Factsheet
May 2023

fi-compass Knowledge Hub

Funding agreement, meeting the requirements of Annex X of the Common Provisions Regulation

European Commission

European Investment Bank

fi-compass Knowledge Hub

Funding agreement, meeting the requirements of Annex X of the Common Provisions Regulation

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 have participated in the Knowledge Hub to receive feedback from the Member States concerning the implementation of financial instruments through the funding agreement, prepared in accordance with Annex X of the Common Provisions Regulations 2021/1060. The participation of the representatives of DG REGIO 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

Financial instruments practitioners gathered on 6 October 2022 in Brussels to participate in an in-person workshop as part of the fi-compass Knowledge Hub – Funding agreement, meeting the requirements of Annex X of the Common Provisions Regulation. During the workshop, several key features of the funding agreement were discussed. This note summarises some of the key insights shared between participants.

Funding agreements are key contractual documents, obligatory in accordance with the Common Provisions Regulation 2021/1060 (CPR), between the managing authorities of shared management funds and the bodies implementing the financial instruments. They set out the rights and obligations of both parties. Annex X of the CPR lists the required elements of the funding agreement for financial instruments implemented under Article 59(5) CPR.

The event considered the regulatory framework under the CPR, best practice (including the sharing of good examples between participants) and recommendations for future implementation based on lessons learned from past operations.

02 Key notes

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

The Investment Strategy (IS) and Business Plan (BP) are at the heart of the funding agreement and need to be flexible to enable the instruments to adapt to changing circumstances.

The IS/BP may be either integrated into a single or separate documents. In both cases the IS/BP will convey clear messages, provide complementary info, and refrain from duplicates or unnecessary details. The IS/BP may be created collaboratively between the managing authority and the body implementing FI in the case of direct award. On the other hand, in the context of a competitive selection procedure scenario, a more formal legal approach is required to ensure procurement rules are respected and the parties' commitments are clearly documented. In both cases it is important to build into the funding agreement streamlined processes to keep the content under review and to amend it when necessary to respond to changing circumstances.

The increased scope to combine grants with financial instruments in a single operation will require the funding agreement to include mechanisms governing the grant component

Article 58(5) of the CPR enables financial instruments to be combined with grants in a single operation. The need for combination of FI and grants will be assessed in the ex-ante assessment. The funding agreement will describe the arrangements for management of these two forms of support, including the cash flow, monitoring and reporting.

Managing authorities are responsible for verifying the data reported under Article 42 CPR and Table 12 Annex VII CPR.

Managing authorities must verify the data. The CPR does not specify a cut-off date for data to be reported. This gives the managing authorities and the bodies implementing FI the flexibility based on the business practices to agree on the cut-off dates of the reported data on 31 January and 31 July of each year.

There is a wide range of different approaches to the treatment of reflows (e.g. interest and capital repaid to the financial instrument).

In some cases, all reflows are returned directly to the managing authority as they are received. In other cases, the financial instrument retains the reflows for a defined period (or even indefinitely) to enable the operation to continue. Reflows may also be paid up to the Holding Fund (HF) which may then either (1) reinvest the resources through existing or new financial instruments or (2) return to the managing authority for re-use in accordance with the conditions of Article 62 CPR 2021/1060. In addition, several participants highlighted that due to the long-term nature of the financial instrument products, reflows will only start to be received in a few years.

03 The funding agreement

3.1 Overview

Article 59 of the Common Provision Regulation 2021/1060 (CPR) provides that when implementing a financial instrument, the managing authority shall enter into a funding agreement with the body implementing either a Holding Fund or a Specific Fund. Further, where a financial instrument is set with a Holding Fund structure, the body implementing the Holding Fund will enter into a funding agreement with the body(ies) implementing the Specific Fund(s). In all cases the funding agreement must include the elements set out in Annex X of the CPR. Where a managing authority implements a financial instrument directly no funding agreement is required but a strategy document must be put in place in accordance with Article 59(1) CPR.

As well as governing the contents of funding agreements Annex X also sets out the contents of the strategy documents required to be prepared when managing authorities implement financial instruments directly under Article 59(1) CPR. The Knowledge Hub considered a number of the key elements of funding agreements proscribed by Annex X CPR, paragraph 1 namely:

- the investment strategy or policy including implementation arrangements, financial products to be offered, final recipients targeted, and envisaged combination with grant support (as appropriate);
- a business plan or equivalent documents for the financial instrument to be implemented, including the estimated leverage effect referred to in point (a) of Article 58(3);
- provisions for monitoring of the implementation of investments and of deal flows including reporting by the financial instrument to the Holding Fund and to the managing authority to ensure compliance with Article 42;
- provisions regarding the re-use of resources attributable to the support from the Funds in compliance with Article 62 and an exit policy for the contribution from the Funds out of the financial instrument;
- conditions for a possible total or partial withdrawal of programme contributions from programmes to financial instruments, including the Holding Fund where applicable; and
- provisions for the winding-up of the financial instrument.

The event considered for each of these topics, the regulatory framework under the CPR, best practice (including sharing good examples between participants) and recommendations for future implementation based on lessons learned from past operations. During the Knowledge Hub meeting, the following two publications were identified as providing useful information for managing authorities and bodies implementing FI preparing funding agreements:

- Commission Implementing Decision of 11 September 2014 on the model of funding agreement for the contribution of the European Regional Development Fund and the European Agricultural Fund for Rural Development to joint uncapped guarantee and securitisation financial instruments in favour of small and medium-sized enterprises (2014/660/EU)[1]; and
- ANNEX I[2] Annotated table of content of a funding agreement between a managing authority and a financial intermediary.

Although developed for the implementation of the FI in 2014-2020 these may be referred to as an example for the template of the funding agreement.

1 Commission Implementing Decision of 11 September 2014 on the model of funding agreement for the contribution of the European Regional Development Fund and the European Agricultural Fund for Rural Development to joint uncapped guarantee and securitisation financial instruments in favour of small and medium-sized enterprises (2014/660/EU)

2 COMMISSION IMPLEMENTING REGULATION (EU) No 964/2014 of 11 September 2014 laying down rules for the application of Regulation (EU) No 1303/2013 of the European Parliament and of the Council as regards standard terms and conditions for financial instruments ANNEX I Annotated table of content of a funding agreement between a managing authority and a financial intermediary

04 Investment Strategy and Business Plan

4.1 Overview - The Investment Strategy/Business Plan

The Investment Strategy (IS) is the key document that sets out the policy and commercial objectives of the financial instrument. The business plan (BP) describes the way in which the financial instrument will be implemented. The two documents are required under Annex X for financial instrument operations implemented both directly by the managing authority (Article 59(1) CPR) and indirectly under the responsibility of the managing authority (Article 59(2) and (3) CPR).

fi-compass model financial instruments and New European Bauhaus Territorial Development model financial instrument

Three new model financial instruments have been published in 2022, each based on the template of the original off the shelf models of the 2014-2020 programming period[3]. The new instruments have been prepared to support three key growth areas for financial instruments in the 2021-2027 programming period.

The model for a financial instrument with a grant component to support energy efficiency provides a non-exhaustive insight into the potential for MAs to use the new flexibilities in Article 58 of the CPR to support energy efficiency projects.

The model financial instrument 'Quasi-equity finance for SMEs' provides a number of examples pointing to the potential for managing authorities to use quasi-equity financial instruments in the 2021-2027 programming period. The model instrument describes how a simple subordinated loan product might be implemented.

The European Commission's New European Bauhaus Territorial Development model financial instrument aims to provide practitioners with the building blocks, they could use to set up and implement the financial instrument supporting the New European Bauhaus projects in the 2021-2027 period based on the CPR.

3 COMMISSION IMPLEMENTING REGULATION (EU) No 964/2014 of 11 September 2014 laying down rules for the application of Regulation (EU) No 1303/2013 of the European Parliament and of the Council as regards standard terms and conditions for financial instruments and COMMISSION IMPLEMENTING REGULATION (EU) 2016/1157 of 11 July 2016 amending Implementing Regulation (EU) No 964/2014 as regards standard terms and conditions for financial instruments for a co-investment facility and for an urban development fund.

The Investment Strategy and Business Plan should be considered living documents that accompany the financial instrument throughout its life. In essence, the Investment Strategy (IS) sets out WHAT the financial instrument will do; and the Business Plan (BP) describes HOW it will do it.

Typically, the IS/BP will be ca. 15-20 pages long and often has similar content to the template used in Annex II of the off the shelf models published by the European Commission in the 2014-2020 programming period. The same template has been used for the recent fi-compass model financial instruments for energy efficiency and quasi-equity. During the event several participants commented that these models capture all the relevant headings to be included in the IS/BP.

PART A: CONTENT OF IS/BP

4.2 Content of the IS/BP

When preparing the initial IS as part of the ex-ante assessment, the managing authority will also take into account the market failures and investment needs which it analysed when drafting the programmes.

Annex X already provides an outline structure for the content of the IS. Further recommendations for the structure of an IS can be found in the fi-compass publication, Manual Ex-ante assessment, published in June 2015[4] (the Manual). By combining these different sources, the following outline of contents can be developed and is shown in Table 1 below.

Table 1: Outline contents of an Investment Strategy

Contents	Description	Source
Conclusions of ex- ante assessment	The starting point of the IS – a summary of the findings of the ex-ante assessment	The Manual
Target market	The sector to be supported and market failure to be addressed	The Manual
Implementation arrangements	The implementation and governance structure of the operation	Annex X
Financial products offered	Description of the types of investment to be provided by the financial instrument – loans, guarantees, equity and/or quasi-equity	Annex X and the Manual
Final recipients targeted	The type(s) of final recipient to be targeted by the financial instrument and their financing needs	Annex X and the Manual
Combination with grant support	Where grant support is included within the operation in accordance with Article 58 CPR a description of the support and when and how it will be provided to final recipients. Envisaged grant support from separate operations may also be described where appropriate	Annex X and the Manual

4 Manual (Ex-ante assessment guidance, Vol. I - General methodology)

The contents of the Business Plan are not specified to the same level of detail in Annex X. It simply refers to the estimated leverage effect being included. In practice, however the content of the BP will overlap with that of the IS albeit reflecting the more operational aspects of the proposals.

The business plan (BP) will reflect the body implementing the financial instrument's proposals for implementing the Investment Strategy. As well as describing in detail the proposed product and target final recipients, the business plan should describe the estimated leverage effect and identify potential private co-investors and/or the strategy for attracting co-investment. These should be based on the proposal made by the bodies implementing the FI during their selection process.

The two documents should complement each other so that they be read together to provide a full description of the financial instrument operation. A non-exhaustive list of contents of a BP includes:

- size of the FI and apportionment between various contributors – the Funds, national public and/or private co-financing (including programme and non-programme);
- expected amount of private investment attracted (depending on the implementation option chosen, information to be split for the Holding Fund and Specific Fund(s));
- estimated leverage effect;
- quantified targets to be achieved (output and result, in line with the programme objectives);
- envisaged implementation of the FI across consecutive programming periods;
- provision of combined support FI and grants in one FI operation;
- envisaged timetable and criteria for selection of bodies implementing the FI (in case of HF) and final recipients;
- in case or urban/territorial development FI, a potential list of projects which may be supported by the FI, when available;
- forecasted level of management costs or fees, including the remuneration schedule of the body implementing FI (not applicable for implementation under Article 59(1) CPR);
- management structure including resources and staff;
- justification of competences and experience in order to ensure ability to implement the investment strategy, proof of avoidance of conflict of interest;
- management of resources returned, if the MA wishes that same body implementing FI is managing also resources returned (will depend also on the type of product, for example particularly with shorter maturities);
- exit strategy and winding up provisions;
- reporting and monitoring provisions;
- audit provisions.

Explanation of risk valuation and risk and profit sharing of the different parties may be part of the IS/BP or may be included as a separate element under other terms and conditions of the funding agreement (subparagraph m) of paragraph 1 of Annex X CPR).

The need for flexibility has also been identified as a key component for both the IS and the BP as well as the associated governance arrangements of the financial instrument. The scope of a financial instrument may change considerably during its investment period, as evidenced, for example, by the recent experience during the COVID 19 pandemic.

4.3 State aid

In addition to the general content as set out in Annex X, it is helpful to include general directions for state aid compliance, (i.e. the proposed State aid treatment) to ensure all parties involved in the financial instrument are aligned. This was highlighted as a positive aspect to the off the shelf models. Where the IS will be used in a competitive selection process, it can be useful to provide a full description of the regulatory framework under the CPR and how it relates to the financial instrument operation for the benefit of the private sector institutions participating in the selection process.

4.4 Combination of financial instruments and grants in the funding agreement

The new flexibilities under Article 58(5) CPR allow more extensive combinations of financial instruments with grants. In a combined financial instrument it is a requirement[5] that the programme support in the form of grants shall be directly linked and necessary for the financial instrument and shall not exceed the value of the investments supported by the financial product.

The managing authority may determine in its ex-ante assessment or in a separate analysis the amount of grant and financial instrument support, which is necessary for the implementation of the financial instrument operation providing combined support.

The analysis should describe the methodology adopted in calculating the amount of grant necessary and this should be referenced in the IS for the Holding Fund and/or Specific Funds. The grant component should be established at the level of the financial instrument and NOT in relation to each investment. It is not necessary for a precise level of grant to be specified in the ex-ante assessment. Instead the findings should identify that grant is necessary and propose a financial range for the grant support at financial instrument level. The range should be sufficient to allow for flexibility during the programming period, based on the current market assessment.

The importance of the methodology is emphasised in the context of audit, which could review whether the estimate was made in a robust way. The use of suitably qualified professional experts and the recording of the methodology used will both be helpful when seeking to demonstrate the robustness of the estimate. The managing authority should be able to justify any deviations from the methodology.

A range of different approaches can be adopted in terms of the management of the grant component by the body implementing the financial instrument. There is scope to include flexibility for the body implementing the financial instrument to determine the amount of grant within a range described in the IS. Alternatively, it may be simpler to implement a financial instrument with a fixed proportion of grant (or a small number of options), reflecting the estimate in the analysis.

Grants can be made in different forms and benefit from financial instrument rules. As a result it is not necessary to hold a call for expressions of interest for potential beneficiaries of the grant. The grant can be accessed at any time through applications to a body implementing the financial instrument. Further, payments of the grant will be governed by the agreement with the final recipient which can allow for grant to paid in advance of investment, without the necessity to demonstrate eligible expenditure has been made. In many places, the initial feedback from the potential bodies implementing FI and the bodies providing the underlying loans and equity investments in the context of guarantees has been positive, indicating a willingness to manage the grant element together with the financial instrument. In terms of products, the most likely model to be adopted may be a loan/guarantee financial instrument combined with a capital rebate, similar to the fi-compass model financial instrument for energy efficiency.

5 Article 58(5) CPR 2021/1060

fi-compass factsheet – Combination of financial instruments and grants under shared management funds in the 2021-2027 programming period

This comprehensive factsheet describes how enhanced flexibilities in the Common Provisions Regulation for the 2021-2027 programming period can be used to combine financial instruments and grants in a single operation.

The factsheet 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. Governed by financial instrument rules, combined financial instrument-grant operations are expected to play an important part in scaling up the use of financial instruments to support Cohesion policy in the 2021-2027 period.

The factsheet describes the options available under the regulations and gives practical examples of how the flexibilities can be applied in practice.

4.5 Duration of the funding agreement

Typically a funding agreement has to cover two stages of the implementation:

- An investment period, the period during which the financial instrument will be able to support final recipients. This is usually aligned with the eligibility period of 31 December 2029 (Article 63(2) CPR); and
- A period until all outstanding investments have been repaid and/or written off. The length of this period will be determined to a large extent by the tenor of the underlying investments being supported by the financial instrument.

Participants shared their experience regarding the duration of the funding agreement for different types of financial instrument (equity, loan and guarantee).

The IS/BP should take into account whether the financial instrument is to be implemented across consecutive programming periods, taking advantage of the flexibility under Article 68(2) CPR. In the recent fi-compass Knowledge Hub on implementation across consecutive programming periods, the need to 'future proof' funding agreements (and the related selection procedure) was highlighted. Article 72(1) of the public procurement directive[6] allows for contract options to be included to allow funding agreements to be extended and/or to be scaled up using funds from a successive programming period.

Finally, the IS/BP is likely to further develop during the period of implementation of the financial instrument.

6 DIRECTIVE 2014/24/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 February 2014 on public procurement and repealing Directive 2004/18/EC

4.6 Practical considerations

The workshop considered first the Investment Strategy and Business Plan and how they are at the heart of the funding agreement. During the discussion, participants shared their experience in relation to the development of the documentation, sources of information (for example, market testing of the proposed products and the size of the instrument, etc), methodology (for example, existing manuals of ex-ante assessment developed for FI in 2014-2020) and new challenges, for example in relation to the financial instruments combining programme support in the form of grants and financial instruments.

The discussion considered a range of approaches, highlighting how different approaches are needed to adapt to the strategic context in which the financial instrument is implemented. One important distinction was made, for example, between the approach to prepare a funding agreement between a managing authority and a body implementing a Holding Fund, appointed through direct award and a funding agreement following the competitive selection of a body to implement a Specific Fund. In the former case, the process can be very collaborative, whereas the latter scenario requires a more formal legal approach to ensure procurement rules are respected and the parties' commitments are clearly documented.

PART B: PROCESS FOR PREPARING OF IS/BP

4.7 The process for preparing the IS and BP

The IS is initially prepared by the managing authority prior to the selection of the body implementing financial instrument following the conclusion of the ex-ante assessment. The IS will then develop during the process (either direct award or competitive selection) to identify and appoint the body to implement the Holding Fund or Specific Fund.

The business plan (BP) is often prepared as part of the body implementing FI's submission during a direct award or selection process to describe the market based implementation arrangements.

In many cases, the initial IS and BP shared during the direct award or competitive selection process are further refined and developed by the managing authority in conjunction with the body implementing the financial instrument. As a result, by the time the funding agreement is signed, the IS should fully reflect both the managing authority's priorities and the objectives of the body implementing the FI's strategic implementation and the BP plays a secondary role relating to operational implementation.

Once the funding agreement is signed, the two documents provide the basis for the on- going governance of the financial instrument, often under the supervision of an Investment Board set up by the managing authority.

4.8 Developing the Investment Strategy and Business Plan – collaboration or competition?

In many cases the IS and BP are two parts of a single document that is developed collaboratively between the managing authority and the body entrusted to implement a financial instrument through direct award.

Where a Holding or Specific Fund is implemented by an International Financial Institution (IFI) or National Promotional Bank or Institution (NPBI) or other body through direct award, the body implementing the HF typically can prepare the document, which is aligned with the ex-ante assessment.

In such cases, the development of the Investment Strategy and Business Plan becomes part of the joint working to design and set up the financial instrument in the way that makes best use of available resources in the context of the local needs. The need to populate and define the different elements of the IS/BP provides a framework within

which the parties develop and agree the proposed financial instrument operation. This work will often commence during the ex-ante assessment with the IS/BP coming increasingly to the fore following completion of the ex-ante assessment and move into the next phase of implementation.

On the other hand, where the body implementing financial instrument is selected through a competitive selection, the IS/BP form two parts of the tendering process. The IS is usually prepared by the managing authority / the body implementing a Holding Fund as part of the Invitation to Tender (or request for Expressions of Interest). Under a competitive selection procedure, the BP forms part of the submission made by the body tendering to implement the financial instrument. In such a case, the BP should describe in concrete terms the products and pricing to be offered by the body implementing the financial instrument.

Once the selection process is complete it is necessary to document the proposals in the funding agreement. In the case of a competitive procedure, the managing authority or the body implementing a Holding Fund must ensure that the IS/BP are drafted in clear and unambiguous terms as they will be key to describing the parties' rights and obligations under the contract.

4.9 Flexibility is key

There was a strong consensus among the fi-compass Knowledge Hub workshop participants that the programme and ex-ante assessment should avoid setting specific financial/quantitative limits or commitments in relation to different financial instruments. Providing only a general framework or possibly a target range for implementation will enable the bodies implementing financial instruments to tailor the products to best match the market's needs with the available public and private resources.

The IS/BP is likely to be amended as a result of changing circumstances and/or a change in available resources. To streamline the process, the funding agreement will often reserve the approval of amendments to an Investment Board set up to govern the implementation of the financial instrument. This governance arrangement, combined with a flexible programme and ex-ante assessment, should avoid having to secure approvals from governmental bodies, thereby avoiding potential for delay.

For example, in response to the COVID 19 crisis many managing authorities amended their IS/BP to allow more support for working capital under the Coronavirus response Investment Initiative (CRII) and CRII+ and associated State aid Temporary Framework. Participants discussed how the IS/BP of financial instruments in the 2021-2027 period will need to reflect the eligibility rules under Article 5 of the ERDF regulation. The new rules emphasise productive investments in SMEs but can include support for working capital where the ex-ante assessment identifies such support to be necessary to safeguard existing and/or create new jobs.

Quantitative targets are best set out in the BP. This will ensure the body implementing the financial instrument has 'ownership' of the achievement of the targets. Furthermore, where an amendment to the financial instrument is proposed it should often be implemented through an amendment of the BP only, avoiding the need to change the IS, ex-ante assessment and programme documents.

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05 Monitoring and reporting

Annex X, paragraph 1(d) requires that managing authorities and the bodies implementing a Holding Fund or Specific Fund (without a HF structure) monitor and report financial instruments in accordance with Article 42 CPR. This provides for reports five times a year of general performance data including for financial instrument operations and bi-annual reports of financial instrument specific and output data.

5.1 Reporting

The format for the report is set out at Annex VII CPR. Table 12, which relates to the reporting of financial instruments. It captures the following information, which the Member State or the managing authority must collect and report to the Commission on 31 January and 31 July of each year.

- eligible expenditure by type of financial product;
- amount of management costs and fees declared as eligible expenditure;
- the amount, by type of financial product, of private and public resources mobilised in addition to the Funds;
- interest and other gains generated by support from the Funds to financial instruments referred to in Article 60 and resources returned attributable to support from the Funds as referred to in Article 62;
- total value of loans, equity or quasi-equity investments in final recipients which were guaranteed with programme resources and which were actually disbursed to final recipients.

5.2 Bi-annual reporting on financial instruments

The core reporting requirements are set out in Article 42 CPR and Table 12 Annex VII CPR.

The frequency of reporting is twice a year and sufficiently flexible to take into account specifics of reporting between the bodies implementing FI and the managing authority. Whilst the format of the reporting is reasonably straightforward, the underlying data which must be reported and verified between the different parties involved in the implementation of the financial instrument should be reliable and plausible.

5.3 Collection and verification of data

It was acknowledged that the complexity of the chain of reporting of data has, in the past, resulted in cases of reduced data quality. It is therefore important to have mechanisms in place to verify the data.

Typically, a more granular data set will be collected by bodies implementing financial instruments and transmitted to managing authorities or Holding Funds (who pass the data on to the managing authorities). Authorities seek to verify the data through system checks based on a sample of investments and use of external sources. This can include verifying corporate information/SME status by reference to publicly available Companies databases, use of internet searches to verify project information and challenging information provided. When verifying data, managing authorities may rely on the checks undertaken as part of the existing management control system, with a view to avoiding duplication of effort.

Once verification checks have been satisfactorily carried out, the managing authority must report the data to the European Commission. It was acknowledged that sometimes significant time is required by the managing authority to enable it to verify data. The CPR does not specify the reporting period that needs to be used for the reports due on 31 January and 31 July of each year. Specifically, for example, it is not expected that the data submitted at the end of January in each year includes all activities up to the end of December in the preceding year.

However, it is important that the funding agreement specifies the deadlines for the data collection and transmission between the managing authority and the body(ies) implementing financial instrument(s) to ensure consistent data availability for the managing authority to meet its requirements towards data transmission to the Commission.

5.4 Reporting combined financial instrument and grant operations

The specificities of reporting for operations that combine financial instruments and grants were discussed. The table provided in the discussion paper and which is also part of the fi-compass model financial instrument for energy efficiency, was welcomed as a helpful illustration of how to do this.

Figure 2: illustration of reporting of loan and capital rebate

<table>
<tr><th></th><th colspan="3">Bank</th><th colspan="3">MA</th><th colspan="3">MA</th></tr>
<tr><th>Risk-sharing loan
+ capital rebate
+ interest rate subsidy</th><th colspan="3">Combined FI accounts</th><th colspan="3">Declared to EC under FI in payment claims</th><th colspan="3">Reported to EC in Annex on FIs (cumulative)</th></tr>
<tr><td></td><td>Y1</td><td>Y2</td><td>Y3</td><td>Y1</td><td>Y2</td><td>Y3</td><td>Y1</td><td>Y2</td><td>Y3</td></tr>
<tr><td>Risk sharing loan</td><td>100</td><td></td><td></td><td rowspan="3">101</td><td rowspan="3">1</td><td rowspan="3">1</td><td>100</td><td>100</td><td>70</td></tr>
<tr><td>Capital rebate</td><td></td><td></td><td>30</td><td>0</td><td>0</td><td>30</td></tr>
<tr><td>IR subsidy</td><td>1</td><td>1</td><td>1</td><td>1</td><td>2</td><td>3</td></tr>
</table>

The table shows an illustrative example of an investment of EUR 100, supported by an interest rate subsidy of EUR 1 per annum and a capital rebate of EUR 30. The table shows how in year one, the FI's accounts and the managing authority's report to the EC reflects the initial EUR 100 loan and EUR 1 interest rate subsidy. The total of EUR 101 is declared to the Commission under the payment claim. The interest rate subsidy continues to be recorded in subsequent years and included in payment claims. In year 3 the capital rebate is made. This is recorded in the FI's accounts but does not give rise to an additional payment claim to the EC. The reports to the EC are adjusted to apportion the total EUR 100 investment between the loan and capital rebate.

It can be a challenge to align reporting within the managing authority with that of the bodies implementing the financial instruments. Generally, where their standard monthly reports can be adopted (with minor modifications if necessary), the experience is easier. Trying to impose detailed reporting templates unfamiliar to bodies implementing FIs can prove to be difficult at an operational level.

5.5 Database of information

The managing authorities are required to maintain an electronic database of information that meets the requirements of Article 72(1)(e) CPR, which in turn refers to the requirements of Annex XVII CPR. These requirements specify several categories of information both general and specific to financial instruments that will need to be maintained by managing authorities. Managing authorities have to establish arrangements that meet these requirements to keep the required data. The information stored in the electronic database allows the managing authority to meet its obligations to report to the Commission in line with Article 42(4) CPR of data transmission in line with the above key principles.

In general terms, the information is straightforward for managing authorities to collect through the reporting requirements. However, there is an important novelty in Field 69 in relation to recording the beneficial owner of the businesses in receipt of financing. Typically, a bank or other institution will check this (as part of its anti-money laundering procedures) but not store the information for data protection reasons. Thus, the CPR allows the managing authority to rely on information from national databases that must be maintained under Article 30 of Directive (EU) 2015/849. This information can be easily accessed as long as the final recipient's company registration number or in some cases their VAT number is known.

Figure 3: Extract of template database of information under Annex XVII CPR showing Field 69

69. Information on:

(a) the final recipient of support from the Funds, name(s) and ID number;

(b) beneficial owners of the final recipient, if any, as defined in Article 3(6) of Directive (EU) 2015/849, namely first name(s) and last name(S), date(s) of birth and VAT registration number(s) or tax identification number(s);

(c) amount of support received (grant, loan, guaranteed loan, equity).

Member States may comply with the requirement under point (b) by using the data stored in the registers as referred to in Article 30 of Directive (EU) 2015/849, provided a unique identification number is included therein.

The reporting of the credit analysis undertaken by the body implementing the financial instrument in respect of individual final recipients was also discussed. In general, although it may be interesting to see this information, it may in many cases be better not to include this in a managing authority's requirements. It is not part of the CPR's requirements and, more importantly, it is an activity regulated by the European Central Bank (ECB) in the context of banking regulations. As such, the managing authority may rely on the external regulation and, therefore, the rating methodology and actual rating of final recipients should fall outside the scope of the managing authority's responsibility (and the associated audit and control of the financial instrument).

06

Reuse of resources, exit, withdrawal of funds and winding-up

6.1 Use of reflows

Article 62 CPR describes how resources returned to the financial instrument by final recipients can be reused. Annex X requires that the funding agreement includes:

'provisions regarding the re-use of resources attributable to the support from the Funds in compliance with Article 62 and an exit policy for the contribution from the Funds out of the financial instrument'

Resources returned should be managed in line with Article 62 CPR which requires that:

- Resources returned during the eligibility period should be used in line with Article 62(1) CPR; and
- Resources returned during and after the eligibility period should be used in line with Article 62(2) CPR.

6.2 Reflows under the funding agreement

There are several different approaches adopted by managing authorities and the bodies implementing FI under the funding agreement in relation to the reuse of resources returned as both interest (or any type of generated interest) and repayments of capital or release of resources set aside for guarantee contracts (reflows). Common approaches include:

- A long-term commitment to reusing the resources returned to the financial instrument which extends well beyond the initial eligibility period. Whilst often subject to a 'longstop' date of say 30 years, the intention is to create 'evergreen' funds that continue to manage the reflows in accordance with the IS over the long term;
- Limited authority for the financial instrument to reinvest the reflows for an extended period (e.g. 12 years from creation of the financial instrument), an approach common for equity funds in line with market practice;
- A requirement for the financial instrument to consult with the managing authority in relation to the reinvestment of reflows, including reserving the right for the managing authority to opt for the repayment of some or all of the reflows to enable them to deploy elsewhere. In many cases the managing authority has delegated their role to an Investment Board which provides a more streamlined governance framework and quicker decision making;
- An obligation for Specific Funds to repay the reflows to the HF which may then either (1) reinvest the resources through existing or new financial instruments or (2) return to the managing authority for re-use in accordance with the conditions of Article 62 CPR 2021/1060; and
- A strict obligation on the financial instrument to repay all reflows to the managing authority as they are received. The managing authority then determines how to use the reflows in accordance with the applicable regulation.

It was noted that the availability of reflows differs considerably depending on the underlying financial instrument products. Whereas microfinance and small loan schemes may repay within 3-5 years, other financial instruments have a much longer repayment period (e.g. 10-15 years) and under such schemes, the amount of reflows received to date is much lower. These approaches to reuse of the resources returned should be reflected in the IS/BP so that there is clarity for the management of those resources on both sides. The task of managing the subsequent cycles of investment should be considered when the body implementing FI is selected through a competitive process.

6.3 Reflows in practice

The experience from the previous programming periods shows that where reflows have been received, they have been used for a variety of purposes including supporting similar investments, complementing the shared management funds resources by funding investments in 'non-eligible' activities such as larger companies or new asset classes and supporting innovative products such as mini bonds.

The limitation in Article 62(1) CPR was discussed which relates to reflows received during the eligibility period. Reflows received during this period must be used within the same or other financial instruments for further investments and other specified uses, including meeting management costs and fees (MCFs) associated with further investments. Re-use of the resources returned after the end of the eligibility period are subject to fewer restrictions and may be used for MCFs arising in relation to the general management of the financial instrument after the eligibility period as well as other investments.

6.4 National co-financing for future programmes

Another possible use for reflows in some Member States and regions is to act as national co-financing for shared management funds resources in financial instruments in the next programming period. Once returned, reflows effectively become national resources. In accordance with Article 45 CPR 2014-2020, the reflows can be used for any form of support, that is, financial instruments as well as grants, in accordance with the aims of the programme(s) for the period of eight years after the end of eligibility period of 2014-2020. Thus, if the programme under the 2021-2027 programming period in accordance with Regulation (EU) 2021/1060 is consistent with the aims of the programme under the programming period 2014-2020 in accordance with Regulation (EU) 1303/2013, the resources returned maybe used as national co-financing of the programme 2021-2027, including as national co-financing in a financial instrument. If the resources returned from 2014-2020 contribute to the financial instrument implemented under 2021-2027 programming period in accordance with Regulation (EU) 2021/1060 as national public contribution (national co-financing) then their use has to comply with 2021-2027 legal framework including thresholds on management costs and fees. This might be especially helpful in case a Member State or region's shared management funds resources decrease in comparison with the previous programming period – the resources can be increased with the national co-financing stemming from the reflows.

6.5 Reflows in successive programming periods

The use of different generations of programme resources is becoming increasingly common. Many JEREMIE and JESSICA instruments and their successor financial instruments introduced in the 2014-2020 programming period are still operational and resources are invested alongside funds from new financial instruments set up in the new programming period. In such cases, it is important to ensure the financial instrument prioritises current programme resources to ensure deployment within the eligibility period.

This can be seen in a range of different sectors although equity financial instruments particularly require such a long-term approach, as in some cases it can be 10-12 years before an exit can be achieved following an investment. Thus, separate funds or sub-funds are created for successive programming periods, managed by the same body implementing the financial instrument, allowing the portfolio to be managed as a single operation whilst keeping monitoring and reporting separate to ensure compliance with the different requirements of the underlying programmes. This kind of structure can also facilitate 'follow-on' investment, with second or third generation funds participating in later investment rounds. The new flexibilities of Article 68(2) CPR, that were discussed in the fi-compass Knowledge Hub – Implementation of financial instruments across consecutive programming periods, should also help facilitate this approach in the future.

6.6 Exit and withdrawal of resources

The funding agreement has also to cover the exit strategy, the conditions for withdrawals and the provisions for winding-up of the financial instrument. The exit strategy refers to the recovery of the contribution from the shared management funds invested in the financial instrument (which might entail sales for example for (quasi) equity investments). It shall be planned and carefully implemented. An exit is the preliminary step in the winding-up process. The total or partial withdrawal of programme contribution may occur as a result of the revised investment strategy (with reduced programme contribution) or as a result of irregularities detected during the implementation of the financial instrument.

6.7 Winding up

The winding-up of a financial instrument means that the financial instrument is brought to an end and the assets and property of the FI are redistributed. Not all financial instruments have to be wound-up (e.g. evergreen funds).

Before the winding-up of the financial instrument, the managing authority has to withdraw any remaining programme contribution and exit any contribution attributable to the shared management funds support. This may be done progressively, as resources are repaid after a specified date, the body implementing the financial instrument passes on the sums received to the managing authority. Alternatively the rights to the receivables may be assigned back to the managing authority.

The winding-up of financial instruments is typically achieved by a requirement in the funding agreement requiring all reflows received after a specified cut-off date to be repaid to the managing authority. The duration of individual financial instruments varies considerably depending on the product and approach of the managing authority and in all cases some flexibility is required to recognise that additional time may be required to recover outstanding liabilities and close down the financial instruments.

07 Final comments – a well established structure for implementing financial instruments

The exchange during the Knowledge Hub illustrated a high level of understanding with the requirements under Annex X CPR for the funding agreement. This reflected the expertise of the practitioners in the room and demonstrated how the growth of financial instruments in the 2014-2020 programming period has contributed to a significant increase in capacity across Member States regarding the form and content of the agreements and the process needed to put these documents in place.

It should, therefore, be expected that the existing expertise will enable managing authorities to further develop their practice to accommodate new sectors (including the expected increase in Energy Efficiency and Renewable Energy financial instruments) and new flexibilities, most notably the potential to combine financial instruments with grants.

The off the shelf models and the new fi-compass and European Commission models published in 2022 provide a good template for managing authorities and Holding Funds responsible for the preparation of Investment Strategies. The identification of the appropriate State aid framework as well as description of the financial products and target final recipients is good practice as it ensures the financial instrument is established on a sound footing from the start. High level models for the funding agreement are also available and provide some assistance although there is no single template. This is unsurprising as it is necessary for each Member State to have a form of agreement adapted to its local legal jurisdiction.

The importance of flexibility was highlighted several times during the discussion. The successful use of financial instruments to support businesses during the COVID-19 pandemic illustrated how financial instruments can adapt to changing circumstances. Flexibility can be achieved by avoiding setting fixed quantitative requirements for investments in the IS/BP, allowing the bodies implementing financial instruments discretion regarding contribution levels and establishing a governance structure with delegated authority to approve changes.

This Knowledge Hub has identified a number of approaches that have been successfully employed in relation to financial instruments. Practitioners seeking to set up new financial instrument may take inspiration from the experience of the participants as described in this Note.

Notes

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