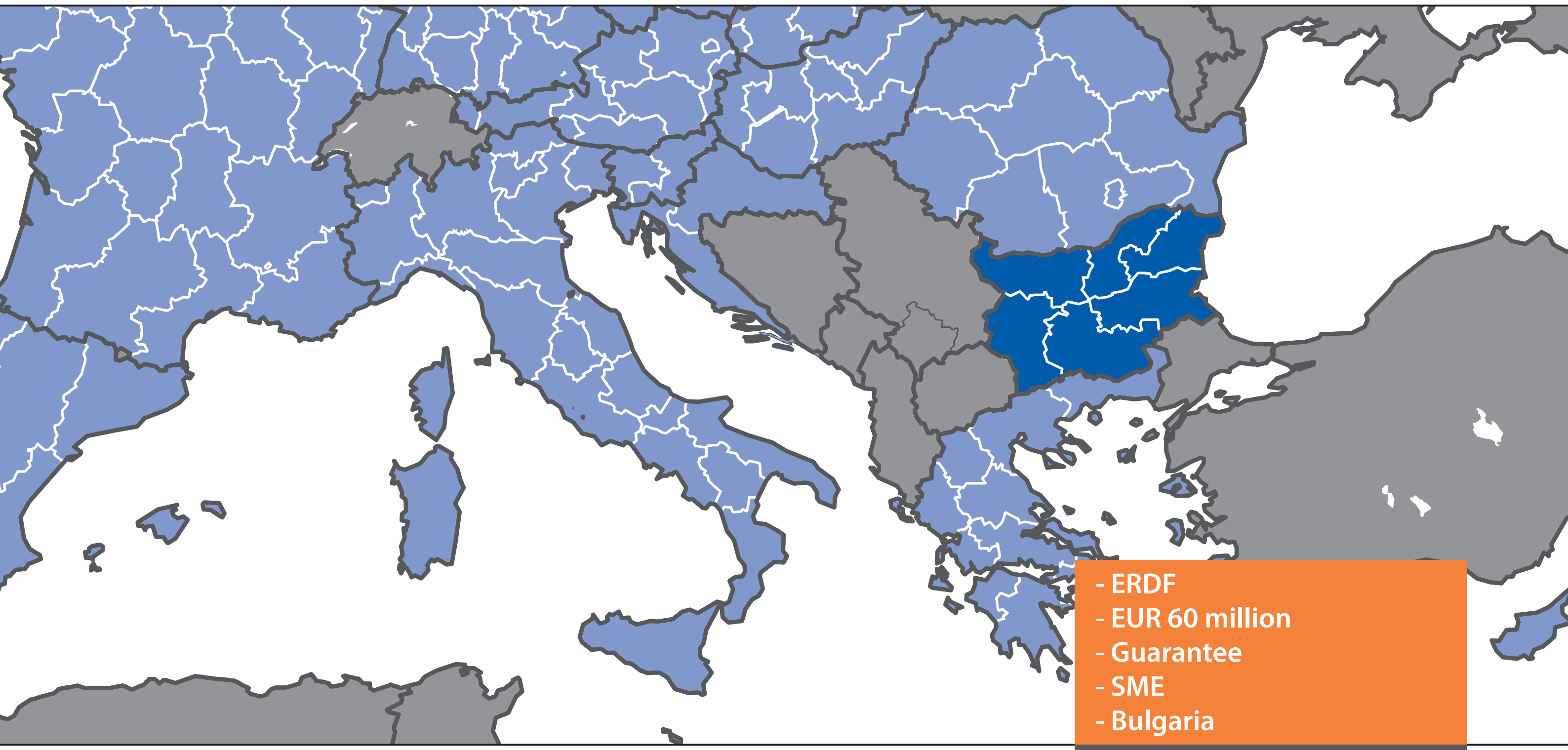

- ERDF
- EUR 60 million
- Guarantee
- SME
- Bulgaria

… addressing the gap in financing due to SMEs' lack of collateral …

First Loss Portfolio Guarantee

Case Study

European Commission

European Investment Bank
The EU bank

DISCLAIMER

The authors of this study are a consortium of three companies: t33 (lead), University of Strathclyde – EPRC and Spatial Foresight.

Abbreviations

EIF	European Investment Fund
ERDF	European Regional Development Fund
ESIF	European Structural and Investment Funds 2014-2020
FLPG	First Loss Portfolio Guarantee
FREDE	Financial Resources for Developing Enterprises
HF	Holding Fund
JEREMIE	Joint European Resources for Micro to Medium Enterprises
MA	Managing Authority
MEE	Ministry of Economy and Energy, Bulgaria
NSRF	National Strategic Reference Framework 2007-2013
OP	Operational Programme
OPC	OP “Development of the Competitiveness of the Bulgarian Economy“ 2007-2013
OPIC	OP “Innovation and Competitiveness“ 2014-2020
PA	Partnership Agreement 2014-2020
SME	Small and Medium Enterprise

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1 Summary

This case study focuses on the implementation of a Bulgarian 2007-2013 ERDF-funded guarantee-type financial instrument directed at SMEs – the First Loss Portfolio Guarantee (FLPG). Through this instrument, SMEs, such as a label producing company from the town Veliko Tarnovo, managed to increase sales, provide higher quality products to clients and better working conditions for employees. All this happened during times of serious economic and financial crisis, experienced by other enterprises in this sector and region. The SME received a European Regional Development Fund (ERDF)-funded guarantee covering 80% of a loan to modernise, expand the business and make it more sustainable. Without this financial instrument, the project would not have been possible.

The example demonstrates how the ERDF can be invested in a sustainable way using a regional network of financial intermediaries. From 2011 until 2014, this scheme benefited nearly 4,000 SMEs in a market traditionally reluctant to support micro-enterprises, high-risk projects or innovative solutions. In Bulgaria, banks typically ask for guarantees of 130 – 140% of the loan value and charge high interest rates. The FLPG scheme broke the vicious cycle of 'no credit – no investments – no growth – no trust'.

The FLPG is implemented by the European Investment Fund, which used the ERDF resource to act as the guarantor for five Bulgarian banks. Thanks to the guarantees the banks could grant loans to SMEs. The FLPG is one of the most effective financial assistance schemes in the country due to its strategy based on market gaps, quick response and adaptability as well as wide regional and industry coverage.

The FLPG instrument stimulates bank lending to micro-, small and medium-sized enterprises (SMEs) by providing credit risk protection (in the form of a first loss portfolio capped financial guarantee) in order to offset the difficulties that SMEs face in accessing finance. These are mainly due to lack of sufficient collateral in combination with the relatively high risk they represent, which leads to high interest rates.

The overall budget of the instrument amounts to EUR 60.2 million (85% of it financed by the ERDF, i.e. EUR 51.17 million). Due to additional contributions from financial intermediaries the instrument generates an amount five times larger than the ERDF funds allocated, with the total budget, including private contributions totalling EUR 301 million.

This case examines the whole lifecycle of the FLPG from design through to implementation. It is an interesting case for three reasons. First, it shows how public policy can respond to market needs – the absorption rate and the modest level of losses suggest that customer demands were met with quality services. Second, the FLPG demonstrates that even SMEs which would otherwise face obstacles in accessing loans can be financed. Third, it shows the importance of a culture of close private and public sector cooperation for successful implementation.

Name
First Loss Portfolio Guarantee (FLPG), Bulgaria

Funding source
Operational Programme "Development of the Competitiveness of the Bulgarian Economy, co-financed under ERDF

Type of FI
Guarantees

Financial size
EUR 60.2 million total = OP resources (EUR 51.17 million ERDF and EUR 9.03 million national funding)

Absorption rate
85% of OP resources: ERDF and national funding (at the end of 2013)

EU leverage
5.9 times (leverage effect of ERDF funds)

ESIF programme Multiplier
5 times (multiplier effect of ERDF and national co-financing)

Re-investment
n.a.

Thematic focus
SME support

Partners involved
European Investment Fund / five financial intermediaries / Managing Authority (Ministry of Economy and Energy)

Timing
From July 2011 to 31 December 2015

Main results
3,990 final recipients/ SMEs - approx. 78,000 jobs supported

Exchange rate: 1 EUR = 1.9515 BGN (Bulgarian Lev)

2 Objectives

In Bulgaria, as elsewhere in Europe, SMEs are an engine of economic development. An analysis carried out in 2006 showed that SMEs provide 37% of Bulgarian jobs and 78% of employment in firms. Both these shares grew by about 5% from 2001 to 2005. SMEs contributed 39% of gross domestic product and 45% of gross value added. By 2014, SMEs provided approximately 50% of all jobs in Bulgaria and produced 62%of Bulgaria's Gross Value Added compared to an EU average of 58%.

The same analysis found that SMEs and start-ups with minimal assets have difficulties in accessing credit due to their lack of credit history or insufficient collateral, although credit is now more available. Based upon the 2006 analysis to see how financial support could address the problems, it was recommended that SME access to finance should be overcome by a combination of guarantees, venture capital and micro-credit funds as well as grants for SMEs to modernise their production and management systems.

The SME financing problem is addressed, at least partially in the 'Development of the Competitiveness of the Bulgarian Economy' (OPC) 2007-2013, co-financed by the ERDF, to develop a dynamic and competitive Bulgarian economy. The OPC makes use of financial instruments to improve access to finance and to increase the availability of and knowledge about finance. The programme improves the business environment and increases enterprise efficiency through innovation, with an overall budget of EUR 988 million. Following the EIF gap analysis carried out in 2007, initially EUR 200 million (EUR 170 million from ERDF and EUR 30 million national contribution) were allocated to financial instruments through an EIF-managed Holding Fund. The Holding Fund includes a First Loss Portfolio Guarantee' (FLPG), which is the main focus of this study, as well as a loan instrument and four equity products.

These funds are aimed to fill market gaps in traditional bank finance for SMEs, adding new opportunities for them to access risk capital in 'financing niches'. The ERDF thus supports this network of alternative financial sources (of which FLPG is an example), with low administration fees, sustainable practices, training, monitoring and close cooperation between the parties, including the banking sector.

Prior to this scheme there was a national guarantee fund, but only for the agricultural sector. Those micro-financing schemes could not cover the existing micro enterprise demand. Some 70% of SMEs mainly rely on self-financing to start a business. Leasing services, although developing rapidly, can only partially substitute for loans to acquire business machines, equipment and vehicles. Small manufacturers have limited options since they usually rely on receivables from trustworthy customers or on state receivables. This is, however, insufficient. Alternatively, the National Innovation Fund provides support for innovation projects outside the agricultural sector, but mostly focuses on large enterprises, rather than SMEs.

High tech firm supported by the financial instrument

The FLPG helped a firm from Veliko Tarnovo (Bulgaria), which specialised in label production, to invest in the most up-to-date production technology and to combine production with a suitable commercial building with a suitable commercial space for its products. The small company is a reputable producer of self-adhesive labels, aluminium foil, market and barcode labels, thermal transfer paper, stretch film and thermo-transfer carbon ribbon.

The company's business plan anticipated a large amount of simultaneous investments. Leasing was an option for hi-tech equipment, but expensive. Renting the building would not have been sustainable long-term, nor would it increase assets for the enterprise, which would facilitate subsequent financing contracts.

3 Set up of the financial instrument

The financial instrument is implemented through a Holding Fund, and the EIF was appointed as the fund manager. Five banks (financial intermediaries) were selected in 2011 under the FLPG and the implementation process was accelerated in 2012 with improved conditions and an increased budget.

3.1 Preceding events

The financial instruments and allocations were designed on the basis of the financing gap assessment for SMEs carried out in 2007 and the Evaluation Study "SME Access to Finance in Bulgaria", which analysed macro-statistical data trends within the SME environment, entrepreneurial activity and the financial system with a review of the main factors affecting both supply and demand for financial instruments. The analysis covered also 'mid-cap' companies (with 250 to 3,000 employees), since these firms have too many employees to fit under the EU definition of an SME[1], but matter in the Bulgarian economy. These enterprises fall under the measures of OPC for some financial instruments but not for SME grant schemes.

The gap analysis was updated in September 2009 to take into account the financial crisis. It confirmed that existing micro-financing schemes did not match the potential demand of micro-enterprises (with a gap of about EUR 110 million) and that SMEs mainly rely on self-financing (70%) for start-up capital. Existing guarantee schemes had a limited effect on SMEs (national guarantee funds did not exist in Bulgaria), and there was a strong need to encourage banks to extend loans to SMEs. Leasing services only partially substituted the need for loans to acquire business machines, equipment and vehicles.

[1] *Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (SMEs) (OJ L 124, 20.5.2003, p. 36).*

CIBank, ProCredit, Raiffeisen Bank, United Bulgarian Bank and UniCredit Bulbank

The FLPG addressed the gap in commercial financing due to SMEs' lack of collateral. It allowed increased business investment and entrepreneurship development. A holding fund was set up to manage all the funds allocated for the six financial products, including the FLPG, and to implement them through financial intermediaries (banks), which would then pass them on to final recipients. The EIF was appointed as Holding Fund manager by the Managing Authority of the OPC (the Ministry of Economy and Energy) in 2009. The guarantee fund was established in 2010.

The Holding Fund selected financial intermediaries (banks and funds) through competitive procedures. In 2010, it held four calls for expression of interest from financial intermediaries to implement the FLPG. In 2011, five banks signed an agreement with the holding fund and offered financing at preferential conditions to a broad range of SMEs across Bulgaria. The FLPG would support them in providing more than EUR 300 million of new loans to nearly 4,000 Bulgarian SMEs. The management costs of the Holding Fund itself are considered eligible expenditure for the ERDF operational programme.

3.2 Funding and partners

There are several partners:

- The Managing Authority is responsible for the overall implementation of the OPC, monitoring and verification of the operations. It is represented by the Ministry of Economy and Energy. It approves any changes required in the holding fund agreement.

- The Holding Fund, in this case managed by the EIF, the holding fund manager, is responsible for drafting documents such as terms of reference or reports, selecting the financial intermediaries, entering into contracts with them, monitoring and reporting implementation to the Managing Authority and the OPC monitoring committee on a semi-annual and yearly basis.

- The Investment Board of the Holding Fund was established to play a methodological and policy guidance role. It includes representatives of structures implementing SME development policies. It approves the priorities for SME financial incentives, the main requirements for financial intermediaries and the basic conditions of the financial products.

- The OPC monitoring committee approves the criteria used by the Holding Fund in selecting financial intermediaries. Together with the Managing Authority, it confirms the financial contributions to be made to financial intermediaries. It also approves any major changes in functions.

- The financial intermediaries provide the financial products (receiving a portfolio guarantee in the case of FLPG), observing the rules approved by the Holding Fund, and following the priorities for financial assistance to SMEs that satisfy these rules, adopted by the Investment Board. They select the final recipients, report to the holding fund on a quarterly basis and must follow information and publicity requirements.

Under the FLPG portfolio guarantee for Bulgaria, EIF is the guarantor acting in its name and on behalf of the Holding Fund. EIF as the guarantor issues its guarantee with an AAA status, thereby providing partnering banks with regulatory capital relief via credit risk transfer. The guarantor's exposure is covered by the ERDF resources set aside in the Holding Fund.

Public funding totalling EUR 60.2 million (85% from ERDF and 15% from national co-financing) was invested in the FLPG scheme to secure the guarantee. Five banks built a portfolio of loans to SMEs of EUR 301 million, providing a six-fold multiplier effect on the ERDF contribution:

Funding source	EUR
ERDF	51.17 million
Public national co-financing	9.03 million
Private from financial intermediaries	301 million

Apart from the on-going information, publicity and capacity-building activities of the Holding Fund, the financial intermediaries, without additional public funding, have been very pro-active through publicity, advertising, information events and even full-scale marketing campaigns with national TV commercials, etc. Mass media, both electronic and print, was relevant in promoting public recognition and understanding of the new funding opportunities.

3.3 Implementation

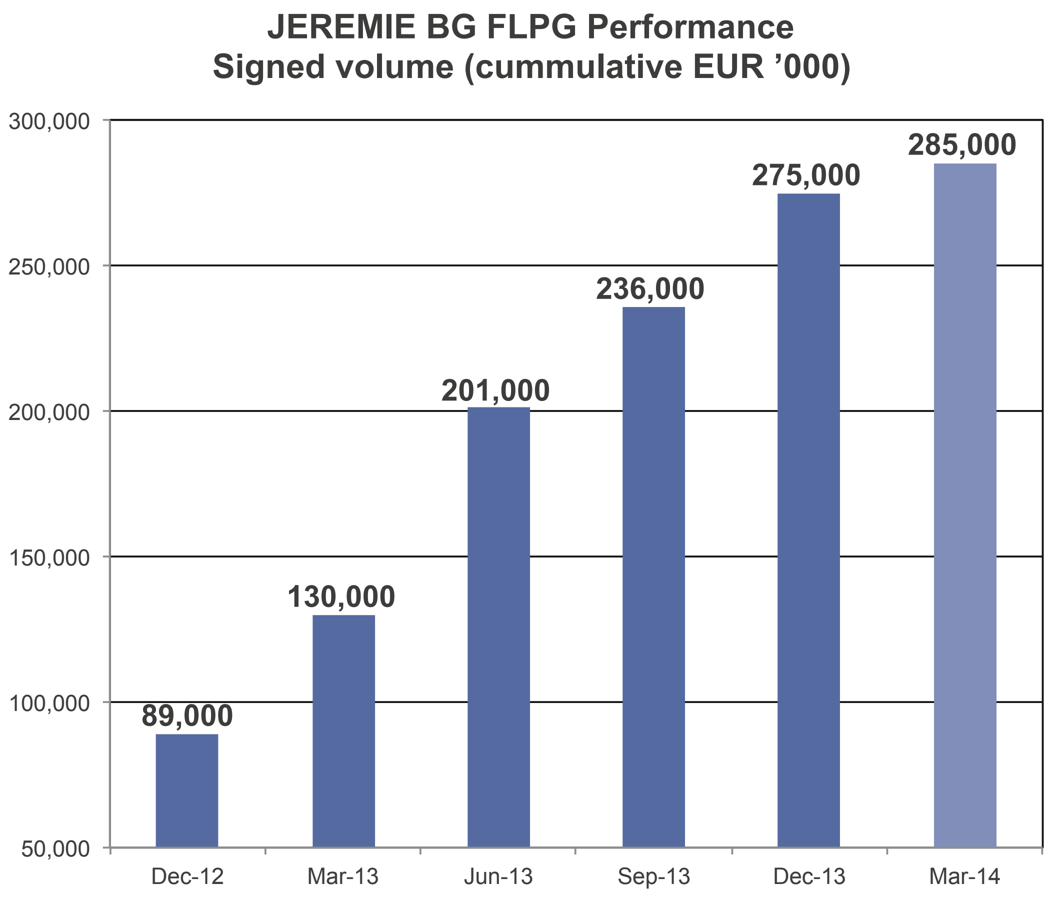
The details on the implementation of the FLPG instrument are set out in the Holding Fund's business plan, based on the market failures and identified needs mentioned earlier. The ratio between debt and equity instruments in the overall fund was initially established on the basis of the SME finance gap analysis report, and then corrected in the process of implementation to correspond to the actual market situation and demand. Based on the report, a targeted intervention with a portfolio of a total amount for all financial instruments of EUR 250 million (the so called 'funding gap' identified) in public funds (ERDF and national) is proposed with the highest share (40% or EUR 100 million) devoted to guarantees.

The FLPG increases the financial products offered to SMEs by offering guarantees on new SME loans from the five selected banks. The FLPG product results in lower interest rates and lower collateral requirements for SMEs. It offers credit risk protection, i.e. guarantees in order to reduce the particular difficulties that SMEs face in accessing finance due to a lack of sufficient collateral. The FLPG also reduces regulatory capital requirements for the five selected banks, since the SME loans are guaranteed. This capital relief gives local banks the incentive to actively promote loans to SMEs eligible under the FLPG.

Before selecting financial intermediaries for FLPG, the Holding Fund manager ensures that sufficient information is provided to the banks which represent potential candidates on the requirements of the FI and the capacities they would need to apply. Banks are thus well-acquainted with the general terms and conditions and are motivated to participate and, if chosen, to implement the guarantee scheme in a successful manner. Larger and more experienced banks often have ready-made teams with expertise in dealing with other external sources of funding, e.g. coming from the European Investment Bank, European Bank for Reconstruction and Development, Black Sea Trade and Development Bank, etc. On the other hand, smaller banks may not have specialised units, but their client base is more homogenous, their funding opportunities more targeted, and they have fewer alternatives that are less time consuming. Consequently, even though the motivations of financial intermediaries may differ, there is serious interest in the FLPG in Bulgaria and the selected banks ensure quality offers, specialized functions within the bank and large populations of potential final recipients.

At the end of 2013, FLPG utilisation reached EUR 275 million in volume. The SMEs could receive preferential conditions on their loans. Preferential conditions among financial intermediaries vary depending on size, reputation, client base profile, etc. These variations are reflected in the five guarantee agreements under FLPG between the Bulgarian bank involved and the EIF. In any case the utilization rate of FLPG is high with a stable growing tendency:

Figure 1: Performance of the FI in volume



Source: European Investment Fund, Annual Report 2013

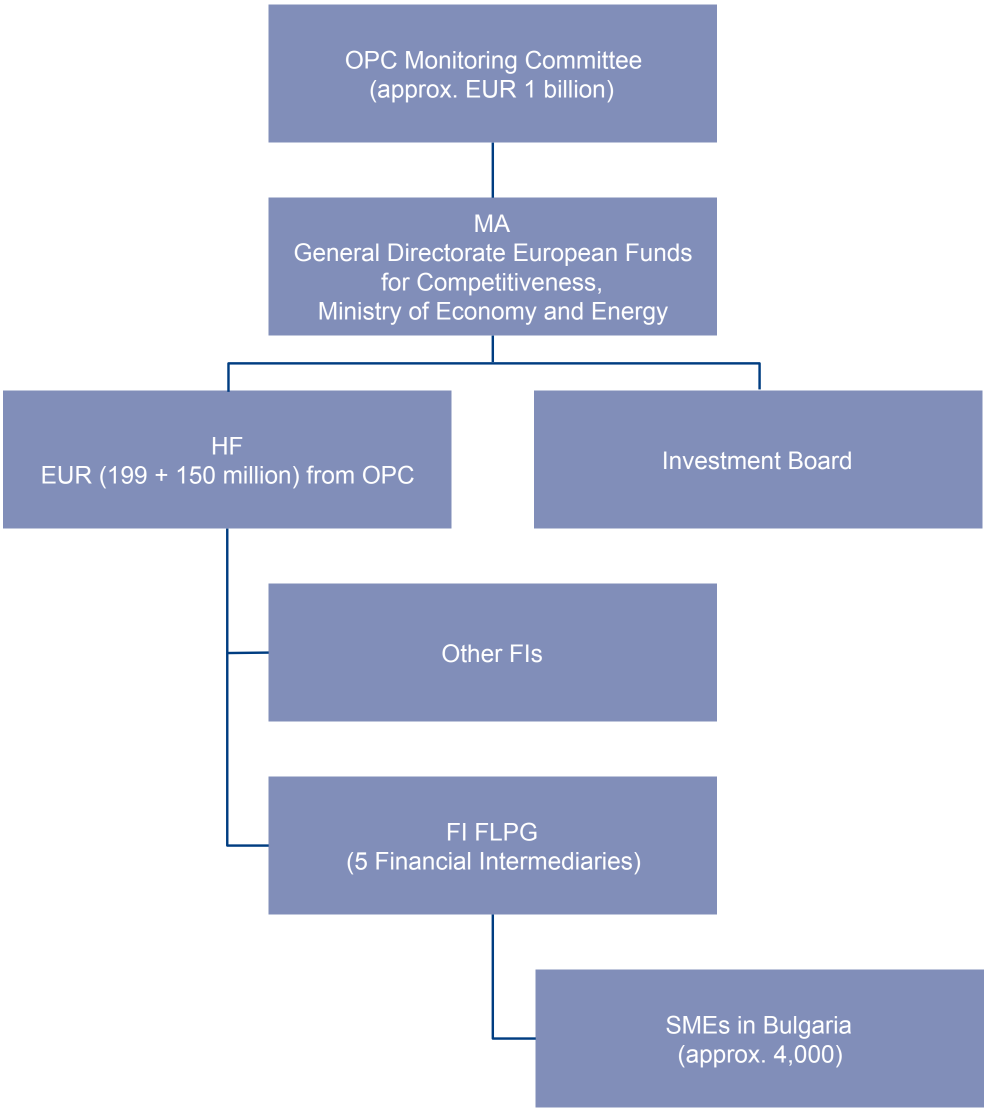
Up to end of June 2014, utilisation of FLPG allocation to the instrument was 95%. There were 3,990 SMEs supported.

3.4 Governance

The Holding Fund selects financial intermediaries on the basis of a competitive procedure under criteria approved by the OPC monitoring committee. It is committed to equal treatment, non-discrimination, confidentiality and transparency. Eligible applications are examined under the quality assessment criteria. Any further selection is based on due diligence and follows standard procedures and guidelines.

The Managing Authority monitors the implementation of the financial instrument at the Holding Fund, financial intermediary and final recipient level, and reports to the European Commission.

Figure 2: Governance arrangements in JEREMIE, Bulgaria



Source: Spatial Foresight, 2014

4 Strategy

The financial instruments implemented under the OPC are balanced between equity and debt to address the gaps in SME financing. Thus, the FLPG should be examined as a part of the whole portfolio. The instrument investment strategy matched the OPC objectives and addressed the market gaps by differentiating between the guarantee conditions of the five banks, thus targeting different types of SMEs.

4.1 Investment strategy

At the start of the programming period, commercial loans concentrated on a limited number of enterprises – loans up to 50,000 Bulgarian Lev (approx. EUR 25 000) represented 68% of the total number of commercial loans given and 4% of the total funds, while loans above 500 000 Bulgarian Lev (approx. EUR 255 000) represented 6% of the total funds and a 73% share of the total number of loans in June 2006. The banks' aversion towards the risks associated with SME financing and the related high collateral requirements were a major problem for SMEs and hampered their development. The following supply and demand disparities resulted in:

- the low amount of long-term credit;
- the collateral requirements (both high amounts and restricted eligibility);
- a short grace period not always in line with project timescales and business plans;
- a financing gap of between 50,000 Bulgarian Lev (approx. EUR 25,000) and 500,000 Bulgarian Lev (approx. EUR 255,000).

The FPLG's initial strategy targeted these disparities and set up a mechanism that was intended to fill the market gaps identified during the programming exercise. The objectives of the instrument as well as its indicators are mentioned in the OP. The scheme was meant to increase the share of enterprises receiving loans and the share of external financing resources available, as well as to support a high number of projects by developing financial products as necessary. Furthermore, additional private funds were envisaged to be three times larger than public funds (ERDF and national). In practice, by November 2014, the private/public ratio was over 5:1.

The operational agreements with the banks contained commercial information that measured performance through additional indicators. In other words, conditions were dependent on the specific bank: its size, reputation, client base profile, etc. The terms of the guarantee agreements with each bank reflect these specificities. Performance is examined on a case-by-case basis according to the agreement between the bank and the Holding Fund. The indicators are market-oriented and the Holding Fund uses them as performance indicators to regularly measure and correct the performance under each agreement.

4.2 State Aid

The initial decision-making process concluded that de minimis aid rules could be used as the basis for FLPG state aid compliance. The Managing Authority, with the support of the Holding Fund, drafted more detailed guidelines on state aid rules for financial intermediaries, which served as key reference documents during the process. The main challenges were at the final recipient level since the Bulgarian national legislation required de minimis aid to be entered into the National Registry within three days of its being granted, which is significantly more restrictive than the Holding Fund's six month reporting requirement to the Managing Authority. The reporting also causes difficulties for checking the threshold between grants and financial instruments, especially when they are launched in parallel by different intermediaries.

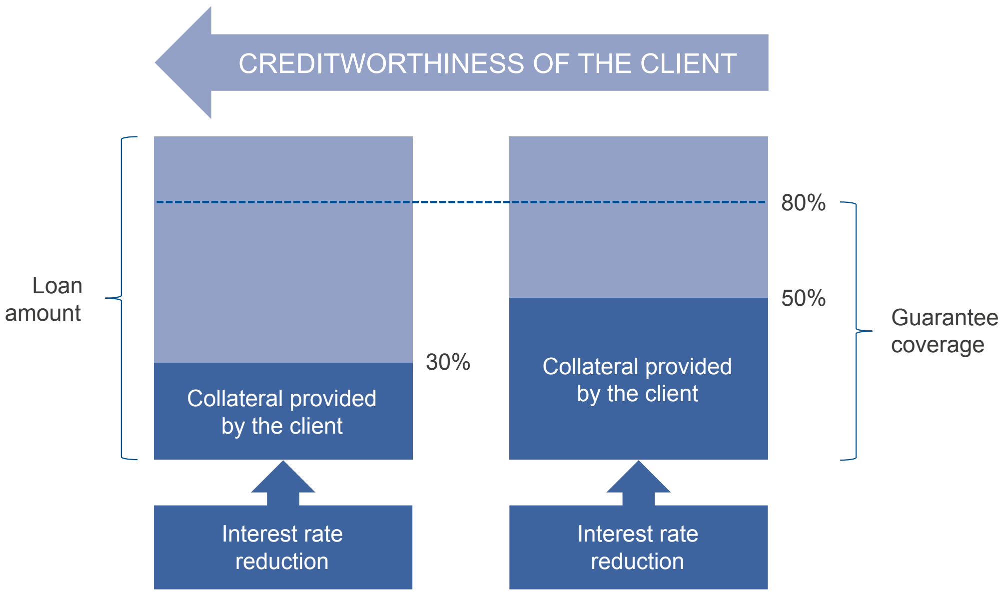
4.3 Financial products and terms

Through the FLPG, the Holding Fund issues guarantees using the funds allocated. It partly covers the credit risk underlying newly extended loans and/or financial leases to SMEs included in the portfolio. In order to ensure an alignment of interest between the financial intermediary and the Holding Fund, 80% of eligible SME loans are covered by the Holding Fund, up to the guarantee cap, calculated as a percentage of the portfolio. It constitutes a direct financial guarantee and covers losses (relating to unpaid principal and interest) incurred by the bank for each defaulted loan up to the cap amount.

The exact SME products may vary with the financial intermediary, but in principle they can cover products such as investment loans, standard working capital loans, revolving loans, overdrafts and letters of credit, depending on the characteristics and the needs of the enterprise. The specific terms refer to the collateral and price of the loan - reduced loan collateralisation and interest rate reduction on the basis of an individual approach, which depends on credit-worthiness. There is no limit on collateral coverage on a loan-by-loan basis. Collateralisation limit is at portfolio level for each financial intermediary. Also, there are no management fees paid to the financial intermediary by the final recipient of the loan.

For the final recipient, the FLPG offers better conditions than typical commercial loans. Guarantees cover 80% of the loan amount. Depending on the creditworthiness of the client (SME), the bank requires them to provide less collateral, which also results in a lower interest rate, since the risk assumed by the bank is lower:

Figure 3: Illustration of how the guarantees were used in commercial loans



Source: FLPG Financial Intermediary

Soft support, i.e. related advisory services (e.g. consultancy, coaching, mentoring) is directly provided by the financial intermediaries to final recipients where necessary, and at no charge.

4.4 Final recipients targeted

Typically, these are micro enterprises, start-ups, innovative SMEs lacking credit or a long-term business history, and SMEs without adequate collateral. Enterprises with high-risk investments mainly related to innovation activities were also targeted. Firms in difficulty were not eligible, and some sectors were not covered (e.g. gambling, production of alcohol/tobacco products). All beneficiaries had to be based and operating in Bulgaria.

Figure 4: Example of Eligibility Presentation by Financial Intermediary

Borrowers	**Small and medium-sized enterprises which:** • are registered in Bulgaria and • operate in Bulgaria
Sector of economic activity / investment	**The enterprises / investments are <u>ineligible</u> if they fall within one of the following sectors:** • production and processing of agricultural goods; • fisheries and aquaculture; • real estate purchase for the purpose of on-selling or on-leasing; • housing contruction (ineligible loan purpose); • coal mining; • road freigth transport vehicle for road freight transport sector; • production and trade with distilled alcolhol or tobacco products; • gambling
Double financing & grant aid	• Combination with other forms of public support **is not allowed**. • The following costs are **ineligible** for financing with a loan under the JEREMIE FLPG: interests on debts, fines, financial sanctions, litigations, recoverable VAT, expens-es for financial transactions and other purely financial expenses, refinancing and restructuring of outstanding loans. • With the loan under JEREMIE FLPG the upper **threshold for de minimis aid** must not be exceeded.

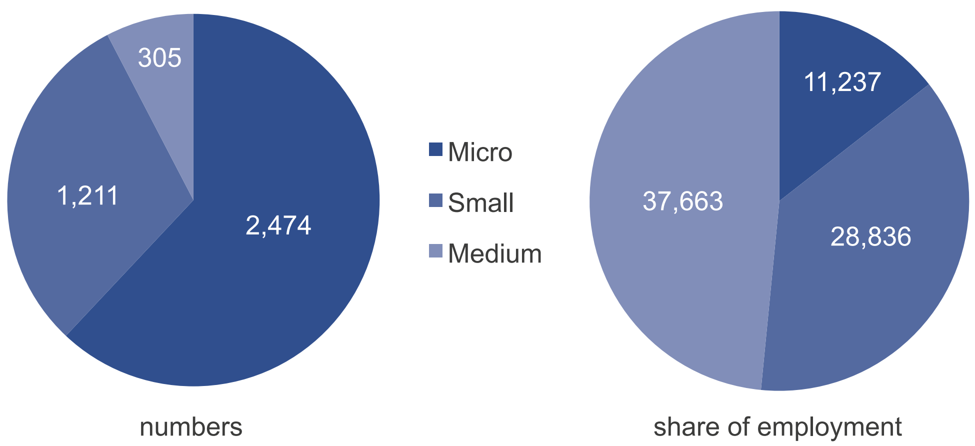
Source: FLPG Financial Intermediary

4.5 Project types

The FLPG finances the purchase of tangible or intangible assets as well as loans for working capital. The loans must have a maturity between 12 and 120 months, including grace periods. The final recipients cannot receive assistance under OPs or from other EU or national-level FIs for the same project or set of investment activities. Loans should not be larger than EUR 1.875 million, or EUR 750 000 for transport sector loans (EUR 1.5 million is the maximum guaranteed amount - 80% of total loan, hence maximum loan size is EUR 1.875 million). The loan portfolios should be spread across economic sectors, with each sector able to receive up to 20% of the portfolio.

As a result of eligibility rules, transaction and portfolio criteria, as well as market demand, loans to micro-enterprises predominate, with typical sectors being manufacturing, wholesale and retail, motor vehicle and motorcycle repair and construction. The figure below shows the proportion of SMEs benefiting from the FLPG by size, as well as by number of employees. The proportion is noticeably different in each case.

Figure 5: Type of final recipients in numbers and share of employment



Source: Spatial Foresight 2014

The distribution among the five intermediaries is shown below (as of end of June 2014). The bank with the highest number of loans (ProCredit Bank) has the lowest volume, whereas the bank with the highest average loan size (Unicredit Bulbank) financed the lowest number of firms. To a large extent, the specificities of the bank, its client base and its strategic orientation predetermine the targeted final recipients, and vice versa. The conclusion is that the selection process for financial intermediaries, particularly for guarantee instruments, should take into account the beneficiaries targeted.

Portfolio name	Number of SMEs (1)	Number of loans	Number of employees as at time of inclusion	Average loan size	Average loan maturity in month	SME Committed Volume
Cibank AD	365	443	11,839	131,657	37	58,323,905
Proredit Bank	1285	1400	12,709	28,387	37	39,741,762
Raiffeisen Bank	1267	1486	20,729	44,112	35	65,550,416
United Bulgarian Bank	901	1027	21,328	72,958	26	74,927,413
Unicredit Bulbank	252	276	11,131	180,306	38	49,764,394
Total						**288,307,890**

(1) 80 SMEs have signed loans with several FIs

The southwest region – BG41 in the capital city of Sofia, accounts for 1,471 of the 3,990 SMEs supported, the south central region (BG42) – for 931, while the north-west region – BG31 has only 199 SMEs. However, it is important to note that the northwest region has the lowest GDP per capita in the whole EU and its performance is even lower under other priorities of OPC, including successful projects financed with grant schemes. This implies that financial instruments can assist in achieving EU Cohesion objectives, even where traditional non-reimbursable mechanisms perform less effectively.

Region	Number of SMEs	Number of loans	Number of employees as at time of inclusion
BG31 Severozapaden	199	213	2,763
BG32 Severen tsentralen	360	432	10,017
BG33 Severoiztochen	473	552	8,951
BG34 Yugoiztochen	556	643	9,954
BG41 Yugozapaden	1,471	1,739	29,419
BG42 Yuzhen tsentralen	931	1,053	16,632
Total	**3,990**	**4,632**	**77,736**

4.6 Changes in Strategy

The strategy has not been changed substantially during the implementation period. The alterations during the process of implementation altered the terms and conditions and practical aspects to address the market situation and the most pressing needs of enterprises not covered by other instruments.

In 2009, when the 2006 market analysis was revised to take into account the situation after the financial crisis, the investment strategy for financial instruments under the JEREMIE initiative was elaborated in more detail.

In 2012, the agreement between the Managing Authority and the Holding Fund was amended a second time, increasing the overall budget for FLPG and all the other FIs (EUR 199 million) with an additional EUR 150 million. The reason for this was to increase the potential for raising additional private funds and to help SMEs benefit more from the EU funding allocation for Bulgaria. This increased the scope of the FI schemes, allowing them to be accessible to a wider range of SMEs. For FLPG in particular the changes can be summarized as follows:

Condition	Description
In the risk profile of the portfolio	• Remove concentration limits for lowest rating • Increase industry concentration • Increase start-up concentration • Remove restrictions on bullet loans
Maximum loan maturity	Increase from 6 years to 10 years for investment loans
Maximum SME exposure	Remove 2% cap, keep *de minimis* maximum at EUR 1.875 million

At the beginning of 2013 the Holding Fund reviewed the performance of the financial intermediaries and decided to adjust the agreed portfolio volumes, which led to the distribution below:

Selected Bank	Agreed SME loan portfolio volume	Corresponding cap amount
CIBANK	EUR 71 m	EUR 14.2 m
ProCredit Bank (Bulgaria)	EUR 40 m	EUR 8 m
Raiffeisenbank (Bulgaria)	EUR 65 m	EUR 13 m
UniCredit Bulbank	EUR 50 m	EUR 10 m
United Bulgarian Bank	EUR 75 m	EUR 15 m
Total	**EUR 301 m**	**EUR 60.2 m**

High Tech firm supported by the financial instrument

The firm had a good relationship with a commercial bank, which informed the company about the FLPG and other funding opportunities, and offered free advice during the application and on state aid and reporting. The entrepreneur was satisfied with the FLPG, because of its relatively low cost and because it fitted the timescale of his company's project and its needs. The financial instrument enabled the bank to offer free advice during the application, implementation and reporting process. According to this business owner, OPC/ERDF support was deployed successfully through banks.

The owner noted that there were several 'beneficiaries' from this instrument, including his firm and the bank: the bank expanded its business while the company received easier access to funds at a lower cost; moreover, the firm's customers clients received higher quality products at the same price or even lower due to efficiency gains, while employees had better working conditions and more job security.

5 Achievements

The FLPG scheme will be active until the end of 2015. The long-term results therefore have yet to be evaluated, but nonetheless the main objectives of the instrument have been achieved – improved access to funding for SMEs and key employment providers in a small, relatively open economy such as Bulgaria. The improvements in access to finance are reflected in lower collateral requirements and borrowing costs, but they can also be sensed in the business climate and the positive changes in the business culture.

5.1 Output

According to the latest report available, covering the period until 30 June 2014, there are 3,990 final recipients (SMEs) with a total of 78,000 employees. SMEs benefited from interest rate reductions of between 0.5% and 2.5%. The final recipients could also pledge assets (that would serve as collateral to the bank should the final recipient default) amounting to just 48% of the loan amount on average (in 2013) compared to a collateralization rate of over 100% on the market.

At the level of the instrument as a whole, about EUR 301 million of private resources were attracted by November 2014. However, another achievement of the FLPG is the low loss rate - under 1.5%, which could be indicative of the selection process for borrowers (and the type of investments). The most important positive change is that 53% of all that loans are granted for investment purposes in a market where working capital is the predominant type of lending. The policy objective to stimulate firm investments and longer-term growth is therefore fulfilled.

High tech firm supported by the FI

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The owner noted that there were several 'beneficiaries' from this instrument, including his firm and the bank: the bank expanded its business while the company received easier access to funds at a lower cost; moreover, the firm's customers clients received higher quality products at the same price or even lower due to efficiency gains, while employees had better working conditions and more job security.

6 Lessons learned

As a newcomer in the EU, Bulgaria had to adapt both to the regulatory requirements of the Structural and the Cohesion Funds, as well as to those of financial instruments, which were a novelty in the country. The willingness of all stakeholders to adapt to the requirements proved important to the FLPG implementation and good results, especially given the fluctuating market situation due to the crisis. Adjustments of the financial instrument itself, e.g. broadening its coverage, also helped, although there were some initial difficulties in attracting SMEs and investment, mainly because FIs were unknown to the business culture and because the economy itself exhibited low levels of trust, predictability and credibility.

6.1 Main success factors

The financial crisis altered the supply and demand equilibrium, reducing the available credit due to risk aversion. Even though the FLPG scheme started slowly, **the willingness of all players to adjust to the dynamic market situation** and to search for ways to address the needs of SMEs helped the instrument gain ground and exceed expectations.

Widening the financial instrument's scope, such as including working capital as an option, its maturity and other portfolio characteristics accelerated its use among firms. The amendments resulted in more interested final recipients, intensified business activity and investment, additional options for enterprises and speeding up the money flows in the system.

6.2 Main challenges

At the start of the 2007-2013 period of the ERDF, when Bulgaria had just joined the EU, it needed to adapt to the Structural and the Cohesion Fund regulatory requirements, and implement financial instruments for the first time. **New administrative procedures**, involving preparatory work, negotiations and other legal issues resulted in a slowdown in providing funding opportunities during the first half of the period. Nevertheless, the pace picked up due to the urgency of addressing the financial crisis, compensating for the initial slow start.

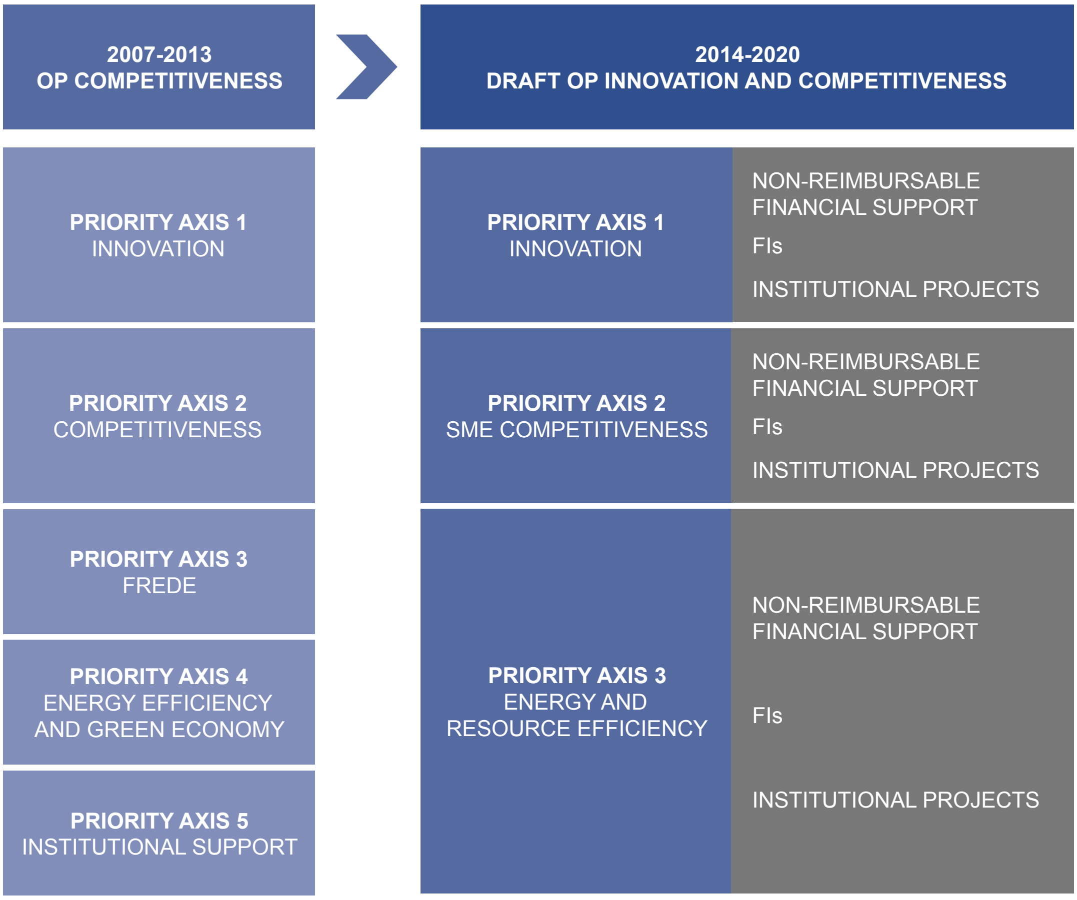
Attracting SMEs proved to be more problematic than motivating and involving financial intermediaries, especially at the start when the tendency was to interpret rules and conditions very restrictively. Using their own resources, the banks initiated advertising and information events, including full-scale marketing campaigns with TV ads. With time, the fundamental challenge that was overcome was fully **adapting the FLPG instrument to the current market situation** and needs of Bulgarian companies.

Last but not least, it should be noted that one of the most significant obstacles for doing business in Bulgaria and for investing in the country, whether as a foreign or a domestic investor, is **the level of trust, credibility and predictability**, as opposed to simple liquidity. The FLPG proved to be the right solution for these challenges, relying upon the EIF brand and its AAA rating as a stability factor. A separate pledge agreement is structured and agreed in advance with the Ministry of Economy and Energy (Managing Authority).

6.3 Outlook

For the programming period 2014-2020, the Bulgarian Partnership Agreement focuses on three priorities stemming from Europe 2020's smart, sustainable and inclusive growth for the ESIF investments. The smart growth is mainly financed through OPIC 2014-2020. However, the approach has taken FIs to an entirely new level. A large financial instruments portfolio is designed, not in a separate and dedicated axis, but as an integral part of the fulfilment of all objectives. This concept ensures that all thematic objectives in OPIC's scope contain not only funding in the form of grants (grant scheme support, vouchers, etc.), but also financial instruments.

Figure 6: Comparison of 2007-2013 and 2014-2020 programming period (on the basis of the draft OPIC 2014-2020, version available at the end of 2014).



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