indicate that the EIF has selected originators with a greater SME focus for their lending activity).

   None of the measures is conclusive in terms of causality, but could be used as a rough indicator, complementing the current reporting from originators.

EIF's Management response: Partially Agreed

EIF would like to highlight that this recommendation from EV relies on the assumption that a theoretical benchmarking is possible and that we can introduce comparability between a situation where there would be no intervention from EIF and the current situation. EIF would like at first to recall that EIF SMESec activity supports Financial Intermediaries that have high capital constrains. Without EIF's intervention, these Financial Intermediaries could be forced to cap their lending activities or turn to different asset classes.

Notwithstanding, following its latest modifications in 2013 and after a few years of performance, EIF will initiate a review of the reporting questionnaires used for its VAM. With this review, EIF will assess whether some modification are required in order to improve the current methodology.

In order to fine-tune its impact assessment of SMESec activities, EIF is also welcoming any concrete suggestion that could allow for a development of the VAM and the creation of a leverage ratio computation.

Recommendation #4. Expand the EIF's advisory and technical assistance for stakeholders and market players.

Background and benefits: The EIF has played an important role in developing SMESec markets across Europe by providing expertise and support to other key stakeholders and market players, as evidenced by:

- Several calls from the EC and the European Council for the EIF to play a key role in revitalising the market and managing additional EU resources to this end;
- The EIF's involvement in EIB Group-wide initiatives on SMESec (such as the EREM, EIB-SLA, etc.);
- The EIF's involvement in SMESec transactions regarded as vital for small and/or less experienced banks and market players in less developed SMESec markets.

The evaluation suggests that more support is needed for smaller banks and new originators lacking experience and market knowledge, for whom administrative and legal costs are too high for securitising assets. In this context, the EIF's experience and knowledge seems highly relevant, as is the possibility to provide more technical assistance. Furthermore, the EIF could provide more advisory services and technical assistance to policy makers and other market players to help revitalise the market and support innovation in the structuring of SMESec transactions.

Hence the evaluation recommends expanding the EIF's advisory services and technical assistance activities in the context of SMESec market segment. This could be done in conjunction with the periodic national market assessments proposed in Recommendation #2.

EIF's Management response: Partially Agreed

Such an expansion of advisory services would need to be discussed at EIB group level.
EIF advisory and TA activities are different compared to typical advisory/TA services. They are very much linked to operational activities (non-transactional securitisation activities) and happen on various levels:

- *Transaction level: support for "unexperienced" originators (involvement in structuring etc.);*
- *Policy level: advice for policy makers (EC, Parliament, ECB, etc.), e.g. regarding regulation;*
- *Market level: regular market assessments.*

EIF is pleased to note that the positive impact of the services offered by EIF have been acknowledged by EV in its report. However, EIF would also like to point out that such advisory services can only be increased to a limited extend (it has to be demand driven and seen case by case).

6.2.2 Organisational recommendations

Recommendation #5. Undertake regular analysis of cost and profitability of the EIF's SMESec business line.

Background and benefits: The effects of the crisis and the increase in staff have impacted on the EIF's costs and income from the SMESec activity, in particular over recent years. Likewise, the return on investment of the EIF's SMESec activities is dependent on the level of expenses being maintained at reasonable levels in the future.

Responding to the challenging times for SMESec markets inside and outside the EU also reinforces the overarching conclusion that the EIF needs relevant and timely financial information at the level of its SMESec business line (i.e. on costs, revenues, etc.). Financial information at market segment level should serve the EIF's management in regularly overseeing and acting upon the institution's performance. This is of paramount importance considering the main conclusions deriving from the analysis of efficiency and sustainability of the EIF SMESec activities.

EV thus recommends that:

a) The EIF undertakes regular analysis of the costs and profitability of its SMESec business line to provide the EIF management with a key tool to manage the economic value of the SMESec portfolio and the risks linked to it in the future.

EIF's Management response: Agreed

EIF welcomes the analysis conducted by Evaluation that evidences that SMESec transactions are managed in a cost-efficient manner. EIF will continue to take rigorous approach to cost-income ratio as it did before and to structure its delivery in securitization in the same manner. Fees are provided on a quarterly basis and reported in the Annual Report. They are monitored on a monthly basis and prospectively taken into account in COP targets.

b) In this context, it is also recommendable to voluntarily[41] apply SMESec market segment reporting in line with IFRS 8 for instance, to the EIF's Annual Reports. This would allow EIF management at all levels to monitor key financial information on a regular basis on the operating results of the EIF's business lines, including SMESec.

EIF's Management response: Not Agreed

In its recommendation, EV makes reference to IFRS 8 which is a standard that applies to the financial statement of a company:

- *Whose debt or equity instruments are traded in a public market*
- *That files, or is in the process of filling its financial statements with a securities commission or other regulatory organisation for the purpose of issuing class of instruments in a public market.*

As a consequence of the above criteria, EIF would like to stress that it is out of the scope of the IFRS 8 standard.

Notwithstanding, EIF reporting (as reflected among others in our Annual Report) is organised by business activities (Guarantee & Securitisation, Equity and Mandate Management). As part of this organisation, SMESec must be seen as one of the numerous tools or products offered by EIF as part of our G&S activity.

6.2.3 Operational recommendations

Recommendation #6. Review the VAM to ensure the EIF's SMESec instrument remains fit for purpose.

Background and benefits: As part of its Value Added Methodology (VAM), first introduced in 2010, the EIF requests originators to provide data ex-post on the impact that the SMESec transaction had on the volume of finance made available to SMEs following the closing of the deal. Such information is then compared to the targeted ex-ante leverage as per VAM and side letter signed with the originator. In the current side letters, originators commit to use all reasonable efforts, subject to materially adverse market conditions and/or other events and circumstances outside of their control, in providing funding to SMEs for an amount equal to at

[41] For the avoidance of doubt, EIF is out of scope of IFRS 8 given that the standard applies to the financial statement of a company: whose debt or equity instruments are traded in a public market or that files, or; is in the process of filling its financial statements with a securities commission or other regulatory organisation for the purpose of issuing class of instruments in a public market. Nevertheless, our recommendation points towards the voluntary adoption of such standard.

least a certain percentage (typically 100%) of the aggregate principal amount of the EIF guaranteed SMESec transaction, within a certain time frame (typically one year) from the date on which the EIF supported their SMESec deal.

Since the ex-post impact assessment was introduced in 2012, the EIF has released two ex-post impact assessment reports (one on SMESec operations closed in 2013 and a second one on those transactions signed in 2014 and 2015). In both reports the originators reported on effectively generating additional SME lending as a result of the EIF's supported SMESec transaction. Yet the evaluation also found evidence questioning that the additional funding or capital released from the EIF's SMESec transactions was effectively used by originators to generate additional SME lending.

Given that the first two ex-post impact assessment reports issued so far are the first attempts by the EIF to provide aggregated ex-post data, EV recommends reviewing the VAM to ensure all of its components (i.e. indicators, frequency or reporting, quality of originator's reporting etc.) address the EIF's information needs. The aim of this review will be to ensure that the EIF can assess ex-ante and ex-post whether the SMESec instrument needs to be adapted from time to time in line with market failures and EIF's policy impact. It will also seek to help the EIF in reporting more comprehensively on delivering its policy goals in this area. This recommendation needs to be undertaken in conjunction with Recommendations #2 and #3.

EIF's Management response: Not Agreed

As explained in our response to Recommendation #3, following its latest modifications in 2013 and after a few years of performance, EIF has initiated a review of the reporting questionnaires used for its VAM. With this review, EIF will assess whether some modifications are required in order to improve the current methodology and with a view to achieve policy impact. This review will ensure that SMESec is adequate at identifying evolving market failures. As SMESec is a market-based instrument, addressing these market failures and achieving expected policy impact does not solely depend on EIF (i.e. other investors, policy actions are required to allow EIF's intervention).

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