

EUROPEAN FUND FOR SOUTHEAST EUROPE SMALL LOANS FOR BIG IDEAS



EFSE – A DEVELOPMENT FINANCE INITIATIVE SUPPORTED BY



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GOOD
GROWTH
FUND



Steyler Ethik Bank



MISSION AND OBJECTIVES

DEVELOPMENT IMPACT

- Supporting micro and small enterprises as the backbone of local economies, thereby contributing to income generation and employment creation;
- Satisfying the basic need of decent shelter; and
- Strengthening local financial markets.

PRODUCTS TO BENEFIT THE TARGET GROUPS

At present, the Fund's long-term funding instruments promote partner lending institution products for the target groups, including:

- Micro and small enterprise loans,
- Rural loans, particularly for agriculture, and
- Housing loans.

MISSION

The European Fund for Southeast Europe aims to foster economic development and prosperity in the Southeast Europe region and in the European Eastern Neighbourhood region through the sustainable provision of additional development finance, notably to micro and small enterprises (MSEs) and to private households, via qualified financial institutions.

In pursuing its development goal the Fund will observe principles of sustainability and additionality, combining development and market orientations.

The EFSE Development Facility works with partner lending institutions to adapt existing credit products and service as well as develop new ones to better address the unmet needs of the various loan customer groups.

THE FUND'S ULTIMATE TARGET GROUPS

- Micro and small enterprises, and
- Private households with limited access to credit.

THE MAIN ADVANTAGES OF THE EFSE IN ITS CURRENT STRUCTURE:

- Ensuring sustainability of operations through institutionalisation and facilitating flexible incorporation of donors at the same time,
- Maximising the potential of its public-private partnership model to mobilise additional funding from private institutional investors,
- Providing a wide range of financial services to the partner lending institutions and the ultimate target groups,
- Generating operational efficiency gains.

DEVELOPMENT PRINCIPLES



As a development finance vehicle, the EFSE offers unique features. The Fund combines investments with market orientation, creating additionality and complementarity with other donor and government initiatives. Operating as a market enabler, facilitator and risk taker, the EFSE is an innovator of and incubator for financial products designed to better benefit the target groups and ensure the sustainability of Fund activities.



DEVELOPMENT PERFORMANCE AND IMPACT ASSESSMENT

Development performance measurement

The Fund's management is assessed annually according to the following development performance criteria:

- Breadth of outreach, i.e. number of micro and small enterprises reached, and
- Depth of outreach, i.e. average loan size.

Development impact measurement

A Development Impact Study conducted by a third party, analyses different aspects of the Fund's development impact, such as employment effects or its social and environmental impact. Results are published as executive summary on the Fund's website www.efse.lu.

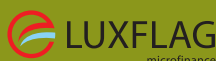


BUSINESS PRINCIPLES

As the largest microfinance fund in the world, the EFSE bases its corporate values on high standards of business ethics:

- Additionality,
- Transparency in the disclosure of information,
- Compliance of partner lending institutions with high standards of business ethics,
- Close monitoring of partner lending institutions and end-borrowers,
- Presence in the markets and proximity to partner lending institutions, and
- A responsible HR policy of Fund service providers.

The Fund targets micro and small enterprises with an individual loan size of max. EUR 100,000, but a focus on microloans below EUR 20,000.



The EFSE was one of the first development finance funds in the world to obtain the LuxFLAG Microfinance Label.

FUND HIGHLIGHTS

1 CONTRIBUTING TO UN DEVELOPMENT GOALS

The Fund supports the UN sustainable development agenda as currently documented by the Millenium Development Goals but also beyond to achieve „the world we want“.

2 PROMOTING REGIONAL COOPERATION

With its regional approach, the EFSE serves as a vehicle to strengthen economic cooperation between different countries.

3 BALANCING SOCIAL DEVELOPMENT AND COMMERCIAL APPROACH

The EFSE combines in an innovative manner a clear development orientation with private sector efficiency and positive risk-adjusted returns, thereby ensuring institutional sustainability.

4 PROMOTING PRIVATE PUBLIC PARTNERSHIPS AND MOBILISE PRIVATE CAPITAL FOR DEVELOPMENT

The EFSE uses donor grants as a risk cushion for attracting private investors for development purposes. Up to seven times the amount of the initial investment and/or grant can be raised for the target group, representing significant leveraging capacity.

5 FACILITATING ACCESS TO CAPITAL MARKETS

By mobilising private capital through the risk protection mechanism set in place with investor and donor funds and mezzanine capital from development finance institutions and international financial institutions, the EFSE helps local and regional financial institutions to access European and international capital markets.

6 SERVING AS A MARKET ENABLER

The EFSE acts as risk taker to overcome prohibitive country-specific and institutional risks, which prevent the financial sector from serving the Fund's ultimate target groups. Furthermore, the Fund plays an important role in anticipating market developments. By continuously adjusting its range of services and products, it pushes the development finance frontier further to the benefit of its target groups.

7 ENSURING THE DEVELOPMENT MISSION THROUGH A MIX OF INSTRUMENTS AT DIFFERENT LEVELS

The EFSE's development mission is continuously assured through investor and donor representation at Board level and in various committees. Furthermore, development performance is constantly assessed against development targets and in the Development Impact Study that is commissioned on a regular basis.

8 COORDINATION PLATFORM FOR LOCAL AND INTERNATIONAL STAKEHOLDERS

The EFSE serves as a coordination platform for donor agencies, development finance institutions, and international financial institutions, as well as local governments.

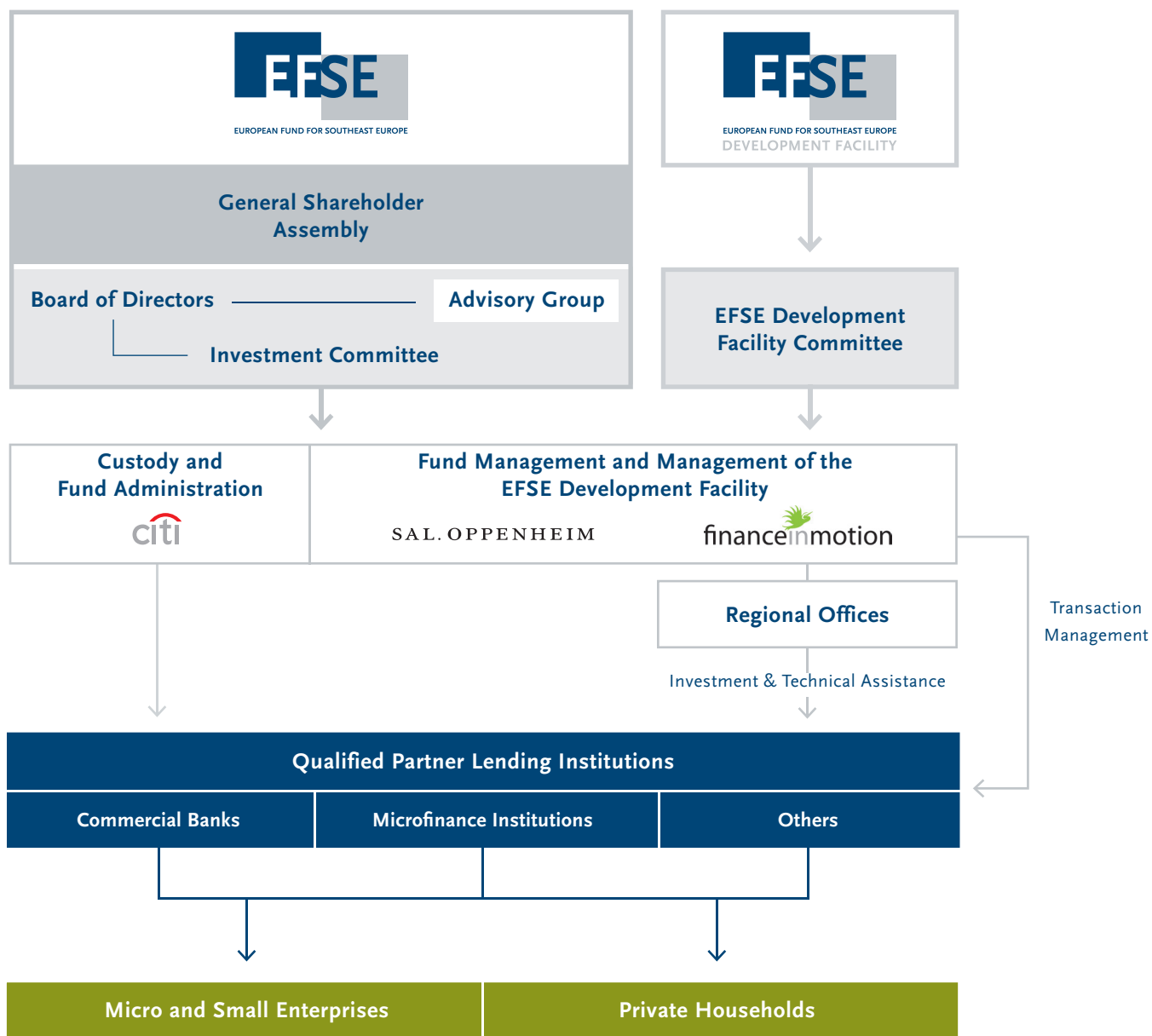
9 LOCAL OWNERSHIP

It is envisaged that donor funds invested in the EFSE will partly or at large be transferred to local stakeholders. In the future, therefore, local stakeholders will increasingly become shareholders of the Fund, adding to the current local shareholders (Armenia and Albania).

10 CATERING FOR THE NEEDS OF DONOR AND GOVERNMENT PROGRAMMES

The EFSE allows earmarking grant funding for investments in specific countries and/or for specific activities of the EFSE Development Facility. Furthermore, the Fund is also open to incorporating existing donor or government programmes that serve the ultimate target groups.

ORGANISATIONAL STRUCTURE



Initiator and Lead Investor: **KfW**

Seasoned bankers with a strong development finance background are members of the Fund's Investment Committee, which decides on each investment.

Representatives from the main donors providing grants to the EFSE Development Facility are members of an independent Committee, which oversees all activities of the Development Facility.

The Advisory Group to the Board of Directors comprises representatives from Central Banks in the region. It meets twice a year. The role of the Advisory Group is to

- Provide the Fund with better linkages to local realities, concerns and needs,
- Share local experiences, and
- Make recommendations to the Fund Manager and/or Board of Directors in terms of Fund policies and operations.

FEATURES

COMPLEMENTARITY

Combination of financial and non-financial services

The EFSE and the EFSE Development Facility work jointly in support of the target group.

Coordination of donors and development finance institutions

The Board of Directors serves as a coordination platform for different donors and development finance institutions active in the region. The Fund aims at complementing existing initiatives of local governments, donors and development finance institutions, and strives to harmonise efforts.

EFFICIENCY

Professional management

Professional service providers are in charge of fund management and administration.

Performance incentives

Service fees are tied to the fulfilment of performance targets regarding financial and development performance.

REGIONAL ENTRENCHMENT

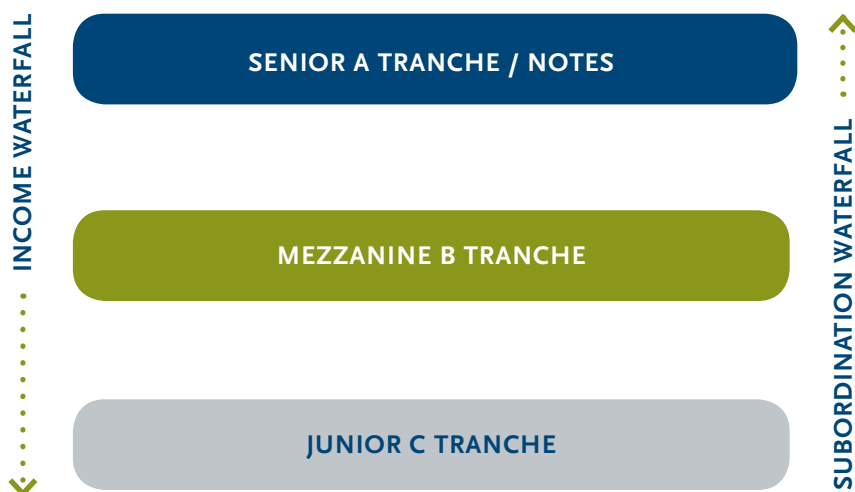
Physical presence in the region

In most countries of operations, local offices facilitate day-to-day contact with partner lending institutions and local stakeholders.

Local participation

Through the Advisory Group, local governments, as future shareholders, can familiarise themselves with the Fund and prepare for their future role.

FUNDING MECHANISM



Investor and donor funds used for development finance initiatives in the target region are generally scarce in view of actual needs. The advantage of the EFSE's funding strategy is to use these donor funds to leverage additional funds at large scale for development purposes. This is achieved by issuing different share tranches as well as notes bearing different risks:

1. Public investors and donors invest in the junior C tranche (first loss piece),
2. Development finance institutions and international financial institutions invest in the mezzanine B tranche,
3. Private investors purchase the senior A tranche or notes.

Whilst mezzanine and senior investors invest at the regional level, junior tranches can either be earmarked to a specific country or the region as a whole. Country-specific junior tranches are exclusively used for investments in one particular country. Regionally earmarked junior tranches allow for a flexible use of funds and can therefore best accommodate changing development finance needs in the target region.

In order to undertake investments, different sources of funds representing different risk tranches are pooled. They then constitute one single source of financing for the Fund. Consequently, the Fund uses these pooled funds flexibly within each country based on the Fund's overall investment policy. This approach creates efficiency gains and also effectively addresses the risks associated with each investment.

Mobilising private capital is only possible due to the subordination mechanism in place for each country in which the Fund invests. In the unlikely event of losses, for example, due to a defaulting partner lending institutions, the C tranche is affected first. Only when these are fully depleted is the mezzanine B tranche affected, then follow by holders of senior A tranches, and, finally, notes.

Income is first distributed to noteholders, while holders of A, B and C tranches follow. Holders of A, B and C tranches receive income based on the success of the investments made by the funds, noteholders receive a fixed interest rate.

DONOR FUNDS

Grant funds provided by donors are essential to the Fund's operating mechanism. They constitute the risk cushion (C Shares) for private investors that otherwise would be reluctant to invest in countries that are generally perceived as high risk. This way, private capital can be mobilised, substantially enlarging the total amount of funds available for development purposes.

Grant funds in the form of risk capital are particularly relevant to:

- Start Fund operations in new countries, and
- Introduce new financial instruments and higher-risk products.

Furthermore, grants can be provided to the EFSE Development Facility to offer complementary non-financial services to maximise investment impact.

INVESTOR FUNDS

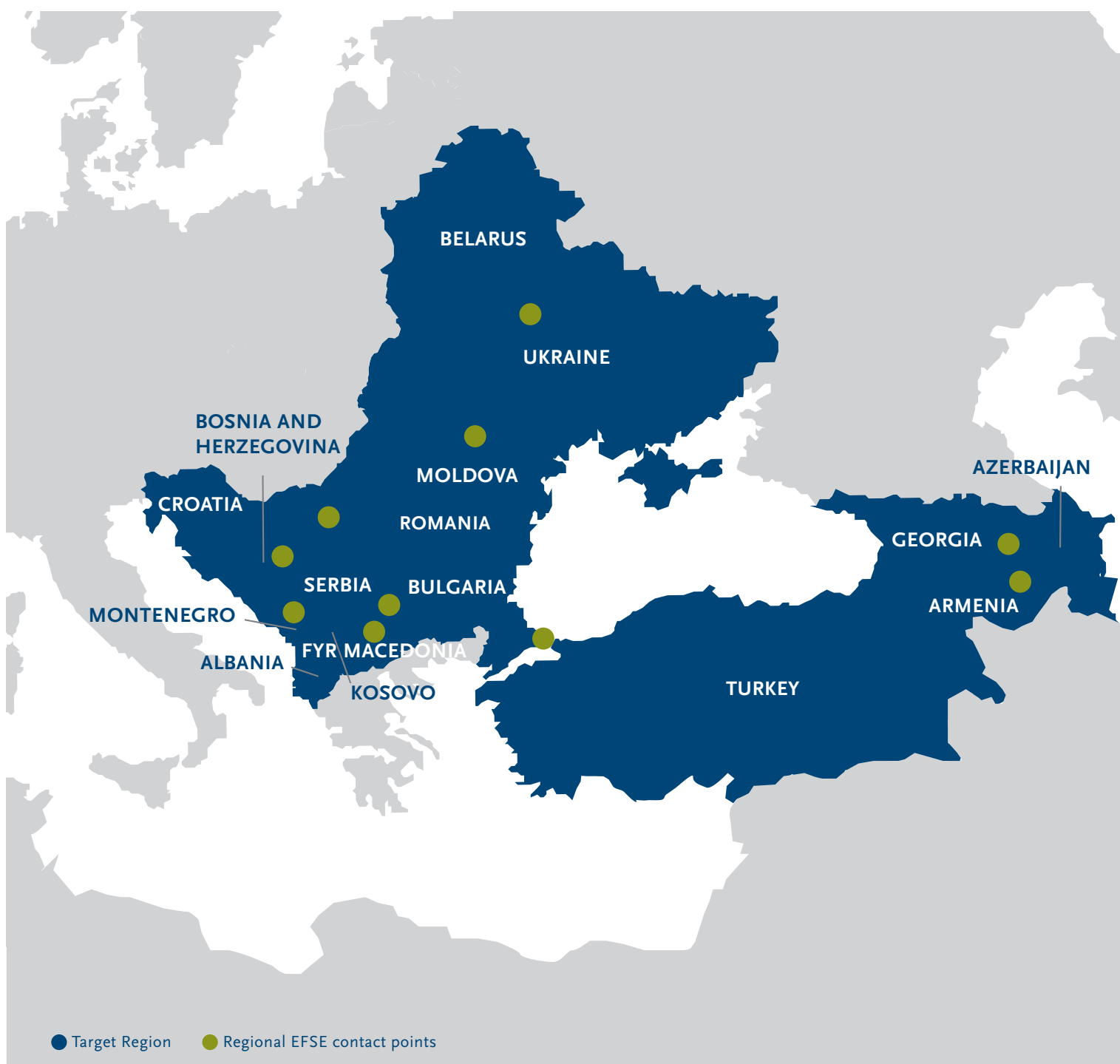
The EFSE attracts a highly reputable group of investors. These include the European Commission as well as the governments of Germany, Austria, Switzerland and Denmark, through the German Federal Ministry for Economic Cooperation and Development (BMZ), Swiss Agency for Development and Cooperation (SDC), Austrian Development Agency (ADA), and the Danish International Development Agency (DANIDA).

In addition, the first governments from the EFSE's target regions in Southeast Europe and the European Eastern Neighbourhood region, the governments of the Republic of Albania and the Republic of Armenia, have also become investors in the Fund.

These public investors have been joined by international financial institutions and development finance institutions, including KfW Development Bank, International Finance Corporation (IFC), Netherlands Development Finance Company (FMO), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), and the Oesterreichische Entwicklungsbank (Austrian Development Bank, OeEB).

Finally, private investors, both with a commercial orientation and social responsibility, also represent a significant share of the funding base.

TARGET REGION



PARTNER LENDING INSTITUTIONS

TARGET FINANCIAL INTERMEDIARIES

- Local commercial banks,
- Specialised microfinance banks,
- Microcredit organisations,
- Other non-bank financial institutions (e.g. leasing companies), and
- Investment companies or funds with a regional orientation.

The target partner lending institutions have to either currently finance or be committed to finance the target group and fulfil a set of financial performance criteria.

FINANCIAL INSTRUMENTS FOR PARTNER LENDING INSTITUTIONS

The Fund provides long-term funding to partner lending institutions through a mix of different instruments. These include:

- Medium to long-term senior loans,
- Subordinated loans,
- Term deposits,
- Subscriptions to bond issues,
- Co-investments (syndicated loans),
- Stand-by letters of credit,
- Guarantees, and
- Equity and quasi-equity participations.

The Fund is able and willing to participate in loan syndications of a broader investors group if this adds value to the respective partner lending institution.



“Established as a non-bank microfinance institution in 1997, Alter Modus began its microcredit program for small entrepreneurs in Montenegro in 1999. This client group had traditionally been considered high-risk, with difficult and limited access to financial resources. As of mid of 2013, we have approved close to 69,000 loans with an aggregate value of over EUR 131 million.

EFSE funding in particular has enabled us to reach out to the smallest and poorest business clientele in Montenegro, and provide loans totalling EUR 9.3 million to over 4,200 clients. They in turn have put our microloans to good use in improving and developing their micro businesses throughout Montenegro. Approximately 45% of our clients are women. The EFSE funds were also instrumental in our efforts to diversify our product range by providing additional tailored loans to our clients in areas such as agriculture, for instance.”

Luka Đurović, Co-Director,
Alter Modus Ltd., Montenegro

SUCCESS STORIES

“As a farmer, even with a larger business like mine and with modern technologies, I still have to adapt to nature’s rhythms, not the other way round. I’m glad to work with Agricovert because they understand that fundamental truth.”

Maria Barbu, farmer,
Agricovert Credit IFN, Romania



SHARING THE VISION OF ENTREPRENEURSHIP

“We were about to start harvesting when the old combine gave up the ghost,” Maria continued. “The repair costs would have been astronomical, and the combine would never have been ready in time. So we risked losing the whole crop. And renting was no option, either: that would have eaten up almost all the revenue and still left us without a combine for the next harvest.” When Maria met with a representative of Agricovert Credit IFN, a bank

specialised in agricultural lending, Maria quickly saw that their expertise wasn’t just advertising, and that they understood farming. Whilst a loan over RON 150,000 (ca. EUR 27,000) made the investment in a new combine possible, Maria and the Agricovert advisor negotiated a working capital credit line to cover inputs, like diesel fuel and fertiliser, for the next cycle.

“I started out ten years ago with 80 hectares,” said Maria, looking out over the golden fields. “Today we have much more land and we have a strong farming operation. And the right financial partner to stay in business and keep growing. A great harvest doesn’t wait for all the approvals from a banker’s office, especially not from one where ‘promptly’ means a few months, not days. We work with nature, so we follow her rhythm.”



WEAVING A PATTERN OF SUCCESS

Just over sixty years ago, in the small town of Ada in northern Serbia, Kornel Boldižar’s grandparents had a dream.

What started with the idea of spinning yarn from recycled textiles eventually grew into a knitwear business, strong enough to sustain one generation and inspire the next, and the one after. In 2006, Kornel, then 29, took over the business, committed to turning one shop and two obsolete knitting machines into a fresh, modern

streetwear brand. It would soon grow faster than its ability to finance its own growth. The 2011/2012 collection would be the turning point, firmly establishing KOOI-KNIT on the domestic market, but also creating export opportunities. To keep up the momentum meant boosting production capacity, hence investing in new equipment. Banca Intesa Beograd in Serbia, an EFSE partner lending institution, Kornel had already been working with for many years, arranged a EUR 25,000 loan

“Banca Intesa came through for us to secure the jobs we’d created, whilst helping us to gain momentum, grow the business, and prepare it for the future. It’s not just about the speed and flexibility they support us with; it’s their ability to understand the reality behind making a dream come true.”

Kornel Boldižar,
knitwear manufacturer,
Banca Intesa ad Beograd, Serbia

to purchase two state-of-the-art knitting machines from Italy. Today, KOOI-KNIT has two manufacturing facilities to keep up with demand. Not to mention three stores in Serbia’s largest cities as well as distributors in Austria, Germany, and Bosnia and Herzegovina. At the time of the loan Kornel employed 50 people; he now expects to create around 20 more jobs. (www.kooi-knit.com)



ACCESS TO CREDIT? ICING ON THE CAKE!

“Getting up long before the crack of dawn isn’t always easy. But when you are as lucky as I am to see how years and years of hard work pay off, you quickly forget the tough times. Especially when you have a partner like Araratbank at your side to steer clear of obstacles and help keep you on course.”

Armen Khachatryan,
baker, Araratbank, Armenia

“I learned the ins and outs of baking during the Soviet era. Even if I knew I had the skills and the drive, to say that I was a bit apprehensive about going to business on my own is to put it mildly,” Patvakan Khachatryan admitted.

That was in 2000, and nobody could have imagined then, least of all Patvakan and his son Armen, that the Vahan Khachatryan and Friends bakery would become the successful business it is today. At the time, Patvakan had started out with three old electric ovens, which were quite

inefficient and costly to operate, eroding his margins. But he just focused on what he did best: bake. The fact customers not only kept coming back, but were also telling others to stop by Vahan Khachatryan and Friends for the finest bread and pastries, was motivation enough for him to work harder. Today, his son Armen has a team of 11 bakers and 4 deliverymen to keep the business humming along. “I couldn’t have done it without Araratbank. I was working with obsolete ovens that made working conditions more

difficult than they had to be, and I dreaded my electricity bill every month,” Armen recalls. As a first step, Araratbank’s credit officer went over the issues that plagued the bakery and mapped out an investment plan to modernise his production setup. Two loans, totalling USD 57,000, went towards the acquisition of gas-fired ovens, which are much more energy-efficient. “And the difference comes through in the quality, too!”

“When you see an opportunity for starting a business, it is even better when you have a partner whom you can trust and who trusts you to make it come true. Working with ProCredit Bank has opened my eyes to more possibilities, and together we are taking the business a big step further.”

Givi Shekiladze,
convenience store owner,
ProCredit Bank, Georgia



ADDING VALUE TO THE NEIGHBOURHOOD

“I looked at the space and imagined the convenience store that was still missing in the neighbourhood,” Givi Shekiladze says, flashing a grin at the memory.

In early 2010, Givi Shekiladze went to see the Lilo branch of ProCredit Bank Georgia – in the Samgori district just to the southwest of downtown Tbilisi – about financing his expansion plans. At the time, he owned a bakery that also came with parking spaces. The latter was a definite plus with his

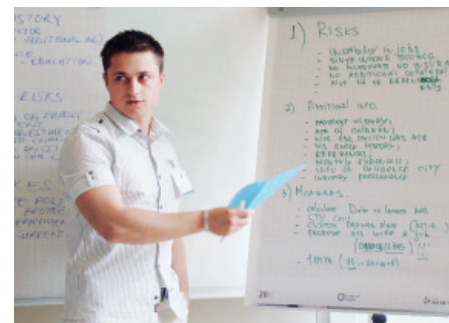
customers. It was already obvious that he had an ideal location, as was the fact that to sell only bread and biscuits was to not realise the full business opportunity. What the neighbourhood needed was a store that also sold groceries and other everyday necessities.

A simple loan request soon developed into a partnership: Givi described his vision and ProCredit Bank helped him to develop the business plan to achieve it. The first step was

to renovate the space, which meant scaling down the bakery side of the business. Then came investments in refrigerators for meat and dairy products. Finally, Givi had to stock up in goods – and open up for business.

The convenience store opened in November 2011 and is already proving a winner – and a nearby property has just become available that would be ideal for enlarging the parking area.

EFSE DEVELOPMENT FACILITY



The EFSE Development Facility (EFSE DF) aims to strengthen the internal capacities of the European Fund for Southeast Europe's partner lending institutions to increase the outreach to the final target group, i.e. micro and small enterprises and low-income private households.

INSTRUMENTS

Individual Technical Assistance

The EFSE DF supports PLIs in enhancing their ability to efficiently and effectively serve micro and small enterprises (MSEs) and low-income households in a sustainable manner.

Sector Technical Assistance

The EFSE DF works with sector bodies in supporting transformational processes within the financial sector to improve the financial infrastructure. Sector bodies include central banks, microfinance and banking associations, and debt advice centres.

Applied Research

The EFSE DF sponsors applied research to identify and address institutional as well as sector needs and challenges.

THE EFSE DF'S APPROACH

In addition to responding to partner lending institution demand, the European Fund for Southeast Europe proactively identifies the technical assistance or capacity building needs of its partner lending institutions. In this way, the EFSE and the EFSE DF seek to establish long-term partnerships with partner lending institutions.

Focused, high-impact support

Technical assistance focuses on key areas or processes in the partner lending institutions. To ensure impact, a combination of dedicated consulting services, training and on-the job coaching is provided. To allow institutions to absorb and implement training and consulting input, technical assistance is structured in short-term, intensive intervals.

Consultant selection

Consultants or trainers for implementation are carefully selected jointly by the EFSE DF and the partner lending institutions. The EFSE DF also draws on local expertise, supporting the development of local know-how.

Cost sharing

Technical assistance is provided on a cost sharing basis, strengthening a sense of ownership on the part of partner lending institutions.

FUNDING MECHANISM

The EFSE DF relies on two funding sources to sponsor its activities:

1. Direct grant contributions from public and private donors, which are either earmarked for specific activities or provided to the EFSE DF as a whole.
2. An annual share of the Fund's income as decided by the EFSE Board of Directors.

Contributions are held in a separate trust, ensuring independence between investment activities and technical assistance. For private donors, the EFSE DF will facilitate the issuance of donation receipts.

PROMOTING RESPONSIBLE FINANCE

The EFSE is committed to promoting responsible financing in a very practical, hands-on manner. This commitment stems from the Fund's social mission to improve access to credit for less privileged population groups. Furthermore, stable and transparent financial markets are the foundation to the EFSE business model and crucial to the Fund's long-term investment horizon. The key dimensions of Responsible Finance as fostered by the EFSE:

END-BORROWERS

Promoting financial literacy

The EFSE aims to enhance the level of understanding of financial terms and concepts among its end-borrowers. The objective is to help clients make well-informed decisions regarding the financial services they need and the obligations they undertake.

Preventing over-indebtedness

The Fund aims to raise awareness of the consequences of over-indebtedness among end-borrowers through public campaigns, by working on industry codes of conduct to limit the debt burden to single client households and by supporting the set-up of debt advice centers.

PARTNER LENDING INSTITUTIONS

Responsible Finance assessment of partner lending institutions

In addition to assessing the financial strength of every partner lending institution, the EFSE also examines the scope and quality of corporate values and business practices employed by its partners. The Responsible Finance assessment covers the following areas: environmental, social and governance aspects, responsible business model and impact for development (ESGRID).

Promoting sound social and environmental management systems

The EFSE promotes the implementation of sound social and environmental policies and management systems in partner lending institutions. For instance, as a minimum standard, the Fund requires each partner lending institution to refrain from financing activities listed in a social and environmental exclusion list.

FINANCIAL SECTOR

Promoting responsible financial instruments

The EFSE aims to provide long-term funding in a manner that is conducive to developing local financial markets. The Fund, for example, provides local currency financing wherever possible.

Raising awareness of Responsible Finance

With the aim to sensitise the public in the target regions to the issues of Responsible Finance, the EFSE organises joint seminars and conferences with KfW and central banks in the regions.

Active support of the SMART Campaign and other industry initiatives

The Fund was among the first signatories of the SMART Campaign (www.smart-campaign.com), a joint initiative of CGAP and ACCION International, to promote consumer protection in the microfinance industry.

FUND AND INVESTORS

Transparency of information

The Fund is committed to maximum transparency of its operations. In addition, to the official reports submitted to the Luxembourg Supervisory Agency for the Investment Fund Industry (CSSF), the Fund publishes quarterly data on its investment portfolio, financial and development performance (available on the Fund's own website (www.efse.lu) as well as on microfinance information platforms).

Regular social performance monitoring

On a quarterly basis, the EFSE monitors the proper use of the funds by the Fund's partner lending institutions to the end-borrowers, i.e. through the collection and analysis of a comprehensive set of subloan data.

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