NOTE

From: General Secretariat of the Council
To: Delegations
Subject: Feasibility study on options for strengthening the future European Financial Architecture for Development - final report

Delegations will find attached the second part of the main report (doc. ST 6961/21 ADD 2) of the Feasibility study on options for strengthening the future European financial architecture for development.
Local regional or central government or corporations under state control or benefiting from a state guarantee. The ELM cover for private sector operations is limited to political risk. The remainder of the risk is borne by EIB often with credit enhancements in the form of third-party guarantees. The ELM focus countries include countries in the pre-accession region, Neighbourhood and partnership countries, Asia and Latin America and the Republic of South Africa.

The ELM includes a guarantee ceiling of EUR 32.3 billion with ceilings for various geographic regions and sub-regions as well as programmatic focus areas. ELM guarantees are to be used exclusively for debt instruments. The need for this guarantee stems from the EIB obligation under Article 16 of the EIB Statute to ensure adequate security for all its lending operations outside of the EU and the need to safeguard its creditworthiness in general. Over the past decade, annual average losses (guarantee calls) amounted to 0.13% of total signed exposure under the ELM.

The ELM mandate was expiring on 31 December 2020 but has been extended automatically by six months, as the successor EU instrument has not been adopted yet. A further extension until 31 December 2021 is politically agreed by the EU legislators and the corresponding amendment of the ELM Decision is expected to be proposed. The successor instrument is currently under discussion as part of the MFF/NDICI negotiations.

**Cotonou Agreement**

Under the Cotonou Agreement, an Investment Facility managed by the EIB had been created, the ACP IF, which primarily focused on private sector operations, as well as a guarantee facility referred to as Cotonou Own Resources for predominantly public sector lending in the ACP countries. Financing for the ACP IF was provided from EU Member States’ budgets through the European Development Fund with the ACP IF being an off-balance sheet programme managed by the EIB. It was structured as a revolving fund supporting commercially viable projects in productive sectors with a particular focus on private sector development through credit lines, indirect equity, senior and subordinated loans and guarantees.

The focus of the ACP IF is private sector development with on-lending to MSMEs through financial intermediaries, service sector and infrastructure projects as key sector focus areas. A total endowment of EUR 4.9 billion was approved for the overall IF operations, mainly for private sector operations, of which EUR 3.7 billion were earmarked for investment, while EUR 1.2 billion were earmarked for interest rate subsidies (84%) and technical assistance (14%). EUR 500 million was allocated to the Impact Financing Envelope (IFE) by Member States to focus on riskier activities with significant development impact, which was further increased to EUR 800 million in 2016. In 2017, an Infrastructure Package of EUR 1.5 billion was introduced, structured as a portfolio guarantee mechanism to public sector loans provided with EIB’s own resources but secured by the IF portfolio. Between 2015 and 2019, EUR 3.5 billion were committed under the ACP IF.

Under the Cotonou Own Resources facility, the EIB has provided loans to ACP countries and Overseas Countries and Territories (OCTs) using own resources but relying on a comprehensive 75% EU Member State portfolio guarantee for public sector loans with a ceiling of EUR 2.6 billion, predominantly for infrastructure finance. Under this programme, USD 2.5 billion were committed between 2015 and 2019, 97% of which to public sector entities.

The ACP IF’s duration was ending with the end of the Cotonou Agreement in the end of 2020, but an extension has been agreed by the parties and a transfer of the IF reflows to NDICI has been agreed by the Member States.

What would be the level of reliance of each option on external enablers (including donor resources), in particular in support of policy engagement, technical assistance and blending?

The EBRD expects its use of support by external enablers to increase in the event of an expansion to LDCs and fragile states. While the division of labour to execute policy engagement, technical assistance and blending is less clear for the EIB under a potential Scenario B at this stage, the required reliance is expected to be in a similar range as in Scenario A.

The reliance of each option on external enablers to provide grant funding for policy engagement, technical assistance and blending is dependent on the ambition of the EU and Member States in each of the scenarios, the kind of support that is offered, the specific geographies, a potential future division of labour as well as potential contributions to fund activities through the Bank’s surplus. The below outlines the expected need for additional grant support from external sources, which include, but are not limited to, EU and Member State contributions. It is key to note, that in Scenario A, B and C, the Banks will also leverage on the work
conducted by other MDBs, DFIs and donors already active in target markets seeking collaboration and coordination of efforts to increase efficiency and effectiveness in policy engagement activities, but also when it comes to providing technical assistance and blending.

Table 2: External support

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<thead>
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<th>Scenario A</th>
<th>Scenario B</th>
<th>Scenario C</th>
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<tbody>
<tr>
<td>EUR billion</td>
<td>EBRD</td>
<td>EIB</td>
<td>EBRD</td>
</tr>
<tr>
<td>Cost Estimate</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>External Support</td>
<td>8-12%</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>required in % of</td>
<td></td>
<td></td>
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<tr>
<td>annual investment</td>
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</tbody>
</table>

Source: Study team estimates and assumptions, based on EIB and EBRD data

A Future Situation

The combination of policy engagement, technical assistance, blending as well as traditional investment instruments is at the core of EBRD’s business model to drive transition in countries, but is financed via a combination of internal and external resources. From 2016 to 2019, funding from donors to the EBRD represented 6% of annual investment. However, when expanding further into SSA, Latin America and Asia, the need for donor resources will increase. As experience from other actors active in these regions have shown, the lower level of development of many countries does necessitate additional policy engagement with governments as well as technical assistance and blending to develop bankable transactions. Internal EBRD estimates suggest the need for external support through donor funding could be up to 12% of ABI for activities in small and fragile countries where business potential is constrained, could be around 10% of ABI for activities in countries of medium size and countries with stronger economic fundamentals and business environment with moderate business potential and might be around 8% of ABI for activities in larger countries and more sophisticated economies with high business potential.

B Future Situation

The EIB is mainly indirectly involved in policy engagement by contributing with advice during the programming activities and liaising with EU Delegations. Collaborations with the EC on policy dialogue have to date been on an ad hoc basis. The EIB does provide technical assistance and blending to specific transactions to facilitate the bankability of projects. In 2019, the funding for technical assistance and blending represents 5% of annual signature value.

In Scenario B, the EIB highlights that the scale of additional funding needs depends on future mandates allocated by the EU and its Member States to the EIB (including sector focus, transaction focus, specific geographical focus) and whether the EU and EU Delegations will take on (additional) responsibilities in the context of policy engagement or the EIB itself will play a more prominent role than they current do. However, independent of the distribution of labour (i.e. whether additional resources will be needed for activities of the EC, the EIB or any other organisation), it is expected that additional activities in less developed countries under Scenario B – or C (please see below) – will require more direct, on the ground support for policy makers, regulators, project sponsors and investees in order to achieve development impact. This is particularly the case if private sector activities are expanded in these geographies, in which case reliance on grant funding is expected to be at a similar level as outlined in Scenario A, i.e., between 8% and 12%. This is supported by the fact that about 37% of grants committed to projects by the EIB in 2019 went to SSA states, the largest regional portion.

C Future Situation

In Scenario C, the EU’s approach of an ‘open and inclusive architecture’ is expected to be given even greater primacy ensuring that external enabler funds are applied to the institutions most capable of executing in target contexts (e.g. sector or geography), which may include institutions other than the EBRD and the EIB, such as European NDBs or other multilateral organisations, each contributing to a holistic system of a wider range of actors with the same goal in mind. A targeted use of funds by organisations that already experts in their field has the potential to increase their effectiveness. However, this is not going to change the ultimate contribution of external enablers that is needed in new target regions and sectors.
2.2.2. Capital Requirements

What are the implications, including a cost estimate, capital needs as well as staffing implications, both at HQ and regional level, of widening the EBRD/EIB’s operations to in SSA, LDCs and fragile states? This should be based on the banks’ current lending/financing strategy and allocations and differentiate between private and public sector operations.

What would be the costs of setting up the appropriate structures as well as their prospective annual costs, and could these be covered by the banks? In particular, what would be the cost associated with scaling up local presence and acquiring the necessary expertise to match the development, policy, and operational requirements of the new entity?

When comparing costs, it must be noted that the business models of both Banks are different. The annual costs for EBRD to expand into SSA, LDCs and fragile states globally are estimated to be 2.6% of annual investment at steady state with EUR -40 million as setup costs. During the expansion phase the costs are estimated to decline from 3.4% initially to 2.6% of annual investment at steady state. Based on their current business model outside the EU, EIB’s cost are estimated to be 3.5% of annual investment at current steady state with setup costs assumed to be included.72 However, as the EIB sees its model evolving with more local staff under Scenario B, costs could decrease to 2.6% of annual investment at steady state in the future.

As Q. 22 and 23 are related, the answer has been combined. It is key to highlight that the current operations and capital allocations of the EIB and the EBRD differ in strategy, approach, and implementation and while both Banks often aim for similar overall goals, they do, to a large extent, serve different parts of the market. While the EIB follows a centralised business model focused on larger sized transactions, the EBRD deploys a decentralised approach with a wide range of local offices and expertise based on the ground. As such, while the below cost estimates are comparable, they should be seen in the context of these different approaches. All cost estimates are based on rationalised estimates provided by the Banks. Actual investment volumes and projections for annual investment depend on numerous factors, which are still to be determined, including decisions by the EU and its Member States about the structure and ambition going forward. At the same time, costs of both organisations are closely linked to the amount of capital committed. Consequently, cost estimates are expressed in relation to the annual investment volume committed. Lastly, it is key to highlight that the figures presented in this answer are based on high-level and very preliminary estimates and will have to be modelled in detail after additional political decisions have been taken.73 As such, the estimates are therefore provided for illustrative purposes only.

When setting up offices in either of the scenarios it should be kept in mind that the countries of SSA, LDCs and fragile states present some specific challenges which have a direct impact on the operating costs, and which are potentially higher than in other regions, e.g. in MENA.74 The elements explored in this answer refer only to the costs related an expansion at HQ and for opening and running country offices in SSA, LDCs and fragile states. They do not include other costs that would arise, e.g. potential capital increase, guarantees for risk coverage or potential transformation of the internal risk management system.

Table 3: Summary Cost Estimates for the three Scenarios

<table>
<thead>
<tr>
<th>Scenario A</th>
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<th>Scenario C</th>
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<tbody>
<tr>
<td>EBRD</td>
<td>EIB</td>
<td>EBRD</td>
</tr>
<tr>
<td><strong>Set up Cost in EUR</strong></td>
<td>0.0475</td>
<td>-</td>
</tr>
<tr>
<td><strong>Operational Cost in % of annual investment in SSA, fragile states and LDCs</strong></td>
<td>2.6% in steady state. During expansion: Decline from 3.4% initially to 2.6%</td>
<td>Not estimated</td>
</tr>
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</table>

Source: Study team estimates and assumptions, based on EIB and EBRD data
In Scenario A, the EBRD would pursue an incremental approach for an expansion of its business model into SSA, LDCs and fragile states over the next decade. The costs presented would grow proportionally with annual investment. For Scenario A, the EBRD costs are expected to be 2.6% of annual investment at steady state after the completion of the expansion into the new geographic focus areas. During the expansion costs are estimated to decline from 3.4% to 2.6% of annual investment at steady state.

The EBRD anticipates the annual investment per Full Time Equivalent (FTE) to increase from EUR 6.6 million in the first ‘wave’ of expansion to EUR 8.7 million per FTE annually at steady state. This figure will increase over time, as the Bank is likely to conduct larger scale sovereign activities as they are today and improve efficiency as the organisation scales in the new geographies. At steady state, of all staff, 31% would be based in its HQs, while 69% would be regional and local staff. As the EBRD does not specifically allocate staff to public or private sector operations, a differentiation is this regard is not possible. A specific allocation of the FTE per subject area is also not included in this high-level estimate. However, the staff cost estimate does include the specific expertise required for the expansion. The Bank estimates its annual staff average costs to be EUR 155 thousand per FTE at steady state, which is in line with cost of bilateral European development banks that averages EUR 150 thousand.

In addition, set up costs for local and regional offices across SSA, LDCs and fragile states are estimated to be EUR 10 million per ‘wave’ of expansion with a total of four ‘waves’ to 60 countries used as based for the total set up cost estimate. As the EBRD has to date established its own offices, this estimate assumes that the Bank would continue to open their own offices instead of seeking to co-locate with existing EU Delegations or other DFIs. If office space could be shared, set up costs and overall running expenses would be reduced. The EBRD confirmed that it could support a first ‘wave’ of expansion to SSA with both capital and budgetary resources. While detailed modelling of the costs is still outstanding, it also confirmed the likely expectation of the EBRD shareholders for the Bank to finance additional expansions from its own income, which is expected to increase as with additional business in the new geographies.

Table 9 in Annex 5, Volume II outlines an illustrative example of this Scenario at steady state based on an annual investment volume of EUR 14.4 billion, double the average 2019 annual investment of the EIB and the EBRD outside of the EU.

In Scenario B, the EIB would pursue an expansion based on their existing presence in SSA, LDCs and fragile states, which currently largely serve a representative function. While the EIB would increase its local presence, it would still hold on to its current HQ centric business structure, which would be decentralised over time. As in Scenario A, the costs presented will grow in line with annual investment.

For Scenario B, a total cost of 3.5% of annual investment is estimated based on their existing business model outside the EU. The new entity would invest EUR 8.65 million per FTE annually. Of all staff, 83% would be expected to be based in the HQ and 13% based locally. The average annual staff costs are currently approximately EUR 219 thousand, which reflects a high percentage of Luxembourg-based staff. The EIB anticipates that the cost of establishing new offices will be covered by the administrative overhead as part of the total staff and non-staff costs associated with outside EU investment referred to above. The EIB is not expecting substantial establishment costs, as it is planning to propose to expand on their already existing presence in EU Delegations. Table 10 in Annex 5, Volume II outlines an illustrative example of this Scenario based on an annual investment volume of EUR 14.4 billion, double the average 2019 investment of EIB and EBRD outside of the EU.

The estimates above are based on the current operating model of EIB. However, under Scenario B, EIB anticipates increasing the proportion of local staff to 80% with 20% of staff being HQ based. With costs for local, non-international staff assumed to be lower, EIB would end up with an average staff cost close to the European DFI average (EUR 150 thousand) and lead to a cost of 2.6% of annual investment at steady state in the future. With the further expansion into SSA, LDCs and fragile states, given the EIB’s current average ticket size, the average annual investment per FTE is likely to decrease due to increased time spent on individual transactions and lower average ticket sizes in these regions. Table 11 in Annex 5, Volume II outlines an illustrative example of this Scenario based on an annual investment volume of EUR 14.4 billion, double the average 2019 annual investment of EIB outside of the EU.

The EIB expects that it would be able to cover the costs for an expansion under Scenario B without any negative impact on the Bank’s long-term net surplus.
**Future Situation**

In line with the principle of a strong and coherent approach, Scenario C would see both Banks as actors in an enhanced EFAD, building on the strength of all actors in the system. Consequently, while EBRD could still expand into SSA, LDCs and fragile states and the EIB increase its activities outside the EU, they would do so in a more focussed way in their areas of strength. This would likely occur at a slower pace in terms of annual investments for each institution, however, the cumulative disbursements have the potential to exceed Scenario A and B. The EU could focus its financial resources on actors within the EFAD making use of their specific technical and/or regional comparative advantages, and this with an incremental participation from all European NDBs and other MDBs, in which Europe is a shareholder. Scenario A and B, in contrast implies that the two Banks would need to develop expertise in areas where they are currently less strong than other parties.

The cost estimate for Scenario C would remain the same in terms of cost as a percentage of annual investment for both Banks, as their organisation costs and ability to execute transactions would not change. The EBRD’s costs of expansion would be reduced under Scenario C, budgeted at EUR 1.47 million.56

**24** What would be the underlying costs to increase EU shares to a controlling majority?

An increase in EU-related shareholding at the EBRD can only be achieved in one of two ways, either some non-EU shareholders are willing to sell their shares or a capital increase is executed in which only the EIB, the EU and its Member States participate. The book value cost of a share purchase is currently, EUR 4.6 billion to increase EU interest to 80% and EUR 8.1 billion to increase it to a 99.18%. To reach 80% by increasing the capital of EBRD, the EU would need to inject EUR 24.3 billion with no other shareholders subscribing. In each case, the AEB would have to be suspended or modified, and the costs are likely to be higher than those quoted.

**A Future Situation**

Full response in Q. 1 above.

**25** What would be the costs and financial risks of transferring a portfolio of operations from one institution to another? How would this portfolio fit into the recipient’s pricing and risk strategy?

The cost of the transfer of portfolio cannot be accurately defined. All stakeholders unanimously agreed that a transfer is not necessary and even if possible, it would take years to complete. In Scenario A, key barriers are challenges around (1) transfer of EU/ Member States guarantees, (2) transfer pricing and (3) integration considerations. In Scenario B, aside from the key questions around the leverage of the EU to demand a transfer from the EBRD to the EIB, the EIB would be unable to accommodate a predominantly sub-investment grade portfolio without EU or member state guarantees with provisioning of up to 50% of net asset value of the transfer. This would be prohibitively expensive for the EU with little benefit to the EIB.77

The full costs of transferring the portfolios from one institution to another cannot be accurately defined. It could be argued that if either institution were instructed to proceed with a transfer, the execution costs would be internal and therefore not a cost to the EU. However, it cannot be overstated how much work this would require with substantial scaling up of the legal teams within each organisation that would have a direct and substantial costs, if even possible. More likely both Banks would have to rely on substantial external support which would not be costless.

There was unanimous agreement among all stakeholders interviewed that a transfer is not necessary and if even possible, would take years to complete. As Figure 1 and Figure 2 in Annex 5, Volume II illustrate, 61% of the external disbursed portfolio of the EIB and 72% of the EBRD portfolio69 mature by the end of 2027 further strengthening the argument for allowing the portfolios to naturally roll-off.90

A transfer will require the practical consideration of executing the legal components of the transfer. All facilities will have different and bespoke conditions relating to transfer, which will need to assessed loan by loan and addressed. At a minimum this will require securing consents from the borrower and any co-lenders or guarantors, but frequently in the case of sovereign loans, this will also require consent of their national parliaments. But aside from the extraordinary but ultimately executable legal challenge there are additional issues, which will need to be taken into consideration.

**Transition Process**

In Scenario A, the transfer of the EIB’s non-EU portfolio to the EBRD will raise three main complications:
(1) **Transfer of EU Guarantees**

In 2019, more than 80% of the EIB’s operations outside the EU were executed under mandates with the support of EU or Member State guarantee. This will require a review of every such mandate and the necessary amendments determined and executed within the Commission and/or donor countries that have provided the funds or guarantees.

(2) **Valuation of assets and hedge unwind costs**

For the transfer to occur a valuation of every asset will be required. The EIB’s pricing is generally lower than the EBRD’s, as the EIB passes on the full value of the guarantees provided to the borrower. In contrast, the EBRD follows an approach of market pricing its assets. It would not be possible for the EBRD to hold two similar assets from a similar institution with different valuations, hence it is almost certain that the valuation at the EBRD for the transferred assets will be below the valuation currently recorded by the EIB.

The net impact of the transfer would represent a write-down at the EIB which would require a corresponding capital injection from either the EU or the Member States to compensate. To put this in context: if the difference in holding yield was 2% for an asset portfolio with a duration of 5 years, the average transfer price would be 90% of par. For the EIB whose external portfolio in terms of disbursed exposure totals EUR 43 billion this would result in a capital cost of EUR 4.3 billion. In the event that loans do not default, this value will accrue to the EBRD over the life of the transactions and compensation could be repaid to the EIB as loans roll-off. But this would still require an upfront contribution to the balance sheet of the EIB.

This transfer is further complicated by the fact that many facilities will also include derivative transactions hedging either interest rate risk or currency risk. These will need to be unwound with possible new hedges executed by the EBRD in line with its own policies and procedures. However, in most cases there will be either a gain or a loss in that hedge, while the new hedges will be executed at the current prevailing market rates. Without an assessment of the hedge position of every transaction it is impossible to provide an assessment of the final cost, but this will further increase the capital cost of the transfer.

(3) **Integration of assets**

As per Article 3 of the AEB, the EBRD is only permitted to conduct activities in countries which are shareholders of the EBRD. This is more than simply a policy position, by joining the EBRD, the Bank acquires the necessary authorizations to operate, which **inter alia** are critical to guaranteeing the EBRD’s creditor status in the country. In contrast, the EIB operates under a Framework Agreement with each country of operation which is outside the EU. Consequently, any country that wishes to become an EBRD borrower first needs to become a shareholder of the Bank. Becoming a recipient country requires approval by the Board of Governors and requires countries to have passed a political and economic assessment. It is unclear what would happen to EIB assets in any country, which are not accepted as new shareholders of the EBRD. Although, a change of statutes could be introduced, to allow the possibility for the EBRD to operate in non-shareholder countries, this is not foreseen as it would fundamentally change the operating model of the institution.

The AEB also contains a limit on the volume of sovereign lending. While as, among others discussed in Q. 19, this can be accommodated for new borrowing, but the EIB’s non-EU portfolio is more heavily weighted to Sovereign loans. Consideration must therefore be given to the EBRD’s overall portfolio mix, which would become skewed to the sovereign sector in the event of a transfer.

**Transition Process**

A transfer of the EBRD’s non-EU portfolio to the EIB is equally, if not more, challenging than a transfer from the EIB to the EBRD. In addition to the legal and accounting issues highlighted above, it is simply not in the EU’s power to demand such a transfer or that the EBRD cease operations in any country in which they are currently operational. In the event that the EU chooses Scenario B, the leverage of the EU to demand any such action would be further diminished. However, assuming that the political issues regarding such a transfer could be addressed, the EIB would be unable to accommodate a predominantly sub-investment grade portfolio without guarantees from the EU or the EU member states. Depending upon the provisioning rate chosen and the nature of the assets (predominantly private sector), this would require a cash provisioning of up to 50% of the net asset value of the transfer. This would be prohibitively expensive for the EU and yield limited benefit to the EIB.

The Study team notes that under Scenario B it is proposed that the EIB establish a new minority-owned subsidiary. The question therefore arises as to whether the EIB would transfer its current portfolio to its subsidiary. Although the issues would be diminished in the case of a subsidiary transfer if, as proposed in Scenario B, the EIB would be a minority shareholder, many of the same issues as highlighted in Scenario A would arise.
2.2.3. Pricing/ Risk Strategies, Corporate and Capital Structures

In Scenario A, no need is seen for major adjustments to EBRD’s pricing and risk management. In Scenario B, there is potential to adjust the pricing and risk strategy and management more to local contexts deploying more risky instruments with higher development impact. The EIB is currently taking significant risk outside of the EU if covered by a guarantee from EU, Member States or third parties.

The Study team sees no need for major changes in EBRD’s pricing and risk strategies or their management in Scenario A, although greater use of blending may enable the development impact of their financing to increase. The EBRD has active operations in countries across the risk spectrum including less advanced states with credit ratings of similar level of most countries in SSA. The Bank accepts higher credit risk in less developed countries without the need for additional guarantees from shareholders. In its operations, the EBRD is required to “apply sound banking principles to all its operations” and to ensure that all investment activities are “additional” to foster the transition to sustainable markets that meet the EBRD’s transition qualities (competitive, green, inclusive, well-governed, resilient and integrated). The Bank has a framework for managing its capital to secure ongoing financial sustainability, where risk is measured on an individual project basis as well as annually at portfolio level through a bank-wide stress test. It is worth mentioning that the EBRD takes most risk with its own resources, with its non-sovereign portfolio currently rated B+ on average. The EBRD’s capital is managed conservatively to support this higher-risk lending. In addition, at the project level, transactions are structured to mitigate risk and priced at market levels to reflect the level of remaining risk. This combination underpins the EBRD’s triple-A rating without blanket guarantees from shareholders. The EBRD analyses risks, takes it and charges for it in line with the market.

In terms of pricing, the EBRD differentiates between sovereign and private sector activities. For the former, the Bank lends at a margin of 100 basis points over London Interbank Offered Rate (LIBOR) without differentiation based on credit ratings. For the latter, margins are risk-based and in line with commercial practice using risk-adjusted return on capital models considering market conditions to ensure complementarity over crowding out of existing actors. The final pricing is subject to scrutiny within internal risk management, which advises on risk mitigation measures, where appropriate. In case a satisfactory risk-adjusted return cannot be reached within the market price, the EBRD makes use of guarantees or blending using concessional funding from donors or multilateral funds to finance projects with specific policy goals in mind. Due to the EBRD’s very limited experience in LDCs and fragile states to date, in Scenario A there would be a need to expand the Bank’s use of guarantee and blending instruments to able to serve clients in these markets. The Wise Persons’ Report highlights the operating principles of sound banking, market-based pricing, ensuring financial sustainability of projects and additionality as a strength of EBRD and requirement for “a system that delivers.”

There is potential to adjust the pricing and risk strategy and management, which has been acknowledged by the EIB. As outlined in Q. 19, for most operations outside of the EU, the EIB draws on guarantees by the EU, Member States or third parties. Article 17 of the EIB Statute sets out that interest rates and other charges should be based on prevailing capital market conditions and generate an income, which enables the EIB “to meet its obligations, to cover its expenses and risks and to build up a reserve fund.”

The EIB distinguishes between public sector and private sector activities. For the former, pricing depends on (a) EIB funding cost, (b) mark-up to cover EIB expenses and (c) a risk premium related to the operation. (a) and (b) are comparably low, due to the Bank’s AAA rating and its centralised operating model. (c) is contingent on whether the operation is connected to a mandate, where the risk premium is set by the mandates at a comparably low rate. The private sector pricing combines a cost recovery with a modular part, which is added to ensure pricing is adapted to market conditions.

It is important to note that reviews of activities outside the EU and interviewees have highlighted that where explicitly mandated the EIB uses its low funding cost and guarantees to offer favourable lending conditions. This may create tension with other European DFIs that cannot be generalised and requires analysis of each
specific situation. Arguably, if the EU can provide a lower cost of funding to a project that has strong developmental impact, this will be a good outcome. Furthermore, the EIB’s loss rates would imply that the Bank is justified in offering highly competitive terms if the probability of default is low. However, this issue of offering low funding costs was raised multiple times implying that some of the EIB’s peers feel that bank uses its pricing power to undercut the market. However, given the absolute scale of financing needs especially in SSA countries, the damage from competition amongst the European DFIs is unlikely to be material.

Where there is a greater risk is in-country with the local market actors and care must be taken not to price these players out of the sector, as it is only by mobilisation and further development of domestic capital markets that the full volumes of investment capital can be secured in the long run. To better meet EU policy objectives, interviewees highlighted the need and willingness for further adjustment. As acknowledged by the EIB itself, to achieve more development impact in line with the requirements for a system that delivers, the EIB in collaboration with mandators should review current trade-offs between volume and ability to take on own off- and on-balance sheet risk in SSA, LDCs and fragile states to respond better to local needs. This could be achieved, for instance, by providing more guarantees in private sector settings and increasing investment in local currency as well as through direct equity investments. The Bank should also align risk management and process. In this context, it is crucial to separate risk management of EU and non-EU operations to ensure a culture shift in risk management for activities in less developed country contexts.

It is important to highlight that the above changes are contingent on two key factors. First, future mandates entrusted by EU or Member States to EIB under Scenario B will direct EIB’s focus and presents an opportunity to increase its ability to take on more risk. Second, the future structure of a subsidiary entity and consolidation status in relation to EIB Group would be key. With the amount of capital being equal, there would be a trade-off between executing larger volumes of less risky investments and smaller volumes of higher risk investments. As the new entity under Scenario B takes on more risk, this would need to be matched by increased capital provision.

![Are there circumstances – and if yes, which – requiring to separate balance sheets and reporting between ‘inside’ and ‘outside’ the EU?](image)

In Scenario A, there is no need to separate balance sheets. In Scenario B, the balance sheets will be separated, as it is assumed that the EIB will establish a subsidiary, in which it will hold a minority stake.

**A  Future Situation**

Under Scenario A, the EBRD proposes to continue to operate with a single balance sheet. There is a clear benefit of this proposal as the future lending programme benefits from the EBRD’s existing balance sheet of retained earnings, paid-in and callable capital, which at December 2019 totalled EUR 41 billion and which will enable an annual investment programme of up to EUR 13 billion over the period 2021-2025. Currently, the EBRD’s portfolio within the EU represents 25% of its outstanding programmes. However, over the past 5 years the EU has represented a declining percentage of new programmes. The EBRD’s commitment to support all of its countries of operations navigate economic impacts of COVID-19 pandemic and the opportunity to be country-cyclic may reverse this trend in the short-term, but the long-term trajectory of a progressive decline will continue as EU countries of operations progress in their transition.

From a reporting perspective, the EBRD already reports to the EU on all programmes which benefit from EU support and this would clearly continue under Scenario A.

**B  Future Situation**

Under Scenario B it is proposed that the EIB will establish a EIB minority-owned subsidiary for all non-EU activities and as such, definitionally Scenario B will result in a separate balance sheet. For this Scenario B, the Study team assumes that all new programmes will be executed on the balance sheet of the new entity. It is less clear whether it is necessary or appropriate to transfer the existing portfolio from the core EIB balance sheet or not. In case of a transfer, the issues outlined in the answer to Q. 25 will remain. At a minimum, the Study team assumes that responsibility for overseeing and reporting on the existing portfolio would transfer to the new entity, as it would be inefficient for the EIB to have two groups interacting with a borrower.

The EIB already reports to the EU on all programmes executed under EU mandates.

While not included in one of the options described by the WPG report, a variation of Scenario B suggested by the EIB includes an EIB majority-owned subsidiary, in which case this entity’s balance sheet would be consolidated at EIB Group level. However, the subsidiary, as a separate implementing entity from the EIB
would undergo separate reporting on its portfolio and its activities with EU operational control as outlined by the WP2 report. This would be similar to the current structure of the EIF.

| 28 | Would the EBRD have to run down (part of) its present portfolio in certain countries of operation in order to free up capital for operations in new EU priority areas? If so, how, in what timeframe and at which cost? |

The EBRD would not have to run down part of or its full portfolio in certain countries of operation to free up capital for operations in new EU priority areas. As outlined in the response to Q. 18 on lending capacity, the EBRD is able to gradually increase its annual investment programme to up to an additional EUR 3 billion without considering the potentially significant support through guarantee envelopes or capital under EFSD+/NDICI or specific additional off-balance sheet mandates from EU Member States, which the EIB is currently benefiting from. At the same time, the level of Bank business in advanced markets will continue to decrease organically as the EBRD becomes less additional. Advanced countries may also over time opt for graduation – the stage after which the EBRD ceases to make new investments as the countries reach an advanced state of transition.

| 29 | What would be the impact for the remaining EBRD operations in EU Member States, if any? |

There would not necessarily be any immediate impact on the EBRD operations in EU Member States. However, as the EU’s Development Bank focus would clearly shift to non-EU operations and, as such, the Study team would expect that the extent of future operations within the EU would decline. During this phase, the EBRD would need to assess the value of its office infrastructure within the EU as the role transitions to one of managing existing assets, rather than generating new assets. The Study team would anticipate a gradual closure of such offices, with the capacity to redeploy resources to new offices outside the EU.

| 30 | Would EIB’s external portfolio (or parts of it) need to be transferred to the EBRD or run down on the balance sheet of the EIB? Would there be any legal constraints for such a transfer and what would be the cost of the different options? To what extent EIB capital would be freed up? In the event of a gradual run-down of the portfolio, what would be the time profile? |

It is preferable for the EIB’s external portfolio not to be transferred. Q. 25 provides an elaborate answer regarding the drawbacks and legal constraints of a portfolio transfer. As mentioned, stakeholders interviewed without exception pointed out the complexity, difficulty as well as time and cost effort for a transfer and strongly advised against it highlighting the lack of necessity of a transfer and time it would take to complete it. Due to the high legal uncertainty and the enormous efforts and negotiations that would be required if a transfer were to be pursued, an estimation of the costs for this transfer is not feasible at this point in time.

| 31 | How would the EIB separate its external development activities from its current balance sheet? What are the potential capital structures and implications for the shareholders? |

In Scenario B, all new operations are assumed to be executed on the balance sheet of the subsidiary. The capital structure depends on the way the EIB would finance the new entity. In case the EIB has a minority holding in the subsidiary, additional capital will be required at the subsidiary level, which could either be provide by EIB as sole lender or the entity could issue bonds in the market in their own name.

As discussed in Q. 27, it is proposed that all new operations are executed on the balance sheet of the EIB minority-owned subsidiary. The capital scenarios will depend upon how the Bank chooses to finance this entity and what level of shareholding the Bank would have in it. As discussed in Q. 18 under Scenario B, where the EIB has a minority holding in the subsidiary and/or does not have control over it, additional capital would be required at the subsidiary level. If the EIB finances the subsidiary from the central EIB Treasury, the EIB would classify the subsidiary as a stand-alone borrower. In this context, the balance sheet of the subsidiary becomes more important. The argument for transferring the full economic risk of the EIB’s existing non-EU portfolio becomes stronger as this would serve to provide a diversification of the subsidiary’s
balance sheet from day one. This risk transfer could, for instance, be executed synthetically via a series of credit default swaps. In parallel it would be necessary to transfer a suitable block of capital to the subsidiary to compensate for the new risk transferred. From an individual loan perspective, the transfer would release capital on the main EIB balance sheet vs increasing the capital need at the subsidiary. However, this position is complicated by the fact that the existing loans provide a diversification benefit to the larger EIB balance sheet and as such the Study team would expect that the capital relief obtained by the EIB from the transfer (actual or synthetic) would be less than the capital required at the subsidiary to absorb the loan.

As discussed in Q. 18, if the EIB is the sole lender to the subsidiary, the quantum of capital held in the subsidiary can be set under agreement between the Board of the EIB and the Board of the subsidiary. The Study team would expect the EIB Board to require a minimum RAC Ratio of 10-15% implying a paid in capital base of EUR 5-7.5 billion for new business operations. With regards to existing operations, arguably the net cost would be neutral as a transfer would free-up capital on the EIB’s balance sheet of the EIB. Given the diversification benefits from the combined balance sheets this can be expected to have a net incremental capital cost.

If it is decided that the EIB minority-owned subsidiary is to commence an issuance programme in its own name, then the capital issues will become more acute. For the subsidiary to be competitive, it would be necessary to secure AAA ratings from each of the leading rating agencies (at minimum Fitch Ratings, Moody’s and Standard & Poor’s). Unlike the EIB, which is able to operate at a high gearing level relative to its multilateral peers, the subsidiary would have capital ratios more comparable to these development bank peers reflecting the higher risk of the underlying portfolio of development loans, but as this will be a new issuer in the market, a degree of conservatism should be employed with regards to the retained capital of the subsidiary to give investors comfort that there is sufficient coverage, not only for the prevailing portfolio but also for future projects to be financed.

The Study team estimates that the subsidiary will wish to hold a Risk-Adjusted Capital (RAC) Ratio of 20-25%. The capital required to back loans guaranteed by the EIB will be very small, so the RAC will primarily impact loans executed using the subsidiaries own balance sheet. As discussed in Q. 18, the precise capital required will depend upon the quality of the loans being made, but there is a trade-off to be struck here between paid-in capital and development impact. The Study team recommends a starting capital base of EUR 10 billion for a EUR 50 billion potential funding programme.

While not proposed in the WP2 report, in the event that the EIB has a holding of more than 50% in the subsidiary, the balance sheet of the subsidiary will consolidate with the main EIB Group balance sheet and it is proposed that financing for the subsidiary will then be executed by the central EIB Treasury. The capital implications for this model are modest as the majority-owned subsidiary would continue to benefit from the EU guarantees for the operations implemented under EU and Member State programmes and mandates, with the exception of operations that are carried out using the Bank’s own activities using the EIB’s own resources. Ultimately the Bank’s activities are constrained by the 2.5x gearing limit, into which calculation of the assets of the subsidiary would be included. In this variant of Scenario B, the Study team would propose that the subsidiary aims to maintain a minimum capital base of 1 year’s operating expenses. Consideration will need to be given to the concept of ‘control’ which if envisaged to lie with the EU and Member States, may alter the capacity of the EIB to consolidate.

32 What would be the impact for the remaining EIB operations in EU Member States, if any?

B Future Situation

While definitionally, if the EIB minority-owned subsidiary is capitalised via a drawing on capital currently held within the EIB’s balance sheet without a commensurate reduction in risk assets, the EIB’s capital resources available for deployment within the EU would be reduced. The assumption for this Study is that under Scenario B a key element is that the EIB’s activities within the EU are in no way impacted.

33 What would be the financial implications for EU Member States of a broader shareholding, i.e. EU Member States, National Development Banks, European Commission, EIB, EBRD and recipient countries?

B Future Situation

As discussed in Q. 18, the Study team believes that under Scenario B, the minority-owned subsidiary will require EUR 5-13.5 billion of fresh capital depending on how the entity is financed to cover for the new MFF period. The Study team notes that any transfer of assets between the EIB and its subsidiary would potentially increase this calculation as the capital relief on the EIB’s core balance sheet would not offset the
RAC capital required by the subsidiary. In this instance, the new capital invested would have to either come from the Commission, Member States, or their DFIs.

Clearly to the extent that the new capital is financed by a party other than the EU Member States, the financial cost to the Member States will be reduced. However, if it is not financed by Member States, then there will be an impact on overall spending on development cooperation in the system. If the Commission is the financier, then there will be a reduction in capital under NDICI for grant programmes. If it is the NDBs, then similarly this will reduce their investment capital for development.

Ultimately therefore, any fresh capital needs under Scenario B will directly or indirectly lead back to the Member States. There is a logic for the Member States to invest as this will give them the right to a governance role of the subsidiary including the right to appoint board members. The Commission does not have to be a shareholder to have equal governance rights, given its position as a guarantor of the majority of the subsidiary’s activities.

Under the variant of Scenario B suggested by the EIB in the course of our study, namely, to create an EIB majority-owned subsidiary, the EIB foresees the subsidiary’s balance sheet being consolidated with other EIB activities at EIB Group level, which would reduce the capital requirements to about half as explained under Q. 18. With the EIB taking up the majority shareholding, the financial burden on Member States, national DFIs and the EC would be reduced substantially. However, if as required under Scenario B, the EU and Member States have majority control, then the auditors may reject the proposed consolidation, resulting in a return to the capital requirements of the minority owned model described above.

What would be the appropriate distribution between public and private lending, particularly in SSA and LDCs/fragile states, to achieve the EU’s policy objectives. How would this balance affect debt sustainability, particularly in LDCs and fragile states?

There is no formula prescribing a public/private distribution – countries require both to meet EU policy objectives. In all scenarios, the EIB and/or the EBRD work as actors in the wider landscape of European DFIs, which have a core private sector focus, and the broader family of multilateral development institutions – each with their own complementary strengths and weaknesses. For the EU to achieve its policy objectives, while ensuring debt sustainability, it must be ensured that countries prioritise productive investments, which contribute to growth and increase domestic revenue in the long run, but also to ensure that the investments are integrating Environmental, Social or Governance (ESG) criteria.

SSA countries, LDCs and fragile states represent a broad spectrum of countries from South Africa at one extreme to Syria, Afghanistan, and Sierra Leone at the other. There is no magic formula of which countries require public sector lending and which require private sector support, these are complementary, and in most cases, both are required to achieve EU policy objectives.

Transitioning from the poorer to the richer countries, the enabling environment for private sector growth tends to strengthen. Key institutional frameworks are required to be put in place during that journey. Public sector lending can support and accelerate these policy changes. The poorest countries tend to have the greatest need for support to basic infrastructure, which is a prerequisite for private sector development, and their Governments tend to face the biggest challenges attracting finance from domestic and international investors. In countries that are transitioning from state-dominated economies to market-based systems, the Study team sees a reduction in the weight of State-owned Enterprises (SOEs) in the economy versus the core private sector.112

As the majority of SSA, LDCs’ and fragile states’ sovereigns are running current account deficits, there is a demand to secure international capital to maintain the value of the national currencies. Therefore, the demand for sovereign financing does not decline as a country grows but frequently accelerates in absolute terms. The difference with the more developed countries is that there are generally more bankable private sector projects that can be supported.

By defining the total EU guarantee vis-à-vis the provisioning rate, the EU’s NDICI programme can have an impact on the split between public and private financing offered if used in combination with the guarantees. Non-sovereign loans carry a higher provisioning requirement and as such the Study team foresees that between 60-75% of funding supported by the EU in the next MFF will need to be targeted at the sovereigns or financed by the development banks on their own balance sheets at risk or with only a political risk guarantee. Greater private sector coverage by the EU guarantee will result in greater risk and a higher provisioning obligation for the EU from the NDICI budget. The Study team notes that the EBRD and the European
DFIs have a core private sector focus and as such complement the more sovereign focus of the EU NDICI programme.

Central to debt sustainability is the capacity of countries to generate both foreign currency revenues and taxes. Again, there is no one size fits all position, and it is not the case that just because a country is an LDC versus a low and middle-income country (LMIC) that it automatically has a greater risk of default. Richer countries that benefit from a significant natural resource endowment can be more vulnerable if the price of their particular commodity materially changes creating debt sustainability issues. However, all SSA countries, LDCs and fragile states have substantial infrastructure gaps which they are under political pressure to fill. To enhance development impact and sustainability, the EU would need to work with its lenders to ensure that countries prioritise productive investment that will not only grow their economies but more critically will increase domestic revenues to improve long-term to ensure debt sustainability.

2.3. Operational Implications

2.3.1. Business Model

What is the existing level of engagement and related business volumes of the EIB/EBRD in developing countries, particularly in SSA, Enlargement, Neighbourhood and LDCs/fragile states, including active exposure, number of operations and field offices?

The EBRD has a strong local presence in its current countries of operations through its well-staffed Residential Offices, which provide a range of complementary services to the investment activities, i.e. supporting policy dialogues. The Bank has significant operations in Enlargement and Neighbourhood countries, but it is not active in SSA countries or LDCs. Its experience in fragile states is very limited with three countries of operation.

The EIB has global operations, but its presence on the ground is very limited. However, the EIB provides technical assistance to its projects and is involved indirectly in policy engagement. It operates in Enlargement and Neighbourhood and in SSA countries, but overall has limited experience in LDCs and fragile states.

Field offices

The EBRD has 43 offices outside the EU, which are generally based in all capital cities of its countries of operations as well as secondary cities (44% of all offices outside the EU are based outside of capitals). These are directly engaged in the Bank’s business to originate transactions and to support clients outside of the capital. None of the 43 office are solely representative offices: Resident Offices in capital cities are equipped to conduct the full range of operational activities, including investment, advisory or policy operations. Offices in secondary cities are mostly focused on SME advisory activities.

The EBRD is employing 819 FTEs in local offices – 30% of their total number of staff. 16 (37%) offices are based in Central Asia, 9 (21%) in Eastern Europe and Caucasus as well as the Southern and Eastern Mediterranean (SEMED) region, respectively, 6 (14%) in the Western Balkans as well as 2 (4.5%) in Turkey and one in Russia. With an average of 19 FTEs per office, the size of individual offices varies according to country size and the volume of business ranging from one to two in small countries or secondary cities over 80 staff in larger capitals. Some of the larger offices also serve as regional ‘hubs’, where staff with regional mandates are based. The senior managers for regions are also based in the field.

Exposure and number of investment operations

62% or EUR 30 billion of the EBRD’s global portfolio exposure is across 18 countries among Neighbourhood and Enlargement countries and two fragile states. The EBRD does currently not operate in SSA or LDCs. Additional investments in the West Bank and Gaza, a fragile territory, are managed through dedicated Trust Fund structures. The EBRD’s overall highest exposure is in the Neighbourhood region with 11 countries of operation and 35% (with 702 operations) of the current total portfolio exposure, following by Enlargement countries with 7 countries of operations and 27% of the exposure (with 578 operations). The Bank is active in three fragile states, which accounts for about 1.4% of total portfolio exposure (with 58 operations). Activities in less advanced countries cover the full range of operations as in other countries of operations, but tend to be more intensive in advisory/technical assistance and focus more on smaller transactions with local private sector clients.
Other activities

Through its extensive local presence and all countries of operations being stakeholders of the EBRD, the Bank conducts a range of services supporting and complementing investment activities. This includes policy dialogue and engagement at sovereign and sub-sovereign level to support the development of a business enabling environment and to stimulate local and international private investment. It also includes a range of advisory activities to support project preparation and implementation as well as SME development. Funding for such activities as well as grants for investment blending represents around 8% of annual investment. EU funds for blending, which has accounted for about 50% of the total blending resources, concentrate mainly on countries in the Western Balkans (30% of EU total between 2015 and 2019), Eastern Europe and Caucasus (27%) and SEMED (23%).

Field offices

EIB representations are distinguished into Country or Regional Representations according to the geographical coverage (and number of countries falling in the region). On average, a Regional Office covers five to six countries. The number of staff may vary from one office to another and includes Operational (OPS), Projects Directorate (PJ), Communication staff and always Local Agents. The common feature is the Head of Office – be it in a Country or Regional Representation – is always an EIB Agent (Expatriate) reporting to the Secretariat General for representational purposes. Additionally, the EIB has Desk Officers: a single EIB representative who is embedded within the EU Delegation as there is no stand-alone EIB office in the country of operations.

The EIB has a global reach of 13 Regional and Country Offices – five are based in SSA (Cameroon, Ivory Coast, Kenya, Ethiopia and South Africa), six in the Neighbourhood (Egypt, Morocco, Georgia, Moldova, Tunisia and Ukraine), two in Enlargement countries (Serbia and Turkey) – as well as five Desk Offices located in SSA (Dakar), the Neighbourhood (Amman and Beirut) and Enlargement countries (Sarajevo and Tirana). In addition, the EIB has relevant Regional Offices for Latin America in Colombia, for the Caribbean in the Dominican Republic, for South Asia in India, and for Southeast Asia in Jakarta.

Interviewees confirmed that the EIB offices in the field mainly serve representative purposes. Outside of the EU, the EIB employ 118 FTEs (including offices outside of SSA, Enlargement, Neighbourhood and LDCs /fragile states) – an average of four people per office and 13% of EIB staff working on operations outside of the EU.

Exposure and number of operations

10% or EUR 55.9 billion of the EIB’s overall global portfolio exposure is across 71 countries in Neighbourhood and Enlargement countries, SSA, LDCs and fragile states. The EIB’s portfolio in the target region has a clear focus on Neighbourhood region and Enlargement with 39% of exposure in 16 countries and 35% in five countries, respectively. 13% of exposure is spread across 43 SSA countries. Fragile states account for 5% (in 18 countries) and LDCs for 4% (in 29 countries). Between 2015 and 2019 EIB signed a total of 576 operations worldwide, of which 121 (21% of total) were regional projects and 455 (79%) country level projects. Of the latter, 96 (21%) were in SSA, 169 (37%) in Neighbourhood countries, 100 (22%) in Enlargement countries, and 90 (20%) in other regions. As for the regional projects, 73 projects (60%) were in SSA, 9 (7%) in the MENA, 1 (1%) in Russia, Eastern Europe, and South Caucasus, 18 (15%) in ACP countries, and 20 (17%) in other regions. Operations in LDCs and in fragile countries represented 70 (12%) and 35 (6%), respectively.

Other activities

In addition to its investment activities, the EIB uses technical assistance, advisory support and blending mechanisms to complement its lending activities outside the EU to de-risk projects and address any shortfalls throughout the project cycle. The largest portion of the technical assistance and blending resources spent between 2015 and 2019 are deployed in ACP states (43%) followed by the Southern Neighbourhood and candidate/pre-accession countries as well as the Eastern Neighbourhood (21%), 20% and 12% respectively, while a significantly smaller portion (4%) is split between Latin America, Asia, cross-regional global activities, and overseas countries and territories. They are mainly used to provide investment grants (48%), technical assistance (21%), interest rate subsidies (17%) and financial instruments (14%). The consensus among development finance experts is that technical assistance in combination with financing increased capacity and financial performance of recipient entities.
36 What are the areas of increased efficiency and addi-
tionality that each option could bring in developing
countries, particularly in SSA, Enlargement, Neigh-
bourhood, LDCs and fragile states, particularly in
complementarity to European DFIs and MDBs already active in the region and in accordance with the
needs of the partner countries?

On the longer run, an ECSDB based on the EBRD or on the EIB would be able to significantly expand the
existing business model of either Bank and bring efficiency and addi-
tionality to developing countries. How-
ever, on the short run, each institution would rely on its comparative advantages to bring additionality. An
ECSDB based on the EBRD would bring mostly efficiency and addi-
tionality in private sector development (with a full range of financial instruments and project sizes), public sector financing at the sub-sovereign
level, and policy engagement. An ECSDB based on the EIB would bring strategic autonomy and addi-
tionality in areas such as private and public sector large infrastructure financing in areas like climate change,
digitalisation, energy, mobility, and water.

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<th>Present &amp; Future Situation</th>
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The consensus among DFIs interviewed is that overall, the EBRD’s current business model is focused on
crowding in finance, especially the private sector. However, it has to be highlighted that the private direct
sector mobilisation has decreased between 2015 and 2019[29]. Strong ties with its countries of operations
enables the EBRD to build on country-led approaches, formalised in regularly updated country strategies
and to establish broader country platforms with other DFIs and EU Delegations. Moreover, the EBRD can
build on policy dialogue experience and has a strong development impact measurement and results man-
gerement culture and expertise. These strengths would be assets for a new ECSDB based on the EBRD.

Particularly, the new institution could provide development priorities and the climate agenda of partner
developing countries having the following strengths:

- Access to a combination of investments, policy engagement and technical assistance;
- A broad range of product offerings, established syndication practice, equity practice; and the capability
to finance a range of project sizes, from under EUR 1 million to over EUR 500 million, with over 60%
of projects considered “small” (under EUR 10 million);
- A broker role between public and private interlocutors with the expertise and experience to operate in
both with access to public sector financing capability, especially at the sub-sovereign level;
- Well-established relationships with bilateral and multilateral donors and EU Delegations in its current
countries of operations.

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This scenario would put an EU institution in the lead as the ECSDB, ensuring a strategic autonomy, if
properly steered by the EU and if the EIB minority-owned subsidiary would have a strong development
mandate and expanded operations, especially with sufficient presence on the ground. Under these condi-
tions, an ECSDB based on the EIB would have the comparative strength of becoming the main EU develop-
ment bank in accordance with the ‘Policy first’ principle. As such the EIB could ensure a focus on areas, such as:

- Climate action in developing countries (in accordance with the European Green Deal);
- EU economic diplomacy – direct financial support of EU policy dialogue (e.g. through policy-based
loans) with partner countries and activity where the EU considers high EU visibility strategically very
important;
- Employment creation programs linked to efforts to reduce illegal immigration;
- Adherence to and promotion of EU standards, policies, and procedures.

An ECSDB based on an EIB minority-owned subsidiary could bring additionality by building up on the
EIB’s existing global portfolio and its strong expertise in areas such as climate, large private and public
infrastructure, energy, digitalisation, mobility, and water anchored in its SDG-based results framework.
Overall, the consensus among DFIs and EU Delegations interviewed is that the EIB is very strong on the
public sector side and financing of large infrastructure projects. In addition, the EIB minority-owned sub-
sidiary could continue to work with a range of multilateral and bilateral institutions including the UN, the
WB, regional development banks and bilateral financial institutions. As mentioned in Qs. 8 and 19, it should
be noted that this review is based on the WPG report recommended a new entity with a minority sharehold-
ing of the EIB.
What would be the implications for the EIB’s / EBRD’s business model of conducting increased volumes of both public and private sector operations outside the EU, particularly in SSA, Enlargement, Neighbourhood and/or LDCs and fragile states?

In the case of the EBRD, some parameters of the existing business model would have to evolve, including focusing on social sectors, increasing its operations in the public sector, and adapting its principles of transition impact and additonality to LDCs and fragile countries. It would need to establish operations in new geographies and would be more dependent on donor resources. For the EIB, a fundamental change of its business model would be needed: the creation of a subsidiary with a strong development focus in its strategy, a more decentralised approach with a stronger presence of technical staff on the ground and a higher risk appetite.

**A Future Situation**

While the balance of public and private sector work would change over time in Scenario A, with a foreseen increase of operations in the public sector, the EBRD’s business model and operating approach would not have to change fundamentally in order to undertake the potential expansion to SSA countries. However, the EBRD recognises that delivery will be more complicated if a geographical expansion to SSA as well as to LDCs and fragile countries is to happen.

As a result, some parameters of the business model would have to evolve:

- The EBRD’s sectoral expertise in energy and infrastructure will be critical as these are the areas of greatest need in SSA and central to the meeting of the Paris Climate Agreement. New sectors will also need to be expanded. Additional expertise in social sectors and inclusiveness, including education, health, and social protection would need to be further developed.
- The EBRD can draw on a proven expertise in policy dialogue which has helped to maximise its additonality in its current countries of operations. With an evolving business model under a Scenario A, the EBRD’s approach to policy dialogue would have to be further extended. First, the EBRD would need to understand its dialogue approach as being part of the overall EU – partner country dialogue (incorporating EU Delegations and Members States). Second, the scope of the policy dialogue would need to be expanded also including LDCs and fragile countries and sectors that have not been in the focus of the Bank so far.
- EBRD’s current political principles of working in countries that are ‘committed to applying the principles of multiparty democracy, pluralism and market economies’ may need to be revisited if the Bank is supposed its geographical coverage. Under the Bank’s track record of gradual expansion, there has been a fairly selective approach to choosing countries in which to operate. As ECSDB under Scenario A, the EBRD would have an obligation to engage based on EU priorities.
- The grant intensity would be higher than in current countries of operations. Bottom-up desktop estimates of possible demand for donor resources suggest a grant intensity of 1.5 to 2x the current EBRD average level of 4-5%.

The Study team also foresees a need for operational changes at the Governance level. Currently, the EBRD board approves all transactions (individually or through frameworks) as required by the AEB. This model can remain, but where ECSDB is leveraging an EU guarantee the Study team foresees a need to create a linkage back to the EU. Under the ‘Policy first’ approach, the EC requires an active and engaged participation in the projects that are to be financed with their guarantee and greater visibility, including their pre-approval. In interviews with the EC became clear, that some EC representatives would like to see such process deepened rather than weakened in the creation of an ECSDB. Therefore, the EBRD would need to develop operational procedures together with the EC to ensure that of active participation in projects, with the traditional mode of operation for the EBRD Board which is one of governance and fiduciary oversight. This would require some changes to the current operational model of the Bank.

Lastly the EBRD will need to operationalise an increase in their countries of operation, rapidly increasing office numbers, which itself will place a strain on management time. These changes are discussed in detail in Q. 386.

**B Future Situation**

The EIB is currently one of largest MDBs in terms of volumes disbursed annually. Despite this fact, the smooth execution of an expansion strategy under Scenario B would require major operational and ownership changes. These start with the key areas of ‘governance’ and ‘oversight’ which have already been adapted by EU decision makers through the NDICI regulation. The EIB already implements numerous EU mandates
and programmes in the current and past MFFs and has extensive experience of executing the EU’s policy agenda, so the concept of ‘Policy first’ is not new to the Bank.

Both the EIB and EC have confirmed during the interviews that they intend to play a more engaged role in working together than in the past. This has been also pointed out as a suggestion in the evaluation of the EIB External Mandate[18]. The proposal under study in Scenario B, whereby the EIB would create a minority-owned subsidiary to serve as the ECSDB would strengthen this point. So far, due to its mandate and limited presence in partner countries, the visibility of the EIB’s policy dialogue has been limited. Under a Scenario B, the respective roles and responsibilities of the EU and the EIB would need to be clarified and the required capacities made available as part of the new business model under a Scenario B.

The Study team does note that the pace of investment proposed under the new NDICI programme is comparable to that of the past 7 years. However, the investment needs of the SSA region are greater than current supply and will only rise in the coming years as the economies grow. Therefore, operational structures, especially governance structures, should be adjusted to facilitate change in the pace of investment without risking that the system will become a bottleneck to project execution.

To sum up, some additional parameters of the business model would have to evolve:

- The Bank and/or the new EIB subsidiary would need to increase its local presence with both local and international staff, experienced in private sector development and access to finance and access to market. It would also need to strengthen existing local offices and establish new ones following a proposed model of co-location with the EU Delegations, when possible (see Q. 38b);
- In close coordination with the EC, the ECSDB would have to significantly improve its capacity to provide policy reform advice to work with government agencies and private sector organisations in upgrading their systems and overall governance (see Q. 51);
- In close cooperation with its mandators, the ECSDB under this scenario would need to review its risk approach with the aim of being able to further increase its risk appetite (see Q. 39);
- To increase EIB’s private sector operations and investment volumes, the business model for the new ECSDB would need to be able to directly work with private sector clients across various types of activity. Most stakeholders interviewed have indicated that today it is rather a “wholesale” approach mainly directed towards financial institutions and Governments (see Q. 57);
- The new EIB subsidiary would also need to strengthen its focus on LDCs and fragile countries and social sectors, including health, education, and social protection.

### Future Situation

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In view of comments from civil society organisations received during the consultation process, efforts to strengthen public participation in the policymaking of both Banks should be enhanced as part of the needed changes in their business models. In addition, the Banks would need to further ensure that local communities and citizens affected by their operations are meaningfully consulted and have access to effective and independent complaints mechanisms, including the right to effective redress. Additionally, civil society organisations have pointed to weaknesses in terms of compliance with environmental, social, and human rights standards of both Banks, which, if proven to be true, should also be addressed as part of the changes needed to their business models.

Also, in the view of stakeholders consulted, both Banks will need to increase their capacity to monitor and evaluate the impact of their projects to measure their development impact contributions. This difficulties for measuring achievements were also recognised by the EC[19]. Moreover, it would also need to be assessed to what extent an extension of the business models and operations under a ECSDB scenario would require adjustments in banking supervision.

Provide an analysis of the possible long-term path that both institutions would have to go through from their current situation to those considered as Option 1 and Option 3, assessing the potential benefits, costs and restrictions involved.

The EBRD could follow different transition paths. One possible option would be to deploy the current EBRD business model with its central emphasis on local presence. Another option could be a less human resource intensive, which is similar to the more centralised approach of the EIB’s business model. In the case of the EIB, the long-term path would require an evolution of its business model from an investment bank to a development bank (for the subsidiary). The business model should be more decentralised than the current one. Both Banks would face common challenges in the operationalisation of their plans – including building relations in new geographies, staffing, and generating a pipeline of bankable projects.
The actual scale, scope, and timeframe of a future ECSDB based on the EBRD or on the EIB would be fundamentally determined by the mandate, priority, and resources to be provided by the EU and its Member States. A consensus has emerged among the interview partners for this Study that both Banks would face common challenges and bottlenecks in their expansion plans if becoming the ECSDB, which should be carefully considered when judging the expansion plans below, especially in relation to the timeframes:

- **Building trustful relations:** In the view of many stakeholders interviewed, it is perceived as important to strengthen durable relationships (buy-in of local players) and know-how of staff which leads to an effective cooperation in order to become a well-accepted development partner in the field;

- **Experienced staffing/specialised expertise:** At least for the short term, recruitment of both experienced international and local staff for the new geographies could become a challenge for both institutions as the supply of qualified international and local staff is limited and many institutions compete for them. This, in the short term, aggravated by the COVID-19 crisis, as training staff will be also a challenge. Moreover, DFIs interviewed mentioned the risk of a new ECSDB poaching their staff;

- **Pricing:** Any expansion of operations should take a sensitive pricing according to local circumstances to avoid crowding out the private sector, as mentioned by DFIs interviewed. Achieving goals in terms of volumes of investments should not be pursued by distorting markets;

- **Pipeline of bankable projects:** All stakeholders interviewed mentioned that the main bottleneck for the expansion of a ECSDB at the operational level will be building up a pipeline of bankable projects without crowding out already existing DFIs. Building such a pipeline is resource and time intensive.

In addition, the competition in the partner countries for bankable projects will increase. A race to the bottom, especially regarding pricing, could take place with negative implications for sustainable development (development aid for “free” without buy-in of partners). This could specially affect smaller DFIs.

### Approach 1

It is assumed that the ECSDB based on the EBRD would deploy the current EBRD business model with its central emphasis on local presence and knowledge to support effective policy engagement and project origination. For this purpose, the Bank’s business model would be assumed to be largely unchanged and – more importantly – its ongoing business mix would not differ significantly. In practice, Scenario A might require the EBRD to expand its sovereign and public activities as well as to start work in new sectors like health and education.

First, new countries for expansion is divided into three stylised ‘types’ of countries:

- Type I countries are small and fragile countries where private sector business potential is constrained;
- Type II countries are medium size and/or countries with stronger economic fundamentals and private sector business environment with moderate business potential corresponding and;
- Type III countries are large and/or more sophisticated economies with high private sector business potential.

For each type of country, a steady state level of investment and number of transactions is calculated and a path for reaching this level of business established based on the Bank’s experience of expansion into the SEMED region. Having developed the typology of countries, an illustrative 10-year framework for global expansion could be presented assuming that by 2032 the EBRD would have started operating in 60 countries. The expansion is thereby assumed to take place in ‘waves’ with different combinations of types of country in each ‘wave’. Table 12 in Annex 5, Volume II shows the assumed pattern, timescale of expansion and staffing.

Although this distribution is constructed without specific countries in mind and can be adapted to political priorities, broadly the first two ‘waves’ correspond to the expansion into SSA countries – the priority for the EU – and the second two ‘waves’ to an expansion into countries in Latin America, Caribbean, Asia and Pacific. For the later ‘waves’, it is assumed possible to expand to countries from more than one region. However, it is also assumed that any multi-regional expansion would be based on discrete and coherent clusters of countries in each region to capitalise on efficiencies and economies of scale.

There is a mechanical assumption that for every five countries, a regional hub is created to supplement Resident Offices in each country and a step change in HQ staffing envisaged, with the incremental costs and workforce needed to support this is included in the calculation.
Approach 2
An alternative approach to achieving global impact could be to concentrate the activity and resources of the ECSDB based on the EBRD in strategically and economically important countries. Achieving transition in these countries would both be beneficial to the country itself and could also provide a regional economic and political anchor. These offices would also act as ‘hubs’ from which activities would be undertoken in neighbouring countries. This approach would be less human resource intensive than in Approach 1.
For simplicity, and to allow comparison, the same 10-year pattern of expansion is assumed. In each ‘wave’ of expansion, in-country presence is established in three ‘hub’ countries and the EBRD based institution is present in 12 additional countries across the world at the end of the period. The pattern is shown in Table 13 in Annex 5, Volume II.
In the countries with ‘hubs’, the level of investment activity is assumed to be same as in the previous Approach. In addition, each ‘hub’ is assumed to support activity in four other countries to achieve the same breadth of coverage as in Approach 1. However, it is also assumed that the ECSDB based on the EBRD’s impact in those countries is diluted given that the approach does not use the full strength of the EBRD business model.

B  Transition Process

This scenario is based on the assumption that a more ambitious strategy in SSA would mean bringing the ratio of EIB signatures/GDP in SSA to the same level as in the EU Neighbourhood.

The EIB operates under a clear policy mandate from the EC and Member States. Thus, the detailed number, composition, location of the staffing for a long-term expansion would be decided by the new ECSDB Board based on policy guidance from its mandates. The overall EIB proposal for expansion and strengthening of its local presence in SSA, LDCs and fragile economies encompassed:

i. Upgrade of EIB’s Regional Offices into regional ‘hubs’ – offering project, sector, policy expertise at regional level;

ii. Strengthening of local presence in the EU Delegations through sharing of facilities and staff,

The EIB intends to increase its local presence outside the EU to integrate further into EU policy dialogue and programming, as well as cooperation with local authorities. The increased local presence would improve the EIB’s capacity to source, appraise and monitor projects, leading to an increase in investment. Co-location of EIB staff with EU Delegations, if further pursued, would strengthen the financial and technical expertise available to the EU on the ground. The primary goal of strengthening the EIB’s external presence would be to increase operational and expert staff to better equip the Bank’s network of local offices.

The specific steps envisaged by the EIB in this scenario could be reached by taking multiple steps simultaneously or by taking one step after the other, assessing the outcome of each before moving to the next.

Step 1: Immediate next steps to already underway engage to continue improving external operations

- Implementation of the key features of the EFSF+ related aspects of the political agreement of December 2020 on the NDICI regulation (an overall strategic governance of NDICI to ensure coherence of the various EU instruments, dedicated EIB mandates to ensure that the EU can continue to have its own financial arm for activity outside the EU participating in the level playing field);

- Specific governance and engagement rules adapted to developing and emerging economies (e.g., introducing separate internal reporting for operations outside the EU to inform dedicated strategies, creating an advisory group for EIB financing operations outside the EU including additional development specialists; introducing dedicated capital orientation for operations outside the EU; developing dedicated strategies and business model and further refining the risk policy for non-EU activity, while safeguarding the EIB’s overall risk metrics);

- Strengthening EIB presence on the ground within the EU Delegations to get closer to its clients, partners, and local decision makers;

- Increasing cooperation with a broader range of European DFIs, including smaller entities, and IFIs.

Step 2: Improve business model (around a year)

The second step would imply hiring an additional ~100 FTEs to reinforce the presence on the ground notably in SSA, LDCs and fragile states to be able to originate more projects in remote or disadvantaged regions and undertake smaller transactions. The estimated staffing needs are based on a qualitative assessment by the EIB operational department. The detailed staff composition and location would be decided by the new ECSDB Board following its launch and would be based on a dedicated strategy and the policy guidance from the EC and Member States under NDICI. The suggested additional ~100 FTEs would combine HQ-
based (~20 %) and local staff (~80 %), with ~50 % allocated to the public sector and ~50 % to the private sector. Additionally, the EIB would need to enhance its governance structures for operations outside the EU in terms of its risk appetite, pricing, and product offering, as discussed in detail in Q. 37a. This second step is not associated with any increase in the volume of activities.

**Step 3: Scale-up**

The third step might entail hiring approximately 170 FTEs to bring the total incremental FTEs to 270 FTEs. The level of increase in staffing is assumed to have a linear associated with the increase of signature levels, so it will depend on business level and strategic decisions. Alternatively, some staff could be reallocated from HQ to field.

These steps, under a subsidiary to be created, would involve a change from the current relatively centralised business model to a more decentralised one where origination, implementation, disbursements, and monitoring are carried out from regional ‘hubs’ based in the existing offices of the EIB.

The potential benefits of this scenario are discussed in Q. 36 and the cost implications in Q. 22/23.

To what extent adaptations will be required for the operationalisation of either of the two options, in order to effectively use the different types of EU support, e.g. as presently proposed under the NDFIC Regulation? Would EIB (in case of option 1) and EBRD (in case of option 3) continue to have a viable business model?

For the operationalisation of Scenario A, the exclusive sovereign window and non-commercial sub-sovereign windows will need to be opened to the EBRD. The EIB would have a viable business model under this scenario focused on EU and accession countries. For the operationalisation of Scenario B, a fundamental change on the business model of the EIB would be needed. The long-term growth and attractiveness of the EBRD could be severely constrained under this scenario, which depends on its further strategic orientation and shareholder decisions but could result in a slow atrophy of the institution.

**Adaptations for the operationalisation**

As discussed in detail in Q. 37a, in the case of the EBRD, some parameters of the existing business model would have to evolve for the operationalisation of this option.

Under Scenario A, and following a transition period as the EBRD expansion would take off, the implementation modality of the exclusive sovereign and non-commercial sub-sovereign window under the EFSF+ entrusted to the EIB (i.e. not open to other implementing partners) would need to be reviewed. There are two possible ways:

- **Centralised execution**: the EBRD, instead of the EIB, could eventually take over this guarantee capacity to expand its public sector activity. This option would require additional resources at the EBRD for back and middle office functions;
- **Decentralised execution**: the window could be opened up to all eligible implementing partners, so that they could jointly scale up their sovereign and non-commercial sub-sovereign lending. This way the EU would draw on the skills of all implementing partners, especially the European NDBs. This option would require a clear steer and strong coordination from the EU. In determining eligible implementing partners, the EU may wish to consider the potential conflicting interest between partners who are also executing bilateral sovereign facilities on behalf of their national governments.

**Would EIB (in case of Scenario A) have a viable business model?**

The EIB would still have a viable business model as most of its operations are focused on the EU countries and pre accession countries, which represent around 88 % of its commitments in 2019 (the signatures by countries in 2019 are as follows: 1 % for European Free Trade Association (EFTA), candidate and potential candidate countries; 2 % for Eastern Europe, Southern Caucasus and Russia; 4 % for Mediterranean countries; 2 % for ACP-OCT states, South Africa; and 3 % for Asia and Latin America).

This assumes that the EIB would retain access to the NDFIC support for operations in the Pre-Accession region. Funding previously used for non-EU activities still could be useful for EU activities related for example, to climate change, digitalisation, and COVID-19 response.
Adaptations for the operationalisation

Under this scenario, the current legal framework enables the EIB to carry out investment activities outside the EU. The Study team assumes that the EIB would continue to function under NDCI as foreseen in the dedicated EIB windows in the draft regulation, which are discussed in Q. 18.

As discussed in detail in Q. 37a, there is a consensus among key informants interviewed that a fundamental change of the EIB’s business model will be needed for the operationalisation of this scenario.

Would EBRD (in case of Scenario B) have a viable business model?

Under this scenario, the long-term growth of the EBRD could be severely constrained depending on what specific decisions are taken. The key question related to the viability of the business model will be whether the EBRD is still seen by its shareholders as an effective and relevant instrument to support the transition of its countries of operation and the European Neighbourhood (with the benefit of involving non-EU member states including as donors) and whether the Bank has still access to EU funding. There would be, almost certainly, no expansion of the Bank’s geographic mandate. The Bank might reduce and/or cease activities in some of its current countries of operations outside the EU. The extent of the impact on the EBRD also depends on whether it would still have access to EU funding. The ultimate decision on these issues lies in the hands of the EBRD’s shareholders, governors, and the EC.

Overall, if its operations are reduced, the attractiveness of the EBRD for shareholders, donors, and staffing will consequently suffer, which might result in a slow atrophy of the EBRD. Moreover, the creation of a new ECSDB based on the EIB could lead to financial and political resources being cut to the EBRD, especially taking into consideration that the EU is EBRD’s major donor and therefore has an enormous influence in this regard. The outcome of the decision above will thus directly affect EBRD’s delivery capacity and the viability of its business model. The most extreme version of this scenario, where the EBRD loses access to all EU funding and EU shareholders block the approval of any new activities in countries of operations outside of EU would have profound implications on the institution.

Additional adaptations for EIB and EBRD to enhance their co-operation with DFIs, IFIs, and MDBs, and how to encourage greater inclusiveness of smaller DFIs, which are common to all scenarios are addressed in Qs. 54 and 63.

What would be the implications of both options for other actors of the European development financial architecture?

An ECSDB based on the EIB or on the EBRD concentrating most of the development finance resources could, if not done correctly, potentially undermine the current open and inclusive EFAD, and be less effective than the current set-up, relying on the combined and diverse strengths of multiple European institutions.

In view of the European DFIs consulted for this Study, an ECSDB based on the EIB or on the EBRD concentrating most of the EU-level development finance resources (capital and human resources) into one single entity could, if not done correctly, potentially undermine the current ‘open and inclusive’ EFAD, and be less effective than the current set-up, relying on the combined and diverse strengths of multiple European institutions. Any change to the current framework must be done under the principle of an ‘open and inclusive’ architecture, which does not eliminate or diminish the role of any stakeholder, regardless of financial power or political influence and which obliges all stakeholders accessing EU budget funds to uphold EU standards, policies and procedures. And it should be complementary to European DFIs and NDIs and create synergies with them, e.g. by acting also as a wholesaler: co-financing with European DFIs and NDIs and provide refinancing.

To what extent can the EIB put in place a less risk-averse and more flexible risk culture to fulfil the development, policy, and operational requirements of the subsidiary, particularly with respect to LDCs and fragile states? What are the possible implications for the banks’ capital needs?

A change in risk culture is linearly linked to the appetite of an institution to take a loss. The current model of the EIB is highly efficient from a capital perspective because of a very conservative approach to risk. However, where the Bank benefits from an EU or Member State guarantee, the Bank has demonstrated a capacity to take on high levels of risk. Greater risk bearing capacity will require a change in the model and a more flexible risk culture of EIB’s business model oriented towards development impact.
The EIB is arguably the most efficient MDB in the world, securing AAA ratings with the highest gearing level. This is achieved because of the Bank’s stringent risk policies, and Europe as a whole benefits for the high volume of low-cost lending provided by the Bank. This structure creates a challenge when the Bank seeks to operate in high-risk environments. There are two solutions to this dilemma: Either the Bank can secure counter-guarantees from the EU or Member States for its high-risk loans or the Bank requires an increase in paid-in capital. For the non-EU portfolio direct capital increases are of moderate benefit because of the scale of the EU side of the balance-sheet (90%). Hence in order to direct specific mandates the EU has used the guarantee route. This strategy has been rewarded with a very low loss ratio in the Bank for its non-EU loans.

Going forward, two options can be foreseen: (1) The EU and Member States encourage the EIB to take more risk with its portfolio of operations guaranteed by EU and Member States, recognising that the EU, for instance, has provisioned for 9% losses and as such could accommodate a significantly riskier portfolio than currently in place. (2) Alternatively, the EIB must establish a subsidiary which is capitalised with its own ring-fenced capital to absorb any future losses from loans outside the EU.

As set out in Q. 18 the gearing and the quantum of paid-in capital will vary depending upon the structure chosen, but in order to operate with the risk appetite of the EBRD or its other multilateral peers, the subsidiary would need to operate with a gearing of 100% or less (the EBRD limit is 92%) as opposed to the limit at the EIB of 250% and with paid in capital of approximately 25% of the operating assets. The rationale for this can be explained by the rating agencies transition matrices which map the default rates of entities with different ratings. For a B+ portfolio which is the average rating of the EBRD’s portfolio, the rating model implies an 18% default rate after 5 years and a 30% default rate at 10 years. While this does not describe the loss, as recovery rates can vary from 10-80%, it can be seen why the agencies look for paid in capital of between 18-30% for a bank that is lending to LDCs. It has been argued and the data is supportive that default rates of emerging market assets do not map unto the rating agencies transition matrices which are skewed by US high-yield bonds that benefit from chapter II protection versus multilateral loans that have preferred creditor status, but there is simply not sufficient scale in the emerging market data set for a re-calibration to be affected. Indeed, for this reason the EIB and its peer organisations have established the Global Emerging Markets (GEMs) – a risk database for emerging market operations – for which the EIB serves as the secretariat to build a robust credit database for the sector. As this grows a more refined rating approach can be developed. In the meantime, the bond market requires the entities to carry AAA ratings from the leading rating agencies and as such the Banks have to respect their data sets. That the Banks always outperform the predicted losses enables a progressive building of retained earnings in the Banks which in turn can be reinvested into development loans.

2.3.2. Operational Capacities

What would be the operational capacity and constraints with respect to loans, concessional loans, direct and indirect equity, guarantees, technical assistance in target countries, including where needed in combination with public funding?

In the case of the EBRD, the main operational constraints with respect to financial instruments and technical assistance would be increased staffing at HQ for the processing of an increased flow of activity and in country. For the EIB, the Scenario B would have significant structural implications. While, overall, the institutional coverage of the operational capacity is broad in terms of asset classes, the depth of experience in some of these asset classes is more limited given the lean and centralised approach of operations.

Operationally, Scenario A represents an acceleration of the pace and outreach of the EBRD activity. The main operational constraints would thereby be staffing at HQ and developing a strong local in-country presence in Resident Offices to undertake the increased flow of operational activities. The EBRD uses an integrated People Analytics & Organisation Design (OrgVue) HR system to map all processes of staffing, which enables a very clear ability to map a scaling of the operations to accommodate new mandates of geographies. As such the Bank can deliver a detailed plan based on any expansion and immediately convert that to an operational hiring plan to ensure that all capacity constraints are addressed.
**Future Situation**

The Scenario B would have significant structural implications for the EIB. Overall, the breadth of operational capacity is given as the Bank has experience in the full spectrum of asset classes. Yet, if direct equity is to play a more significant role in developing countries, then operational augmentation of skills in this area would be required. While the institutional coverage of the operational capacity is broad in terms of asset classes, the depth of experience is more limited given the lean and centralised approach of operations. So, staffing constraints would need to be addressed to ensure a stronger and more diversified expertise in the different asset classes.

**What is the operational capacity on financing under own risk vs. under guarantees? What is needed to enhance this capacity?**

The EBRD is required to act as a bank, taking risk on its own balance sheet and managing it effectively to maintain financial sustainability. In terms of operational capacity, for the EBRD some additional resources may be required if its operations became significantly more widespread, although at a slower pace than the growth in activities. The EIB has the operational capacity on financing under own risk versus third party risk (e.g. through EU or Member State guarantees) without significant staff increase. If the increase of activities outside Europe led to more local currency operations requiring hedging, this would increase modestly the Treasury operation activities.

**Present & Future Situation**

In fulfilling its transition mandate, the EBRD is required to act as a bank, taking risk on its own balance sheet and managing it effectively to maintain financial sustainability. Assuming stable credit conditions after the COVID-19 pandemic, the EBRD’s current capital capacity can support a level of operating assets by 2025 of EUR 42.1 billion, and a sustainable level of annual investment of EUR 13 billion. The EBRD’s lending capacity is primarily determined by its available capital resources, consisting of paid-in capital, accumulated reserves and callable capital commitments from shareholders. Two capital measures represent the binding constraints against which overall lending and investment capacity can be assessed, namely: a risk-based metric, calibrated to key threshold levels to ensure a AAA credit rating is retained at all times; and a statutory capital measure, which is a nominal metric to ensure compliance with the requirement in the AECB that total loans and equity investments do not exceed capital resources (including callable capital). Operationally, access to liquidity is also a consideration and the Bank holds a proven track record in accessing debt capital markets.

The EBRD holds sufficient liquidity to meet its financial obligations including under stress conditions. The 2020 Borrowing Programme, for instance, allows up to EUR 12 billion of medium to long-term borrowing. The EBRD also secures funding in a wide variety of currencies. By September 2020, medium to long-term borrowing had been undertaken in 19 different currencies. The EBRD’s local currency loan and bond portfolio stood at 4.9 billion in Euro equivalent in June 2020.

In terms of capacity, the expansion of Treasury operations with the near doubling of the Borrowing Programme in recent years and increased currency range has been supported by very small increases in the numbers of staff. Some additional Treasury resources may be required if the EBRD’s operations became significantly more widespread, although at a slower pace than the growth in activity. Importantly, as part of its new strategy, the EBRD will need to explore new ways to leverage its capital more efficiently, including using new structures and instruments. In addition, the EBRD’s shareholder approved risk and capital policies could be examined to determine the scope for enhancing risk-bearing capacity further while remaining prudent. Moving to a risk-based capital metric from the current statutory limit it would be an example.

If the EBRD were able to significantly access EU guarantees this would reduce its need of capital and enhance its capacity for increasing its levels of investments, especially in the long term.

**Present & Future Situation**

If one assumes that the proposed EIB subsidiary will be a captive borrower from the EIB’s main balance sheet, then it is the EIB’s overall programme of borrowing that must be assessed. The EIB’s current overall borrowing programme has been and is expected to be stable at around EUR 60-70 billion annually. The maximum that the EIB so far borrowed in any given year has been in the EUR 75-80 billion range; this was achieved without significant staff increase. If the increase of activities outside Europe led to more local currency operations that required hedging this would increase modestly the Treasury operation activities with the likely need for some limited additional staff and investment/current expenditures budget.
One potential limit to the EIB’s borrowing capacity is market absorption capacity and acceptance; although never tested, there is some margin over EUR 80 billion but going beyond EUR 100 billion annually may change the views of investors (and rating agencies) on the EIB and may structurally impact its cost of funding. In this regard the pace of investment under the NDFI programme, which is comparable to the historic pace of investment will be easily accommodated. The only challenge the Study team foresees is if under pressure to rebuild Europe post the COVID-19 pandemic, and demands for EIB financing within Europe rise significantly, then the additional financing for external operations could become a burden.

In the event that a subsidiary is structured to borrow in its own name, the Study team would foresee that all borrowings could still be executed on behalf of the subsidiary by the main EIB Treasury, under contract to the subsidiary. There are several precedents of MDBs Treasuries executing operations on behalf of a client. Recognising that the International Financial Facility for Immunization (IFFIm) is issuing bonds with lower quantum and has only one client (GAVI – the Vaccine Alliance), possibly the closest analogy is the World Bank Treasury which executes the funding programme of IFFIm, which is structured as an entirely independent balance sheet and pays a fee to the World Bank Treasury for the services rendered. In this instance, the Study team would anticipate a modest increase in the staffing requirements within Treasury to manage investor interface for the new entity. Although not highlighted in this Question, the subsidiary would require an increase to internal audit staff, as the subsidiary will require a full external audit annually.

**What is the operational capacity of EBRD / EIB to provide climate/green finance at the required levels in the relevant countries of operation?**

Both Banks have built a strong track record in climate finance and are operating under ambitious objectives in this sector. Climate change and green finance are an integral part of the EIB and the EBRD’s mandates today. Financing under the EBRD’s Green Economy Transition (GET) approach amounted to EUR 4.6 billion or 46% of total business volume in 2019. The EIB’s financing for projects contributing to climate change mitigation and adaptation outside the EU (excluding Western Balkans and the candidate countries) accounted for approximately 52% of the average annual lending volume between 2016-2019.

**Present & Future Situation**

Environmental sustainability is an integral part of the EBRD’s transition mandate, with Article 2.1(vii) of the AEB stipulating that: “the Bank is committed to promote in the full range of its activities environmentally sound and sustainable development...” The EBRD has applied its private sector and policy skills to scale up climate finance over more than two decades. In the run-up to the COP21 in 2015, the EBRD approved the GET approach. One of three cross-cutting themes in the EBRD’s new strategy for 2021-2015 is supporting countries of operations transition to a green, low-carbon economy. To implement this ambition, the new GET approach for this period sets climate action objectives for the EBRD including reaching a green finance ratio of over 50% by 2025. The new GET approach is broadly convergent with the European Green Deal.

In terms of its climate finance track record, EBRD’s share of green finance has been steadily increasing: 32% of annual investment in 2016, 43% in 2017 and a peak of 46% in 2019. But fell to 29% in 2020, mainly due to the COVID-19 pandemic. Within this, the share of climate finance in line with the definition adopted in common reporting by the MDBs was 94% and 91%, respectively. Importantly, 62% of the EBRD’s climate finance was in the private sector in 2019 (see Table 14 in Annex 5, Volume II).

The EBRD operates predominantly with non-sovereign financing products taking the risk of transactions directly on its balance sheet, rather than relying on sovereign or other forms of guarantees. The EBRD uses a broad range of finance instruments to drive investment in climate action including:

- Non-sovereign private lending financing, for example in industrial energy efficiency and private renewable energy generation;
- Non-sovereign public finance used in financing directly city climate mitigation and adaptation projects without recourse to central government;
- Blended finance instruments to, for example, support the penetration of modern climate technology in the EBRD’s least advanced countries;
- Sovereign loans, for example, to finance large-scale climate adaptation projects;
- Direct equity and equity funds, for example, to support renewable energy deployment, and
- A green Trade Facilitation Programme to support, for example, the trade in green technology.

Expanding climate finance into SSA or other parts of the world would require no fundamental change in the EBRD’s organisational model. However, there would be a need for increased capacity in selected sector teams, as well as in the policy and project-related functions.
In November 2019, and in line with the political ambition behind the European Green Deal, the EIB Board of Directors decided to increase the level of climate and environment commitment for the EIB Group and in effect transform the Bank into the “EU Climate Bank”. Against the backdrop of its climate ambition, the EIB Group has set itself three core operational targets equally applicable to the Bank’s activities inside and outside the EU: First, the EIB will increase its level of support to climate action and environmental sustainability to exceed 50% of its overall lending activity by 2025 and beyond. Second, with its intervention, the Bank targets to leverage EUR 1 trillion of investment in green over the critical decade ahead. Finally, the EIB Group will ensure that its financing activities are aligned to the goals and principles of the Paris Agreement by the end of 2020. Importantly, the new climate ambition includes a commitment to just transition and to helping developing countries move toward a low-carbon, climate-resilient and sustainable economy as part of its development agenda. To further integrate climate change, environmental and social considerations into its financing activities, the EIB will enhance and develop additional risk management tools to assess physical, transition and systemic risks at project, portfolio, and counterparty levels.

Financing for projects contributing to climate change mitigation and adaptation outside the EU (excluding Western Balkans and the candidate countries) accounted for approximately 52% of the average annual lending volume of some EUR 4.1 billion attributed to these regions between 2016-2019. When considering the countries outside the EU Neighbourhood (Global Partner countries, including SSA, Asia and Latin America), the percentage increases to 61% (approximately EUR 1.3 billion p.a.). The EIB is a significant investor in SSA and the Bank’s lending to support sustainable economic development in the region was approximately EUR 6 billion between 2012 and 2019. These loans were primarily used to finance projects that promote water security, resilience, and access to renewable energy.

The Bank covers a wide spectrum of financial products and advisory services to support long-term green investment needs. Specifically, for outside the EU, the EIB manages the ACP IF, a EUR 3 billion revolving fund which can support green projects in the ACP region with a broad range of flexible risk-bearing instruments. Moreover, the EIB acts as the manager and treasurer for the EU-Africa Infrastructure Trust Fund (EU-AITF), which supports regional, national and local projects targeting SE4ALL (amongst other) goals in SSA.

43 To what extent is there capacity to crowd in private/public-sector investors and address market failures/sub-optimal investment situations? What would be necessary to increase this capacity to match the needs, particularly with respect to operations in LDCs and fragile states?

The EBRD’s capacity to crowd in private/public investors is a function of its capacity to co-invest, mobilise, and provide policy advice. To significantly increase its capacity to operate in LDCs and fragile states, further donor support will be needed as well as the establishment of operations on the ground and fine tuning its transition approach. The EIB’s capacity to crowd in private/public investors is also a function of its capacity to co-invest and mobilise funds. However, it would need more donor support and increase its risk appetite taking on more risk on its own balance, increasing its exposure to small ticket sizes as well as strengthening its presence on the ground.

The EBRD finance comes from both the EBRD’s own resources and the mobilisation of other sources of private and public financing. The EBRD aims to support the creation of functioning and sustainable markets. The AEB enshrines the importance of crowding in investment from third party investors.139

The EBRD crowds in private and public investment through three main channels:

1. **Co-investment** by project sponsors and other lenders or investors both private and public that participate directly in the project. In 2019, total external investment from these sources amounted to EUR 25.1 billion with the EBRD’s direct investment consisting of EUR 10 billion.

2. **Mobilising** third party investment in its lending activities. Through this, additional finance is channelled to countries of operations and new investors sensitised to the opportunities for future investment that exist. In 2019, the EBRD mobilised EUR 1.3 billion of external finance in 74 transactions (based on the EBRD’s current internal definition of Annual Mobilised Investment). However, it is important to note that the private sector mobilisation shows a decreasing tendency as discussed in Q. 36.

3. **Expanding investment opportunities**, the EBRD catalyses the flow of additional finance through delivering on its objective of achieving systemic change and building functioning markets. Also, the
EBRD plays an important role in engaging in policy dialogue in specific sectors as well as in improving the regulatory environment and the "rules of the game" so that investment opportunities are broadened. In order to increase its capacity to crowd in investors, particularly in LDCs and fragile states, the following issues are critical:

- Further support from the EU and Member States in the form of capital, guarantees, grants, and endowments, and, in the long term, capital;
- Specific expertise and experience in impact investing could enhance delivery;
- Establishing a presence on the ground in the new geographies to be served is especially critical to strengthen project origination and the pipeline of bankable projects, especially in LDCs and fragile states where smaller local clients are the main source of operations.

**Present & Future Situation**

To support local private sector development, the EIB uses instruments such as credit lines to local banks or microfinance institutions. To a much lesser extent, it utilises risk finance and equity for start-ups, social impact funds and innovative SMEs as well as corporate and project finance.

The EIB limits its financing to a maximum of 50% of a project’s total cost (and de facto EIB financing accounts for one fourth on average of projects outside the EU), so it is structurally geared towards crowding-in other actors. This is reflected by: (i) the co-financing of more than 235 projects outside the EU from 2014 to 2019 (total investment of EUR 84 billion) (ii) the European Financing Partners (EFP), a formal agreements on co-financing private sector projects and strengthening co-operation between eligible European DFIs and the EIB, (iii) the Mutual Reliance Initiative with the KfW and the AFD on co-financing operations and pooling resources for project appraisal and monitoring, information-sharing and consultation, (iv) the MoU and Procurement Procedural Framework with the EBRD which make implementation of joint projects easier, (v) and the Interact Climate Change Facility with the AFD, which finances renewable energy and energy efficiency projects in the private sector in developing countries and emerging economies.

In order to increase its capacity to crowd in investors, particularly in LDCs and fragile states, the following issues are critical:

- Further support from the EU and Member States in the form of capital, guarantees, grants, and endowments, and capital;
- The formation of a subsidiary should allow the EIB to increase its risk appetite (lower but riskier volumes per capital deployed) and business model (higher revenues and higher costs);
- The EIB, if required by its mandators, will need to increase its exposure to smaller tickets and direct equity transactions in the private sector;
- The EIB should consider tailoring its pricing policy for private sector operations further to the local context, where possible. Pricing of public sector operations is largely a function of the mandates and in line with standard MDB practise.

**What is the operational capacity of the EBRD to a significant broadening of its public sector operations?**

For the EBRD to broaden the public activities beyond the 40%, it would require a shareholder decision to change the AEB. Access to donor(grant resources would be helpful to support an expansion of public sector activities, including grants for capacity building support for its clients and to the sovereign guarantee window of NDICI/EFSD+. It will also need to expand its operational capabilities in new geographical areas.

**Present & Future Situation**

The EBRD’s mandate is focused on the private sector, with the ability for selective engagement with the public sector. The AEB states that not more than 40% of the amount of the EBRD’s total commitments, whether on a sovereign, non-sovereign or commercial basis, shall be provided to the public sector, including national and local governments, their agencies, and enterprises owned or controlled by any of them. The private share of the EBRD’s portfolio stands at 65% as of September 2020. The public sector portfolio is composed of public sovereign and non-sovereign (structured and priced commercially) exposure (see Table 15 in Annex 5, Volume II).

The EBRD has also expertise in policy, project preparation, and technical knowhow. Taken together, these elements would allow for an expansion of public sector operations. However, access to donor(grant resources would be helpful to support an expansion of public sector activities, including for public stakeholders to access capacity building support, in order to ensure sound policies, good project preparation, well designed bankable structures and efficient implementation.
Under Scenario A, the exclusive sovereign guarantee window currently envisaged for the EIB under NDCI/EFSF+ would need to be changed. The EBRD could effectively use the guarantee capacity under this window to scale up sovereign operations.

What is the operational capacity of the EIB to a significant broadening of its private sector operations (excluding ‘Apex loans’), while avoiding any crowding out effect on private sector operations not financed by the EIB?

To significantly broaden its current operational capacity to serve private sector operations, the EIB would need to increase its in-country staff, especially loan officers and technical to lead transactions and should be able to undertake riskier operations on its own. The Bank will have to strictly apply international standards to avoid crowding out private investment and market-based pricing methodologies.

B Present & Future Situation

As mentioned in Q. 19, a key focus area of EIB’s business model remains to be on larger public scale infrastructure projects; its private sector operations are mainly based on on-lending activities to financial intermediaries and corporate clients. This situation reflects the current centralised approach of the EIB with relative few staff, where a small fraction of its FTEs focusing on private sector activities outside the EU are located on the ground, as discussed in previous questions. The operating model favours standard projects.

To significantly broaden its current operational capacity to serve private sector operations, the EIB would need to increase its in-country staff, especially loan officers and technical staff to lead transactions. This would allow the EIB to pursue more direct transactions and smaller tickets as well as increase its indirect lending through financial intermediaries. Moreover, the EIB will need to increase its operations in local currency loans, micro-loans, and equity guarantees as well as supply chain financing and trade finance, and loan syndications.

The risk of the EIB crowding out investors has been pointed out by the evaluation of the EIB ELM Mandate, in which it is mentioned that the EIB borrowing terms offered are considerably better than market alternatives, both in terms of maturities and interest rates as provided for in the ELM from the EC. In this regard, several DFIs interviewed suggested that a ECSDA based on the EIB would have to strictly apply blended finance principles to avoid crowding out private investment, such as standards of the Organisation for Economic Co-operation and Development (OECD), which the Bank endorsed in March of 2020.

2.3.3. Expertise and Manpower

To what extent is specific expertise available in the EBRD, in particular with regard to public and private operations in the EU Neighbourhood, SSA and LDCs? What would be the underlying costs and timeframes to address possible adaptation needs?

The EBRD has the expertise required to successfully execute both public and private operations in the EU Neighbourhood. The main challenge would be the expansion into SSA, and specifically, the LDCs, and thereby additional staffing and building local expertise.

A Present Situation & Transition Process

The EBRD has significant expertise to successfully execute both public and private operations in the EU Neighbourhood, SSA and LDCs. The Bank is one of the most active multilaterals within the Neighbourhood region from a standing start in 2011. The main challenge would be the expansion into SSA, and specifically the LDCs within SSA. The EBRD does not currently work in any LDCs but has operations in four IDA-eligible countries (Kosovo, Kyrgyz Republic, Tajikistan, and Uzbekistan). To become embedded in selected countries in the SSA region would take at least three years. Market participants expect that it can take up to ten years for the entire SSA region (see Q 15).

Cumulatively, since its inception in 1991, the EBRD has invested EUR 39.8 billion over 1,607 projects in the EU Neighbourhood countries. In 2019, 79 % of EBRD projects corresponding to 75 % of business volume were outside the EU, while 39 % of the EBRD’s signed business volume was in Neighbourhood countries. Moreover, in the EU Neighbourhood countries, EBRD has a network of 18 Resident Offices with 348 staff. It also has additional six satellite offices across the Western Balkans and two in Turkey with 119 and 97 staff, respectively (see Table 16 in Annex 5, Volume II).

The EBRD currently does not work in SSA and thus cannot offer an institutional track record in these countries. To succeed in SSA, the EBRD would need to acquire additional skills and local knowledge for its business model to be fully effective, both for public sector and private sector operations. It will thus need to
hire new expertise, in particular local expertise, as well as international experts with regional experience and the right sets of skills to operate in SSA and fragile countries. To get started quickly, the fastest way to address adaptation needs would be to hire new expertise, in particular local expertise.

The EBRD would also seek to closely work with development partners already present on the ground to gain insight and understanding, including the WB, the IMF, the IFC, and European DFIs, including, when possible, secondments. However, according to stakeholders interviewed, building up its own close relationships at the country level with national and local Governments, NGOs, and EU Delegations, among other local partners, can prove to be time and resource consuming and can take several years (see also Q. 38b).

| 47 | To what extent is specific expertise available at EIB, in particular with regard to public and private operations in the EU Neighbourhood, SSA and LDCs? What would be the underlying costs and timeframes to address possible adaptation needs? |
| 48 | Is sufficient expertise available in the EIB, in particular with regard to project preparation, development impact and private sector operations? If not, how would this need to be further developed and expanded, and at which cost? |
| 49 | To what extent should the EIB scale up its local presence to match the development, policy and operational requirements of the subsidiary and what costs would this imply? |

The EIB would need to strengthen its expertise, in particular local expertise, as well as international expertise with regional experience and the right sets of skills to operate in SSA and fragile countries, especially for the private sector and policy dialogue, which contribute to create the conditions for the creation of a stable pipeline of bankable projects. A less centralised approach will also strengthen EIB’s capacity in project preparation and in directly monitoring the development impact of the projects implemented.

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The current business model of the EIB is rather centralised in comparison with other peers. Moreover, most EIB operations are done through co-financing mechanisms of projects with other DFI and local partners so that it is structurally geared towards crowding-in other actors. As a result, part of the work related to project origination is done through EIB’s project partners. Particularly, in the private sector, the EIB has mostly a wholesale approach and does not significantly engage directly in small transactions.

The EIB has recognised these current limitations and proposed to reinforce its presence on the ground notably in SSA, LDCs and fragile states to be able to originate more projects in remote or disadvantaged regions and undertake smaller transactions. Furthermore, the proposal for expansion encompassed a mix of operational and PJ staff to be either relocated to hired locally, as a greater local presence of PJ experts will further the development and policy requirement, enhancing the impact of the EIB operations. A less centralised approach would also strengthen EIB’s capacity in project preparation and in directly monitoring the development impact of the projects implemented.

The Study team notes that the EIB itself has the view that it can operate with a lighter touch approach, leveraging the presence of EU Delegations and the extensive on-the-ground teams of the European DFIs. It is questionable if this approach would be sufficient for an ECSDB that can provide its own, independent substantial policy support and project development on the ground. For this reason, the Study team concludes that if Scenario B is chosen, the EIB will need to strengthen its local teams more than currently envisioned.

| 50 | To what extent are the banks in a position to provide country and sectoral expertise, as well as analytical input on policy reform needs in countries of operation? Would these capacities need to be beefed up and how at which cost? |

Overall, the EBRD’s country, sectoral, and policy advisory expertise is proven, but will need to be replicated in new countries of operation. Overall, the EIB’s country and policy advisory expertise is very limited at country level due to its centralised business model. While experts are mainly based in Luxembourg, they tend to cover the whole geographical scope of the EIB, i.e. both developed EU countries and developing and emerging partner countries.

The EBRD offers country, sectoral, and policy expertise through its hybrid structure. With Resident Offices spanning across the 38 economies where the EBRD works, the Bank’s “boots on the ground” model aims to ensure an in-depth understanding of markets, including the underlying economic, financial, and political economy dynamics (see Q. 35 and Table 17 in Annex 5, Volume II).
The EBRD leverages teams of country staff, economists, and lawyers to identify a number of ‘priority policy objectives’ every year. These objectives are informed by country diagnostics conducted to support the development of country strategies. The country diagnostics identify the challenges and opportunities for developing transition impact, with a specific focus on the binding constraints to private sector developments. These diagnostics provide an analytical foundation for prioritising the key reforms needed.

Approaches to strengthen the EBRD’s model were set out in the recently approved strategy for 2021-2025. Specific ways to enhance the effectiveness and impact of policy work include:

- Broadening the focus of policy activity from individual transactions at the firm level to seeking systemic impact through sector and economy level interventions;
- Consolidating knowledge, experience gained and lesson learning, especially in the core areas of the EBRD’s distinct expertise and;
- Stepping up coordinated policy work in close partnership with a full range of partners including the Commission, the IMF, the WB Group, regional development banks, and bilateral agencies.

Should the EBRD expand to new countries, especially in SSA, there would be a need to equip or increase its staff with the right skills and knowledge in terms of sectoral and country expertise, especially related to social sectors and inclusiveness. In addition, there may be an even greater need for policy work – and thus the underlying country and sector expertise – for countries less advanced that would require more upstream work to open up markets and create a pipeline of bankable projects.

**Present & Future Situation**

Although the EIB has about 500 front line and 400 back office staff working directly on operations outside the EU, mostly in Luxembourg, its presence on the ground is limited (see Q. 35 for more details). Looking specifically at sector expertise, the 492 EIB staff in the PT 147 is divided as in Table 18 in Annex 5, Volume II. In addition, the Economics Department has 52 staff and is responsible for country risk, macroeconomic and financial sector analysis, and studies to support and influence the Bank in its operations and in the definition of its positioning, strategies, and policies.

If an ECSDB based on the EIB would be decided, these resources would need to be increased. Particularly, the EIB would need to strengthen its local presence. Country expertise and policy reform advisory cannot only be acquired or done remotely in the view of key informants interviewed. Also, sectoral expertise benefits from country presence due to each country’s unique features and regulatory frameworks.

The EIB will need thus to increase the local expertise with loan monitoring officers, engineers, economists, and other experts, who have the required country/sector experience as well as knowledge skills in advisory and policy reform dialogues.

In this context, to what extent is there capacity to carry out advisory and policy dialogue work in close cooperation with the European Commission services/EEAS and the EU Member States?

A future ECSDB should focus on policy reforms conducive to investments in specific sectors and priority areas, and especially conducive to private investments. The EBRD has a strong experience in this in its current countries of operations. Should the EBRD expand to new countries, especially in SSA, there would be a need for increasing its staffing to carry out advisory and policy dialogue, especially in the context of LDCs and fragile states. In the case of the EIB, the Bank would have to significantly increase its capacity of carrying out advisory and policy dialogue.

**Stakeholders interviewed, including EU Delegations, agreed that the EBRD has a strong experience in carrying out advisory and policy dialogue work in its current countries of operation. Similar to the approach of other MDBs/IFIs, the Bank interacts with policymakers through policy dialogue in order to help improve the business environment across our countries of operations. Generally, the EBRD undertakes policy engagement in coordination with the EU and its Member States, leveraging its local knowledge and network of Resident Offices as well as its deep sector expertise. Moreover, the EBRD has 15 staff dedicated to working on European Affairs and EU donor relations, including through a representative office in Brussels (see Q. 9 on the EU presence of the Bank). In addition, the EBRD has significantly invested in knowledge creation and sharing, as well as in training and capacity building, in order to foster dialogue among stakeholders, e.g. policymakers and private sector executives, so that an enabling business environment would emerge in specific areas, e.g. trade finance or energy efficiency. However, as already indicated above, the Study team noted that adaptations will be needed of the EBRD’s transition approach used for engaging in**
country reforms to reflect the contexts of LDCs and fragile states for which capacity building and transfer of knowledge would be required in specific areas, e.g. governance, rule of law.

**Present & Future Situation**

It was stated by the EIB that “effective development financing should include assistance programmes for policy reform and institution-building (in close cooperation with recipient countries), and all interventions should be part of broader regional/ country development strategies. While the EC and the EIBA are responsible for defining EU policies, the EU financing institutions are expected to bring more expertise and be better integrated with the process.”

The EIB has strong expertise in areas such as climate, energy, transport or financial market development. It provides some support to policy dialogues for instances, by engaging with EU staffs, conducting joint missions, and creating good knowledge frameworks on specific themes throughout its high-quality sector and/or country reports.

However, as the bulk of advisory and policy dialogue work takes place in the countries of operations, as pointed out by various key informants interviewed, a prerequisite for policy dialogue is to directly and regularly interact with policymakers in the partner countries. Governments in close cooperation with the EU Delegations and Member States so as to leverage existing development expertise within them and ensure maximum synergies. This involves regular, formal and informal communication at country level with policymakers and CSOs to create trust and fully understand the political context.

For this reason, an increase of the EIB’s local presence would be needed to better support policy dialogues. The aim should be on adding value to existing EU and Member States expertise on the ground. This will require EIB to expand its number of staff specialised in this field or the provision of these services through international and governmental partners under its close supervision. The degree of local presence would have to be decided in close coordination with the EC and Member States in order to avoid duplication of existing EU and bilateral policy dialogues and strategic planning efforts.

As a general rule, a ECSDB based on the EIB would have to support and complement, but not replace existing policy dialogues with beneficiary countries and contribute to and adopt EU country strategies to provide strategic direction to its programmes.

- **To what extent is there capacity to contribute to project generation and origination in countries of operation? What would be the required changes for project generation/origination?**

- **To what extent is the current “in-house” development expertise, the country and sectoral knowledge coupled with the local presence adapted to meet the above policy requirements? What are the implications in adapting to be fit for the task?**

Through its Resident Offices and staff in the field, the EBRD has the capacity to contribute to project generation and origination in countries of operation and meet the above policy requirements. As the mandate expands, new capacity would be added in new country of operations. The Study team’s analysis shows that the EIB has less capacity in the field, relying to a greater extent on partners and on co-financing arrangements. As a result, more capacity would need to be built as the EIB expands.

**Present & Future Situation**

Based on its strong country presence (see Qs. 35 and 50, 51 for more details) the EBRD contributes to generate new bankable projects by capitalising on its ability to combine private and selective sovereign lending with project-level technical cooperation and government-level policy engagement. But this business model and the linked capacity would need to be built up with the expansion to new geographies by establishing a network of Resident Offices and/or regional “hubs” to contribute to project generation and origination.

**Present & Future Situation**

As a result of the limited country-presence of the EIB, the current capacity to contribute to project generation and originations at the country level on its own is limited. For this reason, outside of the sovereign lending sector the EIB frequently depends on its international partners to generate bankable projects, as DFIs have highlighted and referred as a wholesale approach.

Our interviews with DFIs and EU Delegations have pointed out that the lack of sufficient presence on the ground is one reason why the EIB is perceived by them as being passive and depended on others to take the lead in the origination and project preparation, especially on the European DFIs. As mentioned in Q. 51, an
ECSDB based on the EIB would also have to strengthen its policy reform advisory capabilities at country level and its visibility on the ground.

54 How would appropriate local presence be ensured in the future countries of operation? How could this presence be graded/scaled up according to priorities and countries of operation? What operational relations with EU Delegations should be envisaged?

Based on its past expansion to new countries of operations, e.g. SEMED, the EBRD has the experience to build capacity on the grounds, which could be used for expanding in new geographic areas. At the operational level, the ECSDB based on the EIB would continue to work closely with the EU and international partners on the ground. In case of an expansion, the EIB staff could be located within EU Delegations whenever possible to facilitate its local presence.

A  

**Future Situation**

- **Policy first approach**
- **Open architecture**
- **A system that delivers**

The EBRD has the benefit of having experience with four previous ‘waves’ of expansions when it comes to planning the expansion of local presence, including to the SEMED region as well as the existing experience with its operational model of Resident Office and regional ‘hubs’. The EBRD has detailed data on its workforce and the capability to analyse scenarios of different approaches, looking at, for example, the optimal mix of staff in Resident Offices based on expertise, levels of seniority, span of control, etc. The data models also allow for reviewing the composition of offices relative to the level of business volumes generated. This data combined with discussions with development banks already active in new countries would allow the Bank to effectively size the right level of local presence to start operations.

As confirmed by interviews with EU Delegations, the EBRD regularly takes part in EU coordination exercises, which have resulted in joint policy messages and priorities and well-aligned operating models at the country level. The EU Delegations could better leverage and benefit from the EBRD’s network of Resident Offices and by systematically engaging with them, including participating more deeply in EBRD’s country strategies (consultation and coordination already exists) and exchange of information with experts.

B  

**Future Situation**

- **Policy first approach**
- **Open architecture**
- **A system that delivers**

At the operational level, the ECSDB based on the EIB, would have to continue to work closely with the EU and international partners on the ground. The EIB staff could be located within EU Delegations whenever possible, and benefit from joint dialogue with national partners and joint EU country programming. Currently 18 EIB External Offices (out of 26) are co-located within EU Delegations and the co-location regime has been further consolidated and standardised through signature of the EIB-Beas Administrative Service Level Agreement of March 2020.

Regarding the cooperation with the EU Delegations, the EIB has reached out to Heads of Delegation highlighting the Bank’s availability to support the programming process and investment needs assessment, while identifying key contact points per country. In DEVCO (now INTFA) and NEAR regions, preliminary EIB country fiches have been sent to and, in many instances, discussed with, EU Delegations as a further input into the preparatory phase. This proactive engagement has tended to enhance subsequent cooperation and planning and should be continued in the future. However, most stakeholders interviewed, including EU Delegations, have pointed out that the level of engagement of EIB staff should be increased, especially in countries where the EIB does not currently have local presence.

2.4. Development Impact Implications

2.4.1. Alignment to EU Policy Objectives

**Policy first** principles and **Coherence of the European approach** as main criteria for informed decision making on the European Financial Architecture Development

This section focuses on studying how the operations of the EBRD, the EIB, and European DFIs can be better aligned and be more coherent with EU policy and development impact objectives stated in the NDICI regulation and the principles of European preference, among other reference documents. If ‘Policy first’ is correctly implemented, then this will guarantee proper development impact. It recognises the outstanding importance of the Policy first and coherence principles for informed decision making on the future EFAD.

Together with the ambition of an ‘open and inclusive’ architecture, these principles do not only reflect the policy requirements and expectations of the EU Member States and the Commission towards the EFAD, but also CSOs interviewed for this Study. Any scenario should clearly prioritise development impacts and adopt a pro-poor agenda with a strong gender lens, focusing on poverty reduction, tackling inequalities, and
leaving no one behind. The institutional part of this architecture should support the ability of countries to reach the SDGs, the linked 5ps\textsuperscript{19}, the Paris Climate Agreement, the European Green Deal, and other international human rights and labour standards, and should not be seen as a mean to deliver on commercial or foreign affairs objectives of EU countries only.

In addition, development banks at the core of European development finance, including the EIB and the EBRD, should ensure that development outcomes take precedence over profitability. The financial sustainability of the institutions should not undermine their ability to invest in higher risk areas or focus on projects where development returns are high, but profitability may be low. Furthermore, most of the work of DFIs is concentrated in Middle Income Countries (MICs) and in ‘hard’ economic sectors (i.e. physical infrastructure) with very little focus on social sectors (health, education, and social protection) and LDCs and fragile countries. This needs to be addressed to maximise development impact and catalyse real transformations

All of this is even more relevant in the context to the COVID-19 crisis, where a significant reduction in the financing available to developing economies is seen. The OECD has estimated that the external private finance inflows to developing economies could drop by USD 700 billion in 2020 compared to 2019 levels, exceeding the immediate impact of the 2008 Global Financial Crisis by 60\%\textsuperscript{122}.

If an ECSDB is to be created, the following aspects would have to be considered, in view of the stakeholders and the Member States consulted, so that the new institution brings added value:

- It must strictly follow the ‘Policy first’ approach and thus closely follow EU policy objectives in terms of development impact and climate change, EU values, and visibility;
- It must have local presence to ensure a deep understanding of markets, including the underlying economic, financial, and political economy dynamics;
- It must have the capacity to undertake policy dialogue and support policy reforms in close cooperation and synergy with the EEAS and the EC to create the necessary conditions for crowdfunding in private sector finance in collaboration with European DFIs;
- It must apply international standards already endorsed by DFIs and MDBs to avoid crowding out private investment, in line with the DFI Working Group’s ‘Enhanced Principles for Blended Concessional Finance’ and market-based pricing methodologies. All these attributes should be included in the statutes of such an institution;
- It must adhere to high standards in terms of accountability, and social and environmental impact, and human rights;
- It must maximise development results for local people, including strengthening public health systems, delivering on the climate crisis and contributing to the fight against poverty and inequality, including gender inequality;
- It must focus on LDCs and fragile countries, social sectors, and inclusiveness.
- Its governance must include provisions to ensure insulation from undue political influence and corporate pressure, and to ensure democratic accountability\textsuperscript{123}.

It was noted that, according to CSOs interviewed, the operating culture and incentive/reward schemes of both the EBRD and the EIB (as well as other European DFIs) should have a clearer development aim, focusing on development additivity and targeting finance where it is needed most, avoiding competition for low-hanging fruit projects and profitability. Projects should therefore be selected according to their highest development pay out. In their view, most DFIs have the interest and willingness to take the necessary steps to mainstream their priorities towards achieving the SDGs into their strategies and operations. Nonetheless, findings suggest that both strategic and operational endeavours are at early stages of alignment. Actions are still scattered and are not systematised at the portfolio level as a whole, therefore, losing forcefulness and visibility of its possible impact\textsuperscript{124}.

Is there sufficiently “in-built” flexibility at operational level to ensure smooth alignment to evolving EU policy priorities, standards, rules, and sanctions? Is there sufficient capacity in each bank to ensure EU policy coherence and promote synergies between different EU funds and instruments?

Both the EBRD and the EIB have the capacity to ensure EU policy coherence and promote synergies between different EU funds and instruments, although there are significant differences between the two Banks. The EBRD presents a strong case with its “in-built” flexibility at operational and country level because of its development focus and experience in executing major strategies to expand in new regions and sectors outside Europe, with the establishment of well-staffed Resident Offices. The EBRD has generally been able to align to EU policy priorities, standards, rules, and sanctions. The EIB strictly follows the “Policy first” approach from a statutory and institutional governance perspective. This approach is structurally embodied in the EIB, however, according to the consultation processes, there is room for the EIB to further enhance the coherence of its actions with EU policies at operational and country level.
Although the EU has a simple 53.92% shareholding majority, generally the Bank has been able to align to EU policy priorities, standards, rules, and sanctions at operational level. The EBRD has also been able to promote synergies between different EU funds and instruments. In other words, the EBRD has demonstrated to align well to EU policy priorities, standards and rules: In the countries in which the EBRD is currently active, there is evidence that, overall the Bank’s policies are well aligned with those of the EU.

Occasionally, however, there are dealignments between the EBRD and the EU. For instance, an area of dealignment is the EU sanctions regime, to which EBRD, as a broader multilateral institution, is not formally subject, which could have implications for the EBRD’s projects and other operations. The EBRD is currently negotiating an approach on sanctions for when it works with EU donor funds.

The EU is the largest donor to the EBRD and represents more than 35% of the total donor funds received since its inception and recently approximately 50%. Through its donor resources, the EU is able to help guide the EBRD’s operational directions and has a direct impact on standards, priorities, and policy principles. The EBRD is active in the use of various EU funds, facilities, and financial instruments which contributes to promote synergies among them. Many of EBRD’s own policies draw on EU Directives and broader principles and aims. It can be confirmed that for several EBRD countries of operations, the convergence with EU standards provides a strong policy anchor. Additionally, the strong network of local EBRD offices and their cooperation with the EU Delegations allows both to identify and support joint projects on the ground in a flexible and needs-oriented way and to engage in local coordination exercises with international stakeholders and national authorities, in order to advance joint reform and delivery messages.

If the EBRD is to become the new ECSDB, the level of alignment to evolving the EU preference principle (EU policy priorities, standards, rules and sanctions) at operational level should be fully sustained under the following assumptions: (i) the EBRD would be able to operate under the mandate of the EU and ensure a full alignment of operations with EU priorities, especially for operating in new regions, e.g. SSA; (ii) the EBRD would need to adapt its business model (see Q. 37a); and (iii) the EBRD would be required to build a network of functional Resident Offices in the new geographies.

The EIB adheres to the ‘Policy first’ approach from an statutory and institutional governance perspective. This approach is structurally embodied in the EIB through the EIB shareholding structure, being fully owned and exclusively controlled by the Member States, and the EEAS as an observer as well established under the regulatory and contractual framework of the EU mandates entrusting EIB with the implementation of specific EU instruments. Moreover, each operation as part of the EIB project assessment methodology outside the EU already needs to clearly demonstrate how it contributes to the EU policy objectives identified in the specific country, thus ensuring policy coherence with EU policy priorities.

Overall, the EIB has been able to ensure alignment with EU policies and priorities through the funds and instruments which it currently utilises, including grants, blending resources, EFSI, and ELM, and ACP IF all of which are decided and adopted by EU decision makers as discussed in detail in Q. 20 in close cooperation with the EC. However, as pointed out by the evaluation of the EIB ELM there is room for improvements at operational level, including (i) strengthening the alignment of EIB operations with EU policies through stronger policy steer from the EU and closer coordination between the EIB, the Commission and the EEAS. The latter includes early-stage coordination on the specific EU mandates, more substantial information to be provided by the EIB on mandate operations and in addition to the ‘Article 19 consultations’ before financing operations are approved, and joint monitoring of project implementation, (ii) for the EIB, Commission services and the EEAS to work better together in defining the optimal size of envisaged investment operations under mandates, tailored to the beneficiary countries, and (iii) for the EIB to share more information with the Commission on mandate operations and the effective application of contractual clauses enabling the EIB to suspend disbursements in cases of projects’ non-compliance with environmental, social, human rights, tax and transparency standards.

Moreover, at country level, the ‘in-built’ flexibility of the EIB could be further enhanced to ensure smoother alignment and flexibility to align to evolving EU policy priorities, standards, rules, and sanctions as well as its capacity for promoting synergies between different EU instruments. This is already taking place through enhanced upstream cooperation (regular regional and country meetings between the EIB and the EC/ EEAS geographic teams) as well as a more systematic involvement of the EIB in the ongoing programming process. More important, cooperation at country level could be improved given that the current business model of the EIB is centralised and its presence on the ground is limited, as discussed in detail in Q. 50.