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COMMISSION STAFF WORKING DOCUMENT

Financial Instruments in Cohesion Policy

1. INTRODUCTION

Cohesion policy is a dynamic investment policy of the Union aiming at promoting long-term sustainable growth in European regions through removing barriers to growth and facilitating structural adjustment. There has been an evolution in the forms of support and investment over the years to also offer certain types of revolving assistance to projects, where feasible, in the form of financial assistance instruments. Being able to deliver either grants or revolving assistance gives cohesion policy a flexible toolkit to deliver support in Member States and regions. This flexibility is especially relevant in the current uncertain economic climate where financing difficulties constitute a major concern.

Revolving assistance, in addition to the more traditional grant assistance, has been available under cohesion policy in limited amounts since before the 2000-2006 programming period in particular for SMEs. In 2007-2013 the use of different modes of financial instruments has become more widespread. Financial instruments are quickly growing in variety, scope and amounts committed to them. In the 2014-2020 period an even wider application is envisaged – the financial instruments can be used in all policy areas where feasible.

As the use of financial instruments in cohesion policy has grown in prominence during the 2007-2013 programming period, it has become necessary to learn from experience and adjust accordingly the initial legal framework, harmonise rules and offer more detailed guidance.

This paper outlines the role and added value of financial instruments in cohesion policy. It gives an overview of the main difficulties encountered and also presents the actions taken to address these challenges, such as the amendments to the legislation and guidance provided by the Commission to the Member States during the current programming period. It analyses the extent and adequacy of measures to be taken in view of the foreseen wider application of financial instruments and outlines the Commission's proposals for the legislative framework for financial instruments for the 2014-2020 programming period¹.

The objective of this document is to provide information to the European Parliament and the Council on the role and evolution of financial instruments, both institutions having shown great interest in their use in the context of cohesion policy implementation and the discharge procedure.

¹ COM(2011) 615

2. THE ROLE OF FINANCIAL INSTRUMENTS IN COHESION POLICY

Financial instruments can play an important role in the achievement of cohesion policy objectives. Their purpose is to enable public sector resources to be used in a more efficient way by drawing upon commercial practices and actors and by stimulating the participation of private sector capital. Types of support provided through financial instruments include equity, loans, loan guarantees, micro-finance and other forms of revolving assistance. The final recipients include SMEs and other recipients of public funding, such as urban development and energy efficiency/renewable energy projects, and even individual citizens. Financial instruments can be set up indirectly through holding funds, or through direct contributions to equity funds, loan funds and guarantee fund mechanisms. Please see annex II for a graphic illustration.

The possibility of using the same funds several times through various revolving cycles contributes to the impact and sustainability of the instruments. As such, the impact of revolving funds can be many times greater than grant assistance, giving them a particular added value and relevance in times of budgetary constraints. The impact/multiplier effect is further strengthened by the accumulation of interests generated and dividends paid to the funds.

The revolving character of such instruments creates enhanced incentives for better performance on the part of the final recipients - such as better quality of projects and greater financial discipline. Also, the participation of private sector funding guarantees the input of expertise and know-how. Specific expertise in supporting, for example start-up SMEs, can be invaluable. Drawing upon this expertise helps to improve the overall quality of projects.

Financial instruments supported through public resources are especially appropriate for revenue-generating projects that, on their own merits, encounter difficulties in obtaining commercial bank lending or equity investment.

Public resources applied in this way to financial instruments have a more powerful catalytic effect than grant assistance. One early evaluation has found that each one Euro of soft loans leveraged in some 4.5 Euro of private investment (see chapter 5.1 below). By sharing risks with other investors financial instruments can unblock private financing and other public sector funding.

Financial instruments in cohesion policy follow the logic and legal framework of the policy, including shared management and subsidiarity principles. They are a means of achieving the objectives of cohesion policy, not an end in themselves. Furthermore, cohesion policy intervenes mostly in regions which are facing obstacles to development. These often include issues of low administrative capacity, a low rate of entrepreneurship, high unemployment levels, underdeveloped financial markets, and low density population. These issues create market gaps which need to be addressed by policy measures that take into account the specific goals of regional development and the administrative set-up of the Member States. Hence, the primary concerns of financial instruments in cohesion policy cannot be solely motivated by financial returns.

3. THE USE OF FINANCIAL INSTRUMENTS TO DATE²

Financial instruments are gaining importance. Around 5% of European Regional Development Fund (ERDF) allocations of the current programming period were committed to different types of financial instruments by the end of 2010. In total, almost 400 funds have been set up. Most of these funds support businesses but assistance is also available to urban development, energy efficiency and renewable energy projects. All Member States have at least one fund in place for enterprises, while 11 Member States have funds for urban development, and one Member State has set up a fund exclusively focused on renewable energy and energy efficiency activities. The data available at the end of 2010 shows over 20 000 investments in businesses. The numbers for the European Social Fund (ESF) co-financed financial instruments have been more modest, mainly due to a narrower scope of possible revolving interventions, limited in practice until now to micro-credit schemes or guarantee funds for micro-credits. Thirteen Operational Programmes (OPs) in five Member States co-financed financial instruments with ESF resources, for a total amount of nearly 330 MEUR, which represents 0.7% of declared ESF eligible expenditures so far. In addition, several ESF operational programmes' managing authorities in other Member States are currently setting up financial instruments or have expressed the intention to do so in the near future. Please see examples of financial instruments in annex III.

Financial instruments are applied flexibly according to the situation in Member States and regions. Funds have been set up both at national and regional levels. Some managing authorities set specific funds up themselves while others use holding funds. Based on end-2010 data, the vast majority of holding funds are managed by public bodies, such as national or regional development agencies or financial institutions, including the European Investment Bank (EIB).

Different types of financial instruments are used. Most funds have so far been targeted at SMEs as this option was available first. Most financial instruments set up are loan funds. Equity and guarantee funds come next in terms of their number. Operations targeting sustainable urban development activities were mostly (19 out of 22) set up through holding funds and 15 of those are managed by the EIB.

Financial instruments create a multiplier effect. Additional resources come to the funds from national or regional budgets, from banks and other investors. This multiplier effect differs according to the type of financial instrument, the economic sector it addresses and the socio-economic conditions of its location. For equity-related financial instruments based on the information available to date it is estimated that one Euro of public resources led to equity investments into enterprises between one Euro and 3.4 Euro. For guarantee-related financial instruments one Euro of public resources put into guarantee funds supported the disbursement of loans to enterprises in the range from one Euro to 7.5 Euro. The guarantee cover ranged from 27% to 80% of the underlying funds. Regarding loan-related financial instruments, one

² Data in this chapter is based on Commission information and the Synthesis Report "Financial Engineering Instruments Implemented by Member States with ERDF Contributions". The detailed data available to the Commission is based on voluntary reporting from managing authorities, which accounts for more than 75% of the contributions to the financial instruments by the end of 2010. The Synthesis report was presented to the COCOF in October 2011. After the validation of its contents by the Member States, the report was formally transmitted to Member State representatives in the COCOF in December 2011 and to the European Parliament and to the Court of Auditors in January 2012."

Euro of public resources mobilised loans in a range of one to two Euro in loan-related financial instruments.

4. CHALLENGES FACED IN IMPLEMENTING FINANCIAL INSTRUMENTS

The existing financial instruments in the cohesion policy have been subject to internal and external scrutiny. Results of Commission audit work, audit reports and opinions of the Court of Auditors, studies, observations of the European Parliament and the institutions involved in the delivery of financial instruments and others have pointed to the challenges that need to be addressed before the full impact of financial instruments can be felt in cohesion policy. All of the issues outlined below have been addressed by guidance, amendments to the Regulations, and technical assistance as detailed in section 5 of this document.

Issues of capacity and a need for more expertise in implementing financial instruments under shared management have had to be addressed by both the Commission and the Member State administrations. The Commission had to meet the need for appropriate guidance on a fast growing number of issues. Member States' capacity issues led to **delays in launching and delivering the funds to final recipients** and in finding the most appropriate set ups combining the principles and objectives of cohesion policy and the market reality. The use of financial instruments in cohesion policy requires the knowledge of three areas: Structural Funds Regulations, State aid rules and investment know-how.

Operational Programmes are making increasing financial contributions to instruments, which are being set up in the regions. **The availability of data** on these financial instruments and the Union funding allocated to them has now become necessary. Closer monitoring requires the Commission and national authorities to carry out a sufficient level of audits and management verifications during the programming period. Treasury management and accounting need to cater fully for the specificities of financial instruments, while the eligibility rules of cohesion policy need to be followed.

One of the most serious concerns has been the detected practice of **over allocation of resources** to financial instruments which then remain in the funds instead of being disbursed to the final recipients and circumvent the automatic de-commitment rule. Such practices have been discouraged by the Commission, namely through guidance issued in 2008 and 2011, since leaving significant amounts of funding unused on accounts delays the positive effect investment could have on the economy.

In some cases shortcomings have been identified in the **financial gap analysis**. In a few cases funds have been transferred to financial instruments before mature business plans for these funds were in place. Room for improvement has been identified in the areas of setting up clear **exit strategies and winding-up provisions**. The **management costs and fees** have not always been set up in a transparent manner or linked to the performance of the funds.

Financial instruments provide essentially market-based products and typically have a sizeable multiplier effect. However, in the area of cohesion policy, given the specific focus on regional development objectives, a balance needs to be found between these specific objectives and the expectation of private investors. This may lead to **multiplier effects below levels which can be achieved outside cohesion policy**. Also, some have voiced doubts on whether the nature of cohesion policy (regional approach) would work against the necessary **critical mass** for the

financial instruments and result in a scattering of resources and too high overhead costs. Other concerns relate to protection of risks of commercial investors at the expense of the public contribution, heavy collateral requirements and selection of holding funds and financial intermediaries.

For instruments implemented under the ESF additional challenges arise from a lack of separation between assistance provided as loans, parts of which may be "non-revolving", and grants.

The Commission has acknowledged that the 2007-2013 provisions of the **legal framework** on financial instruments in cohesion policy were not detailed enough and a set of clearly outlined rules would have been desirable. Many of the issues described above are being addressed by introducing more specific rules and guidance as detailed in the next section of this document. This comes at the price of flexibility, which is necessary, taking into account the need for higher assurance.

5. LESSONS LEARNT AND ACTIONS TAKEN

Based on the lessons learnt since the 2007-2013 legislation came into force, the Commission has taken steps early on in the period to make available more detailed guidance and rules on financial instruments. This has been done in the form of guidance notes, setting up of collaborative platforms for sharing of experiences, studies, making available technical assistance, and introducing several amendments to the regulations.

5.1. Lessons learnt and actions taken in 2007-2013

Guidance

The Commission has issued guidance notes to Member State authorities in the context of the Committee for the Co-ordination of the Funds (COCOF) on three occasions between mid-2007 and early 2011³. The guidance given has, among other topics, explained rules on the selection of holding funds and financial instruments, including selection of European Investment Bank and European Investment Fund (EIF), and State aid issues. The guidance has also covered the possibility to combine interest subsidies and revolving assistance and the conditions for management fees.

The most substantive guidance note from February 2011 included topics relating to the set-up of financial instruments (including **multiplier ratio** for guarantees), **handling of interests and returns**, eligibility, audit and control, **managing authority responsibilities** and **winding-up** of financial instruments. It explained the need for separate accounting for financial instruments, **phased contributions according to actual investment needs** and **performance-based remuneration** of the fund managers to avoid delays in disbursement. The note confirmed that the Commission would consider all funds left unpaid in instruments

³ COCOF guidance note from July 2007: "Note of the Commission services on Financial Engineering in the 2007-2013 programming period". COCOF guidance note from December 2008: "Guidance note on Financial Engineering". COCOF guidance note from February 2011: "Guidance note on Financial Engineering Instruments under Article 44 of Council Regulation (EC) No 1083/2006".

as ineligible. The **audit and control** chapter of the note outlined the basic framework for audits of the financial instruments. A template monitoring report for **annual data collection** and the Commission's intention to provide a global assessment of the performance of the financial instruments based on this data was established.

Several other guidance documents⁴ have been made available, for example:

- A **common audit framework** "Financial Engineering Instruments in the Context of Structural Funds" has been drafted by the Commission, after consulting Member States' audit authorities and was circulated in October 2011. This framework sets out the common audit approach for financial instruments and the main considerations for the key risk areas relevant to financial instruments at different levels. The audits of financial instruments include legality and regularity as well as sound financial management objectives. It is tailored according to the implementation, management and control structure and the auditor's assessment of the key risks areas. It covers, *inter alia*, the following areas: design and investment strategy, selection of financial intermediaries and funding agreements, functioning and implementation, accounting records and treasury management, contributions to the funds, management costs and fees, monitoring and reporting and winding-up and exit policy.
- Procedures manuals, handbooks and guides have been provided by JEREMIE (Joint European Resources for Micro to Medium Enterprises) and JESSICA (Joint European Support for Sustainable investment in City Areas) platforms and the Commission⁵.

Amendments to the Regulations

The General Regulation has been amended⁶ to include clearer rules on financial instruments. The Implementing Regulation has been amended accordingly⁷ and the ERDF Regulation was amended in 2009⁸. The most relevant amendments included:

- Clarifying **eligibility** of contributions in kind to the financial instruments.
- Creation of the possibility to set up financial instruments in support of energy efficiency and renewable energy and to make them available in all Member States.
- Confirmed that **resources returned must be reused** for the same purpose or in line with the objectives of the Operational Programme.
- Allowing for the treatment of **management fees** as eligible expenditure to reflect better the reality on the ground as funding agreements may foresee the payment of management fees instead of management costs.

⁴ All available through the cohesion policy webpage: ec.europa.eu/inforegio

⁵ Holding Fund Operational Procedures Manual from JEREMIE prepared by the EIF (2007). JESSICA holding fund handbook (November 2010). Urban Development Fund Typologies and Governance Structures in the context of JESSICA implementation (November 2010). Guide to Risk Capital Financing in Regional Policy (Oct 2002). Community Guidelines on State Aid to promote Risk Capital investments in SMEs (OJ C 194, 18.8.2006).

⁶ Council Regulation (EC) No 284/2009 of 7 April 2009 amending Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund concerning certain provisions relating to financial management; Regulation (EU) No 539/2010 of the European Parliament and of the Council of 16 June 2010 amending Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund as regards simplification of certain requirements and as regards certain provisions relating to financial management; Regulation (EU) No 1310/2011 of the European Parliament and of the Council of 13 December 2011 amending Council Regulation (EC) No 1083/2006 as regards repayable assistance, financial engineering and certain provisions related to the statement of expenditure

⁷ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32006R1828:EN:NOT>

⁸ Regulation (EC) No 397/2009 of the European Parliament and of the Council of 6 May 2009 amending Regulation (EC) No 1080/2006 on the European Regional Development Fund as regards the eligibility of energy efficiency and renewable energy investments in housing

The most recent amendment to the General Regulation was adopted in December 2011⁹. Importantly, the amendment made obligatory **yearly reporting** of financial instruments by the Member States as well as by the Commission. Starting from the 2012 annual reports, the Member States will report once a year on four aspects:

1. Description of financial instruments and their implementation arrangements.
2. Identification of bodies involved in the implementation.
3. The Union contribution and national co-financing paid to the financial instruments.
4. Amounts of assistance paid to final recipients.

Nevertheless, data required for the annual accounts of the Commission will become available on the basis of the Regulation by the beginning of 2013 and until then such data will only be provided through voluntary reporting. The Commission has asked Member States to voluntarily report this data for the 2011 accounts.

The Commission also proposed in 2011 to introduce into the current Regulation a **legal obligation** to ensure that the financial resources paid into the funds are **linked to actual investment needs**. This would have ensured that resources do not remain unspent in such funds for long periods. However, this Commission proposal was not accepted by the legislative authorities and the Commission will therefore need to apply other measures - mainly audit, to draw attention to this particular risk.

Additional audit work to provide assurance

With the increase of allocations to financial instruments, audits specifically targeted to their use have become more relevant. Until now, financial instruments co-financed by the ERDF have been included in the scope of other audits carried out by the Commission and the audit authorities. Based on findings related to financial instruments from these audits carried out in 2009-2010, the Commission has set out an audit plan to obtain assurance on the set-up and implementation of financial instruments¹⁰. These audits will be carried out in addition to the previously planned audit work. The audits have been launched and cover most of the issues outlined in section 4 of this document, including **management costs and fees, unjustified payments to the funds, multiplier effect and reporting**. The audits cover financial instruments in six to eight Member States¹¹ and will deliver results towards the end of 2012. The Member State audit authorities have been invited to participate alongside the Commission.

For the ESF, four audits have been performed - of which three were in Italy and one in Latvia at the end of 2011, covering four out of thirteen ESF programmes where financial instruments are used. The first indications from these audits are that the results are mostly positive, even though reports have not yet been finalised.

Findings on financial instruments have also been included in the Court of Auditors 2010 annual report, the Court's opinion on the Commission's proposal for the revision of the Financial Regulation and the Court's opinion on the Commission's proposals for 2014-2020

9 Regulation (EU) No 1310/2011 of the European Parliament and of the Council of 13 December 2011 amending Council Regulation (EC) No 1083/2006 as regards repayable assistance, financial engineering and certain provisions related to the statement of expenditure

10 Enquiry planning memorandum: To obtain assurance on the set up and implementation of financial engineering instruments, pursuant to Article 44 of Regulation (EC) No 1083/2006, ERDF Regulation (EC) No 1080/2006 and Implementing Regulation (EC) No 1828/2006. Pilot phase. September 2011

¹¹ Romania, Lithuania, Germany, Greece, Poland, United Kingdom, Hungary, Portugal

cohesion policy legislation. The Court has indicated its intention to continue to focus on financial instruments, which will complement the audits carried out on the basis of the Commission's audit plan.

Support structures to increase capacity and expertise

In order to promote the use of financial instruments to facilitate SME access to finance and investments in sustainable urban development, the Commission in collaboration with the EIB Group – and with the Council of Europe Development Bank (CEB) for urban development, created in 2007 the two "Cohesion Policy Joint Initiatives" - JEREMIE and JESSICA.

In this context, support provided to interested managing authorities resulted in more than 110 evaluation studies and **gap analyses**. These studies aimed at identifying opportunities and added value for the implementation of financial instruments in access to finance for SMEs and investments in sustainable urban development.

In addition, the JEREMIE and JESSICA Networking Platforms launched in 2009 have supported the **exchange of know-how and good practice** between the Commission, the managing authorities and other stakeholders. This increased the knowledge of financial instruments in support of SMEs and cities. COCOF, which brings together representatives of national authorities and the Commission, has been the forum for in-depth discussion on three guidance notes provided by the Commission. These discussions have facilitated a common understanding of issues covered by the guidance notes. Technical seminars were organised in 2011 on energy efficiency investments and State aid in JESSICA-type instruments.

Evaluations

The effectiveness and efficiency of financial instruments can only be evaluated once all the deployed funds have been invested. Indicators on the effectiveness of financial instruments (*e.g.* number of investments in SMEs, jobs created, additional co-financing attracted) and indicators on the efficiency and economy (*e.g.* performance-based management costs, exits and returns policy, legacy arrangements) should be covered in evaluations carried out during the programming period. At the current early phase of implementation, some early evaluation evidence demonstrates the impact of financial instruments. An interim report of a rigorous impact evaluation¹² of soft loans in Northern Italy has found that EUR 1 of a small soft loan levered in EUR 4.5 of private investment, compared to a control group of capital grants to similar enterprises, which generated no significant leverage. Moreover, the cost per job was only EUR 30,000 for soft loans, but EUR 64,000 for grants.

Further evaluation evidence will become available during the course of 2012. A literature review is currently being carried out on the market failures that financial instruments address, and their value added *vis-à-vis* other policy instruments. Papers, describing the rationale for the use of financial instruments in each country will follow later in the year. As a result of these two streams of analysis, a report will be prepared and published by the end of 2012 that covers the use of financial instruments in cohesion policy throughout the Union.

¹² "Counterfactual Impact Evaluation of enterprise support: lessons from Northern Italy" (2012) ASVAPP for European Commission. Final report due to appear on cohesion policy evaluation webpages in April.

Improvements in some specific areas

Management costs and fees

The Implementing Regulation, adopted in December 2006, included thresholds for management costs, which, on a yearly average should not exceed 2% of the OP contribution in the case of holding funds and guarantee funds, 3% for other funds and 4% for micro-credit instruments. These levels could be higher only as a result of a competitive tendering procedure for the fund manager. Guidance issued since 2007 has clarified that management costs may be frontloaded for a few years, but still need to respect these thresholds over the programming period. The Commission recommended negotiating the terms of management costs to ensure the funding agreements link the remuneration to the performance of the fund to create an incentive for the instruments to be active.

In 2010, amendments to the General Regulation clarified the need to keep management fees in line with market practices.

Multiplier effect

As the funds need to be built on the specific conditions in a region or Member State, market failure needs to be addressed and cohesion policy objectives to be achieved simultaneously, it would be difficult to foresee in the regulation obligatory levels of multiplier effect for all possible cases. For example, the expectation for the multiplier for each product could not be the same everywhere in the Union, dismissing the specific market gaps and cohesion policy objectives or disparities in development levels and population density.

Nevertheless, the Commission's guidance has recalled that conditions need to be optimised to ensure the maximum level of co-investment for the funds or revolving ensured.

Over budgeting of contributions to financial instruments

In order to encourage the early implementation of financial instruments, the 2007-2013 General Regulation foresaw that payments into the funds could be declared to the Commission as eligible expenditure. However, as the disbursement of the funds to the final recipients was not so fast in some cases and management costs were not always linked to performance, delays occurred in the instruments disbursing the funds to final recipients.

Guidance given since 2009 has reiterated the need to disburse the resources as quickly as possible for the benefit of regions' development, and underlined that only payments made to the final recipients would constitute eligible expenditure at closure. Funds left unpaid in the instruments would be considered ineligible. It was also stressed that the instruments should be based on sound financial management principles, which should avoid excessive funds left unused. The ongoing audits on financial instruments analyse the level of payments to the funds compared to actual needs to estimate the level of risk of unused funds.

Legacy resources

The current General Regulation stipulated in its original version that interest earned and resources returned need to be used for the original purpose of the financial instrument. The Implementing Regulation adopted in 2006 specifies that the business plan and funding agreement of a financial instrument must include the winding-up provisions for the instruments, including the reutilisation of resources.

For the future, the Commission has proposed that the capital resources and gains and other earnings in the financial instruments are used in accordance with the aims of the Programme for a period of at least 10 years after its closure.

5.2. Improved legal framework proposed for 2014-2020 programming period

The Regulations for the 2007-2013 programming period show a number of limitations which underlines the need for a clearer regulatory framework if financial instruments are to be used more extensively. The Commission proposals for 2014-2020 cohesion policy take account of the lessons learnt in the 2007-2013 period and provide a comprehensive framework. This will be complemented by more detailed non essential regulatory elements to be included in the delegated act.

Financial Regulation and standardised rules for EU equity and debt instruments

The revision of the Financial Regulation sets out common rules for the EU use of financial instruments in all policy areas financed through the Union budget. The delegated act could complement these common rules by including rules on reporting, fee structures, selection of intermediaries, governance and monitoring among others. While the revision of the Financial Regulation is negotiated, the coherence of proposals made in cohesion policy and in other policy areas concerning the financial instruments needs to be safeguarded.

In the 2014-2020 period, all relevant policy areas are expected to follow harmonised terms and standards which are to be developed in the context of EU equity and debt instruments¹³. Certain financial parameters could also be harmonised, such as sharing the risk and revenue with other investors, risk diversification, fee structures and other measures. This would help to ensure that instruments are in line with market practice and are also attractive to private investors, while preserving consistency with EU policy objectives and the alignment of interests between public and private bodies in the implementation process.

This horizontal approach to using loans, guarantees and equity participation co-financed under the EU budget will facilitate the sharing of experience between different policies, harmonise policies and create synergies with greater ease. The Commission will ensure that overlaps and inconsistencies between financial instruments at EU level and under shared management will be avoided.

In particular, the proposed Common Provisions Regulation include, *inter alia*, the following elements:

Increased effectiveness

Member States and their managing authorities may employ financial instruments in relation to all thematic objectives covered by Operational Programmes and all cohesion policy funds.

All financial instruments will be designed on the basis of an ***ex ante* assessment**. This assessment should identify market failures or sub-optimal investment situations (including the financial gap analysis) that the instrument will address; respective investment needs, possible private sector participation and resulting value added of the financial instrument in question. The *ex ante* assessment will also have to assess the questions of critical mass and possibilities to ensure economies of scale.

¹³ See the Communication A framework for the next generation of innovative financial instruments - the EU equity and debt platforms, COM(2011)662 of 19 October 2011.

Financial instruments can be combined with other forms of funding, in particular grants, to provide tailored assistance reflecting the specific needs of Member States and regions. Furthermore, final recipients of financial instruments may also receive grants or other assistance from a programme or from another instrument supported by the Union budget.

A wider range of implementation options

Three implementation options are proposed for Member States and managing authorities:

1. Financial instruments set up at EU level. Contributions from Operational Programmes to these financial instruments will be ring fenced for investments in regions and actions covered by the Operational Programmes in question.
2. Standardised financial instruments set up at national/regional level (so-called 'off-the-shelf' products) for which the terms and conditions could be pre-defined and laid down in the implementing act.
3. Existing or newly-created financial instruments set up at national or regional level. Managing authorities themselves can directly implement financial instruments consisting solely of loans or guarantees.

Clear financial management rules

The proposal for 2014-2020 provides continuity and certainty for the financial management of Union contributions to financial instruments. The proposed new framework contains clear rules on qualification of financial streams at the different levels of financial instruments and corresponding eligibility or legacy requirements. The following is proposed:

- In order to speed up disbursement to final recipients phased contributions to the instruments are proposed, covering only amounts that are paid or expected to be paid to final recipients over a period of a maximum two years.
- EU contributions to financial instruments will be kept in interest-bearing accounts in the Member States or temporarily invested in line with the principles of sound financial management.
- The share of capital resources, corresponding to the Union contribution, when returned from investments will be re-used for further investments in the same or another financial instrument. This has to be done in accordance with the objectives of the Operational Programme for at least 10 years after the closure of the programme.
- The share of gains/earnings/yields generated by investments, corresponding to the EU contribution, is to be used for further investments in the same or other instruments, in accordance with the OP and for management costs/fees, preferential remuneration of investors operating under the market economy investor principle.
- Reporting, monitoring and evaluation provisions will be strengthened. Managing authorities will send to the Commission a **specific report on operations** comprising financial instruments as an annex to the annual implementation report. This report will cover, inter alia, information on support paid into a financial instrument and support paid by the financial instrument to final recipients. It will also cover the multiplier effect and revenues and repayments to the financial instrument.

The intended 2014-2020 delegated and implementing acts could include provisions on the following aspects: minimum requirements for *ex ante* assessment of financial instruments, combination of revolving assistance with grants, eligibility of expenditure, and treatment of

private investors as well as multiplier ratios to be ensured. They could also set the basic parameters for selecting bodies that would implement the financial instruments, responsibilities of these bodies and conditions for performance-based remuneration. Transfer and management of assets, conversion between currencies, management and control, payments and their withdrawal and calculation rules for the final balance could also be covered. To facilitate the negotiation process of the proposal for the Common Provisions Regulation, the Commission has made available to the Council and the European Parliament details of the intended contents of the envisaged delegated and implementing acts.

6. CONCLUSION

Financial instruments can play an important role in the delivery of cohesion policy objectives by providing significant multiplier effect and attracting private investors. They contribute to making cohesion policies more effective and sustainable, thus helping regions to face their long-term challenges and increasing the long term impact of the policy.

Experience has shown that more clear rules and more guidance are necessary to ensure sound financial management of financial instruments. In many respects, the management of financial instruments has already improved on the basis of guidance given and will further improve as a result of the regulatory amendments which have recently come into force. The **specific audit programme** for financial instruments, which is currently being carried out, will provide a **more systematic overview** of the level of assurance in financial instruments. The audit results will provide input to the Commission and the managing authorities to take the necessary remedial action in the coming years of the current programming period.

Specific challenges need to be addressed to make financial instruments a full success and to ensure sound financial management.

To this end, the legal framework proposed for 2014-2020 provides that, *inter alia*:

- Financial instruments will be set up on the basis of thorough *ex ante* assessments that address the local needs and potential and create flexible responses to development challenges.
- The most suitable method for support can be selected. It can be a Union-level instrument on national or regional level. Standardised, 'off-the-shelf' options can be applied, or unique funds designed. The support could be given in the form of loans, equity investment or guarantees or a policy-based guarantee in the case of ESF. Furthermore the possibility to combine grants with financial instruments for the benefit of final recipient will be extended, for example to support project preparation or to take better account of actions which combine social, economic and financial returns.
- Exit strategies will be foreseen and monitoring and evaluation will be in place to ensure that the instrument continues to meet the development needs throughout the course of its application.
- Technical assistance and guidance for advisory services and capacity building will be available to both managing authorities and final recipients, so that new funds can benefit from the accumulated experiences from earlier programming periods.

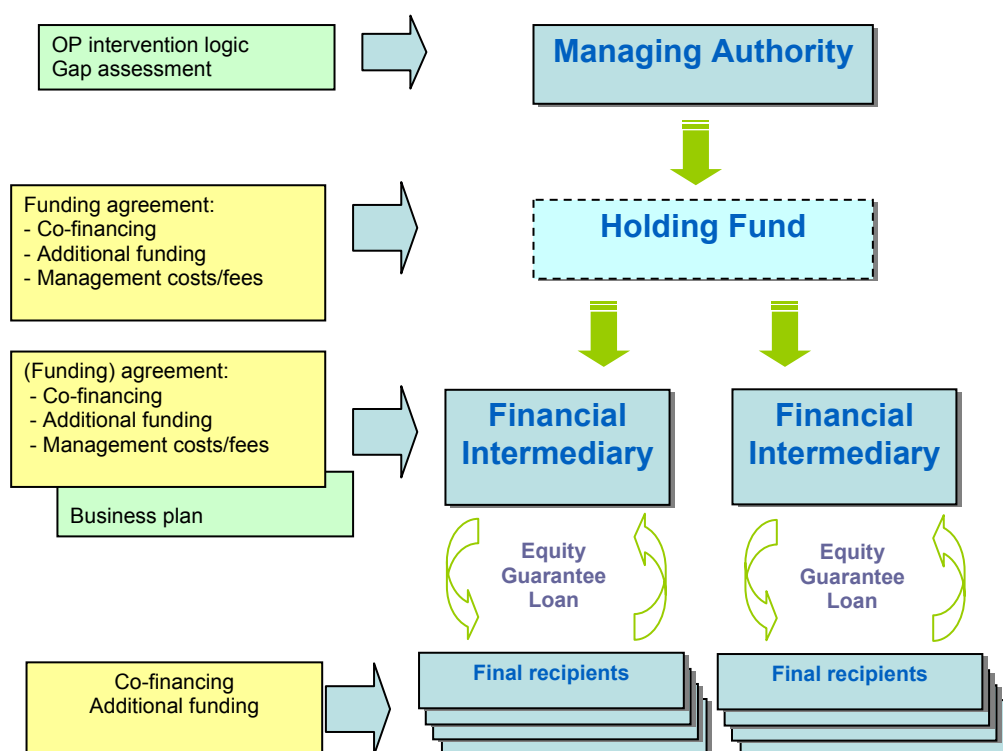
It is important to take into account Member State and sector specificities when financial instruments are set up, implemented and evaluated. **Standard yardsticks do not necessarily apply** when comparing different types of financial instruments, addressing diverse market failures, in diverse regions of the Union, although the Commission proposal aim for a certain

level of standardisation through implementation options mentioned under 5.2 above. Financial instruments have already attracted a lot of interest and the experience is accumulating. The Commission made a proposal for a 2014-2020 legislative framework which aims for the right balance of flexibility for innovation and sound financial management in financial instruments.

Annex I – Glossary

Guarantee	In case of a guarantee there is commitment by a third party called the 'guarantor' to pay the debt of a borrower when the latter cannot pay it himself. The guarantor is liable to cover any shortfall or default on the borrower's debt under the terms and conditions as stipulated in the agreement between the guarantor, the lender and/or the borrower.
Holding fund	Funds set up to invest in several venture capital funds, guarantee funds, loan funds, urban development funds, funds or other incentive schemes providing loans, guarantees for repayable investments, or equivalent instruments, for energy efficiency and use of renewable energy in buildings, including in existing housing.
JEREMIE	Joint European Resources for Micro to Medium Enterprises, is an initiative of the European Commission developed together with the European Investment Fund. It promotes the use of financial instruments to improve access to finance for SMEs via Structural Funds interventions.
JESSICA	Joint European Support for Sustainable investment in City Areas
Legacy resources	Capital resources and gains and other earnings or yields attributable to the support from the CSF Funds to financial instruments
Management cost	Cost items reimbursed against evidence of expenditure (linked to the performance/efficiency of the fund)
Management fee	Agreed price or compensation for services rendered, should include appropriate incentives to be in line with the OP objectives
Market economy investor principle	Applies in the State aid context. If a public authority acts in the same way as a private investor would conceivably have done in the same circumstances, then no benefit is conferred.
Multiplier effect	Additional funds provided by the other sources (public and private) added to the funding provided by the EU. This is expressed as the ratio of "overall funding at final recipient level/EU funding at final recipient level"

Annex II – set-up of financial instruments in 2007-2013



Annex III – examples of financial instruments in cohesion policy¹⁴

Name	JEREMIE Languedoc-Rousillon
Location	France: Languedoc-Rousillon region
Set-up	EIF as holding fund manager
Types of support	Guarantees, co-investment, loans for SMEs
Budget	30 MEUR (15 MEUR ERDF + 15 MEUR regional)
Results	By September 2011, commitments were at 27 MEUR, transfers to financial intermediaries were 1.4 MEUR and investments to firms at 1.2 MEUR

Name	Energy efficiency in apartment buildings
Location	Estonia
Set-up	Public agency Kredex acts as a financial intermediary
Types of support	Loans for energy efficiency investments in apartment buildings
Budget	49 MEUR (17 MEUR from ERDF + 28.8 MEUR additional loan from CEB + 3.2 MEUR from Kredex)
Results	391 projects supported by end of 2011, total amount of 34 MEUR, total investments 45 MEUR

Name	JEREMIE and JESSICA instruments in Poland
Location	Poland
Set-up	Bank Gospodarstwa Krajowego (BGK) - state-owned development bank – acts as holding fund or financial intermediary
Types of support	Loans and guarantees
Budget	738.1 MEUR
Results	JESSICA in Wielkopolskie region – by the end of January 2012, 5 (22.8 MEUR) projects approved. Joint JEREMIE in 5 Polish regions – by January 2012 3240 SMEs supported with 86 MEUR. Multiplier effect between 2 and 5 times.

Name	Hungary JEREMIE
Location	Hungary
Set-up	National holding fund manager – Venture Finance Hungary plc
Types of support	Loans, guarantees, risk/venture capital for micro- and SMEs
Budget	836 MEUR (125 MEUR national/regional, 711 MEUR ERDF from two OPs)
Results	By October 2011, 240 contracts signed with financial intermediaries and 4939 contracts signed with SMEs, worth ca 211 MEUR

Name	Slovene Enterprise Fund
Location	Slovenia
Set-up	Slovene Enterprise Fund is holding fund manager
Types of support	Guarantees, counter-guarantees, mezzanine and venture capital for SMEs
Budget	56.44 MEUR (48.07 MEUR from ERDF + 8.48 MEUR national co-financing)
Results	3762 SMEs supported

¹⁴ Source: IQ-Net Review Paper 20(2) and Commission information

Name	JEREMIE Wales
Location	Wales, UK
Set-up	Managed by Finance Wales
Types of support	Guarantees for SMEs
Budget	175 MEUR (76 MEUR from ERDF + 88 MEUR from EIB loan + 18 MEUR Welsh Assembly Government)
Results	By September 2011 87 MEUR invested in 362 SMEs, 902 jobs created.

Name	Finnvera Loans
Location	Finland
Set-up	Financial instruments provided by the state-owned Finnvera company
Types of assistance	Loans (investments and working capital loans, loans for women entrepreneurs, microloans, environmental loans, entrepreneur loans), guarantees and venture capital
Budget	In western Finland, 16.37 MEUR (2.79 MEUR from ERDF)
Results	In western Finland 1492 projects supported

Name	North Denmark Loan Fund
Location	North Denmark region
Set-up	Den Norhyske Lånefond is a corporate foundation
Types of support	Low interest loans for innovation and development in SMEs
Budget	8.06 MEUR (4.03 from ERDF)
Results	By October 2011 2.7 MEUR in loans had been awarded

Name	Sachsen-Anhalt SME loan fund
Location	<i>Land</i> of Sachsen-Anhalt
Set-up	Fund managed by Sachsen-Anhalt Investment Bank
Types of support	Mezzanine investment and loans for SMEs
Budget	237.9 MEUR (179.4 MEUR ERDF and the rest from the <i>Land</i> government)
Results	By April 2009 248 projects supported with 50.8 MEUR

Name	Scottish Co-investment Fund
Location	Scotland, UK
Set-up	Managed by Scottish Investment Bank
Types of support	Equity in SMEs
Budget	78 MEUR (31 MEUR from ERDF, 47 MEUR regional)
Results	By September 2010, 32 MEUR invested in 110 companies

Name	Microcredits and Guarantees
Location	Calabria, Italy
Set-up	Fincalabra (public regional financial institution) manages the holding fund
Types of support	Microcredits and guarantees for microcredits
Budget	37.5 MEUR (of which 18.75 MEUR from ESF)
Results	By January 2012, 1304 entrepreneurs supported

Name	Guarantee Fund for microcredits
Location	Germany (Federal OP)
Set-up	Investitions und Förderbank Niedersachsen (public bank) is the guarantee fund manager
Types of support	Guarantees for microcredits
Budget	100 meur (of which 57.5 MEUR from ESF)
Results	By January 2012, 7376 entrepreneurs received guaranteed microcredit