EN

COMMISSION DECISION

C(2007)5796 of 30/11/2007

adopting a regional programme for Albania and the former Yugoslav Republic of Macedonia under the IPA Transition Assistance and Institution Building Component for 2007 on the participation in the European Fund for Southeast Europe (EFSE)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1085/2006 of 17 July 2006 establishing an Instrument for Pre-Accession Assistance (IPA)[1], and in particular Article 14(2)(a) thereof,

Whereas:

(1) Regulation (EC) No 1085/2006 lays down the objectives and main principles for pre-accession assistance to candidate and potential candidate countries.

(2) In accordance with Article 7 of Regulation (EC) No 1085/2006, the assistance should be provided through multi-annual or annual programmes, which can be established by country and by component, or, as appropriate, by group of countries or by theme. These programmes should be drawn up in accordance with the general policy framework referred to in Article 4 of Regulation (EC) No 1085/2006 and the relevant multi-annual indicative planning document referred to in Article 6 of that Regulation.

(3) The Council established for all candidate and potential candidate countries an Accession Partnership or a European Partnership. The Commission has adopted on 29 May 2007 a multi-beneficiary multi-annual indicative planning document (2007/2009), which presents indicative allocations for the main priorities for pre-accession assistance to all countries concerned[2].

(4) Therefore, the additional participation in EFSE under the IPA Transition Assistance and Institution Building Component for 2007 aims at providing assistance for fostering economic development and prosperity in the Southeast Europe region through the sustainable provision of additional development finance, notably to micro and small enterprises and to private households, via qualified financial institutions in particular in Albania and the former Yugoslav Republic of Macedonia not covered by the 2006 Commission participation. Since the Commission gave already a mandate to the European Investment Fund (EIF)

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[1] OJ L 210, 31.7.2006, p. 82.

[2] C(2007)2205.

ANNEX TO THE COMMISSION DECISION N°:

Regional programme for Albania and the former Yugoslav Republic of Macedonia under the IPA Transition Assistance and Institution Building Component for 2007on the participation in the European Fund for Southeast Europe (EFSE)

1. IDENTIFICATION

Beneficiary	Albania, the former Yugoslav Republic of Macedonia
CRIS number	2007/019-344
Year	2007
Cost	EUR 6 million
Implementing Authority	European Investment Fund in accordance with Article 54 (2) (b) of the Financial Regulation
Final date for concluding the financing agreements	The programme is implemented without Financing Agreement
Final date for contracting	30 November 2008
Final date for execution	31 December 2015 (see § 4.1)
Sector Code	24030
Budget line(s) concerned	22.02.07.01: regional and horizontal programmes
Programming Task Manager	Regional Programmes D3 - DG Enlargement
Implementation Task Manager	Regional Programmes D3 - DG Enlargement

2. PRIORITY AXES / (MEASURES) / PROJECTS

The objective of the participation of the Commission in EFSE is **to foster economic development and prosperity in Southeast Europe** through the sustainable provision of additional development finance, notably to micro and small enterprises and to private households, via qualified financial institutions. EFSE is built as a Public and Private Partnership with the aim of **attracting private sector capital**[1] and thereby leveraging public donor funds into the region for the development of the private sector.

The Commission additional participation in EFSE will support EFSE in beneficiary countries, not yet covered in 2006 by dedicated sub-funds. The Commission will invest EUR 6 million in a dedicated regional fund including Albania and the former Yugoslav Republic of Macedonia in order to promote microfinancing in these two countries. At end of March 2007, the former Yugoslav Republic of Macedonia only stood for 5% of the investment portfolio of EFSE and no loan was granted in Albania.

[1] for example financial institutions, pension funds, insurance companies, etc.

2.a Priority axes

The participation of the Commission in EFSE complies with the "market economy priority" of the MIPD, which recommends support to enterprises in co-operation with International Financial Institutions (IFIs).

This participation is consistent with the Communication "The Western Balkans on the road to the EU: consolidating stability and raising prosperity"[2], which set out concrete measures to reinforce its policies and instrument in the region. The development of a private sector is crucial to the countries' move towards the fulfilment of the economic Copenhagen criteria – a functioning market economy and the capacity to withstand competitive pressure –, which is a precondition for entering into the EU one day. Support for the European Fund for South East Europe (EFSE) has been explicitly mentioned.

By its increasing participation, the Commission will ensure the continuity of the operations started under the "European Funds," strengthen the access to finance for micro, small enterprises, and households, and induce Private investors to continue to invest in the region, even when EFSE has ceased to exist.

2.b Description of projects grouped per priority axis and (if relevant) per measure

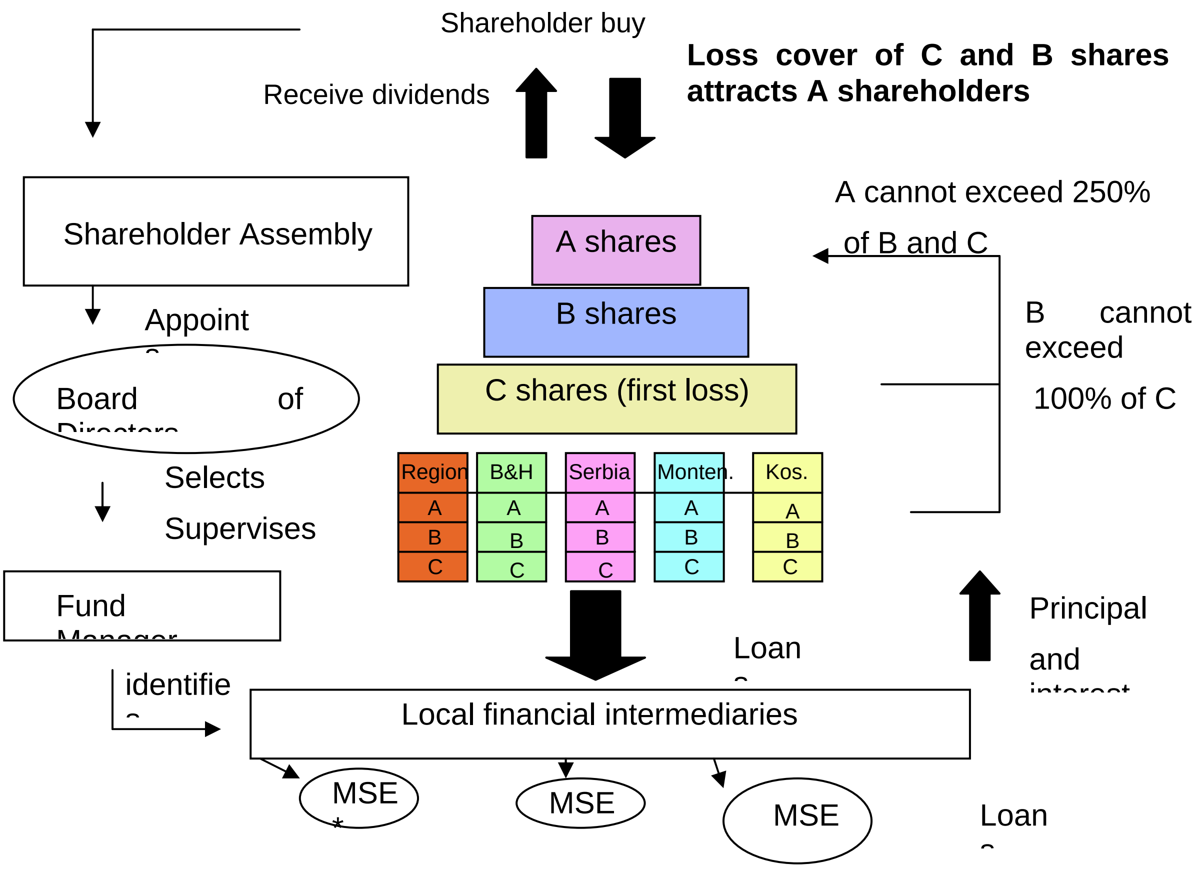
EFSE is an investment company with variable share capital (SICAV) registered in Luxembourg. It is a regional Fund extending loans to local commercial banks and micro finance institutions in Bosnia and Herzegovina, Montenegro, Serbia including Kosovo[3], Romania, the former Yugoslav Republic of Macedonia, Albania, Bulgaria and Moldova for on lending to micro and small enterprises and households.

2 COM(2006)27 of 27 January 2006

3 As defined by UNSCR 1244.

2.b.1 Structure and functioning of EFSE

The following graph illustrates the structure and functioning of EFSE:



*MSE: Micro and Small Enterprises

Shareholder classes

There are three main shareholder groups in EFSE equity according to the share classes available:

C shareholders: Sovereign donors cover the Fund's first losses resulting from any deterioration of the credit quality or any defaults of borrowers until the depletion of their funds. They constitute the largest shareholder group; their purpose to invest is to contribute to development of the private sector and leverage funds from private investors (A shareholders). C shares are of unlimited duration. The Commission will invest in C shares.

B shareholders: International and national financial organisations cover the Fund's losses once the funds of C shareholders are depleted. B shares have a 10-year duration.

A shareholders: Private institutional[4] investors (commercial or investment banks, pension or insurance funds etc.) will only suffer losses after the funds of C and B shareholders are depleted. A shares have a limited duration but this may vary according to the interest of investors.

The Fund's shareholders buy shares in the Fund either (1) through the **payment of cash** or (2) through the **transfer of already existing loans to local financial intermediaries.** The net asset value (NAV) of these shares will be changing according to the performance of the Fund.

[4] EFSE is not open to physical persons and to companies that cannot be qualified as institutional investors within the meaning of the Luxemburg Law of 19 July 1991 on undertakings for collective investment the securities of which are not intended to be placed with the public.

2.b.2 Risk mitigation under EFSE

Without a specific risk cushion, private investors would refrain from investing in EFSE mainly due to the following two risks:

- ***Political and economic risk***: the value of the Fund may be affected by unforeseen political developments, civil disorder, or a constitutional crisis. It may also be affected by abrupt changes with regards to taxation, fiscal and monetary policy, currency repatriation and other economic regulations including expropriation, confiscation of assets or changes in the legislation concerning the permissible level of foreign ownership of assets.
- ***Default and insolvency risk:*** the insolvency of a local financial intermediary in which the Fund has invested could have an adverse affect on the Fund’s performance. There is a low level of experience with the implementation of bankruptcy legislation, and there is no certainty as to how the legislation would be applied in a particular case. Lack of finance increases the risk of insolvency. There is also the risk of the local financial intermediary defaulting on the loan (interest and/or principal payment) received from the Fund.

The risk/return structuring is a key characteristic of EFSE. C shares and B shares are meant to have a **catalytic effect on A shares** as they largely cover the above risks and thereby supposedly attract A shareholders to the Fund.

The risks of C shares will be mitigated by the Fund through a careful selection process of the local financial intermediaries, diversification of risk and a close monitoring through the Fund Manager. In addition, the risk of C Shares and B Shares is limited up to their full loss within specific national or regional sub-funds, and the presence of various C shareholders within a specific national sub-fund reduces the impact of one specific loss on one individual shareholder.

2.b.3 Returns

The expected net return of **C class shareholders** is composed of two elements:

- the target return of 2.2% to be paid from the net cash flow and the amount of the amortisation of the difference between the nominal value of the initial contribution to EFSE on the one hand, and

- the “fair value” of this contribution determined under international accounting standards, on the other hand[5].

The returns of C shares held by the Commission through the EIF are particularly high during the first years of EFSE when the outstanding loan amounts are still high and the corresponding yearly amortisation increases the return over 9%. The minimum expected return has been set at 2.2%.[6] On average Commission's C shares will earn at least 3.86% per year in a conservative estimate.

B class shares carry less risk than C class shares but a higher risk than A class shares. Their expected return is 2.7% per year.

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[5] The loans were transferred to EFSE at fair value. Fair value is the value at which loans could be sold in the market today. This value is lower than the nominal value of the loans due to the risks attached to those loans that mature in the future. The calculated approximate difference between the nominal and fair value of the outstanding loans is -23.79%. Each year when the loans come closer to their maturity, their fair value comes closer to their nominal value as the risk of a loan default decreases – the rise in value is called the amortisation.

[6] As long as the amount of the amortisation is higher than the target return, there will be no amount allocated to C shareholders from the net cash flow of the Fund. As soon as the amount of the amortisation falls below 2.2% the difference between the target return and the amortisation will be paid from the net cash flow on the assumption that there is enough cash flow.

A class shares carry the residual risk, and will only suffer a loss once C and B funds have been depleted. They benefit from a return of 1.42% per year.

As an incentive for **A shareholders**, income is distributed first to A shares (annual dividend), followed by B shares (annual dividend) and C shares.

2.b.4 Decision making in EFSE

The organisational set-up of EFSE includes different decision-making bodies.

- **The shareholder assembly**

The shareholders are represented in the shareholder assembly which is meeting at least once a year in Luxemburg in accordance with Luxemburg Law.

The European Investment Fund (EIF) will represent the Commission in the Shareholder Assembly. In order to ensure a reasonable level of control on the Fund without restricting its operability, the Commission negotiated that any changes to the Articles of Incorporation must be taken at a ¾ majority of present or represented shareholders. This requirement ensures a high degree of consensus between the major shareholders prior to any change to the way in which the Fund has been set up.

The mission of the Fund cannot be modified without the vote of the representative of the Commission. This ensures the public service mission of the Fund, namely to support the economic development of the region in line with EU policy.

- **Board of Directors**

The Shareholder Assembly appoints a Board of Directors (7-9 members), which supervises the daily management of EFSE. The holder of Commission's shares will always be represented with at least one member in the Board of Directors. The Board takes its decisions on investment policy, issuance and conversion of shares, appointment and dismissal of the fund manager and/or custodian, with a simply majority

- **Investment committee**

The Board appoints an Investment Committee of not less than 3 members and a maximum of 4 members. The Investment Committee monitors the pipeline of investments, the portfolio transactions, the financial structure and performance of the portfolio, and approves the investment proposal of the Fund Manager at a simple majority. If no simple majority can be reached, the decision is referred to the Board of Directors.

Investments of EFSE are carried out in line with the Investment Policy specified in the Prospectus following the overall objective of the Fund and fulfil the following eligibility criteria:

Eligible Partner Lending Institutions (PLIs) are local commercial banks, regulated and non-regulated non-governmental organisations (NGOs) and other selected financial institutions which must either finance or be committed to financing micro and small enterprises and households and which are located on the territory of eligible national entities.

The following national entities will be eligible: Albania, Bosnia Herzegovina, the former Yugoslav Republic of Macedonia, Montenegro, and Serbia including Kosovo[7]. Each shareholder may determine whether he wishes to invest into one or several individual **country sub-funds** (e.g. Bosnia & Herzegovina sub-fund, Serbia sub-fund etc.) or into a **regional fund** according to his investment objectives, risk and return expectations.

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[7] As defined by UNSCR 1244.

Eligible final beneficiaries are micro and small enterprises and households.

Eligible investment products are medium and long term debt instruments of local financial intermediaries at market conditions. The financial terms of the investments will be defined in coherence with the objectives of the Fund and its aim to remain financially sustainable. The reflows will be reinvested. The Fund's investments shall have a maximum maturity of 10 years in general and in exceptional cases may reach up to 15 years.

- **Fund Manager**

A professional Fund Manager selected by competitive procedure is entrusted with the day-to-day management of EFSE and specially the identification Partner Lending Institutions (PLIs) for on lending to micro and small enterprises The Fund Manager signs a fund management agreement with the Fund.

- **Advisory Group**

The Advisory Group includes representatives from local administrations or business and finance communities. The Advisory Group will aim to support the Fund in providing a better linkage to local reality and concerns. It may make non-binding recommendations to the Fund Manager or to the Board of Directors. The work of representatives from various beneficiary countries in the advisory group will contribute to regional co-operation.

2.c Overview of past and ongoing assistance (EU/IFI/ Bilateral and national assistance) including lessons learned and donor co-ordination

The European Commission and the European Agency for Reconstruction (EAR) have been closely involved in the discussions about the process of creating a "European Fund for Southeast Europe" (EFSE) to succeed to the European Funds set up in the late 90s to address post-war reconstruction needs in the Western Balkans through revolving loan facilities for commercial banks and non-bank financial institutions in Bosnia-Herzegovina, Montenegro, Serbia including Kosovo[8].

The overall financial endowment of the "European Funds" including the donors Austria, Germany, Switzerland, the European Commission and the European Agency for Reconstruction was in the order of EUR 120 million. The "European Funds" have extended approximately 29,000 loans for a total value of EUR 188 million through 28 partner financial institutions between 1997 and 2005. An independent market study and impact assessment of the "European Funds" was conducted. It concluded that the group of partner banks have strengthened their market position and showed a good level of outreach to micro and small enterprises. Nonetheless, there is still a big gap between loan supply and demand from micro-enterprises and households and the study confirmed the relevance and additionality of EFSE.

International, National Financial Institutions and sovereign donors such as the European Bank for Reconstruction and Development (EBRD), the International Finance Corporation (IFC), Kreditanstalt für Wiederaufbau (KfW) or the Netherlands Development Finance Company (FMO) created EFSE on 15 December 2005 with an initial share capital of EUR 147 million.

In June 2006, the Commission already transferred to EFSE the outstanding loans between KfW and local financial intermediaries, refinanced by the Commission between 1997 and 2002 under National Programmes for Bosnia and Herzegovina, Montenegro and Serbia

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[8] As defined by UNSCR 1244.

including Kosovo under CARDS, Phare and Obnova[9]. The nominal value of the outstanding loans transferred was EUR 63.20 million.

The "institutionalisation" of the "European Funds" in the EFSE has permitted to continue:

- **pursuing the objectives of the existing Programmes**, i.e. the provision of re-financing (loans) to local commercial banks and micro finance institutions in order to promote private sector development, in particular SMEs, rural businesses and housing;

- increasing the funds available for this purpose by **leveraging private sector capital for investments** in a region so far too little attractive to private-sector investors;

- achieving important **economy of scale** while associating national authorities through the advisory group of EFSE.

As of end-March 2007, 40 Partner Lending Institutions (PLIs) already benefited from loans granted by EFSE for a total amount of EUR 272 million. In turn, the PLIs extended more than 54,000 sub-loans for a total amount of EUR 248 million with a size of EUR 4,588 on average. During the first quarter of 2007, more than 89% of sub-loans were below EUR 10,000, which is the usual threshold for micro-credit. Sub-loans benefited to Micro and Small Enterprises (44%), Rural Micro and Small Enterprises (21%) and housing financing (35%). In addition, it is estimated that some 10,000 jobs were preserved and/or created in the micro and small enterprises which have benefited from the funding.

As Albania and the former Yugoslav Republic of Macedonia are on the road towards participating in the Competitiveness and Innovation Programme (CIP), which includes financial instruments managed by the EIF, co-ordination with DG ENTR will be made as appropriate.

2.d Horizontal issues

Not applicable

2.e Conditions

Not applicable

2.f Benchmarks

EUR million	N	N+1 (cumulative)
New subscription	0	6
Subscription rate (%)	0%	100%

[9] Decision C(2006)2307 of 15 June 2006.

3. BUDGET (AMOUNTS IN EUR)

3.1 Indicative budget table

EU – IPA Assistance (in million EUR)				Total co-financing*	Total IPA + co-financing	
Institution Building	Investment	Total	(%)	Total	Total	(%)
6	0	6	100	0	6	100

* public and private national and/or international contributions

3.2 Principle of Co-financing applying to the projects funded under the programme

The Community Contribution shall be considered as an equity investment on the basis of the private investor principle in the meaning of the Article 108, paragraph 2 (c).

The amount of the equity investment is EUR 6 million.

The Community Contribution is not a grant in the sense of the Article 108, paragraph 1, thus no co-financing is required.

Other donors have already contributed to EFSE for a total amount of EUR 230.4 million. Table: Breakdown of subscriptions in equity as of 31 March 2007

Donors	Amount in EUR million
German government	69.2
Swiss government	7.5
Austrian government	3.7
IFC	30.0
FMO	40.0
EBRD	20.0
KfW	60.0

All costs related to the operation of the fund including costs of the management and administration of the Fund, audits, marketing, organisational costs in relation with Board of Directors and Shareholder meetings are borne by the Fund.

4. IMPLEMENTATION ARRANGEMENTS

4.1 Method of implementation

This programme shall be implemented by indirect centralised management in line with Article 54 (2) (b) of the Financial Regulation applicable to the general budget of the European Communities. Implementation tasks will be performed indirectly by the European Investment Fund (EIF)

The EIF has been specifically created to pursue Community objectives, namely through the holding, acquisition, managing and disposal of participations in any enterprise. It was established by the European Investment Bank (EIB) on 25 May 1994. By Council Decision 94/375/EC of 6 June 1994 the Community became a member of the EIF. Article 28 of the EIF statutes specifies that EIF may accept the tasks of administering special resources entrusted to it by third parties, provided they are compatible with its tasks, that they are entered into separate accounts and they are adequately remunerated.

To that end, to the Commission concluded on 16 June 2006 an agreement with the EIF, by which the Commission has entrusted the EIF to represent it in EFSE. This agreement shall be extended to cover the Community participation in the EFSE provided for in this Decision.

The agreement is subject to the provisions and conditions set out in Article 56 paragraph 1 of the Financial Regulation applicable to the general budget of the European Communities[10] and Article 35 of the Implementing Rules of the Financial Regulation[11].

The EC's mandate to EIF will expire on 31 December 2015 at the latest. Before the mandate of the EIF expires and at the latest on 15 September 2015, the Commission shall adopt a Decision on the exit from the EFSE which shall specify the chosen exit option.

The exit options may include:

1. free delivery of the shares to the beneficiary countries under certain conditions or
2. recovery to the EC budget:

   -of liquidated assets to the EC budget in the event of liquidation of the EFSE, or

   -of the sales proceeds in the event of a sale of these shares to an authorized third party.

Consequently, the final execution date of this programme has been set to coincide with the termination of the mandate to the EIF.

4.2 General rules for procurement and grant award procedures

Not applicable

5. MONITORING AND EVALUATION

5.1 Monitoring

The Commission may undertake any actions it deems necessary to monitor the programmes concerned.

EFSE's activities will be monitored in particular by:

- regular reports on progress towards development and performance targets to be provided by the Fund Manager to the Board of Directors, the Shareholder Assembly;

- the annual audit according to IAS standards.

The EIF will provide the Commission with information about the EFSE progress through a semi-annual progress report and through co-ordination meetings. The Commission will ask the EIF to conduct monitoring visits to the region on a regular basis and to provide ad hoc reports on the work of the Investment Committee.

To facilitate the monitoring, EIF and EFSE will keep accounting, financial and operational documents concerning all activities, and will make available to the competent bodies of the European Commission and the European Court of Auditors, on request, all relevant information.

Responsibility for financial monitoring will lie with DG Enlargement.

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10 OJ L 248, 16.9.2002, p.1. Regulation as last amended by Regulation (EC, Euratom) No 1995/2006 (OJ L 390, 30.12.2006, p.1.)

11 OJ L 357, 31.12.2002, p. 1 Regulation as last amended by Regulation (EC, Euratom) No 478/2007 (OJ L 111, 28.04.2007, p. 13.)

5.2 Evaluation

Programmes shall be subject to ex-ante evaluations, as well as interim and, where relevant, ex-post evaluations in accordance with Articles 57 and 82 of IPA Implementing Regulation[12], with the aim of improving the quality, effectiveness and consistency of the assistance from Community funds and the strategy and implementation of the programmes.

The results of ex ante and interim evaluation shall be taken into account in the programming and implementation cycle.

The Commission may also carry out strategic evaluations.

6. AUDIT, FINANCIAL CONTROL AND ANTI-FRAUD MEASURES

The accounts and operations of all parties involved in the implementation of this programme, as well as all contracts and agreements implementing this programme, are subject to, on the one hand, the supervision and financial control by the Commission (including the European Anti-Fraud Office), which may carry out checks at its discretion, either by itself or through an outside auditor and, on the other hand, audits by the European Court of Auditors. This includes measures such as ex-ante verification of tendering and contracting carried out by the Delegation in the Beneficiary Country.

In order to ensure the efficient protection of the financial interests of the Community, the Commission (including the European Anti-Fraud Office) may conduct on-the-spot checks and inspections in accordance with the procedures foreseen in Council Regulation (EC, Euratom) 2185/96[13].

The controls and audits described above are applicable to all contractors, subcontractors and grant beneficiaries who have received Community funds.

7. LIMITED CHANGES

Limited changes in the implementation of this programme affecting essential elements listed under Article 90 of the Implementing Rules to the Financial Regulation, which are of an indicative nature[14], may be undertaken by the authorising officer by delegation (AOD), or by the authorising officer by sub-delegation (AOSD), in line with the delegation of powers conferred upon him by the AOD, in accordance with the principles of sound financial management without an amending financing decision being necessary.

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12 Commission Regulation (EC) No 718/2007 of 12 June 2007 (OJ L 170, 29.6.2007, p. 1)

13 OJ L 292; 15.11.1996; p. 2

14 These essential elements of an indicative nature are, for grants, the indicative amount of the call for proposals and, for procurement, the indicative number and type of contracts envisaged and the indicative time frame for launching the procurement procedures.

for the current Community participation in the EFSE[3], it is appropriate to implement this programme by extending this mandate.

(5) This decision meets the requirements of Article 90 of Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation No 1605/2002[4] (hereafter: "Implementing Rules") and constitutes thus a financing decision within the meaning of Article 75 of Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities[5] (hereafter: "Financial Regulation").

(6) The measures provided for by this Decision are in accordance with the opinion of the IPA Committee.

HAS DECIDED AS FOLLOWS:

Article 1

The regional programme for Albania and the former Yugoslav Republic of Macedonia under the IPA Transition Assistance and Institution Building Component for 2007 on the participation in EFSE, as set out in the Annex, is hereby adopted.

The implementation of this programme is delegated, in accordance with Article 54 (2) (b) of the Financial Regulation, to the European Investment Fund (EIF). To this end, the mandate given to the EIF by Decision C(2006)2307 of 15 June 2006 is extended to cover the Community participation in the EFSE provided for in this Decision.

Article 2

The maximum amount of Community contribution shall be EUR 6 million**,** to be financed through Item 22.02.07.01: regional and horizontal programmes of the general budget of the European Communities for 2007.

Done at Brussels, […]

For the Commission

[…]
Member of the Commission

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3 Commission Decision C(2006)2307 of 15 June 2006.

4 OJ L 357, 31.12.2002, p. 1 Regulation as last amended by Regulation (EC, Euratom) No 478/2007 (OJ L 111, 28.04.2007, p. 13.)

5 OJ L 248, 16.9.2002, p.1. Regulation as last amended by Regulation (EC, Euratom) No 1995/2006 (OJ L 390, 30.12.2006, p.1.)