A sustainable way of achieving EU economic and social objectives

Financial instruments

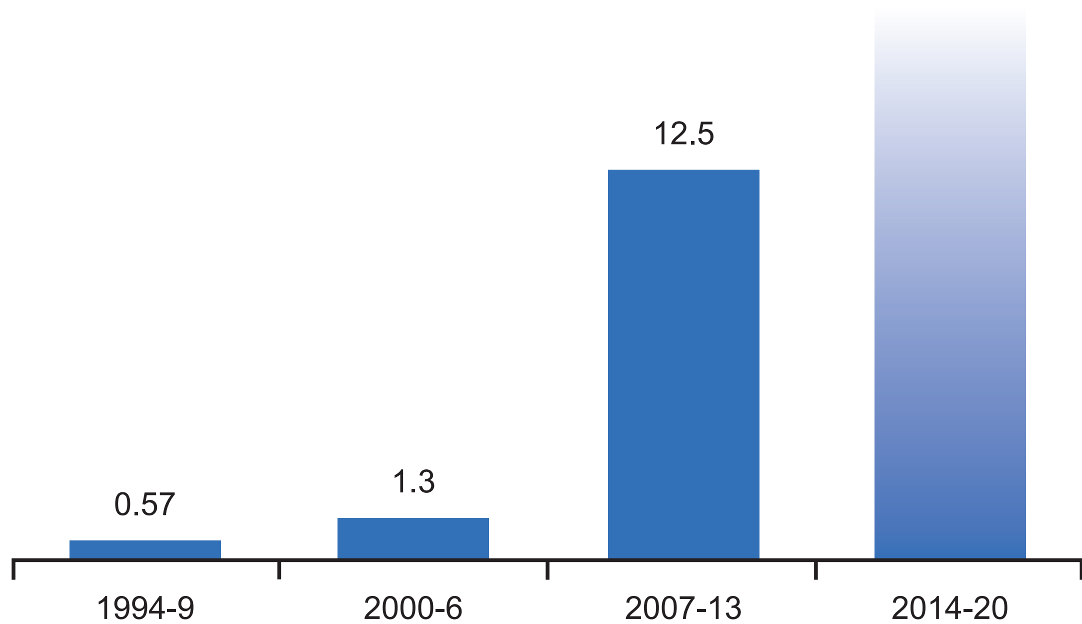
Financial instruments co-funded by the European Structural and Investment Funds are a sustainable and efficient way to invest in the growth and development of people and businesses in the EU Member States and regions. They support a broad range of development objectives to the benefit of a wide range of recipients, with the potential for funds to be reused for further investments.

The **European Structural and Investment Funds (ESIF)** - consisting of the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF) - can be used to support development in a comprehensive way by investing for instance in businesses, research and development, infrastructure, employment and training, agriculture, forestry and fisheries development, with the overall objective to improve the quality of life of EU citizens. Some €450 billion of ESIF are available for the Member States and their regions in the period 2014-2020. **Cohesion, rural development and maritime policies** combined are the biggest area of EU investment for smart, sustainable and inclusive growth.

Member States and regions can use financial instruments as an efficient and sustainable way of providing support targeted at the priorities of a programme co-funded by ESIF. Financial instruments are suitable for financially viable projects, i.e. those which are expected to generate enough income or savings to pay back the support received. Financial instruments must address an identified market failure, e.g. where banks are unwilling to lend and/or where the private sector is unwilling to invest.

The amounts invested via financial instruments under the ERDF and the ESF programmes have grown significantly in recent years. The amounts are expected to increase even more under the five ESIF in 2014-2020, as well as in the context of the Investment Plan for Europe.

Programme contributions to financial instruments (€ billion)



Financial instruments are flexible and can provide support in the form best suited for the investment, e.g. a loan, a microcredit, a guarantee or equity:

Financial instruments: Types of support and illustrative examples

Loans

Loans are funding advanced to a firm or individual that has to be repaid according to a pre-defined schedule. They are used where banks are unwilling to lend or to offer funding on better terms (e.g. a lower interest rate, a longer repayment period, or lower collateral requirements).

An EU-funded loan scheme in Estonia has supported the renovation to modern standards of 619 apartment buildings, with over 22,000 individual apartments, achieving substantial energy savings and improved living environments for the inhabitants.

Microcredit

Microcredits are small loans made to people and very small businesses which are often excluded from access to financial services. They are typically provided over a short borrowing period and with no or low collateral required.

In Hungary, an EU-funded combined microcredit and grant scheme has improved the situation of over 9,000 growing micro-enterprises by increasing their access to financial resources.

Guarantees

Guarantees provide assurance to a lender that their capital will be wholly or partially repaid if a borrower defaults on their loan. The provider of the guarantee will be liable to cover the shortfall or default on the borrower's debt.

An EU-funded guarantee scheme in Romania has granted guarantees to over 694 beneficiaries (farmers and rural SMEs) to help improve their production methods and to protect and enhance the environment. This has so far helped to create or maintain 10,200 jobs.

Equity

Equity instruments involve investing capital in a firm in return for total or partial ownership of that firm; the equity investor may assume some management control of the firm and may share the firm's profits. The instruments include venture capital (sometimes called risk capital), seed capital and start-up capital. The return depends on the growth and profitability of the business. It is earned when the investor sells its share of the business to another investor ("exits"), or through an initial public offering (IPO).

An EU-funded venture capital instrument in Saxony, Germany, has invested in 45 young companies, helping them overcome the difficult start-up phase and supporting their growth, enabling them to exploit innovative ideas and technologies. This helped to create or maintain over 450 jobs.

How do financial instruments work?

Funds are allocated from the EU budget to countries and regions to carry out seven-year economic and social development strategies which fit in Europe's 2020 growth and jobs strategy and which are outlined in 'programmes' agreed with the European Commission. The programmes are implemented by the EU Member States and regions who decide what kind of projects and investments are best suited to their strategies. This work is organised by 'managing authorities' in each country and/or region. The managing authorities decide where to use grants or financial instruments to provide support.

Before allocating money to a financial instrument, managing authorities have to assess what is needed, why and by whom. For example, a region may have high technology firms that cannot access ordinary bank funding because their projects are too risky. Or, there may be very small firms and entrepreneurs that cannot obtain loans because they have no track record with the bank or no collateral to offer. Based on a thorough assessment of needs, one or more financial instruments may be set up.

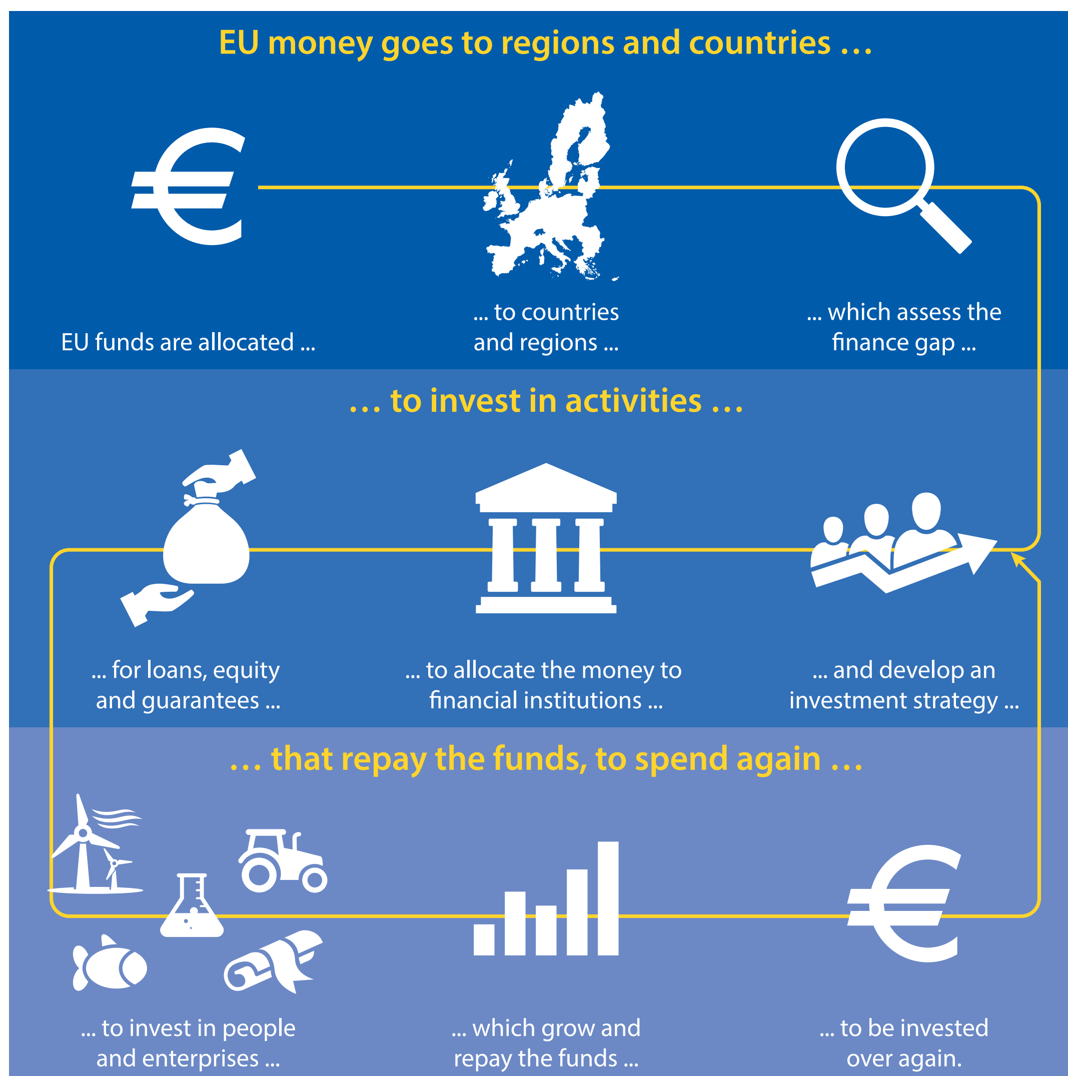
Financial instruments are usually managed by nationally or regionally operating financial institutions (such as banks) that are selected and entrusted with running financial instruments on behalf of the managing authority. The financial instruments using EU funds are therefore delivered regionally or locally, often by institutions that are already familiar to those who finally will receive the support.

Financial instruments must be invested in projects which promote ESIF objectives. These can cover any of the eleven Thematic Objectives defined for the 2014-2020 period:

- Research and innovation
- Information and communications technology (ICT)
- SME competitiveness (including rural businesses, fisheries processing and aquaculture)
- Low carbon economy
- Climate change adaptation and risk management
- Environment and resource efficiency
- Sustainable transport and network bottlenecks
- Employment and labour mobility
- Social inclusion and poverty
- Education
- Institutional capacity

Financial instruments supported with the ESIF must comply with specific regulatory provisions which are set out in a range of legislation: the Common Provisions Regulation (CPR) which governs implementation of ESIF; each of the fund-specific regulations and several related delegated and implementing regulations.

How do financial instruments work?



Financial instruments offer a number of advantages

Money is paid back and used over and over again in the same region for other investments. This is especially important in times of public spending cuts.

Public money **encourages private investment.** For instance, so-called 'business angels' may invest in small businesses alongside EU funded instruments when they would not have invested alone. Urban property that would otherwise lie unused can be reconfigured for a range of commercial and industrial uses because property developers can be persuaded to come on board. Banks may lend to entrepreneurs unable to offer collateral because of an EU-backed guarantee fund.

With private investment comes **private investor expertise**. Firms and local authorities can benefit from a more 'hands on' approach to develop their projects as the organisations appointed to manage financial instruments are incentivised to see their investments succeed.

What is in it for you?

- As a **national, regional or local authority**, you can increase the leverage of the money available for development in your area by attracting other sources of finance and re-investing the money paid back.
- As a **financial intermediary**, you can contribute to sustainable development in your region by helping to invest EU funds in exchange for a management fee, while potentially broadening your customer base.
- As a **citizen, entrepreneur or business**, you may be able to access finance where banks had previously not offered funding or only on unattractive terms. Your managing authority will tell you which financial intermediaries in your region offer financial products co-funded by EU funds that may be appropriate for you.

Managing authorities	• pursue programme objectives e.g. helping SMEs in a region grow by increasing supply of finance • recyle returning funds in programme area • FIs can work with grants in a complementary way • encourage co-investment from public and private sectors, increasing programme resources and results • help develop supply-side though capacity building and extra capital
Banks Fund Managers Investors	• diversification/expansion of product offer, activites or investment opportunities • public sector participation shares risk • additional resources help develop products for new markets or ones which were not previously viable • opportunities to manage funds
Final recipients	• can access funds where none were previously available • obtain funding through banks and other financial intermediaries in the region, often with simpler application procedures than standard bank loans • can be combined with soft support such as consultancy and advice • different kinds of instruments available

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