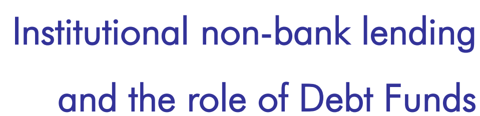

Institutional non-bank lending and the role of Debt Funds

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Abstract[1]

Against the background of the need for alternative or additional financing channels for SMEs, this paper analyses the market segment of *Debt Funds*. Often, the need for alternative financing mechanism and the increase of non-bank lending / bank-disintermediation is voiced – the text provides recent examples of and reasoning for this.[2]

The concept of Debt Funds is presented and the split between *Diversified Funds* and *Selective Funds* is introduced. The main chapter gives a range of examples for Debt Funds and related initiatives to enhance the (SME-) financing via non-bank sources, private initiatives as well as publicly supported initiatives – covering the two groups, mentioned before. Moreover, this chapter presents the emerging market segment of the so-called SME bonds (which forms itself the basis for SME bond funds (as well classified as Debt Funds), with examples from Germany, Italy, France, Spain, and the UK. The chapter *"Debt Funds on the road"* presents some statistics based on various databases (and explains their limited explanatory power).

The dynamic in this market segment shows that its importance is growing and increasing volumes in non-bank lending appear to be a trend (see also Preqin, 2014). So far, only the minority of existing Debt Funds focus on EIF's core final beneficiaries - SMEs and mid-caps. Most of them are targeting the bigger category of companies (bigger mid-caps to large caps) and/or mezzanine instruments. Moreover, initiatives take place so far only in a limited number of countries. Against this background, and the fact that there is a need to strengthen alternative financing channels as well as that there are manifold calls from market participants and policy makers to support alternative financings for SMEs / mid-caps to fill the bank financing gap, the participation of EIF in developing such an emerging market for the smaller segment of companies - learning from its past experience with non-granular portfolio guarantee transactions - appears to be straightforward.

In this context and in particular in the framework of the EIB Group Risk Enhancement Mandate (EREM), EIF intends to implement financing tools for SME focussed Debt Funds in Europe in order to support the development of this market segment. The mandate is explained towards the end of the paper, before the concluding remarks inter alia summarise important pro's and con's of Debt Funds that have to be considered concerning an involvement in these activities.

In general, available information about this market segment - due to its fragmentation and opacity it is even ambitious to speak about A or ONE market segment - is very scarce and *THE* Debt Fund does not exist - there are no generally accepted definitions and the range of structures, that could potentially be called *Debt Funds*, is wide. Hence, it is the aim of this paper to shed more light on important topics around the growing area of Debt Funds and institutional non-bank lending in Europe.

[1] This paper benefited from comments and inputs by Frank Lang, Ricardo Beltran, and Simone Signore for which we are very grateful. All errors are of the authors.

[2] In order to keep the scope of this paper manageable, the topic of non-bank lending refers here to non-bank institutions (e.g. insurance companies, pension funds, private equity funds) and not to the – also growing – segment of non-institutional lending (i.e. crowdfinancing).

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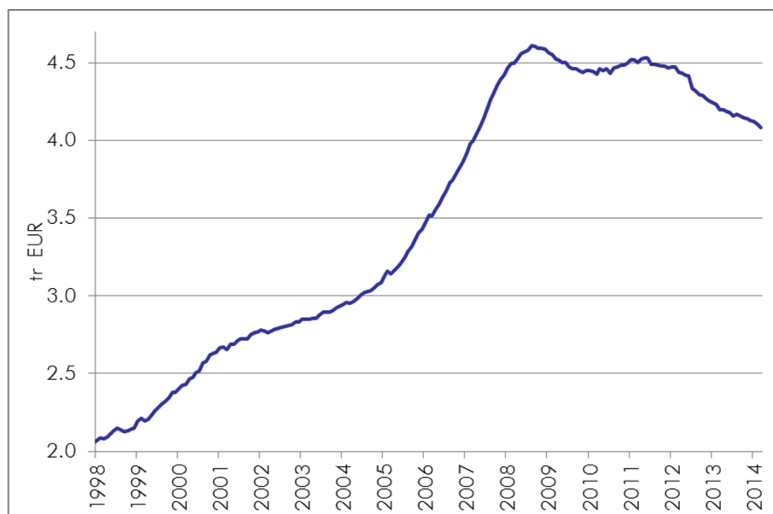
1 Financing gaps and the need to diversify the financing channels

1.1 Market failure and SME financing gaps

According to ECB data, the trend in lending to non-financial corporations in Europe has been declining since 2009 and still has to bottom out (see Figure 1). Compared to the peak of EUR 4.6tr reached at the beginning of 2009, the volume of outstanding loans has decreased by more than 12.8% to EUR 4.1tr in the euro area in August 2014.[3]

Figure 1: Outstanding loans to non-financial corporations in the euro area



Source: EIF, based on data from ECB

Given the strong increase in loan accumulation, the deleveraging is a necessary process to some extent, leading away from potentially unsustainable levels.[4] However, the recent downsizing in

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[3] Consistent SME loan data do not exist on European level. As background information: often, small loans (i.e. up to and including EUR 0.25m) are used as a proxy for loans to SMEs. Even if new business volumes are also reported for small loans, the time series on a European level contains data going back only to June 2010. A longer history (back to 2003) exists for the size-class differentiation between loans to NFCs up to, and including, EUR 1m, and loans over EUR 1m. Looking at moving averages of the preceding 12 months, loans ≤ EUR 1m grew relatively steadily and reached their peak in April 2008 at EUR 86bn, which was 25% larger than by end-2003. Loans > EUR 1m grew for one year longer and peaked in April 2009 at EUR 276bn, which was 81% larger than by end-2003. Following their respective peaks, loans of both size-classes decreased continuously until June 2013, by 36% for loans ≤ EUR 1m and by 42% for loans > EUR 1m. While loans ≤ EUR 1m are today 20% below their 2003 levels, loans > EUR 1m are still 6% above the corresponding level. This particularly reflects the strong differences between the pre-crisis growths of both loan-size classes. However, it is questionable if the growth in loans to NFCs of ≤ EUR 1m can be taken as a proxy for the development of SME loans. For example, since 2011, loans to NFCs ≤ EUR 0.25m have decreased by 13%, while loans to NFCs ≤ EUR 1m (as well as loans to NFCs > EUR 1m) have (both) decreased by only 10% (Kraemer-Eis, Lang, Gvetadze (2014)).

[4] Also the BIS (2014) stated in its recent Annual Report (BIS, 2014) that "high private sector debt levels can undermine sustainable economic growth. In many economies currently experiencing financial booms, households and firms are in a vulnerable position, which poses the risk of serious financial distress and macroeconomic strains. And in the countries hardest hit by the crisis, private debt levels are still high relative to output, making households and firms sensitive to increases in interest rates. These countries could find themselves in a debt trap: seeking to stimulate the economy through low interest rates encourages the taking-on of even more debt, ultimately adding to the problem it is meant to solve."

loan volumes fosters the risk of exaggerating to the downside. Morover, there are significant differences between countries. It is not always clear whether weak lending levels are driven by the supply or by the demand side. In general, the availability of loans to SMEs seems to slightly improve; at least the tightening of credit supply starts to ease (as also shown by the ECB's survey on SMEs' access to finance (ECB, 2014a)), but

1. there are doubts that banks will be able and willing to provide loans once the demand starts to increase, and
2. credit is often allocated away from "risk", in particular away from smaller and younger companies – with related adverse effects for the economy.

In several of the EIF working papers, we discussed already in more detail the situation of SME financing in general, the development of SME lending, structural issues in SME lending, and SME finance gap assessments[5]; we will not go into details here but provide only a short overview.

In the area of access to finance for SMEs, a market imperfection/failure is not only present during a deep recession or a financial crisis but also on an on-going basis as a fundamental structural issue. The reasons for a market failure relate to insufficient supply of capital (debt or equity) and inadequacies on the demand side. This market failure is mainly based on asymmetric information (in the case of debt: information gap between lender and borrower), combined with uncertainty, which causes agency problems that affect debt providers´ behaviour (see i.e. Akerlof (1970), Jaffee and Russell (1976), Stiglitz and Weiss (1981) and Arrow (1985)).[6] Information asymmetries can be reduced via three ways: a firm's ability to signal its credit worthiness (incl. an institutional assessment or rating by an independent agency and the provision of collateral), a strong relationship between lender and borrower, and through due diligence/lenders' examination (screening). However, this means on the other hand that new or young firms, with a lack of collateral and by definition without track record, are the ones with the greatest degree of difficulty accessing debt capital.

This refers as well to situations of (from the bankers' perspective rational[7] but) de facto unjustified credit rationing: the real creditworthiness of the SME can be better than the perceived quality (i.e. if a financial institution's decision to lend is based on collateral and track record, rather than the economic viability of the business (BIS, 2012)). Hence, it is important to stress the fact that, if an SME is rejected as borrower, it does not necessarily mean that it is non-bankable – the company can be viable, but without access to bank lending.

The latest ECB's Surveys on the Access to Finance of SMEs in the euro area, show that access to finance remains to be a pressing problem for euro area SMEs. Moreover, it appears to be of greater concern to SMEs than to large firms. Furthermore, the ex-ante assessment of the EU SME Initiative (European Commission, 2013b) analysed EU SMEs' difficulties in accessing external

[5] See: http://www.eif.org/news_centre/research/index.htm

[6] Agency theory/the principal-agent approach is often applied in economics literature for the analysis of relationships between lenders and borrowers (e.g. contract design, selection processes, credit constraints, etc.).

[7] Stiglitz and Weiss (1981) argued that under certain circumstances credit rationing can be rational for banks; this can be particularly true in the case of SME financing (OECD, 2006).

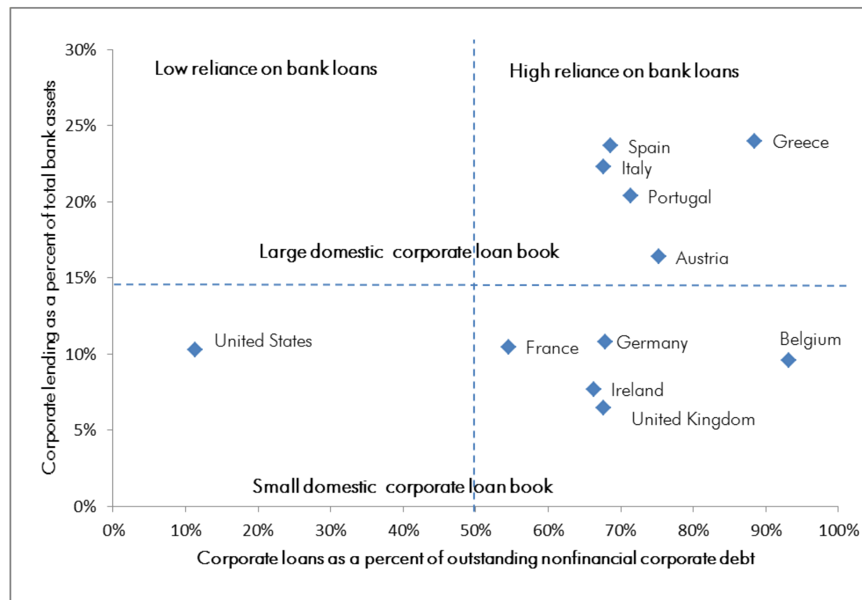
finance and estimated the amount of loans that "financially viable" firms would need but cannot obtain from the banking system (the "financing gap"). An EU-wide gap has been quantified for 2012 to be in area of EUR 105bn.

Credit rationing vis-à-vis SMEs is one aspect regarding the availability of loans for SMEs, another perspective is that smaller companies are often being driven to accept shorter-term loans, most likely as they are having difficulties to receive long-term credits (O'Toole et al., 2014). During the financial and economic crisis, corporate investment in Europe has declined sharply – one reason for this is the macroeconomic environment and related uncertainty, but the (non-) availability of long-term financing has played - and is still playing - a role as well, with related negative impacts on the medium to long-term economic development, including labor demand (see as well European Commission, 2014b).

1.2 SMEs' dependence on bank financing

One potential reason for structural weaknesses in SME financing is that smaller companies in Europe - despite many attempts for establishing a non-bank lending market and alternative financing measures - are very much dependent on bank financing, such as loans and credit lines, since their access to alternative forms of financing (e.g. bonds or equity) is limited so far (see Figure 2).

Figure 2: Reliance on bank financing by non-financial corporations (in %)



Source: IMF (2012), based on data from ECB, Eurostat, Federal Reserve, Halver analytics.

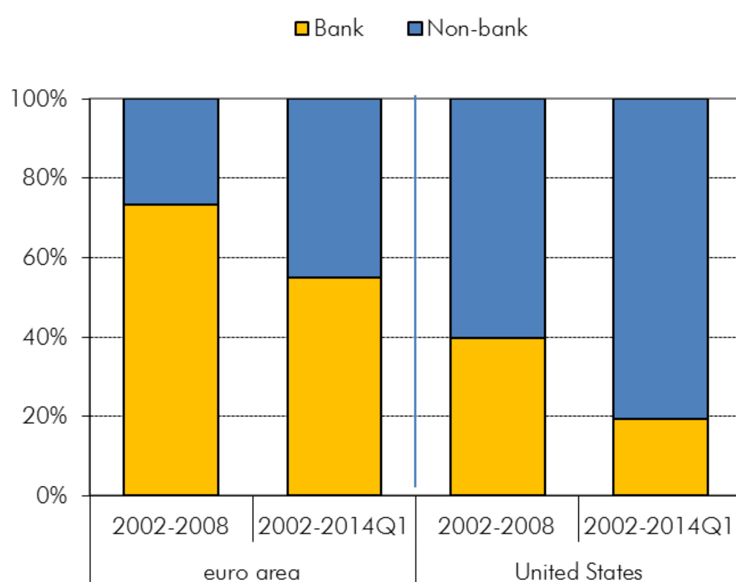
Furthermore, banks in peripheral European countries are facing the highest deleveraging pressure – typically these banks have large corporate and SME loan portfolios (IMF, 2012).[8] Moreover, banks are less willing to supply loans to SMEs due to the difficulties involved in securitising these

[8] See in this context also an overview of financial sector indicators in Annex 1 as background information.

loans. Hence, SMEs are more affected by changes in bank lending due to bank deleveraging than other firms.[9]

ECB president Mario Draghi mentioned in an often quoted statement that "in the United States 80% of credit intermediation goes via the capital markets. … In the European situation it is the other way round. 80% of financial intermediation goes through the banking system" (Draghi, 2013). This ratio is moving towards more capital market action: Cour-Thimann and Winkler (2013) state that external financing of the non-financial corporate sector (financing other than retained earnings) is dominated by bank financing (in the euro area), see Figure 3. However, as the authors point out, this split refers to the stock - in terms of flows the figures fluctuate significantly; in particular as the corporate sector can to some extent substitute bank lending with other sources of finance. However, this possibility exists for SMEs only to a very limited extent. As we could see above (Figure 1), bank funding started declining at the beginning of the crisis, and continues to do so, but part of the decline in bank funding was offset by an increase in capital market funding (see Figure 3): debt securities issued by corporations (but also quoted shares issued) increased. But again, "such substitution is primarily possible for large corporations; it is less so for small and medium-sized firms, which constitute the bulk of employment and activity in the euro area" (Cour-Thimann and Winkler, 2013).

Figure 3: Funding of non-financial corporations in the euro area and the United States (shares in accumulated debt transactions)



Source: Based on Cour-Thimann and Winkler (2013), with updated data from Eurostat, ECB, Federal Reserve System.

[9] For detailed information see our regular European Small Business Finance Outlook (latest version: June 2014) and / or other related publications: http://www.eif.org/news_centre/research/index.htm

Hence, there is a movement towards more capital market financing and alternative sources, but mainly driven by the bigger categories of enterprises. The effects of this dislocation – the movement away from traditional bank lending to alternative forms of finance - "will be felt relatively more strongly in Europe, as its economy is about 75-80% bank financed and this substitution has further to go" (Wehinger, 2012).

Against the background of this bank-dependence it is interesting to look at recovery processes that follow crises. In line with Allard and Blavy (2011), who showed that economies with marked-based financial systems have the ability to recover faster than more bank-based ones, Brutscher (2015) – working on a bigger data-set and comparing recovery processes related to banking and sovereign crises - finds:

- In the case of banking crises: no significant difference is noted in the initial drop in investment between bank-based and market-based countries, but recoveries tend to be more sluggish in bank-based countries. In bank-based systems, banks' liquidity shortages and (limited) risk taking capacity result in a slower speed of recovery.
- In case of sovereign debt crises: investment tends to drop more markedly in bank-based than in marked based countries but the speed of recovery is very much the same in both types of countries.

The findings lead to the conclusion that in countries with more capital market financing for enterprises there are more possibilities to substitute debt and to compensate for a reduced availability of bank lending – hence there are advantages resulting from a diversified range of financing possibilities.

Although also after the crisis banks are going to remain the main source of lending to SMEs, it seems not to be possible that banks entirely fill the SME financing gap and the role of *non-bank* financing is increasing. Moreover, current regulatory developments might also foster developments from bank lending to capital market solutions.

Non-bank institutions (e.g. insurance companies, pension funds, private equity funds) have initiated or stepped up their lending activities in some jurisdictions in order to fill the void left by banks or get access to higher yielding exposures (FSB, 2013), but also the creation of Debt Funds is a reaction of the market. Debt Funds are being created in different European countries as a response inter alia to the on-going banking deleveraging and disintermediation process due to the combined effect of credit deterioration, stricter regulatory requirements and increased capital constraints; Debt Funds can be based on different underlyings like loans, SME bonds/minibonds, or similar instruments (funds that are only based on loans are typically called loan funds or credit funds and form a sub-category of Debt Funds).

1.3 Calls to foster alternative SME financing channels

Already in 2012, Michel Barnier, European Commissioner for Internal Markets and Services, said "I do not think that financial intermediation should be left entirely and solely in the hands of the banks. And I am aware of the role that alternative sources of financing have to play in these difficult times for the European economy, where the banks have to adhere to more stringent prudential ratios. Alternative financing is therefore necessary, but it is important that it is carried out in a solid and transparent framework."[10]

According to the Financial Stability Board (FSB, 2013)[11], "non-banks can have a legitimate role to play in increasing the financing available to borrowers that are experiencing funding shortages, especially as the maturity of their liabilities constitute a better match for the borrower's maturity needs than banks' liabilities. A greater role for investors that are potentially less leveraged and have longer-term liabilities than banks in financing the economy may positively contribute to financial stability."

Furthermore, recently, also Yves Mersch, Member of ECB's Executive Board, said at his speech at the Global ABS 2014 Conference that non-bank lending has a role to play and that the transfer of risks outside the banking system can have benefits.[12]

The capacity of the economy to make long-term financing available to SMEs depends on the ability of the financial system to channel the savings of governments, institutional investors and other stakeholders effectively and efficiently to the right users and uses. An important question is whether Europe's historically heavy dependence on bank intermediation will give way to a more diversified system with significantly higher shares of direct and indirect capital market financing and greater involvement of institutional investors.[13] The current structural barriers for institutional investors are driven by:

- limited scale of investment projects,
- lack of standardisation,
- limited liquidity,
- potential reputational harm in relation to specific projects and the need to spread risk.

In this context, the European Union is working on initiatives to increase the non-bank financing for the real economy in Europe, i.e. via "European Long Term Investment Funds" (ELTIFs). ELTIFs

[10] http://europa.eu/rapid/press-release_SPEECH-12-310_en.htm

[11] The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It brings together national authorities responsible for financial stability in significant international financial centers, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSB is currently chaired by Mark Carney, Governor of the Bank of England. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements. For more information, see: http://www.financialstabilityboard.org/index.htm

[12] Keynote-speech of Yves Mersch on the 11.06.2014 at the Global ABS 2014 conference in Barcelona.

[13] See: http://ec.europa.eu/internal_market/finances/financing-growth/long-term/index_en.htm

provide finance to various infrastructure projects or unlisted companies of lasting duration that issue equity or debt instruments for which there are no readily identifiable buyers. By providing finance to such projects, ELTIFs contribute to the financing of the Union economies (Council of the European Union, 2014). In addition, the European Commission's (EC's) Green Paper on long term financing (European Commission, 2013a) raises the topic of easing SMEs' access to non-bank financing and developing or promoting "non-traditional" sources of finance. In the related Communication from the Commission to the European Parliament and the Council (European Commission, 2014a), the EC explains its main (recent) measures in order to support long term financing.

The High Level Expert Group on SME and Infrastructure Financing (HLEG, 2013) thinks that "specialized Debt Funds may well play a role in creating new non-bank links between the supply of funding and the SMEs who require it. In the short term, the funds have a particular role in increasing the efficiency and liquidity of the secondary market for loans to small and medium sized enterprises originated by banks and willing to transfer them to third parties thus providing incentives ex ante for more SME loan origination primarily by the banking sector." In this context the group proposes to introduce a single market "passport" of EU loan funds to enable such vehicles to acquire assets and advance credit freely on a cross border basis (see Annex 2 for the full version of the respective text).[14]

Casey and O'Toole (2014) show in their recent research on alternative finance (that firms turn to when access to traditional lending channels is strained) that broadening the mix of financing availed of by European SMEs should be an important policy objective at both EU and member state levels. Using a similar analytical approach, the ECB (2014b) found that for financially constrained firms in distressed countries it is more difficult to access alternative sources of finance. Potential instruments and options for policy makers "should ideally include various aspects such as enhancing the role of leasing, factoring, private equity and minibonds as well as expanded stock markets for smaller firms, which could serve as a complement to traditional bank lending in order to broaden SMEs' access to funding. Several initiatives in these fields are under way (…)."

Recently, the City of London Corporation, The IRSG (International Regulatory Strategy Group), TheCityUK and Paris Europlace published a report concerning Financing Europe's Investment and Economic Growth (Jones, Dharmasena and Llewellyn, 2014) as a basis for a public discussion on how to address the shortcomings of Europe's financial system. Three (out of their eight recommendations) are referring to actions related to the topic of this paper:

- "providing a range of funding possibilities for SMEs … is a priority",
- "Europe's capital markets warrant being developed, and non-traditional sources of finance tapped", and
- "market-based credit intermediation will need to play a more prominent and stable role in financing".

[14]In the context of alternative financing, the HLEG "recognises that achieving more integrated, robust and deeper capital markets across Europe should be viewed as an integral part of the banking union project, as this would provide European non-financial corporates, including SMEs and Midcaps, with an alternative and/or complementary source of funding to traditional bank borrowing" (HLEG, 2013).

As a final example, the IMF - in its latest Global Financial Stability Report - states that shadow banking (broadly defined as credit intermediation outside the conventional banking system) "can play a beneficial role as a complement to traditional banking by expanding access to credit or by supporting market liquidity, maturity transformation, and risk sharing" (IMF, 2014).

Against the background of these developments and the frequent requests to support non-bank lending (or to improve bank-lending via non-bank sources) we present in the following chapters selected topics concerning Debt Funds.

2 What is a Debt Fund?

As mentioned in the abstract of this paper, in general, available information about this market segment - due to its fragmentation and opacity it is even ambitious to speak about A or ONE market segment - is very scarce and *THE* Debt Fund does not exist. There are no generally accepted definitions and the range of structures, that could potentially be called *Debt Funds*, is wide. Hence, we will introduce several concepts and definitions; moreover, later in the text we will elucidate concrete examples.

2.1 Lending by non-bank institutions

FSB (2013) sees three different main models as 'direct lending' structures in non-bank lending:

1. "In the first model ('bilateral lending' or 'private placement'), the non-bank institution develops a dedicated expertise to invest in loans, i.e. screen and select suitable borrowers or projects. In some jurisdictions such as the US, these activities are not new and have been in place for a long time. For instance, the US 'private placement' market has enabled insurance companies to finance corporates for decades, also benefiting from a specific credit assessment infrastructure. In other jurisdictions, especially in parts of Europe, non-bank lending and private placements are in the process of being started (e.g. in France) or have recently met with increased investor interest, as in Germany with the long standing Schuldschein market. Large insurance companies, such as Allianz and AXA, have recently announced the set-up of new dedicated debt teams to invest in corporate loans, commercial real estate, and infrastructure projects.

2. In the second model ('specialised loan funds'), a fund manager pools a number of loans together and non-bank investors buy shares in the funds. By the use of pooling and diversification, this is economically similar to securitisation, although there are some differences. The launch of loan funds has accelerated markedly since mid-2012 not only in Europe where banks are still deleveraging, but also in the US. In recent launches, the fund manager was generally part of a hedge fund or a private equity fund, but there are also specialized credit funds. In particular, private equity funds leverage on their expertise of identifying target companies for acquisition purposes, and extend it to debt financing.

Investors in loan funds are generally non-banks that cannot develop an in-house credit selection and assessment capacity and/or want to diversify exposures.

3. The third model ('co-origination with a bank') is a variant of the 'originate-to-distribute model' that was prevalent before the crisis. A non-bank and a bank enter into a partnership whereby the bank screens the borrowers, originates the loans and distributes them to the non-bank, which provides the funding. 'Skin-in-the-game' arrangements are generally in place to facilitate the alignment of incentives between the bank and the non-bank. This model is so far mostly prevalent in Europe, and mostly involves insurance companies."[15]

Lending model 1 is resource-intensive (i.e. expensive), as the new lender has to put in place the respective infrastructure in-house (origination, IT, risk management, back office etc.); hence this model requires high volumes in order to be profitable. Lending-model 2 is a typical case for a Debt Fund, but as well as model 3. Also these models have different sub-types.

2.2 Diversified Funds versus Selective Funds

EIF is in contact with a number of Debt Funds and expects to focus its potential activities primarily on the following two types, both aiming at providing long term financing to SMEs and (smaller) mid-caps (see as well chapter 5.2):

A. *Diversified Funds:* As a typical example, a Debt Fund buys loans from an originating bank (fronting bank) and this bank keeps the client relationship with the borrower as well as the servicing of the loans. As such, the approach is similar to securitisation and is – against the background of the currently difficult framework conditions for securitisation (see for details Kraemer-Eis, Lang and Gvetadze, 2014) sometimes seen as alternative to securitisation. These funds (typically sponsored by banks) operate with diversified portfolio ("Diversified Funds"). They are characterised by risk sharing between investors and the sponsor and, to a lower extent, with the fund manager. Diversified Funds typically originate and service their investment portfolio through the sponsor and base investment decisions on sponsor and/or third party's rating system(s). Diversified Funds fall close to the typical portfolio credit risk business of EIF. A typical fund size is in the area of EUR 250 to 500(+)m with a portfolio of around 100 to 500 companies.

B. *Selective Funds:* Such Debt Funds are typically structured as institutional investment funds. Often, the typical role is not to compete against banks in their core segment but to address those segments that are neglected by the banking sector (e.g. bespoke transactions, also for example based on operational cash flow patterns; the targeted portfolio companies are typically viable enterprises that did not receive – or did not receive enough - the needed

[15]Please note, our understanding of co-origination differs from this definition and refers more to a risk-sharing investment platform where a bank and a number of institutional investors enter into a partnership whereby long term financing is provided to a large number of investees. The bank takes care of the origination, credit assessment and ongoing risk management, while the investment platform provides the funding.

bank financing). These funds are typically (but not necessarily) not promoted by banks and operate under a selective approach ("Selective Funds"). They are characterised by a significant risk sharing and strong alignment of interests between investors and the fund manager. The fund manager's role is critical in Selective Funds, as portfolio origination and servicing are typically driven by the fund manager's expertise and processes. Selective Funds fall close to the equity business of EIF. Investors in such funds seek a regular return on their investment, often they are not satisfied with the returns currently being offered by investment grade bonds or even by the high-yield bond market. A typical fund size could be in the area between EUR 100m to EUR 300m, with a portfolio of 15 to 30 companies

In addition to these loan fund concepts, Debt Funds in the sense of this analysis can as well be funds based on (SME-) bonds – we present this specific market segment later in the text.

3 Examples of initiatives and public support

There are Debt Funds that are purely based on private initiatives, as well as publicly supported projects. Moreover, there can be public support in order to improve the framework conditions and / or the underlying markets (i.e. the set-up of minibond markets). Below, we show several examples for the different types, as well as selected initiatives that are going to have an impact on non-bank lending and i.e. Debt Funds.

3.1 Co-origination initiatives in the Netherlands

3.1.1 Partnership of ABN AMRO and a group of insurers

ABN AMRO[16] is in the process of setting up a Debt Fund in cooperation with nine insurance companies. The idea is to link the investment capital available at insurance companies to the demand for credit among SMEs. ABN AMRO will play the intermediary role by arranging the credit facilities and managing the risks. The insurers and ABN AMRO are planning to invest a total of EUR 280m in financing SMEs, each contributing half the amount. The risks and returns will also be shared equally between the two groups. The initiative will be coordinated by the Dutch Association of insurers and is aimed at providing loans of up to a maximum of EUR 1m and a term of at most seven years. For the insurance companies, the initiative offers a possibility to invest in SMEs in the Netherlands, a market to which the insurance industry has so far had little access, and contribute to strengthening the Dutch economy. For the bank's SME customers, nothing will change in terms of the client-facing staff they will be dealing with: ABN AMRO will continue to arrange their loans (Verbond van Verzekeraars and ABN AMRO, 2014).

[16]Although the Dutch state acquired ownership of the Dutch activities of ABN AMRO Holding N.V. and Fortis Bank Nederland in 2008 and ABN AMRO and Fortis Bank Nederland merged in 2010 to form the current ABN AMRO (see: http://www.abnamro.com/en/about-abn-amro/our-company/index.html) we classify this transaction as a "private" example.

3.1.2 The Netherlands Investment Institute

According to the *Project Group NII Program Manager* (2014), "on 17 September 2013 the Minister of Economic Affairs wrote to the House of Representatives to explain the outcome of the government's consultations with a number of Dutch insurers, pension funds, pension scheme administrators and other stakeholders about strengthening the long-term financing capacity of the Dutch economy. The subject of the consultations was how to give institutional investors the opportunity to realise their ambition of investing more in strengthening the Dutch economy. As a result of the consultations, the government and the pension and insurance sectors decided that a Netherlands Investment Institute (NII) should be established and invited the banks to participate in it. In its role as intermediary such an institute could help to ensure that supply and demand for financing are better matched. The establishment of the NII, as a supplementary and complementary resource to bank lending, is intended to enable institutional investors to put more long-term funds into the Dutch economy."

Until May 2014, thirteen major Dutch institutional investors have signed up to create the NII as a privately owned company that aims to boost the country's economy by increasing long term investments. The NII will not act as investor, but as a private intermediary – it is foreseen that NII focuses on removing hurdles that prevent institutional investors from participating in projects that need long-term funding. The initiative also aims to increase funding options for small and medium-size Dutch enterprises that struggle to gain access to funding (Van Riemsdijk, 2014).

3.2 Co-origination partnership of Axa's pan European platform

Although not structured as a fund, we mention another insurance / bank cooperation. Co-origination partnerships can happen in the form of *one* insurer and several banks, in this specific case focused on mid-caps. Axa's pan European platform includes partnerships with Société Générale (covering France, announced in June 2012), Credit Agricole (also France, announced October 2012) and Commerzbank[17] (covering Germany, Switzerland, and Austria, announced in June 2013).

In the arrangement with Société Générale, the bank originates the loans, capitalising on its large client base, and passes a majority share of these on to AXA. These are term loans with a longer maturity in the range of 3 to 7 years primarily made to French mid-market companies. Issue size is in the range of EUR 30m to EUR 50m. The part funded by AXA is turned into securities (for regulatory and legal purposes). There are no tranches in AXA's loan platform model. This arrangement is a whole loan conduit vehicle rather than a traditional securitisation (TheCityUK, 2013).

In the arrangement with Commerzbank, Axa states for example that "the cooperation includes newly originated credit facilities based on selected syndicated loans, club deals, bilateral loans and Schuldscheindarlehen, carried out in line with the express interest of Commerzbank's clients. The deal will enable AXA to leverage Commerzbank's origination capabilities and close

[17] http://www.axa.com/lib/en/uploads/pr/group/2013/AXA_PR_20130606.pdf

relationships with local corporates, while Commerzbank, as Hausbank to German mid-cap clients, will be able to offer increased flexibility and investor diversification to its clients".[18]

3.3 Legal measures to foster co-origination initiatives in Italy

The Italian government recently announced measures to foster credit to Italian companies. Inter alia, the measures will allow Italian insurance companies to extend financing to companies directly, subject to certain conditions. These conditions foresee in particular that the borrower is identified by a bank or a financial intermediary (a financial intermediary is an Italian regulated entity professionally engaged in financing activities) and that this bank/financial intermediary retains a "significant interest" in the transaction until the relevant maturity. Moreover, it requires that the insurance undertaking is adequately capitalised and that it maintains adequate internal control and risk management systems, enabling it to fully appreciate the underlying risks (see Clifford Chance, 2014).

3.4 Specialty finance firms – examples from the UK[19]

M&G, the European asset management arm of Prudential Plc, has been lending to mid-market companies since 1997 with outstandings (Oct-2013) of around GBP 4.1bn with GBP 930m having been invested through its first UK Companies Financing Fund and a second fund of approx. GBP 500m ready for investment. The latter fund has a commitment from UK Government under the Business Finance Partnership (see next chapter). For the two UK Companies Financing Funds, loans are typically of a maturity of up to 10 years and generate a yield in the mid-single digits.

These M&G loans were often characterised as private placements as if the investments were similar to the US private placement market and not direct lending. This illustrates the problem in classifying different types of private debt. Under their UK Companies Financing Funds, the loans are more expensive than shorter dated bank sourced money, but are attractive because of the 5 to 10 year term nature of the loans (much longer than banks typically lend for in this segment).

Other asset managers have also been entering the direct lending space. For example, BlueBay raised more than EUR 800m for a fund (The BlueBay Direct Lending Fund) lending directly to European corporates. Another example is Alcentra's EUR 500m European direct lending fund (see as well Delaney-Smith, 2013). For such funds, yields from bonds in the public market have hit an all-time low in recent times, hence many of them have been looking elsewhere in the market for other assets, offering higher yields – such as loans to mid-market companies.

In addition to asset managers, also Private Equity groups set up credit funds, sometimes to help financing a firm's own Private Equity deals, but mainly to have independent credit arms, sourcing own deals.

[18] See FSB (2013).
[19] The paragraph is entirely based on TheCityUK (2013).

3.5 Business Finance Partnership as public support in the UK

An example for a publicly supported scheme is the Business Finance Partnership (BFP) in the UK: The UK-government created the GBP 1.2bn BFP facility to be invested to facilitate new players entering the loan market with the objective to increase the level of lending to SMEs (from sources other than banks); the support takes place via participation by HMT and BIS[20] in two separate programmes. The public money is being matched with at least an equal amount from private sector investors and will be invested on fully commercial terms (in order to assure a genuinely market-led approach and in order to avoid state-aid issues (The CityUK, 2013). The first strand (managed by HMT) invests in fund managers (asset management firms) who lend to small and medium-sized businesses with turnover of up to GBP 500m. The first 6 funds[21] have been set up and together they manage GBP 863m of government investment alongside over GBP 1bn from private investors. The funds are: Alcentra[22], Ares, Hayfin, ICG, M&G, and Pricoa. A total of GBP 172m of government money has been used by the lenders alongside an extra GBP 705m from private sector investors to lend a total of GBP 877m to 18 medium-sized businesses and 880 small businesses.

The second strand of the Business Finance Partnership (managed by BIS) invests in fund managers and non-traditional lenders that provide an alternative source of lending for small businesses with annual turnover up to GBP 75m (EUR 94m, i.e. well beyond the EU definition for SMEs of maximum EUR 50m). Seven different lenders have received GBP 85m of government investment and will lend more than GBP 240m to small businesses by attracting matching private sector investment.[23] The fund managers are (so far): Beechbrook Capital, Boost & Co., CAML, Funding Circle, Market Invoice, Urica, and Zopa.

3.6 NOVO and ESNI in France

In France, CDC launched in 2013 its Novo fund series – a new type of vehicle helping institutions to invest in SME bonds. This is another example for a publicly supported scheme. The idea emerged in 2012 and in October 2013 this fund closed with slightly above EUR 1bn (CDC made the initial investment of EUR 100m and also France's EUR 36.6bn Fonds de Réserve pour les Retraites (FRR) has invested EUR 120m). The fund has 24 founders (including 17 insurance firms with the support of the French Federation of Insurance Companies). The French Government has taken strong action to support the creation of Novo, including changing the law to allow insurers to invest up to 5% of their balance sheet in unrated bonds (TheCityUK, 2013).

Novo takes loan portfolios from banks (there are risk-sharing arrangements with the originating banks) and - in contrast to the classic tranched structure of securitisations - puts them in an

[20] HMT: Her/his Majesty's Treasury, the British treasury. BIS: Department for Business, Innovation, and Skills.
[21] Information as per February 2014.
[22] See in this context as well Alcentra's statement on new opportunities in non-bank direct lending (Delaney-Smith, 2013).
[23] More information and links to the individual loan funds can be found here: https://www.gov.uk/government/policies/making-it-easier-to-set-up-and-grow-a-business--6/supporting-pages/encouraging-private-sector-investment

untranched "whole-loan" unrated bond security (The City UK, 2013). During the first five months, nearly 20% of the committed assets have been invested in six bond issues. As with private equity funds, the remaining capital will be called when investments are selected.

BNP Paribas Investment Partners and Tikehau Gestion are managing the fund (management of the fund, insourcing of loans, credit monitoring). Novo is basically a private placement fund platform investing in mid-size firms operating in France, but which need not necessarily be French, which have an annual turnover of at least EUR 50m, and operate in industries or services – excluding financial activities, real estate or leveraged buyouts – and which have a growth project, internal or external, national or international, to finance with a bond issue of between EUR 10m and EUR 50m.[24]

According to TheCityUK (2013), other characteristics of the Novo fund include:

- Loan sizes between EUR 10m and EUR 50m (by implication these are not really SME loans);
- 30 to 40 companies to be financed in the initial fund;
- Non-callable loans with maturities between 5 and 7 years;
- No rating required;
- Significant diversification required in the fund;
- Fund managers required to send a management and credit report to each investor annually;
- Investors buy a percentage of the fund, and receive a pro rata share of all the underlying loans in the fund.

Moreover, in France (see Möglich and Raebel, 2014a, and Bank of America/Merrill Lynch, 2014), a new funding vehicle (Euro Secured Notes Issuer, ESNI) under French law has been launched by five French banks (BNP Paribas, BPCE Group, Crédit Agricole, HSBC France, and Société Générale) with the objective to issue bonds backed by SME loans; each bank has its own compartment and in principle, the vehicle is open to other banks (also outside France). In April 2014, a first pilot transaction was executed.

3.7 Loan Origination Funds in Ireland

In Ireland, the Central Bank of Ireland is discussing potential direct lending by loan funds in the form of "Loan Origination Investment Funds" (Central Bank of Ireland, 2013). Against the background that Irish non-UCITS[25] investment funds are prohibited from originating loans as part of their strategy to source assets for investment purposes, the Irish Central Bank is reviewing this

[24] See for example: http://www.ipe.com/pensions/pensions-in/france-sme-cash-lifeline-gains-investors-attention/10001685.fullarticle

[25] UCITS: Undertakings for Collective Investment in Transferable Securities, based on a set of European Union Directives (with the aim to allow collective investment schemes to operate freely throughout the EU on the basis of a single authorisation from one member state).

policy. It raises a broad number of issues concerning (i) investor protection, (ii) the provision of credit to the real economy, (iii) the regulation of different channels of credit intermediation, (iv) the stability of these channels and (v) monetary policy. In this context, the Irish Central Bank issued a discussion paper and seeks the views of interested public and private sector stakeholders.

3.8 Non-for-profit loan funds in Poland

Another type of Debt Funds is the category of *non-for-profit funds* that are created in order to support micro- and small / medium sized enterprises. In Poland, for example, there are two networks of such funds, covering about 90 funds in Poland. Over the past two decades, loan funds have become an integral part of the Polish financial system architecture. For many start-ups loan funds are the first and, at the very beginning, the only partner offering external funding capital (as well as consulting and business support). In most cases these funds are very small and they are typically funded via grants and public support.[26]

3.9 A Debt Fund as intra-group risk diversification

Debt Funds can also be created in order to achieve risk diversification. In Germany, the German association of savings banks (Deutscher Sparkassen- und Giroverband, DSGV) initiated an SME loan fund in order to achieve risk diversification potential for the members (German savings banks are typically focused on a specific region with only limited possibilities to achieve risk diversification). The fund is called "Mittelstandskreditfonds". Via an investment-platform individual savings banks can contribute new loans to the fund whereas other savings banks can act as fund investors.[27]

3.10 SME bonds (and funds of SME bonds)

Corporate bond issuance is typically used as financing tool by large (and usually rated) companies. In several countries, SME bond markets are emerging, in particular in the form of SME (or mid-cap)-targeted bond platforms. It is important to note (and as further elaborated later in this paper) that - although called *SME bonds* - the issuing companies are often not SMEs in the sense of the EU definition (but rather bigger mid-caps or small corporates).[28]

Also the European Commission (EC) supports the development of this instrument: we mentioned above the European Commission's Green Paper on long term financing (European Commission, 2013a). In the related Communication from the Commission to the European Parliament and the

[26]For further information see e.g. http://www.pzfp.pl/?p=fundusze.
[27]For more information (but only in German) see: http://www.mittelstandskreditfonds.de/mkf/de/index.jsp
[28]In general, for many institutional investors, critical mass (e.g. size of issuance and business) is an entry criterion that decides whether they can or may invest in a company at all. On the one hand, this refers to the volume of the issue and, on the other, to the size of the company and financing requirement, which are implicitly linked to the volume.

Council (European Commission, 2014a), the EC states (with regard to the equity and corporate bond markets) that:

- "The Commission delegated act provided for in MiFID 2[29] will ensure that the requirements for SME growth markets minimise the administrative burden for issuers on these markets, while maintaining high levels of investor protection. These requirements include the minimum proportion of SME issuers on these markets, appropriate criteria for admission to trading, information to investors and financial reporting.
- The Commission services will undertake a study on whether, following the improvements introduced by MiFID 2 for non-equity securities, further measures are necessary to enable the creation of a liquid and transparent secondary market for the trading of corporate bonds in the EU.
- The Commission will assess the implications and effects of the rules of the Prospectus Directive by the end of 2015[30]. This will include in particular an assessment of the proportionate disclosure regime for SME issuers and companies with reduced market capitalisation.
- The Commission will explore whether the eligibility criteria for investments by Undertakings for Collective Investments in Transferable Securities (UCITS) could be extended to securities listed on SME growth markets that display certain liquidity characteristics, in view of the implementation of the MiFID 2 framework. The issue of whether the European Long-Term Investment Funds (ELTIFs) should also be able to invest in listed SMEs is a key issue currently debated in the context of the Commission's ELTIF proposal[31]. The Commission proposal already includes non-listed SMEs as part of the asset classes that would be eligible for an ELTIF investment."

There is as well a trend towards the creation of funds of SME bonds - which are then as well called *Debt Funds*. The following paragraphs explain selected areas concerning the establishment of this market segment - with the examples of Germany, Italy, France, Spain and UK.

3.10.1 Germany

In Germany there is the market for *Mittelstandsanleihen* (SME bonds). It was originally launched as a bond market for the German Mittelstand by the Stuttgart Stock Exchange in 2010 (BondM). These retail bonds are now also being traded on three different German exchange platforms (Stuttgart, Düsseldorf and Frankfurt).

[29]MiFID: markets in financial instruments directive. According to Art. 35 of Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC (MiFID 2) as drafted in the final compromise text.

[30]Article 4 of Directive 2010/73/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

[31]See for example European Parliament (2013).

End of Q3/2014, according to Brächer et al. (2014), there were 148 issuances (since 2010)[32] with an overall market size of around EUR 5.9bn. These bonds are issued typically by companies either with turnover below EUR 50m or (and mainly) above EUR 200m, addressing institutional as well as private investors.[33]

Concerning new issuances:[34] in HY1/2014 there were 8 new bonds with a volume of EUR 385m (for comparison HY1/2013: 1,078m)). The coupons ranged between 6% and 9%. These retail bonds do not have to be rated (and in HY1/2014 more than half of the transactions were without ratings) - but many of them have a rating, given by the regulated credit ratings agencies specialized in the middlemarket segment (there are rating agencies in Germany with a focus on SMEs, in particular Creditreform, Scope, Euler Hermes, Feri Euro Ratings Services). The ratings in 2014 (new issuances) were in the BB- area. In terms of documentation, new issuances must have a prospectus that is compliant with the Prospectus Directive; prospectuses are reviewed by the German Federal Financial Supervisory Authority.

An infrastructure has been developed to support SME bond transactions in Germany and to enhance overall market transparency and confidence (TheCityUK, 2013):

- The exchanges provide web based functionality as regards purchase and sale and pricing in secondary markets;
- The exchanges coach and provide advise; they support the issuer through the analysis, structuring, issuance, and, finally, to the listing in the trading segment;
- Established in 2011, the BondM index ensures an additional market transparency for the BondM trading segment. The index reflects the corporate bonds' price performance of medium sized companies.

To date, the experience with this market segment is mixed – on the one hand there is growing popularity, on the other hand, placements were often only partially successful, there are many downgrades, and the number of defaults (or restructurings) is high; according to Brächer et al. (2014), as per early October 2014, 23 SME bonds were in trouble (counting for a volume of EUR 1bn).

The series of defaults, in particular among renewable energy companies, raised concerns over the implemented transparency, disclosure, accounting and rating standards. As a consequence, there is negative press coverage for this market segment in Germany and a negative impact on the deal pipeline.

There are as well funds, investing in SME bonds in Germany – these are traditional bond funds, but based on SME bonds. Moreover, there are alternative approaches, for example an initiative to pool around 30 SMEs and to issue a (non-structured) bond of approx. EUR 120m. The resulting bond is planned to be BBB with a coupon in the area of 6.5%. The SMEs are going to pay a

[32]See e.g. list here: http://www.bondguide.de/notierte-mittelstandsanleihen/
[33]German speaking readers can find detailed information about this market segment here: http://www.finance-magazin.de/themen/mittelstandsanleihen/
[34]Source: http://www.finance-magazin.de

coupon depending on their risk classification – ranging between 4.5% and 7.25%. The arranger is planning a disagio of 5% for his services. The companies in the portfolio can get an Euler Hermes rating (cost for initial rating: EUR 10k, follow-on rating EUR 5k. They also have to provide a rating by a bank and have to have bank loans available with at least the same volume like their contribution to the bond. For more information see Finance, 2014.

3.10.2 Italy

"Minibonds" were introduced in Italy to extend the possibility to issue short / medium term ordinary and convertible bonds to mid-sized SMEs and small mid-caps. Although the issuer is unlisted, the minibonds are eligible for listing and subject to the same tax regime of bonds issued by listed companies (HLEG, 2013). The Law 134/2012 ("Minibond Law") was issued with the aim of

- expanding the means of financing available to Italian non-listed corporations as alternative to banking financing, and
- creating new investment opportunities for banks and other institutional investors, including those of foreign nationality, by means of increasing the competitiveness of the Italian corporate system and bringing it into line with other European jurisdictions.

According to the Minibond Law, short/medium term ordinary and convertible bonds (minibonds) may be issued by unlisted SMEs, with the exception of micro enterprises[35]. Specifically, the Minibond Law provides for:

1. The non-applicability of the pervious issuance limits (i.e. total bond issuance not higher than twice the issuer's equity), to the extent the bonds are listed;
2. The applicability of the same tax regime as for bonds issued by listed companies, under certain conditions. Specifically:
    a. Interests paid on the minibond are fully deductible from the issuer's tax return if the minibond is (i) listed or (ii) unlisted but held by qualified investors with less than 2% stake in the issuer's capital and resident in Italy or "white list" countries;
    b. Interests paid on the minibond are not subject to withholding tax if the minibond is (i) listed and (ii) held by qualified investors resident in Italy or "white list" countries.

For the time being - and in contrast to the German market - private investors cannot invest in Italian minibonds, the market is limited to professional investors. The related stock exchange segment of Borsa Italiana is ExtraMot pro; it started in February 2013.[36]

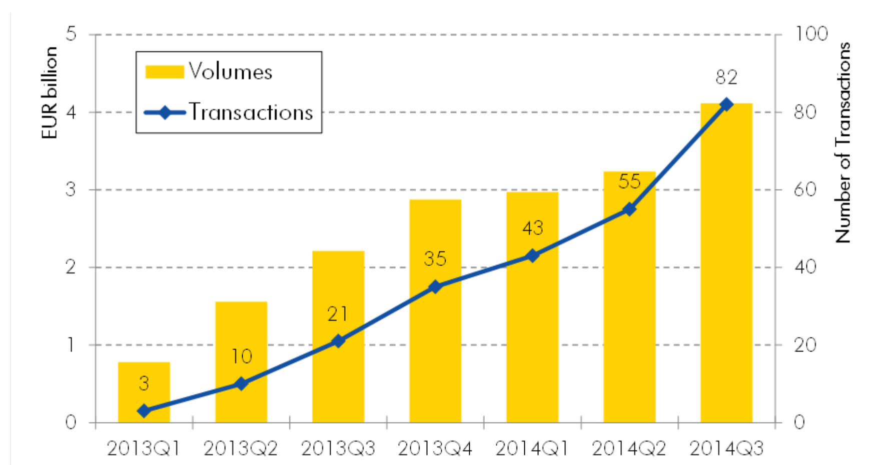
Given the unsecured nature of minibonds, guarantee schemes represent a way of mitigating the credit risk profile and reducing the interest rate of minibonds, therefore potentially broadening both demand and supply. For example, in Italy, minibond issues may benefit from a partial guarantee provided by the Italian Government-owned SACE to the extent the minibond is issued

[35] Enterprises with less than 10 employees and annual turnover (or total assets) not higher than EUR 2m.
[36] See: http://www.borsaitaliana.it/obbligazioni/segmento-professionale/extramot-pro/checosaeextramotpro/checosaeextramotpro.en.htm. See as well Nassr and Wehinger (2014).

to finance an internationalization project (and to the extent the investment is approved by SACE for program compliance and credit risk). Targeted at SMEs, this type of guarantee (aside SACE's traditional insurance products) supports companies wishing to expand their activities abroad and/or to enhance their commercial activities in new countries. Moreover, the public Central Fund of Guarantee (Fondo Centrale di Garanzia) will soon start providing guarantees to professional investors in the minibond market. The public guarantee may cover both single issues and the junior tranche of minibond portfolios. The guarantee rate on single issues (i.e. up to 30-50% depending on the type of transaction) is lower compared to the guarantee on a portfolio (up to 80%, although the guarantee is capped at 8% of the portfolio value), if the portfolio is well diversified. The public Central Fund of Guarantee is soon expected to update its operational rules in order to start providing its first guarantees.

The market segment is still very young, hence the experience is limited, however, expectations are high (e.g. in the press one can read about an expected market potential of EUR 50bn to EUR 100bn per annum)[37]. BPVi, for example has preliminary identified about 800 eligible SMEs (Firpo, 2014) – other sources estimate a much higher potential: Cerved Group (2013) sees about 35,000 companies in Italy with annual turnover of over EUR 5m that are solvent and could be candidates for minibonds.[38] We found so far 82 issuances (as per 30.09.2014) with an average volume around EUR 50m (see Figure 4) most of them from bigger companies.

Figure 4: Cumulative minibond issuance since inception



Source: EIF, based on data from Italian Stock Exchange (09/2014)

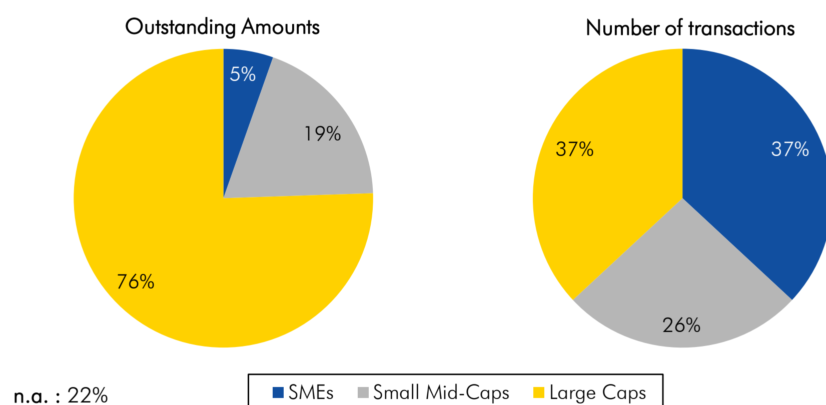
So far, the interest of "real" SMEs in this segment seems to be rather limited (Figure 5). There are currently 25 funds focusing on Italian minibonds and private debt with a fundraising target of around EUR 4.45bn; moreover there is the EUR 500m Fund of Fund "Fondo Italiano d'Investimento", (see Figure 6 below). First closings have reached almost EUR 800m commitments.[39]

[37]See: http://www.ilsole24ore.com/art/notizie/2013-08-11/minibond-mercato-miliardi-082202.shtml?uuid=AbwUGEMI

[38]See also Caselli et al. (2013) for an overview of the Italian Capital Markets.

[39]See: http://bebeez.it/en/2014/06/23/italian-smes-bonds-public-guarantee-to-funds-will-be-higher-with-diversified-portfolio/

Figure 5: Breakdown of minibond transactions by firm type



Source: EIF, based on data from Italian Stock Exchange (09/2014), Bureau Van Dijk's Orbis Database (09/2014)

Figure 6: funds focusing on Italian minibonds and private debt

Manager	Fund	Target (mEUR)	First closing (mEUR)
Advam Partners sgr	Advam 1	200	
Aletti gestielle sgr	Fondo Crescita Impresa Italia	100	
Amundi sgr		200	
Amundi sgr	(SACE)	350	175
Anthilia Capital Partners sgr	Bond Impresa Territorio	200	110
Azimut sgr	(Antares)	250	
Bnp Paribas Investment partners sgr	Bnp Paribas Bond Italia Pmi	150	56
Compass am sa	Blue Lake Sicav-Sif Italian Minibond		
Duemme sgr	Fondo per le Imprese	150	76
Emisys Capital sgr	Emisys Development	150	131
Finint MPS sgr	Fondo Minibond Pmi Italia (with Mps)	150	
Hedge Invest srg	Hl Crescltalia Pmi Fund	250	
Lemanik am	Equita Corporate Debt (with Equita sim)	200	
Lemanik am	Equita Leveraged Debt (with Equita sim)	200	
Lyxor sgr	Lyxor Berica Sme Fund (with Pop Vicenza)	500	100
Muzinich&Co.	Italian Private Debt	250	156
PensPlan sgr	Euregio	100	50
Pioneer sgr	Pioneer Sviluppo Italia		
Riello Investimenti Partners sgr	Fondo Impresa Italia	150	
River Rock	Italian Hybrid Capital Fund		
Tenax	Tenax Opportunity Fund	200	
Ver Capital sgr	Ver Capital Credit Partner Italia V	200	
Vesta Industrial	Fysis Fund sicav	100	
Wise sgr	Wise Private Debt	250	
Zenit sgr	Progetto MiniBond Italia	150	
Total		*4,450*	*854*
Fondo Italiano d'Investimento sgr	FoF	500	250

Source: based on http://bebeez.it/wp-content/blogs.dir/5825/files/2014/06/tab-minibond.pdf[40]

[40]Please note that in the original source Fondo Italiano d'Investimento is listed in line with these (direct) funds. However, as it is a fund of funds, this would lead to double-counting of the respective volumes.

As background information: moreover, other innovative instruments - based on minibonds - are emerging, also in securitisation-like structures (i.e. not in the form of a Debt Fund). For example, recently a group of eight Italian water utility companies issued asset-backed securities, backed by their minibonds (on a cross-collateralised basis). The transaction - Viveracqua Hydrobond – was supported by EIB.[41]

3.10.3 France

Following the recommendations of the Rameix-Giami report, NYSE Euronext began to allow listed and unlisted SMEs to issue bonds to retail investors on NYSE Euronext Paris and NYSE Alternext Paris. As per March 2014, this new public offering of bonds called Initial Bond Offering (IBO) has led to four offerings – with volumes between EUR 7m and EUR 15m (Paris Europlace, 2014), leading to a current overall market volume of EUR 55m. The market targets professional as well as retail investors (TheCity UK, 2013).

The IBO market is squarely aimed at smaller companies. Minimum issues are EUR 5m on Alternext and EUR 10m on NYSE Euronext. There is a concerted attempt to keep costs of issuance as low as possible by minimising disclosure requirements. There is also considerable flexibility in terms of covenants and maturities although the maturity date is expected to be between 5 and 10 years (TheCityUK, 2013).

3.10.4 Spain

In October 2013 Spain's stock-market operator launched a corporate-bond exchange (MARF, alternative fixed income market) for SMEs to give them a way to get financing at a time when bank loans are scarce (see for details Dominguez and Lopez Perea, 2013). The newly formed SME bond exchange in Madrid sets the minimum investment at EUR 100,000. At this level, retail investors are de facto excluded and the market focusses on institutional investors. At the same time, the investment level in Madrid remains far below the threshold for interest by institutional investors (IIF, 2013); as a consequence, there was only one transaction so far.

To issue debt via the new exchange, companies need to meet a set of criteria, notably they must have a credit rating, present audited financial reports for the previous two years, and commit to report relevant information to investors. A previous attempt to widen corporate financing, through an exchange in which small companies and start-ups issue stock, fell short of expectations. The first listing was in 2009, the worst year of Spain's property bust and a time of significant capital flight; since then the over the exchange only EUR 160m have been raised for the firms, some of which are now in bankruptcy proceedings (European Commission, 2013b).

[41] See: http://www.eib.org/projects/pipeline/2013/20130515.htm?lang=en and http://www.globalcapital.com//article/mbnfsm0fnz53/italian-smes-cut-out-banks-with-first-minibond-abs.

3.10.5 United Kingdom

Launched in February 2010, the LSE ORB market (LSE: London Stock Exchange, ORB: order book for retail bonds) has raised around EUR 4.8bn. ORB is an EU regulated market, monitored and supervised by the LSE's Market Supervision. Because of the retail investor base, LSE requires the highest standards of disclosure, transparency, and high quality participants. Issuance at ORB is mainly from larger companies, however more recently there were attempts to establish the market as well as funding source for medium size companies.

TheCityUK (2013) and Paris Europlace (2014) describe the ORB market as follows:

Many ORB bonds have a credit rating which means public analysis is available to investors. The ORB market targets UK retail brokers, wealth managers, and private investors. Most of the investment in the ORB market is channelled through discretionary wealth managers or advisory brokers who do their own detailed credit analysis before investing or making investment recommendations to private clients.

ORB also has an active secondary market so there is good liquidity for investors should they wish to sell their bonds. It offers continuous two way prices throughout the trading day, with private investors given the option to see prices on-screen and trade in bonds in a similar way as they currently do for shares. This helps explain the rising levels of liquidity in the secondary market which support the primary market. Investors are more comfortable subscribing to new issues in the primary market if they know there is a liquid secondary market.

Typical issue size ranges between GBP 20m and GBP 300m, the median size being around GBP 72.5m. Two unlisted companies have successfully also issued debt e.g. the Housing Association "Places for People" raised GBP 140m in 2011 and a further GBP 40m in 2012. Bond maturity ranges between 5.5 years and 10 years, the average maturity being 7.75 years. Most bonds are fixed rate, but there are also floating and index linked bonds issued onto the market. Typical rate ranges between 4.75% and 7%, the average coupon standing at around 6%.

ORB bonds offer greater flexibility for issuers as the issuance size can be tailored to meet issuers' particular needs. Smaller denominations of GBP 1,000 or less, which are the norm in retail bonds, allow private individuals to access the bonds of particular companies while allowing diversification of their investment portfolio.[42]

4 Debt Funds on the road

There is not much consistent information available about the number of (SME-) focussed Debt Funds on the road. The German DZ Bank (Möglich and Raebel, 2014b) undertook a project to estimate the market size for loan funds in Europe, mainly based on a detailed screening of available databases. The project targeted loan funds (Kreditfonds, not Debt Funds in general) based in Europe, in the currencies Euro, GBP and CHF, with investment focus Europe (and on the

[42] See for more information TheCityUK (2013) and Paris Europlace (2014).

real economy). A continuous increase of the number of active loan funds and the respective volumes since 2007 was found and a total (i.e. not only SME focussed) of 95 active loan funds has been identified. The total target volume found for 2013 was EUR 48.3bn; the invested amount is estimated to be in the area of EUR 10bn (20%). Among this group of funds, real estate represents the highest share (42% in terms of number and volume). 31 funds with a focus on SMEs have been identified, representing 33% of all funds (and 27% in terms of target volume = approx. EUR 13.2bn), 26 of these have been classified as "independent" and 5 as being dependent from a bank.

An attempt to screen the *private equity* universe for Debt Funds (also in this case specifically "loan funds") leads naturally to different results. For example, according to the Bloomberg database, there are currently around 240 Debt Funds active in Europe (see Annex 4). However, this is a general classification for the investment in debt instruments, to filter for loans to SMEs / mid-caps is not possible. 20 of these funds have been reflected in the DZ Bank analysis. Seven of the General Partners of the Debt Funds in the Bloomberg database (representing 20 funds) participate in the UK's Business Finance Partnership (see above).

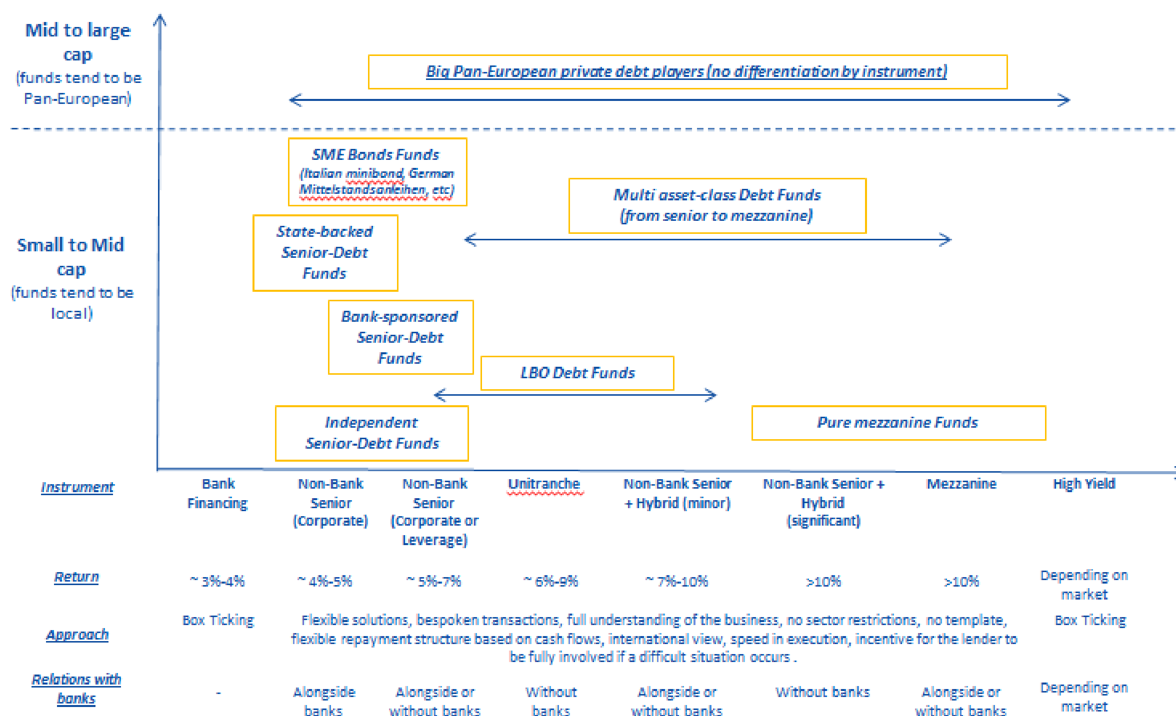
In general, there is a wide range of alternative lenders and active Debt Funds in Europe, with increasing deal flow. However, it is important to note that - according to EIF's market knowledge - most of these funds target mezzanine capital and/or mid-caps respectively corporates, and not the SME segment.

As mentioned above, EIF is in contact with a significant number of active Debt Funds – with Selective Funds (via the Lower Mid-Market activities), and with Diversified Funds (via the guarantee activities), and EIF is actively screening the respective markets. A market screening via databases helps only to a very limited extent in the SME field – for example, only a very small number of Debt Funds that are (or have been) in contact with EIF can be found using the Bloomberg selection. One reason is that - as mentioned above - the "Bloomberg segment" covers mainly mezzanine capital and/or mid-caps/corporates, another explanation is, that many SME-related Debt Fund activities are either new on the market or are in the process of being established.

Figure 7 shows an indicative market mapping for Selective Funds. Only a minority of the players are active in the SME field, in particular as the achievable respectively expected returns are higher in other market segments.[43]

[43] As comparison, mezzanine providers typically seek current yields in the low to mid-teens and, depending on their business models and risk tolerance, they may seek additional yield in the form of payment–in-kind interest and/or re-purchasable warrants. In exchange for the ability to earn these higher yields, mezzanine debt providers understand support a market niche by filling credit needs covered by operating cash flows of their borrowers rather than by unassailable collateral asset coverage. Mezzanine providers often rely on the future cash flows of the borrower for their repayment; as a consequence, underwriting, due diligence, loan covenants and monitoring are often more complex than those required for a fully secured bank loan with appraisable collateral. See for example http://capmatters.com/wp/tag/mezzanine-debt/

Figure 7: Indicative market mapping (Selective Funds)[44]

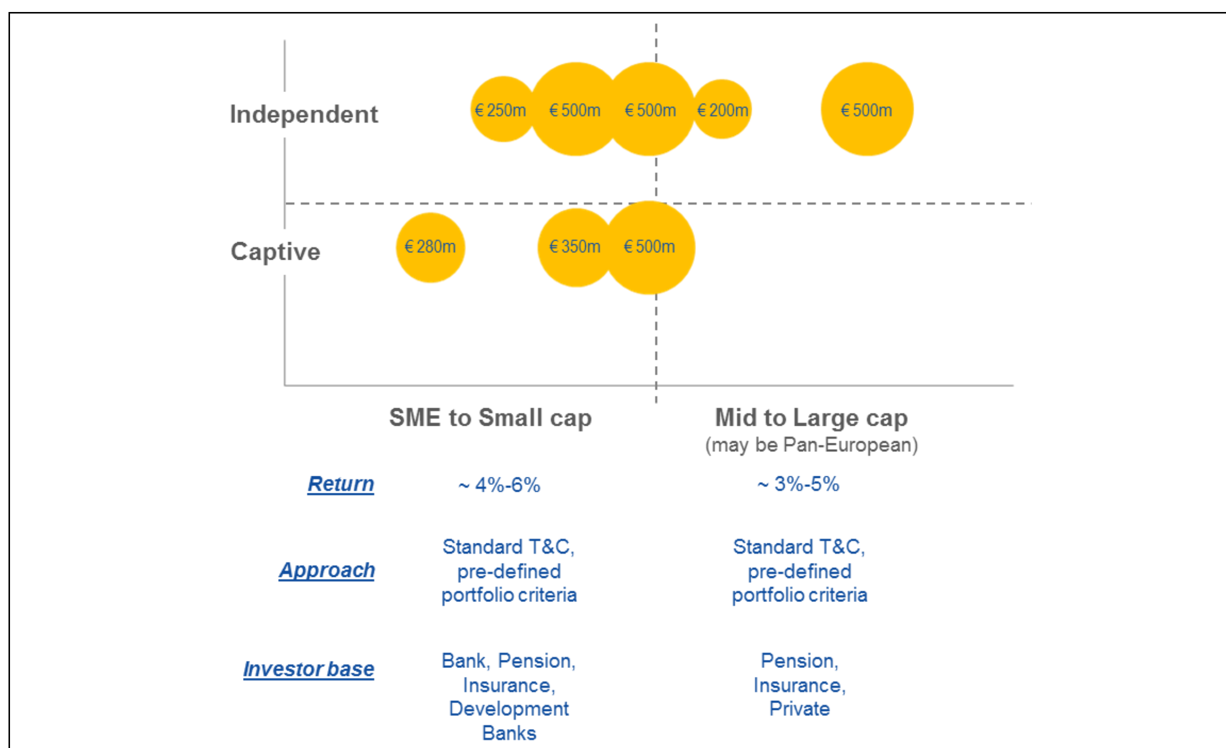


Source: EIF, LMM team (i.e. Matteo Squilloni)

Figure 8 shows an indicative market mapping for recent initiatives in the field of Diversified Funds (funds on the road / anonymised). The expected return profile in the SME and small cap segment is similar to the comparable segment in the Selective Funds field. Potential investors for diversified portfolio structures are typically banks, pension funds, insurance companies, or development banks.

[44]Terminology: Unitranche is a type of financing that combines senior and subordinated debt into one debt instrument. A unitranche credit facility is generally structured as a single credit agreement among the borrower and its senior and junior lenders, with intercreditor arrangements addressed in a separate agreement to which the borrower is not a party. The borrower usually pays one interest rate, and the rate usually falls between the rate for senior debt and subordinated notes. Hybrid capital is a type of financing incorporating both debt and equity characteristics. There are several type of hybrid instruments, e.g. preferred stock, convertible bond, warrant, etc.

Figure 8: Indicative market mapping (Diversified Funds)



Source: EIF, GSM team (i.e. Francesco Battazzi)

The observations above, in combination with the indicative results from EIF's market screening, show on the one hand, that the validity and explanatory power of databases for this market segment (SME focussed Debt Funds) is very limited - direct contacts to market players are key. On the other hand, these direct contacts lead to the conclusion that most initiatives on the market are targeting rather the bigger category of companies (mid to large caps), that only a minority of the players are active in the SME field, and that this area has certainly growth potential. Against this background, EIF is working on pilot transactions to support Debt Funds, in particular under a new mandate, called the EIB Group Risk Enhancement Mandate, EREM. This mandate and indicative product terms are the topics of the next chapter.[45]

[45] Please note that also programmes by the European Commission, for example InnovFin, take these developments towards alternative instruments / Debt Funds into consideration. The InnovFin SME Guarantee Facility (under Horizon 2020) is a demand-driven, uncapped instrument that builds on the success of the Risk Sharing Instrument, developed under the 7th EU Framework Programme for Research and Technological Development (2007-2013), managed and implemented by EIF.

5 EREM and Debt Fund solutions

5.1 The mandate and its structure

The European Council (2013a), (2013b) conclusions of June and October 2013 required an increase of the risk taking capacity of the EIF with the purpose of supporting the impaired financing of European SMEs. The Council underlined that more suitable and targeted financial resources should be made available to achieve a competitive, entrepreneurial, innovative and knowledge-based European economy and to boost SMEs' growth. In response, EIF's shareholders endorsed a capital increase of EUR 1.5bn. In addition, a major new mandate (from EIB), the EIB Group Risk Enhancement Mandate (EREM), has been put in place. The objective of this overall financial support package is to provide an increasing access to finance for SMEs and small midcaps, including through the revitalisation of the SME securitisation market, in the context of the economic crisis. The EREM was approved by EIB and EIF Boards in December 2013 and the EREM Framework Agreement was signed between EIB and EIF in March 2014.

The EREM contribution (EUR 4bn from EIB supplemented by EUR 2bn from EIF) will be fully deployed by the EIF on behalf and in close collaboration with the EIB and will enable raising the credit enhancement capacities of EIF with a view to increasing access to finance for SMEs and small midcaps (defined as enterprises with up to 500 employees), mainly through financial institutions, including guarantee institutions and microfinance institutions. Instruments deployed under the EREM shall:

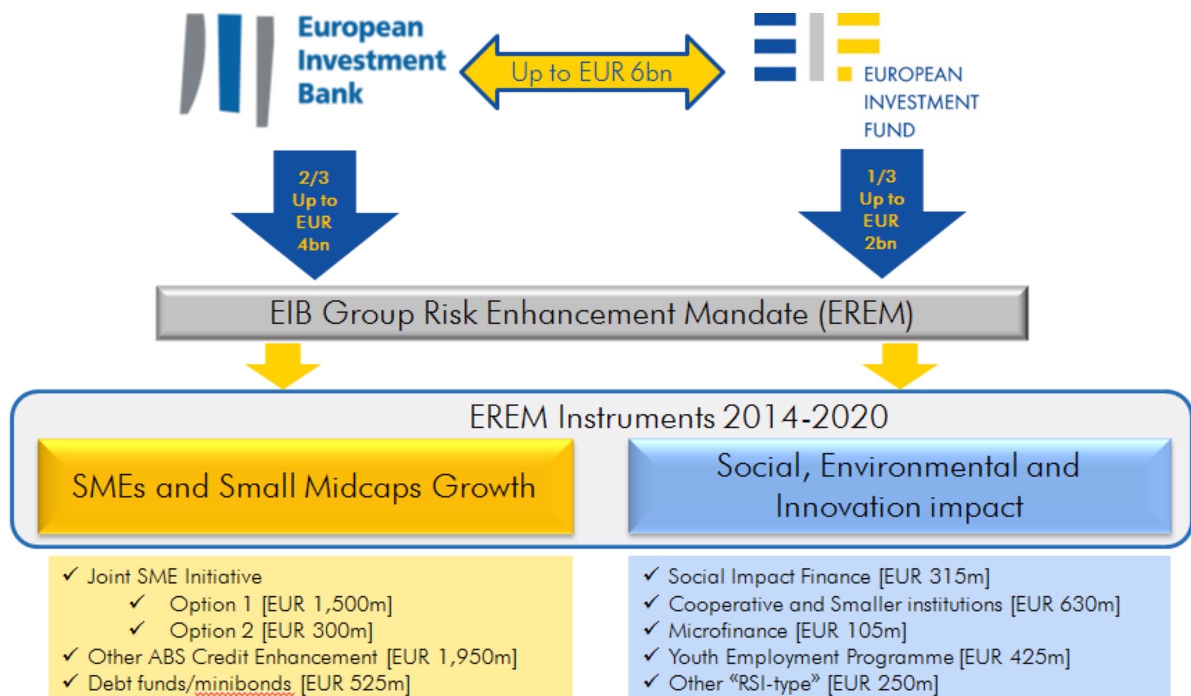
- Contribute to the development of European capital markets instruments to the benefit of SMEs and small midcaps (SME Initiative, SME asset-backed securitisation, loan funds/mini-bonds, etc.), and
- Target specific areas in the fields of youth employment, microfinance, cooperative banks and other smaller financial institutions that do not have access to direct EIB financing, social, environmental and innovation impact, etc. as well as other areas agreed with EIB.

To achieve this in the most efficient manner, EIF will leverage on its catalogue of existing products, systems and procedures. EIF will also establish for each of EREM windows (see below) a clear origination strategy and selection process in full coordination with the EIB to serve the market in an efficient manner. The EREM will focus on the 28 EU Member States and has the following windows (see as well Figure 9, also for indicative amounts):

- Joint SME Initiative (expected end-2014): guarantee scheme and securitisation scheme supported by European Structural and Investment Funds (ESIF) and EU instruments (COSME and Horizon 2020).
- ABS credit enhancement (EREM window active since mid-2014): the amounts made available under the proposed EREM will allow EIF to increase its capacity as credit enhancer of ABS tranches, both in terms of larger ticket size and broader scope in each individual SME securitization.
- Debt Funds/minibonds (expected end-2014): to support loan funds / Debt Funds associated with SMEs and small mid-caps financing.

- Social Impact Finance (available from October-2014): to extend the offer of funding instruments to the actors in the social economy, notably social sector intermediaries such as social investment funds and social banks that are supporting social enterprises.
- Cooperative banks and smaller institutions (expected HY1/2015): to complement EIB financing of cooperative banks and smaller financial institutions.
- Microfinance (expected HY1/2015): to complement EIB and EIF financing of microfinance institutions.
- Youth Employment Programme (YEP!) (subject to availability of a first loss piece from European Commission or EU Member States): to support youth employment in Europe by building a link between the EIB Group's financing and the employment of young people through provision of guarantees for commercial loans to SMEs and small mid-caps creating jobs and offering apprenticeships for young people.
- Other "RSI-type" is a window that builds on the success of the Risk-Sharing Instrument for Innovative and Research oriented SMEs and small mid-caps (RSI) Facility. The RSI was an EIF/EIB/European Commission joint pilot guarantee scheme that aimed at improving access to debt finance for innovative SMEs and small mid-caps (enterprises with fewer than 500 employees) in support of research, development and innovation projects.

Figure 9: EREM potential volumes (2014-2020)[46]



Source: EIF

[46]Please note: the amounts, shown in Figure 9, are indicative amounts.

5.2 The Debt Funds window

As mentioned above, EIF is in contact with many Debt Fund initiatives associated with SMEs and small mid-caps financing, especially in the context of the on-going banking de-leveraging and disintermediation process due to the combined effect of credit deterioration, stricter regulatory requirements and increased capital constraints. As a reaction to the market needs, a product has been designed to cover demand concerning the above mentioned types "Selective Funds" (or Selective Approach) and "Diversified Funds" (or Portfolio Approach).

The new product ("EREM Debt Fund ") will allow the EIB Group to expand its product range and enhance its contribution to the overall growth of SMEs and small mid-caps by helping directly and indirectly (by catalyzing further investments) the launch of the Debt Funds market as complementary to bank funding.

5.2.1 The Selective Funds instrument

EIF's approach to support *Selective Funds* is based on the following elements:[47]

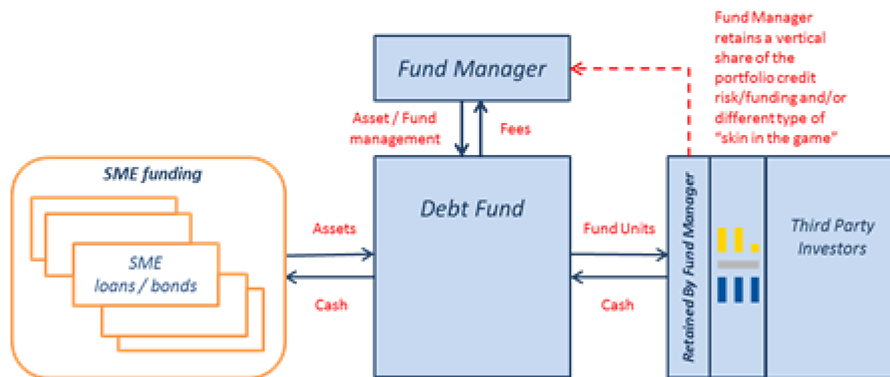
- Securities: EIF will make equity commitments in closed-end funds and/or other investment vehicles. EIF will receive fund units and/or shares of the investment vehicle.
- Capital deployment: equity commitments should be called by the fund manager during the life of the fund according to the investment needs.
- Debt Fund's business model: the fund manager should apply a selective approach in building the portfolios of Debt Funds:
    - investment decision should be taken on the basis of a complete due diligence executed/coordinated directly by the fund manager;
    - the monitoring of the portfolio should be executed with an active approach, based on a set of controls including monitoring instruments, possibly board of directors voting or observer seats, periodical direct interaction with the management team of the target beneficiary, etc.
- Management teams: a strong alignment of interest with funds' investors should be ensured through adequate team commitment, governance structures, incentive schemes, provisions for the resolution of conflict of interests and other specific contractual provisions.
- EIF due diligence: will be based on current EIF's proven due diligence process for equity investments; it will:
    - include one or more visits to meet the management team at their premises;
    - focus on the assessment of all the typical elements of a closed-end fund proposal, including - among others – the fund set-up, governance, origination and

[47] This list explains the main building blocks and is not to be seen as exhaustive set of criteria. In case of questions regarding the Selective Fund approach, please contact either Marco Natoli, Matteo Squilloni, or Remi Charrier (see page 2 for contact details).

investment/portfolio management policies, processes and practices, as well as its reputation.

An overview of the product is displayed in the following Figure 10:

Figure 10: The Selective Funds instrument



Source: EIF

5.2.2 The Diversified Funds instrument

EIF's approach to support *Diversified Funds* is based on the following elements:[48]

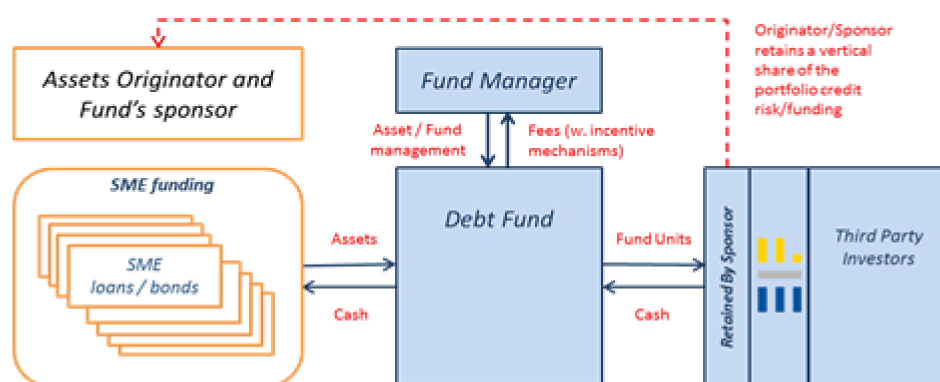
- Securities: equity commitments in closed-end funds and other investment vehicles, or untranched participations in whole loan conduits. EIF will receive fund units, shares of the investment vehicle and/or comparable securities issued by the investment vehicle.
- Commitment deployment: commitments should be called by the fund manager during the life of the fund / investment vehicle according to the investment needs.
- Debt Fund's business model: the fund managers should apply a portfolio approach that aims at establishing a medium to large scale investment platform in loans and/or debt securities, based on:
    - Clear overall risk diversification and portfolio risk target, with pre-defined investment criteria;
    - Investment decisions taken on the basis of a full credit process directly executed or coordinated by the fund manager, based on satisfactory credit assessment/rating process on each investee;
    - Satisfactory and scalable portfolio monitoring and work-out process.

[48] This list explains main building blocks and is not to be seen as exhaustive set of criteria. In case of questions regarding the Diversified Fund approach, please contact either Francesco Battazzi or Remi Charrier (see page 2 for contact details).

- Management team / sponsor: alignment of interest with funds' investors should be ensured through commitment, governance structure, incentive schemes, provisions for the resolution of conflict of interests and other specific contractual provisions.
- In order to assess the expected losses of the investment portfolio, EIF's analysis would take into account both quantitative and qualitative factors such as (for example):
  - Quantitative: credit risk analysis of expected investment pool (default and recovery) portfolio cash-flow analysis, etc.
  - Qualitative: reliability and commitment of the sponsor and fund manager, quality of portfolio origination and servicing processes (e.g. business strategy, management, origination channels, underwriting criteria, risk monitoring, servicing and work-out), economic environment, etc.

An overview of the product is displayed in the following Figure:

Figure 11: The Diversified Funds instrument



Source: EIF

6 Concluding remarks

The increasing number of Debt Funds and initiatives in the area of institutional non-bank lending, as well as the still on-going adjustment processes in the banking sector with related difficulties for SMEs and smaller mid-caps to get access to loans, lead to the assumption of an increasing importance of alternative and / or additional ways. As reported above, there are manifold calls from market participants and policy makers to support alternative financings for SMEs / small mid-caps to fill the bank financing gap, as well as initiatives in favour of diversifying the financing possibilities of SMEs as complementary approach to traditional bank loans. Moreover, there are initiatives in order to "crowd-in" alternative financing sources (e.g. from insurers) with the result that non-bank funding in combination with bank lending emerges

So far, only the minority of existing Debt Funds focus on EIF's core final beneficiaries – SMEs and mid-caps. Most of them are targeting rather the bigger category of companies (bigger mid-caps to large caps) and/or mezzanine instruments. Moreover, initiatives take place so far only in a

limited number of countries. Against this background and the fact that there is a need to strengthen alternative and additional financing channels the participation of EIF in developing such an emerging market for the smaller segment of companies - learning from its past experience with non-granular portfolio guarantee transactions - is straightforward.

Debt Funds can have different advantages (see in this context as well the FSB's comment on benefits and risk implications of non-bank lending in Annex 2):

From a bank's perspective (in the case of bank-sponsored and/or bank (co-) managed structures; i.e. typically Diversified Funds[49]) Debt Funds provide the possibility to:

- transfer and share risks (more effective capital adequacy management);
- increase / diversify their lending business;
- keep their relationships with the companies (for the bank's customer nothing changes as the bank still arranges and services the loans).

From an investor's perspective:

- In the current environment of low interest rates and tight spreads in the debt capital markets, SME debt can present an attractive investment from a relative value perspective (Moody's Analytics, 2013);
- Non-bank investors get access to SME exposures (e.g. diversification opportunity for insurers);
- From Diversified Funds, institutional investors are provided with the possibility to spread risk by joining large scale investment projects, based on standardised instruments/processes and limited reputational harmfulness.

From a SME / small mid-cap (final beneficiary) perspective (depending on the type of Debt Fund),

- Credit rationing can be reduced (in particular in countries with difficulties in the lending channel);
- SMEs can get financing with longer maturities than what is currently often possible via the traditional bank-lending;
- SMEs can keep the relationships with their banks (in the case of bank sponsored funds);
- Companies can get loan / mezzanine instruments that banks would not provide (in the case of Selective Funds);
- Diversification of available financing sources.

On the downside, several issues have to be considered:

- In particular aspects concerning the incentive structures of the various parties involved – the alignment of interests (in order to avoid moral hazard) between *originator, investors,* and (potentially) *manager* is critical for the success of Debt Funds and respective "skin-in-

[49]As mentioned above, Selective Funds are typically not linked to banks.

the game" arrangements have to be put in place. Moreover, incentive structures can have an impact on operational aspects – for example, in case of loan defaults, the originator might be interested in keeping the relationship with the client, whereas the fund manager's interest is only the workout of the defaulted loan.

- In addition, incentive structures and the behaviour of the borrower have to be considered - i.e. in cases where companies do not receive traditional bank loans. As shown above, traditionally, the reliance on bank financing by companies is very high in Europe and the rejection of a non-viable company as borrower by a bank is a reasonable process. These non-viable companies might seek alternative financing sources. The performance of many SME bonds in Germany (many downgrades, defaults, and several fraud cases) suggests the presence of moral hazard and shows that market participants should carefully consider potential incentive issues.
- From the securitisation market, there are lessons to be considered from hybrid products[50], such as lower predictability of future expected losses on the portfolio and relevance of qualitative factors (e.g. incentive structures, as mentioned above).
- Some structures of non-bank intermediation might have the primary objective of circumventing bank capital rules. Motives of regulatory arbitrage have to be carefully considered[51], as well as the fact that specialty finance bears bank-like risks.

To conclude: The volumes of Debt Funds' activities are too small in order to crowd-out the traditional bank-lending channels. Despite the on-going disintermediation processes, also after the crisis banks are going to remain the main provider of external financing to SMEs. However, as the dynamic in this market segment shows, its importance is growing and increasing non-bank lending and capital market solutions seems to be rather a trend than a fashion (Möglich and Raebel, 2014) – as such they can play an important complementary role to the traditional bank financing. Sources and channels of SME financing can be expected to be much more diversified in the future than they were in the past. Moreover, the combination of approaches is already taking place, as shown above.

[50]Hybrid products are defined as Collateralised Debt Obligations (CDOs) backed by mezzanine finance instrument – such as subordinated loans and profit participation rights – and consisting of a rather limited number of obligors (typically less than 100). See for example Kraemer-Eis, Passaris and Tappi (2013).

[51]On a macro level, capital arbitrage has the potential to undermine the effectiveness of a safety net that is installed by regulators to prevent financial crises, see e.g. Luck and Schempp (2014).

7 ANNEX

Annex 1: Overview of financial sector indicators

	Relative to 2012 GDP, %	EU	EA	US	JAP	UK	FRA	NLD	IRL	DNK	DEU	SWE	BEL	ESP	ITA	PRT	GRC	Source:
1	Bank assets	308	287	91	208	438	362	347	546	377	255	156	275	321	159	309	179	IMF GFSR 2014
2	Assets of banks domiciled in	-	303	96	344	801	366	370	-	-	274	-	-	313	241	-	-	FSB 2013
3	Assets of non-bank financial intermediares	-	184	166	64	354	96	565	-	-	72	-	-	72	40	-	-	FSB 2013
4	Bank credit to private sector	136	134	55	105	188	116	105	198	208	209	136	93	204	122	192	118	CPB 2013
5	Bank credit to non-financial companies	46	54	18	81	31	44	35	61	64	58	53	31	80	57	68	53	CPB 2013
6	Assets of pension funds and insurers	93	80	-	-	178	102	242	180	178	78	107	80	36	36	44	7	Eurostat
7	Stock market capitalisation	65	48	104	61	137	64	84	51	77	46	111	62	43	25	33	18	IMF GFSR 2014
8	Stocks traded	44	28	132	61	101	43	57	6	34	36	72	21	81	38	13	6	World Bank
9	All (public / private) debt securities	189	179	217	246	233	173	297	571	292	127	148	152	183	193	186	96	IMF GFSR 2014
10	Non-financial corporate bonds	15	18	35	17	14	26	25	7	4	13	16	13	3	20	25	4	CPB 2013
11	Securitisation market	12	11	51	-	23	2	44	24	0	3	0	21	18	11	22	14	afme
12	SME securitisation	0.9	1.2	-	-	0.3	0.1	1.3	0.0	0.0	0.2	0.0	4.7	3.7	1.8	3.2	3.7	afme
13	Venture capital	0.02	0.01	0.17	0.03	0.04	0.03	0.03	0.05	0.03	0.02	0.05	0.02	0.01	0.01	0.01	0.01	OECD

Notes: Variables 2 and 3 use FSB definitions of the bank and non-bank sectors. Variable 2 refers to all deposit-taking institutions. Variable 3 refers to all financial institutions that are not classified as banks, insurance companies, pension funds, public financial institutions, or central banks (see FSB, 2013 for more). Variables 4, 5, and 10 are taken from CPB (2013) and are for 2011, with the euro-area average calculated as the simple average of euro-area countries. For variables 10, 11, and 12 European averages are GDP-weighted averages.

Well above European average(s)
Above European average(s)
Around European average(s)
Below European average(s)

Source: Jones, Dharmasena and Llewellyn (2014)

Annex 2: FSB on benefits and risk implications of non-bank lending (quote)

According to the FSB (2013), non-banks can have a legitimate role to play in increasing the financing available to borrowers that are experiencing funding shortages. It summarises the benefits and implications of non-bank lending as follows:

"In recognition of the positive role of non-banks in financing the economy, recent public initiatives, for instance in the UK and the euro area,[52] *have tended to support non-bank lending and facilitate market-based finance. In other jurisdictions, some of the legal hurdles for non-banks to engage in lending activities are being lifted.*

However, in order to reap the full benefits from non-bank financing, and ensure its sustainable growth, there are a number of aspects that could deserve a more thorough assessment and closer monitoring:

Risk management, incentives and search for yield

Direct lending by non-banks requires the development of an in-house credit risk management capacity (or alternatively stringent procedures for selection of third party managers) and appropriate internal controls to undertake due diligence on borrowers. The smooth development of non-bank lending in the US over many years shows that this does not necessarily constitute an obstacle for non-banks to successfully undertake lending activities. However, in a context of intense search for yield, there is higher risk that some non-banks under-invest in credit risk assessment capacities.[53]

Furthermore, the incentives of fund managers and co-originating banks may not be fully aligned with those of the non-bank investor due to potential incentive and negative selection problems.[54] *The development of skin-in-the game arrangements and rigorous performance monitoring for specialised loan funds and co-origination are possible tools for reducing incentive problems. The fact that specialised loan funds are usually part of larger asset management firms would also normally provide an incentive for them to manage in their client's interests.*

Finally, direct lending is essentially a banking activity performed by non-banks. However, supervision still remains segmented by type of financial institution. As activities performed or intermediated by insurance companies, pension funds and investment managers become closer to banking activities – with the notable exception that they do not take deposits -, the supervision of these entities might need to be adapted to reflect their expanded scope of activities and the related

[52] The UK government announced the Business Finance Partnership (BFP) in November 2011, whereby fund managers are selected and required to co-invest with the government by making loans to SMEs for an amount at least equivalent to the public financing provided. The ECB has started consultations with other European institutions on initiatives to promote a functioning market for asset-backed securities (ABS) collateralised by loans to non-financial corporations.

[53] Estimates are that yields for direct lending to SMEs are at least 150 basis points higher than yields available in the public bond market for similar credit quality corporates.

[54] Incentive problems and negative selection are not unique to non-bank lending, and may also arise between banks (i.e. between a larger and a smaller bank) in syndicated loan markets.

risks (e.g. credit risk, liquidity risk) in order to avoid unintended regulatory arbitrage.[55] *Consideration could also be given to whether insurance/securities regulators can or should regulate and/or supervise lending activities of non-banks.*

Leverage and maturity / liquidity transformation

Given the low leverage and long-dated liabilities of institutional investors such as insurance companies and pension funds, direct lending performed on a bilateral basis or in co-origination with banks is less likely to present shadow banking risks.

Similarly, the majority of loan funds follow a private equity model which implies long lock-in periods that greatly reduce the maturity and liquidity transformation risks. However, some specific structures can bear higher risks. For instance, some funds reportedly do not impose lock-in periods and instead rely on a cash buffer to meet redemptions, which may not be sufficient in stress situations.

Furthermore, while it is difficult to assess the exact degree of leverage in specialised loan funds given scarce information, some funds have put in place borrowing facilities representing a sizeable share of their assets in order to boost returns in a context of declining yields.[56] *This should be monitored carefully as it may open up the possibility to indirectly take on leverage for institutions that are traditionally not allowed to do so (such as insurance companies).*

Transparency

As direct lending markets are by nature private, information is scarce and patchy. The information presented in this report is based on a mix of market intelligence, research reports by banks, and dozens of financial news reports. Systematic market-wide information on these activities would be needed to monitor their size, growth and characteristics and detect any build-up of risk."

[55]For instance, regarding insurance companies, significant direct lending activities could expand the scope of non-traditional non insurance activities (NTNI) that may contribute to systemic risk. It was also reported that certain co-origination partnerships involve a bank and an insurance company of the same group, and might result in a regulatory arbitrage, since capital requirement levels for insurance and banks can be different.

[56]For instance, Carlyle GMS Finance, a closed-end fund of USD 1bn structured as a business development company in the US, and providing senior loans to middle-market companies, has a revolving credit facility of up to EUR 500m with various lenders. Usually, leverage of loan funds is between 0% and 35% of their assets.

Annex 3: Comments from the HLEG (quote)[57]

"Funds of Loans

In addition to more traditional venture capital and mezzanine funds (funds combining debt and equity or hybrid instruments) there is a recent and growing market interest for direct financing to SMEs by the setting up of specialized Debt Funds, particularly in EU jurisdictions with banking sectors under stress where a bottoming out of the business cycle has paved the way for business opportunities by newly created Debt Funds to engage in SME risk.

In playing an immediate role in providing new funding sources for European SMEs, these funds may have the major advantage of not having to deal with impaired legacy assets stemming from previous boom and bust cycle. In addition, the liability structure of these funds with no deposits and only qualified investors on their equity and debt may allow them to enjoy a less stringent regulatory framework vis-a-vis banks in the areas of liquidity and solvency.
However, there are challenges.

- The typical leaner structures of funds and their management limit their ability to obtain efficiently the level of grass root information required from being a significant player in originating new loans other than those targeted to the bigger end of the medium sized enterprises and mid-caps corporates (…).
- In addition, non-bank financial institutions may face a myriad of differing regulatory rules in extending credit in different countries across the EU. There is no ability to passport this activity from one country to another. Indeed, in some, it may even be necessary to have a banking license before extending credit in that jurisdiction.
- In some instances, credit provided by banks benefits from preferential treatment on the insolvency of the debtor.
- Some regulatory structures for loan funds do not accept funds which plan to include as assets loans originated by the manager as favourably as loans simply purchased in the secondary market by the manager.

Notwithstanding these limitations, the HLEG believes specialized Debt Funds may well play a role in creating new non-bank links between the supply of funding and the SMEs who require it. In the short term, the funds have a particular role in increasing the efficiency and liquidity of the secondary market for loans to small and medium sized enterprises originated by banks and willing to transfer them to third parties thus providing incentives ex ante for more SME loan origination primarily by the banking sector.

Medium-Term Recommendation – SMM13 (EU Commission)

The EU introduce a single market "passport" of EU loan funds to enable such vehicles to acquire assets and advance credit freely on a cross border basis and not just be able to use (as is currently the case) their passport to generate investment into the fund on the liability side of the fund's balance sheet."

[57] High Level Expert Group on SME and Infrastructure Financing on loan funds. See HLG (2013).

Annex 4: List of active loan funds (based on Bloomberg / PE universe)[58]

	Fund	General Partner	Vintage	Status
1	Abraaj Special Opportunities Fund I	Abraaj Group Ltd/The	2003	Harvesting
2	Abraaj Special Opportunities Fund II	Abraaj Group Ltd/The	2005	Harvesting
3	Accession Mezzanine Capital II LP	Mezz. Management Central Europe Fin.	2007	Investing
4	Accession Mezzanine Capital III LP	Mezz. Management Central Europe Fin.	2009	Investing
5	ActoMezz	ACG Private Equity	2008	Investing
6	ADM CEECAT Recovery Fund LP	ADM Capital	2011	Investing
7	ADM Gladius Fund LP	ADM Capital	2007	Investing
8	ADM Maculus Fund III LP	ADM Capital	2006	Harvesting
9	ADM Maculus Fund V LP	ADM Capital	2008	Investing
10	AEA Mezzanine Fund III LP	AEA Investors	2013	Fundraising/Invest
11	AEA Mezzanine Fund LP	AEA Investors	2005	Harvesting
12	AEA Mezzanine II Fund LP	AEA Investors	2008	Investing
13	AEA Middle Market Debt Management LP	AEA Investors	2007	Investing
14	Alcentra European Direct Lending Fund	Alcentra Group Ltd	2013	Fundraising/Invest
15	Alcentra Mezzanine Fund I LP	Alcentra Group Ltd	2005	Harvesting
16	Alcentra Mezzanine Fund II LP	Alcentra Group Ltd	2007	Investing
17	Alchemy Special Opportunities Fund II LP	Alchemy Partners LLP	2011	Investing
18	Alchemy Special Opportunities Fund III LP	Alchemy Partners LLP	--	Fundraising
19	Alchemy Special Opportunities Fund LP	Alchemy Partners LLP	2006	Harvesting
20	Almack Mezzanine I LP	Babson Capital Europe Ltd	2006	Harvesting
21	Almack Mezzanine II LP	Babson Capital Europe Ltd	2009	Investing
22	Almack Mezzanine III LP	Babson Capital Europe Ltd	2010	Investing
23	Altercap II	LBO France	2011	Investing
24	AMP Capital Infrastructure Debt Fund I LP	AMP Capital Holdings Ltd	2012	Investing
25	AMP Capital Infrastructure Debt Fund II	AMP Capital Holdings Ltd	2013	Fundraising/Invest
26	AnaCap Credit Opportunities Fund II	AnaCap Financial Partners LLP	2012	Investing
27	AnaCap Debt Opportunities LP	AnaCap Financial Partners LLP	2010	Investing
28	Anthilia Bond Impresa Territorio	Anthilia Capital Partners SGR SPA	2013	Fundraising/Invest
29	AP Investment Europe Ltd	Apollo Global Management LLC	2007	Harvesting
30	Apollo Credit Liquidity Fund LP	Apollo Global Management LLC	2007	Investing
31	Apollo European Principal Finance Fund II LP	Apollo Global Management LLC	2012	Investing
32	Apollo European Principal Finance Fund LP	Apollo Global Management LLC	2008	Investing
33	Apollo Investment Europe II LP	Apollo Global Management LLC	2008	Investing
34	Ares Capital Europe II LP	Ares Management LLC	2013	Fundraising/Invest
35	Ares Capital Europe LP	Ares Management LLC	2007	Harvesting
36	Ares Special Situations Fund II LP	Ares Management LLC	2009	Investing
37	Ares Special Situations Fund III LP	Ares Management LLC	2011	Investing
38	Ares Special Situations Fund IV LP	Ares Management LLC	--	Fundraising
39	Ares Special Situations Fund LP	Ares Management LLC	2007	Investing
40	Armada Mezzanine Fund II	Armada Mezzanine Capital Oy	2005	Harvesting
41	Armada Mezzanine Fund III	Armada Mezzanine Capital Oy	2008	Investing
42	Armada Mezzanine Fund IV	Armada Mezzanine Capital Oy	2014	Investing
43	ASOF II Feeder Fund LP	Abraaj Group Ltd/The	2010	Investing
44	Assets Overflow Fund	Fortress Investment Group LLC	2008	Investing
45	Avenir Entreprises Mezzanine	FSI Regions	2007	Harvesting
46	Avenue Capital European Distressed Assets Fd.	Avenue Capital Group LLC	--	Fundraising
47	Avenue Capital European Senior Loan Fund	Avenue Capital Group LLC	--	Pre-Marketing
48	Avenue Europe Capital Solutions Fund LP	Avenue Capital Group LLC	2014	Fundraising/Invest
49	Avenue Europe Special Situations Fund II LP	Avenue Capital Group LLC	2012	Investing
50	Avenue Europe Special Situations Fund LP	Avenue Capital Group LLC	2008	Investing
51	AXA Mezzanine I LP	Ardian	2005	Harvesting
52	Beechbrook Mezzanine I LP	Beechbrook Capital LLP	2008	Investing
53	Beechbrook Mezzanine II LP	Beechbrook Capital LLP	2013	Fundraising/Invest

[58]The managers that are marked in red participate in the UK Business Finance Partnership (BPI).

Annex 4 continued:

54	BioMed Credit	BioMedPartners AG	2006	Investing
55	BlueBay Direct Lending Fund I LP	Royal Bank of Canada	2012	Investing
56	BlueMountain Credit Opportunities Fund I LP	BlueMountain Capital Management LLC	2012	Investing
57	BPM Mezzanine Fund	BPM Capital OU	2013	Fundraising/Invest
58	Bulgaria Mezzanine Capital I LP	Bulgaria Mezzanine Partners	2013	Fundraising/Invest
59	CapMan Mezzanine IV LP	CapMan OYJ	2004	Harvesting
60	CapMan Mezzanine V LP	CapMan OYJ	2010	Investing
61	Capzanine I	Capzanine	2004	Harvesting
62	Capzanine II	Capzanine	2007	Investing
63	Capzanine III	Capzanine	2012	Investing
64	CELF Loan Partners 2008-2 Ltd	Carlyle Group LP/The	2008	Investing
65	CELF Loan Partners V PLC	Carlyle Group LP/The	2008	Investing
66	Centerbridge Capital Partners Debt Acqu. LP	Centerbridge Capital Partners LLC	2007	Investing
67	Centerbridge Special Credit Partners II LP	Centerbridge Capital Partners LLC	2012	Investing
68	Centerbridge Special Credit Partners LP	Centerbridge Capital Partners LLC	2009	Investing
69	Cerea Capital	Cerea Gestion	2007	Investing
70	Cerea Mezzanine I	Cerea Gestion	2005	Harvesting
71	Cerea Mezzanine II	Cerea Gestion	2008	Investing
72	CIC Mezzanine 2	CIC Mezzanine Gestion	2007	Harvesting
73	CIC Mezzanine 3	CIC Mezzanine Gestion	2012	Investing
74	Colony Distressed Credit and Special Sit. Fd III	Colony Capital LLC	--	Fundraising
75	Colony Distressed Credit Fund II LP	Colony Capital LLC	2011	Investing
76	Colony Distressed Credit Fund LP	Colony Capital LLC	2008	Investing
77	Crescent European Specialty Lending Fund	Crescent Capital Group LP	2014	Fundraising/Invest
78	Darby Converging Europe Fund III LP	Darby Overseas Investments Ltd	2011	Investing
79	Darby Converging Europe Mezzanine Fund LP	Darby Overseas Investments Ltd	2005	Investing
80	EMSA Capital CEE Special Situations Fund LP	EMSA Capital	2011	Investing
81	EQT Credit II	EQT Partners AB	2013	Investing
82	Euromezzanine 4	Euromezzanine Conseil	2003	Harvesting
83	Euromezzanine 5	Euromezzanine Conseil	2006	Investing
84	Euromezzanine 6	Euromezzanine Conseil	2009	Investing
85	European Mezzanine Fund III LP	Indigo Capital LLP	1999	Harvesting
86	Farallon European Private Credit LP	Farallon Capital Management LLC	2014	Investing
87	FCPI Indigo Capital	Indigo Capital France	2013	Fundraising/Invest
88	FCT Tikehau Corporate Leveraged Loan Fund	Tikehau Investment Management SAS	2013	Fundraising/Invest
89	FF&P Special Situations III LLP	FF&P Private Equity Ltd	2007	Investing
90	FIP Mezzano	Midi Capital	2009	Investing
91	FIP Mezzano II	Midi Capital	2011	Investing
92	FIP Mezzano III	Midi Capital	2011	Investing
93	Five Arrows Credit Solutions	Rothschild Concordia SAS	2013	Fundraising/Invest
94	Fondo Ver Capital Mezzanine Partners	Ver Capital SGRpA	2006	Harvesting
95	Fortress Credit Opportunities Fund LP	Fortress Investment Group LLC	2008	Investing
96	Fortress Credit Opportunities II LP	Fortress Investment Group LLC	2008	Investing
97	Fortress Credit Opportunities III LP	Fortress Investment Group LLC	2011	Investing
98	France Special Situations I	Perceva Capital	2010	Investing
99	Global Microfinance Facility	Cyrano Management SA	2004	Harvesting
100	GS Mezzanine Partners 2006 LP	GS Mezzanine Partners	2006	Harvesting
101	GS Mezzanine Partners III LP	GS Mezzanine Partners	2003	Harvesting
102	GS Mezzanine Partners V LP	GS Mezzanine Partners	2007	Investing
103	GSC European Mezzanine Capital I LP	Black Diamond Capital Mgmnt LLC/Gw	2000	Harvesting
104	GSC European Mezzanine Capital II LP	Black Diamond Capital Mgmnt LLC/Gw	2005	Harvesting
105	GSC Partners CDO Investors II Ltd	Black Diamond Capital Mgmnt LLC/Gw	1998	Harvesting
106	GSC Partners CDO Investors III Ltd	Black Diamond Capital Mgmnt LLC/Gw	2001	Harvesting
107	GSC Partners CDO Investors IV Ltd	Black Diamond Capital Mgmnt LLC/Gw	2003	Harvesting
108	GSC Recovery II LP	Black Diamond Capital Mgmnt LLC/Gw	2000	Harvesting
109	GSC Recovery III LP	Black Diamond Capital Mgmnt LLC/Gw	2007	Investing

Annex 4 continued:

110	Harbert European Growth Capital Fund I LP	Harbert Management Corp/AL	2013	Fundraising/Invest
111	Hayfin European Direct Lending Fund	Hayfin Capital Management LLP	2014	Investing
112	Hayfin Special Opportunities Credit Fund	Hayfin Capital Management LLP	2013	Investing
113	HIG Bayside Debt & LBO Fund II LP	Bayside Capital Inc	2008	Investing
114	HIG Bayside Loan Opportunity Fund II LP	Bayside Capital Inc	2010	Investing
115	HIG Bayside Loan Opportunity Fund III LP	Bayside Capital Inc	2012	Investing
116	HIG Bayside Opportunity Fund LP	Bayside Capital Inc	2004	Harvesting
117	Highbridge Principal Strat. - Mezz. Partners LP	Highbridge Principal Strategies LLC	2008	Investing
118	Highbridge Principal Strat. - Mezz. Partners II LP	Highbridge Principal Strategies LLC	2012	Investing
119	Hiperion Turnar. Fd I FCR de Regimen Simpl.	Hiperion Capital Mgmnt SGECR SA	2009	Investing
120	Hirtle Callaghan Special Opp. Fund 2009 LP	Hirtle Callaghan & Co LLC	2009	Investing
121	Hutton Collins Capital Partners II LP	Hutton Collins Partners LLP	2006	Harvesting
122	Hutton Collins Capital Partners III LP	Hutton Collins Partners LLP	2009	Investing
123	Hutton Collins Mezzanine Partners LP	Hutton Collins Partners LLP	2004	Harvesting
124	i2 Capital Partners Fund	i2 Capital Partners SGR SpA	2008	Investing
125	ICG Europe Fund V	Intermediate Capital Group PLC	2012	Investing
126	ICG European Fund 2006 LP	Intermediate Capital Group PLC	2006	Harvesting
127	ICG Mezzanine Fund 2003	Intermediate Capital Group PLC	2003	Harvesting
128	ICG Recovery Fund 2008 LP	Intermediate Capital Group PLC	2008	Investing
129	Idinvest Dette Senior	Idinvest Partners SA	2013	Investing
130	Idinvest Private Debt Fund	Idinvest Partners SA	2012	Investing
131	Idinvest Private Value Europe	Idinvest Partners SA	2012	Investing
132	Idinvest Private Value Europe II	Idinvest Partners SA	--	Fundraising
133	IFE III Mezzanine	IFE Mezzanine	2011	Investing
134	Indigo Capital IV LP	Indigo Capital LLP	2003	Harvesting
135	Insight Consumer Debt Recovery Fund I LP	Bank of New York Mellon Corp/The	2010	Investing
136	IPF Growth Debt Fund 1	Avebury Capital Partners LLP	--	Fundraising
137	IPF I	IPF Management I Sarl	2013	Investing
138	KapNord Fond AS	Pronord AS	2006	Investing
139	Kartesia Credit Opportunities I SCA	Kartesia Advisor LLP	2013	Fundraising/Invest
140	KKR Special Situations Fund	KKR & Co LP	2013	Investing
141	KPS Special Situations Fund II LP	KPS Capital Partners LP	2002	Harvesting
142	KPS Special Situations Fund III LP	KPS Capital Partners LP	2007	Investing
143	Kreos Capital II LP	Kreos Capital Management UK Ltd	2005	Harvesting
144	Kreos Capital III LP	Kreos Capital Management UK Ltd	2007	Harvesting
145	Kreos Capital IV LP	Kreos Capital Management UK Ltd	2012	Investing
146	Kronborg Limited	AXA Real Estate Investment Managers Ltd	2014	Investing
147	LBO France Altercap Debt Fund I LP	LBO France	2009	Investing
148	LCN Capital Fund	LCN Capital Partners	2013	Fundraising/Invest
149	Lehman Brothers European Mezz. Fund 2003	Lehman Brothers Holdings Inc	2004	Investing
150	Lone Star Fund III LP	Lone Star Funds	2000	Harvesting
151	Lone Star Fund IV LP	Lone Star Funds	2002	Harvesting
152	Lone Star Fund V US LP	Lone Star Funds	2005	Harvesting
153	Lonehill Fund LP	Sandton Capital Partners LP	2013	Investing
154	M Cap Finance Deutsche Mezzanine Fonds …	M Cap Fin. Mittelst. GmbH & Co KG	2010	Investing
155	M&G Debt Opportunities Fund Ltd	M&G Investment Management Ltd	2012	Investing
156	M&G UK Cies Financing Fund II LP	M&G Investment Management Ltd	2013	Investing
157	MD Mezzanine SA Sicar	Ardian	2006	Harvesting
158	Melody Capital Partners LP/Fund	Melody Capital Partners LP	--	Fundraising
159	Mezzanine Management Fund III	MML Capital Partners LLP	1999	Harvesting
160	Mezzanine Management Fund IV LP	MML Capital Partners LLP	2006	Harvesting
161	Mezzanis 2 FCPR	Omnes Capital SAS	2005	Investing
162	Mezzanis Fund SA	Omnes Capital SAS	2002	Harvesting
163	Mezzanove Capital I	Mezzanove Capital SpA	2006	Harvesting
164	MezzVest I LP	Capvest Ltd	2002	Harvesting
165	MezzVest II LP	Capvest Ltd	2005	Harvesting

Annex 4 continued:

166	MezzVest III LP	Capvest Ltd	2012	Investing
167	Mittelhessenfonds GmbH	BM H Beteiligungs Mgmntges. Hessen	2008	Harvesting
168	Morgan Stanley Credit Partners II LP	Morgan Stanley Alt. Investment Partners	2014	Fundraising/Invest
169	Morgan Stanley Credit Partners LP	Morgan Stanley Alt. Investment Partners	2011	Investing
170	Mount Mezzanine II	Capital Trust Ltd/United Kingdom	2008	Harvesting
171	Nordic Mezzanine Fund II LP	Nordic Mezzanine Advisers Ltd	2002	Harvesting
172	Nordic Mezzanine Fund III LP	Nordic Mezzanine Advisers Ltd	2009	Investing
173	North East Investment Fund 3	NEL Fund Managers Ltd	2004	Harvesting
174	NYLCAP Mezzanine Partners III LP	GoldPoint Partners LLC	2012	Investing
175	NYLIM Mezzanine Partners II LP	GoldPoint Partners LLC	2007	Investing
176	NYLIM Mezzanine Partners LP	GoldPoint Partners LLC	2002	Harvesting
177	Oaktree Emerging Market Opp. Fund LP	Oaktree Capital Group LLC	2013	Investing
178	Oaktree European Credit Opp. Fund LP	Oaktree Capital Group LLC	2006	Harvesting
179	Oaktree European Dislocation Fund LP	Oaktree Capital Group LLC	2013	Fundraising/Invest
180	Oaktree Opportunities Fund IX LP	Oaktree Capital Group LLC	2011	Investing
181	OCM European Principal Opp. Fund II LP	Oaktree Capital Group LLC	2008	Investing
182	OCM European Principal Opp. Fund II LP	Oaktree Capital Group LLC	2008	Investing
183	OCM European Principal Oppo. Fund LP	Oaktree Capital Group LLC	2006	Harvesting
184	OHA European Strategic Credit Fund	Oak Hill Advisors LP	2011	Investing
185	Oquendo Mezzanine I	Oquendo Capital	2007	Harvesting
186	Oquendo Mezzanine II	Oquendo Capital	--	Fundraising
187	Orlando Italy Special Situations II SICAR SCA	Orlando Italy Management SA	2012	Investing
188	Orlando Italy Special Situations SICAR	Orlando Italy Management SA	2006	Harvesting
189	Palio Superflex Fund I LP	Palio Capital Partners LLP	--	Fundraising
190	Palmer Vinci Construction Fund	Palmer Capital Partners Ltd	2011	Investing
191	Park Square Capital Credit Opportunities II LP	Park Square Capital LLP	2013	Fundraising/Invest
192	Park Square Capital Credit Opportunities LP	Park Square Capital LLP	2007	Investing
193	Park Square Capital Partners II LP	Park Square Capital LLP	2011	Investing
194	Park Square Capital Partners III LP	Park Square Capital LLP	--	Fundraising
195	Park Square Capital Partners LP	Park Square Capital LLP	2005	Investing
196	PCCP Mezzanine Recovery Partners I LP	PCCP LLC	2005	Harvesting
197	PCCP Mezzanine Recovery Partners II LP	PCCP LLC	2008	Investing
198	Perseus Market Opportunity Fund LP	Perseus LLC	2004	Harvesting
199	PIMCO BRAVO Fund II LP	Pacific Investment Management Co LLC	2013	Investing
200	PIMCO Bravo Fund LP	Pacific Investment Management Co LLC	2010	Investing
201	PMRP Preferred LLC	PCCP LLC	2010	Investing
202	Praesidian Capital Europe I LP	Praesidian Capital	--	Fundraising
203	Precision Lending Fund I FCPR	Boost & Co SAS	2011	Harvesting
204	Promethean Investments Fund II LP	Promethean Investments LLP	2014	Fundraising/Invest
205	Promethean Investments Fund LP	Promethean Investments LLP	2005	Harvesting
206	PSCP Credit Opportunities B LP	Park Square Capital LLP	2011	Investing
207	RiverRock European Opportunities Fund	RiverRock European Capital Partners LLP	2011	Investing
208	Sankaty Credit Opportunities II LP	Sankaty Advisors LLC	2005	Harvesting
209	Sankaty Credit Opportunities III LP	Sankaty Advisors LLC	2007	Investing
210	Sankaty Credit Opportunities IV LP	Sankaty Advisors LLC	2008	Investing
211	Sankaty DIP Opportunities LP	Sankaty Advisors LLC	2009	Investing
212	Sankaty Middle Market Opportunities Fund II LP	Sankaty Advisors LLC	2013	Investing
213	Sankaty Middle Market Opportunities Fund LP	Sankaty Advisors LLC	2011	Investing
214	Scottish Loan Fund	Maven Capital Partners UK LLP	2013	Investing
215	Sherpa Capital SCR	Sherpa Capital Gestion	2010	Investing
216	Special Situations Venture Partners II LP	Orlando Management AG	2006	Harvesting
217	Special Situations Venture Partners III LP	Orlando Management AG	2012	Investing
218	Special Situations Venture Partners LP	Orlando Management AG	2002	Harvesting
219	Strategic Value European Opp. Fund II LP	Strategic Value Partners LLC	2012	Investing
220	Strategic Value European Opp. Offshore Fd II	Strategic Value Partners LLC	2011	Investing
221	Strat. Value European Opp. USD Offshore Fd II	Strategic Value Partners LLC	2012	Fundraising/Invest

Annex 4 continued:

222	Strategic Value Special Situations Fund II LP	Strategic Value Partners LLC	2011	Investing
223	Strategic Value Special Situations Fund III LP	Strategic Value Partners LLC	2013	Fundraising/Invest
224	Strategic Value Special Situations Fund LP	Strategic Value Partners LLC	2008	Harvesting
225	Summit Subordinated Debt Fund II LP	Summit Partners LP	1997	Harvesting
226	Summit Subordinated Debt Fund III LP	Summit Partners LP	2004	Harvesting
227	Summit Subordinated Debt Fund IV LP	Summit Partners LP	2008	Investing
228	Summit Subordinated Debt Fund LP	Summit Partners LP	1994	Harvesting
229	Suomi Valirahoitusrahasto I Ky	Vaaka Partners Oy	2007	Investing
230	Syntaxis Mezzanine Fund I LP	Syntaxis Capital UFB GmbH	2007	Investing
231	Syntaxis Mezzanine Fund II LP	Syntaxis Capital UFB GmbH	2009	Investing
232	TA Subordinated Debt Fund II LP	TA Associates Management LP	2006	Harvesting
233	TA Subordinated Debt Fund III LP	TA Associates Management LP	2009	Investing
234	TA Subordinated Debt Fund LP	TA Associates Management LP	2000	Harvesting
235	TCW Energy Fund X LP	TCW Capital Investment Corp	2004	Harvesting
236	Thesan Capital Special Situations Fund	Thesan Capital SL	2008	Investing
237	Tikehau Preferred Capital Fund	Tikehau Investment Management SAS	2013	Investing
238	Triton Debt Opportunities Fund I LP	Triton Advisers Ltd	2013	Fundraising/Invest
239	Trocadero Capital & Transmission II	123Venture SA	--	Fundraising
240	Value Growth Fund Slovakia BV	Value Management Services GmbH	2003	Harvesting
241	Ver Capital Credit Opportunity Fund	Ver Capital SGRpA	2010	Investing
242	VSS Structured Capital III	Veronis Suhler Stevenson LLC	--	Fundraising

Source: Bloomberg

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About …

… the European Investment Fund

The European Investment Fund (EIF) is the European body specialised in small and medium sized enterprise (SME) risk financing. The EIF is part of the European Investment Bank group and has a unique combination of public and private shareholders. It is owned by the EIB (65.1%), the European Union - through the European Commission (24.3%) and a number (26 from 15 countries) of public and private financial institutions (10.6%).[59]

EIF's central mission is to support Europe's SMEs by helping them to access finance. EIF primarily designs and develops venture capital and guarantees instruments which specifically target this market segment. In this role, EIF fosters EU objectives in support of innovation, research and development, entrepreneurship, growth, and employment.

The EIF total net commitments to venture capital and private equity funds amounted to over EUR 7.9bn at end 2013. With investments in over 480 funds, the EIF is the leading player in European venture capital due to the scale and the scope of its investments, especially in the high-tech and early-stage segments. The EIF commitment in guarantees totaled over EUR 5.6bn in over 300 operations at end 2013, positioning it as a major European SME loan guarantees actor and a leading microfinance guarantor.

… EIF's Research & Market Analysis

Research & Market Analysis (RMA) supports EIF's strategic decision-making, product development and mandate management processes through applied research and market analyses. RMA works as internal advisor, participates in international fora and maintains liaison with many organisations and institutions.

… this Working Paper series

The EIF Working Papers are designed to make available to a wider readership selected topics and studies in relation to EIF´s business. The Working Papers are edited by EIF´s Research & Market Analysis and are typically authored or co-authored by EIF staff. The Working Papers are usually available only in English and distributed only in electronic form (pdf).

[59]Situation at 06.10.2014. As a result of the General Meeting's approval of EIF's capital increase in May 2014, EIF's authorised capital was increased from EUR 3bn to EUR 4.5bn, resulting in a total of 4,500 authorised shares of a nominal value of EUR 1m each. Following the first capital increase subscription period, and as at 6 October 2014, of the 1,500 newly authorised shares, 1,161 have been issued. 339 shares are not yet issued, having been allocated to the European Union for subsequent subscriptions from 2015-2017.

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