The World Bank

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Report No: 68467-HR.

PROJECT PAPER

ON A

PROPOSED ADDITIONAL LOAN AND RESTRUCTURING

IN THE AMOUNT OF EUR50 MILLION
(US$61.41 MILLION EQUIVALENT)

TO

CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

WITH THE GUARANTEE FROM THE REPUBLIC OF CROATIA

FOR THE

CROATIA EXPORT FINANCE INTERMEDIATION LOAN PROJECT

August 08, 2012

Finance and Private Sector Development
Central Europe and the Baltic Countries Unit
Europe and Central Asia

CROATIA - GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective August 1, 2012)

US $1	=	HRK6.12
EUR1	=	US$1.23

ABBREVIATIONS AND ACRONYMS

CEE	Central and Eastern Europe
CEFIL	Croatia Export Finance Intermediation Loan
CEFTA	Central European Free Trade Agreement
CNB	Croatian National Bank
CPS	Country Partnership Strategy
EA	Euro area
EBA	European Banking Association
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EMF	Environment Management Framework
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
FX	Foreign Exchange
GDP	Gross Domestic Product
HBOR	Croatian Bank for Reconstruction and Development
HRK	Croatian Kuna
IFC	International Finance Corporation
IFI	International Financial Institution
KfW	Kreditanstalt für Wiederaufbau
LoC	Line of Credit
NPL	Non-performing loan
PAD	Project Appraisal Document
PDO	Project Development Objective
PFI	Participating Financial Intermediaries
PIU	Project Implementation Unit
SEE	South Eastern Europe
SME	Small and Medium Enterprises
UN	United Nations
WB	World Bank

Vice President:	Philippe H. Le Houerou
Country Director:	Peter Harrold
Sector Director:	Gerardo Corrochano
Country Manager	Hongjoo Hahm
Sector Manager:	Lalit Raina
Task Team Leader:	Isfandyar Zaman Khan

CROATIA

EXPORT FINANCE INTERMEDIATION LOAN PROJECT
ADDITIONAL FINANCING AND RESTRUCTURING

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EXPORT FINANCE INTERMEDIATION LOAN PROJECT
ADDITIONAL FINANCING AND RESTRUCTURING

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Basic Information - Additional Financing (AF) and Restructuring	
Country Director: Peter Harrold Sector Manager/Director: Lalit Raina Team Leader: Isfandyar Zaman Khan Project ID: P129220 Expected Effectiveness Date: December 2012 Lending Instrument: Financial Intermediary Loan Additional Financing Type: Financial Intermediary Loan	Sectors: General industry and trade sector (40%); General finance sector (30%); Other industry (25%); Agro-industry, marketing, and trade (5%). Themes: Other financial sector development (50%); Other private sector development (50%). Environmental category: Financial intermediary assessment Expected Closing Date: August 31, 2015

Basic Information - Original Project	
Project ID: P116080 Project Name: Export Finance Intermediation Loan Lending Instrument: Financial Intermediary Loan	Environmental category: Financial intermediary assessment Expected Closing Date: August 31, 2013

AF Project Financing Data

[x] Loan [ ] Credit [ ] Grant [ ] Guarantee [ ] Other:
Proposed terms: IBRD Flexible loan at 6 month EURIBOR for Euro plus fixed spread with a 28.5 year maturity including a 7 year grace period, with level repayment of principle

AF Financing Plan (US$m)

Source	Total Amount (US$m)
Total Project Cost:	
Cofinancing:	-
Borrower:	-
Total Bank Financing:	
IBRD	**61.41**

Client Information
Guarantor: Republic of Croatia, Ministry of Finance Katanciceva 5, 10000, Zagreb Croatia **Borrower and Implementing Agency:** Croatian Bank for Reconstruction and Development (HBOR) Strossmayerov trg 9, 10000, Zagreb Croatia

AF Estimated Disbursements (Bank FY/US$m)

FY	FY13	FY14	FY15			
Annual	20	30	11.41			
Cumulative	20	50	61.41			

Project Development Objective and Description
Original project development objective: The objective of the Project is to support the preservation and growth of exports by providing medium and long term working capital and investment finance to exporters and foreign exchange earning enterprises. Project Description: This is a single component Financial Intermediation operation, which will support the establishment and operation of a credit facility within the Borrower for the financing of Sub-loans from participating financial intermediaries to beneficiary enterprises (exporters and foreign exchange earning enterprises) for the purposes of the carrying out of Sub-projects.

Safeguard and Exception to Policies

Safeguard policies triggered:	
Environmental Assessment (OP/BP 4.01)	[X]Yes [ ] No
Natural Habitats (OP/BP 4.04)	[ ]Yes [X] No
Forests (OP/BP 4.36)	[ ]Yes [X] No
Pest Management (OP 4.09)	[X]Yes [ ] No
Physical Cultural Resources (OP/BP 4.11)	[X]Yes [ ] No
Indigenous Peoples (OP/BP 4.10)	[ ]Yes [X] No
Involuntary Resettlement (OP/BP 4.12)	[ ]Yes [X] No
Safety of Dams (OP/BP 4.37)	[ ]Yes [X] No
Projects on International Waterways (OP/BP 7.50)	[ ]Yes [X] No
Projects in Disputed Areas (OP/BP 7.60)	[ ]Yes [X] No
Does the project require any waivers of Bank policies?	[ ]Yes [X] No
Have these been endorsed or approved by Bank management?	[ ]Yes [ ] No

Conditions and Legal Covenants:		
Loan Agreement Reference	Description of Condition/Covenant	Date Due
Article V	Effectiveness condition: At least one Subsidiary Loan Agreement between the Borrower and an original participating financial intermediary has either been amended, or a new Subsidiary Loan Agreement between the Borrower and an original participating financial intermediary has been signed, in form and substance satisfactory to the Bank, and related satisfactory legal opinion has been submitted to the Bank.	Effectiveness
Section II.B Schedule 2	Disbursement conditions: Payment in full of the Front-end Fee; Sub-loans made in accordance with the criteria and procedures set forth in the Operational Manual and on the terms and conditions referred to in paragraph B of Section I of Schedule 2 of the Loan Agreement.	Disbursement/ Recurrent
Section I.A. Schedule 2	Institutional Arrangements, covenants regarding Borrower's maintenance of PIU, compliance with manual, provision of compliance certificates, selection of participating financial intermediaries and on-lending to participating financial intermediaries	Recurrent/ Continuing
Section I.B. Schedule 2	Criteria, Terms and Conditions of On-lending to participating financial intermediaries, including eligibility criteria of participating financial intermediaries, on-lending terms, and conditions to be included in the subsidiary loan agreements with participating financial intermediaries	Recurrent/ Continuing

Section I.C. Schedule 2	Terms and Conditions of Sub-loans to beneficiary enterprises, including terms of on-lending by participating financial intermediaries to beneficiary enterprises, eligibility criteria of beneficiary enterprises, eligibility of sub-projects and provisions to be included in the sub-loan agreements between participating financial intermediaries and beneficiary enterprises.	Recurrent/ Continuing
Section I.E Schedule 2	Safeguards, regarding compliance with EMF, ensuring sub-projects are approved and implemented in accordance with clauses in the loan agreement and EMF, and listing sub-projects excluded (those involving international waterways, safety of dams, involuntary resettlement and Category A sub-projects).	Recurrent/ Continuing

I. INTRODUCTION

1. This Project Paper seeks the approval of the Executive Directors to provide an additional loan in an amount of EUR50 million (US$61.41 million equivalent) to the Croatia Export Finance Intermediation Loan Project (Croatia EFIL Project - P116080), with a guarantee from the Republic of Croatia.

2. The Croatia EFIL Project is a Financial Intermediation Loan (FIL) and is implemented by the Croatian Bank for Reconstruction and Development (HBOR). The Original Project was supported by a loan to HBOR of EUR100 million (US$141.2 million equivalent) with a 28.5 year maturity including a 7 year grace period, with a guarantee from the Republic of Croatia.

3. The proposed additional loan would help finance the scaling up of the Project, which is being successfully implemented. Importantly, the additional financing will enable banks to continue extending credit to exporters and foreign exchange earning enterprises (project beneficiaries) in an environment of constrained funding due to the impact of the eurozone crisis on the financial sector thus ensuring these companies remain competitive. Given the success of the Original Project, additional funds would enhance the development impact.

4. The Original Project has achieved impressive results to date with a broad spectrum of exporting companies that benefited from access to medium and long-term finance. The funding helped them strengthen their long-term business opportunities, and more importantly ride out the 2010 crisis. As of June 1, 2012, 85 percent of the funds have been disbursed into the special account and slightly over 70 percent to final beneficiaries for working capital purposes, with most of the financing provided to the agri-business and pharmaceuticals. The rest was distributed to the agricultural production, IT and tourism related activities. Exports of the supported companies, which account for 5 percent of overall exports of Croatia, grew by more than 30 percent. The portfolio under the project remains robust and to date there are no non-performing loans (NPLs). While the crisis has left many people jobless, and the companies financed through the CEFIL were not immune, access to funds enabled most of the companies to preserve the current workforce and even create new jobs. Collectively, by 2011, companies preserved the overall employment level. Out of 53 companies that were able to use the funds from CEFIL, only 7 companies reduced their workforce while others managed to keep their workers and create new jobs.

II. BACKGROUND AND RATIONALE FOR ADDITIONAL FINANCING

Project Background

5. The existing Project is a EUR100 million (US$141.2 million equivalent) IBRD flexible loan with a 28.5 year maturity including a 7 year grace period. The Project was approved by the Board on August 4, 2009 and became effective on November 25, 2009. The project development objective is to support the preservation and growth of exports by providing medium and long term working capital and investment finance to exporters and foreign exchange earning enterprises. There are no changes to the Original Project objectives, design or scope. Given the success of the Project, additional funds are requested to enhance the development impact. The additional financing loan will enable further expansion of private sector by enhancing the impact

of improved access to finance and ensuring the competitiveness of Croatian exporters as Croatia is moving towards EU integration.

Country and Sector Background

6. The sovereign debt crisis in euro area countries and worries about the global recovery are slowing growth across Europe and deeply affecting growth recovery in Croatia. In three consecutive years real GDP fell by over 8 percent, led by large drops in investment and private consumption. By and large, the private sector has borne the brunt of the crisis; since it began, the private sector lost some 115,000 jobs (about 10 percent of total pre-crisis employment). The sectors most affected were manufacturing, construction, and trade. Overall, since 2009, Croatia has seen its convergence gap with the EU10 and EU15 countries increase. At the end of 2010, Croatia's GDP per capita (in purchasing power terms) declined to 61 percent of the EU27 average, a loss of 3 percentage points since 2008.

Figure 1: GDP and domestic demand growth, y/y

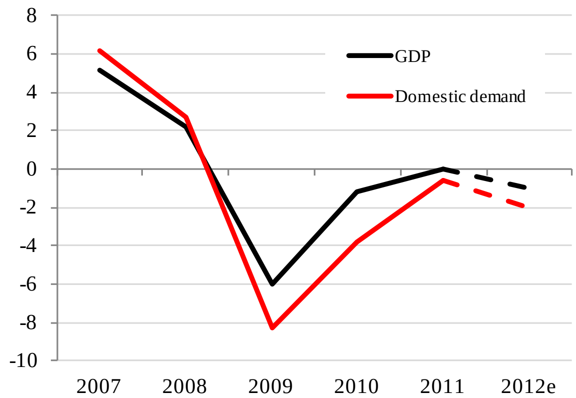
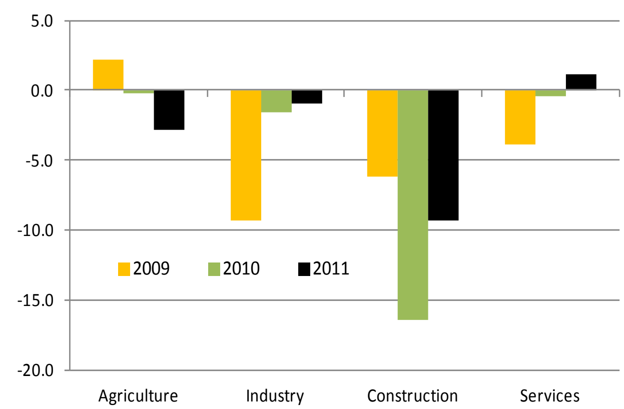


Figure 2: Gross value added by sectors, y/y



Source: CROSTAT, CNB, World Bank calculations

7. The new external challenges have arisen just as the Croatian economy was making a fragile recovery amongst low investment, and persistent unemployment. Data from 2012 suggests a continued deterioration of the economic activity. Given the drop of domestic demand and exports and a significant slowdown in imports arising from a drop in import-intensive demand, the Croatian economy is entering in repetitive contraction. After having grown in the last quarter of 2011, industrial production declined sharply in the first four months of 2012 by more than 7 percent, particularly affected by fall of capital investments and demand for intermediary goods. This was accompanied by a fall in real retail trade turnover and, after several months of stagnation, new decline in construction activity.

8. Significant external adjustment has taken place over the last couple of years. Mounting risk aversion continues to dampen capital inflows, reversing the upward trend in external debt in 2011. The gross external debt stood at 96.7 percent of GDP in 2011, some 4.5 percentage points lower than in 2010. The share of short-term debt in total debt increased to about 14 percent, as compared to 10 percent in 2010 with somewhat changed structure. The state and the banking sector increased their foreign borrowing, but the corporate sector saw a significant contraction, especially debt to affiliated companies. Monetary policy continues to safeguard a stable currency in a highly euroized economy through foreign exchange interventions and prudential measures.

Foreign exchange (FX) reserves strengthened further in 2012, standing at EUR12.5bn (end-April) and covering more than eight months of imports.

Figure 3: Net capital inflows, in EUR billion

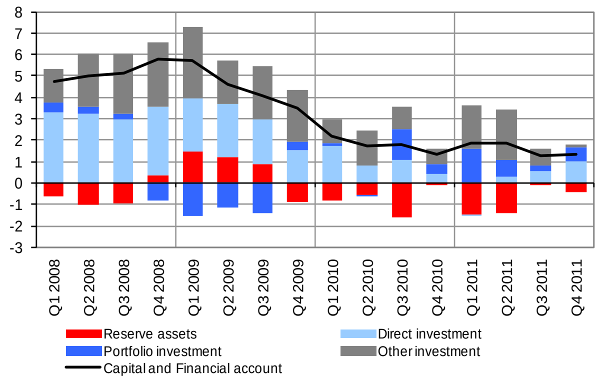
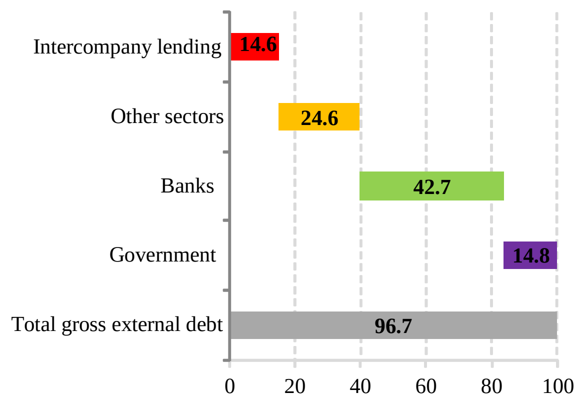


Figure 4: 2011 Gross external debt, in % of GDP



Source: CROSTAT , CNB, World Bank calculations

9. The near-term growth outlook is modest at best and subject to substantial downside risks due to an increasingly turbulent external context. A fall in gross fixed capital formation continues to be severe, led by a double-digit decline in construction. Household spending is suppressed by rising unemployment and declining real disposable income. Due to a combination of weak export demand and impeded access to foreign financial markets, the Croatian economy could be affected by a much more adverse macroeconomic scenario which in turn constrains access to finance further.

10. Access to longer-term financing remained difficult. Unfavorable financing conditions in 2011 were accompanied by a slowdown in total corporate financing. This led to a continued decline in corporate borrowing with the domestic non-banking sector as well as deleveraging of the corporate sector abroad. Slower foreign borrowing of the corporate sector was due not only to low demand but also to the fact that foreign creditors are holding back on lending under the impact of uncertainty in global financial markets and pessimistic expectations. Corporate sector partly compensated for this fall by increased borrowing from domestic banks. However, the short-term maturities seen lately in corporate borrowing are inadequate to support growth-enhancing investments.

Rationale for Bank Involvement

11. In the context of growing uncertainty and risks, in both global and local terms, the key challenge is to create the conditions for economic growth and maintaining macroeconomic stability. According the Government program, this is envisaged primarily to be achieved by supporting investment activity. The private sector strongly adjusted to the reduced market demand and risk-averse banking sector by reducing its investments and increasing its savings preference, hindering much needed recovery. The government is determined to provide the incentives by starting its own investment cycle, by supporting private investment and ensuring financial stability. However, access to long-term finance remains a serious obstacle for the Croatian exporters in increasing their exports, competitiveness and employment.

12. Banks are relying more on domestic sources, and are actively seeking funding from other sources including development banks and international financial institutions (IFIs). As funding of a longer maturity is particularly scarce, the environment is not supportive of growth-enhancing investments. Against this backdrop, the World Bank's long term funding intermediated through eligible private financial institutions ((Participating Financial Intermediaries or PFIs) will meet a market gap and help the private sector navigate the economic downturn. The project will in addition strengthen the banking sector's balance sheets by providing long term funding. The project also improves the level of financial intermediation within the financial system and leads HBOR to operate under market principles.

13. The current Country Partnership Strategy (CPS) sees fostering productivity and improving competitiveness as key factors for growth. The CPS aims to address one of the main constraints to private sector led growth -- access to long-term financing -- using HBOR and PFIs to on-lend to creditworthy private enterprises for viable projects throughout the economy. The progress report specifically mentions continued cooperation with HBOR.

Rationale for Additional Financing

14. Additional financing is chosen as the fastest and lowest cost instrument to scale up the development impact of improving access to long-term finance. It allows for a faster and cost-efficient delivery of improved access to finance than would a new project in part by using a streamlined approval procedure in the Bank and in part by leveraging the experience and institutional capacity that has been built within the PIUs to execute the project. The proposed additional financing is consistent with OP/BP 13.20 under which the Bank may provide an additional loan to finance the implementation of additional or expanded activities that scale up a project's impact and development effectiveness.

15. The scale up of the Original Project will enable further expansion of private sector by enhancing the impact of improved access to finance and ensuring the competitiveness and preservation of Croatian exporters as Croatia is moving towards EU integration. HBOR has also replicated the market based principles under this project in its other loan programs.

16. The implementation performance of the existing Project is strong. The implementation performance rating for all categories is rated satisfactory in the current Implementation Status and Results Report (ISR) *(approved November 17th, 2011).* There are no outstanding fiduciary or safeguards issues. Activities under the additional financing are expected to be completed within two years after the current closing date.

III. PROPOSED CHANGES

17. There are no changes to the Development Objective, and associated outcome targets will be enhanced to match the amount of the additional finance loan and refined to enable improved monitoring and reporting against the impact of the credit line. The implementation arrangements will remain the same as under the Original Project. The existing operations manual is generally adequate for the additional financing, but some parts will be updated; since updates are mainly administrative this is not an effectiveness condition. A complete set of PDO and intermediate results indicators is detailed in Annex 1, including an explanation of how the indicators will be

monitored. The results framework is revised a to clarify and better present the project achievements.

18. The closing date for the original loan is August 31, 2013 and it will not be extended as the loan proceeds under the original loan are expected to be disbursed by its current closing date. Disbursements under the original loan are at 85 percent as of June 1, 2012. The closing date for the Additional Loan will be August 31, 2015 - two years after the original closing date.

Costs by component

Component	***Original cost***	***Changes with AF***	***Revised cost***
Credit line to be extended through PFIs to creditworthy private enterprises for viable projects	EUR100,000,000	EUR50,000,000	EUR150,000,000
Total	**EUR100,000,000**	**EUR50,000,000**	**EUR150,000,000**

IV. APPRAISAL SUMMARY

Economic and financial analyses

19. Sub-projects that will receive funding and associated project costs are not pre-identified, thus, a traditional economic/financial analysis cannot be conducted. The approach taken is to measure the development results in relation to the amounts intermediated. The M&E framework looks at the dynamics of exports and employment in companies supported through the project. There are no NPLs for the existing project. In addition, there is strong demand from creditworthy companies for long-term funds, which lack in the market, thus the proposed AF is sound from both economic and financial perspectives.

Technical

20. The Project is in substantial compliance with legal covenants.

21. The Additional Financing continues to meet the requirements of OP 8.30 on Financial Intermediary Lending. Provisions are included in the Project to ensure that the lending rates reflect the cost of intermediating the funds, including an appropriate credit risk margin as required by OP8.30. The final lending rate and the margin charged therefore is in line with market rates.

22. Under the Project the Project Implementation Unit (PIU) interacts regularly with the PFIs. Typically, the PFIs contact the PIU to ensure eligibility of the subproject and of the related safeguard and fiduciary requirements. The PIU also conducts regular onsite visits to gauge the impact of the project and ensure adherence with project requirements.

23. As an APEX institution, HBOR will provide six monthly project monitoring reports and an annual compliance certificate. Unaudited financial statements of the Borrower are to be submitted to the Bank by applying International Financial Reporting Standards (IFRS) semi-annually throughout the life of the Project. These will include: (i) Statement of Financial Position, (ii) Income Statement, (iii) the Statements of Cash Flows, and (iv) the Statement of

Changes in Equity. Such reports will be due for submission within forty five (45) days after each semester end.

24. To qualify for participation under the Project, an interested financial institutions should meet the following criteria:

- adequate profitability, capital and portfolio quality as confirmed by audited financial statements;
- acceptable level of loan collections;
- appropriate capacity, including staffing, for carrying out subproject appraisals (including environmental assessment);
- appropriate prudential policies, administrative structure and business procedures.

25. In additions all PFIs have to comply with a detailed list of prudential norms as listed below:

Table 4: Compliance with CNB's prudential provisions[1]

	Prescribed value / (% liable capital)
Minimum Capital Adequacy Ratio	12%
Exposure to 1 person	(≤ 25%)
Exposure to directly or indirectly controlled persons	(≤ 20%) / (≤ 25%)
Exposure to a person in a special relation with a bank	(≤ 10%)
Total sum of large exposures	(≤ 600%)
Total investments in tangible asset	(≤ 40%)
Total investments in equity of non-financial institutions	(≤ 30%)
Total investments in equity of 1 non-financial institution	(≤ 15%)
Minimum liquidity ratio (MKL), up to 1 week, up to 1 month	*(≥1)*
Total open FX exposure toward regulatory capital	*(≤30%)*
NPLs (NPL/total loans)	*Maximum double than industry average (industry average is 12.5% in 2011)*

26. PFIs will be obligated to provide an on-going proof of compliance with listed compliance criteria – every 6 months by its management, and annually by auditor's certification. As of June 2012, due diligence on existing PFIs has been carried out and these PFIs have been re-qualified.

Financial Management

27. The Project's financial management (FM) arrangements are acceptable and the overall FM risk for the Project is low. The financial management arrangements for the AF including budgeting, flow of funds, internal control, staffing, accounting records, reporting, and auditing

[1] These are based on current CNB prudential requirements and are subject to change.

remain the same as for the Original Project. The last implementation support mission of the ongoing Project was conducted in November 2011 and FM arrangements of the Project were assessed to be satisfactory. No critical issues were identified and there was no action plan.

28. For the original Loan, semi-annual IFRs have been submitted to the Bank in the negotiated content and format as per the agreed timeframe. Such IFRs had been found acceptable and were received on time. As the AF covers the same activities as the Original Project and will also be denominated in Euro, the format of the IFRs used for the ongoing project remains valid. The project unit will produce a full set of IFRs in Euro for each calendar semester throughout the life of the Project. Such reports will be due for submission within forty five (45) days after each semester end.

29. The Bank received the auditor's report for the Project for the year ended 2011. The Bank received the auditor's report for the entity audit of HBOR 2011 annual financial statements. The Borrower's annual financial statements were prepared in compliance with IFRSs. The auditors have issued an unmodified opinion on both Project and HBOR annual financial statements.

30. The audit of the Project will be carried out by the appointed statutory auditor of the HBOR annual financial statements. The audit of the Project will be carried out under the terms of reference acceptable to the Bank. That means that the annual project audit will be assigned to the HBOR statutory auditor and contracted separately from the HBOR annual financial statements audit engagement.

31. The audited annual financial statements of the Borrower and the independent auditor's report and audited financial reports of the Project, together with the independent auditor's report will be provided to the Bank within six months of the end of each calendar year. The audited financial reports of the Project together with the independent auditor's report will be provided to the Bank within 6 months after the closing of the Project. The audit will be conducted in accordance with the International Standards on Auditing (ISA).

32. In accordance with "The World Bank (the Bank) Policy on Access to Information" dated July 1, 2010 for Bank-financed operations for which the invitation to negotiate is issued on or after July 1, 2010, and Section 5.09 (b) of the General Conditions applicable to the Loan Agreement, the Bank requires that the Borrower makes the audited financial statements publicly available in a timely fashion and in a manner acceptable to the Bank. In addition, following the Bank's formal receipt of these financial statements from the Borrower, the Bank makes them available to the public in accordance with this policy through its external website, except the information that contains commercially sensitive data. The Borrower, through the PIU, will publish the project auditor's reports and audited project financial statements on its website, in a timely manner after it received a confirmation from the World Bank that such reports had been found acceptable. However, given that the HBOR's audited project financial statements contain proprietary and commercially sensitive information, HBOR will be exempted from publicly disclosing the full set of audited financial statements, but is still required to publicly disclose an abridged version of them. However, HBOR is obliged to present the full set of the audited Project financial statements to the World Bank for review and clearance. Project financial statements will be audited in compliance with ISA 810 Engagements to Report on Summary Financial Statements. Furthermore, agreed formats of the audit ToR and IFRs for the Project will be attached to the Minutes of Negotiation.

Disbursement

33. The Project will follow the same arrangements as the Original Project. HBOR will open a new designated account, in the name of HBOR, denominated in the loan currency. Funds from the loan will be made available to PFIs following submission of payment request supported by the list of invoices, pro forma invoices or orders for the respective goods and works ordered by the export companies. The invoices themselves are kept by PFIs in their loan files. Disbursements from the Loan Account will follow the transaction-based method, i.e., traditional Bank procedures: Advances, Reimbursement (with full documentation and against Statements of Expenditures (SOEs)), Direct Payment and Special Commitment. Detailed instructions will be agreed and provided in the Disbursement Letter. Retroactive financing will be allowed up to an aggregate amount not to exceed EUR10,000,000 for payments made prior to the date of the Loan Agreement but on or after August 1, 2012, for eligible expenditures.

Procurement

34. The overall administrative coordination, general information management and implementation of the activities under the proposed *Additional Financing* (AF) rests with the PIU established within the HBOR's Accounting Division, Analysis Division, Credit Division, and Fund Managing Division for the purposes of the CEFIL. The PIU will be responsible for (i) on-lending to PFIs for final lending to sub-borrowers (ii) ensuring effective functioning of the on-lending facility to final borrowers through PFIs; (iii) on-going monitoring of the PFIs to ensure compliance with project criteria; (iv) ensuring adherence to all fiduciary and safeguard requirements of the World Bank for final borrowers; and (v) monitoring and evaluation based on key project development indicators.

35. The PIU shall carry out its day-to-day activities related to the project in line with the agreed provisions in the Operations Manual (OM). The procurement under each sub-loan shall be carried out by the relevant sub-borrowers, following the applicable and well established commercial practices and in accordance with the additional provisions outlined in the OM. All documents related to the procurement shall be kept by the sub-borrowers. The PIU in HBOR shall, however, maintain sub-loan files and readily available details about the items financed, their value, eligibility, procurement process, payment information, etc. It shall provide assistance and advice to the participating financial institutions and sub-borrowers on all aspects of the CEFIL additional financing, including terms and conditions, procurement, disbursement, and environment procedures. The funds from the AF shall not be used for payments of second hand goods and for awarding contracts to affiliate companies to the sub-borrowers.

36. Procurement arrangements for the Additional Finance will be in accordance with the World Bank's "Guidelines: Procurement of Goods, Works and Non-consulting Services under IBRD Loans and IDA Credits and Grants by World Bank Borrowers" dated January 2011. Procurement of goods, works and non-consulting services for contracts estimated to cost equal to or below Euro 10 million equivalent shall follow well established private sector procurement methods or commercial practices that shall be acceptable to the Bank. However, International Competitive Bidding (ICB) in accordance with Section II of the World Bank's procurement Guidelines would be required for individual contracts for goods, works and non-consulting contracts estimated to cost more that Euro 10 million equivalent per contract.

37. Given the demand-driven nature of the Project, it is neither possible to estimate the sub-borrowers nor their procurement requirements. Therefore, it is not possible for the borrower to develop and prepare a Procurement Plan. As relevant, each sub-borrower shall be required to provide in its sub-loan application a list of procurements planned to be financed and for this will follow the form provided in the OM.

38. Based on the assessment of HBOR's capacity, the overall project risk is determined at Moderate to Low. It is recommended that procurement supervision, including post review, is carried out once in 12 months. The post review arrangements shall be in accordance with the agreed provisions in the OM.

Social

39. The proposed project will be socially beneficial. By increasing access to finance and growth of exporters and FX earning firms, it is expected that the operation contribute to employment and economic growth. Gender issues were considered in the preparation and design of the AF. As a result, a new gender disaggregated indicator has been included for monitoring by HBOR and PFIs.

40. The Project would not trigger OP 4.12. No potential beneficiaries can participate in the Project if they would need land acquisition for the activities to be supported under this Project. Rehabilitation and reconstruction (which could involve demolition of no longer suitable structure and erection of a new one) of existing buildings within the same footprint would be permissible. Investments will only be accepted if they involve unencumbered land or property (i.e. no squatters or encroachers or not requiring the eviction of anyone resident in such property and no other land usage for any purpose or restrictions of access). The PFIs should verify for each sub project the unencumbered status of the property prior to approving any sub-project, which could raise such issues. This is clearly stipulated in the Environment Management Framework (EMF).

Environmental and Safeguard policies

41. Environmental Assessment Policies will apply to the proposed Project. The Project triggers Environmental Assessment (OP/BP 4.01). The design of the Project calls for FI environmental category, as HBOR (borrower) will intermediate the funds through PFIs, which in turn will on-lend to eligible private and quasi exporters. Environmental due diligence will be applied through the procedures for the selection and implementation of investments agreed between the Bank, the Borrower and PFIs. The EMF document was prepared to outline the guiding principles of environmental screening, assessment, review, management, and monitoring of sub-loans as well as to describe roles and responsibilities in carrying out the environmental work in the course of the project implementation.

42. Only EA Category B and C sub-projects will be eligible, therefore projects having large scale impacts are excluded. The environmental due diligence procedures identified in the EMF comply with both Croatian national and WB environmental safeguards procedures.

43. The Pest Management policy for the Project is triggered as potential sub-projects are in the export-oriented field and may operate in the food production and processing sector. If eligible sub-projects will include financing purchase of pesticides (including post-harvest treatment) or investments which are likely to increase or expand the use of pesticides in such

operations, the EMF sets out requirements for applicants to prepare a simple Pest (and Pesticide) Management Plan consistent with OP 4.09 requirements.

44. Given the rich cultural heritage of Croatia the policy of physical cultural resources OP/BP 4.11 is triggered in view of expectations that some operations will likely have a direct impact on historical structures or sites (e.g. in tourism sector), but also, possible chance finds in sub-projects. The EMF indicates that sub-projects will comply with local legislation on chance finds as well as including advance consultation with the Ministry of Culture through local permitting process in case of potential impact on historical sites or structures. Local legislation on this matter was reviewed and found acceptable by the Bank.

45. The draft EMF document along with an announcement of the Public Consultation Workshop was disclosed on the web-pages of the HBOR in June 2009 and the Public Consultations Workshop for the Original Project was held at the premises of the HBOR, on June 19, 2009. The updated EMF was again disclosed on InfoShop on July 12, 2012. Safeguards procedures were implemented successfully under the original loan. HBOR has a department that deals with approval of projects that have environmental impact, and it demonstrates adequate capacity for covering environmental issues. Training on environmental compliance was provided by both the Bank and HBOR for PFI staff to strengthen their understanding of the processes. The training will be repeated for the additional financing if individuals working on the project implementation in the PFIs have changed.

46. **Restructuring of Original Loan.** The original loan will be restructured to make revisions to the Results Framework and to carry out editorial changes to some legal covenants and definitions related to safeguards in order to improve clarity. These changes will be reflected in an amendment letter to the original loan agreement.

ANNEX 1: RESULTS FRAMEWORK AND MONITORING

CROATIA: EXPORT FINANCE INTERMEDIATION LOAN ADDITIONAL FINANCING AND RESTRUCTURING

Results Framework

Revisions to the Results Framework		Comments/ Rationale for Change
PDO		
Current (PAD)	*Proposed*	
To support the preservation and growth of exports by providing medium and long term finance to exporters and foreign exchange earning companies.	Same	
PDO indicators		
Current (PAD)	*Proposed change*	
Preservation and growth of exports by the final beneficiaries.	Level of exports growth or preservation of beneficiary firms	Clarification
	New: Volume of medium and long-term lending by PFIs to firms under the project	Addition; changed target value
Intermediate Results indicators		
Current (PAD)	*Proposed change*	
Amount disbursed to private sector firms	Dropped	Indicator monitored above
Number of medium and long-term loans granted by PFIs under the project	Dropped	Indicator monitored above
	New: Number of firms financed by PFIs under the project New: Number of firms with female owners financed	Addition; changed target value Addition; for information purpose only
Quality of Portfolio - Total NPLs as number of loans Total NPLs (in percent)	Revised: Total NPLs as number of loans Total NPLs (in percent)	Clarification; changed target value
Employment preserved or created	Revised: Level of job creation or preservation	Clarification

REVISED PROJECT RESULTS FRAMEWORK

Project Development Objective (PDO):

The PDO is to enhance the access to finance to support the preservation and growth of exports by providing medium and long term finance to exporters and foreign exchange earning companies.

PDO Level Results Indicators	Core	UOM[2]	Baseline Original Project Start (2009)	Progress To Date (May 2012)	Cumulative Target Values				Frequency	Data Source/ Methodology	Responsibility for Data Collection	Comments
					2013	2014	2015					
1. Level of exports growth or preservation of beneficiary firms	☐	%	0	32.1	>0	>0	>0		6 Monthly	PFI and PIU Reports	PFI and PIU	
2. Volume of medium and long-term lending by PFIs to firms under the project (US$ equivalent)	☐	N°	0	140m	160m	190m	207m		6 Monthly	PFI and PIU Reports	PFI and PIU	

Intermediate Results and Indicators

Intermediate Results Indicators	Core	Unit of Measurement	Baseline Original Project Start (2009)	Progress To Date (May 2012)	Target Values				Frequency	Data Source/ Methodology	Responsibility for Data Collection	Comments
					2013	2014	2015					
Intermediate Results												
3. Number of firms financed by PFIs under the project		N°	0	53	55	57	60		6 Monthly	PFI and PIU Reports	PFI and PIU	
4. Number of firms with female owners financed		N°	0	Na (new)					6 Monthly	PFI and PIU Reports	PFI and PIU	New indicator for information only
5. Total NPLs as number of loans		%	0	0	<7	<7	<7		6 Monthly	PFI and PIU Reports	PFI and PIU	

[2] **UOM = Unit of Measurement.**

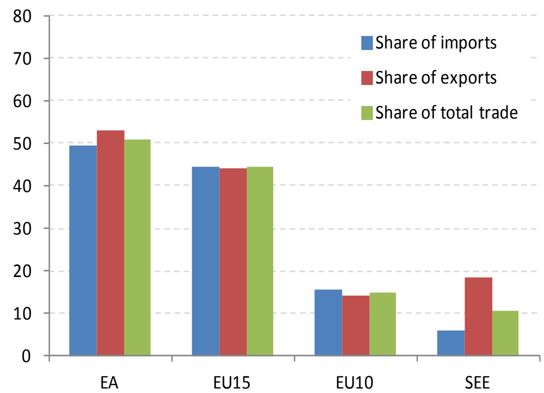
Intermediate Results and Indicators												
Intermediate Results Indicators	**Core**	**Unit of Measurement**	**Baseline Original Project Start (2009)**	**Progress To Date (May 2012)**	**Target Values**				**Frequency**	**Data Source/ Methodology**	**Responsibility for Data Collection**	**Comments**
					2013	**2014**	**2015**					
6. Total NPLs		%	0	0	<7	<7	<7		6 Monthly	PFI and PIU Reports	PFI and PIU	
7. Level of job creation or preservation		%	0	1.003	>1	>1	>1		6 Monthly	PFI and PIU Reports	PFI and PIU	

ANNEX 2: SECTOR BACKGROUND

Overview of Croatia's Export and Quasi-Export sectors

1. Croatia is an open economy with total exports in goods and services accounting for around 41 percent of GDP in 2011. Apart from exports of machinery and transport equipment (mainly ships) tourism remained the biggest source of export revenue, generating 14.4 percent of GDP in 2011. European Union, primarily Germany and Italy, has continued to be Croatia's largest trading partner. Its share in total Croatian exports remained relatively stable in 2011 at 60 percent. CEFTA countries accounted for a fifth of total Croatian exports in 2011, slightly higher from the share in 2009. Euro area is the source of about three-fourths of FDI flows into the country which and is the strongest possible contagion transmission between the euro area and Croatia.

Figure 5: Croatia's Foreign Trade by Region (Percent)



Source: CROSTAT, World Bank calculations

2. The absence of recovery in the real sector of the economy limited the room for improvement in domestic financing conditions. Investment activity continued to fall sharply, from 27.1 percent in 2009 to 22.6 percent in 2011. Domestic banks started to change the relative credit supply by sector, reducing the share of loans to corporate dealing in construction and real estate management. The decline in investment in industry in particular, has impacted the prospects for faster technological change, due to low diversification of exports and declining existing exports demand.

Financial Sector Background and Outlook

3. The Croatian banking sector continues to safeguard overall macro-stability but remains exposed to eurozone risks. The Croatian banking system relies on domestic savings as the primary source of funding. However, in the case of foreign funding, 90 percent of foreign funding comes from parent sources. While parent banks have been a stable source of funding since the onset of the crisis, this might be more difficult going forward, in light of the difficulties the parent banks might face and the higher cost of funding in international capital markets. Furthermore, actions taken by home regulators to limit the exposure of banks to the Central and Eastern Europe region, as well as EU rules on banking sector capitalization might impact the ability of parent banks to continue supporting their local subsidiaries, at present levels. Although these banks are well capitalized with good governance and management, the banking sector may face systemic risks arising from shifts in the strategies of parent banks, resulting in possible deleveraging.

4. There are no indications of a credit contraction, despite weakness in the economic environment and cautiousness among lenders and borrowers. Private sector credit growth remained sluggish, growing by 3.5 percent by April 2012. However, exchange rate fluctuations

are partly responsible because three-quarters of all loans are foreign and foreign-currency-denominated (excluding exchange rate, growth slowed down to 0.9 percent). The sectoral structure shows that the credit growth relates exclusively to the corporate sector (3.5 percent year on year, exchange rate excluded), largely accounted for by an increase in loans for working capital. Due to the absence of any economic recovery and the situation on the labor market, the annual fall in household lending continued.

Figure 6: NPLs as share of total loans, %, by sector

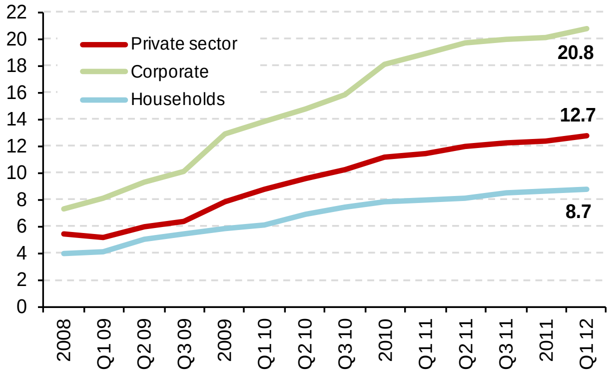
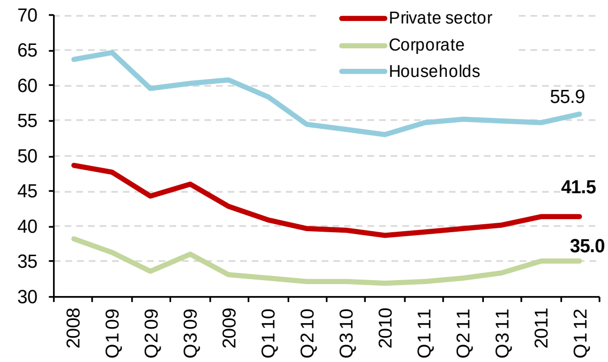


Figure 7: Provisions as share of NPLs, %, by sector



Source: CNB, World Bank calculations

5. Risks to the banking sector health are also increasing as a result of a downturn of the economy. NPLs accounted 12.7 percent of the total loans at the end of March 2012, with considerable differentiation between sectors. Of particular concern are NPLs in the corporate sector, which stood at 20.8 percent by end of March 2012. The sharp increase in the corporate NPLs could be attributed to reduced refinancing and rescheduling of loans, which had been used to postpone the recognition of the deterioration in credit portfolio quality. The economic sectors most affected by high NPLs are construction, manufacturing and trade. Within NPLs in the household sector (8.74 percent), there is significant variation in the subcategories, with mortgage loans recording high NPLs (21.4 percent). The increase in loan loss provisions, in particular in household sector, also raised the coverage of NPLs, as banks used the slower growth in NPLs to make value adjustments to the loans.

6. Banks are however well-capitalized with a capital adequacy ratio of 19.9 percent at the end of March 2012, well above the regulatory minimum of 12 percent, providing a relatively large buffer to protect its solvency. However, differentiation within the sector is increasing, and smaller banks, which are less well-capitalized, might see their capital base weaken if additional value adjustments need to be made. However, at less than 2 percent of total assets of the system, these banks are not likely to pose any systemic threat to the banking system. Profitability remained positive, but stayed at a much lower level than in the pre-crisis period**.** Earnings were affected by a continued increase in loan loss provisions and the fall in interest income from the higher share of irrecoverable loans, as well as lower non-interest income from fees and commissions.

Table 1: Key Prudential Indicators of the Banking System

	2007	2008	2009	2010	2011	Q1 2012
Capital Adequacy						
Regulatory capital to risk-weighted assets[1]	16.3	15.1	16.4	18.8	19.2	19.9
Asset Quality						
NPLs/loans	4.8	4.9	7.7	11.1	12.4	12.7
Provisions to NPLs	54.4	48.7	42.8	38.8	41.4	41.5
Liquidity						
Liquid assets to total assets	27.6	23.9	23.7	22.4	22.5	21.0
Liquid assets to short term liabilities	38.1	33.4	32.9	30.9	31.5	29.5
Loan-to-Deposit ratio	1.06	1.13	1.12	1.14	1.17	1.20
Earnings and Profitability						
Return on Average Assets (ROAA) before tax	1.6	1.6	1.1	1.1	1.2	n.a.
Return on Average Equity (ROAE) after tax	10.9	9.9	6.4	6.5	7.1	n.a.
Financing by Foreign Owners (% of financing sources)						
Through deposits	7.6	9.6	11.5	10.9	13.0	13.3
Through loans	6.1	7.4	7.5	7.1	7.5	7.3
Euroization						
Loans	61.4	66.2	72.7	73.6	75.1	74.6
Deposits	69.9	73.2	77.5	79.4	77.6	75.7

Source: CNB, World Bank staff calculations
[1]*Basel II introduced in 2010*

7. Looking ahead, approaching EU accession could lead to an increase in demand for investment credit, particularly in areas such as renewable energy and infrastructure for energy efficiency. Furthermore, there is expectation among banks that the Government will start implementing projects from the second half of 2012 onwards, particularly in the above mentioned sectors. However, the further increase in NPLs could constrain credit growth as banks' ability to extend new loans is undermined. Meanwhile, household credit growth is likely to remain weak, given the expectations of a new wave of recession.

Table 2: Changes in Business Strategies of Foreign Parent Banks

Parent Banks	Changes in Business Strategies
Erste, Hypo A.A., Raiffeisen (Austria)	• Given the measures adopted by the Austrian authorities, and lack of enough capital to support the operations of their major banks in CEE, prioritization is being done across CEE markets to focus on the "core markets" and subsidiaries are being asked to finance any new lending from local sources, putting pressure on banks to increase deposits. • Asset-Liability operations (Erste): Offered to repurchase up to a nominal EUR500 million worth of its hybrid capital to raise its capital buffer and meet the EBA's capital targets within deadline. • Some subsidiaries are being asked to reduce their holdings of local government bonds creating potential pressure on debt management operations of the authorities.

Societe General (France)	• Has revealed plans to offload assets. Planning cuts to its networks in Russia, Romania, the Czech Republic and Egypt. • Have announced plans to restructure its corporate and investment bank, cutting a total of 1580 jobs in the division, including both in France (880) and outside France (700). It cited a tougher economic and regulatory environment for its decision, following similar moves by other French banks which have been reportedly reducing jobs in response to tight liquidity conditions and higher capital requirements. It also announced that it still plans to hire 2500 staff in France this year, mainly in retail banking.
UniCredit SpA (Italy)	• Restructuring its investment banking operations, and reorganizing its CEE businesses. • Launching a EUR7.5 billion capital increase. • Planning to narrow its geographic focus in Eastern Europe, retreating from less profitable markets and focusing on its profitable markets (Poland, Turkey, Russia and Croatia). • Selling assets (in Persian Gulf project finance and corporate loan books) to Arab banks • Cutting its reliance on funding from abroad at their units in CEE countries and focus more on local funding.
Volksbank **(Austria)**	• Selling its subsidiaries from its diversified presence in nine CEE countries (except for its Romanian operation) to a Russian bank (Sberbank), reflecting the reduced ability of diversified banks to move resources across their operations in different jurisdictions as national regulators try to prevent outflows of capital and liquidity (through ring-fencing of their subsidiaries)

Sources: ECB and IIF Survey of Lending Standards; JP Morgan Analyst Reports, various news sources (including FT, WSJ, the Economist, Reuters).

ANNEX 3: HBOR PROFILE

An overview on HBOR

1. Since the onset of the global financial crisis in 2008, HBOR has performed a countercyclical role, like several other state development banks in Europe and around the world. At the end of 2011, HBOR's assets amounted to EUR2.9 billion or 5.4 percent of the entire asset of the banking sector. HBOR's capital adequacy ratio, which is calculated using the same parameters applicable to private banks operating in Croatia, was 63.5 percent, reflecting the financial soundness of the institution and annual equity injections from the State Budget. Data for 2011 show a 25 percent increase of profit, driven by a significant contraction of interest expense which in turn reflects HBOR's favorable funding strategy. HBOR's function as a development and export bank does not bring it into competition with the commercial banking sector—an important feature in differentiating HBOR from other lending institutions. In addition, HBOR is able to provide longer-term financing than Croatian commercial banks.

2. HBOR is a non-deposit taking institution that funds its operations with credit lines from commercial banks, development banks and international financial institutions (IFIs), such as CEB, EIB, KfW and the World Bank, and international capital markets. Due to unfavorable market conditions in the euro area, HBOR has not raised any money in the capital markets for the past three years, relying on sources provided by commercial banks and IFIs. HBOR's bottom-line profitability continues to benefit from special privileges such as (i) an exemption from paying profit tax, (ii) access to low cost funding and, importantly, (iii) an exemption from having to maintain obligatory reserves with the Croatian National Bank. HBOR is looking now to re-entry the international capital markets with help of a bond placement that could be guaranteed by the Bank through a Partial Credit Gurantee. This approach will help HBOR to diversify its funding sources.

3. HBOR's credit activity has contracted by 3.6 percent in 2011, but remains strong. The total gross loan portfolio stood at EUR3.1 billion, out of which EUR2.0 billion was intermediated through commercial banks. Currently, almost two thirds of HBOR's lending activities goes through commercial banks, while the rest is extended directly to end borrowers. Nonperforming loans (defined as overdue receivables that are more than 90 days overdue) amounted to HRK439.6 million or 5.5 percent of the overall gross directly extended loans, still significantly lower than the industry average. Loan-loss provisions stood at 11.0 percent of total lending as at end-2011, while in case of direct lending provisioning amounted 21.8 percent of directly extended loans. Under the project HBOR has been made to use market based lending rates, this has resulted in competition between the PFIs, HBOR has utilized the model under the CEFIL project and is now emulating it in its other programs.

Figure 8: Structure of HBOR's loan portfolio, in percent

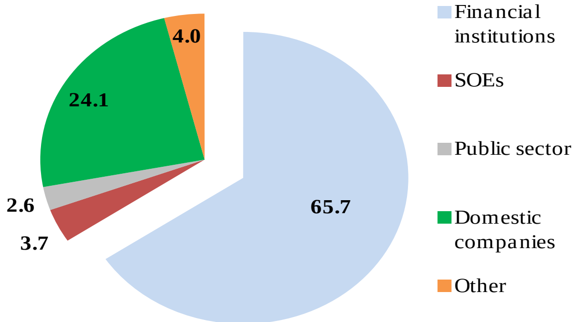
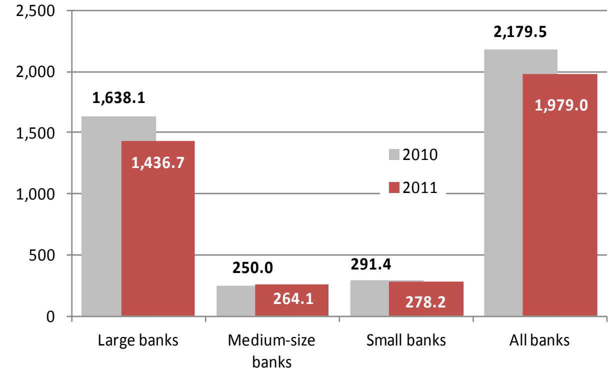


Figure 9: Banks Borrowings from HBOR, in EUR millions



Source: HBOR, CNB, World Bank staff calculations

4. HBOR exhibits both high single-party and industry concentrations (to Croatia's financial sector). These primarily arise from its cooperation agreements with commercial banks, whereby HBOR disperses funds under its various loan programs in cooperation with Croatian commercial banks. Although HBOR dictates the terms of the loans to the ultimate beneficiaries and may monitor compliance, it is to the cooperating banks that HBOR extends credit lines, ultimately bearing their credit risk. HBOR's limit of exposure towards commercial banks is established in accordance with the internal rating of a commercial bank, commercial banks' liable capital and HBOR's liable capital.

Table 3: HBOR's selected financial indicators in HRK thousands (unless otherwise indicated)

	2008	2009	2010	2011
Assets				
Total assets	18,751,714	20,789,652	22,922,297	21,992,924
Cash, due from banks, deposits with other banks and liquid securities (net)	998,770	489,443	1,547,955	1,383,415
Total Gross loans	19,717,688	22,382,123	23,567,742	23,005,870
Provision for losses on loans	2,081,879	2,186,216	2,321,902	2,521,448
Liabilities				
Total liabilities	12,467,874	14,116,727	15,912,521	14,668,683
Deposits	439,017	204,840	222,658	154,243
Other liabilities	1,140,055	1,170,603	1,160,195	1,172,353
Borrowings and bonds payable	10,888,802	12,741,284	14,529,668	13,342,087
Capital	6,271,417	6,660,962	6,997,684	7,311,911
o/w Founder's capital	4,723,739	4,943,739	5,163,739	5,343,739
Total equity and guarantee fund	6,283,840	6,672,925	7,009,776	7,324,241
OTHER ITEMS:				
NPL over 90 days/Balance sheet portfolio (%)	0.50	1.14	1.53	2.01
Guarantees	1,701,092	693,858	353,203	325,630

Operating income	448,942	342,563	314,323	388,682
Net income	174,906	165,530	117,962	148,060
CAR (%)	60.64	61.95	63.50	63.5
Highest single exposure ratio (%)	22.54	22.10	20.09	19.41
Deposits/total liabilities (%)	3.52	1.45	1.40	1.05
Liquid assets (up to 90 days)/total assets (%)	17.59	29.98	29.74	27.08
Liquid assets (up to 90 days)/total liabilities (%)	26.46	44.15	42.84	40.60
Risk-Weighted Assets	7,714,438	8,295,245	8,946,342	9,133,539
Return on Average Assets (%)	0.97	0.84	0.54	0.66
Return on total Equity - period end (%)	2.90	2.55	1.72	2.06
Net Interest Margin (%)				
Net Interest Margin (%)	2.24	1.69	1.31	1.48
Government transfers to HBOR	520,000	490,000	490,000	607,400
o/w subsidized interest rates	146,000	260,000	250,000	237,400

Source: HBOR

5. HBOR's capital-raising flexibility is limited due to the bank's ownership structure. As a result, the bank's principal sources of funds are IFIs and commercial banks. Total borrowings in 2011 amounted to EUR1.1 billion, equivalent to 56 percent of total liabilities and 16 percent more than in 2010. The contribution from the state budget in 2011 stood at EUR80.7 million, of which around 40 percent was earmarked for interest rate subsidies.

ANNEX 4: OPERATIONAL RISK ASSESSMENT FRAMEWORK (ORAF)

Croatia

Export Finance Intermediation Loan (Additional Financing) and Restructuring

PDO: The project development objective is to support the preservation and growth of exports by providing medium and long term working capital and investment finance to exporters and foreign exchange earning enterprises.

<table>
<tr><td>1. Project Stakeholder Risks</td><td>Rating</td><td colspan="3">Low</td></tr>
<tr><td rowspan="2">Description:
Lack of ownership of the project by both HBOR and Ministry of Finance.</td><td colspan="4">Risk Management:
The project does not address any controversial area that could cause opposition from any of the stakeholders. As a state development bank, HBOR benefits from a public policy mandate and strong government and private sector support. It also enjoys large support from business associations and financial institutions that endorse HBOR's role in financing long term investments and exports and see it as a reliable partner in supporting Croatian businesses.

Commitments have been demonstrated through repeated correspondence by both HBOR management and Ministers of Finance by confirming project's relevance and need.</td></tr>
<tr><td>Resp: Bank</td><td>Stage: Preparation</td><td>Due Date: n/a</td><td>Status: Completed</td></tr>
<tr><td colspan="5">2. Implementing Agency Risks (including fiduciary)</td></tr>
<tr><td>2.1 Capacity</td><td>Rating:</td><td colspan="3">Low</td></tr>
<tr><td rowspan="2">Description:
The risk is that current project implementation arrangements are changed to the system that would not be in accordance with the World Bank requirements. Such a move could delay disbursements to beneficiaries at the time of expected credit crunch.</td><td colspan="4">Risk Management:
The counterpart confirms that the existing implementation arrangements will be maintained. The staffing levels, skill sets and experience gained through the original project is transmitted to all junior members of the PIU. The Bank will also during constant supervision mission ensure that the implementation arrangements are maintained.</td></tr>
<tr><td>Resp: Bank</td><td>Stage: Implementation</td><td>Due Date: recurrent</td><td>Status: On-going</td></tr>
<tr><td>Financial Management: Implementing Agency is unable to implement and manage project and does not respond to all FM requirements in a timely fashion.</td><td colspan="4">Risk Management:
The Financial and Operational Manuals reflects specific activities of the project, the internal control procedures as well as accounting policies and procedures. The FM Operations Manual clearly defines and prevents the conflict of interest and the related party transactions. Since this is continuing process the FM oversight and support will be done by the Bank team during implementation support missions.</td></tr>
<tr><td></td><td>Resp: Bank</td><td>State: Implementation</td><td>Due Date: recurrent</td><td>Status: On-going</td></tr>
<tr><td>Procurement: Implementing Agency is unable to implement and manage project and use commercial practices to the standard acceptable to the Bank.</td><td colspan="4">Risk Management:
Assessment and description of commercial practices used in Croatia are captured in the Projects' Operations Manual. Regular monitoring by the WB will check for consistency and quality of the practice</td></tr>
</table>

	Resp: Bank	**State: Implementation**	**Due Date: recurrent**	**Status: on-going**
3. Governance	**Rating:** **Low**			
Description: Political influence can lead to financing of nonviable or ineligible sub-projects.	**Risk Management:** This is risk is considered to be low. Project selection is based on clear and transparent procedures developed during the original loan. The final selection of companies is based on pure commercial practices and there is no window for any influences. And a risk management action to the governance risk elaborated in its place.			
	Resp: Bank	**Stage: Implementation**	**Due Date:recurrent**	**Status: on-going**
4. Project Risks				
4.1. Design	**Rating:** **Moderate**			
Description: The risk is that due to the economic slowdown and developments in the Eurozone and Croatian economy, the demand for long-term financing may decline and the Banking sector may face stress.	**Risk Management:** The Bank confirmed that companies continue to face obstacles in getting funding for investment projects with long maturity in tourism, energy and restructurings in industrial sector. This ensures take-up of the project, in addition the design of the project is flexible enough to respond to a wide range of financing demands. The PFIs under the project have to meet through the life of the project the eligibility criteria and this will be monitored annually.			
	Resp: Bank	**Stage: Implementation**	**Due Date: recurrent**	**Status: on-going**
4.2. Social & Environmental	**Rating:** **Low**			
Description: The risk is that, as the sub-projects are not predetermined, there is a possibility of negative environmental impact.	**Risk Management:** The project has been assigned Environmental category (FI), and Environmental Safeguard Review Framework acceptable to the World Bank was prepared and disclosed by the Borrower. This framework includes screening of sub-projects to exclude those entailing significant environmental risk or involve land acquisition and /or resettlement. Category A projects are also specifically excluded			
	Resp: Client	**Stage: Implementation**	**Due Date: recurrent**	**Status: on-going**
The risk is that client does not have adequate capacity to manage the environmental aspects of the project.	Environmental Screening is in place to ensure the Project will not finance projects with substantial environmental/social risks. This includes activities corresponding to Category A projects, activities involving land acquisition and/or resettlement.			
	Resp: Bank	**Stage: Implementation**	**Due Date: recurrent**	**Status: on-going**
4.3. Program & Donor	**Rating:** **Moderate**			
Description: There is a risk of commercial banks deleveraging, as foreign parent banks may be under pressure from the escalating Eurozone crisis.	**Risk Management:** This remains a possible risk however it does not impact the project. In the case of any deleveraging the project funds are even more needed in the country. However overall credits to the corporate sector will be monitored through the life of the project to ascertain any developing risks.			
	Resp: World Bank	**Stage: Preparation and implementation**	**Due Date: recurrent**	**Status: on-going**

4.4. Delivery Monitoring & Sustainability	Rating:	Low		
Description : The risk is that PIUs and PFIs do not undertake regular and thorough monitoring of subprojects financed by the loan. The risk is that project benefits are one-off and impact of loan funds does not last beyond a business cycle, i.e. they do not ensure SME viability and profitability in the future.	**Risk Management :** The World Bank will evaluate progress on the proposed outcome and implementation progress indicators as part of the implementation support missions, regular field visits, and through regular project related reporting by the PIUs.			
	Resp: Bank	**Stage: Implementation**	**Due Date: recurrent**	**Status: on-going**
	The PIUs will conduct quarterly activities' reviews and produce semi-annual reports to the Bank, as mandated by IFRs, based on the information collected and regular reports provided by the PFIs. The PIUs will also submit detailed annual reports including all output and all agreed outcome indicators.			
	Resp: Client	**Stage: Implementation**	**Due Date: recurrent**	**Status: as above**
	The project benefits are expected to be sustainable. For the subprojects, sustainability will be addressed through appraisal of creditworthiness of individual private sector borrowers and of financial viability of subprojects.			
	Resp: Client	**Stage: Implementation**	**Due Date: recurrent**	**Status: as above**
	Sustainability of the credit line beyond the first sub-loan cycle will depend on regular repayment of sub-loans by borrowers, which is assured by appropriate assessment of creditworthiness of the sub-borrowers.			
	Resp: Client	**Stage: Implementation**	**Due Date: recurrent**	**Status: as above**

5. Overall risk	
	Implementation Risk Rating: Low
Description: The overall Risk is deemed to be 'Low' as this is a follow-up project to a successful operation with the same implementing entities and solid capacity already in place. Additionally there is high demand for the kind if intervention the Bank is providing	