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FINANCIAL ENGINEERING

Complement to Eurada-News Nr 359 dated 10 June 2013. You will find below a short summary of the items discussed in the informal meeting DG Regio organized on 20 June 2013.

It would seem that the "off-the-shelf-instrument" fiches will be published by DG Regio and the European Investment Bank in July 2013.

Proposed framework for financial instruments under the European Structural and Investment (ESI) funds 2014 - 2020

Informal stakeholder meeting. DG Regio. 20 June 2013

Introduction

The European Commission (EC) states that delays on this meeting are due the institutional process of approving the regulation. It is still under negotiations in the trilogue, but it is almost finished. It is planned to be voted by European Parliament in a plenary session in September. A similar meeting to this one has taken place in the same week (Monday) with national experts.

EC recalls Financial Instruments (FI) are very efficient means to reach policy objectives. They encourage us to use them because it is possible to recycle resources (revolving funds), leverage private resources, we get better performance, sustainability and increase the overall quality because FI makes necessary to bring qualified expertise. At the same time, FI are more complex than traditional grants, it is challenging to implement them. The EC has developed models, the off-the-shelf financial instruments, to easier and speed-up their implementation. They offer technical assistance for member states and managing authorities (MA).

The regulation is applicable to the European Regional Development Fund (ERDF), the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF). The last document available publicly is the Council agreement of 20th June 2012 ([2011/0276 \(COD\)](#)), but despite is one year old, there are not bigger changes with the proposal no publicly available that is currently under negotiations. This document could be a good reference. For the end of June there will be a definitive text. These funds involve public money and are consequently under state aid rules.

FI have increased their use over the years. During the period 2000-2006, only 1% of the ERDF funds were used in a few countries (UK, PT, DE, etc.) with tradition in these instruments. In the current period (data are available until 2001), the investment in financial instruments is over 5%. It is estimated in 10.7 billion of euro with 8.2 billion dedicated to companies. But the EC recognises that there had been difficulties due its inadequate legal framework, there new challenges for MA and there had been critics about how has been done the implementation¹.

Main characteristics of the proposed framework for financial instruments

- Wider scope: Any of the 11 thematic objectives² of the structural funds could be carried out using FI.
- Unique legal framework for all the shared management funds, to make easier creation of synergies and making possible the creation of funds using different funds.

¹ In particular it is necessary to consider the report of the Court of Auditors ([special report 2/2012](#)) on financial instruments for SMEs co-financed by the European Regional Development Fund

² See article 9 of the regulation laying down common provisions for the CSF funds ([COM\(2013\) 246](#))

- Legal framework will be easier, because there will be interpretation guidelines. The EC will write them to answer questions pointed out by MA or member states. To make the legal framework easier to understand it will be eliminated the current dispersion with several guidance notes of the Coordination Committee of the Funds (COCOF).
- It provides new options to implement financial instruments:
 - i. Shared managed FI, where the responsibility is the MA and are tailor made for the special conditions of the region.
 - ii. A new option, off-the-shelf, with a standard set of conditions to save time and difficulties to set-up a financial instrument. It will be available in a draft version in July.
 - iii. Make use of the FI put in place by EC, directly or indirectly, as the risk sharing facility, H2020 or COSME.
 - iv. It is possible to provide funds directly by the MA in loans and guarantees but not in equity.
- It is going to be necessary to carry out an ex-ante assessment³ to avoid a bad design of FI. It has been detected cases of over allocation of resources⁴, in part to avoid de-commitment rules. This has caused that some funds are not used while there is a societal demand to use those financial resources. The European Investment Bank is preparing a detailed methodology about how to carry out an ex-ante assessment that would be available in October 2013.
- Greater flexibility, because it is possible to combine grants and FI within the same operation. For example, it would be possible to give grants to help companies to make business plans and later apply loans for the investments. The same fund manager could use different instruments in its fund as grants, guarantees, loans or equity; it is also possible to combine in the same fund different public sources of money with private co-financing contributions. For example, the fund would be able to provide to an existing factory a loan for the investment in a new manufacturing line and combine it with a grant to set-up a depuration line to comply with environmental regulations.
- There is an incentive to use FI instruments, EC cofinancing rate is increased by 10% if an entire priority axis is implemented through FI⁵.
- There are provisions to avoid the use of FI as means to park money, thus designing the instrument to answer actual needs by transferring up to 25% of the total resources needed upfront⁶.

³ See article 32.2 of the Presidency of the Council compromise on financial instruments ([11027/12 ADD 2 REV 1](#)) where it could be seen the contents of the ex-ante assessment.

⁴ See page 4 of the Commission Staff Working Document on Financial Instruments in Cohesion Policy ([SWD\(2012\) 36 final](#))

⁵ See article 110.5 of the Proposal for a Regulation laying down common provisions of the CSF Funds ([COM\(2011\) 615 final/2](#))

⁶ See article 35.1.b of the Presidency of the Council compromise on financial instruments ([11027/12 ADD 2 REV 1](#))

- It is possible to consider an asymmetric remuneration of the private contribution to financial instruments. These are means to combine public policy objectives and profit sought by the private contributors to the fund. But has to be done accordingly with state-aid rules. Public authorities give up some of their return to cover the expected profits of the private contribution to the FI.
- There is going to be detailed rules about monitoring on a yearly basis, the EC does not have updated information about what is happening in the execution of the fund in the regions. For example in this moment the EC only have information up to 2011.

Delegated acts

- It will be possible to purchase land up to 10% as states art. 32.10. In the special case of funds dedicated to urban regeneration this 10% limit works only for the whole fund, thus it is possible to provide financial instruments to a single operation with more than 10% of purchase of land or land with a building in it; in the same fund for urban regeneration there should be operations with less than 10% of land purchases to compensate this operation.
- Financial instruments are public money and should be used to solve market failures. Considering Art. 33.4, there should be a transparent process for the selection of operations, that guarantees equal opportunities, done with enough publicity and with a selection under due diligence principles. Accordingly with draft regulation it is possible to provide a preferential remuneration to some private investors in the funds. However it is not possible to shield private investors for taking risks.
- Regarding audits as states in art. 34.5, the EC could not provide more details than the draft because it is under discussions in the trilogue. However, the draft of the audits limits the time available to do the audits in order to cause less inconveniences to final recipients. The audit system is like a pyramid, with a single MA, below the fund of funds, below the financial intermediaries and in the base of the pyramid the recipients. The auditors of the EC go where it is necessary to collect evidences. If these evidences are available in the MA the auditors do not go further below.
- The EC has doubts about what would be the translation of the term "escrow account"⁷ in each language. Antonio Goncalves (DG Regio) would be very grateful if we could provide a translation into our language.

Implementation acts

- Accordingly with Art.33.9 it is possible to set-up transnational funds. But it should be taken into account that there are national laws for structural funds that differs one from another. A financial instrument that would cover several member states has to comply with the national laws where it has effect.

⁷ In Spanish it could be "cuenta de depósito en garantía", but I am not sure!

- Art.36.5 limits the fees of the fund manager. In some experiences in the past, the fund manager perceives a fee calculated just as a percentage of amount of money paid into the fund, considering that in some of them the total payment was done upfront, the fund manager does not have any incentive to make the fund work. Accordingly with current regulation it is acceptable to guarantee a minimum level of income to the fund manager, but to get a successful fund it is necessary to link the remuneration of the fund manager with the reception of money by the SMEs or when the money is recycled and used in another operation.

Off-the-shelf instrument

- There will be five instruments. We will have a draft of them in July.
- The instruments have been designed using the limits imposed by the different regulations, in particular state aid. If the MA wants to set-up an instrument with different conditions, it has to be tailor made and the MA has to check if it is done accordingly with different regulations. In any case, these off-the-shelf instruments could be a starting point to develop the financial instruments.
- The five instruments are:
 1. Loan for SMEs (RS Loan). It is an instrument similar to Jeremie. It is under discussion how will be the risk sharing, but probably it could be up to 80%-20%
 2. Guarantee for SMEs (partial first loss portfolio). There should be a leverage effect of 4.
 3. Venture capital for SMEs and start-up (Co-investment facility). It is establish in those places where equity market is not mature enough. It is used the block-exemption of the state aid regulation, with a maximum investment of 10 million euro and private investments of 10%-40%-60%.
 4. Loan for energy efficiency. It is similar to Jessica
 5. Loans for urban development. The EC has doubts regarding the effectiveness of this off-the-shelf instrument because normally urban development depends highly on local conditions. Probably it is not going to be used because there will be needed tailor made FI for sustainable urban development.

The EC will develop on demand further off-the-shelf instruments. DG Agri is developing similar instruments for EAFRD.

A technical assistance platform for financial instruments in cohesion policy

- EC is going to consolidate all the assistance services in one single support system. It will provide methodological support and capacity to MA and stakeholders during the whole life cycle of the financial instrument, from its design, its set-up, implementation to exit and closure. For example this assistance could be used for the ex-ante assessment, to develop a business plan for the financial instrument or to establish public procurement.

- **It will be used by all the CSF funds:** European Regional Development Fund (ERDF), the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF).
- The main provider of assistance will be the European Investment Bank, because it has the capacity and similar objectives in regional development as DG Regio. The operative will be similar to Jeremie and Jessica with written material, workshop and seminars; but all the efforts are going to be concentrated in a single technical platform that would be complemented with a multi-regional platform that will be created by a call for proposal to be open at the end of this year 2013.

Conclusions

- EC is very interested on getting our feedback. Any comments on delegated acts, implement acts, of-the-shelf and technical assistance, should be sent to the EC before the end of this week (28th of June).
- There will be another meeting like this in September. In July will be published the off-the-shelf draft and the text approved in the European Parliament.

References

- Presidency of the Council compromise on financial instruments ([11027/12 ADD 2 REV 1](#))
- EC Brochure: [Financial Instruments in Cohesion Policy 2014-2020](#)
- Commission Staff Working Document: [Financial Instruments in Cohesion Policy](#). SWD(2012) 36 final