



**Expert evaluation network  
delivering policy analysis on the  
performance of Cohesion policy 2007-2013  
Year 2 – 2012**

**Task 1: Financial engineering**

**Bulgaria**

**Version: Final**

**Ruslan Stefanov, Daniela Mineva, Stefan Karaboev  
Center for the Study of Democracy (Project One Food)**

**A report to the European Commission  
Directorate-General Regional Policy**

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## List of abbreviations

- EEN Expert Evaluation Network
- EIB European Investment Bank
- EIF European Investment Fund
- EC European Commission
- FEI Financial Engineering Instrument
- FLPG First Loss Portfolio Guarantee
- FRSP Funded Risk Sharing Product
- HF Holding Fund
- JHF JEREMIE Holding Fund
- MA Managing Authority
- MEET Ministry of Economy, Energy and Tourism
- MRRB Ministry of Regional Development and Public Works
- MSs Member States
- OP Operational Programme
- OPC Operational Programme Development of the Competitiveness of the Bulgarian Economy
- OPRD Operational Programme Regional Development
- PPP Public-Private Partnerships
- RUDF Regional Urban Development Fund
- SVP JEREMIE Bulgaria EAD
- UDF Urban Development Fund
- VC Venture Capital

## Executive summary

**JEREMIE** and **JESSICA** are the two European initiatives, providing EU funding for the use of Financial Engineering Instruments (FEIs) in Bulgaria. The First Loss Portfolio Guarantee (FLPG), the Risk Capital Fund, the Growth Capital Fund, the Mezzanine Fund, the Entrepreneurship Acceleration and Seed Financing Instrument and the Funded Risk Sharing Product (FRSP) are the currently available types of FEIs under the JEREMIE initiative. Two Regional Urban Development Funds provide investments under JESSICA. Due to slow structuring and implementation, however, only one of the the above mentioned FEIs are operational: FLPG. Experts cite several key advantages for using FEIs rather than grants in Bulgaria, such as better **risk sharing, higher leveraging of public funds, more flexible partnership with local financial institutions**, and better **access to development capital** for SMEs. Despite the potential benefits of FEIs, **traditional grant financing remains the predominant form of European funds disbursement** in Bulgaria. This is mostly due to the lack of indigenous experience with FEIs but also to the fact that most of Bulgaria's funding in the 2007 - 2013 period has been in the public infrastructure area, which is less suitable for FEIs. It seems that **Managing Authorities (MAs) will have little influence over the selection of final beneficiaries** in the case of JEREMIE. The European Investment Fund (EIF) left Fund managers free to select the different FEIs to manage the Funds and to establish their own criteria according to their market experience. The few private Venture Capital (VC) funds in Bulgaria have partnered together to manage the new FEIs. Therefore, it is reasonable to expect that they will transfer their objectives and governance approach to EIF-funded FEIs. The **Bulgarian authorities will have a greater say in the in the case of JESSICA**, as principal final beneficiaries are municipalities. A **monitoring framework is available** for both JEREMIE and JESSICA as part of their respective operational programmes. Whether or not these assessment mechanisms will be effective remains to be seen, as no comprehensive evaluations have been executed so far. There are **no specific performance indicators** and targets, at least publicly available, for the separate FEIs in Bulgaria.

In conclusion, the Bulgarian **market for FEIs is still underdeveloped**, and the general level of expertise and understanding, when it comes to financial engineering, is low. Still, it is expected that FEIs will play a bigger role in Bulgaria during the 2014-2020 period.

## 1. Use of financial engineering instruments

**JEREMIE** established within the Operational Programme “Development of the Competitiveness of the Bulgarian Economy” (OPC) and **JESSICA** under the Operational Programme “Regional Development” (OPRD), are the two European initiatives providing EU funding for the use of FEIs in Bulgaria.

JEREMIE includes the following FEIs:

- **Risk Capital Fund** (capital of EUR 30 million) – risk capital investments, in the form of equity. The Fund will provide seed, start-up and/or expansion capital;
- **Growth Capital Fund** (capital of EUR 60 million) - equity, growth capital investments.
- **Mezzanine Fund** (capital of EUR 60 million) - mezzanine funding: hybrid debt/equity financing. **Fund managers are already selected for the three Funds, which are to start investment activities in 2012.**
- **“Entrepreneurship Acceleration and Seed Financing Instrument” (also referred to as “Seed Fund”)** – a total capital of EUR 21 million; to start investment activities in the autumn of 2012; Type: risk capital investments, in the form of equity.
- **FLPG** – providing bank loans and/or financial leases; capital of EUR 400 million of which EUR 78 million from private funds;
- **FRSP** – loan facility with a capital of EUR 300 million, of which EUR 150 million from private funds; Fund managers have yet to be selected; to start investment activity late 2012;

JESSICA provides financial engineering instruments for urban development, energy efficiency, etc. **There are two Regional Urban Development Funds (RUDFs)** – one for Sofia (EUR 12.5 million) and one for the six biggest Bulgarian cities (EUR 18.8 million) – with a total capital of EUR 31.3 million. Currently an **Urban Development Fund (UDF)** - Joint Stock Company to invest around EUR 18.8 million of JESSICA funds and additional EUR 37.6 million of its own capital (in total EUR 56.4 million) has started and partners have already been selected.

The **Fund for Housing Renovation** is another initiative, based on financial engineering principles and introduced in March 2012 under OP Regional Development. For a more detailed description of the available FEIs, see Annex A.

Many of the currently available or soon to be launched FEIs were not part of the initial JEREMIE strategy as foreseen in the planning stage of OPC.<sup>1</sup> The shift occurred mainly in response to the changing market dynamics in Bulgaria and the experience of the initial implementation of OPC. The worsening economic environment, in particular for SMEs in recent years, mainly influenced by the global financial crisis, has called for the introduction of more innovative financial products. In particular, Bulgarian SMEs lacked turnover capital and up-front matching funds to pre-finance their OPC projects. JEREMIE FEIs target these shortcomings of OPC grant financing. JESSICA was formally adopted in Bulgaria on July 27, 2010. No changes as to the amount of funding or foreseen mechanisms have occurred since then.<sup>2</sup>

<sup>1</sup> JEREMIE: Executive Summaries of Evaluation Studies on SME Access to Finance in EU MSs. [http://ec.europa.eu/regional\\_policy/archive/funds/2007/jjj/doc/pdf/jeremie\\_sme\\_access.pdf](http://ec.europa.eu/regional_policy/archive/funds/2007/jjj/doc/pdf/jeremie_sme_access.pdf)

<sup>2</sup> Information provided from MRRB, DG “Programming of Regional Development” on 20/04/2012.

## 2. Rationale for using financial engineering instruments

### *Reasons given in OPs (or by the relevant authorities) for the use of FEIs rather than grants*

One of the main reasons for the use of FEIs rather than grants in Bulgaria is the utilisation of EIF and other external experience in handling risk, related to EU Funds management. An additional benefit is that FEIs speed up the spending of the ERDF funds in order to avoid de-commitments. Moreover, provision of resources through a Holding Fund (HF) alleviates the MAs administrative burden by delegating some of their tasks. Another important benefit, particularly because it concerns SMEs, is the fact that FEIs provide up-front finances, which is not the case with grant support. This is essential in many cases, as liquidity has turned into a particularly severe constraint for Bulgarian SMEs in this time of crisis. Other important benefits when compared to grants include: more flexibility and smoother adaptation to the current fast-changing environment; reduction of the many indirect costs notoriously associated with grants, such as consultation fees, time consuming administrative burdens.<sup>3</sup> Finally, other reasons for the use of financial engineering are directly related to the intrinsic characteristics of the FEIs such as their revolving nature (returns from investments are reinvested in enterprises thus re-using and recycling public funds), increasing the impact of the EU funds and public recourses.

### *Referring to particular kinds of market failure*

The main market failure that authorities refer to in explaining the reasons for setting up the FEIs is the bank's aversion to risk and provision of loans, especially to start-up and/or innovative SMEs. The expected FRSP will address another discrepancy in the Bulgarian financial market, namely the fact that there is a lack of long-term lending (the FRSP will offer long-term lending for a period of 10 years).<sup>4</sup>

### *Main reasons for not using FEIs to provide policy support in particular policy areas (such as enterprise support or support for innovation) but using non-refundable grants instead*

Grants are the predominant means of distributing EU funds in Bulgaria. This is partly due to the relative underdevelopment of the Bulgarian economy, the low penetration of FEIs before EU accession and the fact that JEREMIE and JESSICA mechanisms are still in their inception stages. It is expected however that even after they start to support SMEs, grants will continue to be the main funding mechanisms, due to the profile of Bulgarian Cohesion needs, which are linked primarily to larger infrastructure projects.<sup>5</sup>

### *Perceived benefits (by policy makers, programme managers) of using FEIs rather than grants in particular policy areas*

The promoted benefits at local level in Bulgaria coincide with the potential JEREMIE benefits listed by the European Investment Fund (EIF), namely: providing flexibility to the MA in allocating interim up-front payments by EU Structural Funds; diversifying risks through umbrella fund approach that allows reallocation of resources to one or more financial products according to demand; recycling funds – the revolving of the funds means receiving repayments from the financial intermediaries for further investments in the SME sector; leveraging public funds through the ability to engage the financial sector either at the Holding Fund level (with

<sup>3</sup> Interview with Mr. Tzalov (EIF) and Ms. Meracheva (MEET) held on 18/04/2012

<sup>4</sup> <http://www.opcompetitiveness.bg/news.php?id=476>

<sup>5</sup> Interview with Mr. Tzalov (EIF) and Ms. Meracheva (MEET) held on 18/04/2012

additional capital from financial institutions) or at the level of financial instruments (through co-financing); using EIF's expertise as a Holding Fund manager; establishing Long-term partnership with local financial institutions; improving access to development capital for micro, small and medium-sized enterprises.<sup>6</sup>

The JESSICA focus is very different from the JEREMIE focus. Whereas the latter supports SMEs, JESSICA funds are targeting projects, concerned with socio-economic impacts in areas, such as urban infrastructure, including transport, water, waste, energy; heritage or cultural sites, tourism and other sustainable issues; redevelopment of brownfield sites; office spaces for SMEs, IT or R&D sectors; university improvements; energy efficiency improvements; etc.<sup>7</sup>

The mid-term evaluation of OPRD values JESSICA for its principal ability to recycle funds. A significant implied advantage of JESSICA is also its ability to engage the private sector, thereby leveraging further investments. Flexibility is also among the initiative's principal potential benefits.<sup>8</sup>

*Relative costs involved in using the two kinds of measures, including the time taken to set them up as well as to administer them*

Each financial instrument has to go through several stages (from the call for expression of interest and selecting the fund managers, to capitalisation) before starting investment activities. Low efficiency in these stages has been time-consuming and has resulted in slow implementation of JEREMIE activities in Bulgaria. Low expertise and insufficient administrative capacity are some of the reasons for the slow implementation of FEIs under JESSICA (similar to setting up and operating OPs in the country). *For more information on the timeframes for setting up the JEREMIE and JESSICA initiatives in Bulgaria, Annex Tables A and B.*

### **3. The effectiveness of financial engineering instruments: selected examples**

*Differences in objectives and way that they are operated between FEIs used as part of Cohesion policy and private ones*

The main difference between private funds and those, supported through EC financing is that the former are solely aimed at profitability of the private investors, while the latter should have greater socio-economic meaning within the objectives of the EU Cohesion policy. Another general difference is the fact that EU-funded FEIs must, where applicable, conform to the rules of State Aid.<sup>9</sup>

However, it is hard to measure effectiveness or compare FEIs that are a part of the Cohesion policy, to those operating with private Funds. This is due to the fact that only one ERDF co-financed FEI is currently fully operational in Bulgaria: the FLPG, under the JEREMIE initiative. The other funds have appointed managers and established their structure, but are now in the

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<sup>6</sup> JEREMIE: Executive Summaries of Evaluation Studies on SME Access to Finance in EU MSs.

[http://ec.europa.eu/regional\\_policy/archive/funds/2007/jji/doc/pdf/jeremie\\_sme\\_access.pdf](http://ec.europa.eu/regional_policy/archive/funds/2007/jji/doc/pdf/jeremie_sme_access.pdf)

<sup>7</sup> Mid-Term Evaluation of OPRD 2007-2013

[http://ec.europa.eu/regional\\_policy/sources/docgener/evaluation/evalsed/evaluations/bulgaria/files/1102\\_midterm\\_op\\_reg\\_dev\\_eval\\_en.pdf](http://ec.europa.eu/regional_policy/sources/docgener/evaluation/evalsed/evaluations/bulgaria/files/1102_midterm_op_reg_dev_eval_en.pdf)

<sup>8</sup> Mid-Term Evaluation of OPRD 2007-2013

[http://ec.europa.eu/regional\\_policy/sources/docgener/evaluation/evalsed/evaluations/bulgaria/files/1102\\_midterm\\_op\\_reg\\_dev\\_eval\\_en.pdf](http://ec.europa.eu/regional_policy/sources/docgener/evaluation/evalsed/evaluations/bulgaria/files/1102_midterm_op_reg_dev_eval_en.pdf)

<sup>9</sup> Information provided from the Bulgarian Ministry of Regional Development and Public Works, DG "Programming of Regional Development" on 20/04/2012.

process of capitalisation and are yet to make their first investments. However, no great differences in objectives and strategies of private and EIF-supported FEIs are expected. Bulgaria has a very small VC market. Several bigger private VC Funds exist, which have not been very active in the past. Most of them, following the EIF selection procedures, have gone into partnerships to manage the activities of the FEIs in Bulgaria. Therefore, it is reasonable to assume that the objectives of the two are very similar, if not identical. Difference in governance should also be marginal, due to the fact that the EIF gives particular freedom to the selected Fund managers of the different FEIs, thus allowing them to manage the Funds according to their market experience.<sup>10</sup>

*How much control or influence do MAs exert over the way that the funds set up by financial engineering means are allocated and over the firms or organisations which receive support*

The JEREMIE Holding Fund for Bulgaria is financed by the ERDF and co-financed (15%) by the State Budget within the framework of the OPC for the current programming period.<sup>11</sup> The JEREMIE initiative in Bulgaria is organised through the EIF, which operates and manages JEREMIE Bulgaria EAD (SVP), a joint stock company under Bulgarian law, wholly owned by EIF. The SPV, and EIF, jointly constitute the JEREMIE Holding Fund (JHF).<sup>12</sup> This leaves little space for Bulgarian authorities to significantly influence the FEI management structure.

MAs will most probably have little influence over final beneficiaries. This also stems from the fact that the EIF leaves the selected Fund managers free to select the different FEIs. In that way, the influence and control over final beneficiaries is left to the fund managers of each particular FEI.

JESSICA for Bulgaria has chosen a two-stage structure model – a Holding Fund, managed by the EIB, and two UDFs.<sup>13</sup> The Directorate General - Programming of Regional Development at the Bulgarian Ministry of Regional Development and Public Works (MRRB) for the JESSICA initiative is the MA. The MA has several major functions: approve the criteria for projects eligibility, including selection and implementation of investments; determine the amount of funds to be re-allocated from the Structural Funds to the JESSICA financial engineering instrument; decide through which operations of the Priority Axis 1 the funds will be provided; define the Investment Principles for the management of the Holding Fund.<sup>14</sup> The UDF has two managing bodies- the Executive Body and the UDF Manager (Executive Director). The main role of the Executive Body is to select projects that have to be financed with respect to their financial feasibility and compliance with the JESSICA framework (*for visual presentation of the JESSICA structure in Bulgaria, see Annex Figure B*). As seen, as a contrast to the JEREMIE initiative, Bulgarian authorities have a greater say in the in JESSICA. In addition, the initiative heavily relies on effective cooperation and contributions on behalf of municipalities and local authorities.<sup>15</sup>

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<sup>10</sup> Interview with Mr. Tzalov (EIF) and Ms. Meracheva (MEET) held on 18/04/2012

<sup>11</sup> EIF [http://www.eif.org/what\\_we\\_do/jeremie/news/2011\\_news/2011\\_JEREMIE-bulgaria.htm](http://www.eif.org/what_we_do/jeremie/news/2011_news/2011_JEREMIE-bulgaria.htm)

<sup>12</sup> EIF [http://www.eif.org/what\\_we\\_do/jeremie/calls-for-expression-of-interest/2010\\_jeremie\\_bulgaria\\_009\\_1/2010\\_Call\\_for\\_EOI\\_JEREMIE\\_Bulgaria\\_JER-009\\_2010\\_1.htm](http://www.eif.org/what_we_do/jeremie/calls-for-expression-of-interest/2010_jeremie_bulgaria_009_1/2010_Call_for_EOI_JEREMIE_Bulgaria_JER-009_2010_1.htm)

<sup>13</sup> Presentation by the MRRB – 12/01/2012, Stara Zagora, Bulgaria

<sup>14</sup> JESSICA: Preliminary Study for Bulgaria <http://www.eib.org/attachments/documents/jessica-preliminary-study-for-bulgaria-en.pdf>

<sup>15</sup> JESSICA: Preliminary Study for Bulgaria <http://www.eib.org/attachments/documents/jessica-preliminary-study-for-bulgaria-en.pdf>

*Criteria final beneficiaries need to fulfill in order to receive support*

Generally, final beneficiaries of JEREMIE support (financed through the financial intermediaries) must qualify as SMEs<sup>16</sup> and not be "in difficulty".<sup>17</sup> On rare occasions, large enterprises could also benefit from FEIs under the JEREMIE initiative, in the form of equity investments. Although there is a broad spectrum of sectors eligible to receive financial support under JEREMIE FEIs, several fields are generally not allowed (tobacco and gambling). Financial intermediaries decide which specific sectors are eligible and which are not<sup>18</sup>.

Additional criteria for lending JEREMIE loans are set and applied by the banks, under the FLPG instrument, which is currently the sole operational FEI in Bulgaria. For example, ProCredit Bank<sup>19</sup> requires existence of concrete investment projects for granting the loan, as well as collaterals such as vehicles, equipment, goods, real estate, etc. It also requires market experience of at least 12 months. The minimal loan term is 12 months and the maximum is 72 months. The United Bulgarian Bank<sup>20</sup> does not accept SMEs that are primarily active in the areas of agriculture, fisheries and coal-mining, retail, etc. The loan period in the United Bulgarian Bank is maximum 75 months. The loan period in CIBank and Unicredit Bulbank is 12-72 months. The amounts of the loans under JEREMIE in Bulgaria vary – in ProCredit Bank they are in the range of EUR 3,000 - EUR 800,000; in the United Bulgarian Bank and CIBank they can reach EUR 1,875 million<sup>7</sup>; the loans in Unicredit Bulbank<sup>8</sup> are up to EUR 1 million. The loans use preferential interest rates that can be increased after the evaluation of the firm's financial indicators. The FRSP and Seed Fund instruments also rely on the general requirements under the JEREMIE initiative, mentioned before. The two FEIs are not yet operational and more specific requirements are to be expected. This is especially true for the FRSP mechanism, which still has to select its management.

The Risk Capital Fund, Growth Capital Fund and the Mezzanine Fund have not yet publicly disclosed specific requirements (different from those discussed above) for their future final beneficiaries. The three funds are currently in the process of capitalisation. More specific requirements can be expected once a particular instrument is ready to begin its investment activity.

Final beneficiaries of the JESSICA for Bulgaria initiative are municipalities, investors in real estate, financial institutions and public-private partnerships (PPP). Their project propositions need to fulfill various requirements, in order to receive financing. Projects need to be in

<sup>16</sup> According to the EC 2003 definition - SMEs are micro, small and medium-sized enterprises with fewer than 250 employees, turnover of max. EUR 50 million or a balance sheet total of max. EUR 43 million; EC DG Enterprise and Industry [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm)

<sup>17</sup> (within the meaning of Article 2.1 of the Community guidelines on State Aid for rescuing and restructuring firms in difficulty (OJ C 244, 1.10.2004, p.2))

EIF JEREMIE: Funded Risk Sharing Product (FRSP) EIF JEREMIE: Funded Risk Sharing Product (FRSP) <http://www.eif.org/attachments/publications/jeremie/frsp-blueprint-v-3.pdf>

<sup>18</sup>SME Loans under the JEREMIE FLPG Financial Instrument [http://www.unicreditbulbank.bg/weblayout/groups/bulbankwebsite/documents/bbproductdocument/en\\_jeremie\\_general\\_information.pdf](http://www.unicreditbulbank.bg/weblayout/groups/bulbankwebsite/documents/bbproductdocument/en_jeremie_general_information.pdf)

<sup>19</sup> ProCredit Bank, <http://www.procreditbank.bg/main/bg/company.php?here=135>

<sup>20</sup> United Bulgarian Bank, <http://ubb.bg/bg-BG/FCK/516>; <http://jeremie.ubb.bg/>

<sup>7</sup> CIBank, <https://www.cibank.bg/en/leftmenu/ll/126>

<sup>8</sup> Unicredit Bulbank, [http://www.unicreditbulbank.bg/en/Corporate\\_Clients/European\\_Competence\\_Centre/JEREMIE\\_FLPG/Description/index.htm](http://www.unicreditbulbank.bg/en/Corporate_Clients/European_Competence_Centre/JEREMIE_FLPG/Description/index.htm)

accordance with eligible activities under Priority Axis 1 of OPRD and with the HF's investment strategy; be located within the city construction limits and in line with relevant documents for strategic planning; have prospects of profit; have significant social effects and be supported by the general public; be in accordance with the goals and vision of the related municipalities; and be compatible with planned investments of other OPs.<sup>21</sup> General sectoral requirements encourage project applications, concerned with the fields of urban infrastructure, including transport, water, waste, energy; heritage or cultural sites, tourism and other sustainable issues; redevelopment of brownfield sites; office spaces for SMEs, IT or R&D sectors; university improvements; energy efficiency improvements; etc.<sup>22</sup>

*Criteria applied to assessing the performance of the funds. Indicators and targets set for FEIs and progress made towards achieving these targets. Appropriateness of the indicators selected and the targets set.*

Since the reviewed instruments are financial mechanisms, their assessment is primarily based on the level of profitability - providing satisfactory ROI is crucial in determining the effectiveness and performance of every financial instrument. However, there is not much public information on specific targets by each available FEI. With the exception of the Seed Fund, where a total of 320 investments are expected to be made (see Annex A for more detailed description of the available and planned FEIs). Lack of specific targets is understandable in light of the fact that most of the available FEIs in Bulgaria have not yet been completely structured.

Monitoring of the JEREMIE initiative is executed at three levels - (1) monitoring on the part of the MA; (2) the Investment Board; and (3) from the Monitoring Committee of OPC. The oversight of the MA should include monitoring of the EIF, as well as of the financial and final beneficiaries. Such monitoring is done through quarterly monitoring reports presented to the MA and the Investment Board by the EIF; annual and six-month monitoring reports; and inspections in person.<sup>23</sup> Despite this commitment however, an assessment, entirely dedicated to the JEREMIE initiative is yet to be made in Bulgaria.

General guidelines require Fund managers of the available FEIs to periodically provide EIF with progress information. Fund managers and eligible SMEs are also required to grant IEF access to relevant documentation.<sup>24</sup> However, no specific indicators for assessment have been set for each FEI under the JEREMIE initiative for Bulgaria, or at least are not publicly available yet, but are likely to be developed in the near future.<sup>25</sup> To some degree, this allows for more flexibility on the part of the fund managers to define and guide their delegated funds according to their own idea. Such flexibility has already been listed among the major advantages of FEIs, when compared to grants. However, the lack of specific indicators hampers future evaluation, especially from a policy point of view, as there is no clear structure which can assess whether or not the provided investments have benefited employment, social conditions, etc. Such indicators are, however, available for JEREMIE, on a programming level (in OPC) and fund managers of the

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<sup>21</sup> <http://jessicafund.bg/kriterii>

<sup>22</sup> Mid-Term Evaluation of OPRD 2007-2013

[http://ec.europa.eu/regional\\_policy/sources/docgener/evaluation/evalsed/evaluations/bulgaria/files/1102\\_midterm\\_op\\_reg\\_dev\\_eval\\_en.pdf](http://ec.europa.eu/regional_policy/sources/docgener/evaluation/evalsed/evaluations/bulgaria/files/1102_midterm_op_reg_dev_eval_en.pdf)

<sup>23</sup> Information provided by the Bulgarian Council of Ministers on 24/04/2012

<sup>24</sup> EIF [http://www.eif.org/what\\_we\\_do/jeremie/calls-for-expression-of-interest/2010\\_Jeremie\\_Bulgaria\\_009\\_4/2010\\_009\\_4\\_jer\\_call\\_eoi\\_mezz\\_annexii.pdf](http://www.eif.org/what_we_do/jeremie/calls-for-expression-of-interest/2010_Jeremie_Bulgaria_009_4/2010_009_4_jer_call_eoi_mezz_annexii.pdf)

<sup>25</sup> Interview with Mr. Tzalov (EIF) and Ms. Meracheva (MEET) held on 18/04/2012

different FEIs can be expected to relate to them. These indicators include: *Increase in the share of enterprises receiving loans; Share of venture capital funds in sources of financing; Share of external financing sources for investment needs of enterprises; Number of investment projects supported by supported risk capital funds; and Number of financial products created/developed.* Mid-term (2010), End of implementation period (2013) and Ex-post (2015) evaluations are foreseen for each indicator. Statistical data, surveys and/or monitoring system are the means of measurement.<sup>26</sup>

Assessment of the JESSICA initiative mainly relies on the Holding Fund's investment strategy. The investments strategy of the JESSICA HF for Bulgaria aims at supporting convergence policy in the context of urban recovery; creating opportunities for different forms of public projects and PPPs in the sphere of urban development; and aiding the finding and financing of sustainable solutions of urban problems in mid- and long-term perspectives.<sup>27</sup> In addition, the operational agreements, establishing the UDF, include clauses, defining assessment criteria for JESSICA activities. For instance, such conditions include a requirement that obliges the Regional UDF to invest at least 50% of received funds from the HF by 31/12/2013; not less than 80% by the end of 2014; and 100% by 30/06/2015.<sup>28</sup>

#### 4. Main problems in using financial engineering instruments

##### *Main problems experienced in practice in using FEIs as part of Cohesion policy*

FEIs are still in their inception period, thus no concrete problems in using FEIs can be identified. Instead, several issues can be identified as potential problems. It is clear that the biggest challenge is for FEIs to flexibly correspond to and satisfy the needs of final beneficiaries, without burdening them with additional administrative obstacles.<sup>29</sup> The lack of clearly-defined, publicly available assessment indicators and targets of the different FEIs is also a major problem, which could result in unsatisfactory evaluations, thus potentially limiting the socio-economic impact of FEIs in Bulgaria. The Bulgarian market for FEIs is still underdeveloped, while the general level of expertise, when it comes to financial engineering, is low. In addition, banks are also, at times, reluctant to participate.<sup>30</sup> The problem of decreased social trust in the financial system as a whole should not be underestimated either.

When it comes to the JESSICA initiative, the understanding of the public administration of how FEIs function is low, especially at the local level. The changed attitude to EU funding (from grants to FEIs) seems to be confusing for Bulgarian local (and to some degree also for national) authorities as they have just started to understand the Structural Funds' grant mechanisms. Often during discussions, municipal officials raise the question of why they should use repayable instruments like JESSICA when they could use grants. It should be noted that Bulgarian municipalities have long been waiting for the EU structural funds grants – they have

<sup>26</sup> Operational Programme "Development of the Competitiveness of the Bulgarian Economy" 2007-2013 [http://www.opcompetitiveness.bg/images/module3/83\\_opcompetitivenesseng\\_final\\_2007.pdf](http://www.opcompetitiveness.bg/images/module3/83_opcompetitivenesseng_final_2007.pdf)

<sup>27</sup> JESSICA in Bulgaria [http://www.bgregio.eu/media/files/jessica\\_bg.pdf](http://www.bgregio.eu/media/files/jessica_bg.pdf)

<sup>28</sup> Information provided from MRRB, DG "Programming of Regional Development" on 20/04/2012

<sup>29</sup> Information provided from the Bulgarian Council of Ministers on 24/04/2012

<sup>30</sup> Interview with Mr. Tzalov (EIF) and Ms. Meracheva (MEET) held on 18/04/2012

been preparing strategies and building capacity for absorption of the EU funds for years. JESSICA, however, requires another type of capacity and skill.<sup>31</sup>

There is a need for a new, proactive approach to coordination between Bulgaria and the international financial institutions. The Bulgarian experience with managing FEIs has identified the necessity for further harmonisation of the cooperation with international financial institutions, especially with regard to the management and implementation of available financial instruments. In light of this, national policy coordination of FEIs has been delegated to the Bulgarian Minister of Finance.<sup>32</sup>

*Have these problems been overcome and if so how?*

The very limited operational experience of the FEIs in Bulgaria and thus the lack of concrete (case-based) problems, only allows for several recommendations to be made on how to solve the potential problems, discussed above. More specific, publicly available performance indicators and targets are essential for the success of FEIs in Bulgaria. They have to be transparent and easily understood by final beneficiaries. Making FEIs not only easily accessible, but also easily understandable for the SMEs and the administration is a crucial condition. The lack of FEIs expertise, understanding and awareness, as a whole, calls for the initiation of information campaigns aiming at a better understanding of the potential benefits of FEIs for Bulgarian cities and businesses.

## 5. Evaluations of financial engineering instruments

A gap analysis has been carried out to determine market disparities in the country, prior to introducing the FEIs under JEREMIE<sup>33</sup>. Apart from that, no specific evaluation, solely dedicated to the performance of FEIs in Bulgaria, has been carried out so far.

**The MAs of OPRD and OPC are responsible for planning and executing evaluations of the respective FEIs under the two programmes.**<sup>34</sup> Lack of concrete evaluations is understandable, as it is too early for such assessments to produce specific results. As already noted, only the FLPG, part of JEREMIE initiative, has started actual investment activities.

Nevertheless, mid-term evaluations of the Operational Programme “Regional Development” and Operational Programme “Development of the Competitiveness of the Bulgarian Economy” highlighted and further contributed to the use of FEIs in Bulgaria. The mid-term evaluation of OPRD encouraged the JESSICA initiative, as an innovative support during the crisis.<sup>35</sup> The mid-term evaluation of OPC, on the other hand, actively contributed to the creation of the newly introduced JEREMIE instrument – the FRSP.<sup>36</sup>

A more complete assessment of FEI performance will accompany the final evaluation of OPC, which is expected in 2013.<sup>37</sup> The World Bank Group has also planned to undertake studies and

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<sup>31</sup> JESSICA: Preliminary Study for Bulgaria <http://www.eib.org/attachments/documents/jessica-preliminary-study-for-bulgaria-en.pdf>

<sup>32</sup> Information provided by the Bulgarian Minister of Finance, Simeon Djankov, on 24/04/2012

<sup>33</sup> Interview with Mr. Tzalov (EIF) and Ms. Meracheva (MEET) held on 18/04/2012

<sup>34</sup> Information provided from the Bulgarian Council of Ministers on 24/04/2012

<sup>35</sup> Mid-Term Evaluation of OPRD 2007-2013

[http://ec.europa.eu/regional\\_policy/sources/docgener/evaluation/evalsed/evaluations/bulgaria/files/1102\\_midterm\\_op\\_reg\\_dev\\_eval\\_en.pdf](http://ec.europa.eu/regional_policy/sources/docgener/evaluation/evalsed/evaluations/bulgaria/files/1102_midterm_op_reg_dev_eval_en.pdf)

<sup>36</sup> <http://eufunds.bg/bg/page/829>

<sup>37</sup> Interview with Mr. Tzalov (EIF) and Ms. Meracheva (MEET) held on 18/04/2012

gap analyses, assessing the progress and/or plausibility of various FEIs.<sup>38</sup> It remains to be seen, however, whether or not the foreseen evaluations will produce concrete results. As already mentioned above, there is still a lack of specific performance assessment indicators for each of the available FEIs (especially of socio-economic impact). **This might influence negatively the FEIs comprehensive evaluation in Bulgaria, especially from a policy perspective.**

## 6. Concluding remarks

Financial engineering is still in its infancy in Bulgaria and the FEIs supported through EU funds can be seen as a test for maturity. It is too early to judge the success of the ERDF co-financed FEIs as they have not been fully deployed yet. Most mechanisms are still to make their first investments in 2012.

Still, the progress made so far is important for the remainder of the programming period, as well as for better planning the next one. It is expected that FEIs will play a bigger role in Bulgaria during the 2014-2020 period, based on the assessment of their current performance.  
39

Another positive development is “the gathering of experience” and capacity building in managing FEIs on the part of the Bulgarian administration. JEREMIE creates an important shift in the focus of the public administration towards more market-based approaches.

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<sup>38</sup> Information provided from the Bulgarian Council of Ministers on 24/04/2012

<sup>39</sup> Interview with Mr. Tzalov (EIF) and Ms. Meracheva (MEET) held on 18/04/2012

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## Annex

### Annex A: description of AVAILABLE FEIs in Bulgaria

Introduced in mid-2011 under the JEREMIE mandate, the so-called **First Loss Portfolio Guarantee (FLPG)** is the first (and so far the only) operationally active financial engineering instrument in Bulgaria.<sup>40</sup> The FLPG has a capital of EUR 400 million (of which EUR 78 million is private funds) and provides substantial risk sharing coverage to five financial intermediaries, further allowing them to supply additional finance to SMEs in Bulgaria. In July, 2011, five banks, serving as financial intermediaries, entered into contract with the European Investment Fund. These are CIBANK, ProCredit Bank, Raiffeisenbank, UniCredit Bulbank and United Bulgarian Bank.<sup>41</sup> . By benefitting from the guarantee, the banks will increase their risk lending, including, in certain cases, to new businesses without credit history, which often face difficulties in receiving financial support. With the signature of the guarantee agreements the total debt allocation under the JEREMIE Holding Fund in Bulgaria has now been fully utilised.<sup>42</sup> So far, around 150 enterprises have benefited from the FLPG instrument.<sup>43</sup>

In addition to the Guarantee instrument, three funds (**Risk Capital Fund, Growth Capital Fund** and **Mezzanine Fund**) have been launched under the JEREMIE initiative. The **Risk Capital Fund** with a size of EUR 30 million and will focus on seed, start-ups and late stage transactions in Bulgarian technology companies. Investments into individual portfolio companies will typically be in the range of EUR 0.5 million – EUR 1.5 million per annum. The **Growth Capital Fund** has a target size of EUR 60 million and will provide growth/expansion capital to Bulgarian lower mid-market companies, across a wide range of sectors. The **Mezzanine Fund** with a size of EUR 60 million will provide mezzanine financing for growth expansion, external growth and capital restructurings in the Bulgarian lower mid-market, across a wide range of sectors. The targeted investment size per transaction is EUR 2 million – EUR 5 million.<sup>44</sup>

In the autumn of 2011, the EIF negotiated commitments from three private equity funds to manage the new instruments. In result, the Risk Capital Fund will be managed by “*Neveq Capital Partners*”; the Growth Capital Fund is delegated to “*Axxess Capital*”, while the

<sup>40</sup> Interview with Mr. Tzalov (EIF) and Ms. Meracheva (MEET) held on 18/04/2012

<sup>41</sup> EIF [http://www.eif.org/what\\_we\\_do/jeremie/news/2011\\_news/2011\\_JEREMIE-bulgaria.htm](http://www.eif.org/what_we_do/jeremie/news/2011_news/2011_JEREMIE-bulgaria.htm)

<sup>42</sup> [http://www.eif.org/what\\_we\\_do/jeremie/news/2011\\_news/2011\\_JEREMIE-bulgaria.htm](http://www.eif.org/what_we_do/jeremie/news/2011_news/2011_JEREMIE-bulgaria.htm)

<sup>43</sup> Interview with Mr. Tzalov (EIF) and Ms. Meracheva (MEET) held on 18/04/2012

<sup>44</sup> EIF [http://www.eif.org/what\\_we\\_do/jeremie/news/2011\\_news/2011\\_JEREMIE-bulgaria\\_equity.htm](http://www.eif.org/what_we_do/jeremie/news/2011_news/2011_JEREMIE-bulgaria_equity.htm)

Mezzanine Fund, to **“Bulgaria Mezzanine Capital”** – a joint venture between **Growth Capital Partners AG and Rosslyn Capital Partners**.<sup>45</sup> Despite the prognosis that the three new instruments will effectively be making their first investments at the end of 2011 or the first quarter of 2012, the funds are not yet operational. The legal documentation is complete and the funds are in the process of capitalisation.<sup>46</sup>

**“Entrepreneurship Acceleration and Seed Financing Instrument” (also referred to as “Seed Fund”)** is the latest FEI to be introduced in Bulgaria under the JEREMIE initiative. The instrument will undertake risk capital investments, taking form of either equity or quasi-equity. The Seed Fund will **operate in two stages**. During its **Acceleration stage**, financing would be provided for research, and product prototypes, while the **Seed stage** is to be concerned with providing finances to undertakings that may have been in business for a certain time but their product has not entered the phase of commercialization.<sup>47</sup> The EIF has recently announced the selection of the Entrepreneurship Acceleration and Seed Financing Instrument management structure, while the first investments are expected to take place in the autumn of 2012. The FEI will be managed by **“Eleven”**, which is to have a capital of EUR 12 million, expected to be distributed in the form of around 200 investments (each between EUR 20,000 and EUR 200,000); and **“LAUNCHub”**, which would dispose of EUR 9 million, expected to turn into around 120 investments (each between EUR 30,000 and EUR 200,000) during the next four years.<sup>48</sup>

One additional FEI is foreseen by the EIF. The so-called **Funded Risk Sharing Product (FRSP)** is structured as a straightforward term loan facility.<sup>49</sup> The aim of the new foreseen instruments is to reduce the interest rate with at least 50% for final beneficiaries, which are Bulgarian SMEs. The selected financial beneficiaries will receive a total of EUR 150 million with 0% interest rate, for three years. Afterwards, the banks would have to input the same amount (or higher) of capital into the facility. Thus, the combination of the JEREMIE and the private funds will result in 50% decreased interest rate. The FRSP is expected to commence in the autumn of 2012.<sup>50</sup> *For a visual presentation of the available FEIs under the JEREMIE initiative for Bulgaria, see Annex Figure A.*

**Two Urban Development Funds have been established under the JESSICA initiative** and managed by the European Investment Bank (EIB) – one for the capital of Bulgaria, Sofia, with funds in the amount of EUR 12.5 million; and one for the biggest six cities, with a capital of EUR 18.8 million.<sup>51</sup> In January 2012, the EIB concluded an agreement to establish an **Urban Development Fund (UDF)** with “Regional Urban Development Fund” to invest in projects in the six major Bulgarian cities - Plovdiv, Varna, Burgas, Ruse, Stara Zagora and Pleven. The UDF is established as a Joint Stock Company by **Societe Generale Expressbank** (leader of the consortium), **Elana Holding, Elana Investment** and **Balkan Advisors**, to invest around

<sup>45</sup> EIF [http://www.eif.org/what\\_we\\_do/jeremie/news/2011\\_news/2011\\_JEREMIE-bulgaria\\_equity.htm](http://www.eif.org/what_we_do/jeremie/news/2011_news/2011_JEREMIE-bulgaria_equity.htm)

<sup>46</sup> Interview with Mr. Tzalov (EIF) and Ms. Meracheva (MEET) held on 18/04/2012

<sup>47</sup> Financial Instrument: Description and Selection Criteria [http://www.eif.org/what\\_we\\_do/jeremie/calls-for-expression-of-interest/2011\\_Jeremie\\_Bulgaria\\_009\\_5/annex-2.pdf](http://www.eif.org/what_we_do/jeremie/calls-for-expression-of-interest/2011_Jeremie_Bulgaria_009_5/annex-2.pdf)

<sup>48</sup> <http://eufunds.bg/en/pubs/1731>

<sup>49</sup> EIF JEREMIE: Funded Risk Sharing Product (FRSP) <http://www.eif.org/attachments/publications/jeremie/frsp-blueprint-v-3.pdf>

<sup>50</sup> <http://www.opcompetitiveness.bg/news.php?id=476>

<sup>51</sup> Presentation by MRRB – 12/01/2012; Stara Zagora, Bulgaria

EUR 18.8 million of JESSICA funds and additional EUR 37.6 million own capital (in total EUR 56.4 million) over the next four years in urban projects.<sup>52</sup>

The **Fund for Housing Renovation** is another, recently introduced mechanism, targeting provision of low interest loans for renovation of buildings. It is financed by OP Regional Development, which has a total of BGN 63 million (EUR 32.2 million) allocated for renovation of buildings. Additionally the state will provide the Fund with BGN 12.5 million (EUR 6.4 million), out of which the managing bank should provide BGN 9.5 million (EUR 4.87 million) as loans or bank guarantees by the end of June 2015. Except for the initially planned funds, another EUR 500,000 of private financing would follow after public procurement procedure.<sup>53</sup>

Other potential eligible FEIs under JESSICA are loans, bank guarantees, mezzanine and equity funds.<sup>54</sup>

## Annex B: Tables

**Annex Table A: Timetable of setting up the JEREMIE initiative in Bulgaria**

Beginning of 2006	DG Regional Policy and EIF ) launch the initiative
27 May 2009	Framework agreement between EIF and the Government of Bulgaria (adopted 30 May 2009, in force from 17 July 2009).
29 April 2010	Signature of a JEREMIE Funding Agreement between the EIF and the Bulgarian Ministry of Economy, Energy and Tourism (MA of OP Competitiveness) for EUR 199 million.
26 May 2010	Amendment to the Signature of a JEREMIE Funding Agreement (adopted by Law, 26 May 2010, in force from 8 June 2010).
14 July 2011	Negotiations and contracting 5 banks/financial intermediaries (ProCredit Bank, United Bulgarian Bank, CIBank, Raiffeisen Bank and Unicredit Bulbank). JEREMIE allocated EUR 78m as guarantee to the 5 banks. The credit lines are expected to reach EUR 400 million.
September 2011	Launch of some JEREMIE credit schemes by some banks. Still, by the end of 2011 the requests from the enterprises are more than the actually granted loans.
October 2011	Appointing of managers of the 3 funds.  NEVEQ Capital Partners will manage the Venture Capital Fund (EUR 21 million from JEREMIE and EUR9m private recourse).  Axxess Capital will manage the Growth Fund (EUR 30 million from JEREMIE and EUR 30 million private recourse).  The Austrian Mezzanine Management - Growth Capital Partners and the Bulgarian Rosslyn Capital Partners will manage the Mezzanine Fund (EUR 30 million from JEREMIE and EUR 30 million private recourse). The Fund aims about 15 contracts for the next 4-5 years <sup>55</sup> .

<sup>52</sup> EIB <http://www.eib.org/about/press/2012/2012-001-jessica-helps-to-revitalise-six-major-cities-in-bulgaria.htm?lang=en&>

<sup>53</sup> Information provided from the MRRB, DG "Programming of Regional Development" on 20/04/2012

<sup>54</sup> JESSICA in Bulgaria [http://www.bgregio.eu/media/files/jessica\\_bg.pdf](http://www.bgregio.eu/media/files/jessica_bg.pdf)

<sup>55</sup> Capital Daily newspaper

[http://www.capital.bg/biznes/kompanii/2011/10/07/1171210\\_tursiat\\_se\\_predpriemachi/](http://www.capital.bg/biznes/kompanii/2011/10/07/1171210_tursiat_se_predpriemachi/)

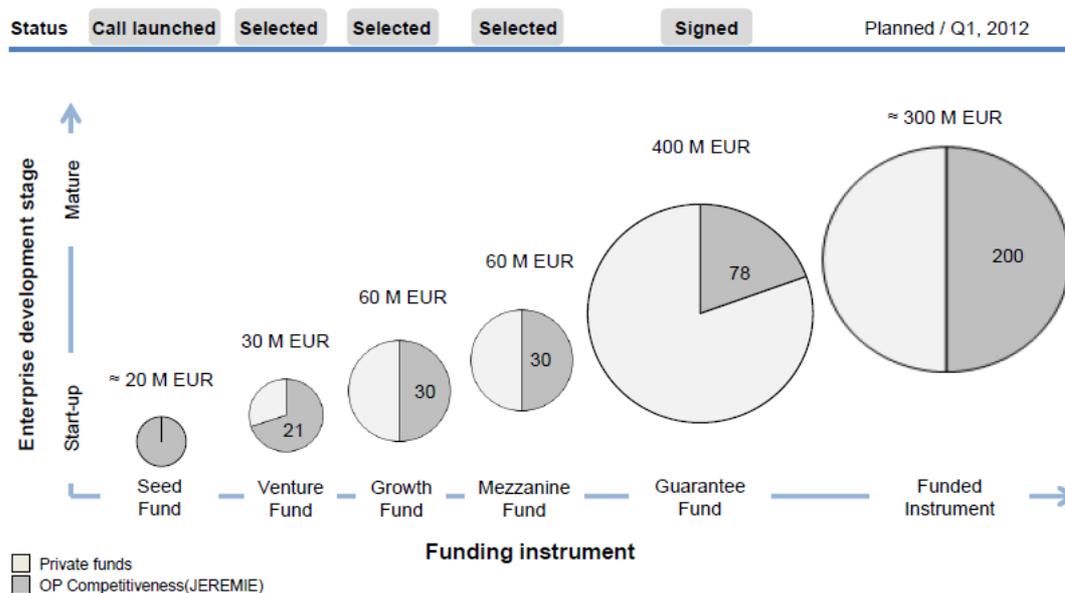
April 2012	EIF selects the “Entrepreneurship Acceleration and Seed Financing Instrument” management in the face of “ <i>Eleven</i> ” and “ <i>LAUNCHub</i> ”.
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### Annex Table B: Timetable of setting up the JESSICA initiative in Bulgaria

27 May 2009	Framework agreement between EIB and the Government of Bulgaria.
29 July 2010	Signature of a Jessica Funding Agreement between the EIB and the Bulgarian Ministry of Regional Development and Public Works for EUR 31.3 million.
2010	Establishment of 2 urban funds, managed by EIB- one for Sofia with EUR 12.5 million and another one for the other six cities with EUR 18.8 million.
Middle of 2011	Money starts flowing to municipalities and businesses.
January 2012	The EIB, in its capacity as manager of the JESSICA Holding Fund for Bulgaria, has concluded an agreement establishing an Urban Development Fund with “Regional Urban Development Fund” (“UDF”) to invest in urban projects in six major cities in Bulgaria. <sup>56</sup>

### Annex C: Figures

#### Annex Figure A: FEIs under the JEREMIE Initiative

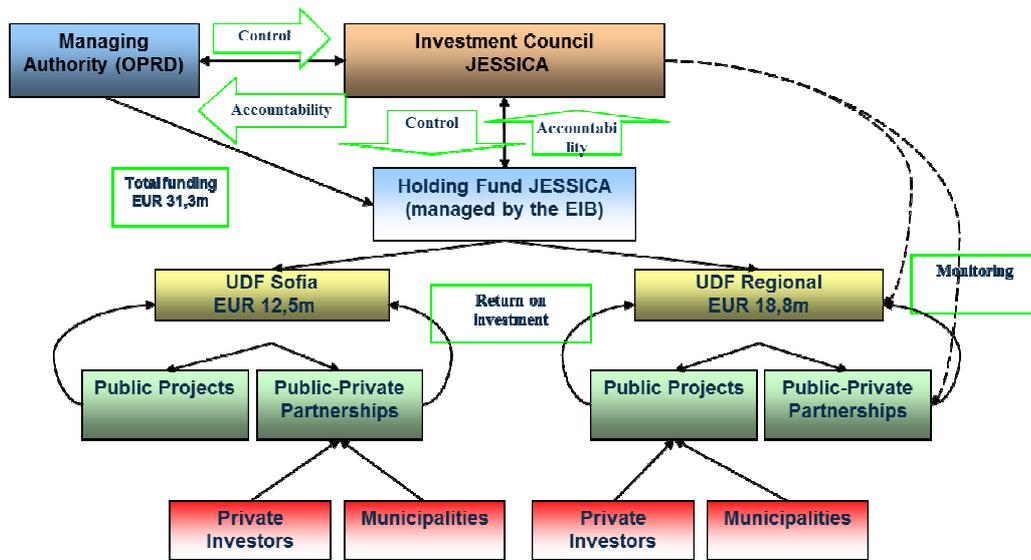


Source: *Structural Funds in Support of Bulgarian Competitiveness; Ministry of Economy, Energy and Tourism*<sup>57</sup>

<sup>56</sup> EIB <http://www.eib.org/about/press/2011/2012-001-jessica-helps-to-revitalise-six-major-cities-in-bulgaria.htm>

<sup>57</sup> Presentation - Structural Funds in Support of Bulgarian Competitiveness; Ministry of Economy, Energy and Tourism [http://magzrt.hu/nyomtatvanyok/sajtoanyagok/2011\\_nemzetkozi\\_konferencia\\_prezentaciok/4\\_Evgeny%20Angelov\\_111027\\_OPC-Bulgaria\\_EAngelov.pdf](http://magzrt.hu/nyomtatvanyok/sajtoanyagok/2011_nemzetkozi_konferencia_prezentaciok/4_Evgeny%20Angelov_111027_OPC-Bulgaria_EAngelov.pdf)

**Annex Figure B: Structure of the JESSICA initiative in Bulgaria**



Source: Presentation by the Bulgarian Ministry of Regional Development and Public Works – 12/01/2012, Stara Zagora, Bulgaria