COMMISSION DECISION
OF 2003

Establishing a Phare multi-beneficiary programme on the SME Finance Facility with the European Bank for Reconstruction and Development in 2003,

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EEC) No 3906/89 of 18 December 1989 on economic aid to certain countries of Central and Eastern Europe\(^1\), as last amended Regulation (EC) No 807/2003\(^2\), and in particular Article 8 thereof,

Whereas:

(1) Regulation No 3906/89 lays down the rules and conditions for the granting of economic aid to certain countries of Central and Eastern Europe,

(2) The measures provided for by this Decision are in accordance with the opinion of the Committee on Aid for Economic Restructuring in certain countries of Central and Eastern Europe,

HAS DECIDED AS FOLLOWS:

**Article 1**

The programme described in the Annex to the present decision is hereby adopted.

**Article 2**

The maximum amount of Community assistance shall be €25 million to be financed through Budget line B7-030 in 2003.

Done in Brussels,

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\(^1\) OJ no. L375 of 23/12/1989

\(^2\) OJ L 122, 16.5.2003, p. 36
FINANCING PROPOSAL

1. IDENTIFICATION

Beneficiary Countries: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovenia, Slovakia

Programme: SME Finance Facility 2003 with the European Bank for Reconstruction and Development

CRIS-Number: 2003/005-745

Year: 2003

Cost: €25 million

Expiry Dates:
- Contracting: 31.12.2004
- Execution of Contracts: 30.11.2012

Sector: PR

Group: L

DAC Code: 25010

Budget Line: B7-030

Task Manager: Judith Novak (DG ELARG, Unit D4, Implementation, Contracts and Nuclear Task Force)

2. SUMMARY

The provision of equity and debt finance to small and medium-sized enterprises (SME) is an important aspect of the functioning of the financial sector in the candidate countries. While the development of the financial sector has made good process in the acceding and the candidate countries during the last couple of years there is still some reluctance of the financial sector to engage in SME related activities. SME’s access to finance is, however, a key building block for a functioning market economy and for the acceding and candidate countries’ capacity to cope with competitive pressure and market forces within the Union.

The overall objective of the Programme is to assist the acceding and the candidate countries in continuing the reform and strengthening of their financial sectors in order to cope with the competitive pressure and market forces within the Union.

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1 This is the date by which the Contribution Agreement between the Commission and the EBRD must be signed.
A new feature under this Programme will be the creation of a Rural Sub-Window as part of the existing Loan, Guarantee and Leasing Window. The Rural Sub-Window aims at strengthening the financial sector’s capacity to increase access to finance for farmers and rural businesses (FRBs).

To this end, the Programme combines resources from the European Bank for Reconstruction and Development (EBRD) with non-reimbursable Phare support in order to provide incentives for banks and leasing companies in the acceding and candidate countries to expand their offer of finance to SMEs, including farms and rural businesses, and to enhance their capacity to assess and monitor the related risks and to manage their exposure.

After four earlier Financing Proposals for a total of €130 million, this Programme makes available a further €25 million for this purpose. Concerning the acceding countries, this is the last allocation to the SME Finance Facility under the Phare Programme. The EBRD in turn will increase its contribution to the Programme’s objectives by at least an additional €125 million including a contribution of at least €50 million for the new Rural Sub-Window.

3. STRATEGY AND BACKGROUND

Strategy

3.1. Access to Finance for SMEs

The Regular Reports of October 2002 assessed the progress made by the acceding and the candidate countries, as well as the overall situation in terms of the adoption of the Acquis and the capacity to enforce it.

In the context of the Copenhagen economic criteria, the Regular Reports 2002 continue to call for a strengthening of institutions in the area of financial inter-mediation. The reform and strengthening of the financial sector is an issue likewise addressed in the June 2002 “Action Plans for administrative and judicial capacity”.

The provision of equity and debt finance to small and medium-sized enterprises (SME) is an important aspect of the functioning of the financial sector. While the financial sector has made good progress in the acceding and the candidate countries, there is still some reluctance to engage in SME related activities, in particular, in remote areas, to small borrowers or for longer term maturities. There is a need to increase experience with these activities. However, SME’s access to finance is a key building block for a functioning market economy and for the acceding and candidate countries’ capacity to cope with competitive pressure and market forces within the Union.

It is widely recognised that SMEs play a vital role in the generation of a dynamic economy and in particular in the creation of new employment. Still, SMEs are often undercapitalised and face significant problems in raising debt finance and in obtaining risk capital, or subordinated debt.

3.2. Access to finance for Farmers and Rural Businesses

In the acceding and the candidate countries, the pace of economic development in rural zones has generally been slower than in urban areas. As a result rural incomes, jobs and business opportunities, education and living standards have been lower compared to urban areas and therefore, the contribution of rural zones to the GDP is generally decreasing. In contrast to this, the workforce employed in the agricultural sector is far greater than in the EU. With a high
degree of labour intensity and low productivity in the agricultural sector, structural adjustments of rural zones are vital. A key to this structural adjustment of the rural economy is seen in the development of the non-farming sectors such as the processing of agricultural products or rural tourism. An expansion of these sectors would create new employment opportunities, in particular, for labour set free from farms increasing their productivity. In order to develop their potential and prepare for the common market, both farms and rural businesses must invest. For financing they depend on a functioning rural credit market.

Compared to the SME credit market, the rural credit market faces different challenges. Across all accession and candidate countries similar problems are encountered on the supply and the demand side of rural credit sector:

- **Supply Side (local financial intermediaries)**
  - rural businesses and in particular farmers lack collateral and also enforceability of security
  - rural businesses and farmers lack adequate cash flow planning; in particular, farmers are not obliged to bookkeeping or keeping financial statements; in addition, it is particularly difficult to assess cash flows where farmers sell directly to the consumers;
  - it is difficult for local banks to design repayment schedules, which rural businesses and in particular farmers can meet; standard repayment schedules of local banks are not adapted to the seasonality of farming and business areas depending from farming;
  - due to small financing needs (small size of farms and rural businesses) the transaction costs per loan are high compared to the revenue generated;
  - there is a lack of know how at the level of local financial intermediaries to evaluate and analyse the creditworthiness of farmers and rural businesses due to difficulties in assessing a number of its characteristics i.e., for example, assessment of the market value of farming machinery used as collateral or assessment of the impact of seasonal income and dependence on weather conditions

- **Demande Side (farmers and rural businesses)**

  There is generally a lack of know-how to prepare bankable loan applications; there are no special products offered by banks to meet their financing needs and interest rates and margins are not affordable.

As a consequence of deficiencies on the demand and supply side of rural credit financing, local financial intermediaries have started reducing their branch network in rural areas. With a high percentage of workforce employed in the rural sector, this withdrawal from rural financing has severe effects on the financing situation of farms and rural business and consequently on their competitiveness. Even if farms and rural businesses have access to finance as part of the group of “SMEs” under the SME Finance Facility, it requires a special structuring of incentives for local financial intermediaries to motivate them to finance their special needs.

### 3.3. Commission and EBRD Combining Resources to Address Needs for Access to Finance

Therefore, the Commission and the EBRD have decided to create a special Sub-Window, the Rural Sub-Window, under the Loan, Guarantee and Leasing Window of the SME Finance Facility. The Commission and the EBRD will continue combining Phare grant money with
EBRD financing in order to help the financial sector in the central European acceding and candidate countries develop its SME business. Part of the Phare grant money (€ 10 million) and EBRD financing will be strictly dedicated to strengthen the financial sector in rural credit finance.

From the Commission point of view the combination with EBRD funding will bring additional leverage to grants from Phare and therefore substantially broaden the reach of the Programme.

Background

The Commission launched the SME Finance Facility with the EBRD in 1999. Since then, similar programmes have become operational with the EBRD in 2000 and 2001, with the Council of Europe Development Bank in association with Kreditanstalt für Wiederaufbau (EBRD) in 2000 and with the European Investment Bank in 2001. Funding from the International Financial Institutions (IFIs) has been used to provide loan and equity finance to SMEs; since 2001 SME leasing operations of leasing companies have also been supported.

While it took time to commit funds under the 1999 programme, the Bank has since been able to increase the leverage of Phare to EBRD funds from 1:2 to 1:6.2, and to build up a strong pipeline for expansion of the Facility. As per June 30, 2003, EBRD has approved €700 million (see table below) for the SME Facility and committed €596.25 million in Projects (€ 580 million under the LGLW and €16.25 million under the EW).

<table>
<thead>
<tr>
<th>Financing in 1999</th>
<th>LGLW</th>
<th>EW</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBRD resources</td>
<td>50</td>
<td>75</td>
</tr>
<tr>
<td>Phare Contribution</td>
<td>25</td>
<td>/</td>
</tr>
<tr>
<td>EBRD resources</td>
<td>25</td>
<td>/</td>
</tr>
<tr>
<td>Phare Contribution</td>
<td>25</td>
<td>/</td>
</tr>
<tr>
<td>Total</td>
<td>125</td>
<td>75</td>
</tr>
<tr>
<td>Additional financing in 2000</td>
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<td>180</td>
</tr>
<tr>
<td>EBRD resources</td>
<td>150</td>
<td>150</td>
</tr>
<tr>
<td>Phare Contribution</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>EBRD resources</td>
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<td>0</td>
</tr>
<tr>
<td>Phare Contribution</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>180</td>
<td>180</td>
</tr>
<tr>
<td>Additional financing in 2001</td>
<td>275</td>
<td>295</td>
</tr>
<tr>
<td>EBRD resources</td>
<td>275</td>
<td>275</td>
</tr>
<tr>
<td>Phare Contribution</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>EBRD resources</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Phare Contribution</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>295</td>
<td>295</td>
</tr>
<tr>
<td>Total with EBRD</td>
<td>700</td>
<td>855</td>
</tr>
</tbody>
</table>

Notes: amounts in € million

LGLW: Loan Guarantee and Leasing Window
EW: Equity Window

One of the objectives set by the Commission in 1999 was to ensure a balanced country coverage of the SME Finance Facility. As of the end of 2002, each of the eligible countries benefited from at least one Project under the Facility’s Loan, Guarantee and Leasing Window, which currently includes Projects with 26 banks and 8 Leasing Companies in all 10 beneficiary countries.

As to the Equity Window, €16.25 million of the total available resources of €25 million made available by the EBRD cover 9 countries (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, following the EBRD Board decision of April 2000, the Bank raised its contribution by an additional €75 million.
Lithuania, Romania, Slovakia and Slovenia). Progress under the Equity Window has been slower than expected due to a difficult market environment and the consequent reluctance of private investors. In order to ensure the best possible use of available resources, the Steering Committee agreed that no new Equity Funds shall be created under the SME Facility. The Steering Committee has recommended to transfer the uncommitted amount of €8.75 million from the Equity Window (EW) to the Loan, Guarantee and Leasing Window (LGLW), reducing the size of the EW from €25 million to €16.25 million. EBRD will focus on developing operations of the most efficient Equity Funds. Where, inefficiencies are discovered or slow progress, funds will be de-committed and transferred to the LLGW upon recommendation of the Steering Committee.

4. Objectives and Description

4.1. Objectives

The overall objective of the Programme is to assist the acceding and the candidate countries in continuing the reform and strengthening of their financial sectors in order to cope with the competitive pressure and market forces within the Union.

The Programme’s specific objectives are to

- build further the confidence of financial intermediaries to engage in financial operations with SMEs;
- enhance further the capacity of financial intermediaries to assess and monitor the related risks and to manage their financial exposure;
- deepen country coverage at a regional level by concluding more Projects within each country;
- sustain and maximise the impact of existing Projects under the Loan, Guarantee and Leasing Window by providing additional credit lines to the financial intermediaries concerned

and thereby to continue to induce financial intermediaries to expand and maintain in the long term their financing operations with SMEs.

With reference to the Rural Sub-Window, a particular focus will be on reaching the following specific objectives:

- help financial intermediaries to provide appropriately structured, including long-term financing to rural businesses
- help financial intermediaries develop a clear strategy to support the rural economy;
- help financial intermediaries adapt products and risk assessment procedures to circumstances of the rural economy and thereby make available credit financing to rural businesses at more affordable rates;
- improve services of financial intermediaries towards rural sector borrowers.
4.2. Results

It is expected that financial intermediaries in the candidate countries will have expanded capacities to service the financial needs of SMEs including farms and rural businesses, and that SMEs will have greater access to finance, as witnessed by

- the degree to which Participating Banks or Participating Leasing Companies will have a clear strategy for supporting SMEs;
- the degree to which SME credit or lease processing times will have shortened significantly;
- the degree to which credit and leasing application procedures will have been simplified;
- the amount of staff from banks or leasing companies that will be familiar with the concept of lending/leasing to SMEs and its implication for their business;
- the increase in the volume of loans/leases of Participating banks/Participating Leasing Companies to SMEs compared to the present;
- the increase in the number of SME clients of participating banks or leasing companies compared to the present;
- the increase in the number of small loans or leases to SMEs compared to the present.

With reference to the Rural Sub-Window, a particular focus will be on achieving the following results:

- Financial intermediaries will have a clear strategy for supporting farms and rural businesses,
- Product and risk assessment procedures will have been adapted to the specific group of clients
- The total volume of loans/leases to farms and rural businesses will have increased compared to the present
- The quality of loans/leases extended to farms and rural businesses will have improved
- Services, conditions and terms of loans will have improved for borrowers with farms and rural businesses;

4.3. Activities

4.3.1 Summary – Loan, Guarantee and Leasing Window

Phare funds will be paid in instalments to an interest bearing Special Account at the EBRD.

The EBRD will identify local financial intermediaries in the acceding and the candidate countries, which have the capacity, interest and willingness to expand their SME financing operations.

An agreement on a financial package between the EBRD and the local financial intermediary providing EBRD funds together with a Phare Contribution will represent the “Project”. Before signing this agreement EBRD has to propose the Project to the competent Commission services for their approval. In its proposals the EBRD will inform the Commission about the total resources allocated to the financial intermediary and the corresponding Phare Contribution. The EBRD will provide the loan funds or credit lines to the local financial intermediaries at market rates.
Upon approval the EBRD will sign the “Project Agreement” with the local financial intermediary, which then becomes the Participating Bank (PB) or Participating Leasing Company (PLC).

The Participating Bank or Leasing Company will, in turn, engage in the promotion of the Facility amongst SMEs, and conclude loan or financial lease agreements with individual SMEs or award them overdraft facilities (Sub-Projects).

Examples
A Project might consist of:

(1) A loan or credit line for on lending to the SMEs. The combination of EBRD loan funds with a Phare performance fee incentive shall produce the attractive margin required to induce Participating Banks to take the loan and undertake the necessary organisational changes, most notably the specialisation of loan officers and branches to SME lending;

(2) Technical assistance to perform institution building in the Participating Banks (e.g. adjust organisational structure, train loan officers in appraisal and supervision, introduce new management information systems, etc.) to meet the special administrative needs of lending to the SME sector, which is very different from the requirements of lending to a small number of large clients;

Or of:

(1) A loan or credit line provided by the EBRD to the PLC linked to the financial lease agreements to be contracted with the SMEs;

(2) A performance fee to be paid from the Phare Contribution to the PLC which will be paid directly to the PLC. The performance fee is not netted against the interest due on the EBRD loan;

(3) Technical Assistance provided to improve skills of PLC’s personnel.

The type and the precise mix of the support offered under individual Projects may vary country by country and may depend on the Project’s specific circumstances.

4.3.1.1 Rural Sub-Window

Under the Loan, Guarantee and Leasing Window, a Rural Sub-Window will be opened to allow a specific targeting of the development of the rural credit sector among local financial intermediaries. While the summary described under 4.3.1 fully applies to the Rural Sub-Window, the latter has the following additional characteristics:

-EBRD will select local financial intermediaries that are willing, interested and capable to expand their rural financing operations;

-the financial package combining EBRD resources and the Phare Contribution will be specifically designed by EBRD to motivate local financial intermediaries to strengthen their capacities in the long term to meet the financing needs of farmers and rural businesses;
4.3.2. Phare Contribution

The €25 million allocation to this Programme and all income generated under the Special Account represent the Phare Contribution. They may be used for

(1) Technical Assistance to the Participating Banks (PB) or Leasing Companies (PLC)
   For institution building purposes, notably with the aim to:
   • install management information systems specifically geared towards SME portfolios including FRB portfolios;
   • recruit and train PBs’ or PLCs’ staff in SME customer support including in particular, FRB clients and small loan/lease appraisal, supervision and loan/lease administration skills;
   • assist in the introduction and implementation of organisational and managerial procedures and practices involved with SME lending/leasing including in particular FRB clients;
   • strengthen administrative, credit and management capacities;
   • help local financial intermediaries strengthening awareness and demand for rural credit through the organisation of workshops and training seminars for SMEs and in particular farmers and representatives of rural businesses.

(2) Performance fee to the Participating Banks and Leasing Companies
   In the form of a grant partly compensating for the interest to be paid by the PBs or PLCs to EBRD. The Phare incentive will be determined on a downward sliding scale and be paid only in relation to actual performance of the PB/PLC on the SME lending/leasing including FRB lending/leasing.

(3) Loan Guarantee to the Participating Banks
   Where appropriate, to provide a partial guarantee on the SME sub-loan portfolio managed by the PBs. This guarantee is limited to a maximum of 40 % of the loss per Sub-Project.
   Concerning loan guarantees for the Rural Sub-Window, the loss will be limited to 50 % of the loss per Sub-Project.

   Exit strategy for Loan Guarantees: If in a Project, the Phare funds dedicated to the Loan Guarantee are not fully used at the end of the guarantee period agreed between EBRD and the PB, the Commission will recover this unused amount.

(4) Management fee
   It shall be paid to EBRD as 1.25 % of each instalment paid to the Special Account and corresponding to a maximum amount of €312,500. The annual auditing costs are included in the management fee. The Commission shall not provide any additional amount to support the ordinary EBRD cost resulting from the implementation of this Programme, except where duly justified.

Upon proposal of the EBRD and subject to approval by the Commission other appropriate incentives for the benefit of PBs or PLCs may be granted.
4.4. Financial Support Ratios and Benchmarks

Programme Leverage
The overall ratio between the EBRD resources and the Phare allocation for this Programme shall be equal to or higher than 5/1. The EBRD will provide at least €125 million in the form of loans and the EC will provide a maximum of €25 million.

Project Leverage
For each Project, the ratio between EBRD resources and the Phare Contribution will not be lower than 3/1.

Project and Sub-Project Size
The size of each Project will be, in principle, between €5 - €15 million and the maximum size of a loan or lease per SME (Sub-Project) shall be €250,000. Each Project will therefore cover a number of Sub-Projects.

Technical Assistance
No more than 70 % of the Phare Contribution allocated to the LGLW may be used for TA. The share of TA in the Phare Contribution to specific Projects may however vary between Projects.

4.5 Eligibility and Selection Criteria

4.5.1 Participating Banks and Participating Leasing Companies
Eligible Participating Banks or Leasing Companies are those operating in the beneficiary countries including locally registered, licensed or incorporated entities and subsidiaries or branches of EC banks.

Participating Banks and Leasing Companies will be selected on the basis of their capacity, financial strength, branch networks and regional presence, and their interest to participate in and promote the Facility and its objectives. The selection will also take into account the possible previous involvement in institution building programmes.

The selection criteria include the geographic location, market competition between banks/leasing companies, business potential, branch management competence, commitment to lending or financial lease to SMEs, openness to new technology and willingness to devote personnel.

4.5.2 SMEs
Enterprises eligible for Sub-Projects must comply with the definition of SME as per Commission Recommendation of 30 April 19963. The term SME includes the individual entrepreneur. Eligible SMEs must:

(1) have no more than 249 employees;
(2) no more than an annual turnover of €40 million;
(3) no more than a maximum annual balance sheet of €27 million;
(4) have majority private ownership and control or be in the final stage of the process of privatisation;

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3 OJ L 107; 30/04/1996
(5) not be conducting business in activities such as, gambling, real estate, banking, insurance or financial inter-mediation and the manufacture, supply or trade in arms, as well as activities excluded by the EBRD.

4.5.2.1. Loan/Lease Beneficiaries under the Rural Sub-Window

The creation of the Rural Sub-Window allows to specifically address the financing needs of a special group of SME beneficiaries. The beneficiaries of the Rural Sub-Window fall into two groups:

1) **Farmers**: Farmers are “registered agricultural producers” according to the registration method used for farmers under national legislation.

2) **Rural Businesses**: Rural Businesses are businesses located in rural zones. The indicators used to define an eligible rural zone will be based on appropriate criteria, like e.g. population density or location, and will be derived, as far as possible, from the “rural zone” specifications under national legislation.

Both groups of beneficiaries will be identified using the limitations specified under (1) to (5) of Section 4.5.2.on the basis of equivalent information collected by the PBs or PLCs.

4.5.3 Eligible Expenditure at SME level

Funds utilisation by SMEs may be for the financing of investment in fixed assets and working capital and may involve new projects, or the modernisation or expansion of existing business within sectors in the following non-exhaustive list: manufacturing industry, agro-allied business, hotel, tourism, energy saving and environment, construction, trade, services and farming.

5. **BUDGET**

The European Commission will support the Loan, Guarantee and Leasing Window of the SME Finance Facility 2003 with €25 million. An amount of €10 million from the Phare Contribution will be specifically dedicated to a Rural Sub-Window.

<table>
<thead>
<tr>
<th>Phare Funding in million €</th>
<th>IFI</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Institution Building (IB)</strong></td>
<td>INV</td>
<td>Phare Total I+IB</td>
</tr>
<tr>
<td>25</td>
<td>-</td>
<td>25</td>
</tr>
<tr>
<td>125</td>
<td>150</td>
<td></td>
</tr>
</tbody>
</table>

(The figures in the budget table are indicative only)

Co-financing for Institution Building projects is provided by the beneficiary bearing certain infrastructure and operational implementation costs, through financing the human and other resources, required for effective and efficient absorption of Phare assistance.
6. **IMPLEMENTATION ARRANGEMENTS**

6.1. Financial and Project Management

This Programme will be implemented on a centralised basis by the Commission in accordance with Council Regulation 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the General Budget of the European Communities. To this end, the Commission will conclude a grant agreement with the EBRD.

The provisions of Part Two, Title 4, Chapter 3 of Council Regulation 1605/2002 apply to EBRD procurement of works, services and supplies financed by Community funds.

6.2. Deadline for contracting and execution of contracts between EBRD and Participating Banks (PBs) or Participating Leasing Companies (PLCs)

All contracts between EBRD and PBs or PLCs must be concluded by 30/11/2006. Execution of these contracts must end by 30/06/2012.

The execution of contract period exceeds the average length allowed for the execution of contracts. The length of the execution period is justified due to a number of steps involving the SME Facility mechanism. The length is required to allow the Programme to develop its full impact.

As from the signature of the Contribution Agreement EBRD has to carry out due diligence on local financial intermediaries and sign a Project Agreement with them. The deadline for signing these Project Agreements has been set at 30/11/2006 (3 years). For each Project selected, EBRD provides credit lines to local financial intermediaries with a duration of several years (normally 4 years of more). The execution of contract period has been set to allow an implementation period of the last Project of 6 years.

Should EBRD managed to sign Project Agreement well before 30/11/2006, e.g. by end of 2004, leading to the termination of all Projects in 2010 an early termination of the Facility is possible.

6.3. Recovery of Funds

In the case of default on Projects, the Commission will initiate recovery from EBRD. EBRD will undertake recovery proceedings in a manner consistent with the care and diligence applied in EBRD projects financed out of its ordinary resources for final recovery to the Commission. The Commission will assist in this process where required.

Fund recovered from Projects will be credited to the Special Account and may be used for the purpose of the Programme as set out in section 4.3.2.

The Phare Contribution, which has not been allocated to a Project by 30/11/2006 (contracting expiry date between EBRD and PBs or PLCs) will be de-committed by the Commission.

The Phare Contribution allocated to Projects and not disbursed from the Special Account of the EBRD by 30/11/2012 (overall end of contract execution period) will be recovered by the Commission.
6.4. Interest earned on the Special Account

The EBRD will continue to manage a separate interest bearing Special Account for this Programme. Interest will be reported to the European Commission and used for the purpose of the Programme as set out in section 4.3.2. and after approval of the competent Commission services in accordance with sections 6.5. (1) and 6.6.

The modalities for managing the Special Account will be set in the Contribution Agreement.

6.5. Implementation Principles

(1) No Phare funds will be used for the purposes of a Project without prior approval of that Project by the Commission and the EBRD (i.e. the Co-financing Members).

(2) Those Projects that address key priorities defined in the road maps for Bulgaria and Romania and monitoring reports for the acceding countries will be particularly welcomed, as well as those focusing on micro-enterprises and those encouraging investments which aim at protecting the environment (e.g. encouraging the introduction of cleaner technologies).

(3) An effort will be made to reach a balanced country coverage although final Project selection will be made on the basis of the quality of the proposals.

(4) The specific procedures relating to the implementation of the Project will be set down in Project Agreements with the Participating Bank or the Participating Leasing Company. Project Agreements will specify the terms and conditions applicable to the use of EBRD resources and the Phare Contribution and will ensure that relevant provisions will be incorporated in the corresponding agreements between the Participating Banks and Leasing Companies on the one hand and the SMEs on the other.

(5) Project Agreements shall encompass specific, objectively verifiable criteria by which Sub-Project compliance with agreed rules will be controlled.

6.6. Project Selection and Approval

Project proposals shall be assessed as to their compliance with the following criteria:

(1) the compliance with the Contribution Agreement including their compliance with eligibility criteria;

(2) the justification of the need of a particular beneficiary

(3) the additionality and sustainability of the Project

(4) the expected quantitative and qualitative results of the Project

(5) the Project’s impact on SME/FRB development in the beneficiary countries;

(6) the country in which the Project is located, the degree to which the requested grant leverages additional funds from EBRD and PBs or PLCs.

Subject to the legal obligation of bank secrecy and the rules of confidentiality, the Commission shall have access to all relevant information in connection with the Project proposals.
Given that the particular requirements of Projects may differ considerably depending on the country concerned and the SME market segment being targeted, the EBRD may propose to the Commission exceptions to the general principles and eligibility criteria. The EBRD shall highlight the particular exceptions and provide justifications, so that the Commission may consider the proposals on their own merits and on a case by case basis.

By its approval of the Project, the Commission authorises the mobilisation of the Phare Contribution held in the Special Account with the EBRD including interest.

6.7. Co-ordination

The Commission co-operates under the SME Finance Facility with three Sponsor groups: EBRD, CEB/KfW and EIB. The EBRD and the other Sponsor groups are authorised to commit the Phare Contribution into Projects that meet the Facility requirements under a co-ordinated approach. This implies defining mechanisms that are applicable to all three Sponsor groups for:

(a) the approval of Projects proposed by the Sponsors;
(b) the co-ordination of the implementation of the Facility to make sure that:
   • there is no overlap between the Projects of the respective Sponsors;
   • there is complementarity between the Projects proposed by different Sponsors;
   • an appropriate country coverage is reached between the Sponsors.

The necessary co-ordination between the different Sponsors is ensured by a Steering Committee composed of representatives of the Commission and each Sponsor. The Steering Committee convenes at the request of any of its members, but meets at least twice per year under the chairmanship of a representative of the Commission in order to

(1) monitor financial and operational progress of the Facility;
(2) review, as appropriate, publications reporting on the Facility;
(3) review the experiences of the Facility overall with a view to proposing improvements;
(4) co-ordinate activities of the Facility, where necessary.

The decisions of the Steering Committee are taken by unanimity.

The Commission endeavours in particular to facilitate the necessary co-ordination between the Sponsors within the Steering Committee, while ensuring the confidentiality of the operations of each Sponsor with the Participating Financial Intermediaries.

6.8. Secretariat

The Commission (DG ECFIN/L) provides the Secretariat of the Facility. The Secretariat co-ordinates the flow of information between the Commission and all the Sponsors for all matters related to Projects, the Steering Committee meetings and any technical meeting and the administration of the Special Account.
7. MONITORING AND EVALUATION

7.1. Monitoring

At operational level, the implementation of this Programme will be monitored through technical and financial reports to be submitted by the EBRD and through the Steering Committee referred to above.

After an initial advance payment, the payment of instalments will be conditioned to the presentation to the Commission of a semi-annual or annual operational progress report and a financial report and their subsequent approval indicating the progress of operations and of expenditure of the Special Account.

Moreover, the accounts and operations of all activities carried out under the Programme may be checked at regular intervals by an outside auditor contracted by the Commission without prejudice to the responsibilities of the Commission and the Court of Auditors. Also the Commission may carry out any necessary audits and on-the-spot checks necessary to verify the correct use of the Phare Contribution.

To facilitate this, the EBRD, Participating Banks, Leasing Companies will keep accounting, financial and operational documents concerning all activities financed by the Phare Contribution under this Programme, and will make available to the competent bodies of the European Commission and the European Court of Auditors on request all relevant information.

7.2. Evaluation

The Commission may also carry out, from time to time, assessments of the activities under the Agreement. To this purpose Commission’s agents or duly authorised representatives may pay monitoring visits down to the Sub-Project level. The Commission also exercises its responsibilities through reviewing the audited accounts and reports produced by the EBRD and through its own independent assessment and audits.

Two interim evaluations have been carried out since the launch of the SME Finance Facility in 1999. Its recommendations have been discussed in the Steering Committee and have been taken into account for the drafting of the financing proposals and Contribution Agreements with the EBRD. The Commission services shall ensure that ex-post evaluation is carried out after completion of the Programme.

8. AUDIT AND ANTI-FRAUD MEASURES

The Financing Decision for this Programme as well as the utilization of the Phare Contribution in Projects are subject to supervision and financial control by the Commission (including the European Anti-Fraud Office, OLAF), and the Court of Auditors. In order to ensure efficient protection of the financial interests of the Community, the Commission can conduct check-ups and inspections on site, in accordance with the procedures foreseen in Council Regulation (Euratom, EC) No 2185/96\(^4\), concerning on-the-spot checks and inspections carried out by the

\(^4\) OJ L 292; 15. 11. 1996; p. 2-5
Commission in order to protect the European Communities’ financial interests against fraud and other irregularities.

The procedures foreseen in Article 15 of the Commission Regulation (EC) No 2222/2000 of 7 June on the communication in case of irregularities and the putting in place of a system to administrate the information in this field shall apply.

Project Agreements to be concluded by the EBRD with the financial intermediaries, as well as agreements between the latter and beneficiaries of Sub-Projects, shall contain provisions to this effect. Relevant documentation should be maintained at all levels for a period of at least five years after closure of the Project.

There shall be full coordination between the EBRD, the Commission and Court of Auditors to minimise any potential disruption to activities.

9. VISIBILITY

All Projects financed under the Facility involving Community funds shall reflect explicitly the input of the Commission through: (i) announcements in the national press of the country concerned; and (ii) inclusion of specific clauses promoting visibility in the Sub-Projects supported at the FI level. Phare visibility measures are based on the provisions of the regulations and decisions applicable to the Structural Funds 5.

In addition, EBRD will report on the activities under the SME Facility in its Annual Report at the same visibility level granted to other special funds.

10. SPECIAL CONDITIONS

In the event that agreed commitments are not met for reasons which are within the control of the EBRD, the Commission may review the programme with a view, at the Commission’s discretion, to cancelling all or part of it and/or to reallocate unused funds for other purposes consistent with the objectives of the Phare programme.