EUROPEAN
INVESTMENT
FUND

CIP
Competitiveness and Innovation Framework Programme

SME Guarantee Facility

INTRODUCTION

The purpose of this document is to provide some general information about guarantees issued by the European Investment Fund ("EIF") in the framework of the Competitiveness and Innovation Framework Programme (2007– to 2013) of the European Community ("CIP"). The first part of this document contains background information on CIP and the purpose of the guarantees issued by EIF under CIP ("Guarantees"). The second part provides information on the key terms and conditions of such Guarantees.

I. CIP AND THE SME GUARANTEE FACILITY

CIP was adopted[1] to further the objectives concluded at the 2000 European Council in Lisbon, which emphasised the importance of creating a friendly environment for starting up and developing innovative businesses, especially small or medium-sized enterprises ("SMEs").

CIP aims at providing for action to support and enhance:

- access to finance for the start-up and growth of SMEs and investment in innovation activities;
- cross-border co-operation;
- all forms of innovation, in particular eco-innovation;
- entrepreneurship and innovation culture;
- enterprise and innovation-related economic and administrative reform.

In the Decision establishing CIP, the European Council and Parliament recognise that Community financing has a role to play in leveraging support and providing complementary funding in order to tackle situations of market failure for the benefit of SMEs. To add leverage to the provision of debt finance to SMEs, CIP establishes a guarantee scheme, the "SME Guarantee Facility".

In September 2007, the European Commission mandated EIF to implement and manage the SME Guarantee Facility on behalf of the European Community.

The SME Guarantee Facility Windows

Through the SME Guarantee Facility, EIF has been mandated to provide Guarantees to financial institutions ("Intermediaries") covering portfolios of SME financing. The SME Guarantee Facility comprises four "windows", or product types, each with a specific focus:

- The Loan Guarantee Window aims at reducing the particular difficulties SMEs face in accessing finance either due to the perceived higher risk associated with investments in certain knowledge-related activities, or to lack of sufficient collateral. Under this window, Guarantees cover portfolios of mid- to long-term financing such as loans and/or lease

[1] Decision No. 1639/2006/EC of the European Parliament and the Council establishing a Competitiveness and Innovation Framework Programme.

transactions entered into with SMEs to finance investments, or portfolios of guarantees issued by Intermediaries covering such financing.

- The Micro-Credit Window aims at encouraging the provision of micro-finance and to assist in mitigating its proportionately higher unit handling costs. Under this window, Guarantees cover portfolios of micro-finance to micro-enterprises, especially start-ups, or portfolios of guarantees issued by Intermediaries covering such micro-finance.

- The Equity Guarantee Window aims at helping SMEs improve their financial structure and achieve business transfers.

  - Equity Guarantees cover portfolios of guarantees issued by Intermediaries covering equity investments in SMEs in the seed and start-up phases.

  - Quasi-Equity Guarantees cover portfolios of quasi-equity investments[2], or portfolios of guarantees issued by Intermediaries covering such quasi equity investments.

- Under the Securitisation Window, Guarantees are provided to support securitisation structures with a view to enabling Intermediaries to mobilise additional debt financing for SMEs.

II. THE GUARANTEE

Set out below is a description of the key provisions of the contract under which a Guarantee is issued (the "Guarantee Agreement") under the Loan Guarantee, Micro-Credit and Equity Guarantee Windows. Where relevant, some of the differences between these windows are identified. Guarantees issued under the Securitisation Window are not covered in the description.

The following outline of the Guarantee Agreement's key terms does not purport to be complete, and is qualified in its entirety by the detailed terms and conditions of the Guarantee Agreement. Furthermore, Guarantees may contain certain specific terms for different Intermediaries. This document does not constitute an offer of any nature whatsoever and does not create any binding obligations on EIF to enter into a contract with any third party on the terms set out in this document or otherwise.

[2] Debt finance having some characteristics of equity investments, e.g. flexible repayment, performance-related remuneration, unsecured, subordinated. Quasi-Equity investments include, inter alia: subordinated loans, silent participations, participating loans, profit participation rights and convertible bonds/bonds with warrants.

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1. DIRECT GUARANTEES AND COUNTER-GUARANTEES

A Guarantee may be either:

- a direct guarantee, where the Guarantee covers new portfolios of financing transactions entered into between the Intermediary and eligible SME beneficiaries ("Final Beneficiaries"); or

- a counter-guarantee, where the Guarantee covers new portfolios of guarantee instruments issued by the Intermediary in favour of an institution (a "Sub-Intermediary") to cover (either directly or via one or more sub-intermediaries) financing transactions entered into with Final Beneficiaries.

Under the Loan Guarantee and Micro-Credit Windows, Guarantees may take the form of a direct guarantee or a counter-guarantee. Under the Equity Guarantee Window, Quasi-Equity Guarantees may take the form of a direct guarantee or a counter-guarantee. However, Equity Guarantees may only take the form of a counter-guarantee.

2. ENHANCED ACCESS TO FINANCE

A key feature of Guarantees is that their purpose is to stimulate the provision of additional finance for SMEs and reduce the particular difficulties that SMEs face in accessing finance, with a view to stimulating job-creation.

The level of enhancement of SMEs' access to finance is considered with reference to:

- increased volumes of financing being made available to SMEs; and

- enhanced access to financing through, for example, less stringent acceptance criteria in relation to start-ups or investments in intangible assets, extended maturities or reduced cost of finance for SMEs; and/or

- higher risk-taking by Intermediaries, e.g. increased loss cover or relaxed security requirements.

To stimulate enhanced access to finance, the Guarantee Agreement contains a mechanism whereby the extent of guarantee cover is dependent upon the amount of principal made available under financing transactions (such as loans and/or leases) entered into with Final Beneficiaries ("Final Beneficiary Transactions") ultimately benefiting from the Guarantee.

The amount of principal made available under Final Beneficiary Transactions covered by the Guarantee is referred to as the "Actual Portfolio Volume". If the Guarantee is a direct guarantee, the Actual Portfolio Volume is the full principal amount made available under of Final Beneficiary Transactions covered by the Guarantee. If the Guarantee is a counter-guarantee, the Actual Portfolio Volume is that portion of the principal amount that is covered by the guarantees issued by an Intermediary, which are covered by the Guarantee. The Guarantee Agreement contains a mechanism whereby the Actual Portfolio Volume is adjusted at the end of a Final Beneficiary Transaction's disbursement period (or, if earlier, at the end of the period in which transactions may be included for cover by the Guarantee (the "Availability Period")). This adjustment is made to ensure that the Actual Portfolio Volume is in line with the amounts ultimately drawn down under Final Beneficiary Transactions.

The Guarantee Agreement contains an estimate reference volume of transactions that the Intermediary would enter into in the absence of the Guarantee in the normal course of its business (the "Reference Volume"). The Guarantee Agreement also sets two target volumes of transactions greater than the Reference Volume (the "Minimum Portfolio Volume" and "Maximum Portfolio Volume"). In order to maximise enhanced access to finance for SMEs, the amount payable by the EIF under the Guarantee is dependent on whether the Actual Portfolio Volume reaches the Minimum Portfolio Volume and/or the Maximum Portfolio Volume. This mechanism is described further below and in section 4 "Guarantee Cap".

Intermediaries must use their best efforts to ensure that the Actual Portfolio Volume reaches the Maximum Portfolio Volume. If the Actual Portfolio Volume reaches the Maximum Portfolio Volume, the amount payable by EIF shall be determined at its maximum level.

If, however, the Actual Portfolio Volume does not exceed the Reference Volume at the end of the Availability Period (which is typically two or three years), the Guarantee Agreement will terminate and the Intermediary shall repay any amounts paid to it by EIF under the Guarantee. This mechanism ensures that the Guarantee will only survive if SMEs' access to finance has been enhanced.

In no circumstances may Guarantees substitute any public funds available to Intermediaries to cover losses incurred in their guarantee or lending activity. Therefore, the guarantee or lending capacity generated by the public funds will be taken into account by EIF when setting the Reference Volume.

The Guarantee Agreement may contain further provisions that Intermediaries must comply with in order to further the principles of enhanced access to finance. These are agreed on a case-by-case basis with Intermediaries.

3. ELIGIBILITY CRITERIA

In order to benefit from the Guarantee, Final Beneficiary Transactions must comply with certain eligibility criteria (the "Eligibility Criteria").

3.1 Eligibility Criteria – Final Beneficiaries

Under the Loan Guarantee Window, Final Beneficiaries must be SMEs, which means, in accordance with the Commission Recommendation 2003/361/EC (the "Recommendation") enterprises which employ fewer than 250 employees and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.

Under the Micro-Credit Window, Final Beneficiaries must be micro-enterprises, which means, in accordance with the Recommendation, enterprises which employ fewer than 10 persons and which have an annual turnover and/or annual balance sheet total not exceeding EUR 2 million.

Under the Equity Guarantee Window, Final Beneficiaries must be SMEs (in accordance with the Recommendation) in their seed or start-up phase and, if already founded, they must have been established or operating for less than ten years.

Final Beneficiaries must be established in Member States of the European Union, Norway, Liechtenstein, Iceland, Croatia, Montenegro, Serbia, FYROM, Turkey, and any other country notified by EIF from time to time. An updated list of the participating countries is found on EIF's website, www.eif.org.

3.2 Eligibility Criteria - Final Beneficiary Transactions

a. Eligible types of finance

Under the Loan Guarantee Window, Guarantees cover portfolios of mid- to long-term financing, such as loans and/or lease transactions, or, in the case of a counter-guarantee, portfolios of guarantees issued by Intermediaries covering such financing.

Under the Micro-Credit Window, Guarantees cover portfolios of micro-loan transactions not exceeding EUR 25,000, or portfolios of guarantees covering such micro-loans.

Under the Equity Guarantee Window, Quasi-Equity Guarantees cover portfolios of mezzanine financing (such as subordinated debt finance, profit participation rights or convertible bonds), or guarantees covering such transactions. Equity Guarantees cover guarantees issued by Intermediaries covering equity investments.

b. Purpose of finance

Under the Loan Guarantee and Micro-Credit Windows, Final Beneficiary Transactions shall provide financing for (i) investment in tangible and intangible assets, (ii) business transfers, (iii) working capital, or (iv) innovation activities, such as technological development and the acquisition of licences. The Loan Guarantee Window particularly focuses on supporting the long-term business development of Final Beneficiaries.

Under the Equity Guarantee Window, the purpose of the financing is inherent in the equity nature of the investment and financing.

c. Maturity

Under the Loan Guarantee Window, the term of Final Beneficiary Transactions must be at least 18 months.

Under the Micro-Credit Window, the term of Final Beneficiary Transactions must be at least 12 months.

The Guarantee Agreement may contain additional eligibility criteria which are agreed on a case-by-case basis with Intermediaries.

4. THE GUARANTEE CAP

The amount payable by EIF under the Guarantee is subject to a cap (the "Guarantee Cap").

In order to stimulate the provision of additional finance to SMEs, the Guarantee Cap is dependent upon the Actual Portfolio Volume and is calculated, throughout the life of the Guarantee Agreement, in accordance with the following formula:

Guarantee Cap = Actual Portfolio Volume x Guarantee Rate x Guarantee Cap Rate

Actual Portfolio Volume: the Actual Portfolio Volume most recently reported to EIF is used when calculating the Guarantee Cap (details of the Intermediary reporting requirements are set out below).

Guarantee Rate: Guarantees always establish a risk-sharing arrangement with Intermediaries. Therefore, they cover Intermediary losses at a percentage rate specified in the Guarantee Agreement (the "Guarantee Rate"). Under the Loan Guarantee and Equity Guarantee Windows, the Guarantee Rate is typically up to 50%. Under the Micro-Credit Window, the Guarantee Rate is typically up to 75%.

Guarantee Cap Rate: each Guarantee Agreement contains a percentage rate based on an estimate of the Intermediary's expected cumulative net[3] losses on the portfolio covered by the Guarantee (the "Guarantee Cap Rate"). If, following the end of the Availability Period, the Actual Portfolio Volume is less than the Minimum Portfolio Volume, the Guarantee Cap Rate shall be reduced. This, in turn, will reduce the Guarantee Cap.

5. INCLUSION AND EXCLUSION PROCESS

The transactions entered into by Intermediaries that may be covered by the Guarantee are termed "Intermediary Transactions".

If the Guarantee is a direct guarantee, the Intermediary Transactions are financing transactions entered into between the Intermediary and Final Beneficiaries (ie. Final Beneficiary Transactions). If the Guarantee is a counter-guarantee, the Intermediary Transactions are the guarantees issued by the Intermediary in favour of Sub-Intermediaries.

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[3] Net of recoveries and of the risk premium contained in the fees charged by the Intermediary covering risk which is also covered by the Guarantee.

All Intermediary Transactions that comply with the Eligibility Criteria and that have been entered into during the Availability Period must be included in the Guarantee's portfolio (the "Portfolio"). However, once the Actual Portfolio Volume has reached the Maximum Portfolio Volume, no further Intermediary Transactions may be included.

To include Intermediary Transactions in the Portfolio, Intermediaries must submit to EIF an inclusion notice within the deadlines specified in the Guarantee Agreement. Upon EIF's receipt of such notice, the Intermediary Transactions referred to therein shall be automatically included in the Portfolio.

If an Intermediary Transaction is cancelled or does not comply with the Eligibility Criteria or any other provision of the Guarantee Agreement, then it may be excluded from the Portfolio. Exclusion of an Intermediary Transaction from the Portfolio will result in a reduction of the Actual Portfolio Volume and, therefore, in the Guarantee Cap (as the Guarantee Cap is dependent on the Actual Portfolio Volume).

As explained above, the Guarantee Agreement contains a mechanism whereby the Actual Portfolio Volume will be adjusted at the end of a Final Beneficiary Transaction's disbursement period (or, if earlier, the end of the Availability Period) to be in line with the amounts drawn down under Final Beneficiary Transactions.

6. EXTENT OF GUARANTEE COVER – LOSS

The Guarantee covers, at the Guarantee Rate, certain losses incurred by an Intermediary in connection with Intermediary Transactions included in the Portfolio ("Loss"), subject to the Guarantee Cap and the other provisions of the Guarantee Agreement.

If the Guarantee is a direct guarantee, the loss typically covered is any amount of principal or interest due (excluding default or capitalised interest or other costs or expenses), payable and outstanding under the relevant Final Beneficiary Transaction following acceleration by the Intermediary.

If the Guarantee is a counter-guarantee, the loss typically covered is any amount paid by the Intermediary under the terms of a guarantee issued to a Sub-Intermediary following the acceleration of the relevant Final Beneficiary Transaction.

Under the Loan Guarantee and Equity Guarantee Windows, the Guarantee only covers losses if the default that triggered acceleration of the relevant Final Beneficiary Transaction occurred no later than ten years after the date of such Final Beneficiary Transaction. Under the Micro-Credit Window, such default must occur no later than five years after the date of the relevant Final Beneficiary Transaction.

7. GUARANTEE CALLS

Intermediaries may claim payment under the Guarantee by sending a guarantee call to EIF in the form set out in the Guarantee Agreement. EIF shall pay any amounts claimed in any calendar quarter within two months of its receipt from the Intermediary of the quarterly report relating to such quarter (details of the Intermediary reporting requirements are set out below).

If payment of all amounts claimed under the Guarantee in any calendar quarter would result in the Guarantee Cap being exceeded, then EIF shall only make payment up to the Guarantee Cap amount. Any amounts claimed above the Guarantee Cap will be paid following an increase (if any) of the Actual Portfolio Volume which results in an increased Guarantee Cap.

8. RECOVERIES

The Guarantee Agreement may contain an estimated recovery rate reflecting an amount expected to be recovered by an Intermediary in respect of Losses. If a Guarantee Agreement contains such an estimated recovery rate, the amount to be paid by EIF following a Loss shall be reduced by such percentage rate.

If no estimated recovery rate is set out in the Guarantee Agreement, Intermediaries must use their best efforts to maximise recoveries in respect of a Loss. The Intermediary shall be required to pay to EIF a percentage equal to the Guarantee Rate of all such recoveries.

9. CLAWBACK

Intermediaries shall be required to repay amounts paid by EIF under the Guarantee under certain circumstances such as:

- if an amount has been paid to an Intermediary above the Guarantee Cap, any such excess amount must be repaid;
- if the Actual Portfolio Volume does not exceed the Reference Volume, all amounts paid to the Intermediary under the Guarantee must be repaid;
- if the Guarantee Agreement is terminated before the Actual Portfolio Volume has reached the Reference Volume, all amounts paid to the Intermediary under the Guarantee must be repaid;
- if an Intermediary Transaction does not comply with the Eligibility Criteria or any other provision of the Guarantee Agreement, any amount paid by EIF related to such Intermediary Transaction must be repaid together with interest;
- if an Intermediary, a Sub-Intermediary or a Final Beneficiary is found guilty of fraud in relation to the SME Guarantee Facility, then all amounts paid to such Intermediary, Sub-

Intermediary or Final Beneficiary (as applicable) must be repaid together with interest; and

- if any amount paid by EIF under the Guarantee relates to an illegal activity of a Final Beneficiary, any amount paid by EIF related to such Final Beneficiary must be repaid, together with interest.

10. COMMITMENT FEE

Under the Loan Guarantee and Equity Guarantee Windows, a commitment fee may be payable by Intermediaries following the end of the Availability Period. The amount of commitment fee payable is dependent upon the Actual Portfolio Volume. Such commitment fee is in fact calculated on the difference between the Minimum Portfolio Volume and the Actual Portfolio Volume, multiplied by the Guarantee Rate and by 0.3%. No commitment fee shall be payable if the Actual Portfolio Volume reaches the Minimum Portfolio Volume.

No commitment fee shall be payable under the Micro-Credit Window.

11. REPORTING

Intermediaries shall be required to send to EIF a report containing information about Intermediary Transactions included in the Portfolio. Intermediaries will be required to submit such report every calendar quarter until the expiry or termination of the Guarantee Agreement.

Under the Loan Guarantee and Equity Guarantee Windows, Intermediaries shall also be required to provide reports on the creation and maintenance of jobs by Final Beneficiaries benefiting from the Guarantee. Certain eligible expenses incurred by Intermediaries in connection with producing such employment reports may be reimbursed.

Employment reports are not required under the Micro-Credit Window.

12. VISIBILITY AND PROMOTION OF THE SME GUARANTEE FACILITY

It is important that the SME Guarantee Facility is promoted and that Final Beneficiaries are made aware of the EU support. Therefore, Intermediaries are required to promote the SME Guarantee Facility on their websites and in promotional material, and are encouraged to provide success stories related to Final Beneficiaries benefiting from the Guarantee. Intermediaries are also required to provide a link from their website to a dedicated EU website "Access to Finance", containing certain information about the products covered by the Guarantee. The link needs to be established prior to signature of the agreement. Certain eligible expenses incurred by Intermediaries in complying with these visibility and promotion requirements may be reimbursed.

Intermediaries must also ensure that Final Beneficiary Transaction documentation states: "This financing benefits from a guarantee issued under the European Community's Competitiveness and Innovation Framework Programme." The exact wording needs to be used; translations will be provided by the EIF as applicable.

13. MAINTENANCE OF RECORDS, MONITORING AND AUDIT

Monitoring and audit of Intermediaries

Intermediaries are required to maintain and provide upon request information necessary to enable EIF, the Commission (including the European Anti-Fraud Office – OLAF), and the European Court of Auditors to verify the correct use of the European Community's funds and compliance with the terms of the Guarantee Agreement. Intermediaries are required to maintain such records throughout the life of the Guarantee Agreement and for five years following its termination or expiry.

Intermediaries must also allow EIF, the Commission, and the European Court of Auditors to carry out controls and inspections at Intermediaries' premises.

Monitoring and audit of Sub-Intermediaries and Final Beneficiaries

Intermediaries are also required to ensure that EIF, the Commission (including the European Anti-Fraud Office – OLAF), and the European Court of Auditors have these same monitoring and audit rights in respect of Sub-Intermediaries and Final Beneficiaries benefiting from the Guarantee. To this end, Intermediaries are required to ensure that each Sub-Intermediary (if applicable) and each Final Beneficiary undertakes to maintain relevant records for a period of five years from the date when the EIF's liability in respect of the relevant Intermediary Transaction expires.

Intermediaries are further required to insert in their agreements with Sub-Intermediaries (where applicable) and Final Beneficiaries the following standard text:

"The counter party acknowledges that the European Investment Fund (the "EIF"), the agents of the EIF, the Court of Auditors of the European Community (the "ECA"), the Commission and the agents of the Commission including OLAF (the "Agents") shall have the right to carry out controls and to request information in respect of this agreement and its execution. The counter party shall permit inspections by the EIF, the agents of the EIF, the ECA, the Commission and the Agents of its business operations, books and records. As these controls may include on the spot controls of the counter party, the counter party shall permit access to its premises to the EIF, the agents of the EIF, the ECA, the Commission and the Agents during normal business hours."

Again, the exact wording needs to be used and translations will be provided by EIF.

14. STATE AID

Intermediaries are required to comply with all applicable State aid rules. Because of the public nature of the CIP budget, the Guarantee is to be taken into account by its direct and/or indirect beneficiaries when considering State aid rules.

15. CURRENCY

Typically, the reference and target volumes and payments made under the Guarantee Agreement by and to EIF shall be in Euro. In such cases, if an Intermediary Transaction is denominated in a currency other than Euro, or a Loss occurs in a currency other than Euro, the Guarantee Agreement will set out the exchange rate mechanism to be applied.

However, in some cases and subject to certain conditions, currencies other than Euro of the participating countries mentioned in section 3.1 above may be used under the Guarantee Agreement.

16. GOVERNING LAW

The Guarantee Agreement shall be governed by, and construed in accordance with, the laws of the Grand Duchy of Luxembourg.