

The European Investment Bank can afford to take more risks

Significant reserves built up through decades of profit-making should enable the bank to absorb volatility of riskier investments

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The European Investment Bank (EIB) is the largest multilateral development bank (MDB) in the world, given the volume of its borrowing and lending¹. However, it has been criticised as being too conservative in its investment strategy (Claeys and Leandro, 2016)². This prudence has contributed to its robust AAA credit rating.

Conscious of the European Union's evolving needs, the EIB Board of Governors has started to remove the statutory limit on its gearing ratio (GR; how much it can lend out in relation to its own resources), raising it from 250 to 290 percent³ subject to the approval of the change in statute by the European Union institutions. This will enable it to invest more without increasing its equity base. This is welcome and hopefully indicates that the EIB is willing to invest in riskier projects, beyond just a planned expansion of business-as-usual.

A bigger role for the EIB

The EIB has committed to being 'Europe's climate bank' in line with the EU's climate goals. It will gradually increase the share of its financing dedicated to climate action and environmental sustainability to exceed 50 percent by 2025 (EIB Group, 2020). Achieving these targets requires unprecedented levels of investment in renewable energy, sustainable infrastructure and innovative technologies (Pisani-Ferry *et al*, 2023).

These investments often involve greater risk due to the uncertainty of returns and the long time horizons required for commercialisation and profitability (D’Orazio and Valente, 2019; Ghisetti *et al*, 2016). Investments in innovation are essential for European competitiveness and are inherently risky because of the uncertainties surrounding the innovations and their market introduction (Fernandes and Paunov, 2015). Taking on this risk may increase the volatility of the EIB’s returns.

Significant reserves built up through decades of profit-making should enable the EIB to absorb said volatility of this risk. In the last ten years, despite being a not-for-profit⁴ organisation, the EIB has made an average of €2.4 billion annually in continuous profits. Larger reserves allow the Bank to increase its lending capacity and shift its portfolio towards riskier assets. However, the minimal increase in annual lending and the low quantity of riskier assets thus far raise doubts about the effectiveness of maintaining such significant capital buffers.

Eliminating the GR constraint from the statutes will provide greater flexibility for future adjustments. Most MDBs have similar legal lending limits in their charters⁵. Removing the GR cap does not mean compromising financial prudence (G20, 2022). Other MDBs including the European Bank for Reconstruction and Development (EBRD), the Asian Development Bank (ADB) and the World Bank Group have removed similar limits to their GRs.

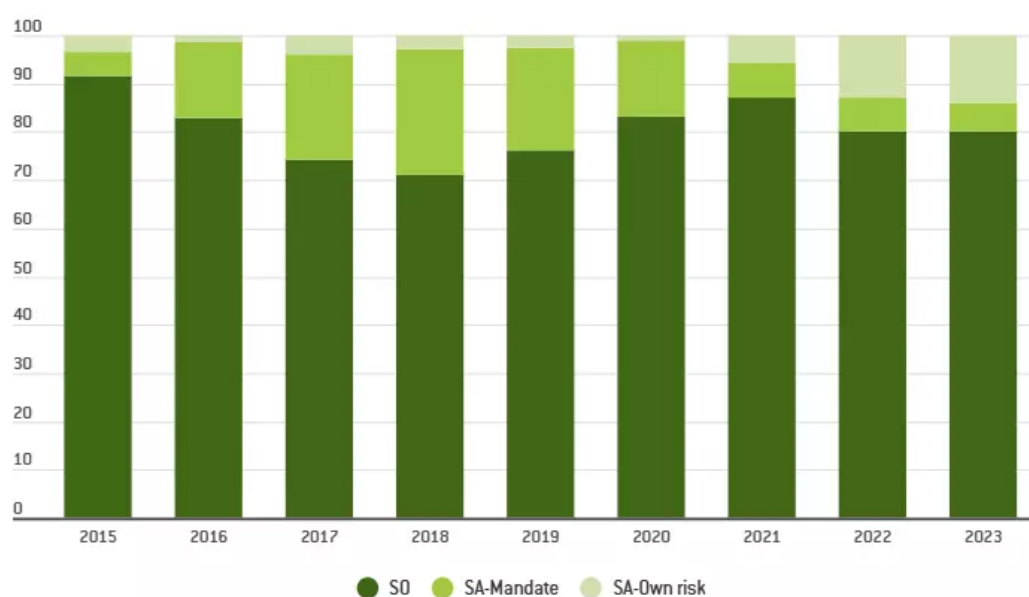
When discussing increasing risk, it is important to differentiate between expanding current activities (which will grow the balance sheet and thereby increase risk) and investing in inherently riskier projects (which will change the risk profile of the portfolio). The removal of the GR limit will enable the EIB to ‘do more’ and give out more loans without the need to simultaneously increase its equity. However, instead of the EIB investing in riskier projects, it could simply do more of the same.

EIB risk-taking

The EIB reports that it has taken on more risk in recent years by expanding its ‘special activities’. It defines these as (i) lending/guarantee operations with a risk profile determined by their loan grading of D- or below and (ii) equity and equity-type operations. Special activities are of two types: (i) own-risk, and (ii) under risk-sharing mandates, where third parties, such as the European Commission, absorb part of the risk.

There was a substantial increase in the volume of annual new signed operations of special activities at own risk from €1.5 billion in 2018 to €10.4 billion in 2023. Before 2021, most of the new financing that the EIB signed each year under special activities was under risk-sharing mandates (Figure 1). Since 2022, more own-risk special activities have been signed, meaning the EIB takes on all the risk. Special activities still represented under 20 percent of new volume signed in 2023.

Figure 1. Share of Special Activities versus Standard Operations in new financing signed (%)

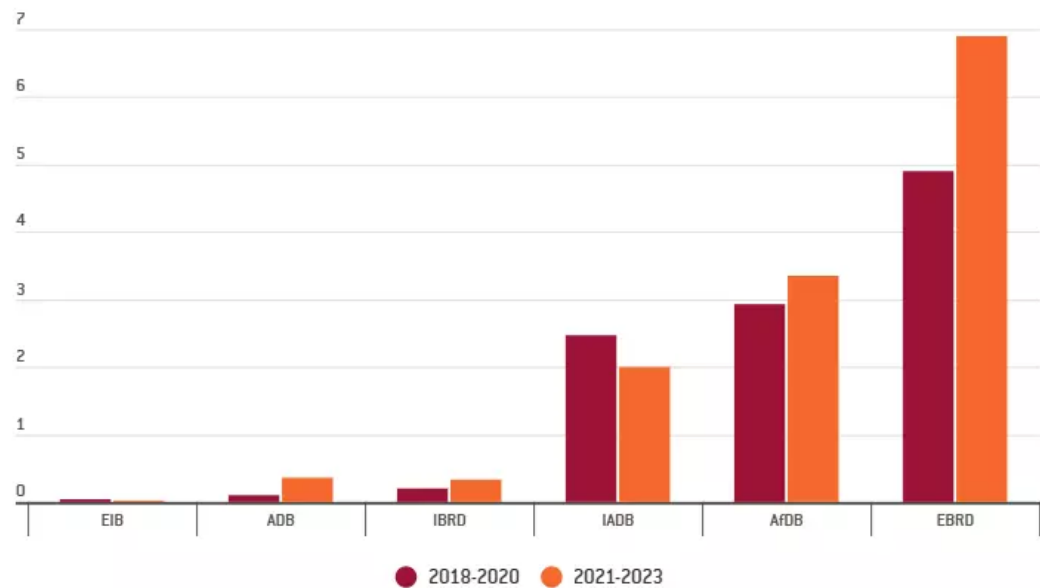


Source: Bruegel based on financial statements. Note: share of each of the categories in total annual new financing signed.



While special activities have expanded significantly, two metrics question whether the EIB's portfolio reflects substantial risk-taking. First, the Bank's non-performing loans (NPL) and impaired loans remain at very low levels, at 0.02 percent and 0.4 percent of total loans, respectively. This is extremely low compared to most other MDBs (Figure 2), which invest in much riskier environments and which are less leveraged (Figure 4). While low NPLs could simply reflect excellent risk management, the differences between the EIB and other MDBs are striking and suggest that the EIB overwhelmingly favours low-risk loans, even relative to other MDBs.

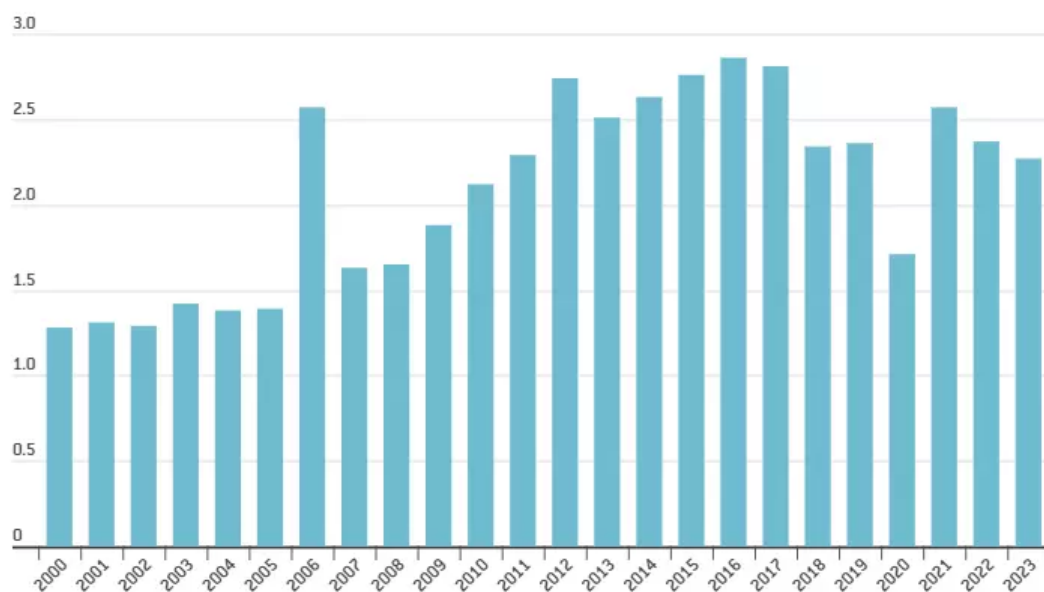
Figure 2: NPL ratio, % of total loans, 3Y average



Source: Bruegel based on financial statements.



Second, the EIB has made uninterrupted and rather stable profits since 2000, following the accrual accounting over the life of the loans it gives (Figure 3). The high profits have contributed to the decrease in the EIB’s leverage ratio (LR, total assets/equity) over the past decade, a trend that has been positively received by rating agencies (Moody’s, 2023).

Figure 3: EIB profits in the last 24 years (€ billions)

Source: Bruegel based on financial statements.



A lower LR suggests that loans are mostly funded with equity rather than debt⁶. Despite the negative trend, the EIB is still highly leveraged compared to other MDBs (Figure 4). In 2023, the Bank's LR was 678 percent, down from 754 percent in 2020. This de-leveraging was driven by a significant increase in equity rather than a balance sheet reduction. The largest assets on the EIB's balance sheet are disbursed loans, which have remained relatively constant since 2014. Meanwhile, equity has grown by over 30 percent from 2014 to 2023 (Figure 5).

The Bank has seen an increase in undisbursed loans held off its balance sheet, reflecting a gap between signed commitments and actual disbursements. The rise in undisbursed loans suggests that a significant amount of funds that have been committed are yet to be disbursed. There was no corresponding increase in the Bank's balance sheet over time because the disbursed loans have remained rather stable. Disbursement of loans and repayments on loans have been close since 2015, except in 2021 when disbursements were much lower than repayments on loans, explaining why the stock of disbursed loans and the Bank's assets have not moved much.

Figure 4. Leverage ratios (%)

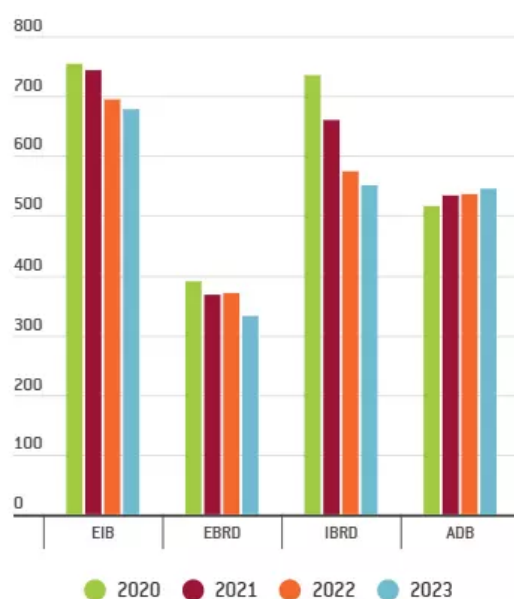
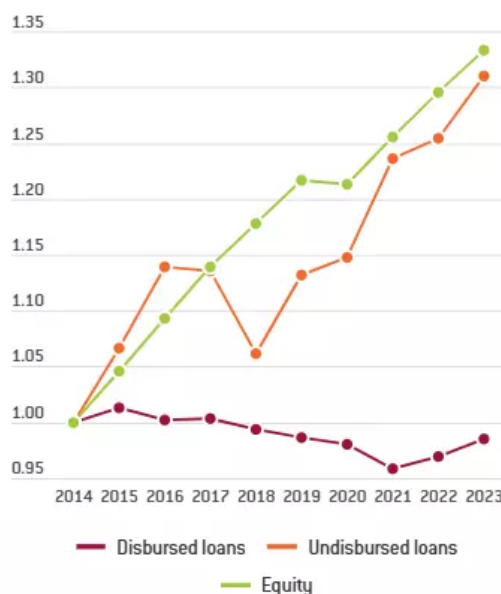


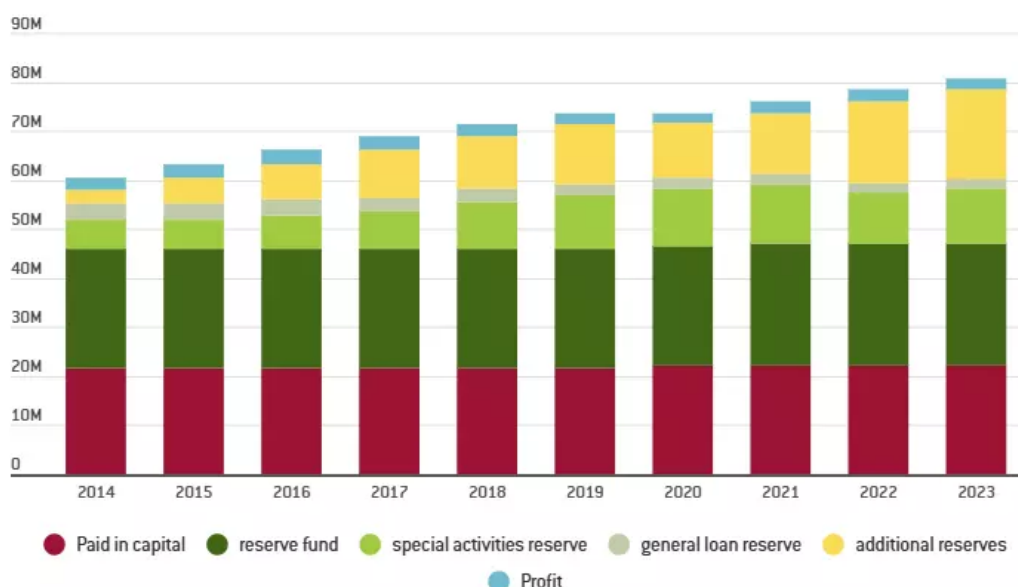
Figure 5: Evolution loans and equity relative to 2014 levels



Source: Bruegel based on financial statements. Note: the disbursed loans are on-balance sheet and the undisbursed loans are on the off-balance



A build-up of reserves fuelled by continuous annual profits (Figure 6) explains the increase in equity. In 2023, reserves totalled over €56 billion compared to €36 billion in 2014. Article 22 of the statute states that *“A reserve fund of up to 10% of the subscribed capital shall be built up progressively. If the state of the liabilities of the Bank justifies it, the Board of Directors may decide to set aside additional reserves”*. This mandatory reserve fund amounts to €24.9 billion. Additionally, the statute states the Bank should make specific reserves for its special activities. By the end of 2021, these reserves amounted to €12 billion, while investments under special activities at own risk stood at €21.6 billion⁷. Therefore, the EIB is holding very high reserves for these activities.

Figure 6: Decomposition of EIB equity (€ billions)

Source: Bruegel based on financial statements.



Finally, out of the €56 billion in total reserves, €18 billion is additional reserves, which have grown faster than the reserves for the Bank's special activities. This would suggest that the EIB has capital buffers that would allow it to expand its own risk activities and absorb volatility in profits that likely comes with riskier investments.

The EIB is in the position to invest more in riskier projects that contribute to the EU's goals. We hope that the gearing ratio debate indicates a willingness to do so and that it is not only a planned expansion of business-as-usual. The EIB can afford to deal with the likely higher volatility in returns through its capital buffers without immediately putting shareholder capital or its credit rating at risk.

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Endnotes

1. In this article, we refer only to the EIB itself, not the EIB Group that also includes the European Investment Fund.
2. See also Rochelle Toplensky and Alex Barker, 'European Investment Bank: the EU's hidden giant
3. See EIB press release of 21 June 2024, 'EU Ministers formally endorse EIB Group Strategic Roadmap and reaffirm its role as financing arm of the EU', <https://www.eib.org/en/press/all/2024-214-eu-ministers-formally-endorse-eib-group-strategic-roadmap-and-reaffirm-its-role-as-financing-arm-of-the-eu>.
4. The task of the EIB shall be defined as in Article 309 of the Treaty on the functioning of the EU: "For this purpose the Bank shall, operating on a non-profit-making basis [...]" (emphasis added).
5. We compare the EIB to MDBs rather than commercial banks, because it is not-for-profit.
6. Higher leverage implies greater risk for investors in debt in the institution, this should not be confused with the higher risk of loans extended by the institution.
7. 2021 is the latest year with information available on the stock of special activities.

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