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(pursuant to Article 287(4), second subparagraph, TFEU)

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GLOSSARY

Additionality: The EU SME Guarantee facility is intended to provide *additional* access to finance for SMEs and not to substitute for state spending. Additionality will typically occur if lending volumes increase when compared to a scenario without EU intervention.

CIP: The Competitiveness and Innovation Framework Programme was established by Decision No 1639/2006/EC of the European Parliament and of the Council covering the period 2007–13. It is a programme launched by DG ENTR and DG ECFIN, managed by the EIF under the supervision of DG ECFIN to foster entrepreneurship and innovation of EU SMEs.

CIP Decision: Decision No 1639/2006/EC of the European Parliament and of the Council of 24 October 2006 establishing a Competitiveness and Innovation Framework Programme (2007 to 2013)

DG ECFIN: Directorate-General for Economic and Financial Affairs at the Commission

DG ENTR: Directorate-General for Enterprise and Industry at the Commission

EIB: European Investment Bank

EIF: The European Investment Fund has been set up by the EIB to structure and grant specialised financial products, including venture capital, guarantee instruments for SMEs and securitisation. The EIF works with a network of financial intermediaries, many of which are specialised in SME finance. In the context of the CIP, the EIF can be seen as the operational manager of the SME Guarantee facility.

EIP: The Entrepreneurship and Innovation Programme is one of three pillars of the CIP framework to promote entrepreneurship and innovation.

Ex ante **impact assessment**: Commission Staff Working Document, Annex to the Proposal for a Decision of the European Parliament and of the Council establishing a Competitiveness and Innovation Framework Programme (2007–2013), SEC(2005) 433.

Financial instruments: The financial intermediaries participating in the SMEG facility can be public guarantee institutions, mutual guarantee organisations, micro-finance institutions and commercial or publicity owned or controlled banks.

Financial intermediary: The financial intermediaries participating in the SMEG facility can be public guarantee institutions, mutual guarantee organisations, microfinance institutions and commercial or publicly owned or controlled banks. They may be direct lenders that provide loans to SMEs, or indirect guarantee organisations that either co-guarantee or counter-guarantee a loan portfolio, of one or several direct lenders.

FMA: Fiduciary and Management Agreement of 20 September 2007 between the European Community and the EIF for the SMEG facility under the Competitiveness and Innovation Framework Programme (2007–13).

G & E: The Growth and Employment initiative established by Council Decision 347/1998/EC covering the period 1998–2000. The successor programme of G & E is the MAP.

Guarantee cap amount: The guarantee cap amount refers to the maximum amount of losses for which the EIF is liable under an EU guarantee.

Guarantee cap rate: The guarantee cap rate is a pre-agreed rate at which the EIF's liability is capped under a guarantee agreement. The amount of the EIF's liability under a guarantee agreement (guarantee cap amount) can be calculated by multiplying the actual portfolio volume by the guarantee rate and the guarantee cap rate.

For example, portfolio volume = 1 000; guarantee rate = 50 %; guarantee cap rate = 10 %. Thus, maximum EIF liability (guarantee cap amount) = 1 000 x 50 % x 10 % = 50.

Guarantee deal: Guarantee deals are the individual guarantee agreements between the EIF and a financial intermediary covering the activities performed on the basis of these agreements.

Impact: Longer-term socioeconomic consequences that can be observed after the completion of an intervention, which may affect either direct or indirect addressees of the intervention.

Implementation report: The CIP Council decision stipulates that the Commission should draw up an annual implementation report for the framework programme and for each specific programme, examining the supported activities in terms of financial implementation, results and, where possible, impact. The Commission should communicate the annual implementation reports to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions.

Input: Financial, human and material resources that are mobilised for the implementation of an intervention.

Lisbon strategy: During the meeting of the European Council in Lisbon (March 2000), the Heads of State or Government launched a 'Lisbon strategy' aimed at making the European Union the most competitive economy in the world and achieving full employment by 2010.

MAP: The Multi-Annual Programme for Enterprise and Entrepreneurship covering the period 2001–06 is an SME programme of DG ENTR managed by the EIF under the supervision of DG ECFIN. It was the predecessor programme of the CIP.

Maximum portfolio amount: The maximum portfolio amount is the maximum loan volume which may be covered by the EU guarantee. It is established by the EIF for each financial intermediary, taking into account various considerations such as the available EU budget and comparable past lending volumes.

OECD: Organisation for Economic Cooperation and Development

Outcome: Change that arises from the implementation of an intervention and which normally relates to the objectives of this intervention. Outcomes include results and impacts. Outcomes may be expected or unexpected, positive or negative.

Output: What is produced or accomplished with the resources allocated to an intervention.

Reference volume: Reference volume represents the amount of guarantees or financing which the intermediary could reasonably be expected to achieve in the absence of the EU guarantee.

Result: Immediate changes that arise for direct addressees at the end of their participation in an intervention.

SME: Small and medium-sized enterprise. As per the Commission recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, SMEs are defined as enterprises which employ fewer than 250 employees, which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro and which conform to the criterion of being an autonomous enterprise.

SMEG facility: SME Guarantee facility: a financial instrument managed by the EIF, providing guarantees or counter guarantees to financial intermediaries for loans granted by financial institutions to SMEs aiming at increasing the SMEs' debt financing supply.

SMEG windows: The four windows of the SMEG facility are:
- debt financing via loans or leasing,
- microcredit financing,
- guarantees for equity or quasi-equity investments in SMEs, and
- securitisation of SME debt finance portfolios.

EXECUTIVE SUMMARY

I.

The SME Guarantee (SMEG) facility is a financial instrument managed by the European Investment Fund on behalf of the European Commission and providing guarantees or counter guarantees to financial intermediaries for loans granted by financial institutions to SMEs aimed at increasing the supply of debt financing.

II.

The objective of the Court's audit was to assess the effectiveness of the SMEG facility, notably the design and planning, the management of its operations and the achievement of its objectives.

III.

The Court found that the objectives of the current SMEG facility are more precise than under the predecessor programmes, but they are only specific, measurable, achievable and timed in relation to the expected outputs. The intervention logic was not made explicit and limited quantification of potential impacts was provided at the planning stage of the facility.

EXECUTIVE SUMMARY

IV.
The framework for the management of daily operations is considered appropriate, but does not include scoring standards or minimum requirements for the selection of financial intermediaries.

V.
Sufficient output indicators were established, which were used to report on SMEG's implementation. Reporting requirements are satisfactory and accepted by the financial intermediaries.

VI.
The only quantified target relating to the number of SMEs to be reached with the SMEG facility is attainable. Concerning the purpose of the loans granted, less than half were given to SMEs that lacked collateral and only 12 % were given to SMEs that used them for innovative investments. The analysis of the Court's sample of loans identified a deadweight of 38 %. The EU added value of the facility was not clearly demonstrated before it was launched neither is it indicated in the guarantee agreements with the financial intermediaries.

VII.
The Court recommends that the programme logic should be made explicit in any similar future intervention, and additional or better performance indicators considered. The selection of potential financial intermediaries should be based on minimum requirements for the criteria that have to be fulfilled by the applicants and a scoring system should be put in place to make the applications comparable. Appropriate measures to minimise deadweight should be envisaged. During the planning period, the EU added value of the instrument should be clearly demonstrated.

INTRODUCTION

SMEs AND ACCESS TO FINANCE

1. Small and medium-sized enterprises (SMEs) are the backbone of the EU economy[1], representing 99 % of all enterprises and providing 75 million jobs in the European Union[2]. However, the financial markets are wary of investing in new or young SMEs which are perceived as high-risk investments, especially if they are in innovative markets. According to the Observatory of European SMEs[3], limited access to finance is a problem for SMEs in Europe. The public sector has an important role to play in supporting the SME sector, in particular the provision of suitable financing.

2. SME policy is a key element of the Lisbon strategy aiming to make Europe a more attractive place to invest and work[4]. The Lisbon strategy stressed that entrepreneurial initiatives and innovation must be stimulated and encouraged. Therefore a friendly environment should be created for starting up innovative businesses, especially SMEs[5]. One of the EU support measures to SMEs facilitates their access to external finance and is known as the SME Guarantee (SMEG) facility.

3. The SMEG facility was established in October 2006 as part of the Competitiveness and Innovation Framework Programme (CIP)[6]. It originates in Council Decision 98/347/EC on measures of financial assistance for innovative and job-creating SMEs — Growth and Employment (G & E), which was continued as part of the subsequent Multi-Annual Programme for Enterprise and Entrepreneurship (MAP)[7] established in 2001. Under the CIP, the SMEG facility is one of the Community's financial instruments which were launched under the Entrepreneurship and Innovation Programme (EIP) (see ***Annex I***).

[1] 'Giving SMEs the credit they need', The magazine of enterprise policy, European Commission, 12.2.2009.

[2] COM(2005) 551 final, 10.11.2005.

[3] Observatory of European SMEs, Analytical Report, November 2006–January 2007, Flash Eurobarometer.

[4] COM(2005) 24 final, 2.2.2005.

[5] Lisbon European Council 23 and 24 March 2000, Presidency conclusions.

[6] Decision No1639/2006/EC of the European Parliament and of the Council of 24 October 2006 establishing a Competitiveness and Innovation Framework Programme (2007 to 2013) (OJ L 310, 9.11.2006, p. 15).

[7] Council Decision 2000/819/EC of 20 December 2000 on a multiannual programme for enterprise and entrepreneurship, and in particular for small and medium-sized enterprises (SMEs) (2001–2005) (OJ L 333, 29.12.2000, p. 84).

4. The EIP has wide-ranging objectives: 'to improve access to finance for the start-up and growth of SMEs and investment in innovation activities'. The SMEG facility encompasses different types of guarantee schemes, each aiming to support entrepreneurship through the enhancement of SME access to finance. It comprises four different schemes (or 'windows'), the loans and leases window, the microcredit window, the equity and quasi-equity window and the securitisation window.

5. The SMEG facility was allocated 978 million euro for the period 1998 to 2013 under the three successive framework programmes (G & E, MAP and CIP). At the end of 2009, this budget guaranteed a total loan portfolio of 10,6 billion euro (see ***Table 1***).

TABLE 1

SMEG FACILITY OVERALL BUDGET

	Budget *(million euro)*	Guaranteed loan portfolio as at the end of 2009 *(million euro)*
SMEG 1998 (G&E)	187	2 402
SMEG 2001 (MAP)	281	4 642
SMEG 2007 (CIP)	510[1]	3 534
Total	**978**	**10 578**

[1] Indicative budget for SMEG at the start of the CIP. The allocation of budgets between the different types of financial instruments is done on an annual basis.

Source: ECA based on various reports from the European Commission and the European Investment Fund.

6. 510 million euro are earmarked under the current CIP for the period 2007 to 2013. The budget is only drawn upon when guaranteed loans default, and for each intermediary a maximum EU budget liability is fixed. Until 31 December 2009 the total amount of guarantee calls made under the CIP was 1,7 million euro. For a detailed breakdown of the results achieved by the facility under the CIP, see ***Table 2***.

THE MAIN FEATURES OF THE SMEG FACILITY

7. The operational management of the SMEG facility involves several parties (see ***Figure 1***).

TABLE 2

RESULTS ACHIEVED BY THE SMEG FACILITY UNDER THE CIP — KEY FIGURES AS AT 31 DECEMBER 2009

	Total	Loan window	Microcredit window
Number of intermediaries	**21**	17	4
Number of agreements	**25**	21	4
Countries covered	**13**	11	4
Number of SMEs	**58 767**	50 476	8 314
Number of loans	**64 327**	55 796	8 531
Number of employees (estimated at inclusion date)	**217 134**	204 155	13 004
EU guarantee in million euro	**3 534**	3 306	228
Net called guarantees in million euro	**1,7**	0,8	0,9
Loan amount in million euro	**3 793**	3 695	98
Investment amount in million euro	**6 849**	6 692	157
Estimated SME financing guaranteed in million euro	**11 610**	11 264	346

Source: 'Quarterly Report 31 December 2009 — SMEG 2007 facility', the European Investment Fund.

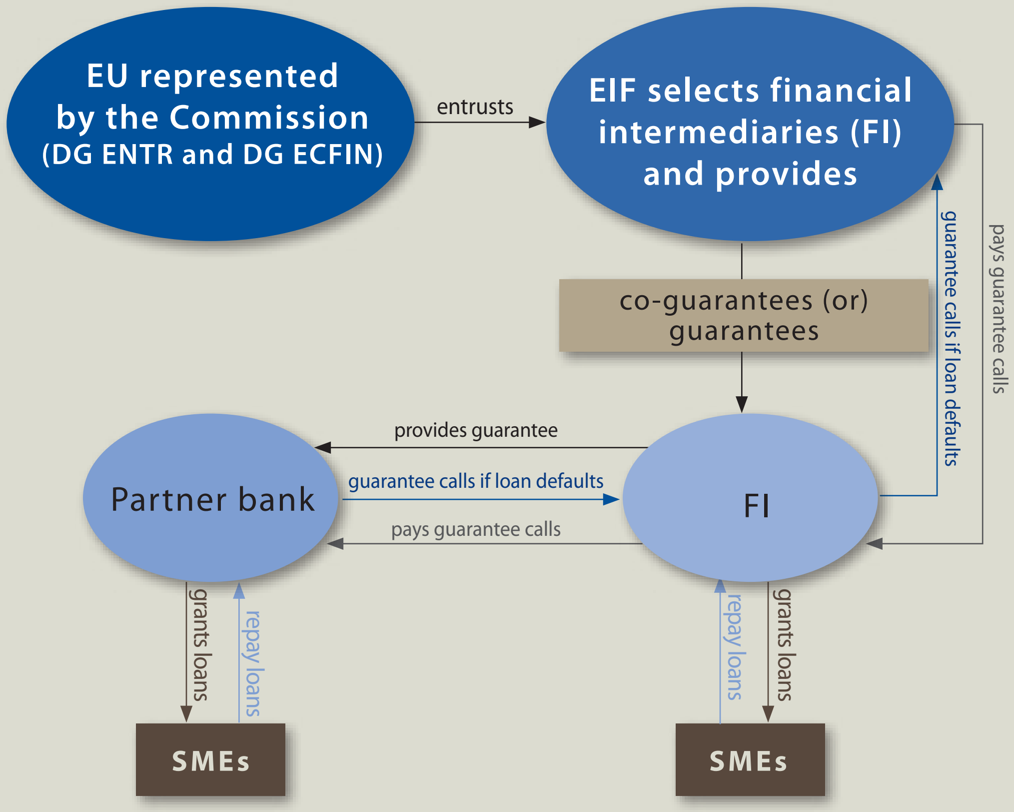
8. Two directorates-general at the European Commission, plus the European Investment Fund (EIF)[8], are all involved in the design, management and monitoring of the SMEG facility. The Directorate-General for Enterprise and Industry (DG ENTR) is the coordinator of the legal basis, prepares the annual work programmes and implementation reports of the various CIP pillars and is responsible for organising the programme evaluations. The Directorate-General for Economic and Financial Affairs (DG ECFIN) has the direct management responsibilities for SMEG, being in charge of negotiating the Fiduciary and Management Agreement (FMA) with the EIF[9], approving financial intermediaries, monitoring cash movements on the trust accounts and ensuring that funds are spent in line with the CIP's objectives.

[8] The EIF is the European Union body specialised in providing guarantee instruments and risk capital for SMEs.

[9] Fiduciary and Management Agreement dated 20.9.2007 between the European Community and the EIF for the SMEG facility under the Competitiveness and Innovation Framework Programme (2007–13).

FIGURE 1

OVERVIEW OF THE SMEG PROCESS FLOW



Source: European Court of Auditors.

9. The EIF provides guarantees to financial intermediaries aiming to improve their lending capacity and, therefore, the availability and terms of loans towards SMEs. The EIF signs guarantee agreements in its own name, on behalf of the Commission and at the risk and cost of the Union budget. In order to allow the Commission to monitor the facility, the EIF reports to DG ECFIN on the progress achieved on a quarterly basis.

10. The financial intermediaries participating in the SMEG facility are public guarantee institutions, mutual guarantee organisations, microfinance institutions and commercial or publicly owned or controlled banks. They can be direct lenders that provide loans to SMEs or indirect guarantee organisations that either co-guarantee or counter-guarantee[10] a SME loan portfolio of one or several direct lenders. Each guarantee deal[11] determines specific target volumes for the loans to be achieved by the financial intermediary.

11. SMEs have to meet the Commission's SME definition to be eligible for a guarantee under the SMEG facility. An SME is defined as an enterprise which employs fewer than 250 employees and which has an annual turnover not exceeding 50 million euro and/or an annual balance sheet total not exceeding 43 million euro. It must also satisfy the criterion of being an autonomous enterprise[12].

[10] A co-guarantee provides a second guarantee in addition to the main guarantee to the lender, whereas a counter-guarantee guarantees part of the first guarantor's guarantee.

[11] 'Guarantee deals' are the individual guarantee agreements between the EIF and a financial intermediary and the activities performed on the basis of these agreements.

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

AUDIT SCOPE AND APPROACH

12. The objective of the Court's audit was to assess the effectiveness of the SMEG facility by addressing the following audit questions:

- Has the Commission designed the SMEG facility and its management structure in a coherent and effective manner?
- Have the Commission and the EIF established and applied effective procedures to select appropriate financial intermediaries and to monitor the performance of the SMEG facility?
- Have the SME guarantee deals contributed to the achievement of the policy's objectives?

13. The audit examined the roles and responsibilities of all main parties involved in the SMEG facility — the Commission, the EIF and the financial intermediaries. The main focus was the SMEG facility under the CIP (2007–13); the SMEG under the MAP was used for the purpose of comparisons with the CIP.

14. The audit covered the following:

- an assessment of whether the SMEG objectives were SMART and whether the design and planning of the facility was likely to achieve effective results;
- an evaluation of the management of the SMEG facility's operations, comprising an assessment of the financial intermediary selection procedures and the Commission and EIF reporting and monitoring procedures;
- visits to nine financial intermediaries[13] (out of the 14 that were contracted at the audit planning stage in June 2009). They were selected according to the following criteria: (i) type of guarantee; (ii) actual guarantee volume achieved; (iii) type of financial intermediary; and (iv) direct guarantee or counter-guarantee. For each financial intermediary the related guarantee proposal, its assessment by the EIF and the Commission and the agreement signed between the EIF and the financial intermediary were examined;

[13] Financial intermediaries in Belgium, France, Hungary, Slovenia, Italy, Spain and Germany were visited.

- selection of a sample of 181 loans from the nine financial intermediaries visited in order to assess that the use of the guaranteed SME loans was in line with the SMEG objectives[14]; and
- a questionnaire to all 51 financial intermediaries participating under MAP and/or CIP[15] in order to obtain their views on the design and management of the SMEG facility[16].

[14] Documentation concerning the proposal and approval of the loan, the assessment of the borrower's credit risk and the purpose of the loan was inspected on the financial intermediaries' premises.

[15] The questionnaire invited the intermediaries to answer 48 questions on topics such as: (i) the SMEG application process; (ii) the EIF's management during the lifetime of the guarantee; (iii), the guaranteed product; and (iv) the impact of the financial crisis on the products. In addition, the intermediaries that participated under the MAP but not the CIP were asked to indicate the reasons.

[16] Comments from both the EIF and Commission were taken into account when drafting the questions. A response rate of 82 % was obtained (42 out of 51 financial intermediaries).

AUDIT FINDINGS

DESIGN OF THE SMEG FACILITY

15. Public intervention is more likely to be successful if it is properly designed. In order to assess the design, this section analyses the intervention logic underlying the SMEG facility. It scrutinises the *ex ante* impact assessment for the CIP[17] related to the SMEG facility and the extent to which the results of this assessment were taken into account during the design stage. Finally, the objectives of the SMEG facility are assessed in the light of specific, measurable, achievable, relevant and timed (SMART) criteria.

THE SMEG FACILITY IS BASED ON A VALID IMPLICIT INTERVENTION LOGIC

16. The intervention logic provides the link between an intervention's inputs and the production of its outputs and, subsequently, to its impacts on society in terms of results and outcomes. It describes how an intervention is expected to attain its global objectives. An explicit intervention logic shows how the programme is supposed to function.

17. Neither the CIP Decision nor the Commission's proposal or the impact assessment for CIP explicitly described the intervention logic of the SMEG facility in this manner. The absence of an explicit intervention logic was also noted by the EIP interim evaluator[18].

18. The different preparatory documents, however, do provide sufficient information to make an implicit assumption on how the SMEG facility is supposed to function. For lenders it can be difficult to assess individual loan applications and the risks involved, especially if a borrower does not have an established track record (start-ups). In such a situation the borrowers can guarantee the loan to the lender through the provision of collateral, but those who do not have sufficient collateral may be denied access to credit even with viable business propositions. The SMEG facility seeks to remedy this situation by providing guarantees in cases where the SMEs are unable to do so.

[17] Commission Staff Working Document, Annex to the Proposal for a Decision of the European Parliament and of the Council establishing a Competitiveness and Innovation Framework Programme (2007–13), SEC(2005) 433, 6.4.2005.

[18] The interim evaluator recommended providing 'a clear statement of intervention logic for each measure in order to improve the overall coherence of the programme and to demonstrate the impact', European Commission 'Interim evaluation of the Entrepreneurship and Innovation Programme', 2009.

19. Nevertheless, in the absence of an explicit intervention logic, it is difficult to understand the rationale of some specific elements of the SMEG facility, such as targeting innovative SMEs by the loan window. Innovative SMEs are targeted through debt financing although equity investments are generally considered more appropriate for this type of SME[19].

THE IMPACT ASSESSMENT HELPED TO DESIGN THE FACILITY; HOWEVER, IT CONTAINED LITTLE FACTUAL EVIDENCE IN SUPPORT OF THE FACILITY

20. The impact assessment is an important instrument used by the Commission when designing a policy[20]. The impact assessment should identify and analyse the problem at stake, the objectives to be pursued and the main policy options that are available to achieve those objectives. For the various policy options, the assessment should evaluate their likely economic, social and environmental impacts. Finally, the impact assessment should identify the monitoring and evaluation arrangements needed during policy implementation.

21. As regards the SMEG facility, this type of analysis forms part of the CIP impact assessment. The CIP impact assessment contained all the mandatory sections and as such it gives insight into the considerations that shaped the design of the CIP and its main elements such as the SMEG facility. Thus, the CIP impact assessment represents an improvement compared to the MAP, for which no such analysis was made.

22. However, many parts of the CIP impact assessment are not sufficiently detailed and quantified. For example, the analysis of the problem lacks any indication of its magnitude and the analysis of different policy options is based only on a simplistic qualitative comparison without any quantification of the likely impacts. For the retained option, except for the impact on the number of jobs, the Commission quantified expected outputs[21] instead of the impact.

[19] See for instance North, Baldock, Ekanem, Whittam and Wyper: 'Access to Bank Finance for Scottish SMEs', 2008.

[20] COM(2002) 276 final, 5.6.2002.

[21] The impact assessment considers the outputs such as number of loans or number of SMEs as impacts. However, the actual impact is lower than the outputs, because a part of the SMEs would have obtained the loans without the guarantee.

COMPARED TO MAP, THE OBJECTIVES ARE MORE PRECISE, BUT STILL LACK CLARITY AND SPECIFIC TARGETS

23. SMART objectives shall be set for any budget activity[22]. The objectives are considered:

- specific if they are precise and concrete enough not to be open to varying interpretations[23];
- measurable if the output can be measured and therefore any improvements assessed;
- achievable if the expected results can realistically be produced with the available resources;
- relevant if they relate to the needs and to the strategic objectives; and
- timed if they relate to a deadline or time period[23].

24. Due to the rather complex structure of the CIP (see ***Annex I***), the hierarchical structure of the objectives is also complex. Four global objectives are set at the level of the framework programme[24]. In the case of the EIP which includes the SMEG facility, the immediate objectives[25] are defined at the level of the specific programme[26]. Although no specific objectives are set at the level of the financial instruments, Article 19.2 of the CIP Decision describes each window of the SMEG facility in an objective-like fashion (see ***Box 1***).

25. The objectives are relevant, but they are only specific, stated in a measurable format and timed as regards the expected outputs of the facility. The quantified target of reaching 315 750 SMEs seems to be reasonably achievable (see paragraph 77).

[22] Article 27(3) of Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 248, 16.9.2002, p. 1).

[23] The definition is taken from the European Commission, 'Impact assessment guidelines', SEC(2005) 791, 15.6.2005.

[24] CIP Decision, Article 2.

[25] Immediate objectives concern the result of an intervention on direct addressees and take account of the envisaged specific domain and particular nature of the policy intervention under consideration. For SMEG, the relevant EIP objective is considered to be the immediate objective.

[26] CIP Decision, Article 10.

26. Compared to the MAP, the objectives of the SMEG facility were more precise. However, they are defined in a very broad manner. For instance, according to the EIP immediate objective, the loans have 'to improve access to finance for the start-up and growth of SMEs'. Such an objective implies a very broad set of potential target SMEs as it can be argued that almost any borrowing by any SME will be undertaken in order to ensure the growth of a company. Also, the concept of innovation has been interpreted in a wide way[27].

[27] Examples of innovation found in the sample: investment in new packaging and sorting technology in a warehouse and a new oven with additional functionalities in a bakery shop.

BOX 1

OBJECTIVES RELEVANT TO THE SMEG FACILITY

Global objective

To foster the competitiveness of enterprises, in particular of SMEs.

Immediate objective

To improve (…) access to finance for the start-up and growth of SMEs and investment in innovation activities.

The four SMEG windows

Loan window — shall reduce the particular difficulties SMEs face in accessing finance either due to the perceived higher risk associated with investments in certain knowledge-related activities such as technological development, innovation and technology transfer, or due to a lack of sufficient collateral.

Microcredit window — shall encourage financial institutions to play a greater role in the provision of loans of a smaller amount which would normally involve proportionately higher unit handling costs for borrowers with insufficient collateral. In addition to guarantees or counter-guarantees, financial intermediaries may receive grants to partially offset the high administrative costs inherent in microcredit financing.

Equity and quasi-equity window — shall include investments which provide seed capital and/or capital in the start-up phase, as well as mezzanine financing, in order to reduce the particular difficulties which SMEs face because of their weak financial structure, and those arising from business transfers.

Securitisation window — shall mobilise additional debt financing for SMEs under appropriate risk-sharing arrangements with the targeted institutions. Support for those transactions shall be made available upon an undertaking by the originating institutions to grant a significant part of the liquidity resulting from the mobilised capital for new SME lending in a reasonable period of time.

27. The CIP impact assessment sets an output target for the number of SMEs expected to benefit within the seven-year programme horizon. Targets in terms of results or impact have not been set (for more details, see paragraph 64). An estimated number of direct jobs maintained or created within five years was provided in the impact assessment. This does not directly relate to any of the objectives, but can be derived from the renewed Lisbon strategy.

SETTING UP THE MANAGEMENT STRUCTURE OF THE SMEG FACILITY: DELEGATING THE DAY-TO-DAY MANAGEMENT TO THE EIF

28. The cornerstone of efficient and effective delegation is the contractual agreement detailing the provisions for the implementation of the tasks entrusted to the specialised body. This contractual agreement should in particular detail the obligations of the specialised body and include all appropriate arrangements for ensuring that the policy objectives will be attained[28].

29. The EIF has systematically developed expertise in providing financial engineering products to SMEs in Europe. It was selected by the European Community to operate the day-to-day management of the SMEG facility at its start in 1998. Using the EIF under the successive multiannual programmes (G & E, MAP and then CIP) aims to ensure the required continuity of the management of the SMEG facility.

30. In this context, the Court examined:

- whether the implementation of the SMEG facility was being effectively planned to avoid delays and to provide an uninterrupted support to the SMEs; and
- whether the regulatory framework[29] defining the services to be provided by the EIF ensures efficient and effective management of the facility.

[28] In accordance with Article 43(4) of Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 357, 31.12.2002, p. 1).

[29] For SMEG: the Fiduciary and Management Agreement and the related operational guidelines (such as the 'Guidance on enhanced access to finance').

DELAYS IN PLANNING THE SMEG FACILITY

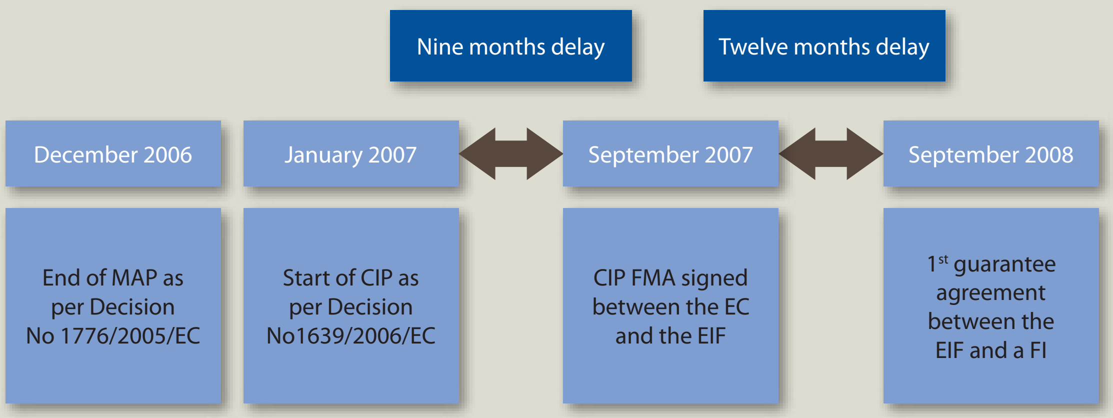
31. Considering that the MAP covered the period from 2001 to 2006 and the CIP covers the period from 2007 to 2013, the start of the operations under the CIP should have been planned in order to preserve the continuity of the financial support. The FMA should have been in place at least 11 months (see paragraph 33) before the start of the CIP as this would have left sufficient time for signing the guarantee agreements between the EIF and the financial intermediaries.

32. The first draft version of the FMA under the CIP was dated March 2006, but was not signed until 20 September 2007, nearly nine months after the start of the CIP. Thereafter, it took almost one year until the first guarantee agreement between the EIF and a financial intermediary was signed[30] (see ***Figure 2***).

[30] The first guarantee agreement under the CIP between a financial intermediary and the EIF was signed on 2 September 2008.

FIGURE 2

TIMELINE OF THE MAP AND CIP LEGAL BASE



33. The average period from the receipt of the CIP application from an intermediary up to the signature of the agreement was nearly 11 months[31]. Moreover, the timeframe for the application process was considered to be unreasonable by eight out of 21 respondents to the Court's questionnaire[32]. This delay in the selection process was mainly caused by the need to resolve technical issues raised by the EIF before the implementation of the SMEG facility, such as agreeing on a definition of and measuring the additionality of the loan guarantees (see paragraph 84). Altogether, this led to a significant time gap in the transition of the successive programmes.

TO PRESERVE THE CONTINUITY OF THE SUPPORT A 'RETROACTIVITY CLAUSE' WAS INTRODUCED

34. The continuity of the support is important for the financial intermediaries as some introduced specific loan products tailored to the needs of the SMEG facility. The interruption of EU support could cause higher losses to the financial intermediaries if the product was maintained without the EU guarantee.

35. The 'retroactivity clause' was introduced with the aim of minimising the time gap between the two successive programmes and preserving continuity between the MAP and CIP programmes. This clause enabled the financial intermediaries to retroactively include loans to be supported by the facility which they had entered into between the end of the availability period under MAP and the date on which their CIP guarantee agreement was signed.

36. As a result, the equal treatment of financial intermediaries was not ensured since the financial intermediaries which had participated in the MAP benefited from favourable treatment through the retroactive inclusion of loans. Loans could be retroactively included as from September 2007, whereas new financial intermediaries could only include loans once their guarantee agreement with the EIF[33] had been signed.

[31] Calculated on the basis of the nine intermediaries visited, the average number of days for processing a successful application under CIP was 323.

[32] Based on the questionnaire (Q6) sent to all FIs who applied under CIP.

[33] The first guarantee agreements under the CIP were signed in September 2008.

37. Although the retroactivity clause was designed to resolve the financial intermediaries' funding gap between MAP and CIP, it could not always prevent a disruption of EU support to SMEs. This was the case for two of the nine financial intermediaries visited for which the availability period under MAP ended before the start of the CIP availability period (a gap of four months).

APPROPRIATE MANAGEMENT FRAMEWORK ESTABLISHED TO OPERATE THE SMEG FACILITY

38. The SMEG facility operates under the joint management of the Commission and the EIF[34]. To ensure a successful delegation, the FMA and the related operational guidelines should include:

- a definition of the action to be implemented, such as the specific objectives per window (see ***Box 1*** for a description of the windows);
- the management structure for the implementation of the tasks; and
- the setting up of an adequate fee structure for the services provided by the EIF.

39. Article 3 of the FMA stipulates the tasks the EIF has to implement (see ***Box 2***):

[34] In accordance with Article 53 of Council Regulation (EC, Euratom) No 1605/2002.

BOX 2

EIF MAIN TASKS FOR MANAGING THE SMEG FACILITY

- Identification, evaluation and selection of financial intermediaries
- Determination of, and agreement with, the financial intermediaries on the nature and detailed conditions of the EU guarantees
- Decisions to commit funds
- Execution, management and termination of the EU guarantees (including reporting and monitoring)

40. For each SMEG window, operational guidelines[35] were developed detailing the specific purpose, the selection of the intermediaries, the eligibility criteria, the EU guarantee and the modus operandi. The Commission issued 'Guidance on enhanced access to finance' on 29 October 2007 to supplement these operational guidelines, in particular the provisions of the FMA on establishing the parameters of the guarantee agreement.

[35] Fiduciary and Management Agreement, Annexes 1A to 1D.

41. The management structure established for the SMEG facility was appropriate as it improved the operational guidelines and the other provisions for the implementation of the tasks compared with those under the MAP, since they cover all tasks to be carried out in sufficient detail.

42. The fees to be paid to the EIF should be calculated so as to take into account:

- performance in achieving specific targets;
- the geographical distribution in the eligible countries; and
- the degree of novelty and complexity of the guarantee instrument.

43. The EIF fee scheme has been improved under CIP compared to MAP since:

- the fee structure has been split into four distinctive components better reflecting the associated workload for each task; and
- the fee entitlement is triggered by the achievement of specific results (see ***Table 3***).

TABLE 3

OVERVIEW OF THE FOUR INCENTIVES FEES THAT CONSTITUTE EIF REMUNERATION

Type of incentive fee	To mainly encourage
Start-up Fee	Setting-up the programme within 12 months
Signature Fee	Broad geographical coverage of the programme and use of specific windows
Implementation Fee	Additional volume achieved and daily operations
Monitoring Fee	Assurance of sound financial management

Source: Annex 13 of the Fiduciary and Management Agreement.

44. The EIF 'signature fee' gives a specific bonus for wide geographic coverage of intermediaries. Furthermore, fees are paid for the participation of intermediaries in countries that were not covered before and also for new intermediaries who did not participate under the previous programmes.

45. Despite the incentive fee for using specific windows, the equity and quasi-equity guarantees and securitisation windows had not been utilised as at 31 December 2009. This is partly due to the financial crisis, which negatively impacted the securitisation market as a whole.

SELECTION OF FINANCIAL INTERMEDIARIES

46. The audit assessed the selection process in respect of the following:

- whether the framework guiding the EIF on the selection of financial intermediaries was complete and ensured fair and transparent selection;
- whether the agreement parameters, determining the extent of the EU's intervention, had been correctly set; and
- whether policy objectives had been correctly translated into the guarantee agreements.

WELL-DESIGNED SELECTION FRAMEWORK

47. The appraisal process should apply common standards to evaluating financial intermediaries, so as to ensure fair, structured and transparent selection. The EIF and the Commission should create and apply minimum standards for the selection of potential intermediaries.

48. The Commission empowered the EIF[36] to select intermediaries by applying the selection criteria and process set out in the relevant guarantee policies[37]. The guarantee policies further state that the intermediaries are to be selected in conformity with best practice. An overview of the SMEG selection process carried out by the EIF is provided in ***Box 3***.

49. When defining the facility's management framework, the following criteria for selecting potential financial intermediaries were laid down in the FMA[38]:

- financial standing and operational capability of the intermediary and its ability to manage risk and to comply with the terms and conditions of the SMEG facility;
- whether the intermediary guarantees debt and/or microcredit financing provided by a wide range of lenders to SMEs;
- geographic coverage (loan window only);
- possibility of providing mentoring and business support (microcredit window only); and
- acceptance of the 'Enhanced access to finance' criterion (see paragraph 54).

[36] Fiduciary and Management Agreement, Article 3.1.

[37] The Fiduciary and Management Agreement contains four guarantee policies relating to the four specific windows of the facility. The guarantee policies set out in specific terms the purpose of the underlying window, the selection process for intermediaries, the eligibility criteria, the modus operandi as regards enhanced access to finance, the reporting, the monitoring and audit, the promotion and the visibility.

[38] Criteria corresponding to the loan and microcredit windows. The selection criteria relating to the equity and securitisation windows were not examined as these windows were not used until 31 December 2009.

BOX 3

THE EIF'S SELECTION PROCESS FOR INTERMEDIARIES

- Analysis of intermediaries' applications following an open call procedure
- Pre-selection of the applications — standardised check on formal requirements
- Due diligence process (including setting of guarantee parameters)
- Independent opinion of the EIF's Risk Management Department
- Assessment by the EIF's Compliance Department
- Approval by the EIF Board of Directors and by the European Commission (Director ECFIN — L)

50. The Court considers the criteria for the selection of financial intermediaries to be in line with practices in comparable financial institutions. However, neither the Commission nor the EIF set scoring standards against which the intermediaries' applications could have been assessed, rated and compared according to their degree of compliance with those criteria. The lack of precision regarding the selection criteria allowed the EIF to exercise a high level of discretion in evaluating the applications.

INSUFFICIENT RECORDS JUSTIFYING THE AGREEMENT PARAMETERS

51. The two main parameters of the guarantee agreements are the reference volume and the guarantee cap rate. The reference volume represents the amount of guarantees or financing which the intermediary could '*reasonably be expected to achieve* [...] *in the absence of the EU guarantee*'[39]. The reference volume further serves as a basis for the computation of additional agreement parameters. The guarantee cap rate[40] refers to the maximum amount of losses for which the EIF is liable under a guarantee agreement. Both parameters are key factors as they will determine:

- whether the EU intervention is additional to the guarantee scheme's existing level of activity or simply replaces it; and
- the maximum level of budgetary exposure the EU is expected to face under a specific agreement.

52. In accordance with the FMA and with the 'Guidance on enhanced access to finance', the volumes, including the reference volume, are determined on the basis of the EIF's professional judgement, based on past budgets and loss rates or forecasts (especially for public guarantee schemes) and considering the market conditions and their evolution over time.

[39] "Guidance on enhanced access to finance", 25 October 2007.

[40] The guarantee cap rate is a pre-agreed rate at which the EIF's liability is capped under a guarantee agreement. The amount of the EIF's liability under a guarantee agreement (guarantee cap) can be calculated by multiplying the actual portfolio volume by the guarantee rate and the guarantee cap rate. For example, portfolio volume = 1 000; guarantee rate = 50 %; guarantee cap rate = 10 % Thus, maximum EIF liability (guarantee cap) = 1 000 x 50 % x 10 % = 50.

53. Weaknesses were found in the EIF's documentation relating to the setting of the agreement parameters, including the reference volume and the cap rate. Only a summary of the results of the due-diligence step is included in the EIF's request for the Board of Directors' approval. When setting these parameters, the EIF takes as a basis the information provided by the financial intermediary. No evidence was found that the EIF verified this information.

POLICY OBJECTIVES NOT FULLY DEFINED IN THE GUARANTEE AGREEMENTS

54. Each guarantee agreement should contribute to the achievement of the policy objectives by specifying exactly what should be achieved. The general undertakings applicable to every intermediary in the guarantee agreements include principles of enhanced access to finance. These principles are derived from the broader objectives set out in the legal basis[41] and in the FMA and reflect these objectives appropriately. ***Box 4*** presents the principles applicable to the loan window.

[41] CIP Decision, Article 19.

BOX 4

PRINCIPLES OF ENHANCED ACCESS TO FINANCE AS PER GUARANTEE AGREEMENT (LOAN WINDOW)

The purpose of this agreement is the provision of a guarantee by the EIF to the intermediary in order to partially cover the intermediary's portfolio risk with a view to:

(i) enhancing SMEs' access to finance;

(ii) reducing the particular difficulties that SMEs face in accessing finance, either due to the perceived higher risk associated with investment in certain knowledge-related activities such as technological development, innovation and technology transfer, or due to the lack of sufficient collateral; and

(iii) stimulating job creation by supporting SMEs with growth and employment creation.

55. Besides these general provisions, specific financial intermediary guarantee terms may include 'further qualitative undertakings in respect of enhanced access to finance'. However, some of the intermediary guarantee terms are inconsistent with the objectives of the CIP or provide little operational guidance. For instance:

- in respect of the lack of collateral aspect it was found for one intermediary that 'in addition to complying with any relevant provision of this agreement [...] the intermediary undertakes [...] to require a low collateral level in relation to intermediary transactions'. In this case the specific terms of the agreement translate the general conditions relating to the lack of collateral into reduced collateral requirements. However, this allows de facto all SMEs to benefit from the reduced collateral requirements and does not ensure that only SMEs effectively lacking collateral, and thus unable to borrow under usual commercial terms, benefit from the facility; and

- the specific terms of the agreements leave broad discretion in the matter of interpretation of innovation. The same guarantee agreement stated, without providing any further explanation, '[...] the intermediary undertakes [...] to enter into intermediary transactions with newly created SMEs or SMEs involved in innovative projects'.

PERFORMANCE MONITORING AND REPORTING

56. Effective monitoring and reporting requires relevant, reliable and timely information on the status of the policy implementation and the extent to which the policy objectives are being met.

57. Performance monitoring of the SMEG facility is carried out by both the Commission and the EIF (see ***Annex II***). The information flows from the SMEs (i.e. final beneficiaries) through one or more layers (in the case of co- or counter-guarantees) of financial intermediaries to the EIF and finally to the Commission. Financial intermediaries report to the EIF on a quarterly basis on the SMEG facility. Based on this information, the EIF prepares quarterly consolidated reports for the Commission, which then uses these reports for the annual implementation reports on the EIP and on the CIP.

58. The Court examined the following aspects of performance monitoring and reporting:

- whether the Commission established a balanced set of performance indicators to reliably measure the status of policy implementation; and
- whether the reporting requirements are clear and reasonable.

PERFORMANCE INDICATORS WERE ESTABLISHED, BUT SHOULD BE MORE STABLE AND BALANCED

59. The prerequisite for effective monitoring (i.e. to measure progress of the implementation of the SMEG facility) is the definition of a set of clear indicators and associated targets. Indicators should be relatively stable so that changes over time can be observed and compared.

60. The SMEG performance indicators should contribute to an assessment of the achievement of the programme's specific objectives as laid down in the legal basis and the global objectives of the European Union policy from which these objectives are derived.

61. For SMEG the Commission established six indicators (see ***Table 4***).

62. Of the four indicators (numbers 2, 3, 5 and 6) included in the *ex ante* evaluation and in the EIP 2009 Work Programme, only two were carried over (numbers 2 and 3) to the Commission's EIP Implementation Report. In the EIP 2010 Work Programme, two initial indicators were dropped (numbers 5 and 6) and two new indicators were added (numbers 1 and 4). These changes, made in 2010, were a reaction to a study on the evaluation of the indicators[42].

[42] 'Evaluation of the indicators of the EIP', February 2010.

TABLE 4

SMEG INDICATORS ESTABLISHED BY THE COMMISSION

	SMEG indicators	Indicators foreseen in the *ex ante* impact assessment[1]	Indicators in the EIP Work Programme 2009	Indicators reported in the EIP Implementation Report 2009	Indicators in the EIP Work Programme 2010	Type of indicator
1	EC commitment to debt finance and total financing guaranteed	n/a	n/a	111,8 million euro (cap amount) guar-anteeing an actual loan volume of 2 771 million euro	Yes, but no target value was assigned	Output
2	The number of jobs created or maintained in SMEs receiving new financing	315 750[2]	Yes, but no target value was assigned	Number of em-ployees at inclusion date: 151 475	Yes, but no target value was assigned	Impact
3	The number of SMEs receiving new financing	315 750	Yes, but no target value was assigned	47 791	Yes, but no target value was assigned	Output
4	Number of SMEs supported, classified by sector of activity	n/a	n/a	n/a[3]	Yes, but no target value was assigned	Output
5	The change in the volume of investment financing	Yes, but no target value was assigned	Yes, but no target value was assigned	Not reported.	n/a	Result
6	Total net disbursement	Yes, but no target value was assigned	Yes, but no target value was assigned	Not reported.	n/a	Output

1 Annex to the Proposal for a Decision of the European Parliament and of the Council establishing a Competitiveness and Innovation Framework Programme (2007–2013), SEC(2005) 433.

2 One job created or maintained for each SME receiving new financing. The Commission considers that as the data of the Growth and Employment initiative indicate that beneficiary SMEs created on average 1.2 jobs, a more conservative ratio should be used to account for the fact that microcredit guarantee corresponds to more than 20 % of all companies reached by SMEG and thus, fewer jobs are expected to be created by these companies, bringing down the overall average.

3 The information can be found in the EIF quarterly reports only.

63. In the *ex ante* evaluation only two indicators (numbers 2 and 3) had target values assigned to them. The EIP 2009 and 2010 Work Programmes did not set targets for the indicators to achieve in the respective period. In the absence of target values, it is difficult to assess whether the programme is developing as expected.

64. Even though the Commission tried to create a balanced set of measurable indicators, including output, impact and result indicators, the only result indicator (number 5) was not carried over and was finally dropped by the Commission. The only impact indicator (number 2) is problematic (see paragraphs 67 and 68) and all remaining indicators are output indicators. Thus, the indicators have become more of an instrument of operational management than an indicator to measure the impact and the success of the programme. It is difficult to strike the right balance between collecting the data economically and monitoring performance effectively. The evaluators of the EIP indicators suggested a set of balanced indicators including data collection methods and timing[43].

65. If meaningful conclusions as to the achievements of the SMEG programme are to be drawn, it is essential that the monitoring data provided by the financial intermediaries should be reliable, i.e. accurate and complete.

66. The financial intermediaries visited by the Court had all established procedures for collecting the data necessary for reporting to the EIF. The quality of the reporting processes at intermediary level is checked during the on-site monitoring visits by the EIF.

67. The collection of data related to 'the number of jobs created' indicator poses difficulties for some financial intermediaries. In some countries the data are obtained from governmental institutions[44], some financial intermediaries collected them on a sample basis[45], others made calculations using expected values[46] or the financial intermediaries did not update employment data annually as it would be too burdensome[47]. Since the quality of employment data varies from country to country, adding them up raises concerns as to the reliability of the value of the indicator concerning the number of jobs created (number 2).

[43] To measure results and impacts, several indicators were suggested, for example contribution to the performance of beneficiaries (growth of sales, jobs created/maintained, new products or services developed) or total (or average) turnover growth of SMEs financed.

[44] For example, an intermediary in Slovenia obtained the employment data from the national social security and insurance institution.

[45] An intermediary in Spain collects the information annually from the regional guarantee societies on a sample basis.

[46] Another intermediary in Spain calculates the change in employment by comparing expectations at the time of the loan request compared with actual employment at the time of calculation.

[47] For example, an intermediary in Italy collects the employment data only in the initial guarantee application and does not update those at later stage.

68. Another problem with this indicator is that the values are taken from the number of persons employed by the supported SMEs, which is not equivalent to the number of jobs created or maintained at SMEs receiving new financing. The new financing received by an SME is not the only factor which leads to maintaining or creating jobs. There is no analysis as to how the guaranteed loan contributed to maintaining or creating jobs.

REPORTING REQUIREMENTS ARE CLEAR AND REASONABLE AND ONLY SOME FINANCIAL INTERMEDIARIES CONSIDER THEM AS A BURDEN

69. Financial intermediaries should have clear reporting requirements in order to collect the data for monitoring and reporting on the SMEG programme. Time and resources to obtain the required information for the indicators should not create an unnecessary administrative burden.

70. Financial intermediaries are required to collect various data on the supported SMEs and report to the EIF on a regular basis (see ***Annex III***). Reporting requirements are listed in the guarantee agreement between the EIF and the financial intermediary. To this end, clear guidelines[48] have been issued by the EIF to the financial intermediaries as to how to compile the requested data. Corroborating this statement, 88 % of the financial intermediaries agreed that the operational instructions provided by the EIF were clear[49]. Furthermore, 98 % of the financial intermediaries stated that the EIF is always willing to provide further information to clarify operational issues[50].

71. The results of the Court's questionnaire also showed that only 20 % of financial intermediaries participating under the CIP and/or the MAP find the reporting requirements unreasonable[51].

[48] 'Manual for compiling reports under the SME guarantee facility 2007–13 (CIP)' — EIF.

[49] Based on a questionnaire (Q14), 36 out of 41 financial intermediaries who answered this question agreed that the operational instructions provided by the EIF were clear.

[50] Based on a questionnaire (Q15), 40 out of 41 financial intermediaries who answered this question agreed that the EIF is always willing to give explanations during the lifetime of the guarantee.

[51] Based on a questionnaire (Q16), eight out of 42 financial intermediaries who answered this question did not agree that the reporting requirements were reasonable.

72. In cases where data collection through financial intermediaries poses a lot of difficulties (for example, employment data), alternative methods of collecting information could have been more appropriate. Both reports, 'Evaluation of the indicators of the EIP' and the 'Interim evaluation of the EIP', suggested using surveys in the context of an evaluation.

ACHIEVEMENTS OF THE SMEG FACILITY

73. This section describes the outputs delivered by the SMEG facility. The outputs are analysed in relation to the facility's objectives. Furthermore, the European added value of the facility is examined, in particular whether the facility's objectives are better achieved by implementation at Community level than at national or regional level.

OUTPUTS OF THE SMEG FACILITY

74. The CIP financial instruments should 'improve (...) access to finance for the start-up and growth of SMEs and investment in innovation activities[52]'. More specifically, the SMEG facility under CIP sets out to:

- reach 315 750 SMEs[53];
- guarantee loans that finance SMEs' innovative investments[54] or are provided to SMEs lacking sufficient collateral; and therefore
- enhance access to finance where the market fails.

75. The following analysis was based on a review of the loan sample selected by the Court[55]. As regards investments in certain knowledge-related activities such as technological development, innovation and technology transfer, reference is made to the OECD Oslo Manual for the measurement of scientific and technological activities[56].

[52] CIP Decision, Article 10.

[53] Annex to the Proposal for a Decision of the European Parliament and of the Council establishing a Competitiveness and Innovation Framework Programme (2007–13), SEC(2005) 433.

[54] Relevant only for the loan window. CIP Decision, Article 19.2 refers to 'investments in certain knowledge-related activities such as technological development, innovation and technology transfer'.

[55] A sample of 181 loans was selected from the nine financial intermediaries visited. The number of loans chosen per intermediary reflecting the achieved guarantee volume and was limited to a range from 10 to 45.

[56] 'The OSLO Manual, Proposed guidelines for collecting and interpreting technological innovation data', OECD, 1997, also referred to in recital 8 preceeding the CIP Decision and in the European Commission's 2009 impact assessment guidelines — SEC(2009) 92.

The overall target of reaching 315 750 SMEs is attainable

76. All financial intermediaries visited clearly targeted SMEs and all had procedures in place to verify the SME status of the borrower.

77. As regards the overall target of reaching 315 750 SMEs[57], the Commission and the EIF made a successful effort to overcome the consequences of the initial delay (see paragraph 32) by concentrating on the larger financial intermediaries. In the three years since the CIP came in force, the EIF has signed 25 deals with 21 financial intermediaries (see ***Table 2***). At the end of 2009, the total guarantee cap amount[58] of these guarantee agreements stood at 191,1 million euro, representing 37,5 % of the overall budget for the SMEG facility. The financial intermediaries had provided loans to almost 59 000 SMEs, representing 19 % of the target number of SMEs. Taking into account the results from the MAP, the signed guarantee agreements reach more than half of the target number of SMEs (57,4 %) if the maximum portfolio amount is reached for each of these agreements[59] (see ***Figure 3***). Therefore, the progress in implementation is sufficient to expect that the overall target of reaching 315 750 SMEs will be attained.

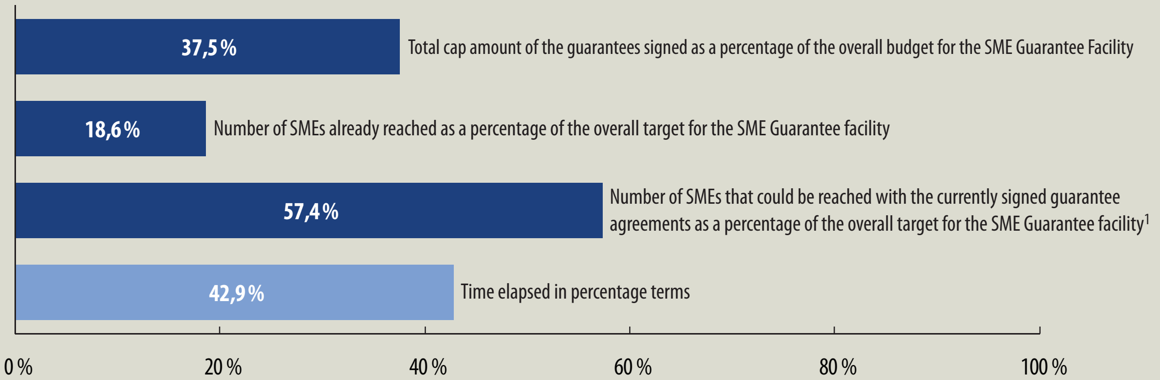
[57] As provided in the CIP impact assessment, SEC(2005) 433.

[58] The cap amount represents the ceiling of the costs for the EU budget and will materialise only if the financial intermediary reaches the maximum portfolio amount and realises the expected losses on the loan portfolio.

[59] For instance under the MAP, only two out of 45 financial intermediaries reached less than 90 % of the maximum portfolio amount.

FIGURE 3

OUTPUTS OF THE SMEG FACILITY UNDER CIP AS AT THE END OF 2009



[1] Calculated by the Court assuming the same average costs to the EU budget for reaching one SME as in the MAP programme (1 055 euro) and that the maximum portfolio amount is reached for all existing guarantee agreements.

Source: European Court of Auditors.

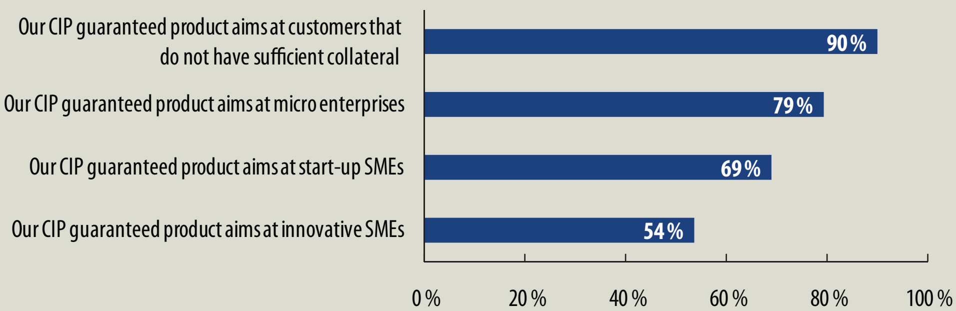
The facility reaches SMEs which lack collateral; innovative projects are scarce

78. The SMEG facility is designed to enhance access to debt funding for SMEs that have viable projects but are unable to secure a loan from commercial lenders. Such a situation can occur if an SME does not have sufficient collateral to fulfil the requirements of a commercial lender. Alternatively, the SME can be denied access to loan financing if the commercial lenders are not in a position to easily estimate the viability of the business proposition, as might be the case for innovative investments. The more novel the investment, the less likely it is that a loan will be granted.

79. Based on the responses to the Court's questionnaire, the CIP financial intermediaries aimed to target primarily SMEs without sufficient collateral, secondly micro enterprises and then start-ups. The innovative SMEs represent the category that is least targeted. While 90 % of the intermediaries agreed with the statement that their CIP-guaranteed product was aimed at customers that did not have sufficient collateral, only approximately half of the intermediaries agreed with the statement that their CIP-guaranteed product was aimed at innovative SMEs (see ***Figure 4***).

FIGURE 4

SURVEY OF FINANCIAL INTERMEDIARIES — SMEs TARGETED BY THE GUARANTEE/LOAN PRODUCT



The CIP financial intemediaries had to indicate on a 5-point scale their level of agreement with these four statements. The percentage in the chart indicates the portion of the respondents that either agreed or strongly agreed with the statement. The number of responses provided to each of these questions slightly varied from 28 to 30 out of 31 financial intermediaries either participating or planning to participate in the CIP.

Source: ECA questionnaire to the financial intermediaries.

80. The analysis of the loan sample shows that SMEs with a lack of collateral benefited more often than SMEs that were carrying out innovative investments. Out of the 181 loans in the sample, 77 loans (43 %) were provided to SMEs that lacked sufficient collateral to gain access to finance through existing commercial lending. Only 22 loans (12 %) were used to finance projects that had innovative aspects (see ***Table 5***).

81. Although innovative investments were rare, the loan sample included some highly innovative investments. Half of the innovative projects (11 out of 22) were assessed as market-new or world-new types of innovation. These projects aimed at creating new or significantly improved products, production processes or delivery methods that were new at least for the operating market of the enterprise. For an example of such an investment, see ***Box 5***. The remaining innovative investments could be described as a novelty only for the enterprise concerned, and were already being implemented by other firms that were directly competing with the borrower.

TABLE 5

RESULTS OF THE LOAN ANALYSIS IN TERMS OF NUMBER OF LOANS AND PERCENTAGE OF SAMPLE SIZE

	SMEs that lack sufficient[1] collateral	SMEs with sufficient collateral	Lack of collateral not demonstrated	Total
Loans used to finance innovative investments	7 4 %	12 7 %	3 2 %	22 12 %
Loans used to finance projects without significant innovative element	70 39 %	69 38 %	20 11 %	159 88 %
Total	77 43 %	81 45 %	23 13 %	181 100 %

[1] In the cases where a financial intermediary defined the level of sufficient collateral or this level could be implicitly deduced, this was applied to determine the 'sufficiency' of the collateral. In the remaining cases, an SME was considered to possess sufficient collateral if the loan amount did not exceed 70 % of the value of realisable assets. In the latter category, other factors which increased the risk profile of the SME were also taken into account (e.g. loans to unemployed) and as a result these SMEs were considered as 'SMEs that lack sufficient collateral'.

Source: European Court of Auditors.

82. However, for 23 loans no assessment could be made regarding the reported lack of collateral due to the absence of information at the financial intermediaries.

Financial intermediaries strive for additional lending volumes, but more attention could have been paid to deadweight

83. In guarantee schemes, 'deadweight' occurs if the borrower could have obtained the loan from commercial lenders without public support. In such situations, the effects, such as creation of jobs, economic or innovation activity, would have been realised anyway. Publicly supported guarantee schemes are most effective when the financed investment would otherwise not have been carried out, and the desired effects would not have been realised.

84. To ensure that the SMEG facility provides additional access to finance for SMEs, the Commission has developed 'Guidance on enhanced access to finance'. This aims to ensure that the financial intermediary can use the portfolio guarantee only after the actual lending volume exceeds the lending volume that the intermediary would have achieved without the guarantee. This concept of additionality is simple to use and can be easily embedded into the guarantee agreement.

BOX 5

EXAMPLE OF AN INNOVATIVE PROJECT

The entrepreneur did not have sufficient collateral to secure a normal commercial loan of 40 000 euro. However, in his previous job as a researcher he had acquired significant knowledge about the production of vinegar. He therefore used the guaranteed loan to start up a company producing high-quality vinegar. The production process used specifically cultivated bacteria that made the fermentation process more stable. The resulting vinegar had a better taste and higher sugar content — qualities appreciated by consumers. The company's operating market was regional and there were no other competitors using the same production process.

85. However, additionality does not ensure that the additional volume at the level of the financial intermediary is also additional at the level of the economy. In the context of the SMEG facility, it is considered that deadweight occurs if guarantees are provided for loans to SMEs with sufficient collateral and without innovative investments. However, when providing assistance on a portfolio basis, a certain level of deadweight is inevitable. The loan analysis revealed deadweight in more than a third of the loans in the sample (38 %, 69 out of 181, see ***Table 5***). Other things being equal, these borrowers could have obtained the loans from commercial lenders without the SME guarantee. A survey of the MAP borrowers conducted by the interim evaluator showed a similar level of deadweight[60].

[60] 'The survey results indicate that two out of three companies would not have undertaken the project without the guaranteed loan, or would have done less. Only one out of three companies surveyed responded that they would have either set up the business or undertaken the project even without the guaranteed loan.'

Specific lending conditions

86. Each guarantee agreement between the EIF and the financial intermediary contains a standard clause listing the principles of enhanced access to finance (see paragraph 54) for the benefit of SMEs without collateral or with innovative investments. There is not always a clear indication as to how the financial intermediary intends to target them. Some financial intermediaries used specific lending conditions to attract such SMEs, thus minimising deadweight (see ***Box 6***).

BOX 6

LENDING CONDITIONS TO ATTRACT EITHER INNOVATIVE SMEs OR SMEs WITHOUT SUFFICIENT COLLATERAL

- The guaranteed loans can be provided only to start-ups and SMEs with a short business history
- Ceiling on the loan amount
- Providing non-monetary benefits to the SMEs[61] so that the guaranteed loans are not cheaper than non-guaranteed loans
- Higher guarantee rates for investments that are innovative or constitute to some extent a novelty

[61] Such as reduced collateral requirements, accelerated credit decisions and fixed interest rates.

87. While the first three lending conditions will lead to automatic preference for borrowers that lack collateral, the last condition will probably increase the interest of innovative SMEs. The relative absence of lending conditions geared towards innovative SMEs may explain the low number of innovative investments found in the sample (see ***Table 5***).

EUROPEAN ADDED VALUE

88. As all the fields covered by the CIP are the shared responsibility of the Member States and the Community[62], the SMEG facility also has to respect the subsidiarity principle stipulated in Article 5 of the Treaty. EU actions not falling within the exclusive competence of the Union, such as the SMEG facility, should be undertaken only if, and in so far, as the objectives of the proposed action cannot be sufficiently achieved by the Member States, but can rather, by reason of the scale or effects of the proposed action, be better achieved at the EU level.

89. The concept of subsidiarity is reiterated in a recital preceding the CIP decision[63], in the CIP proposal[64] and in the CIP impact assessment[65]. In essence, the arguments used by the Commission in favour of the EU dimension of the financial instruments can be grouped under two headings:

- ensuring coherence in implementation; and
- the global nature of competition and innovation.

THE SMEG FACILITY MAY HAVE SIZEABLE NON-MONETARY BENEFITS FOR AN INTERMEDIARY; HOWEVER CONSISTENCY OF IMPLEMENTATION IS NOT ACTIVELY STRIVEN FOR

90. In its CIP preparatory documents, the Commission argued that the European dimension would ensure diffusion of good practice in the delivery of financial instruments, including the SMEG facility. Although similar measures exist in some Member States, the Community intervention will contribute to the consistency of implementation.

[62] The Commission derived the legal bases of the CIP from Articles 172, 173(3) and 192(1) of the Treaty on the Functioning of the European Union (consolidated version after Lisbon Treaty).

[63] CIP Decision, recital 62.

[64] COM(2005) 121 final, 6.4.2005.

[65] SEC(2005) 433, 6.4.2005.

91. Several cases were found in which the financing from the EU budget was crucial, not only as a partial coverage of the credit losses, but also because it allowed the intermediary to try something new. In two instances the SMEG facility helped with the development of guarantee or lending products that were new to the intermediary. For one of them, multiple attempts had to be made until the product gained sufficient recognition from the on-lending banks and the clients. It can be assumed that the product would not have been developed if the EIF and the Commission had not repeatedly collaborated with that intermediary. Furthermore, cooperation with the EU institutions may help smaller private financial intermediaries especially to gain recognition among the on-lending banks and/or their clients.

92. This is corroborated by the result of the questionnaire sent to the financial intermediaries. Six out of 31 CIP intermediaries[66] have developed a new loan or guarantee product and 16 out of 31 have significantly modified their existing products to participate in the CIP.

93. The SMEG facility increases the visibility of EU support among financial intermediaries. The audit visits showed that awareness of the EU guarantees among SMEs was not very high. However, actively driven attempts to ensure consistency between the practices of different intermediaries were not observed. The EIF simply collects the information about the practices of the financial intermediaries, but does not question these practices. As has been shown in the case of lending conditions (see paragraph 86), a more active approach by the EIF might improve take-up of the facility by SMEs with innovative projects or insufficient collateral.

The SMEG facility increases the competitiveness of individual enterprises; this does not imply that EU added value is delivered

94. This aspect of EU added value is directly related to one of the CIP global objectives: ‘to foster the competitiveness of enterprises, in particular of SMEs’[67]. In the preparatory documents, the Commission argued that the competition European firms face is increasingly global and innovation is seen as a global phenomenon that is not successful and sustainable in a closed environment.

[66] Intermediaries that participate or plan to participate under CIP.

[67] CIP Decision, Article 2.

95. The loan analysis showed that the SMEG facility does indeed help individual enterprises to increase their competitiveness. It was found that 74 out of 181 loans (41 %) were directly used to increase the enterprise's competitiveness[68]. The SMEG facility delivers many other valuable results in relation to the creation of a more competitive environment. It enables small start-ups — mainly in the service sector — to emerge. Out of the 181 loans in the sample, 26 loans (14 %) were used to start a new business and 15 loans (8 %) were used to finance post-start-up expansions of the business[69]. It also helps to maintain the competitive landscape allowing individuals to become entrepreneurs by buying an existing SME (47 loans, 26 %).

96. However, the EU added value of these results is not conclusive as the same effects could be achieved with funding from national budgets. For instance, the Commission[70] gives three suggestions on how an EU policy may impact competitiveness at the EU level[71]. The EU policy might:

- have an impact on the competitive position of EU firms in comparison with their non-EU rivals;
- stimulate cross-border investment flows, including relocation of economic activity; or
- be necessary to correct undesirable outcomes of market processes in European markets.

97. None of these effects were observed during the audit. The loan analysis confirmed that most of the SMEs are operating in local, regional or national markets. Nineteen out of 181 loans (10 %) were provided to SMEs that had some cross-border activities and 13 loans (7 %) were used for investments that had a significant cross-border element[72]. The scarcity of cross-border activities is not surprising given the types of businesses of the SMEs in the sample (for an overview, see ***Figure 5***): 17 restaurants, eight taxi drivers, 41 small retail shops (bakery, butcher, newspaper shop or supermarket) or 17 craftsmen (carpenter, electrician, mason or roofer). Given these examples of borrowers whose businesses are usually local, the need for EU intervention is not sufficiently demonstrated.

[68] The enterprise's competitiveness was deemed to have increased if the business plan included information that the investment would either:
- increase the enterprise's production capacity of goods or services; or make it more efficient;
- increase its market share;
- increase its exports;
- increase the performance/training of its staff;
- lead to more productive use of information technology; or
- improve the marketing of its products or services.

Start-ups were considered separately as always increasing the competitive landscape.

[69] Post start-up expansion means an expansion of the business within three years after the start-up.

[70] Commission Staff Working Paper 'Impact assessment: Next steps — In support of competitiveness and sustainable development', SEC(2004) 1377.

[71] Also mentioned in SEC(2005) 791.

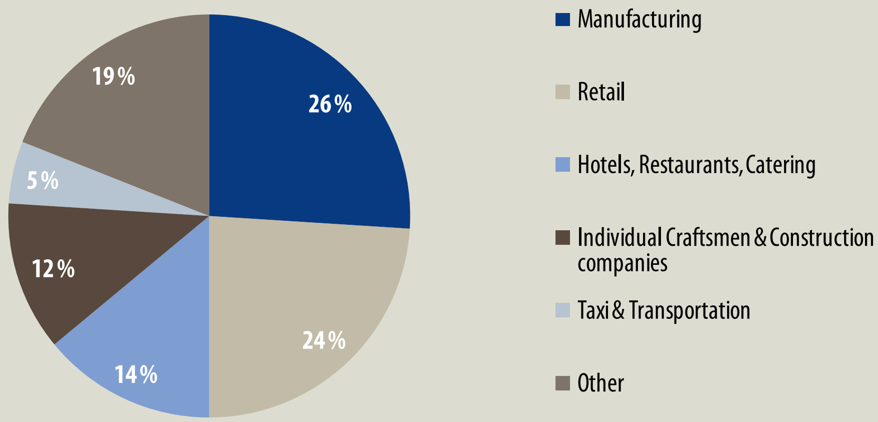
[72] The cross-border element was deemed significant if the aim of the investment was to increase production abroad, expand into markets abroad or create new business relations with foreign counterparts (e.g. suppliers).

98. Indeed, the scale of the individual guarantee deals does not go beyond national borders. In essence the SMEG facility operates as a set of national guarantee schemes, because there are significant differences between the national debt markets[73]. These differences are caused by cultural as well as legal constraints and are so significant that the debt markets can be considered to be purely national.

[73] Also noted for instance by the ECB, 'The financing of small and medium-sized enterprises in the Euro area', ECB Monthly Bulletin, August 2007, p. 77.

FIGURE 5

LOAN ANALYSIS — TYPES OF BUSINESSES



Source: European Court of Auditors.

CONCLUSIONS AND RECOMMENDATIONS

Design of the SMEG facility

99. Although no explicit intervention logic was provided in the CIP preparatory documents for the SMEG facility, an implicit intervention logic can be found in the different preparatory documents of the CIP Decision. However, there is no conceptual link between the problem at stake and the expected results and impacts as presented before the start of the intervention. Although the objectives are now more precise than under the previous MAP programme, they are only specific, measurable, achievable and timed in relation to the expected outputs.

RECOMMENDATION 1

Future SME support programmes should be based upon an explicit intervention logic linking the inputs to the expected outputs, results and impacts.

Setting the management structure

100. Overall an appropriate framework has been established for the management of the SMEG facility. The fee structure has been improved compared to MAP by adding performance-triggered incentives. However, delays in the planning of the facility prevented effective budget allocation during the first year and caused an interruption of the support for some financial intermediaries.

RECOMMENDATION 2

For the purpose of planning any subsequent facility, the Court recommends finalising the legal basis and the management agreement well before the effective start of the programming period in order to have time to select adequate financial intermediaries and to complete contract negotiations with them by the effective start of the programming period, thus avoiding the need to have recourse to any retroactivity clause in the future.

Selection of financial intermediaries

101. The Commission devised appropriate procedures for the selection of financial intermediaries. However, no scoring standards were established to rate the applications from the different potential intermediaries and no minimum requirements are defined for the different selection criteria. Weaknesses were found in the documentation of the parameters setting in the guarantee agreements with financial intermediaries.

RECOMMENDATION 3

To enhance the transparency of the selection, a scoring system for the assessment of potential intermediary applications should be put in place for any successor programme. Minimum requirements should be defined for the selection of financial intermediaries. The calculation of the parameters in the guarantee agreements should be documented in greater detail.

Performance monitoring and reporting

102. Sufficient output indicators were established which were used to report on SMEG's implementation. The data for the only impact indicator which refers to the 'number of jobs created' is difficult to collect and, due to varying calculation methods, not comparable between countries. Reporting requirements are clear and not perceived as a burden by a majority of the financial intermediaries participating in SMEG.

RECOMMENDATION 4

The Commission should consider the scope for creating additional or better performance indicators in order to monitor better the achievements of the facility's objectives and draw appropriate conclusions.

Achievements of the SMEG facility

103. The only quantified target, that of reaching 315 750 SMEs, is likely to be achieved. The analysis of the Court's sample of loans showed that less than half of the loans (43 %) were given to SMEs that had a lack of sufficient collateral and only 12 % used the loans for innovative investments. The loan analysis revealed a deadweight of 38 %, i.e. loans made to SMEs with sufficient collateral and not using them for innovation.

RECOMMENDATION 5

The Commission should in future set more specific targets which better reflect the objectives of the financial instrument. During the lifetime of the instrument monitoring should measure progress towards achieving such targets, allowing remedial action to be taken as necessary. Appropriate measures to minimise deadweight should be envisaged, drawing inter alia on best practices already in place at certain intermediaries.

104. The SMEG facility enabled some financial intermediaries to develop and offer new lending or guarantee products, but no active identification and dissemination of good practices is undertaken. The EU added value of SMEG is not demonstrated as the results from SMEG might also have been achieved by funding under national schemes. Significant cross-border investments or effects of the SMEG loans were not observed.

RECOMMENDATION 6

As the Court emphasised in the past, expenditure from the Union budget must offer clear and visible benefits for the EU and for its citizens which could not be achieved by spending only at national, regional or local levels [74]. The Budgetary Authorities and the Commission should therefore consider how EU added value could be maximised in any successor to the SMEG facility.

[74] 'Response by the European Court of Auditors to the Commission's communication 'Reforming the budget, Changing Europe' (paragraphs 7 to 9), and Opinion 1/2010 'Improving the financial management of the European Union budget: Risks and challenges' (paragraphs 18 and 19).

This report was adopted by Chamber IV, headed by Mr Igors LUDBORŽS, Member of the Court of Auditors, in Luxembourg at its meeting of 22 March 2011.

For the Court of Auditors

Vítor Manuel da SILVA CALDEIRA
President

ANNEX I

OVERVIEW OF THE CIP STRUCTURE DOWN TO THE SME GUARANTEE FACILITY

CIP structure: 3 pillars Budget 2007 to 2013: 3 621 million euro		
i. EIP: Entrepreneurship and Innovation Programme	ii. IEE: Intelligent Energy Europe	iii. ICT: Information and communication technologies policy

EIP: Entrepreneurship and Innovation Programme (2 172 million euro)			
i. Financial instruments	ii. Enterprise Europe Network: Services in support of business and innovation	iii. Innovation and eco-innovation pilot and market replication projects	iv. Policy analyses, development, coordination and twinning

Financial instruments (1 130 million euro)		
i. SMEG facility	ii. High Growth and Innovative facility (GIF)	iii. Capacity-Building Scheme (CBS)

SME Guarantee facility (510 million euro) 4 different guarantee windows:			
i. Loans and leases	ii. Microcredit	iii. Equity and quasi-equity guarantee	iv. Securitisation

MONITORING BY THE COMMISSION AND THE EIF

1. The Commission performs:

- monitoring of the EIF to assess the management of the SMEG facility. This includes a review of:
  - the EIF checks on portfolio inclusion;
  - the guarantee calls; and
  - the EIF's findings during its on-site visits to financial intermediaries.
- monitoring of financial intermediaries and SMEs. This includes:
  - visits to financial intermediaries. The visits include a review of systems in place in order to ensure compliance with the Guarantee Letter and the FMA; a review of the implementation progress of the facility by the financial intermediary; review of the systems put in place by the financial intermediary to implement the facility; a compliance check of a sample of SME loans or guarantees (transactions);
  - visits to SMEs; and
  - a SMEG employment survey, the purpose of which is to check compliance with the requirements as per FMA.
- other monitoring tasks such as a review of the EIF quarterly fee.

2. The EIF mainly checks:

- the data collected from financial intermediaries using plausibility tests;
- through on-site monitoring visits to financial intermediaries:
  - the quality of the reporting process;
  - the guarantee payment and recovery processes; and
  - the process relating to the verification of the eligibility criteria for portfolio inclusion.
- the financial intermediary's payment demand by cross-checking the consistency of the data reported by the financial intermediary during its quarterly reporting and the information provided in the payment demand. Based on a sample, additional substantive tests are performed using supporting documents provided by the financial intermediaries to ensure the validity of the defaulted financing.

ANNEX III

REPORTING BY THE FINANCIAL INTERMEDIARIES TO THE EIF

The financial intermediaries' reporting[1] to the EIF is structured as follows:

- Part A is related to new operations (quarterly reporting):
  - borrowers — tax code, name, address, postal code, place, region, country, data of establishment, economic sector, legal status, current number of employees, comments; and
  - loans — tax code, loan reference, currency, purpose of financing, investment amount, tangible assets, intangible assets, working capital, loan amount, loan maturity, grace period, loan signature date, first disbursement date, comment.
- Part B is related to the list of information included (quarterly reporting):
  - tax code, loan reference, currency, total reduction loan amount, final outstanding loan amount, end of disbursement period.
- Part C is related to the guarantees calls (quarterly reporting):
  - tax code, loan reference, default occurred date, currency, default amount, recoveries amount, interests accrued, loss.
- Part D is related to the expired loans (quarterly reporting):
  - tax code, loan reference, repayment date.
- Part E is related to cancelled loans (quarterly reporting):
  - tax code, loan reference, type of cancellation.
- Part F is related to modifications (quarterly reporting).
- Part G is related to employment report (yearly reporting).

[1] This summary is based on the EIF document 'Manual for compiling reports under the SMEG facility 2007–2013'.

REPLY OF THE COMMISSION

EXECUTIVE SUMMARY

III.

The SMEG under the Competitiveness and Innovation Framework Programme (CIP) built on extensive experience from the Multiannual Programme for Enterprise and Entrepreneurship (MAP), validated by external evaluators who recommended the continuation of the programme with its diversity of instruments. It was therefore not considered necessary, either by the Commission or the Budgetary Authority, explicitly to state the intervention logic, since loan guarantees are accepted to be a highly effective and efficient way to address the policy objectives.

There is no doubt that the best practices for extended impact assessments have evolved since the time when the CIP extended impact assessment was carried out, back in 2005. The Commission services will strive to apply higher standards and to address the Court's concerns in the preparation of any successor to SMEG.

The Commission is fully aware of the benefit of clear and meaningful indicators and in 2009 commissioned an evaluation to review the indicators. The proposals made — based on a thorough review of the intervention logic — have already been implemented and constitute an improvement that should address some of the Court's concerns.

REPLY OF THE COMMISSION

IV.
The Commission welcomes the Court's positive evaluation of the management of daily operations.

The Commission will further consider whether it would be appropriate for the EIF to use a scoring system in order to define a minimum score level.

However, in the pre-selection process of assessing an application, the EIF requires intermediaries to meet minimum standards as regards the sufficiency of information provided.

VI.
The Commission shares the Court's view that the target number of SMEs to be reached is attainable.

'Deadweight' should not be seen as synonymous with inefficient budget allocation.

SMEG guarantees are provided on a portfolio basis, as opposed to a loan-by-loan guarantee.

The CIP programme is addressing potential deadweight issues in its design by requiring an intermediary to do more than it would do without the CIP guarantee, as the guarantee is conditional upon the intermediary exceeding the reference volume. The latter is defined as the estimated volume of finance that the intermediary would provide in the absence of the CIP guarantee. The Commission nonetheless agrees that appropriate measures to minimise deadweight (see point VII below) should be envisaged in any successor programme.

The Commission takes note of the Court's figures. According to recent telephone interviews of SMEG beneficiaries, carried out in the context of the ongoing EIP evaluation, the percentage of those who innovated is significantly higher.

The Commission believes that there is a strong presumption in favour of EU added value being present, as observed by the independent evaluation of SMEG under the MAP (final evaluation). This presumption was also accepted by the Budgetary Authority and confirmed by its adoption of the legal basis.

VII.
The Commission accepts the recommendation that in any similar future intervention the EU added value should be maximised. It is already being taken into account in the discussions and planning for the next generation of financial instruments in the post-2013 Multiannual Financial Framework, where 'ensuring EU added value' is one of the key principles that must be respected by all proposed instruments.

REPLY OF THE COMMISSION

AUDIT FINDINGS

17.
The SMEG under CIP built on extensive experience from a previous programme (MAP), validated by external evaluators who recommended the continuation of the programme with its diversity of instruments except the ICT loan window which was closed. It was not considered necessary, either by the Commission or the Budgetary Authority, to explicitly state the intervention logic, since loan guarantees are accepted to be a highly effective and efficient way to address the policy objectives.

19.
Please see reply to observation 17. The SMEG seeks to improve the financial environment for SMEs, expand the volume of lending to SMEs and, as far as possible, provide better loan conditions than would otherwise be possible.

It is true that for high growth and technology and research-orientated newly established enterprises equity financing is the preferred instrument. However, loan financing is an appropriate complement to equity financing to optimise the growth of the specific enterprise. Moreover, loan financing is more relevant to most enterprises than equity, since it is usually cheaper, less difficult to access and does not require the entrepreneur to give up partial control of the enterprise. Therefore, this diversity of instruments is based on a notion of complementary nature of instruments over the life cycle of an enterprise.

22.
The SMEG under CIP built on extensive experience from a previous programme (MAP), validated by external evaluators. Therefore, it was felt that, for the financial instruments, the CIP impact assessment was sufficient, given that these instruments were effectively a continuation of a successful predecessor programme and there was already broad support for them within the Budgetary Authority. In this context it is not clear why an even more extensive impact assessment would have added value.

There is no doubt that the best practices for extended impact assessments have evolved since the time when the CIP extended impact assessment was carried out, back in 2005. It is equally clear that the Commission services will strive to apply higher standards and to address the Court's concerns in the preparation of the CIP successor programme.

The Commission is fully aware of the benefit of clear and meaningful indicators and in 2009 commissioned an evaluation to review the indicators. The proposals made — based on a thorough review of the intervention logic — have already been implemented and constitute an improvement that should address some of the Court's concerns.

25.
The Commission shares the view of the Court that the facility will support more than 315 750 SMEs. Given the current high take up of the facility, this target might even be exceeded.

REPLY OF THE COMMISSION

26.
The objectives were set by the legislative authority in a way that allows implementation in a number of individual markets with differing needs (for example, focus on start-ups, increased lending, etc.), as well as the flexibility to respond to changing market conditions during the programming period. The concept of innovation reflects the best practices according to the OECD Oslo Manual as referenced in the CIP Decision.

29.
The Commission welcomes the Court's appreciation of the EIF's expertise.

31.
In 2006 and 2007, the Commission debated internally a number of key issues relating to the performance of the facility including the parameters of enhanced access to finance.

Both the Commission and EIF found it necessary to address in detail and reassess a large part of the delivery of the facility and these new measures are reflected in the FMA under the CIP SME Guarantee facility.

However, MAP agreements could be signed until the end of 2006 with availability periods lasting up to December 2008, which for many intermediaries covered at least part of the gap between MAP and CIP.

32.
Please see our reply to observation 31.

33.
The average period does not reflect the average duration of the whole process for all intermediaries, but is based on nine intermediaries whose applications were processed by the EIF at the start of the programme. It is true that the first applications were treated over a relatively long period, for a number of reasons (for example, modification of an initial application in close cooperation with the FI; waiting for FIs to reply or submit requested information; negotiations of the guarantee agreement between the EIF and FI). It should be noted, however, that once the initial backlog was cleared, the applications were expedited in a short timeframe. In 2010, the average time from application to signature dropped and is six months on average.

In addition, the Commission would like to point out that application-to-signature periods do not reflect certain key factors relevant for the assessment of the efficiency of the application process:

1. The initial application of an intermediary is rarely a basis for further concrete work — more information needs to be received from intermediaries to continue due diligence and advance concrete work further.

2. Regarding the requirement for enhanced access to finance, it should be noted that, often, the portfolio proposed by the intermediary undergoes substantial changes during the deal analysis and negotiation, which can absorb considerable additional time.

REPLY OF THE COMMISSION

3. Intermediaries often need additional time to set up the operational implementation — the signature date can be delayed by agreement in order to give them time to prepare before the start of the period during which SME loans can be included into the portfolio (referred to as the availability period).

34.
The Commission and the EIF have no indications that the facility has suffered as a result of the delay in launching it. On the contrary, the improved management structures, together with efforts undertaken to streamline the approval process, have yielded positive results in terms of smoother processing of EIF submissions.

36.
The retroactivity clause was introduced to minimise the time gap between MAP and CIP for the intermediaries who wanted to continue with their SME programmes under the CIP programme (which was already published). The concept of equal treatment is only applicable to equal cases. It does not entail the same treatment of cases that are objectively different. As regards new financial intermediaries, there was no such time gap to be covered by a retroactive inclusion of loans. The Commission examined the legal implication of the possibility of a retroactive application of the CIP SMEG, and concluded that equal treatment for new financial intermediaries is ensured via the availability periods of the same duration.

41.
The Commission welcomes the Court's positive assessment of the management structure.

45.
Following the financial crisis, there have been almost no securitisation transactions since 2008. It is therefore not surprising that the demand for this specific SMEG window has been non-existent. However, now that the securitisation market is picking up slightly, a first CIP securitisation is being examined by the EIF and one national promotional bank is asking for CIP participation to open up the securitisation market for SME loan portfolios. In addition, the first transaction under the equity window was approved in September 2010 by the EIF board and in October 2010 by the Commission.

50.
The EIF works with clear selection guidelines as agreed with the Commission (Annex 1 to the FMA) to implement the mandate under an open call and, as mentioned by the Court in paragraph 29, the EIF has the necessary expertise.

The Commission wishes to point out that in the pre-selection process of assessing an application the EIF requires intermediaries to meet minimum standards as regards the sufficiency of information provided as described below.

The pre-selection procedure is a formal selection by the guarantee transaction team based essentially on the quality of the application with respect to the eligibility and selection criteria. Furthermore, each proposal is subject to an independent opinion from the EIF's risk management, a compliance opinion and a formal pre-Board review meeting including all relevant EIF services.

The Commission, however, will further consider whether it would be appropriate for the EIF to use a scoring system in this kind of call procedure in order to define a minimum score level for any successor programme.

REPLY OF THE COMMISSION

53.
The CIP approval requests contain a detailed analysis of the volumes and the basis and methodology of determining the proposed cap rate (see also reply to paragraph 63 below). These are the result of extensive exchanges with the intermediary, inter alia, as the exact additionality is being refined and the relevant past volumes and losses need to be extracted by the intermediary. This also includes volumes achieved and losses reported under prior agreements, if any, which are available within the EIF.

In addition, this is only one input, as the cap rate needs to consider future developments (e.g. effects of additionality on expected losses, expected economic changes). This is detailed in the request for approval to the EIF`s Board of Directors.

The EIF performs plausibility checks on the information provided by intermediaries and draws on its extensive SME credit risk knowledge in various European markets. As many intermediaries have been working with the EIF for a number of years under previous SMEG agreements, EIF has volume and loss data available for these intermediaries, although these are not the sole parameters considered by the EIF.

The Commission will consider with the EIF how the documentation of the setting of the parameters could be further improved for any successor programme.

55.
The guarantee terms are in compliance with the Fiduciary and Management Agreement between the Commission and the EIF (FMA) which reflects the broader objectives of the legal basis. The examples provided by the Court reflect specific agreements for these deals.

The CIP objectives include: 'to foster the competitiveness of enterprises, in particular SMEs'; and 'to promote all forms of innovation including eco-innovation'. Furthermore, SMEG is meant to: improve access by existing SMEs to loan finance; respond to the changing financing needs of SMEs; support access to finance for the start-up and growth of SMEs and investment in innovation activities; and support the cross-border expansion of their business activities.

The introduction of too restrictive requirements regarding the final beneficiaries would not be consistent with the broad policy objectives and would be detrimental to the implementation of the programme. It might also have adverse consequences for the efficiency of the programme:

1. cumbersome procedures for the lending institution to rigorously screen and document the lack of collateral;

2. the foregoing of the benefits of portfolio (of loans) diversification;

3. the increase in default probabilities and expected losses resulting in higher budget needs, lower leverage and lower efficiency.

REPLY OF THE COMMISSION

62.
The change of indicators has been requested by the representatives of the Member States at the EIP management committee and the Commission complied with this request. In addition please note that the *ex ante* evaluation clearly states that these indicators are subject to review and updating.

63.
The Commission assesses the development of the programme not only on the basis of the indicators, but also taking into account the number of countries covered, the number of intermediaries signed each year, the volume of the underlying portfolios and significant amount of additional information provided in the context of EIF reporting.

As the EIP management committee is regularly updated on the above, the monitoring of the development of the programme is ensured. The Commission considers that rather than setting yearly targets, it is more important to see the long-term development and, as the Court states in paragraph 103, the target regarding the number of SMEs reached 'is likely to be achieved'.

64.
The Commission accepts that there is a need for better measurement of the success of the programme. The Commission has accepted the indicators suggested by the evaluators and has commissioned a survey in the framework of the final evaluation of the EIP. Results will be delivered in mid-2011.

67.
Due to differing market and administrative realities the EIF may not impose one system for collecting such data. The Commission considers that employment data in such a programme is better assessed in the context of an evaluation.

An analysis of employment data was carried out by the independent evaluators in the context of the interim evaluation of the Entrepreneurship and Innovation Programme under CIP (data on MAP beneficiaries) and concluded that there was a 17 % growth in employment since receiving the loan guaranteed by the p-rogramme.

68.
The assessment of causality between the jobs and the new financing received by the SME is indeed a complex issue and the Commission agrees that this is best addressed in the context of an evaluation.

79.
The CIP objectives include: 'to foster the competitiveness of enterprises, in particular SMEs'; and 'to promote all forms of innovation including eco-innovation'. Furthermore, SMEG is meant to

1. 'improve access by existing SMEs to loan finances for activities that support their competitiveness and growth potential' (recital 27 of the legal basis),

2. 'respond to the changing financing needs of SMEs' (recital 29),

3. support 'access to finance for the start-up and growth of SMEs and investment in innovation activities' (Article 10.2(a))

4. support 'the cross-border expansion of their business activities' (Article 17.1)

REPLY OF THE COMMISSION

The Commission is pleased to note that the vast majority (90 %) of surveyed intermediaries agreed that CIP SMEG guarantees are aimed at customers with a lack of collateral which is in accordance with Article 19.2 first indent.

80.
The structure of Table 5 appears to be based on the assumption that for an SME to benefit from SMEG it should either lack collateral or be innovative. This is based on Article 19 of the legal basis taken in isolation. The Commission considers that the combined reading of recitals 20, 22 and 27 shows that the programme has a broader scope and aims at a wide range of SMEs, including their full life cycle (Articles 10 and 17 of the legal basis).

The Commission considers that, from a legal point of view, the SME Guarantee facility must be implemented in such a way to cover a wide range of SMEs, and not only innovative SMEs, in order to fully comply with the legal basis.

Innovation is one of the objectives described in the CIP legal basis, and the results of the survey clearly show that SMEG has supported innovation and this to a high degree. On the other hand, innovation is not the sole objective and there is no specific quota or target given in the legal basis nor any mandate regarding the percentage of investments that should be made in support of innovation.

As regards ***Table 5***, it is very difficult in any public programme to reach exactly and only the predefined clients. One would therefore also expect some deadweight in a programme like SMEG. The use that can be made of the figures presented on the SMEs that lacked sufficient collateral is limited by the fact that it is assumed that the documentation at the financial intermediary level was comprehensive and therefore fully represented the actual financial situation of the SMEs examined. It seems at least debatable whether a request for approval would contain any detailed analysis of assets that would not be proposed as collateral for the loan.

Finally, in the context of the ongoing EIP evaluation[1], external evaluators have carried out telephone interviews of 200 SMEs under the CIP SMEG loan guarantee window. According to the draft report, 65 % of the SMEG beneficiaries indicated that they have innovated with respect to strategy and business practices in the past three years, 61 % responded that they have been involved in product and/or service innovation and 50 % in process innovation.

81.
While innovation is only one of multiple objectives of CIP, it is positive to see that there were a number of market-new and world-new investments supported by SMEG.

The innovation goals of SMEG are not limited to market-new or world-new types of innovation and the importance of firm-only innovation should not be understated. Indeed, such innovation enables an enterprise to advance in line with its competitors, therefore achieving a core objective of CIP (competitiveness).

[1] 'Final evaluation of the Entrepreneurship and Innovation Programme, First findings and recommendations report', February 2011.

REPLY OF THE COMMISSION

82.
The documentation relating to the decision of the on-lending bank mentions the collateral offered to secure the financing. It should be noted that it is in the best interest of the loan applicant to offer as much collateral as possible to increase chances of a positive financing decision from the bank.

83.
Please see reply to observation 85.

85.
'Deadweight' should not be seen as synonymous with inefficient budget allocation.

SMEG guarantees are provided on a portfolio basis, as opposed to a loan-by-loan guarantee.

The CIP programme is addressing potential deadweight issues in its design by requiring an intermediary to do more than it would do without the CIP guarantee, as the guarantee is conditional upon the intermediary exceeding the reference volume. The latter is defined as the estimated volume of finance that the intermediary would provide in the absence of the CIP guarantee.

Furthermore, apart from the micro issue of whether or not an individual SME has enough collateral or is innovative, there is the macro issue of whether or not the intermediary will exceed the reference volume set. If the intermediary does not exceed this target, the facility will not provide guarantee support to the 'deadweight' component of the portfolio.

86.
The clause on the principles of enhanced access to finance sets out (mirroring the FMA) the main objectives of the facility, namely enhancing access to finance for SMEs, helping in cases of lack of sufficient collateral or innovative projects and stimulating job creation and growth of SMEs through additional provision of debt financing.

The clause is interpretive, not prescriptive — the specific additionality requirements are set out in the intermediary terms. In line with the FMA, there is always an increase in volume requested and, according to the specifics of the project set up together with the intermediary, there may be more specific clauses in the intermediary terms, for example qualitative additionality undertakings by the intermediaries to provide finance to riskier categories of SMEs, such as start-ups.

87.
Please see above replies regarding deadweight (paragraph 85) and regarding objectives of the programme (paragraph 26).

93.
The EIF does spread good practices, especially in countries with developing financial markets and developing guarantee schemes. It is not intended that the Commission and the EIF unilaterally impose guarantee conditions/practices. All the relevant information is carefully evaluated and tailor-made solutions are proposed to fit the economic situation, taxation regime and business practices in the relevant market.

As regards visibility, the Commission has carried out information activities in almost all participating countries to increase awareness of the SMEG and GIF. SME Finance Days were organised in 28 CIP participating countries, reaching out to a broad audience of intermediaries, SMEs and multipliers.

Common reply for 96, 97 and 98

The Commission believes that there is a strong presumption in favour of EU added value being present, as observed by the MAP final evaluation.

The 2004 external evaluation of the MAP concluded that: '*Both instruments demonstrate clear European added value which is both quantitative: they have allowed financial intermediaries to take more risk through investing (ETF Start-up) and guaranteeing (SMEG) larger volumes; and qualitative: MAP support and EIF signature have given "legitimacy" to funds supported and to some extent to SME final beneficiaries (ETF Start-up), and helped micro-enterprises to become "bankable" (SMEG Micro-credit)*'.

It should be further noted that the same external evaluation concluded that:

'*[...] in countries where EIF has worked with powerful national financial intermediaries,[...] there have been strong complementarities leading to particularly high added value [...] and cross-fertilisation*';

The outcome of this selection of cases could also be a reflection of the financial and economic crisis in 2008–10 (with the most severe recession since the Great Depression). The recession has meant that risk levels have increased and led to less investment in innovation by SMEs.

REPLY OF THE COMMISSION

CONCLUSIONS AND RECOMMENDATIONS

99.

The SMEG under CIP built on extensive experience from a previous programme (MAP), validated by external evaluators who recommended the continuation of the programme with its diversity of instruments (except the ICT loan window which was therefore closed). It was not considered necessary, either by the Commission or the Budgetary Authority, to explicitly state the intervention logic, since loan guarantees are accepted to be a highly effective and efficient way to address the policy objectives.

There is no doubt that the best practices for extended impact assessments have evolved since the time when the CIP extended impact assessment was carried out, back in 2005. It is equally clear that the Commission services will strive to apply higher standards and to address the Court's concerns in the preparation of the CIP successor programme.

The Commission is fully aware of the benefit of clear and meaningful indicators. This is illustrated by the fact that the Commission services took the initiative in 2009 to commission an evaluation to review the indicators. The proposals made — based on a thorough review of the intervention logic — have already been implemented and constitute an improvement that should address some of the Court's concerns.

Recommendation 1

The Commission accepts this recommendation, which is already being taken into account in the discussions and planning for the next generation of financial instruments in the post-2013 Multiannual Financial Framework.

REPLY OF THE COMMISSION

100.
In 2006 and 2007, the Commission debated internally a number of key issues relating to the performance of the facility, including the parameters of enhanced access to finance. Both the Commission and the EIF found it necessary to address in detail and reassess a large part of the delivery of the facility and these new measures are reflected in the FMA under the CIP SME Guarantee facility. However, MAP agreements could be signed until the end of 2006 with availability periods lasting up to December 2008, which for many intermediaries covered at least part of the gap between MAP and CIP.

In addition, the Commission and the EIF have no indications that the facility has suffered as a result of the delay in launching it. On the contrary, the improved management structures, together with efforts undertaken to streamline the approval process, have yielded positive results in terms of smoother processing of EIF submissions.

Recommendation 2
The Commission fully understands the reasoning behind this recommendation and agrees that it would be desirable to proceed in the way suggested by the Court. However, the timetable of the co-decision process for the legal basis means that the final content of the legal basis is usually not known until shortly before its entry into force. For this reason, while the Commission will do a significant amount of preparatory work in advance, it cannot be sure whether or not it has fully covered all aspects of the legal basis until the latter is formally adopted. The aim will be to have a possibly forthcoming programme operational at the start of the programme period.

101.
The EIF works with clear selection guidelines as agreed with the Commission (Annex 1 to the FMA) to implement the mandate under an open call and, as mentioned by the Court in paragraph 29, the EIF has the necessary expertise.

In the pre-selection process of assessing an application, the EIF requires intermediaries to meet minimum standards as regards the sufficiency of information provided as described below.

The pre-selection procedure is a formal selection by the guarantee transaction team based essentially on the quality of the application with respect to the eligibility and selection criteria. Furthermore, each proposal is subject to an independent opinion from EIF's risk management, a compliance opinion, and a formal pre-Board review meeting including all relevant EIF services.

The Commission, however, will further consider whether it would be appropriate for the EIF to use a scoring system for any successor programme in this kind of call procedure in order to define a minimum score level.

Recommendation 3
The Commission will further consider whether it would be appropriate for the EIF to use a scoring system for any successor programme in order to define a minimum score level.

As regards documentation of guarantee parameters, the Commission will further consider the need for any clarification of requirements, as well as any additional measures, regarding the EIF's documentation relating to calculations of parameters for the guarantee agreements.

REPLY OF THE COMMISSION

102.
The Commission agrees that the 'number of jobs created' is the more appropriate indicator to collect in the light of evaluation of the programme.

Recommendation 4
The Commission accepts this recommendation, which will be taken into account for any successor programme to the SMEG.

103.
Innovation is one of the objectives described in the legal basis, and the results of the telephone interviews carried out in the context of the ongoing EIP evaluation clearly show that SMEG has supported innovation. On the other hand, innovation is not the sole objective and there is no specific quota or target specified in the legal basis nor any mandate regarding the percentage of investments that should be made in support of innovation.

The Commission considers that a combined reading of recitals 20, 22 and 27 shows that the programme has a broader scope than that indicated by the Court. SMEG aims at a wide range of SMEs including their full life cycle (Articles 10 and 17 of the legal basis) and not only at innovative SMEs or those lacking collateral. This is reflected in its implementation.

'Deadweight' should not be seen as synonymous with inefficient budget allocation. SMEG guarantees are provided on a portfolio basis as opposed to a loan-by-loan guarantee.

The CIP programme is addressing potential deadweight issues in its design by requiring an intermediary to do more than it would do without the CIP guarantee, as the guarantee is conditional upon the intermediary exceeding the reference volume. The latter is defined as the estimated volume of finance that the intermediary would provide in the absence of the CIP guarantee. The Commission nonetheless agrees that appropriate measures to minimise deadweight should be envisaged in any successor programme.

Recommendation 5
The Commission accepts this recommendation, which will be taken into account for any successor programme to the SMEG.

104.
The EIF does spread good practices especially in countries with developing financial markets and developing guarantee schemes. It is not intended that the Commission and the EIF unilaterally impose guarantee conditions/practices. All the relevant information is carefully evaluated and tailor-made solutions are proposed to fit the economic situation, taxation regime and business practices in the relevant market.

The Commission believes that there is a strong presumption in favour of EU added value being present, as observed by the MAP final evaluation.

REPLY OF THE COMMISSION

The 2004 external evaluation of the MAP concluded that: 'Both instruments demonstrate clear European added value which is both quantitative: they have allowed financial intermediaries to take more risk through investing (ETF Start-up) and guaranteeing (SMEG) larger volumes; and qualitative: MAP support and EIF signature have given "legitimacy" to funds supported and to some extent to SME final beneficiaries (ETF Start-up), and helped microenterprises to become "bankable" (SMEG Microcredit)'.

It should be further noted that the same external evaluation concluded that:

'[...] in countries where EIF has worked with powerful national financial intermediaries,[...] there have been strong complementarities leading to particularly high added value [...] and cross-fertilisation';

The outcome of this selection of cases could also be a reflection of the financial and economic crisis in 2008–10 (with the most severe recession since the Great Depression). The recession has meant that risk levels have increased and led to less investment in innovation by SMEs.

Recommendation 6
The Commission accepts this recommendation, which is already being taken into account in the discussions and planning for the next generation of financial instruments in the post-2013 Multiannual Financial Framework, where 'ensuring EU added value' is one of the key principles that must be respected by all proposed instruments.

European Court of Auditors

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ONE OF THE FINANCIAL INSTRUMENTS ESTABLISHED UNDER THE COMPETITIVENESS AND INNOVATION FRAMEWORK PROGRAMME OF THE EUROPEAN UNION IS THE SME GUARANTEE FACILITY. IN THIS REPORT, THE COURT EXAMINES THE FACILITY'S DESIGN AND PLANNING, THE MANAGEMENT OF ITS OPERATIONS AND THE ACHIEVEMENT OF ITS OBJECTIVES IN ORDER TO ASSESS ITS EFFECTIVENESS. WHILE THE COMMISSION HAS ALREADY MADE SIGNIFICANT PROGRESS COMPARED TO THE PREVIOUS PROGRAMMES, FURTHER IMPROVEMENTS ARE RECOMMENDED CONCERNING THE DESIGN AND THE OPERATIONAL MANAGEMENT AND FOR MEASURING THE ACHIEVEMENTS OF THE FACILITY.

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