Creation of a FEMIP Trust Fund ("FTF")

1. Background

The European Council of 12.12.2003 mandated the Bank to enhance its activities in the Mediterranean region along the lines of the so-called "reinforced FEMIP", based on the decision of the ECOFIN of 26.11.2003. In particular the ECOFIN resolution stipulated: *"Establish a trust fund of initially 20-40 m euros modelled on the special co-financing funds of other IFI's, directing resources to projects in certain priority sectors (water, transport, electricity, human capital) that can be made financially viable via a grant contribution or risk capital participation. Participation in the trust fund would allow other donors to complement on a voluntary basis the contributions from the Community budget already pledged to the Facility under the MEDA programme. Donors would need to be identified."*

2. Introduction

The FTF would be a multidonor, multipurpose, multisector trust fund whose main objective would be the creation of an "enabling environment" for private sector development in the Mediterranean Partner Countries ("MPCs"). The FTF would be financed by **untied voluntary contributions** from Member States. The fund would be structured around three "windows": (i) Priority sectors lending; (ii) Upstream Technical Assistance; and (iii) Direct private sector support. The FTF would aim to achieve a target size of EUR 20m in the first year of operation, to further expand in size in the following years. The fund shall remain a **flexible instrument**, open at all times to new eligible members and capable of financing new activities under its umbrella. The FTF would be first operational in 2005.

3. Rationale for the FTF

The FEMIP Trust Fund would:

- As mentioned in the ECOFIN decision, provide contributing Member States with an opportunity to complement, on a voluntary basis, financial resources already pledged to the region under the MEDA programme. In particular, the FEMIP Trust Fund will provide Member States who wish to reinforce their presence and/or visibility in the region with a European-managed scheme.
- Provide the Bank with an additional, flexible, instrument to foster the development of an "enabling environment" for private sector activity and directly support the private sector itself, filling some of the gaps in the existing Bank mandates in the region.
- Raise the visibility of the Reinforced FEMIP and the region itself for the business community, both within and outside the FEMIP area.
- Adapt financial support to basic needs in FEMIP countries deserving special terms

4. Objectives and Guiding Principles

The overall objective of the FTF would be to foster private sector development in the FEMIP region. Specific key objectives to achieve this goal would include: (i) the development of an "enabling environment" for private sector activity by fostering the creation of adequate capital and human "infrastructure" in the region, with a special emphasis on certain priority areas; (ii) foster and diversify the availability of financial instruments for the private sector.

Arrangements under the FTF shall ensure that the following guiding principles are based on:

- *Additionality:* as mentioned, the FTF aims at filling some of the gaps in the Bank mandates in the FEMIP region. Accordingly, the FTF shall not be financing activities which can currently benefit from similar resources under existing Bank mandates in the FEMIP area. It is important to stress that the aim of the FTF is to complement and not duplicate existing Reinforced FEMIP instruments.

- *Ownership and Feasibility:* the FTF shall be a demand-driven instrument i.e. finance activities for which a concrete, tangible demand already exists on the ground.

- *Flexibility:* to conform to the two principles mentioned above, the FTF shall be a relatively flexible instrument, capable of responding quickly and efficiently to the changing needs of the recipient countries and, accordingly, progressively undertake new activities under its umbrella.

5. Scope of Activity

The FTF shall be articulated around three "windows":

- *Priority Sectors Lending:* This window will focus on developing the "enabling environment" for private sector activity, mainly by making available grant resources for the purpose of interest subsidies to FEMIP's standard loans. The subsidies will aim at stimulating **selected investments in designated priority areas**, particularly areas that carry a strong social component which would normally have a low or insufficient return to be financially viable on a standalone basis. Under the existing Council regulation[1], grant money from the European Commission may be used for interest subsidies in respect of certain environmental projects **only**, with priority currently given to projects which mitigate or decrease negative environmental impacts (e.g. sewage treatment, solid waste management, depollution of industrial areas). Just to provide an order of magnitude of the activities which could be supported, assuming an interest rate subsidy of 1%, it is estimated that EUR 20m of grant money could subsidise approx. up to EUR 300m of loans. In addition, while today EC-funded interest subsidies almost exclusively benefit public sector promoters, subsidies provided under the FTF could be used to foster private sector involvement in the infrastructure sector of the MPCs.

- *Upstream Technical Assistance:* Under the current FEMIP Technical Assistance Support Fund only activities which have a direct link with a Bank project can be financed with Community Budget resources (i.e. project identification, preparation and implementation activities as well as upstream activities for which a direct link to projects exists). The Trust Fund would be used to finance technical assistance activities which do not necessarily have a direct link to an existing or foreseen Bank project. Activities which could fall under the scope of this window are, among others, policy, legal, regulatory and institutional reform, sector development strategies, capacity building, etc. **Activities pursued will focus in particular on strengthening, directly and indirectly, private sector development.** Accordingly, this instrument could be particularly useful in fostering privatisation processes in the region. The Bank will coordinate closely with the European Commission and other bilateral and multilateral agencies to avoid duplication of efforts and overlapping activities, in particular with MEDA or WB-funded initiatives.

- *Direct Private Sector Support:* This window aims at increasing the range of financial instruments currently available to directly support private sector development in the MPCs. In particular the Trust Fund would focus on increasing the Bank involvement in equity type operations, with special emphasis on overcoming the limitations of the MEDA-funded FEMIP Risk Capital Facility. Operations which could be financed under this window include, in order of preference:

  (a) Injection of equity into industries which are being privatised - experience of other IFIs in other regions of the world demonstrate that direct participation by an IFI in a **privatisation process** constitute a key instrument in fostering foreign investors participation. The Bank, through the FTF, would provide equity capital only subject to a clear privatisation strategy on the Government side as well as a defined exit strategy.

[1] Council Regulation No. 2698/2000

(b) Equity participations in Regional Funds and/or “Funds of Funds” – the existing FEMIP EC-funded Risk Capital Facility allows for the injection of equity into “Fund of Funds” and/or Regional Funds under clearly defined circumstances only. Financial resources from the Trust Fund could be used to expand the Bank activity in this area

Over time, the inclusion under this “window” of other private sector support instruments for which a strong demand already exists on the ground but which require additional preparation on the Bank part, such as local currency lending (the FTF would assume all or part of the foreign exchange risk of the operation), the provision of guarantees for SME lending and direct equity injections into SMEs for capital restructuring purposes, shall be considered.

6. Funding

The FTF would be financed by voluntary contributions from Member States. As a multi-donor multi-purpose trust fund relatively limited in size and in order to guarantee maximum flexibility, the FTF will pool all donor contributions into a common fund, meaning that contributions earmarked for a specific activity or “window” will not be accepted. However, donors could collectively express their priorities through the Donors Committee (see below section 9).

As a general rule, the minimum contribution to the FTF would normally be EUR 1m, reflecting the fact that there are various fixed costs associated with processing and reporting on each contribution and smaller contributions would not be cost-effective.

In accordance with the Council decision, the target initial size of the FTF is EUR 20m, possibly reaching a size of EUR 40m or more over time. Considering the grant-nature of the activities pursued under two of the three “windows” envisaged, the Bank will seek from donors, as and when needed, periodic replenishments, Over time, the FTF could assume a more revolving nature if risk capital operations financed under the FTF produce sufficient financial returns.

7. Membership

The FTF will be open to contributions from the Member States in 2004. In a second stage, the FTF will be open to participation of new members according to the Donors Committee orientations (see below section 9).

8. Inception Date and Duration

The FTF shall become fully operational in 2005. The FTF shall be conceived as an open-ended fund and shall remain in force until all funds provided have been disbursed. However, to ensure appropriate time is provided to deliver results, a target initial commitment period of 3 years is envisaged[2]. Decisions on the duration of the FTF shall be based on the FTF performance and coordinated with the outcome of discussions on the future of MEDA, in the context of the new financial perspectives 2007-2013

9. Governance

The FTF shall be governed by a Donors Committee meeting at least once a year and responsible for setting the overall strategic direction of the fund. The Donors Committee should review the operational and financial results of the fund and set future priority goals. Voting shares will be based on contribution levels. Rules of procedure of the Donors Committee shall be drawn up.

10. Modalities of Administration

The Bank’s FEMIP Department shall administer the FTF on behalf of donors in accordance with customary Bank management and operational procedures. To the extent that is necessary, specific operational guidelines will be drawn up for activities for which no such procedures currently exist.

10.1 Management Fee

[2] The notion of “commitment period” is introduced due to the risk capital participations to be taken. The presence of the latter will mean that (i) funds committed will have to be disbursed over time (beyond three years) on an “as needed basis”, and (ii) the legal structure of the FTF, the holder of equity shares, will have to be maintained beyond three years, until such shares are sold or liquidated. Besides, enough resources will have to be kept aside at the end of the commitment period in order to pay for fees related to follow-up of participations, annual accounts, etc.

The Bank will charge a management fee of between 3% and 5% to recover costs incurred in the administration of the FTF. The management fee will depend on the final size of the FTF and the allocation of funds among the different windows.

10.2 Project Management

Appraisal, approval, disbursement, monitoring and evaluation procedures, environmental and social safeguards will reflect procedures and safeguards followed in the normal EIB-assisted project-cycle.

10.3 Procurement

Procurement of any goods, works and services will follow applicable Bank guidelines.

10.4 Project Information and Reporting

Having received a report containing a brief description of the project, objectives, general justification for the project, project costs and expenditure categories, the donors will be responsible for approving or rejecting financing proposals according to the rules of procedure adopted by the Donors Committee.

Standard reporting measures under the FTF shall include:

- A yearly Annual Report, describing the operations of the FTF
- Yearly externally audited financial reports
- Project completion reports
- Any general policy documents related to the FTF, including evaluation reports

In addition, the Bank as Administrator of the FTF will maintain close consultation and coordination with the donors at all times.

10.5 Financial Audit and Control

The FTF will operate on a stand-alone accounting basis vis-à-vis EIB's own accounts. Copy of separate yearly accounts, subject to the same internal/external auditing procedures as EIB accounts, will be submitted to the donors together with the Annual Report.

11. Visibility

All activities undertaken by the FTF shall clearly indicate the funding source. FTF shall develop appropriate mechanisms/ initiatives to ensure donors receive adequate recognition for their financial support. These might include: (i) inviting local donors representatives to attend signing ceremonies in the countries of operation; (ii) increased publicity/marketing through publications and press releases; (iii) within the Bank, ensure donor recognition is included in all project related documents; (iv) for technical assistance projects, envisage the inclusion into the Terms of Reference of clauses obliging the consultant(s) to undertake some visibility initiatives.

12. Next Steps

- Start drafting legal agreements and necessary internal operational guidelines.
- Present this paper to Ministers at Alexandria Ministerial meeting on 7 June 2004.
- Address the funding issue with potential donors in the margins of the next High-Level experts meeting.