Standard Summary Project Fiche – IPA centralised programmes

1. Basic information

1.1 CRIS Number:	2008/020-300
1.2 Title:	**Participation in the European Fund for South East Europe in 2008**
1.3 ELARG Statistical code:	02.20
1.4 Location:	Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Serbia as well as Kosovo[1],

Implementing arrangements:

1.5 Contracting Authority (EC)	European Community represented by the Commission of the European Communities for and on behalf of the Beneficiaries
1.6 Implementing Agency:	European Investment Fund in accordance with Article 54 (2) (b) of the Financial Regulation
1.7 Beneficiaries:	Western Balkans: Albania, Croatia, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Montenegro, Serbia as well as Kosovo

Financing:

1.8 Overall cost:	€8 million
1.9 EU contribution:	1. Subscription of C shares: €8 million 2. Subscription of C shares paid up by means of a contribution in kind equal to the fair value of 2 loan agreements between the EBRD and ProCredit Bank and 1 loan agreement between the Federal Investment Bank of Bosnia and Herzegovina and Micro Credit Organisation Sunrise: no additional funding sources and no budgetary impact
1.10 Final date for contracting:	30/11/2009
1.11 Final date for execution of contracts:	31/12/2015
1.12 Final date for disbursements:	31/12/2016

[1] under UNSCR 1244/99.

2. Overall Objective and Project Purpose

2.1 Overall Objective:

The objective of EFSE is **to foster economic development and prosperity in Southeast Europe.** The overall objective of the EC participation in EFSE is to contribute to the Beneficiaries' capacity to resist competitive market pressure.

2.2 Project purpose:

The project's purpose is to provide **additional development finance** to micro and small enterprises and private households in the Beneficiaries and to **attract private sector investments** into the region.

There are two components to this project:

(1) Subscription of new shares to the EFSE Western Balkans Regional Sub-Fund

The European Investment Fund, on behalf of the European Commission, will subscribe an amount of €8 million to the Western Balkans Regional C Sub-Fund of EFSE. This contribution will increase the first loss risk cover for any investments made by EFSE in local financial intermediaries in the Western Balkans. The purpose of this contribution is the following:

- It allows EFSE to develop its operations in line with its Business Plan 2008-2012 and meet strong demand from the market. An annual increase of between €8 and 10 million in regional C shares is necessary for the Fund according to its projections. No other donors plan to contribute funds to the regional Western Balkans C Sub-Fund in 2008.
- The provision of an additional amount of C shares will leverage funding from private sources worth €56 million to local financial intermediaries (leverage 1:7).
- While EFSE disposes of C shares pertaining to national sub-funds, it is only through regional C shares that the risk diversification in EFSE can be optimised and additional private investors can be attracted due to this reason. There is no risk sharing across the national sub-funds.
- The contribution will lead to the issuance of new shares in favour of the European Investment Fund, representing the EC, and strengthen its position in the Fund further. It will indirectly, strengthen the ownership of the beneficiaries in EFSE, due to the fact that a transfer of EC shares to the beneficiaries is foreseen by 2015 at the latest.

The contribution will lead to the issuance of an additional amount of 160 shares to the EIF.

(2) Subscription of new shares to the Bosnia Herzegovina Sub-Fund of EFSE pursuant to the transfer of 3 loan agreements to EFSE

The European Investment Fund, on behalf of the European Commission, will subscribe new shares to the Bosnia Herzegovina Sub-Fund of EFSE as a result of the transfer of 3 loan agreements in favour of micro-enterprises in Bosnia Herzegovina with an initial nominal amount of approximately €11.5 million.

This contribution in kind, which will be entered into EFSE at fair value, will lead to the issuance of additional shares to the EIF. The final amount of additional shares will depend on the fair value of loans on the date of the transfer into EFSE.

2.3 Link with AP/NPAA / EP/ SAA

All Accession and European Partnerships have identified short and medium term priorities under the Chapter "Sectoral Policies- Industry and SMEs". For almost all Beneficiaries progress in the implementation of the European Charter for Small Enterprises is identified as a priority. One of the key issues of the European Charter for Small Enterprises is to improve access to finance throughout the entire life cycle of an enterprise.

2.4 Link with MIPD

Support to EFSE is defined as a strategic priority under Article 2.3.2. of the Multi-Annual Indicative Planning Document 2008-2010.

2.5 Link with National Development Plan (where applicable)

NA

2.6 Link with national/ sectoral investment plans

Croatia has developed a strategic development framework for SMEs for the period 2006 to 2013. A new role is defined for the state as a facilitator of the growth process, through constant dialogue with the private sector and social parties. The strategy is coupled with yearly SME action plans that include concrete actions and the assignment of funds as well as the organisations in charge.

Montenegro has adopted a SME strategy for the period 2007-2010. Its main pillars include ten clearly defined strategic goals (such as regulating the system for statistical reporting on the SME sector and strengthening financial support for SME development.)

The former Yugoslav Republic of Macedonia has a long term SME strategy for the period 2002-2012. Practical implementation of the strategy occurs through the programme of measures and activities for entrepreneurship promotion.

Serbia's strategic document is the Strategy for the Development of SMEs and Entrepreneurship 2003-2008. SME projects are foreseen to be funded under the Government's National Investment Plan.

In Albania, METE and Albinvest have developed together a new SME strategy for Albania, which is not yet final. The programme will cover activities in the short and medium term from 2007-2009 and from 2010 to 2013. The Albanian government plans to invest EUR 17.5 million in EFSE in 2008 with own budgetary funds. In addition, the government has established a EUR 200,000 competitiveness fund managed by Albinvest. It is a cost-sharing grant scheme that helps develop businesses. Italy has agreed with Albania on a EUR 30 million credit facility but this facility has not started yet.

In Bosnia Herzegovina an SME strategy was drafted but it has never been adopted at state level.

In Kosovo an SME strategy is being drafted as part of a Kosovo Development Plan.

3. Description of project

3.1 Background and justification

3.1.1. Background

3.1.1.1. EC participation in EFSE to date

EFSE is a public limited company qualifying as an investment company with variable share capital (SICAV) registered in Luxembourg. EFSE mainly provides financing to local commercial banks and micro finance institutions in South East Europe for on-lending to micro and small enterprises and households. Selected financial intermediaries do also benefit from technical assistance. Due to its structuring involving a reduced risk for private investors coupled with reasonable returns, EFSE is set to attract private investments into the region of the Western Balkans.

ESFE was created in December 2005 as the result of a joint effort of the EC, EAR and KfW and IFIs to consolidate various micro-credit schemes extended across the region into one single instrument in order to leverage funding from private investors, achieve management efficiency gains and increase the sense of ownership of beneficiaries. The Fund was created with a size of €147 million of outstanding portfolio.

The European Community subscribed for the first time to EFSE with a nominal value of €63,20 million (fair value approx. €50 million) in the form of outstanding loans from previously existing programmes in Bosnia-Herzegovina, Montenegro, Serbia and Kosovo on 19 June 2006[2].

It increased its participation by €5.7 million (fair value €2.6 million) at the end of 2007 through a transfer of a loan agreement in Kosovo[3] and by €7.5 million dedicated to Albania and the former Yugoslav Republic of Macedonia in March 2008[4].

3.1.1.2. Key figures of EFSE - Results achieved

EFSE is operating in three different groups of South East Europe: (1) The candidates and potential candidates, (2) new Member States (Romania, Bulgaria) and (3) countries of the European Neighbourhood Policy such as the Republic of Moldavia and in the near future also the Ukraine. The participation of the EC in EFSE is restricted to supporting access to finance in the Western Balkans and this is also where EFSE's investments are focused.

The total amount of subscriptions by investors to EFSE stands at **EUR 425** million at the end of 1st quarter 2008. Of the total Fund subscriptions **EUR 134 million** (32%) were provided by **private investors**. It is foreseen that within the next 5 years the share of private investors will reach 50%.

EUR **414 million** constitute outstanding investments in local financial intermediaries. From this amount EUR **312 million**[5] alone is invested in the candidates and potential candidates .

The number of total final beneficiaries has reached over 68,000 micro enterprises and households at the end of the first quarter 2008. The average size of loans to enterprises and households stands at €4000. During the year 2007 EFSE approved €176 million and disbursed €167 million. This demonstrates EFSE's capacity to turn around large amounts of funding into concrete projects within a short time period.

Through its development facility EFSE and equity investments in local financial intermediaries, EFSE has strengthened the capacities of micro finance institutions and supported the transformation of micro-finance institutions into licensed, deposit taking banks. The first equity investment undertaken by EFSE took place at the end of 2007 into the Kosovar micro finance institution KRK, after the successful transfer and restructuring of a loan agreement previously funded by the European Agency for Reconstruction.

3.1.1.3. Micro Credit Schemes in Bosnia and Herzegovina

[2] Commission Decision C (2006)/2307 of 8 June 2006
[3] Commission Decision H(2007)2824 of 5 December 2007
[4] Commission Decision C(2008)930 of 14 March 2008
[5] As per first Quarterly Report 2008 dated 31 March 2008

Since 1997, the European Commission has funded 3 micro credit schemes in Bosnia and Herzegovina worth approximately €11.5 million as follows:

(1) 1 Financing Agreement between the European Commission and the Federal Investment Bank of Bosnia and Herzegovina

Based on Commission Decision C/1997/4260 of 10 December 1997 – concerning "Assistance to the Return of Refugees" in 1997, in particular its chapter on "housing and related infrastructure" the European Commission signed a financing agreement on 21/02/1998 with the German Armed Forces in Bosnia and Herzegovina (GECONSFOR G5/CIMIC) for an amount of ECU2.9 million to undertake reconstruction/rehabilitation works. Under this Agreement the organisation Malteser Hilfsdienst was entrusted by GECONSFOR with the management of a revolving micro credit scheme worth ECU0,51 million. This contract expired on 31 July 1999. On 10 December 2001 a four-partite agreement was signed between the European Commission, GECONSFOR, Malteser Hilfsdienst and The Local Initiatives Department (LID) through which the responsibility for managing the micro credit scheme was transferred from GECONSFOR/Malteser to LID. LID disbursed, following a tender between micro finance organisations, the loan portfolio to the micro credit organisation SUNRISE Sarajevo. Subsequently, the responsibility of managing the revolving micro credit scheme has been transferred from LID to the Federal Investment Bank of Bosnia and Herzegovina (FIBBH) following an official government decision. The loan has an outstanding amount of €513299 as at 31 March 2008 and it priced at a fixed interest rate of 3%.

(2) 2 Loan Agreements between the EBRD and ProCredit Bank

Based on Commission Decision C/1997/2709 of 30 July 1997 on "Economic Regeneration in Bosnia and Herzegovina" (€16.654.942,80) the Commission signed a Co-Financing Agreement with the EBRD on 25/06/1998 through which it contributed €6,000,000 to the Investment Co-operation Fund of "Micro-Enterprise Bank", a micro finance organisation that had been created by IFC, FMO, IPC and BH Banka d.d, and entrusted the EBRD with the management of a loan agreement to Micro-Enterprise Bank for a period of 10 years. EBRD subsequently signed a loan agreement with Micro-Enterprise Bank, which later become ProCredit Bank.

Based on Commission Decision C/1999/2392 of 16 July 1999 on "Economic Regeneration and Social Development in Bosnia and Herzegovina" (€14.600.000) the Commission signed a Replenishment Agreement with the EBRD on 30/06/2000 through which it contributed an additional €5,000,000 to the Investment Co-operation fund of "Micro-Enterprise Bank". The Commission entrusted the EBRD with the management of a loan agreement to Micro-Enterprise Bank for a period of 10 years. EBRD subsequently signed a loan agreement with Micro-Enterprise Bank, later renamed into ProCredit Bank.

In view of the nearing expiry of the Agreements referred to under (1) and (2) and the need to ensure continuity of funding, it is proposed to capitalise the portfolio managed by FIBBH respectively EBRD in EFSE via the EIF, on behalf of the EC, subscribing C shares to the Bosnia and Herzegovina sub-fund. The advantages of this solution are as follows:

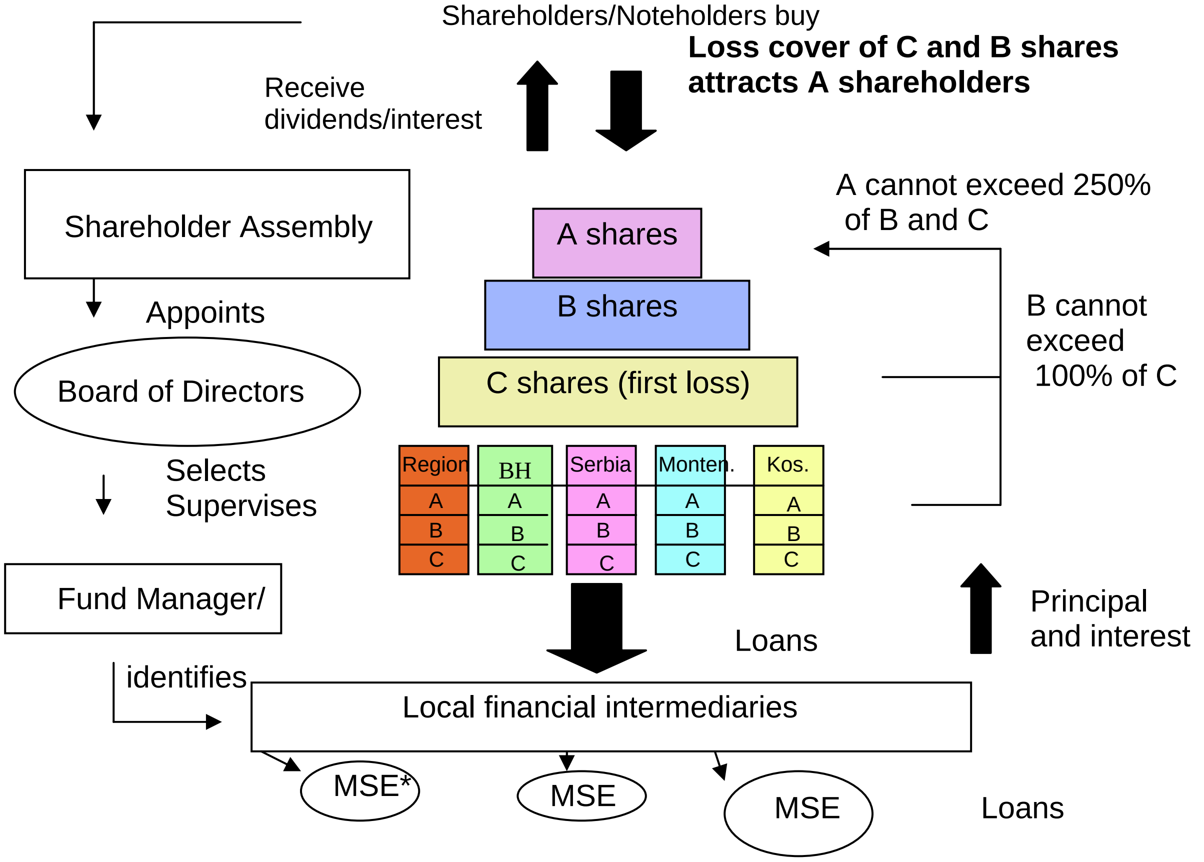
-Continued funding to micro finance organisations in Bosnia and Herzegovina

-Funds transferred to EFSE may be leveraged as much as seven times, attract further private investors into EFSE and increase overall financial support for micro lending in Bosnia and Herzegovina.

-In 2015 at the latest, ownership of the shares held by the EC on behalf of the Beneficiaries, will be transferred to the Beneficiaries, who will then become co-owners of EFSE.

3.1.1.4. Structure and Functioning of EFSE

The following graph illustrates the structure and functioning of EFSE:



3.1.1.5. Shareholder classes

There are three main shareholder groups in EFSE 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 still 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[6] 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.

A fourth class of investors has emerged since the inception of the Fund. These are noteholders. For the moment, all private institutional investors in EFSE hold notes. These are, in contrast to shares, debt instruments with a fixed interest and a given maturity (see above under key figures chapter XXX). This is an effective means of providing financing to the Fund without providing the private investors with ownership rights in the Fund. Given the increasing amount of private investments in EFSE, which is set to reach 50% by 2012, it is

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6 EFSE is not open to physical persons and to companies that cannot be qualified as institutional investors within the meaning of the Luxemburg L *MSE: Micro and Small Enterprises ve investment the securities of which are not intended to be plac

important that the control of the EFSE remains in the hands of the B and C shareholders together. Noteholders are creditors to EFSE and not co-owners.

The Fund's shareholders and noteholders buy shares/notes in the Fund either (1) through the payment of cash or (2) through the transfer of existing loans to local financial intermediaries. The net asset value (NAV) of these shares will change according to the Fund performance.

Current Shareholder Structure (Q1 2008)[7]:

		No of shares	% by share	Subscription amount	Statement Position
				amounts in EUR million	
German Government (BMZ)	**Total**	**1,440**	**22.1%**	**72.5**	**79.0**
	C-shares	*1,440*	*22.1%*	*72.5*	*79.0*
KfW	**Total**	**1,130**	**17.4%**	**55.4**	**54.4**
	A-shares	*349*	*5.4%*	*35.4*	*34.9*
	B-shares	*781*	*12.0%*	*20.0*	*19.5*
EIF, European Investment Fund (as Trustee for EC)	**Total**	**1,121**	**17.2%**	**56.0**	**63.1**
	C-shares	*1,121*	*17.2%*	*56.0*	*63.1*
IFC	**Total**	**796**	**12.2%**	**29.6**	**29.2**
	A-shares	*124*	*1.9%*	*12.5*	*12.4*
	B-shares	*672*	*10.3%*	*17.1*	*16.8*
FMO	**Total**	**793**	**12.2%**	**28.1**	**27.6**
	A-shares	*103*	*1.6%*	*10.4*	*10.3*
	B-shares	*690*	*10.6%*	*17.7*	*17.2*
EBRD	**Total**	**782**	**12.0%**	**20.0**	**19.5**
	B-shares	*782*	*12.0%*	*20.0*	*19.5*
Swiss Government (SDC)	**Total**	**148**	**2.3%**	**7.5**	**8.5**
	C-shares	*148*	*2.3%*	*7.5*	*8.5*
EIB	**Total**	**199**	**3.1%**	**5.0**	**5.0**
	A-shares	*0*	*0.0%*	*0.0*	*0.0*
	B-shares	*199*	*3.1%*	*5.0*	*5.0*
Austrian Government (ADA)	**Total**	**75**	**1.2%**	**3.8**	**4.3**
	C-shares	*75*	*1.2%*	*3.8*	*4.3*
Danish Government (DANIDA)	**Total**	**16**	**0.2%**	**0.8**	**0.8**
	C-shares	*16*	*0.2%*	*0.8*	*0.8*
Frankfurt School of Finance & Management	**Total**	**8**	**0.1%**	**0.2**	**0.2**
	B-shares	*8*	*0.1%*	*0.2*	*0.2*
Total		**6,508**	**100%**	**278.9**	**291.6**

3.1.1.6. Risk mitigation under EFSE

Without a specific risk cushion, private investors would refrain from investing in EFSE mainly due to p*olitical and economic risk*s and *default and insolvency risks.* 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 and noteholders.

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.

[7] Note-holders are not included in the list as they are not EFSE shareholders.

3.1.1.7. 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[8].

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%.[9] 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 set at a spread of 2% over EURIBOR[10].

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 set at a spread of 1.25% over EURIBOR.

Noteholders' returns are fixed. Income is distributed first to notes (interest returns), then to A shares (annual dividend), followed by B shares (annual dividend) and C shares.

3.1.1.8. 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.

The European Investment Fund (EIF) represents 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

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[8] 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.

[9] 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.

[10] European InterBank Offered Rate.

The Shareholder Assembly appoints a Board of Directors (7-9 members), which supervises the daily management of EFSE. The holder of the 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.

The Board of Directors is the central decision making body of EFSE.

Currently the Board consists of 9 members.

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:

3.1.1.9. Eligible Partner Lending Institutions

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 Beneficiaries.**

The portfolio is invested with 58% in commercial banks (41% small and medium sized), 39% in microfinance institutions and 2%[11] in non bank financial institutions such as leasing companies.

3.1.1.10. Eligible final beneficiaries

Eligible final beneficiaries are micro and small enterprises and households.

3.1.1.11. Eligible products

Eligible investment products are mainly 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. During 2008 a reflow of €38 million is foreseen into EFSE. The Fund's investments shall have a maximum maturity of 10 years in general and in exceptional cases may reach up to 15 years.

Since the beginning of 2008 EFSE is also undertaking, though to a limited extent, investments in equity of participating financial intermediaries. Other financial products include guarantees and sub-ordinated loans. Equity investments are limited to 5% of total investments of EFSE.

By the end of 2007 94% of EFSE's investments took the form of senior loans, 5% sub-ordinated loans, 0.5% in convertible loans, 0.5% in guarantees, and 0.2% in equity.

3.1.1.12. Fund Manager

[11] The missing 1% of the portfolio is invested in a special foreign currency hedging fund that provides hedging instruments in currencies for which no other sources are available.

A professional Fund Manager – Oppenheim Asset Management Services S.A.R.L. assisted by the Fund advisor Frankfurt School of Finance & Management is entrusted with the day-to-day management of EFSE and especially the identification of Partner Lending Institutions (PLIs). The Fund Manager has signed an investment management agreement with the Fund and its performance is evaluated on a yearly basis.

3.1.1.13. 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.

3.1.2. Justification

3.1.2.1. Political background

The European perspective of the Western Balkans implies the need for continuous progress towards meeting the Copenhagen economic accession criteria, implying the existence of a functioning market economy and the capacity to cope with competitive pressures and market forces within the European Union. In particular, with regards to the capacity to copy with competitive pressure and market forces, an adequate sector structure and enterprise structure play an important role.

The Enlargement Strategy 2007-2008 recognizes that economic growth has advanced in the Western Balkans, the financial sector developed and further restructuring and opening of the economies continued. The Strategy also highlights that despite of those developments, major economic challenges remain. Among others, investments and SME growth need to be further stimulated, including through improved access to finance. In the Communication of the Commission of 5 March 2008 entitled: "Western Balkans: An enhanced European Perspective" the Commission committed itself to dedicate support to micro-small and medium sized enterprises, in close co-ordination with International Financial Institutions.

3.1.2.2 Micro and Small Enterprises

Small and medium sized enterprises play a vital role for the development of the economies in the Western Balkans. They account for nearly the total number of registered enterprises in the Western Balkans region, with a share ranging between 95% and 98%.[12] In the Western Balkans SMEs are employment generators compensating the steady loss of employment in larger companies. The majority of SMEs are **micro and small enterprises** concentrated in low value added operations in the service, wholesale, and retail and transport and construction sectors.

Despite strong growth rates in bank lending to the private sector, financial intermediation through banks to the private non-financial sector, i.e. enterprises and households, remains very low in all beneficiaries except Croatia and limits the growth of the approximately 365,000 micro-small and medium sized enterprises, which are officially registered in the Western Balkans.[13]

There are various factors for low financial intermediation: They include deficiencies in the regulatory environment, such as a lack of operational bankruptcy laws[14], onerous collateral requirements and poorly functioning credit registries but also market gaps, such as the lack of

[12] SME Policy Index 2007 – Report on the Implementation of the European Charter for Small Enterprises in the Western Balkans – Prepared by the EC and OECD in 2007.

[13] This figure excludes Croatia, which is not a current beneficiary of EFSE; EFSE Business Plan 2008-2012, IFC 2006, OECD.

[14] Kosovo

availability of long term finance[15] and the **lack of access to local currency financing.** The latter is a major constraint for micro and small enterprises as they remain exposed to the prolongation risk of subsequent short term currency loans or a substantial foreign exchange risk. Other factors include a large size of an informal economy with cash based transactions.

Similar constraints prevail for households with a growing demand for housing loans. In many areas of the Western Balkans housing stock is in the state of complete neglect and urgent repairs or renovation is needed.

3.1.2.3. Financial Intermediation

The Banking Sector

The banking sector in the Western Balkans is dominated by the large international banking groups. The four largest international banking groups (Erste Bank, Raiffeisen, Societe Generale, Unicredito) alone make up a combined market share of 44%. The banking sector is characterised by the following:

- High share of assets held by foreign owned banks. Over 75% of assets is held by foreign banks.
- Increasing consolidation and merger activities among banks.
- Increasing competition on market share. The competition is fuelled through parent funding by international banking groups.
- Credit to the private sector has increased by 49% in 2006 on average in the region. The rapid credit growth is primarily concentrated on consumer lending.
- Banks refinance their growth through domestic short term savings, e.g. in Serbia deposits account for 77% of total banking sector liabilities.
- Capital markets are used only reluctantly by banks to raise finance. In Serbia, Procredit Bank has issued a first bond in the banking sector in 2007. However, no second bond offering by another bank in Serbia has taken place.
- IFIs continue to play a major role in providing **long term refinancing**.

Therefore, the following key trends are expected in 2008:

- Consolidation will continue. This will lead to a reduction of potential partner institutions for EFSE and a stronger competition.
- Trust in the banking sector is expected to increase further. This will result in more long term deposits and a more diverse product offering of banks.
- The banking sector will continue to grow and credit growth will go with it.

Resulting from the above the following is the main challenge for financial intermediation:

Although financial markets have deepened there is an unsatisfied demand from micro and small enterprises and households. Credit growth is due a rapid expansion of consumer lending. While this growth can be viewed as a convergence trend to make up for low levels of financial intermediation the speed of this growth could be a threat to overall financial sector stability. Consequently, central banks in several countries are limiting credit growth mainly through applying minimum reserve requirements on foreign borrowings by banks. These measures combined with a risk averse management by banks have a negative effect on lending to micro and small enterprises.

[15] Bosnia and Herzegovina

From an overall macro economic point of view **financial intermediaries need to be convinced to put more emphasis on lending to enterprises and productive purposes** rather than consumption of private individuals. Appropriate incentives can help address this issue. An example is to encourage financial intermediaries to **shift to cash flow based lending for small loans**, as opposed to standard collateral based lending, and overcome the regulatory restrictions with regards to collateral.

In addition, financial institutions need to be supported in developing products and instruments to provide **long term local currency funding**, as the lack of these instruments and the resulting risks hinder the development of SMEs and renewal of housing stock.

Financial intermediation to the productive sector can also be widened through **enlarging the group of potential financial intermediaries.** Non bank financial institution, such as mortgage and leasing companies have not yet fully developed their capacities to provide financing solutions to micro and small enterprises. As most of these institutions are subsidiaries of large banks and non-desposit taking institutions, they rely on external debt funding for their growth.

The widening of potential financial intermediaries also includes the strengthening of **micro credit institutions.** There are approximately 60 micro finance institutions in EFSE targets. Sizeable operations only exist in Bosnia and Herzegovina. While Albania and Kosovo have a medium sized micro finance sector, the sector is almost non existent in Serbia where the national bank policy does not favour micro finance institutions.

In summary, there are still gaps in the financial markets of the Western Balkans where EFSE steps in as a "market enabler", "facilitator" and "risk taker".

3.2 Assessment of project impact, catalytic effect, sustainability and cross border impact

Loan and equity financing, as well as technical assistance provided by EFSE to local financial intermediaries have a catalytic effect on the availability of finance for micro enterprises and households.

EFSE is self sustainable. It is structured in a way to continuously attract private institutional investors but also additional donor funding and mezzanine finance from IFIs to ensure appropriate risk coverage. The objective for the EC is to transfer its shares in EFSE to the beneficiaries in the future. EFSE i.e. funding for micro-enterprises will continue beyond this moment in time with the new shareholders. After the exit of the Commission EFSE will be partly in the hands of the targets in which it is invested.

A cross border impact is achieved by the project, as EFSE has become a regional platform for discussions and co-ordination between donors but also between high level representatives of the business finance community of the Western Balkans. Once the shares of the EC are transferred to the Beneficiaries they will be taking the responsibility for the future of EFSE together.

3.3 Results and measurable indicators:

3.3.1. Results

The main expected results of EFSE are based on the EFSE strategy for the coming years (until 2012) and are as follows:

Increased Long Term Lending Available for Micro Enterprises, in particular in local currency

EFSE will strengthen its role as a provider of local currency lending. This will become possible due to EFSE's investment in a global currency fund, which allows the hedging in currencies for which there is no or only a very limited market.

Increased amount of Subordinated Debt for Local Financial Intermediaries

Subordinated loans are loans provided to financial intermediaries that enable the financial intermediary to raise additional loans on the capital market and therefore leverages finance available for micro and small enterprises and households. It is an important vehicle in liquid markets.

Equity Investments in local financial intermediaries

To a limited extent only, EFSE will acquire minority equity participations in micro finance institutions to support their transformation process to become fully fledged financial intermediaries. Such operations help expand micro-lending best practices and enlarge the number of financial intermediaries with access to finance for micro and small enterprises. The overall equity operations of EFSE remain limited to 5% of EFSE.

Lending to non bank financial institutions

EFSE will have extended financing to non bank financial institutions such as mortgage and leasing companies.

Technical Assistance to Selected financial intermediaries

EFSE hosts the Development Facility, which is a special fund from which dedicated technical assistance is provided to selected financial intermediaries. The Development Facility is partly financed from the revenues from EFSE, partly from dedicated donor contributions[16]. In 2007 the Development Facility financed 34 assignments (approx €1.5 million in total). To ensure impact a combination of consulting services, training and on-the-job coaching is provided. The Facility requires from the financial intermediaries to share the cost of the assistance (average cost share 23% in 2007) to ensure commitment and allow EFSE to maximise the number of beneficiary institutions.

For housing loans EFSE and increased number of housing energy efficiency loans

EFSE will promote energy efficient housing through Technical Assistance offered to financial intermediaries for developing financial products in this field.-Substantial increase in the availability of long term finance, in particular, in local currency to local financial intermediaries.

3.3.2. Measurable Indicators:

The objectively verifiable indicators to measure the degree of achievements of the results will be as follows:

- Increase in the total outstanding portfolio of EFSE in the Western Balkans by 30% by 2012 (from €289 million to €390 million)
- Increase in the number of micro-loans to enterprises and households by at least 60% by 2012 (from 68,000 to at least 110,000)

[16] The EC has currently not made any direct contribution to the Development Facility. It supports the Facility indirectly in so far as part of the returns from EFSE flow into this Facility.

- Increase in the amount of co-financing investments in EFSE from private investors from 30% to 46% of the Fund volume by 2012 (share of EFSE noteholders)
- Average size of loans provided by local financial intermediaries to micro enterprises below €5,000 and decreasing further by 2012
- Technical Assistance projects with average size of €50,000 have reached at least 50% of EFSE financial intermediaries eligible for technical assistance by 2012. Assistance volume[17] increased by 100% by 2012

The sources of verification of the indicators of achievement will be the EFSE Annual Report, the EFSE Quarterly Report, and the EFSE Business Plan 2008-2012.

3.4 Activities

On the basis of the new EC contribution, EFSE will identify new eligible financial intermediaries for on-lending to micro and small enterprises and sign respective loan agreement with them.

This programme shall be implemented by centralised indirect 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.

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. 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[18] and Article 35 of the Implementing Rules of the Financial Regulation[19].

The agreement has been extended with each additional EC contribution (first addendum in December 2007, second addendum in March 2008) – be it in kind or in cash- to EFSE.

This agreement shall be extended again to cover the Community participation in the EFSE provided for in this Decision. The extension will foresee

(1) that the EIF shall sign a subscription form worth €8 million to be made available to EFSE's regional Western Balkans C sub-fund.
(2) that the EIF mandate includes the contribution in kind in Bosnia and Herzegovina.

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[17] As EFSE practices cost sharing with the beneficiary, the TA volume target above includes the costs shared by the beneficiary, not only the EFSE contribution.
[18] OJ L 248, 16.9.2002, p.1.
[19] OJ L 357, 31.12.2002, p. 1.

Prior to the extension of the EIF mandate, a transfer agreement shall be signed between the EC, EBRD respectively the Federal Investment Bank of Bosnia and Herzegovina as Fund Managers, and SUNRISE respectively Pro-Credit Bank and EFSE through which the loan agreements shall be transferred under the umbrella of EFSE.

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 beneficiaries 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.

3.5 Conditionality and sequencing

- A stable political and macro-economic situation is essential for the attraction of private investors into EFSE.
- Continued financial support and commitment by international financial institutions, development banks and donors is necessary to ensure a maximum leverage with private investments. Sufficient C and B shares are necessary to cover risks of A shareholders.
- The regulatory development of the financial sector is necessary to broaden the basis of eligible financial intermediaries of EFSE and the development of new products.
- Approval of adjustments of EFSE issue document and Articles of Incorporation by the Luxembourg Financial Market Supervisor is a necessary condition for the geographical extension of EFSE but also the diversification of its products and instruments.
- The functioning of the Development Facility is conditional to the co-financing by local financial intermediaries.
- Training provided to local staff is being institutionalised.

3.6 Linked activities

Concerning access to finance for micro-enterprises all existing schemes funded under national programmes have either ended or have been transferred to the European Fund for South East Europe except the scheme contained in the project fiche.

The Competitiveness and Innovation Framework Programme has been extended to some of the beneficiaries, in which EFSE is operating, namely, the former Yugoslav Republic of Macedonia. It is planned that this Programme will also be extended to the potential candidates. Among others, the CIP Programme will provides better access to finance for SMEs through venture capital investment and loan guarantee instruments. The CIP Programme component dealing with access to finance will be managed by EIF.

Under its pre-accession facility the EIB is providing global loans to local financial intermediaries for on-lending to SMEs

EBRD has launched several initiatives to support SMEs. This includes most recently, the Western Balkans and Croatia Financing Framework of the EBRD. This framework is a €250 million loan facility targeting amongst others financial institutions focusing on micro-lending. Next to that there is a US/EBRD SME Finance Facility and a EAR/Italy/EBRD SME Finance Facility through which the EAR has been supporting technical assistance to financial intermediaries in some of the Western Balkans. The EBRD is also managing a donor funded Turnaround Management Programme and Business Advisory Services for enterprises.

3.7 Lessons learned

Since the inception of EFSE the following lessons have been learned

- The national sub-fund structure is suboptimal. The risk diversification and leverage effect is optimised through regional funds only. This is, why the European Commission, when providing a new contribution to EFSE going forward, will provide regional IPA funding without any specific dedication to a specific beneficiary. In case of the transfer of existing loan agreements the restrictions to a specific beneficiary must be maintained based on previous commitments to the beneficiaries in this respect. During 2008/2009 ways will be explored to allow for a transformation of the national sub-funds and integrate them into the regional Western Balkans sub-fund structure in the future.
- EFSE has expanded in terms of products and geographically. It is important that the focus of EFSE be kept in the future on the candidates and potential candidates and the European Investment Fund, representing the EC, in co-operation with other donors of EFSE shall ensure mission focus in its main decision making bodies both geographically and in terms of products.
- Due to the rapid development of the activities of EFSE, the workload of the European Investment Fund, in particular with regards to its representation of the EC in the Board Meetings is substantially higher than initially estimated. The high number of complex issues to be analysed in preparation of Board Meetings and the necessary follow up will require a fee adjustment for the years to come.

4. Indicative Budget (amounts in EUR)

			0	SOURCES OF FUNDING								
			TOTAL EXP.RE	IPA COMMUNITY CONTRIBUTION		NATIONAL CONTRIBUTION					PRIVATE CONTRIBUTION	
ACTIVITIES	IB (1)	INV (1)	EUR (a)=(b)+(c)+(d)	EUR (b)	%(2)	Total EUR (c)=(x)+(y)+(z)	% (2)	Central EUR (x)	Regional/ Local EUR (y)	IFIs EUR (z)	EUR (d)	% (2)
Activity 1	x	-	8 000 000	8 000 000	*100*							
contract 1.1	–	–	8 000 000	8 000 000	*100*							–
TOTAL IB			8 000 000									
TOTAL INV												
TOTAL PROJECT			**8 000 000**	**8 000 000**	**100**							

<u>NOTE: DO NOT MIX IB AND INV IN THE SAME ACTIVITY ROW. USE SEPARATE ROW</u>

Amounts net of VAT

(1) In the Activity row use "X" to identify whether IB or INV

(2) Expressed in % of the **Total** Expenditure (column (a))

*Extensive co-financing is provided to EFSE through national contributions (German, Austrian, Danish and Swiss Government), International Financial Institutions and private investors. As at 31 March 2008 the total size (subscriptions) of EFSE stands **€425 million.***

5. Indicative Implementation Schedule (periods broken down per quarter)

Contracts	Start of Tendering	Signature of contract	Project Completion
Contract 1.1	NA	1st quarter 2009	31 December 2015

6. Cross-cutting issues (where applicable)

6.1 Equal Opportunity

Both women and men are among the sub-borrowers (end-beneficiaries) of EFSE.

6.2 Environment (NA)

6.3 Minorities (NA)

ANNEXES

1- Log frame in Standard Format

2- Amounts contracted and Disbursed per Quarter over the full duration of Programme

3- Description of Institutional Framework

4 - Reference to laws, regulations and strategic documents:

Reference list of relevant laws and regulations

Reference to AP /NPAA / EP / SAA

Reference to MIPD

Reference to National Development Plan

Reference to national / sectoral investment plans

ANNEX 1: Logical framework matrix in standard format

LOGFRAME PLANNING MATRIX FOR Project Fiche	Programme name and number **Multi-beneficiary Programme for Support to Cooperation with the International Financial Institutions-IFIs – 2008 (2008/020-300)**	
Participation in the European Fund for South East Europe	Contracting period) expires on 30/11/2009	Disbursement period expires 31/12/2016
	Total budget : **Approx. €8000000**	IPA budget **2008**: €8000000

Overall objective	**Objectively verifiable indicators**	**Sources of Verification**	
Foster economic development in the Western Balkans	-Decrease in unemployment levels -Increase in Gross Domestic Product -Increased credit growth towards productive investments -Improvement of current account balance (driven by increased exports and foreign direct investments)	International Monetary Fund, Central Banks, National Statistics Office, International Financial Institutions	
Project purpose	**Objectively verifiable indicators**	**Sources of Verification**	**Assumptions**
(1) Provide access to finance to micro and small enterprises and households (2) Increase private investments into the region through the Fund	-Increase in the number of micro-loans for enterprises and household in the Western Balkans by at least 60% by 2012 (from 68,000 to at least 110,000); -Increase in the amount of co-financing in EFSE from private investors from 30% to 46% of Fund volume by 2012; -Average size of loans provided by local financial intermediaries to micro enterprises below 5000 and decreasing further by 2012; -Increase in the number of micro loans provided in rural areas;	EFSE Annual Reports EFSE Quarterly Reports EFSE Business Plan 2008-2012	-Stable political situation and continued price stability -Regulatory environment in financial sector and in microcredit sector in particular develops further -EFSE continues to be profitable -Trained staff stays with the local financial intermediary
Results	**Objectively verifiable indicators**	**Sources of Verification**	**Assumptions**
-Increased Long Term Lending Available for Micro Enterprises, in particular in local currency -Increased amount of Subordinated Debt for Local Financial Intermediaries -Equity investments in financial intermediaries -Financing for non bank financial intermediaries -Capacity strengthened of financial intermediaries to provide microloans	-Increase in the total outstanding portfolio of EFSE in the Western Balkans by 30% by 2012 (from EUR 289 million 390 million) -Technical assistance projects with average size of €50,000 have reached at least 50% of eligible financial intermediaries in 2012. Assistance volume increased by 100% by 2012	EFSE Annual Report EFSE Quarterly Report EFSE Business Plan 2008-2012	-continued demand and interest by local financial intermediaries for EFSE products filling market gaps
Activities	**Means**	**Costs**	**Assumptions**
-Identification of local financial intermediaries as beneficiary of debt or equity instruments and/or technical assistance -Investment decisions concerning financial intermediaries -Continuous risk management and monitoring of credit portfolio -Organisation of training for selected local financial intermediaries -Marketing activities towards private investors to join EFSE as shareholders -Financing reporting to shareholders -Preparation of documentation for Board and shareholder meetings and organisation of those meetings	-EFSE Fund Manager and Advisor including local offices staff -Investment Committee members -EFSE Board members -Custodian and Administration Agent staff -Advisory Committee	€ 8 million for investment in the Western Balkans Regional Sub-Fund; funds will be used to provide mainly loans to financial institutions for on-lending to micro-enterprises and households; the funds will be allocated to C class and therefore carry the risk of first losses in the Western Balkans regional sub-fund. Other shareholders in EFSE also continuously provide EFSE with additional funding. The cost for managing EFSE is borne by the revenues of the Fund. The cost of the Development Facility is also borne by the revenues of EFSE.	-Continued financial support and commitment by international financial institutions and other donors to the EFSE initiative -Approval of adjustments of EFSE issue document and articles of incorporation by the Luxembourg Financial Market Supervisor -local financial intermediaries co-finance TA projects

ANNEX II: amounts (in €) Contracted and disbursed by quarter for the project

Contracted	**1st quarter 2009**										
Contract 1.1	8,000,000										
Cumulated	**8,000,000**										
Disbursed		2nd quarter 2009									
Contract 1.1		8,000,000									
Cumulated		**8,000,000**									

Annex III - Description Institutional Framework

The institutional framework relevant for this project relates on the hand to the institutions in charge of designing and implementing policies and laws with regards to financial sector development, and on the other hand, institutions dealing with SME policies and implementation.

3.1. Institutional Framework with regards to Financial Sector Development

A central institution driving the global policy orientations for financial sector regulation and development is the Bank for International Settlements (BIS) located in Basel, Switzerland. It is an international organisation, which fosters international monetary and financial cooperation and serves as a bank for central banks. The BIS hosts the Basel Committee on Banking Supervision, which provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide and consequently, contribute to an effective functioning of the financial sector. The Committee is best known for its international standards on capital adequacy, the Core Principles for Effective Banking Supervision and the Concordat on cross-border banking supervision. The Basel II Framework describes comprehensive measures and a minimum standard for capital adequacy that national supervisory authorities are now working to implement through domestic rule-making and adoption procedures. Basel II seeks to improve on the existing rules by aligning regulatory capital requirements more closely to the underlying risks that banks face.

The BIS also hosts the Committee on the Global Financial System (CGFS), which monitors developments in global financial markets for the central bank Governors of the G10 countries and issues policy recommendations in this respect. The Committee has a mandate to identify and assess potential sources of stress in global financial markets, to further the understanding of the structural underpinnings of financial markets, and to promote improvements to the functioning and stability of these markets. The European Commission and the European Central Bank are participating in this Committee.

At EU level, it is the European Commission which is putting forward policy proposals in the field of regulation of banks and financial conglomerates. The current EC policy framework is the EC's Financial Services Action Plan 2005-2010, the main policy concerning the implementation of the EU Single Market in the field of services. The key policy instrument to achieve this goal is the development, implementation and application of EU banking and financial conglomerates legislation with all stakeholders, covering prudential rules for credit institutions, financial conglomerates and investment firms. This includes the correct and timely transposition of legislation and the pursuit of any necessary infringement procedures, as well as the development of any useful interpretative guidance on the EU banking legislation.

In the candidates and potential candidates the institutional framework regulating the financial sector is presented as follows:

Albania:

The banking system in the Republic of Albania has a two-tier structure. The first tier includes the Bank of Albania, whereas in the second tier there are banks and branches of foreign banks and non-bank financial institutions licensed by the Bank of Albania.

The Bank of Albania's activity is conducted in compliance with the Law "On the Bank of Albania". The Bank of Albania is the main regulator of the financial system. It is a fully state owned – bank and is accountable to the People's Assembly of the Republic of Albania. Apart from the appliance of monetary instruments to achieve monetary policy targets, the Bank of Albania supervises the banking activity to ensure banking system stability and issues and revokes banking licenses. It keeps and administers the foreign reserves of Albania, issues and circulates the national currency and promotes the functioning of the payment system.

The banking system activity is conducted in compliance with Law "On banks in the Republic of Albania". There are 16 commercial banks registered by the Central Bank of Albania, 6 non-bank financial institutions, one representative office of a foreign banks, and 3 unions of saving and loan associations. The privatisation of the banking sector is completed in Albania.

The microfinance sector is integrated 4 big MFIs and a large number of smaller institutions. They are supervised by the Central Bank according to the Banking Law, the Law on Commercial Companies and the Law on Associations and Foundations. There are not limitations for the maximum amount of their loans, and capital adequacy requirements are the same applied to banks.

Bosnia and Herzegovina:

The Central Bank of Bosnia and Herzegovina was established in accordance with the Law adopted at the Parliament of Bosnia and Herzegovina on 20 June 1997.

The main goals and tasks of the Central Bank are defined by the Law and in accordance with the General Peace Agreement in Bosnia and Herzegovina. The Central Bank defines and controls the implementation of monetary policy of Bosnia and Herzegovina. It supports and maintains appropriate payment and settlement systems. It co-ordinates the activities of the *Bosnia and Herzegovina Entity Banking Agencies* which are in charge of bank licensing and supervision.

At the Central Bank, 18 banks are registered from the Federation of Bosnia and Herzegovina, and 10 banks from Republika Srpska. The MFI sector is by far the largest of the region, with more than EUR 500 million in total assets. MFIs currently serve more than 250,000 final borrowers in urban and rural areas having a huge development impact. Regulation is differentiated between the Republika Srpksa and the Bosnian Federation. In the Republika, new regulations allow MCOs to transform into profit companies under the form of "limited liability companies". All MCOs present in the Republika have undergone this process already. In the federation, on its side, MCOs are first required to re-register as foundations and only after that they can become a profit-company. All MCOs in the Federation already re-registered as foundations, and during 2008 the first transformations into companies are expected to take place.

Kosovo:

The Banking and Payments Authority of Kosovo (BPK) performs a number of tasks typical of a central bank. Its objective is to improve the stability and reliability of the banking system in Kosovo. The BPK manages the Governments' funds, keeps the Government deposits and the budget surplus in its accounts, handles the Government spending and transfers within Kosovo and abroad. The Government resources are put in short-term investments with major banks in the EU in order to minimise risks and to maintain ready access to liquidity.

As the Financial Services Authority, the institution, among others, sets the rules for the banking and insurance sectors. It also the supervises commercial banks, micro-finance institutions, insurance companies and employer-funded pension.

The MFI sector in Kosovo has made important progress in the last years with 4 institutions with sizable operations. This leading MFIs reached a total portfolio of EUR 50 million by end 2007. The regulatory framework took a big step in 2008 by proposing one of the first MFI laws in the region, allowing MFIs that fulfil certain conditions to become deposit-taking institutions. The MFI law is still under discussion and pending legal approval.

Montenegro:

The Central Bank of Montenegro was established on the basis of the Law on Central Bank of Montenegro of November 2000. The Central Bank prepares and participates in the preparation of laws and other regulations concerning the monetary, foreign currency and banking system, in accordance with international standards. It is the regulator and supervisor of the banking system. In this function it issues and withdraws licenses to banks and financial institutions and supervises their operations, bankruptcy and liquidation proceeding. The Central may also provide loans from its reserves to licensed banks, regulates and supervises the payment system and takes deposits from banks, state agencies and organizations.

There are currently 14 banks registered with the Central Bank of Montenegro. The banking sector has been one the most dynamic of the region during the last years, showing impressive rates of growth (100% loan growth in 2007). In this context, the biggest challenge for all players is to ensure a soft landing. The Central Bank has already taken some measures to ensure this by restricting the portfolio growth of banks.

The MFI sector in Montenegro consists of one specialised microfinance bank and two large institutions, one primarily serving rural areas and one serving urban areas. Recent changes in the regulatory framework gave more freedom to MFIs by eliminating – for example – the maximum loan amount and the maximum leverage. Unlike banks, MFIs were not subject to portfolio growth limits. These measures were complemented with requirements to improve operational risk management, an essential feature in order to keep a good portfolio quality in a period of rapid growth.

Serbia:

Banking system of the Republic of Serbia consists of the central bank (National Bank of Serbia) and commercial banks.

The National Bank of Serbia has been established on the basis of the Constitution of Serbia and the Law on the National Bank of Serbia in 2003. Pursuant to Article 2 of the Law on the National Bank of Serbia, the National Bank of Serbia is the central bank of the Republic of Serbia and as such its main responsibilities are the protection of price stability and maintenance of financial stability. The National Bank of Serbia acts as an autonomous institution and is independent from the government or its bodies. On the basis of the determined economic policy targets and key macroeconomic indicators adopted by the Parliament, the National Bank independently develops the monetary and credit policy measures that are to be implemented. Also, the National Bank of Serbia passes an opinion on the certain enactments related to the budgetary, economic and fiscal policy issues, as well as on the draft laws and other legal regulations within the scope of its authority.

The main responsibilities of the National Bank of Serbia include determining and implementation of the monetary policy, as well as that of the dinar exchange rate policy, management of the foreign currency reserves, issue of banknotes and coins, and maintenance of efficient payment and financial systems. With regards to the financial system the National Bank assumes a supervisory function aimed at monitoring the solvency and legal grounding of operations performed by commercial banks and other financial institutions. The National Bank also provides for the minimal scope of auditing for banks and other financial institutions.

There are 34 commercial banks in Serbia and 7 representative offices of foreign banks registered at the National Bank of Serbia.

Serbia does not allow microfinance institutions to directly disburse funds to clients. Instead, they have to operate through a commercial bank, which significantly hampers the microfinance sector from developing. However, in addition to ProCredit Bank, Opportunity Bank recently obtained a license as a second full-fledged commercial banks specialised in serving low-income households and micro and small entrepreneurs.

The former Yugoslav Republic of Macedonia:

The National Bank of the former Yugoslav Republic of Macedonia has been established based on the law on the National Bank of the Republic of Macedonia. The National Bank is the only supervisory authority responsible for licensing and supervision of banks and savings houses.

The main purpose of the supervisory function performed by the National Bank is the maintenance of a safe and sound banking system and the protection of the depositors and other creditors that had invested their money in the banking system. The National Bank of the Republic of Macedonia has established supervisory standards that are incompliance with the international standards and practices set by the Basle Committee on Banking Supervision.

While performing their activities, banks are obliged to comply with the existing supervisory standards that are implemented for the purpose of limiting the banks’ risk exposure. The supervisory standards established and implemented by the National Bank are derived from the Basle Committee’s principles and the European Directives.

The National Bank also establishes and conducts the monetary policy, regulates the liquidity in the international payments, establishes and conducts the Denar exchange rate policy, manages the foreign exchange reserves, regulates the payment system, issues banknotes and coins and performs activities for the account of the central government and the government administration bodies.

There are currently 18 banks registered with the National Bank, one representative office of a foreign bank, and 11 savings houses. Micro clients are mostly reached by savings houses and one NGO with sizable operations. However, saving houses are not allowed to borrow from abroad and therefore have to use commercial banks as intermediaries. NGOs are permitted to borrow but cannot perform any lending activities and therefore need to channel funds through commercial banks similar to Serbia.

3.2. Intergovernmental co-ordination in SME policy elaboration

Four beneficiaries have a single, fully operational institution responsible for SME policy elaboration, drafting and co-ordination with a system of regular consultation with the implementing SME agencies.

In **Albania** this is the Department of Business Promotion within the Ministry of Economy, Trade and Energy (METE).

In **Croatia** this is the Directorate for SMEs at the Ministry of Economy, Labour and Entrepreneurship (MELE).

In the former **Yugoslav Republic of Macedonia** there is a special unit within the Ministry of Economy dealing with the SME sector, which acts as a key co-ordinator for SME policy issues.

In **Montenegro** a separate Directorate for Development of small and medium sized enterprises is responsible for SME Policy elaboration.

In **Serbia**, the SME Department within the Ministry of Economy has a clear co-ordination structure and an inter-ministerial SME Council was recently established.

In **Kosovo**, the private sector development department is in charge of developing the private sector (including the SME sector). A number of donor led agencies and non governmental institutions are dealing with specific areas of SME development, virtually, substituting for the government. There are other government departments that deal partially with SME issues such as the Department of Youth, dealing with entrepreneurship education.

In **Bosnia and Herzegovina**, several institutions are responsible for SME policy. The SME unit in the Ministry of Foreign Trade and Economic Relations (MOFTER) is responsible for state level policy co-ordination with the entities and Br ko District. In Republika Srpska there is a Department for SMEs and production craftsmanship in the framework of the Ministry of Economy, Energy and Development, which is responsible for SME policy elaboration, along with the operational Republic Agency for Development of SMEs, which is responsible for SME policy implementation. In the Federation of Bosnia and Herzegovina and the Br ko District there are relevant departments for SME development within the Ministries, but no leading institution in charge of SME policy.

3.3. SME policy implementation agency or equivalent

In the Western Balkans region, only **Bosnia and Herzegovina and Kosovo** have no fully operational SME agencies responsible for implementing SME policies which enjoy full political support.

In **Montenegro** it is the SME Development Agency (SMEDA) which is in charge of implementing SME policy. It is structured in five departments (1) institutional support, (2) education, (3) strategy and development, (4) international projects, (5) research projects. It has a staff of about 20. The agency implemented successfully programmes to stimulate SMEs (e.g. franchising, leasing, technological parks, incubators).

In **Serbia** the Agency for Development of SMEs is divided into 3 key sectors (1) international co-operation, (2) support to SMEs, (3) Common Affairs. The Serbian agency has been predominantly active in providing legal and financial consulting and training to SMEs in co-operation with the National Employment Service.

Croatia's SME agency is HAMAG.

The former Yugoslav Republic of Macedonia's Agency for Promotion of Entrepreneurship (APE) is the country's only national implementation institution.

In **Albania** a new SME agency has been established called Albinvest. This agency is responsible for implementing governmental SME policies.

In **Kosovo** it is the department of private sector development within the Ministry of Trade and Industry of the provisional government institutions which is in charge SME policy implementation. The department is policy maker and implementor. It relies largely on donors and focuses on the Prishtina area.

There is no national SME agency yet **in Bosnia and Herzegovina**. There is an operational SME Agency in the country's Republika Srpska with staff and budget.

Annex IV- Reference to laws, regulations and strategic documents:

Relevant EU policies in the field of access to finance for SMEs

- Communication from the Commission to the European Parliament and the Council: Enlargement Strategy and Main Challenges 2007-2008 of 6 November 2007
- Communication from the Commission to the European Parliament and the Council: Western Balkans: Enhancing the European Perspective of 5 March 2008
- Communication from the Commission to the European Parliament and the Council: Consolidating Stability and Raising Prosperity of 27/01/2006
- Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - Implementation of the Lisbon Programme – Think Small First – A Small Business Act for Europe of 26 May 2008
- White Paper on Financial Services Policy 2005-2010 of 5 December 2005