CREDIT OPINION
8 July 2022

Update

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RATINGS
European Investment Fund

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<th>Rating</th>
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<tr>
<td>Short-term Issuer</td>
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European Investment Fund – Aaa stable
Regular update

Summary
The European Investment Fund’s (EIF) credit profile reflects its robust capitalisation, very strong liquidity and funding position and the very high ability and willingness to support by its key shareholders, the European Investment Bank (EIB, Aaa stable) and the European Union (EU, Aaa stable), which together currently account for 89.4% of authorised and subscribed capital. EIF’s key credit challenge relates to effectively preserving its solid capital position, particularly in the context of a rapid expansion of its portfolio as part of the EU’s coronavirus crisis policy response.

Exhibit 1
EIF’s credit profile is determined by three factors

Credit strengths
» High asset quality and very strong liquidity position coupled with no debt outstanding
» Track record of low impairments on equity investments and limited guarantee calls
» Very high ability and willingness of key shareholders to provide support

Credit challenges
» Focus on inherently risky equity participations in small- and medium-sized enterprises
» Potential risks stemming from the rapid expansion of business activities
Rating outlook
The stable outlook reflects our view that the EIF’s credit strengths will be maintained over the coming years. In particular, we expect asset quality and performance to remain very strong even in light of strong business growth. The EIF’s prudent and robust risk management policies are an important support factor in our view.

Factors that could lead to a downgrade
A severe deterioration in the EIF’s treasury or equity portfolios, a material rise of called guarantees, and/or rating downgrades of the entity’s main shareholders would exert downward pressure. The rating would also come under pressure if shareholders were unwilling to provide further capital support or strong risk mitigation in a scenario of rapid business growth.

Key indicators

Exhibit 2
European Investment Fund

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<td>Callable Capital / Gross Debt</td>
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</tbody>
</table>

[1] Usable equity is total shareholder’s equity and excludes callable capital
Source: Moody’s Investors Service

Profile
The EIF was founded in 1994 as an EU body owned by the EIB, the European Community (now the EU) – represented by the European Commission (EC) – and a group of mainly European financial institutions. The EIF has a mandate to support the creation, development and growth of small and medium-sized enterprises (SMEs). Its regional focus is mainly on EU member countries, but also those in the European Free Trade Association (EFTA) and in EU candidate and potential candidate countries.

The EIF managed the SME Window of the EU’s European Fund for Strategic Investments (EFSI, or the “Juncker Plan”), and now plays a key role in the implementation of InvestEU, the successor to the EFSI. The EIF was also part of the EU’s coronavirus crisis response through the Pan-European Guarantee Fund (EGF), which was mainly deployed in 2021.

The EIF designs and implements financial instruments to provide market-based finance to SMEs such as (1) guarantees on tranches of securitisations of SME loans, leases and other debt financings and guarantees on a portion of SME loan portfolios made by financial institutions; and (2) stakes in private equity funds oriented toward investments in SMEs. For this type of funding, the EIF typically requires private investors to contribute at least 50% of the capital (on average, the private-sector contribution is 70%-75%).

The EIF considers itself to be an alternative asset manager, as an increasing share of the financing is done on behalf and at the risk of the EIB and the EU, as well as individual EU member states and their national promotional/development banks (“mandate” resources).

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on https://ratings.moodys.com for the most updated credit rating action information and rating history.
Detailed credit considerations

Our determination of a supranational’s rating is based on three rating factors: capital adequacy, liquidity and funding and strength of member support. For Multilateral Development Banks, the first two factors combine to form the assessment of intrinsic financial strength, as shown on the cover page graphic. Additional factors can affect the intrinsic financial strength, such as risks stemming from the operating environment or the quality of management. The strength of member support is then incorporated to yield a rating range. For more information please see our Supranational Rating Methodology.

FACTOR 1: Capital adequacy score: a2

EIF’s capital adequacy score of “a2” combines high leverage (development-related assets/usable equity) and excellent asset quality and performance. In contrast to most rated MDBs, the EIF does not extend loans but has a large off-balance sheet (“own-risk”) guarantee exposure of €10.9 billion as of year-end 2021, which we incorporate into our credit analysis and key ratios. The EIF also has an unusual combination of large but relatively low-risk guarantee exposures with a portfolio of inherently high-risk private equity funds, including venture capital investments.

High leverage mitigated by large share of mandate business and absence of debt

The EIF’s leverage ratio assesses the available capital buffer relative to the entity’s development assets (including liquid assets rated A3 and lower). At 339% as of end-2021 the ratio is still high, but has declined slightly from 348% in 2020 (Exhibit 3). Due to the capital increase it has decreased significantly from 597% in 2019, a peak that was reached because of rapid business expansion between 2014 and 2019 linked to the EU’s multi-year strategic investment programme, the European Fund for Strategic Investments (EFSI).

Prior to the coronavirus pandemic the EIF had planned to stabilise business volumes at around €10 billion per year in 2020-22, but revisions to the corporate operation plan (COP), reflecting the EIF’s participation in the crisis response, resulted in much higher volumes in 2020-21. The latest COP projects business volumes of €10.1 billion per year on average for 2022-24.

Exhibit 3

Leverage remained broadly stable in 2021, much lower than the 2019 peak

€ million and in %

Risks are mitigated by the fact that the vast majority of EIF’s business is done under mandate from and at the risk of either the EIB, the EU or individual member states. For instance, in 2021, out of €30.5 billion in total signatures, almost €30 billion were done under mandate, and the share was 60% in 2019 and 85% in 2020. In addition, the absence of debt means that EIF’s usable equity is entirely available to absorb losses from business activities and the EIF’s predominant guarantee business has an inherently lower risk profile than extending loans.

Most Aaa-rated MDBs are able to carry much higher leverage than their lower-rated peers because of the strength of their other core credit metrics, and elevated leverage is common among highly-rated MDBs (Exhibit 4). Moreover, the EIF’s rising leverage between 2015 and 2019 was a clear indication of the EIF’s relevance to and success in achieving the EU’s policy goals – in this case to channel financial resources to SMEs in the EU member states.
Elevated leverage is fairly common among highly-rated MDBs

Leverage ratio: Development-related assets and liquid assets rated A3 and lower over usable equity (2021)

Note: Aaa-rated MDBs appear in green, Aa-rated ones in blue

Source: Respective MDBs’ financial statements and Moody’s Investors Service

The EIF’s statutes limit the size of the guarantee and securitisation (G&S) portfolio to five times the amount of subscribed capital, which implies a headroom of €25.6 billion at the end of 2021. Similarly, own-risk PE commitments are subject to a statutory ceiling of 100% of own funds (defined as shareholders’ equity minus the fair value reserve) or almost €4 billion as of year-end 2021.1

The board also limits the risk appetite (including treasury assets, operational risks and other assets besides the core assets) to 100% of the EIF’s own funds. As of year-end 2021, economic capital consumption stood at 51% of own funds.

Very strong development asset credit quality

Our assessment of the EIF’s development asset credit quality at “aa” focuses mostly on the entity’s guarantee portfolio, which accounts for over 85% of the own-risk exposure. Riskier equity investments are a small share of the EIF’s total exposure. The guarantee portfolio has a high credit quality in itself and benefits from credit protections provided by the EU (Exhibit 5). Portfolio diversification, for both the guarantee portfolio and private equity investments, is a further strength. The top-10 exposures accounted for around 27% of EIF’s own-risk guarantee portfolio and 43% of the own risk equity portfolio2 at the end of 2021. For both combined, the concentration was 23.6% in 2021, down from 45.8% in 2020.

Over 96% of the EIF’s guarantee commitments were rated in the A-category or above in 2021

EIF’s own-risk guarantee portfolio exposure by retained rating, % share

*Non-investment grade: Ba1-C, NR: not rated.

Source: EIF and Moody’s Investors Service
The key ratio we consider to assess asset performance is the level of non-performing assets, which we score at “aaa”. The EIF has a long track record of very strong asset quality, reflecting solid governance and prudent risk management. There have been very limited calls on guarantees and impairments on the equity portfolio in recent years. In 2021, calls on guarantees amounted to €214,000, which is insignificant compared with the size of development-related assets. Even at their peak in 2015-2016, non-performing assets accounted for just 1.3% of disbursed development-related assets.²

**FACTOR 2: Liquidity and funding score: aaa**

We consider the EIF’s liquidity and funding position to be very strong and score it at “aaa” on both of the key indicators that we consider. We also take into account that the EIF has no debt outstanding and hence does not face any refinancing risks. It also has good visibility over its cash flow needs, given that it pays out on called guarantees according to the original schedule of payments (non-acceleration clause), such that payments are distributed over several years. The EIF also potentially has access to the ECB’s refinancing operations via the EIB.

**Large liquid resources**

The EIF has a large treasury portfolio at its disposal which stood at €2.7 billion at the end of 2021, up from €1.4 billion in 2020. We consider only highly liquid assets such as cash and short-term bank deposits, as well as securities rated A2 or higher, because we believe only those would be available in a stress scenario at short notice and with minimal loss.³

The EIB manages the EIF’s long-term liquidity portfolio (€2.2 billion at end-2021), while the EIF directly holds and manages its cash and short-term treasury assets (€382 million, consisting of short-term deposits of €198 million and overnight cash balances at banks of €184 million) for meeting its operational liquidity needs. There is no currency risk in the EIF’s treasury portfolio, as all of the assets are invested in euro-denominated securities. The treasury portfolio is also well diversified across countries and sectors.

We consider the size of the available liquid assets relative to cash outflows in a stressed scenario over the coming 18 months, in which the MDB has no access to markets but continues its normal business operations. Because the EIF has no debt outstanding, we simulate a stress scenario by assuming guarantee calls at the peak historic level, while noting that the EIF would have several years to pay out under the guarantees, given the non-acceleration clauses in its guarantee contracts.

**No debt outstanding and no issuance planned, but market access would likely be solid**

We also score the EIF at “aaa” on our second key liquidity indicator, the quality and structure of funding. Given the EIF’s lack of any debt outstanding and no plans to borrow, judging the EIF’s potential breadth and depth of market access is a theoretical exercise. However, we view the EIF’s very high liquidity position, as well as the strength and track record of support from its key shareholders, as ensuring that it would have solid market access. In addition, the EIB’s long-standing role as anchor shareholder gives us comfort that the EIB would provide liquidity in the unlikely event it was ever needed.

A further positive feature is that the EIF would potentially have access to the ECB’s liquidity operations via the EIB, given that the EIB already manages the largest part of the EIF’s treasury portfolio. We factor in this potential access (it has never been tested) by applying an upward adjustment to the EIF’s liquidity score.

**Qualitative adjustments to intrinsic financial strength**

**Operating environment**

We do not make any adjustment for the operating environment. The EIF mainly operates in EU countries. While the coronavirus pandemic triggered an unprecedented recession in the region, we expect the support measures put in place by national governments and European institutions to keep the supply-side of the economies largely intact. In addition, the EIF’s business model has proved resilient to a temporary deterioration in its operating environment.

**Quality of management**

The EIF’s risk management policies are prudent and robust, and its governance principles are of a high standard, as we would expect from a highly rated entity. The risk management department is involved at an early stage in the origination of transactions, and it monitors the performance of existing transactions and the portfolio as a whole on a quarterly basis.
FACTOR 3: Strength of member support score: Very High
We assess the strength of the EIF’s member support as “Very High”, which provides a +3 notch uplift from its intrinsic financial profile of "aa2". The assessment reflects the shareholders’ strong ability and willingness to support the EIF, as evidenced by the 2021 capital increase and extension of the EIF’s mandate, among other features. In addition, the EIB has granted a put option to financial institutions that want to exit their shareholdings at a predetermined price. The EIF and EIB together form the EIB Group, with the EIF’s financial accounts consolidated into the Group’s accounts. Aaa-rated shareholders account for more than 90% of the EIF’s subscribed capital.

Very strong shareholder ability to provide support
Our assessment of the ability to provide support is based on the weighted average shareholder rating; in the case of the EIF this stands at Aa1, one of the highest in our rated MDB universe. The EIB is the EIF’s largest shareholder, with a share of 59.4% of the EIF’s authorised capital of €7.37 billion, followed by the EU, represented by the European Commission with a share of 30%, and 38 public and private financial institutions from the EU, the United Kingdom (UK, Aa3 stable) and Turkey (B2 negative), with a total share of 10.6%.

Large callable capital buffer, strong capital call mechanism and non-contractual commitment by shareholders
Our score for EIF shareholders’ contractual willingness to provide support is “baa1”. This reflects the size of the callable capital buffer relative to the EIF’s asset base and also takes into account the put option offered by the EIB to any private financial institution shareholders should they wish to exit the EIF.

The EIB offers to buy back the shares at a predetermined price, and has done so repeatedly in the past. This Replacement Share Purchase Undertaking (RSPU) has been maintained, also for new shares, for financial institutions shareholders following the 2021 capital increase. The RSPU has been terminated with the EC, reflecting the EC’s strong commitment to support the EIF.

In addition, the EIF statutes have an EU law statute, superseding national law and hence providing a stronger-than-usual legal basis for the capital call mechanism. The mechanism to call capital is robust and transparent; a capital call has to be honoured within 90 days.

Beyond callable capital we consider the shareholders’ (non-contractual) willingness to provide support to be very high, given the EIF’s importance for and expertise in financing SMEs in Europe. The EIF’s participation in the EU response to the coronavirus crisis further demonstrates the importance of its mandate for its shareholders.
ESG considerations

European Investment Fund’s ESG Credit Impact Score is Positive CIS-1

Exhibit 6

ESG Credit Impact Score

CIS-1
Positive

For an issuer scored CIS-1 (Positive), its ESG attributes are overall considered as having a positive impact on the rating. The overall positive influence from its ESG attributes on the rating is material.

Source: Moody’s Investors Service

The EIF’s credit impact score is positive (CIS-1), reflecting very limited environmental and social risks and a very strong governance framework. In addition, very strong backing by shareholders provides material support to the rating.

Exhibit 7

ESG Issuer Profile Scores

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<th>ESG Category</th>
<th>Score</th>
<th>Description</th>
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<tbody>
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<td>Environmental</td>
<td>E-2</td>
<td>Neutral-to-Low</td>
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<tr>
<td>Social</td>
<td>S-2</td>
<td>Neutral-to-Low</td>
</tr>
<tr>
<td>Governance</td>
<td>G-1</td>
<td>Positive</td>
</tr>
</tbody>
</table>

Source: Moody’s Investors Service

Environmental
The EIF’s environmental issuer profile score is neutral-to-low (E-2). The Fund exhibits neutral-to-low exposure to environmental risks across all five categories given that its projects are mainly in European countries that face limited environmental risks. As part of the EIB Group, the EIF also plays a role in EU climate policies: for instance Climate & Infrastructure Funds were transferred to EIF from EIB in early 2021.

Social
The EIF’s social issuer profile score is neutral-to-low (S-2), benefitting from strengths in responsible production, and showing neutral-to-low exposure to all other areas of social risk. Being a key financial vehicle to advance the development and growth of small and medium-sized enterprises (SME) across Europe the EIF provides products that support sustainable development.

Governance
The EIF’s governance issuer profile score is positive (G-1). The entity has a very strong governance profile, benefitting from being part of the EIB Group. This is underpinned by its strong risk management and high quality of management, which is reflected in superior asset performance and profitability throughout most of its history. The risk management department is involved at an early stage in the origination of transactions, and it monitors the performance of existing transactions and the portfolio as a whole on a quarterly basis.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.
All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks. Additional information about our rating approach is provided in our Supranational Rating Methodology.

Recent developments

Exceptionally strong financial performance in 2021, unlikely to be repeated

The EIF has been consistently profitable since its inception, except in 2009 and 2011 when it had small losses. Financial performance in 2021 was exceptionally strong (Exhibit 8): Net income was €564.4 million, double the 2019 results, more than four times the 2020 results, and more than five times higher than the COP target of €100 million. Strong results were mainly driven by significantly higher revenues (€771.8 million, up from €328 million in 2020), mainly as a result of changes in fair value equity operations, and also higher management fee income. Total expense (€172.5 million) increased by only slightly more than €10 million from 2020, and stayed below the €193 million outlined in the COP.

Exhibit 8

Financial performance was very strong in 2021

€ million

Source: EIF and Moody’s Investors Service

Return on equity increased to 19% from 6.5% in 2020, and the EIF’s operating margin reached 41% (up from 29%). Following no dividend distributions in 2020 and 2021, reflecting the EIF’s voluntary application of European Central Bank guidance, dividend payments of 10% of net operating income were resumed in 2022.

Negligible direct exposure to the military conflict in Ukraine

The EIF has total signed exposure of €106.5 million in Ukraine (Caa3 negative), Russia and Belarus (Ca negative). The largest portion is in Ukraine which accounts for 87.7%, followed by Russia (10.8%), and only 1.5% in Belarus. However, the actual outstanding exposure is only €25.7 million, with €24.7 million in Ukraine, and of which €24 million is covered by guarantees. The EIF has much larger signed exposure of €5.1 billion in “neighborhood” countries in Central and Eastern Europe, out of which actual EIF exposure is only €2.2 billion, and similarly to the exposure to Ukraine almost 100% of it is covered by guarantees. The EIF does not have any direct exposure through its treasury portfolio, but is subject to market impact through rising yields.

Corporate plan for 2022-24: InvestEU as key priority

Together with the EIB, the EIF will manage 75% of InvestEU. Most of the impact on business activity will materialise from H2 2022 onwards. Total business volumes expected to normalise again (towards €10-11 billion per year, Exhibit 9). Revenues expected to decline to €357 million in 2022 (back to normal) and grow in 2023 (€397 million) and 2024 (€416 million). Expenses to grow, mainly driven by digitalization initiative in 2023 and 2024, leading to net income of around €110 million to €135 million, RoE in the 3% area.
As part of InvestEU, the EU will provide a guarantee of €26 billion to mobilise total investments of around €400 billion, with the EIB Group (EIB and EIF) responsible for 75% of the total. According to the COP 2021-2023, the EIF is assumed to manage around 60% of the amounts allocated to the EIB Group, although the share may evolve over time.

**Credit line with EIB introduces debt element to EIF’s balance sheet**

One new feature in the context of InvestEU will be a €8.2 billion funding line from the EIB in the form of an intra-group loan. The funding agreement is defined in a tri-partite agreement between EC, EIB, and EIF. Funds borrowed from the EIB can only be used for EIF’s InvestEU operations. Ultimately, any debt service payments from EIF to EIB will be covered by the EU guarantee and made by the EC.
## Rating methodology and scorecard factors

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<th>Adjusted score</th>
<th>Assigned score</th>
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<td>Capital position (20%)</td>
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<td>Impact of profit and loss on leverage</td>
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<td>Development asset credit quality (10%)</td>
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<td>Non-performing assets</td>
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<td>Trend</td>
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<td>Excessive development asset growth</td>
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<td>Liquid resources (10%)</td>
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<td>Quality of management</td>
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<td>Adjusted intrinsic financial strength</td>
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<td><strong>Factor 3: Strength of member support (+3,+2,+1,0)</strong></td>
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<td>Ability to support - weighted average shareholder rating (50%)</td>
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<td>Willingness to support (50%)</td>
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<td>Contractual support (25%)</td>
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<td>Strong enforcement mechanism</td>
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<td><strong>Scorecard-Indicated Outcome Range</strong></td>
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<tr>
<td>Rating Assigned</td>
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Note: Our ratings are forward-looking and reflect our expectations for future financial and operating performance. However, historical results are helpful in understanding patterns and trends of an issuer’s performance as well as for peer comparisons. Additional considerations that may not be captured when historical metrics are used in the scorecard may be reflected in differences between the adjusted and assigned factor scores. Furthermore, in our ratings we often incorporate directional views of risks and mitigants in a qualitative way. For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

Source: Moody’s Investors Service
Moody’s related publications

» **Outlook:** Multilateral Development Banks – Global: 2022 outlook is stable given resilience to challenging economic and financial conditions in emerging markets, 31 January 2022

» **Sector In-Depth:** Multilateral Development Banks – Global: ESG credit impact is neutral for most, positive for many MDBs, 18 January 2022

» **Rating Methodology:** Multilateral Development Banks and Other Supranational Entities, 28 October 2020

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Related websites and information sources

» **Moody’s Supranational web page**

» **Moody’s Sovereign and supranational rating list**

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Endnotes

1 These limits had been raised in past years. In 2020, the board had raised the statutory limits in 2020, to five times the amount of subscribed capital from three times for the G&S portfolio, and to 100% of owned funds for the PE portfolio, from 70% previously. The limit for PE investments had already been raised from 50% in 2017, to reflect the increasing focus on the PE business.

2 For the equity concentration we use net drawn commitments excluding conditional commitments, at current exchange rates.

3 For the calculation of this ratio, we only consider drawn guarantees, instead of total committed guarantees, as part of the denominator.

4 More precisely, we include cash and cash equivalents, deposits with a term of less than one year held at financial institutions rated Baa3 or higher, treasury assets rated A2 or higher, and committed, unrestricted and undrawn credit lines with prime lenders with a maturity greater than two years in our calculation.
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