EUROPEAN INVESTMENT FUND

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EIF CORPORATE OPERATIONAL PLAN

2004 – 2006

CONTENTS

1. Executive Summary

- Thanks to a considerable rise in the SME Guarantee activity, the overall level of EIF operations has increased in 2003 while adverse market conditions were continuing to affect the VC segment.
- New guarantee volumes in 2003 have progressed strongly with signatures amounting to EUR 2209m. The guarantee activity proceeds on one hand from the development of the securitisation market and credit enhancement operations; and on the other hand from the MAP in the EU, noting a progressively increasing demand and related workload from ACC.
- As regards VC operations, some EUR 135m of new commitments have been signed in 2003, an amount lower than expected. However, EIF continuous presence in the market is achieved through ongoing disbursements of a level comparable to prior years. Forecast for 2004 shows the possibility of some kind of a "return to normal", and higher investment capacity potential is achieved through the extension of the RCM, and the ERP mandate.
- In order to achieve an increased balance in the portfolio composition by stages (for example through second and third round investing) and – where possible – by vintage years (for example through secondary transactions), EIF aims at complementing early stage tech funds with later stage tech funds with above average expected performance.
- In line with previous COP objectives, EIF intends to develop a number of cooperation agreements with strategic partners, i.e. with institutions operating similar products or in the same markets, and develop further advisory and third-party mandates in order to leverage the Fund's operations and contribute to EU objectives.
- EIF has been rated AAA both by Moody's, Standard and Poor's and Fitch and has applied to the Basle Committee for the Multilateral Development Bank (MDB) status recognition (obtained in 2004). The AAA rating and the MDB status are preconditions for the EIF to be zero weighted under the Basle II Capital Accord.
- For the very first time, EIF has been mentioned in European Council conclusions (October), the latter inviting EIF to give specific attention to funding of innovative SMEs operating on the technological boundary, business start-ups, high-tech firms and micro-enterprises and step up the provision of venture capital to innovative SMEs through the release of an additional 500 million euros for venture capital operations from the Bank's operating profit, and stepping up the Fund's guarantee and advisory activities.

– In the medium-term it is envisaged that the main drivers underpinning operations development should be driven by market upswing, increasing demand from ACC and new policy and institutional demands placed upon EIF. In particular the evolving context of the Lisbon process initiated in 2000 which undertook to transform the EU into the most "competitive and dynamic knowledge-based economy in the world" by 2010, recently reinforced by the RDI 3% objective and the related EU Growth Initiative, requires that EIF continue to increase its reach to better meet European SME needs, through its core activities, but also increasingly through additional, complementary new activity lines such as advisory services. As a pro-active EU policy driven organisation in close contact with market needs, EIF should in the coming years continue to exploit its reactivity and flexibility to develop instruments for SMEs in cooperation with main institutional counterparts.

2. Shareholders

2.1 European Investment Bank

The extension of the RCM (EIB risk capital mandate operated by EIF) investment capacity reflects the strong commitment of EIB to support the financing of RDI and, through EIF, the VC industry. The complementarity between the European Commission and the EIB VC mandates still prevails, with the EC mandate focused on very early-stage and high-tech investments, and that from the EIB not only on Venture Capital but moving more towards development capital.

2.2 European Commission

Cooperation with the European Commission is planned to develop further in the coming years. The natural bridge between the European Commission and EIF is the Multi-Annual Programme for Enterprise (MAP). Although the current mandate runs until end-2005, discussions on the MAP2 guidelines are starting this year with the European Commission. The launch of advisory services in late-2002 has created new opportunities for cooperation through bilateral agreements between EIF and various Directorates-General. The first framework agreement was signed in 2002 with DG REGIO, and was followed by a contract with DG Transport and Energy. Other advisory contracts should be signed with individual Directorates-General, and in particular DG Research within the framework of the recent European Growth Initiative. It is thus expected that cooperation with the EC will gradually strengthen, on the one hand through the ongoing implementation of the operational MAP mandate, and on the other hand through bilateral agreements with individual Directorates-General aiming at serving Community Objectives and responding to EU and to market needs in specific segments.

2.3 Financial institutions

Care has also been taken to foster relations with the third group of shareholders, the Financial Institutions. Bilateral meetings with almost all shareholders have been held to present EIF, and efforts have been made to develop business. This cooperation is likely to be reinforced in the coming years, for instance through the new agreement with CDC or with Vaektsfonden (planned new shareholder), and the development of joint-operations (e.g.: securitisation operations with KfW). EIF also foresees completing the introduction of three new shareholders from Acceding and Accession Countries and existing Member States (the Hungarian Development Bank and Encouragement Bank which became shareholders in 2003; SanPaolo IMI, Bank of Valletta currently underway and Vaekstfonden at a later stage). Expanding the list of shareholders in CEE countries would not only give EIF a higher visibility in these markets, but would also provide EIF operational teams with a better insight into local market developments and hence improve the prospects and potential leverage in VC, guarantees, MAP and advisory.

3. The global context

A number of economic, institutional and regulatory trends are changing the overall environment of SME financing in Europe, in particular for venture capital, notably the very difficult economic conditions prevailing since the beginning of the market downturn in 2000. In the short term, enlargement will become a reality with further investment and guarantee opportunities, while in the longer term, developments such as the implementation of the Basle 2 agreement are likely to have lasting effects on SME-finance, one of which could well be an increase in SME securitisation operations. These changes and challenges will affect EIF operations and need to be anticipated.

3.1 The market environment

The economic downturn, affecting in particular the venture capital sector, observed since 2000 has continued in 2003. However, there has been a moderate pick-up in activity in the second half, and latest confidence indicators generally point to some improvement in economic expectations. The economic upturn should therefore gradually strengthen in the course of 2004, impacting the level of EIF operations, in particular the venture capital segment.

- Fund managers currently fundraising are still facing difficulties to reach their target sizes. Lower appetite for risk- taking on the part of private investors renders the establishment of first time funds and high-tech difficult, affecting to a large extent this tech/early-stage segment of the industry and in particular incubators and seed funds.
- However, there are some preliminary signs that the trend may have started to reverse. Thus, preliminary figures for 2003 suggest that funding available to the Venture Capital/ Private Equity area is recovering from its significant drop in the first quarter of 2003. There are a number of indicators that a recovery may be under way:
- Since March 2003 listed markets and in particular NASDAQ have shown a strong upswing;
- With hindsight, 2003 could turn out to be either near or at the bottom of the cycle, a time typically resulting in the best vintages for venture capital funds. Currently observed investment opportunities and prices are considered to be attractive by active investors;
- Experienced investors with a long-term investment horizon still see attractive returns in this asset class and steadily continue their private equity programmes to achieve diversification over time;
- New funds in Private equity in Europe have reached US levels and IPOs are on the drawing board again in the US.

Moreover, the depressed market conditions provide excellent investment opportunities for investments to balance previous choices. Over the last few years, EIF has steadily built up experience and teams, and is now well placed not only to provide an added value to the EU objectives and the venture capital industry, but also to implement a more balanced strategy in a market that is returning to equilibrium with newly emerging investment opportunities.

As for SME guarantees, the gloomy economic situation has impacted both the banking sector and companies with a downturn effect on credit growth. Credit quality deterioration continued as also evidenced by the steep increase in the number of bankruptcies, particularly in certain countries. On the other hand, SME securitisation transactions flourished in the last few years, fuelled by more conducive regulatory frameworks in the Member States. Furthermore securitisation techniques represent an effective means to actively manage banks' loan books and to seek alternative sources of funding at competitive conditions and to achieve better return on equity.

For the EIF, SME securitisation has indeed been core business activity (portfolio upgrades) and is expected to grow in the future. To date, in the credit enhancement deals entered into by the EIF, there have been no tranche downgrades or guarantee calls for missed payments.

The recent changes in the regulatory and economic environment (phasing-out of the statutory guarantees provided by the German Laender, increasing budget constraints on public budget, higher returns on equity requirements) will make securitisation more attractive. These developments should positively impact the EIF credit enhancement activity in the coming years, subject to the still as yet debated impact of Basle II on SME financing.

3.2 The institutional policy drivers

One of the core drivers of EIF strategy and EIB's Innovation 2010 initiative (i2i) is linked to the conclusions of the Lisbon Process initiated in 2000 which aims at transforming the EU into "the most competitive and dynamic knowledge-based economy in the world", as well as the Barcelona objective of reaching 3% of GDP by 2010 in RDI investments, including those from the private sector. The strong role to be played by EIF in the financing of RDI was reinforced by the last Thessaloniki European Summit which launched the European Action for Growth Initiative to support growth and integration by increasing overall investment and private sector involvement in TENs and major R&D projects (approved at the 2003 November ECOFIN before submission to the December European Summit in Rome).

Accordingly, EIF will continue to reinforce and adapt its means to mobilise venture capital resources as well as extend guarantees. Furthermore, EIF will seek to provide advisory services towards academic and research institutions or RDI-related entities and launch of special action in cooperation with the European Commission to support the setting up of common seed and development capital funds by groups of leading technology universities.

In addition to completion of the necessary steps to fully contribute to the Innovation 2010 requirements, it is to be expected that a number of new policy initiatives will require increased EIF activity. Thus the second part of the decade will see entry into force from 2006 of the new Economic and Social Cohesion program which includes new generation Structural Funding 2006-2012 likely to involve considerably modified delivery mechanisms with a partial departure from grant financing in favour of revolving financial engineering initiatives which are typically the EIF's domain in the EIF Advisory activity.

Finally, enlargement will automatically result in requests for increased action in highly work and resource-intensive markets for practically all EIF activity lines.

4. Operational plan

EIF operations are focused on two main product lines:

- Venture capital,
- SME Portfolio guarantees

With a subscribed capital of EUR 2bn, EIF is a relatively small organisation in the institutional framework. However, operational capacity is comparatively important – EIF is active in several specific market segments - and impact potentially high, thanks to the management of external mandates and to gearing instruments. EIF operations are affected by the economic cycle to a large extent – as co-investor and guarantor availability – and the level of market competition. Thus, the success of EIF in helping SMEs lies in its capacity of remaining flexible, reactive and competitive, which implies the necessity of managing instruments that meet these objectives, and leveraging the use of its resources.

4.1 Venture Capital

4.1.1 Highlights

- The VC downturn has affected the volume of commitments: some EUR 135m have been signed in 2003.
- This brings the total VC portfolio measured on the usual commitments basis close to the EUR 2. 6 billion mark at end 2003.
- The number of VC operations should increase in 2004, and reach a cruising speed in 2005 and 2006.
- EIF portfolio is balanced in terms of sectors and areas with a focus on high-tech (two-thirds). EIF will continue to look at investment opportunities in non-core regions, taking into regional balance. However, the willingness to invest can be limited by the absence of co-investors in the less developed markets and the level of expected returns. The stage rebalancing already approved has started to be implemented.
- EIF has been awarded an external mandate from a non-shareholder (ERP).

4.1.2 VC operations in 2003

- Although the level of commitments for the year 2003 has decreased, the level of disbursements – including those on operations previously signed – allowed EIF to maintain a fairly constant level of investment resources available for the VC industry.

4.1.3 Forecast medium term activity

All resources / by year	2002	2003	2004	2005	2006
Yearly commitments	460	135	Min 200 Max 400	Min 400 Max 550	Min 400 Max 570
Cumulative Signatures	2,460	2,600	3,000	3,550	4,100

In EUR m. Figures are rounded-up and rounded-down

- Future signature figures in the above table and the extended summary presented in the appendix are based on an appreciation of the amount of possible investments the EIF could in fact achieve on the basis of identified or potential market demand.
- EIF should not over pessimistically react to the current downward pressure in valuations and opportunities, but rather in line with the cost-averaging principle take advantage of current downturn-related investment opportunities and try to maintain a constant level of signatures to reinforce its presence in the market and to achieve a degree of diversification over the vintage years.
- There are finally some signs of VC activity and potential exits after a very hard couple of years. Moreover, EIF's investment spectrum is increased by the policy of moving further towards funds having a mid and later stage focus in addition to investments in early-stages.

4.2 SME Guarantees (Own Risk and MAP)

4.2.1 Highlights

Estimated new guarantee volumes in 2003 are well in excess of expectations, with signatures as of December amounting to EUR 2209m.

This confirms the overall good balance of the guarantee business activity and of the revenue streams between own risk operations and MAP activity, which is expected to be maintained in the coming years.

For 2004, balanced development of the guarantee activity between own risk operations and MAP business. Total volumes in 2004 to reach EUR 1,340 m (high volume scenario), with a balanced contribution from MAP and own risk operations. With regard to the MAP activity, a lower leverage on budgetary resources is expected as compared to the current year, mainly due to the relatively higher cap of ACC operations

For 2005 no major changes in the guarantee activity, targeting full commitments of the budgetary resources under the MAP by the end of 2005, while further developing the own risk activity.

4.2.2 Own Risk activity

- Credit Enhancement has become and will continue to be an EIF core product, representing an important share of the deal flow and already now a substantial portion of the existing portfolio. The leverage effect of the use of EIF capital is particularly strong with approximately EUR 10 of new guarantees for every EUR 1 of EIF capital.
- Continued development of the activity, with emphasis on further diversification by originator, country (including Accession Countries with well-developed markets), asset classes and rating classes, including selectively chosen secondary market transactions as approved by the Board.
- Further product development with a view to providing tailor-made products for specific intermediaries, such as multi-seller structures (e.g. for smaller regional banks) and securitisation of trade receivables originated by SMEs.
- EIF will widen and deepen its network of investors underwriting EIF wrapped ABS, building on its existing contacts as well as on its official AAA/Aaa rating.
- EIF will continue its cooperation with EIB on the EIB SME securitisation platform, pursuing operational synergies within the Group that best serve Group income development.
- EIF will continue to be an active party in the various national working groups (e.g. in France) addressing the opportunities for improved access to debt finance for SMEs by means of securitisation and will strengthen its cooperation with financial institutions and public authorities committed to supporting enhanced access to finance for SMEs by way of securitisation.
- Limited guarantee volume for the standard Credit Insurance product, due to EIF insufficient underwriting capacity to achieve meaningful deal size for the originator and at the same time adequate portfolio diversification by originator for EIF and further development of such transactions towards structured forms (like e.g. Frispar, signed in 2002). Extension of existing, well performing credit insurance contracts.

- Marginal deal flow for risk capital leveraged funds (SIVs), in view of the current difficult market conditions. Transactions to be selectively chosen on the basis of the experience acquired by EIF with the more recent and more robust structures.
- The outlook is subject to the activities and pricing policies of competitors in this market.

4.2.3 MAP activity

- Addressing market failure focusing particularly on start-ups and smaller enterprises, thus complementing the own risk guarantees market coverage. Again, as with the own resource guarantees, a particular feature is the important leverage effect attained, represented in the new lending volumes by prudent use of the EU budget available.
- The 2 first ACC guarantee operations have been signed. Full commitment of the available budget under the MAP by the end of 2005 is expected, also helped by the cooperation with multilateral and promotional banks and selection of commercial banks in the ACC.
- Most commitments are expected to continue mainly under the Loan Guarantee Window. Under the micro-credit window, commitments are expected shortly to surpass EUR 100m, gearing up the budget applied by a factor of six times. This activity is particularly sustainable in ACC where the number of the micro enterprises is high.
- For 2004, MAP activity (approx. EUR 600 m) to account for about 50% of the total guarantee volumes, with an increasing number of transactions in the ACC following active promotion in this area throughout 2003, and generally with a higher cap rate since risks are generally higher. The extension of MAP budget for 2004 (additional EUR 33m, under approval by the EP) has been integrated in the forecasts.
- Selection of new financial institutions as well as extension of cooperation with existing intermediaries that are successfully co-operating with EIF under the MAP.
- Portfolios of relatively smaller size (in addition to the lower gearing mentioned above); agreements entered into with new, less experienced financial institutions especially in the ACC.

4.2.4 Forecast activity

The following table shows the expected results for 2003 as well as the projections for the following years, through to 2006.

For 2003, a total signatures figure of EUR 2,209 m (+80% over 2002).This is the result of the substantial volumes originated under the MAP facilities (EUR 1,657bn), as well as the further development of Own Risk (EUR 552).

Business Plan 2004 – 2006 (EUR m)

Year	2001	2002	2003	2004	2005	2006
Guarantee volumes						
Own risk – net (*)	*403*	*524*	552	low 600 high 690	low 645 high 755	low 710 high 790
Trust (SME GF, MAP)	*555*	*707*	1657	low 550 high 650	low 400 high 475	600 (**)
Total	958	1,230	2,209	Low 1,150 high 1,340	Low 1,045 high 1,230	Low 710 high 790 1390 (**)

(*) New guarantee commitments net of reinsurance from third parties

(**) For 2006, estimation with MAP 2 (mid-range figure)

For 2004, based on the expected deal pipeline with regard to both own risk and trust activities, the total guarantee volume is estimated at EUR 1,340 m (high volume scenario), or 41% lower than in 2003. This reduction is only due to the expected reduced nominal guarantee commitments under MAP, as compared to the exceptionally high nominal volume achieved in 2003. However, the volume of operations could possibly be higher for the trust activity (up to EUR 900m).

For 2006, after the commitment period of the MAP facilities, the continuity of EIF operations could be achieved through MAP2.

Demand is likely to be considerable in the longer term in ACC, both for MAP instruments and in the longer term for own risk guarantees when markets become more sophisticated and the regulatory environment more conducive.

4.3 Advisory Services

Advisory services and other strategies to leverage on EIF's unique skill-set and market position:

In April 2002, DG REGIO of the European Commission proposed to EIF to start advising Objective1 and 2 entities in the context of SME risk capital. This resulted from the implementation of the EU budget amounts dedicated by structural funding (European Regional Development Fund) to financial engineering in Regions (EUR 1.6bn for 2000/2005).

Following this request, a framework agreement was signed between EIF and DG REGIO in September 2002. Since then two contracts have been signed and completed with the Instituto de Fomento de Andalucia (IFA) and the Gouvernement de Wallonie. In both cases, EIF's central role in establishing European best practices was a determinant element of the mission given to the Fund.

EIF's advisory activity also includes other areas. Thus a third assignment has been undertaken, this time on behalf of DG Energy Transport within the European Commission. It is expected another advisory assignment on behalf of DG Research may be finalised shortly in the context of the Growth Initiative. Other contracts are being discussed for technical assistance in several countries.

Also a number of contacts with financial institutions including EIB point to new ways in which EIF can utilize its key strengths.

5. Future developments

Achieved 2002 COP objectives:

- Rating: EIF has been rated AAA both by Moody’s, Standard and Poor’s and Fitch and is recognised by the Basle Committee as Multilateral Development Bank (MDB), both being preconditions for the EIF to be zero weighted under the Basle II Capital Accord.
- Advisory Services: one year after its launch, the activity looks promising with new contracts foreseen in 2004. However, Advisory should remain a marginal activity in the future in terms of volume, complementary to core business.
- The rebalancing of the EIB venture capital portfolio is underway, leading to a more diversified situation in terms of exposure by sectors and stages.

For 2004, there are several key developments planned which are broadly speaking designed to strengthen internal processes and to enhance the added value of the Fund in its markets or its products.

- In order to make fuller use of the knowledge built up in the Fund, EIF shall continue to provide information (various newsletters / technical publications) and expertise to third parties, the latter on a fee paying basis,
- Pursue strategic partnerships, with institutions operating similar products or in the same markets, in order to leverage the Fund's operations: as an illustration, the combination of EIF's EU wide expertise in certain sectors, with the more in-depth/specific knowledge of some players in their market or product.
- Study further, and implement if satisfactory, increased interaction between the VC and guarantee products, including securitisation.
- Seek to develop further third party mandates following that awarded by BMWA, notably in the venture capital fields, again to leverage the Fund's expertise and to diversify its sources of income. Developing such mandates is a long-term exercise.