Factsheet
September 2025

Financial instrument for competitiveness and innovation: Equity combined with grant

fi-compass model

ERDF

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European Commission

European Investment Bank

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Abbreviations

Abbreviation	Full name
BA	Business Angel
CPR	Common Provisions Regulation – Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021
EIC	European Innovation Council
ERDF	European Regional Development Fund
GBER	General Block Exemption Regulation
HF	Holding fund
ICT	Information and communication technology
IPO	Initial Public Offering
MA	Managing authority
MCF	Management costs and fees
NGEU	Next Generation EU
NRRP	National Recovery and Resilience Plan
PE	Private equity
RDI	Research, Development and Innovation
SF	Specific fund
TRL	Technology Readiness Level
PE	Private Equity
SME(s)	Small and medium-sized enterprise(s)
SoE	Seal of Excellence
SIU	Savings and investments union
STEP	Strategic Technologies Europe Platform
VC	Venture capital

Introduction

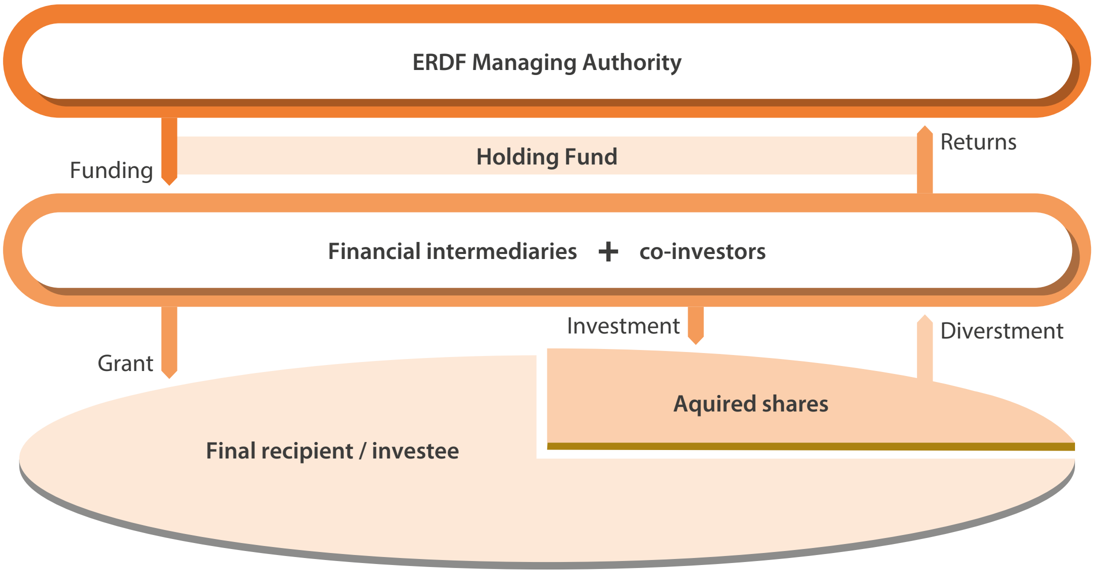
This document, developed by the European Investment Bank with the assistance of the European Commission under fi-compass, aims to describe a model of financial instrument that managing authorities may use to support innovation in enterprises and innovative enterprises, combining equity with grants in a single financial instrument operation. This model financial instrument provides examples of how the programming, design and implementation requirements can be applied by the bodies implementing a specific fund (SF) and a holding fund (HF). It describes specific types of grants for innovative companies and investments to be used in combination with equity depending on their development stage. It also addresses State aid as well as monitoring and reporting procedures. The model financial instruments are intended to provide a non-exhaustive insight into the potential for managing authorities to use the new flexibilities in Article 58(5) of the Common Provisions Regulation (CPR). The document does not constitute formal guidance and the use of the model remains entirely under the responsibility of the managing authorities who have to ensure the correct application of the CPR and other applicable EU legislation, including State aid rules and procurement rules, under their own specific circumstances.

Further information regarding the use of grants in combination with financial instruments can be found in the fi-compass factsheet Combination of financial instruments and grants under shared management funds in the 2021-2027 programming period, which was published in May 2021, and the notes of the fi-compass Knowledge Hub – implementation of grants and financial instruments combined in a single operation, published on 28 June 2023.

Innovation financing gap in EU Member States

This model financial instrument aims to fill an equity financing gap that may be generally observed for innovative companies at all stages of the lifecycle by providing access to funding that may not be available from the market. Public funds play a crucial role in closing the innovation gap both at regional and national level, as well as in acting as catalyser to attract additional private resources. These funds supporting investments in enterprises would lead to increase the competitiveness and productivity in the economy. The model should be seen as a tool to boost the European venture capital (VC) market in the different member states, in alignment with the Competitiveness Compass initiative[1] recently launched by the Commission. This model will encourage the national authorities to make equity capital available in the EU financial markets, reinforcing the supply side and create a start-ups friendly financial environment both at regional and national level. In fact, the Savings and investments union (SIU) encourages policy measures to promote equity and call for efforts by industry and other stakeholders to build dynamic local ecosystems, including within regions, and engaging with business angels, networks, incubators, and partnerships with industry and academia.

The fi-compass factsheet ERDF equity financial instruments highlights how many innovative start-ups in the EU either fail to achieve scale and remain small or, if they achieve scale they are acquired by overseas investors. This is, among all, due to a lack of suitable funding tailored to support companies through the different stages of a start-up's lifecycle. For example, compared to other territories, the amount of VC financing for the early stage of innovative projects is relatively limited due to the low level of development of the national or regional equity ecosystem, to the actual or perceived level of risks and the risk appetite of the market financiers. Similarly, as a company grows, its need for investments increases, meaning access to equity, quasi-equity products and lending is key to sustain and support the enterprise.



1 COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS A Competitiveness Compass for the EU.

Aim of the financial instrument	The aim of the combined equity financial instrument is: • to deploy grant(s) in combination with the equity product offered by the financial instrument within a single Investment Strategy in order to support innovation investments as well as innovative companies, in particular in their early stage of development, before equity financing is provided; • to use European Regional Development Fund (ERDF) programme resources to mobilise additional investment to finance innovation investments by all types of companies and/or to finance innovative companies to improve their performance, to promote sustainable growth and to boost their competitiveness in line with the market gaps identified and the investment strategy proposed in an ex-ante assessment. These grants may take the following forms: • **Technical support subsidy:** paid to or on behalf of entrepreneurs for services supporting the preparation of the investment e.g. business coaching services, advisory services or support networks; • **Capital grant as an accelerator:** paid to the early-stage company or innovation projects to help them reach a development stage mature enough for repayable financing. This grant may cover part or the totality of the various costs to demonstrate the feasibility and viability of the concept under development and make it ready for equity investment. The financial instrument will be made available within the framework of the ERDF Policy Objective 1, 'a more competitive and smarter Europe by promoting innovative and smart economic transformation and regional information and communication technology (ICT) connectivity'. Financial instruments designed and set-up under specific objectives 1.1 and 1.4 need to be in line with the relevant smart specialisation strategy, The model financial instrument is aligned with the European Commission's Strategic Technologies for Europe Platform (STEP) Portal[2], which brings together different stakeholders from inside the EC, EU Member States and partnering institutions, who will work together to support sovereignty investment in Europe as part of the EC's Strategic Technologies Europe Platform (STEP). The financial instrument may also be made available, within the framework of new specific objective under the ERDF/CF, under Policy Objective 1 (more competitive and smarter Europe), generally 1.6 and Policy Objective 2 (green), generally 2.9. STEP seeks to reinforce, leverage and steer EU funds – existing and new – to investments in deep and digital, clean and bio technologies in the EU, and in people who can implement those technologies into the economy[3].

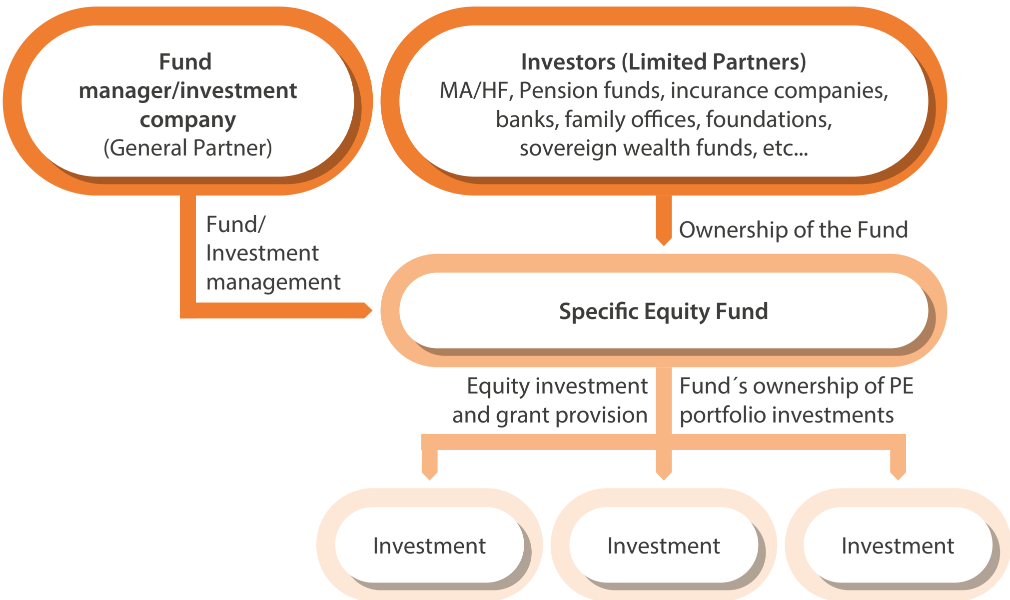
2 https://strategic-technologies.europa.eu/investors_en.
3 STEP identifies three major priority areas for investment:
- Deep and digital technologies including microelectronics, high-performance computing, quantum computing, cloud computing, edge computing, artificial intelligence, cybersecurity, robotics, 5G and advanced connectivity, and virtual realities;
- Clean technologies such as renewable energy; electricity and heat storage; heat pumps; electricity grid; renewable fuels of non-biological origin; sustainable alternative fuels; electrolysers and fuel cells. It can also include carbon capture, utilisation and storage; energy efficiency; hydrogen; water purification and desalination; and advanced materials such as nanomaterials, composites and future clean construction materials; and technologies for the sustainable extraction and processing of critical raw materials; and
- Bio technologies such as biomolecules and its applications, pharmaceuticals, medical technologies and crop biotechnology.

The financial instrument's Investment Strategy will recognise the importance of projects that have been awarded the STEP Seal (Sovereignty Seal) and the Seal of Excellence (SoE) under the European Innovation Council (EIC). Such projects will be potentially eligible for support by the financial instrument. Final investment decisions shall, however, remain the sole responsibility of the body implementing the financial instrument which shall undertake the same due diligence and appraisal procedures for projects awarded the STEP Seal (Sovereignty Seal) as it would for other potential final recipients.

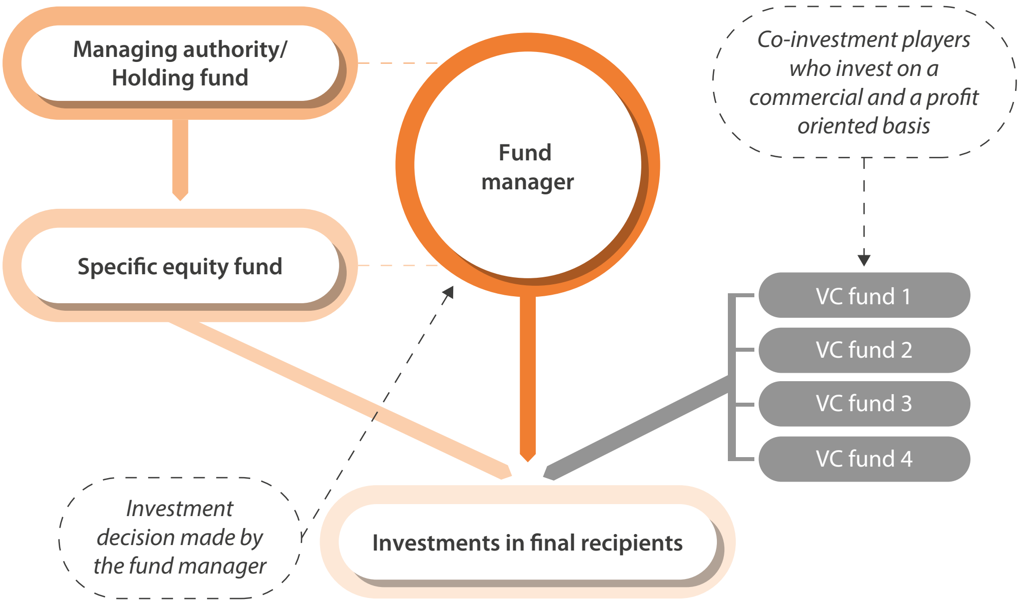
The STEP Seal (Sovereignty Seal) is awarded to all projects that scored high during the selection process of a competitive procedure of calls for proposal under Horizon Europe, the Digital Europe programme, the European Defence Fund, the EU4Health programme, or the Innovation Fund. In case a high-quality project cannot receive financing under the programme for which it applied due to the limited budgetary availabilities, with the label of the STEP Seal (Sovereignty Seal) it may get a privileged and simplified access to other sources of funding under STEP, provided that the project contributes to the STEP objectives and that it has been assessed as eligible and complying with the quality requirements of a call for proposals. These high-quality projects may therefore be considered as investment opportunities under this financial instrument model. The STEP Seals dashboard, which lists project proposals, is accessible on the portal at https://strategic-technologies.europa.eu/investors_en#paragraph_190.

The Seal of Excellence is awarded in the context of the EIC, to projects that applied to a Horizon Europe call and were assessed as excellent but could not be financed due to lack of budget. To facilitate the uptake by the ERDF and other funds of Seals of Excellence issued by the EIC, the Commission has launched a dedicated online dashboard providing the information on the projects awarded with the label of Seal of Excellence from this Horizon Europe programme. The dashboard provides structured and complete information on the projects awarded with this label, and is open to all interested funding organisations, including the managing authorities of the cohesion policy programme. The managing authorities should request access to the dashboard as it constitute a pipeline of projects with potential to be considered by the equity fund managers. The investment decision will still be independently made by the fund manager in line with the defined Investment Strategy. Due to the confidentiality of the information displayed in the dashboard, the access to the data is restricted to nominated users from the funding organisations.

To be able to access the EIC Seal of Excellence dashboard we invite you to nominate a representative of your managing authority. Please send an email to the Horizon Europe Seal of Excellence Secretariat at RTD-SEAL-OF-EXCELLENCE@ec.europa.eu.

Structure of the financial instrument	The scope of the combined financial instrument shall be in accordance with the scope of the priority under which it is implemented and the ex-ante assessment, including the proposed Investment Strategy, carried out under Article 58(3) CPR. This will include the nature and amount of grant support in accordance with Article 58(5) CPR. ERDF programme resources shall be committed by a managing authority to a holding fund (HF) or a specific equity fund (managed by a body implementing specific fund, further in the text referred to as equity fund manager). The fund manager then identifies and invests the resources, together or alongside funds committed by other investors, into target final recipients and pays the grant to or on behalf of the latter. In return for the investment, the equity fund receives a share of the ownership of the company. In the case of a holding fund structure, the body implementing the HF shall contribute the ERDF programme resources to the equity fund manager. In addition to the programme contribution, the HF may provide its own resources. The HF shall in this case take the pro-rata part of the risk sharing between the different contributions in the portfolio of investments. State aid rules have to be respected if the resources provided by the HF are public resources (including ERDF resources). Two implementation models may be used: • **A pooled specific equity fund:** A pooled fund is a type of investment fund where multiple investors combine their resources into a single fund managed by a professional fund manager or investment company. Investors – including the managing authority directly or through a HF – typically contribute their resources by buying shares or units in the Fund. A fund manager or management team is selected by the managing authority or the HF and responsible for making investment decisions on behalf of the fund, in line with the defined Investment Strategy. In this case, investors' contributions in the equity fund may constitute co-financing and may be part of the programme contribution (as per Article 2(19) CPR. Additional co-financing may come at project level from other investors external to the equity fund. 

- **A co-investment equity fund:** This model foresees combination of different investors' resources on a project-by-project basis. Under a co-investment model, ERDF resources are committed by a managing authority or holding fund into a specific equity fund managed by a fund manager, who may invest in companies alongside other investors through separately managed accounts. In this case, co-financing is not provided at fund level but at company level by external investors as well as the fund manager's own resources to a lesser extent. In this case, usually a lead investor identifies an investment opportunity, commits funds to it and carries out the role of manager of the investment. Then other investors are invited to participate in the investment opportunity.



The co-investment financial instrument is similar to the off-the-shelf model co-investment facility, which was published by the European Commission in 2016 under 2014-2020 programming period. One of the features of the off-the-shelf model was the alignment of co-investment ratios with the requirements of Article 21 GBER (Risk financing), see State aid section.

	Under both options described above and in line with Article 58(5) CPR, grant(s) may be managed and provided either by the equity specific fund manager or by the holding fund, acting as bodies implementing the financial instrument. The body implementing the financial instrument / fund manager will be responsible for implementing both, the equity financial product and providing the grant component of the combined financial instrument (unless a HF takes over the task of managing the grant component). Its role will include: • Identification and mobilisation of private investors, either at fund level in the case of a pooled fund structure or at project level in the co-investment model; • Marketing of the products and identification of a pipeline of companies to invest in; • Appraisal of applications, performance of due diligence on the investment opportunities (unless it is carried out by another lead investor); • Negotiation of the investment documentation with the companies; • Disbursement of the grants and of the equity financing; • Provision of strategic advice to support the companies' growth, directly or indirectly via the mobilisation of external experts; • Monitoring and reporting on transactions' performance, deal follow-on investments and post-investment events; • Reporting to the HF or the managing authority about the Fund's activities and performances; • The definition and execution of an exit strategy from the investment (e.g. sale of shares, IPO, reinvestment of resources following exit of investments).
Selection of bodies implementing the financial instrument	The effective implementation of the equity financial instruments relies on the selection of fund managers with demonstrated capacity and expertise in early-stage innovation finance and experience in managing equity investments involving public resources. Managing authorities are encouraged to organise a competitive and transparent selection procedure, to ensure the best alignment between fund manager profiles and the objectives of the financial instrument. The managing authority should select the body implementing the financial instrument in line with public procurement law (Article 59(2) CPR) or directly award a contract for the implementation of the financial instrument in accordance with the provisions in Article 59(3) CPR. When the body selected by the managing authority implements a Holding Fund, that body might further select other bodies implementing specific funds (Article 59.4) Where the financial instrument is set up to operate longer than the 2021-2027 programming period, the managing authorities should ensure that the body implementing financial instrument is selected respecting the public procurement rules to allow the implementation going beyond one programming period in line with the provisions of Article 68(2) CPR. For example, Article 72(1)(a) of the Public Procurement Directive 2014/24 provides a framework for the scope of a public contract to be increased as long as it was foreseen at the time of procurement.

	Bodies selected may be public and private bodies established in a Member State, which shall be legally authorised to manage third party resources and make equity investments in companies as well as provide grants to the types of final recipients targeted by the programme which contributes to the financial instrument. Such bodies are financial institutions, fund managers and, as appropriate, any other institution authorised to provide equity investments and grants. To ensure coherent delivery of the financial instrument and safeguard alignment with programme objectives, the managing authority shall establish a clear governance and accountability framework, complying with the requirement in letters (d) and (k) of Annex X CPR 1060/2021. The respective roles and responsibilities of the managing authority, holding fund (if applicable), and equity fund manager shall be clear and defined.
Technology readiness level	The financial instrument's Investment Strategy may be aligned with the Horizon Europe Technology Readiness Level (TRL) framework[4]. This describes the stage at which development of new technology being developed by the final recipient has reached and is divided into nine levels as follows: • TRL 1 — Basic principles observed; • TRL 2 — Technology concept formulated; • TRL 3 — Experimental proof of concept; • TRL 4 — Technology validated in a lab; • TRL 5 — Technology validated in a relevant environment (industrially relevant environment in the case of key enabling technologies); • TRL 6 — Technology demonstrated in a relevant environment (industrially relevant environment in the case of key enabling technologies); • TRL 7 — System prototype demonstration in an operational environment; • TRL 8 — System complete and qualified; • TRL 9 — Actual system proven in an operational environment (competitive manufacturing in the case of key enabling technologies, or in space). The use of TRLs shall enable to clearly articulate the innovation goals and milestones the financial instrument aims to achieve with the combined financing support. The Investment Strategy would typically target investments between TRL 4 and TRL 9 with different products being suitable for different stages of the project's lifecycle. To be noted that, in practice, the development of an innovative product or process may not be fully linear. It means that a technology that has reached a higher TRL may still comprise components that would need research and development investments at a lower TRL[5]. This has consequence in terms of the forms of financing to be used and may be efficiently addressed by a combined financial instrument, where the grant element would for instance be used for covering the costs and risks of the research to be done at lower TRL while the equity investment would support the wider growth of the company.

4 Horizon Europe, Work Programme 2021-2022, 13. General Annexes, (European Commission Decision C (2022)2975 of 10 May 2022).
5 Doussineau, M., Arregui Pabollet, E., Harrap, N. and Merida Martin, F., Drawing funding and financing scenarios for effective implementation of Smart Specialisation Strategies, EUR 29367 EN, Publications Office of the European Union, Luxembourg, 2018, ISBN 978-92-79-94684-4, doi:10.2760/422868, JRC112708.

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<td>Eligible final recipients / projects</td>
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The final recipients shall be eligible under the relevant programme and funding agreement. They may comprise small and medium-sized enterprises (SMEs), mid-caps or larger enterprises which comply with all the relevant eligibility criteria, including SMEs and mid-caps that are innovative enterprises as defined in Article 2 point (80) GBER and enterprises which are active in key enabling technologies.
Financial intermediaries / fund managers shall ensure that the final recipients, the financial transactions, the portfolio of investments, as relevant, comply with a set of eligibility criteria set out in the funding agreement.
For example, eligible enterprises or projects could fall into one or more of the following categories:
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<tr><td>Innovative products / processes</td><td>The company undertakes to spend the financing granted to invest in producing or developing products, processes and/or services that are innovative and where the business plan evidences a risk of technological or industrial failure, or a business risk.</td></tr>
<tr><td>Research Development and/or Innovation (RDI)</td><td>The final recipient undertakes to spend an amount at least equal to 80% of the financing granted in RDI expenses or investment in the next three years and the remainder on costs necessary to enable such activities.</td></tr>
<tr><td>SMEs</td><td>The final recipient is an enterprise with less than 250 employees and operating in a market for less than seven years following its first commercial sale, whose RDI costs represent at least 10% of its total operating costs, in at least one of the three accounting years preceding the financing decision.</td></tr>
<tr><td>Small mid-caps</td><td>For enterprises with at least 250 but less than 500 employees, the final recipient's RDI costs represent at least 10% per year of its total operating costs in the three accounting years preceding the financing decision or at least 15% in at least one of the three accounting years preceding the financing decision (or current financial statements if no financial history).</td></tr>
<tr><td>Intellectual Property Right (e.g. patent)</td><td>The final recipient has registered at least one Intellectual Property Right (such as a patent) in the last three years preceding the financing decision and the purpose of the sub-financing is to enable, directly or indirectly, the use of this Intellectual Property Right.</td></tr>
<tr><td>Venture capital</td><td>The final recipient has received an investment over the last 36 months from a private equity (PE) fund or from a business angel (BA) being a member of a business angel network, or such a private equity fund or business angel is a shareholder of the final recipient at the time of the financing decision.</td></tr>
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Risk finance investment	The final recipient requires a 'risk finance' investment, an investment which is at least 50% of the final recipient's average annual turnover in the five-year accounting period preceding the financing decision, as evidenced in the business plan prepared in view of entering a new product or geographical market.
Innovation support	The final recipient has been formally awarded grants, loans or guarantees from European RDI support schemes or through their funding instruments[6] over the last three years preceding the financing decision.
Innovation prize	The final recipient has been awarded a Research and Development or Innovation prize provided by an EU institution or an EU body during the last three years preceding the financing decision.
Designated as an innovative company by an EU institution or body	The Final recipient has been designated in the past three years preceding the financing decision as an innovative company by an EU Institution or body, which can be verified by the Intermediary, and the purpose of the sub-financing is to maintain or further develop the business activity of the Final recipient. The company may have awarded a STEP Seal (Sovereignty Seal) by the EC.
Fast-growing enterprise	The final recipient operates in a market for less than 10 years following its first commercial sale and with an average annualised endogenous growth in employees or in turnover greater than 20% a year, over the three-year period preceding the financing decision, and with ten or more employees at the beginning of the observation period.

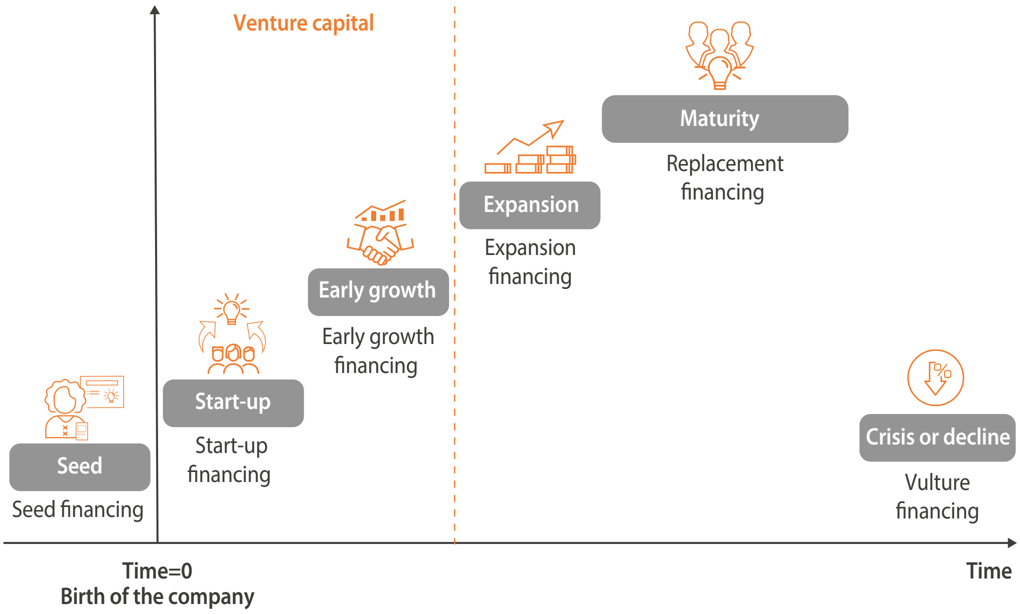
6 This includes National Recovery and Resilience Plan (NRRP) support for achieving digital targets and SME digitalisation financed from Next Generation EU (NGEU) funds.

Financial products

Under this model financial instrument, depending on the development stage and/or the nature of the innovation investment, the equity fund manager will deliver to final recipients equity products in combination with various types of grants to finance projects that contribute to the objective(s) of the programme.

A single financial instrument may deliver different product types to support a range of different innovative enterprises. Alternatively, one or more financial instruments may be developed to deliver a single product with a view to meeting a specific market failure in a region.

Options to combine equity products and grants are described below. An illustrative example of how products may be tailored to different stages of a project's lifecycle include:



Under this model financial instrument, the two types of grants that may be combined with equity are the following:

- **technical support subsidy:** paid to or on behalf of entrepreneurs for point-in time services supporting the preparation of the investment;
- **capital grant as an accelerator:** paid to support early-stage innovative companies or innovation investments to help projects reach a maturity stage from the proof-of-concept stage up to TRL 9(system complete and qualified).

Stage	TRL	Financial product	Grant
'Pre-seed'	1-3	-	• Accelerating capital grant • Technical support
Seed The first phase of the business cycle, when the founders create and develop the business idea	4-5	**Seed capital (equity)** Covers the initial costs of developing an investment proposal Co-investors: FFF, public sector, PE firms, BA, corporate investors, crowdfunding platforms	• Technical support • Accelerating capital grant
Start-up This phase entails the concrete outset of business activities	5-8	**Start-up capital** • Equity (first round / series A) Co-investors: FFF, PE firms, BA, banks, VC, crowdfunding	• Technical support • Accelerating capital grant
Early growth This is the stage where the company begins to grow	7-8	**Early growth capital** • Equity (second round / series B) • Quasi-equity Co-investors: management team, corporate investors, VC, crowdfunding	• Technical support • Accelerating capital grant
Expansion This phase entails a company's sales growing steadily and consistently	9	**Expansion capital** • Equity (third, fourth round / Series C) • Quasi-equity • Loan Co-investors: management team, banks, mezzanine providers, corporate investors, VC, crowdfunding, IPO	• Technical support • Accelerating capital grant
Maturity	9	Debt	Interest rate subsidy

Financial instrument combined grant component	The combination of grant with the financial instrument should be identified in the programme as a possible form of finance for the specific objectives concerned. If not, the programme should first be amended. The ex-ante assessment (or separate analysis) should be used to identify that the use of grant is directly linked and necessary for the financial instrument in accordance with Article 58(5) CPR. Article 58(5) CPR provides flexibility in terms of the features of the grant to be combined with the financial instrument in one operation. Given the specificity of equity financial products, two main types of grants may be implemented in this case, i.e. technical support subsidy and capital grants. **Technical support subsidy** A technical support subsidy may be provided as a cash grant to (or for the benefit of) the final recipient. A technical support subsidy may be provided to companies at any TRL to support the preparation of an innovation investment. Equity investors typically provide extensive capacity building support (non-financial support) alongside financial resources to the companies they invest in. The technical support subsidy may therefore be used to fund point in time specific activities such as a feasibility studies, preliminary investigation of potential industrial applications, market research, intellectual property rights strategy, patent budget, business coaching services (i.e. business, organisational, financial development[7]), business acceleration support (connecting with investors, procurers and other business partners alike, possibilities of networking and learning opportunities) and/or supporting participation of SME in support networks. The technical support subsidy can be provided in early stages of development of the innovation project and, based on the CPR, may not necessarily need to be followed-on by an equity investment, as long as total grants do not exceed equity support at financial instrument level. The fund manager would therefore have the capacity to accompany the development of a variety of innovative projects through technical support subsidies. It may only provide a further capital grant and/or equity support, at a later stage, to those projects which have successfully developed. **Accelerating capital grant** A capital grant can be defined as a non-repayable provision of financing that aims to finance part of an investment (on specific cost or on a pro-rata basis) or at covering a viability gap into an innovation project for instance. In the case of the model equity financial instrument, the accelerating grant is provided under financial instruments rules and so does not need to be used to finance a specific expenditure item. It may also be paid to or on behalf of the final recipient to cover part of the general costs of the development of the innovative company. The grant may be provided to early-stage projects to accelerate their growth to reach a higher development stage at which equity financing may be provided. The fund manager may select a number of projects and companies and closely accompany them over a defined period of time to help them develop their projects to the next steps and make them ready for equity financing.

7 Business development: focused on the identification, analysis and evaluation of business opportunities, including Value Proposition and Business Model development, industry and market analysis, strategic partnerships and marketing;
Organisation development: mobilising enterprise's resources on entrepreneurship, leadership and team building to recruiting, organisation building, manufacturing management and distribution channels;
Financial development: to support enterprises with investment readiness and financial planning, including revenue/cost structure and cash flow management.

For this purpose, the accelerating grant may be used to finance innovation expenses such as the demonstration of the technology in the relevant environment, prototyping and system level demonstration, R&D and testing required to meet regulatory and standardisation requirements or the purchase of a specific equipment that is needed to the innovation process.

The combination of this accelerating grant with the equity financial instrument may allow a single fund manager to develop its network of potential final recipients using grant support to develop a pipeline of investment ready projects. A typical conversion rate may be 10%, meaning 1 in 10 recipients of grant will go on to receive equity in the form of seed capital that would be needed before the company is able to reach a Series A (or later financing rounds) capital investment.

This grant may also constitute an incentive for innovation projects with a strong technological innovation dimension (e.g. deep tech investments) that would require significant research at lower TRLs. The provision of the capital of the grant may also mitigate the financial risks by covering part of the investment costs. As a non-repayable and non-dilutive form of finance, the capital grant may also help attract additional private investors.

An option may be foreseen to possibly convert fully or partially the capital grant into equity shares so that the managing authority may benefit from the upside of an investment project. This option may be used for projects benefiting from a larger grant amount and with a material growth potential in terms of value of the company in case of successful development of the innovation project. There may be an option in the financing agreement, that the fund manager would reserve the right to convert it to equity (or to a loan). In this case, the conversion would be triggered in case pre-defined milestones are met.

General rules applicable to all types of grants combined with the financial instrument

In all cases, the grants should be directly linked and necessary to the equity instrument. The necessity and the objective of the grant support would be analysed and defined in the ex-ante assessment. The objectives of the grant used in connection with the financial instrument may include for instance

- to provide incentives for a maximisation of the policy impact in terms of launching innovative investments;
- to support the financial viability and mitigate the risk profile of the project; or
- to enhance the coherence and efficiency of support schemes.

In accordance with Article 58(5) CPR, in a combined financial instrument, the total grant support shall not exceed the value of the investments supported by the equity investments. This rule shall be verified at the level of the financial instrument and not in relation to each individual investment.

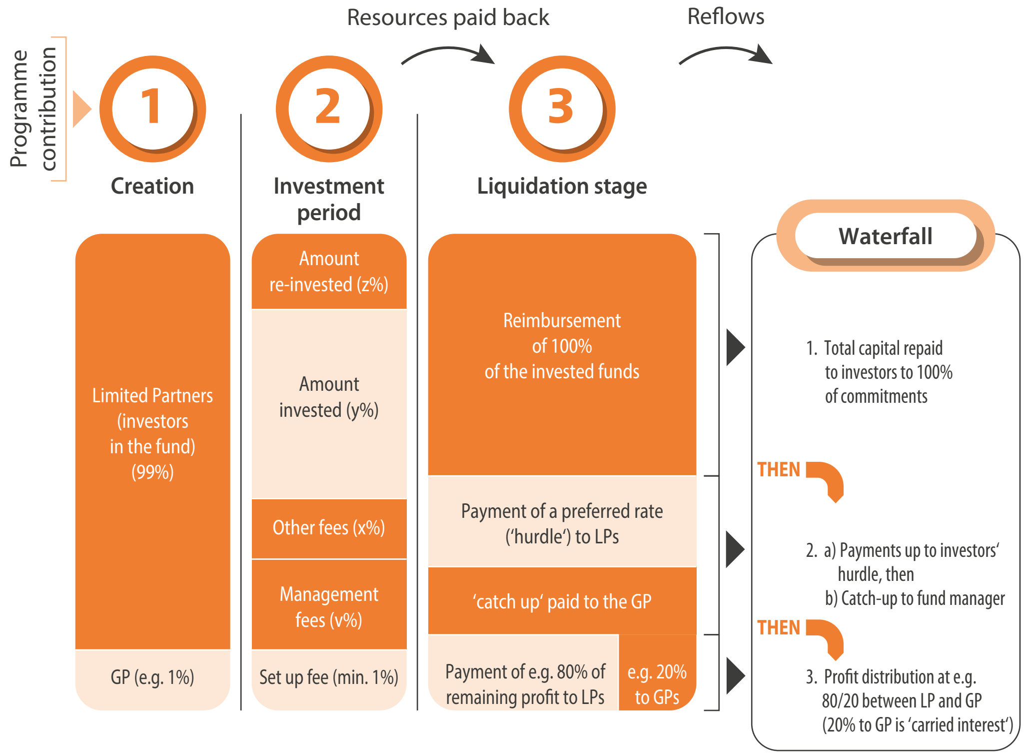
In fact, CPR 2021-2027 offers the flexibility to provide some final recipients with a higher level of support from the grant component than the equity instrument if necessary. In the case of the combined equity financial instrument, this situation may occur when companies have received grant to support the initial development of an innovation project, which has not successfully developed to reach the first equity funding round.

The funding agreement should include specific arrangements for ensuring monitoring of fulfilment of this requirement. They should consider the nature of the financial instrument and the expected total costs of the different grant components which are planned in line with the ex-ante assessment or separate analysis and market testing (expected technology levels achieved, increased innovation capacity achieved in enterprises, needs for technical support, etc).

State aid or *de minimis* aid	*At the level of the equity fund manager and the body implementing HF:* State aid is normally excluded when one of the following conditions is satisfied: • The co-investing body implementing the specific equity fund and the managing authority or HF carry out the investment on a *pari-passu* basis, i.e. under the same terms and conditions, at the same time (via the same transaction), they bear at any time the losses and benefits in proportion to their contributions (pro-rata), hold the same level of subordination in relation to the same risk class and there is an economically significant participation of the independent and private co-investors of at least 30%. The independent and private co-investors should be in a comparable situation to the bodies investing State resources. Any grant component should be exclusively paid to the final recipient and not constitute a direct incentive for private co-investors. In that case, the provision of a grant may not affect the *pari-passu* principle as it would support the growth of the company and therefore the value of the investments of all the shareholders in an equal way; • The remuneration (i.e. management costs and/or fees) of the bodies implementing the financial instrument reflects the current market remuneration in comparable situations, which is the case when the latter has been selected through an open, transparent, non-discriminatory and objective selection procedure. *At the level of the final recipient:* For the equity financing: • No aid – where equity FIs invest on *pari-passu* terms with independent private investors the activity is demonstrably market confirming and there is no aid; • Article 21 GBER provides the framework for risk finance aid that is not provided at market rates to SMEs. Under this article, depending on the growth stage of the company, different levels of private co-financing are required; • Other provisions under GBER for supporting innovation and SME finance including Article 22 (Aid for start-ups), Article 25 (Aid for research and development projects), Article 28 (Innovation aid for SMEs) and Article 29 (Aid for process and organisational innovation); • In case risk financing guidelines under Article 21 GBER apply to the equity component of the combined instrument, a separate regime (such as the *de minimis* Regulation[8], other provisions of GBER) would need to be relied on to support the grant component; • Notification including within the framework of the Risk Finance Guidelines[9]. For grants: • *De minimis* aid; • Other provisions under GBER for supporting innovation and SME finance including Article 22 (Aid for start-ups), Article 25 (Aid for research and development projects) and Article 28 (Innovation aid for SMEs); and • Notification including within the framework of the Risk Finance Guidelines. Cumulation rules of the applicable State aid rules apply to the combined financial instrument if both the equity investment and the grant part contain State aid.

8 COMMISSION REGULATION (EU) 2023/2831 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid.
9 COMMUNICATION FROM THE COMMISSION Guidelines on State aid to promote risk finance investments (2014/C 19/04).

Investment policy	*Contribution from the managing authority or body implementing HF to the equity fund manager:* Under the funding agreement signed between the managing authority or body implementing HF and the equity fund manager, the public contributions from the programme are committed to the equity fund manager to establish the combined equity financial instrument. The programme contribution shall cover both the equity and grant components of the combined financial instrument as well management costs and fees. The target investment and volume shall be defined in the funding agreement. *Equity fund managers' obligations* Equity fund managers shall be managed on a commercial basis. This requirement is met where the equity fund manager and, depending on the type of risk finance measure, the fund manager, fulfil the following cumulative conditions: • they shall be obliged by law or contract to act in accordance with best practices and with the diligence of a professional manager acting in good faith and avoiding conflicts of interest; regulatory supervision shall apply, where relevant; • their remuneration shall conform to market practices. This requirement is presumed to be met as long as they are selected through an open, transparent and non-discriminatory selection procedure; • they shall share part of the investment risks by either co-investing their own resources or receiving a remuneration linked to performance, so as to ensure that their interests are permanently aligned with the interests of the Member State or its entrusted entity; • they shall set out an Investment Strategy, criteria and the proposed timing of investments; • investors shall be allowed to be represented in the governance bodies of the investment fund, such as the supervisory board or the advisory committee, if any. *Origination of a portfolio of new investments:* The fund manager shall be required to originate within a pre-determined limited period of time – the investment period – a portfolio of new investments in eligible innovation investments and innovative businesses, (partly) funded from the disbursed funds under the programme in line with the conditions agreed in the funding agreement. The fund manager shall implement a consistent investment policy, enabling a sound portfolio management and complying with the applicable industry standards, while remaining aligned with the managing authority's financial interests and policy objectives. The identification, selection, due diligence, documentation and execution of the investments in the final recipients shall be performed by the fund manager in accordance with its standard procedures and in accordance with the principles set out in the relevant funding agreement. The amount and criteria of the grant(s) shall be set out in the combined financing agreement signed with the final recipient. Where applicable, clearly defined innovation project's milestones may therefore be used to trigger the conversion of a part of the grant into an equity element.

Alignment of interest with the equity fund manager	Alignment of interest between the managing authority and the equity fund manager shall be achieved through the following: • Management costs and fees (MCF) as provided by Article 68(4) CPR: the MCF are aimed at covering the equity fund manager's operating costs and shall not be primarily used to remunerate the performance of the investments made; • The remuneration of the financial intermediary shall reflect the current market remuneration in comparable situations; • The equity fund is expected to invest own resources into the fund, usually about 1% of the fund size. These resources will be invested in the business equity and not be provided as grant; • The waterfall of the distribution of gains from investment exits at the end of the fund's lifecycle or investment period shall incentivise fund managers' performance thanks to the potential use of catch up and carried interest mechanisms;  • In practice, fund managers shall commit to an exclusivity clause that would prevent them from raising a similar fund that could compete with the specific equity financial instrument, until a large part of the resources have been invested and the remaining part is already earmarked for upcoming investments.

Duration of the financial instrument	The model financial instrument may have an indicative duration of 10 years and may be extended with the consent of the managing authority. The investment period of the financial instrument shall be set to ensure that the programme contribution is used for investments to final recipients at the latest by 31 December 2029. Follow-on equity investments and grants may be provided after the end of the eligibility period, i.e. beyond 31 December 2029, using the resources of the new programming period and provided they are in line with the new rules and eligibility criteria. For this purpose, the equity fund manager needs to be properly selected to be able to carry out equity investments over the subsequent programming period as well.
Management costs and fees	Management costs and fees are calculated on programme contributions covering the combined amount of grants and equity investments, following the rules of Article 68(4) CPR. Where bodies implementing a HF and/or specific funds, pursuant to Article 59(3) CPR, are selected through a direct award of contract, the amount of management cost and fees paid to those bodies that can be declared as eligible expenditure shall be subject to a threshold of up to 7% for a HF and up to 15% for a specific fund of the total amount of programme contributions disbursed to final recipients in equity and grants. Where bodies implementing a holding fund and/or specific funds are selected through a competitive tender in accordance with the applicable law the amount of management costs and fees shall be established in the funding agreement and shall reflect the result of the competitive tender. In the case of a combination of an equity investment with grant(s), the management costs and fees proposed in the competitive tender shall apply to the total amount of programme contribution, i.e. to the grant and the equity without distinction.
Recovery of equity and grants	Equity investments are not secured on any assets and, as a result, the equity fund faces the risk of failure like any other shareholder. If the business fails, equity investors will rank alongside other shareholders, after the banks and other lenders, and stand to lose their investment. The risk of business failure being constituent to an equity investment, the fund manager is therefore not expected to try and recover the grant(s) provided in case the company goes bankrupt, unless irregularities have occurred. The grant shall therefore be provided on terms that require the repayment of all or some of the funding to the equity fund manager in specified circumstances such as fraud or significant breaches of the funding agreement. The bodies implementing financial instruments shall reimburse to the managing authority programme contributions affected by irregularities, together with interest and any other gains generated by these contributions.

Deadline for use of the programme resources	The combined financial instrument support from the programme resources of 2021-2027 shall be invested in final recipients as equity and the grant support disbursed to or for the benefit of final recipients no later than on 31 December 2029. To enable the financial instrument to provide support in the subsequent programming period (i.e. post 2027) the flexibility under Article 68 CPR, may be used. Where a financial instrument is implemented across consecutive programming periods, support may be provided to, or for the benefit of, final recipients, including management costs and fees, based on agreements made under the previous programming period, provided that such support complies with the eligibility rules of the subsequent programming period. In such cases, the eligibility of expenditure submitted in payment applications shall be determined in accordance with the rules of the respective programming period. This permits resources from successive programming periods to be committed to existing financial instruments to enable its continued implementation. This would, for example, allow additional resources to be committed by the managing authority to allow support to, or for the benefit of, final recipients, including follow-on investments and payment of management costs and fees, based on agreements made under the 2021-2027 period, provided that support complies with the eligibility rules of the subsequent programming period. Importantly, the equity fund manager shall be selected for a period covering both current and subsequent programming periods to allow for a continuation of its activities and implementation of the financial instrument over the following programming period.
Re-use of resources	The funding agreement shall include provisions providing for the use of resources paid back, before the end of the eligibility period, to financial instruments from investments in final recipients, including investment exit proceeds and any type of generated income that is attributable to the support from the Funds in the same financial instruments for further investments in final recipients. Such possibility shall be explicitly provided for in the agreement and be automatically triggered when the committed programme amounts are disbursed and certain pre-defined minimum threshold of the resources returned is reached, with the new exclusion period starting at that moment.
Reporting and targeted results	Financial intermediaries / fund managers shall provide the managing authority or HF (if applicable) with at least quarterly information in a standardised form and scope. Separate records must be maintained for each form of support, i.e. for the financial products and the grant parts of the combined financial instrument, in order notably to • verify if the conditions set out in Article 58(5) CPR are fulfilled; and • for audit purposes. As a consequence, the equity fund manager shall ensure a distinct accounting and reporting of the two elements of the support. The reporting for the grant is part of the financial instrument requirements and occurs following the templates defined in the CPR (Table 12 Annex VII CPR). In this case, when granted, the full amount of the equity investment and grant will be reported using the template set out in the Table 12 of Annex VII CPR. The declaration of expenditure made by the managing authority for payment to the EC will not be split by form of support, grants and financial products are mixed as indicated in the model of the payment application.

Reporting example for an equity investment with a capital grant and a technical support subsidy:

	Fund manager			Managing authority			Managing authority		
Equity investment + capital grant + technical support subsidy	**Financial instrument accounts**			**Declared to EC under financial instrument in payment applications**			**Reported to EC in Annex on financial instruments (cumulative)**		
	Y1	Y2	Y3	Y1	Y2	Y3	Y1	Y2	Y3
Equity investment			80						80
Capital grant		20		5	20	80		20	20
Technical support subsidy	5						5	5	5

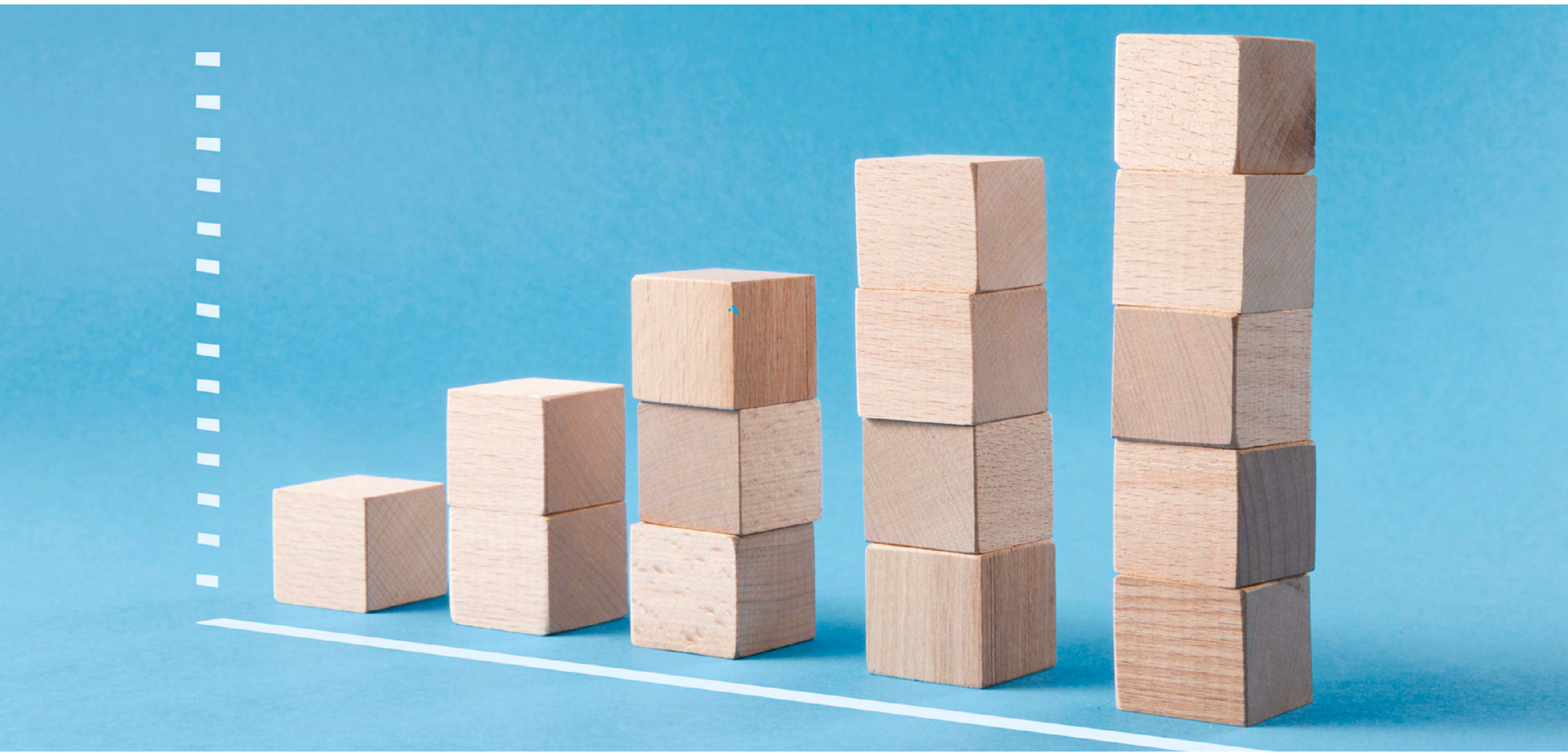
The body implementing the financial instrument (HF and or specific fund) reports to the managing authority in line with the requirements of Article 42(3) CPR. The financial instrument should deliver on the specific objectives of the programme and contribute to the output and result indicators of the priority which contributes to the financial instrument (Article 42(2)(b) CPR).

It is expected that the financial instrument contributes to the values of the common output and result indicators in accordance with Annex I of ERDF regulation.

In addition to the common output and result indicators, other indicators measuring implementation progress/performance of the financial instrument should be included in the reporting and monitoring structure of the financial instrument:

- Number of equity investments made in accordance with the Investment Strategy;
- Number of companies in which investments have been made;
- Volume of equity investments;
- Forecast of investment, progress against the forecast, write-offs;
- Gain or loss generated by the investments;
- Number, size, type of grants provided;
- Respect of the thresholds for grant support in certain support categories as defined in section 'Use of grant component (Article 58(5) CPR)'.

Notes



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