



BLACK SEA TRADE AND DEVELOPMENT BANK

SPECIAL FUNDS

**BSTDB DONOR SUPPORTED
PROGRAMS FOR CO-FINANCING
& TECHNICAL ASSISTANCE**

**THESSALONIKI
OCTOBER 2010**

SPECIAL FUNDS: BSTDB Donor Supported Programs for Co-financing and Technical Assistance

TABLE OF CONTENTS

Executive Summary

- 1. Overview of the Black Sea Trade and Development Bank**
- 2. Special Funds & BSTDB**
- 3. Institutional Mandate for Special Funds**
- 4. Objectives of the Special Funds Program**
- 5. Applications of Special Funds**
- 6. Types of Technical Assistance Activities**
- 7. BSTDB Management and Operation of the Special Funds Program**
 - (i) Bank Administrative Capacity*
 - (ii) Bank Approval Process for Special Funds*
 - (iii) Framework Agreements versus Specific Ad Hoc Agreements*
 - (iv) Portfolio Risk Limit Considerations*
 - (v) Extent of Bank Execution Versus Recipient Execution of Trust Funds*
 - (vi) The Processing Cycle for Project Finance and Trade Finance*
 - (vii) Procurement Procedures*
 - (viii) Disbursement Procedures*
 - (ix) Reporting, Supervision, Post-Evaluation, and Audits*
 - (x) Cancellation, Restructuring, or Closing a Trust Fund*
 - (xi) Cost Recovery*
 - (xii) Possibility of the Bank Participation in Special Fund Managed Partly or Entirely by Another Organization*
 - (xiii) Conflicts of Interest and Risks of Liability*
 - (xiv) Contacting BSTDB*

SPECIAL FUNDS: BSTDB Donor Supported Programs for Co-financing and Technical Assistance

EXECUTIVE SUMMARY

Outline of proposal to establish Special Funds for activities in the Black Sea Region

BSTDB has an explicit mandate for Special Funds to promote activities

Broad scope for Special Funds' application

Including Co-financing...

This proposal lays out the rationale, the strategic objectives, the operational scope of coverage, and the modes of implementation for the design, set-up and implementation of Special Funds established with, and operated by, the Black Sea Trade and Development Bank (BSTDB). It is intended for multi-lateral institutions, official bilateral agencies and donors, as well as for profit and non-profit private sector entities- who are interested in cooperating with the BSTDB and enhancing the quality and scope of their existing or planned activities in the greater Black Sea Region.

BSTDB intends to use all available facilities in order to fulfill its dual mandate of promoting (i) development and (ii) greater regional cooperation among the founding Member States of the Black Sea Economic Cooperation; these 11 Members constitute the shareholders of BSTDB and comprise the area of coverage of Bank activities. In addition to its Ordinary Capital Resources, which consist of the Bank's capital stock, borrowed capital, and income derived from its regular operations, the Bank has made provision for Special Resources, defined as other contributions of capital to be provided for a specific purpose or purposes that help to promote fulfillment of the dual mandate of the Bank. Specifically, Article 12 (f) of the *Agreement Establishing the Black Sea Trade and Development Bank* states "The Bank shall carry out its operations... by deploying Special Funds Resources in accordance with the agreements determining their use". Article 16 of the Agreement states "The Bank may accept the administration of Special Funds provided by a Member State, a group of Member States, or a third party donor which are designed to serve the purpose and come within the functions of the Bank".

Special Funds may be dedicated for stand alone financing/ co-financing of projects, for provision of technical assistance, or some combination of these. They may be employed for a long time period covering a number of projects or technical assistance operations, or they can be limited in time and scope to a specific activity. Likewise, they may (i) be focused on specific sectors or countries of activity, (ii) promote a general theme topic, or (ii) be utilized on a case by case basis.

Co-financing (and stand alone financing) helps to mobilize additional resources for specific projects, either covering shortfalls or permitting a broader scope of coverage; co-financing helps financiers coordinate their programs, establish common policies and avoid redundancy or conflict in the implementation of their programs; co-financing permits donors interested in the Black Sea region- but either new to it, or without the organizational structure- to become involved through the Bank's capacity and network of operations. Thus, co-financing plays a strategic cooperation role in addition to its financial role, helping to rationalize policies and improve (i) the management of country-wide assistance programs and (ii) the implementation of individual operations.

Provision of technical assistance is an equally critical element in the successful fulfillment of the mandate of the Bank. In addition to requiring additional financial resources, the countries of the greater Black Sea region often

... and
Technical
Assistance

require technical resources in order to gain access to new ideas, best practices, latest knowledge and know-how, new techniques, or new technologies in a specific area of interest. It is an additional activity, intended to serve the objectives of BSTDB, when financing may not be otherwise available in a ready form to clients.

BSTDB
promotes
Regional
development
&
integration

The availability of technical assistance will increase the impact of BSTDB's activities, helping to complement, expand, and enhance Bank programs. BSTDB plans to sign agreements with interested donors who will provide technical assistance in areas such as financial accounting, feasibility studies, environment, and corporate governance, among others.

The Black Sea Trade and Development Bank, in accordance with its mandate, aims to play a catalytic role in the Region, supporting public and private sector projects, with high developmental impact, which also promote increased cooperation among Member states. The main value added of BSTDB is in filling key niches which promote regional economic activity, but which are not adequately covered by other actors at present- either governments, international organizations, or private banks and enterprises.

The
challenge of
mobilizing
knowledge
and capital
for the
benefit of
the Region

A significant operational challenge for BSTDB is to leverage its assets to bring in maximum flows of capital and know-how into the Region. Given its capacity and funding, BSTDB intends to inspire positive movement, ensuring that the operations in which it becomes involved are economically sound and actively assist market development, at sectoral, institutional, and even enterprise level. Similarly, one of the key contributions BSTDB can make to the Region is increasing knowledge about the Region, including improving access to information, and contributing to the development of greater managerial, technical, and financial capacity in the region

Special
Funds are an
additional
operating
tool to meet
the
challenge

In order to meet this challenge, the Bank has made provision for the establishment of Special Funds, trusts, endowments, or other pools of resources which may be used for operational purposes that further the mandate of the Bank. Typically, these Special Funds would be established to provide financing for projects (usually joint co-financing, but on occasion also stand alone financing) or to provide technical assistance to build capacity, effect skill transfer, provide know-how, or to help improve the quality and flow of information available. The Bank has developed the internal procedures to design and operate Special Funds, and it possesses the necessary experience and capacity to maintain efficiency, transparency, and consistency with the intended objectives of the Special Funds.

Institutional
cooperation
a key for
success

The Bank is a small institution, but it can play the role of a catalyst for both public and private sector operations. Most significantly, it can- and already does- cooperate with multilateral, official bilateral, private financiers to channel additional resources into the Black Sea region, thus contributing to the processes of development and deepening cooperation, while ensuring that the operations in which it becomes involved are economically sound and actively assist market development. The Bank intends that Special Funds will play a significant role for such activities, offering an additional vehicle through which multi-lateral, official bilateral, and private sector entities may be mobilized for the complementary processes of regional development and increased cross-country integration.

BSTDB currently operates two Special Funds, and is constantly updating its knowledge and contacts with international financial institutions that have

BSTDB
intends to
work with
all interested
public,
private, and
multi-lateral
entities

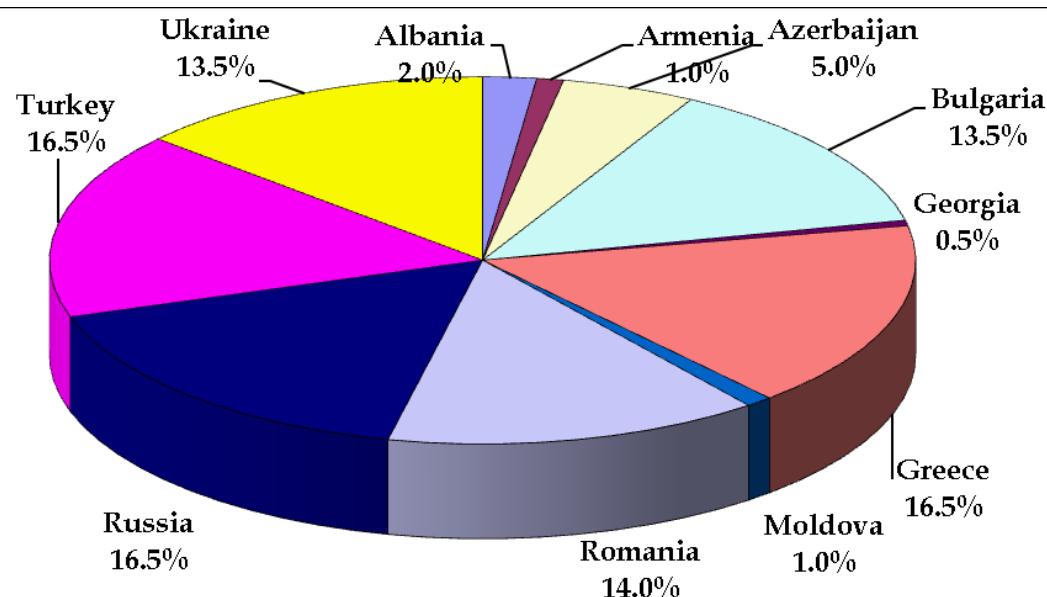
experience in handling Special Funds, and with representatives of the governments and/ or organizations that provide funding or act as donors for Special Funds- either for technical assistance or for co-financing. Potential donors have been targeted for their interest in the greater Black Sea region, and for their track record in providing effective development assistance in the past. The Bank has organized numerous events bringing together public and private sector representatives with an active interest in the Black Sea Region, and will continue to play a pivotal role in bringing together parties which desire to discuss and coordinate regional development and cooperation issues.

BSTDB Donor Supported Programs for Co-financing and Technical Assistance

1. Overview of the Black Sea Trade and Development Bank

The Black Sea Trade and Development Bank (BSTDB) is an international financial institution (IFI) established in February 1998, upon the initiative of the Black Sea Economic Cooperation Organization (BSEC). The founding Member Countries of BSEC are the shareholders of BSTDB, as follows:

Albania-	2.0%	Bulgaria-	13.5%	Moldova-	1.0%	Turkey-	16.5%
Armenia-	1.0%	Georgia-	0.5%	Romania-	14.0%	Ukraine-	13.5%
Azerbaijan-	5.0%	Greece-	16.5%	Russia-	16.5%		



Shareholding Structure of the Black Sea Trade and Development Bank

BSTDB, which commenced operations in June 1999, possesses the dual mandate to (a) promote regional cooperation among, and (b) support economic development in, Member States principally via the financing of operations in the private and public sectors. This mandate guides the operational vision of the Bank to establish itself as a pre-eminent partner financial institution for the Black Sea Region:

- (i) catalyzing regional trade and investment,
- (ii) attracting external investors,
- (iii) nurturing regional businesses and financial institutions, and
- (iv) contributing to cooperation in the Black Sea Region and to the promotion of common regional perspectives.

The initial authorized capital of the Bank was SDR 1 billion¹. In December 2007, the Bank's shareholders decided to increase the authorized capital by three-fold to SDR 3 billion, while the subscribed capital offered to the existing shareholders was doubled to SDR 2 billion, of which the paid-in portion would remain at 30%. The Bank enjoys preferred creditor status and offers a standard array of financial products, mainly loans, but also equity investment,

¹ SDR= Special Drawing Rights- 1 SDR approximately equals 1.50 \$US, October 2010.

guarantees, or combinations depending on the requirements of the potential recipient and the nature of the operation. A distinctive feature of BSTDB is its explicit mandate to promote trade, mainly via revolving credit lines to local financial intermediaries, which then provide financing to Regional exporting and importing firms.

BSTDB operations have grown at a rate which seeks to balance the need for expansion with the need to lend prudently. This approach has contributed to the Bank achieving a Baa2 credit rating with Moody's in 2003. BSTDB was upgraded by Moody's to Baa1 in October 2006 and to A3 in October 2010, and currently possesses a rating that is higher than the long term sovereign rating of each of its 11 shareholders. The Bank has consistently maintained positive net income for several years and has built up a robust portfolio of operations. While the Bank is still small, it is growing and it has established a position in the Black Sea Region as a key option for firms seeking to obtain greater access to funds and to mitigate country risks.

During its years of operation, BSTDB has also sought to promote the Black Sea Region in the course of its activities by developing relationships with IFIs as well as donors which have shown interest in the Region. The Bank is party to two MoUs concluded by the European Commission with leading IFIs, and has granted observer status to the Association of European Development Finance Institutions, the European Investment Bank, the International Finance Corporation, the International Investment Bank, KfW of Germany, the Nordic Investment Bank, OeDB of Austria, and Proparco of France.

In coming years, BSTDB intends to continue its strategy of managed growth that seeks to strike a balance between sustainable expansion with the desire to meet the growing financing needs of the Region. As it does so, the Bank will seek to diversify further its activities to meet growing needs in areas such as infrastructure, municipal services, and the emergence of so-called 'second tier' firms- less well established and with a smaller track record, but which show growth promise, management quality, and vision. These will be supported by a growing array of instruments including targeted financial support to the SME sector, continuation of trade finance activities, and the expansion of the use of equity to assist clients to mobilize substantially higher levels of external resources. The Bank will also target clients for operations may yield important energy efficiency and environmental benefits and intends to intensify its efforts to identify more cross-country operations, in order to achieve ever greater regional cooperation impact.

2. Special Funds & BSTDB

BSTDB seeks to leverage its assets in order to bring in maximum flows of capital and know-how into the region. In view of the limited resources of the Bank and the ambitious political and economic priorities of its Member States, development and implementation of a policy to attract and utilize Special Funds is essential to the successful achievement of the mission of the Bank. Consequently, the Bank has developed a strategy for Special Funds, putting it within the context of its overall operations and defining clearly the objectives.

Special Funds represent a form of additional resource mobilization. By definition, they are beyond the Bank's Ordinary Capital Resources and are mobilized from outside sources. They differ from other forms of resource mobilization in that they generally come in the form of grants², and they have an 'identity' in that the funds are earmarked for their end use, or are labeled by the country, organization, or firm from which they originate.

² It is almost inconceivable that Special Fund resources might arise from bond issues or general loans, no matter how concessional. Crucially, they imply that the Bank is incurring a liability, and therefore for purposes of internal risk management they need to be counted among the Bank's Ordinary Resources which are subject to exposure limits. Though unlikely, resources for a credit line could be set up as a Special Fund if the resources (i) come from

Special Funds generally mean the mobilization of funds to support high priority activities by providing (i) technical assistance, (ii) resources to finance projects on a stand alone basis, and (iii) co-finance projects by adding these resources to other BSTDB resources³.

Technical Assistance

Technical assistance⁴ may be for conveyance of general knowledge, or for transmission of specific ideas and methods in order to complete a particular task. Normally such assistance takes the form of a facility to provide access to new ideas, best practices, latest knowledge and know-how, new techniques, or new technologies in a specific area of interest. Its justification is based upon the necessity of having the activity or service in question, but its lack of availability due to problems of information, funding, or access. Therefore, it is an additional activity, one considered integral to promotion of the main objectives of BSTDB, that is not otherwise available in a ready form to clients. Another way of looking at it is that technical assistance should complement, expand, and enhance Bank programs.

Co-financing

Co-financing is the financing by two or more partners of activities to provide financing support for a project, program, or other activity. The partners are thus able to achieve consistency of approach in providing the financing, and/ or are able to mobilize funds in excess of those available to any one partner for the intended activity. Other benefits of co-financing include (i) helping donors that wish to be involved in the region to do so by using the Bank's capacity to support the development and implementation of operations,(ii) combining public and private financing to allow borrowers' access to private financing, and (iii) facilitating the establishment of working relationships with external public and private financiers.

In the context of Special Funds, such co-financing would most likely be "joint", meaning that it would be administered by BSTDB alongside other resources committed to a venture, since that is the very purpose of establishing a Special Fund. In addition to being administered by the Bank, joint co-financing normally implies the provision of funds for the same items as would be financed by other BSTDB resources. However, in certain cases the co-financing could be administered by BSTDB but be more "parallel" in nature- funding a discrete set of items distinct from those financed by other BSTDB resources.

3. Institutional Mandate for Special Funds

The *Agreement Establishing the Black Sea Trade and Development Bank*⁵ states that the Bank shall have the power to "establish and operate Special Funds for specific purposes" (Article 2.d). This foresees both "deploying Special Funds Resources in accordance with the agreements determining their use" (Article 12.f) and "participating in loans and providing technical assistance for the reconstruction or development of infrastructure, including environmental programs" (Article 12.g). Articles 16, 17, and 23.2.d additionally empower the Bank explicitly to carry out technical assistance and co-financing activities, and a number of other Articles indirectly lay an

an outside Donor, (ii) have specific uses for which they are intended, (iii) are concessional in nature, and (iv) either do not place a liability (of repayment) upon the Bank, or are determined by the Board of Governors to have a special nature that excludes them from Ordinary Resources.

³ For reasons of simplicity of presentation, references to Special Funds for co-financing in this text may be applied equally to co-financing and stand alone project (or trade) financing, except for those cases where distinct references are made to each.

⁴ A useful working definition of 'technical assistance' is the one provided in Operational Practice 8.40 of the World Bank which defines 'technical assistance' as "the transfer, adaptation, mobilization, and utilization of services, skills, knowledge, technology, and engineering to build (capacity) on a sustainable basis". Technical assistance (TA) is used interchangeably with 'technical cooperation' and 'technical coordination' in this paper.

⁵ The full text of the *Agreement Establishing the Black Sea Trade and Development Bank* is available at: http://www.bstdb.org/cps/rde/xfw/bstdb/Establishing_Agreement_of_the_BSTDB.pdf

enabling framework (e.g. Article 2.a/e/f). Section 12 ‘Co-financing’ of the *Rules and Regulations for Financing Projects and Commercial Activities* also makes provision for co-financing and coordination of activities with other institutions.

Furthermore, Resolution 16 of Board of Governors on 13 April 2001 states “Pursuant to Article 2(d) of the Agreement Establishing the Bank, the Bank is hereby authorised to establish and operate Technical Cooperation Special Funds for the purposes of financing the cost of technical assistance for project preparation and related operational activities to be carried out by the Bank consistent with its purpose and functions.”

Relevant Articles Pertaining to Special Funds from the *Agreement Establishing the Black Sea Trade and Development Bank*

Article 10 ORDINARY AND SPECIAL OPERATIONS

The operations of the Bank shall consist of ordinary operations financed from the Ordinary Capital Resources of the Bank referred to in Article 8 of this Agreement and special operations financed by the Special Funds Resources referred to in Article 17 of this Agreement. The two types of operations may be combined.

Article 11 SEPARATION OF OPERATIONS

1. The Ordinary Capital Resources and the Special Funds Resources of the Bank shall, at all times and in all respects, be held, used, committed, invested or otherwise disposed of entirely separately from each other. Financial statements of the Bank shall show the reserves of the Bank together with its ordinary operations and the special operations, separately.

2. The Ordinary Capital Resources of the Bank shall under no circumstances be charged with, or used to discharge, losses or liabilities arising out of special operations or activities for which Special Fund Resources were originally used or committed.

3. Expenses appertaining directly to special operations shall be charged to Ordinary Capital Resources of the Bank. Expenses appertaining directly to special operations shall be charged to Special Fund Resources. Any other -expenses shall, subject to *Paragraph 1* of Article 16 of this Agreement, be charged as the Bank shall determine.

Article 16 SPECIAL FUNDS

1. The Bank may accept the administration of Special Funds provided by a Member State, a group of Member States, or a third party donor which are designed to serve the purpose and come within the functions of the Bank. The full cost of administering any such Special Fund shall be charged to that Special Fund.

2. Special Funds accepted by the Bank may be used in any manner and on any terms and conditions consistent with the purpose and the functions of the Bank, with the other applicable provisions of this Agreement, and with the agreement or agreements relating to such Funds.

3. Each Special Fund shall be governed by specific rules and regulations adopted for such Fund by the Board of Directors. Such rules and regulations shall be consistent with the provisions of this Agreement and the law of the countries of operations of the Special Fund.

Article 17 SPECIAL FUNDS RESOURCES

The term "Special Funds Resources" shall refer to the resources of any Special Fund and shall include:

(a) Funds accepted by the Bank for inclusion in any Special Fund;

(b) Funds repaid in respect of loans or guarantees, and the proceeds of equity investments, financed from the resources of any Special Fund which, under the rules and regulations governing that Special Fund, are received by such Special Fund; and

(c) Income derived from the investment of Special Funds Resources.

4. Objectives of the Special Funds Program

The Special Funds program is fully consistent with the Bank's mission to mobilize financial and technical resources for the benefit of the Member States of BSEC. In addition, it is a critical necessity given the limited resources which BSTDB has and the challenging development agenda facing most of the Bank's Member States. Mobilization of such funds:

- (i) increases the impact of BSTDB's activities,
- (ii) provides an alternative route for raising funds without increasing the obligations or exposure of the Bank itself in project activities,
- (iii) improves harmonization of procedures and consistency of approach among co-financiers/ co-donors
- (iv) establishes working relationships with governments, organizations, and other entities with an active interest in the BSEC region, and
- (v) provides the opportunity to attempt different activities such as pilot projects, complicated ventures, undertakings with high development and/ or cooperation impact but low financial return, experimental endeavors with lengthier time horizons and other initiatives which for one reason or another might be considered high risk.

One essential element to achieving success is that any such effort should have clear and demonstrated 'ownership' by the beneficiary party or the sponsors. Furthermore, Special Funds, mobilized by BSTDB for purposes of providing technical assistance or additional co-financing resources, must promote the key objectives of the *Agreement Establishing BSTDB*. At a minimum, therefore, Special Funds should promote- preferably both, but at the very least one of- the two principal goals of (i) promoting cooperation among member states and (ii) contributing to the development of one or more of the member states.

Other major International Financial Institutions (IFIs), including the World Bank, the European Investment Bank, the Inter-American Development Bank and the Asian Development Bank have a variety of Trust Fund, Technical Assistance, and other Special Fund- type programs. They have received support from numerous donors, and have had great success over the years, helping to mobilize resources for development activities which otherwise would not have been possible.

Uses and Benefits of Special Funds

The Inter-American Development Bank in its publication *Technical Cooperation Trust Funds* mentions the following benefits that can emerge from Special Funds:

- Increasing the opportunities for reciprocal technical cooperation or exchange of experiences among member countries;
- Increasing the Bank's capacity for financing technical cooperation, in addition to its own resources;
- Promoting new forms of technical cooperation among the donor countries and the beneficiary countries;
- Helping to expand and diversify the exchange of external expertise, through access to the experience and knowledge of the relatively more developed countries;
- Promoting better and more intensified use of institutional, human, and physical resources from the relatively more developed countries to support pre-investment activities, execution of Bank loans, sectoral adjustment and implementation of policies, and institutional strengthening in the borrowing member countries
- Establishing links among public and private institutions of the various member countries and international organizations;
- Promoting integration of enterprises, association of private capital and expansion of commerce among all of the member countries;
- Promoting new opportunities for new joint investment opportunities; and
- Increasing the opportunities for the donor countries to have ever greater access to regional experience on economic and social development promotion, thus helping their aid programs for other regions of the world.

5. Applications of Special Funds

A Special Fund, depending on its nature, may be general purpose, permitting a wide scope of activities. Otherwise it may be earmarked for a specific country, a specific sector (environment, transport, etc.), or for a specific purpose such as strengthening cross-country cooperation or private sector development. Limitations on the free use of funds will generally impose direct and indirect costs which will need to be accounted (see also section on Establishing an Internal Framework for Management of Special Funds). Within the framework of co-financing and technical assistance, the types of Special Funds will fall into one of the following four categories:

Financing support for projects⁶. This includes co-financing and all activities which assist in the mobilization of external funds for a project, trade transaction or program. The co-financier (or stand alone financier) may request the Bank to administer the project- partly or in total- and disburse funds on its behalf, or it may disburse funds directly and employ the Bank for particular administrative functions. In the case of co-financing, the support may be *parallel*, meaning that the Bank and the co-financier finance different goods, services, or activities of a project. Otherwise co-financing may be *joint*, meaning that the Bank and the co-financier both finance specific goods, services, or activities of a project, according to some agreed apportionment of financing shares.

⁶ The term 'projects' here applies to project finance activities, as well as trade finance products and other programs which BSTDB may undertake (such as program credit lines).

Financing advisory services, research, or knowledge/ skills transmission. This could involve a range of activities including: project preparation and pre-investment work; from feasibility studies to strategic planning to project evaluation; training; institution building; seminars; secondments; scholarships and fellowships; and other pilot activities.

Preparation of studies. These studies would focus on issues of regional importance, country or cross-country interest, and sector (or cross-sector) concern. This could involve research and studies; focus on ways to promote regional integration; analysis of economic sectors; and seminars and conferences. This category contains much overlap with the financing advisory services category, except that the advisory services would tend to be directly involved with the preparation of a project or program for financing; preparation of studies is less directly operationally oriented and may cover research, issues of general interest, or establishing links with other research institutions⁷.

Supporting special regional programs. There may also be programs that contain elements of the previously described categories, addressing specific need(s) within the economies of the countries of operation. Such programs may be project/ transaction oriented, or they may be regionally focused, based upon sector policy development or cross-border initiatives (including countries and projects)

The common thread is that any initiative would address a specific need, and not substitute for Bank financing of regularly Bank budgeted activities.

6. Types of Technical Assistance Activities

The list below provides an indication of the types of technical assistance for which needs have been identified by Bank staff, as well as by other International Financial Institutions. A particular fund may be tailored to provide technical assistance for a particular type of activity, a particular group of activities, or for general needs identified later under the auspices of a framework fund. The list is not necessarily comprehensive, nor absolute, since new requirements may evolve over time requiring alternative forms of technical assistance to be established.

While there are numerous-often overlapping- ways to classify the various types of technical assistance available, BSTDB broadly defines technical assistance along four lines: (i) directly project oriented TA (ii) Research into a particular topic of interest or sector of activity, (iii) TA that is intended for provision of training, and (iv) other types of technical expertise involving various corporate and administrative skills which are necessary but not conveniently categorized. The reason for this particular set of distinctions is because BSTDB is an operationally oriented institution which will normally seek TA that can be practically translated into on the ground results, and more effective operations.

⁷ Such institutions may include other international financial institutions, academic institutions, private institutions such as think tanks, possibly even private research firms.

Priority TA Needs: Feasibility Studies

The feasibility study is an important, sine-qua-non, stage in project appraisal. In order for the Bank to undertake thorough evaluation of the costs and benefits of a project, to assess its estimated environmental impact and finally its economic viability and long-term sustainability, a substantial amount of time and financial resources need to be dedicated to primary and secondary research, where applicable. However, in the Bank's countries of operation the skills required for such an endeavor may be scarce or the data may be poor. This makes the preparation of the application costly and overburdening for the Bank's clients, in particular for medium size enterprises in the private sector which do not benefit from the participation of foreign capital.

Since capacity building and transfer of technology and know-how are some of the most useful long-term effects of Bank involvement in an operation, there is a clear need for external assistance in the preparation of feasibility studies. However, applicants are often unable to bear the costs of such studies, and the Bank is not in a position to cover the cost of such detailed and intensive planning work either. Therefore, there is an opportunity for cooperation with other donors who may be interested in assisting this vitally important project preparation activity.

The major areas that need to be covered are: (i) Technical or Engineering Module, in which the input parameters (quantities and types of inputs, prices, sources, concentration and availability of supply, information on and evaluation of the technology used) are specified in detail and cost estimates developed; (ii) Market Analysis Module, in which the demand for the goods and services and prices of the relative needs of social services are estimated, quantified and justified; and (iii) Environmental Impact Assessment

Direct Project Oriented

- Project Identification
- Feasibility Studies
- Project Appraisal
- Final Design
- Support/ Assistance to Project Implementation
- Project Supervision & Monitoring
- Post-Evaluation of Projects
- Rehabilitation of Existing Projects
- Institutional Design
- Institutional Strengthening

Sector Research

- Basic Studies
- Analysis of Economic Sectors
- Regional Cooperation Structures
- Promotion of Cross-Border Integration and Cooperation

Priority TA Needs: Research on Regional Cooperation Structures

Promotion of regional cooperation is a key raison d'etre of the Bank, but fulfillment of this mandate raises questions of how best to implement it. Studies of countries in the Black Sea region have either focused on a country individually or an economic sector of activity in the country. If there has been an international dimension, it has focused upon removal of trade barriers and liberalization of investment in order to integrate in the world economy. Such studies have tended to focus on preparing for accession to the European Union, or conforming to the requirements of the World Trade Organization. By and large there has been little work on the implications- at region-wide level- of improved regional cooperation and expanded trade links. Sector studies have tended to restrict themselves to one country, even though links to neighbors in areas such as transport and telecommunications are important, and there may be significant advantages such as economies of scale, or expansion of capacity, to coordinating trans-nationally. Regional studies at 'macro' level could assess trends and provide recommendations on future directions, including issues such as strengthening frameworks for cooperation and improving the compatibility of economic policies on trade and investment issues. Regional sector studies could link up the sectors across countries and identify key possibilities, opportunities to achieve efficiencies, and other sectoral prospects which would confer tangible economic and cooperation benefits to the countries concerned.

Training

- On the Job Training
- Preliminary Training
- Seminars and Informational Conferences

Other Types of Technical Expertise

<ul style="list-style-type: none">• Financial Management and Expenditure Control• Financial Reporting Methods and Standards• Restructuring Reviews• Management of Procedural Optimization Studies• Technical Evaluation	<ul style="list-style-type: none">• Management Information Systems• Other Equipment/ Input Upgrading• Market Operations Know-How• Enterprise Corporate Governance
---	--

Priority TA Needs: Financial Reporting Methods and Standards

Financial analysis forms the backbone of any appraisal. It is necessary in order to review financial performance of the clients/ sponsors involved and to assess the profitability (non-sovereign projects) or sustainability (sovereign projects) of the proposed operation. A sensitivity analysis testing assumptions and key factors is a necessary component of the financial analysis. However, the analysis can only be as good as the quality of the data available. A major problem encountered by the Bank in many cases concerns the lack of reliability of financial data provided.

There exists great need for credible financial reporting according to International Accounting Standards, both in terms of quality and type of information and formats. The reporting should accurately depict a firm's operations and projections. Whether it is assisting a firm to conform its existing figures to international accounting standards, or whether it involves assisting a firm to conduct financial reports in the first place, technical assistance can improve corporate governance and provide tremendous value added by helping to upgrade the quality of financial reporting and institutionalizing proper business accounting processes.

More specifically, technical assistance can begin to address a number of problems including differing methods of depreciation from one year to another, inventory valuations, provisions for losses etc. In addition, it can help improve the meaningfulness of the notes to the financial statements, making them suitably comprehensive so that they explain debt maturities, depreciation methods, accounts receivables and payables breakdowns, related party transactions and other accounting policies as well as subsequent events that may have material future financial implications.

7. BSTDB Management and Operation of the Special Funds Program

A number of operational and managerial issues are covered in this section. Two themes running through all of them are (i) how to incorporate Special Funds into the various internal operational procedures and processes, and (ii) to what extent will BSTDB procedures be adaptable to meet the requests or requirements of donors within a framework that does not impose unreasonable costs or intrusive reporting commitments. Transparency is a principle to be maintained in all cases, but with due regard to (i) reasonable confidentiality, (ii) the costs certain activities may impose upon the Bank, and (iii) the fact that harmonization of Bank operational procedures and Special Fund operational procedures will make management of the Special Funds more effective and ultimately, more transparent and responsive to both recipients and fund donors.

The following issues are covered in this section:

- (xv) *Bank Administrative Capacity*
- (xvi) *Bank Approval Process for Special Funds*
- (xvii) *Framework Agreements versus Specific Ad Hoc Agreements*
- (xviii) *Portfolio Risk Limit Considerations*
- (xix) *Extent of Bank Execution Versus Recipient Execution of Trust Funds*
- (xx) *The Processing Cycle for Operations*
- (xxi) *Procurement Procedures*
- (xxii) *Disbursement Procedures*
- (xxiii) *Reporting, Supervision, Post-Evaluation, and Audits*
- (xxiv) *Cancellation, Restructuring, or Closing a Trust Fund*
- (xxv) *Cost Recovery*

- (xxvi) *Possibility of the Bank Participation in Special Fund Managed Partly or Entirely by Another Organization*
- (xxvii) *Conflicts of Interest and Risks of Liability*
- (xxviii) *Contacting BSTDB*

(i) Bank Administrative Capacity

The Bank possesses the necessary capacity, and has the required internal operational policies to guide the establishment and operation of Special Funds for technical assistance and co-financing activities (and stand alone financing). The Bank has also developed the necessary internal procedures, equipment and software infrastructure, as well as staff skills to support such a venture. As a rule, management and use of Special Funds will conform to the structure of the *Operations Cycle Policy* Document to ensure consistency with ongoing operational policies. Procurement, unless otherwise agreed, would follow the Bank's Procurement Rules and Procedures both for retention of consultants and for financing of goods and services. In order to ensure consistency, ease of application, and comparability, the Bank's reporting formats for Special Funds- where applicable- will conform to the Operations Data Sheet for Projects (See the *Operations Manual*).

BSTDB has also gained practical experience in the operation and management of Special Funds through the successful administration of the two Special Funds it currently runs: (i) the Technical Cooperation Special Fund provided by the Hellenic Republic, and (ii) Technical Cooperation Special Fund provided by the Development Bank of Austria (OeEB)

(ii) Bank Approval Process for Special Funds

The Bank accepts proposals for Special Funds from any interested government agency, foundation, donor, or private firm. Similarly, the Bank itself may initiate proposals for Special Funds by approaching government agencies, foundations, donors, or private firms. After the proposal is developed, it would be submitted to the Bank's Credit Committee for final approval. Depending on the nature and complexity of a Special Funds proposal, it might be reviewed twice by the Credit Committee along the lines of operational reviews: once for Concept Clearance, in order to identify key issues and to clarify directions that will need to be followed; and once for final approval. Following final approval by the Credit Committee, the Special Fund would be presented for approval to the Board of Directors and subsequently to the Board of Governors for final agreement.

(iii) Framework Agreements versus Specific Ad Hoc Agreements

The Bank may enter into a 'framework agreement' for a Special Fund, under which activities could be financed directly. This would involve a financial and administrative arrangement between the Bank and an external donor under which the donor entrusts the fund to the Bank to finance a range of activities which are different in nature, or multiple activities of a similar nature. The framework agreement provides an overarching set of agreements under which project by project or case by case funds can be provided. It allows the case by case funding- either for co-financing or for technical assistance- to be provided with minimum reference to all the legal details- the case by case agreement can be almost entirely operationally oriented with just a reference to the framework. Alternatively, the agreement could be structured in such a way so that funds are drawn down for the agreed activities without having to agree with the donor each time. Once there is a framework in place, it becomes considerably easier to allocate additional funds. Thus, establishment of framework agreements is often an efficient way to reach understandings with a donor.

The alternative is to set up individual funds with a donor for a specified purpose or purposes with the full set of legal documentation- so called individual ad hoc arrangements. The formal agreement designates the Bank as administrator, and defines the terms and conditions for the use of the funds. Although less efficient, such an arrangement may prove easier initially with a new donor since it can establish a working relationship before undertaking a more expanded framework type of arrangement. Ultimately, preparing framework agreements or having individual case by case agreements will depend on two factors: (i) the Bank's own preference for one type of arrangement versus the other (with due regard to administrative costs and the efficiency of focusing on the details of technical assistance or co-financing for a particular project, rather than re-writing the framework of cooperation every time) and (ii) the preferences of the provider(s) of Special Funds, who may wish to limit the scope of involvement or to gradually develop a working relationship with a newly established organization such as BSTDB.

In both cases, framework and specific purpose agreements, the funds would be accounted separately from the Bank's ordinary capital resources.

(iv) *Portfolio Risk Limit Considerations*

According to Section 3.1 of the *Portfolio Risk Management and Investment Policies* paper of BSTDB (April 1999), Special Funds resources and related operations are excluded from calculation of the gearing ratio of BSTDB and other portfolio limit calculations. Those limits apply only to the Bank's Ordinary Capital Resources. Similarly, since Special Funds are not part of the Bank's Ordinary Capital Resources, they would not be factored into Country Risk, Sector Risk, Single Obligor, or Single Project Limits.

(v) *Extent of Bank Execution Versus Recipient Execution of Trust Funds*

This applies more for cases of technical assistance than for financing an operation where the lines of responsibility are clear. Borrower/ recipient execution of technical assistance makes better sense in terms of shifting the burden of proper procurement and getting the recipient to 'own' the process more. However, in certain instances Bank execution may make sense, especially where the time constraints are critical, the fund is of a regional nature, utilization capacity with the recipient is lacking, and international procurement is slow or burdensome when done by the recipient. Either way, the Bank insists that proper budget accounting and fund use accountability must be maintained in order to ensure transparency consistent with Bank standards.

(vi) *The Processing Cycle for Operations*

The crucial issue with respect to the preparation and appraisal cycle is to be as simple and consistent as possible with Bank procedures. Otherwise, as procedures for utilization of a Special Fund deviate relative to regular Bank procedures, there is exponential growth in the scope for inconsistency, incompatibility, and confusion.

An additional factor may involve the timing of the preparation/ appraisal for use of the proceeds of a Special Fund (particularly in the case of co-financing a project). The Donor may wish to follow a separate cycle, or the timing of the signing or length of an agreement may differ from the Bank's. Issues such as cross-effectiveness and cross-default also need to be kept in mind; in other words, what are the implications for a project in the event of a default⁸ affecting another party, or if an agreement for funding from one source (say the Bank itself) is signed, but no such agreement ends up being signed for the other source (say the Special Fund, since even if it is Bank administered, the Donor may wish to follow their own preparation cycle and process). The benefits of the availability of additional resources, and the greater impact and consistency of

⁸ Default is defined generally here. It may be financial, technical, or related to other key covenants of the project.

joint efforts would need to be weighed against the added complexity that use of the additional resources may impose.

(vii) Procurement Procedures

A fund would normally follow Bank procedures with respect to procurement. For reasons of simplicity, consistency with other Bank procedures, and maximum transparency, this will be the preferred course of action. In the case of technical assistance, this would mean the procedures for the selection of consultants and consulting firms. For projects, procurement rules and procedures for sovereign and non-sovereign projects would have to apply.

Although the Bank prefers that one set of procurement procedures is followed (namely, its own), a Donor may request that the Bank ‘tie’ use of fund proceeds to consultants (for TA) or firms (for co-financing) from that country and/ or the beneficiary countries. This is a common issue with funds provided by some institutions and certain bilateral donors. Open, or untied trust funds are preferable, for reasons of principle and practicality, as fewer restrictions promote greater economy, efficiency, and transparency. Nevertheless, as long as the special request of a Donor does not contravene Bank rules or impose excessive costs, the Bank may consider tied funds, since the fund’s objectives may be of high developmental or regional cooperation impact to the ultimate beneficiaries. However, the additional costs- administrative and financial- of managing such a fund will need to be accounted clearly.

(viii) Disbursement Procedures

Similarly to procurement, a fund would normally follow regular Bank procedures for disbursement of funds. This would maximize simplicity and consistency in the management of the fund and the execution of the program. Special requirements could be accommodated, but they would have to be consistent with the Bank’s rules on disbursement; moreover, the additional administrative and financial costs would need to be accounted clearly.

(ix) Reporting, Supervision, Post-Evaluation, and Audits

As a matter of policy, the Bank will provide consolidated quarterly reports to Donors on use of funds, and an annual supervision (or project evaluation) report on use of fund proceeds, with input from the managers involved in fund execution. For specific funds, Donors may participate in the preparation of relevant supervision and monitoring reports as well as the post-project or fund completion report. An Annual Audit of all the Trust Funds is also carried out, and its results are provided to Donors.

The Bank prefers that donors accept the Bank’s own reporting and accounting requirements so as to ensure maximum compatibility. However, Donor requests for special formats, reporting provisions, or auditing requirements, that go beyond the scope of the Bank’s regular accounting and expenditure control procedures may be considered as long as they are agreed upfront and do not impose undue time and administrative costs on Bank staff, or lead to a breach of confidentiality agreements with clients. Any extraordinary requests would be paid for by the Donor, unless it has been agreed upfront that for the Trust Fund in question the Bank will provide additional reports.

(x) Cancellation, Extension, Restructuring, or Closing a Special Fund

Any fund established will have a starting date, a description of its purpose, mention of the amount involved, and a closing date. It may also contain provisions for cancellation, extension, and additional contributions to the fund. The legal agreement under which the fund operates will determine these various factors, taking into consideration the Bank’s own policies on cancellation, extension, restructuring, and closing of projects. It will naturally consider the reasonable requirements of the Donor as well, with whom the Bank must delineate these alteration and closure issues when setting up a fund. This will include deciding how to allocate

cancelled resources, or resources unused at the end of the life of the fund. Similarly, questions of how to treat interest accrued will be clarified.

(xi) *Cost Recovery*

Article 16.1 of the *Establishing Agreement* mandates that costs must be fully charged to the Special Fund set up. This raises the question of how does this translate operationally as regards Bank's policy for coverage of costs for administration of funds that are established. The Bank may be flexible with respect to the forms of cost recovery, but as a matter of policy BSTDB will seek to cover costs- direct and indirect- of fund management and execution. There are numerous options which can be applied on a case by case basis with each Special Fund Provider, including: imposing a charge on trust fund principal, retaining investment income, reimbursement of actual costs, separate payment of an agreed fee, or some combination of these.

(xii) *Possibility of Bank Participation in Special Funds Managed Partly or Entirely by Another Organization*

This may arise in the case of a technical assistance or guarantee fund for a specific issue, such as a regional cooperation program or a post-disaster reconstruction effort. It would have to take the form of a project, or special program participation, rather than being looked at strictly as a Special Fund (as discussed here). Such participation would be considered on the basis of its developmental and/or regional cooperation impact, and more generally on the promotion of BSTDB's shareholders' interests. For example, a key consideration would likely be the degree to which it improves the access of the firms, governments, and/or other organizations to capital and technical resources.

(xiii) *Conflicts of Interest and Risks of Liability*

In order to minimize the risk of conflicts of interest, the following principles must generally be observed:

- The Bank should retain decision-making authority over the use of the funds (within the agreed framework agreement)
- The funds clearly advance recipient country interests and the Bank's policy and institutional objectives
- No special advantages or benefits accrue to the Donor

(xiv) *Contacting BSTDB*

More information about the Black Sea Trade and Development Bank can be found on the internet at www.bstdb.org , through a brochure which is available upon request, or by contacting the Bank directly at:

Banking Division
Black Sea Trade and Development Bank
1 Komninon Street
54624 Thessaloniki, GREECE
tel- 30-31-290400
fax- 30-31- 221796
website- www.bstdb.org

The Bank assesses all inquiries and applications promptly, and equally welcomes proposals for the private sector, the public sector, and from multi-lateral or other international institutions.