Capped portfolio guarantees Innovations & Energy efficiency

Concept summary

February 2019

Foreword

Dear Partners,

Thank you for your interest in our instruments for innovations and energy efficiency.

We are delighted to share with you this summary of Capped portfolio guarantees funded by the Operational Programme Innovation and Competitiveness 2014-2020.

As always, we believe that your feedback as one of the pivotal elements towards the successful implementation of our products. Hence, we remain on your disposal to discuss in details any comments or suggestions that you may have with respect to the intended *modus operandi* of our guarantee scheme.

We would like to draw your attention to the Important notice section below which provides certain details with respect to the limitations which this document entails from a legal perspective.

We look forward to discussing with you further.

Kind regards,

The FMFIB team

About this document

Background

- Fund Manager of Financial Instruments in Bulgaria EAD (FMFIB) has been appointed by the Managing Authority of Operational Programme "Innovations and Competitiveness" 2014-2020 (OPIC, the Programme) to manage the financial instruments encompassed in the Programme

Our role

- FMFIB is tasked with: (i) structuring the financial instruments in line with the objectives of OPIC; (ii) selection of intermediaries; and (iii) monitoring and supervising the implementation of the instruments

Market testing

- With the aim to execute its mandate transparently, as well as align the structures of our financial instruments with the appropriate market practices, FMFIB is conducting comprehensive consultations with the potential stakeholders with respect to the OPIC financial instruments (i.e. potential intermediaries, final borrowers, policy makers, consultants, entrepreneurs etc.)

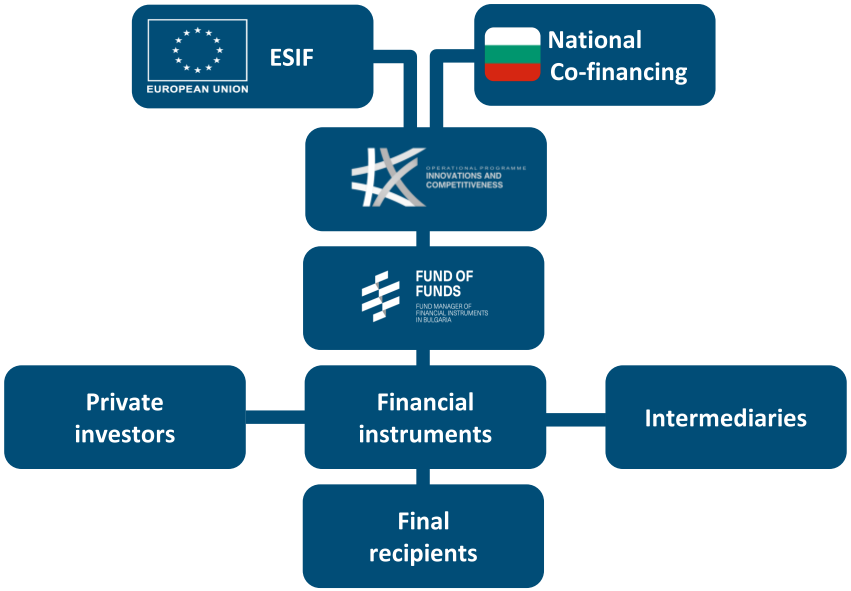
Purpose of this document

- To present a summary of the intended structure and approach for implementation of the financial instrument "Capped portfolio guarantees"
- In addition, FMFIB published an indicative term sheet for the financial instrument as a basis for detailed discussions (refer to www.fmfib.bg)

Structure of this document

- The document presents a high level overview of:
  - FMFIB structure and operations
  - Background and policy rationale of the Capped portfolio guarantees financial instrument
  - Main features and key indicative terms & conditions of the financial instrument
  - Tentative roadmap of the overall process

The Fund of funds in a nutshell



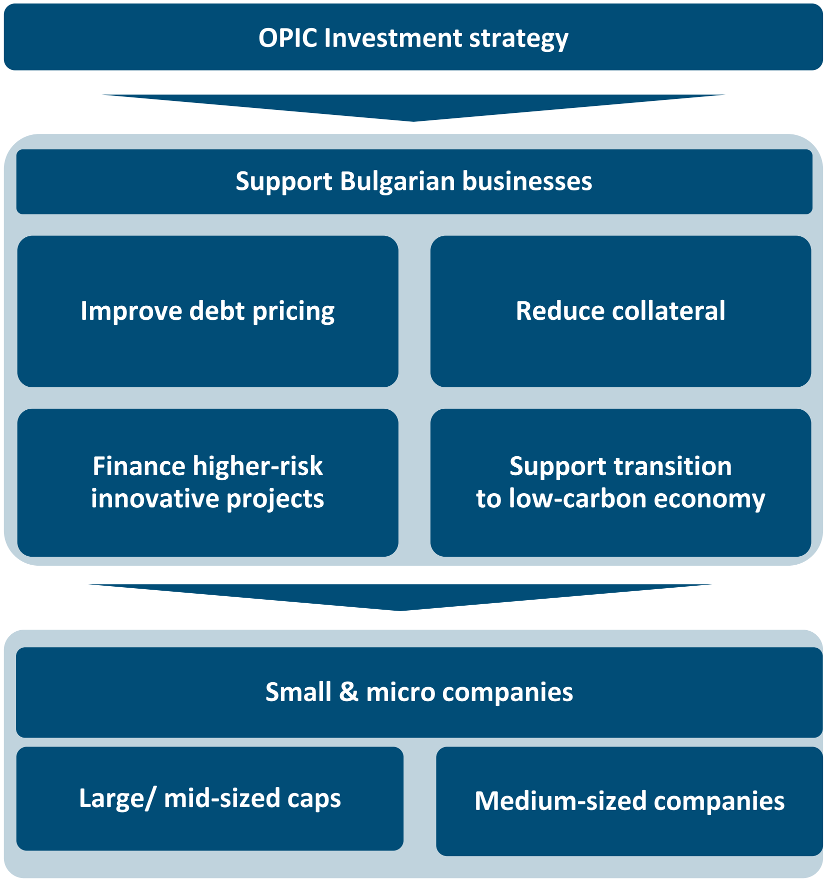
Financial instruments background

- By definition, the EU-funded FIs are designed to support final recipients via market-driven mechanisms (e.g. loans, investments etc. as opposed to grants) while mobilising additional funds and expertise from the private sector
- FIs' structure also entails revolving funds, i.e. reuse of the public funds for the same policy goals
- Given their advantages over grants, an increasing portion of the Union budget is channelled to financial instruments

FoF rationale

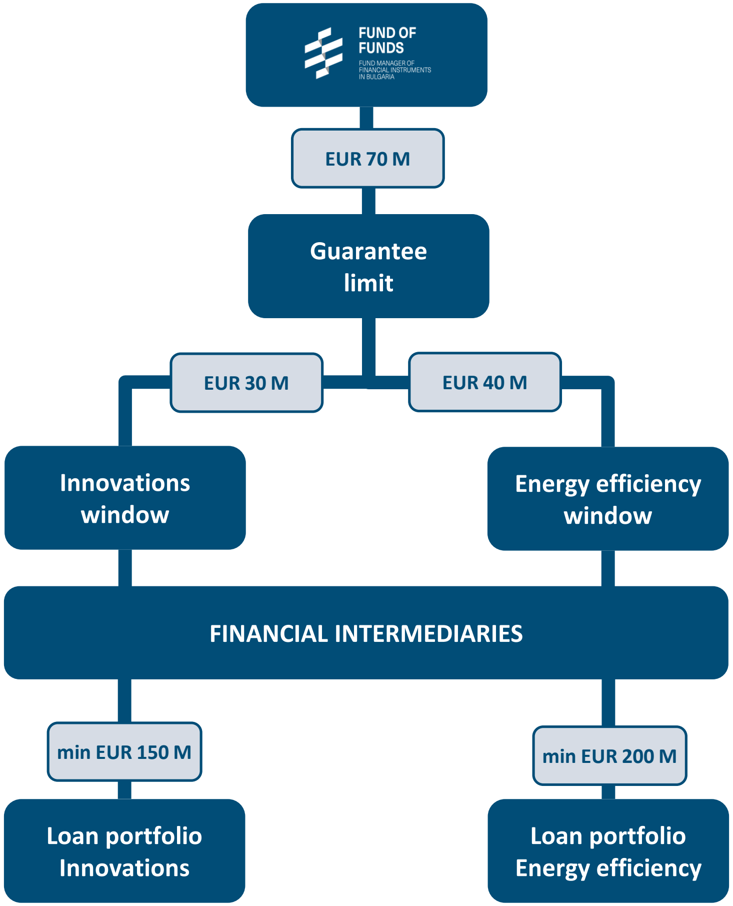
- Bulgaria has taken the strategic decision to implement the FIs under its operational programmes (OP) via a national investment vehicle structured as a *"Fund of funds"*
- Currently, four OPs contribute funds earmarked for FIs in the FoF in the total amount of EUR 606 million
- The financial instruments are expected to mobilize support and capital from the private sector and the fully leveraged FoF is expected to facilitate the investment of ~EUR 1.4 billion in the Bulgarian economy (including its own dedicated resources)
- FMFIB, has been established by the government as the entity managing the FoF and its sole mission is the effective implementation of the FIs in Bulgaria
- The investment of the FIs would be entrusted to intermediaries selected and monitored by FMFIB

Policy rationale of the financial instrument. Scope of services



- The main principles of OPIC are aligned with the strategic framework that defines the national development roadmap in a number of sectors
- As a result, the policy objectives of the OP aim to foster economic growth that is: (1) knowledge-driven; (2) environmentally sustainable; and (3) socially inclusive
- The financial instrument would support eligible projects and recipients through guarantees issued in favour of the financial intermediaries
- The financial instrument aims to support enterprises that have difficulties in obtaining a loan due to:
  - Lack of sufficient collateral and
  - Perceived higher credit risk
  - Prohibitive interest rates vis-à-vis the project return
- As a integral element of the implementation of the policy objectives are the activities performed by the intermediaries. In a nutshell, the scope of their services would encompass:
  - Originate, close and monitor a loan portfolio of eligible loans
  - Manage NPLs
  - Contribute to the achievement of the KPIs of the Programme
  - Maintain and provide the required reporting
  - Ensure compliance with the respective EU and national regulations
  - Ensure compliance with the respective State aid rules, including estimation and reporting of the gross grant equivalent (re. de minimis)

Sector windows



- The Guarantee is divided into two windows with separate budgets:
  - Innovations window and
  - Energy efficiency window
- FMFIB is contemplating to issue a single call for both windows and to provide the flexibility for the selected intermediaries to originate sub-loans in any of the two categories
- However, the intermediary would have to commit to certain volumes in either Innovations or Energy efficiency or both
- The volume of the resulting portfolio would be driven by the structure of the capped guarantee and is projected to be at least five times the amount of the guarantee coverage provided by FMFIB (refer to next Guarantee mechanism for details)

Eligibility

INNOVATIONS

- Organic R&D
- Implementation of R&D
- Acquisition and implementation of IP
- Development, acquisition & implementation of other innovation

INNOVATION for the purpose of the scheme is any product, service or internal business process which is new for the prospective borrower OR

A product, service or internal business process for the firm which underwent improvement

Consecutively, in order to ensure compliance with the eligibility criteria, the borrower should present:

- Business plan which provides for the implementation of a new product, service or business process OR
- Document related to the resp. IP (i.e. Patent, License, contract, etc.) OR
- Cost proofing documents related to organic R&D

ENERGY EFFICIENCY

- EE in commercial real estate, including production facilities
- EE in production systems, machinery, equipment, processes, etc.
- All projects should be related to EE measures in EE Audit

All sub-loans should support the implementation of measures envisaged in an Energy efficiency audit of the company business activity

Therefore, generic capacity expansion would not be eligible under this scheme

EE measures for all kinds of assets could be financed (i.e. offices, retail, tourism, production, machinery, etc.)

Under BG law, certain companies (i.e. energy intensive producers) already have obligatory energy audits. Smaller energy consumers could benefit from the guarantees as far as they provide an energy audit with recommended measures

Eligibility (cont.)

Borrower/ Project

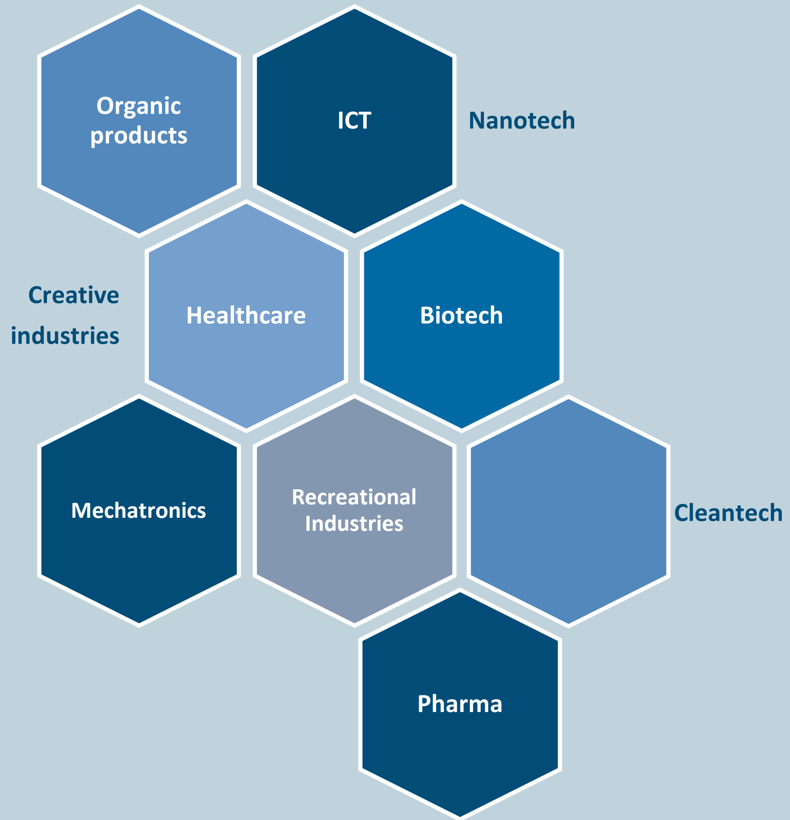
- √ SMEs & Mid caps
- ✗ Co's in difficulties
- ✗ Restricted sectors (i.e. Fisheries, Aquaculture, Tobacco, Defense, Nuclear, etc.)
- ✗ Limited sectors (i.e. special limitations apply to Finance, Transportation, Agriculture
- ✗ Physically implemented projects
- ✗ Real estate financing (exceeding 10% of project costs)

Deal

- New deals only √
- Investment & working capital loans √
- Senior debt only √
- Term & revolving loans √
- Financial leasing √
- Refinancing/ restructuring/ recap ✗
- Bridge financing to grant ✗
- Bullet at maturity & sizable balloon payments ✗
- Operating lease ✗

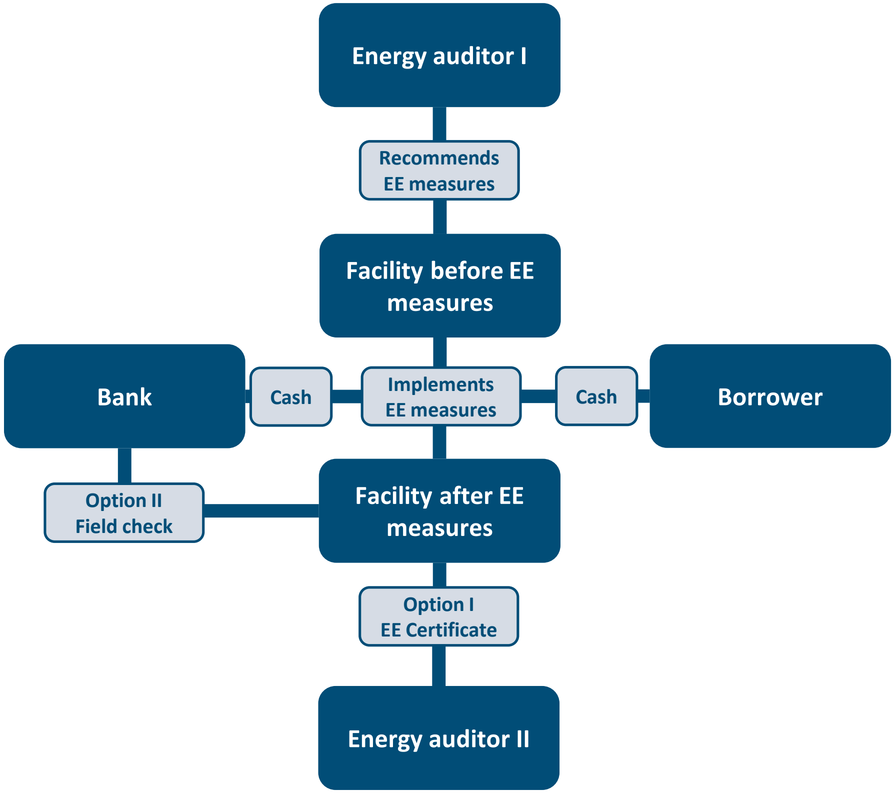
Focus of the projects of the borrowers re. innovations

The inclusion strategy is sector agnostic.
However, the loans should be related to projects in a limited number of high impact priorities



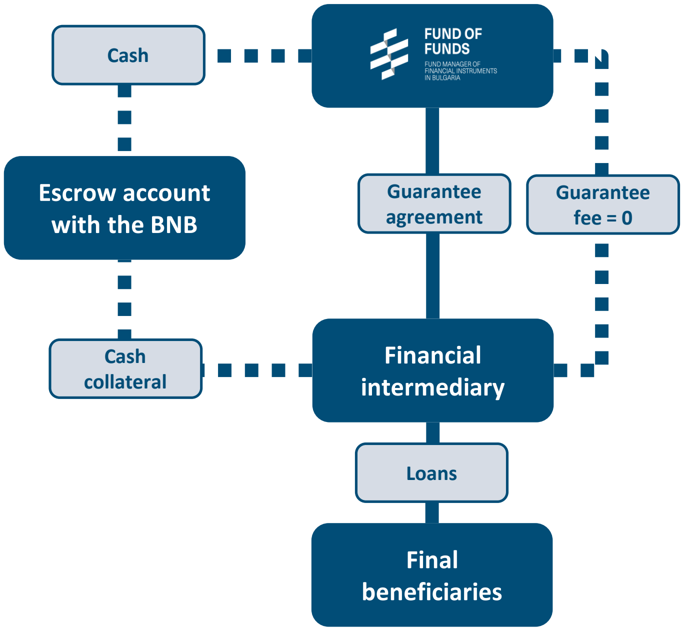
- Given the horizontal policy objectives of the Programme, the portfolio gurantee is further underpinned by the notion that the fund should invest in specific activities and projects defined in four broader categories (list not exhaustive):
  - Mechatronics & clean technologies;
  - Informatics & ICT;
  - Life sciences & bio technologies
  - New technologies in creative and recreational industries
- Nevertheless, the investees which implement the particular projects could operate in any industry, save for the ones explicitly excluded from the eligibility list as per the documentation

Confirmation of EE effects



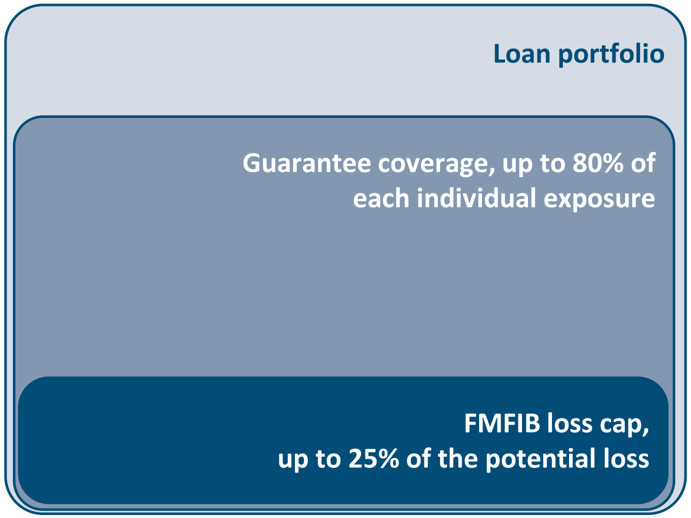
- All EE measures supported by the guarantee scheme in any company should be substantiated by an energy audit
- According to the Energy efficiency law, all companies which consume more than 3,000 MWh p.a. or large production companies would have an energy audit and thus would have envisaged EE measures
- Apart from the large energy consumers, all public and private companies (including municipal and state owned companies) are eligible for financing provided that the financed measures are included an energy audit
- Eligible Energy audits are conducted by EE Auditors duly registered by the Sustainable Energy Development Agency, Ministry of Energy
- Following the implementation of the EE measures, their effect should be formally confirmed
- FMFIFB is considering two broader options in respect to the ex-post confirmation, i.e.:
  - A certificate from a registered EE auditor (different from the one that devised the measures)
  - A report drafted by the bank which confirms that the measures have been implemented (i.e. confirmation of respective construction works, installation of machinery, etc.)
- At this point, FMFIB does not envisage any ex-ante confirmation of the EE measures and the related investments

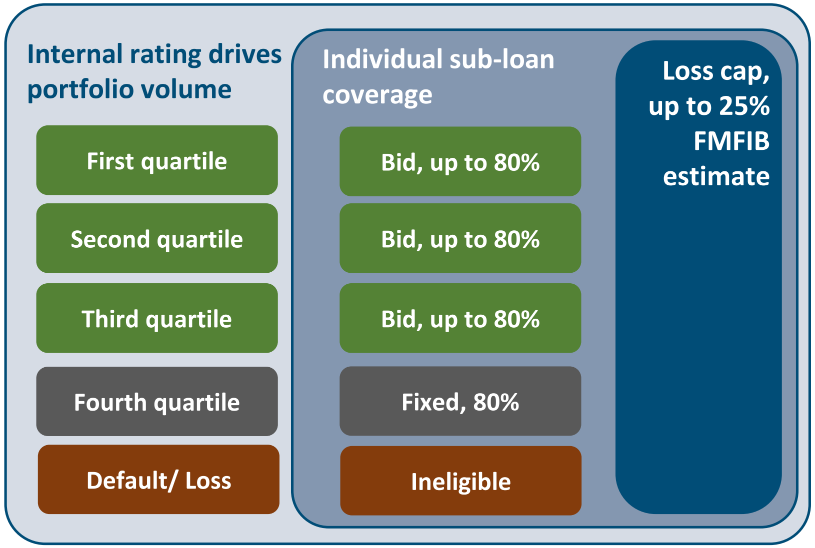
Guarantee mechanism



- The details of the proposed guarantee would be construed in a contract between the intermediary and FMFIB as guarantor
- In return, the intermediary would originate a portfolio of eligible loans
- The intermediary may send guarantee claims directly to FMFIB which we will promptly pay as per the terns of the guarantee agreement
- The FMFIB obligation would be covered by a cash collateral in BGN. The cash would be deposited in a special account of FMFIB with the Bulgarian National Bank. The account balance would be blocked and pledged in favour of the respective intermediary

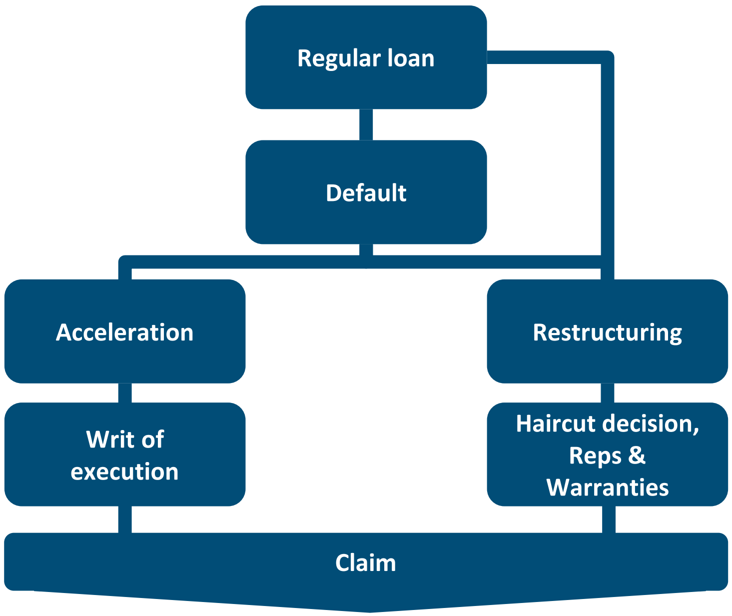
Summary of the financial instrument

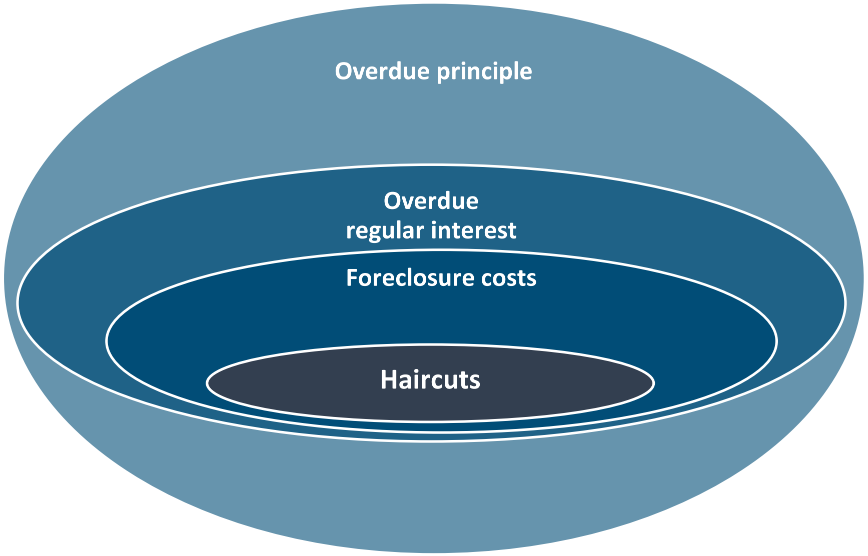




- Guarantee issued by FMFIB would reimburse the intermediary for up to 80% of the covered losses in relation to a sub-loan duly included in the Covered portfolio
- Notwithstanding any other provisions, FMFIB would limit its exposure (i.e. losses) towards the respective intermediary with a loss ceiling or cap. The cap would be determined by a specific risk assessment methodology and would never exceed 25 % of the potential cumulative loss related to all sub-loans included in the portfolio
- Currently, FMFIB contemplates to base the estimation of the cap on either:
  - Market data on NPLs in the banking system as reported by the BNB
  - The share of Stage 2 and Stage 3 exposures as defined under IFRS 9 in the total SME portfolio of each particular bank
- In addition, FMFIB considers to provide any interested banks to propose the rate of the coverage of the individual sub-loans
- The proposals in that resect would be differentiated by the credit rating (or scoring) of the particular borrower as assigned by the financing bank itself
- For convenience, the rating scales (besides the Default/ Loss ratings) of each bank would be divided in quartiles which banks would propose coverage for each quartile
- In light of the above, the resulting portfolios could exceed EUR 350 mln provided that the banks propose less than 80% coverage for certain quartiles

Covered loss. Triggers & claims. Irregularities





- FMFIB would reimburse the financial intermediary for any losses sustained with respect to the covered loan portfolio within the limitations set forth in the documentation
- FMFIB would cover overdue principle, regular interest and haircuts but no default interest and overdue fees
- The intermediary would have the right to cover external foreclosure costs with proceeds from release of collateral before distribution to FMFIB
- Claims could be submitted and would be processed following a receipt of Writ of Execution for each particular case
- In case of Irregularities or ineligible borrowers or cost, the respective limits would be excluded from the portfolio and the intermediary would not be able to enjoy the full guarantee cover over the loan life
- Irregularities and ineligibility may apply to the whole loan amount or could be partial
- If the Irregularities are caused by the borrower, the intermediary would have the right to accelerate and to claim the guarantee coverage in relation to the respective amounts
- If the Irregularities or ineligibility are caused by the intermediary the guarantee coverage will be rescind in relation to the respective amount

Indicative TS of the sub-loans

FUND OF FUNDS
FUND MANAGER OF FINANCIAL INSTRUMENTS IN BULGARIA

Option I

Maximum exposure of FMFIB, thresholds		
	Up to and including 5 years	**Up to and including 10 years**
Road transport	**Up to EUR 0.75 M**	**Up to EUR 0.38 M**
All other borrowers	**Up to EUR 1.5 M**	**Up to EUR 0.75 M**

Option II

- Option II entails calculation of net present value of Gross Grant Equivalent at all cases
- The estimation of the GGE is based on a "formal" risk premium defined by the Commission
- The GGE estimate in this case is based on the risk rating of the client
- Albeit complicated, this approach may allow for significantly larger loans particularly for shorter maturities

Option III

- Option III provides that the nominal amount of the loan is taken into account in calculating the maximum investment amount which shall not exceed **EUR 15 million**
- Under that option **only micro, small and medium enterprises are eligible**

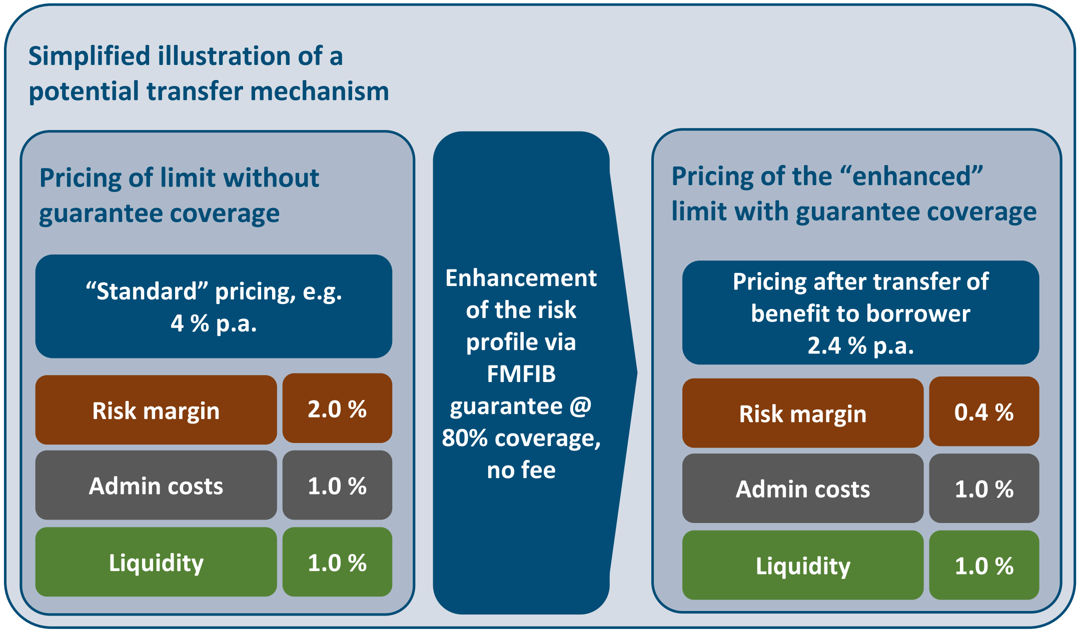
De minimis Regulation (Option I and Option II)

- The maximum loan amount is driven by the applicable State aid rules, i.e. the de minimis Regulation in this case
- In any event, the maximum maturity of the sub-loans would be 10 years from signing including any grace periods
- Thresholds of the individual exposures to group of connected borrowers is presented on the adjacent table
- However, the intermediary would have to calculate the Gross Grant Equivalent (GGE) in each case which under Option I is calculated as a corresponding proportion of the ceiling (EUR 200k) and under Option II it shall result in GGE bellow EUR 200k
- FMFIB would provide non-binding guidance and a GGE calculator outside the framework of the Guarantee agreement but the ultimate responsibility with respect to the compliance with the State aid rules would remain with the intermediary

GBER (Option III)

- In addition to the conditions outlined in the chart the borrowers shall comply with the following conditions: are unlisted SMEs and fulfil at least one of the following conditions:
  - they have not been operating in any market;
  - they have been operating in any market for less than 7 years;
  - they require an investment which is based on a business plan for entering a new product or geographical market and is higher than 50 % of their average annual turnover in the preceding 5 years.
- Similar parameters shall apply: the guarantee rate shall be limited to 80 % and total losses shall be capped at a maximum of 25 % of the underlying guaranteed portfolio
- Asymmetric loss-sharing between public and private investors may be applied.

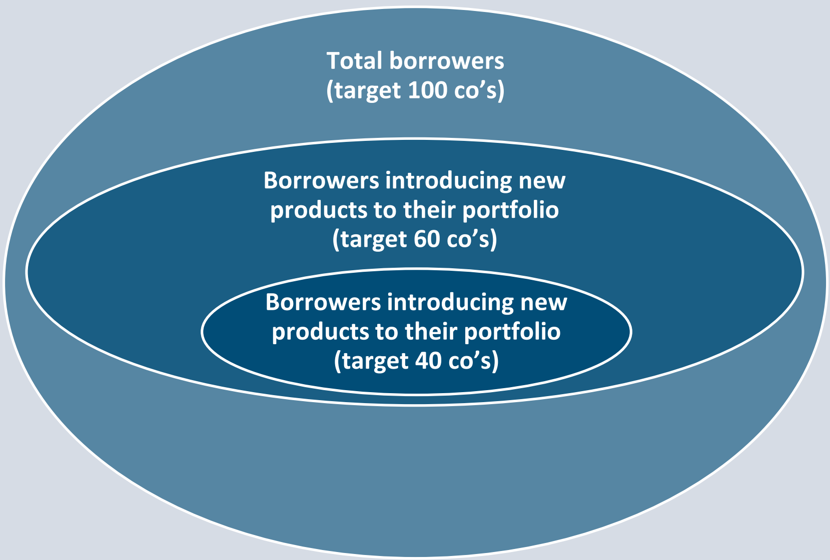
Transfer of benefits from the guarantee to borrowers



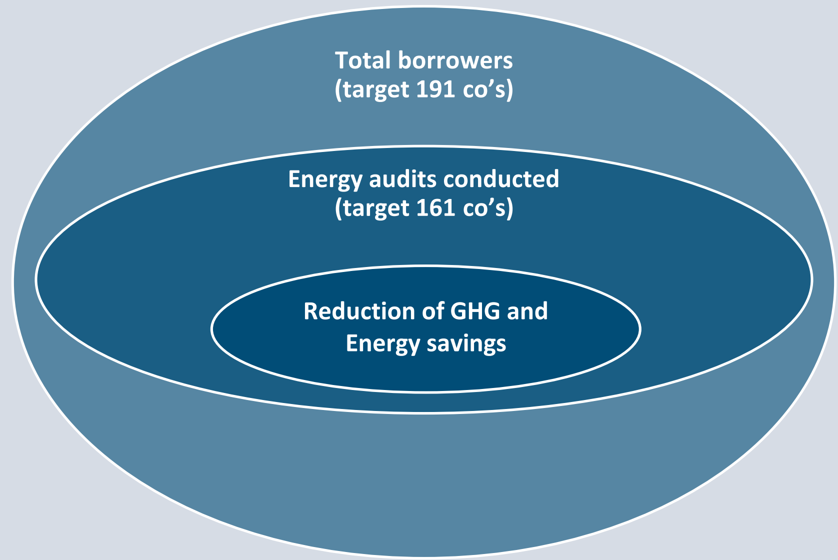
- Given the fact that economic benefit from the guarantees could be defined as state aid it should be transferred to the borrowers
- The benefit could be transferred through various mechanisms, i.e. *cet. par.* reduction of: loan pricing, collateral requirement, credit rating thresholds or a combination of these
- FMFIB contemplates to define the mechanism for transfer of the economic benefits to borrowers in the product Term sheet

KPIs

Innovation window

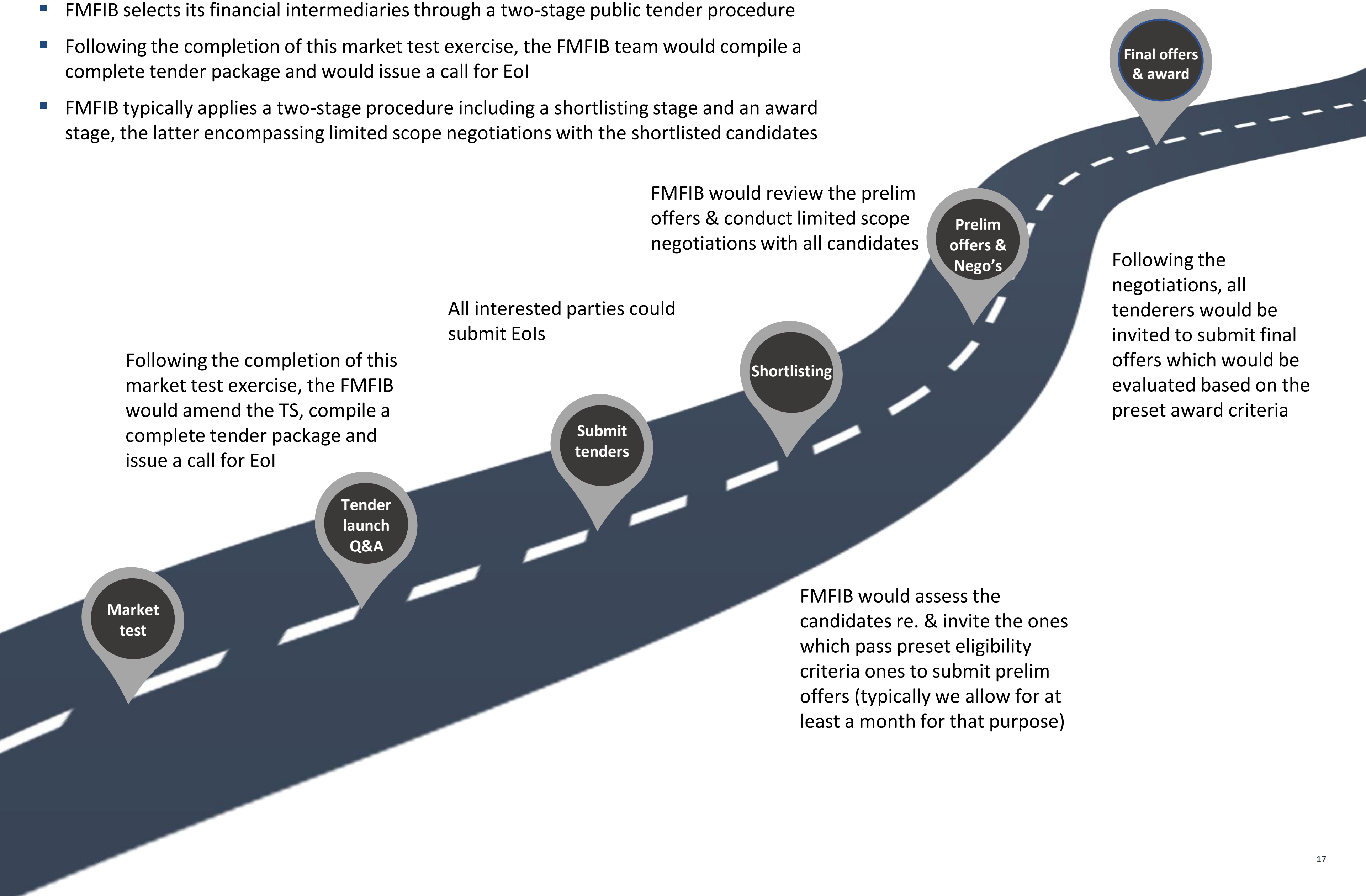


Energy efficiency window



Process roadmap

- FMFIB selects its financial intermediaries through a two-stage public tender procedure
- Following the completion of this market test exercise, the FMFIB team would compile a complete tender package and would issue a call for EoI
- FMFIB typically applies a two-stage procedure including a shortlisting stage and an award stage, the latter encompassing limited scope negotiations with the shortlisted candidates



Following the completion of this market test exercise, the FMFIB would amend the TS, compile a complete tender package and issue a call for EoI

All interested parties could submit EoIs

FMFIB would assess the candidates re. & invite the ones which pass preset eligibility criteria ones to submit prelim offers (typically we allow for at least a month for that purpose)

FMFIB would review the prelim offers & conduct limited scope negotiations with all candidates

Following the negotiations, all tenderers would be invited to submit final offers which would be evaluated based on the preset award criteria

Important notice

Opinion. Investment recommendation. Advice

This document ("the Document"), in whole or in part, is not to be construed as an opinion, or an investment recommendation, or a recommendation, or an advice to proceed or not with any considered transaction or other course of action.

According to the applicable regulations, the selection of financial intermediaries with respect to the implementation of the financial instruments under OPIC is subject to successful completion of a formal tender procedure and decision of FMFIB's competent authorities.

Change in regulations

The information provided in this Document is based on a number of laws and other regulations, both national and European, effective as of the date of its preparation. Changes in the applicable regulations may render the Document, in part or in whole, obsolete or not applicable.

FMFIB assumes no responsibility towards third parties in relation with any such changes, amendments as well as with respect to interpretations of either the law or other legal documents with respect to any legal forum. FMFIB shall assume no liability or responsibility for any costs, damage, losses or expenses incurred by any party arising out of use of or reliance on this Document.

Forward looking assumptions & extrapolations

This Document includes certain estimates and projections with respect to the future performance of the Bulgarian economy and the developments in the local SME segment. These reflect certain assumptions and extrapolations concerning the anticipated results, which may or may not prove to be correct and may have significant impact on the conclusions drawn herein. FMFIB does not assume any responsibility with respect to these assumptions and conclusions.

Document distribution

This Document has been prepared solely for the purpose stated herein and should not be used for any other purpose. Neither it nor its contents are to be referred to or quoted, in whole or in part, in any legal document without our prior written consent. This Document is intended for publication but it should not be reproduced or distributed without FMFIB prior express consent.

Third party information

In preparing this Document, we have used information and documents provided by the Managing authority of Operational programme "Innovations and Competitiveness" as well as information available from publicly available sources. In addition, we have used information provided by Consortium Partners for European Financing in Ex-ante assessment and strategy for effective implementation of the financial instruments under OPIC and should not be used for any other purpose without OPIC's or Consortium Partners for European Financing prior authorization. We have not sought to establish the reliability of the above mentioned data by reference or analyses and hence we do not accept responsibility for such information.

Important disclaimer

Any information you provide will be used solely for the purposes of market consultations in the context of the requirements of the Public Procurement Act ("PPA"). The terms and concepts used in this presentation have the same meaning as in the indicative technical specification of the Financial Instrument. The information provided is considered by FMFIB as indicative and does not cause obligation to you or FMFIB. In connection with the requirements of Article 44 of the PPA, FMFIB reserves the right to publish the received feedback without mentioning specific organization bringing it together with the answers from our side and occurred in this regard changes to the indicative technical specification (if applicable).

Contact details:

Fund Manager of Financial Instruments in Bulgaria

1606 Sofia, Bulgaria
30/32 Totleben Blvd