

HIGH LEVEL GROUP REFLECTING ON FUTURE COHESION POLICY

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FINANCIAL INSTRUMENTS

This document has been prepared by DG Regional Policy as the basis for a discussion with experts as part of a general reflection process on the future of cohesion policy. It does not prejudge in any way the final position of DG Regional Policy or the Commission on these questions.

1. INTRODUCTION

The EU budget review ¹ makes a strong case for increasing the leverage effect of the EU budget and gives particular relevance to financial instruments, as catalysts of public and private resources, to achieve the strategic investment levels needed to implement the EU 2020 strategy. Accordingly, the next Multiannual Financial Framework is expected to foresee a stronger role for financial instruments which have a multiplying effect on EU budget investments and mobilise additional public or private co-investments to address market failures in line with EU 2020 policy priorities.

In the context of cohesion policy, new forms of repayable finance for investment were further developed in the 2007-2013 programming period, providing more efficient and sustainable alternatives to traditional grant-based financing, including combining grants and financial instruments. The analysis and conclusions of the 5th Cohesion Report clearly confirmed the rationale for financial instruments in cohesion policy and set the aim of extending their use in post 2013, both in terms of scope (wider range of activities and sectors) and scale.

At various instances, and more specifically in the context of the sixth meeting of the High Level Group in September 2010, Member States expressed general support to the proposed expansion and strengthening of financial instruments in future cohesion policy, but not for a total replacement of grants in specified sectors (such as enterprise support). At the same time, Member States also stressed the need for simpler, clearer and more flexible rules, particularly regarding the scope of actions, geographic coverage, but also for a clearer distinction between specific rules applicable to grant financing and those applicable to financial instruments.

This document sets out the proposed modalities for an effective and efficient implementation of financial instruments in the post-2013 cohesion policy, taking into account the political orientations proposed in the budget review and in the 5th Cohesion Report, as well as the views expressed in the High Level Group meeting of 23 September. It also takes into account other relevant EU policy initiatives currently being discussed, as well as the implementation experience of the current programming period.

¹ COM(2010) 700 of 19.10.2010.

2. COMPLEMENTARITIES AND CONSISTENCY BETWEEN FINANCIAL INSTRUMENTS AT EU LEVEL AND NATIONAL/REGIONAL LEVEL

The political orientations expressed in the EU budget review point to a much higher degree of coordination and consistency between financial instruments implemented across EU policy areas, as well as to a much stronger involvement of the private and financial sectors, in partnership with the EIB and other financial institutions. Financial instruments should be designed and implemented in a way to promote substantial participation by private sector investors and financial institutions on an appropriate risk-sharing basis, with the view to deliver growth, job creation, innovation, economic infrastructure and to support policies.

To this end, the Commission developed a new basic concept for a more systematic and standardised use of financial instruments, based on EU Equity and Debt Platforms (the Platforms), which aim to ensure a high degree of harmonisation and efficiency in the design and management of financial instruments. The Platforms will represent a set of common rules, standards and procedures, forming a harmonised foundation on which to build EU equity and debt instruments for the next financial framework, in the interest of transparency, simplification and sound financial management.

To achieve synergies and consistency between financial instruments implemented across EU policy areas, financial instruments to be implemented under cohesion policy at the national/regional level need to be coherent and complementary with the future instruments implemented by the Commission under direct management. At the same time, the principles of shared management and relevant specificities of Structural Funds need to be safeguarded. Moreover, such a framework should not generate additional burden for the parties concerned.

The Commission services are currently developing proposals for the first debt and equity financial instruments for specific EU 2020 policy priorities, along the lines of the proposed Platforms, for example in the area of research and innovation. These proposals acknowledge that synergies and complementarities between the new EU level financial instruments and national/regional financial instruments need to be developed in the context of the Cohesion/Europe 2020 Framework, which focuses on galvanising growth at national and regional level.

Future Structural Funds regulations must provide the regulatory and operational frameworks which facilitate complementarities and consistency of financial instruments at national/regional and EU-level.

3. SCOPE OF FINANCIAL INSTRUMENTS IN THE POST-2013 COHESION POLICY FRAMEWORK

With reference to the political orientations expressed in the budget review and in the conclusions of the 5th Cohesion Report concerning the future of financial instruments, in line with the framework discussed above and taking into account the lessons learnt from the current programming period, it is proposed that Structural Funds regulations post-2013 should:

- be non-prescriptive concerning sectors, beneficiaries, types of projects and activities which are intended to be supported through financial instruments. Instead, financial

instruments should be based on programme objectives and projects' capacity to generate revenue needed for financial instruments to be effective;

- encourage Member States and regions to make a wider use of financial instruments instead of grants, whenever justified by reasons of public policy, economy and/or efficiency of the assistance;
- provide for a range of implementation options, including the possibility to contribute to EU-level instruments, allowing Member States and regions to implement financial instruments in accordance with their specific technical and managerial capacity;
- avoid current difficulties, where non typified repayable forms of assistance fall outside the remit of financial engineering instruments;
- allow for an efficient combination of repayable forms of assistance with other forms of assistance, including contributions from the private sector and financial intermediaries.

4. BUILDING BLOCKS FOR FINANCIAL INSTRUMENTS POST-2013: TOWARDS INCREASED FLEXIBILITY AND EFFICIENCY

Taking into consideration sections 1 to 3 of this document, the following concepts and principles are proposed to form the basis of the regulatory and operational cohesion policy framework for financial instruments in the programming period post 2013.

4.1. Design of financial instruments

Financial instruments are a special category of spending and their success hinges on a correct assessment of market gaps and needs and suitable, well thought-out design, also in order to avoid the overlaps and inconsistencies between instruments implemented at different levels. In the context of an operational programme, financial instruments should be designed therefore on the basis of an *ex ante assessment* which has identified market failures or sub-optimal investment situations and investment needs. Financial instruments should also be implemented in a way to promote substantial *participation by private sector and other non-public investors and financial institutions on an appropriate risk-sharing basis*.

Q1 - Design of financial instruments: Do you agree with the requirement of ex-ante assessment to inform the design of financial instruments? Do you agree that financial instruments should be designed in a way to attract participation by private sector investors?

4.2. Implementation principles

Where Member States decide to contribute Structural Funds and Cohesion Fund resources to financial instruments under an operational programme in order to achieve the specific objectives of a priority axis, it is proposed that they may choose following options:

- (1) *Contribute to specific compartments² within financial instruments set up at Union level, managed directly or indirectly by the European Commission.*

In such cases the scope and structure of the financial instruments, including governance structures, management responsibilities, implementation principles, monitoring and control and other relevant provisions, will be defined in the Financial Regulation, Implementing Rules, Commission Decisions and other specific legislation.

These Implementing rules or other horizontal legislation concerning financial instruments at Union level must provide Member States with the assurance that their contributions would be "ring fenced" for investments in beneficiaries and regions as defined in the programme. Contributing Member States should also have the possibility to participate in governance structures at the appropriate level.

- (2) *Contribute to financial instruments set up at national or regional level, managed by or under the responsibility of the managing authority.*

In such cases, the Member States may implement the financial instruments by using:

- (a) *standardised (off-the-shelf) models of financial instruments, including governance structures and standard terms and conditions (to be laid down in the Commission Implementing Regulation concerning Structural Funds and in further guidance notes). This option is meant to facilitate an early set-up of financial instruments and to streamline monitoring and control procedures.*
- (b) *tailored financial instruments already existing or newly created at national or regional level which are designed to achieve the intended purpose and which respect the applicable Union and national rules.*

This option provides for tailor-made instruments to be designed by each Member State or region, in accordance with the specific needs and characteristics of the support measures envisaged. These instruments are to be designed and implemented within the limits of the provisions of the regulations and in line with the principles expressed above for a closer coordination of financial instruments at national/regional and EU-level.

Regardless of the option chosen, it is proposed that managing authorities should have the possibility to implement financial instruments either by investing in the capital of existing or newly created legal entities or by providing capital contributions in the form of segregated assets to an entity, which will undertake implementation tasks. Such entity could be the EIB Group or another international financial institution, or a body governed by public or private law in accordance with applicable Union and national rules. Managing authorities would also have the possibility to implement financial instruments by undertaking directly implementation tasks, namely in the case of financial instruments consisting of loans or guarantees.

² The establishment of a compartment under the European Microfinance Platform of the European Progress Microfinance Facility is an example of this option.

Q2 – Complementarities with EU-level instruments: Do you agree that the future regulations should provide Member States with the flexibility to contribute cohesion policy resources to financial instruments at EU-level, provided that such contributions can be ring-fenced for investments in regions and beneficiaries as defined in the relevant programme and in pursuit of underlying programme objectives?

Q3 – Standardised models of financial instruments: Do you agree that standardised models of financial instruments in the cohesion policy framework would facilitate, speed-up and catalyse the implementation of such instruments?

Q4 – Direct implementation by the managing authorities: Do you agree that the direct implementation of financial instruments adds additional flexibility for achieving the objectives of the programmes? If so, do you consider this option feasible in terms of technical and managerial capacities of managing authorities?

5. MANAGEMENT OF PROGRAMME RESOURCES CONTRIBUTED TO FINANCIAL INSTRUMENTS

5.1. Contributions from the Funds to Financial Instruments

Co-financing requirements – incentivising the use of financial instruments

The current provisions regarding the calculation of interim payments on the basis of the co-financing rate of the priority axis concerned often raise the basic problem of lack of match funding at the level of funds. Solutions are therefore proposed which offer the possibility of 100% reimbursement of EU contributions into funds without putting into cause the principle of co-financing:

- *Contributions to specific compartments of financial instruments set up at Union level, managed directly or indirectly by the European Commission (as proposed in section 4.2, option (1), may be funded entirely with resources from the Structural Funds or the Cohesion Fund and should not be subject to the co-financing rates of the operational programme at the level of the contribution to the financial instrument proper. As a result, the statement of expenditure shall only include the total amount of the EU contribution paid to the financial instrument. However, at the level of investments in enterprises and other beneficiaries, it is expected that such financial instruments will always co-invest with other public or private investors, in line with the objectives of each instrument.*
- *For contributions to financial instruments set up at national or regional level, managed by or under the responsibility of the managing authority (as proposed in section 4.2, option 2), it is proposed that the statement of expenditure should include the total amount of the EU contribution paid to the financial instrument, plus the corresponding national contribution paid or expected to be paid to the financial instrument. In this way, when contributing resources to financial instruments, managing authorities would be reimbursed 100% of the EU contribution. At closure, however, the co-financing rates of the priority axis should be effectively achieved, measured at the level of the investments in final recipients.*

Phased contributions to financial instruments – fostering sound financial management

In accordance with the principles of sound financial management, the Commission considers that irrespective of the commitments made, actual payment of the EU contributions to financial instruments must correspond to the amounts necessary to meet investment needs and demand over a pre-defined period of time, based on realistic business plans.

It is proposed therefore that the statement of expenditure should include the total amount paid to the financial instrument, for concrete investments expected to be made by the financial instrument over a pre-defined period of maximum two years, including management costs and fees. The amount calculated in accordance with this approach should then be adjusted in the subsequent statements of expenditure, to take account of the difference between the contributions previously paid to the financial instrument concerned and the amounts effectively invested, plus management costs and fees paid.

Q5 – Co-financing: *Do you consider the proposed possibility of 100% reimbursement of EU contributions into funds (without putting into cause the principle of co-financing) a feasible incentive for the use of financial instruments?*

Q6 – Phased contributions: *Do you agree with the concept of "phased payments to funds based on a realistic assessment of the investment needs over a predefined period of maximum two years" to enhance the effectiveness and efficiency of programme resources?*

5.2. Financial management of budget commitments

Building on recent discussions in the context of the COCOF, future provisions concerning the financial management of EU contributions to financial instruments should provide more clarity when it comes to the qualification of financial streams at the different levels of financial instruments and corresponding eligibility and legacy requirements. The following provisions are proposed:

Interest and other gains generated by EU contributions to financial instruments prior to investments

EU contributions paid to financial instruments should be placed in interest-bearing accounts domiciled within financial institutions in the Member States or invested on a temporary basis according to the principle of sound financial management. Moreover, interest and other gains attributable to the EU contribution paid to financial instruments should be used for the same purposes as the initial EU contribution within the same financial instrument.

Re-use of resources attributable to EU contributions until closure of the programme

Capital resources paid back to the financial instruments from investments or from the release of the resources committed for guarantee contracts, which are attributable to the EU contribution, should be re-used for further investments through the same or other financial instruments, in line with the aims of the programme.

Gains and other earnings or yields, such as interests, guarantee fees, dividends, capital gains or any other income receipts generated by investments, attributable to the EU contribution to

the financial instrument, should be used for the following purposes, where applicable, up to the amounts necessary:

- reimbursement of management costs incurred and payment of management fees of the financial instrument;
- preferential remuneration of investors operating under the market economy investment principle, who provide counterpart resources to the EU contribution to the financial instrument or who co-invest at the level of investments;
- further investments through the same or other financial instruments, in line with the aims of the programme.

Q7 – Management of budget commitments: *Do you agree with the proposed provisions concerning the management of EU contributions to financial instruments? Are they sufficiently clear?*

5.3. Use of legacy resources after closure of the programme

The Commission proposes that Member States should ensure that the capital resources and gains and other earnings or yields attributable to the EU contributions to financial instruments are used in line with the aims of the operational programme for a period of at least 10 years after the closure of the programme.

Q8 – Legacy resources after closure: *Do you agree with the proposed provisions regarding the use of legacy resources? Is the 10-years timeframe considered feasible?*

5.4. Reporting on implementation of financial instruments

The Commission faces increasing demands by the Budgetary Authority and by the Court of Auditors for more information and transparency regarding EU budget support provided to financial instruments. To meet these demands but also to ensure an adequate monitoring and assessment of the effectiveness of financial instruments, it is necessary that both the managing authorities and the Commission possess reliable and harmonised data concerning the use of financial instruments.

The Commission intends therefore to propose a set of reporting requirements for financial instruments in the next programming period. Such reporting should collect information permitting to identify financial instruments supported through Structural Funds or Cohesion Fund resources and their implementation arrangements, as well as monitoring data regarding *inter alia* financial transactions, investment performance and contribution to the objectives of the operational programme and the priority axis concerned.

Q9 – Reporting: *Do you agree that a standardised reporting procedure will contribute to more transparency and facilitate the monitoring and assessment of financial instruments?*

6. ENSURING CLARITY AND DIFFERENTIATION – OTHER RULES APPLICABLE TO FINANCIAL INSTRUMENTS

In the current programming period, the rules on the eligibility of expenditure are drawn at national level, except as provided in Article 7 of the ERDF regulation. Regarding financial engineering instruments, additional rules have been introduced, namely in Articles 43 to 46 of the Implementing Regulation. This has led to legal restrictions being imposed on investments implemented through financial engineering instruments, when no similar restrictions exist for similar actions financed by grants. This is namely the case for investments in firms in difficulties, financing working capital, as well as certain provisions regarding management costs and fees.

In addition to the proposals outlined in sections 4 and 5 of this document, the future regulations should enhance the interplay of the relevant regulatory provisions (at the level of Cohesion policy and at EU level) which may affect the set-up and implementation of financial instruments. For example,

- at the level of cohesion policy instruments, a clear distinction is needed in the legal framework between grant rules and those applicable to financial instruments. In accordance with the recent guidance provided in COCOF Guidance Note 10-0014-04, it needs to be spelled out that certain provisions, such as the thresholds and principles for major projects, revenue-generating projects and durability are not applicable to financial instruments;
- the General Regulation needs to include provisions allowing the Commission to adopt specific implementing rules for financial instruments, namely regarding the setting up and functioning of the financial instruments proper, including the provision of term sheets for standardised financial instruments which are compatible with EU legislation (e.g. regarding State aid and public procurement), the combination of grants with financial instruments, management and control matters, audit trail, irregularities, eligibility, the relationship between managing authorities and implementing bodies as proposed in section 4.2 of this document, etc.;
- specific provisions need to be included in the future regulation to ensure that contributions to financial instruments set-up and implemented by the European Commission at European Union level follow the same rules and governance principles as financial instruments implemented under direct management by the Commission (including inter alia audit and control rules and procedures).

7. TECHNICAL ASSISTANCE PLATFORM FOR FINANCIAL INSTRUMENTS

In line with the conclusions of the sixth meeting of the High Level Group in September 2010, the Commission recommends to explore options for the strengthening of national and regional capacity in regard to the design and management of financial instruments with particular emphasis on specific sectors where financial instruments are expected to play an important role in delivering cohesion policy and EU2020 objectives.

Capitalising on the implementation experiences of the current programming period and the know-how generated by the joint initiatives of the Commission and the EIB Group, an

assistance mechanism should be set up for the next programming period, to support managing authorities and their partners in the design and subsequent implementation of financial instruments, including the development and dissemination of best practices.

The range of optional support services could include initial ex-ante assessments, design of sector-specific investment strategies and products, development of implementation structures, identification of potential co-financing sources and the set-up or management of the financial instrument on behalf of the managing authority. To this end, it could be envisaged to set up a central instrument for technical advisory on financial instruments, which could serve as a platform for sector- or instrument-specific discussions and assistance arrangements for the benefit of Member States and managing authorities.

Q10 – Technical Advisory platform: Would a central European technical advisory platform for the benefit of Member States and managing authorities catalyse the design and subsequent implementation of financial instruments? Do you agree with the proposed scope?