



COMMISSION OF THE EUROPEAN COMMUNITIES

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**ELISE**

(European Loan Insurance Scheme for Employment)

Reinforcing confidence through  
renewed investment and employment creation

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Proposal for a  
**COUNCIL DECISION**

on the provision of loan guarantees for investments carried out  
by SMEs creating employment

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(presented by the Commission)



**A. INTRODUCTION**

In its report presented to the Madrid European Council<sup>(1)</sup>, the Commission referred to the widespread recognition within the EU that small and medium-sized enterprises are one of the key sectors for generating employment opportunities and growth in the European Union. Both the Community and the Member States at national, regional and local level, already try to unlock the potential of SMEs through an array of policy measures and support schemes.

Available evidence clearly shows that SMEs, particularly at the smaller end, now play a key role in terms of growth and that these firms moreover generate an above average share of new jobs. Due to a number of basic market and policy imperfections in a number of areas (regulatory environment, labour market, access to new technologies, product and services market, access to financing, etc.), their full potential for growth and employment creation is however not properly realized.

**B. ACCESS TO THE FINANCIAL MARKET**

SMEs are much more dependent on internal sources of funds (e.g. own capital, retained profits, etc.) than the larger ones, and typically face a difficult financial environment. Bank lending constitutes the predominant form of external funding for these firms. However, many firms experience serious difficulties in getting access to sources of long-term lending in order to finance their investments and to expand their activities.

This problem is of particular relevance for small and medium-sized enterprises, as banks consider that the credit risks applying to these companies are high (failure rates indeed exceed those applying to larger companies), notably also because these enterprises are often under-capitalized. They are, moreover, often unable to provide adequate collateral or other forms of loan security required by banks. This situation is exacerbated in the case of transnational investments, as banks are reluctant for a variety of reasons to finance cross-border operations.

The small and medium-sized firms, which manage to get access to sources of loan funding, will generally end up paying higher interest rates than the ones charged to large companies. These impediments have a significant adverse impact on their development and thus on their potential for growth and for job creation.

**C. RELEVANCE OF LOAN GUARANTEES**

Loan guarantees constitute a powerful and cost-effective tool to help overcome these obstacles, both by facilitating the access to sources of lending and by bringing down the level of borrowing costs. Following the establishment of the European Investment Fund (EIF) on 14 June 1994 (see section D below), the Community is endowed with a specialized institution for the extension of loan guarantees, notably in favour of SMEs. For operations involving SMEs, the Fund operates in an indirect manner i.e. through financial intermediaries, while the loan guarantees are not extended on an individual basis, but to portfolios of loans. The appraisal of the individual loan applications is carried out by financial intermediaries; these institutions remain exposed to a certain share of the credit risk of the loan (in general 50%) in order to ensure the quality of their appraisal work.

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<sup>(1)</sup> Small and medium-sized enterprises, a dynamic source of employment, growth and competitiveness in the European Union. Report presented by the European Commission to the Madrid European Council. Brussels, December 1995.

As the EIF operates on a commercial basis, it charges guarantee premiums in order to cover the risks taken on, as well as its operational costs. By covering the cost of the EIF guarantee premiums through the budget, the Community will ensure that these guarantees are provided to the beneficiaries at no cost. As the budgetary cost of the guarantee premiums is relatively modest in comparison with the corresponding volume of guaranteed loans (which themselves cover part of the cost of the associated investments), a significant leverage effect can be obtained with limited budgetary resources. These financial interventions benefiting enterprises must be coherent with the principles of Community State aid policy. Eligibility criteria regarding beneficiary enterprises will be in compliance with Commission Recommendation C(96) 261 final.

This guarantee approach has also been adopted in the framework of the "Growth and Environment" pilot project, where enterprises carrying out investments producing environmental benefits get access to EIF loan guarantees at no cost. It should be noted that the loan guarantees extended by the Fund do not create any contingent liabilities upon the Community budget, as any claims resulting from calls being made upon the guarantees will be honoured by the Fund.

#### D. SUMMARY DESCRIPTION OF THE EIF

The creation of the EIF was decided at the European Council in Edinburgh. The Fund has an authorized capital of ECU 2 billion, of which 30% has been subscribed by the Community and 40% by the EIB. An important number of financial institutions (currently 78), representing all Member States of the European Union, constitute the third part of the Fund's shareholder base. The Fund has been formally established on 14 June 1994 and is located in Luxembourg.

The activities of the EIF are focused on two target areas of Community interest, namely trans-European networks (TENs) and small and medium-sized enterprises (SMEs). The Fund is currently providing loan guarantees in both areas of activity, while its Statute also allows for the provision of equity, subject to a favourable decision by the Fund's General Meeting in June 1996.

The total amount of operations approved by the EIF since inauguration amounts to approximately ECU 1.5 billion, of which about 10% concerns SMEs; a further amount of SME operations is under appraisal. In addition, the Fund is currently preparing the signature of contracts corresponding to about ECU 0.5 billion in the framework of the "Growth and Environment" scheme.

#### E. DESCRIPTION OF THE PROPOSED COMMUNITY SCHEME

While SMEs, and particularly small firms, are at a disadvantage to obtain bank funding, they are also the biggest creators of jobs. The annexed Decision on the establishment of a guarantee scheme, which the Council is invited to adopt, will effectively encourage investment programmes by these companies when linked to employment creation. The scheme will have a double impact as it will not only facilitate access to bank funding, but also reduce the interest rates charged to the borrowers.

The benefit of the loan guarantee scheme will be restricted to SMEs, and particularly small enterprises, while only investment projects involving the creation of employment will be eligible. The guarantees provided by the EIF will in general cover 50% of the amount of the loan, while transnational investments (such as the creation of a production, research or distribution facility in another Member State, or the creation of a joint venture) will enjoy priority access to the scheme and benefit from guarantee cover up to 75% of the loan size.

The scheme will be implemented by the EIF, while the loans will be extended by a network of financial intermediaries throughout the European Union. The Commission and the Fund will ensure that the network of intermediaries is sufficiently broad to ensure that

the scheme operates on a fully competitive basis in the interest of SMEs. As a starting base, this network will include banks operating as intermediaries in the framework of the EIB's global lending programme. The conditions applying to the Bank's lending ensure that the loans are used for productive investments and for suitable projects. Within this network, priority will, moreover, be given to financial institutions with particular experience and interest in SME lending. Other financial institutions with the necessary qualifications (e.g. guarantee institutions) will also have the possibility to join the network and become involved in the scheme. The Fund will sign framework agreements with these financial intermediaries.

The detailed terms and conditions applying to this new scheme will be set out in a cooperation agreement, to be signed between the Commission and the EIF. The conditions relative to the creation of employment will be largely inspired by the ones which apply to the SME facility.

#### F. FINANCING AND EVALUATION

The proposed Council decision is for an initial scheme, lasting 24 months at most from the date of its adoption, which will be financed entirely by ECU 25 million entered in the 1996 budget on the "Employment and Growth for Europe" budget line (B5-322). This requires the prior adoption of an SAB for this line.

The aforementioned amount of budgetary support will allow for EIF guarantees covering a total loan portfolio of ECU 1 000 million. The budgetary appropriations destined to cover the cost of the guarantee premiums will be transferred directly to the Fund and into a special Community account. Neither the financial intermediaries nor the final beneficiaries will therefore receive Community funds in a direct manner.

The Commission will report on the implementation of this scheme to the budget authority and will provide an overall evaluation of the functioning and impact of the scheme within 18 months at most from the date of its adoption. On this basis, the Commission will decide whether to propose to the legislative authority an extension of the scheme.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 235 thereof;

Having regard to the proposal from the Commission<sup>(1)</sup>;

Having regard to the opinion of the European Parliament<sup>(2)</sup>;

Whereas the European Council, meeting in Brussels on 10 and 11 December 1993, adopted the White Paper on Growth, Competitiveness and Employment, as the basis for action by the Community and its Member States, supporting the development of SMEs as a key element of increased competitiveness in the Community; whereas the White Paper, in particular Chapter 2 thereof, emphasized the importance of SMEs for the competitiveness of European industry; and whereas specific attention has been drawn to the need to improve access to sources of financing and credit;

Whereas the Commission presented a report to the European Council in Madrid on 15 and 16 December 1995, entitled "SMEs: a dynamic source of employment, growth and competitiveness in the European Union", in which in Chapter III.D, the Commission put forward a number of concrete action proposals as regards improved access of SMEs to appropriate sources of funding;

Whereas the Presidency Conclusions of the European Council in Madrid referred, in relation to SME policy, to the need to "improve the financial environment for them by means of better access to capital markets and encourage development of the European Investment Fund function with regard to SMEs";

Whereas, on 14 June 1993, the Council adopted Decision 93/379/EEC<sup>(3)</sup>, relative to a multi-annual programme of Community actions; whereas, on 20 March 1996, the Commission adopted a proposal for a third multi-annual programme for enterprises, in particular SMEs, in the European Union<sup>(4)</sup>; and whereas this Decision should be complementary with these programmes, and should constitute part of the Integrated Programme in favour of SMEs and craftsmanship;

Whereas, on 22 November 1993, the Council adopted a resolution on the reinforcement of the competitiveness of enterprises, notably small and medium-sized enterprises and craftsmanship, and the development of employment<sup>(5)</sup>;

Whereas the present initiative should be in compliance with Commission Recommendation [C(96) 261 final];

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(1) OJ No

(2) OJ No

(3) OJ No L 161, 2.7.1993, p. 68.

(4) OJ No

(5) OJ No C 326, 3.12.1993, p. 1.

Whereas bank lending constitutes an important, if not predominant, form of external funding for small and medium-sized enterprises; whereas such enterprises experience particular difficulties when trying to obtain access to sources of loan finance, because of the fact that credit risks are perceived to be higher than for loans granted to larger companies, and because such enterprises are often unable to provide sufficient collateral or other forms of loan security; whereas interest rates charged to such enterprises are generally higher than those applying to larger borrowers; and whereas the particular difficulties of financing innovative and new technology investments should be noted;

Whereas loan guarantees constitute a cost-effective instrument to facilitate access to loans and moreover lower the interest rates applying to these loans; whereas such guarantees should facilitate and stimulate investments by the beneficiary enterprises and should be extended exclusively in those cases where the loans and investments lead to the creation of employment; and whereas both material and immaterial investments should be eligible under the scheme;

Whereas investments with a transnational character deserve special attention in view of the fact that the impediments towards gaining access to sources of loan finance are exacerbated in comparison with other forms of investment;

Whereas the European Investment Fund (EIF) was set up in June 1994 to contribute to the pursuit of Community objectives by stimulating investment in trans-European networks and small and medium-sized enterprises; and whereas the Community has become a member of the Fund by virtue of Council Decision 94/375/EC<sup>(6)</sup>;

Whereas the Fund is empowered to issue loan guarantees according to its Statute; and whereas the cost of the guarantee premiums corresponding to these loan guarantees can either be borne by the beneficiary of the loan guarantee, or alternatively by a third party, notably by the Community;

Whereas the payment of the guarantee premium by the Community implies that the loan guarantees are provided at no cost to the final beneficiary, and whereas the credit risks associated with these loan guarantees are not borne by the Community budget, but by the EIF; and whereas a significant leverage effect can be achieved with a limited volume of budgetary resources;

Whereas the EIF has indicated its willingness to participate in the implementation of this Decision;

Whereas the EIF and the Commission will enter into a cooperation agreement on the implementation of this Decision; whereas the European Investment Bank (EIB) will be closely involved in the implementation of this Decision; and whereas the loans guaranteed by the EIF will be made available throughout the Community by a network of financial intermediaries;

Whereas the budgetary resources necessary for the payment of the premiums will be paid out directly to the EIF on a special Community account;

Whereas the loan guarantees are to be made available throughout the Community and be implemented as quickly as possible;

Whereas the Treaty does not provide powers others than those of Article 235 for the adoption of this Decision,

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<sup>(6)</sup> OJ No L 173, 7.7.1994, p. 12.

HAS DECIDED AS FOLLOWS:

Article 1

The Community shall provide subsidies for the purpose of paying the cost of the guarantee premiums linked to loan guarantees extended by the EIF on a volume of ECU 1 000 million of loans, subject to the availability of appropriations written into the Community budget. Only loans for investment projects involving the creation of employment, and extended to small and medium-sized enterprises, shall be eligible. Particular priority shall be given to small enterprises.

The guarantees shall apply during the whole life of the loans and shall in general cover 50% of the size of the loans. They shall be extended by the EIF under the usual terms and conditions applying to its guarantee operations. For investments with a transnational character, the cover rate may reach up to 75% of the size of the loans.

Article 2

The scheme shall operate for an initial period of up to 24 months from the date of its adoption. The scheme shall be administered by the EIF on behalf of the Community, exercising the same diligence as for operations carried out from its own resources.

The detailed terms and conditions for implementing this Decision, notably as regards the monitoring of employment creation, shall be laid down in a cooperation agreement between the Commission and the EIF.

Article 3

The Commission shall inform the European Parliament and the Council on the implementation of this Decision. The Commission shall, notably on the basis of the information made available by the EIF, and within 18 months at most from the date of its adoption, provide an evaluation on the overall utilization of the scheme and its impact on the creation of employment and on investment, notably for the purpose of assessing possible future action beyond the initial period.

Done at Brussels,

For the Council  
The President



## FINANCIAL STATEMENT

### 1. TITLE OF OPERATION

ELISE (European Loan Insurance Scheme for Employment).

### 2. BUDGET HEADING INVOLVED

B5 - 322.

### 3. LEGAL BASIS

Article 235.

### 4. DESCRIPTION OF OPERATION

4.1 General objective: Facilitate the access of small enterprises to sources of loan finance, through the provision of loan guarantees extended by the EIF (European Investment Fund). Only enterprises creating additional employment will be eligible.

4.2 Period covered: 1996.

### 5. CLASSIFICATION OF EXPENDITURE

5.1 NDC.

5.2 DA.

### 6. TYPE OF EXPENDITURE OR REVENUES

The expenditure will take the form of subsidies destined to cover the cost of the guarantee premiums, which are charged by the EIF for the extension of loan guarantees to the beneficiary enterprises on a loan volume of ECU 1 billion, extended by qualified financial intermediaries. The loan guarantees will be made available to the beneficiaries at no cost, as the cost of the guarantee premiums will be borne by the Community budget.

### 7. FINANCIAL IMPACT

#### 7.1 Method of calculating total cost

Total cost is estimated at ECU 25 million (taking account of the fact that the subsidies concerned will be transferred to the Fund on a present value basis). This cost figure notably includes all operational costs (management, administration, control, etc.) of the Fund, promotion costs and the costs related to an independent evaluation of this action.

#### 7.2 Distribution of costs (in current appropriations)

	Budget 1996	TOTAL
Subsidies (guarantee premiums)	ECU 25.0 million	ECU 25.0 million

### 7.3 Indicative schedule of appropriations

#### 7.3.1 Schedule for proposed new action

	1996	TOTAL
Appropriations for commitments	25.0	25.0
Appropriations for payments	25.0	25.0

(current appropriations; in ECU million)

## 8. ANTI-FRAUD MEASURES

The appraisal, monitoring and administration of the loans will be carried out by qualified financial intermediaries and subject to certain contractual conditions imposed by the EIF. The intermediaries have an interest in the successful conclusion of the lending operation as they will cover the remaining part of the credit risk on the loans.

As regards the creation of employment, an administrative follow-up mechanism will be implemented by the Commission and the EIF in order to verify that the necessary conditions have been complied with by the beneficiaries.

## 9. ELEMENTS OF COST-EFFECTIVENESS ANALYSIS

### 9.1 Specific objectives

- The proposed operation will foster and accelerate the implementation of investment programmes by SMEs because the loan guarantees will facilitate and enhance the access of these companies to loan finance. The loan guarantees will, moreover, lower the interest rates applying to these loans. The proposed action will be specifically targeted towards investment programmes leading to the creation of additional employment. In addition, the underlying investments will strengthen the competitiveness and profitability prospects of these enterprises and contribute to economic growth.
- Target population: small and medium-sized enterprises creating employment. Particular priority will be given to small enterprises.

## 9.2 Justification of the action

- By facilitating the access of SMEs, and particularly small enterprises, to sources of bank lending, and by reducing the cost of this lending, an important incentive is provided to these companies to consider additional investments, specifically when linked to the creation of jobs. Renewed impetus in the field of productive investment, notably by such firms, contributes to the reinforcement of growth perspectives within the European Union and the creation of extra jobs.
- Choice of modalities: the usefulness of loan guarantees as a stimulator of investments, particularly by SMEs, has been extensively demonstrated in the past at various levels. Loan guarantees are extremely relevant as such companies typically face difficulties to attract sufficient funding because of the fact that the perceived credit risk is higher and/or available collateral insufficient. The loan guarantees will be extended by the EIF, which has been set up to further objectives of Community interest, notably in the area of the financing of TENs (trans-European networks) and SMEs. The Community is a shareholder of the Fund, owning 30% of subscribed capital, while the EIB owns a further 40% of the subscribed capital. This offers the advantage of channelling Community aid through a well-established institution, familiar with Community rules procedures and closely linked to the European Investment Bank.

## 9.3 Monitoring and evaluation of the operation

The following elements will be considered when evaluating the overall effectiveness of the proposed action:

- the overall amount of employment created in the framework of the present initiative;
- the overall take-up of loans under this initiative;
- the aggregate volume of investments realized in the context of the present action.

The budget authority will be informed of the impact of this initiative. Possible extensions of the action will be examined in the light of the results achieved and the evaluation of the initiative, which will be transmitted to the budgetary authority within 18 months at most from the date of its adoption.

## 10. ADMINISTRATIVE EXPENDITURE

The proposed operation will not involve any increase in the number of Commission staff or administrative expenditure.

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# DOCUMENTS

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