



Factsheet  
June 2023

# fi-compass Knowledge Hub

Implementation of grants and financial  
instruments combined in a single operation



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## The Knowledge Hub

has been developed to meet the growing need amongst experienced practitioners for events and materials that provide a more in-depth look into topics affecting financial instruments. Its format utilises email exchanges to promote a longer term engagement between participants together with traditional face to face workshops to allow experienced practitioners to work together to explore the subject matter through peer to peer exchange and expert-led sessions.

In order to encourage openness between the parties the discussions are undertaken under the Chatham House Rule which states: 'When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed'.

In particular, the representatives of the European Commission, namely DG REGIO and DG COMP have participated in the Knowledge Hub to receive feedback from the Member States concerning the implementation of grant and financial instruments combined in a single operation under the Common Provisions Regulations 2021/1060. The participation of the representatives of the European Commission and the European Investment Bank should not be interpreted as an official endorsement of any of the suggestions that may be discussed and/or described during the Knowledge Hub.



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# Introduction

The rules for combining financial instruments (FI) with grants under Article 58(5) of the Common Provisions Regulation 2021/1060 are designed to simplify and expand the use of combination of FI and grant in one operation under financial instruments rules. In addition to technical support, guarantee fee and interest rate subsidies (which were permitted in the 2014-2020 programming period), bodies implementing financial instruments can be entrusted to provide grants that are necessary and directly linked to financial instruments, to meet part of the investment costs, whether by way of up-front capital grant or rebate.

Several fi-compass resources have been published on the topic of combination including:

- The fi-compass factsheet - [Combination of financial instruments and grants under shared management funds in the 2021-2027 programming period \(the Combination factsheet\)](#);
- The Note of the [fi-compass Knowledge Hub - Combination of financial instruments with grants](#);
- The [Model for a financial instrument with a grant component to support energy efficiency \(the EEFI model\)](#);
- Quasi-equity finance for SMEs - A fi-compass model financial instrument and
- Episode 3 of the [Calling the Tune podcast - Combination](#).

In addition the European Commission published the [New European Bauhaus Territorial Development Model \(NEB TDM\) FI](#) which also takes advantage of the expanded options to combine grant and FI in a single operation.

Following the initial work to promote the potential to use grants with financial instruments in one operation, many managing authorities are starting to design and implement combined financial instruments. This has given rise to a number of issues being identified that can prove challenging.

On 26 April 2023, a group of practitioners (representatives of managing authorities, national promotional banks, and bodies implementing financial instruments) gathered in Brussels with experts from the European Commission (EC) and European Investment Bank (EIB) to take part in a workshop to discuss the topic of combination of grant and financial instruments. This Note captures the key points discussed, best practice shared and lessons learned during the workshop.

In this paper, the term 'grant' is used as part of a combined financial instrument. The following terminology is used to designate different types of grants:

- (i) a **capital grant** refers to the non-repayable support provided within a combined financial instrument to cover the estimated viability gap or identified cost items of an investment project;
- (ii) a **capital rebate** refers to the conversion (immediate or delayed) of a loan outstanding amount into a non-repayable support based on the fulfilment of pre-defined criteria (e.g. performance of the investment, final recipients' characteristics).

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## Key notes

Some of the key points that were discussed during the Knowledge Hub were as follows.

*The rules in the CPR relating to FI apply 'from ex-ante assessment to audit' to both the grant and the FI when they are combined in a single operation.*

This message was returned to frequently during the event. At all times, the CPR FI rules apply to the grant and the FI components (i.e. loan, (quasi-)equity or guarantee) and the legal and financial implementation of both components may have specific characteristics, depending on the Member State's national rules.

*The justification that programme support in the form of grants is directly linked and necessary for the FI should be made at the level of the FI and not at the level of the individual investment.*

Article 58(5) CPR includes the requirement that "the programme support in the form of grants shall be directly linked and necessary for the financial instrument". Managing authorities (MAs) designing operations that combine grants and FIs should undertake an analysis to show that the grant is necessary and directly linked. This requirement notably means that the financial product and the grant element(s) should be part of a single financial package. This analysis should be done at the level of the financial instrument and does not need to be repeated in relation to each investment supported by the FI.

*MAs are currently designing FI that combine grant with all different FI product types, i.e. loans, guarantees and equity/quasi-equity investments.*

A number of participants shared their developing proposals for using grant in combination with different types of financial products. Examples were given of proposals for FIs that will combine grants with loan, guarantee and equity FIs. Several references were made to the different options identified in the Combination factsheet and a positive view of the new flexibilities to combine FIs and grants under the CPR.

*There is an appetite amongst banks and other institutions in certain sectors and regions to manage grants alongside FI products. MAs must further strive to simplify processes as much as possible to ensure successful implementation.*

Participants shared feedback from potential bodies implementing FI, in particular banks in relation to the management of grants within a FI operation. Generally, the response is positive with banks cautiously welcoming the opportunity. Nevertheless, banks have understandable reservations about how the operation will work in practice and MAs should seek to discuss and address these concerns as part of the design and set-up of the FIs combined with grant.

The Funding Agreement (FA) signed between the MA and bodies implementing FI shall foresee simple implementation modalities for combined FI. The FA should therefore notably include clear and easy to understand grant criteria as well as standardised grant rates as far as possible. Responsibilities and templates for reporting on combined FI should also be defined clearly in the FA.

*Cash flow management.*

It was clarified that the amount requested in the first payment application provides the necessary cash flow to provide both forms of support, i.e., the grant and FI components.



*State aid should be calculated at the date of signature of the agreement with the final recipient. All potential grant that may be payable under the agreement should be included in the calculation (including any conditional capital rebate, for example).*

The discussion during the KH reflected the fact that State aid was a constraining factor within which the support must be provided. The calculation of the amount of aid at the date of signature of the financing contract means that the maximum level of support is used to calculate the application of the different State aid regimes. As a result, the *de minimis* threshold is often unavailable, requiring reliance on GBER.

Although grant is more aid intensive than FI support, participants reported a staged approach to compliance under which *de minimis* is first considered, with GBER options considered if necessary. A number of examples were shared where one component of support is given under GBER with the other made under *de minimis*. It was indicated that the grant component could not be provided under GBER articles referring to financial instruments.

*Early engagement through market testing with potential bodies implementing FI is recommended to ensure that the combined FI are designed in an easy to implement way.*

Early dialogue with bodies that may potentially implement FI will enable MAs to design a selection process and FA that is simple to implement for a combined FI. For instance, capital rebates were identified by some participants as being more 'bank-friendly' as they are potentially easier to implement as they do not require separate cash flows in most cases and account for as they can be treated as an early repayment or a write-off of part of the loan if pre-defined criteria are met.

*FI and grants shall be recorded separately for monitoring and reporting purposes.*

The reporting requirements should also be designed to align with the framework under the CPR, providing a simple way to separately report the grant and FI related expenditure, recognising, in the case of performance-based capital rebates that this will require adjustment from year to year as capital rebates are triggered.

Separate records must be kept at the level of the body(ies) implementing the FI for the loan (or other product) and the grant parts of the combined FI. Information on the disbursed/written off grant elements should be included at the moment of payment or write-off. Disbursed/written off grants should be reported separately from the grants which might be awarded/provided in the future.





# Design and set-up of combination of FI and grant in one operation

## 3.1 Directly linked and necessary

During the initial set-up phase, the envisaged form of support should be identified and justified at programme level and the ex-ante assessment must be carried out. It is at this stage that the need for grant must be assessed to demonstrate compliance with the requirement at Article 58(5) CPR that 'the programme support in the form of grants shall be directly linked and necessary for the financial instrument'.

The workshop considered several questions regarding this requirement including:

- How can a managing authority demonstrate in practice the direct link and necessity? and
- How much is enough detail, for example where the ex-ante assessment may only be able to provide a range for grant support based on hypothetical projects?

The assessment of the need for a grant component should start at programme level, where the form of support should be justified, and the planned use of financial instruments described. The programme should as a minimum identify the potential use of a FI/grant combination, justify the form of support and describe the planned use of FI.

The ex-ante assessment may analyse in more detail why a combination of grant and FI is needed, the possible type(s) of grant and percentage (range of potential grant intensities or a maximum grant allowance) of total investment cost to be met by grant. If the justification for grant is not in the ex-ante assessment, MA should justify why and how the grant element is necessary and linked to the FI in a separate analysis.

Importantly, there was strong agreement that the justification that programme support in the form of grants is directly linked and necessary for the FI should only be made at the level of the FI. The analysis should be undertaken at that level, having regard to the set-up of the financial instrument, the programme objectives to be met by the operation and the benefit of having the financial product and the grant element(s) as part of a single financial package. It is not necessary that each investment must demonstrate that the grant is necessary and directly linked to the FI.

Participants discussed how the requirement of a grant which needs to be 'necessary and directly linked' to the FI would be applied to performance-based capital rebates. For example, the fact that the trigger of the provision of the capital rebates would be the completion of the works would not vitiate any assessment that these capital rebates are necessary. In that case, capital rebates would be used to provide incentives to project promoters to engage energy efficiency renovations as well as to alleviate the overall financial burden of the investments.



The type of grounds used to justify the use of grant were discussed. The group considered how this issue is approached in the recent EEFI and NEB TDM model FIs published by fi-compass and the European Commission as shown in Figure 1 below.

Figure 1 justification for FI/grant combination in EEFI and NEB TDM model FIs

EEFI – Design & set-up	NEB FI – Design and set-up
<ul style="list-style-type: none"> <li>• In EE, grants are <b>key to support TA, energy poverty, incentives, investment viability and affordability</b>;</li> <li>• Ex-ante assessment may <b>justify the direct link and necessity</b> of the grant for the FI, <b>cover the nature, criteria, amount computation method. of grants</b> (technical support, capital grant/rebate trigger);</li> <li>• <b>Capital rebates may be related to energy savings' achieved levels</b> (also climate adaptation). Automatic grant % are expected for granular portfolios of lower scale EE/RE investments;</li> <li>• Fint. may deploy both grant and loan components (marketing, project appraisal, disbursement). A HF may also be in charge of grant management.</li> </ul>	<ul style="list-style-type: none"> <li>• In NEB projects, grants are key to cover <b>non-revenue generating</b> activities (<math>\leq 20\%</math>), <b>green</b> or <b>public spaces</b> (<math>\leq 10\%</math>), <b>project development</b> (<math>\leq 10\%</math>), advanced <b>technologies</b> (<math>\leq 30\%</math>) or <b>energy poverty</b> or <b>social housing</b> (<math>\leq 75\%</math>);</li> <li>• Programme contributions, incl. grant use, are quantified and justified based on the investment needs and the outcome of the ex-ante assessment;</li> <li>• The body implementing the FI must be a public or private body established in a MS and be legally <b>authorised to provide financial products and grants</b> to territorial development projects;</li> <li>• The <b>HF may also manage the grant</b> depending on FI's design.</li> </ul>

The payback model for energy efficiency investments was cited as one example of the kind of analysis that can be used to support the use of grants. Where the cost of the works would require excessive payback periods, grant can be justified to ensure the products offered will be attractive both to potential final recipients and the participating banks.

A combined FI/grant support whereby the grant can be approved for final recipients by the body implementing the financial instrument at the same time as the loan (or other investment) is significantly more straightforward. It would be reasonable for a MA to conclude that the combination into a single operation would be necessary to put in place a streamlined, efficient delivery model capable of achieving the applicable programme objectives.

Some of the most common factors to be taken into account when considering whether grant is necessary for a FI operation were identified as follows:

- The need to incentivise a policy effect, including to help reducing the reliance on grant. As described in the Combination factsheet, grants can be combined with FI to open up new riskier markets, tailor products to specific final recipients' needs, attract private investors and incentivise high performing interventions (amongst other things); this may be achieved through FI including performance-based capital rebates;
- The need to cover a financing gap for investments, which are not fully financially viable (e.g. energy efficiency investments, etc.). This may be achieved through FI including capital grants aimed at covering some part of investment costs to decrease the financial burden for project promoters and/or end users.

Previous successful activities that have benefited from grant support as part of the financing package may be a good indication of the need and level of the grant component.

## Residential energy efficiency financial instruments in Lithuania



The fi-compass case study, 'residential energy efficiency financial instruments in Lithuania' describes how grants and FI are combined. Grants have been used in combination with the financial instruments to fund technical support, interest rate subsidies and capital rebates. As it was established in the 2014-2020 programming period, the capital rebate was a separate operation using national (non-EU) resources.

Nevertheless, the case study provides a good illustration of the different types of grant support that can be combined with a FI.

The measures were offered as a single 'Modernisation Loan', which was the centrepiece of the Lithuanian government's programme to improve energy efficiency in residential properties. Under the current programming period, the different types of grant support provided in the Lithuanian case study could be provided in a single operation,

where necessary to ensure the streamlined and efficient implementation of the instrument so as to achieve the programme objectives.

### 3.2 Guarantee FIs and grants: avoiding double support

Another question that was raised during the workshop regarding the initial design was in relation to the requirement that there is no double financing. Participants considered how guarantee financial instruments combined with grants (notably capital rebates) should be designed to ensure that double financing is avoided?

An example was given of a project that initially received a EUR 100 000 loan from a bank with the benefit of an ERDF backed guarantee FI to cover a project with a total investment requirement of EUR 100 000. The FI was combined with grant in the form of a performance-based capital rebate of EUR 40 000 payable following successful completion of the investment project.

The discussion at the workshop identified the following way to treat the combined operation from a reporting perspective.

- At the time of the initial investment – at this stage the total value of the loan is attributable to the ERDF guarantee component, calculated by reference to the multiplier ratio in accordance with Article 68(1)(b) CPR. So, if we assume the multiplier ratio is 5, at this stage the EUR 100 000 loan is guaranteed by EUR 20 000 of programme resources set aside in the guarantee contract which constitute the eligible expenditure;
- Following trigger and payment of the capital rebate, EUR 40 000 is attributable to the grant component. The equivalent part of the loan is treated as repaid and therefore the eligible expenditure attributable to the guarantee is reduced to EUR 12 000 ( $\text{EUR}60\,000/5 = \text{EUR}\,12\,000$ ). In total, the eligible expenditure amount to EUR 52 000 ( $\text{EUR}\,12\,000 + \text{EUR}\,40\,000$ ).





This demonstrates how the guarantee combined with performance-based capital rebate can be provided in case of a loan of EUR 100 000 with a rebate of EUR 40 000 without double support. Similarly, as the combined support is provided in a single operation whereby the capital rebate is committed at the same time as the loan the arrangement is consistent with the requirement under Article 58(7) CPR that FIs should not be used to pre-finance grants.

Participants gave examples of FIs which combine grants and guarantees. This includes a scheme for energy efficiency investment by SMEs which utilises a guarantee to mobilise loan finance from participating banks, combined with grant in the form of an interest rate subsidy to reduce the cost of the loan. To be noted that in the latter case, the risk of double financing is reduced given that the eligible costs of an interest rate subsidy consist of the financing costs i.e. the interest on debt paid by the borrower and not the investment costs themselves. Another FI was mentioned and is being implemented to finance the purchase of equipment, which combines a loan with a capital rebate of between EUR 5 000 – EUR 10 000 depending on the equipment type.

## The fi-compass Combination factsheet



The fi-compass publication, 'Combination of financial instruments and grants' describes how a number of different types of grant support including interest rate subsidies, technical assistance, investment grant and capital rebates can be combined with loan, guarantee and equity financial instruments in a single operation.

The factsheet includes a description of the main reasons why MAs should consider combining FI with grants in a single operation. It also provides a practical guide to setting up different types of FI/grant combination.

A number of sector specific examples are also provided, including examples of successful FI/grant combinations made in previous programming periods, which may be suitable for adaptation to single operations in the current programme.

### 3.3 Selection of bodies implementing financial instruments

Following the initial design and completion of the ex-ante assessment, the MA will start the process to select and appoint the bodies implementing the financial instrument either through direct award or through competitive selection<sup>1</sup>. The recommendations of the ex-ante analysis of the need for grant may need to retain a degree of flexibility to adapt to market conditions and to allow the managing authority to further develop the design of the products through market testing and the procedure to entrust bodies to implement the financial instrument.

Participants commented that in many cases the initial assessment may identify the need for grant of up to 50%. This is then further refined through engagement with the market. It was commented that MAs should strive to keep the administration of the grant as simple as possible for bodies implementing FIs, for example by specifying that grant shall be given as fixed lump sum or percentage (in the case of a capital grants or rebates) of the investment or the financing. Other types of grant support such as interest rate subsidies will be linked to the implementing

<sup>1</sup> For a discussion of selection, please see the [fi-compass Knowledge Hub selection of financial intermediaries](#), [Notes of workshop: fi-compass Knowledge Hub - Selection of financial intermediaries](#) | fi-compass.



bank's pricing methodology and may provide a fixed discount to the rate or reduce the interest rate to a fixed level. In all cases the selection process and the funding agreement should ensure that the benefit of the grant as well as the FI component is passed on to the final recipient.

As part of this process, training and awareness raising amongst potential bodies implementing FI and bodies providing the underlying new loans and equity investments in the context of guarantees may be necessary to address any concerns regarding the implementation of grants.

Participants considered what the appetite/legal capacity will be amongst the potential financial intermediaries to manage combined instruments?

In some cases, it is likely that banks will be concerned about reputational risk associated with the management of the grants. This may in part reflect past experience of trying to align grant programmes and market loan products. The enhanced flexibility to combine grants and FIs in a single operation governed by FI rules is designed to address this issue. Nevertheless, it is to be expected that some reservations will remain.

In addition, the mechanics of managing grants alongside loans will need to be developed by bodies implementing FIs, including potentially through IT tools and accounting practices as well as separate reporting procedures. Although these factors will need to be addressed as FIs are implemented, participants reported some interest amongst banks and other institutions to take on the role of managing FIs and grants combined in a single operation.

It was commented that in many cases a capital rebate model (at contract signature based on final recipients' characteristics or triggered later based on investment performance) may be easier for banks to implement than a capital grant, which would be provided alongside or ahead of the FI support to cover some specific investment costs or the viability gap of the project. This reflects the fact that the capital rebate would be used to reduce the outstanding principal, effectively as a prepayment/write-off which the bank or other implementing body can account for in the usual way.

### 3.4 Funding Agreement

The final arrangements for managing the grant and FI in a single operation are documented in the FA which will set out the conditions for providing grant support. The FA shall notably clearly describe the calculation methodology of the grant element(s) to be provided and determine whether the body implementing the combined FI has any room for manoeuvre to modify grant features on a case-by-case basis, depending on investments and/or final recipients.

These arrangements are to be negotiated and agreed between the Managing Authorities and the bodies implementing the financial instruments in view of the programmes, the type of investments and of final recipients as well market constraints. For granular portfolios (large number of smaller scale investments), it is expected that the grant will be a fixed/pre-defined percentage(s) whereas for other financial instruments the grant may vary, depending on the nature of the project being financed.

Participants discussed which criteria are sufficiently objective and simple for the bodies implementing FI to assess regarding the award of grants? Are there differences between types of bodies implementing FI in terms of grant management capacity and/or appetite (e.g. commercial banks vs. NPBs and between sectors)? Figure 2 shows the recommendations for the Funding Agreement made in the EEFI and NEB TDM model FIs.





The parties discussed whether the combination in one operation necessarily leads to the signature of one single funding agreement? The mechanism of providing ERDF programme resources to a bank to be used for both grant and a loan was considered. The resources will be contributed and held initially by the bank as a separate block of finance or fiduciary account.

The programme resources to be provided to or for the benefit of final recipients in the form of a financial product and grant elements will be jointly provided to the body implementing the combined financial instrument.

The characteristics of the combined FI (incl. grant amount and criteria) should be precisely described in the FA. In the FI/Bank accounts, one suggestion was that the FI component would be accounted as a Conditional Loan, in line with past practice in many places.

Figure 2 Funding Agreement recommendations of EEFI and NEB TDM

EE FI – content of the FA	NEB FI – content of the FA
<ul style="list-style-type: none"> <li>• Under the FA, <b>programme contributions - i.e. grant and loan components - are committed</b> to the Fint;</li> <li>• The FA should include arrangements to fulfill minimum standards concerning the energy audit and other activities (e.g. authorised list of energy auditors etc.);</li> <li>• The FA shall include specific <b>arrangements for ensuring monitoring of the % of grants vs. FI</b>, taking into account the total costs of different grant components;</li> <li>• The FA <b>may provide that the technical support grant remains eligible</b> even if the EE investment is financed from non-programme resources or is not financed at all;</li> <li>• <b>Capital rebate: its application method</b> (e.g. write off) <b>should be specified in the FA</b>, allowing the Fint. to account for the rebate as grant rather than loan.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Specific rules on the use of the grant</b> when directly linked to and necessary for the FI., notably the type, intensity and criteria of the grant components. MA should consider the local context as described in the ex- ante assessment and set limits;</li> <li>• Specific arrangements for final recipients receiving <b>grant support in the development stage of an investment that ultimately is not implemented</b>;</li> <li>• Such arrangements could include <b>repayment of the grant support</b> (e.g. conversion of grant into loan, without the need to pay interest for the past period) or <b>termination of the agreement without the need to repay</b> (e.g. risky investments that in the end are deemed not be financially viable yet or not mature enough).</li> </ul>

Another key issue that was identified as being vital to ensure participation of the market is clarity on the bank's role regarding recoveries in the event of default. Audit arrangements were also identified as being an area where clarity is important to ensure private sector organisations participate in FIs. These issues are discussed further in section 4. In all cases, it is important that the funding agreement is clear regarding the responsibility of the body implementing FIs in the case of events of default, including in relation to the exercise of any rights of clawback of the grant component.



Where grant management responsibilities are split between bodies implementing financial instruments, e.g., between the holding fund and specific funds (SF) or bodies providing underlying loans, the funding agreement should be drafted to reflect accurately the apportionment of roles and responsibilities, for example in relation to monitoring, reporting and control. It was commented that in order to facilitate the implementation and the monitoring of a combined FI in the case where a single funding agreement may cover numerous FI, the MA may decide to include the above listed detailed elements in other binding documents (for instance a national legal act or other documents describing the combined FI implementation structure and its characteristics).

### 3.5 State aid

The State aid implications of FIs and grants combined in a single operation were also discussed.

The workshop considered which State aid regime(s) is/are appropriate for combined operations.

The workshop identified a number of circumstances where State aid can be excluded. At the level of the body implementing FI State aid both in relation to the loan and grant components can be excluded when the financial intermediaries are selected through an open and transparent call and where the financial advantage of the programme public contribution to the instrument is quantified and then fully passed on to the final recipients for example in the form of an interest rate reduction and/or a decrease in collateral requirements and/or grant.

At the level of the final recipient, it was highlighted that for many residential energy efficiency schemes, the final recipients are natural persons and therefore fall outside the State aid regime. The Marininvest decision<sup>2</sup> was discussed as potentially applying to small businesses such as hairdressers although some participants commented that their national State aid authorities adopt a more risk averse approach and thus do not rely on this judgement for their FIs, preferring to rely on the *de-minimis* regulation<sup>3</sup>.

The methodology for calculating State aid was discussed. It was acknowledged that the calculation must be made at the time of the signature of the financing agreement with the final recipient based on the maximum possible grant that could be paid to the final recipient (including any conditional capital rebate granted on achievement of a milestone). In case the decision is taken following signature not to award the capital rebate, the question whether the total amount granted to the undertaking could be adjusted accordingly at that later date was discussed. This may not be possible given that a capital rebate option enclosed in the loan financial product from the beginning may imply an aid element that remains even if the rebate is not triggered in the end.

Where State aid cannot be excluded the participants shared a range of different approaches to securing compliance, relying on both the *de-minimis* regulation and the General Block Exemption Regulation (GBER)<sup>4</sup>.

For example, a scheme designed to support SMEs to make low carbon investments relies on Article 21 GBER (Risk Finance) for the loan component with the grants (in the form of capital rebate and interest subsidy) being made under *de minimis*. A similar approach to finance energy efficiency in buildings was also shared. In this case final recipients that are natural persons can be excluded, with commercial buildings occupied by SMEs receiving the loan under Article 39 GBER and grant under *de minimis*. Another scheme relies on *de minimis* for a guarantee component<sup>5</sup> with the grant being made under Article 14 GBER (Regional investment aid).

<sup>2</sup> For a discussion of this decision please see the [fi-compass Knowledge Hub, State aid, Note of Workshop](#).

<sup>3</sup> COMMISSION REGULATION (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid.

<sup>4</sup> COMMISSION REGULATION (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

<sup>5</sup> Under [Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees \(2008/C 155/02\)](#).



Participants also shared examples where loan and/or grant is made under other GBER articles including, Article 25 GBER (Aid for research and development projects), Article 38 GBER (Investment aid for energy efficiency measures), Article 41 (Investment aid for the promotion of energy from renewable resources) and Article 53 GBER (Aid for culture and heritage conservation).

The group also discussed how Article 16 GBER (Regional urban development aid) has previously been an important tool to promote urban development type projects. As a result, it may be expected to play an important role in the delivery of the European Commission's New European Bauhaus initiative. However, it is concerning that it cannot be extended to the use of grant in combination with FIs. It was commented that certain notified schemes that predated GBER, that allowed investments similar to Article 16 GBER also authorised the use of grant alongside the FI<sup>6</sup>. It was suggested that an early notification of a scheme by one or more MA could pave the way for increased flexibility in the future, potentially relying on the extended governance and flexibility for the use of grant under Article 58(5) CPR to justify an extension of Article 16 GBER.

In general, the participants agreed that a 'staged' approach was necessary which generally seeks to rely on the simple *de minimis* rules where they can be applied and then turning to GBER where the aid amount exceeds the *de minimis* threshold. The discussion identified a high level of expertise amongst MAs. It was however, strongly agreed that the complexity of the rules acts as a strong disincentive to participation by banks and other private sector institutions.

Typically to secure participation, MAs must reduce the compliance requirements to a simple set of rules, which can be included in the Funding Agreement. The additional complexity resulting from the potential need to rely on more than one regulation for different components of the support will act as a barrier risking delay or failure of implementation of FI/grants combined operations and further development of the State aid legal framework to facilitate the implementation of the new flexibilities under the CPR would be welcomed.

<sup>6</sup> See for example, Case SA.32835/2011 Northwest Urban Investment Fund (OJ C 281 24.09.2011, p. 7-8) and State aid SA.34660 (2012/N) – The Netherlands. JESSICA Urban-development Funds The Hague and Rotterdam.







# Implementation of combination of FI and grant

## 4.1 Providing final recipients with a combined package of FI and grant

During the implementation phase, the bodies implementing the FI have been selected and contracted under Funding Agreements. Following the launch of the financial instrument, the body implementing FI is responsible for the origination and due diligence on borrowers and their investments in line with best banking practice.

Following the appraisal of proposals from potential final recipients, the body implementing FI approves the combined package including possibly a pre-agreed grant percentage (for instance, in a combined FI targeting energy efficiency investments, the amount of grant may be linked to the level of energy savings achieved or, in a combined FI targeting innovation, the achievement of a specific product development stage by a start-up company). For energy efficiency investments, an IT tool can be used to assess the grant amount and terms of the loan.

The recommendations of the EEFI model for the implementation of grant/FI combined operations were discussed. Figure 3 shows some of the key features of the implementation measures included in the model.

Figure 3 implementation under the EE FI model

### EEFI – implementation

- FI and grant support may be provided only **to parts of the investments, which have not been completed yet** ('in advance'). Payment schedule may be adapted to project needs;
- EEFI loans, TS grants, capital grants and IRS should be disbursed no later than 31/12/2029. **Capital rebates may also be awarded after this date;**
- Contract with bodies implementing FI may last beyond 21-27 programmes to make use of art. 68(2);
- In case of competitive tender, MCF proposed should apply to the total amount of fund contribution, i.e. to the grant and the loan without distinction;
- Technical support as cash grant based on reimbursement of up to 100% of the real costs incurred or lump sum
- Interest rate subsidy may be made through a single capital payment at contract signature.

The final loan and grant will be captured in the form of a single financial package in the agreements signed with borrowers which will include both the terms of the loan and the parameters of the grant award. Participants discussed how the terms relating to the different financing components would be different and separately described within the single agreement.

There is considerable scope for flexibility for MAs, bodies implementing financial instruments to design the regime for the grant component, to complement the terms applicable to the loan or other investment. It is for the MA to decide for instance if a clawback provision allowing the body implementing the FI to claim back all or part of the grant in the event of default may be included, depending on the type of investments and final recipients. However, bodies implementing FI shall not be asked by MA to payback any grant beyond the normally recovered amounts following standard market practice.



Similarly, events of default in relation to the loan may (or may not) be extended to include the grant committed alongside the loan. In each case, the MA and bodies implementing the grant/FI combination should agree the most suitable framework to ensure the combined product is attractive to final recipients, incentivises eligible expenditure and policy objectives' achievement, provides for remedies proportionate to the risks of default and is easy to administer.

## 4.2 Assessing eligible expenditure

The 'trigger criterion' for the release of a capital rebate is a key feature for granting a capital rebate. The body implementing the FI must describe in the agreement with the final recipient the requirements that should be satisfied to enable the release of the rebate. Such criteria should be objective, evidence based and easy to manage.

A capital rebate could be immediately triggered at contract signature if it is based on final recipients' characteristics (e.g. lower income household, very small company acquiring green equipment) and thus serve as an incentive for those final recipients to use financial instruments to finance their investments. It may also facilitate the provision of the grant element by the bank through an established banking practice (early repayment/write-off of the loan).

In case of risk of delivery of more complex investments, the capital rebate may be provided later once the performance of the investment has been checked. For this purpose, in the context of energy efficiency in housing, participants agreed that the Energy Performance Certificates (EPCs) of buildings could be used. For example, a target of improving a building's efficiency to achieve class B (or for some buildings class C) was cited as an example of a simple to measure trigger criteria that is being successfully implemented with FIs. For energy efficiency investments to support the purchase and installation of new efficient plant and machinery, the verification that the item(s) have been bought and are now operational may be sufficient if such requirements to grant the capital rebate are included in the financing agreement with the final recipient. It was recommended to keep ex-post verifications as light as possible for standard investments.

Participants reported how other tools are being developed to allow for the transparent calculation of energy savings achieved. The [Green Eligibility Checker](#) developed by the EIB as part of its [Green Gateway Advisory platform](#) is one example of a simple to use tool that can be adopted to estimate ex-ante the impact and help verify achievement of trigger criteria.

In other cases, FIs will rely on public sector agencies and/or private sector consultants to undertake an assessment of whether the investment has achieved the criteria for triggering a performance-based capital rebate. The use of independent third parties was suggested to be the preferred option for financial institutions.

Where an energy audit is required to verify the performance, for example for more complex investment projects, technical support grant can be provided to meet the cost of this activity, alongside more general investment support. It can be provided:

- as a cash grant to the final recipient based on reimbursement of up to 100% of the real costs incurred;
- as a cash grant for the benefit of the final recipient provided by the body implementing the financial instrument. This body may select a company or companies to provide such support either at no charge for final recipient, or with the final recipient paying for a certain part of the costs outside the Programme contribution;
- as a fixed amount paid to or for the benefit of the final recipient to fund the above-mentioned activities, with a methodology based on estimated costs of such activities verified as part of ex ante assessment or in another document.





An example was given where the cost of the audit is included in the project cost supported by the loan from the FI. In the event that the energy audit confirms the target energy efficiency measures have been achieved, the capital rebate will include a sum attributable to the cost of the audit.

Once applied, the capital rebate leads to a write-off or early repayment of the loan in the FI accounts. The trigger of the grant component (either a payment by HF to banks or a non-cash movement converting part of the loan into non repayable item) for this purpose will be governed by the Funding Agreement. It was commented that banks and other financial institutions may have to develop their existing IT systems to accommodate the application of the performance-based capital rebate. However, this is a matter MAs should discuss with their local market actors with a view to identifying the most practical mechanism that will be easy to apply by the bodies implementing FIs.

The mechanism for applying other types of grant with FIs were also discussed. An example was given of an interest rate subsidy whereby the grant component meets part of the monthly interest payable on loans. In this case, the banks making the loans (which benefit from an ERDF guarantee) provide the body implementing the guarantee instrument with quarterly payment requests for the interest paid in the period. A single payment is then made directly to the participating banks who account for the interest in respect of each loan accordingly.

### 4.3 Application of FI rules to the grant component

The participants discussed the meaning of the provision contained in Article 58(5) CPR which states that where grant is combined with an FI in a single operation, “the rules applicable to financial instruments shall apply to that single financial instrument operation”.

Importantly it was clarified that this requirement is related to the set up and implementation of the grant/FI combined operation at the level of the MA.

This means that the articles in the CPR concerning grants, including Articles 53-56 CPR (Forms of grants), Article 65 CPR (Durability) and Article 67 CPR (Specific eligibility rules for grants) DO NOT apply to the grant component in a combined operation.

Conversely, Articles 58-62 CPR (Financial instruments), Article 68 CPR (Specific eligibility rules for financial instruments), Article 81 CPR (Management verifications and audits of financial instruments) and Article 92 CPR (Specific elements for financial instruments in payment applications) DO apply to the grant component as well as the FI in a combined operation.

In this context, a discussion was held between participants whether the ‘simplified cost options’ approach should be adopted for grant/FI combination instruments. It was highlighted that the use of features such as flat rate grants may well be part of a combined grant/FI instrument but that the specific requirements of Articles 53-56 CPR are not applicable to grant in a combined operation as FI rules apply to the grant component. Thus, MAs designing combined schemes may draw on such models for inspiration but have greater flexibility to design products tailored to work with the FI and respond to the needs of the market than they would have under a grant-only operation.



## 4.4 Management costs and fees

The Management Costs and Fees (MCFs) for managing both the FI and grant components of a combined operation are eligible under Article 68(1)(d) CPR. When the body implementing the FI is selected through a competitive process such fees can be set by the market as part of the selection process. In the case of direct award, the eligible MCFs are subject to the thresholds defined in Article 68(4) CPR.

The MCF percentages apply also to grant components when combined in one FI operation. The funding agreement can be structured so that the MCFs are performance based and reflect the market practices. This means that the management fee structure should contain performance-based remuneration, which might be defined on achievement of milestones/objectives related to both grant and FI components.

The participants discussed how the thresholds were calculated and if the trigger of a capital rebate after the end of the eligibility period would have an impact. It was confirmed that in the case of a capital rebate, the date at which the rebate is triggered has no impact on the level of MCF. On the contrary, for other grants, such as interest rate subsidies, the disbursement of the grant may have a direct impact on the level of MCF.

Thus, where bodies implementing a holding fund are selected through a direct award of contract the amount of management costs and fees that can be declared as eligible expenditure for MCF for grant combined in a single operation shall be subject the threshold of up to 5% of the total amount of programme contributions disbursed to final recipients where the grant is combined with loans or guarantee and up to 7% of the total amount of programme contributions where the grant is combined with equity or quasi-equity investments. For bodies implementing a specific fund selected through a direct award of contract the amount of management costs and fees that can be declared as eligible expenditure for MCF for grant combined in a single operation shall be subject to a threshold of up to 7% of the total amount of programme contributions disbursed to final recipients where the grant is combined with loans or guarantee and up to 15% of the total amount of programme contributions where the grant is combined with equity or quasi-equity investments.

## 4.5 Role of the body implementing the FI regarding the grant management

The flexibility given to the body implementing the FI and the grant was considered during the workshop. Participants considered whether the Funding Agreement could provide that deviations from pre-agreed grant rate can be permitted or alternatively may be authorised by Investment Board/Managing Authority's approval?

It was generally considered that the simpler the approach the better both from the point of view of the final recipient and that of the body implementing the FI. Such schemes based on flat rate grants or a single percentage are easy to market, understandable for the borrower and easy to administer by the bank. In many cases it was felt that for many loan and guarantee FIs, banks would not wish to have too wide a discretion, particularly when the operation creates a granular portfolio of a large number of similar loans. More heterogeneous models, such as FIs based on NEB TDM or equity FIs may be more suited to allowing the body implementing the FI more flexibility in deploying grant to meet a specific financing gap identified through the project appraisal or due diligence.



# Monitoring and reporting

## 5.1 Management control systems

The provision of loan and grant by the body implementing FI is included in future reports of the MA to the Commission. This is supported by the reporting requirements under the funding agreement(s), for example through quarterly reports and meetings of the Investment Board. The body implementing specific fund will report to the body implementing the holding fund which in turn will report to the managing authority (or directly to the managing authority in the absence of the holding fund structure). The use of the grants and the FIs must be recorded separately in the reporting made to EC.

General reporting requirements under the CPR were also recently discussed at the fi-compass Knowledge Hub – Funding Agreement<sup>7</sup>.

The approach to reporting under the EEFI was considered. Figure 4 shows how the model FI proposes the requirements of the CPR are met.

Figure 4 reporting under the EEFI model

- **Reporting** By HF/MA should be **based solely on the following information provided by financial intermediaries**, in line with the loan agreements signed with the final recipients:
  - disbursement of loan and, where applicable, capital grant/interest rate subsidy component,
  - after verification by the financial intermediary confirming fulfilment of conditions for the award established in the loan agreement, the amount converted into a grant component;
- The **technical checks by the financial intermediary** shall be completed by the cut-off date, as in line with the loan contract;
- **Information on policy impact indicators should be updated twice during implementation**, in line with procedures for verification of delivery described in the model, namely:
  - **When the loan (and a capital grant where applicable) is disbursed** the expected results are included for the first time, on the basis of estimates included in the EPC or equivalent documents used to approve the support;
  - **When the conditions for granting the capital rebate or the capital grant are verified and the capital rebate/grant is definitely granted and paid** (or the decision not to convert the grant into loan is taken in case of performance-related capital grants), the reported value of the indicators should be updated if needed at the same time as the breakdown between the loan and grants is updated (or definitely confirmed).

In accordance with Article 58(6) CPR, separate records must be kept for each form of support, i.e. for the loan and the grant parts of the combined financial instrument. Information on the disbursed/awarded grant elements should be included at the moment of payment or write-off. The illustrative example of how to report grant/FI combined operations that first featured in the Combination factsheet (shown in table 1) was identified as a good illustration of the correct approach to take.

<sup>7</sup> To add reference when published.





Table 1 reporting grant/FI combination operations

	Bank			MA			MA		
Risk sharing loan + capital rebate + IRS	Combined FI accounts			Declared to EU under FI in payment applications			Reported to EC in Annex on FIs (cumulative)		
	Y1	Y2	Y3	Y1	Y2	Y3	Y1	Y2	Y3
Risk sharing loan	100			101	1	1	100	100	70
Capital rebate			30				0	0	30
IRS	1	1	1				1	2	3

Disbursed/awarded grants should be reported separately from the grants which might be paid/awarded in the future. Information on foreseen (but not yet paid/awarded) grant components is not a part of reporting by the MA to the Commission, but it should be readily available and may help the body implementing the FI in monitoring the 50% ceiling applicable to grant components.

It is also recommended that the reporting of the body implementing the FI to the MA provides a break-down of both disbursed and future grants by type and purpose, as follows:

- technical support grant;
- interest rate subsidy;
- capital grant (e.g. investments which are not fully financially viable);
- capital grant/rebate linked to performance.

Participants discussed how bodies implementing FIs can manage the requirement under Article 58(5) CPR that the grant component “shall not exceed the value of the investments supported by the financial product”. In cases where individual projects can receive grant for more than 50% of the cost of the project, it will be necessary to monitor closely the overall balance between grant and FI to ensure compliance with this rule. At this stage no specific monitoring tools have been identified within the participant group although it is expected that this will be a feature of future governance of FI/grant combination operations, where necessary.

The mechanism for calculating the leverage effect was also discussed. The same approach as has been adopted for InvestEU is also applicable under the CPR. In line with the CPR definition, the grant component will be disregarded when calculating leverage, which will be amount of reimbursable financing provided to final recipients (excluding the grant) divided by the amount of the contribution from the Funds (excluding the grant and MCF).

## 5.2 Irregularities

The participants considered how irregularities would be treated in the context of a FI and grant combined in a single operation. For example, who should bear the liability for ineligible grants? On the other hand, if no irregularity occurs but the loan agreement is in breach for other reasons (non-repayment) should the grant also be reclaimed along with the loan? If yes, how long shall be the grant also reclaimed?

The ‘unknown’ risks associated with management of grants was identified as a potential concern for financial institutions and therefore clarity on what their liability would be in the case of irregularities will be an important part of future funding agreements.



The following scenarios were identified when the final recipient cannot payback the loan (event of default) and:

- a. there is no irregularity at the level of the loan nor the grant, the loan and the grant are eligible and reimbursed by the Commission. In this case, there is no obligation to call back the grant. The recovery of the loan follows the normal market practice of the body implementing the FI as stipulated in the funding agreement.
- b. there is an irregularity at the level of the grant (e.g. irregular technical support), but the loan is regular and eligible. The Commission can reimburse only the loan, but not the grant component. The grant and the loan components may have to be recovered from the final recipient as it was agreed in the funding agreement. Bodies implementing FI shall not be asked by MA to payback any grant beyond the normally recovered amounts (i.e., when recovering a loan).
- c. there is an irregularity at the level of the loan but the grant component is regular and eligible. The Commission can reimburse only the grant component, but not the loan. In this case, there is no obligation to call back the grant. The recovery of the loan follows the normal market practice of the body implementing the FI as stipulated in the funding agreement.

All irregular amounts need to be either withdrawn from the payment applications to the Commission or deducted from the accounts (Article 103 CPR).

When combining grant and FI to support energy efficiency investments, if a capital grant linked to expected energy savings is provided, the loan agreement may provide for ex post verification or control of delivery (or non-delivery) of the renovation works (to be noted that such ex-post verification might not be needed e.g. in case the grant is used for equipment with known characteristics). If the verification or control of delivery envisaged in the loan agreement requires cancellation or the decrease of the already paid grant amount, but the loan still fulfils the criteria for a support in the form of the loan and is thus eligible, the financial intermediary may convert the affected amount from the grant component to loan financed from programme resources. The repayment schedule of the final recipient and reported amounts to the Commission should be revised accordingly.

### 5.3 Audit of FI and grant combinations

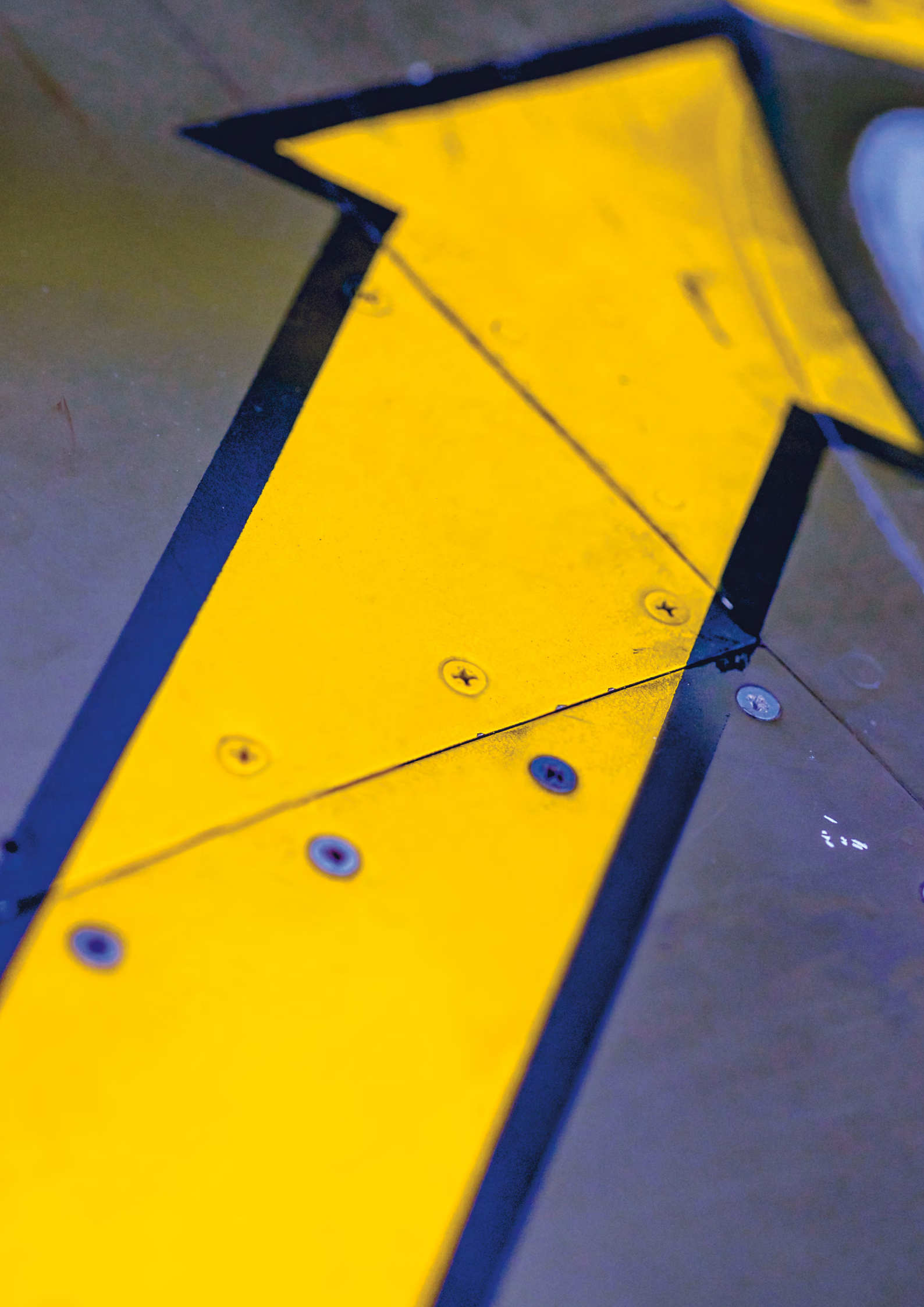
FI audit principles will apply in the same way to the repayable part and to the grant element of the FI if they are combined in one single operation. This means, among others, that no audit will be performed at the final recipient level on the grant element.

The following audit implications were discussed including in relation to the justification in the ex-ante assessment or in a separate analysis by the MA, that the grant component is directly linked to the FI is included .

Checking the eligibility of investments remains the responsibility of the body implementing FI and auditors would ask for evidence that their usual procedures for controlling eligibility have been followed. A major novelty for the 2021-2027 programming period is that eligibility of the use of support for intended purpose is prospective, with bodies implementing the FI being required to retain evidence to show that the financing “is to be used for the intended purpose”. In other words, this will be verified by reference to applications forms or equivalent (e.g. based on submitted documents, including business plans) for support.

The audit of all FIs will also verify that checks are made to ensure the project has not been physically completed or fully implemented at the date of the investment decision, that the body implementing FIs takes following its procedures for appraising, committing and disbursing loans as well as applying consistently the award of the grant, e.g. triggers of capital rebate. However, FI audit principles will apply in the same way to the repayable part and to the grant element of the FI if they are combined in one single operation.





## Final comments – moving in the right direction

The workshop demonstrated that experienced FI practitioners in Member States are progressing in setting up combined grant and FI operations. Although challenges are being encountered, importantly there are no 'showstopper' issues that would prevent the successful implementation of these important new flexible instruments.

The event allowed early experiences to be shared regarding the analysis of the necessity and direct link of potential grant components. As a result, MAs are developing the confidence to rely on their own judgement, based on past experience and available data to decide and document how grants can be used in combination with their FIs.

Early market practice on the use of grants to support energy efficiency, SMEs, Research and Development and urban development/NEB all came to light. Experience of some MAs and bodies implementing FI from previous programmes is invaluable to practitioners to illustrate 'what works'. The importance of engaging early with the market to seek their views on how best to design and provide the grant component was identified. This will ensure that the package offered to the market, in particular in the case of capital rebate, can be implemented without significant changes to existing practices within the bank. Capital rebates and interest rate subsidies were recognised as potentially the easiest type of grant to be implemented, although technical support was also highlighted as important and straightforward to manage.

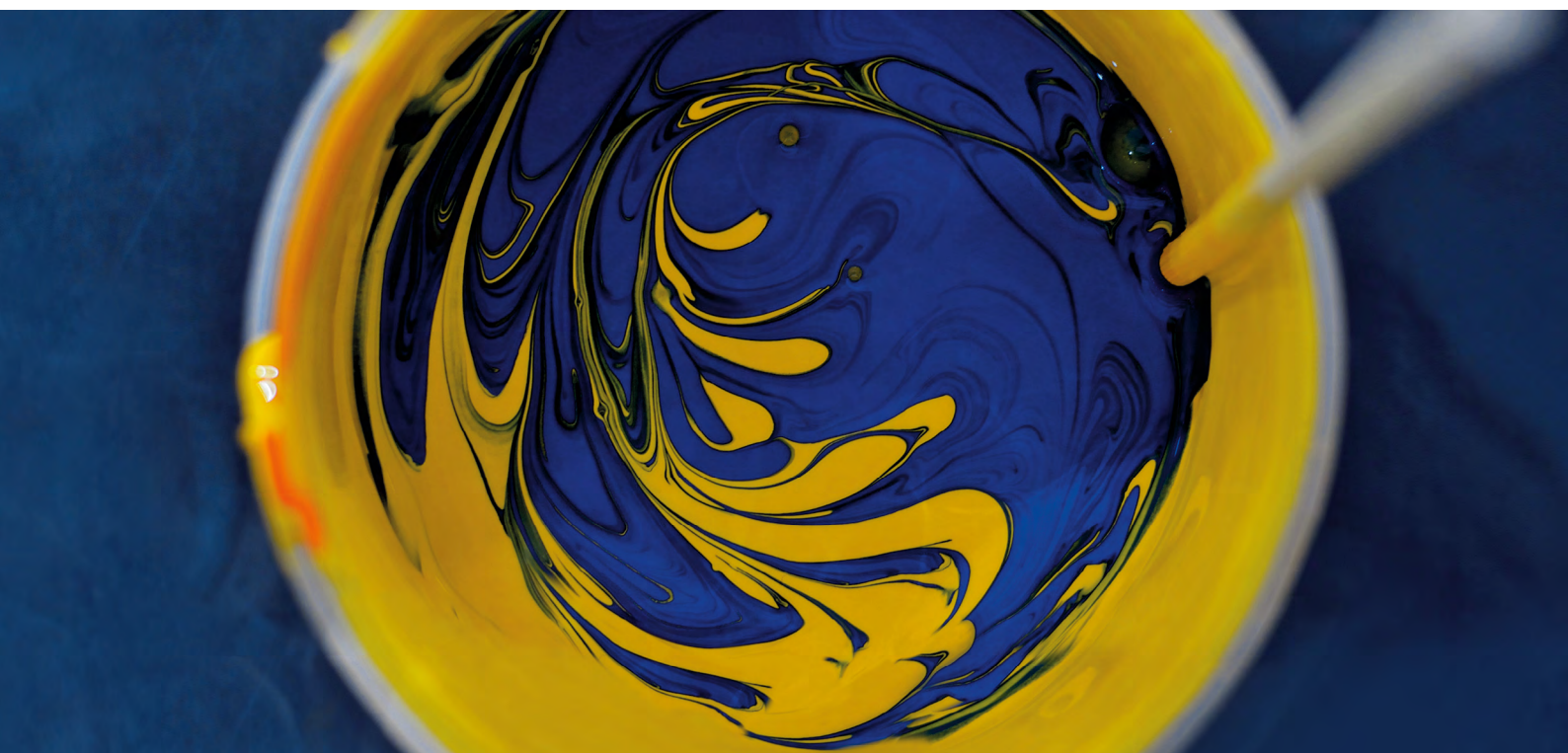
State aid remains a challenge although there is considerable expertise amongst some practitioners which enable the development of schemes that often take a staged approach to compliance, exploring *de minimis* first and then turning to GBER where necessary. Notification of the State aid schemes to address the needs of the specific investment needs of the Member States and regions is another solution for the programme authorities to implement the combination of grants and FI in one operation.

The workshop clarified the meaning of "the rules applicable to financial instruments shall apply to that single financial instrument operation". Participants reported a reluctance to fully commit to this principle in some parts of their organisation. Nevertheless, it was recognised that this important flexibility provides a great opportunity for MAs to use grant in a much more targeted and dynamic way, harnessing the added value that FIs bring to secure their programme objectives.

Applicability of FI rules also to the grant component will help the design of monitoring and reporting arrangements, as well as the audit activities. The streamlined approach based on a principle of proportionality was also considered to be positive and the move to a prospective assessment of the use of support for intended purpose is potentially a great leap forward, reducing the burden on bodies implementing the FIs and hopefully encouraging more new entrants (and increased financial resources) into key priority investment areas of the EU market, such as supporting the green and digital transition of the EU's businesses and citizens.







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