advancing with ESIF financial instruments

Developing an action plan

Design, set-up, implementation and winding-up of financial instruments

European Commission

European Investment Bank

The EU bank

DISCLAIMER

This document has been produced with the financial assistance of the European Union. The views expressed herein can in no way be taken to reflect the official opinion of the European Union or the European Investment Bank. Sole responsibility for the views, interpretations or conclusions contained in this document lies with the authors. No representation or warranty expressed or implied are given and no liability or responsibility is or will be accepted by the European Investment Bank or the European Commission or the Managing Authorities in relation to the accuracy or completeness of the information contained in this document and any such liability or responsibility is expressly excluded. This document is provided for information only. Neither the European Investment Bank nor the European Commission gives any undertaking to provide any additional information on this document or correct any inaccuracies contained therein. The authors of this study are a consortium of: SWECO (lead), t33, University of Strathclyde – EPRC, Spatial Foresight and infeurope.

Introduction

Financial Instruments (FIs) co-funded by the European Structural and Investment Funds (ESIF) are a sustainable and efficient way to invest in growth and development in EU regions and cities. They can support a broad range of development objectives to the benefit of a wide range of final recipients (FRs) with the potential for EU funds to lever in additional public and private contributions and/or to be reused for further investments.

Managing Authorities (MAs) can use FIs to efficiently deliver support under thematic objectives when there are market failures or suboptimal investment situations. Addressing the market gap can encourage national, regional and/or private co-investors to contribute funding and expertise. Such significantly increased resources can additionally stimulate local capabilities ensuring continued development of the local economy.

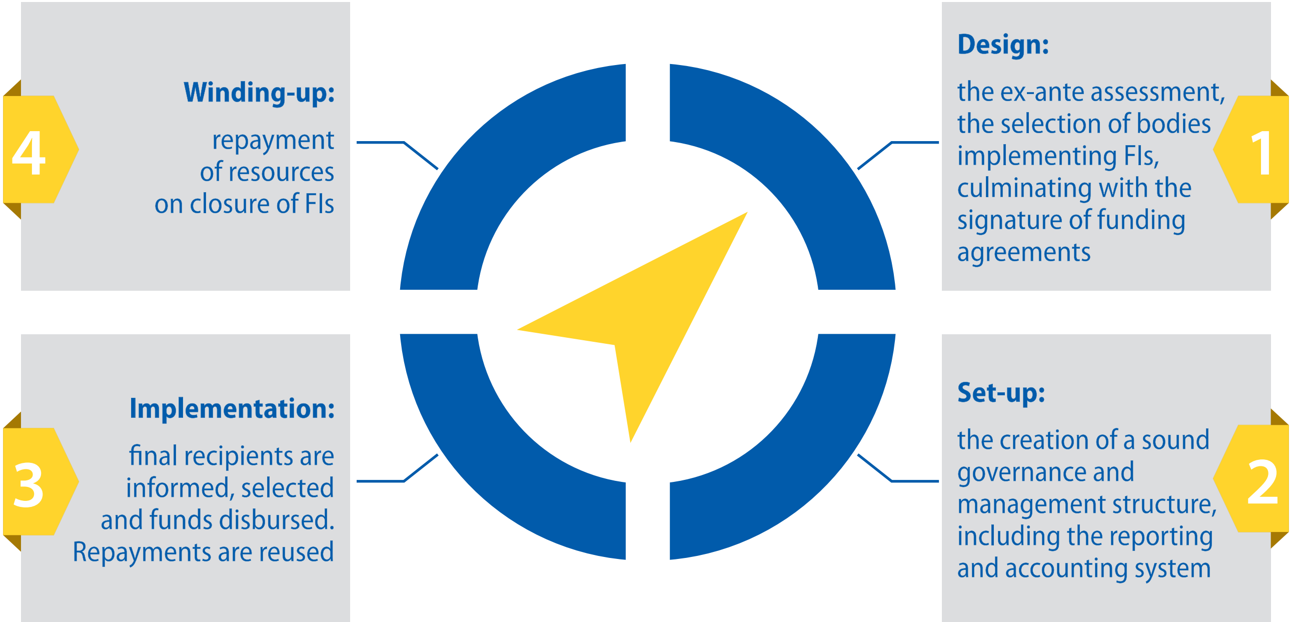
FIs in the 2014-2020 programming period must be implemented in accordance with the relevant regulatory provisions, in particular Title IV of the Regulation (EU) No 1303/2013, the Common Provisions Regulation (CPR). Implementing FIs can be perceived as complex, especially because it involves multiple stakeholders, such as the bodies implementing FIs - Fund of Funds (FoF) and Financial Intermediaries (F.Ints)[1] - as well as a range of choices and actions.

To ensure a comprehensive and efficient process, MAs and other stakeholders may refer to the **action plan**[2] described in this short reference note, which structures the life cycle of FIs along four logical phases.

1 In this short reference guide, for clarity we will use "F.Int" meaning the body implementing the specific FIs vis-à-vis final recipients and FoF for the body implementing a fund of funds

2 The action plan is not a regulatory requirement but a methodological scheme which may help develop the FIs. The aim is to illustrate the different phases and activities of FIs in a coherent framework.

Figure 0.1 FI Life cycle



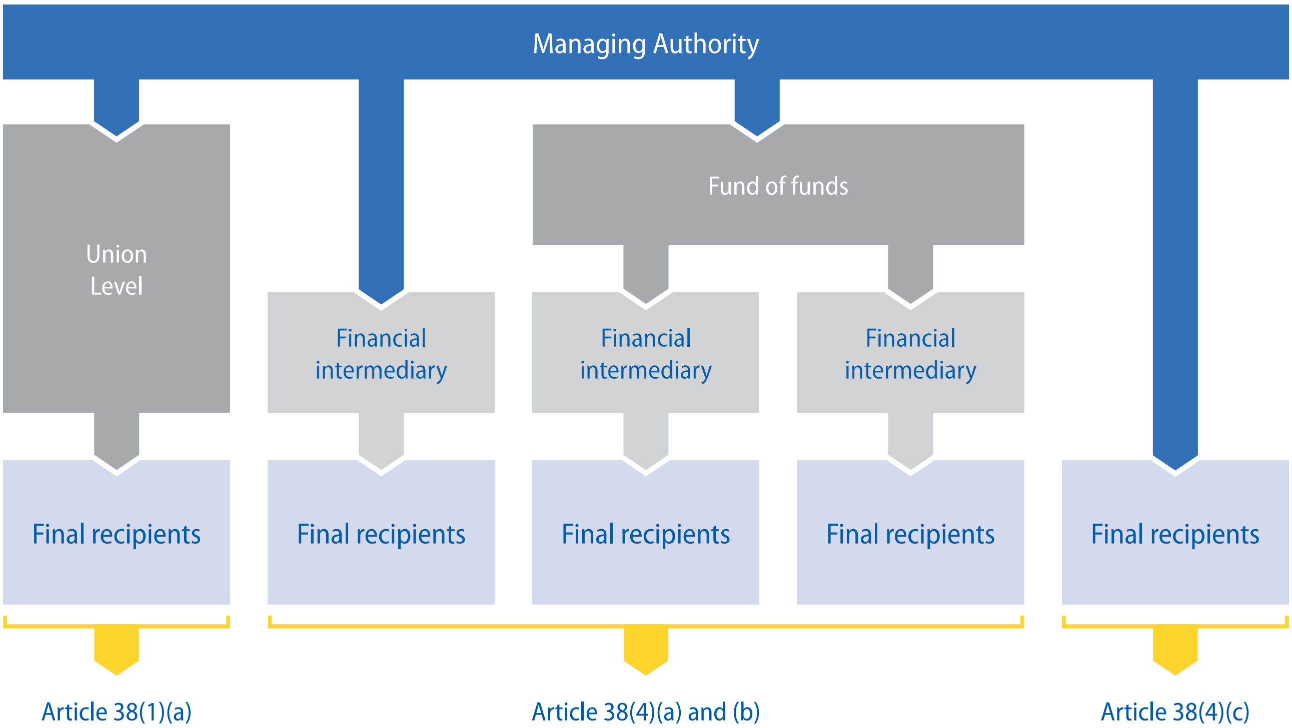
Each phase is crucial for the success of the following one, since:

- Good **design** helps define the choice of FI and the implementation arrangements. The investment strategy and relationship with other stakeholders determines the set-up.
- Sound **set-up** safeguards and accelerates **implementation**, which avoids delays in disbursement to FRs.
- These three phases precede the **winding-up** which is usually defined in the design and/or set-up phase.

This **short reference guide** is structured in 4 sections dedicated to each phase of the action plan (design, set-up, implementation and winding-up). Each section (phase) is framed by the main activities that, according to EU regulations, are needed.

Specific activities within the phases of the action plan depend on the implementation option chosen by the MA according to Art. 38 of the CPR. Implementation options give MAs the choice of using instruments set up at Union level under Art. 38(1), of investing in a legal entity under Art. 38(4)(a), or entrusting implementation to F.Ints directly or through a FoF under Art. 38(4)(b). Alternatively the MA can manage the implementation of loans or guarantees directly under Art. 38(4)(c).

Figure 0.2 Implementation options under Article 38



Since the main objective of this action plan is to help structure the different steps to follow when using FIs, in the design phase, it presents the example of the most commonly used option in which implementation tasks are entrusted to institutions and bodies under Art. 38(4)(b) of CPR.

The following table provides an overview of the main regulatory provisions and their relevance to the particular phases and activities.

	ACTIVITY[1]	EU Regulation 1303/2013	EU Delegated Regulation 480/2014	EU Implementing Regulations
DESIGN	1. Reference to FIs in the OP	Art. 96(2)(b)(iii)		
	2. Ex-ante assessment	Art. 37(1)-(2)		Reg. (EU) No 964/2014
	3. Selection of the implementation option	Art. 38(1)-(4)		Reg. (EU) No 964/2014
	4. Selection of the body implementing FI	Art. 37(1) Art. 38(4)-(5)	Art. 7	
	5. Drafting and signature of the funding agreement	Art. 38(7) + Annex IV Art. 42(5)-(6)	Art. 12, 13	
SET-UP	1. Governance structure		Art. 6(2)-(3)	
	2. Open fiduciary accounts or set up the FI as a separate block of finance Transfer of resources	Art. 38(6) Art. 38(10)		Reg. (EU) No 821/2014 Art. 1
	3. Documentation, management and control system	Art. 40 Art. 46	Art. 9	Reg. (EU) No 821/2014 Art. 1
	4. Setting up operational structure			
IMPLEMENTATION	1. Selection, funding and disbursement to the FRs		Art. 6(1)	
	2. Payments	Art. 41, 42		Reg. (EU) No 1011/2014 Art. 6, Annex IV
	3. Monitoring, control and reporting	Art. 46, Annex IV	Art. 9	Reg. (EU) No 821/2014 Art. 2, Annex I
	4. Management verifications and audit	Art. 40, 125, 127	Art. 9 Art. 25	
	5. Reuse of the repaid funds for further investments within the eligibility period	Art. 44		
	6. Revision of the ex-ante assessment and/or the funding agreement (if needed)	Art. 38(7) + Annex IV		
WINDING-UP	1. Execution of the exit strategy			
	2. Re-use after the eligibility period	Art. 45		
	3. Winding-up of FI			

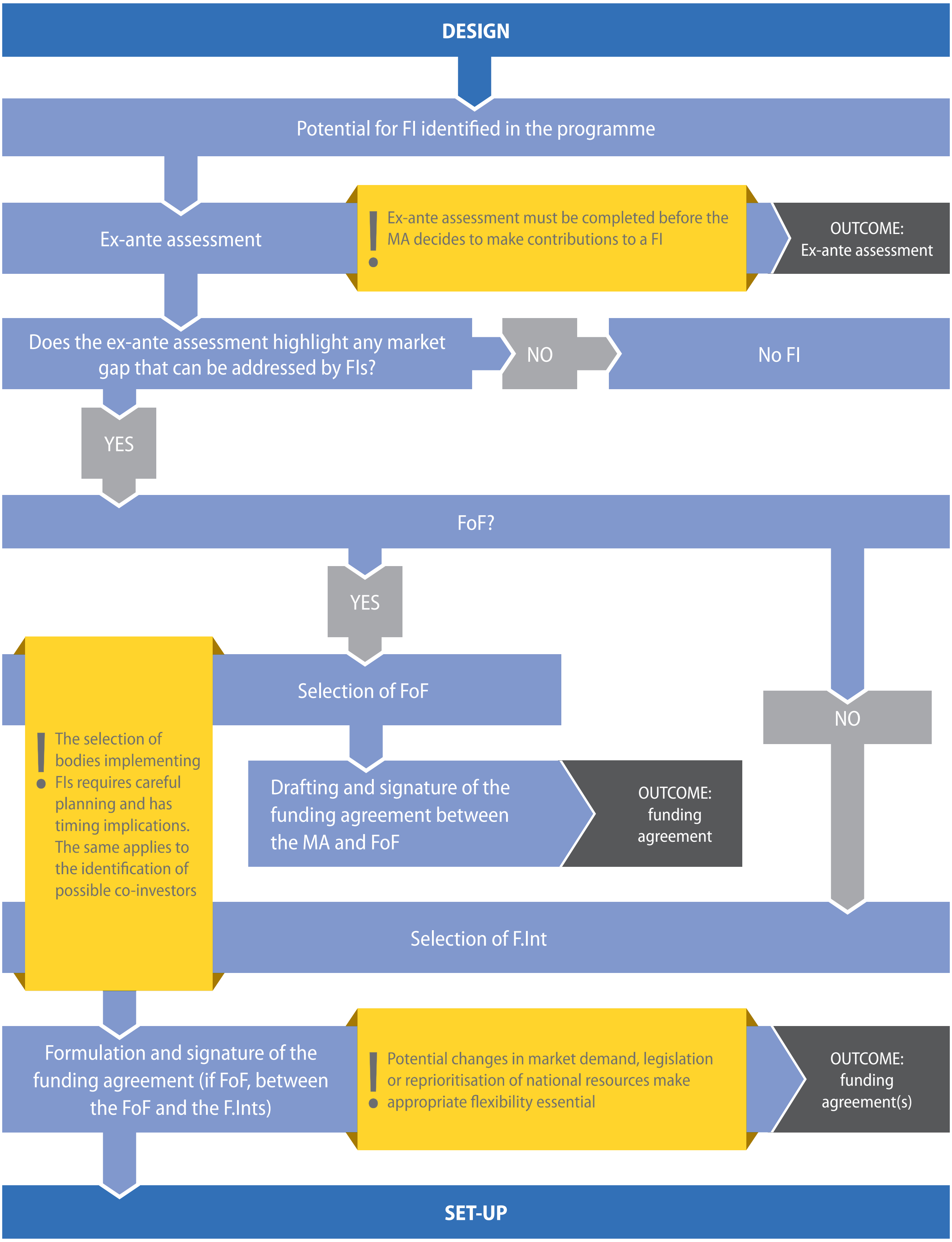
1 This is a schematic overview. The sequence of activities is not always linear. Some of them may or even should take place in parallel.

1 Design

ACTIVITY	HIGHLIGHTS	TIPS
FIs in the programme	MAs who wish to implement FIs should signal this in the programme. Art. 120(5) of the CPR allows a 10% increase of the maximum co-financing rate where the whole of a priority axis is delivered through FIs.	Including information in the programme assures a better understanding of the delivery of the actions. However, the information should be not too prescriptive or detailed since the decision to implement a FI is taken on the basis of the ex-ante assessment which may be updated if conditions change.
Ex-ante assessment	MAs organise the ex-ante assessment to provide evidence-based decision making in the design and implementation of FIs taking account of, *inter alia*, State aid issues. The MA must submit the document to the Monitoring Committee for information. The summary of the ex-ante assessment must be published. The ex-ante assessment must be completed before the MA decides to contribute programme resources to a FI.	Using off-the-shelf instruments under CPR Art. 38(3)(a) can be a valid solution to ensure compliance with State aid rules.
FoF selection (Optional)	The MA can decide to entrust a FoF with the management of the FIs according to the criteria provided for in Art. 7 of the Regulation (EU) No 480/2014. The FoF is an umbrella fund set up to invest via F.Ints to allow for flexibility and diversification in investments (i.e. risks). When there are multiple funds, the FoF can also generate significant economies of scale. Eventually, the steps under the action plan will correspond to the ones below for a F.Int.	FoF has significant added value when there is no considerable in-house financial or fund management expertise within public sector organisations. However, it also entails a longer set-up and higher management costs and fees because of the multi-level implementation structure.

ACTIVITY	HIGHLIGHTS	TIPS
Selection of F.Int	In selecting a F.Int, the MA or the FoF ensures the most suitable bodies are chosen in accordance with applicable law, including on public procurement, and according to the criteria provided for in Art. 7 of the Regulation (EU) No 480/2014. These include *inter alia* economic and financial viability, capacity to implement the FI, effective and efficient internal control and accounting systems, robust methodology for selecting FRs and the ability to add financial resources.	In addition to the selection criteria required by the Regulation, the MA may consider further criteria. These could include training for internal staff of the F.Int as well as effective marketing and communication plans for potential FRs.
Funding agreement	The funding agreement is the legal commitment between the MA and the FoF or between the MA and F.Int, or where applicable, between the FoF and the F.Int. It must include, *inter alia*: • **investment strategy**, including implementation arrangements, the financial products offered, target FRs and any combination with grants; • **business plan or equivalent document** for the FI, including the expected leverage effect. If the financial product is a guarantee, the MA must establish a multiplier ratio through a prudent ex-ante risk assessment.	Information needed for the funding agreement will normally be requested by the MA and/or provided by the F.Int as part of the F.Int selection process. Here also the management costs and fees must be agreed, taking into account the legal provisions.

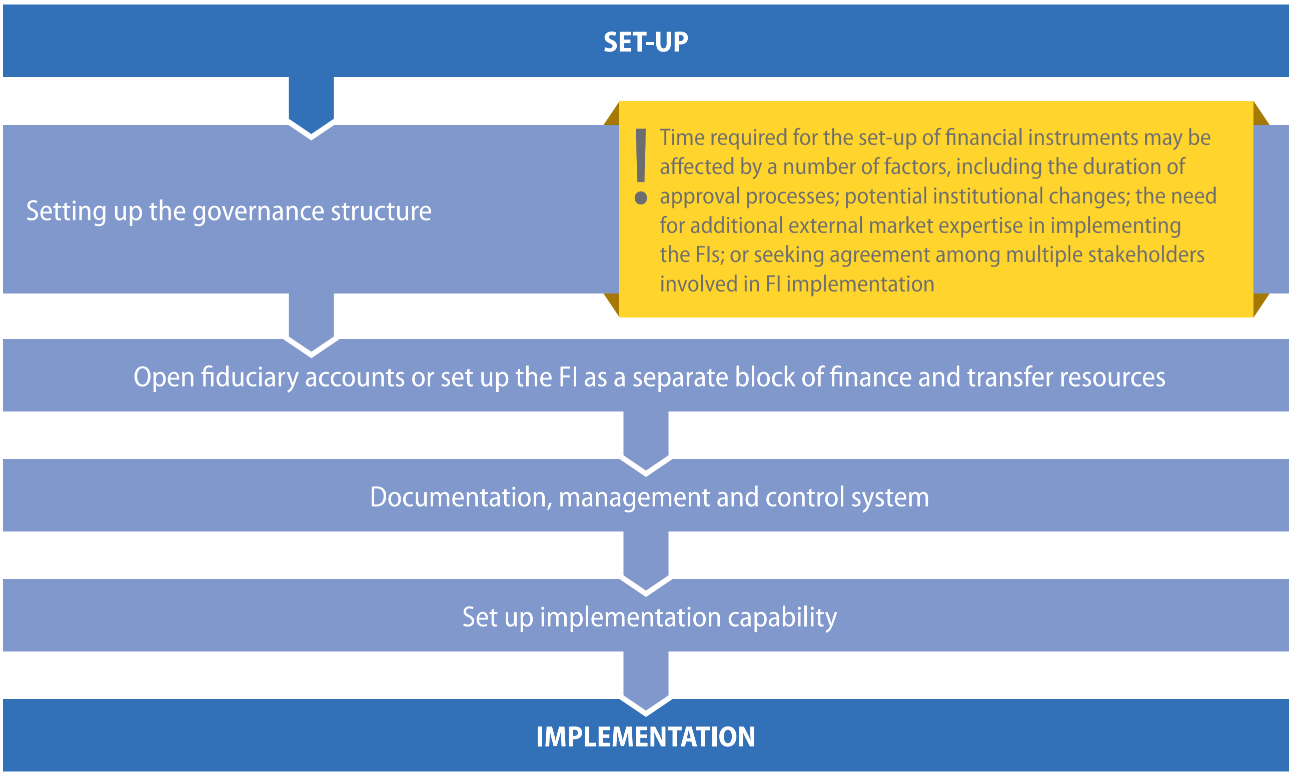
Figure 1.1 Design phase



2 Set-up

ACTIVITY	HIGHLIGHTS	TIPS
Setting up the governance structure	The governance structure established in the funding agreement becomes operational. In particular the decision-making process is activated according to the roles and responsibilities of the different parties. The governance structure can be tailored to the specificity of the FI and any national or regional procedure, including the establishment of arrangements necessary to ensure proper governance.	An investment board (also called 'investment committee' or 'steering committee') was set up by many FIs in 2007-2013, with members from the MA, the fund manager, and other relevant parties. Responsibilities included compliance with legal obligations, implementation of the investment strategy and signalling the need for its revision according to market developments upon revision of the ex-ante assessment.
Open fiduciary accounts or set up the FI as a separate block of finance and transfer resources	The FoF/F.Int either opens a separate account for the FI, or fiduciary accounts in their name on behalf of the MA, or sets up the FI as a separate block of finance with a clear accounting distinction. This ensures proper accounting and an audit trail. Under the funding agreement, rules are established for payments to the FI and for treasury management. Then the MA transfers the resources to the FI as agreed under the funding agreement and applies for the first interim payment (request of payment) for a maximum of 25% of the total amount of programme contributions committed to the FI.	Include the use of interest and other gains in the regular reporting from the beginning.
Documentation, management and control system	An adequate system for documentation, management and control is already designated in the funding agreement. However at this stage the MA ensures that the system is operational.	It is recommended that the MA requires FoF/F.Int to provide templates for reporting as part of the selection process.
Implementation capability	The F.Int sets up the facilities and develops the capabilities needed to ensure efficient channeling and adequate promotion of the FI. This may require training of F.Int staff.	MA can request examples of marketing material as part of the selection process.

Figure 2.1 Set-up phase



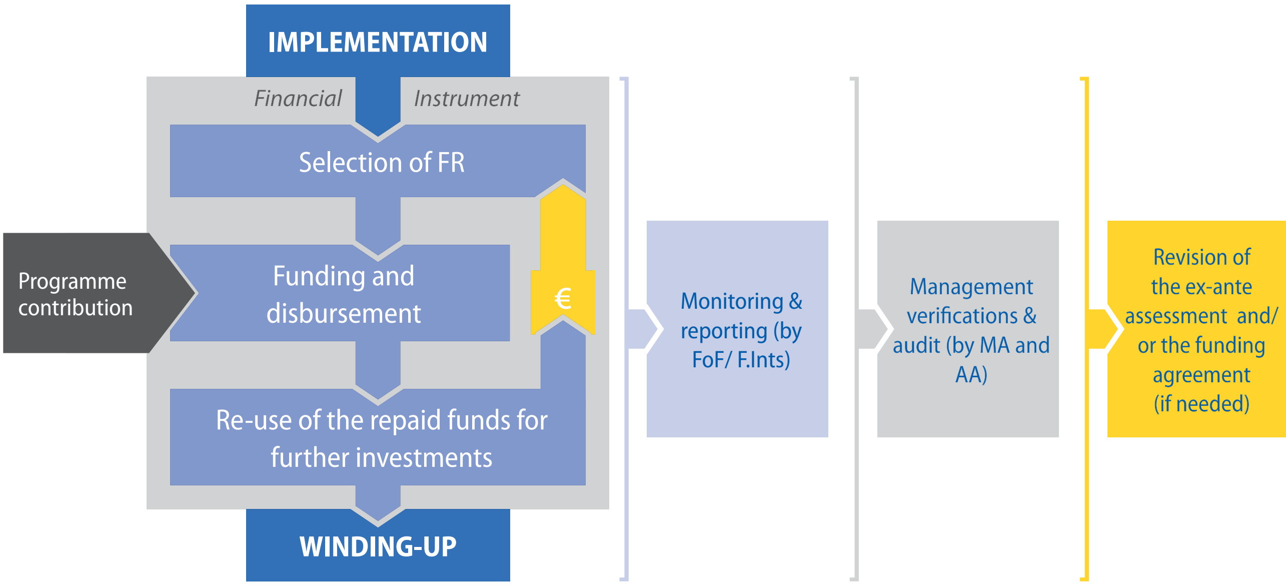
3 Implementation

ACTIVITY	HIGHLIGHTS	TIPS
Selection, funding and disbursement to the project	FRs need to be informed of the availability of the FIs as well as the requirements for accessing them. Eligibility, risk and the returns of potential investments need to be assessed, together with their capacity to deliver positive impacts in line with the investment strategy.	F.Int personnel need to be trained on documentation and appraisal procedures.
	F.Int and FRs enter into a contract governing the obligations of the parties. These might include, for example, terms and conditions of the transaction, availability of documents proving the investments, specific separate accounting, etc.	Ensure that reporting obligations in relation to result indicators are included.
	Disbursement will take place after the contract between the F.Int and the FR is signed and any documents proving eligibility are provided.	F.Int must generally disburse resources within a specified time after signing the contract.
The flow of payment	**From F.Int to MA** The F.Int (and any FoF) prepares the request for each payment by the MA as agreed in the funding agreement, in the case of the 2nd and any following payment declaring the resources disbursed (or committed in the case of guarantees) as well as the management costs and fees.	Financial planning should take into consideration not only absorption capacity but also the forecasted disbursement pattern.
	From MA to Certifying Authority The MA verifies the information from the F.Int and transfers the information to the Certifying Authority (if the MA is not carrying out the certifying functions).	Payments from the MA to FoF or F. Int should mirror the same phases.
	From Certifying Authority/MA to Commission The Certifying Authority (or MA embedding the functions) submits first payment application of max. 25% of the committed programme contribution to the Commission. Once at least 60% of this amount has been spent by the FI as eligible expenditure: • a second application for a further 25% may be made; • subsequent applications can only be submitted when 85% of payments from previous applications has been spent.	

ACTIVITY	HIGHLIGHTS		TIPS
The flow of monitoring and reporting	**From F.Int to MA** The F.Int reports regularly to the MA (or FoF, and this to the MA) the support paid to FRs (or resources committed as guarantees), management costs and fees, the value of investments and the results of internal controls and monitoring. The F.Int collects information such as output and result indicators directly from the FR. Reporting provisions are established in the funding agreement. **From MA to Monitoring Committee and EC** The MA verifies the information from the F.Int (or FoF) and prepares a report on implementation of FIs to be annexed to the Annual Implementation Report (AIR).		The flow of information between the MA and F.Ints (or FoF) should go beyond the legal requirement for annual reporting to the Commission and be at least quarterly and possibly monthly. This will help the MA to understand the performance of the FI and take necessary decisions promptly. Monitoring Committee meeting agendas should include discussion on FIs.
	MC The Monitoring Committee specifically examines the FIs.	**EC** From 2016, based on the AIR, the Commission shall prepare a summary on the progress made by the FIs for the Parliament and the Council.	
Management verifications and audit	The MA carries out management verifications throughout the programming period and during the set-up and implementation phases of the financial instruments in accordance with Art. 125(4) of the CPR. Management verifications are also a basis for approval from the Certifying Authority for payment applications to the Commission. The F.Int and the FoF carry out performance and monitoring checks including *inter alia* performance and monitoring visits.		Compliance with relevant legislation and regularity of expenditure should be accompanied by the principle of sound financial management when performing management verifications.
	The Audit Authority could carry out an audit on the MA, FoF and F.Int. Any controls at the level of FRs could take place only if there are inaccurate or unavailable supporting documents at the level of the MA, FoF and F.Int.		The audit and audit trail are already described in the funding agreement. The audit trail shall include information on management verifications and audits carried out on the operation.

ACTIVITY	HIGHLIGHTS	TIPS
Re-use of the repaid funds for further investments	Revolving resources are part of the value added by the FIs, as it means ESIF support is more sustainable over the long term.	The availability of repaid resources should be taken into account already in the ex-ante assessment when assessing the market gap, the size of the FI and the amount of the programme contribution to it.
Revision of the ex-ante assessment and/or funding agreement (if needed)	If conditions change (including the economic situation, the market, or legislation) the ex-ante assessment and/or the funding agreement, may need to be revised.	Different terms and conditions may be better suited to new circumstances.

Figure 3.1 Implementation phase



4 Winding-up

ACTIVITY	HIGHLIGHTS	TIPS
Execution of the exit strategy	Exit refers to the recovery of resources invested in FRs (which might entail sales). It shall be planned and carefully implemented. An exit is the preliminary step in the winding-up process.	Establish provisions for exit of resources.
Re-use of resources	Resources paid back before the end of the eligibility period to FIs can be re-used for: • further investments through the same or other FIs, in accordance with the specific objectives set out under a priority; • preferential remuneration of private investors, or public investors operating under the market economy principle, who provide additional resources to the FI or who co-invest at the level of FRs; • reimbursement of FI management costs and fees. Resources paid back include capital repayments with gains and other earnings or yields, such as interest, guarantee fees, dividends or any other income generated by the instrument, which are attributable to support from ESIF.	Establish provisions regarding the reutilisation of resources in the funding agreement.
Winding-up of the FI	FIs can continue to work after the exit of resources attributable to ESIF. On the other hand, an FI can complete its life cycle and be liquidated. As part of the liquidation of FIs, accounts should be settled and shareholders paid out their share of the initial investment plus any surplus on realised investments.	Resources in FIs that are attributable to ESIF should be used in the same FI, or following the exit of those resources, in other FIs after the eligibility period if justified by market conditions.

FSC
www.fsc.org
RECYCLED
Paper made from recycled material
FSC® C103749

www.fi-compass.eu
contact@fi-compass.eu
© EIB (2015)

European Commission
Directorate-General
Regional and Urban Policy
Unit B.3 "Financial Instruments and IFIs' Relations"
B-1049 Brussels

European Investment Bank
Advisory Services
fi-compass
98-100, boulevard Konrad Adenauer
L-2950 Luxembourg