



Financial instruments in ESIF programmes 2014-2020

A short reference guide for managing authorities

This short reference guide is designed to provide an overview of the main elements of the 2014-2020 legislation as pertains to financial instruments. Further to feedback from stakeholders it will be supplemented with more detailed specific guidance as relevant, including in complementarity with *fi-compass*, the unique platform for advisory services on financial instruments under the ESIF.

DISCLAIMER:

"This is a working document prepared by the Commission services. On the basis of the applicable EU law, it provides technical guidance to the attention of public authorities, practitioners, beneficiaries or potential beneficiaries, and other bodies involved in the monitoring, control or implementation of the Cohesion policy on how to interpret and apply the EU rules in this area. The aim of this document is to provide Commission services' explanations and interpretations of the said rules in order to facilitate the implementation of operational programmes and to encourage good practice(s). However this guidance note is without prejudice to the interpretation of the Court of Justice and the General Court or decisions of the Commission."

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1. INTRODUCTION

This is a short reference guide for ESIF managing authorities (MA) intending to set up financial instruments in the 2014-2020 programming period under their respective programmes. It is designed to provide a quick explanatory overview of the main elements of the legislation and its content has been based largely on the subjects raised in enquiries received from MA and other stakeholders to date. In view of feedback from stakeholders it will be supplemented with more detailed specific guidance as relevant, including in complementarity with the *fi-compass*, the unique platform for advisory services on financial instruments under the ESIF (<http://www.fi-compass.eu/>).

2. LEGAL BASES

The specific provisions on financial instruments are set out in 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 (CPR) and the delegated and implementing acts linked to the relevant articles of this Regulation. Other 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.

3. WHAT IS CHANGING FOR 2014-2020?

Table 1: Changes relating to 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, regional level, transnational or cross-border level: Tailor-made OR off-the-shelf OR MA loans/guarantees Contribution to EU level instruments |
| Payments | Possibility to declare to the Commission 100% of the amount paid to 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 costs and fees, interest, resources returned, legacy | Legal basis set out in successive amendments of the regulations and recommendations/interpretations set out in three COCOF notes | Full provisions set out from outset in basic, delegated and implementing acts |
| Reporting | Compulsory reporting only from 2011 onwards, on a limited range of indicators | Compulsory reporting from the outset, on a range of indicators linked to the financial regulation. |

Table 2: Changes relating to the EAFRD

| | 2007-2013 | 2014-2020 |
|-----------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Scope | Support for all revenue generating investments under the RDP | Support for all revenue generating investments under the RDP |
| Set-up | Ex-ante assessment only for guarantee funds | Compulsory ex-ante assessment for any FI |
| Implementation options | Financial instruments at national or regional level – tailor made only | Financial instruments at national, regional level, transnational or cross-border level: Fund of funds; Tailor-made OR off-the-shelf OR MA loans/guarantees Contribution to EU level instruments |
| Final recipients | Indirect access to the FI - access only for those with grant applications under a RDP measure selected by Paying Agencies | Direct access to the FI - any final recipient that fulfils the eligibility and selection criteria without the need to submit an application to the Paying Agency |
| Payments | Possibility to declare to the Commission 100% of the amount paid to fund – not linked to disbursements to final recipients | Phased payments linked to disbursements to final recipients |
| Management costs and fees, interest, resources returned, legacy | General legal basis set in the implementing rules | Full provisions set out from outset in basic, delegated and implementing acts |
| Reporting | No compulsory reporting – part of the general annual reporting on the programme's implementation | Compulsory reporting from the outset, on a range of indicators linked to the financial regulation. |

With regards to the European Maritime and Fisheries Fund (EMFF), in addition to the applicability of the CPR provisions concerning financial instruments, and contrary to the situation under the European Fisheries Fund, the EMFF includes an obligation that support provided to enterprises in the processing sector other than SMEs must be through financial instruments (Article 69.2 of the EMFF).

4. DEFINITIONS

The applicable definitions are set out in a number of legal bases: the Financial Regulation and its Implementing Rules, the CPR, the ESI Fund-specific regulations, and the applicable state aid framework.

The first point of reference has been the Financial Regulation; therefore, for example, in 2014-2020 reference is made to 'Financial instruments' rather than financial engineering instruments, and the CPR does not itself contain a specific definition of financial instruments, or of other relevant terms. However, during the negotiation of the legislative framework, the co-legislators added in the CPR definitions for terms not included in the Financial Regulation and specific to the ESIF context i.e. escrow account and fund of funds. A glossary is under preparation for publication in early 2015.

5. FINANCIAL INSTRUMENTS IN 2014-2020 ESIF PROGRAMMES

5.1. What is the overall political message?

Both the MFF¹ and ESIF policy frameworks emphasise the need for more use of financial instruments in 2014-2020, particularly in a context of fiscal retrenchment: the overall aim is therefore to deliver more ESI funding through financial instruments in future. In this context, the October 2013 European Council called for a significant increase in use of financial instruments for all countries compared to 2007-2013 period and doubling amounts of ESIF support delivered to SMEs through financial instruments in programme countries.

Managing authorities should therefore consider the use of financial instruments as an option wherever suitable, but not for reasons of absorption. Financial instruments cannot be considered as a way of frontloading expenditure or for avoidance of automatic decommitment. They are a delivery mode and not a stand-alone objective.

Activities supported by financial instruments must be judged by the financial intermediary or managing authority to be able to repay the investment. For the ERDF, CF, EAFRD and EMFF, they must therefore generate income or revenue, or savings on future expenditure, while for the ESF, they must be used on the basis of the final recipients' capacity to reimburse the loan. Synergies and complementarity should be sought – financial instruments through ESIF should take account of and work together when justified with ESIF grants, other EU instruments (financial instruments and grants) and national public programmes.

In addition, MAs should seek critical mass and economies of scale. Both the European Court of Auditors and the European Parliament have pointed out that there is room for consolidation towards larger more efficient instruments. While the overall amounts delivered through financial instruments should therefore 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 general policy line is that there should be consolidation of resources into national or supra-regional instruments, as well as using the possibility of contributing to EU-level instruments whenever suitable.

5.2. What are the benefits of financial instruments?

The benefits linked with financial instruments can be summarized as follows:

- Leverage resources and increased impact of ESIF programmes;
- Efficiency and effectiveness gains due to revolving nature of funds, which stay in the programme area for future use for similar objectives;
- Better quality of projects as investment must be repaid;
- Access to a wider spectrum of financial tools for policy delivery & private sector involvement and expertise;
- Move away from “grant dependency” culture; and
- Attract private sector support (and financing) to public policy objectives.

¹ Communication from the Commission – The EU Budget Review, SEC(2010)700

5.3. What is the intervention logic for financial instruments?

Managing authorities will need to go through a step by step process for determining whether or not financial instruments should be used.

Firstly, overall programming should be relatively advanced. Programming can already give a first indication of the potential use for financial instruments at various stages, including analysis of development needs at national and regional level, selection of thematic objectives, focus areas, investment priorities according to market failure analysis in the domain of financial instruments, set up and description of priority axis, measures, etc. For example, the analysis may point the programme towards use of financial instruments on the basis of previous experience of financial instruments, or identify a general gap in terms of SME access to finance.

Next, there must be potential for use of financial instruments. As mentioned before, the planned activities must be income generating or saving and there must also be interest by financial intermediaries and final recipients. There may be cases where a grant with a low co-financing rate might be a better option e.g. in case of a negative financial cost-benefit ratio in terms of amount of loan as opposed to management fees and costs.

Finally, where the MA sees the possibility for use of financial instruments, this shall be further developed and confirmed by the ex-ante assessment referred to in CPR 37(2) (see section 7.1 for further details).

6. PROGRAMMING FINANCIAL INSTRUMENTS IN 2014-2020

6.1. Financial instruments in the ex-ante evaluation

The regulation provides that the ex-ante evaluation 'shall appraise... the rationale for the form of support proposed'. The ex-ante evaluation is a high-level gap analysis carried out in parallel with the programming which evaluates the fit of the proposed priorities and actions with the needs assessment. In this context it should also include consideration of financial instruments or other forms of support as delivery tools to contribute to these selected priorities and actions. It should help to determine the potential inclusion of financial instruments as a delivery tool as relevant.

This could have different implications depending on the context. For example, in the case of a MS where grants for SMEs are proposed rather than financial instruments the ex-ante evaluation might find that more consideration should be given to financial instruments. In the case of a MS where only financial instruments are proposed, the ex-ante evaluation may find that a grant element should be re-introduced.

The assessment should be logical, and include considerations such as: advantages & disadvantages of each option, relevant elements from the specific market failure leading to choice of thematic objective / focus area / investment priority, the potential revenue-generating nature of activities, and the financial sustainability of public objectives (potential re-use of funds as opposed to one-off grant).

6.2. Financial instruments in the partnership agreement

There is no legal basis for inclusion of information on financial instruments in the Partnership Agreement (PA). However, it would be useful to include general information

on the use of financial instruments in relation to relevant thematic objectives and / or investment priorities where use of financial instruments is envisaged. In addition, if the MS plans to set up a financial instrument at national level with contributions from more than one programme (e.g. regional ESIF programmes contributing to a single financial instrument), this information could also be included in the PA. If a contribution to the 'SME initiative' is planned, the single national programme per fund has to be included in the list of programmes under ERDF and EAFRD as appropriate.

6.3. Financial instruments in the programmes

Any financial instrument supported by the ESIF must be in compliance with the relevant programme, its objectives under priorities (and focus areas for EAFRD); eligibility rules (under measures for EAFRD); expenditure related provisions; co-financing elements; monitoring and reporting requirements. While some general and common to all ESIF rules are defined in the CPR, the fund-specific rules (e.g. relating to the funding agreement) play a special role for financial instruments set up under the EAFRD. It will also be necessary to comply with sector-specific rules for the EMFF.

ERDF, ESF and Cohesion Fund operational programmes

Article 96(2)(b)(iii) of the CPR requires for each priority axis a description of actions ... 'and the planned use of financial instruments'. It should therefore be indicated at priority axis level where there is consideration of financial instrument(s) on the basis of the ex-ante evaluation of the Operational Programme and with reference to the thematic objectives selected in the PA, supplemented as far as appropriate by the information already available in any on-going ex-ante assessment(s).

This could take the form of broad text in the relevant priority axis referring to the possibility of delivering the investments through either financial instruments or other form of support, or a combination of both. The MA should signal that it envisages the use of financial instruments. This can be supplemented as far as possible with further information, but an appropriate balance will need to be achieved between providing neither too much nor too little information in order to avoid a subsequent programme modification. It is also important to avoid pre-empting the results of the ex-ante assessment(s) for the FI(s).

For example, it is not obligatory to identify the specific financial instrument in the operational programme. This specific information can only be determined by the ex-ante assessment, which may be completed shortly after programme adoption, or indeed at any time during implementation.

The exception to the above general rule is where MAs wish to make use of the incentives to apply a 10% top-up for a whole priority axis delivered through financial instruments or wish to make a contribution to an EU-level instrument and apply a 100% co-financing rate for whole priority axis for OP contributions to support an EU-level financial instrument. In such cases, it is evident that certain elements from the ex-ante assessment, like the information on the amount of support to be delivered through financial instruments, would need to be available before the finalisation of the construction of the relevant priority axis or, if this were to become available only later, that a programme modification be made.

EAFRD rural development programmes

First programming of RDP 2014-2020

MAAs can programme financial instruments from the beginning, at the time of the first adoption of the RDP 2014-2020. In principle, MA should indicate at measure level, or commonly for several measures, where there is consideration of financial instrument(s) on the basis of the ex-ante evaluation of the Rural Development Programme and with reference to the priority and/or focus area selected, supplemented as far as possible by the information already available in any on-going ex-ante assessment(s).

This could take the form of broad text in the section common to several measures referring to the possibility of delivering the investments through either financial instruments or grants, or a combination of both. MAAs that have completed their ex-ante assessments before the programme to be adopted, or have advanced sufficiently with the ex-ante assessment (allowing them to identify the market gap/sub-optimal situations, budgets and implementation options), should describe this in detail in their RDPs to avoid the need of further modifications.

As a minimum, the MA should signal that it envisages the use of financial instruments (per measure or commonly for several measures). This can be supplemented as far as possible with further information, but an appropriate balance will need to be achieved between providing neither too much nor too little information to avoid a subsequent programme modification, and ensuring at the same time coherence with the programme strategy and SWOT analysis. MS are advised, however, not to pre-empt the outcomes of any future ex ante assessment. If such future ex-ante assessment leads to substantial differences between the initially envisaged in the RDP approach and the one to be put in place by the MA (including on financial matters), programmes will have to be modified.

If the measure's financial elements such as, for example, contribution rate are different for the financial instrument(s) than those for the grants (including when the MA wants to use the 10 percentage point incentive for the maximum contribution rate as provided by Article 59(4)(d) of R 1305/2013) then the MA has to ensure that the ex-ante assessment is done or that it is sufficiently well advanced to allow the full programming of the financial instrument(s) at the time of adoption.

Within the programming period 2014-2020

When a MA decides to set up a financial instrument supported by its RDP within the programming period, and so far the possibility for use of financial instruments has not been envisaged, it should modify its programme. A modification of the RDP is necessary, for example, when a financial instrument is set up under a measure or for a specific operation, which has not been programmed so far, or when the financial instrument has only been indicated as a potential type of support under a programmed grant measure or commonly for several programmed grant measures, but with no further concrete information on its set up and implementation. The MA should describe in its RDP the financial instrument that will be set up and its major elements.

Any financial instrument receives contributions from the budgets of the individual measures. If the measure is not programmed and respective budgets have not been planned, then the MA has to ensure the necessary opening of the relevant measure to the financial instrument and its budget support.

Article 59(4)(c) of the EAFRD regulation (R 1305/2013) provides that the maximum EAFRD contribution rate shall be 100% for contributions to EU-level financial

instruments, while for financial instruments set up under shared management Article 59(4)(d) of the same regulation provides the maximum EAFRD contribution rate applicable to the measure concerned to be increased by 10 percentage points.

It has to be noted that some EAFRD measures comprise different types of operations and activities (e.g. under Articles 19 or 20 of R 1305/2013). It is therefore possible grant support to be given for one type of operation and support under financial instruments for another type of operation (investments), both falling in the scope of one single measure. The eligibility rules related to the measure concerned (for example, the type of final recipients, type of investments and scope of implementation, etc.) should be respected and the support provided should remain within the limits of the CPR and the EAFRD regulations. This should also be well documented in the RDP.

It is also possible to have different target group(s) [i.e. final recipients] for the financial instrument in comparison with the target groups under the grant approach for the same measure. This has to be defined by the ex-ante assessment of the financial instrument and specified in the measure description in the programme. Complementarity with the other ESI Funds should also be taken into account.

EMFF maritime and fisheries programmes

Given the limited uptake of financial instruments under the EFF in the 2007-2013, for the 2014-2020 period, setting up financial instruments in the fisheries and aquaculture sector under the EMFF will be a new challenge for MA located in often small fisheries administrations. Subject to the results of the ex-ante assessment, it may therefore be important to try to avoid setting up completely new sector-specific instruments, but rather to build on existing national, regional or local financial instruments (sector-specific or other). Another alternative is to explore synergies with other financial instruments already set up in the ERDF, ESF or EAFRD, or to be established in the 2014-2020 period.

Each EMFF OP is programmed on the basis of a strategic approach, including an assessment of the strengths, weaknesses, opportunities and threats, and taking into account the results of the needs assessment. The strategy of the EMFF OP therefore defines the priorities, objectives, targets and measures selected for achieving the goals. FIs for the fisheries and aquaculture sector should therefore be focused on the objectives set out in the strategy of the EMFF OP.

The EMFF includes a list of ineligible operations. For example, operations increasing the fishing capacity of a vessel or that consist of the construction or importation of fishing vessels are ineligible. Other fund-specific rules in the EMFF set specific conditions for the application of measures (for engine replacement, start-up support for young fishermen, on-board training, permanent and temporary cessation) or set phasing out dates (2017 for permanent cessation; 2019 for storage aid).

7. IMPLEMENTATION OF FINANCIAL INSTRUMENTS IN 2014-2020

7.1. Ex-ante assessment

The compulsory ex-ante assessment for financial instruments provided for in Article 37(2) of the CPR is a key novelty for 2014-2020. Its introduction is aimed at ensuring sound evidence-based decision-making on the part of the managing authorities in terms

of use of financial instruments. It should not be confused with the ex-ante evaluation under CPR 55, which is part of the programming process.

The ex-ante assessment can be performed in stages. It does not have a formal deadline (i.e. not required before adoption of the programme) but it must be completed before the decision to make the programme contribution to the financial instrument. It needs to cover each financial instrument, either already co-financed during the previous programming period or new, but work can be combined in one ex-ante assessment. The same ex-ante assessment could also be used to justify contributions from more than one ESI fund to the same financial instrument.

The requirements of the ex-ante assessment are as follows:

- An analysis of market failures, suboptimal investment situations, and investment needs for policy areas and thematic objectives or investment priorities to be addressed with a view to contribute to the achievement of specific objectives set out under a priority and to be supported through financial instruments. That analysis shall be based on available good practice methodology;
- An assessment of the value added of the financial instruments considered for support from the ESI Funds, consistency with other forms of public intervention addressing the same market, possible State aid implications, the proportionality of the envisaged intervention and measures to minimise market distortion;
- An estimate of additional public and private resources to be potentially raised by the financial instrument down to the level of the final recipient (expected leverage effect), including as appropriate an assessment of the need for, and level of, preferential remuneration to attract counterpart resources from private investors and/or a description of the mechanisms which will be used to establish the need for, and extent of, such preferential remuneration, such as a competitive or appropriately independent assessment process;
- An assessment of lessons learnt from similar instruments and ex ante assessments & evaluations carried out by the Member State in the past, and how these lessons will be applied in the future;
- The proposed investment strategy, including an examination of options for implementation arrangements within the meaning of Article 38, financial products to be offered, final recipients targeted, envisaged combination with grant support as appropriate;
- A specification of the expected results and how the financial instrument concerned is expected to contribute to the achievement of the specific objectives set out under the relevant priority or measure including indicators for that contribution;
- Provisions allowing for the ex ante assessment to be reviewed and updated as required during the implementation of any financial instrument which has been implemented based upon such assessment, where during the implementation phase, the managing authority considers that the ex ante assessment may no longer accurately represent the market conditions existing at the time of implementation.

The ex-ante assessment will need to contain all the elements set out above. It is not the same as the JEREMIE / JESSICA gap evaluation carried out for certain ERDF contributions to financial engineering instruments in 2007-2013.

The ex-ante assessment can be funded by the programme's technical assistance from 2007-2013 or 2014-2020. The MA has the choice between carrying out the work itself and externalising it, although it would seem that generally a consultant will be needed for reasons of administrative capacity, expertise and independence of assessment.

As regards the methodology and approach, the ex-ante assessments for various types of financial instruments are likely to differ considerably and depend on many factors – type of financial instrument, economic sector and target groups, implementation design, etc. The general and SME-specific good practice ex-ante assessment methodologies developed in cooperation with the EIB group were made available and presented to EGESIF on 27 March and are available online at http://ec.europa.eu/regional_policy/thefunds/fin_inst/index_en.cfm. National authorities can therefore use that methodology or apply any high quality methodology which provides the elements mentioned in the Regulation.

Finally, the ex-ante assessment must be submitted to the programme monitoring committee for information and its summary findings and conclusions must be published within three months of their date of finalisation (e.g. on the MA website).

7.2. Implementation options

The Managing Authority has the choice of five options. Examination of the first four options is a compulsory part of the ex-ante assessment described under 7.1.

(1) Implementation under shared management through an entrusted entity

The Managing Authority may set up a financial instrument at national, regional, transnational or cross-border level (Article 38(1)(b)) and entrust the implementation to other bodies: either directly to the EIB group or to another IFI or body fulfilling the relevant conditions (Article 38(4)(b)).

As part of this option, MA can avail themselves of the so-called off-the-shelf instruments, set out in an implementing act (Article 38(3)(a)). This is a facility offered by the Commission, consisting of sets of standard conditions for a limited number of different products. A risk-sharing loan instrument for SMEs, a guarantee instrument for SMEs and a renovation loan instrument for energy efficiency or renewable energies in the housing sector are available in Implementing Act 2014/964/EU. For the time being, rural development will offer loan, guarantee and equity off-the-shelf instruments. Further off-the-shelf products may be developed in the future, depending on the needs.

(2) Implementation under shared management through investment in capital of existing or newly created legal entity

Article 38(4)(a) enables managing authorities to implement financial instruments in the form of direct investments in the capital of existing or newly created legal entities, including legal entities financed from other ESI funds. This provision allows the managing authority to participate directly with share capital in investment vehicles which have or will be set up with the objective of supporting investment activities and final recipients consistent with the investment priorities and priority axis from which ESI funds resources are provided.

However, Article 38(4) imposes important limitations to such direct investments in share capital, of existing or newly created legal entities, namely:

- The target legal entity must be dedicated to implement financial instruments consistent with the objectives of the respective ESI Funds;
- The amounts and purpose of such direct investments must be limited to the amounts necessary to implement new investments in accordance with the provisions of Article 37; and
- This form of support, its amount and purpose must be strictly in line with the findings and conclusions of the ex-ante assessment, must comply with State aid rules and must target investments and recipients in line with the provisions of the ESI funds regulations, national eligibility rules and programme provisions.

Managing authorities must not use this implementation option and the provisions of Article 38(4) to provide ESI Funds to recapitalise existing legal entities, or to provide constitutive share capital to legal entities that have been set up with a broader scope. Such use would be contrary to the policy objectives and legal framework expressed in Article 38(4).

(3) Implementation under shared management of loans or guarantees directly (or through an intermediate body)

The managing authority can also directly implement loans or guarantees without the formal set-up of a fund under Article 38(4)(c). This partially exists today whereby Article 43a paragraph (1)(b) of the General Regulation (December 2011) envisages credit lines managed by the MA through intermediate bodies which are financial institutions (payments then follow a grant model). For this option there is no funding agreement but instead a Strategy Document (elements are set out in annex IV of the CPR) which will have to be examined by the Monitoring Committee. There is no advance payment to the "fund". Applications for payment should include the total amount of payments made by the MA for investments in final recipients (loans disbursed, guarantees committed). Management costs are not eligible under the same operation; however, they can be covered under programme technical assistance.

It is most likely that this option would be used for cases where there are a limited number of interventions not enough to justify the establishment of a stand-alone fund.

It should be noted that this option may not be possible in all Member States: it is subject to national law which will need to explicitly allow for the MA/IB to issue loans and guarantees (in certain cases there may be national legislation prohibiting para-banking).

(4) Contribution of ESIF programmes' allocation to EU level instrument (all except 'SME initiative')

This possibility to make ESIF programmes' contributions to EU level instruments established and managed in line with FR (title VIII, Articles 139-140) is a novelty for 2014-2020 and is included in Article 38(1)(a) of the CPR. The advantages include:

- The possibility for the MA to save time and resources on the set-up phase (e.g. selection of financial intermediaries) as the EU level instrument delivery system is used;

- The MA will not have to undertake on the spot verifications (regular control reports by bodies entrusted with the implementation) and the audit authority will not have to undertake audits of operations and audits of management and control systems (regular control reports from the auditors designated in the agreements setting up these FI); and
- One EU level instrument may comprise several compartments, thus achieving significant critical mass and economies of scale.

Some elements do not change, however. The decision to make a contribution will have to be based on the ex-ante assessment just as for the other implementation options. The ESIF programmes' allocation is ring-fenced and to be invested in the programme area. The CPR rules for ESIF programmes' contribution apply (eligibility scope, geographical limitation, end date of eligibility), alongside the EAFRD regulation for rural development interventions. The MA is ultimately responsible for this operation and the rules for payments and reporting are the same as for options (1) and (2).

(5) Contribution of ESIF programmes' allocation to EU level instrument ('SME initiative' only)

In view of the anti-crisis objective of the SME initiative, there are specific rules governing the contribution of ESIF programme allocations to this initiative, set out in Article 39 of the CPR. These apply only to the ERDF and EAFRD and include some rules which differ from those governing other ESIF contributions to financial instruments, including:

- Ex-ante assessment at EU-level to replace both programme ex-ante evaluation and MS / regional ex-ante assessment;
- A single national programme for each fund. National coverage of this single programme regardless of origin of funding contribution, unless otherwise negotiated in the funding agreement;
- Requests for payment to the Commission can be 100% of the amounts paid to the EIB, thus no national co-financing is required;
- Additional reporting elements to ensure monitoring of the amounts of new loans disbursed to SMEs; and
- Exemption from the performance framework and performance reserve.

It should also be noted that a MS can contribute up to 7% of its total ERDF and EAFRD allocation to the SME initiative, with a global ceiling at EU level of EUR 8.5 billion (2011 prices).

7.3. Combination of funds and forms of support

The CPR makes it clear that all types of combination will be possible: combination of different programme contributions and different funds in one financial instrument, combination of financial instruments and grants and other forms of support.

Combination of funds from different sources in one financial instrument may contribute to benefiting from advantages of critical mass and economies of scale as well as covering a wider spectrum of policy objectives. In this case, each stream of funding will constitute a separate operation and will have to contribute respectively to the objectives of the

respective priority axis. In addition, separate records for reporting and for audit purposes will need to be kept as well as sector-specific eligibility conditions.

For the combination of ESIF financial instruments with ESIF grants or other forms of support, there are two possibilities. Firstly, it will be possible for certain specific types of grants (interest rate subsidy, guarantee fee subsidy or technical support as provided by Article 37(7) of the CPR and specified in Article 5 of the Delegated Act²) and financial instruments to be combined within the same operation and to be treated as a single financial instrument. Other types of grants or other forms of support cannot be considered to be part of an operation comprising a financial instrument. Secondly, it will be possible for operations comprising grants or other forms of support on one hand and on the other hand operations comprising financial instruments to be combined to finance the same investment at the level of final recipient, however as separate and distinct operations.

The overall guiding principle for all cases is that the same expenditure cannot be declared twice to the Commission. Grants shall not be used to reimburse support received from financial instruments and financial instruments shall not be used to pre-finance grants.

7.4. Co-financing

Significant additional flexibility is introduced whereby national public & private co-financing contributions under programmes may be provided at the level of the financial instrument (fund of funds or financial intermediary) or at the level of the investment in final recipient (including in-kind contributions where relevant, except for the EAFRD). National co-financing does not have to be paid to the financial instrument upfront but may be provided at later stages of financial instrument implementation. The article on payments contains provisions to allow for the full reimbursement of ESIF contributions even when material co-financing is provided at a later stage. However, it has to be provided before the end of the eligibility period.

In many financial instruments a private contribution will be present and is encouraged to increase leverage (it may also be required by State aid rules). For cohesion policy, programmes based on total eligible expenditure may facilitate co-financing and implementation (MA to decide upfront).

In kind contributions are possible only in the form of land and real estate for rural development, urban development or urban regeneration where the land or real estate is part of the investment and where the conditions under CPR 69(1) are met.

7.5. Financial management of ESIF contributions to financial instruments and resources paid back

The legislative framework aims to ensure continuity and certainty regarding the financial management of ESIF contributions to financial instruments.

ESIF contributions to financial instruments are to be placed in interest-bearing accounts in Member States or to be temporarily invested in accordance with the principles of sound financial management. Interest or other gains generated at the level of the financial

² Commission Delegated Regulation (EU) No 480/2014

instruments prior to investment in final recipients, which are attributable to ESIF support, are to be used for the same purposes as the initial ESIF contribution.

The ESIF share of capital resources paid back from investments and of gains/earnings/yields generated by investments during the eligibility period must be used for:

- Further investments in the same or other financial instruments, in line with the OP;
- Where applicable, preferential remuneration of investors operating under the market economy investor principle (MEIP) and providing co-investment at the level of financial instrument or final recipient. In this case the ex-ante assessment must demonstrate this need and the investment strategy should provide indications for its quantification; and
- Where applicable, management costs/fees.

Member States must have in place the necessary provisions (legislation, eligibility rules etc.) to ensure that capital resources and gains and other earnings or yields attributable to the EU contributions to FIs and generated during a period of at least 8 years after the end of the eligibility period are used in line with the aims of the programme.

7.6. Eligibility

(1) What types of financial instruments are eligible? What constitutes eligible expenditure at closure?

ESIF programme support delivered through financial instruments will take the form of loans, guarantees and equity/venture capital. Standalone interest rate subsidies and guarantee fee subsidies are not considered to be financial instruments (whereas if they are combined in a single operation with financial instruments the provisions applicable to financial instruments will apply also to them).

Eligible expenditure at closure includes:

- Payments to final recipients (for example, loans actually disbursed) and to the benefit of final recipients.
- Resources committed for guarantee contracts, whether outstanding or already come to maturity, in order to honour possible guarantee calls for losses, covering a multiple amount of underlying new loans or other risk-bearing instruments for new investments in final recipients effectively disbursed before the end of the eligibility period. The guarantee product needs to have been developed on the basis of an ex-ante risk assessment (NOT the same as the ex-ante assessment)
- Capitalised interest rate subsidies or guarantee fee subsidies to be paid for a period not exceeding 10 years after the eligibility period used in combination with financial instruments and paid into an escrow account specifically set up for that purpose.
- Management costs and fees (see also 7.9), including capitalised management costs or fees for equity-based instruments and micro-credit due to be paid for a period not exceeding 6 years after the eligibility period, in respect of investments in final recipients which occurred within the eligibility period and when paid into an escrow account specifically set up for this purpose.

- In the case of equity-based instruments targeting enterprises, for which the funding agreement was signed before end-2017, which by the end of the eligibility period invested at least 55%, a limited amount of payments to final recipients to be made within 4 years after the end of the eligibility period, if paid into an escrow account specifically set up for this purpose.

(2) Other eligibility questions: VAT, working capital, completed projects, capitalised expenditure, durability

VAT

VAT at the level of final recipient is eligible only for the repayable type of assistance and in relation to the supported investment. Where financial instruments are combined with grants under paragraph 7 or 8 of Article 37 of the CPR, the provisions of the relevant article for grants apply to the grant part.

Working capital

Working capital can be included as part of the support provided to enterprises at their establishment, as early stage capital (seed capital and start-up capital), expansion capital, capital for the strengthening of the general activities of an enterprise, or the realisation of new projects, penetration of new markets or new developments by existing enterprises. This is with a view to stimulate the private sector as a supplier of funding to enterprises, and only within the limits of applicable State aid rules.

Working capital that is ancillary and linked to a new investment in the agriculture or forestry sector, which receives EAFRD support through a financial instruments established in accordance with the CPR, may be eligible expenditure (Article 45(5) of R 1305/2013). It shall not exceed 30% of the total amount of the eligible expenditure for the investment (or its part) supported by the financial instrument and the relevant request shall be duly substantiated. For forestry, it is additionally limited to maximum 200,000 euro (forestry "de minimis").

Completed projects

As for grants, financial instruments should not provide support to completed projects. Exceptions to that rule are financial instruments which support infrastructure with the objective of supporting urban development or urban regeneration or diversifying agricultural activities in rural areas. In these cases such support may include the amount necessary for the reorganisation of a debt portfolio for infrastructure forming part of the new investment, up to maximum of 20% of the total amount of programme support from the financial instrument to the investment.

Transfer of enterprises

In case of support to enterprises the acquisition of proprietary rights as part of a new investment does not count as a completed project but does have certain conditions (e.g. it must take place between independent investors or it must be related to at least one activity listed in Article 37(4), like realisation of new projects, or penetration of new markets etc.).

Durability

The CPR specifies that the provisions of Article 71 on durability do not apply to contributions to or by financial instruments. This is because for financial instruments the operation is constituted both by the contribution to the financial instrument and the subsequent investments by the financial instrument i.e. not just the investment in final recipient.

Nevertheless the provisions of Article 40(3)(a) of the CPR and of Article 9(1)(d)(i) of the Delegated Regulation (EU) No 480/2014 on management and control speak about the evidence of use of support from the financial instrument for the intended purpose in line with applicable law. At the time of the investment and during the reimbursement of the loan, final recipients shall therefore have a registered place of business in a Member State and the economic activity for which the loan was disbursed shall be located in the relevant Member State and Region/Jurisdiction of the ESIF programme. Any resources paid back must be reused in accordance with Article 44 and 45 CPR.

7.7. State aid

For financial instruments, State aid has to be complied with by all three levels: managing authority, Fund of Funds and the Financial Intermediary. Aid should be considered at different levels: the fund manager (who is remunerated), the private investor (who is co-investing and may receive aid) and the final recipient. For the ESIF, Article 37(12) of the CPR clarifies the relevant applicability: *'For the purposes of the application of this Article, the applicable Union State aid rules shall be those in force at the time when the managing authority or the body that implements the fund of funds contractually commits programme contributions to a financial instrument, or when the financial instrument contractually commits programme contributions to final recipients, as applicable.'*

For financial instruments supported by the EAFRD and covering investments in agriculture and forestry, the specific state aid rules on agriculture and/or forestry should be respected as well as the amounts and support rates as defined in Annex II of the EAFRD regulation and in the respective RDP.

For financial instruments supported by the EMFF the specific state aid rules applicable to the fisheries and aquaculture sector should be respected as well as the amounts, co-financing rates and intensity of public aid rules as defined in the EMFF and its Annex I.

7.8. Management costs and fees

Bodies implementing financial instruments may charge to the ESIF programmes costs and fees for managing contributions received from operational programmes to support final recipients. For 2014-2020 Article 12 and Article 13 of the Delegated Act set out criteria for determining management costs and fees on the basis of performance and applicable thresholds aimed both at increasing the efficiency and effectiveness of investments undertaken by the instruments and avoiding undesirable practice such as double-charging of costs to both the final recipients and the ESI Funds.

This performance-based approach will take into account the disbursement of contributions provided by the ESI Funds programmes, the resources paid back from investments or from the release of resources committed for guarantee contracts, the quality of measures accompanying the investment before and after the investment decision to maximise its impact and the contribution of the financial instrument to the objectives and outputs of the programme. Eligible management costs and fees have to comply with the provisions under Article 13 of Regulation 480/2014. The methodology should be included in the relevant funding agreement and the monitoring committee is to be informed of the methodology. The monitoring committee should receive reports on an annual basis on the management costs and fees effectively paid in the preceding calendar year.

8. PAYMENTS

The CPR provides for phased applications for interim payment in a way that prevents excessive payment of programme resources to financial instruments, while ensuring both the proper functioning and liquidity of these instruments. In this context, it also provides flexibility concerning payment of national co-financing to the instruments.

For all ESIF programme contributions to financial instruments with the exception of the SME initiative and financial instruments implemented directly by the MA, this will work as follows. Each application for interim payment shall include the amount of programme contribution paid to the financial instrument and shall not exceed 25% of the total programme contributions committed to the financial instrument. Each interim payment can also include up to 25% of the national co-financing expected to be paid to the financial instrument or final recipient, thus allowing that the whole amount of ESIF contributions to a financial instrument could be reimbursed even when national co-financing is provided at a later stage (before the end of the eligibility period) along the investment chain.

The second application for interim payment can only be submitted once 60% of the amount included in the first interim payment has been spent as eligible expenditure i.e. has been disbursed to final recipients, has been committed for guarantee contracts, has been paid as management costs and fees etc. The third and subsequent applications for interim payment can only be submitted once 85% of the amounts included in the previous applications for payment have been spent as eligible expenditure i.e. have been disbursed to final recipients, committed for guarantee contracts or reimbursed as management costs and fees etc.

9. MONITORING AND REPORTING

9.1. Annual and final implementation reports

Given the specific procedures and delivery structures for financial instruments, the availability and reporting of monitoring data on the use of budgetary resources from the ESI Funds is of key importance to all ESIF stakeholders as it allows conclusions to be drawn on the actual performance of supported instruments and adjustments which may be needed to safeguard their effectiveness.

Managing authorities will therefore need to provide specific reporting on operations comprising financial instruments as an annex to the annual implementation report. This will be similar to the reporting for ERDF and ESF under the current regulation, with the addition of a number of elements (leverage, performance) to bring the ESIF reporting in line with the Financial Regulation. For the CF, EAFRD and EMFF this reporting is a novelty. The Commission services will from 2016 onwards need to compile this information in summaries per each ESI Fund.

9.2. Monitoring committee

The monitoring committee has a specific responsibility to examine financial instruments. The monitoring committee also has to receive the ex-ante assessment 'for information' and the strategy document for the financial instrument implemented directly by managing authority or intermediate body "for examination", and should be informed of the methodology for management costs and fees and receive annual reports on the management costs and fees effectively paid, as well as the specific reporting on financial instruments referred to in point 9.1, above.

10. AUDIT

Financial instruments form part of operations supported with ESIF resources within a priority of a programme, and as such should be subject to normal management and control provisions as foreseen by the CPR, unless specified otherwise.

The CPR provisions on audit allow for controls at the level of the final recipient only if necessary documents are not available at the level of the managing authority or body implementing the financial instrument or there is evidence that the documents available at these levels do not represent a true and accurate record. Furthermore, the bodies implementing financial instruments will be responsible for ensuring that supporting documents are available and shall not impose on final recipients record-keeping requirements that go beyond the necessary. Article 9 of the Delegated Act also sets out specific arrangements on management and control provisions including evidence for eligible expenditure, and provisions for management verifications, adequate audit trail, and mandating a firm operating under a common framework contract for on-the-spot verifications or audits of financial instruments implemented by the EIB.

Funding agreements should contain provisions concerning the responsibilities and liabilities of the MA, bodies implementing the financial instruments and final recipients in the case of irregularities and financial corrections. The management and control provisions will reflect the specificities of all the Funds covered by the CPR.

11. TECHNICAL ASSISTANCE

In the 2007-2013 programming period, the Commission put in place a system to provide technical assistance for the implementation of financial engineering instruments, comprising of JEREMIE (FEIs for enterprises), JESSICA (FEIs for urban development) and JASMINE (micro-credit) initiatives.

For the 2014-2020 programming period, following the extended scope for the use of financial instruments, *fi-compass*, a unique platform for advisory services on financial instruments under the ESIF has been created (<http://www.fi-compass.eu/>).

The *fi-compass* platform will be applicable to all ESI Funds and will provide common and fund-specific products related to financial instruments, covering the whole implementation cycle.

The EIB Group will be entrusted with the horizontal strand of the *fi-compass* focusing on advisory services applicable to all Member States and types of financial instruments to ensure high standards and consistency (e.g. exchange of best practice, networking, training, methodological guidance on common themes such as ex-ante assessments, public procurement, State aid, etc.).

There will also be a strand for Multi-region assistance responding to proposals of various policy stakeholders for the benefit of minimum two regions in at least two Member States. Such activities would typically include support for the feasibility assessment and possibly development of financial instruments targeting specific development objectives that are shared by the concerned regions (e.g. the financing of energy efficiency interventions in large housing estates in Central and Eastern Europe or support to cross-border initiatives aimed at reaching economies of scale and integration).

In addition, Member States will be able to use the technical assistance budget foreseen in their programmes for any further specific assistance, for instance for carrying out the ex-ante assessment or for hiring a specialised body to assist the setting up of a financial instrument in its programme area.