COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 24.10.2006
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2006/0203 (CNS)

Proposal for a

COUNCIL DECISION

on the Community participation in the capital increase of the European Investment Fund

(presented by the Commission)

[SEC(2006) 1347]

EXPLANATORY MEMORANDUM

1) CONTEXT OF THE PROPOSAL

- **Grounds for and objectives of the proposal**

The European Investment Fund (the Fund) was created in 1994. Its founder members are the European Community, represented by the European Commission, the European Investment Bank (EIB) and a number of financial institutions. The Community membership of the Fund is determined by Council Decision 1994/375/EC (OJ L 173, 7 July 1994, p. 12).

The Fund will exhaust its own resources by mid-2007 and will be unable to continue its own resources operations. Therefore, following an exhaustive examination of the outlook and alternatives by the Fund's Board of Directors, the Board proposes to increase the subscribed capital by 50% in nominal terms.

Article 3 of the Council Decision 1994/375/EC specifies that the position of the Community on a possible capital increase in the capital of the Fund and on its participation in that increase shall be decided unanimously by the Council, acting on proposal from the Commission and after consulting the European Parliament. Consequently, the purpose of this proposal for a Council Decision is to approve the 50% increase in the nominal capital of the Fund and Community participation in it. Following the adoption of the proposed Decision by the Council, and in line with the Statutes of the Fund, the General Meeting of the Fund would authorise the Fund to increase its capital by 50% in nominal terms. This new Council Decision would enable the Commissioner for Economic and Monetary Affairs to vote in favour of the capital increase at the Fund's General Meeting.

- **General context**

European venture capital markets must provide not only better access to equity for innovative SMEs in seed and start-up stages, but follow-on investments for SMEs in more mature stages to help businesses reach their full potential, bring their products and services to the market thus creating jobs and continue funding their research activity. With regard to the European banking sector, securitisation is widely seen as one of the possible answers to the problem for SME lending that may derive from the Basle II capital requirements which will be in place as of 2008. Since its creation, the Fund has been able to support around 270 000 SMEs through venture capital investments and portfolio guarantees in the European Union and accession countries. The EIB Risk Capital Mandate, the EIF/ERP[1] mandate initiated by the German Ministry of Economics and Labour and the Community mandates (notably ETF Start-up Facility, SME Guarantee Facility and Growth & Environment Scheme) have supported around 263 000 SMEs under the Fund's management.

While the Fund's operations have a high leverage effect, these have to be further developed to respond to the changing needs of all types of SMEs and to shifting market circumstances. The Fund plays an important role in addressing in a flexible

[1] European Recovery Programme

way persistent and well-identified market gaps that limit SMEs' access to finance, thus hindering their potential growth in all stages: creation, expansion and development. In the absence of the capital increase, the Fund would have to gradually scale down all new operations funded by its own resources. Due to its co-investment obligations under certain mandates, there would also be an impact on the mandate activity.

The Fund's capital increase falls within the framework of the Lisbon strategy and is considered as a further measure to those laid down in the Commission Communication "Implementing the Community Lisbon Programme: financing SME Growth – Adding European Value" COM(2006) 349, which includes measures to generate more risk capital investments, to develop bank finance for innovation and make existing financing systems more SME-friendly.

- **Existing provisions in the area of the proposal**

An Act amending the Protocol of the Statute of the EIB was adopted on 25 March 1993 (OJ L 173, 7 July 1994, p. 14) empowering the Board of Governors of the EIB to create the Fund. Article 4 of this amendment specifies that the European Community and financial institutions may become members of the Fund and contribute to its subscribed capital. Council Decision 1994/375/EC provides for the Community participation in the Fund. Following the conclusions of the March 2000 Lisbon Summit, which called for increased support for risk capital initiatives in favour of SMEs, the shareholders of the Fund approved in June 2000 a reform of the institution with a view to making the Fund a key financial instrument of Community policy directed at SMEs.

- **Consistency with other policies and objectives of the Union**

The Fund's policy objective has been reinforced in recent years through its active support of the Lisbon strategy for growth and employment, of which enhancing SMEs' access to finance and the financing of innovation and research are key elements. The Fund's operations complement EIB's Risk Capital Mandate and Community financial programmes such as the Competitiveness and Innovation Framework Programme (CIP), Joint European Resources for Micro to medium Enterprises (JEREMIE), the Seventh Research Framework Programme, which also includes measures to help SMEs under the Cooperation and Capacities programmes. Each of these programmes will work according to their individual policy scope and guidelines, mainly targeting specific group of SME beneficiaries, different SME development stages and they mainly have different risk-profiles. Thus, the one and same eligible costs will not be double-funded, but the Fund may make co-investments from its own capital in order to leverage the Community budget funding for specific programmes. Finally, the Fund's Board of Directors has the responsibility to ensure that Fund's resources are used to contribute to the pursuit of Community objectives.

2) CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

- **Consultation of interested parties**

Consultation methods, main sectors targeted and general profile of respondents

The ECOFIN of 14 March 2006 adopted a report on the proposal by the EIB Group (the EIB and the Fund) for reinforcing the contribution by the EIB Group to promoting growth and employment in the EU under the Lisbon strategy. This report, which was prepared in co-operation with the Commission, included a proposal to increase the Fund's subscribed capital by 50% in nominal terms. The European Council of 23/24 March 2006 welcomed the EIB Group's report and emphasised that a fully integrated financial market and sufficient access to finance are crucial for the growth of small and medium-sized enterprises. Finally, the capital increase was endorsed by the EIB's Board of Governors on 7 June 2006.

Summary of responses and how they have been taken into account

The views of the Fund's Board of Directors and of the EIB are fully reflected in the proposal. The Economic and Financial Committee of 2-3 March 2006 invited the Commission to table a legal proposal to be examined by the ECOFIN Council.

- **Collection and use of expertise**

Scientific/expertise domains concerned

Financial and market expertise of the Fund.

Methodology used

Not applicable.

Main organisations/experts consulted

The Fund, the EIB and the Board of Directors of the Fund.

Summary of advice received and used

The nature of the risk related to the Community's shareholding in the EIF does not change as a result of this proposal.

The position of the Fund and the views of the EIB and the Board of Directors on the capital increase are reflected in the proposal and in the ex-ante evaluation.

Means used to make the expert advice publicly available

Not applicable.

- **Impact assessment**

No formal impact assessment has been carried out. Since Autumn 2005, the Board of Directors of the Fund however has assessed various options and alternatives in order to improve the Fund's own resources' situation. Without a capital increase the Fund would have to cease its own resources activity. Finally, sale of assets, hedging or borrowing were not considered as meaningful alternatives considering the risk-profile, liquidity requirements and long-term character of the Fund's operations.

The capital increase, the first since the inception of the Fund in 1994, is fundamental to achieving the Fund's objectives. In the short- to medium-term, it would increase the Fund's potential for cooperation with the Commission, with the EIB and with the financial shareholders, as well as with new or existing non-shareholder mandators requiring co-investment by the Fund. No additional request for increased capital would be made during the forthcoming Financial Framework period 2007-2013. The Fund will use its own resources for venture capital and guarantee operations to increase financing available for SMEs and growth-enhancing investments by SMEs in innovation and R&D. The EIB and the Commission are dedicated to providing the resources deemed necessary to make EU policies work, notably in the fields of the Lisbon agenda: innovation, SME growth and job creation.

The Fund has a significant track record in facilitating SMEs' access to debt finance through the setting-up of and participation in securitisation transactions. Without a capital increase the Fund would no longer be able to participate in securitisation transactions. Due to the limited budgetary resources, the proposed securitisation window under Competitiveness and Innovation framework Programme 2007-2013 (CIP) could only cover a small portion of the current overall guarantee activity of the Fund. Furthermore, the Fund would not be able to extend its activities, especially venture capital operations, to markets with development potential, notably in the new Member States.

Within the context of the reorientation of the EIB Group's priorities by the Board of Governors in June 2005, which placed emphasis on innovative products making use of Group-level synergies, the Fund has been called upon to clearly strengthen its support for EU policies. The Governors' request for extended activity is reinforced by the Fund's ongoing discussions with the Commission on a number of important new initiatives.

3) LEGAL ELEMENTS OF THE PROPOSAL

- **Summary of the proposed action**

The Fund's own resources will be exhausted by mid-2007. The Board of Directors of the Fund has therefore suggested increasing the subscribed capital of the Fund by 50% in nominal terms, of which 20% will be paid-in. The intention is to issue 1000 new shares, which would mean, in nominal terms, an increase of the total subscribed share capital from EUR 2 billion to EUR 3 billion and, maintaining the current paid-in ratio of 20%, an increase from EUR 400 million to EUR 600 million of the paid-in capital. The capital increase of the Fund was endorsed within the framework of the EIB Group's contribution to the growth and jobs initiative which was welcomed by the ECOFIN of 14 March 2006 and European Council of 23-24 March 2006.

It is proposed that the Commission, on behalf of the Community, will subscribe for up to 30% of the new nominal capital. Under the Financial Framework 2007-2013, an amount of EUR 100 million is allocated in the general budget for this purpose.

The total share purchase price to be paid to the Fund comprises two components: the nominal value of capital paid-in and the share premium. Subject to a constant rate of dividend payments, the share purchase price reflects the financial performance of the Fund, i.e. the better the performance of the Fund the higher the price of its shares and consequently the higher the amount of the share premium. In order to accommodate any price uncertainties, the Commission proposes to use the dividends paid by the Fund to the Community during the four-year period to cover part of the cost of the capital increase. The dividends earned and required during the period 2007-2010 to cover the cost of the capital increase are considered as assigned revenue in accordance with Article 18(2) of the Financial Regulation. This would support the Commission's intention to maintain the Community shareholding at 30% in order to support the Fund's continued focus on EU policies. In any case, the maximum Community liability will not exceed the budget allocation of EUR 100 million and the dividends received during this period, estimated at around EUR 20 million.

- **Legal basis**

Article 3 of Council Decision 1994/375/EC of 6 June 1994 on Community membership of the European Investment Fund.

- **Subsidiarity principle**

The proposal falls under the exclusive competence of the Community. The Community participation in the Fund is based on Council Decision 1994/375/EC. The establishment of the Fund and its Statutes have been approved by the Board of Governors of the EIB. The subsidiarity principle therefore does not apply.

- **Proportionality principle**

The proposal complies with the proportionality principle for the following reasons.

The market failures in the area of access to finance to SMEs, which existed at the time of the Fund's creation in 1994, still persist and for this reason Community level intervention is considered to remain valid. The Fund has proven to be able to offer financing products supporting SMEs in a very effective way throughout the EU which would not be possible for a national institution. The Fund shall continue to manage its increased own resources operations with the usual investment and credit policy criteria and procedures.

In addition, the capital increase takes into consideration the budgetary constraints of the agreed Financial Framework and the Fund's business projections demonstrate that the 50% capital increase is sufficient to continue its own resources operations until 2013.

The additional own resources of the Fund will increase the amounts of finance available for SMEs. Following a thorough due-diligence process the Fund selects appropriate partners, i.e. venture capital funds and financial institutions which in turn provide equity or debt finance to SMEs. The Board of Directors of the Fund, in which the Commission has two Nominees, must approve all project proposals.

- **Choice of instruments**

Proposed instruments: other.

Other means would not be adequate for the following reason(s).

Article 3 of the Council Decision 1994/375/EC specifies that the position of the Community on a possible capital increase in the capital of the Fund and on its participation in that increase shall be decided unanimously by the Council, acting on proposal from the Commission and after consulting the European Parliament.

4) BUDGETARY IMPLICATION

The Community will subscribe to up to 300 new shares of the EIF. The annual payments of the shares will be done over the four-year period 2007-2010. The indicative budget appropriation for the four-year period would amount to around EUR 100 million, i.e. EUR 25 million per year.

The intention is to maintain the Community shareholding in the Fund at the level of 30% of the capital of the Fund by 2010. Due to the variable share issue price the Commission does not have the possibility to determine in advance the exact overall and annual budgetary commitments and payments. In order to maintain the shareholding at 30% by 2010 and to face any price uncertainties, the Commission proposes that the dividends which will be paid by the Fund during the years 2007-2010 will be used each year to cover part of the cost of the new shares. In any case, the maximum Community liability will not exceed the budget allocation of EUR 100 million and the dividends received during this period, estimated at around EUR 20 million.

5) ADDITIONAL INFORMATION

- **Review/revision/sunset clause**

The proposal includes a review clause.

- **Detailed explanation of the proposal**

Article 1 determines that the Community shall subscribe to the 50% capital increase of the Fund in nominal terms. The Community would thus purchase up to 300 shares. The terms and conditions of the capital increase will be set by the General Meeting of the Fund in 2007.

Article 2 covers the budgetary aspect of the proposal. In order to maintain the 30% Community shareholding, the Commission would purchase up to 300 of the Fund's new shares. Within the Financial Framework 2007-2013, the budgetary funds allocated for the purpose of the capital increase are limited to EUR 100 million. As the share purchase price is variable and it is uncertain whether the budgetary funds are sufficient to maintain the 30% shareholding in the Fund by 2010, the Commission proposes to use each year the dividends paid by the Fund during this period to cover part of the costs of the Community participation in the capital increase. The maximum Community liability is thus limited to the budget allocation of EUR 100 million and the dividends received each year during 2007-2010, i.e. an amount estimated at EUR 20 million.

Article 3 covers the evaluation of the Fund's activities to be carried out by the Commission by 31 July 2012.

In the past, based on the 10th recital of the Council Decision 1994/375/EC, the Commission forwarded the Fund's Annual Report to the Council and the Parliament. Article 4 proposes a change to this practice and invites the Fund to send its Annual Report and the Annual Report of the Audit Board directly to the European Parliament and the Council. In accordance with Article 2 of the Council Decision 1994/375/EC, the Commission will continue to notify the Council of the matters to be discussed at the Funds' General Meeting.

2006/0203 (CNS)

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Decision 1994/375/EC of 6 June 1994 on Community membership of the European Investment Fund[2], and in particular Article 3 thereof,

Having regard to the proposal from the Commission[3],

Having regard to the opinion of the European Parliament[4],

Whereas:

(1) The authorised capital of the European Investment Fund, hereinafter "the Fund", was set at the time of its establishment at EUR 2 billion, divided into 2 000 shares each with a nominal value of EUR 1 million. In accordance with Article 7(1) of the Statutes of the European Investment Fund[5], hereinafter "the Statutes", the subscribed capital shall be paid-in at a rate of 20%.

(2) Pursuant to Decision 1994/375/EC, the European Community, represented by the Commission, subscribed for 600 shares of the Fund for a nominal value of EUR 600 million of which EUR 120 million are paid-in.

(3) The guarantee and venture capital operations of the Fund may not exceed the ceilings set by Article 26 of the Statutes or by the General Meeting of the Fund. The ceilings depend on the size of the Fund's capital and own resources. As the Fund is expected to exhaust its own resources by mid 2007 and therefore will be unable to continue its own resources operations, the Board of Directors has proposed to increase by 50% the Fund's authorised capital in nominal terms.

(4) The ECOFIN Council of 14 March 2006 adopted a report on the proposals put forward by the European Investment Bank Group, hereinafter "the EIB Group", for reinforcing

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2 OJ L 173, 7.7.1994, p. 12.
3 OJ C , , p. .
4 OJ C , , p. .
5 OJ L 173, 7.7.1994, p. 1. Statutes as amended on 19 June 2000 by the General Meeting of the European Investment Fund (OJ C 225, 10.8.2001, p. 2).

the contribution by the EIB Group to promoting growth and employment in the EU, which includes the proposal for a capital increase of the Fund.

(5) The European Council of 23-24 March 2006 welcomed the EIB Group contribution and invited the relevant actors to take the necessary follow-up steps, taking into account the final agreement on the Financial Framework 2007-2013.

(6) The Community subscription for the new shares would support the implementation of the Lisbon strategy and help achieve the Community's objectives in the field of small and medium-sized enterprises, job creation, innovation, research and development, cohesion and regional policy and enlargement.

(7) A budget allocation of EUR 100 million for the capital increase of the Fund is consistent with the final agreement on the Financial Framework 2007-2013.

(8) New shares should be subscribed by the Fund's shareholders at their discretion over a four-year period, starting in 2007 and ending in 2010, while respecting the interests of the financial institution shareholders and the European Investment Bank as well as the budgetary constraints of the Community. The price of the new shares should be set annually and be based on the net asset value formula agreed between the Fund's shareholders.

(9) The annual dividends received for the Community participation in the Fund from 1995 to 2006 have been duly returned to the Community budget. During the years 2007-2010 the dividends received should be considered as assigned revenue and be used to cover part of the cost of the capital increase. This should increase the amount of budgetary funds available for the capital increase, thus supporting the objective of maintaining the Community shareholding in the Fund at 30% of the capital of the Fund.

(10) Until now the Commission has forwarded the Annual Reports of the Fund to the European Parliament and the Council. With a view to simplifying the reporting procedure, it is necessary to provide that the Fund should send directly its Annual Report and the Annual Report of the Audit Board to the European Parliament and the Council.

(11) Appropriate co-ordination, synergy and complementarity will be ensured between the operations of the Fund and the European Investment Bank, Community financial instruments for small and medium-sized enterprises and, where appropriate, other financial institutions.

HAS DECIDED AS FOLLOWS:

Article 1

In addition to its current shareholding in the European Investment Fund, hereinafter "the Fund", the Community shall subscribe for up to 300 shares each of nominal value of EUR 1 million in the Fund. The subscription of shares and the annual payments shall be carried out in accordance with the terms and conditions that shall be approved by the General Meeting of the Fund.

Article 2

The Community shall purchase the new shares over a four-year period starting in 2007. During 2007-2010, the dividends received for the Community participation in the Fund shall be considered as assigned revenue, in accordance with Article 18(2) of Council Regulation (EC, Euratom) No. 1605/2002[6], to cover part of the cost of subscription.

In addition, a total amount of up to EUR 100 million for the whole period shall be available within the general budget of the European Communities to cover the remaining cost. The budgetary commitment may be broken down into annual instalments over four years in accordance with Article 76(3) of Council Regulation (EC, Euratom) No. 1605/2002.

Article 3

The Commission shall submit to the Council an evaluation of the own resources activity of the Fund by 31 July 2012.

Article 4

The Fund shall transmit its Annual Report and the Annual Report of the Audit Board to the European Parliament and the Council.

Done at Brussels,

For the Council
The President

6 OJ L 248, 16.9.2002, p. 1.

LEGISLATIVE FINANCIAL STATEMENT

1. NAME OF THE PROPOSAL:

Capital increase of the European Investment Fund (EIF) and the Community participation in the capital increase.

2. ABM / ABB FRAMEWORK

Economic and Financial Affairs

01.04 Financial operations and instruments

3. BUDGET LINES

3.1. Budget lines including headings:

Expenditure.

01.0409: European Investment Fund

01.040901: European Investment Fund — Provision of paid-up shares of subscribed capital

01.040902: European Investment Fund — Callable portion of subscribed capital

Revenue line.

850 : Dividends paid by the EIF

3.2. Duration of the action and of the financial impact:

An amount of EUR 100 million is allocated within the financial framework 2007-2013 under the sub-heading 1A, i.e. EUR 25 million annually during the four-year period 2007-2010. The Commission will subscribe the new shares in accordance with the decision to be taken by the General Meeting of the EIF on the modalities of the capital increase and pay them in four annual instalments in accordance with Article 76(3) of the Financial Regulation.

The final impact on the Community budget mainly depends on the annual share price to be paid for the new shares issued by the EIF. In order to address any share price uncertainties whilst maintaining the Community shareholding in the EIF at 30%, the Commission proposes to use the EIF dividends, which would be received during the four-year period, to cover part of the cost of the capital increase. The dividends earned during 2007-2010 are considered as assigned revenue in accordance with Article 18(2) of the Financial Regulation. In any case, the maximum Community liability will not exceed the budget allocation of EUR 100 million and the dividends received during this period, estimated at around EUR 20 million.

The commitments and payments of the Community participation will be subject to the approval of the issue of new shares, the appropriation of annual net income and the distribution of dividends by the General Meeting of the EIF.

3.3. Budgetary characteristics:

Budget line	Type of expenditure		New	EFTA contribution	Contributions from applicant countries	Heading in financial framework
01 04 09	Non-comp	Diff[7]	YES	NO	NO	No 1A

4. SUMMARY OF RESOURCES

4.1. Financial Resources

4.1.1. Summary of indicative commitment appropriations (CA) and indicative payment appropriations (PA)

The table provides for the amounts allocated in the Financial Framework 2007-2013 to cover the commitment and payment appropriations without taking into account the EIF dividends (see point 4.1.3).

EUR million

Expenditure type (indicative amounts)	Section no.		2007	2008	2009	2010	2011	2012 and later	Total
Operational expenditure[8]									
Commitment Appropriations (CA)	8.1.	a	25.0	25.0	25.0	25.0	-	-	100.0
Payment Appropriations (PA)		b	25.0	25.0	25.0	25.0	-	-	100.0
Administrative expenditure within reference amount[9]									
Technical & administrative assistance (NDA)	8.2.4.	c	-	-	-	-	-	-	-
TOTAL REFERENCE AMOUNT									
Commitment Appropriations		a+c	**25.0**	**25.0**	**25.0**	**25.0**	-	-	**100.0**
Payment Appropriations		b+c	**25.0**	**25.0**	**25.0**	**25.0**	-	-	**100.0**

7 Differentiated appropriations
8 Expenditure that does not fall under Chapter xx 01 of the Title xx concerned.
9 Expenditure within article xx 01 04 of Title xx.

Administrative expenditure <u>not</u> included in reference amount[10]

Human resources and associated expenditure (NDA)	8.2.5.	d	-	-	-	-	-	-	-
Administrative costs, other than human resources and associated costs, not included in reference amount (NDA)	8.2.6.	e	-	-	-	-	0.1	-	0.1

Total indicative financial cost of intervention

TOTAL CA including cost of Human Resources		a+c+d +e	25.0	25.0	25.0	25.0	0.1	-	100.1
TOTAL PA including cost of Human Resources		b+c+ d+e	25.0	25.0	25.0	25.0	0.1	-	100.1

4.1.2. Compatibility with Financial Programming

X Proposal is compatible with existing financial programming.

☐ Proposal will entail reprogramming of the relevant heading in the Financial Framework.

☐ Proposal may require application of the provisions of the Interinstitutional Agreement[11] (i.e. flexibility instrument or revision of the Financial Framework).

4.1.3. Financial impact on Revenue

☐ Proposal has no financial implications on revenue

X Proposal has financial impact – the effect on revenue is as follows:

Dividends paid by the EIF during the period 2007-2010 are considered as assigned revenue in accordance with Article 18(2) of the Financial Regulation and will be used to cover part of the expenditure of the Community participation in the EIF's capital increase. Any excess amounts not required to cover the cost of the capital increase will be returned to the Community budget. All details relating to the method of calculating the effect on revenue and an example are provided in the Annex. The amounts hereunder are only indicative and based on 30 June 2006 profit and loss account figures of the EIF.

[10] Expenditure within chapter xx 01 other than articles xx 01 04 or xx 01 05.
[11] See points 19 and 24 of the Interinstitutional agreement.

EUR million

Budget line	Indicative amounts	Prior to action 2006	Indicative situation following action 2007	2008	2009	2010	2011	2012
850 Dividends paid by the EIF	*a) Indicative Revenue*	5.1	*6.2*	*5.6*	*6.4*	*7.5*	-	-
	b) Change in revenue	*Δ*	*-6.2*	*-5.6*	*-6.4*	*-7.5*	-	-

4.2. Human Resources FTE (including officials, temporary and external staff) – see detail under point 8.2.1.

Annual requirements	2007	2008	2009	2010	2011	2012 and later
Total number of human resources	0.6	0.6	0.6	0.6	0.6	0.6

5. CHARACTERISTICS AND OBJECTIVES

5.1. Need to be met

EIF uses its own resources as capital allocation for its guarantee operations and as equity payments for its venture capital investments. Based on the business forecasts for 2006-2009, the EIF will run out of own resources by mid-2007. The proposed capital increase is fundamental to the achievement of the EIF's objectives, i.e. to support SMEs' access to finance in the EU, accession, candidate countries and certain other third countries. The EIF would continue to consolidate its position as a centre of excellence, know-how and professionalism in managing its core business of venture capital and portfolio guarantees, as well as extending financial engineering techniques, to areas where there are acknowledged market failures (early stage, innovation, technology transfer, etc.) and where EIF's added value can be demonstrated, in particular in the new Member States and accession countries. It could extend its activity to provide increasingly flexible funding for SMEs and a new range of innovative schemes.

5.2. Value-added of Community involvement, consistency of the proposal with other financial instruments and possible synergy

The capital increase would enhance the EIF's potential for co-operation with its shareholders (the Commission, the EIB and the financial institutions) and third parties. It would allow the EIF to broaden its current geographic coverage and to deepen its activity in the areas of R&D/innovation, SMEs and new Member States.

EIF's own resources will complement the Community and EIB mandates (i.e. the financial instruments under the Competitiveness and Innovation Programme (CIP) and the EIB Risk Capital Mandate), and contribute to the achievement of the Lisbon objectives. EIF's own resources will be required to leverage Community funds, i.e. to co-invest with Community resources in venture capital funds and possibly technology transfer projects, as well as to participate in risk-sharing under the CIP guarantee facilities.

5.3. Objectives, expected results and related indicators of the proposal in the context of the ABM framework

The ex-ante evaluation provides detailed information on policy objectives, expected results and related indicators.

The EIF has distinguished itself by being the only Community institution which has a specialised focus on SME financing, pursuing relevant EU objectives particularly innovation, research and development, entrepreneurship, growth, and job creation. Such objectives, which are also to be placed within the general objective of successful EU enlargement, are still highly topical and their pursuit remains a key EU priority, as underlined in the spring 2005 and 2006 Council conclusions.

No additional request for increased capital would be made during the forthcoming Financial Framework period (2007-2013).

5.4. Method of Implementation (indicative)

X ***Centralised Management***

X directly by the Commission

6. MONITORING AND EVALUATION

6.1. Monitoring system

The EIF's annual accounts are audited by external auditors under the mandate of EIF's Audit Board. These accounts have to be approved by the shareholders at the Annual General Meeting.

The internal audit, which is outsourced to the EIB, evaluates the relevance and effectiveness of the internal control systems and the procedures involved. It is introducing an internal control framework based on BIS guidelines. Internal audit also reviews and tests controls in information technology and administrative areas.

The Board of Directors assesses the EIF's individual operations and monitors the venture capital and guarantee portfolios. It also ensures that the Fund is managed in accordance with its Statutes and the specific guidelines adopted by the Board. The Commission has designated two directors and two alternates to the Board of Directors. In performing their duties as directors or alternates, Members of the Board of Directors and Alternates are accountable only to the General Meeting of the EIF. In carrying out their duties as Members of the Board or Alternates, they have to act independently and to serve the best interests of the EIF. They shall ensure that their action remains within the powers conferred upon them by or under the Statute and otherwise comply with the provisions of the Statutes and the Rules of Procedure of the EIF. Any conflict of interest and disclosure issues are dealt with in the code of conduct signed by all Members and Alternates of the Board.

The EIF is rated by the three major rating agencies, Fitch, Moody's and Standard & Poors.

Finally, a Tripartite Agreement between the EIF, the Court of Auditors and the Commission covers the arrangements for providing the Court with the documents and information relating to the Community participation in the capital of the EIF.

6.2. Evaluation

6.2.1. Ex-ante evaluation

The ex-ante evaluation was prepared by the Commission services (DG ECFIN) in March 2006.

6.2.2. Measures taken following an intermediate/ex-post evaluation (lessons learned from similar experiences in the past)

No ex-post evaluation has been carried out. The ex-ante evaluation contains conclusions of other relevant evaluations carried out by the Commission.

6.2.3. Terms and frequency of future evaluation

The proposal for the new Council Decision stipulates that the Commission will carry out an evaluation by 31 July 2012. This report shall assess EIF's SME activity and the situation of its own funds.

7. ANTI-FRAUD MEASURES

EIF Anti-Fraud Procedures were implemented on 22 January 2002 in order to ensure that appropriate measures are in place in the event of detection of fraud or fraudulent behaviour at the EIF.

In addition, the EIF Board of Directors adopted in June 2004 a document "OLAF: Decision on measures to combat fraud" which sets out the terms and conditions for investigations in relation to the prevention of fraud, corruption and any illegal activity detrimental to the Community's financial interests.

8. DETAILS OF RESOURCES

8.1. Objectives of the proposal in terms of their financial cost (indicative amounts)

Commitment appropriations in EUR million

	Type of output	Av. cost	2007		2008		2009		2010 *)		2011 and later		TOTAL	
			No. outputs	Total cost	No. outputs	Total cost	No. outputs	Total cost	No. outputs	Total cost	No. outputs	Total cost	No. outputs	Total cost
	Dividends used to cover part of the cost of the capital increase	6.4	Acquisition of new shares	6.2	Acquisition of new shares	5.6	Acquisition of new shares	6.4	Acquisition of new shares	7.5	-	-	Acquisition of new shares	25.7
	Participation in the EIF capital increase (initial budget allocation)	25.0	Acquisition of new shares	25.0	Acquisition of new shares	25.0	Acquisition of new shares	25.0	Acquisition of new shares	25.0	-	-	Acquisition of new shares	100.0
TOTAL COST		31.4	Acquisition of around 90 new shares	31.2	Acquisition of around 91 new shares	30.6	Acquisition of around 91 new shares	31.4	Acquisition of around 28 new shares	32.5	-	-	Acquisition of up to 300 new shares	125.7

*) The amounts indicated in 2010 are the total amounts available to cover the cost of the capital increase. The amount needed in 2010 to cover the purchase of the new shares is expected to be significantly lower.

8.2. Administrative Expenditure

The needs for human and administrative resources shall be covered within the allocation granted to the managing service in the framework of the annual allocation procedure.

8.2.1. Number and type of human resources

The tasks will be carried out by the current Commission staff.

Types of post		Staff to be assigned to management of the action using existing resources (**number of posts/FTEs**)					
		2007	2008	2009	2010	2011	2012
Officials or temporary staff[12] (XX 01 01)	A*/AD	0.6	0.6	0.6	0.6		
	B*, C*/AST	-	-	-	-	-	-
TOTAL		0.6	0.6	0.6	0.6		

8.2.2. Description of tasks deriving from the action

Besides administrative work in relation to the financial transactions, the capital increase will not create significant additional tasks.

However, in order to manage ongoing relations with the EIF, the official in charge is responsible for the preparation of all administrative procedures, such as Commission decisions on the designation of Commission nominees to the EIF Boards; liaison with the EIF and follow-up of negotiations of any types of undertakings, such as the put option; and the co-ordination with the Court of Auditors under the Tripartite Agreement.

Furthermore, the official assists the Commission Nominees in the preparation of the Board of Directors meetings. In this respect, the official examines the implications of the EIF proposals for the interest of the Community within the framework of EIF's policies and in co-ordination with the relevant Commission services. This task also covers the assessment of EIF operations involving investments or co-investment of EIF's own resources. The official also assists the Commissioner or his representative in the preparation of the EIF's General Meetings.

Finally, the official ensures that the Council is appropriately informed of the work of the EIF in accordance with the Council Decision 1994/375/EC.

8.2.3. Sources of human resources (statutory)

When more than one source is stated, please indicate the number of posts originating from each of the sources.

X Posts currently allocated

12 Cost of which is NOT covered by the reference amount

8.2.4. *Other Administrative expenditure included in reference amount (XX 01 04/05 – Expenditure on administrative management)*

None.

8.2.5. *Financial cost of human resources and associated costs <u>not</u> included in the reference amount*

EUR million

Type of human resources	2007	2008	2009	2010	2011	2012 and later
Officials and temporary staff (XX 01 01)	0.065	0.065	0.065	0.065		
Total cost of Human Resources and associated costs (NOT in reference amount)	**0.065**	**0.065**	**0.065**	**0.065**		

Calculation– ***Officials and Temporary agents***

EUR 108 000 * 0.6 = EUR 64 800.

8.2.6. Other administrative expenditure <u>not</u> included in reference amount

EUR million

	2007	2008	2009	2010	2011	2012 and later	TOTAL
XX 01 02 11 04 – Studies & consultations	-	-	-	-	0.1	-	0.1
Total Other Management Expenditure (XX 01 02 11)	-	-	-	-	0.1	-	0.1
Total Administrative expenditure, other than human resources and associated costs (NOT included in reference amount)	-	-	-	-	0.1	-	0.1

Calculation - ***Other administrative expenditure <u>not</u> included in reference amount***

This indicative amount of EUR 100 000 covers the costs of an external evaluation to be prepared by July 2012.

Annex

The capital increase and the share price

The EIF aims to achieve a cash injection of around EUR 330 million, which would be based on the 50% capital increase in nominal terms. In order to achieve this, 1000 new shares will be issued by the EIF and subsequently subscribed by its shareholders . As far as the Community is concerned, payments will follow over a four-year period. The EIF proposal for the capital increase foresees that the new shares will be priced on the basis of the Replacement Share Purchase Undertaking (RSPU) formula agreed between the shareholders in June 2005 which is determined as follows:

> Share price = (Capital paid-in + share premium account + reserves + unrealised venture capital gains + profit brought forward + profit of the year – dividends of the year) / number of shares.

Under this net asset value (NAV) formula, the annual share issue price will vary as a function of the annual NAV calculation and the shareholders will pay for each share more than the nominal value of the capital paid-in. The excess value will be allocated to EIF's share premium account, thus further increasing the amount of EIF's own resources.

Following the Council authorisation to increase the capital of the EIF by 1000 shares the General Meeting of the EIF would adopt the decision to issue the new shares.

The EIF will offer the same conditions to each shareholder, i.e. the possibility to purchase the new shares over the four-year period 2007-2010. However, the most of the financial institutions that currently own around 8% of the EIF shares have indicated that they could purchase their entire share allocation in 2007. The calculations below are based on the assumption that the EIB will also purchase its portion of the shares in 2007 in order to respond to the financial institutions' request to provide EIB's irrevocable commitment to the capital increase. Consequently the number of shares to be issued in 2007 would be higher than in the following years.

The annual budget available for the Commission for the purchase of EIF shares amounts to EUR 25 million. In order to be able to purchase the indicated number of the shares, it is proposed to use the EIF dividends received during the period 2007-2010 for the purchase of the new shares in accordance with Article 18(2) of the Financial Regulation. This would notably enable the Community shareholding structure to remain relatively stable by 2010 and show the Commission's intention to purchase as many shares as possible right from the start, thus demonstrating its commitment to the EIF and to the capital increase. However, as a consequence of the limited budgetary resources available per year, during 2007-2009 the Community shareholding percentage of 30% will be slightly diluted (based on the indicative calculations presented hereunder, in 2007 the Community shareholding would be around 25%, in 2008 around 27%, in 2009 around 29% and from 2010 at around 30%).

Based on the EIF's 30 June 2006 profit and loss account of the EIF and the indicative share price, the table hereunder provides an example of the number of shares the Commission could possibly purchase and the budget needs:

	2007	2008	2009	2010	Total
Indicative number of shares to be subscribed by the shareholders	790	90	89	26	1000
Indicative number of shares to be subscribed by the Commission	95	90	89	26	300
Indicative annual share price (in EUR)	326 526	338 912	351 406	364 376	
Indicative budgetary need (in EUR)	31 019 970	30 502 080	31 275 134	9 473 776	102 270 960

Community Revenues

According to Article 24 of its Statutes, EIF targets appropriate returns for its shareholders. Following the decision of the General Meeting of the EIF, the EIF distributes dividends from the annual net profit to its shareholders. With regard to the Community shareholding, these dividends are returned to the Community budget (line 850 : dividends paid by the EIF).

Currently, EIF's income mainly consists of treasury income, management fees and income from its own resources guarantee operations. However, venture capital income, which is difficult to predict, will possibly make up an increasing share of EIF's overall income in the future. Furthermore, possible new mandates will provide additional management fees, thus increasing EIF's profitability. It is therefore difficult to provide definitive figures on future income and the subsequent dividends. For illustrative purposes, the table below shows a simplified example:

	Financial Year *)			
	2006	2007	2008	2009
Number of shares initially subscribed by the Commission	600	600	600	600
Indicative number of new shares to be subscribed by the Commission	0	95	90	89
Cumulative number of shares subscribed by the Commission	600	695	785	874
Annual estimated dividend per share (in EUR)	10 299	8 014	8 197	8 8534
Estimated amount of dividends to be received by the Commission in the following year (in EUR)	6 179 400	5 569 730	6 434 645	7 458 716

*) Dividends pertaining to financial year n are paid in May/June of year n+1.

Overall impact on the Community budget

In order to maintain the Community shareholding at approximately 30%, the Commission would purchase up to 300 new EIF shares. The annual payments will be done during the period 2007-2010 in accordance with Article 76(3) of the Financial Regulation. In addition to the annual budget allocation of EUR 25 million the Commission proposes to use the dividends paid during the period 2007-2010 to cover part of the cost of the capital increase.

The payment of dividends follows immediately upon approval of the dividend distribution by the General Meeting of the EIF. Simultaneously, following the decision of the General Meeting, the shareholders would be invited to subscribe to the new shares and would be requested by the EIF to pay for the new shares subscribed. In accordance with Article 18(2) of the Financial Regulation, the Commission would use the dividends earned to cover part of the cost of the capital increase. Any excess amounts of dividends earned each year in 2007-2009, which were not needed to cover part of the cost of the capital increase, would be transferred to the following year. Should the excess of dividends in 2010 not be required to cover the cost of the capital increase, these excess dividends would be returned to the Community budget.

A further impact would be that the amounts of commitments and payments would be front-loaded, i.e. it is likely that the amounts needed for budget commitments and payments in 2010 could be significantly reduced.