EMN response to "Targeted Consultation for the Members of the GECES Working Group on Social Investment and Skills"

In anticipation of the EC's MFF proposal, EMN published a number of concrete proposals to optimise support for the microfinance sector. They can be found on the EMN website here: link.

1. What improvements can be made to the existing financial instruments? Should any of the existing financial instruments be scrapped? *Please provide concrete solutions on product features that can be improved.*

A preliminary note on implementing partners: Over the past programming periods, the EIB group has proven itself a capable implementing partner, with strong governance and procedures for deploying large sums to sophisticated beneficiaries. However, the majority of non-bank financial institutions in Europe are smaller than this, and (a) do not have the capacity to understand the many ways in which the EU can support them, (b) do not have the expertise required to apply for such support successfully, and (c) are such small companies that even the smallest ticket size may be too much for them to absorb.
For the delivery of EU budget support to the microfinance sector, we would urge the EC to support actively the development of complementary implementing partners and possibly adapt Articles 62 (1)(c) accordingly.

A preliminary note on consistency of financial instruments: As financial support becomes available to the market, its beneficiaries begin to implement processes to adapt their businesses to allow them to benefit from the support. However, as the EU support evolves, there is a real risk for companies that requirements continue to change and governance conditions become more stringent. Once companies have made the necessary commitments and invested the necessary up-front costs to apply for EU support, it can be extremely disruptive if that support is unpredictably delayed ("stop-and-go"), or even cancelled. Following this, we strongly urge the EC to seek consistency and predictability in the delivery of the supporting instruments, in terms of availability and requirements.

- **EaSI guarantee**: This instrument has proven its effectiveness, and we strongly encourage its expansion. To further increase the impact of this financial instrument its scope could be expanded to include non-credit portfolios e.g. micro-equity/own funds investments.
- **EaSI capacity building:** The contribution to the HELENOS fund is a welcome initiative, which should be used as a proof-of-concept to deploy much more potent support amounts. To be geographically diverse, as HELENOS intends to be, multiples of the current budget will be needed. There is however an issue about the expected return requested by EIF, which is currently given with expectations of financial returns in line with commercial rates. The argument given for this is always that they seek to avoid crowding out of the market, but it de facto results in the benefits of the public support not flowing down to the final beneficiaries. The expected returns may be better defined in social impact terms rather than financial return.
- **EFSI equity social impact pilots:** Our understanding is that this financial tool is currently being implemented by the EIF under the "Social Impact Accelerator' (SIA). the reality is that this is managed by the EIF by a team that is entirely separate from its microfinance team. Therefore, it looks like microfinance is (regrettably) excluded from the scope of this tool.
  The importance of equity and quasi-equity investments for the organizational development of non-bank microfinance organisations is growing in Europe, mostly due to more challenging market environments and the need for better ICT-infrastructure in the sector. On the other hand, European microfinance organisations are still relatively small, which limits the absorption capacity for bigger equity tickets. We

recommend to include support to microfinance institutions into the objectives of the SIA and future similar initiatives.

- **EaSI funded instrument:** While EMN supports the objectives and design of this instrument, in practical terms it has proven to be impossible to deploy this instrument. The goal of this instrument (boosting on-lending to MFIs) could also be achieved by a guarantee instrument for banks that lend to MFIs. If we may safely conclude that financial guarantees have proven to be well-absorbed by the market, transforming this product as described may allow us to achieve the same objective. This could be piloted in the existing MFF, and expanded upon in the next MFF.
- **EaSI transaction cost support:** given the relatively short period that any capacity building instruments were brought to market, it is not clear yet if the microfinance sector could benefit from this. It could be useful to know explicitly if the goal of this instrument is also to support transaction costs of such initiatives as HELENOS and any successors it may have.
  Microfinance organizations also need subsidies to mitigate the high transaction costs of serving microfinance clients in a fair and sustainable manner without raising interest rates. We recommend to look into the possibility of providing direct institutional subsidies or very low interest rate capital for on-lending to microfinance organisations, if they agree lend below a negotiated interest rate level.
- **EaSI business development services pilot:** Despite the importance of BDS for the social working of microfinance, the BDS grants have been extremely small, and have taken a huge amount of time to launch. As the call for proposals only launched recently, we expect that it will quickly prove that there is demand for this.
- Stimulating the financial inclusion of migrants/refugees is a laudable goal, and one that is fully in line with the objectives of the microfinance industry. It is important to note that this is not the only group for which BDS is essential. In fact, it is foundational for the entire operations of microfinance, and as such more BDS grants should be available centrally to stimulate financial inclusion.

EaSI Technical Assistance: This programme has proved to be strongly demanded by the microfinance sector as it was also the case from its predecessor with the JASMINE Initiative. Nevertheless, we consider that there is still scope for improvement regarding one of its basic ideas of a limited up to 12 days tailored-trainings services. While these 12 days could be effective, if properly designed, for more mature MFIs, it is clearly insufficient for greenfield and Tier 1 MFIs that would require a more extensive support of around 40 days in order to really enhance an organizational change.

2. What new EU-level financial products should be considered to address current market failures or sub-optimal investment situations? *Please specify the market gap that a new product would address and explain why an EU-level solution is needed (e.g. why this cannot be adequately addressed by EU structural funds or national schemes).*

EMN is in the process of proposing a new platform that would act as an implementing partner for EU support to the microfinance sector. It would be a one-stop-shop accessible to MFIs and Social Enterprises Financial Institutions alike, streamlining the process of deploying EU support.

The development of BDS is often quoted as an important goal of the European Social Fund (specifically TO 8, 9, 10[1]). However, in practice there is little to no evidence that this is effective. Rather, a more comprehensive and ambitious central programme of EaSI business development services could strongly emplify the capacity for mentoring, coaching, and training for inexperienced entrepreneurs across Europe.

Low interest-rate senior loans are also a very relevant instrument to help business microcredit providers scaling their portfolios. With a total potential loan volume of € 1.15 bill. per year and a still underdeveloped capital market access for many microfinance organisations in Europe, a substantial part of the funds needed for on-lending has to be covered by senior loans, be them of budget origin or guaranteed by budget sources.

Based on the results of the recent market potential study of business microcredit in Europe the total cost of the provision of relevant non-financial services (BDS) to business microcredit clients amounts to € 100 mill. per year.

[1] https://www.fi-compass.eu/sites/default/files/publications/Factsheet_Financial-instruments-working-with-microfinance_0.pdf

Since these costs cannot be fully covered via fees for the client, microfinance organisations need substantial subsidies to guarantee high quality support for their business microcredit clients. These could be realized via ESIF resources (esp. ESF), that are put into predesigned off-the-shelf instruments, combining grants for BDS provision with centrally managed financial instruments.

3. What lessons can be drawn in light of the limited market take-up of EU-level instruments for equity investments targeting social enterprises? Is there potential here but the market needs more time to develop and/or could grants (e.g. for transaction cost support) be a more effective solution to support small ticket investments of below € 500 000 in social enterprises? ***Please provide specific and concrete solutions.***

Though we cannot offer specific reasons for the limited market take-up, it highlights the need to maintain the flexibility to reallocate financial support between envelopes according to take-up, to maximise the overall impact the EU tools.

4. What forms of "hybrid financing" are needed (i.e. combining grants and financial instruments) and how can they be promoted in a more systemic way?

The current design of the BDS grant requires its recipients to be a pre-existing EaSI guarantee beneficiary. This ensures that the final grant beneficiary is equally subject to the governance requirements and customer protection requirements set out in the Code of Good Conduct. Though this approach is conceptually sound, the current scale of the BDS grants is so small that the requirements do not feel proportionate. Our recommendation would be to be more ambitious with the scale and outreach of the BDS grants.

5. Are other innovative types of instruments (e.g. social bonds, social impact bonds, social impact incentives, outcome funds, or other forms of outcomes- or results-based finance) effective and scalable in improving access to finance for social enterprises and should they be developed further at EU level? ***If yes, please ensure conceptual clarity (i.e. does it concern improving access to finance or innovating social service delivery); provide evidence of successful pilots; provide concrete solutions on how social outcomes can be easily measured, factoring in the full set-up costs and complexity of setting up such instruments, and how to mitigate the danger of mission drift and concerns around the commodification of citizens.***

More so than innovative instruments, the biggest improvement that could be made is an innovative implementation partner that is tailored to the needs of the smaller players in the microfinance and social enterprise financial institutions, being a one-stop-shop for instruments, catering to small ticket sizes, and transforming the simplicity of access for small organisations.

Another innovation, given the current status quo, would be to streamline the responsibilities of supporting microfinance inside the EIF/EIB, rather than the current situation where financial support instruments are spread over a number of departments, reducing the possibility of synergies and making the experience for the final beneficiaries much more complex.

Annex: Financial instruments and grants proposed by EC consultation document (for reference)

Financial instruments	Description	Amount
EaSI Guarantee (since Jun. 2015)	Capped guarantee (or counter-guarantee) offered free-of-charge to financial intermediaries in order develop loan portfolios for microfinance and social enterprises. The guarantee rate is maximum 80% with a guarantee cap rate of up to 30%.	€ 396m
EaSI Capacity Building (since Dec. 2016)	Equity or quasi-equity investments in financial intermediaries aimed at building up their institutional capacity for both microfinance and social enterprise.	€ 16m
EFSI Equity social impact pilots (since Oct. 2016)	Equity investments in early-stage innovative social enterprises in two pilots: - Incubators, accelerators and/or funds links to incubation services supporting the investment readiness of innovative social enterprises from pre-seed stage up to emerging growth stage; - Business angel co-investment schemes targeting innovative social enterprises from seed stage up to start-up/ expansion stage; In addition, a third pilot consists of a payment-by-results pilot scheme aimed at scaling up the provision of social services for vulnerable groups by private sector providers, which would be paid upon the achievement of specific social outcomes.	€ 150m
EaSI Funded instrument (not yet deployed)	Debt instruments in the form of senior or subordinated loans channelled primarily to non-bank financial intermediaries to boost their on-lending capacity for both microfinance and social enterprises	€ 200m

Grants	Description	Amount
EaSI transaction cost support (since Jan. 2018)	Financial intermediaries that undertake long-term risk capital investments in social enterprises can apply for a grant to cover costs related to the preparation, conclusion and follow-up of these investments.	€ 3m
EaSI business development services pilot (since Dec. 2018)	As a complement to the EaSI Guarantee for microfinance, financial intermediaries may also benefit from a grant in order to help provide business development services (training, coaching, or mentoring) to vulnerable groups.	€ 1m