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RESEARCH FOR REGI COMMITTEE - FINANCIAL INSTRUMENTS IN THE 2014-2020 PROGRAMMING PERIOD: FIRST EXPERIENCES OF MEMBER STATES

STUDY

EN

2016

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT B: STRUCTURAL AND COHESION POLICIES

REGIONAL DEVELOPMENT

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This research paper was requested by the European Parliament's Committee on Regional Development.

Policy departments provide independent expertise, both in-house and external, to support EP committees and other parliamentary bodies in shaping legislation and exercising democratic scrutiny over EU external and internal policies.

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Abstract

The aim of this study is to provide a synthetic input about the practical implementation of the legislative framework governing financial instruments in the 2014-2020 programming period. Based on the analysis of the previous and the current EU legislation, policy documents and the first experiences of Member States, this study presents recommendations on how to remove obstacles and on how to improve the use of financial instruments.

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CONTENTS

LIST OF ABBREVIATIONS

AGRI	Agriculture and Rural Development Committee
BGK	Bank Gospodarstwa Krajowego
CAP	Common Agricultural Policy
CEF	Connecting Europe Facility
CMZRB	Czechomoravian Guarantee and Development Bank
COCOF	Coordination Committee of the Funds
COSME	Competitiveness of Enterprises and Small and Medium-sized Enterprises
CPR	Common Provisions Regulation
CSF	Common Strategic Framework
DG AGRI	Directorate-General for Agriculture and Rural Development
DG ECFIN	Directorate-General for Economic and Financial Affairs
DG EMPL	Directorate-General for Employment, Social Affairs and Inclusion
DG REGIO	Directorate-General for Regional and Urban Policy
EAFRD	European Agricultural Fund for Rural Development
EaSI	Employment and Social Innovation Programme
EC	European Commission
ECA	European Court of Auditors
EFSI	European Fund for Strategic Investments
EIAH	European Investment Advisory Hub
EIB	European Investment Bank
EIF	European Investment Fund
ERDF	European Regional Development Fund
ESF	European Social Fund
ESIF	European Structural and Investment Funds
FI	Financial Instrument
FLPG	First Loss Portfolio Guarantee

GBER	General Block Exemption Regulation
HDB	Hungarian Development Bank
HF	Holding Fund
InnovFin	EU Finance for Innovators
JASMINE	Joint Action to Support Micro-finance Institutions in Europe
JEREMIE	Joint European Resources for Micro-to-Medium Enterprises Initiative
JESSICA	Joint European Support for Sustainable Investment in City Areas
MA	Managing Authority
MS	Member State(s)
NPB	National Promotional Bank
NSRF	National Strategic Reference Framework
OP	Operational Programme
PPP	Public-Private Partnerships
ROP	Regional Operational Programme
SMEs	Small and Medium-sized Enterprises
SZRB	Slovenská Záručná a Rozvojová Banka (Slovak guarantee and development bank)
UDF	Urban Development Fund
VC	Venture Capital

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EXECUTIVE SUMMARY

Background

The role of financial instruments[1] has grown over several programming periods, thanks to their leverage effect on public investment resources, their capacity to combine different forms of public and private resources, and their longer-term financial sustainability. FIs can thus be more sustainable than grants, generate better quality projects, and they may be considered more cost-effective in some circumstances. However, the success of the financial instruments significantly depends on the existence of a properly functioning, cost-effective institutional system, too. This requires a special combination of skills and expertise covering both financial and banking knowledge as well as understanding of and familiarity with cohesion policy implementation. EU financial instruments may be implemented under shared management (with the support of the European Structural and Investment Funds -"ESIF/ESI Funds") or may be implemented under the European Commission's direct or indirect management (e.g. "COSME" and "InnovFin" under H2020, the Cultural and Creative Sector Guarantee Facility ("CCS LGF") within the Creative Europe Programme, the Private Finance for Energy Efficiency ("PF4EE") and the Natural Capital Financing Facility ("NCFF") under the LIFE programme etc.)

For the programming period 2014-2020, FIs in cohesion policy are designed to address specific market needs in accordance with the objectives of the ESI Funds programmes. The Common Provisions Regulation (CPR)[2] applies to all five ESI Funds and FIs can support all thematic objectives (laid down in Article 9 of the CPR). The legislative framework that governs the implementation of FIs has also become more complex, with the EU level co-legislators aiming at better tailoring rules to the specificities of these instruments. The provisions included in the CPR are complemented by delegated and implementing acts and Guidance documents issued by the European Commission (EC).

The main difference between the 2007-2013 and 2014-2020 regulations is that in the 2007-2013 programming period there were short and limited rules and later few guidance documents on Financial Engineering Instruments (FEIs) which gave a lot of room for manoeuvre for the Member States without legal certainty. In the 2014-2020 programming period a more detailed regulation has been introduced and several guidance documents have been issued on FIs which are not necessarily in line with the Member State practices that have been in place since 2007-2013.

In terms of implementation of FIs, the 2014-2020 programming period is at a relatively early phase in the Member States. By 2016, strategic programming has been completed, thus the choices have in many cases been made as regards the forms of support (FIs versus grants), the management structures and modalities of FIs. There is hence available experience in the Member States and first feedback about the new provisions can now be collected.

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1 Regulation (EE, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002; "financial instruments" means Union measures of financial support provided on a complementary basis from the budget in order to address one or more specific policy objectives of the Union. Such instruments may take the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments, and may, where appropriate, be combined with grants".

2 Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006.

Aim

The aim of the present study is to provide synthetic input about the experience that certain Member States have gained so far in implementing the legislative framework governing FIs in the 2014-2020 programming period under cohesion policy.

Taking into account the state of play of implementation, the study addresses the following specific themes:

- FI related considerations in the strategic planning process (i.e. in the Partnership Agreements and programmes, including the choice about whether to apply Article 39 of the CPR ("SME Initiative");
- Setting up FIs: ex ante assessment, choices made about implementation modalities, co-operation with EIB; selection of financial intermediaries; choice among the different types of FIs, thematic scope of FIs, possible combination with grants;
- Clarity of provisions, including delegated/implementing acts and guidance documents;
- Public procurement and state aid related challenges.

The methodology comprised a twofold approach:

- desk research - examination of the previous and the new EU legislation, policy documents, collection and processing of secondary data available from the literature and evaluation documents on financial instruments;
- interviews and case studies - eight case studies (PL, HU, CZ, SK, IT, IE, BG, UK) have been selected in agreement with the European Parliament to complement the literature review and consultations/interviews. The thematic chapters and sub-chapters include thematically relevant results from the comparative assessments of the case studies as well as the interviews, in addition to the literature review.

The interview and evaluation questions were the following:

- What is the state of play of the implementation of the 2014-20 financial instruments in the selected Member States? (Including information about the process of setting up FIs: ex ante assessment, choices made about implementation modalities, co-operation with EIB; selection of financial intermediaries, etc.;
- How have choices been made among the different types of FIs? Were there intentions to use FIs in combination with grants or “off the shelf” products or “SME Initiative” and why? What are the challenges linked to the broader thematic scope of FIs that are now available for all thematic objectives under the CPR?
- What is the opinion on the clarity of provisions, including delegated/implementing acts and guidance documents? Is the current legal framework providing legal certainty on FIs? How are the new FIs provisions being applied in the different Member States? What are the main issues emerging at this stage of the implementation (e.g. uncertainties, positive versus negative evolution compared to the previous period, practical challenges, etc.)?

Single examples from both the consultations/interviews and the case studies are used in the narrative or in the text boxes, as well. The challenge of compiling the information into the analysis has been the large amount of qualitative and quantitative information collected (e.g. entire reports or graphs provided by the interviewees).

Key Findings and recommendations

The new provisions in the 2014-2020 period and the European Commission's legal interpretations changed the operational environment compared to what was in place in 2007-2013. In several cases, the demand for uniform standards and management methods of the new FIs instigate the use of solutions different from what were used before. However, with the change of the FI architecture it is important to take into account the MS experiences and the need for expertise and administrative capacity is crucial. Additionally, the adjustment of the legal and other conditions is necessary.

On the basis of the research carried out for this study the key findings are that one of the main advantages of using FIs is the added value that revolving instruments have over grants in terms of the efficient use of public resources. Repayable forms of support can also act as an incentive for better quality investments as the investments need to be economically viable so that the final recipient is able to repay the support provided. Restricted access to finance is identified as a problem in all the countries analysed in this study and cost-effectiveness of public funds is an additional rationale in most countries for establishing financial instruments.

The Investment Plan for Europe strongly encourages the use of financial instruments instead of traditional grants in ESIF funding. While the overall amounts delivered through financial instruments should increase, the EC's implicit general policy line is that there should be consolidation of resources into national or supra-regional instruments.

Ex-ante quantification and justification of FIs is obligatory, however, this is a complex and time-consuming process. Proper functioning of financial instruments requires a well-functioning, cost-effective institutional system and adequate administrative capacity. Involving diverse fund managers creates wider access for SMEs, since they are able to use their range of specialisations to reach out to more companies in need of funding. However, obligatory formal public procurement for the selection of financial intermediaries does not support this approach - several Member States have to change their method for establishing their FI institutional system, despite the fact that setting up FIs within the existing structures minimises operational costs and helps to speed up implementation. On the contrary EIB/EIF in general is exempt from applying EU public procurement rules. Remuneration is the most effective mechanism to ensure that actors perform as expected. It must be attractive for the intermediaries but also in line with state aid rules, therefore designing the right remuneration scheme for a FI is not an easy task.

In the framework of FIs, various kinds of assistance schemes are offered by the CPR. EU level FIs have several advantages, namely that no national co-financing is needed or contracts can be concluded with the EIB/EIF directly by managing authorities without the need for a competitive process/public procurement and the EIB/EIF can select financial intermediaries to manage FIs on the basis of its internal procedures. Despite the advantages mentioned, Member States still prefer the use of national/regional FIs. Off the shelf FIs provide standard terms and conditions compatible with ESI Funds regulations and state aid rules, but they do not always fit with market needs. Due to this, tailor-made solutions are the best tools, nonetheless they are more complicated to implement because of the complexity of the applicable rules. Furthermore in the 2014-2020 period more types of combination will be possible than earlier, which facilitates the transition from a financial support regime based on grants towards the use of revolving FIs. The main financial resource used for FIs is the ERDF, nevertheless a few financial instruments financed by the ESF are also planned (e.g. PL, HU).

In the 2014-2020 period there is a more sophisticated regulation and several guidance documents on FIs which are not necessarily in line with Member State practices that have been in place since 2007-2013. There has been a move from under-regulation to overregulation. Despite the clarity of the provisions in the CPR, in several cases the interpretation is not explicit and there is an apparent need to amend the text of the CPR. Risk of "audit freak" of practitioners and final beneficiaries may also lead to inflexible and inefficient use of funds.

On the basis of this research carried out for this study, the following recommendations are made:

1. The legislative gap between financial instruments implemented by the EIB and those implemented at Member State level is wide. It seems that the rules defined for centrally implemented financial instruments allow more room for manoeuvre and they are less strict. For the more effective and efficient use of FIs, it is recommended to align the conditions of these two implementation types so that the rules for national FIs also become more flexible.
2. The correct implementation of FIs may cause challenges: inconsistent rules (cohesion policy, state aid, public procurement regulations), too much guidance in comparison to the volume of legislation or EC interpretation of the rules sometimes making oversight more difficult. For the effective implementation of FIs clearer rules and stronger methodological guidance – or clearer decision on "laissez-faire" - are needed.
3. Regarding the leverage effect, the interpretation of the CPR is not explicit. The regulation should provide a definition for the leverage effect of financial instruments which clearly distinguishes between the leverage of private and national public contributions under the OP and/or of additional private or public capital contributions, and takes into account the type of instrument involved, as well. This definition should clearly indicate how the amounts mobilised by the EU and national public contribution are determined.
4. The new cohesion policy regulations provided opportunities to use financial instruments based mainly on the consideration whether the administrative capacity at national/regional level is available or not. The EIB Group has undoubtedly got the necessary knowledge and administrative capacity, however, the strengthening of the national administrative capacity is also necessary in order to improve the use of financial instruments in the current period and also in the future. The challenges to be faced require more and highly qualified management resources in order to mitigate risks and accomplish the goals set out by the policy plans.
5. For the wider use of tailor-made FIs better harmonization of the applicable rules (cohesion policy, state aid) is needed, especially by ensuring common definitions of the terms used. Requirements in the delegated and implementing acts should be described in a clearer way. More off the shelf products may also be helpful. For the better implementation of combining the different funds, the Member States need encouragement and guidance so that they can use the simplest options[3].
6. Finally, for the effective and efficient implementation of FIs it will also be vital for the Commission, the EIB and the national authorities to coordinate the use of the FIs under shared and centralised management with the European Fund for Strategic Investments (EFSI), also known as the 'Juncker Plan'.

[3] Despite the clear intention of the co-legislators to make combination possible in a simple way, avoiding the need to artificially split expenditure into sub-operations, the Commission's guidelines do not provide any encouragement for Member States to use these options.

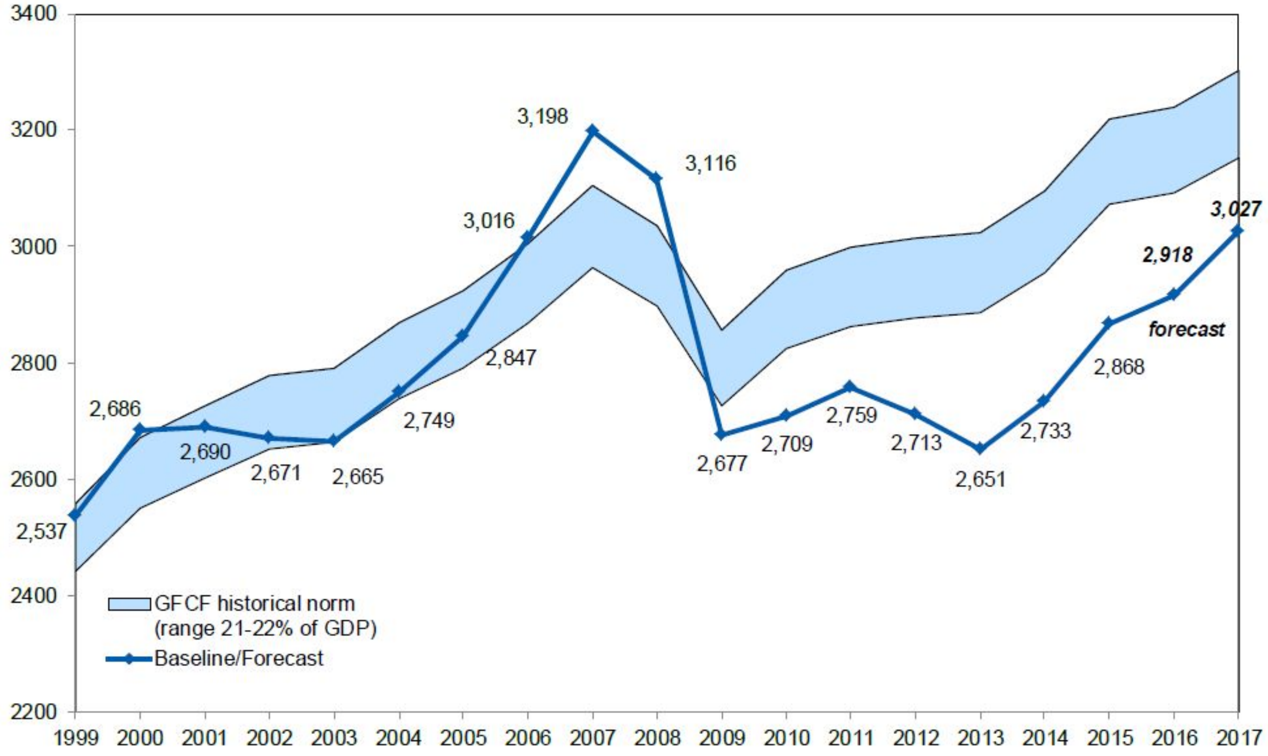
1. GENERAL INFORMATION

KEY FINDINGS

- One of the main advantages of using FIs is the added value that revolving instruments have over grants in terms of the efficiency of the use of public resources;
- Repayable forms of support can also act as an incentive for better quality investments as the investments need to be economically viable so that the final recipient is able to repay the support provided;
- The Investment Plan for Europe strongly encourages the use of financial instruments instead of traditional grants in ESIF funding.

When facing the European investment gap, one of the main problems is how to meet the needs for public investments, which are growing faster than Member States' budgetary possibilities. Even though the investment in the EU surprised on the upside in the last quarter of 2015 and making a larger contribution to economic growth than any other component, still the gap with pre-crisis levels remained wide. Total investment in the EU is expected to rise by 3% in 2016. Hopefully the European Investment Plan will have the potential to bring investments back in line with historical norms.

Figure 1: EU investment (private/public) trend (Real gross fixed capital formation (GFCF) in EU28 in 2015 prices, € bn)



Source: European Commission - based on the 2016 Spring forecast, 2016

In this context access to finance seems to be also an important challenge. Public-Private Partnerships and the use of financial instruments[4] (FIs) appear as the modern ways of solving these dilemmas.

[4] "Financial instruments" is the term used for the 2014-2020 programming period in preference to "financial engineering instruments" that was the terminology in the 2007-13 period.

In particular, FIs can:

- take the form of loans, guarantees, equity capital or venture capital, using
  - tailor-made instruments (see details in section 3.3.) or
  - off the shelf instruments (see details in section 3.2.) or
  - combined solutions (see details in section 3.4.).
- be implemented
  - FIs can be established at EU level and managed directly or indirectly by the EC (for FIs indirectly managed by the EC see more details in section 3.1.) or
  - directly implemented by Managing Authorities (MAs) or
  - via a Holding Fund where the holding fund manager may be the European Investment Bank (EIB), the European Investment Fund (EIF) or other financial institutions or agencies and with financial intermediaries or
  - implemented via financial intermediaries without holding fund.

Financial instruments[5] have attracted interest because of their revolving character, meaning that FIs invest on a repayable basis. Their use has been promoted[6] because of the added value the revolving instruments have over grants in terms of the efficiency of the use of public resources. Primarily, the revolving nature allows for much greater efficiency in the allocation of public capital and for the long-term sustainability of public investment. Secondly, by unlocking other public sector funding and private sector resources through co-financing and co-investment, FIs aim to increase the overall capital available. In addition, the private sector participation enables policymakers to make use of private sector skills and expertise in areas such as identifying investments, decision-making, managing commercial operations and the ability to achieve returns.

Repayable forms of support can also act as an incentive for better quality investments as the investments need to be economically viable so that the final recipient is able to repay the support provided. By targeting projects with potential economic viability, FIs provide support for investments by way of loans, guarantees, equity and other risk-bearing mechanisms, possibly combining with technical support, interest rate subsidies or guarantee fee subsidies within the same operation.

However, it should be also noted that a shift from traditional financing to more innovative instruments is not advisable in all policy areas; it should not be used for projects that can only benefit from the use of grants, which are particularly important for less developed regions. Using FIs is not compulsory; it is a “tool” not an objective.

For the decision about support schemes policy-makers/experts have to estimate separate effects: (i) different levels of the economic value of the incentives; (ii) different types of incentives (distinguishing between below market rate loans (“soft-loans”), grants to repay interest-rate costs and non-refundable capital grants); (iii) different sizes and (iv) industrial sectors of the assisted firms; (v) different geographic areas where the programme is implemented[7]. The choices between the impacts of different types of programme incentives often involve trade-offs.

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5 FIs are defined in the Financial Regulation (Article 2(p) of Regulation (EU, EURATOM) No 966/2012 of 25 October 2012) as Union measures of “financial support provided on a complementary basis from the budget in order to address one or more specific policy objectives of the Union. Such instruments may take the form equity or quasi-equity investments, of loans or guarantees, or other risk-sharing instruments, and may, where appropriate, be combined with grants”. The CPR uses this definition (see Article 2(11)).

6 ESI Fund programmes should contribute to delivering the objectives of the Investment Plan for Europe by more effectively using funding and by doubling use of financial instruments (FIs) during the 2014-2020 period compared to the previous programming period. The Investment Plan for Europe focuses on removing obstacles to investment, providing visibility and technical assistance to investment projects and making smarter use of new and existing financial resources.

7 Final Report to DG Regional Policy “Counterfactual Impact Evaluation of Cohesion Policy. Work Package 1: Examples from Enterprise Support” (2012).

FIs have been considered[8] more economical than non-repayable capital grants and they may be more effective if market imperfections lead to underfunding of businesses that lack sufficient assets to offer as guarantee. With the same amount of public funds, FIs allow a much larger number of investment projects to be funded.

The crucial criterion for the evaluation of a financial instrument's added value is its ability to fill the funding gaps and compensate for the market failures that were identified in the market analysis. "The size of the market of a public sector led FI is the amount of finance that could be extended by the fund given any level of return sought, but only in those parts of the market in which the private sector will not invest for reasons of market failure. It is therefore highly dependent on the rate of return sought and the specific investment and pricing strategy which a fund may adopt (...) [Correspondingly] the size of the market for a new fund is subject to a large degree of uncertainty (...) Evidence of the finance gap and the optimum size of FIs should be drawn from a variety of sources, including, very importantly, the insight gained from operating these funds in the same or similar markets"[9].

Added value can only be created when coherence with the other existing possibilities of financial support can be guaranteed. Coherence is satisfied when the planned financial instrument can be justifiably and consistently integrated into the totality of existing European and national funding mechanisms. This is the case when the financial instruments make currently existing support instruments redundant or when the existing support mechanisms alone are incapable of closing the gap in demand. Furthermore, added value can be created through complementarity with other instruments, large leverage effect, positive effects on public budgets through back flow, avoidance and reduction of dead-weight-effects and the attainment of (more) challenging political goals[10].

Box 1: The use of fund-type of FI forms

Loans are the most widely used and well-established form of co-financed FIs. Loans are the main source of private financing for SMEs – over 60 % of SMEs have used them[11]. Loan funds are widely viewed as relatively simple and quick to launch compared to other types of support, and the market uptake also tends to be more rapid[12]. A very wide range of loan sizes is offered in the stocktake countries, and also their terms vary considerably. Generally the loan funds lend at below market interest rates and interest rates, which are subject to the state aid ceilings and are calculated by taking account of the creditworthiness of final recipients.

Guarantees encourage banks or financial institutions to advance credit to SMEs unable to obtain commercial finance (typically loan finance) due to the lack of collateral[13]. Counter-guarantee FIs, where guarantee given by a guarantee agency/bank to another bank issuing a guarantee, secure the guarantees rather than loans, as seen in Italy and Hungary.

Equity FIs are used to support innovative firms and business start-ups with high growth potential (and therefore high returns), but also with high risk (and potentially high losses). Equity and venture capital finance are considered of limited relevance by most SMEs (80%+).[14]

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8 E.g.: Ex post evaluation of cohesion policy programmes 2007-2013, focusing on the European Regional Development Fund (ERDF) and Cohesion Fund (CF) Work Package 3: Financial instruments for enterprise support (2016).

9 EIB (2015), Using Financial Instruments for SMEs in England in the 2014-2020 Programming Period - A study in support of the ex-ante assessment for the deployment of EU resources,

10 TAURUS ECO Consulting GmbH (2014), Ex-ante Evaluation of the Financial Instruments from the Operational Programme for the Federal State of Berlin within the European Regional Development Fund (ERDF) during the funding period of 2014-2020.

11 EC, (2013), SME's Access to Finance Survey report.

12 Michie R and Wishlade F, with Gloazzo C (2014) Guidelines for the Implementation of Financial Instruments: Building on FIN-EN – sharing methodologies on FINancial ENgineering for enterprises, Report to Finlombarda SpA.

13 Collateral is a property or other asset that a borrower offers as a way for a lender to secure the loan. If the borrower stops making the promised loan payments, the lender can seize the collateral to recoup its losses.

14 EC (2013), SME's Access to Finance Survey report.

Estimating separate impacts for different firm sizes and industrial sectors is also important. Smaller and larger firms may face different degrees of credit market imperfection (leading to different impacts of the intervention). Moreover, operating in different sectors (primarily distinguishing between manufacturing and service sectors) may lead to different employment outcomes if the propensities to use the subsidized investment for substituting labour with capital are differently distributed across the sectors.

Finally, estimating separate impacts across regions with different socio-economic conditions is also important, particularly in the case of the availability of non-refundable capital grants. This is because in economically distressed areas such grants have a higher potential to spur additional investment activities (that would not have occurred in the absence of the incentives) than in areas with better economic conditions. Additionally, generous non-repayable grants may face greater challenges in distressed areas – for example in terms of the relative difficulty of attracting and sustaining economic activity there.

While examining rationales for implementation of 2007-2013 FIs in the countries studied, the restricted access to finance has been identified as a major problem in all countries, together with other issues, such as:

- lack of appropriate finance available on the market and unwillingness of commercial banks to lend (HU, PL, SK and UK);
- credit rationing (IT)[15];
- cost of credit was highlighted as a rationale for FI use in some countries (CZ and PL);
- risk sharing to encourage private sector funders to participate in investment activity is also a frequent motivation (PL and UK) and
- increasing the cost-effectiveness of public funds is stated as an additional rationale in most countries (CZ, SK, IT, HU).

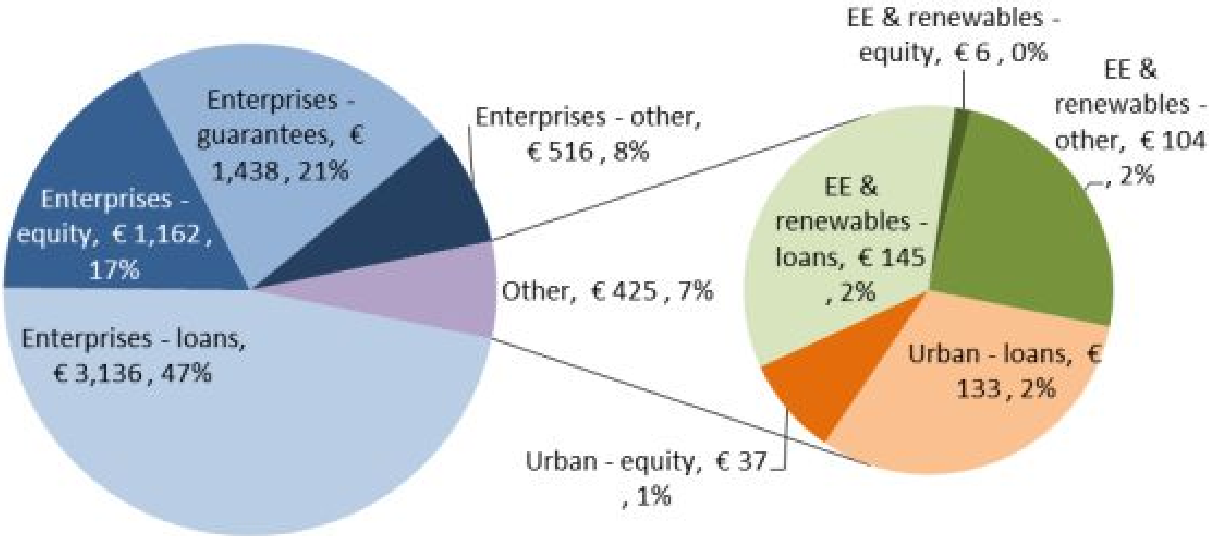
The three principal forms of FI used in 2007-13 Cohesion Policy programmes were equity, loans and guarantees[16] and FIs were used mainly to support enterprises through loan funds (see figure 2 below).

[15] Credit rationing is the result of asymmetry of information in the credit market, which keeps lenders from accurately gauging the risk of default for each borrower or loan. Direct measures of credit rationing provided by surveys carried out by the Bank of Italy and by Capitalia for the period 1995-2003.

[16] The specific regulatory provisions on the setting up and implementation of financial instruments in the programming period 2007-2013 were the following:

- Art. 44 and Art. 78(6)-(7) of Council Regulation (EC) No 1083/2006 as well as Art. 55(8) of Council Regulation (EC) No 1198/2006 on financial engineering instruments;
- Arts 43-46 of Commission Regulation (EC) No 1828/2006 and Arts 34-37 of Commission Regulation (EC) No 498/2007.

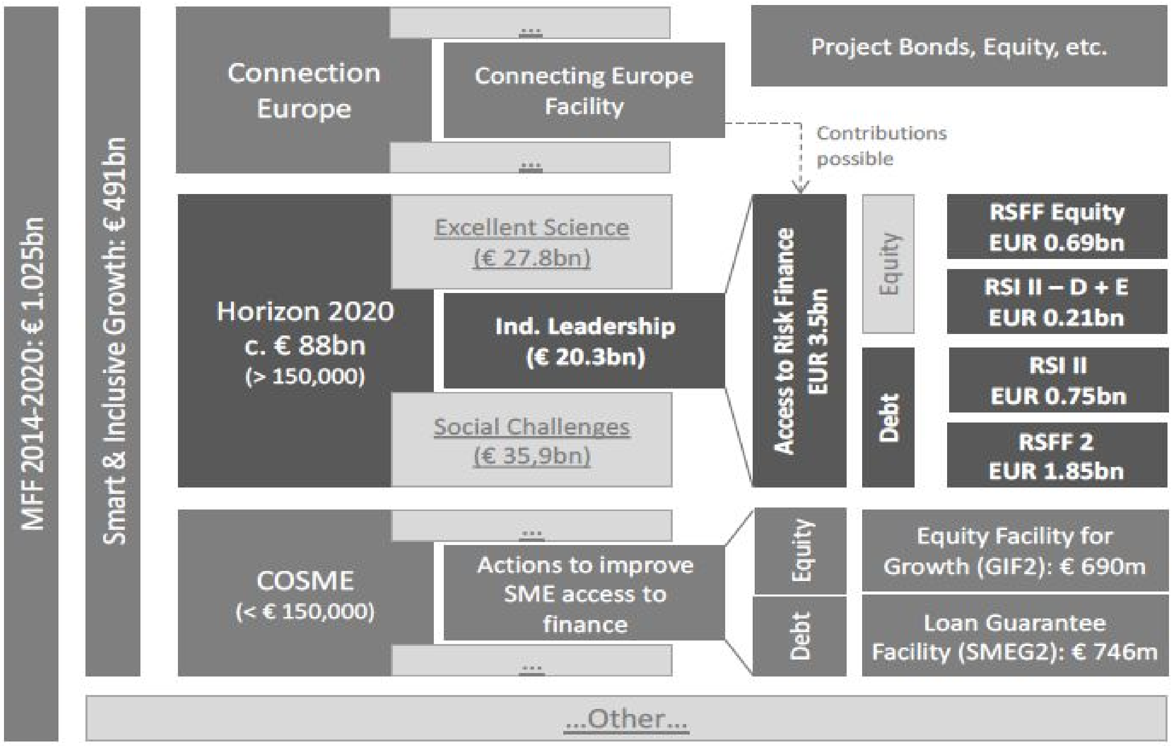
Figure 2: Sums disbursed to final recipients by type of FI and target (million EUR and % of total)



Source: European Commission Summary Report 2014

The CPR puts a stronger framework in place with increasing importance on the widespread use of FIs, which are to become more significant in 2014-2020 as a more efficient alternative to traditional grant based financing in those policy areas where investment leads to financial returns allowing beneficiaries to pay back at least part of the received assistance.

Figure 3: EU Budget Structure - Main logic of the FIs directly and indirectly managed by the EC



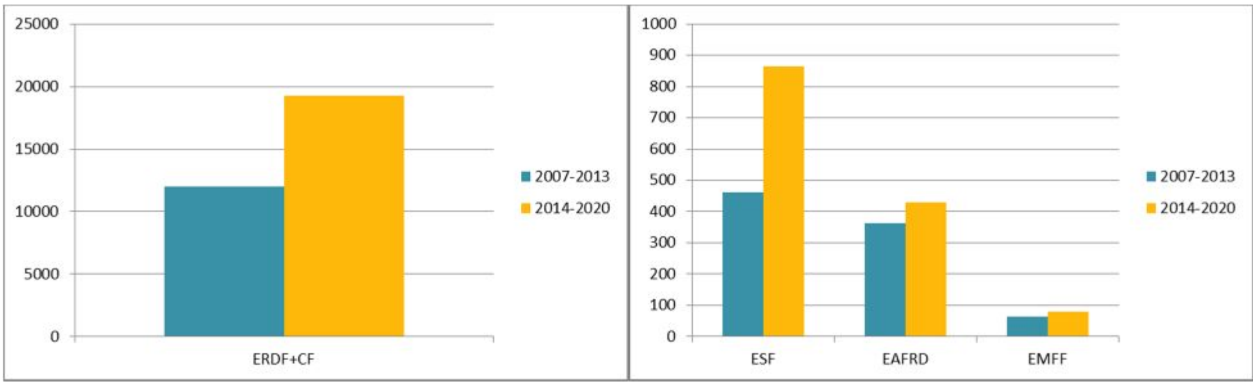
Source: 2013 presentation by EIB[17]

[17] Ex-ante assessment methodology for financial instruments in the 2014-2020 programming period Strengthening research, technological development and innovation (Thematic objective 1) Volume II pp. 45.

In addition, through the Investment Plan for Europe the Commission strongly encourages the use of financial instruments that could replace traditional grants in ESIF funding, in areas such as SME support, CO2 reduction, environmental and resource efficiency, ICT, sustainable transport, R&I. It is expected that the funds committed to innovative financial instruments over the 2014-2020 period will have a direct leverage effect and will generate additional investment of EUR 40–70 billion, with an even higher multiplier effect in the real economy by attracting private investment.

As a result of the Investment Plan for Europe, the planned allocations from all ESIFs into financial instruments have increased considerably. It might be interesting to notice, that it is done, before the compulsory ex-ante assessments (see 2.1.point) have been finalised[18].

Figure 4: Amount of ESIF funding delivered through financial instruments in 2007-2013 and 2014-2020 (EUR million)



Source: EC, Investing in jobs and growth - maximising the contribution of European Structural and Investment Funds, COM(2015)639final, 14.12.2015

The regulatory texts on FIs for the 2014-2020 period show that the co-legislators have attempted to address in the regulatory provisions many of the challenges that have arisen in 2007-2013 programming period and also to deal with issues raised by Managing Authorities[19] and the European Court of Auditors[20]. The specific provisions on financial instruments supported by the ESIF are set out in the CPR and in the delegated and implementing acts linked to the relevant articles of this regulation. Relevant provisions for financial instruments (e.g. information on priorities/measures, co-financing, eligible expenditure etc.) can be found in the fund-specific regulations and applicable horizontal regulations.[21]

[18] All 2014-2020 operational programmes under the European Structural and Investment Fund (ESIF) and the Fund for European Aid to the most Deprived (FEAD) were adopted by the end of 2015.

[19] A managing authority is a national, regional or local public authority, or any other public or private body, which has been designated by a Member State to manage an operational programme.

[20] For example, revised provisions relating to the ex-ante evaluations that must be undertaken before FIs are established in the OPs. It has been made clear that ex-ante evaluations will tie the findings related to market gaps more closely into the objectives and priorities of the OPs, and will include more information on what type of financial products should be put in place.

[21] The Financial Regulation and its Rules of Application.

Table 1: Regulatory changes relating to FIs supported by the ERDF and ESF

	2007-2013	2014-2020
Scope	Support for enterprises, urban development, energy efficiency and renewable energies in building sector;	Support for all thematic objectives covered under a programme;
Set-up	Voluntary gap analysis for enterprises and at the level of holding fund;	Compulsory ex-ante assessment;
Implementation options	Financial instruments at national or regional level – tailor made only;	Financial instruments at national or regional level, transnational or cross-border level: tailor made OR off the self OR MA loans/guarantees Contribution to EU level instruments;
Payments	Possible to declare to the Commission 100% of the amount paid to the fund – not linked to disbursements to final recipients;	Phased payments linked to disbursements to final recipients National co-financing which is expected to be paid can be included in the request for the interim payment;
Management cost and fees, interest, resources returned, legacy	Legal basis set out in successive amendments of the regulation and recommendations/interpretations laid down in COCOF notes;	Detailed provisions set forth in basic, delegated and implementing acts;
Reporting	Compulsory reporting only from 2011 onwards.	Compulsory reporting from the outset, on a range of indicators linked to the financial regulation.

Source: EC "Financial instruments in ESIF programmes 2014-2020 - A short reference guide for Managing Authorities", July 2014

Any financial instrument supported by the ESIF must comply with the relevant programme, its specific objectives set out under priorities (and focus areas for EAFRD); eligibility rules (under measures for EAFRD); expenditure related provisions; co-financing elements; monitoring and reporting requirements[22]. Also, the CPR frequently references the need to ensure compliance with state aid requirements[23], public procurement rules and it contains certain clarifications on management fees and costs (with further provisions to be included in the secondary legislation) as well as on the re-use of revolving resources. Additionally the Commission released and intends to issue further guidance on different aspects of FIs. In several cases, these documents seem to be more restrictive than the regulation[24].

While preparing their future operational programmes[25], Member States needed to think about how to build up FIs. A greater use of FIs should be accompanied by quality assessments of SME financing gaps, reinforced attention to ensure added value, satisfaction of the requirements for leverage from the private sector and more synergies between different ESIF as well as proper systems that guarantee compliance with EU rules. It will be also important to give due consideration to the economies of scale and critical mass, wherever relevant.

Clearly, the main difference between the 2007-2013 and 2014-2020 regulations is that in the 2007-2013 period there were short and limited rules and few[26] guidance on Financial Engineering Instruments, which gave a lot of room for maneuver for the Member States without legal certainty. In the 2014-2020 period there is a more sophisticated regulation with several guidance on FIs which are not necessarily in line with current Member State practices that have

[22] EC, Financial instruments in ESIF programmes 2014-2020 - A short reference guide for Managing Authorities, July 2014.

[23] State aid is any form of direct or indirect financial support provided by public authorities to private sector undertakings. The Treaty on the Functioning of the European Union (TFEU) generally prohibits state aid within the common market unless it is duly justified.

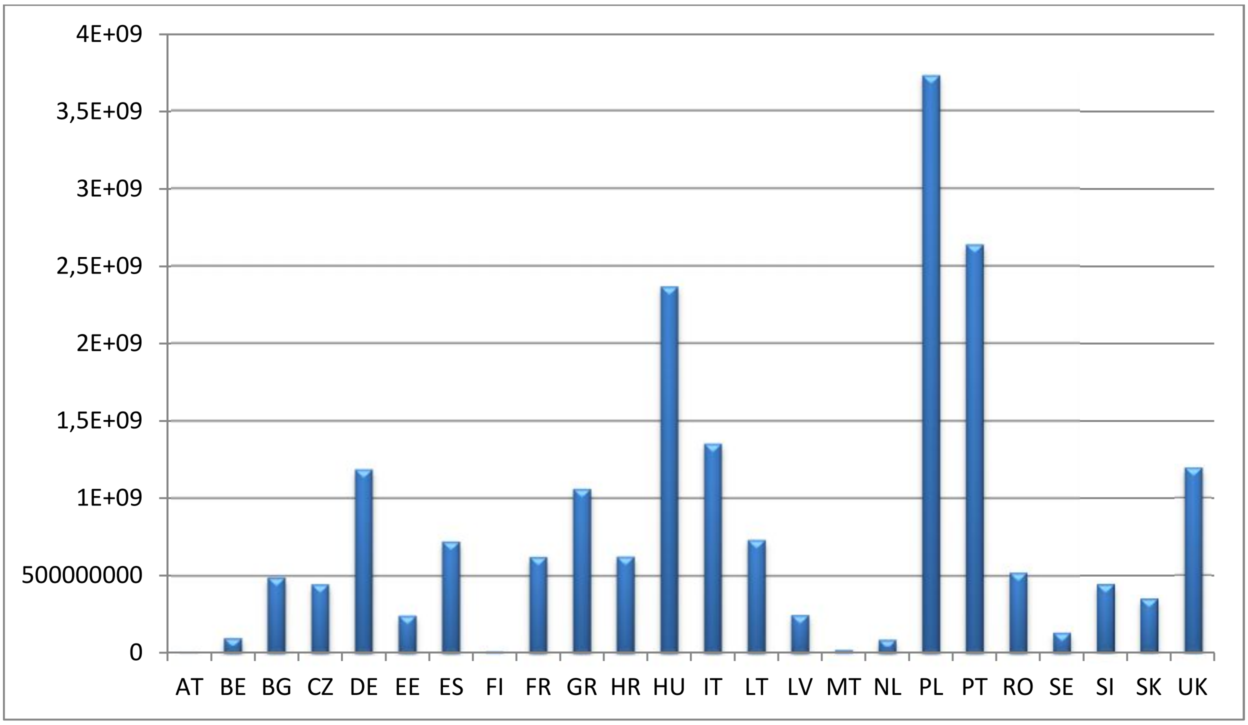
[24] See detailed explanation in Nyikos: The Role of Financial Instruments in Improving Access to Finance, Combined Microcredit in Hungary EStIF 2|2015.

[25] An operational programme (OP) sets out a Member State's priorities and specific objectives and how funding will be used during a given period, generally seven years, to finance projects. These projects must contribute to achieving one or more of a certain number of objectives specified at the level of the OP's priority axis.

[26] four COCOF notes on financial engineering instruments from 2007 (COCOF/07/0018/01), 2008 (COCOF 08/002/03) 2011 (COCOF 10/0014/004) and 2012 (COCOF 10/0014/05).

been in place since 2007-2013[27]. However, the success of financial instruments significantly depends on the existence of a properly functioning and cost-effective institutional system, as well. This requires a special combination of skills and expertise covering both financial and banking knowledge and familiarity with the process of cohesion policy implementation.

Figure 5: FIs in 2014-2020 period (ESIF in EUR)



Source: Author's own compilation, data from the EC (downloaded on 9. 7. 2016), OPs adopted by EC

[27] see e.g. selection of financial intermediaries.

2. SETTING UP FIS: EX ANTE ASSESSMENT, CHOICES MADE ABOUT IMPLEMENTATION MODALITIES

KEY FINDINGS

- Restricted access to finance is identified as a problem in all the countries analysed in this study and cost-effectiveness of public funds is an additional rationale in most countries for establishing financial instruments;
- While the overall amounts delivered through financial instruments should increase, the EC's implicit general policy line is that there should be consolidation of resources into national or supra-regional instruments;
- Ex-ante quantification and justification of the set-up of FIs is obligatory, however, this is a complex and timely analysis-process;
- Proper functioning of financial instruments requires a well-functioning, cost-effective institutional system and administrative capacity;
- Involving diverse fund managers creates wider access for SMEs, due to their different specialisation. However, obligatory formal public procurement for the selection of financial intermediaries does not support this approach - several Member States have to change their approach for establishing their FI institutional system, despite the fact that setting up FIs within the existing structures minimises operational costs and helps to speed up implementation; EIB/EIF in general is exempt from applying EU public procurement rules.
- Remuneration is the most effective mechanism to ensure that actors perform as expected. It must be attractive for the intermediaries but also in line with state aid rules - to design the right remuneration scheme for a FI is not an easy task.

EU FIs may be implemented under shared management, supported by the ESI Funds and managed by or under the responsibility of the managing authorities or they may be implemented under the European Commission's direct or indirect[28] management (CPR, Article 38) (e.g. “COSME” and “InnovFin” under H2020, the Cultural and Creative Sector Guarantee Facility ("CCS LGF") within the Creative Europe Programme, the Private Finance for Energy Efficiency (“PF4EE”) and the Natural Capital Financing Facility (“NCFF”) under the LIFE programme etc.). In addition there are joint instruments, which have been planned to be implemented enabling the combination of central EU budget resources (see previous paragraph) with ESIF resources. In the European Commission these different instruments are managed by different departments.

[28] Through the EIB Group.

Figure 6: Possible joint implementation arrangements of the FIs

	Centrally managed by EC	Shared management
Thematic Objective 1 Research, Development & Innovation	Horizon 2020[29]	FIs under ESIF
Thematic Objective 3 Competitiveness of SMEs	COSME[30]	
Thematic Objective 4 Supporting the shift towards low-carbon economy in all sector	Life Programme	
Thematic Objective 5 Promoting climate change adaption, risk prevention and management		
Thematic Objective 6 Preserving and protecting the environment and promoting resource efficiency		
Thematic Objective 7 Sustainable transport and network infrastructure	Connecting Europe Facility (CEF)[31]	
Thematic Objective 9 Promoting social inclusion and combating poverty	Social Change and Innovation Creative Europe	
Thematic Objective 10 Education, skills and life-long learning	Erasmus for All	

Source: Drawn up by author.

For the 2014-2020 programming period, one novelty is that cohesion policy FIs are designed to address specific market needs in accordance with the objectives of the ESI Fund regulations[32] and operational programmes. The European Parliament endorsed and encouraged the use of revolving financial instruments that are to be extended to those areas eligible for funding which prove to be appropriate[33].

The other key novelty is the fact that support of FIs must be based on detailed ex ante assessment ensuring a thorough analysis underlying the establishment of the tool. Regarding this issue the Parliament (in agreement with the Council) overturned the Commission's proposal and such assessment became part of the basic act instead of a delegated act, so that legal certainty was ensured as of the beginning of the programming period with clear definitions of the specific terms used and through incorporation of provisions into the basic act instead of secondary legislation[34].

2.1. The obligatory ex-ante assessment

The introduction of mandatory ex-ante assessments during the 2014-2020 programme period for financial instruments under both shared and centralised management can largely contribute to the proper establishment of FIs; its success will depend on whether or not it was built on sound assumptions and analysis. In addition, the European Court of Auditors[35] noted that operations should be based on a "sound assessment of the financing gap"

[29] Horizon 2020, the successor to the 7th Framework Programme (FP7), is the EU's largest ever Research and Innovation programme with nearly €80 billion of funding available in 2014-20.

[30] COSME, with a total allocation of €2.5 billion for the period 2014-20, aims to strengthen the competitiveness and sustainability of the Union's enterprises and encourage an entrepreneurial culture.

[31] The CEF is the funding instrument for the trans-European networks, rolling-out joined-up trans-European networks in the fields of transport, energy, and telecom (broadband & digital services).

[32] CPR applies to all five ESI Funds and FIs can support all thematic objectives defined in Art. 9 of the CPR.

[33] European Union Cohesion Policy 2014-2020 A comprehensive presentation of the legislative package and the role of the European Parliament PE532.425v01-00.

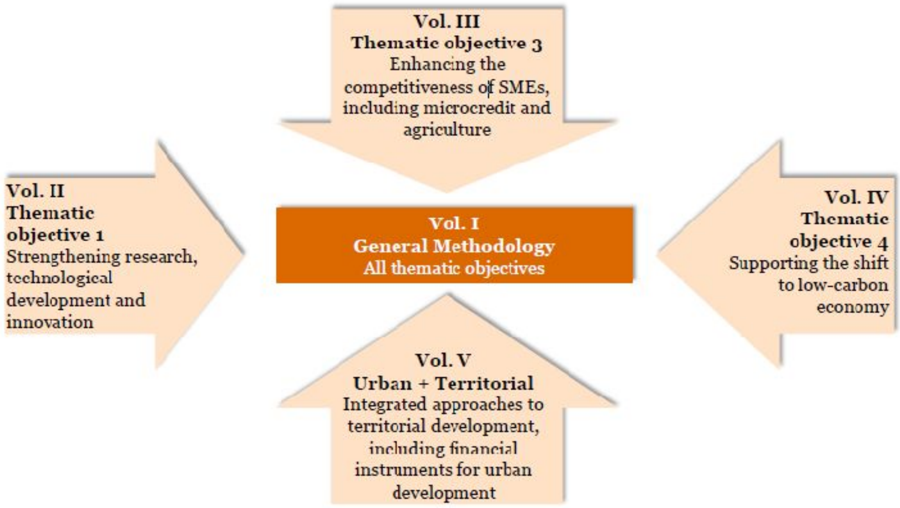
[34] European Union Cohesion Policy 2014-2020 A comprehensive presentation of the legislative package and the role of the European Parliament PE532.425v01-00.

[35] European Court of Auditors (2012) Financial instruments for SMEs Co-financed by the European Regional Development Fund, Special report No 2, Luxembourg.

and the Court highlighted several key issues which should be taken into consideration when conducting future assessments: a full analysis of nationwide demand and supply of finance by type of financial instrument and, where applicable, taking regional specificities into account; areas where the existence of financing gaps could or could not reasonably have been established; references to previous ERDF support or other EU access to finance schemes, including on the role of the EIB Group; information on the intended structuring of the co-financed funding of SME finance (fund allocation), including a link with the operational programme submitted to the Commission for approval; information on which potential financial intermediaries could be capable of implementing the funding.

The EIB has been heavily involved in developing methodologies for ex-ante assessment[36] (see Figure 6) based on EIF methodology[37] and can – when asked by MAs – take on the responsibility for carrying them out, as well.

Figure 7: The structure of the ex-ante assessment methodology



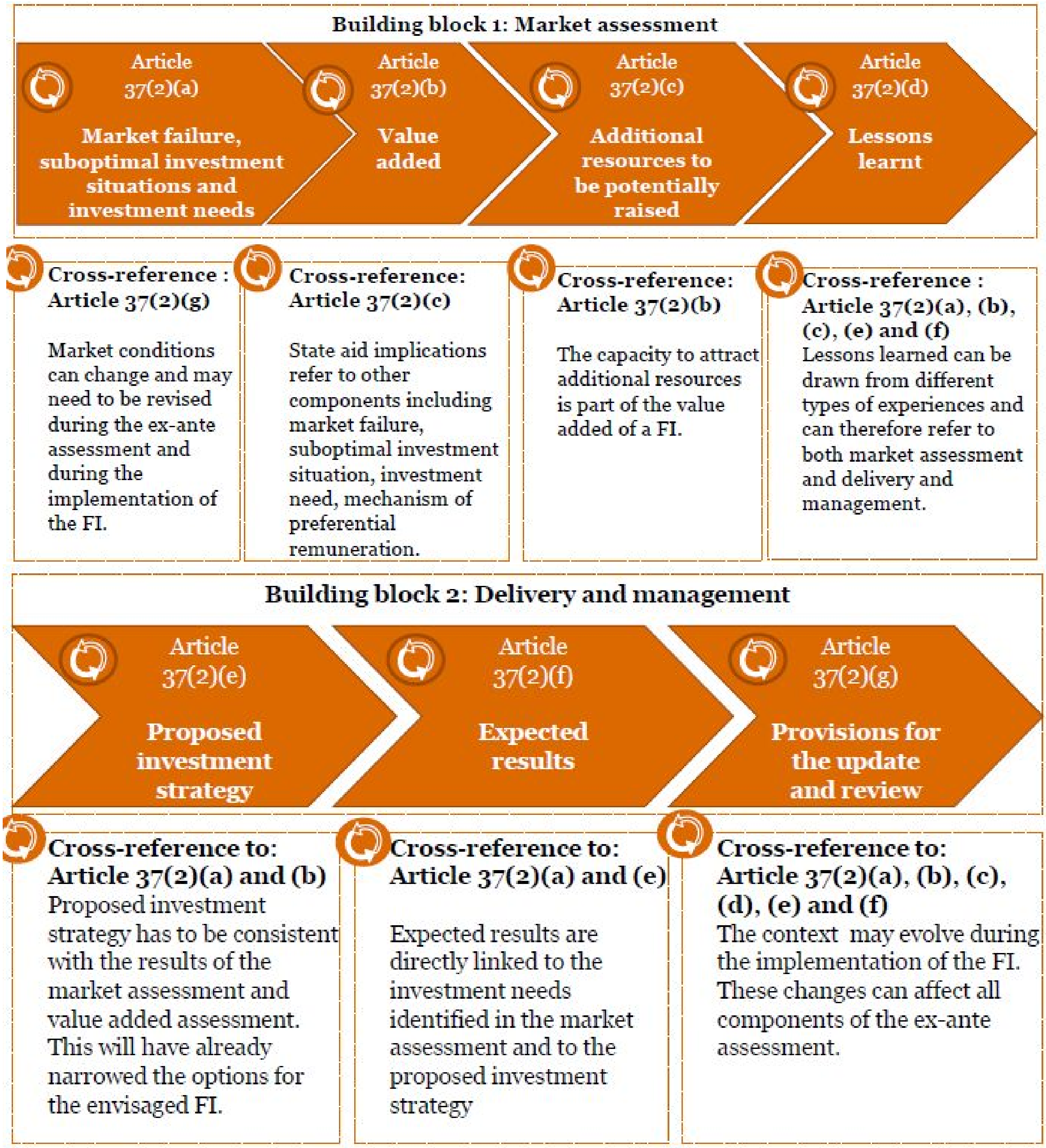
Source: PwC, Managing Authority training, June 2014

However, the requirements for the ex-ante assessment are quite complex and require comprehensive studies by expert consultants on the financing gap alone. The problem is not so much in the CPR, which defines the coverage of the ex-ante assessment, but lies more in the extensive EC guidance. Accordingly the Member States and co-legislators must take into consideration that it is a time-consuming process.

[36] fi-compass (2014) Ex-ante assessment for ESIF financial instruments, quick reference guide, available at: http://ec.europa.eu/regional_policy/sources/thefunds/fin_inst/pdf/ex_ante_vol0.pdf

[37] EIF (2014a) Guidelines for SME ACCESS to Finance Market Assessments (SAFMA), working paper 2014/22, European Investment Bank, Luxembourg, available at: http://www.eif.org/news_centre/publications/eif_wp_22_gafma_april14_fv.pdf;
Kraemer H and Lang F (2014) A Practical Approach to the Market Analysis Part of SME-Related Ex Ante Assessments, ESTiF 3.

Figure 8: Building Blocks of the ex-ante assessment



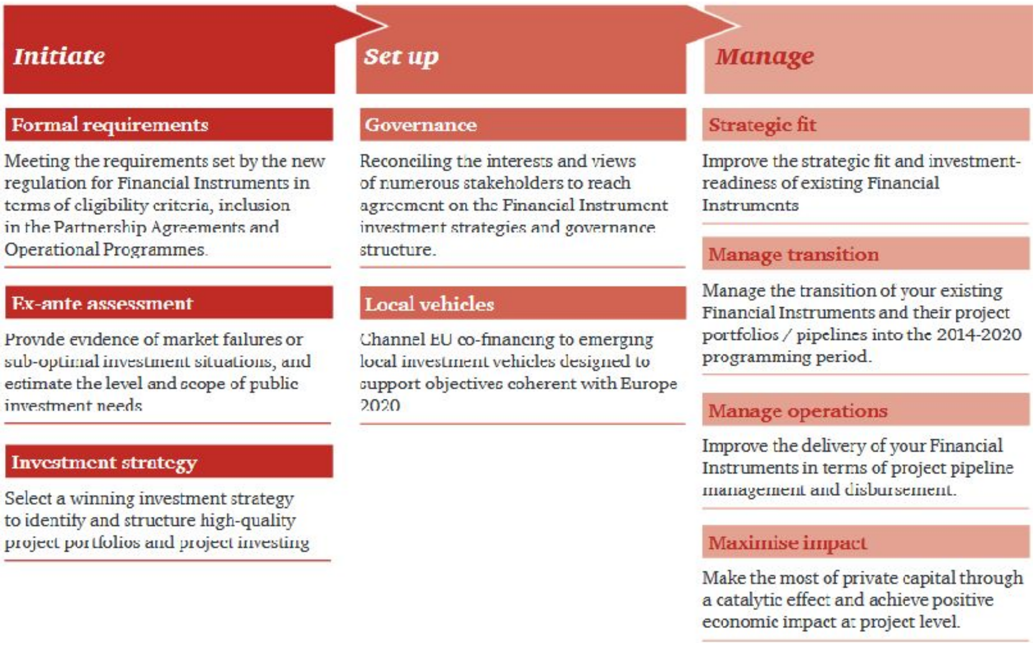
Source: FI-COMPASS 2015[38]

The CPR[39] requires the analysis of market failures[40], suboptimal investment situations[41] and investment needs under the policy areas, thematic objectives or investment priorities to be addressed by the envisaged FI. Considering that managing authorities are traditionally used to providing grant support and FIs are often a novelty, an independent and experienced partner for the ex-ante assessment is an advantage. A well prepared analysis allows the managing authority to determine the size of the investment gap (viability gaps[42] and/or financing gaps[43]) to be filled by the FI.

38 https://www.fi-compass.eu/sites/default/files/publications/presentation_201501_Brussels_ESIF_Patricia-Llopis.pdf
39 Article 37(2)(a) CPR.
40 Non-functioning aspects of the market which result in an inefficient allocation of resources and entail the underproduction or overproduction of certain goods and services.
41 Underperformance of investment activities, or a situation where the existing investment activity is insufficient to achieve a policy objective.
42 In the case where the business plan of a project or of a group of projects demonstrates returns below market level.
43 In the case where a certain sector or the economy as a whole shows evidence of unmet financing demand.

The MAs also have to assess the value added of the envisaged FI[44], the consistency with other forms of public intervention in the same market, possible state aid implications and the proportionality of the envisaged FI and measures to minimise market distortion. These last two elements are important components of the state aid assessment. This part of the analysis allows MAs to demonstrate that the envisaged FI has a higher added value than possible alternatives, thus being the most efficient use of ESIF resources. MAs must also consider conflicting elements or overlaps with other forms of public interventions, including grants and interventions at other political levels.

Figure 9: Challenges in establishing and managing Financial Instruments



Source: PwC, Managing Authority training, June 2014

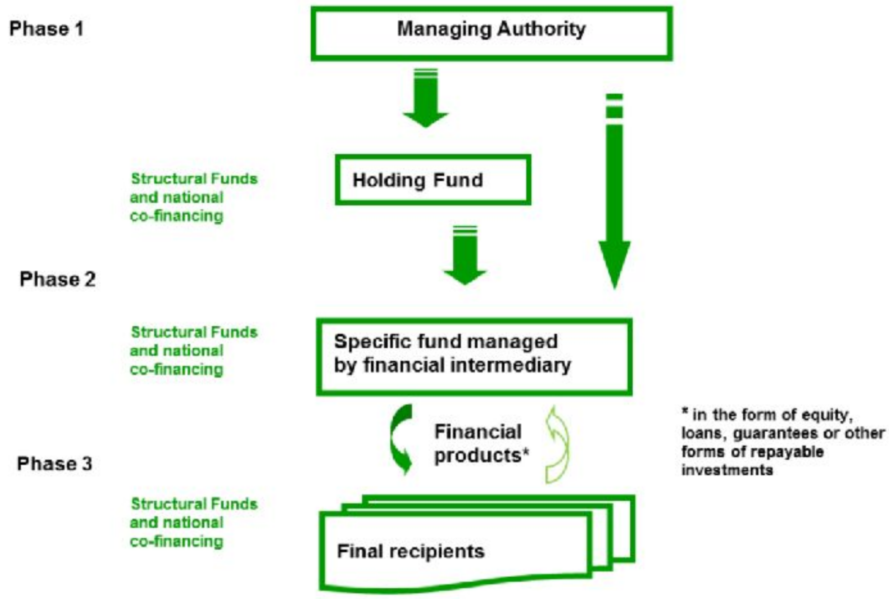
However, the ex-ante analysis provides a snapshot at a specific moment in time, which represents the market reality, usually also with forward-looking view of the possible changes. Nevertheless, it cannot really take into account how the country's economic situation may change. The analysis of the current situation must be done within a determined period of time in order to ensure perfect capture and it needs to be reviewed from time-to-time to verify if context conditions changed and to readdress the policy and financial instruments.

2.2. Establishing the implementation structure, selection of financial intermediaries – public procurement difficulties

FIs can be rather complex and they require specialist management teams: a usual management structure involves a cascade system whereby a Managing Authority selects a holding fund manager (see Figure 10). The fund manager is responsible for launching a 'call of interest' looking for possible financial intermediaries which will then reach final recipients on the ground.

[44] Art. 37(2)(b) CPR.

Figure 10: Models of implementation of FEIs in the programming period 2007-2013



Source: EC, Summary Report 2015 (data until the end of 2014)

Opinions differ on the potential of using holding funds to manage FIs: advantages seem to include increased flexibility, a portfolio approach to diversifying risk, sufficient scale of funds and delegation of administrative tasks at holding fund level. However, it generates an additional layer of costs and additional reporting obligations. In the analysed Member States most financial intermediaries (below holding fund level) were selected through a competitive process (public procurement or call for applications). Only in case of the CZ OP Enterprises & Innovation were public bodies directly appointed to manage the FIs.

Financial intermediaries tend to be:

- banks or other financial institutions, private and publicly owned;
- venture-capital companies (including business angel entities), all private; and
- regional or sectoral support institutions, predominantly public.

Holding funds are usually public institutions and also there is a clear dominance of public ownership for guarantee instruments.

Management and operational structures vary widely across Member States and regions. The CPR has left open many aspects of how FIs could function and there is no obvious link between the types of FIs and the types of management structure chosen. Governance structures can involve holding funds that feed several specific funds, each run by one fund manager (e.g. PL, UK), or the same set of financial products offered through a national network of financial intermediaries (e.g. HU).

The EIB Group (EIB and EIF) has played a significant role in FI planning and implementing enterprise FIs in some countries, including in Bulgaria and Slovakia.

Table 2: FIs for enterprises, urban development and energy efficiency/renewable energies implemented and financed in the 8 analysed Member States (at the end of 2014)

Member State	Sector	N° of FIs	out of which HF	out of which specific funds with a HF	out of which specific funds without a HF
BG	enterprises	6	1	5	0
	urban development	3	1	2	0
	energy efficiency	1	0	0	1
CZ	enterprises	2	0	0	2
	urban development	2	0	0	2
	energy efficiency	1	1	0	0
HU	enterprises	170	1	168	1
IT	enterprises	114	14	16	84
	urban development	5	2	3	0
	energy efficiency	9	4	4	1
PL	enterprises	237	10	133	94
	urban development	11	5	6	0
SK	enterprises	6	1	5	0
	energy efficiency	1	0	0	1
UK	enterprises	55	7	22	26
	urban development	9	3	5	1
	energy efficiency	10	0	0	10

Source: Author's own compilation, data from the EC Summary Report 2015, European Commission (data until the end of 2014)

Looking at the overall pattern of management in the EU, the holding funds were managed by either national financial institutions (42 %), were put out to public tender (15 %), or were managed by the EIF or EIB (43 %)[45]. Most of the 73 operating holding funds reported by the Member States were set up in 2009 or in 2010.

Box 2: The number of FIs in Hungary

What is behind the high number of FIs in Hungary?

The governance structure of the Hungarian implementation system was not an obvious match with the EU standard structure envisaged. The main factor of the misinterpretation is that the high number of financial intermediaries (in EC terminology: beneficiaries or fund managers) did not mean a high number of financial instruments in reality. Hungary ran 11 different FI schemes managed by one MA, one central Holding Fund Manager and several financial intermediaries. The schemes of a given FI type offered by the different intermediaries, however, were essentially the same by using standardized framework calls and funding agreements during implementation.

Source: Author's own compilation

In the 2007-2013 programming period there was a significant diversity in allocations to FIs in different sectors and their performance, with the focus mainly being on support of enterprise. Obviously several factors for weak absorption emerged from institutional or legal issues, such as late start-up of funds (HU, CZ, SK, UK), uncertainty of legal framework (SK, HU, PL, IT, CZ, UK), combination of OP-funded loans and guarantees but no clear legal framework for combined support (PL, HU, IT) and problems with audits related to the management and control system (CZ).

The current cohesion policy regulations contain several opportunities with respect to a wider use of FIs; they foresee five types of FIs[46] (at regional, national, cross-border, transnational or EU-level) implemented through an entrusted entity (EIB Group consisting of EIB and EIF) or other international financial institutions, a newly created entity, by direct implementation of

[45] EC (2013), Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds.

[46] Article 38 CPR.

loans and guarantees by MA and by contributions to EU-level instruments. However, the different kinds of implementation methods have a number of aspects to be considered (see Table 3). In the 2014-2020 period it is expected that especially in the area of energy efficiency and renewable energy the share of financial instruments will increase significantly.

Table 3: Aspects of the various implementation models/structures (2014-2020)

<table>
<tr><th></th><th>Time and resource limitation</th><th>Management control and flexibility</th><th>Effective use of resources</th><th>Reach</th></tr>
<tr><td>Single-stage procedure</td><td>Only one intermediary is needed, there are no additional intermediaries, fast implementation.</td><td>Less operators in the system, opportunity for greater control.</td><td>Limited opportunities for the involvement of private capital (no further funds).</td><td>It may be harder to find an intermediary that reaches the (heterogeneous) target group and is able to provide a wide range of products.</td></tr>
<tr><td>Fund of funds – European Investment Bank</td><td>Experience and knowledge is readily available, but the local system must be built up, taking up time.</td><td>Control is more costly (translation, visits)[47] Development policy objectives of Member States may be limited.</td><td>There are opportunities to involve additional private capital through the financial intermediaries.</td><td>By choosing financial intermediaries, a wide selection of the target group can be reached.</td></tr>
<tr><td>Fund of funds – a financial institution in which a Member State is a shareholder or which has an objective of common interest</td><td>The system is much like the institutional framework used in the 2007-2013 period, thus, it can be developed rapidly.</td><td>Development policy objectives are under strict control (i.e. through ownership rights) because of the share of the Member State and/or the objective of common interest, considerations regarding grants are easier to take into account.</td><td rowspan="2">Resources can be provided to the target group in an effective way.</td><td rowspan="2">Can be selected for the specific product group.</td></tr>
<tr><td>Fund of funds – market operator governed by public or private law</td><td>The market operator may lack experience regarding the relevant aid policies and regulatory area. Choosing one market operator (ensuring that this does not happen in a way that distorts competition) is time-consuming.</td><td>Market operators appear on two levels of the institutional model (fund of funds and financial intermediaries), development policy principles can only be achieved in a roundabout way, this may mean that development policy objectives take a backseat to market considerations.</td></tr>
<tr><td>Managing authority direct implementation</td><td>Capacities and competences are limited. Aid can only be granted to the final recipients through intermediaries.</td><td>With grants and repayable assistance products, development policy goals are directly achievable, and not through intermediaries. Financial intermediaries do not need to be consulted in case of a change in conditions.</td><td>Limited opportunity to involve private capital.</td><td>Not possible to develop a national branch network. According to the regulation, not eligible to provide capital type products.</td></tr>
</table>

Source: EDIOP GAP analysis 2015

[47] The use of EIB was discontinued in Latvia due to high costs.

At the time of writing, the implementation of the 2014-2020 programmes is at a stage, where many financial instruments are being designed, it is important that managing authorities take into account the considerations of critical mass and economies of scale. While the overall amounts delivered through financial instruments should increase, this should not necessarily correspond to a multiplication in the number of regional or local instruments. While each case should be judged on its merits, the EC's implicit general policy line derived from EC "behaviour" during programming and other encounters with MS is that there should be consolidation of resources into national or supra-regional instruments, whenever suitable.

The implementation of FIs is highly demanding in terms of administrative capacity. The operational management of FIs (as opposed to investment undertaken by fund managers) requires a high level of expertise and a considerable level of resources, especially for the larger and more complex funds. Whilst the approach and extent of the responsibilities can vary, there is a need to ensure that these activities are adequately resourced, especially during the investment period (to ensure that value for money is attained).

Box 3: Establishing national administrative capacities in Bulgaria

Fund Manager of Financial Instruments in Bulgaria EAD

On 22 July 2015 the Council of Ministers in Bulgaria set up a sole-owner joint-stock company with government interest called Fund Manager of Financial Instruments in Bulgaria EAD. The company's activity is the management of financial instruments to be implemented under the programmes co-financed by the ESIF in the 2014-2020 programming period. The set-up company, Fund Manager, should meet the requirements of good corporate governance, should take steps to reduce the risk of political influence on the operational decisions and it should prove the professional experience and expertise of its staff during the course of managing the financial instruments.

Based on Memoranda of Understanding with the three international financial institutions, the European Investment Bank (EIB), the International Bank for Reconstruction and Development (IBRD) and the European Bank for Reconstruction and Development (EBRD) will provide technical assistance to ensure the professional and effective management of ESI Funds and the unlocking of the potential of financial instruments for multiplying public resources through mobilising private finance.

Source: Website of Ministry of Finance, Bulgaria.

For the decision on how to implement FIs one of the most important factors to consider is whether the administrative capacity at national/regional level is available or not. The managing authority decides on the most appropriate implementing structure taking into consideration the findings of the ex-ante assessment (see Table 3 above).[48] The three main FIs implementation possibilities not including the EU level FIs is shown in Figure 11.

It can be considered that the EIB Group has undoubtedly got the necessary knowledge and administrative capacity however Member States' opinions on the performance of the EIF in 2007-2013 are not consistent. Managing authorities mentioned the high management fees to be paid for EIB holding funds and that implementation practices of the EIB/EIF were too slow and rigid in terms of their conditions (see table 4).

[48] Required under Article 37(2) CPR.

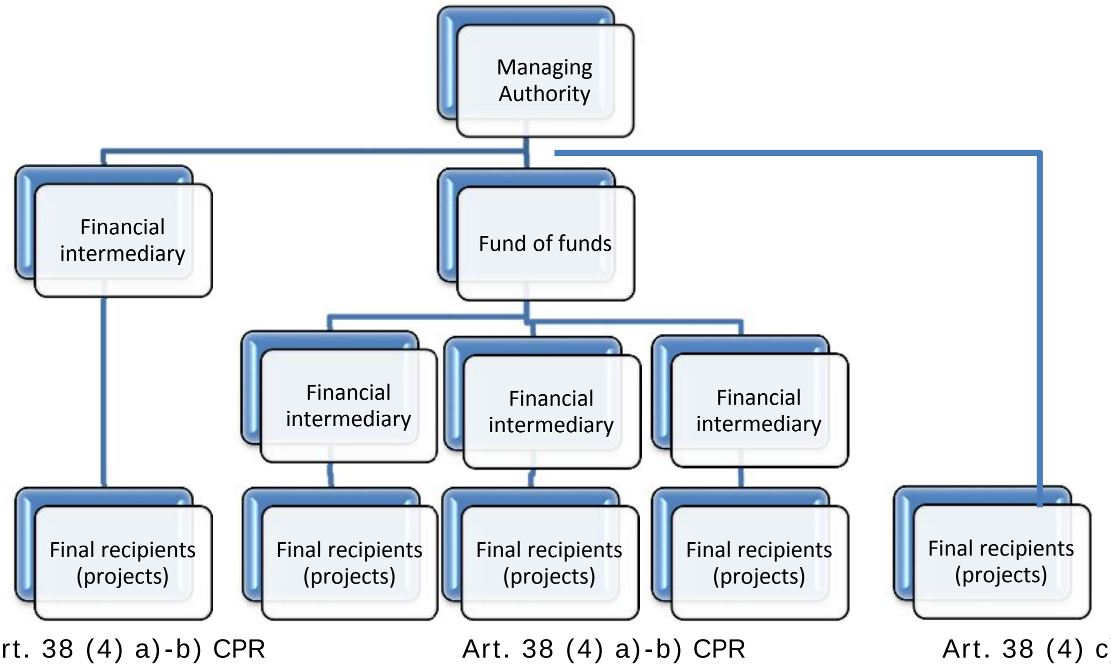
Table 4: Holding fund performance data 2007-2013

HOLDING FUNDS	% of Total OP Contribution to Holding Fund Reaching FIs	% of Total OP Contribution to Holding Fund Reaching Final Recipients	Management Costs as % of Total OP Contribution to Holding Fund 2013
EIB Holding Funds	63.83% (Sample: 28/30 HFs)	46.31% (Sample: 26/30 HFs)	5.21 % (Sample 26/30)
Non-EIB Holding Funds	85.44% (Sample: 43/46 HFs)	64.12% (Sample: 40/46 HFs)	4.99% (Sample 30/46)

Source: EC (2015d) Summary of data on the progress made in financing and implementing financial engineering instruments

This led to a situation that some countries (e.g.: SK) - which initially intended to have holding funds with the EIF – switched to their 'own' national banks.

Figure 11: FI implementation possibilities in 2014-2020 (except the EU level FIs)



Source: Drawn by the author.

Direct implementation of the FI by the MA can be used exclusively when the financial product to be provided by the FI is a loan or a guarantee. For this option significant in-house experience and knowledge of FIs in the MA are needed. The advantages of this option are that instead of establishing a dedicated FI, which could be complex and potentially time-consuming, the MA can start quickly and that way it can also avoid introducing additional layers of reporting and monitoring. However, it could be problematic that para-banking may not be allowed by national law and no advance payment to the FI is possible. Also, management costs are not eligible, but these expenditures can be covered by OP technical assistance. In the countries studied there are no plans to use this option.

For the selection of the financial intermediaries, according to the CPR, the MA has to use "open, transparent, proportionate and non-discriminatory procedures, avoiding conflicts of interest" – which would allow open calls for proposals/interest without formal public procurement. It was the practice in several Member States in the 2007-2013 period (PL, HU, IT, PT, UK) with the approval of the European Commission[49].

[49] in several cases even with formal decision by EC in the state aid notification process on FIs (including selection of intermediaries and implementation system).

Box 4: Standard document signature for selection in Italy

FRIM ERDF Lombardy, Italy

In the case of loan financial instrument, developed without holding fund (FRIM ERDF) in the Lombardy Region it was decided that rather than using a public tender (formal public procurement procedure) a so called 'regulation' would be elaborated and employed: this is a document fully describing the role, activities, remuneration of and deadlines to be respected by the financial intermediary willing to adhere to the initiative. Accordingly the financial intermediaries which intended to participate, instead of submitting an offer, had to sign this regulation. Evidently, the content of the regulation had to be carefully defined by the managing authority in order to be in line with the regulation and appealing to financial institutions.

In the case of FRIM ERDF, 33 banks adhered to the initiative by signing the regulation, it was a success in terms of involving private co-financers, as well. The procedure respects EU requirements in terms of public procurement principles: it is open, transparent, and non-discriminatory.

Source: Finlombarda Spa, 2015

However, the Commission has been recently arguing the mandatory nature of the use of public procurement. This is an interpretation different from which was applied in 2007-2013 with similar wording in the cohesion policy regulations and the same public procurement rules. According to the European Commission's new legal explanation[50], the MA has to comply with the general principles[51] as well, including the process of selecting bodies implementing financial instruments: they must comply with applicable law, in particular on state aid and public procurement. Consequently, services performed by bodies implementing financial instruments set up under the ESIF regulatory framework fall within the scope of public procurement rules and principles. Therefore, the selection of such entities (whether fund of funds managers or financial intermediaries) must comply with the applicable law.

The main question arising is whether we are looking for financial services or co-investors, which depend on the structure of the FIs. In the case of the first, it might be more reasonable to think about public procurement, but in the second, it is clearly not the good direction.

Furthermore it is important to consider whether public procurement rules apply if the legal structure is established in the way that the MA does not provide for remuneration against contractual performance? This was the case in the 2007-2013 Hungarian microfinance system (see Box 6). The question also arises whether the fund manager/financial intermediary provides service to the managing authority/holding fund manager or not, whether the management fee is, instead of a reward, rather an incentive for better quality fund management activity resulting in a higher rate of fund return for the profit of the public investor.

It is also important to notice, that in the case of equity/venture capital financial intermediaries, where capital fund shares are issued by the investor, using public procurement is illogical and even a public procurement exception is applicable: namely "financial services in connection with the issue, sale, purchase or transfer of securities or other financial instruments, in particular transactions by the contracting authorities to raise money or capital, and central bank services"[52]

[50] See the EC Guidance for Member States on The selection of bodies implementing FIs, including funds of funds.
[51] Art. 37(1) CPR
[52] Directive 2004/18/EC Art. 16(d) and Directive 2014/24/EU Art. 10(e).

Lately also the European Commission perceives differences between the co-investment and the financial service provided by fund manager stating in the guidance that „The selection of bodies implementing financial instruments must not be confused with the selection of the financial instrument operation. The selection of the operation is done by the managing authority on the basis of the selection criteria defined by the monitoring committee. Unlike the selection of the body implementing the financial instrument, selection of the operation is not subject to public procurement rules and principles[53]“. However, the lack of clarity leads to confusion regarding how these processes should be arranged separately, having in mind that the scope and specific features of the planned operation are proposed by the fund of funds manager/financial intermediary and directly related to it.

The public procurement procedure for the selection of financial intermediaries may in many ways decrease the efficiency of the implementation of financial instruments, too. Amendments to terms and conditions of financial instruments during the implementation-period (potentially 15 years) cannot be handled under inflexible service contract conditions and this could cause significant implementation issues for private investors and final recipients.

The public procurement directive[54] specifically addresses the entrustment of tasks to public entities owned and controlled by a contracting authority (vertical cooperation, or "in-house") as well as inter-administrative cooperation (horizontal cooperation). Public managing authorities may, subject to compliance with the conditions laid down in case law, be able to enter into inter-administrative cooperation agreements with other contracting authorities that could be entrusted with the task of implementing financial instruments. The EC guidance[55] refers to different implementing modalities for inter- administrative cooperation:

- a contract between the managing authority and another contracting authority controlling a 100% publicly owned entity which is able to implement financial instruments. In this triangular relation the contractual relation would be between the managing authority and a contracting authority controlling an in-house entity, able to implement financial instruments.
- a contract between the managing authority and the entity owned in house by another contracting authority. The managing authority would conclude directly a funding agreement with a contracting authority as in-house entity.[56]

Another interesting question is the selection of the body to implement FI based on the exclusive right option as this option is stipulated in the public procurement directive. Several MSs share the opinion that it is also a feasible alternative and the possibility to apply the exclusive right is clarified in the Commission Staff Working Paper Concerning the application of EU public procurement law to relations between contracting authorities[57] ('public-public cooperation'). However the Commission services cannot see room for exclusive rights conferral by a law compatible with the treaty in the field of implementation of financial instruments[58] and they state that in case an audit body comes to different conclusions than the MS on the fulfilment of the conditions for exclusive right, a financial correction may be necessary.

[53] EC Guidance for Member States on The selection of bodies implementing FIs, including funds of funds.
[54] Directive 2014/24/EU.
[55] In section 3.6.
[56] See for instance Case C-480/06, Commission v Germany.
[57] Dated on 4.10.2011, SEC(2011) 1169.
[58] QA Table GN Selection of Bodies (Comments from the Member States on the Commission – Guidance on Selection of Bodies implementing financial instruments, including Fund of Funds following the EGESIF meeting of 21 October 2015).

Box 5: The legal possibility for using the exclusive right option

Exclusive right as legal basis for selection of FI intermediaries

In the Commission Staff Working Paper Concerning the application of EU public procurement law to relations between contracting authorities it is stated that "the term "exclusive rights" could refer to quite different phenomena ranging from reserving a whole economic sector to public authorities to the exclusive assignment of one specific task to one specific undertaking. However, not every exclusive right justifies the exemption of the award of a public service contract. Article 11 of Directive 2014/24/EU stipulates that the respective exclusive right needs to be granted by a law, regulation or administrative provision which is published and compatible with the Treaty[59]. Furthermore, Article 11 only concerns rights granted to particular public sector bodies to provide certain services, on an exclusive basis, to the public sector." Accordingly, in order to apply the above mentioned exception the main criteria that have to be evaluated and fulfilled are as follows:

1. The exclusive right is given by one contracting authority to another contracting authority;
2. The exclusive right has to be based on a legal act;
3. The exclusive right must be compatible with the Treaty.

The most sensitive question in this case is the compatibility with the relevant rules of the Treaty, in particular Articles 49 and 56 of the Treaty and the rules and principles that derive from these articles. These rules and principles include non-discrimination, transparency, proportionality, mutual recognition and the protection of the rights of individuals. Considering the jurisprudence regarding the exclusive rights that are compatible with the Treaty, the exclusive rights are linked with the services of general economic interest.

As also stipulated in Article 1(4) of the Directive 2014/24/EU, the Directive does not affect the freedom of Member States to define, in conformity with Union law, what they consider to be services of general economic interest, how those services should be organized and financed, in compliance with the state aid rules, and what specific obligations they should be subject to. Equally, this Directive does not affect the decision of public authorities whether, how and to what extent they wish to perform public functions themselves pursuant to Article 14 of the Treaty.

According to that, the evaluation of the aforementioned criteria and principles depends on the legal basis and national legal acts in force in each Member State. Moreover, granting of the exclusive rights is under the responsibility of each Member State and in each case the Member State itself has to decide and ensure that the exclusive rights granted under respective legal acts are compatible with the Treaty.

Source: Author's own compilation.

An additional problem of public procurement is the reduced possibility of modification of service contract: support from FIs is supposed to be a long-term public intervention addressing market failures. Market conditions can change during the period of implementation, but the public procurement rules restrict the possibility for contract modification (any substantial modification is not allowed and would constitute an irregularity). In addition, contracts of a very long duration may be seen as restricting market access for new economic operators willing to provide a service, therefore its lawfulness can be doubtful in light of EU internal market rules and principles. Therefore flexibility of FIs under public procurement rules is very limited, and at the moment of issuing the public tender it is hard to predict how the market needs for public intervention would change.

[59] The Treaty on the Functioning of the European Union.

Based on this, the possibilities to attract private investors are very limited under inflexible public procurement contracts. The private investors, entrusting their money for investment within a FI, have to be sure that the contract will not be terminated because of an unnecessary administrative provision and that it may be amended in a relatively flexible way in case the economy/market situation changes.

Another limitation of public procurement is that the application of public procurement procedure makes it difficult to choose more than one entity, since public procurement procedures usually have one “winner” with whom the contract is signed. A possible way to solve this problem may be to divide the contract into lots (e.g.: on a geographical basis or based on FI products etc.) or use a framework agreement. However it is not easy to see on what basis a contract for the implementation of FIs can be divided into lots especially if it is politically important to have the same conditions for SMEs in the whole country/region. As regards, framework agreements, their duration is limited to 4 years, save in exceptional cases duly justified, in particular by the subject of the framework agreement.[60] It is not entirely clear whether the exception is applicable to the case of implementing FIs. In order to manage the FI in an effective way and diversify the risk, it would be crucial to have the possibility to entrust tasks to more than one entity.

Clearly, because of this new legal interpretation by the Commission, several Member States have to change the approach for establishing FI institution system, despite the fact that the setting up of FIs within existing structures minimises operational costs and helps speed up implementation, also set-up times are faster when no public procurement process is employed.

The MA has to select a body which will open a fiduciary account (or will set up a separate block of finance within its accounts) to manage the funds in line with the funding agreement and with the principles of economy, efficiency and effectiveness. These bodies should act for the managing authority’s benefit in line with the funding agreement. The programme resources are represented in their financial statements as "off-balance sheet" assets.

For the 2014-2020 programming period most analysed Member States have set up financial instruments at national level, managed under the responsibility of the managing authority. No intention has yet been reported from Member States to set-up implementation structures at transnational or cross-border level. Poland, however, intends to set up financial instruments at regional level, although at the moment, the Polish Authorities are struggling with the administrative procedures of national legislation.

Most analysed Member States reported that managing authorities have entrusted implementation tasks as holding fund to national organizations, thus they have involved neither the EIB nor any international financial institutions in the implementation of financial instruments (exception is Bulgaria). In this context, Member States have decided to designate a body that implements the holding fund, which may further entrust part of the implementation to financial intermediaries. This concept, therefore, means, that in many Member States a similar implementation structure is planned as in the 2007-2013 programming period.

[60] Art 33(1) of Directive 2014/24/EU.

Box 6: Holding fund managers in the Member States 2014-2020

National Promotional Banks as holding fund managers

In the Czech Republic the Czech-Moravian Guarantee and Development Bank (CMZRB), will serve as a professional body operating the holding fund under the supervision of the Ministry of Industry and Trade.

In the Hungarian case a government decree on the regulation concerning the use of aid stemming from various EU funds for the programming period 2014-2020, already set forth the fund of funds model, and named the Hungarian Development Bank as the managing organization for the holding fund. It was a designation based on exclusive rights as well as inter-administrative cooperation rules.

In Slovakia, the body implementing FI as holding fund is the ‘Slovak Investment Holding’, which is managed by ‘SZRB Asset Management (SZRB AM)’ instead of the cooperation with EIF as was the previous practice. The SZRB AM is a subsidiary of the Slovak Guarantee and Development Bank, which is supervised by the National Bank of Slovakia. The Slovak Investment Holding, moreover, will involve financial intermediaries in the implementation.

In the UK for the 2014-2020 period the British Business Bank as economic development bank 100% owned by UK Government will act as the holding fund and it will provide debt and equity finance to SMEs including Enterprise Finance Guarantee, Enterprise Capital Schemes, UK Innovation Investment Fund, the Angel Co-investment Fund, and the Business Finance Partnership. The Enterprise Investment Scheme and the Seed Enterprise Investment Scheme are HMRC operated tax relief schemes which aim to encourage private investment in SMEs.

In Poland, the body implementing the holding fund is the ‘Bank Gospodarstwa Krajowego’, the state development bank of Poland owned in 100% by the State. BGK used to be the holding fund manager for national FIs, also in more Polish regions for the JEREMIE initiative in the 2007-2013 programming period; moreover, it also implemented JESSICA as Urban Development Fund in three regions.

In Ireland the Strategic Banking Corporation of Ireland was founded in September 2014 as a limited company owned by the Minister of Finance. The key objective when setting up the company was to source low cost, long term finance from multilateral finance providers and state/EU resources and to reinforce Ireland’s economic recovery by improving funding and access to finance mechanisms for the economy.

In Bulgaria, the body implementing the fund of funds is the newly created ‘Fund Manager of Financial Instruments in Bulgaria EAD’. EAD has been set up as a sole-owner joint-stock company with government interest. The subject of its activity is the management of financial instruments to be implemented under the programmes co-financed by the ESIF in the 2014-2020 programming period. Besides, Bulgaria also allocated ESI Funds to set up financial instruments at Union level. In such context, a Single Dedicated National Programme was approved by the European Commission on 12 October 2015 with the objective of launching the SME Initiative in Bulgaria and with the EIF managing the scheme on behalf of the different contributors (Government of the Republic of Bulgaria, EU Commission and EIB Group (i.e. the European Investment Bank and the European Investment Fund).

Source: Author’s own compilation

Member States provided different reasons for opting for the above presented implementation structures. Poland explicitly reported that the choice of implementation structure was driven by the conclusions of the ex-ante assessment. Slovakia indicated, that their authorities could not examine the options in detail, as the implementation of the 2007-2013 JEREMIE programmes started with delay in 2013, therefore there was no capacity to prepare an adequate implementation environment.

As for the selection of financial intermediaries, the Member States reported huge delays, which – in their opinion – is a consequence of Commission's requirement of public procurement. Therefore, in many countries, financial intermediaries are not yet entrusted with implementation tasks. Some Member States even signalled that they have rather abandoned the negotiations with the Commission and decided to use public procurement for the selection of financial intermediaries.

Nevertheless, MAs are still confused of how to properly publish a public procurement call, as – in their opinion – the subject does not fit into the framework of public procurement procedures.[61] According to the general opinion, the use of open calls would be much more efficient and (at the time of writing) Poland and Slovakia still try to convince the Commission of alternative procedures.

As for the SME Initiative OP in Bulgaria, the selection of financial intermediaries is still ongoing at the time of writing (October 2016). Financial intermediaries will be selected on the basis of EIF's policies, rules, procedures and statutes and in conformity with best practices with an open, transparent, proportionate, non-discriminatory and objective selection procedure, avoiding conflicts of interest, taking into account the criteria and principles underpinning the programme and the experience and financial capacity of the applicants; thus it won't be carried out within a public procurement procedure, as EIB/EIF in general is exempt from using EU public procurement rules.

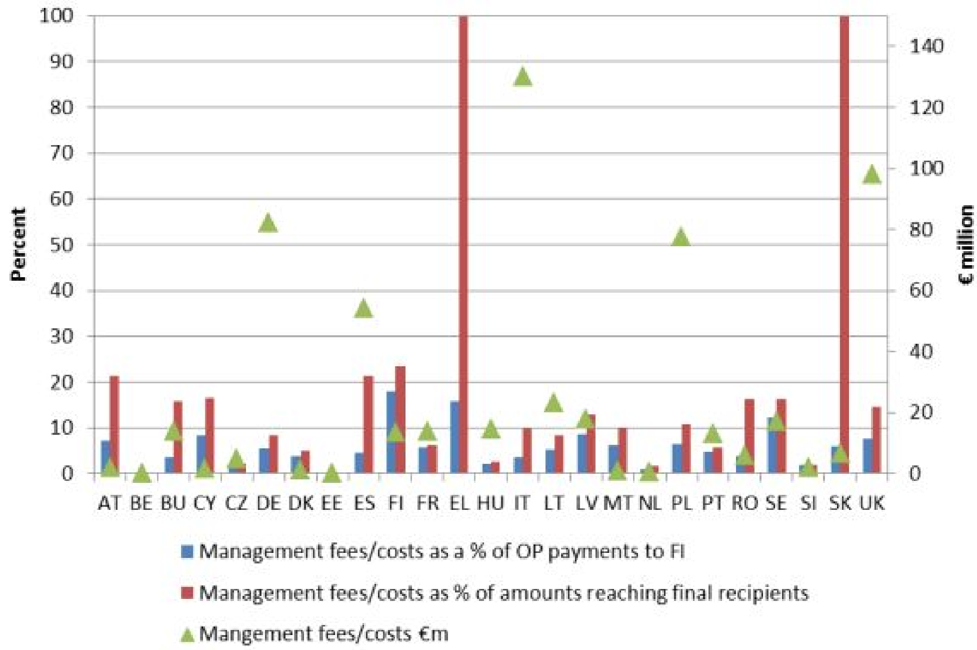
2.3. Management costs and fees

Remuneration is probably the most effective mechanism to ensure that actors perform as expected. If an activity is carried out through third parties – which is usually the case for FIs – the fee-system is a key factor to their behaviour to be aimed at achieving the pursued objectives. Therefore, fees are critical for the overall performance of FIs and poorly designed fees can cause negative effects (e.g. to compensate just closed deals can lead to large investments without significantly overcoming the gap). Remuneration must be attractive for the intermediaries but also it must be in line with state aid rules.

In the 2007-2013 programming period[62], the management cost may not have exceeded on a yearly average 2% of the capital contributed from the operational programme to the holding fund. However, management fees and costs are difficult to assess owing to their structure. Fund managers were basically selected through competitive selection processes, but evaluations suggest that management fees (and costs) differ widely, depending on the nature of the FI and the bodies involved in its implementation.

[61] E.g. use of qualitative selection criteria exclusively.
[62] As clarified by Article 43(4) of Commission Regulation No 1828/2006 of December 8 2006.

Figure 12: Management costs and fees



Note: Greece is off the scale both in management costs as a proportion of amounts reaching final recipients (109 percent) and total management fees and costs (€238 million); Slovakia is off the scale in terms of management costs as a proportion of amounts reaching final recipients (over 700 percent). The Commission Summary report notes that some data is implausible and it may be that these are among them.

Source: European Commission, 2014

The different member states/regions have designed and implemented a wide range of remuneration schemes; there is a great deal of diversity in them in the following aspects:

- nature (%, unit price, evidence of expenditure, etc.);
- timing (annual, on a deal basis...);
- payer (fund, HFM, recipient, etc.);
- the pursued effect (e.g. yields restriction + loss mitigation VC).

Management fees and costs are sometimes paid outside the OP resources, and the remuneration of fund managers may come from sources other than fees[63]. Additionally at risk sharing FIs earnings on private contributions may provide an incentive for the fund manager to perform even if no performance fees are envisaged. All remuneration schemes show advantages and disadvantages and many aspects are considered (efficiency, state aid regulation, etc.). In conclusion, designing the right remuneration scheme for a FI is not an easy task.

Box 7: Individual remuneration system in Hungary 2007-2013

Individual cost and fees scheme in Hungarian microfinance

In order to implement the JEREMIE programme in Hungary a widespread network of external intermediaries was set up. Corresponding to the highest share of allocated funds and transactions, loans were offered by three types of financial intermediaries (credit institutions, financial enterprises and local enterprise development agencies). Banks were the primary providers of guarantees and the counter-guarantee programme, which was exclusively offered by the public guarantee organization (Garantiqa Ltd). Companies registered as venture capital funds were invited to offer equity products.

[63] To establish complementary funding streams to cover the HFM's operating costs via a grant has been reported by Northwest England.

> The financial intermediaries providing loans were attracted by the profit they could gain from the difference between the low source cost (the refinancing interest rate was 0.5%) and the interest paid by the clients (capped max. 9%, in the practice 6% interest rate during the investment period). However, the operation had to be financed from these profits, as in this case no management cost was eligible from the programme sources. The MA and the Holding Fund relied on performance-based incentives in calculating the allocations of next-phase ERDF contributions to the financial intermediaries. The so-called "partner-limits" served for sequential allocation of available funds – calculated on the basis of past performance. Although these allocation-limits were shifting upwards on the volume scale during the implementation period, they proved to be good benchmarks for assessing the actual performance of the given beneficiary and they helped to reduce implementation risk by allowing sequential allocation of the total funds.

Source: Author's own compilation

For the 2014-2020 a delegated act[64] sets out criteria - which are linked to the legal, financial, economic and organizational capacity of the body to be entrusted with implementation tasks of the financial instrument - to be applied by the managing authority when selecting financial intermediaries. The Member States can "designate one or more intermediate bodies to carry out certain tasks of the managing or the certifying authority under the responsibility of that authority" applicable to the Funds[65].

One of the criteria to be applied when selecting the body implementing a financial instrument is the level of the management costs and fees, which constitute the "price" of the services provided to the managing authority. For 2014-2020 programming period there are more detailed provisions and stricter limits and the imposition of specific methodologies for establishing costs and fees that seem likely to lower management fees overall. In fact, it is very difficult to assess the full scale of management costs, because for many funds no fees are explicitly reported and it is unclear whether or when such information might be available.

The CPR and state aid schemes provide for two possibilities for the alignment of interest with private partners:

- Pari passu[66] - private investor contributes with own funds in the same risk position as the EU contribution;
- Preferential remuneration - measures aimed at the alignment of interests, for instance performance-based remuneration of the management, a commercial orientation of the management decisions and, where appropriate, the managers' direct participation with the FI.

For the 2014-2020 programming period MAs may consider, as appropriate, using the following types of preferential remuneration schemes:

- Asymmetric profit-sharing (e.g. the hurdle rate is not pari passu to the investors in infrastructure funds, but gives preference to the private partners);
- Asymmetric loss-sharing (e.g. guarantee schemes, covering a first loss piece of the downside risk for innovation loans;

[64] Article 7 of Commission Delegated Regulation (EU) No 480/2014 of 3 March 2014 supplementing Regulation (EU) No 1303/2013 of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund.

[65] Article 123(6) CPR, Article 66(2) of Regulation (EU) No 1305/2013 for EAFRD.

[66] An investment is pari passu when 1) it is made under the same terms and conditions by public and private investors, 2) both investors intervene simultaneously and 3) the intervention of the private investor is of real economic significance.

- Preferential fee payment to the managers: to the extent they are also co-investors within the limits established by the delegated act[67] (e.g. microfinance);
- Preferential exit regime (e.g. risk taking on the engagements not sold in energy efficiency funds).

According to above mentioned delegated act eligible management costs and fees incurred by the fund of funds and the financial intermediaries are regressive over the development eligibility period; the legislation sets a maximum threshold for them by the type of financial intermediary concerned.

Table 5: Remuneration of financial intermediaries and fund of funds

<table>
<tr><th></th><th>Max. amount</th><th colspan="2">Schedule of eligible fees</th></tr>
<tr><th></th><th>that may be used in the eligibility period (in percentage of programme contribution, per year)</th><th>Basic fees</th><th>Performance based remuneration (per year)</th></tr>
<tr><td>Fund of funds</td><td>7%</td><td>3% in the first 12 months, 1% in the next 12 months, 0.5% per year after that</td><td>0.5%</td></tr>
<tr><td>Intermediary providing equity</td><td>20%</td><td>2.5% per year in the first 24 months, 1% per year after that</td><td>2.5%</td></tr>
<tr><td>Intermediary providing loans</td><td>8%</td><td rowspan="4">0.5% per year</td><td>1%</td></tr>
<tr><td>Intermediary providing guarantees</td><td>10%</td><td>1.5%</td></tr>
<tr><td>Intermediary providing micro-credit</td><td>10 %</td><td>1.5%</td></tr>
<tr><td>Intermediary providing grants, interest rate subsidies, guarantee fee subsidies</td><td>6%</td><td>0.5%</td></tr>
</table>

Source: Author's own compilation based on Commission Delegated Regulation (EU) No. 480/2014

The management costs and fees set by the legislation may be exceeded, if the financial intermediary 'has been selected through a competitive tender in accordance with the applicable rules and the competitive tender proved the need for higher management costs and fees'. The question arises, however, whether a public procurement process is to be considered automatically as competitive tender or not, especially if at the end-phase it runs with one consortium.

The cost and fees of the financial intermediaries in the loan area generally may be based on the following elements:

- capital expenditure: according to the EU regulation[68] risk weight of the SME loans is 75%. Based on this counting with 8% capital requirement, around 6 unit capital is necessary behind a 100 unit SME loan depending on the IRB method used estimation of the cost of risk (see table 6);
- OPEX[69] estimation (operating costs);
- cost of funds, which depend on the EURIBOR.[70]

[67] Commission Delegated Regulation (EU) No 480/2014 of 3 March 2014 supplementing Regulation (EU) No 1303/2013 of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund.

[68] Article 123 of Regulation 575/2013/EU on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

[69] An ongoing cost for running a product, business, or system.

[70] Euro Interbank Offered Rate. The Euribor rates are based on the average interest rates at which a large panel of European banks borrow funds from one another. There are different maturities, ranging from one week to one year.

Table 6: Margins are to be applied at pricing[71]

Loan margins in basis points			
Rating category	Collateralization		
	High	Normal	Low
Strong (AAA-A)	60	75	100
Good (BBB)	75	100	220
Satisfactory (BB)	100	220	400
Weak (B)	220	400	650
Bad/Financial difficulties (CCC and below)	400	650	1000[72]

Normally, 100 basis points are added to the base rate. For borrowers that do not have a credit history or a rating based on a balance sheet approach, such as certain special-purpose companies or start-up companies, the base rate should be increased by at least 400 basis points (depending on the available collaterals) and the margin can never be lower than the one which would be applicable to the parent company.

In the case of the ESIF OP we can count with the red-letter area, and based on this the interest rate could be between 2-7.5%.

The question arises whether this cost structure would be in line with the prescribed remuneration matrix for financial intermediaries. It is impossible to answer exactly as there are several open issues and costs which are not covered by the proposed mechanism in the delegated act, linked to the development nature of the FIs (e.g. special assistance by preparation of loan application of SMEs, etc.). Management costs and fees should cover not only the administration, but also trainings and consultations with the final recipients which bring the added value to the financial instrument (e.g. makes the loan instrument more sustainable).

Also risks arise that capable financial intermediaries may not bid to run the funds because they find the level of remuneration inadequate.

Although the methodology of calculating the management costs and fees and their thresholds and limits is defined in the Commission Delegated Regulation (EU) No 480/2014 with the above explained complex matrix, making the overall and particular calculations can be difficult in practice. This legislation[73] also says that management costs shall comprise direct or indirect cost items reimbursed against evidence of expenditure, and that management fees shall refer to an agreed price for services rendered established via a competitive market process. Some Member States are still confused about what should be understood under “agreed price” and what evidence should be provided for supporting this. According to the delegated act, management costs and fees shall be based on a performance based calculation methodology; however the relevant guidance document on management costs and fees contains no reference to applicable methodology.

Seemingly the current provisions combine two different financing methods (the obligation to substantiate expenditure is now combined with fixed maximum fee rate). The rationale for his combination is not evident, and also, this approach notably increases administrative burden.

[71] Based on 2008/C 14/02 - Communication from the Commission on the revision of the method for setting the reference and discount rates.

[72] Subject to the application of the specific provisions for rescue and restructuring aid, as currently laid down in the Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ C 244, 1.10.2004, p. 2) and in particular point 25(a), which refers to ‘a rate at least comparable with the rates observed for loans to healthy companies, and in particular at the reference rates adopted by the Commission’. Hence, for rescue aid cases, the 1-year IBOR increased with at least 100 basis points shall be applied.

[73] Art 42(5) CPR.

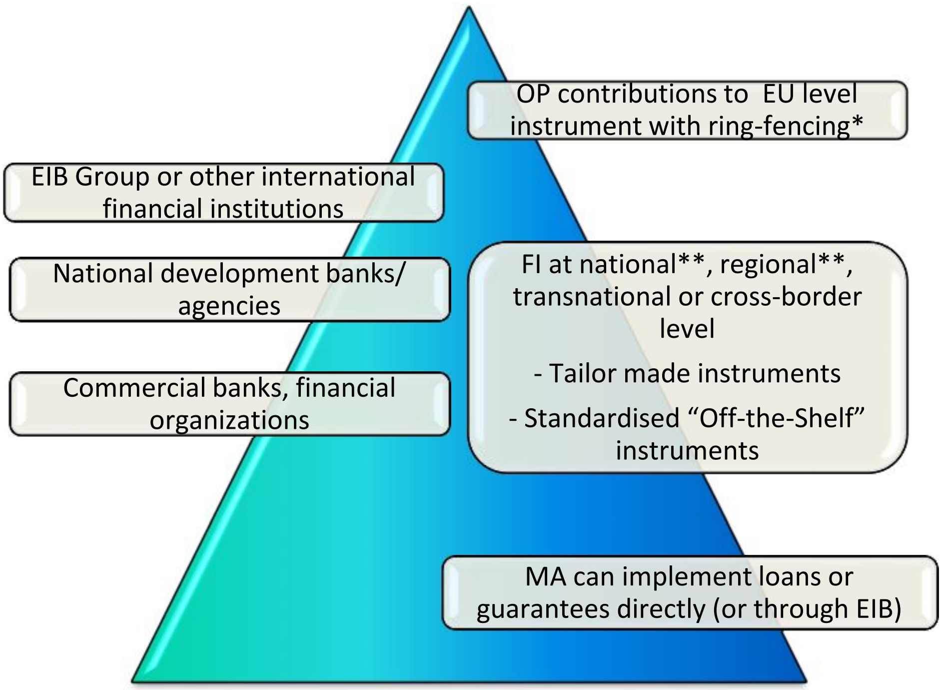
3. OTHER TYPES OF FIS

KEY FINDINGS

- In the framework of FIs various kinds of assistance schemes are offered by the CPR;
- EU level FIs have several advantages in the implementation, namely no national co-finance is needed or contracts can be concluded with the EIB/EIF directly by managing authorities without the need for a competitive process/public procurement and the EIB/EIF can select financial intermediaries to manage FIs on the basis of its internal procedures. Yet Member States are rather using national/regional FIs;
- Off the shelf FIs provide standard terms and conditions compatible with ESI Funds regulations and state aid rules, but they do not always fit with market needs. Tailor-made solutions are the best tools, nonetheless they are more complicated to implement because of the complexity of the applicable rules;
- More types of combination will be possible than earlier and it is facilitating the transition from a grant regime towards revolving FIs.
- The main financial resource used for FIs is the ERDF, nevertheless a few funds financed by the ESF are also planned (e.g. PL, HU);

According to the CPR, ESIF FIs can be developed for allocations from all five EU funding sources. The cohesion policy regulation for the 2014-2020 programming period contains also several opportunities regarding different kinds of financial products: SME initiative[74], off the shelf and tailor-made solutions.

Figure 13: Different types of FIs at different levels and the possible intermediaries in 2014-2020



Source: Author's own compilation

* Up to 100% of the paid support may come from ERDF, ESF and CF; separate priority axis to be foreseen

** ERDF, ESF, CF co-financing rate is to increase by 10 percentage points if an entire priority axis is implemented through financial instruments

[74] Article 39 CPR.

The two main legal bases for the different types for FIs are:

- CPR Art. 38 (1) - Managing authority may provide financial contribution to:
  a) Financial instruments set up at EU level (e.g. H2020, COSME, etc., i.e. financial instruments managed by the Commission);
  b) inancial instruments set up at national, regional, transnational or cross-border level (i.e. financial instruments managed or under the responsibility of the managing authority).

- CPR Art. 38 (3) - Managing authority may provide financial contribution to:
  a) Financial instruments complying with the standard terms and conditions laid down by the Commission = off the shelf instruments,
  b) Already existing or newly created financial instruments, specifically designed to achieve the specific objectives set out under a relevant priority = tailor made instruments.

3.1. EU level financial instruments

3.1.1. EIB/EIF and Financial Instruments (FI)

According to the CPR definition of the EIB includes the European Investment Bank, the European Investment Fund or any subsidiary of the European Investment Bank.[75]

Article 31 of the CPR sets out broad requirements regarding the 'participation of the EIB', such as its capacity as an advisory body. Article 38 of the CPR applies specifically to the implementation of FIs and outlines the direct role which the EIB can adopt. Article 38(4)(b)(i) in particular specifies that a managing authority may entrust implementation tasks to the EIB. In such cases, the EIB is bound by the same liabilities, conditionalities and responsibilities applicable to other bodies that can implement funds of funds. These include, for example, the requirement either to open separate fiduciary accounts in the name of the managing authority to manage the transactions of the FI, or to 'set up the financial instrument as a separate block of finance' within the organisation (i.e. the EIB). However, where the EIB is designated as the implementing body responsible for a holding fund, the managing authority is obliged to mandate a firm(s) to carry out on-the-spot verifications and audits[76].

The EIB as the European Union's bank works closely with other EU institutions and Member States to implement EU policy and as the largest multilateral borrower and lender by volume, it provides finance and expertise for investment projects which contribute to furthering EU policy objectives. As such EIB also plays an important role concerning the implementation of operational programmes and FIs in the EU.

Some of the Member States analysed (especially Slovakia and Bulgaria) took advantage of co-operation with EIB, IBRD and EBRD within Technical Assistance Services in order to improve the process of setting up their FI institutional systems. In Slovakia, for example, EIB helped the Slovak counterpart with the preparation of the ex-ante assessment, including the specification and the supervision of the study. In addition, the EIB also has a potential role as a fund manager.

[75] Art. 2(23) CPR.
[76] Commission Delegated Regulation (EU) No. 480/2014.

Table 7: Role of the EIB in the analysed Member States[77]

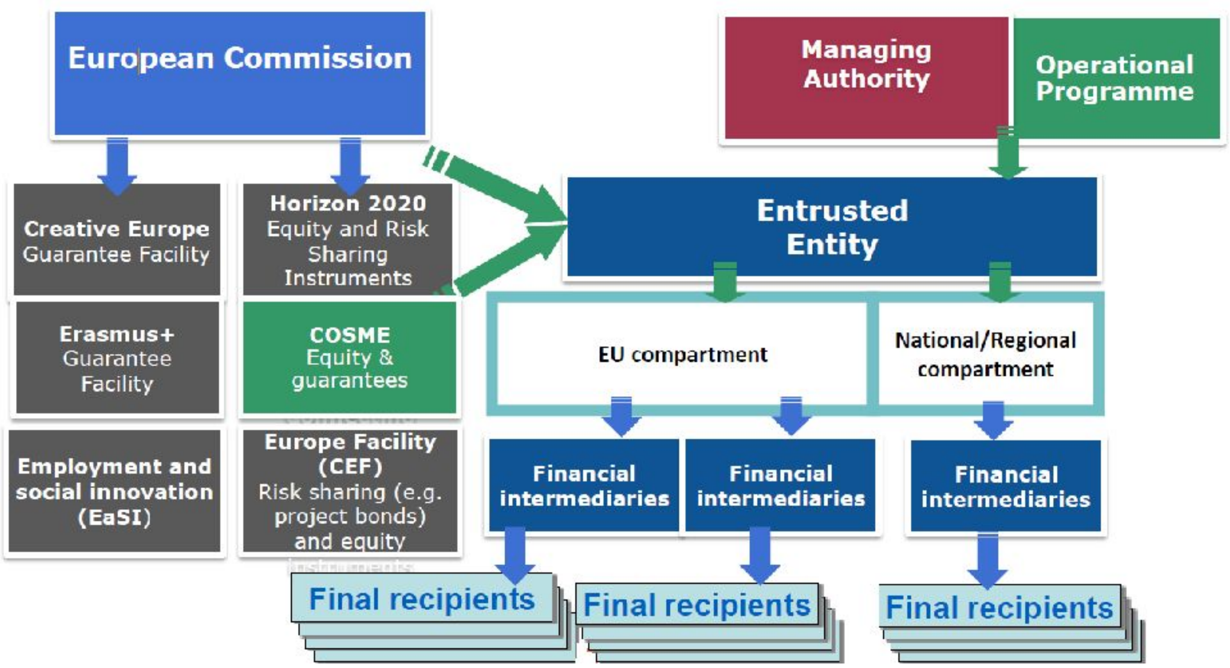
Member State	Advisory	(B)lending			Management			Co-financing for projects	Capacity building and TA	Other	No role
		enterprises	urban	energy	enterprises	urban	energy				
Bulgaria											
Czech Rep.											
Hungary											
Ireland											
Italy											
Poland											
Slovakia											
UK (England)											
UK (Scotland)											

Source: interviews with MS' experts

Article 39 of the CPR refers to the contribution which can be made by the ERDF (and the EAFRD) to uncapped joint guarantee and securitisation financial instruments in favour of SMEs where they are implemented by the EIB (see also Chapter 2.1.2). The Regulation specifies that requests for payment to the Commission can be 100 percent of the amounts paid to the EIB, thus no national co-financing is required for allocating ERDF or EAFRD funds to the SME Initiative[78].

The advantages for the MA contributing OP allocation to EU level instrument could be that the OP allocation is ring-fenced and it is to be invested in the OP area, the set-up phase is skipped (e.g. selection of Fund of Funds/Financial Intermediaries, preparation of parameters of FIs, etc.) as the EU level instrument delivery system is used. The audit authority shall not carry out system audits/audits of operations either.

Figure 14: MA contributing OP allocation to EU level instrument



Source: European Commission, EU level and "Off-the-shelf" Financial Instruments MADRID, 8 November 2013

[77] Czech Republic did have a HF until 2014, Poland had five HFs of which one was terminated in 2014. There is no HF planned in Slovakia where the EIB is manager.

[78] Art. 39(7) CPR.

The Commission Guidance on the selection of bodies implementing FIs, including funds of funds confirms that contracts can be concluded with the EIB and EIF directly by managing authorities without the need for a competitive process/public procurement. Furthermore, the EIB/EIF can select financial intermediaries to manage FIs on the basis of its internal procedures without public procurement.

There are significant differences between the criteria applicable to financial instruments implemented at the EU level (such as the SME Initiative) and at the national level, where EU level instruments benefit from preferential treatment. The main advantages of financial instruments implemented at EU level are:

- flexibility (no distinctions between regions);
- selection of financial intermediaries;
- exemption from performance framework;
- state aid compatibility;
- no obligation to fulfil article 7 of CDR;[79]
- ease of administrative procedures, especially in audits of operations;
- ex-ante assessment performed at central level;
- funds are transferred in total and not in tranches – implications on management costs and fees, administrative burden, quicker disbursement;
- exemption from eligibility rules applicable to EFRD and EAFRD.

To sum up, the main reasons for contributing with ESI Funds to an EU Level FI could be:

- the alignment with EU policy objectives;
- the reinforcement of EU funds and scale effect (investors' interests);
- the easier management (design, tendering, legal, financial, audit, reporting, administrative costs, state aid, etc.);
- a possible early start that could help to maximise impact;
- the high co-financing rate (up to 100%).

3.1.2. SME Initiative

The SME Initiative[80] is a joint instrument that aims to capitalise on synergies between existing SME support programmes at national and EU levels to foster financial instruments for small and medium-sized enterprises in the 2014-2020 programming period. Its main objective is to rapidly increase the lending to SMEs at European Union level in order to significantly stimulate financing available to SMEs, economic growth and the creation of jobs as well as to enhance the contribution of ESIF to EU level FIs.

The SME Initiative is co-funded by the European Union through COSME and/or Horizon 2020 resources as well as EIB Group resources. The CPR[81] introduces the option that managing authorities may provide financial contribution to financial instruments set up at EU level, managed by the Commission with implementation tasks entrusted to the EIF[82] in close cooperation with the EIB. Although the CPR contains provisions for different kinds of EU-level instruments, it particularly refers to one type[83] - for ERDF and EAFRD contribution to EU-

79 Commission Delegated Regulation (EU) No 480/2014 of 3 March 2014 supplementing Regulation (EU) No 1303/2013 of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund

80 Art. 39 CPR.

81 Article 38(1) CPR.

82 EIF toolbox for SME development: guarantees, co-guarantees and counter-guarantees; equity guarantees; micro-loans; export-credit insurance; securitisation; venture capital; business angel matching funds; and investment in technology transfer funds.

83 Article 39 CPR.

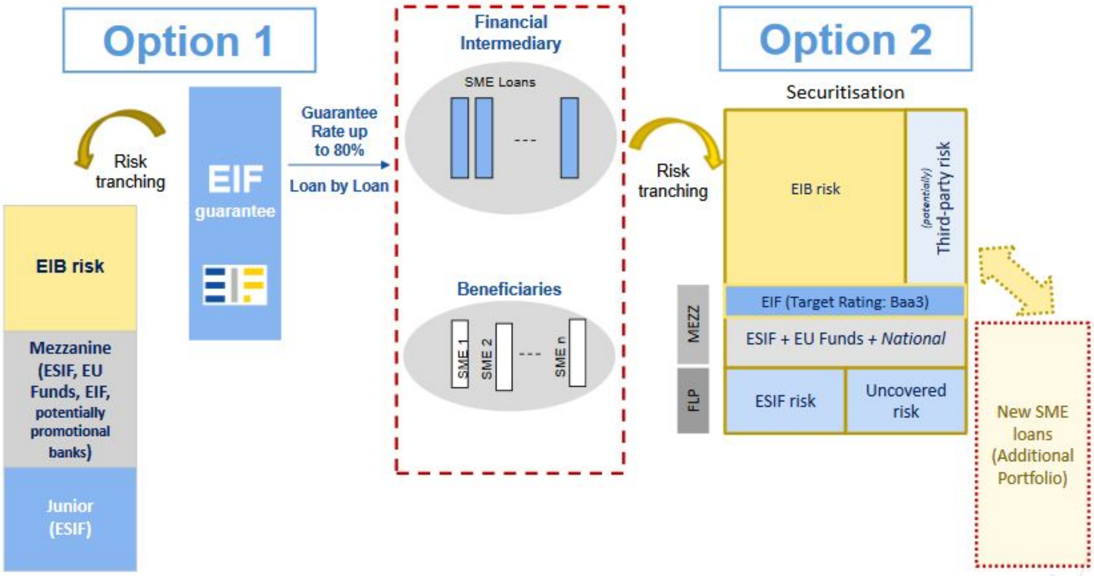
level FIs in favour of SMEs. The EIB together with the European Commission prepared the SME Initiative.

The SME Initiative provides:

- Uncapped guarantee instrument, which offers uncapped portfolio guarantees and partial capital relief to banks building up new portfolios of loans, guarantees for loans and leasing to SMEs;

- Joint securitisation for new and existing loans, where a portfolio of SME loans must be built up by the banks which benefit from having their portfolios of already existing or new SME loans securitised with support from ESIF, COSME/H2020 and EIB Group resources. Financial Intermediaries are selected by EIF via an Open Call for Expression of Interest.

Figure 15: The SME Initiative’s two risk-sharing options



Source: EIF, The SME Initiative: improving access to finance for SMEs, 2015

The participating Member States are required to conclude a funding agreement[84] with the EIB and the contribution to the SME Initiative should be provided as part of a single dedicated national programme per fund. The Model Funding Agreement gives an indication as to its composition but this can be tailored to each MS’ needs (e.g. in Spain there is a rotation system allowing all stakeholders to participate).

Although the SME Initiative has special advantages - no co-financing required from national or regional resources; no need to conduct additional ex-ante assessment than the one already completed by the European Commission and the EIB in 2013 and state aid has already been cleared by the European Commission - the uptake of the initiative has been considerably lower than initially expected. Six Member States (Bulgaria, Finland Italy, Malta, Romania and Spain) have signed up to the SME Initiative.

84 The European Commission and the EIB Group have adopted a ‘Model Funding Agreement’, which is a ready-made template for the Funding Agreement to be negotiated between Member States and the EIF.

Table 8: SME Initiative, signature and implementation phase

Country	Spain	Malta	Bulgaria	Italy	Romania	Finland
ESIF	EUR 800m	EUR 15m	EUR 102m	EUR 102.5 plus EUR 100m of national	EUR 100m	EUR 40m
Option	1	1	1	2	2	2
H2020/COSME	EUR 14.3m	EUR 228k	EUR 1.8m	EUR 4.25m	EUR 2m	EUR 840k
Minimum leverage	4x	4x	4x	6x	4x	4x
Guarantee rate	50%	75%	60%			
Call published	23/02/2015	15/07/2015	17/05/2016			
Expression of interest received	9	3	8			
Transaction signed	7	1				
Disbursed SME loans at Q2 2016	EUR 2.02 bn (24 204 loans)	EUR 12.5m (120 loans)				

Source: Author's own compilation, data from the EIF

Member States can opt-in to the SME Initiative until the end of 2016, by expressing their interest to the European Commission. The potential integration of the initiative into national programmes might be a challenge, as programming has already been completed and changing the operational programmes may present difficulties: Member States would have to submit a request for amendment of the single dedicated national programme and reallocate the contribution to other programmes and priorities.

A motivation for joining the SME Initiative seems to be - besides of the advantages given by the CPR – the capacity challenges that exist in certain Member States such as Bulgaria and Malta (see point 2.2.).

Box 8: The SME Initiative in Bulgaria

SME Initiative - launched in Bulgaria in 2016

Bulgaria has launched a national OP for SME Initiative with the EIF managing the scheme on behalf of the different contributors (i.e. the Government of the Republic of Bulgaria, the EC and the EIB Group). The SME Initiative in Bulgaria is to be implemented with the uncapped portfolio guarantee instrument[85]. The management of the OP has just been confronted with the first practical difficulties (e.g. on-the-spot checks should be carried out by EIF without the presence of the audit authority; however it is the audit authority that should prepare the audit report).

Source: Ministry of Economy Bulgaria 2016

Other Member States reported that the SME Initiative would mean direct competition to nationally implemented financial instruments and they prefer to use the national FIs. Even though the general conditions of implementing the SME Initiative are easier, the products are more inflexible than those of nationally implemented financial instruments. Other

[85] The Facility entails the issuance of Guarantees for the benefit of lenders and leasing companies to partially cover the portfolio credit risk of newly originated Eligible SME Transactions granted to Bulgarian SMEs included in the guaranteed Portfolio during a pre-defined Inclusion Period.

interviewees noted that the SME Initiative was an EU product for solving bank liquidity problems after the crisis. However, the relevance of this product is not evident anymore[86]. Another counter-argument was that the SME Initiative is to be implemented at national level, and its aligning with regional implementation levels is almost impossible (e.g. PL).

3.1.3. European Fund for Strategic Investments

The European Fund for Strategic Investment (EFSI)[87] is to help overcoming the current investment gap in the EU by mobilising private financing for strategic investments. EFSI as one of the three pillars of the Investment Plan for Europe should unlock additional investment.

Box 9: National Promotional Banks (NPBs) cooperation and the role of investment platforms in the context of the EFSI

Eight countries announced in 2015 that they would participate in the EFSI project via their NPBs (or similar institutions): Bulgaria, Slovakia, Poland, Luxembourg, France, Italy, Spain and Germany. In addition, the United Kingdom announced in July 2015 that it would make guarantees available to co-finance EFSI infrastructure projects in the UK (€8,5bn (£6bn)). The UK contribution is not via an NPB.

In detail, the amounts of the announced national contributions via NPBs are as follows:

- Bulgaria, June 2015, EUR 100 million, Bulgarian Development Bank,
- Slovakia, June 2015, EUR 400 million, Slovenský Investičný Holding and Slovenská Záručná a Rozvojová Banka,
- Poland, April 2015, EUR 8 billion EUR, Bank Gospodarstwa Krajowego (BGK) and another public institution Polish Investments for Development (PIR),
- Luxembourg, April 2015, EUR 80 million via Société Nationale de Crédit et d'Investissement (SNCI),
- France, March 2015, EUR 8 billion via Caisse des Dépôts (CDC) and Bpifrance (BPI),
- Italy, March 2015, EUR 8 billion via Cassa Depositi e Prestiti (CDP),
- Spain, February 2015, EUR 1.5 billion via Instituto de Crédito Oficial (ICO),
- Germany, February 2015, EUR 8 billion via KfW.

Source: European Commission, 2015

Legally, EFSI is neither a financial instrument under the Financial Regulation applicable to EU level budgetary operations nor under the definition of the CPR applicable for ESI Funds. However, EFSI provides financing for economically viable projects using loans, guarantees and equity investments. Also, it is an important factor that combining ESI Funds and EFSI is possible either at individual project or at financial instrument level in cases where the respective applicable eligibility criteria are satisfied.

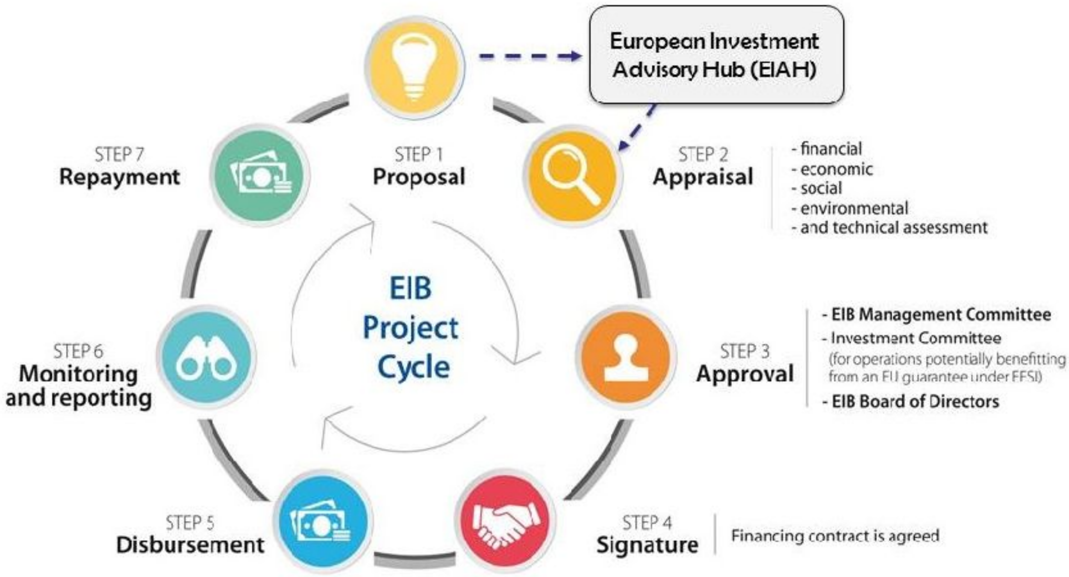
EFSI is a EUR 16 billion guarantee from the EU budget, complemented by a EUR 5 billion allocation of the EIB's own capital which provides additional guarantee permitting higher risk-taking to the EIB project finance. In practice, the EIB performs its standard due diligence in respect of any proposed operations ("business as usual") in order to decide on the project's eligibility, additionality, mobilisation of private capital, consistency with Union policies as well as its economic, technical and financial viability (see Figure 16). However, a higher risk profile

[86] The European Central Bank has started a programme of quantitative easing which has improved liquidity.

[87] Regulation (EU) 2015/1017 of the European Parliament and of the Council of 25 June 2015 on the European Fund for Strategic Investments, the European Investment Advisory Hub, and the European Investment Project Portal and amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013 – the European Fund for Strategic Investments, OJ L169, 1.7.2015, p. 1 (the "EFSI Regulation") entered into force on 4 July 2015.

is possible as compared to standard EIB activities and the pricing policy is also different due to the support of the EFSI guarantee. Additionally, a dedicated governance structure for EFSI decision process has been established. This has been put in place to ensure that the investments made under EFSI remain focused on the specific objective of addressing the market failure in risk-taking which hinders investments in Europe.

Figure 16: EIB project cycle



Source: EIB, The investment Plan for Europe (EFSI) 5th October 2015, Prague.

EFSI has two channels to support projects: an Infrastructure and Innovation Window (IIW) to be deployed through EIB and an SME Window (SMEW) to be deployed through the EIF to support SMEs and mid-caps.[88]

Figure 17: EIB – NPB cooperation possibilities under EFSI

Infrastructure and Innovation Window (IIW) - EIB:					SME Window (SMEW) - EIF:	
Bilateral cooperation (with higher EIB risk-taking)			Investment platform	Advisory cooperation	Bilateral cooperation	SME finance platform
Re-finance (e.g.: EIB Global Loan)	Project co-finance	Portfolio risk-sharing	Common investment platform (thematic and/or geographical)	European Investment Advisory Hub EIAH	Cooperation in the preparation and co-finance of tailor-made SME products	Joining multilateral platform (e.g.: Equity Platform)

Source: Author's own compilation

[88] There is no common EU definition of mid-cap companies. While SMEs are defined as having fewer than 250 employees, mid-caps are broadly said to have between 250 and 3000 employees.

Article 2 of the EFSI Regulation provides that: (3) "national promotional banks or institutions" means legal entities carrying out financial activities on a professional basis which are given a mandate by a Member State or a Member State's entity at central, regional or local level, to carry out development or promotional activities." The detailed arrangements of NPBs benefitting from EFSI loans or investments will have to be agreed with the EIB and be approved by the EFSI Steering Board.

At the project level it is possible to combine national (public/NPB or private) sources with ESIF. However, in case of combining ESIF and EFSI in a single project, the part of the project supported by ESIF (consisting of ESI Fund(s) plus the respective national co-financing) cannot receive support from EFSI; otherwise this would constitute double-financing. This also means that EFSI support to the project cannot count as national co-financing of the ESI Funds programme and the EFSI supported part of the project consequently cannot be declared as eligible expenditure for ESI Funds' support. However, it is possible to match sources to finance separate parts of the project, or to structure the financing in a way that EFSI funds used for the revenue-generating part of the infrastructure project and ESIF for the rest.

Concerning the planned infrastructure projects to be financed by EFSI, there are considerations in PL, HU, SK and CZ; however no exact plans have been reported. It is only Slovakia, where a PPP project[89] has been already financed through EFSI (contract signed on 16/06/2016). According to the relevant data on EFSI projects in the analysed Member States (see Table 9) IT, UK, IE are involved in the implementation of such projects.

Table 9: EFSI projects in the analysed Member States

Title	Country	EFSI financing	Total investment related to EFSI	Sector	Approval date
Novamont Renewable Chemistry	Italy	15m	93m	RDI	15/12/2015
2I Rete Gas Smart Metering	Italy	200m	415m	Energy	15/12/2015
Raffineria di Milazzo	Italy	30m	225m	Environment and resource efficiency Smaller companies	17/11/2015
Trenitalia Regional Rolling Stock	Italy	300m	617m	Transport	17/11/2015
TI - Accelerated Fixed High Speed BB rollout	Italy	500m	1808m	Digital	17/11/2015
Capenergie 3 Fund	Italy Germany France	50m	Not disclosed	Energy	21/07/2015
Arvedi Modernisation Programme	Italy	100m	194m	RDI	21/04/2015
Banca del Mezzogiorno loan for SMEs and Mid-Caps	Italy	50m	140m	Smaller companies	19/07/2016
Toscana energia gas network & metering	Italy	90m	151m	Energy Smaller companies	19/07/2016
Aimag settore idrico e ambiente	Italy	59m	119m	Energy Environment and resource efficiency	19/07/2016
Societá Gasdotti Italia - Gas transmission	Italy	44m	88m	Energy Smaller companies	16/06/2016
ISP Risk Sharing Initiative for SMEs and Midcaps	Italy	100m	280m	Smaller companies	16/06/2016
Euromed RORO	Italy	200m	501m	Environment and resource efficiency	02/02/2016
Autovie Venete A4 widening	Italy	120m	1117m	Transport	22/09/2015

[89] It is a transport project of 1332 Million EUR, and it consists of the design, construction and financing of approximately 27 km of the D4 motorway around Bratislava, and is to be procured as part of the D4R7 public-private partnership (PPP).

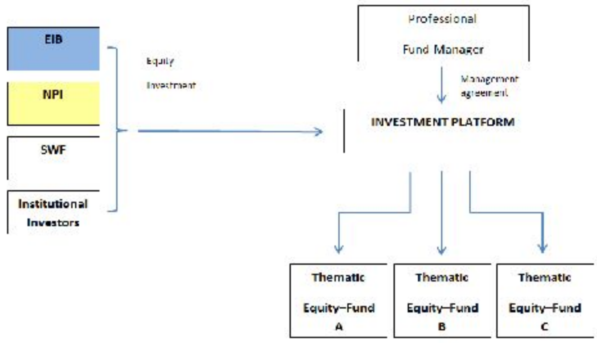
Automotive Steel RDI	United Kingdom Sweden Spain Germany France	160m	330m	RDI	19/05/2016
Calvin Smartmeter roll-out	United Kingdom	52m (1st tranche)	2115m	Energy	19/05/2016
Beatrice Offshore	United Kingdom	292m	2466m	Energy	21/10/2015
Midland Metropolitan Hospital PPP	United Kingdom	148m	468m	Social infrastructure RDI	22/09/2015
Galloper Offshore Wind	United Kingdom	314m	1556m	Energy	22/09/2015
Smart meters - Project Spark	United Kingdom	478m	1378m	Energy	21/07/2015
Copenhagen Infrastructure II	United Kingdom Germany	75m	1275m	Energy	19/05/2015
Smart meter roll out No 2	United Kingdom	458m	1313m	Energy	19/07/2016
Palm energy efficient paper production	United Kingdom France	37m	73m	Energy	19/07/2016
Infracapital Greenfield Infrastructure Fund	United Kingdom EU Countries	Not disclosed	Not disclosed	Digital Energy Transport Environment and resource efficiency Social infrastructure	19/05/2016
IMPAX Climate Property Fund II	United Kingdom	36m	Not disclosed	Energy	17/11/2015
London Energy Efficiency cofinancing Facility	United Kingdom	136m	Not disclosed	Energy	21/10/2015
Malin corporation - Life Sciences Investments	United Kingdom Ireland	70m	1425m	Smaller companies Social infrastructure RDI	16/06/2016
Primary Care Centres PPP	Ireland	70m	135m	Social infrastructure	21/04/2015
Irish Water Investment Programme I - ERVIA	Ireland	200m	459m	Environment and resource efficiency	15/12/2015
D4R7 Slovakia PPP	Slovakia	427m	636m	Transport	21/10/2015

Source: EIB, downloaded on 20.8.2016

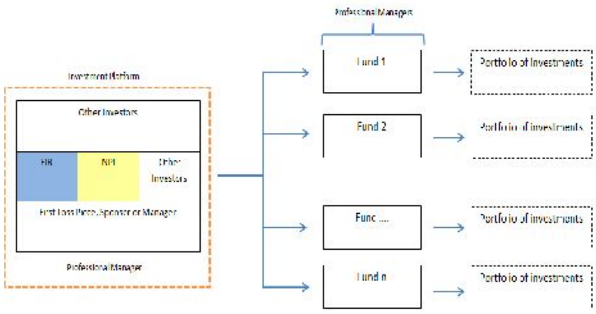
At the financial instruments level, the ESI Funds can be used to support the risk-bearing capacity of an EFSI Investment Platform in the form of a "layered fund" (see Figure 18), and they leverage other sources of finance, most notably private investors as well as NPBs. It could be a newly established investment platform as well as a contribution into an existing one. Another advantage in the case of combination is that EFSI is frontloading financial instruments. EFSI-supported EIB interventions do not constitute state aid and they are not subject to state aid consistency controls.

Figure 18: Investment Platforms – Examples

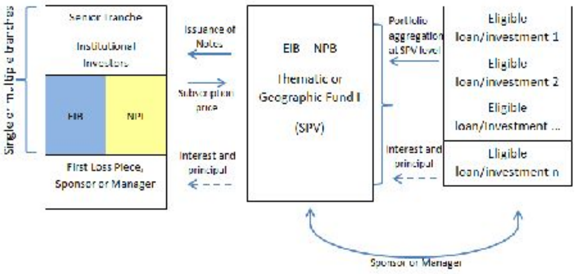
Option 1: Fund Investment Platform – Geographical or Thematic



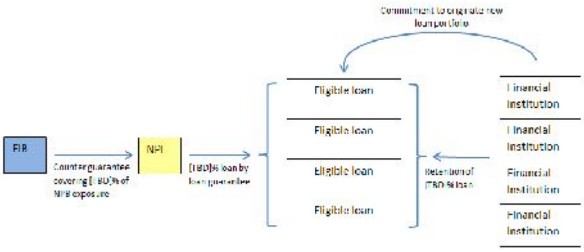
Option 2: Layered Fund Platform Structure



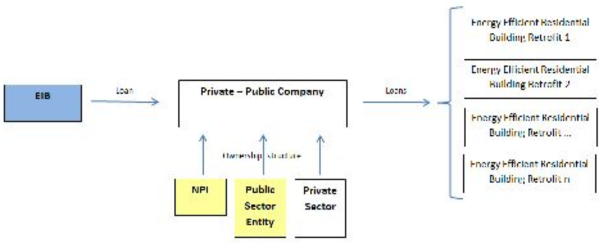
Option 3: Non Granular Platform – Geographical or Thematic



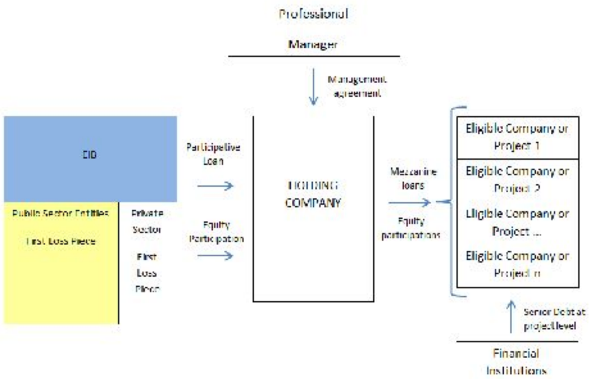
Option 4: Bank Loan Risk Sharing Platform



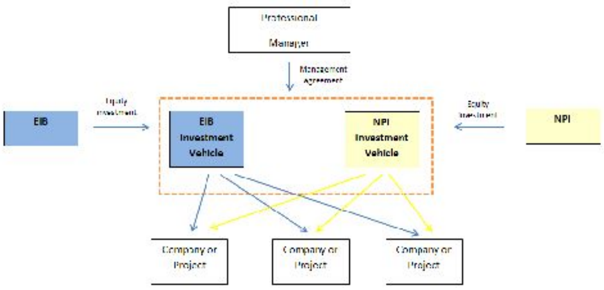
Option 5: Thematic Platform – Energy Efficient Housing



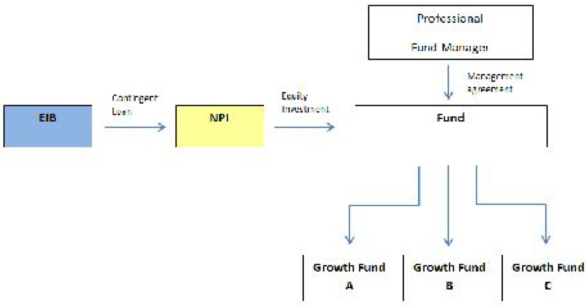
Option 6: Thematic Platform – Low Carbon Economy



Option 7: EIB – NPI Co-investment



Option 8: Contingent Loan to Fund of Funds



Source: EIB, European Structural and Investment Funds and European Fund for Strategic Investments complementarities Ensuring coordination, synergies and complementarity, 2016

3.2. Off-the-shelf financial instruments

The so called off-the-shelf financial instruments[90] are also part of the implementation options. They provide standard terms and conditions[91], which are compatible with ESI Funds regulation and state aid rules and seek to combine public and private resources. Term sheets[92] of a minimum set of technical and legal requirements for each of the instruments are set forth in the implementing regulation and managing authorities may add conditions to the term sheets if these do not alter the minimum technical and legal requirements.

Off-the shelf financial instruments may be appropriate when the available instruments fit the market needs, the targeted final recipients identified during the ex-ante assessment phase and a fast roll-out of the FI is crucial. It is a good solution if the MA has limited resources to commit for the development of a specifically designed FI.

Box 10: Off-the-shelf financial instruments[93]

1. The loan for SMEs, based on a portfolio risk sharing loan model (RS Loan), is a loan from the programme contribution to a selected financial intermediary aiming to co-finance a portfolio of newly originated loans. Risk-sharing: 80%/20%, i.e. the financial intermediary shall contribute with its own private funds for a minimum of 20% (at market conditions) of the loan amount: up to EUR 1m at preferential conditions financing tangible & intangible investments as well as the working capital linked to the investment financed. This financial instrument may be combined with a grant type of support such as advisory service to support the business development of the companies benefitting from the RS Loan.
2. Guarantee for SMEs (Capped Guarantee) is to support loans to SMEs by providing credit risk protection (in the form of a first loss portfolio capped guarantee) with the aim to reduce the particular difficulties that SMEs face in accessing finance because (i) of the lack of sufficient collateral in combination with the (ii) relatively high credit risk they represent.

   Guarantee rate: up to 80% on a loan by loan basis (credit risk retained by the financial intermediary is in no case less than 20%) and the cap rate has to be determined in the ex ante risk assessment (No more than 25%). The loan maturity: between 1 year and 10 years (including grace period) and loan amount: up to EUR 1.5 million.
3. Equity Investment fund for SMEs and start-up companies, based on a co-investment model (Co-investment Facility), serves as a means of attracting additional investments in SMEs through a partnership approach with Equity Investment funds or other market participants making investments. The financial intermediary is a private entity which takes all investment/divestment decisions with the diligence of a professional manager in good faith. The public and private contributions depend on the type of investment target, the private contribution (matching the contribution programme) shall be of a minimum

[90] CPR Art. 38(3)(a).
[91] Commission Implementing Regulation (EU) No 964/2014 of 11 September 2014 laying down rules for the application of Regulation (EU) No 1303/2013 of the European Parliament and of the Council as regards standard terms and conditions for financial instruments.
[92] Term sheet: Structure of the financial instrument / Aim of the instrument / State aid implication / Lending/ guarantee/ investment policy / Pricing policy / Programme contribution to the financial intermediary (product details) / Programme contribution to financial instrument (activities) / Managing authority's liability / Duration / Alignment of interest / Eligible financial intermediaries / Targeted results (reporting, monitoring and evaluation) / Final Recipients eligibility / Characteristics of the product for the final recipients / Evaluation of the economic benefit .
[93] Commission Implementing Regulation (EU) No 964/2014 of 11 September 2014 laying down rules for the application of Regulation (EU) No 1303/2013 of the European Parliament and of the Council as regards standard terms and conditions for financial instruments.

10%/40%/60% of the overall amount invested in an SME. Duration of the funds is typically 10 years after the signature of the funding agreement and the equity investment amount is maximum EUR 10 million per SME (including follow-on investments).

4. Loan for energy efficiency and renewable energies in the residential building sector (Renovation Loan) is a loan from the programme contribution to a selected financial intermediary aiming to provide loans to natural persons (final recipients) under a risk sharing arrangement with the financial intermediary. Risk-sharing: 85%/15%, i.e. the financial intermediary shall contribute with its own private fund for a minimum of 15% (at market conditions). The loan maturity is up to 20 years (including grace period) and the loan amount is up to EUR 50 000 per owner.

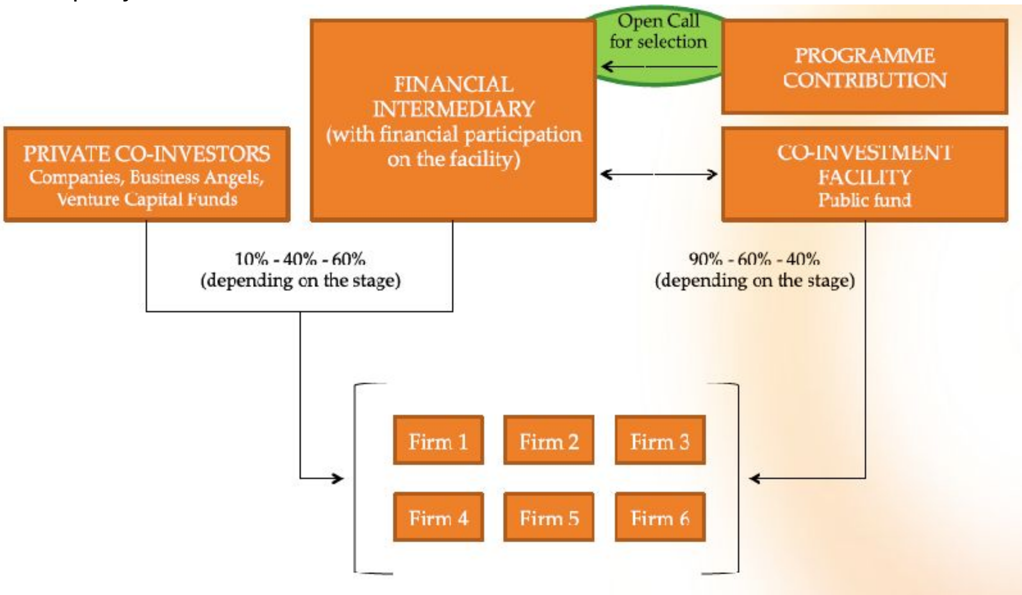
5. Urban development funds will support sustainable urban projects in public transport, energy efficiency or the regeneration of urban areas, for example. Projects must be financially viable and part of an Integrated Sustainable Urban Development strategy. Total investment combining public and private resources can amount to up to EUR 20 million per project. The support will take the form of a loan fund managed by a financial intermediary, with ESI Funds resources and a contribution of at least 30% from private capital.

Source: Author's own compilation

Using off the shelf products may be a good choice, as such products do not have state aid issues as they are fixed FIs complying with the standard terms and conditions[94] laid down by the regulations[95]. Nonetheless, their adequacy to the national/regional economic situation and conditions could be questionable.

Some Member States were considering the use of off the shelf financial instruments. However, according to several opinions (especially MAs in Slovakia and Poland), the implementation rules of some products are not in line with market conditions (e.g. the venture capital product allows for co-investment only, which may make the implementation too complicated – see also figure 18).

Figure 19: Equity Co-Investment FI for SMEs and start-up companies: Off the shelf equity financial instrument



Source: fi-compass, Luigi Amati, Warsaw, 8 March 2016

[94] Optional implementation but mandatory terms and conditions if chosen.
[95] Commission Implementing Regulation (EU) No 964/2014.

Moreover, some Member States reported that understanding and incorporating particular local needs in financial instruments contribute to better take-up. Therefore, they will implement tailor-made products only.

3.3. Tailor-made instruments

In the case of tailor-made instruments[96] the managing authority provides financial contribution to already existing or newly created financial instruments. It may be appropriate when the market needs and the targeted final recipients are very specific and cannot be covered by off the shelf FIs or the MA wants to address an intervention field where a broad experience is already built up and/or no off the shelf is defined yet. The tailor-made instruments serve as the solution when an 'advanced' model of risk-sharing with private and public partners or grant-loan combination (or a broader combination of grants with 'bankable instruments') is envisaged, where a tailor-made instrument is the only way forward.

Box 11: Examples of past experience with revolving finance in RTDI (2007-2013)

Revolving finance in RTDI

The National Capital Fund (NCF) was launched in 2007 in order to fill the equity gap in the market by investing in innovative Polish businesses. The NCF is funded by the Polish and Swiss governments together with the European Union.

The ERP-Startfonds (KfW) in Germany mobilises equity capital for young innovative companies. KfW enters into participation but in most cases it does not assume management tasks within the companies.

The High-Tech Gründerfonds (HTGF) in Germany is to significantly reduce the financing gap for high-tech enterprises in their seed phase and ultimately to contribute to the creation of highly-skilled jobs. The fund also intends to act as an icebreaker for private Venture Capital.

The JEREMIE Innovation fund in Andalusia aims to foster the development of companies with high growth potential, the creation of sustainable and qualified jobs and the facilitation of access to finance through the provision of equity and mezzanine finance.

Source: European Commission, Ex-ante assessment methodology - volume II (research, technological development and innovation) Strengthening research, technological development and innovation 2014.

Common opinion of the interviewees seems to be that tailor-made solutions are the best; they are more complicated to implement though because of the complexity and several times confusing nature of applicable rules (cohesion policy, state aid, public procurement).

3.4. Combined solutions

The CPR makes it clear that more types of combination may be possible[97]:

- combination of different programme contributions and different funds in one financial instrument; and
- combination of financial instruments and grants and other forms of assistance.

The advantage of using the combined solutions can be the achievement of critical mass and economies of scale as well as a wider spectrum of policy objectives.

In the "Guidance for Member States and Programme Authorities on Combination of support from a financial instrument with other support" the Commission presented two types of

[96] Art. 38(3)(b) CPR.
[97] Art. 37(7) CPR

combination of support: within a financial instrument operation (a single operation) and at the level of the final recipient (combination of two separate operations).

According to the guidance, grants as technical support, interest rate subsidies and guarantee fee subsidies can be combined with the FI in a single operation if they are directly related to the FI and target the same final recipients. However, separate records must be kept for each form of support. Alternatively, final recipients supported by an ESI Fund FI may also receive assistance from another ESI Fund priority or programme or from another instrument supported by the EU budget. Yet again, separate records shall be maintained for each source of assistance.

The main criticism Member States have voiced is that the Commission’s guidelines go beyond the scope of the regulatory provisions, e.g.:

- by limiting the grant-component amount only to the financial costs,
- requiring all the capital to be covered by a financial instrument only,
- by introducing an additional condition excluding the possibility to pay any grant component directly to final recipients in the case of combining the grant with a FI[98] or
- by requiring that distinct eligible expenditure has to be defined for combining grants and FIs when the combination is done through two separate operations within the same priority axis, etc.

Several Member States (e.g. HU, PL) do not share the Commission’s interpretation of Art. 37(7) CPR, according to which in case of combining financial instruments with grants, the combined product cannot be managed within one operation. The CPR uses the term "including" for the specifications (interest rate subsidy, guarantee fee subsidy, technical support), which does not exclude other cases such as grant or capital rebate to be used as part of an FI within a single operation. Grants can also be combined with FIs within one operation if - in line with the regulations - they (1) directly relate to the FI and (2) final recipients are the same. According to the legal text, the two types of combination can be separated on the basis of these two conditions and not on the basis of the form of support.

Despite the clear intention of the co-legislators to enable the combination of grants with loans or other FIs in a simple way, avoiding the need to artificially split expenditure into sub-operations, the EC guidelines do not provide any encouragement to use the simplest option, and without proper legal basis they attempt to restrict the combination to only those cases where the option of covering the same expenditure item explicitly provided by Art. 37(9) CPR is not used.

Nevertheless, artificially splitting an investment into two parts with distinct eligible expenditure, one of them benefitting from a financial instrument and the other from a grant is too complex, it destroys transparency, creates audit risks and in several cases it counteracts the whole purpose of combination: it is no longer any real combination, rather two separate streams for two separate sub-investments.

The main advantage of combining FIs with grant support is that it is facilitating the transition from a former grant regime towards revolving FIs and it also gives flexibility in choosing the appropriate mix of grant and FIs, depending on the specific needs of the targeted final recipients and their access to finance. Additionally, there is the effectiveness of EU public spending by promoting and achieving to the extent possible a lower aid intensity than with grants.
As for the combined products, Member States envisage their use, however their introduction has not started yet. Slovakia and Hungary plan to combine grant with loan; the management

[98] “The support is for the benefit of final recipients but it is not directly paid to the final recipient” (point 3.1) - this condition derives neither from Art. 37(7) nor Art. 42(1)(a) CPR.

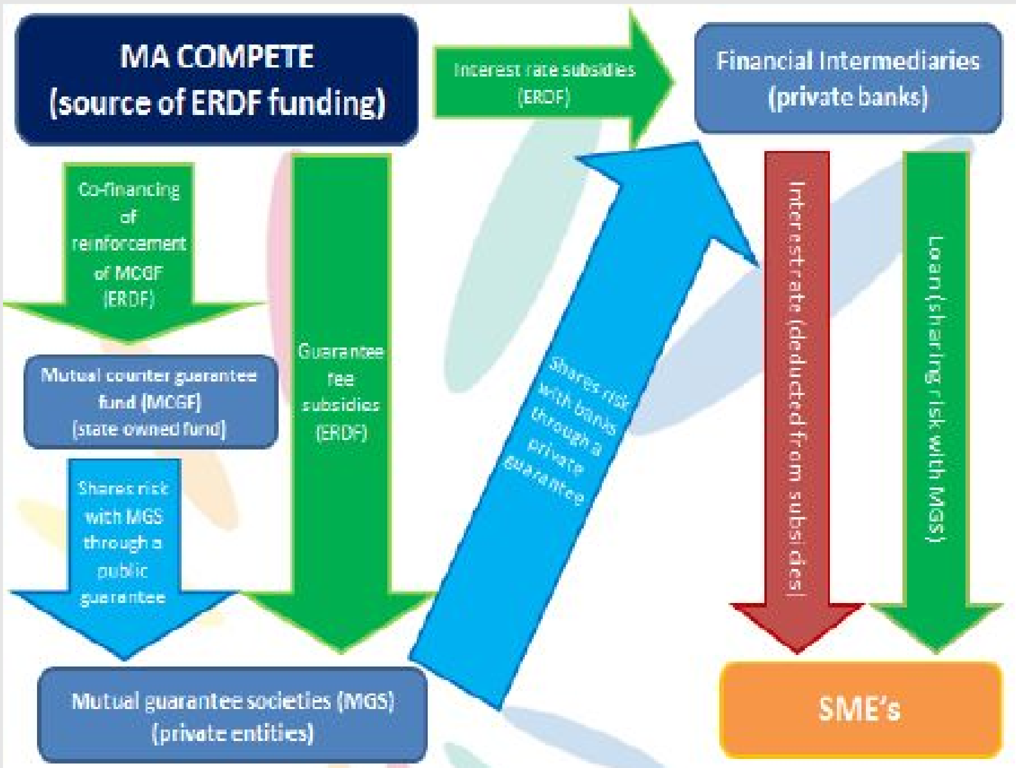
of combined products will be assigned to the fund of funds. Bulgaria plans to combine grant with guarantee, however, decisions have not been made yet.

In case of launching combined products, it should be taken into account that processes should not be much longer and complicated than in case of regular, single-profiled products (direct grants and assistances with revolving nature).

Box 12: Combination success stories

Different type of combinations (in 2007-2013)

The combined microcredit in Hungary is functioning from the state aid point of view under the "de minimis" principle[99]. In the combined scheme, SMEs can get maximum 45% of the project value or 10 million HUF grant, maximum 60% of the project value or 20 million HUF micro credit and they have to contribute with their own resources with 10% of the total investment. The amount of grant cannot exceed that of micro credit and application requirements stipulate that applicants have to make 10 % own contribution available, which cannot be financed by any other subsidized loan. In the decision process, first the loan amount has to be calculated, the amount of 10 % own contribution will be automatically considered and then the remaining gap can be covered as grant in accordance with the conditions of the call. An outstanding advantage of this combined product is that it also develops the financial attitude and business thinking of SMEs through the mandatory use of financial instruments. The admission and assessment of loan applications, the disbursement of loans, and the management of loan accounts were carried out by financial intermediaries in a one-stop-shop system.
In the case of Credit Lines PME Investe I & II in Portugal credit lines are combined with guarantees programmes. The MA COMPETE set up a FEI consisting of a credit line, combined with guarantees, guarantee fee subsidies and interest rate subsidies, according to the following scheme:



MA Compete supports start-ups in 3 regions in Portugal with a Business Angels network (over 200) and their co-investment programme worth EUR 41 million. The Business Angels must bring to the new company 35% of the necessary funds, while MA Compete will make a 10 year

99 Under Commission Regulation (EC) No 1998/2006.

(maximum) loan of 65% of the necessary funds. The repayment ratio between Business Angels and MA Compete will occur in 3 different phases:
- phase A – until Business Angels receive their investment (80-20%),
- phase B – until MA Compete receives its loan back (50-50%) and
- phase C – after MA Compete and Business Angels have received their investment, until the exit strategy occurs (80-20%).
Therefore, phase C will begin when the ROI has achieved a value of 156%. The success of this initiative lies in the fact that the Business Angels are more local to SMEs and more flexible than venture capital funds (which have specific objectives and intervention areas).

Source: F I N - E N Sharing Methodologies on Financial Engineering for Enterprises, Interreg project 2014

4. CLARITY OF PROVISIONS, THE MAIN ISSUES EMERGING AT THIS STAGE OF THE IMPLEMENTATION

KEY FINDINGS

- In the 2014-2020 period there is a more sophisticated regulation and several guidance documents on FIs which are not necessarily in line with Member State practices that have been in place since 2007-2013. There has been a move from under-regulation to overregulation;
- The legislative gap between FIs implemented by the EIB Group and those implemented at Member State level is wide - it is recommended to align the conditions of these two implementation types so that the rules for national FIs also become more flexible;
- State aid rules are an important factor in determining the scope of FIs (exception: EIB/EIF), as they can impose a range of restrictions in terms of the proposed investment strategies – thus the EC should work on harmonising the various sets of rules (ESIF, state aid, etc.) by ensuring common definitions of the terms. Despite the clarity of the provisions in the CPR, in several cases the interpretation is not explicit and there is an apparent need to amend the text of the CPR;
- Requirements in the delegated and implementing acts should be described in a clearer way;
- Risk of "audit freak" of practitioners and final beneficiaries may also lead to inflexible and inefficient use of funds;

In the 2007-2013 period the implementation of FIs was characterised by a great deal of uncertainty: the use of FIs was new in many Member States and the regulatory provisions were fairly limited; MAs had to seek clarification on many elements of the implementation process[100]. Supplementing the regulations with COCOF notes[101] also had repercussions for audit, with the retrospective application by auditors of guidance notes on FIs that had been set up prior to the issue of the guidance. The focus of EC auditors on issues based on grant related audit experiences also created difficulties.

4.1. The Common Provisions Regulation

In designing the new ESIFs, and the associated Common Provisions and Fund specific Regulations, the co-legislators demonstrated the clear intention of ensuring that there is a greater concentration of resources on fewer priorities. The selection of these is clearly linked to the economic challenges of the target area. The operations and instruments implemented are expected to secure more effective impacts and value for money for the EC and Member States, including the development of better working frameworks for managing performance.

The 2014-2020 legislative framework governing the implementation of FIs has also become more complex, with the EU level co-legislators aiming at tailoring provisions and rules better to the specificities of these instruments. The provisions of the CPR are complemented by delegated and implementing acts and guidance documents issued by the European Commission. Clearly, the main difference between the 2007-2013 and 2014-2020 regulations is that in the 2007-2013 period there were short rules of limited scope, and little guidance on Financial Engineering Instruments, which gave a lot of room for manoeuvre for the

[100] Such as specific type of FIs, audit and monitoring issues, public procurement, preparation for closure and State aid etc.

[101] Four COCOF notes on financial engineering instruments from 2007 (COCOF/07/0018/01), 2008 (COCOF 08/002/03) 2011 (COCOF 10/0014/004) and 2012 (COCOF 10/0014/05).

Member States, without legal certainty. In the 2014-2020 period there is a more sophisticated regulation with several guidance on FIs which are not necessarily in line with Member State practices that have been in place since 2007-2013.[102]

The CPR is generally clear and contains well defined and detailed rules, and most lessons learnt in the 2007-2013 programming period have been addressed. On the one hand Member States and MAs generally welcome that the implementation of financial instruments is supported by more detailed legislative rules than in the former programming period. On the other hand FI managers also have several concerns. In their view the regulation is over-complicated and administratively burdensome. The general "feeling" is that there has been a move from under-regulation to overregulation on FIs. The FIs' system in the legislation, especially in the delegated/implementing acts is unnecessarily mirroring grant schemes, a development stemming from the Commission's ideas and interpretation. Accordingly "the burden on the final recipient of the loan is perceived in some Member States as more or less the same as the burden on the beneficiary of a grant in terms of the information required to access the loan and the monitoring of the investment".[103]

The common opinion of the interviewees is that the legislative gap between financial instruments implemented by the EIB Group[104] and those implemented at Member State level[105] is wide. It seems that the rules defined for centrally implemented financial instruments allow more room for manoeuvre and they are less strict.[106] For the more effective and efficient use of FIs in general it is recommended to align the conditions of these two implementation types so that the rules for national FIs also become flexible.

The leverage effect is also an important issue in FIs: one of the expected benefits of FIs is to attract private investment and other public funding, notably thanks to risk-sharing provisions. This is particularly relevant in the context of budgetary constraints or when private investors show restrictions in their risk appetite, constraints in their risk bearing capacity or they are not fully confident in the market and would like to share risks. The private investments have to be aligned with public policy goals. Correspondingly, the important question is whether the FIs are able to attract private sector investors and how the leverage should be measured.

On one hand the difficulty is that costs may be calculated in different ways during the implementation of the OP (total eligible expenditure versus eligible public expenditure), and on the other hand the calculation may be affected by the kind of implementation structure that has been established, by the level of the FIs (holding fund, financial intermediary, final recipients) employed for the calculation of the costs, and furthermore whether the own resources of the final recipients are relevant or not. Contrary to the overall opinion about the adequacy of the provisions in the CPR, the interpretation of the relevant part of the CPR[107] does not offer clarity.

According to the view of several Member States there is an explicit need to improve the text of the CPR. The Commission has applied a restrictive interpretation that under the EU regulation national co-financing cannot be provided by the final recipient[108], which is not really justified:

[102] See e.g. selection of financial intermediaries.
[103] Interim Report on Access to Financial Instruments from the High Level Expert Group on Monitoring Simplification for Beneficiaries of ESI Funds HLG_16_0004_00 22/08/16.
[104] Art. 38(1)(a) and (4)(b)(i) CPR and Art. 39 CPR.
[105] Art. 38(1)(b) CPR.
[106] 100% co-financing rate, call of interest instead of public procurement, exception under state aid regulation, less complicated management (design, tendering, legal, financial, audit, reporting, administrative costs...), etc.
[107] Art. 37(2)(b) and (c), 38(9) and 42 CPR
[108] "the own contribution by the final recipient cannot be declared as eligible expenditure under the financial instrument operation, because in accordance with Article 42(1)(a) eligible expenditure is the payment to the final recipient".

CPR Art. 38(9) explicitly allows providing national public and private contribution at the level of final recipient. The regulation should lay down a definition for the leverage effect of financial instruments which clearly distinguishes between the leverage of private and national public contributions under the OP and/or of additional private or public capital contributions, and takes into account the type of instrument involved, as well. This definition should distinctly indicate how the amounts mobilised by the EU and national public contribution are determined.

In relation to the leverage effect the opposite regulatory approach is present in the reporting method set out the implementing regulation[109]. The provisions are too complex. They request the employment of a detailed breakdown instead of the total amounts and force micromanagement. Yet the rules are still unclear on how the national authorities have to exactly calculate the leverage sums[110]. It is also important to note that the leverage dimension cannot be the only evaluation criteria of FIs, as 'additionality' and the assessment of the contribution to the fulfilment of the EU's political objectives bear outstanding importance.

The reporting requirements for financial instruments are too complex, as well. The model of reporting and interpretation concerning financial instruments, which was modified by the European Commission several times during the 2007-2013 period, significantly complicated the managing authority's efforts to meet reporting obligations. As a result, the European Commission adopted a comprehensive format for reporting on financial instruments under Commission Regulation (EU) No 821/2014 at the beginning of the 2014-2020 programming period. This new framework requires MAs to include a specific report on operations comprising FIs as an annex to the annual implementation report, which is then sent to the Commission. All categories will be obligatory. The first reporting cycle will be in 2016. These information requirements are very extensive[111] and they should be described in a clearer way.[112]

Other articles of the CPR and the delegated and implementing acts on issues linked to FIs (selection, management cost and fees, combination etc.) have been described and commented upon in the previous chapters.

4.2. Guidance on financial instruments

Generally, it is not the legislation on financial instruments that may cause challenges, but their proper implementation. This is due to the fact that:

- in several cases the rules are not consistent and systematic (cohesion policy, state aid, public procurement regulations) and are not always in line with Member States' practices (or with commercial financial logic);
- format of rules is not balanced: there is too much guidance in comparison to the amount of legislation and this leads to misinterpretation of obligations, moreover, some Managing Authority also expressed the view that lack of guidance actually means that the EC does not support the use of certain legal possibilities[113];
- EC's interpretation of the rules is sometimes not traceable, which leads to time-consuming negotiations instead of focusing on doing business;
- practical implementation of rules/guidance based on theory is limited.

[109] Implementing regulation (EU) No 821/2014 Section VIII: Concerning leverage effect point 38.3.
[110] Implementing regulation (EU) No 821/2014 Section IX: point 40.
[111] Implementing regulation (EU) No 821/2014 Section VII.
[112] Implementing regulation (EU) No 821/2014 Annex I lines 6, 39, 40.
[113] E.g: possibility of selection of financial intermediary based on exclusive right pursuant to laws, regulations or published administrative provisions which are compatible with the TFEU (Art. 11 of Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC).

Also the conclusions of the High Level Group on Monitoring Simplification for Beneficiaries of ESI Funds noted that “the guidance provided from the Commission on the subject is extensive but often interprets the regulations in a different way than had been understood by Member States, some of which created more difficulties and questions than they answered”.[114] Furthermore, Member States are still waiting for forthcoming EC guidance,[115] which causes serious delays in setting up and running the FIs.

The situation seems to be the Catch-22 (i.e. a paradox): complex detailed regulation with several guidance makes the implementation overly complicated and administratively burdensome but could provide legal certainty; otherwise in the Commission’s current practice it is the EC auditors who ex post clarify what is regular and what is not, with the possibility to impose financial corrections. Several FI managers and MAs find the circumspection of audit authorities unreasonable. They think that the activities of audit authorities follow those experiences that they gained with grants, however the logic and the implementation of financial instruments is different and therefore evidence should be interpreted differently for loans and risk-sharing instruments, etc. There seems to be a risk of “audit freak” of practitioners and final beneficiaries, which may lead also to inflexible and inefficient use of funds.

The possible solution for the future could be if the Commission would reassure Member States that besides following the clearly defined rules in the regulation, they could have the freedom to act in accordance with the circumstances and conditions of each case. In that case changing auditors’ approach would also be necessary. “Regular, specific seminars for auditors were recommended to address this issue and improve the awareness in 2014-20 before first audits would be carried out”. [116]

A further common challenge is the future use of recycled funds. Member States are still waiting for guidance on the specific requirements for the use of the recycled funds “through the same or other financial instruments, in accordance with the specific objectives set out under a priority”. MAs are confused about what this legal obligation means in practice: whether it also means that investments should be made in the same category of regions, through the same financial product, or whether re-allocation between products (e.g. between loans and risk-sharing products) is allowed if the product aims at the same purpose. According to the interviewed Member States, urgent guidance on this issue – or the declaration that they can use the funds as they consider appropriate – would be important, as re-useable resources from 2007-2013 FIs are becoming available and some Member States already set up a separate fund for reflows. This question is also relevant for the proper implementation of FIs for the 2014-2020 period.

4.3. State aid rules

While funding instruments centrally implemented by the European Commission/EIB/EIF are exempt from state aid procedures, provision of funding under the EU’s Cohesion policy is subject to state aid rules.

In general experience shows that compliance with state aid rules significantly complicates and delays the implementation of cohesion policy. The cause of this phenomenon is that there are inconsistencies in the applicability of state aid rules on cohesion policy cases – e.g.: each set of different rules laid down eligibility criteria for projects

[114] Interim Report on Access to Financial Instruments from the High Level Expert Group on Monitoring Simplification for Beneficiaries of ESI Funds HLG_16_0004_00 22/08/16.
[115] Forthcoming guidance are e.g.: Selection of bodies implementing FIs; Preferential remuneration of private investor; Implementation options; Eligibility in FIs; Reporting on FIs; State aid.
[116] Interim Report on Access to Financial Instruments from the High Level Expert Group on Monitoring Simplification for Beneficiaries of ESI Funds HLG_16_0004_00 22/08/16.

that may be funded -which creates difficulties. Based on this experience a re-occurring question during delivery is whether cohesion policy spending should be exempt from state aid procedures or not.

In practice, the same project may be subject to state aid verification based on the source of EU funding it received rather than based on the nature of the project. From the viewpoint of a project promoter such a situation is incomprehensible. It should be noted, that there have been special rules for EMFF and EARDF financial instruments as well, namely EMFF and EARDF State aid rules are not covered by the present draft Guidance Note[117]. It is recommended to harmonise the competition rules and remove the disadvantages of ESIF spending compared to centrally managed tools.

Figure 20: State aid assessment by type of resource

Types of resources				
ESI Funds resources (in shared management)	National public resources	Directly/indirectly managed Union Funds (e.g. Horizon 2020, COSME or ESI Funds in direct/indirect management)	EIB group own resources (without any risk coverage or other support from Union or national public resources)	EIB group own resources covered by EFSI guarantee
State resources: yes Need for full compliance with State aid rules	State resources: yes Need for full compliance with State aid rules	State resources: no Need to ensure consistency with State aid rules	State resources: no No State aid requirements	State resources: no No State aid requirements
If different resources-types are combined the application of State aid rules is assessed separately for each part				

Source: European Commission, 2016

As shown in Figure 20, state aid is an important factor to determining the scope of FIs, as it can impose a range of restrictions in terms of the proposed investment strategies; state aid compliance needs to be checked for each level of the FI (at private co-investor, at holding fund manager, at financial intermediary and also at final recipient).

[117] Draft Guidance on State aid in ESI Funds financial instruments.

Figure 21: State aid implications of FIs

Common assessment principles for state aid	Ex-ante assessment of FIs (CPR Art.37)
Contribution to a well-defined objective of common interest;	Contribution to the achievement of specific objectives set out under a priority;
Need for state aid intervention;	Analysis of market failure or suboptimal investment situations and investment needs;
Appropriateness of the aid measure; Avoidance of undue negative effects;	Added value of the FI and measures to minimise market distortion;
Incentive effect;	Leverage of additional resources and assessment of the need for and the level of, preferential remuneration to attract counterpart resources from private investors;
Proportionality of the aid;	Proportionality of the envisaged intervention;
Transparency of aid.	Depending on the support scheme the quantified value added may contribute to the assessment of the transparency.

Source: Author's own compilation

An area where difficulties arise concerning the use of financial instruments under the ESI Funds is that financial support from FIs is repayable, which entails also risks of loss arising from the non-repayment. State aid elements are difficult to determine.

To improve the situation for 2014-2020 programming period, the new General Block Exemption Regulation (GBER)[118] contains specific provisions for supporting access to finance for SMEs[119]. The Commission has also adopted new Guidelines on Risk Finance aid[120]. Last, so-called 'off the shelf' instruments (see point 2.1.2 above) have been designed by the Commission to be state-aid compliant on the basis of the so-called de minimis regulation[121]. This regulation does, however, imply significant administrative requirements for the managing authorities.

Regarding State aid rules, the envisaged FI should be either:

- Market-conform; or
- covered by the de minimis regulation (specific de minimis rules for primary production in agriculture and for fishery apply), which means that the support is presumed not to affect competition and trade between MS; or
- covered by the block exemption regulation (GBER, ABER) which defines categories of state aid that are presumed to be compatible and hence are exempt from the notification requirement; or
- if the envisaged FI is set up as an off-the-shelf instrument it is exempt from notification procedures, since the design of such instruments ensures that they do not need to be notified to the Commission; or
- if not covered by a block exemption regulation and hence requires a state aid notification under the appropriate state aid rules as well as approval by the Commission before implementation so as to confirm the compatibility of the aid with the internal market.

The new GBER was issued by the European Commission in 2014 covering Regional Aid, RD&I and the most commonly used sections such as access to finance for SMEs.

118 Commission Regulation (EU) No 651/2014

119 Commission Regulation (EU) No 651/2014 (GBER); main relevant provisions for (ERDF, ESF and CF) FIs:
- Art. 16 GBER Regional urban development aid;
- Art. 21 GBER Risk finance aid;
- Art. 22 GBER Aid for start-ups;
- Art. 39 GBER Energy efficiency in buildings.

120 OJ EU C19/4 22/1/2014.

121 Commission Regulation (EU) No 1407/2013.

This updated GBER has a number of implications for SME finance delivered through the new ESIF programmes including:

- Allowing larger amounts of investment per SME;
- Requesting lower amounts of private sector leverage required at the level of the deal;
- Providing more scope to support mid-caps (up to 500 employees) and in some instances larger companies;
- Making fewer distinctions between assisted and non-assisted areas;
- Restricting risk capital investment to SMEs which have been operating for more than seven years.

A number of these changes have implications for FIs, in particular providing them with greater flexibility to invest larger amounts of finance in growing businesses and across geographies. More important, the seven year rule[122] will have consequences for the extent to which businesses can be supported through risk capital and the GBER does not allow the application of simplified cost rules.

Another state aid relevant issue is that according to both rules (ERDF[123] and state aid) FI cannot support companies which are in economic difficulty: "ERDF shall not support: (d) undertakings in difficulty, as defined under Union State aid rules". However the de minimis regulation does not exclude from the support expressis verbis the undertakings in difficulty, only in specific cases ("if the beneficiary is not subject to collective insolvency proceedings nor fulfils the criteria under its domestic law for being placed in collective insolvency proceedings at the request of its creditors. In case of large undertakings, the beneficiary shall be in a situation comparable to a credit rating of at least B-") (see Box 13).[124]

Accordingly, one legal interpretation is that not all the firms in difficulty are excluded but only those which are excluded by the state aid rules – in the case of this interpretation there is a need to analyse the FIs' state aid basis and in the case of the use of de minimis, it is not necessary to exclude this potential group of beneficiaries. The other interpretation is stating that the ERDF regulation, additionally to state aid rules, prescribes the examination of whether the firm is in difficulty or not. Given the objective that through FIs companies that cannot access commercial/private finance should be supported, this provision seems to be a contradiction.

[122] Art. 21 GBER; in the risk finance SMEs within 7 years from first commercial sale are eligible with lower minimum private investment.
[123] Regulation 1301/2013/EU (ERDF Regulation) Art. 3(3)(d).
[124] Commission Regulation (EU) No 1407/2013 Art. 4(3).

Box 13: Definition of undertaking in difficulty

The definition of undertaking in difficulty, Commission Regulation (EU) No 651/2014

„(18) 'undertaking in difficulty' means an undertaking in respect of which at least one of the following circumstances occurs:

(a) In the case of a limited liability company (other than an SME that has been in existence for less than three years or, for the purposes of eligibility for risk finance aid, an SME within 7 years from its first commercial sale that qualifies for risk finance investments following due diligence by the selected financial intermediary), where more than half of its subscribed share capital has disappeared as a result of accumulated losses. This is the case when deduction of accumulated losses from reserves (and all other elements generally considered as part of the own funds of the company) leads to a negative cumulative amount that exceeds half of the subscribed share capital. For the purposes of this provision, 'limited liability company' refers in particular to the types of company mentioned in Annex I of Directive 2013/34/EU (1) and 'share capital' includes, where relevant, any share premium.

(b) In the case of a company where at least some members have unlimited liability for the debt of the company (other than an SME that has been in existence for less than three years or, for the purposes of eligibility for risk finance aid, an SME within 7 years from its first commercial sale that qualifies for risk finance investments following due diligence by the selected financial intermediary), where more than half of its capital as shown in the company accounts has disappeared as a result of accumulated losses. For the purposes of this provision, 'a company where at least some members have unlimited liability for the debt of the company' refers in particular to the types of company mentioned in Annex II of Directive 2013/34/EU.

(c) Where the undertaking is subject to collective insolvency proceedings or fulfils the criteria under its domestic law for being placed in collective insolvency proceedings at the request of its creditors.

(d) Where the undertaking has received rescue aid and has not yet reimbursed the loan or terminated the guarantee, or has received restructuring aid and is still subject to a restructuring plan.

(e) In the case of an undertaking that is not an SME, where, for the past two years:

(1) the undertaking's book debt to equity ratio has been greater than 7,5 and

(2) the undertaking's EBITDA interest coverage ratio has been below 1,0.

The conclusions of the High Level Group on Monitoring Simplification for Beneficiaries of ESI Funds also recommend that "follow-up investments in firms that have become a firm in difficulty only after the first ESIF-investment should be permitted if all other private investors are equally willing to invest further". [125]

From the procedures point of view, it is recommended to establish the possibility of using a single approval form for FI schemes (state aid, ESIF) by the European Commission or to enable that the approval of tailor made instruments by DG REGIO incorporate state aid assessment and approval by DG COMP, and inversely. At present, if the Member State receives an EC decision (DG COMP) on state aid notification of an FI with all the technical details of implementation included, DG REGIO auditors could still state irregularity ex-post referring to the fact that DG REGIO was not in charge of the examination and decision-making.

[125] Interim Report on Access to Financial Instruments from the High Level Expert Group on Monitoring Simplification for Beneficiaries of ESI Funds HLG_16_0004_00 22/08/16

It is recommended to unify the various sets of rules (ESIF, State aid) as eligibility bases, and to use identical terminology for each category of costs (operating costs, investment costs, overheads, wage costs, etc.). This should include harmonising the state aid-ESIF rules and also ensuring common positions in the various directorates-general of the European Commission (DG REGIO, EMPL, COMP, etc.), as well as common definitions of terms.

CONCLUSIONS

The overwhelming evidence from the information and data collected through audits, reviews and evaluations of financial instruments that are used to provide finance in response to market failure shows that FIs can be very effective and efficient tools for achieving the underlying goals. Repayable grants and FIs have a beneficial impact on project preparation, in particular in terms of quality. The obligation of repayment is a clear motivation for better planning. However grants are still more appropriate for those projects where financial returns are not realistic or rather limited. Also projects realised in underdeveloped areas are justified to receive grant assistance.

Financial instruments are amongst the most complex funding instruments, with significant risks if they lack adequate planning and delivery mechanisms.

Figure 22: Risks affecting the performance of FIs

Risk category	Examples of types of risks
Executive and governance risk	Lack of commitment, support or sponsorship; insufficient alignment with other initiatives;
Management risk	Insufficient project/programme management; unsatisfactory planning, monitoring or controls; inadequate scope; or inappropriate decision-making process;
Financial risk	Credit risk (defaulting loans or mezzanine loans, defaulting underlying loans covered by guarantees), counterpart risk (final recipient or financial intermediary), treasury risk, or operational risk, costs of the FI;
Organisational risk	Inadequate organisational alignment; change management; insufficient communication; lack of competences; insufficient staffing; lack of training; ineffective business continuity plan; or IT risks (related to hardware, software, security, availability, disaster recovery, etc.).

Source: Author's own compilation

The 2014-2020 cohesion policy regulations indeed addressed the issue of legal uncertainty, a major problem in the previous period. However, following the new legal provisions and the European Commission's legal interpretations, despite the co-legislators' intention of simplification and flexibility, there are still problems in the implementation: lack of adequate regulations (2017-2013) has now been replaced by overregulation and the logic of grants management is felt to have prevailed in many areas of FI rules (e.g. transaction based audit, monitoring and reporting system; unmanageable amount of indicators coupled with interpretation problems).

The level of details, especially the provisions set forth in the form of guidance makes difficult to implement the rules. Fear of observations from auditors seems to have driven both overregulation and restrictions (audit experience suggests that it is better to prescribe everything than argue with auditors at a later stage). Less regulation laying down the fundamental criteria would be more useful. "New requirements should not be imposed without taking into account the differentiation of particular forms of financial products and the fact, that certain provisions applicable to one product may not be applicable to other ones. For the final recipient, the process for accessing the financial instrument should be simpler than receiving a grant, especially for SMEs, and similar to the requirements for other types of financial products from public and private sources, otherwise there will not be an incentive for final recipients to apply for and use financial instruments".[126]

[126] Interim Report on Access to Financial Instruments from the High Level Expert Group on Monitoring Simplification for Beneficiaries of ESI Funds HLG_16_0004_00 22/08/16.

While, the obligatory ex-ante assessment has proved to bring added value; the comprehensive review serves as a strong encouragement to address inconsistencies, controversies, outstanding issues, etc. The exercise has improved the quality of FI planning.

Furthermore, the introduction of off the shelf instruments has been a good initiative providinge standard terms and conditions compatible with ESI Funds regulation and state aid rules but they do not always fit to market needs. One important limitation is that combination with grant assistance is missing from the instruments.

FIs as market tools have to comply with the complexity of ESIF, state aid, public procurement and financial rules and regulations. The flexibility by the EU level regulations, namely more favourable implementing conditions of EU level instruments vis a vis tailored instruments implemented nationally is far from being justified. “Certain privileges that seemed to be offered to the EIB in terms of entrustment of implementation tasks or application of state aid rules should also be offered to Member States or national banks or other public institutions when managing ESI Funds”.[127]

The use of public procurement instead of open call for the selection of financial intermediaries is a major hindering factor for the establishment of FIs at national level.
“To facilitate and accelerate implementation of financial instruments, Member states and the Commission should take the advantage of CPR and CDR[128] provisions as regards the selection of bodies implementing financial instruments and select them through open, transparent, proportionate and non-discriminatory procedures, preventing conflicts of interest. Public procurement should not be the primary procedure for selection of such bodies”. [129]

The demand for uniform standards and management methods of the new FIs is, in several cases, pushing the delivery structure towards different solutions than what was done before. This new direction using centrally defined unified solutions could be a good way forward; nevertheless clear rules and strong methodological guidance – or clear decision on more flexibility – are needed.

However, even with the change of the FI architecture, the incorporation of experiences is very important and the need for expertise and administrative capacity is crucial. Administrative capacity at all levels, including at the EC level is needed as the combination of knowledge on cohesion policy implementation and banking experience is rather rare. Accordingly, the challenges to be faced require more and highly qualified human resources.

Increased coordination among the Member States and dissemination of information on good practice, problems and solutions, etc. would be useful and more emphasis should be placed on producing and making available for the Member States summary documents, and other comprehensive information.

[127] Interim Report on Access to Financial Instruments from the High Level Expert Group on Monitoring Simplification for Beneficiaries of ESI Funds HLG_16_0004_00 22/08/16.
[128] Commission Delegated Regulation (EU) No 480/2014.
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Annex 1: Case Studies

1. POLAND

In Poland in the 2007-2013 period the FI allocation was EUR 1.1bn (1.6 % of total allocation), two OPs at national level contained FIs in the form of 'Technological loans' or Venture Capital (VC) funds:

1. Operational Programme Innovative Economy (OP IE), 5.6% of the OP allocation was dedicated to FIs, 4.8% coming from the ERDF
2. Operational Programme Development of Eastern Poland (OP DEP), just over 1% was allocated to FIs (measure 1.2.) and just under 1% was financed by the ERDF

FIs were also included in the 16 Regional Operational Programmes (ROPs): 5 were implemented under the JEREMIE initiative, whereby in four cases the programme manager is the BGK and in one region it is the Kuyavian-Pomeranian Loan Fund Ltd.

Detailed rules for the implementation have been determined by the Managing Authority, so when selecting financial intermediaries to participate, the fund manager's role is essentially to assess the business plan presented (including these target values). In the remaining 11 regions, they have been operated by financial intermediaries directly selected by the Managing Authorities (without a holding fund) and have taken the form of loans and loan guarantees for SMEs. All fund managers were recruited from the region in a competitive, transparent procedure of calls for applications and all fund managers have been public, having previous experience in managing EU funded FIs.

JESSICA funds, which also operated at the regional level, have been implemented through agreements signed with the European Investment Bank (EIB) on the financing of such funds.

To sum up, in 2007-2013 BGK served as the Holding Fund Manager in respect of the OP for the Development of Eastern Poland (central OP for 5 regions). It has been involved in the implementation of FIs at regional level by delivering the JESSICA Initiative (3 regions) where BGK has operated the Urban Development Fund and has also served as the Holding Fund Manager in JEREMIE (6 regions). BGK has also played an important role as a national Holding Fund Manager in respect of FI schemes using the ESF, i.e. the Financing Scheme for Entities in the Social Economy through the Human Capital OP and in respect of the ERDF (Holding Fund Manager in Guarantee Fund for the OP "Innovative Economy") and lastly as an Implementing Agency for Technology Credit (a "hybrid instrument").

In the 2014-2020 programming period a large part of Poland's ESIF allocation (EUR 3.4 billion) will be used for financial instruments mainly aimed at:

Regional Development EUR 1.7 BN (Loans, Guarantees, Equity)

- smart growth 1.1bn EUR (loans, guarantees, equity);
- infrastructure and environment 556m EUR (loans); and
- knowledge education development 36m EUR (loans, guarantees).

The ex-ante assessments for most 2014-2020 OPs have already been completed. They confirmed the financial gap mostly for micro-enterprises and gave justification for the implementation of FIs in SME support and urban projects (as in 2007-2013) but also in new areas such as: energy effectiveness, renewable resources of energy, employment or labour mobility.

The analyses recommend the combination of FIs with grants, but they also realize that under strict and rigid EU rules it may be difficult.

Table 10: Envisaged FI allocation within OPs 2014-2020 (based on ex-ante assessment)

Funding source (OP and ESIF)	Envisaged ESIF allocation (m EUR)	ESIF + national public or private co-financing (m EUR)	Thematic objective (TO)	With a FoF or without a FoF	Envisaged financial products
16 Regional Operational Programmes (ERDF and ESF)	1 727	1 985	TO 1, 3, 4, 8, 9, 10	some with FoF some without FoF	loans, guarantee and perhaps equity
Infrastructure and Environment OP (ERDF and CF)	556	654	TO 4	FoF	loans
Smart Growth (ERDF)	1 095	1 260	TO 1 and 3	FoF	loans, guarantees and equity
Knowledge Education Development (ESF)	36	42	TO 9	FoF	loans and guarantees

Source: Ministry of Economic Development, Poland 2016

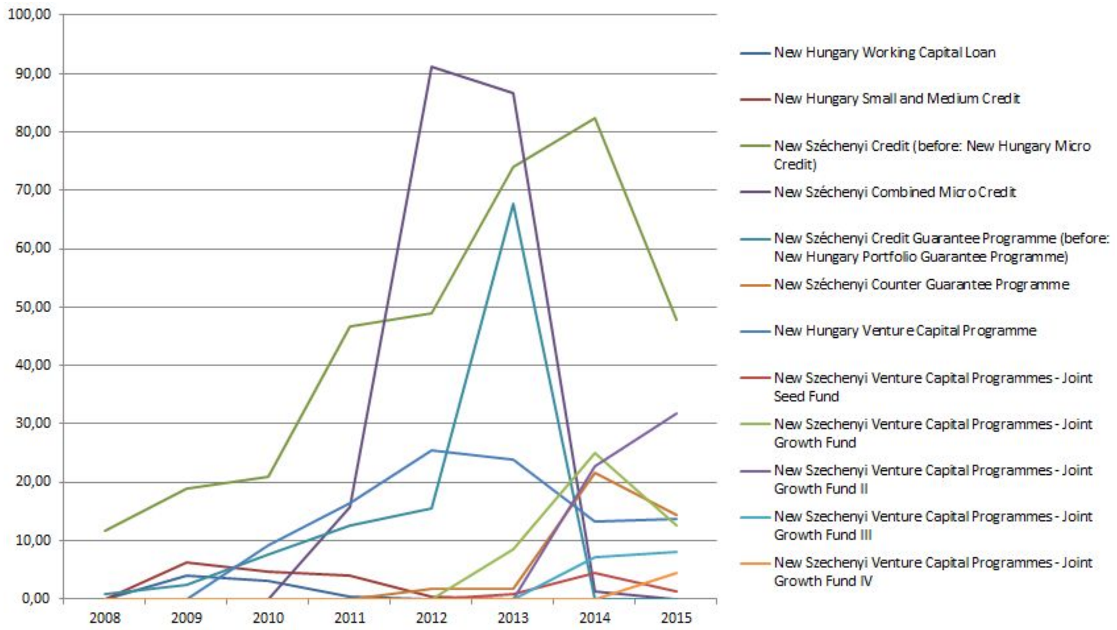
For the implementation of 2014-2020 FIs in Poland no final decision has been made so far, primarily because of the several open and problematic issues on selecting the financial intermediaries. BGK hopes to be able to continue implementation of similar schemes, nonetheless the decision-making process is still ongoing. The only decision that has been taken so far was to replicate the structure of loan for social economy entities with BGK acting as the holding fund manager.

2. HUNGARY

In the 2007-2013 programming period Hungary decided to use FIs in order to provide access to finance for SMEs. According to programme documents and AIR 2013; the main objective of FIs was to overcome the limited access of finance on the market, moreover the idea of introducing financial instruments was strongly driven by the assumption that FIs may represent more efficient forms of SME supports than grants. The total amount of FIs set up in percentage of the ERDF support was around 6%[130] and mainly the Economic Development Operational Programme financed FIs[131].

Until the end of 2011, only 27.91% of the FIs sources had been disbursed to final recipients, but the absorption of resources largely accelerated in the second half of the programme period. The New Hungary Joint Fund (27.62%), the Combined Microcredit (24.85%) and the New Széchenyi Loan (18.14%) were the top three “products” with the highest share of the allocated funds.

Figure 23: Absorption process of the different Hungarian FIs



Source: author’s own compilation, data from Fontium, Hungarian Development Bank 2016.

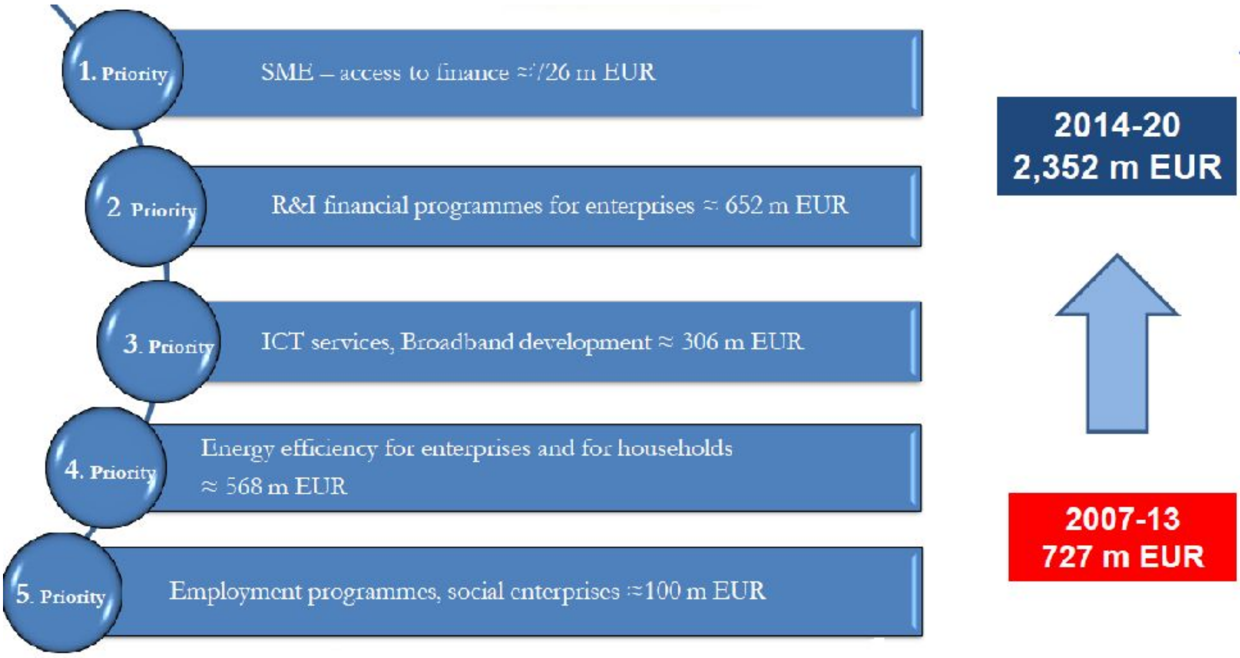
Although Hungary was severely hit by the economic and financial crisis, the economy began to recover in 2014. Nevertheless, there are still significant gaps in respect of the national Europe 2020 targets. The innovation activity and competitiveness of SMEs are weak. There is a need to increase R&I spending and the use of renewable energies, and to improve energy and resource efficiency. Significant inequalities remain at regional and sub-regional level, and rural areas are also lagging behind.

As a result of this situation in the 2014-2020 period 60 % of all ESI Funds will be dedicated to economic development and job creation. With an allocation of EUR 2.3 billion, Hungary is almost tripling its allocation to financial instruments compared with 2007-2013. The use of FIs will be expanded to RD&I, energy, ICT and the social economy.

130 The financial allocation of the Economic Development Operational Programme 4th priority (financial instruments) was increased by 3% in 2009 through Operational Programme (OP) modification.

131 Economic Development Operational Programme 2007-2013. CCI number: 2007HU161PO001. http://www.nfu.hu/umft_operativ_programok.

Figure 24: Indicative proportion of financial instruments



Source: Ministry of National Economy 2016

In the 2014-2020 programming period Hungary is planning to use FIs for all thematic objectives. The relevance of this financing vehicle is not yet tested for all the objectives. Nevertheless, FIs are appropriate in those policy areas where envisaged projects promise sufficient financial returns and beneficiaries have achieved the necessary level of financial literacy and are not appropriate in policy areas where the financial return for projects is zero or very low, beneficiaries lack financial literacy skills and/or cannot offer collateral.

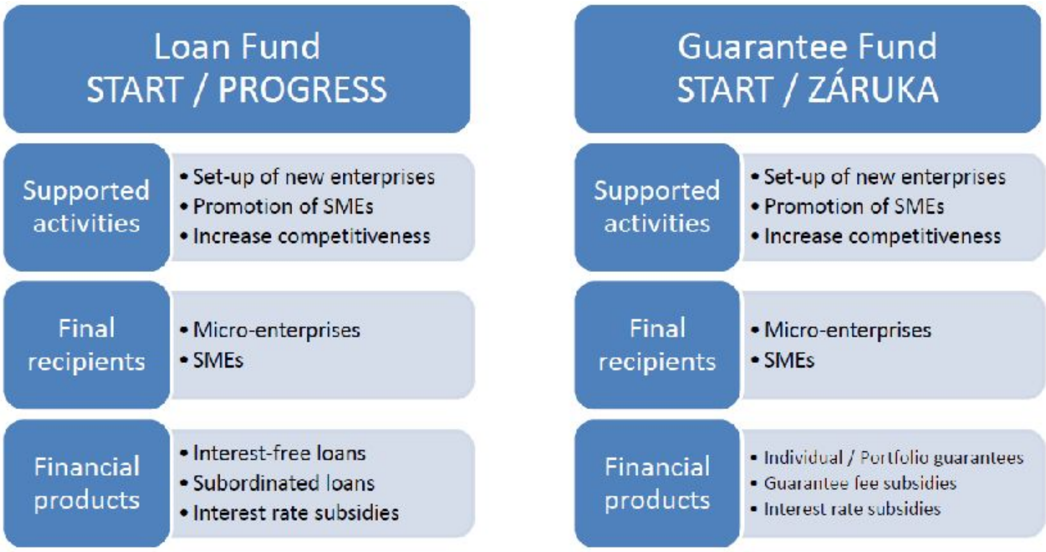
For the implementation of FIs the Hungarian Development Bank is designated as fund of funds manager based on the MFB Act[132], Government Decree stating the tasks of the organization in the EU funds management[133] and also on Art. 11 (Service contracts awarded on the basis of an exclusive right) and Art. 12(4) (Public contracts between entities within the public sector) of Directive 2014/24/EU.

[132] Act XX of 2001.
[133] Government Decree 272/2014 (5 November).

3. CZECH REPUBLIC

In the 2007-2013 period the following forms of FIs were in use in the Czech Republic for enterprise support: Loan Fund, Guarantee Fund and Venture Capital Fund, in three (sub)programmes (START, GUARANTEE and PROGRESS). Altogether approximately 10% of Operational Programme Enterprise and Innovation has been allocated to these 3 (sub)programmes.

Figure 25: Loans and Guarantees



Source: Ministry of Industry and Trade of the Czech Republic 2015

In the Czech Republic the use of FIs dates back to the 1990´s and since then the Czechomoravian Guarantee and Development Bank (ČMZRB), serving as a professional body operating as an "implementing agency" under the supervision of the Ministry of Industry and Trade, has been charged with operating these FIs. However, there was a dispute concerning legal issues over the implementation mode of FIs between the Managing Authority and the European Commission because ČMZRB as intermediate body had not been selected via public tendering procedure, but had been appointed directly by the MA as a state-owned bank with a long history of national funded FIs. Even though the Czech funds were among the first to be set up, uncertainties surrounding the precise requirements contributed to a suspension of the funds upon request by the EC auditors[134].

Despite these delays caused by EC stopping the OP, the financial performance of FIs is good: 90% of the planned volume of funds has been paid to FIs, of which 91% has already been disbursed to final recipients.

According to JESSICA investment strategy in ROPs, sustainable urban development projects have been supported via low interest loan. The implementation was based on EIB's gap assessment and feasibility study (PwC) and on a funding agreement with the EIB. A holding fund (507 million CZK) had been created and then the EIB procured UDFs (ČMZRB, Contera).

[134] ČMZRB was not selected in accordance with the Public Procurement Act, but was appointed for providing guarantees in accordance with Czech Law. According to the EC auditors, it was non-transparent and in conflict with EU legislation in the field of public procurement (despite the fact that Czech Law No 47/2002 Coll., on support of SMEs, as amended, as a public law expressly entitles ČMZRB as an entity that is authorised to provide funding, guarantees or loans with reduced interest rates, essentially to allow the use of public funds for this purpose through other entities). The EC also disagreed with the management fees. According to the EC's observation, management fees were paid indirectly by contributing to the price of the guarantee while the EC challenged this setup. Provision of guarantees from the Guarantee Fund was suspended for over two years because of these issues.

In accordance with the IOP as a JESSICA initiative for modernisation/reconstruction of (multi)apartment buildings a holding fund (609 million CZK) had been established and in 2013 via procurement Komerční banka as financial intermediary was selected.

In the 2014-2020 programming period around EUR 763 million under cohesion policy programmes are planned to be channelled through financial instruments. This more than doubles the amounts available in the previous programming period. The main areas of intervention are support for SMEs, transport infrastructure, investment in energy efficiency and, to a lesser extent, resource efficiency.

The planned financial instruments (10 % of total OP allocation, EUR 431 million) are based on ex ante assessment. It includes an expansion: EUR 327 million of loans and guarantees, access to finance for SMEs and also energy savings in enterprises and energy savings in heat supply – financial instruments for energy efficiency – EUR 31 million.

The implementation is planned mainly in cooperation with ČMZRB, but also an investment platform “National Innovation Fund” (NIF) is being created in close cooperation with EIF and EIB in order to operate innovative, equity financial instruments for pre-seed, seed and start-up funding. The Czech Authorities intend to invest EUR 40 million in cooperation with the EIF (EIB would add another EUR 10 million), EUR 25 million directly via NIF, out of which EUR 12 million will be available for Proof-of-Concept projects (for commercialization of research and development) and EUR 13 million for start-ups in seed stage.

The central management of financial instruments and activation of national development bank ČMZRB - creation of a central fund of funds available to all operational programmes -are currently under discussion.

NIF shall be the central implementation body for those Managing Authorities which opt in transformation of ČMZRB: ČMZRB will become shareholder of NIF through a capital increase of ČMZRB (CZK 2.5 billion) via the law on ČMZRB as national development bank.

4. SLOVAKIA

In the 2007-2013 period the total allocation of financial resources for JEREMIE amounted to EUR 100 million, provided by the Operational Programme Bratislava region (OP BK), OP Competitiveness and Economic Growth (OP CaEG: EUR 67 million on two instruments FLPG and PRSL) and OP Research and Development (OP R&D). The JEREMIE initiative was governed by the EIF via the Slovak Guarantee and Development Fund (SGDF). The SGDF shareholders were Slovenská Záručná a Rozvojová Banka (SZRB) and EIF on behalf of the Slovak government until its exit at the end of 2015.

In August 2011, the EIF launched an open competition (Call for application submission) to select the most appropriate financial intermediaries for providing loan guarantees to SMEs (First Loss Portfolio Guarantee Financial Instrument). In January 2012 the EIF launched a second open competition (Call for application submission) for risk capital financial instruments. The eligible applicants were financial intermediaries which should invest in SMEs. According to MAs the delay of establishment of FIs was caused, besides the lack of experience, by the difficult and time consuming negotiations between the EIF and the relevant national authorities.

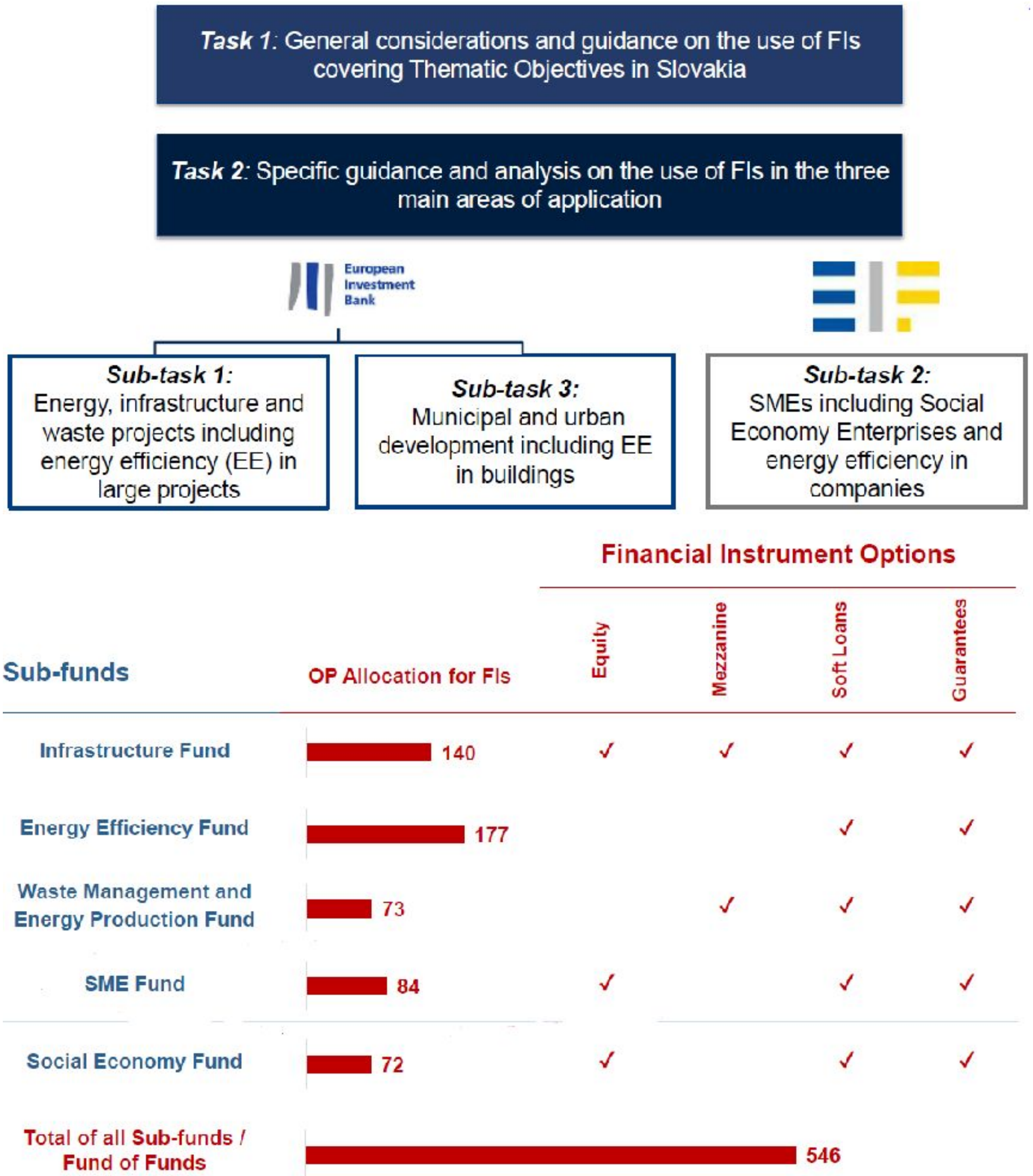
In the 2014-2020 programming period the use of financial instruments is planned to increase more than fivefold from the initial allocation in the previous programming period and will reach around EUR 455 million. Most of the support will go to SMEs, energy efficiency and environmental and transport infrastructure. The scope should be explored for extending instruments to R&I and ICTs, including broadband infrastructure.

A wider use of FIs in the 2014-2020 period is planned and also more OPs will participate. As an interesting novelty, the government decided to use a new structure of FI implementation under the responsibility of the Ministry of Finance, without EIF, but establishing an SPV (Slovak investment holding) with multi-instrumental portfolio and common decision-making process across OPs involved. The proposed FI structure is based on the ex-ante assessment drafted by PwC under the supervision of the EIB.

The main goal of the ex-ante assessment was swift and efficient start of implementation. The Technical Assistance Services Agreement with the EIB was signed on 5 March 2014 to deliver a study in support of the ex-ante assessment. The study was drafted by PwC at the instruction and under the supervision of the EIB[135]. One obstacle was that the methodology for the ex-ante assessment was only approved in July 2014.

[135] Source: Martin Polonyi, Ministry of Finance, Slovakia

Figure 26: Ex-ante assessment in Slovakia: kick off



Source: Ministry of Finance of the Slovak Republic 2016

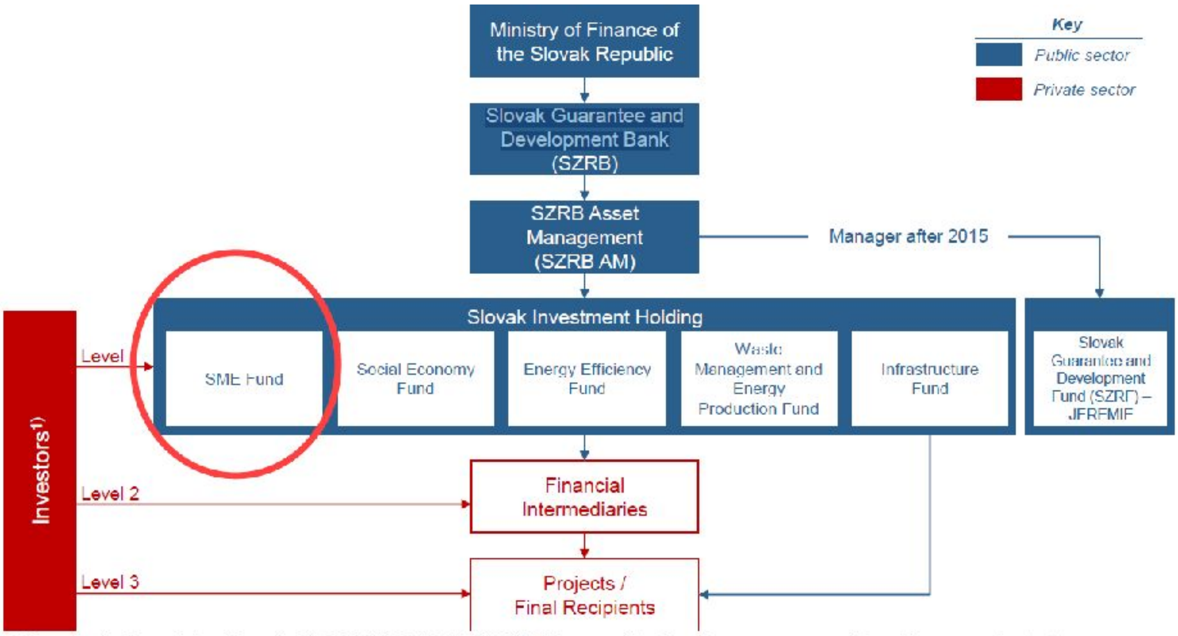
Based on the ex-ante analysis the Ministry of Finance of the Slovak Republic proposed a new initiative to support national investment-priorities with a centralised and more efficient implementation of ESIF via financial instruments: min. 3% ESIF allocation from each OP (approx. EUR 546m expected total allocation) through a fund of funds mechanism by SZRB Asset Management as manager.

On the implementation the Ministry of Finance proposed a new initiative[136]: the Slovak Investment Holding (SIH) should become a fund of funds, an umbrella fund structure is to be used for channelling the use of financial instruments in Slovakia. The SIH has to function as an integrated, long-term support system for national investment priorities using different kind of sources (minimum 3% of the ESIF allocations for each operational programme except OP TA, approximately EUR 450 million, international financial institutions, private investors, recycled JEREMIE funds, etc.).

[136] Mandate in Government Resolution no. 736/2013.

The SZRB Asset Management (SZRB AM)[137] should act as the fund manager of SIH. Through centralisation of expertise with management of financial instruments efficiency gains and a streamlined strategy avoiding overlaps are expected.

Figure 27: FI institutional structure in Slovakia for 2014-2020



Notes: 1) Potential co-financing IFIs: EBRD, EIB, CEB, KfW, IIB; potential private investors: commercial and investment banks & equity investors

Source: Ministry of Finance of the Slovak Republic 2016

[137] Subsidiary of the Slovak Guarantee and Development Bank; supervised by the National Bank of Slovakia.

5. ITALY

In the 2007-2013 programming period the use of FIs was extensive: eighteen out of 21 regional operational programmes and 3 national operational programmes applied FIs. In the Regional Employment and Competitiveness objective areas, 14 regions out of 17 set up one or more FIs as part of their Regional OP (ROP) ERDF and all 4 Convergence objective regions also set up a fund in the context of their ROPs. These FIs mostly concern enterprise support (4 based on the JEREMIE initiative) while FIs for urban development (based on JESSICA) were introduced by only three regions (Sicily, Campania, Sardinia), but no intervention was actually implemented. The majority of existing FIs was guarantee funds and to a more limited extent loan and Venture Capital (VC) initiatives.

The large majority of FIs for enterprise support was implemented without a holding fund and 61 of the FIs constituted specific funds. Holding funds were used by seven OPs with a total of just 12 FIs. This indicates the very limited number of FIs under each holding fund as only holding funds in OP 'Campania' and 'Latium' had more than one. Interestingly, OP 'Calabria', OP 'Latium' and OP 'Lombardia' set up both FIs and specific funds, suggesting the need to adopt different implementation mechanisms to address local enterprise needs.

Managing Authorities highlighted that in the 2007-2013 period for FIs managed by the Holding Funds the implementation procedures were delayed partly by unclear EU regulations, partly by problems which occurred in the course of concluding contracts with the European Investment Fund and European Investment Bank. Also, an important impediment was the belated selection of intermediaries by EIF. On the other hand there was a long delay in selecting the managing authorities and in signing agreements with the banks to implement finance operations. This was caused by the lack of familiarity of the Italian public administration with FIs and their shortage of capacity to adapt an existing scheme to the EU regulations. Moreover, the banks failed to define internal procedures in time and to adjust their information systems appropriately. MAs exerted some degree of control or influence over the way the funds set up by FIs was allocated. This happened through participation in technical selection or management committees (e.g. in the case of VCs or CGFs) or it was limited to the FI tender specifications that require the managers of a fund to apply certain criteria and procedures for selecting beneficiaries and allocating resources.

In the 2014-2020 period around EUR 2.187 million will be delivered through financial instruments, in particular for SMEs and innovation and to a lower degree for energy efficiency as well as employment and labour market. This amount, supplemented with legacy resources from the previous programming period, is consistent with the investment strategies of the various programmes and with the absorption capacity demonstrated in the 2007-2013 period. Further opportunities to widen the scope and/or increase the volume of resources allocated to financial instruments will be explored as part of the outcome of the on-going ex ante assessments.

For the implementation of FIs, Italy intend to use the two already existing Holding Funds, created under the JEREMIE Program (Campania and Lombardy). Two additional JEREMIE Holding Funds managed by EIF are expected to be created: Sicily and Calabria. Finlombarda is the manager of the JEREMIE Holding Fund Lombardy, the others are/will be managed by the EIF.

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6. IRELAND

In the 2007-2013 programming period financial instruments in the form of refundable aid and shares co-funded by ERDF, while on a modest scale, have been used extensively throughout Ireland to support micro-enterprise development in the case of companies employing less than ten people. These can usefully be referred to as “quasi financial engineering instruments” since they do not contain any leveraged private equity funding. They are managed by County and City Enterprise Boards (CEBs)[138] and a special CEB Co-ordination Unit in Enterprise Ireland under the government Department of Jobs, Enterprise and Innovation. The main funding was provided under Ireland’s National Strategic Reference Framework 2007-2013 through the Innovation ICT & Knowledge Economy Priorities of the Micro-Enterprise, Innovation and Entrepreneurship Themes of the two Irish Regional Operational Programmes. A number of publicly-supported schemes are also present in the country: including the Seed and Venture Capital Scheme and the Innovation Ireland Fund initiated by Enterprise Ireland and managed by the private sector, as well as the Western Development Investment Fund under the auspices of the Western Development Commission. In April 2012 the government adopted legislation to establish a new the Credit Guarantee Scheme, designed to provide credit to job-creating SMEs struggling to obtain finance from the banks. Legislation was also published in June 2012 to establish a Micro-enterprise Loan Fund Scheme.

The economic downturn has significantly changed the condition of the implementation of the FIs and suggests the need for a fresh examination of these instruments. Imaginative loan, equity and share schemes co-funded by ERDF, EIB and other financial institutions could play a key role in dealing with the current difficulties.

Against this backdrop Ireland is considering using ESIF supported financial instruments in the 2014-2020 period for SME development, to address price volatility in the agricultural sector, and potentially also for energy efficiency in social housing.

It is outlined in Ireland’s Partnership Agreement that the wider EU SME Initiative proposed by the EIB was considered as a financial instrument to be co-financed. In early 2014, the Departments of Public Expenditure & Reform, Finance and Jobs, Enterprise and Innovation held exploratory discussions with the Commission, EIB and EIF concerning possible participation by Ireland. The relevant Departments undertook the necessary market testing to examine the level of interest and capacity of prospective financial intermediaries to participate in this initiative. The outcome of these investigations suggests that, at this stage, Ireland is not participating in this initiative but the use of this initiative is not ruled out a later stage in the programming period.

An evaluation study[139] was conducted by PwC and Arup between November 2012-June 2013 on behalf of the European Investment Bank, European Commission and the Department of Public Expenditure and Reform into the prospective demand, potential thematic focus, potential financial instrument architecture and size of the fund. The study found that, based on indicative projects that had been submitted, there would be potentially suitable projects in the categories of Resource Efficiency and Innovation, with the Resource Efficiency theme composed of three sub-themes, namely Greener Social Housing, Energy Efficiency and Waste-to-Energy. The study concluded that the implementation of a financial instrument in Ireland could provide significant advantages and a valuable source of finance to take forward projects related to these strategically important themes and that there was considerable appetite from partners to investigate the opportunity presented by a financial instrument. The invitation to submit projects identified a strong current demand for a financial instrument in Ireland particularly with respect to the Resource Efficiency thematic objective and a financial instrument could help fill an identified market gap.

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[138] A Network of 35 CEBs play a key role in financing, mentoring and supporting microenterprise throughout the country in both BMW and S&E regions.

[139] Border, Midland and Western Regional Operational Programme 2014-2020 and Southern & Eastern Regional Operational Programme 2014-2020

Based on the above mentioned study a Resource Efficiency financial instrument in the order of €120-150m would be a sufficient size to support implementation of the initiative, while a much larger fund would be required to support the demand if a Social Housing Retrofit project is included. A potentially suitable vehicle to be co-funded was identified in the national energy efficiency fund. Separately, Ireland has established a commercial Energy Efficiency Fund to target energy efficiency improvements in the non-residential sector. However, as the procurement process had already been completed it is not possible for it to retrospectively comply with the EU Procurement requirements specific for FIs.

The potential use of financial instruments will be kept under review and ERDF OPs in 2014-2020 will introduce financial instruments where possible during the implementation.

For the implementation of FIs, the Strategic Banking Corporation of Ireland (SBCI) has been founded in September 2014 as limited company owned by the Minister of Finance. SBCI intends to be an innovative, counter-cyclical support mechanism offering the Irish financial market longer term financing and risk sharing mechanisms that create additionality and do not displace natural commercial activity. It should be a common platform and related channels to market, and accessing risk capital through co-ordination of approach with current Irish Credit Guarantee Scheme and from European schemes (COSME, Innovfin, EFSI, ESIF) is also a goal of SBCI. A central function focused on ensuring the most benefit is obtained from EU resources by combining programmes into single measures in Ireland.

Table 11: SBCI Approach for 2016: Products and Delivery

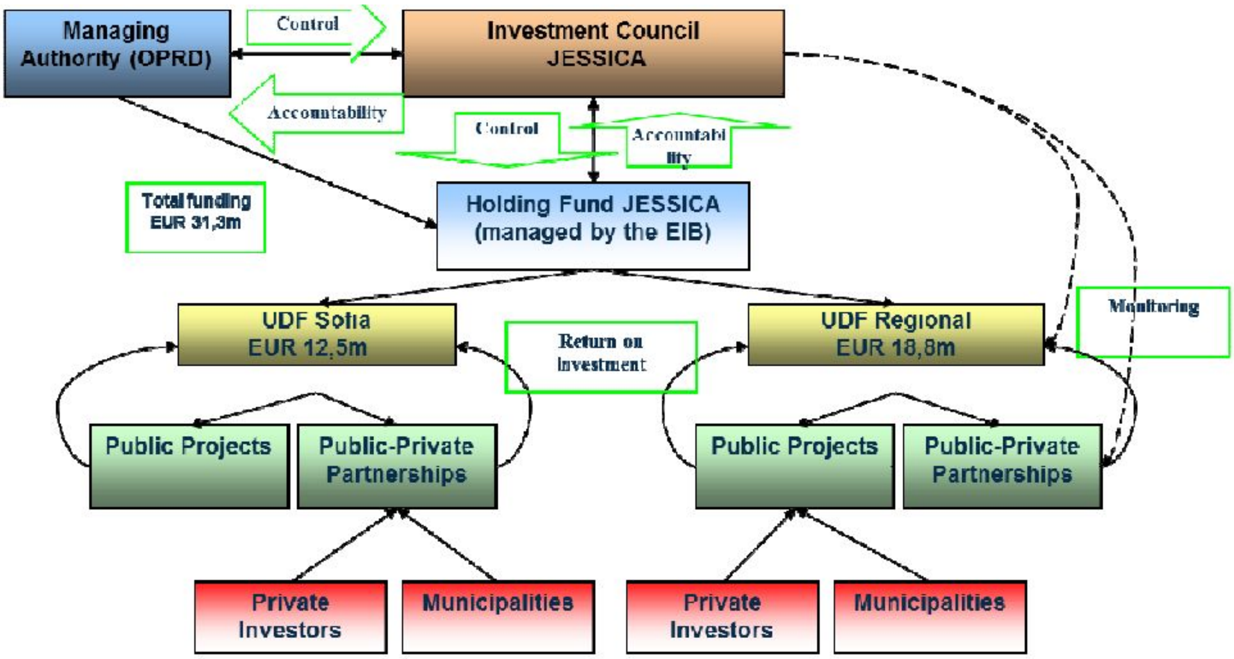
Initiative	Method of delivery
Increase number and diversity of on-Lender platforms:	**Seek On-Lenders under the following categories** • Term lending • Invoice Discounting (New) • Peer to Peer • Market Place Financing • Supply Chain finance
Development of Risk Sharing capability:	**Pilot Products** • New Business Loan (COSME backed) • Expansion Loan (COSME or Innovfin backed)

Source: Strategic Banking Corporation of Ireland (SBCI).

7. BULGARIA

In the 2007-2013 period in Bulgaria JEREMIE established within the Operational Programme the "Development of the Competitiveness of the Bulgarian Economy" (OPC) with First Loss Portfolio Guarantee (FLPG), the Risk Capital Fund, the Growth Capital Fund, the Mezzanine Fund, the Entrepreneurship Acceleration and Seed Financing Instrument and the Funded Risk Sharing Product (FRSP). Two Regional Urban Development Funds provide investments under JESSICA in the Operational Programme "Regional Development" (OPRD). The Holding Fund manager is the EIB Group: on one hand JEREMIE Bulgaria EAD (SVP)[140] and EIF, jointly constituted the JEREMIE Holding Fund[141], on the other hand for JESSICA has chosen a two-stage structure model – a Holding Fund, managed by the EIB, and two UDFs.

Figure 28: Structure of the JESSICA initiative in Bulgaria 2007-2013



Source: Presentation by the Bulgarian Ministry of Regional Development and Public Works 2016

In the 2014-2020 programming period Bulgaria has 70% more funding earmarked for financial instruments: EUR 612 million from the ERDF, Cohesion Fund and ESF budgets. Most support will be directed towards energy efficiency, the waste and water sectors, SMEs, urban development and tourism. Bulgaria has also joined the SME Initiative Guarantee Instruments contributing EUR 102 million (no national co-funding), there the expected total portfolio is of above EUR 600 million.

Bulgarian Financial instruments – Triple approach:

- OP "SME Initiative";
- Recycled funds coming back from the previous programming period – approximately EUR 260 million;
- Financial instruments under OPIC (approximately 20% of the OPIC budget) – at least five new instruments – establishment of a new national organization, Fund of Funds which will manage all the funds planned for financial instruments under four OPs.

140 A joint stock company under Bulgarian law, wholly owned by EIF.
141 EIF http://www.eif.org/what_we_do/jeremie/calls-for-expression-ofinterest/2010_Jeremie_Bulgaria_009_1/2010_Call_for_EOI_JEREMIE_Bulgaria__JER-009_2010_1.htm

Table 12: Envisaged FI allocation within OPs 2014-2020

Thematic objective	Form of finance	Fund	Envisaged ESIF allocation (€)
Operational Programme Human Resources Development	guarantee	ESF	25000000
Operational programme “Environment”	loan or equivalent	CF	81349664
Operational programme “Environment”	guarantee	CF	20337416
Operational programme “Environment”	loan or equivalent	ERDF	18229332.56
Operational programme “Environment”	guarantee	ERDF	4557333.14
Operational programme “Regions in Growth”	venture and equity	ERDF	7132103
Operational programme “Regions in Growth”	loan or equivalent	ERDF	153559119
Operational programme “Innovations and Competitiveness”	venture and equity	ERDF	127500000
Operational programme “Innovations and Competitiveness”	guarantee	ERDF	59500000
Operational programme “Innovations and Competitiveness”	loan or equivalent	ERDF	12750000

Source: Author’s own compilation, data from Open Data Portal 09.07.2016.

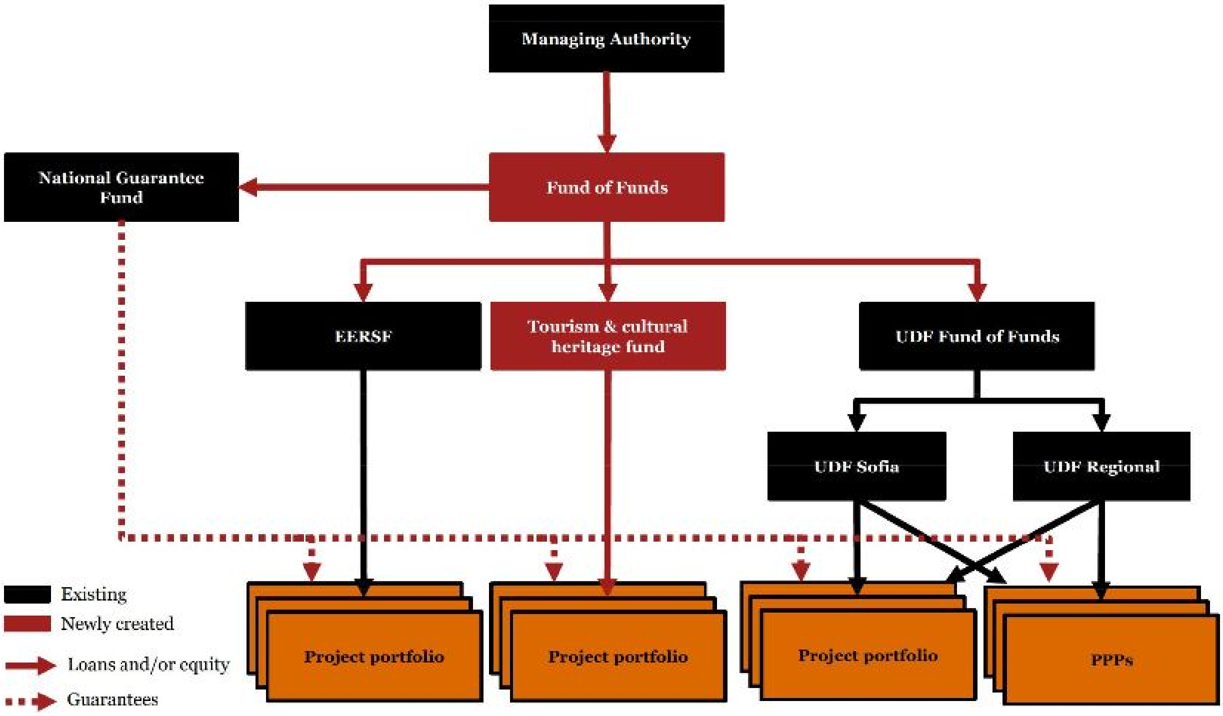
On 13 October 2015 the European Commission approved the Operational Programme “Initiative for Small and Medium Enterprises” 2014-2020 (OP ISME). It was developed within the implementation of the Initiative for SMEs in Europe. Bulgaria is the third country in the EU that will provide resources for SMEs through that instrument. So far it has been applied in Spain and Malta.

The Managing Authority of the programme is the European Funds for Competitiveness Directorate General of the Ministry of Economy. The budget of the new operational programme is EUR 102 million, provided entirely by the EU under the European Regional Development Fund as no national co-financing is required. The funding comes from allocations under Axis 2 of OP "Competitiveness and Innovation" 2014-2020 provided for the implementation of financial instruments. The loan portfolios will be guaranteed not only with allocations under the operational programme but also with funds from COSME/HORIZON 2020 and with resources of the European Investment Fund and the European Investment Bank.

One guarantee product is to be implemented under the SME Initiative in Bulgaria. The product includes unlimited guarantees for the provision of capital relief to financial intermediaries for new portfolios of debt financing to eligible SMEs that will be implemented under more favourable conditions than the similar product implemented under Operational Programme "Development of the Competitiveness of the Bulgarian Economy".

The Managing Authority and the European Investment Fund are currently engaged in negotiations on the signing of a Financing Agreement that will set out the specific conditions of participation in the SMEs initiative.

Figure 29: Proposed institutional structure in Bulgaria for ROP



Source: Bulgarian Ministry of Finance – Ex-ante Assessment of Financial Instruments for the Operational Programme « Regions in Growth » 2016.

8. UNITED KINGDOM

The UK has significant experience of setting up and implementing a variety of financial instruments[142]: in the 2007-2013 period all of the UK's ERDF OPs, except Gibraltar, offer support through FIs. Also a new type of structure was developed and implemented with the EIB Group: secured EIB lending to the regional structure to boost the critical mass of capital alongside allocated ERDF funding. These 'leveraged' JEREMIE Holding Funds were implemented in Wales, the North West, the North East and the Yorkshire & Humberside region.

Each of the three northern regions established a 'fund of funds' to deliver a mix of loan and equity finance to SMEs:

- Finance Yorkshire: a £90m Holding Fund managed by Finance Yorkshire Limited (FY) which is being invested via three sub-funds;
- North East Finance: a £125m Holding Fund managed by North East Finance (NEF) which is being invested via seven sub-funds; and
- The North West Fund: a £155m Holding Fund managed by North West Business Finance Limited (NWBF) which is being invested via six sub-funds.

The FIs co-financed under the English ERDF OPs are all regional. There are 21 funds under seven co-financed Holding Funds for enterprise support in the UK, with varying numbers of funds underneath each. There are about 25 other specific funds offering support for enterprises that are not under Holding Funds.

Securing fund managers who have the appropriate expertise and will deliver high quality fund management services is vital to the success of FIs. The position of the United Kingdom's Government is that project developers need to be aware of the strict procurement rules, but also have a well-defined strategy that sets out how they will use the procurement process to ensure that the skills they need are secured and value for the funders is delivered. This may include building on the expertise and knowledge that already exists amongst Fund Managers in the region and/or drawing in new expertise.

In the 2014-2020 programming period the ESI Funds will be used to improve SME access to finance by increasing the supply of funding where there is market failure and putting in place support services. UK will increase its allocation to financial instruments by around 50% compared to 2007-2013, exceeding EUR 1 billion. The majority will be used in SME support, innovation and energy. Furthermore, there is scope in the programmes for exploration of use of financial instruments to deliver broadband and environmental infrastructure.

The EIB has been appointed by the Department for Communities and Local Government (DCLG) to provide analysis and guidance to support the requirements of an ex-ante Assessment.

Proposed Investment Strategy 2014-2020:

- Establish Fund of Fund Structure;
- Secure EIB loan facility to match ERDF;
- Portfolio of 4 funds:
  - Micro-finance: provision of small business loans;
  - Debt: provision of business loans;
  - Early Stage Technology: provision of equity funding;
  - Equity: Provision of equity / growth capital;
- Diversified investment strategy;
- Predictable reflows from the underlying financial instruments in order to service the debt element.

[142] The UK has co-financed financial instruments in ERDF programmes since the 1994-99 programme period and has a lengthy tradition of using FIs within domestic SME support policy.

Table 13: Envisaged FIs allocation within OPs 2014-2020

Fund and region	Thematic objective	Form of finance	Envisages ESIF allocation (€)
ERDF England	Enhancing the Competitiveness of SMEs	guarantee	8 044 848
	Enhancing the Competitiveness of SMEs	interest rate	25 787 014
	Supporting the Shift Towards a Low Carbon Economy in all Sectors	loan or equivalent	106 957 200
	Preserving and Protecting the Environment and Promoting Resource Efficiency	venture and equity	8 974 000
ERDF Northern Ireland	Enhancing the Competitiveness of SMEs	venture and equity	43 800 000
	Enhancing the Competitiveness of SMEs	loan or equivalent	47 300 000
ERDF Scotland	Strengthening Research, technological development and innovation	venture and equity	6 600 000
	Strengthening Research, technological development and innovation	loan or equivalent	9 900 000
	Enhancing the Competitiveness of SMEs	venture and equity	15 400 000
	Enhancing the Competitiveness of SMEs	loan or equivalent	23 100 000
	Supporting a shift towards a low carbon economy in all sectors	venture and equity	14 610 513
	Supporting a shift towards a low carbon economy in all sectors	loan or equivalent	12 105 256
	Preserving and protecting the environment and promoting resource efficiency	loan or equivalent	7 200 000
ERDF West Wales and The Valleys	SME Competitiveness	venture and equity	19 873 920
	SME Competitiveness	loan or equivalent	68 568 266
	Connectivity and Urban Development	venture and equity	4 062 135
	Connectivity and Urban Development	loan or equivalent	20 000 000
	Connectivity and Urban Development	interest rate	1 000 000
ERDF East Wales	SME Competitiveness	venture and equity	3 258 239
	SME Competitiveness	loan or equivalent	10 776 624
	Connectivity	venture and equity	4 062 135

Source: Author's own compilation, data from Open Data Portal 09.07.2016.

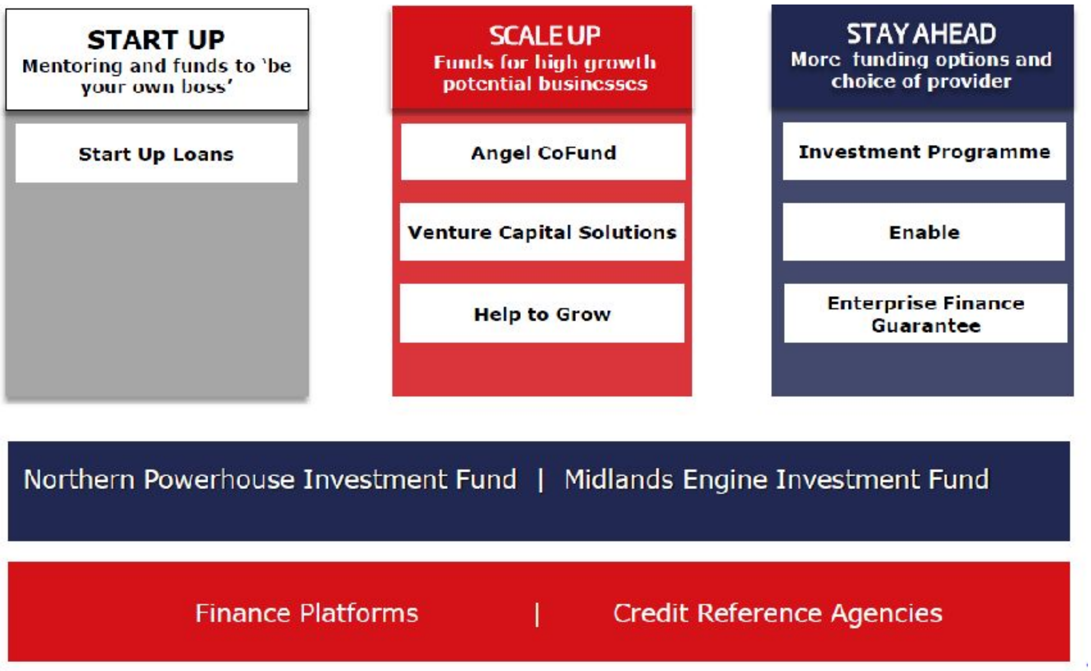
The holding fund structure in 2007-2013 facilitated the ability to 'right size' funds based on performance and market conditions and adjustments to targets; the involvement of private investors enabled the FIs to respond to changing market conditions. At the same time, however, the relatively large number of funds within the holding fund incurred additional management costs; this seems likely to lead to a rationalisation of FIs in 2014-2020. To save administration costs, a smaller number of funds are foreseen, and it is likely that there will be no specific sectoral funds.

For the 2014-2020 period the British Business Bank[143] represents the major development in the after crisis process leading to policy re-definition, coordinating an intelligence-led, national

[143] Economic Development Bank, Independent Board, 100% owned by UK Government.

and flexible approach which is intended to work alongside the private sector in addressing major market gaps. Major schemes run by the Business Bank which provide debt and equity finance to SMEs include Enterprise Finance Guarantee, Enterprise Capital Schemes, UK Innovation Investment Fund, the Angel Co-investment Fund, and the Business Finance Partnership. In addition, the Enterprise Investment Scheme and the Seed Enterprise Investment Scheme are HMRC operated tax relief schemes which aim to encourage private investment in SMEs.

Figure 30: Programmes managed by British Business Bank



Source: British Business Bank 2016.

Proposals for new ERDF backed funds at a sub-national level need to be carefully aligned not only in terms of the finance gap but also in relation to the national initiatives under the British Business Bank (including their increased resources announced in the 2014 Autumn Statement). There is a need to ensure complementarity rather than duplication in these activities, although based on the Business Bank's current strategy and the delivery of schemes which operate on a national basis there may be little overlap at the regional level.

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