Council of the
European Union

Brussels, 28 January 2015
(OR. en)

DS 1073/15

Interinstitutional File:
2015/0009

LIMITE

MEETING DOCUMENT

From:	General Secretariat of the Council
To:	Ad Hoc Working Party on EFSI
Subject:	Commission Services Non-Paper on remuneration and cost coverage under the proposed EFSI Regulation Numerical Example - Waterfall Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the European Fund for Strategic Investments and amending Regulations (EU) No 1291/2013 and (EU) No 1316/201

Delegations will find attached the above non-paper.

Commission Services Non-Paper

Remuneration and cost coverage under the proposed EFSI Regulation

Numerical Example - Waterfall

This note complements the note previously distributed by the Commission on remuneration and cost coverage by providing an illustrative example of remuneration and potential losses under an individual operations and an associated numerical example showing the waterfall of revenues and costs.

Under the Infrastructure and Innovation Debt window (IIDW), which, as indicated in the separate note on "*Risk calibration of the EU guarantee under EFSI*", is expected to be the largest window under EFSI, the EU guarantee will be provided to the EIB as an on demand guarantee on a portfolio basis. The EU guarantee will cover the first loss piece of a portfolio of projects whereas the EIB will bear the residual risk. Preliminary assumptions indicate that the EU guarantee will provide an €11bn first loss guarantee which would represent around 25% of the size of the overall portfolio. This portfolio approach has implications for the remuneration of the EU guarantee and on the waterfall associated to costs and revenues impacting the EU Guarantee[1].

The numbers in this note are illustrative and have, in some cases, been exaggerated for clarity purposes. The note also takes a number of simplifying assumptions (one year loan duration, bullet loan, simple interest, interest paid every 6 months and ignoring interest from other projects) to provide an explanatory example.

<u>Example One – How an individual operation functions</u>

The EIB, with support of the EFSI, invests in a project building a toll-bridge between Member State A and Member State B. The EIB grants a subordinated bullet loan to the project, which enables the project to attract sufficient private sector investment at senior level to fully finance the project.

The loan is a one-year subordinated bullet loan, with principal of €100mn and an annual interest rate of 5%. The 5% interest rate is made up of 1% administrative mark-up, 1.5% funding costs and 2.5% for risk. The interest is to be charged on a simple interest basis every 6 months.

[1] The Infrastructure and Innovation Equity Window is expected to be carried out on a *pari passu* basis between the EU and the EIB at the level of each individual operation. The risk-revenue mechanism is thus rather straightforward and is not treated in this note.

Remuneration of the EIB loan

The project is successful and repays the EIB in full.

The EIB receives the full amount including interest. The EIB retains the amounts due to it, i.e. the administrative mark-up (€1mn) and funding costs (€1.5mn), whilst the risk related amount (€2.5mn) is identified and allocated, alongside remuneration stemming from other operations, between the risk-taking parties in proportion with their respective risk share over that portfolio.

Assuming for simplicity that the EU €11bn guarantee would be the only first loss piece provider, the risk related remuneration would then be shared only between the EU and the EIB. The precise level of risk-remuneration sharing will depend on the risk profile and the size of the portfolio and on the corresponding amount of the first loss piece at any point in time. We assume for this illustrative example that when the EIB receives the interest (including the risk related spread), the risk associated to the first loss piece covered by the EU Guarantee would amount to 70% of the overall risk whereas the residual risk borne by the EIB would amount to 30%.

As the operation generated €2.5mn of risk related revenue, €1.75mn (70% of €2.5mn) will be provided to the EU in remuneration for the guarantee and €0.75mn (30% of €2.5mn) will be provided to the EIB in remuneration for its risk share.

Call of the EU Guarantee

The project is unsuccessful and collapses in full after 6 months. The EIB attempts to recover the amounts and receives nothing. The interest due at the point of collapse was €2.5mn (€0.5mn administrative fees, €0.75mn funding costs and €1.25mn for risk).

The EIB will register the associated losses within the portfolio covered by the EU guarantee. The associated losses that can be covered by the EU guarantee are the outstanding principal (€100mn), and all interest due by the borrower up until the point of default[2] (€2.5mn).

Assuming that all other outstanding operations under the EFSI portfolio perform correctly, the EIB would be entitled to call as an on demand guarantee an amount of €102.5mn, to the extent that there is still sufficient room under the EU guarantee initially set at €11bn.

According to the proposed Regulation, the EU guarantee may also be called by the EIB to cover the expenses of the project that should have been charged to the beneficiary but have not been and are not recoverable (up to the €2.5mn interest that the borrower would have paid in the final 6 months), as long as the cumulated maximum limit corresponding to 1% of the total outstanding EU guarantee obligations has not been reached.

[2] Although remuneration for risk will be split amongst contributors (and so by registering a claim against the EU guarantee on the project for all interest due, this contains the risk element of the pricing that may be due to the Union), the split amongst contributors is done at portfolio basis and not on an individual project.

Example Two – How the revenue and losses/costs waterfall functions

In 2017, five projects that the EIB has invested in reach conclusion:

Project	Initial EIB Investment, with EFSI support	Repaid EIB?	Overall Project Revenues	Remuneration/(Losses) due to Union *
Energy Infrastructure - Wind Farm	250,000,000	Yes	290,000,000	25,000,000
Medical Research - Pharmaceuticals	750,000,000	Yes	820,000,000	50,000,000
Construction - Social Housing	150,000,000	Yes	170,000,000	10,000,000
Digital Infrastructure - Broadband Installation	450,000,000	Yes	490,000,000	30,000,000
Transport Infrastructure - Toll Road	30,000,000	No	(32,000,000) **	(32,000,000)
* Illustrative figures only				
** 2,000,000 would have been charged to the project past the point of default				

There is €115mn due to the Union in remuneration for the projects (€25mn + €50mn + €10mn + €30mn). The waterfall on remuneration and costs will dictate how the remuneration and losses which are due to the Union for a given year will be handled:

1. *In a first instance, proceeds from a given year should serve as a buffer against losses of the investment portfolio.*

The €115mn will be reduced by the €32mn losses due to the Union for this year. €83mn remains.

2. *In a second instance, EIB requests for paying EFSI-related costs should be deducted from remaining profits.*

The EIB would have received from the project that collapsed an additional €2mn in costs over the lifetime of the project. The EIB can recover up to this €2mn from the EU guarantee, subject to the absolute cumulative cap of 1% of the total outstanding EU guarantee obligations being respected. As the €2mn is deducted from the remaining €83mn after step 1, €81mn remains.

3. *In the third instance, two types of costs should be deducted from remaining profits as due:*

a. *Costs incurred by the EIB when providing funding to the European Investment Fund (EIF) on the Union's behalf.*
b. *Expenses related to the European investment Advisory Hub (EIAH, up to an amount of €20m per year.*

The Commission proposal has indicated an initial expectation that €5.7mn would be needed by the EIB for providing funding to the EIF on the Union's behalf. Additionally, although the Regulation foresees that "up to a maximum amount of EUR 20 000 000 per year" will be made available for the expenses related to EIAH, this is only for the "additional services" that are provided. It is assumed, for this example, that only €12mn is necessary for the additional services in 2017.

The €81mn remaining from step 2 is reduced by the €17.7mn (€5.7mn for EIF fees and €12mn for EIAH), leaving €63.3mn for the Union. This amount is credited to the EU guarantee fund.