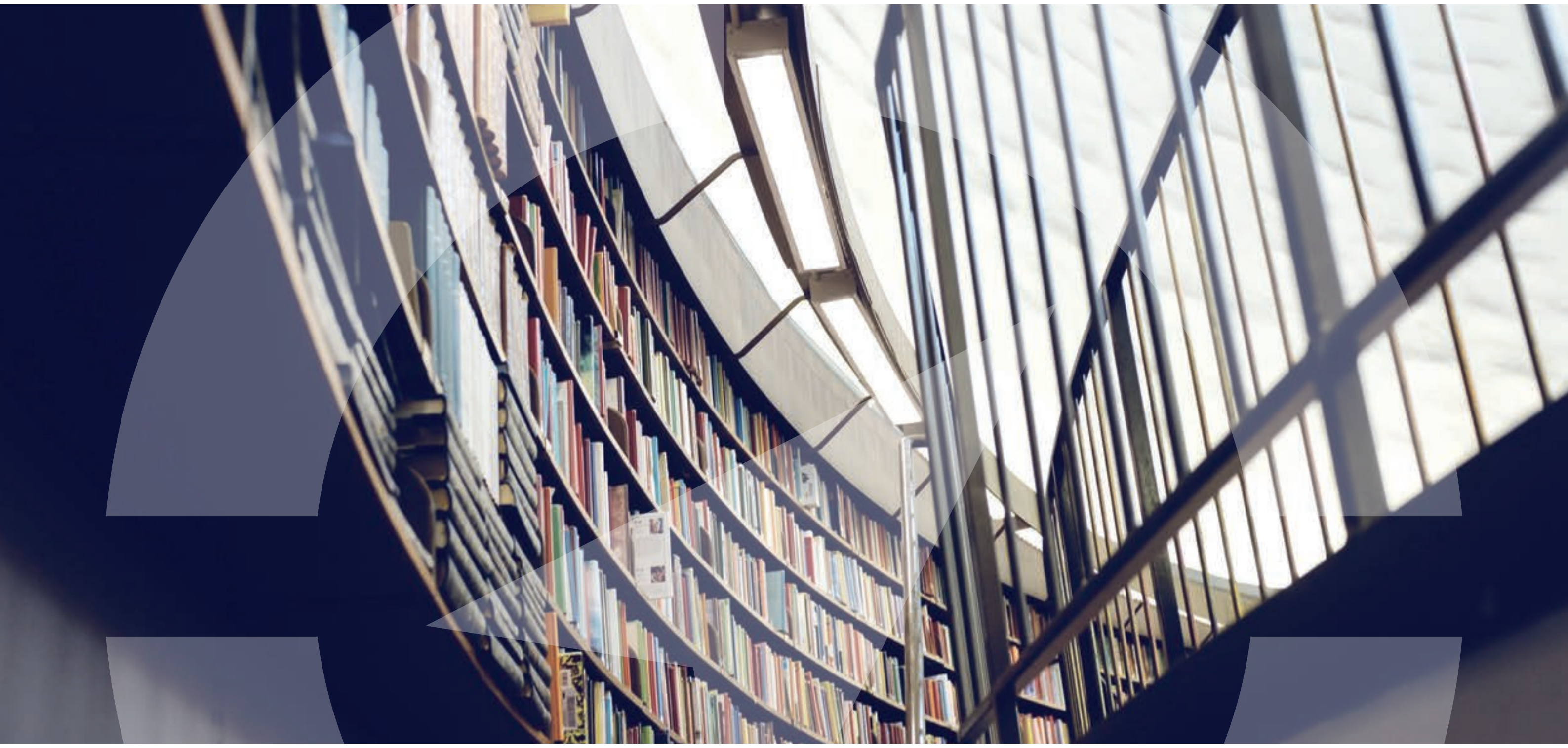
fi compass



Ex-ante assessment methodology for financial instruments in the 2014-2020 programming period

General methodology covering all thematic objectives

Volume I

European Commission

European Investment Bank

The EU bank

General methodology

covering all thematic objectives

Please note that this version of the methodology reflects the current state of the Regulation as of April 2014.

The author reserves the right to update this document according to the evolution of the relevant regulatory framework.

Version 1.2 - April 2014

DISCLAIMER

This study was commissioned by the EIB, co-financed by DG REGIO and assigned to the consortium led by PwC."

'Framework Agreement for the provision of technical assistance and advisory services, within the context of the JESSICA initiative
37th assignment contract No CC3912/PO62604'

Table of contents

Glossary and definitions 5

Introduction 10
How to use this methodology? 10
Structure of the ex-ante assessment methodology 13

1. Financial instruments: Overview 15
1.1 Rationale for the use of financial instruments and experience in the 2007-2013 programming period 15
1.2 What are the options available to Managing Authorities? 18

2. Ex-ante assessment: Purpose and preliminary considerations 25
2.1 Scope and value of the ex-ante assessment for financial instruments 25
2.2 Preliminary considerations 28

3. Analysis of market failures, suboptimal investment situations and investment needs 32
3.1 Identifying existing market problems 33
3.2 Establishing the evidence of market failure and suboptimal investment situations 47
3.3 Assessing market failures: two practical examples 52

4. Assessment of the value added of the financial instrument 56
4.1 Analysing quantitative and qualitative dimensions of the value added for the financial instrument 57
4.2 Assessing the consistency with other forms of public intervention addressing the same market 65
4.3 Identifying possible State aid implications 66

5. Additional public and private resources to be potentially raised by the financial instrument 78
5.1 Estimating additional public and private resources 79
5.2 Estimating the leverage of the envisaged financial instrument 83
5.3 Attracting additional private resources 84

Table of contents

6. Lessons learnt 90
6.1 Gathering relevant information 91
6.2 Identifying success factors and pitfalls of past experiences 92
6.3 Applying lessons learnt to enhance the performance of the financial instrument 93

7. Proposed investment strategy 96
7.1 Process to develop a proposed investment strategy 98
7.2 Defining the scale and focus of the financial instrument 99
7.3 Defining the governance structure of the financial instrument 105

8. Specification of expected results consistent with the relevant Programme 116
8.1 Establishing and quantifying the expected results of the financial instrument 117
8.2 Specification of how the financial instrument will contribute to the strategic objectives 121
8.3 Monitoring and reporting 122

9. Provisions for the update and review of the ex-ante assessment methodology 125

10. Ex-ante assessment completeness checklist 128

Appendices 132
Appendix A
List of useful documents 132
Appendix B
Notification and pre-notification procedure 135
Appendix C
Example of an access to finance survey for the Euro zone with a breakdown at national level 137
Appendix D
Breakdown of calculations for the quantitative value added example 139

Glossary and definitions

ABER	Block exemption Regulation for Agriculture
CEB	Council of Europe Development Bank
CEI	Call for Expression of Interest
CIP	Competitiveness and Innovation Framework Programme
CLLD	Community-Led Local Development
COCOF	Coordination Committee of the Funds as established under Article 150 of the CPR
Common Strategic Framework (CSF)	The framework which translates the objectives and targets of the EU strategy for smart, sustainable inclusive growth into key actions for the ESI Funds
CP	Cohesion Policy
CPR	Common Provisions Regulation
de minimis	See below under 'State aid'
DG AGRI	Directorate General for Agriculture and Rural Development of the EC
DG REGIO	Directorate General for Regional and Urban Policy of the EC
EAFRD	European Agricultural Fund for Rural Development
EC	European Commission ('the Commission')
EE/RE	Energy Efficiency and Renewable Energy
EEEF	European Energy Efficiency Fund
EIB	European Investment Bank
EIF	European Investment Fund
EMFF	European Maritime and Fisheries Fund
ERDF	European Regional Development Fund
ERR	Economic Rate of Return
ESF	European Social Fund
ESI Funds	European Structural and Investment Funds for the programming period 2014-2020. This includes: European Regional Development Fund (ERDF), Cohesion Fund (CF), European Social Fund (ESF), European Agricultural Fund for Rural Development (EAFRD), and European Maritime and Fisheries Fund (EMFF)
ESIF Policies	Policies making use of the ESI Funds
EU	European Union
Ex-ante assessment	As in Article 37 (2) of the CPR. MS/MA are required to conduct ex-ante assessments before supporting financial instruments, including: rationale/additionality against existing market gaps and demand/supply, potential private sector involvement, target final recipients, products and indicators

Ex-ante evaluation	Ex-ante evaluation required for Programmes in line with Article 55 of the CPR
fi-compass	Platform for advisory services on ESIF financial instruments www.fi-compass.eu
Final recipient	Legal or natural person that receives financial support from a financial instrument as described in Article 2 (12) of the CPR
Financial Instruments (FIs)	As in Article 2 (11) of the CPR, the definition of financial instruments as laid down in the Financial Regulation[1] shall apply mutatis mutandis to ESI Funds, except where otherwise provided in the CPR. In this context, financial instruments means Union measures of financial support provided on a complementary basis from the budget to address one or more specific policy objectives of the Union. Such instruments may take the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments, and may, where appropriate, be combined with grants.
FRR	Fair rate of return for entrepreneurial activities in a certain sector in a certain country
Focus Area	EAFRD proposes 6 priorities with 18 focus areas, between 2 and 5 for each priority
Fund of funds	Means a fund set up with the objective of contributing support from a Programme or Programmes to several financial instruments. Where financial instruments are implemented through a fund of funds, the body implementing the fund of funds shall be considered the only beneficiary in the meaning of Article 2 (27) of the CPR.
Funding agreement	Contract governing the terms and conditions for contribution from Programmes to financial instruments. This shall be established between a MA and the body that implements the FoF or the financial intermediary, between a FoF and the financial intermediary or between the MA and the financial instrument, as described in Article 38 (7) of the CPR.
GAFMA	Guidelines for SME Access to Finance Market Assessments: a methodology developed by the EIF to be used to prepare market assessments to identify market failures, suboptimal investment situations and investment needs related to the access to finance of micro-enterprises and SMEs
GBER	General Block Exemption Regulation
GGE	Gross grant equivalent (NPV consideration for State aid purposes)
GHG	Greenhouse gases
HA	Horizontal Assistance as foreseen in the proposed fi-compass
IFI	International Financial Institution

1 *Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 (OJ L 298, 26.10.2012, p. 1).*

IRR	Internal Rate of Return
JEREMIE	Joint European Resources for Micro to Medium Enterprises
LEADER	Liaison Entre Actions de Développement de l'Économie Rurale/Links between the rural economy and development actions Programme
Leverage effect	According to Article 140 of the Financial Regulation and Article 223 of its Rules of Application "*Financial instruments shall aim at achieving a leverage effect of the Union contribution by mobilising a global investment exceeding the size of the Union contribution. The leverage effect of Union funds shall be equal to the amount of finance to eligible final recipients divided by the amount of the Union contribution*"
LGD	Loss Given Default (e.g. for a loan)
Managing Authority (MA)	Managing Authority, as defined in the Regulations regarding ESI Funds
MF	Market failure
MFF	Multi-annual Financial Framework of the EU (2007 – 2013, 2014-2020)
MFI	A microfinance institution (MFI) is an organization that provides financial services targeted to a clientele poorer and more vulnerable than traditional bank clients.
MRA	Multi-Region Assistance as foreseen in the proposed fi-compass
Multiplier ratio	An appropriate multiplier ratio shall be established through a prudent ex-ante risk assessment for the specific guarantee product to be offered, in addition to the ex-ante assessment in accordance with Article 37 (2) of the CPR, taking into account the specific market conditions, the investment strategy of the financial instrument, and the principles of economy and efficiency. Such ex-ante risk assessment may be reviewed where it is justified by subsequent market conditions
NPV	Net present value (of a cash flow)
Other Revolving Instruments	Defined in the context of these ToR to refer to funds which are similar to the FEI/FIs, for the eligible sectors, but which are not established under Title IV of the CPR
Pari passu	Situation where a transaction is made under the exact same terms and conditions by public and private investors, with private investor contribution which has economic significance and with simultaneous interventions by both types of investors
PD	Probability of Default (e.g. of a loan)
PPP	Public-private partnership
Programme	Means 'Programme' as described in Article 2 (6) of the CPR
RDP	Rural Development Programme referred to in the EAFRD Regulation (document approved by the Commission comprising a set of measures which may be supported by EAFRD)

RDR	Regulation EU (No) 1305/2013 of the European Parliament and of the Council on support for rural development by the European Agricultural Fund for Rural Development (EAFRD)
Repayable finance	Defined in the context of these ToR to refer to either all, or a subset of, FEIs, FIs and other revolving instruments
RSFF	Risk Sharing Finance Facility
SGEI	Service of General Economic Interest
SI	Suboptimal investment conditions
SME	Small and medium-sized enterprises as per European Commission Recommendation 2003/361/EC
Specific Fund	A term used in the Summary Reports for 2011 and 2012. In the context of 'JESSICA type' of FEIs refers to an urban development fund (UDF); in the context of 'JEREMIE type' refers to loan, guarantee or equity/venture capital funds investing in enterprises.
State aid	'State aid' means aid falling under Article 107 (1) of the Treaty, which shall be deemed for the purposes of this Regulation, to also include *de minimis* aid within the meaning of Commission Regulation (EC) No 1407/213 of 18 December 2013 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid[2], Commission Regulation (EC) No 1408/2013 of 18 December 2013 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid in the sector of agricultural production[3] and Commission Regulation (EC) No 875/2007 of 24 July 2007 or its successor Regulation on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid in the fisheries sector and amending Regulation (EC) No 1860/2004[4].
Structural Funds (SFs)	EU Structural Funds for the programming period 2007 – 2013 (ERDF and ESF)
Summary Report	Report published by DG REGIO in December 2012, on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds. Situation as at 31 December 2011. The follow-up report on 2012 was published in September 2013.
Technical support	Grants for technical support, which are combined with a financial instrument (FI) in a single operation are provided for the preparation of the prospective investment (please refer to Article 37 (7), (9) of the CPR).
TFEU	Treaty on the Functioning of the European Union

2 *OJ L 379, 28.12.2006, p. 5.*

3 *OJ L 337, 21.12.2007, p. 35.*

4 *OJ L 193, 25.7.2007, p. 6.*

Thematic objectives	Objectives supported by each ESI Fund in accordance with its mission to contribute to the Union strategy for smart, sustainable and inclusive growth (see Article 9 of the CPR)
Union priorities for rural development	For the EU rural development policy (EAFRD) 'Thematic Objectives' are translated into Union priorities for rural development as defined by Article 5 of Regulation EU (No) 1305/2013 (EAFRD). So, the term 'Thematic Objectives' will also cover the Union priorities for rural development.
Urban Regeneration / Development/ Transformation	A range of actions aimed at sustainable renewal, rehabilitation, redevelopment and/or development of city areas, which may include area-based and city-wide initiatives

Introduction

How to use this methodology?

This methodology is intended as a toolbox encompassing good practices and providing practical guidance to Managing Authorities (MAs) in the preparation and the realisation of the ex-ante assessment of the financial instrument (FI) envisaged in the Programme(s).

This methodology is a reply of the Commission to the frequent questions from the managing authorities on the particular elements of ex-ante assessment included in Article 37 (2) of the Common Provisions Regulation (CPR). The formal status of this methodology has no legal value and it is not binding for managing authorities[5].

FIs shall be implemented to support investments which are expected to be financially viable but do not receive sufficient funding from market sources.[6] The ex-ante assessment is necessary (i) for the setting up of an FI or (ii) the continuation of an FI as far as it comprises a contribution from European Structural and Investment Funds (ESIF) 2014-2020 and follows the requirements of Article 37 (2) of the CPR.

The ex-ante assessment aims to ensure that ESI Funds resources allocations to FIs are fully aligned with the objectives of ESI Funds and Programmes and are used in accordance with the principles of sound financial management. The ex-ante assessment should allow MAs to tackle high-priority market gaps and to define the priorities for the allocation of public resources in accordance with Programmes and priority axis.

Article 37 (2) of the CPR articulates the required content of an ex-ante assessment around seven main groups, namely:

a) Analysis of market failures or suboptimal investment situations and the estimated level and scope of public investment needs;

b) Assessment of the value added of the FI, consistency with other forms of public intervention in the same market and possible State aid implications;

c) Estimate of additional public and private resources to be potentially raised by the FI, including assessment of preferential remuneration when needed;

5 *It must be, however pointed out that the analysis of market failures, suboptimal situations and investment needs shall, in line with Article 37 (2) (a) be based on available good practice methodology.*

6 *Article 37 (1) CPR.*

d) Identification of lessons learnt from similar instruments and ex-ante assessments carried out in the past;

e) Proposed investment strategy, including an assessment of its possible combination with grant support, options for implementation arrangements, financial products and target groups;

f) Specification of expected results including measurement of indicators;

g) Provisions allowing the ex-ante assessment to be reviewed and updated.

MAs are not obliged to strictly follow the order described in Article 37 (2) CPR. The ex-ante assessment is to be conceived as an iterative process rather than as a strictly linear one. This means that MAs will most likely go back and forth in their elaboration and will have to ensure the coherence of the whole assessment as described in item (a) to (g) before finalisation. It is important to note that the ex-ante assessment can be performed in stages, as foreseen by Article 37 (3) CPR. It could be useful to split the requirements of Article 37 (2) into two building blocks, namely 'market assessment', covering the points from (a) to (d) and 'implementation and delivery', covering the points from (e) to (g). The building blocks are intended to facilitate the development of robust ex-ante assessments.

In accordance with Article 37 (3) of the CPR, the MA should submit the ex-ante assessment to the Monitoring Committee. This should enhance the procedural reliability in implementing the FI by the MAs. In addition, the summary findings and conclusions of ex ante assessments in relation to FIs shall be published within three months of their date of finalisation

It is therefore crucial to identify the main cross-references to other elements of the assessment, as shown in Figure 1 below.

Figure 1: Main cross-references among the elements of the ex-ante assessment

Building block 1: Market assessment

Article 37(2)(a)
Market failure, suboptimal investment situations and investment needs

Cross-reference: Article 37(2)(g)
Market conditions can change and may need to be revised during the ex-ante assessment and during the implementation of the FI.

1

Article 37(2)(b)
Value added

Cross-reference: Article 37(2)(c)
State aid implications refer to other components including market failure, suboptimal investment situation, investment need, mechanism of preferential remuneration.

2

Article 37(2)(c)
Additional resources to be potentially raised

Cross-reference: Article 37(2)(b)
The capacity to attract additional resources is part of the value added of a FI.

3

Article 37(2)(d)
Lessons learned

Cross-reference: Article 37(2)(a), (b), (c), (e) and (f)
Lessons learned can be drawn from different types of experiences and can therefore refer to both market assessment and delivery and management.

4

Building block 2: Delivery and management

Article 37(2)(e)
Proposed investment strategy

Cross-reference to: Article 37(2)(a) and (b)
Proposed investment strategy has to be consistent with the results of the market assessment and value added assessment. This will have already narrowed the options for the envisaged FI.

1

Article 37(2)(f)
Expected results

Cross-reference to: Article 37(2)(a) and (e)
Expected results are directly linked to the investment needs identified in the market assessment and to the proposed investment strategy

2

Article 37(2)(g)
Provisions for the update and review

Cross-reference to: Article 37(2)(a), (b), (c), (d), (e) and (f)
The context may evolve during the implementation of the FI. These changes can affect all components of the ex-ante assessment.

3

Figure 1 shows that all components of the ex-ante assessment are linked to one or more of the others. In practical terms, this implies that when addressing one issue, the MA needs to ensure consistency with the other related components of the assessment. To facilitate this process, this methodology tries to provide a clear indication of these cross-references throughout the document.

Structure of the ex-ante assessment methodology

Considering the significant changes the regulatory environment has undergone between the 2007-2013 and the 2014-2020 programming periods, **Chapter 1** provides MAs with a short overview of the different FI implementation options offered by the CPR.

Secondly, as the ex-ante assessment for FIs is in itself a new requirement for MAs, **Chapter 2** presents the purpose of the ex-ante assessment as well as an analysis of the rationale behind the different requirements of Article 37 (2) CPR. This is essential to help MAs to focus on achieving the ultimate goal of this assessment.

The remainder of this document will be dedicated to describe a general methodology to go through the seven groups of requirements of Article 37 (2) CPR. As the ex-ante assessment may be performed in stages, two separate building blocks can be defined.

Chapters 3 to 6 can be considered as a building block dealing with the assessment of market conditions (**building block 1: market assessment**). This includes the analysis of market failures, suboptimal investment situations and investment needs, the assessment of the value added of the envisaged FI, an estimate of additional public and private resources, which could be potentially raised by the FI, and lessons learnt from past experience in the implementation of similar instruments and in carrying out ex-ante assessments for FIs. After completing this first building block, MAs should have acquired a good understanding of the market conditions in which the FI will have to operate.

Chapters 7 to 9 can be considered as a second building block dealing with the delivery and management of the FI. **Building block 2: delivery and management** encompasses the issues linked to the definition of the proposed investment strategy for the FI, the specification of expected results and how the FI will contribute to the achievement of the specific objectives of the relevant priority under a Programme, as well as the provisions allowing the FI to be reviewed and updated during the implementation of the FI.

In addition to the requirements of Article 37 (2) CPR, **Chapter 10** provides MAs with information on the publication (Article 37 (3) CPR) and a completeness checklist to help ensure that the ex-ante assessment complies with all applicable requirements.

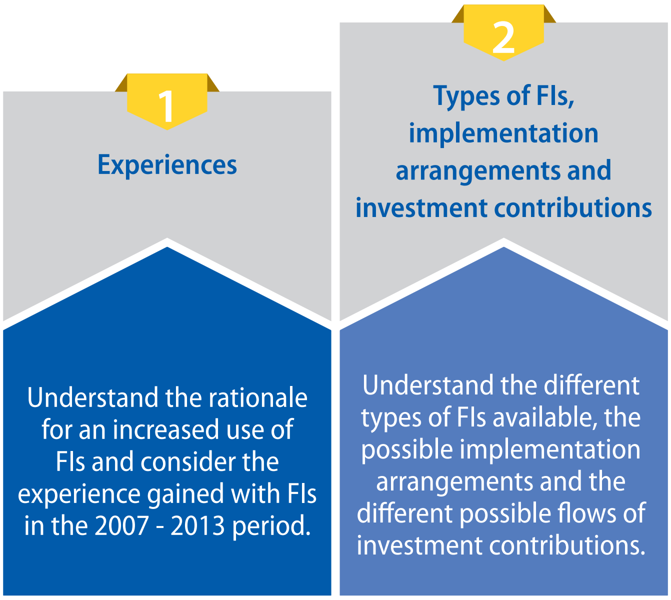
This Volume I is complemented by four other Volumes dedicated to the following Thematic Objectives/domains:

- Volume II dedicated to Thematic Objective 1, namely: 'Strengthening research, technological development and innovation';
- Volume III dedicated to Thematic Objective 3, namely: 'Enhancing the competitiveness of SME, including microcredit and agriculture';
- Volume IV dedicated to sectors related to Thematic Objective 4, namely: 'Supporting the shift to low-carbon economy';
- Volume V dedicated to 'Financial instruments for urban and territorial development'.

These Volumes aim to present thematic/sectorial specificities to be taken into account for the ex-assessment of the FI, proposing adapted tools and sharing good practices. These specific Volumes should be used in conjunction with Volume I.

1. Financial instruments: Overview

Main steps of this chapter



1.1 Rationale for the use of financial instruments and experience in the 2007-2013 programming period

1.1.1 Objectives and advantages of financial instruments in pursuing EU policy objectives

Article 174 of the TFEU defines the EU objective to reduce disparities between the levels of development in the European regions and strengthen the economic, social and territorial cohesion of the EU. For the 2014-2020 programming period, ESIF Policies play a decisive role in reaching the objectives set up in the Europe 2020 strategy for a smart, sustainable and inclusive growth, while promoting harmonious development of the Union and reducing regional disparities.[7]

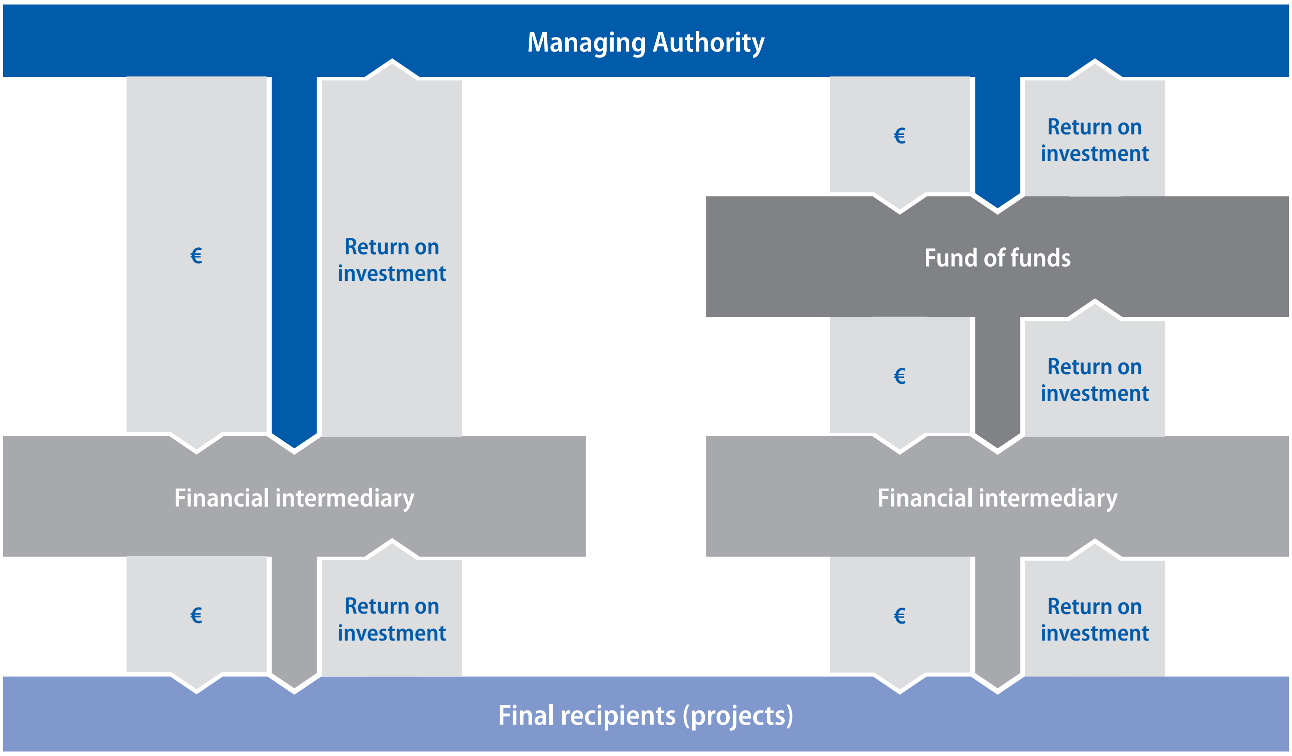
7 *Communication from the Commission, Europe 2020 A strategy for smart, sustainable and inclusive growth, COM(2010) 2020 final, Brussels, 3.3.2010.*

The financial constraints for public administrations will further increase the orientation of the 2014-2020 ESIF Policies on results and will require a higher efficiency in the use of public funding.

In this context, financial instruments (FIs) can play an important role in the achievement of ESIF Policies objectives. According to the Financial Regulation, FIs are defined as *"Union measures of financial support provided on a complementary basis from the budget in order to address one or more specific policy objectives of the Union. Such instruments may take the form of equity or quasi-equity investments, loans or guarantees, or other risk sharing instruments, and may, where appropriate, be combined with grants."*[8]

The preamble of the CPR highlights that FIs are increasingly important due to their leverage effect on the ESI Funds, their capacity to combine different forms of public and private resources to support public policy objectives[9], and because revolving forms of finance make such support more sustainable over the longer term (as illustrated in Figure 2 below).

Figure 2: Revolving effect in the use of financial instruments



Source: Adapted from Financial Instruments in Cohesion Policy, SWD (2012) A financial intermediaries *may be (i) an existing or newly created legal entity dedicated to implementing FIs consistently with objectives of the ESIF, (ii) an entrusted intermediary or (iii) the MA undertaking the implementation directly.*

8 *Article 2 (p) Regulation (EU, Euratom) no 966/2012 of 25 October 2012 on the financial rules applicable to the general budget of the Union.*

9 *For example, an impact evaluation conducted in Northern Italy has found that €1.00 of soft loans leveraged €4.50 of private investment. This is particularly relevant in times of budgetary constraints and funding concentration, as leveraging external funds will increase FIs' added value in the delivery of ESIF Policies objectives, when compared to grants;*

FIs encourage MAs to move towards a more business-oriented attitude in the administration of public funds, while pursuing public policy objectives and drive final recipients to improve the quality and financial discipline of their projects.

1.1.2 Use of financial instruments in the past programming period

FIs have been used for delivering Structural Funds investments since the 1994 – 1999 programming period. Their role has increased substantially during the 2007 – 2013 programming period, and they represent nowadays around 5% of total European Regional Development Fund (ERDF) and 0.7% of total European Social Fund (ESF) resource allocations.

During the 2007 – 2013 programming period, FIs have been implemented to support SMEs, urban development and energy efficiency, as shown in Table 1 below.[10]

Table 1: Examples of FIs used in the 2007 – 2013 period (as of 31 December 2012)

Types of FI	Types of support	Number of FIs[10]
Support to SMEs via ERDF	• Loans for SMEs • Guarantees • Co-investment • Equity capital • Venture capital • Mezzanine capital	831
Urban development	• Guarantees • Investment loans • Mezzanine capital • Equity capital	56
Energy efficiency and renewable energy	• Loans for investments • Mezzanine capital • Equity capital	20
Support to SMEs via ESF	• Mostly loans	33

With the high number of FIs established thus far, the Commission recommends to carefully consider issues related to the achievement of critical mass and potential of economies of scale, where relevant.

During the 2007-2013 programming period, the following areas for improvement have been identified[11]:

- Improving the expertise in implementing FIs at all levels;
- Closer monitoring and control of EU financial contributions to FIs;

10 *Summary Report on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds, programming period 2007 – 2013, situation as at 31 December 2012, DG Regio, DG Empl, September 2013.*

11 *Commission staff working document, financial instruments in Cohesion Policy, SWD(2012) 36 final, Brussels, 27.2.2012.*

- Achieving the necessary critical mass for FIs, notably the size of the target market, the identification of a sufficient project pipeline and appropriate geographical coverage;
- Improving market gap analysis and defining a solid investment strategy associated to the FIs; and
- Ensuring effective disbursement.

Against this background, the legal framework for the 2014-2020 programming period has been adapted to further expand and strengthen the use of FIs as an efficient and sustainable way to complement traditional grant-based financing.

Indeed, to encourage and to increase the use of FIs, the CPR foresees the following[12]:

- A greater flexibility and scope to EU Member States and regions in terms of target sectors and implementing structures;
- A stable implementation framework founded on a clear and detailed set of rules (Title IV), building on existing guidance and experiences on the ground;
- The possibility to generate synergies and combined products between FIs and other forms of support, such as grants;
- Different implementing options, including FIs set up and implemented at EU level as well as a set of standardised instruments (off-the-shelf), for which terms and conditions are pre-drafted to facilitate the roll-out.

In addition, the Commission is setting up a single Financial Instruments Technical Advisory Platform (fi-compass) for the programming period 2014-2020, with the aim of supporting MAs with a wide range of tools (e.g. interpretations, technical knowledge, case studies, training, communication, etc.) related to FIs.[13]

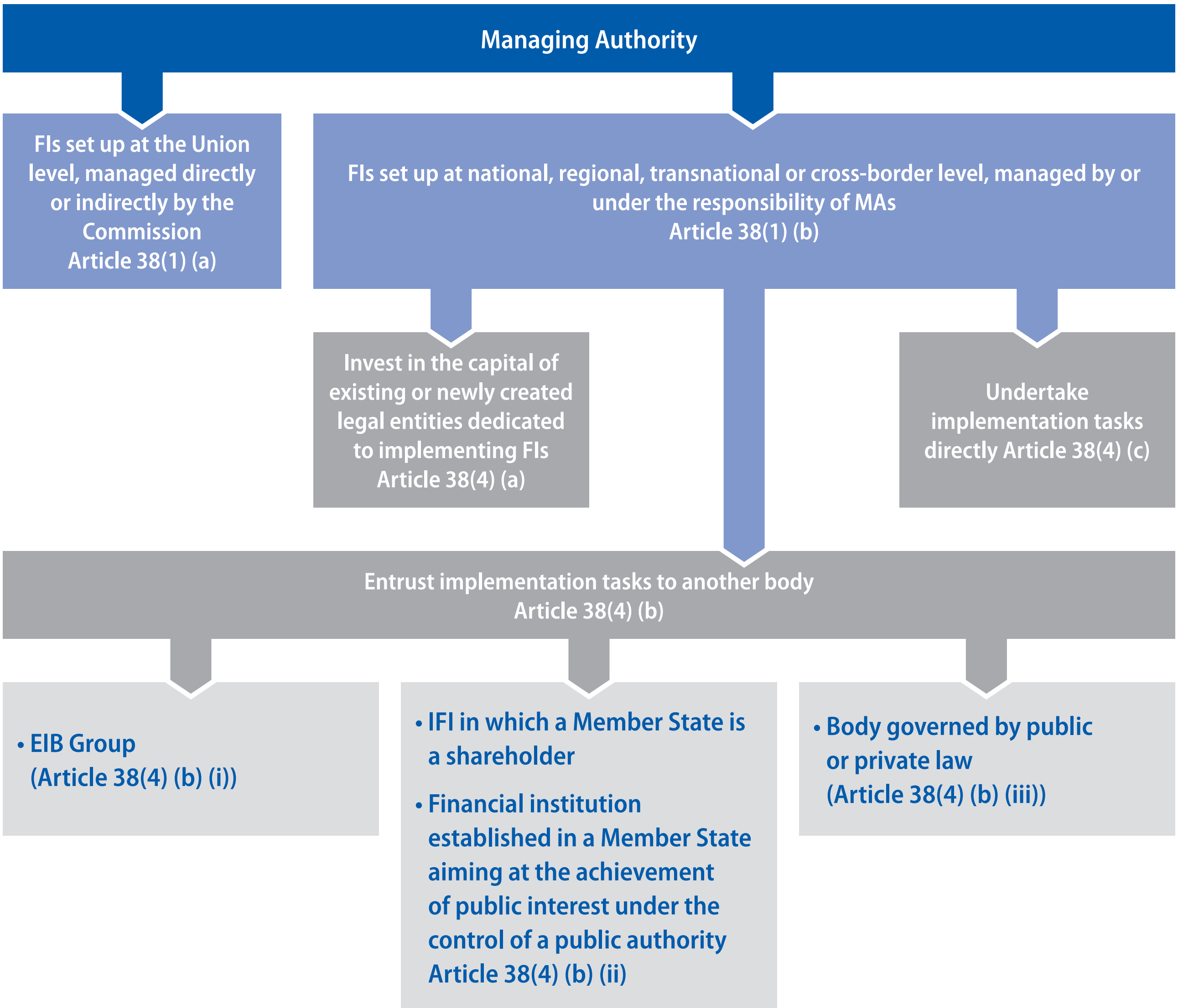
1.2 What are the options available to Managing Authorities?

Before dealing specifically with the content of the ex-ante assessment of FIs according to Article 37 CPR, it is useful to present the implementation options available to MAs. A thorough understanding of these options will facilitate the task of ensuring that the most efficient option is selected. The ex-ante assessment shall include an examination of options for implementation arrangements. A detailed analysis of Article 38 provides a comprehensive picture of the implementation options for the setting up of an FI is shown in Figure 3 below.

12 *Financial Instruments in Cohesion Policy 2014-2020, Factsheet, DG Regio, 2012.*

13 *A dedicated Financial Instruments Technical Advisory Platform to facilitate the use of financial instruments is currently being developed.*

Figure 3: Implementation options and structures for FIs according to Article 38 CPR



To begin with, FIs can be set up at the national, regional, transnational and cross-border level. Since each MA is responsible for its own Programme, the ex-ante assessment should provide evidence that the geographical scale at which the MA operates is appropriate to set up of the envisaged FI.

If, on the other hand, the appropriate geographical scale is broader than the territory for which the MA is responsible, the FI can be set up at a higher level, thereby pooling ESIF contributions from different Programmes. In this case, geographical and thematic eligibility have to be maintained for each Programme and separate accounting and audit trails need to be kept.

The initially identified delivery option will be reconsidered in several steps of the ex-ante assessment, and the decision on the investment strategy in chapter 7 might trigger a review of the prior steps.

1.2.1 Options for the implementation arrangement

As shown in Figure 3, MAs can choose to allocate the contribution from the Programme to **EU-level instruments.** Their contribution is ring-fenced for investments in countries or regions and actions covered by the Programme.[14]

This choice may be appropriate for instances when the technical capacity and/or the expertise of the MA is considered insufficient or where the critical mass for establishing an FI has not been reached and the existing EU-level instruments are well aligned with the Programme objectives. This option avoids duplicating FIs at lower levels and gives assurance to MAs that resources will be used through tested vehicles and experienced teams. Another advantage of this alternative is that it allows MAs to increase the co-financing rate of the ESI funds up to 100%.[15]

If MAs decide to set up an FI at a national, regional, transnational or cross-border level, the Regulation offers them:

- Three options for the most suitable **implementation arrangement;** and
- Two options for the type of the FI.

These options will be described in more detail in the following paragraphs.

The CPR foresees three possible implementation arrangements.

Option (a): The first possibility is to **invest** in the capital of an existing or newly created legal entity dedicated to implement FIs consistently with the objectives of the ESI Funds.

Option (b): The second possibility is to **entrust** implementation tasks to another entity, namely:

- The EIB Group (EIB,EIF or any subsidiary of the EIB);
- International financial institutions in which a Member State is a shareholder, or financial institutions established in a Member State aiming at the achievement of public interest under the control of a public authority; and
- A body governed by public or private law selected in accordance with applicable Union and national rules.

14 This implies that the bodies designated in accordance with Article 123 of the CPR for ERDF, CF, ESF, EMFF and with Article 65 of the RDR for the EAFRD shall not carry out on-the-spot verifications of operations. They shall receive regular control reports from the bodies entrusted with the implementaion of these financial instruments. It also implies that the bodies responsible for the audit of programmes shall not carry out audits of operations comprising FIs implemented under Article 38 (1) (a) and of management and control systems relating to these instruments. They shall receive regular control reports from the auditors designated in the agreements setting up of these FIs.

15 See Article 120 (7) of CPR.

In this case, the MA entrusts the implementation of the FI to an entity which will implement the FI in accordance with a funding agreement to be signed between the MA and the body in question. The entrusted entity pursues the investment strategy agreed with the MA, reports on the progress of the various investments and carries out treasury management.

Notwithstanding the choice of the option (a) or (b), the selection of bodies implementing the FI has to take into account requirements and selection criteria as stipulated in the Delegated Act. The selection process has to be transparent, justified and based on objective grounds. A funding agreement will define the obligations of each part.

Under option (b), in cases in which the FI is set up as a fund of funds, the body implementing the fund of funds will select and sign funding agreements with financial intermediaries (that will implement the FI) and will monitor and control their FI implementation activities. In line with Article 38 (5) of the CPR, financial intermediaries shall be selected on the basis of open, transparent, proportionate and non-discriminatory procedures, avoiding conflicts of interest. The same requirements and selection criteria, as stipulated in the Delegated Act, apply.

Option (c): The third possibility for the MA is to **undertake** implementation tasks **directly**. This possibility only applies in case the FI exclusively consists of loans and guarantees.

Under this option MA directly implements loans or guarantees without the formal set-up of a fund under Article 38 (4) (c). For this option there is no funding agreement but instead a Strategy Document (elements are set out in annex IV of the CPR) which will have to be examined by the Monitoring Committee.

Payments from the Commission are the same as for grants i.e. reimbursement of loans disbursed or guarantees committed. There is no advance payment to the "fund". Management costs are not eligible under the same operation; however, they can be covered under Programme technical assistance. It is most likely that this option would be used for cases where there are a limited number of interventions not enough to justify the establishment of a stand-alone fund.

It should be noted that this option may not be possible in all Member States: it is subject to national law which will need to explicitly allow for the MA/Intermediate Body to issue loans and guarantees (in certain cases there may be national legislation prohibiting para-banking).

1.2.2 Options for the type of financial instrument

If the envisaged FI is implemented according to option (a) or option (b) described above, the MA can decide to structure it applying a set of standard terms and conditions provided by the Commission. So the **first option** is to setup the FI as an **'off-the-shelf' instrument**, a **new option** available for the 2014-2020 programming period and aiming at facilitating roll-out. This includes a notification-free approach to State aid.[16]

The technical and legal requirements for off-the-shelf FIs form a minimum set of requirements. Specific regional conditions are possible, as long as the latter are in addition to these minimum requirements.

The off-the-shelf FIs[17] to be proposed include the following:

- Loan fund for SMEs based on a portfolio risk-sharing loan model (*RS Loan*);
- Guarantee fund for SMEs (partial first-loss portfolio) (*capped guarantee*);
- Equity investment fund for SMEs and starter companies based on a co-investment model (*co-investments facility*);
- Loan fund for energy efficiency or renewable energies in the building sector (renovation loan);
- Loan fund for sustainable Urban Development (UD Fund).

The **second option** is to use FIs specifically designed for the scope of each unique circumstance, and therefore called a '**tailor-made'** instrument. It can be a new FI or, in the case of existing FIs, the MA may consider to use them as delivery mechanisms for ESIF 2014-2020, possibly with the necessary adaptations. In any case, the ex-ante assessment needs to prove that this is the best course of action. In addition, attention is drawn to the fact that the relevant public procurement and State aid rules need to be equally respected. If the FI is new and a specific design is envisaged, the ex-ante assessment may be helpful in developing a robust process for the set-up and implementation.

1.2.3 Flow of investment contributions

In order to understand the strategic fit of the different options it is crucial to follow the flow of ESIF resources from the MA to final recipients. Indeed, as shown in Figure 4: Flow of ESIF resources from the MA to final recipients below, this differs according to the chosen implementation arrangement.

16 *See below in this section.*

17 *This legislation on the off-the-shelf instruments will gradually enter into force during the course of 2014 (depending on the adoption of the future GBER).*

If the MA chooses to invest in the capital of an existing or newly created legal entity dedicated to the implementation of the FI or to entrust implementation tasks to another entity (option (a) and (b) defined above), the FI can be set up either with or without a fund of funds.

A fund of funds means a fund set up with the objective of contributing support from one or more programmes to several FIs implemented by financial intermediaries. These can be, for instance, several venture capital funds for SMEs, several urban development funds and/or several loan funds covering different Thematic Objectives or geographic areas.

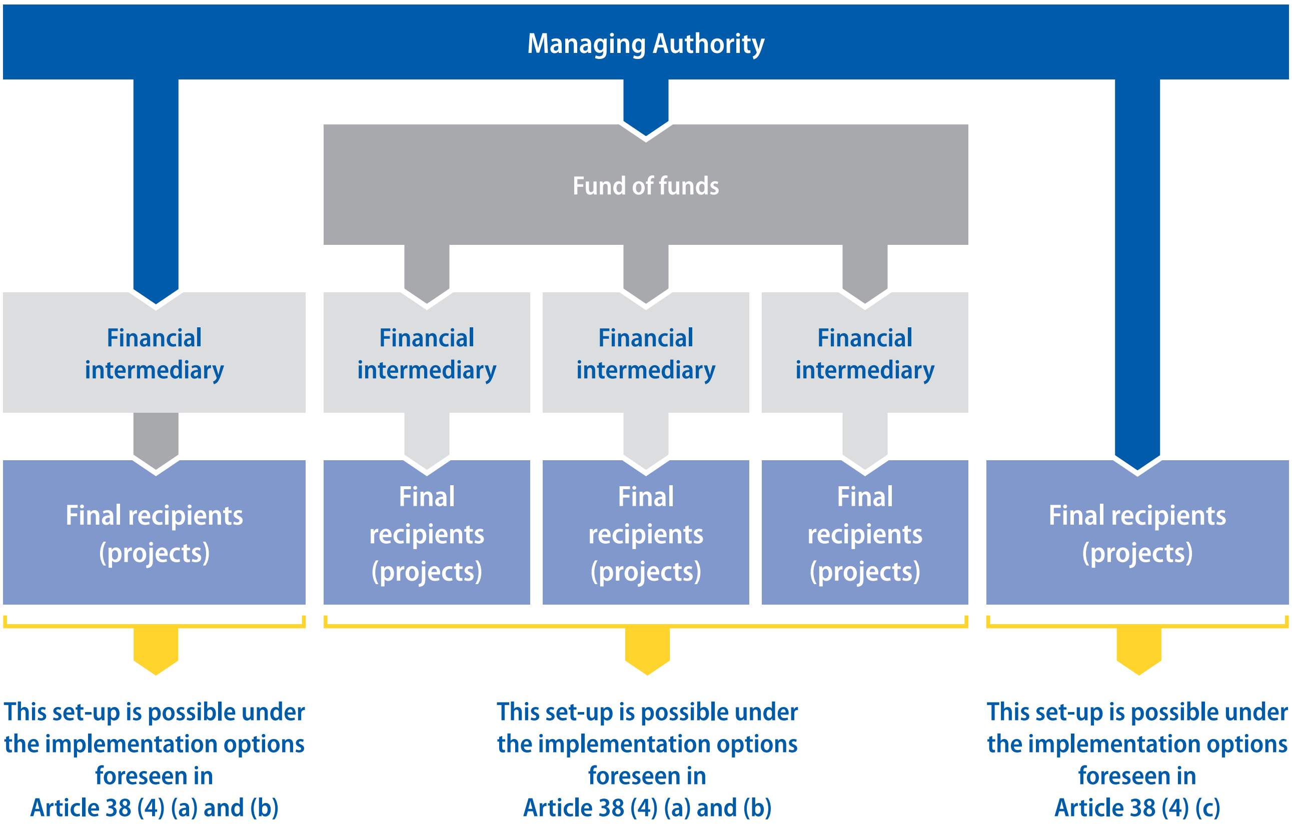
According to Article 38 (5) CPR, when a fund of funds is foreseen, part of the implementation tasks will be entrusted to multiple financial intermediaries, which will then provide funding to final recipients. In doing so, the fund of funds will make sure that the financial intermediaries are selected according to an open, transparent, proportionate and non-discriminatory procedure that avoids conflicts of interests. In addition, they have to comply with Article 140 (1), (2) and (4) of the Financial Regulation.

On the other hand, in a case where no fund of funds is foreseen, the contribution from ESIF resources will reach final recipients passing through one single layer of implementing bodies instead of two.

Finally, if the MA chooses to undertake implementation tasks directly, there are normally no financial intermediaries between the MA and final recipients. However, the MA may designate one or more intermediate bodies to carry out these tasks under its responsibility. The relevant agreement between the MA and the intermediate bodies should be formally recorded in writing.[18]

18 *See Article 123 and 125 of the CPR and Article 66 of Regulation (EU) 1305/2013 [EAFRD].*

Figure 4: Flow of ESIF resources from the MA to final recipients

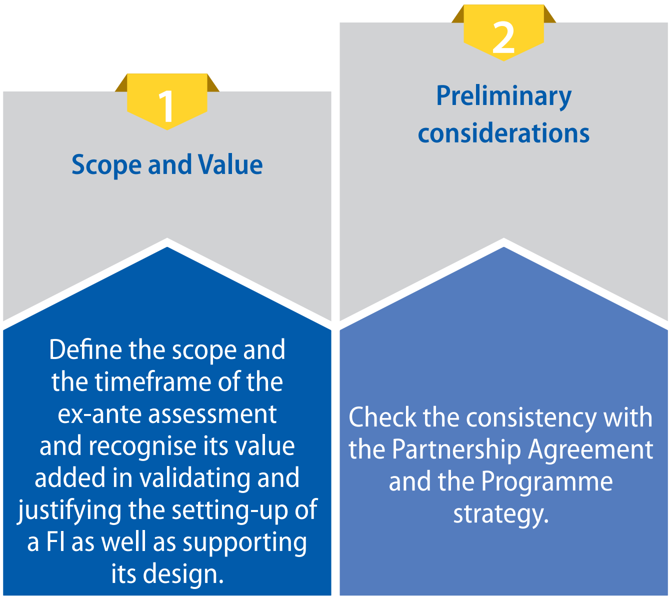


The choice of the implementation option and typology of FI will be based on the consideration of organisational pros and cons and opportunities according to the specific needs the FI has to address. The reasons that could justify this choice are part of the ex-ante assessment as defined in Article 37 (2) (e) CPR.

2. Ex-ante assessment: Purpose and preliminary considerations

It is important to clarify the purpose of the ex-ante assessment before detailing its content in order to keep the final objective in mind throughout the elaboration process.

Main steps of this chapter



2.1 Scope and value of the ex-ante assessment for financial instruments

The ultimate objective of the ex-ante assessment is to provide evidence of the adequacy of the envisaged FI against an identified market failure or suboptimal investment situation and to ensure that the FI will contribute to the achievement of the Programme and the ESIF objectives. As such, it can be considered as a validation tool which checks whether the decisions to deliver certain objectives laid down in the Programmes through an FI are adequate.

As explained in the introductory section of this methodology, the ex-ante assessment can be divided into two building blocks: market assessment and delivery and management. Should the results of the market assessment lead to the conclusion that setting up an FI is not justified, at least not in its initially envisaged form, it seems logical not to go through all the further steps of the ex-ante assessment. Should this situation arise, the MA could consider a different way to achieve the Programme objectives with other instruments. Another possible outcome is that, by the time the ex-ante assessment is carried out, some of the objectives of the Programme are questioned. This may entail a revision of the Programme before considering setting up an FI.

If the market assessment demonstrates the validity and the justification for establishing an FI, the next step of the ex-ante assessment is to further develop the main characteristics of the FI and to facilitate its implementation by mitigating possible risks (e.g. poor set-ups, unsuccessful implementations and non-adapted investment strategies in terms of financial products and volumes).

Article 37 (2) CPR foresees seven key group of elements that must be included in the ex-ante assessment which are described in Table 2 below.

Table 2: Breakdown of the Article 37 (2) CPR requirements

Article 37 (2) requirements	Description
a) Analysis of market failures, suboptimal investment situations and investment needs	• Analysis of the amount of ESIF resources to be allocated to the FI in order to attract other investors and fill the investment gap or contribute to this objective; • FI needs to contribute to the strategy and to the expected results of the relevant Programme(s) by bridging a viability gap or a financing gap; • Identification of the main reasons, type and size of market failure and suboptimal investment situations with a good practice methodology to make sure the FI resources are used where they make a difference.
b) Value added of the financial instruments	• Check the value added of the FI; • Consistency with other forms of public intervention addressing the same market failure to limit overlap and avoid conflicting targets; • Possible State aid implications including the proportionality of the envisaged intervention to the identified market needs; • Measures to minimise market distortion resulting from the FI.
c) Additional public and private resources	• Estimate of additional public and private resources to be potentially raised by the FI; • Co-financing down to the level of the final recipient[19]; • Expected leverage effect[20]; • If relevant, an assessment of the need for and level of preferential remuneration to attract counterpart resources from private investors.

19 *In the case of EAFRD, cofinancing at the level of final recipients is not possible (public expenditure criteria).*

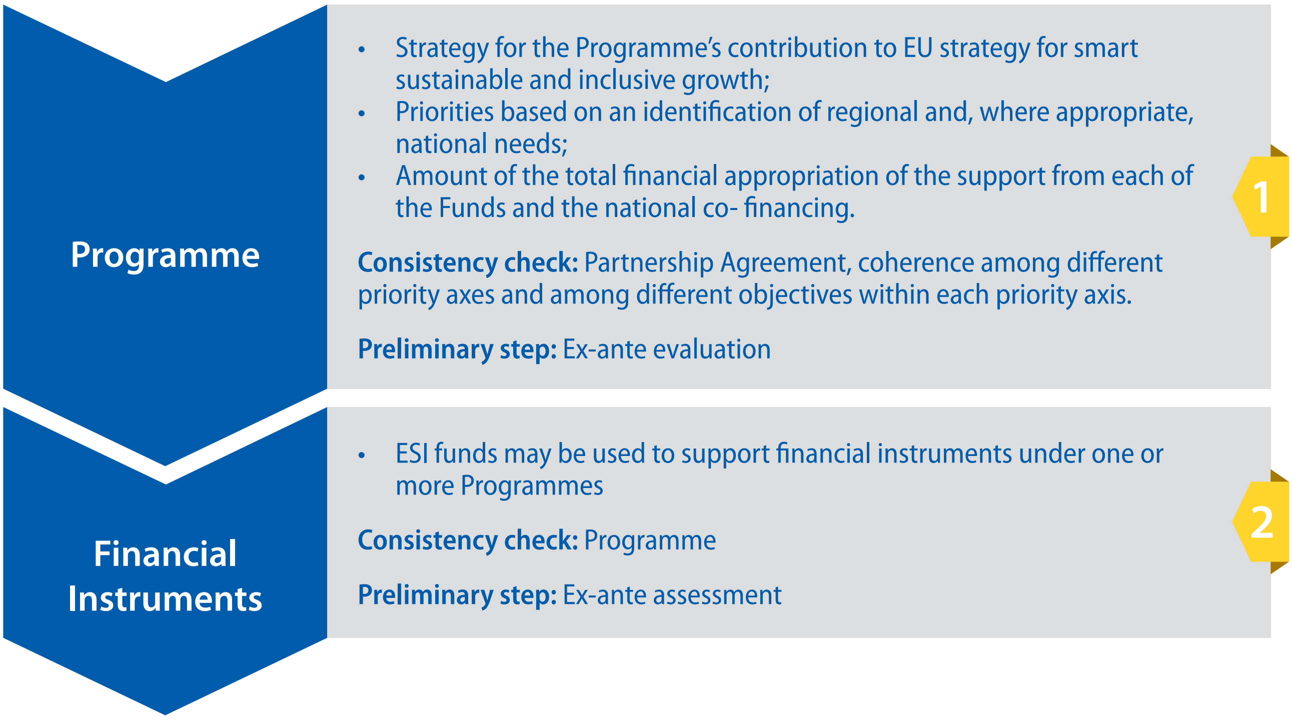
20 *According to Article 140 of the Financial Regulation and Article 223 of its Rules of Application, the leverage effect of Union funds shall be equal to the amount of finance to eligible final recipients divided by the amount of the Union contribution.*

Article 37 (2) requirements	Description
d) Lessons learnt	• Analysis of lessons learnt from similar or instruments considered relevant in the past; • Analysis of ex-ante assessments carried out by the MS in the past; • Application of these lessons to make sure that the FI builds on existing and acquired knowledge.
e) Investment strategy	• Thematic and geographical coverage of the FI; • Ensure that within the meaning of Article 38, the most appropriate implementation option is chosen in regard to the country/regional situation; • Financial products to be offered to ensure an adequate response to market needs; • Final recipients targeted; • If relevant, envisaged combination with grant support to maximise efficiency and ensure minimum intensity of the support element/element of subsidy.
f) Expected results	• Specification of the expected results and outputs of the FI within the priority of the Programme(s); • Definition of reference and target values based on the specific contribution of the FI to the priority of the Programme results and outputs indicators.
g) Provisions allowing the ex-ante assessment to be reviewed	• Rationale for the revision of the ex-ante assessment; • Practical and methodological procedures to update the ex-ante assessment; • Steps to adapt the FI implementation.

2.2 Preliminary considerations

MAs are supposed to ensure consistency of the FI with the priority axis under the Programme, as shown in Figure 5.

Figure 5: Consistency among the envisaged FI and the priority axis under the Programme



The following aspects should be taken into account:

- **Consistency with Thematic Objectives and Programme priorities**
  The FI shall fit into the intervention logic established by each Programme to contribute to the Europe 2020 priorities and the selected Thematic Objectives or Policy areas. The use of an FI should then be consistent with the ex-ante evaluation(s) of the corresponding Programme(s) and the expected outputs and results of each concerned priority axis or focus areas.

  Furthermore, some outputs of the related ex-ante evaluation(s) can provide relevant inputs for the ex-ante assessment of FIs. These potential inputs are highlighted in Table 3 below.

Table 3: Contribution of the ex-ante evaluation to the ex-ante assessment

Content of the ex-ante evaluation	Potential inputs	Requirements of the ex-ante assessment
• Contribution to EU strategy for smart, sustainable and inclusive growth, having regard to the selected TOs and priorities, national and regional needs and lessons drawn from previous periods;[21] • Rationale of the form of support proposed.	Analysis of needs and disparities of development at the national and regional level as well as their potential for development.	Analysis of market failures, suboptimal investment situations and investment needs; Value added of the FIs; Lessons learnt.
• Relevance and clarity of the proposed programme indicators; • How the expected outputs will contribute to the results; • Whether the quantified target values are realistic having regard to the support envisaged from the ESI Funds; • The suitability of procedures for monitoring the programme and for collecting the data necessary to carry out evaluations; • The suitability of milestones selected for the performance framework.	The FI should help reach the expected results and impacts of the Programme.	Expected results.
Strategic Environmental Assessment (except for ESF).	No specific relevance for FIs but relevant for instruments targeting environmental issues (such as Thematic Objectives 4, 5 and 6).[22]	Not applicable.

- **Financial consistency**
  In the case where the FI is funded through contributions from multiple priority axis, focus areas or Programmes, the balance between the different financial contributions and their distinction has to be reflected in the investment orientations of the FI.

21 *The SWOT analysis of the ex-ante evalaution could prove particularly useful. However, it should be noted that EAFRD is different from the other ESI Funds since the SWOT is a separate document outside of the scope of the ex-ante evaluation (See Art. 8(1)(b) EAFRD).*

22 *Thematic Objective 4 - Supporting the shift towards a low-carbon economy in all sectors; Thematic Objective 5 -Promoting climate change adaptation, risk prevention and management; Thematic Objective 6 - Protecting the environment and promoting resource efficiency.*

- **Governance consistency**
  The governance of the FI has to be consistent with the governance of the Programme and has to assess the relevance of the involvement of national and regional stakeholders. In the case of an FI with contributions from different Programmes, a strong collaboration between the different participating MAs is needed and the governance of the FI has to be adapted accordingly.

  The CPR mentions several instruments for implementing 'multi-purpose' FIs. These are mainly territory-oriented and include CLLD and ITI, with also the possibility of a delegation to intermediate bodies (e.g. Local Action Groups) and sub-regional levels.[23]

  The FI should be set up at the **optimal level of government** to efficiently and effectively solve market failures or suboptimal investment situations in compliance with the subsidiarity principle. For example, some countries had good experience with schemes supporting energy efficiency at national level and sustainable urban development or village renewal at a regional or sub-regional level. In the same vein, setting up instruments related to economic growth and entrepreneurship at regional level may result in wasteful competition among regional governments (e.g. subsidy race to attract firms and investments in its own region) thus a national scheme could be considered thus internalising negative cross-border externalities. However this may increase the complexity of FI set-up and management.

- **Consistency with other regions**
  Taking into account the high number and the rather small size of FIs developed in the financial perspective 2007-2013, a further significant increase of FIs possibly reinforced by support schemes implementing new TOs in the 2014-2020 programming period seems likely. In some cases a consistency check with FIs of other regions could avoid potential duplication, benefit from competences, help identifying good practices and, even, achieving critical mass and economies of scale. Solutions can also come from the adoption of more standardised FIs which are blueprinted in the different regions of the same country or the establishment of FIs at the national level. While each case needs to be assessed on own merits, the general policy line is that there should be consolidation of resources into national, supra-regional or EU-level instruments, where appropriate.

23 *See http://ec.europa.eu/regional_policy/informing/dialog/pdf/clld_guidance_2013_04_29.pdf for CLLD.*

Box 1: Why is it important to check consistency with Programme priorities?

In its 2012 Special Report (Special Report 21/2012), the European Court of Auditors evaluated Cohesion Policy investments under the heading 'energy efficiency'. The findings of the report highlight that the main purpose of the support was directed to refurbishment and that energy efficiency was a secondary topic. Further, the Court of Auditors stated that the energy-saving potential should have been assessed beforehand.

A consistency check would have ensured a clearer identification of the targets of the envisaged FI. Let us consider an FI aiming at supporting sustainable urban development through integrated actions to tackle the economic, environmental, climate and social challenges affecting urban areas. Investments in the field of energy efficiency could definitely be a part of such an FI, even though they do not constitute its primary focus. If on the other hand, the envisaged FI deals mainly or exclusively with energy efficiency, in the future it can be set up under investment priority aligned to TO 4.

Also, the Court of Auditors recommended investing where the energy saving potential is high enough to achieve (with the support of the ESIF) a viable project and to establish indicators like saved GHG per invested €1,000.

The remainder of this document will address each of the requirements set out in Article 37 (2) CPR.

3. Analysis of market failures, suboptimal investment situations and investment needs

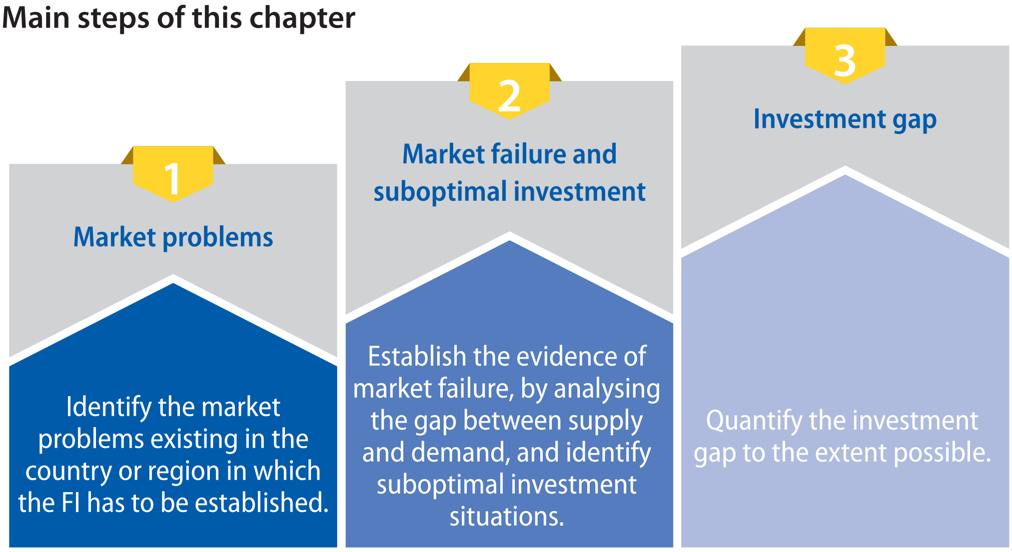
According to Article 37 (1) and (2) of the CPR, FIs shall be implemented to support investments that are expected to be financially viable but are unable to raise sufficient funding on the market. This may be due to insufficient availability of funding (e.g. high risk of the sector or low profitability expectations) or due to the high costs associated with the available funding sources. FIs can provide additional liquidity at terms, e.g. interest rates or collateral requirements, more favourable than offered by the market thus allowing the realisation of these investments.

Article 37 (2) (a) of the CPR requires the analysis of market failures, suboptimal investment situations and investment needs under the policy areas, Thematic Objectives or investment priorities to be addressed by the envisaged FI.

Each FI should contribute to the strategy and the results of the Programmes through which ESIF resources are allocated. However, it is well understood that FIs may support only specific segments of the strategy or target specific elements of the whole programme.

It is important to notice that the analysis of market failures or suboptimal investment situations and the found investment needs constitutes one of the key elements of the State aid assessment, which is presented in section 4.3 of this methodology.

Main steps of this chapter



3.1 Identifying existing market problems

A first essential distinction needs to be made between market failure and suboptimal investment situations.

The concept of **market failure** refers to non-functioning aspects of the market which result in an inefficient allocation of resources and entail the underproduction or overproduction of certain goods and services.

On the other hand, suboptimal investment situations concern the underperformance of investment activities. In both cases, it is key to assess the need for a support scheme compared to other means of achieving the same objectives (e.g. a change in a national regulation).

3.1.1 Causes of market failure and investment gap

To begin with, it is important to analyse the underlying causes of market failure, which encompass several dimensions[24]. To demonstrate the existence of market failure, at least one of the following elements has to be evident in the country or region under consideration. Table 4 below presents definitions and examples of the underlying causes of market failure most commonly identified by the economic literature[25].

Table 4: Underlying causes of market failure

Causes of market failure	Definitions	Examples
Positive or negative externalities	These are consequences of individual or corporate decisions or activities that are experienced by a third party. This implies that the individual or the firm is not able to collect the full benefits or does not pay the full costs resulting from his decision or activity.	Agricultural activities contribute to landscape and biodiversity conservation but the price of agricultural commodities does not account for these services. A driver bears the costs of fuel consumption but its impact on road congestion is borne by all other drivers.

24 *The analysis of market failures to be tackled by the EU resources applies to grants as well.*

25 *The underlying causes of market failure identified in Table 4 are not specific to financial instruments and they can be used to justify any type of government intervention including grants.*

Causes of market failure	Definitions	Examples
Public goods	These goods are non-excludable and non-rival in consumption. This typically results in free rider problems since, even if a person does not contribute to the production of a public good, the cost of preventing him/her from benefitting from the good are prohibitive. Missing markets may address the same issue.	National defence, public parks and basic infrastructure are considered as public goods.
Informational asymmetry	This occurs when two parties wishing to enter a contract or an agreement have different levels of information and this affects their ability to make decisions. Time-inconsistent preferences are part of this asymmetry.	Innovative start-ups may find it difficult to access funding since finance providers are not familiar with their product and have difficulties in assessing the capability and future profitability of the company.
Split incentives	This occurs when two parties wishing to enter a contract or an agreement have different goals and incentives and this affects their ability to make decisions.	Landlords provide tenants with appliances, but the tenant is responsible for paying the energy bills. In this case, the landlord seeks to minimise the capital cost of the appliance while the tenant wants to maximise the energy efficiency of the appliance to save on energy costs.
Unstable markets	Non-rational behaviour identified often as reason for crisis. This should not be confused with a change in demand preferences on the market.	Financial markets have experienced bubbles, herding behaviour and speculation.
Government and Regulation failure	This situation arises when policy decisions fail to realise that the market is able to correct some of its failures. In such cases, the government's intervention creates inefficiencies. Conflicting policy objectives result in inefficiencies and failures, too.	Providing subsidies to firms will support their development, but this may also protect inefficient firms from competition and create barriers to entry for new firms since prices are kept artificially low.

Causes of market failure	Definitions	Examples
Incomplete property rights and difficulties of enforcement	This refers to a situation where it is difficult to establish or to enforce existing property rights on a resource or a product.	Incomplete or unenforceable property rights may result in reduced incentives to innovation, due to free-rider and competition problems.
Inequality issues	Market transactions reward consumers and producers with incomes and profits, but these rewards may be concentrated in the hands of a few. Inequality issues go beyond the income gap and include gender inequalities, but also unequal access to basic services, such as education and healthcare.	Access to education, discrimination
Incomplete markets and underproduction of merit goods	Merit goods are characterised by the fact that the net private benefits of consuming them are not known at the time of consumption and that their consumption generates benefits for the society as a whole. Markets may produce a certain amount of merit goods but total supply will be below the socially optimum level.	Healthcare services and education are examples of merit goods. The national government needs to intervene to ensure an adequate provision of these goods and services.

Sub-optimal investment situations represent a specific type of market failure for which FI are particularly suitable and have been applied in the past. This issue is directly linked to the evidence of an investment gap.

The gap has to be identified between the existing level of investment and a quantitative EU, national or regional objective. In most of the cases, the reference should be an analysis of current investment trends, which shows the extent to which the policy objective could be attained without additional support schemes.

Suboptimal investment situations may be found in conjunction with a longstanding experience of market underperformance**.** This refers to a situation where the existing investment activity is insufficient to achieve a policy objective. As an example let us consider a national policy objective aiming at a 20% reduction in CO2 emissions over a certain period of time. There may be private sector investment in renewable energy and energy efficiency but it may not be sufficient to achieve the target.

In other cases, a comprehensive or integrated plan for public objectives exists. For certain Thematic Objectives, most envisaged investments may be based on sectorial or integrated plans. Where those plans exist a decision, where to invest (e.g. area), in what to invest (e.g. district heating) and in which part of the value creation chain (e.g. heating energy demand reduction, metering) is already taken or prepared.

Table 5 presents an illustrative list of sectors for which rather detailed planning is likely to exist. Some of them will not be addressed by an FI at all, some of them will be analysed following the approach for a suboptimal investment situation and some of them will be analysed following the general analysis of supply and demand described below.

Table 5: TOs addressed with detailed investment plans

TO1	Research infrastructure	e.g. research centres
TO2	Broadband	e.g. broadband in less developed regions and rural areas
TO4	Energy efficiency	e.g. energy efficiency in housing
TO6	Sustainable urban/village development	e.g. brownfield regeneration
TO 6/7	Sustainable public transport	e.g. tram system
TO6	Water (directive)	e.g. waste water system in line with EU directives
TO6	Waste (directive)	e.g. system for recycle and reuse
TO9	Combating poverty	e.g. access to high-quality services and healthcare
TO10	Education, skill	e.g. investment in education infrastructure (there might be some exceptions where private schools are planned without integration in public plans and public offers)
TO11	Efficient public administration	e.g. organisational set-up with ICT support and one-stop information points for the people

The results of the market failure and suboptimal investment analyses are prerequisite for the identification of a need for support. In this sense, the ex-ante assessment has to provide an explicit statement on the identified investment gap that cannot be closed by market forces alone.

The analysis for the existence and, to the extent possible, the quantification of the market failure or the suboptimal investment situation allows determining the size of the investment gap to be filled by the FI. This can result from the following:

1. A **viability gap** – in the case where the business plan of a project or of a group of projects demonstrates returns below market level.[26] The viability gap is a cross-cutting issue which tends to be independent from the financial structuring of the project. As a matter of fact it can occur in sectors where project finance is the most common financial structure (e.g. energy, transport, urban development) but also where equity investment prevail (e.g. investment in SMEs and start-ups).

2. A **financing gap** – in the case where a certain sector or the economy as a whole shows evidence of unmet financing demand. The financing gap occurs especially for SME and mid-cap finance and in crises situations. Looking closer into the financing gap, it may be a gap for a certain financial product group like an equity gap for risk finance or a general lack of access to finance.

3. A **combination of viability and financing gaps**.

3.1.2 Map of market problems (market failures or suboptimal investment situations)

Based on evidence from existing literature on the types of market failures and suboptimal investment situations, Table 6 below provides an overview of the most common market failures and suboptimal investment situations which could hamper the achievement of the Thematic Objectives in a given economic environment. Typical key actions are listed and typical examples are given[27].

To reduce the complexity, the ex-ante assessment should focus on the issues closely related to Programme priorities and market segments concerned by the envisaged FI.

Moreover, market failure or suboptimal investment situations are not always permanent and support schemes may have the declared objective to build up markets, thus they may be phased out after a successful implementation of the first generation.

The conditions may also change, as a result of market-driven developments as well or other societal changes. As a result, since the ex-ante assessment may be performed in stages and a significant lapse of time may pass between the end of the market failure assessment and the actual implementation of the FI, MAs should ensure that the identified market failure still exists before the contribution from the ESI funds is made[28].

26 *The project or the portfolio of projects are intrinsically less profitable because they are perceived as too risky or not generating sufficient returns (e.g. as located in an under-developed area). The returns are compared with a fair rate of return (FRR) and should not be due to poorly structured underlying investments.*

27 *This is not intended to be an exhaustive list and it is based on past experiences with the implementation of FIs as well as on existing relevant literture and on the professional experience of the authors.*

28 *See also chapter 9.*

Table 6: Overview of the main sources of market failure and suboptimal investment situations for the different Thematic Objectives

Thematic Objective	Typical key actions	Typical market problems	MF/SI[29]	Examples for FIs
Strengthening research, technological development and innovation	ERDF: (1) Research infrastructure and innovative financing solutions for equipment and competence centres with a focus on applied research; (2) Innovation in enterprises through technology transfer, applied research, technology development and demonstration facilities. EAFRD: (1) Clusters and networks between agriculture, food and forestry and other actors; (2) Establishment of advisory services. EMFF: (1) Innovation in the field of sustainable exploitation of fish stocks (e.g. increased selectivity of fishing gears) and reducing the impact of aquaculture on the marine environment.	• Information asymmetry; • Risk aversion of banks; • Limited access to finance; • Externalities; • Incomplete or unenforceable property rights.	MF	• Subordinated loans for (small) parts meeting effective demand; • Loans/Guarantees without/with lower collateral requirements.
Enhancing access to, and use and quality of ICT	ERDF: (1) Next Generation Access Infrastructure; (2) eGovernment and eHealth applications; (3) Large-scale uptake of ICT-based innovations within and between regions.	• Information asymmetry; • Risk aversion of banks; • Externalities.	MF/SI	• Capped guarantees; • Loans without/ with lower collateral requirements; • Grant/Loan combination.

29 *MF market failure, SI suboptimal investment situation.*

Thematic Objective	Typical key actions	Typical market problems	MF/SI[29]	Examples for FIs
Enhancing access to, and use and quality of ICT	EAFRD: (1) Broadband infrastructure; (2) ICT applications and services (rural areas, agriculture and food processing); (3) e-content relevant (rural tourism); (4) Digital competence.	• Information asymmetry; • Risk aversion of banks; • Externalities.	MF/SI	• Capped guarantees; • Loans without/ with lower collateral requirements; • Grant/Loan combination.
Enhancing the competitiveness of SMEs	ERDF: (1) Setting up and provision of appropriate financial products for start-up and innovative businesses (2) Commercial exploitation of new ideas and research results (3) Business advisory services (4) Development of web tools (5) Internationalisation (6) SMEs in emerging areas EAFRD: (1) On-farm investments (2) Business start-up aid for young farmers (3) Promotion in local markets, quality schemes (4) Farm risk management EMFF: (1) Entrepreneurship in fisheries (2) Improved products, processes, technologies and management and organisation systems (fisheries, aquaculture, processing)	• Information asymmetry; • Risk aversion of banks; • Limited access to finance; • Transaction costs; • Incomplete or unenforceable property rights; • Growth externalities.	MF	• Guarantees, loans, quasi equity/mezzanine and seed capital; • Grant/Loan combination; • Loans without/ with lower collateral requirements; • Subordinated loans.

Thematic Objective	Typical key actions	Typical market problems	MF/SI[29]	Examples for FIs
Supporting the shift towards a low-carbon economy in all sectors	ERDF: (1) Energy Performance Contracting in public buildings and housing sectors ERDF and the Cohesion Fund: (1) Energy efficiency, renewable heating and cooling in public buildings (2) Energy efficiency measures and renewable energy use in SMEs (3) Innovative renewable energy technologies (4) Marine-based renewable energy production (5) Low-carbon strategies and sustainable energy action plans for urban areas EAFRD: (1) Efficiency in energy use in agriculture and food processing (2) Promotion of the bio economy (3) Reduce nitrous oxide and methane emissions from agriculture (4) Enhance carbon sequestration and emission reduction in agriculture and forestry EMFF: (1) Increase energy efficiency of fishing vessels. Reducing emissions of pollutants by fishing vessels. Reduction of waste in processing	• Externalities; • Public goods; • Information asymmetry, access to finance, transaction costs of financing; • Incomplete or unenforceable property rights.	MF/SI	• Guarantees or soft loan; • Bridging finance gap and/or viability gap with soft loans or guarantees; • Contracting approach (ESCO, emergency agency with soft loans).

Thematic Objective	Typical key actions	Typical market problems	MF/SI[29]	Examples for FIs
Promoting climate change adoption, risk prevention and management	ERDF and the Cohesion Fund: (1) Strategies, action and management plans (2) Investment in adaptation to climate change and risk prevention and management (3) Investment in disaster management systems EAFRD: (1) Sustainable water management (2) Improved soil management (3) High potential for adaptation to climate change and diseases and maintaining genetic diversity	• Incomplete or unenforceable property rights; • Externalities, public goods; • Incomplete markets (insurance systems).	MF	Loans with long tenors for protection infrastructure, paid by adjacent land and building owners with fees and/or contributions.

Thematic Objective	Typical key actions	Typical market problems	MF/SI[29]	Examples for FIs
Protecting the environment and promoting resource efficiency	ERDF and the Cohesion Fund: (1) Efficient water supply, waste-water treatment, water reuse (2) Waste management (3) Green infrastructure (4) Cleaner transport ERDF: (1) Diversification of local economies (2) Sustainable urban development EAFRD: (1) Restoring, preserving and enhancing biodiversity (2) Efficient use of water in agriculture (3) Water and soil quality, protection soil from erosion EMFF: (1) Environmentally sustainable fisheries (2) Eco-innovation (3) Aquaculture (protection of environment) (4) Better compliance with CFP (5) production (sustainable sourcing, environmental friendly methods)	• Incomplete or unenforceable property rights; • Externalities, public goods; • Information asymmetry; • Limited access to finance; • Transaction costs.	MF/SI	• Soft loans for infrastructure partly covered by customer fees; • Soft loans for UD projects; • Guarantees or soft loans for investments in improving water efficiency; • Grant/Loan combination; • Quasi equity/Mezzanine finance; • Subordinated loans.

Thematic Objective	Typical key actions	Typical market problems	MF/SI[29]	Examples for FIs
Promoting sustainable transport and removing bottlenecks in key network infrastructures	ERDF and the Cohesion Fund: (1) Core TEN-T infrastructure (2) Core TEN-T railway infrastructure (3) Pricing and charging systems (4) Integrated, sustainable and accessible urban mobility concepts (5) Environmentally friendly inland water transportation	• Public goods; • Negative externalities (polluter pays principle – not enforced by market).	MF	• Loans for infrastructure partly covered by toll and/or charges;
Promoting employment and supporting labour mobility	ESF: (1) Access to employment for job seekers and inactive people (2) Integration of young people into the labour market (3) Self-employment, entrepreneurship and business creation (4) Equality between men and women, reconciliation between work and private life (5) Adaption of workers, enterprises and entrepreneurs to change (6) Active and healthy ageing (7) Strengthening of labour market institutions ERDF: (1) Business incubators, investment support for self-employment and business creation (2) Modernisation of public employment services EAFRD: (1) Diversification of the agricultural sector, creating new small enterprises and other forms of job creation in rural areas	• Information asymmetry; • Limited access to finance; • Transaction costs; • Incomplete markets (underproduction of merit goods).	MF	• Microfinance, micro-loan (self-employment, business creation); • Guarantees or soft loans. subordinated loans, loans without collateral requirements, grant/loan combination; • Microfinance, micro-loan (self-employment, business creation);

Thematic Objective	Typical key actions	Typical market problems	MF/SI[29]	Examples for FIs
Promoting employment and supporting labour mobility	EMFF: (1) Long life learning in fisheries and aquaculture (2) Job creation in fisheries communities (3) Diversification in fisheries communities		MF	• Guarantees or soft loans, subordinated loans, loans without collateral requirements, grant/loan combination.
Promoting social inclusion and combating poverty	ESF: (1) Active inclusion (2) Integration of marginalised communities (3) Combating discrimination (4) Access to high quality services of general interest and health care (5) Promoting social enterprises (6) CLLD strategies ERDF: (1) Health and social infrastructure (2) Improvement of health systems (3) Shift from institutional to community-based care (4) Childcare, elderly care and long-term care (5) Physical and economic regeneration of deprived urban and rural communities (6) Social enterprises (7) Remove/Prevent accessibility barriers (8) CLLD strategies EAFRD: (1) CLLD strategies EMFF (1) Sustainable development of fisheries areas	• Exclusion, inequality; • Information asymmetry; • Limited access to finance; • Transaction costs • Incomplete or unenforceable property rights; • Externalities, public goods.	MF	• Microfinance, micro-loan (self-employment, business creation); • Guarantees or soft loans. subordinated loans, loans without collateral requirements, grant/loan combination (social enterprises); • Soft loans for infrastructure partly covered by customer fees; • Grant/loan combination; • Microfinance; • Soft loans with long tenors for social housing.

Thematic Objective	Typical key actions	Typical market problems	MF/SI[29]	Examples for FIs
Investing in education, skill and lifelong learning by developing education and training service	ESF: (1) Reducing early school leaving, equal access to good-quality education (2) Improving quality, efficiency and openness of tertiary and equivalent education (3) Enhancing access to lifelong learning, upgrading skills and competences of the workforce, increasing labour market relevance of education and training systems ERDF: (1) Investments in education and training infrastructure EAFRD: (1) Fostering lifelong learning and vocational training	• Under provision of merit goods and public goods.	MF	• Student loans (soft loans).
Enhancing institutional capacity and an efficient public administration	ESF: (1) Reforms, good governance (2) Capacity building for stakeholders ERDF: (1) Strengthening institutional capacity and efficiency of public administration and public services	• Public good (missing markets).	MF	

Thematic Objective	Typical key actions	Typical market problems	MF/SI[29]	Examples for FIs
Financial instruments for urban and territorial development UD[30]	CPR: (1) Innovative action for UD (e.g. €0.33bn allocation) (2) Innovative strategies for UD and territorial investment (3) Urban development and urban regeneration (4) UD or territorial strategy, under more than one priority axis/OP it may be implemented as ITI (5) CLLD carried out through integrated and multi-sector, area-based local development strategies	• Public space (missing market, no excludability); • Exclusion, inequality Public good (missing markets, sustainability).	MF	• Dependent from governance structure equity or loans; • Equity for redevelopment projects with high sunk costs; • Soft loans with long tenors.

30 *This is not a Thematic Objective but it refers to specific Programmes for Urban Development and is also addressed in one of the specific methodologies (Volume V).*

3.2 Establishing the evidence of market failure and suboptimal investment situations

As a first premise, it should be noted that there is no 'one size fits all' approach to assess the existence of market failures. For instance, investments in some segments or sectors are driven by changes in market conditions, while others are mainly driven by the evolution of the regulatory framework. In addition, the assessment of mature markets can rely much more on experiences collected over the years than the assessment of nascent markets. As a result, the elements to be included in the analysis vary depending on the Thematic Objective tackled by the FI. The specific methodologies will present these elements in more detail.

As discussed in the previous sections of this chapter, the aim of this analysis is the calculation of the **investment gap** i.e. the imbalance between supply and demand for investment in the sector or market segment under consideration.

3.2.1 Demand analysis

Estimating the potential demand for investment in the specific sector or market segment to be targeted by the FI can prove challenging, mainly due to data availability and quality issues. Assessing the level of demand targeted by the envisaged FI could imply analysing:

- The level of financing needed per potential final recipient or the volume of financing needed for the envisaged objective;
- The potential number of applications for funding under the envisaged FI or the potential number of projects needed to achieve the envisaged objective.

The latter aspect appears to be particularly complex to assess since it will have to focus on unmet demand, which, by definition, can be difficult to accurately capture. The following elements need to be taken into account, where **access to finance (financing gap)** seems to be an issue and is envisaged as the focus of the FI:

- **Rejected transactions**, the cases in which the public or private finance provider decided to not make an offer to the applicant as well as those in which the offer was rejected by the applicant for various reasons, for instance high cost;
- **Lack of applications**, the cases in which the potential final recipient did not apply for financing because he or she considered that the chances of obtaining it were too limited. As this component includes perception factors and is linked to issues of financial exclusion, a quantitative measurement is not always considered and data may not be available. The lack of information may contribute to the lack of applications as well.

It is important to investigate the underlying reasons for rejected transactions. Transactions may have been cancelled due to several factors, such as insufficient incentives, low profitability or high risk linked to the potential recipients[31]. The issue of low profitability and high risk are important as they signal the presence of a viability gap of the firms or projects seeking financing.

On the other hand there is a certain share of the rejected applications which should not be considered as a market failure. For instance, if either the underlying business model or the company applying for funding present significant weaknesses, the finance provider will most likely reject the application, according to the principles of sound financial management.

Transactions rejected for these reasons should not be considered as a sign of market failure, since, as it has already been argued, the FI should only foster the development of high quality projects.

It would be useful to collect additional information concerning the reasons behind rejected transactions as this may help to either better design the FI *(please refer to chapter 7)*, better determine the value added *(please refer to chapter 4)* or better address potential partners for additional private contributions *(please refer to chapter 5)*. Even if the data quality only allowed determining the order of magnitude, this might be helpful. Many state-of-the-art surveys give only indirect figures for this share of the unsatisfied demand. Please refer to Appendix C for a brief illustrative example of such a survey.

One way of accessing this information would be through specific surveys, which may have been carried out in the past. Alternatively it is possible to consider relevant proxies, such as the average rejection rate of the financial sector due to non-sustainable business models. The needed information may also be found in past experiences of FI set up in the same or in related economic sectors.

Against this background, the unsatisfied demand and the level of market failure can be computed as the difference between supply and demand, which is not due to inadequacy of the final recipient or of its business model.

3.2.2 Supply analysis

The demand analysis described above needs to be complemented by an inventory of the available supply of financing for the specific sector or market segment to be targeted by the FI. This should include:

- A description of the public and private finance providers active on the market (this should also include grants targeting the same sector and the existing FEI co-financed from SF which are generating revolving funds);

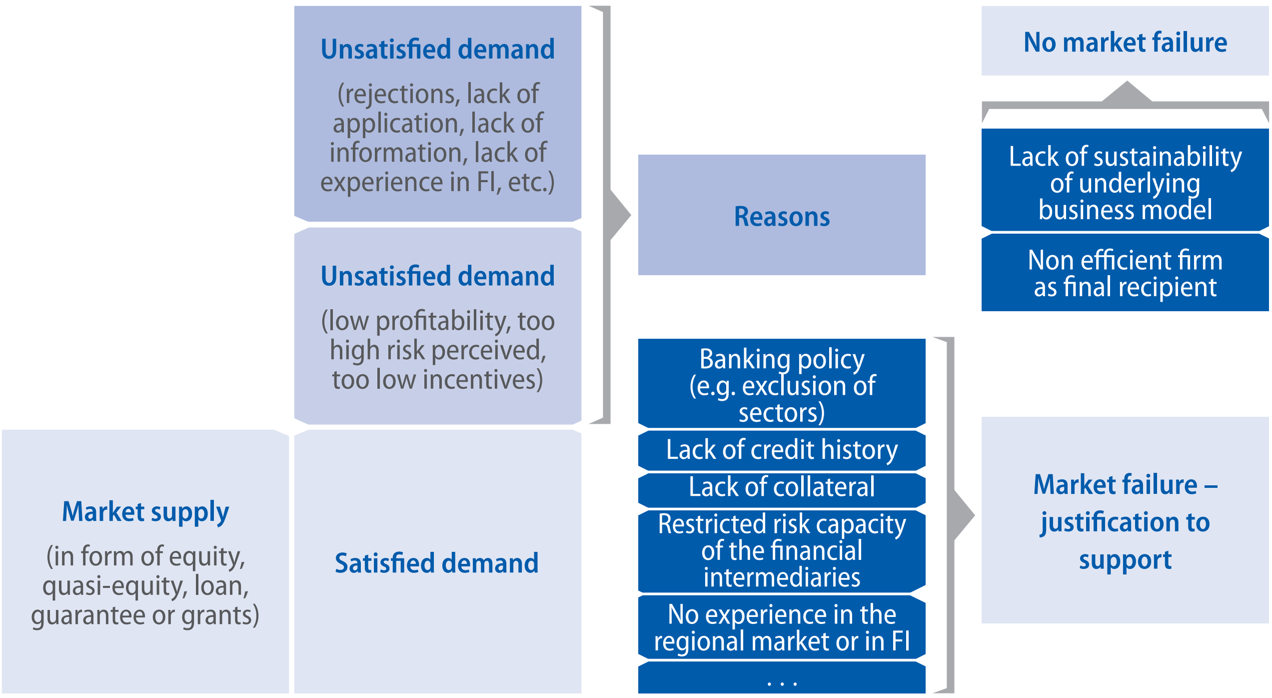
31 *It is very difficult to provide an exhaustive inventory of the reasons why a transaction may have been cancelled and MA need to understand that this analysis needs to be performed on a case-by-case basis.*

- An evaluation of the possible re-use of future resources paid back to the financial instrument for which the ex-ante assessment is carried out. This will be especially relevant in the situation where the long-term investment needs identified can be addressed by short-term financial products. The possibility of reusing resources paid back should be reflected in the analysis of investment needs and in the investment strategy.
- Types of financial products provided by the different actors;
- Targeted final recipients.

Most statistical data show the successful transactions only, which are equal to the satisfied demand where projects where realised. As statistical data are not always complete, corrections might apply (e.g. private financing, informal financing). A supply component beyond realised successful transactions may be relevant where promotional offers in the past were not fully utilised. This information should be easier to collect compared to demand data, since MAs should have information on the utilisation rate of FIs or other support schemes set up in the past[32].

Combining the results of demand and supply analysis will facilitate the quantification of the existing market failure and the investment gap to be covered by the envisaged FI, as shown in Figure 6 below.

Figure 6: Calculation of unsatisfied demand and estimation of the level of market failure



Finally, since, as stated above, suboptimal investment situations are considered as a specific type of market failure, it is important to highlight the specificities of the assessment of the investment gap in such cases. This analysis can be carried out as follows:

32 *More specific operational details are provided in the other volumes of this methodological guidance.*

- Identification of a quantitative EU/national/regional objective and of the level of investment required to reach it[33];
- Trend analysis of the existing investment volumes, including already existing promotional schemes at all levels (if any);
- Calculation of the investment gap as the difference between the level of investment required to reach the target and the current level.

Based on experience, a rather robust assessment can be made in respect of the contribution to a common objective, the incentive effect and the accuracy of support and proportionality of the support scheme (aid limited to the minimum). However, further analyses are needed in respect of:

- The distribution of tasks and responsibilities between the different levels of intervention in a coordinated way, where it is evident that only a part will be addressed with EU support;
- The absorption capacity for support, including the industrial capacities and, to the extent necessary, the capacities of the financial sector as well;
- The interaction between 'push factors' due to legal obligations and 'pull factors' due to promotion and incentives, where one would expect a policy mix to deliver the objective in the best way.

3.2.3 Operational tools

Considering the difficulties of the task, the analysis of the investment gap will need to take advantage of several tools and to gather information coming from different sources, as shown in Figure 7.

Literature review and data gathering consist of collection of all existing information, which enables to assess and quantify market failure in the specific sector or segment under consideration.

Potential data sources include:

- Evaluations of the experience collected in the past;
- Statistical data published by official institutions, associations and stakeholders;
- Publications from scientific institutions, universities and think tanks;
- Research publications from banks, rating agencies, central banks and insurance companies.

This is not an exhaustive list since data availability and quality varies across countries and regions. It may also vary according to the characteristics of the envisaged FI.

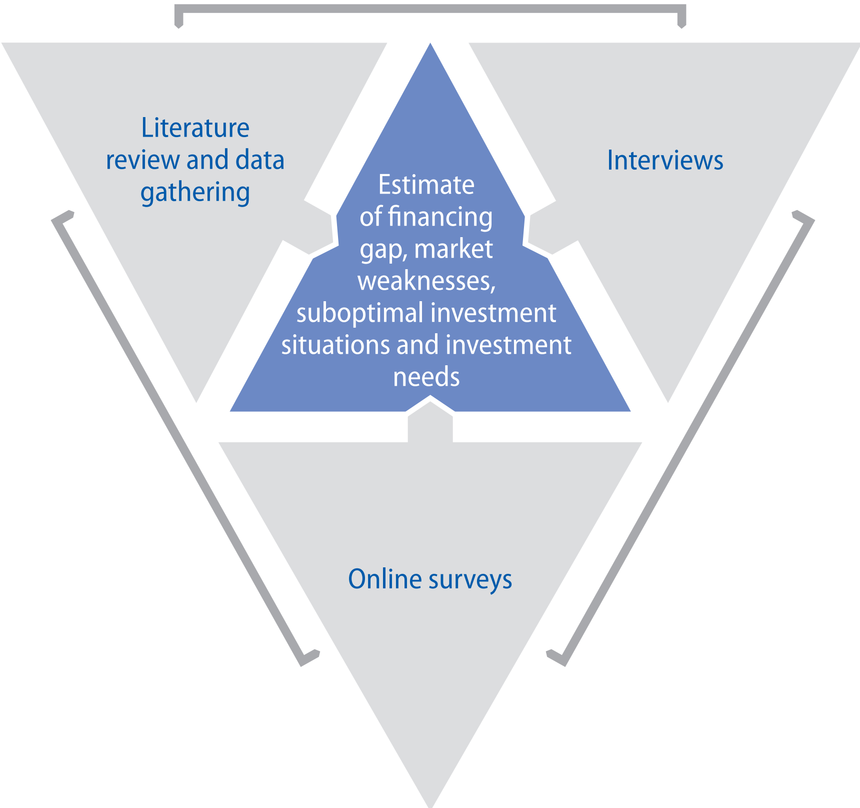
33 *As an example, let us consider the case of a quantitative (EU, national and regional) objective to increase the share of total energy consumption coming from renewable energy by a certain percentage and over a defined period of time. In this case, the MA would most probably already have an estimate of the cost of achieving the target and, as a result, the level of investment needed.*

Interviews are often an important tool where qualitative considerations are an essential dimension of the analysis. Interviews may also be an appropriate tool to understand the content of new policy and new policy objectives, as written proposals may still be subject to changes, during the discussion and decision-making process.

Surveys may also provide high-quality indicators for empirical facts, provided that they are carried out over an appropriate period of time and that the survey sample is representative. Several public and private actors, at the EU, national and regional level, may already produce relevant surveys from which information can be retrieved. However, should no survey and insufficient statistical data be available, a dedicated survey could be developed for the purposes of the ex-ante assessment. Surveys can be administered in several ways, for instance online, over the telephone or through a written questionnaire[34].

Each of these tools may be more or less suitable and applicable depending on the characteristics of the envisaged FI. Their use will be presented in more detail in the specific methodologies.

Figure 7: Triangulation of information to establish evidence of market failure and estimate investment gap



34 *Surveys need to be tailored to the specific characteristics of the sector in which the FI is to be set up. However, the SME specific methodology provides an example of such survey.*

As already mentioned in Chapter 1, sometimes even with careful preparation not all information needed will be available in the ex-ante assessment phase. As a result, data collection will be an iterative process, combining the different sources of information, to achieve an educated guess or expert's judgement.

3.3 Assessing market failures: two practical examples

3.3.1 Example 1: financial instrument targeting SMEs

The supply and demand analysis for an FI targeting SMEs needs to factor in the large number of actors operating on the market as well as existing previous experience in setting up FIs, either at the national or regional level. The analysis of the investment gap can be implemented through the following steps:

1. Analysis of past **experience**, for instance in the previous multiannual financial framework (MFF) or over the last three or five years[35], and the prevailing trends. Where such an experience is available, it is a powerful instrument to assess market failure. The data base tends to be rather good, the analysis of the existing support schemes, including non-EU and non-FI schemes, as well as their outcome, provide strong evidence of the presence of a market failure and its evolution over time. However, it has to be taken into account that the initial scope and depth of the market failure could have been reduced by past public support.

2. Assessment of the **weaknesses of the relevant market segment**. In the financial sector, most of the statistics refer only to successful transactions. Unsuccessful transactions are not part of the statistics and have to be assessed with a model or with surveys.[36] Three components of **unrealised demand** should be estimated with the survey:
   - Rejected transactions showing the unmet demand (if possible including the reasons for the rejection);
   - Suppressed demand;
   - Stimulated demand where additional transactions could have taken place with new or more active partners in the market, but they were not signed due to a perceived high risk, low incentives or low profitability.

All three components contribute directly to the **financial gap**.

An example for such a survey in the whole euro zone is provided in Appendix C. Such surveys are often available only at an aggregate level, e.g. at the national level, thus not being sufficiently

35 A longer time span might be considered appropriate in case pre-crisis data would add helpful information.

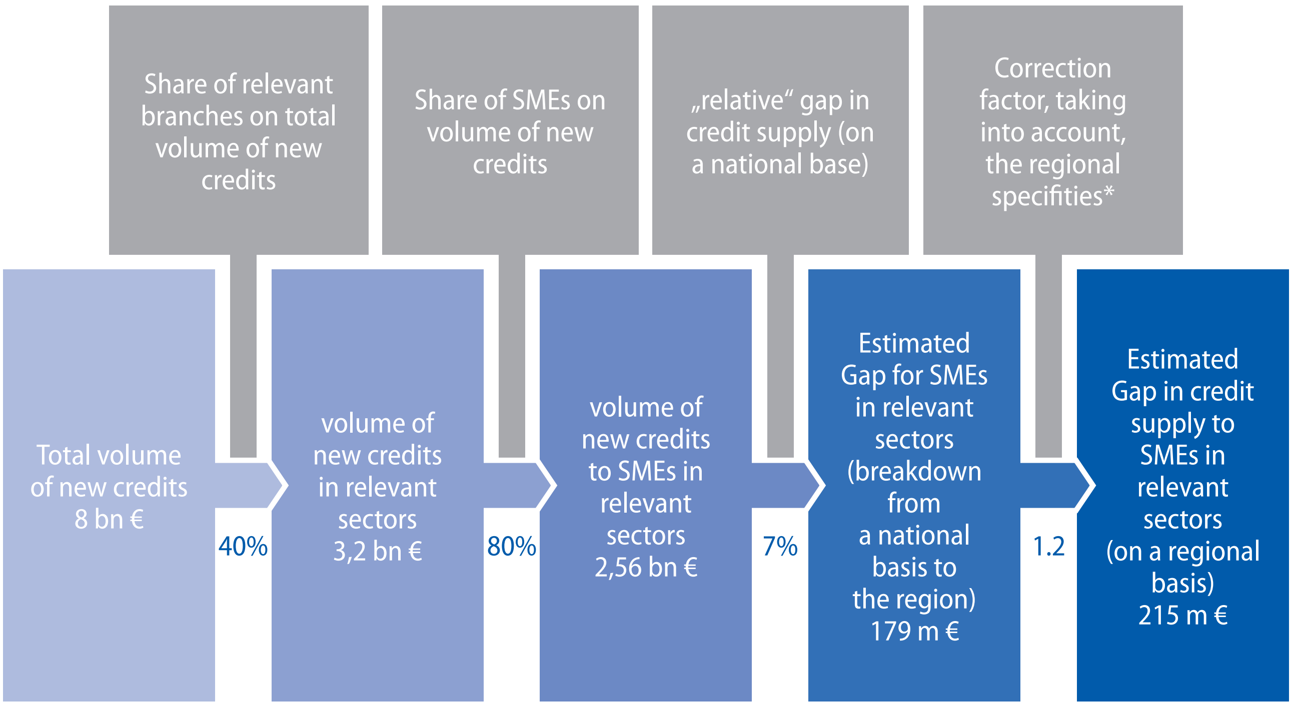
36 The estimate of unsatisfied potential demand addresses the financing gap directly. Other methods estimate the supply and the demand seperately, and the financing gap is estimated indirectly as the difference of the two. All methods have some advantages and disadvantages.

detailed to provide meaningful information at the regional level. Often a breakdown of national data to a region implies poorer quality, the need of correction factors and significant delay. The results of such estimation should go through a quality check by experts[37] or through a plausibility check with a comparison with other (comparable) regions. Correction factors may be the result of quality check. The conduct of a similar survey at regional level could also be considered.

Let us consider the case of an ex-ante assessment for an FI targeting SMEs to be set up at the regional level, where no regional data are available. National data showed a gap in credit supply of 7%.

Taking into account the lower level economic development of the region with respect to the national average as well as the weaknesses of specific sectors, correction factors are estimated by experts, as shown in Figure 8 below.

Figure 8: Breakdown of national data to estimate a regional investment gap for SMEs



* e.g. the share of sectors with poorer access to finance might be larger in the considered region compared to the national level

Source: PwC

37 *This could be a group of regional experts where the breakdown of national data may require some correction factors.*

Having identified the existence and the level of a financial gap, it has to be assessed whether or not the gap should be addressed by an ESIF support scheme or by other means, including non-financial support, and whether an FI could deliver the objective (**needs assessment**). The ex-ante evaluation of the Programme under which the FI is to be established should already encompass this aspect. The need assessment could also be addressed by questionnaires to experts, target groups or relevant stakeholders[38]. Based on such an assessment, the evidence of market failure is either established or not.

3.3.2 Example 2: financial instrument targeting sustainable urban development

In the specific case of FI targeting sustainable urban development relevant experience on market failure analysis or suboptimal investment situation already exists, in particular through the JESSICA initiative[39]. More precisely, the various JESSICA Evaluation studies carried out prior to the setting up of Urban Development Funds (UDFs) represent a useful source of information. Based on these experiences the assessment of market failure and suboptimal investment situations can be summarised as follows:

1. Overview of the relevant Programme(s) and the corresponding priorities in order to ensure consistency of the new FI.

2. Assessment of the current situation in terms of socio-economic and demographic conditions and the characteristics of the urban territorial systems under consideration.

3. Assessment of the main challenges of the considered territory and of potential projects to be financed (e.g. regeneration of degraded areas, urban brownfield sites, housing supply, energy efficiency, sustainable mobility, etc.).

4. Assessment of the potential projects to be financed and of the corresponding investment needs. If a funding gap is identified the underlying reasons should be analysed. Experience showed in the past that a viability gap was found in urban development projects in different project sizes and different sectors of the urban development.

5. Assessment of the potential appetite of the private sector for financially viable projects in the identified fields.

6. Analysis of public funding available for these projects and, in particular, past use of Structural and Cohesion Fund resources. If support schemes (grants, interest rate subsidies or FIs)

38 Stakeholders could be ESCOS and energy agencies for support schemes to improve energy efficiency, or chambers of commerce and universities for schemes to boost innovation.

39 Joint European Support for Sustainable Investment in City Areas (MFF 2007 – 2013).

are already in place, there is high likelihood of the existence of a market failure. However, the ex-ante assessment should analyse the need for an additional FI. MAs can take advantage of own experiences or analyses of good practices and successful examples of the envisaged investments from other regions or countries.

7. If a funding gap is identified, the quantification of the investment needs and description of the envisaged investments enabled by the FI should take into account that the possible size of the support scheme may need to be lower than the investment need, due to limited absorption capacity.

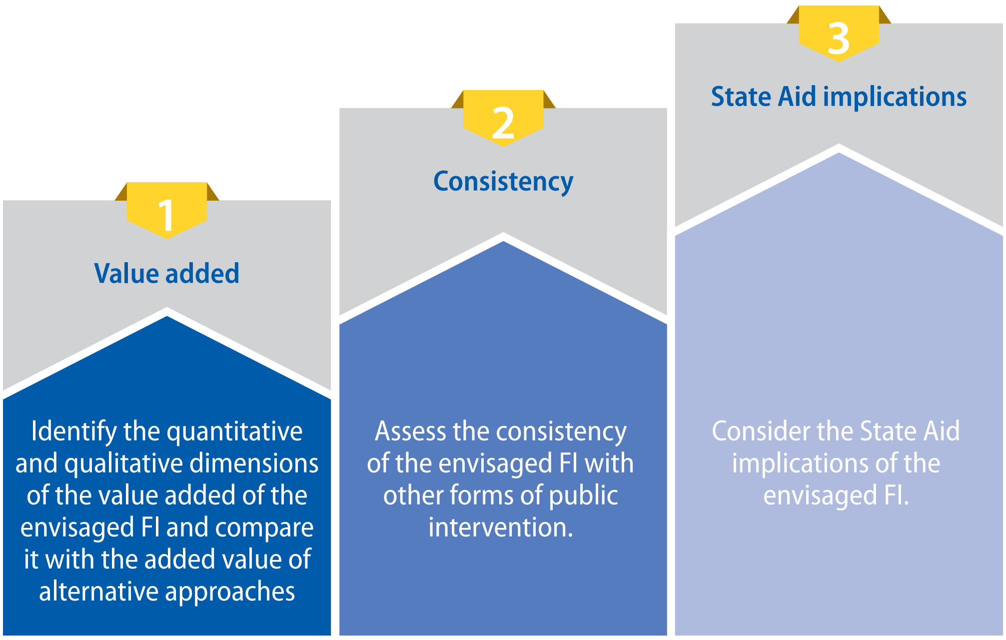
The results of the market failure and suboptimal investment assessment allow the quantification of the investment gap and thus the estimation of the amount of support to be provided by the envisaged FI.

4. Assessment of the value added of the financial instrument

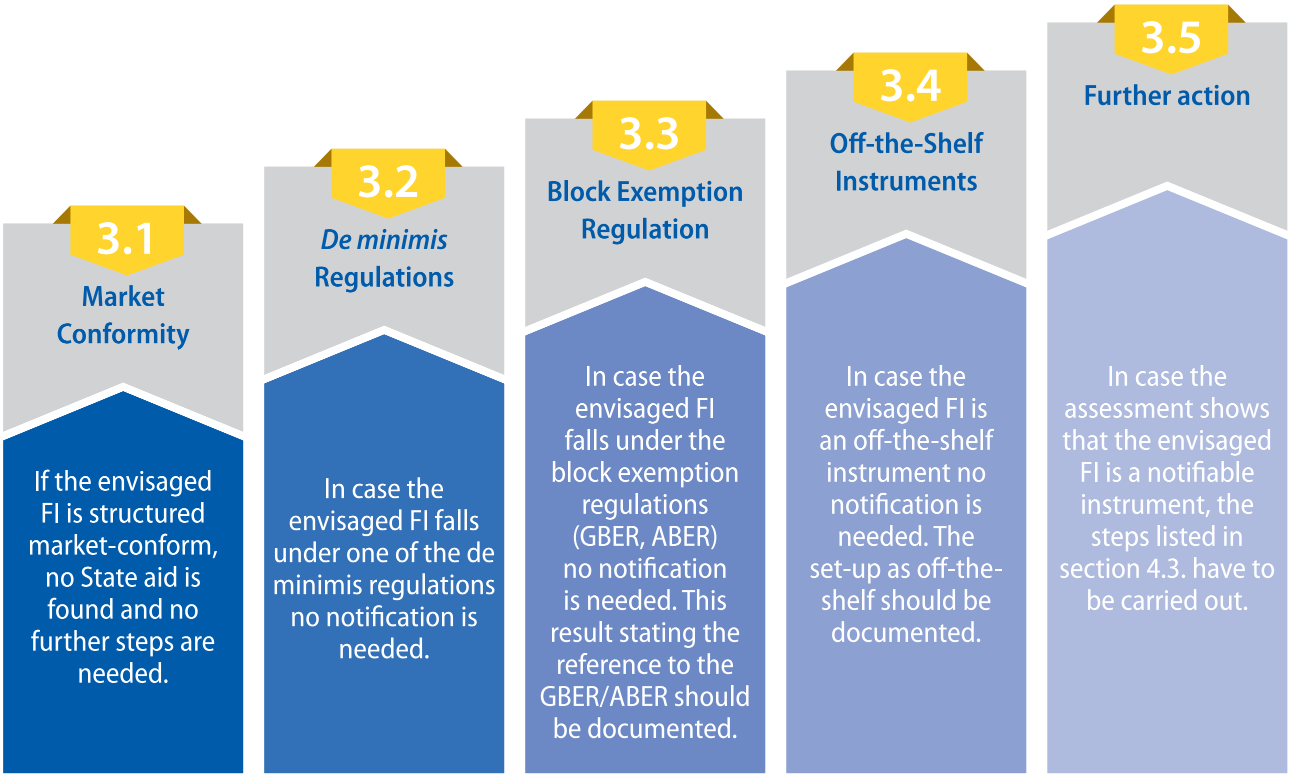
After having identified the presence of market failure or suboptimal investment situations that justify public intervention and quantified the amount of support needed, the ex-ante assessment has to justify the value added of the envisaged FI.

In accordance with Article 37 (2) (b) CPR, this chapter will focus on value added of the FI considered, the consistency with other forms of public intervention in the same market, possible State aid implications, the proportionality of the envisaged FI and measures to minimise market distortion, the last two elements being two important elements of the State aid assessment.

Main steps of this chapter



The consideration of State aid implications (step 3) can be further subdivided into 5 additional steps.



4.1 Analysing quantitative and qualitative dimensions of the value added for the financial instrument

It is important to stress the fact that the objective to be pursued by the envisaged FI could be achieved in several ways. The ex-ante assessment should compare different possible ways to achieve the objective, in particular as different types of support are concerned. The objective should be delivered in the most **efficient and effective** way, taking into account the synergies created.

4.1.1 Quantitative dimension

As a first step, the ex-ante assessment should analyse the **quantitative** dimension of the value added by the envisaged FI. This analysis has to examine:

- The leverage of the EU (i.e. ESIF) contribution of additional contributions to the investment at all levels down to the final recipient. The higher the leverage achieved by the FI the higher its value added;[40]

40 *Leverage is explained more in detail in chapter 5As the additional public and private resources are mentioned in Art. 37 (2) (c) explicitly, which form for their part the leverage, see for further description there.*

- The intensity of subsidy of the FI, which may be quantified in addition to the qualitative consideration (see below) of non-distorting the competition. The quantification helps to rank different options. The lower the intensity for a given project or group of projects the higher the value added;
- The revolving effect allowing the recycling of funds;
- Additional contributions coming from the final recipients, since these are excluded from the calculation of leverage.

The analysis of the value added implies comparing the envisaged FI with other FIs, with grants or with other possible support mechanisms. Leverage represents one component of the quantitative value added and it assesses primarily the non-EU financial contributions by third parties during the first investment process. An appropriate method to calculate the quantitative value added compares the NPV of the FI with the investment. Leverage[41] is calculated in nominal terms, taking into account all contributions to the final recipient, (excluding financing coming from the final recipient), and focussing on the first cycle of investment (since with a revolving instrument there can be multiple investment cycles).

According to the Financial Regulation, support schemes for interest rate subsidy and for guarantee fee subsidies alone are considered as grant mechanisms. FIs, grants including fixed interest rate subsidies, other financial support mechanism such as tax-reductions can be compared by taking into account the investment volume and the element of subsidy in NPV terms.

Box 2 and Box 3 provide an illustrative example of the calculation of the quantitative dimension of the value added of an FI. The example is encompasses the following steps:

- A comparison with a grant approach, since a grant regime may already be in place as legacy or could be used as reference. The grant scheme has different patterns for the same type of projects in the different regions across the EU;
- A comparison with an fixed interest rate subsidy scheme, which is treated by the Financial Regulation as grant support;
- A comparison with a loan scheme, where the liquidity of the financial support stems from the ESI Funds; and
- In a fourth step a quantitative consideration of the value added is made to show the quantitative impact of future revolving. Such a calculation supports the qualitative consideration that revolving supports policy implementation in the future.

Some of the calculations are shown more in detail in Appendix D. The illustrative example is presented in a way that the quantitative argument only doesn't give preference for a revolving instru-

41 *According to the Financial Regulation, the leverage of EU funds shall be equal to the amount of finance to final recipients divided by the amount of the EU contribution.*

ment, but the combination of quantitative and qualitative value added results in a preference for the revolving instrument. Moreover, please note that this illustrative example does not take into account State aid rules limitations in terms of aid intensity (for more details on this issue please refer to section 4.3).

Box 2: Illustrative example of the link between the quantitative dimension of value added and the co-financing structure

Example: Quantitative value added and co-financing of a regional grant scheme

Let us assume that a project having a total cost of € 2.0m is co-financed by a regional grant scheme encompassing an ESIF contribution. ESIF financing and regional co-financing covers € 1.6 m. The ESIF maximum co-financing rate depends on the region in which the scheme is established. The € 0.4 m not covered by the ESIF intervention and the regional co-financing could be non-eligible parts of the investment where other sources of public or private financing are mobilised.

Let us consider three possible scenarios:

- **Scenario 1: The FI is compared with a grant support scheme set up in a developed region.**
  ESIF resources support 50% of the eligible cost and national or regional budgets cover the remaining 50%. This means that with € 0.8 m ESIF resources a total investment of € 2.0 m can be realised. As a result, the leverage achieved by the EU contribution is 2.5.

- **Scenario 2: The FI is compared with a grant support scheme set up in a transition region.**
  ESIF resources support 60% of the eligible cost of € 0.96 m and national or regional budgets cover the remaining 40%. The leverage achieved by the EU contribution is 2.1.

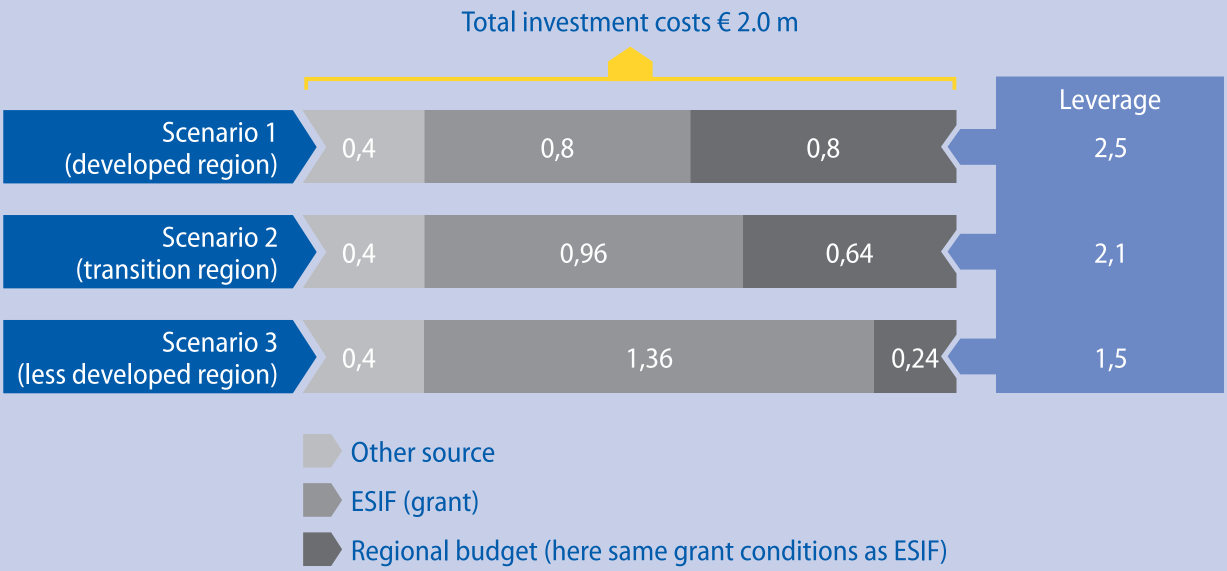
- **Scenario 3: The FI is compared with a grant support scheme set up in a less developed region.**
  ESIF support 85% of the eligible cost of € 1.36 m while national and region budgets cover the remaining 15%. The leverage achieved by the EU contribution goes down to 1.5.

In case the financing of the other 20% of € 0.4 m is provided by commercial loans or other external sources the leverage equals the value added[42]. It is important to see that the quan-

42 *If the € 0.4 m is provided by the final recipient the leverage is lower the value added and it is reduced to 2, 1.67 and 1.18 in the different scenarios described in Box 2.*

titative value added is not changed by the composition of the other sources of financing. In case the other 20% would be contributed by the final recipient the quantitative value added remains, the leverage (see chapter 5 below) would be lower. Figure 9 below shows the comparison of these three scenarios.

Figure 9: Quantitative value added/Leverage and co-financing



The determination of the quantitative value added is an essential component to prepare the State aid assessment and provide evidence of the proportionality of the aid granted. As a result this analysis should pursue the minimum NPV.

The NPV calculation may also allow for a quantitative consideration complementing the argument of the benefit of the recycling of funding due to the revolving nature of FIs, as shown in Box 3.

Box 3: Quantitative value added for different types of soft loans

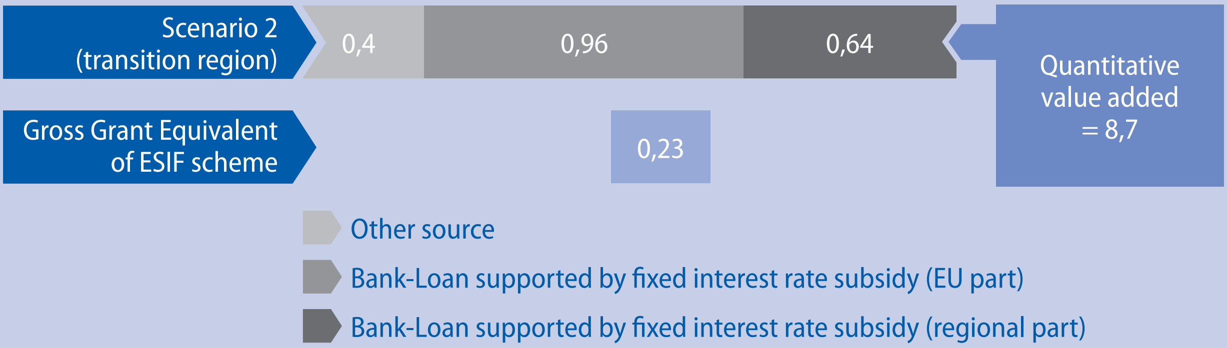
Example: The FI is compared with a fixed interest rate subsidy scheme (soft loan scheme in a transition region)

Hypotheses:

- Total project cost = € 2.0 m;
- Eligible cost = € 1.6 m.

The NPV is calculated as the sum of discounted cash flows generated by the envisaged FI throughout its lifetime. Let us consider the case where, instead of a grant as described in the previous example, the MA decides to set up a fixed 5% interest rate subsidy from ESIF for a 10-year loan of an intermediary bank[43] and to cover 60% the eligible cost[44]. The loan volume is € 0.96 m, the intensity of subsidy from ESIF amounts to 24% of the value of the loan, resulting in a GGE 0f € 0.23 m only. This means that with a contribution of € 0.23 m from ESIF resources, a total investment of € 2.0 m can be realised. As a result, the quantified value added of the EU contribution in NPV terms is 8.7, as shown in Figure 10 below.

Figure 10: Quantitative value added as the interest rate subsidy of a 10-year loan co-financed through ESIF resources (5% discount rate and proportional repayment)



In a case where the financing of the other components of the investment comes from banks or other external sources the leverage equals the quantified value added.

This grant support of a loan is now compared with a loan given with the same financial parameters from the ESI Funds as revolving instrument to the final recipient. For the final recipients the support is the same in financial terms.

Figure 11: Comparable support by a loan from ESI Funds (quantitative value added)

43 *For the avoidance of doubt: the loan of the intermediary bank is a non ESIF loan.*

44 *Please note that State Aid issues are not considered in this example. – However the subsidy element for the different years in this illustrative example can be found in Appendix D.*

Here, € 0.96 m has to be taken from the ESI Funds, the quantitative value added is 2.1, taking into account exclusively the first investment cycle without any revolving effect. In the case where the financing of the other components of the investment comes from external sources and is provided neither by the final recipient nor as grant to the final recipient the leverage has the same value as the quantitative value added, i.e. 2.1.[45]

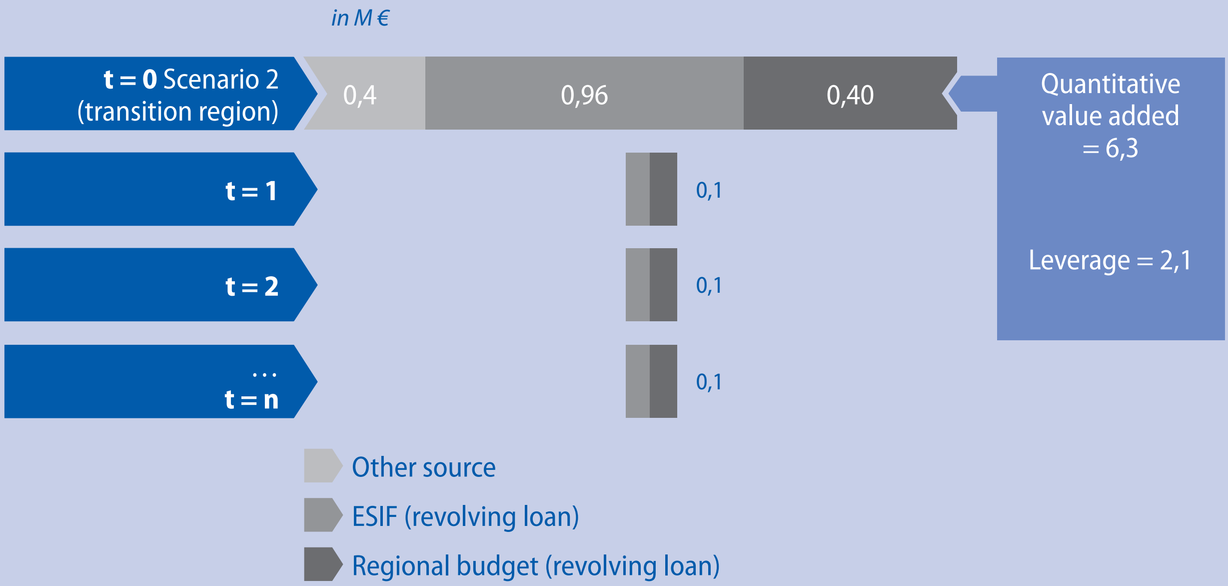
The investment triggered by the whole support scheme seems at the first glance very much different for the interest rate subsidy (by ESIF) by comparison to the loan expenditure (by ESIF). For this illustrative case the triggered volume with the first approach is more than 4 times as high as the investment volume with the second approach. It must be noted that the following qualitative arguments are also in evidence and should be brought into the assessment to support the second approach: (i) lending capacity to finance Cohesion Policy related investments by the banks or other financial intermediaries is a prerequisite (the assessment of market gap may conclude that there is no such a capacity) and (ii) revolving is itself a value added of FIs as compared to grants, especially as revolving ESI funds must be reused in line with the objectives of the programme.

However, it is useful to support these qualitative arguments with a quantitative calculation of the value added (leverage remains unchanged). The quantitative calculation of the value added can be computed in NPV terms, the recycling of the proportional repayments of 10% of the loan each year results in a present value of annuity of 200% of the face value of the loan. As a consequence, the quantified value added is much higher than in the case of a grant (2.1) and of the ESIF loan described above (2.1) with the result (2.1 * 3 = 6.3).[46] If we compare the quantitative value added of 6.3 with the leverage we see that the leverage in case of the loan remains at 2.1, as shown in Figure 12.

45 *In terms of leverage there is no difference between a grant support or a loan support, as face values are considered.*

46 *In the illustrative example the yearly repayment of € 96,000.00 is re-invested directly due to the revolving character of the loan. This is taken into account by a perpetual annuity: W0 = R (= constant payment) / i (= discount rate) and results in € 1,920,000.00 (= € 96,000.00 / 0.05). Beside the quantitative value added in the above mentioned base case (2.1) there is an additional component of the quantitative value added concerning the revolving character of the loan. Due to the re-investment of the repayments there is a future investment volume of € 1,920,000.00 in NPV terms, which is twice of the origin amount of the ESIF part of the loan (€ 960,000.00). The total quantitative value added factor is 3 * 2.1, that means 6.3 in total.*

Figure 12: Quantitative value added generated by a revolving loan from ESI Funds



In our illustrative example the calculation of the quantified value added generating by a revolving loan delivers a strong argument. When looking exclusively at the leverage the difference between the interest rate subsidy and the revolving instrument looks significant. When considering the calculation of the quantitative value added the ratio turns out to be rather small (8.7/6.3 as the ratio in terms of quantitative value added instead of 8.7/2.1 as the ratio in terms of leverage), showing a much more realistic picture. In addition as the qualitative dimension (see below) delivers additional added value for a FI, the final decision for a positive assessment of the FI in comparison with other support schemes can be made on a realistic analysis.[47] It is important to recognise that there may be cases where the quantitative component already delivers a clear result in favour of a grant option, a revolving instrument or a combination of both. Nevertheless, a sound conclusion can only be reached by combining the assessment of the quantitative and the qualitative value added.

47 E.g. creating a permanent investment capacity, supporting the lending capacity of the regional financial sector.

The specific **quantitative** dimension of the value added of loans, guarantees and other bankable instruments lies in the area where lower intensities of support are possible and the objective is still delivered.

4.1.2 Qualitative dimension

After the quantitative dimension has been addressed, the ex-ante assessment should identify the **qualitative** value added of the envisaged FI. Examples of qualitative categories of the value added include:

- Providing a financial product which exactly matches the market gap without distorting the competition;
- Developing a new financial product type through the form of the envisaged FI that has not been provided previously (e.g. microcredit);
- Supporting the building of or strengthening of the capacity of a sector, e.g. a nascent urban development fund sector;
- Giving preference to an FI which provides liquidity in the form of pre-financing of investment;
- Giving preference to a revolving long-term support scheme. This could be desirable for objectives such as seed support for SMEs, because the future generation of SMEs should also have the opportunity to be supported. More general: in sectors where issues such as access to finance or inequality and social inclusion are addressed, a revolving fund may be useful as new recipients might be supported in the future, since, although they do not meet eligibility requirements at the time when the FI is launched, they may meet them in the future. In sectors where project preparation takes a longer lead time, a predictable long-term offer of FI investments may increase significantly the efficiency of the projects such as a loan scheme for innovation. A long-term offer might be of specific value for those firms which cannot plan a steady flow of innovation projects but follow rather volatile cycles defined by technical opportunities[48];
- Overcoming a specific market failure (e.g. lending capacity of the financial sector, which gives preference to a specific group of support schemes);
- Attract additional sources of expertise and know-how in delivering support to final recipients;
- The FI contribution to the implementation of the objectives of a Programme. A trade-off between achieving policy objectives and maximising leverage may exist. The need to respect a certain timing of the support schemes may also contribute to such a trade-off. As an example, reaching a higher leverage could imply a longer preparation time for higher performance of the programme. In addition, if an administrative system in a region is used to implement grant programmes, then the move to another system for FIs may cause frictions and slow down the achievement of the political priorities or the effectiveness of the results.

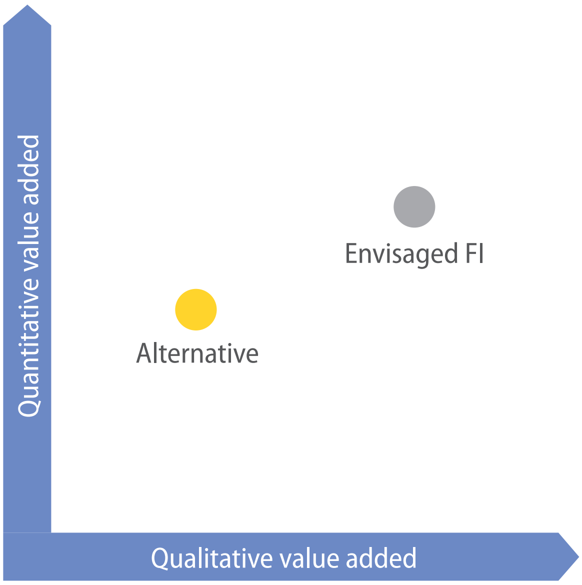
Further elements that could contribute to the qualitative dimension of the value added of an FI are described in the specific methodologies.

The selection of one FI over possible alternatives has to take into account both the quantitative and qualitative dimensions. The decision is strictly dependent on the time and geographical context in which the FI has to be established, since the levels of quantitative value added and/or leverage vary in the different regions of the EU reflecting different economic environments, differ-

48 *The MA assesses the FI, including the future planned for the FI. This allows the MA to go beyond the EU contribution and to take into account additional resources mobilised from different sources.*

ent co-financing regimes and different support schemes. Moreover, during periods of prosperity, higher quantitative values added than in periods of economic downturn can be expected. If the qualitative and the quantitative elements are brought together, the choice of the best combination of the two will depend on the weight given by the MA to these different elements.

Figure 13: Illustration of the value added of an envisaged FI compared with an alternative



All these considerations, including the resulting choice of the value added should find a clear statement in the **conclusions** according to Article 37 (2) CPR and being reflected in terms of quantitative objectives and indicators *(please refer to chapter 8)*.

The assessment of the value added has to be transformed into a proposed investment strategy *(please refer to chapter 7.2.1)*. As mentioned in the introduction, this might trigger an iterative process including checking again the value added following adaptions in the making of a proposed investment strategy.

4.2 Assessing the consistency with other forms of public intervention addressing the same market

Closely linked to the assessment of the value added is the need to ensure consistency with other forms of public interventions, including grants and interventions at other political levels.

The main assessment with respect to consistency is about conflicting elements or overlaps with other forms of public interventions in the very same market segment, including:

- Policy orientations and legislative/regulatory background, such as:

  - Laws enforcing the objective of the envisaged FI which may make the FI redundant;
  - Laws ruling out the objective of the FI;
- Fiscal interventions, such as:
  - Tax reductions or exemptions;
  - State transfers;
  - Transfers of the social security system[49].
- Other public financial interventions, such as:
  - Grant programmes;
  - Other FI;
  - Activities from other sources of budget and other levels of administration;
  - Support offered by MA from any existing revolving funds.

It may be impossible to completely eliminate any possible overlap. In this case the assessment should provide an explanation as well as a description of the measures taken to minimise them. The measures to minimise should be mentioned in the assessment. As overlaps imply duplication of work, the measures may result in reduced administrative costs for MAs and lower bureaucratic burden for final recipients.

On the other hand, some forms of combination of public interventions will deliberately intend to exploit the possible synergies among different FIs or among FIs and grant instruments (cf. Article 37 (7) of the CPR).

4.3 Identifying possible State aid implications

EU funds under shared management are considered part of the national or regional budgets and as such are subject to compliance with the State aid rules and potentially, to notification to DG Competition of the European Commission before its implementation can start.

This is different from Union funding centrally managed by the institutions, agencies, joint undertakings or other bodies of the Union, which is not directly or indirectly under the control of the Member States, and therefore does not constitute State aid. Where such Union funding is combined with State aid from national or regional budgets, only the latter will be considered for determining whether the notification thresholds and maximum aid amounts are respected, provided that the total amount of public funding granted in relation to the same eligible costs does not exceed the most favourable funding rate laid down in the applicable rules of Union law.

49 *E.g. subsidies for heating costs. – During the State aid assessment one takes tax reliefs into account when the break-even point for the investment is estimated.*

An early consideration of the compatibility with State aid requirements is recommended, since the design of the entire FI has to follow the detailed rules set out in the applicable State aid legal base. In view of the importance of the State aid compatibility of the FI, other sections of the ex-ante assessment beyond this chapter, such as the analysis of the market failure (chapter 3), the analysis of the additional public and private resources to be raised by the FI (chapter 5) and the proposed investment strategy of the FI (chapter 7), including the governance structure of the FI (section 7.3), are all important elements for the State aid assessment of the FI, and the State aid rules provide compatibility conditions for these elements.

It is important to assess the State aid implications of the planned FI upfront, i.e. at the very beginning of the design phase. This is because the applicable State aid compatibility legal base is relevant for the main parameters of the design of the FI, in particular as regards eligible undertakings, maximum amounts per beneficiary, the financial conditions attached to them, and the governance structure.

The need for the ex-ante assessment to consider State aid implications is mentioned several times in Article 37, in particular in (1), (2) (b), (5), and (7) of the CPR. More precisely, the ex-ante assessment shall provide evidence that the envisaged FI either:

- Is market-conform;
- Is covered by a *de minimis* Regulation (specific *de minimis* rules for primary production in agriculture and for fishery apply), which means that the support is presumed not to affect competition and trade between MS;
- Falls under a block exemption Regulation (GBER, ABER) which defines categories of State aid that are presumed to be compatible and hence are exempt from the notification requirement;
- Is exempt from notification procedures, if the envisaged FI is set up as an off-the-shelf instrument, since the design of such instruments ensure that they do not need to be notified to the Commission; or
- Amounts to State aid which is not exempted by a block exemption Regulation and hence requires a State aid notification under the appropriate State aid legal base and approval by the Commission before implementation so as to confirm the compatibility of the aid with the internal market.

Therefore, the design of the entire FI has to follow the detailed rules set out in the applicable State aid legal base.

Table 7: Main reference documents concerning State aid

Main sources and documents	Publication
Regulation (EU) No 1408/2013 of 18 Dec. 2013 on the application of Art. 107 and 108 of the TFEU to *de minimis* aid in the agriculture sector Regulation (EU) No 1407/2013 of 18 Dec. 2013 on the application of Art. 107 and 108 of the TFEU to *de minimis* aid Commission Regulation (EC) N° 875/2007 of 24.07.2007 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid in the fisheries sector or its successor Regulation	OJ L 352 of 24.12.2013, p. 9 OJ L 352 of 24.12.2013, p. 1. OJ L 193 of 25.07.2007, p. 6
Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Article 87 and 88 of the Treaty (General block exemption Regulation)	OJ L 214 of 9.8.2008, p. 3 (Commission Regulation (EU) No 1224/2013 of 29 November 2013 extended its period of application of the Regulation until 30 June 2014)
Draft successor General Block Exemption Regulation	Public consultation from 18 December 2013 to 12 February 2014. (New Regulation expected to enter into force on 1 July 2014)
Draft successor of the Block Exemption Regulation for the agriculture and forestry sector and for rural areas	Public consultation from 24 February 2014 to 24 March 2014.
Guidelines on State aid to promote risk finance investments[50]	OJ C 19 of 22.1.2014, p. 4. Adopted on 15 January 2014 Published on 22 January 2014
Draft Union framework for State aid for research and development and innovation	Public consultation from 20 December 2013 to 17 February 2014. (The new Framework is expected to enter into force on 1 July 2014)
Draft Guidelines on environmental and energy State aid for 2014-2020	Adopted on 9 April 2014.
Guidelines on regional State aid for 2014-2020 (2013/C 209/01)	OJ C 209 of 23.7.2013, p. 1.

50 *These new guidelines replace the 2007-2013 Community Guidelines on State aid to Promote Risk Capital Investments in Small and Medium-Sized Enterprises.*

It is also noted that agricultural activities are governed by specific State aid rules. These activities are the ones falling under the scope of Article 42 of the TFEU and concern products listed in Annex I of the Treaty. The European Agricultural Fund for Rural Development (EAFRD) Regulation stipulates that for such activities supported under the EAFRD, State aid rules neither apply to co-financing payments nor to additional national financing ("top-ups").

As regards the fisheries and aquaculture sector, the State aid rules of the Treaty do not apply to payments made by Member States pursuant to and in conformity with the EMFF within the scope of Article 42 of the Treaty. The State aid rules of the treaty apply to national provisions going beyond the provisions of the EMFF concerning financial contributions. In addition, a specific block exemption Regulation sets the conditions under which individual aid granted by Member States under national aid schemes will be compatible with the internal market and will be exempted from the notification requirement of Article 108 (3) of the Treaty.

There is a specific *de minimis* Regulation for fisheries sector[51] which sets up ceilings lower than those in the general *de minimis* Regulation (EUR 30,000 per beneficiary for a period of 3 years) and ensure that the total amount of the aid granted to all undertakings in the fisheries and aquaculture sector over three years is below a ceiling of the annual fishery, aquaculture and processing turnover by Member State (2.5%).

4.3.1 Links between the elements for State aid assessment and the requirements for the ex-ante assessment of FIs

As specified in the previous section, there are close links between the key elements of the State aid assessment and the requirements for the ex-ante assessment as specified in Article 37 of the CPR. As already noted Article 37 (2) not only refers to possible state aid implications but explicitly mentions two of the key elements of the State aid assessment, namely the proportionality of the envisaged intervention and the minimisation of the market distortions by the intervention.[52]

This implies that State aid must be proportionate to the market failure to be addressed and it should be limited to the minimum required to achieve the desired objective. For State aid measures that fall under a block exemption Regulation, these requirements are presumed to be fulfilled.

However, should the FI be subject to notification to the Commission, the State aid assessment will be carried out by the Commission (DG Competition) according to the Common Assessment

51 Commission Regulation (EC) N° 875/2007 of 24.07.2007 or its successor Regulation.

52 Both elements are closely linked to limit State aid where it has been identified that measures constitute aid. Proportionality aims at limiting aid to the recipient the selective advantage to the minimum necessary (e.g. no selective advantage beyond a FRR). Minimisation of the market distortion aims to avoid distortions of competition and trade (e.g. aid is given to efficient companies and is limited to what is necessary to close the viability gap).

Principles. Figure 14 displays the links between the common assessment principles for State aid assessment and Article 37 requirements for the ex-ante assessment of FIs.

Figure 14: Elements of the State aid assessment

Common assessment principles for State aid assessment	Article 37 requirements for the ex-ante assessment of FIs
Contribution to a well-defined objective of common interest	**Article 37 (1) and (2) (f)** Contribution to the achievement of specific objectives set out under a priority
Need for State intervention	**Article 37 (2) (a)** Analysis of market failure or suboptimal investment situations and investment needs
Appropriateness of the aid measure	**Article 37 (2) (b) and (c)** Added value of the FI and measures to minimise market distortion
Incentive effect	**Article 37 (2) (c)** Leverage of additional resources and assessment of the need for, and the level of, preferential remuneration to attract counterpart resources from private investors
Proportionality of the aid	**Article 37 (2) (b)** Proportionality of the envisaged intervention
Avoidance of undue negative effects	**Article 37 (2) (b) and (c)** Measures to minimise market distortion
Transparency of aid	**Article 37 (2) and (b)** Depending on the support scheme the quantified value added may contribute to the assessment of the transparency

4.3.2 Off-the-shelf financial instruments

Article 38 (3) explicitly mentions FIs complying with standard terms and conditions, laid down by the Commission, the so-called off-the-shelf FIs. These instruments will be provided for by Implementing Acts which will gradually enter into force in the course of 2014, depending also on the adoption of new State aid rules (see table 7 in chapter 4.3).

The off-the-shelf FIs to be proposed include the following:

- Loan fund for SMEs based on a portfolio risk-sharing loan model (RS Loan);
- Guarantee fund for SMEs (partial first-loss portfolio) (capped guarantee);
- Equity investment fund for SMEs and starter companies based on a co-investment model (co-investments facility);
- Loan fund for energy efficiency or renewable energies in the building sector (renovation loan);

- Loan fund for sustainable Urban Development (UD Fund).

Off-the-shelf instruments pave the way for:

- A safer method of implementation, which may speed-up the time required to launch the support programme or might reduce the development cost of an FI;
- A notification exemption with respect to State aid, provided that all conditions are met. It is to be noted though that an ex-ante-assessment is still required for off-the-shelf instruments to comply with Article 37 of the CPR.

The implementation conditions to be met, in relation to State aid, consist of three groups, the first addressing the final recipients (eligibility, maximum amounts, etc.), the second addressing the implementing bodies (fund of funds, financial intermediaries and their managers), and the third the private finance providers.

The term sheets will be an integrated part of the off-the-shelf instruments. This helps to ensure compliance with State aid rules.

The off the shelf FIs are also applicable for agricultural and fisheries SMEs, for which the term sheets contain specific provisions in line with the state aid rules applicable in those areas.

4.3.3 State aid control system

A high-level assessment[53] of the State aid implications of different types of FIs should give authorities guidance on which action they have to take in different scenarios.

State aid control basically consists of three assessments:

- Assessment of whether the measure constitutes State aid within the meaning of Article 107 (1) of the Treaty on the Functioning of the European Union (TFEU); e.g. State aid can be excluded if the FI respects the market economy investor principle;
- If the measures constitutes State aid, assessment whether it can be found compatible without notifying it to the Commission, e.g. because it fulfils the requirements of a *de minimis* Regulation or a block exemption regulation;
- If the measures constitutes State aid, and does not fulfil all the conditions of the rules that exempt it from notification, it has to be notified to the Commission which carries out a compatibility assessment of the aid measure with the internal market according to the provisions of Article 107 (3) TFEU and its implementing rules, prior to the implementation of the

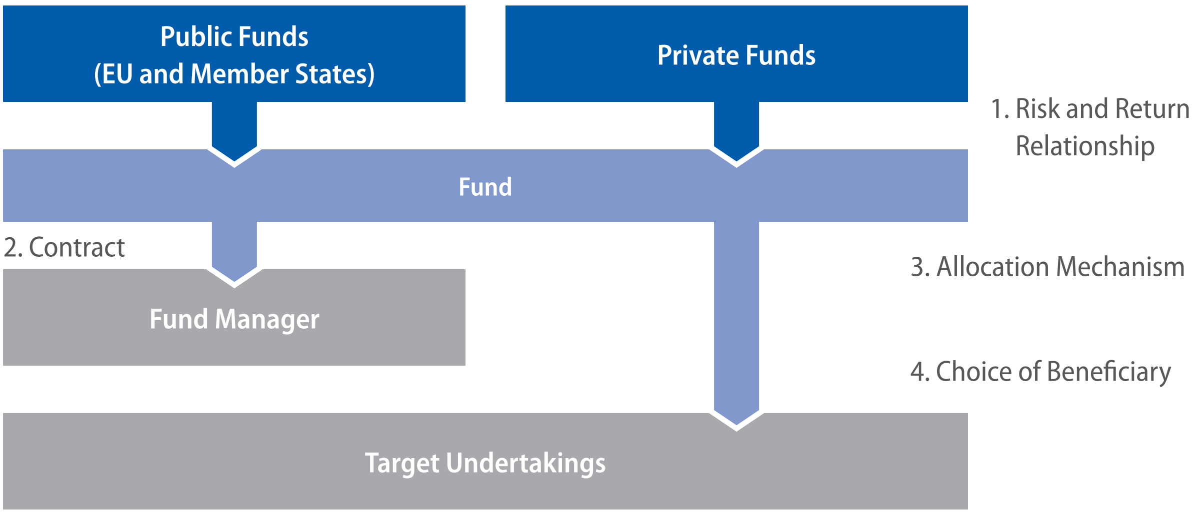
53 *This section and the following aim to explain the basic ideas and the general procedure of the control system. They should not be understood as exhaustive. The main documents about the rules are mentioned above. The rules are supposed to change in the direction described in the document as of 1 July 2014. Further changes in the MFF until 2020 are not excluded.*

FI. The State aid pre-notification and notification procedures are analysed in more detail in Appendix B.

4.3.3.1 Assessment of whether the measure constitutes State aid

To begin with, MAs should determine whether the envisaged FI constitutes State aid at any level. If the MA is not sure, it can always notify the planned measure for legal certainty to the Commission (DG Competition), which can provide assurance in that regard ultimately in the form of a decision. Since the FI will be controlled by the MAs (shared management, with or without national budget resources) and as the private undertakings involved might operate in competitive cross-border markets[54], the assessment will focus on the existence of a **selective economic advantage** within the meaning of Article 107 (1) TFEU. Such an advantage can be granted at different levels, as described in Figure 15 below.[55]

Figure 15: Assessment of whether the measure constitutes State aid



First level: Private investors (Risk and Return Relationship of the Contributions)

The first step of this analysis aims to determine whether Member States are granting State aid to private investors when making their contributions. State aid could be excluded at this level if there is a *pari passu* and pro rata distribution of risk and rewards between the public and private investors and the contribution of the private operators is economically significant.

54 This does not mean that the FI will necessary invest cross border or outside the respective region.

55 Another labelling of the four levels of the so-called market operator test are (i) aid to investors, (ii) aid to financial intermediaries, (iii) aid to managers of financial intermediaries, (iv) aid to the undertaking in which the investement is made (see draft of Union guidelines to promote risk finance investments, paper of the services of DG Competition, 2013).

According to the Risk Finance Guidelines[56], the Commission will consider the investment to be effected *pari passu* between public and private investors, and thus not to constitute State aid, where its terms would be acceptable to a normal economic operator in a market economy in the absence of any State intervention. This is assumed to be the case only if public and private investors share exactly the same upside and downside risks and rewards and hold the same level of subordination, and normally where a significant proportion of the funding of the measure is provided by private investors, which are independent from the companies in which they invest. The Commission considers that, in the case of risk finance measures, 30% independent private investment can be considered economically significant.

In order to attract private investors where situations of market failure exist, FIs may need to provide preferential remuneration, i.e. grant sub-commercial terms for private investors. For instance, the public investor may accept to assume the first loss, invest on less advantageous terms than private investors (i.e. non *pari passu* investment), or the private investor may receive more from the returns It is to be noted that in the case of certain types of FIs, e.g. typically loan or guarantee measures, the financial intermediary, usually a bank, is the private investor at the same time. In other measures, such as equity measures, the private investors are different from the financial intermediary.

Second level: Financial intermediary and its management

The second step will analyse whether the terms of the contract between the MA and the financial intermediary on the one hand, and the manager/management and the financial intermediary on the other hand, reflect normal market conditions. MAs should carry out this analysis under the 'market economy operator principle'.

It will also be examined whether all ESI Funds contributed are passed through to the target undertakings. The question is whether the fund is a mere clearing mechanism or an intermediary vehicle for the transfer of aid as opposed to an entity which profits from Member States' contributions. State aid could be excluded at this level if it becomes clear that all funds are forwarded to the selected final recipients.

In many cases in the past, not all funds were transferred to the final recipients. In most of these cases, management costs and fees were paid by the programmes. In such cases, market-conform remuneration, including for the administrative costs, is not considered as state aid, if the intervention is otherwise *pari passu* or market conform.

56 *Guidelines on State aid to promote risk finance investments 2014/C 19/04.*

Third level: Target Undertakings (final recipients)

For final recipients, State aid can be excluded if the FI respects the market economy investor principle. If not, the eligibility criteria and the maximum amounts play an important role. State aid for them is not subject to notification if it is covered by a block exemption regulation or does not exceed the *de minimis* threshold. Therefore, the design of the FI including maximum amounts of support will play a crucial role in determining whether the final recipient will be considered as aid recipient or not, and whether the FI will require a notification.

4.3.3.2 Compatibility and notification assessment

In the previous section, we have described the four levels at which State aid can be identified in the setting up of an FI.

De minimis FIs, off-the-shelf FIs and FIs covered by the block exemption regulation do not need to be notified. This could simplify the task of MAs and allow a faster roll-out of the FI. Tailor-made FIs can be also covered by *de minimis* or the block exemption regulation, but an own assessment by the MA is needed.

If the FI does not fit into any of the cases described above, it shall be notified to the Commission that carries out a holistic assessment of the entire intervention and for all levels at which aid may be found.

The State aid assessment shall answer the following questions:

- Is the aid measure aimed at a well-defined objective of common interest? (*Please refer to chapter 2, mainly the consistency with the programme strategy.)*;
- Is the aid well designed to deliver the objective of common interest, i.e. does the proposed aid address the market failure or other objectives? Is there a need of intervention*? (Please refer to chapter 3, market failure or suboptimal investment situation.)*;
- Is the aid an appropriate policy instrument – more appropriate than other possible instruments? (*Please refer to value added and consistency in chapter 4 and in the investment strategy in chapter 7*);
- Is there an incentive effect, i.e. does the aid change the behaviour of the aid recipient? *(Please refer to chapter 7 with the determination of the intensity of support)*;
- Is the aid measure proportionate to the problem tackled, i.e. could the same change in behaviour not be obtained with less aid? *(Please refer to chapter 4, value added and comparison with other potential instruments.)*;
- Are the distortions of competition and effect on trade limited, so that the overall balance is positive? *(Please refer to chapter 4.)*

In the case of FIs, the ex-ante assessment provides the opportunity to collect most or all of the information needed for a State aid test, comprising the elements of the general State aid test and the specificities of the FI, which could support the notification and speed up the process.

Box 4:The balancing test for the approval of aid granted through FIs under Article 107 (3) (c) TFEU

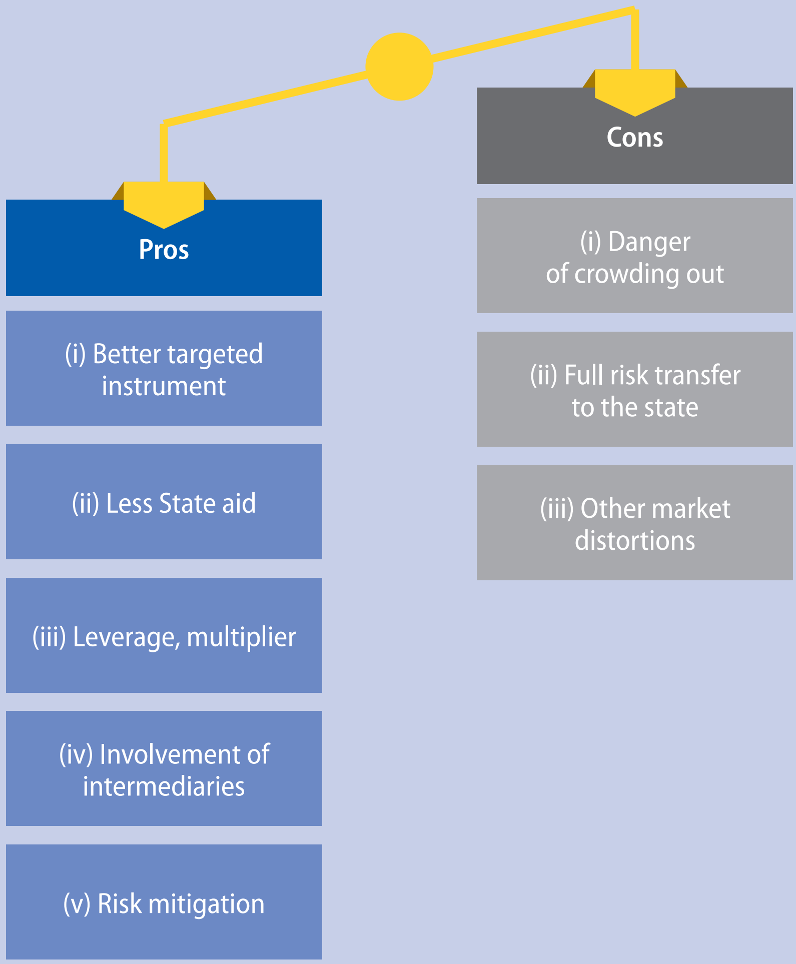
The balancing test for the approval of aid granted through FIs under Article 107 (3) (c) TFEU

State-aid rules have been historically developed along rather homogeneous groups of interventions, either in terms of sector or in terms of size. *De minimis* and sectorial guidelines are examples of this development. With the creation of FIs for urban development over recent years, FIs started to address different sectors and sizes of investment classes. This is likely to continue given the broadened range of FIs for the 2014-2020 programming period and the increased focus on territorial integrated development schemes, which include different sectors and projects of different size in one area by definition.

As discussed in the analysis of quantitative and qualitative dimensions of value added, FIs may be better suited to overcome some market failures than traditional grant instruments. If the FI is set up to cover multiple sectors and to address multiple issues it could minimise the overall level of state intervention, since this set up facilitates risk mitigation. In addition, the risk of the portfolio can be reduced with the involvement of experienced intermediaries through the establishment of professional incentives to achieve public goals. Finally, the analysis of existing good practices may help to reduce the risk since it would allow building on the results of past experience and to avoid causing unintended distortion effects. The Commission's decisions on State aid compliance of FIs under JESSICA[57] stressed those features in a balancing test.[58]

57 Joint European Support for Sustainable Investment in City Areas (JESSICA).
58 Description in Competition Policy Newsletter 2011-3.

Figure 16: Approach to the balancing test for the approval of aid granted through FIs under Article 107 (3) (c) TFEU



As shown in Figure 16, the advantages of a properly designed FI may outweigh potential disadvantages.

While urban projects by their nature are diverse and, taken in isolation would fall under different legal frameworks for State aid, the Commission considers that FIs for such an area-based approach pursue a distinct policy objective. Moreover, to be effective, FIs need to operate under a coherent set of operating principles, since projects are interrelated. This could be achieved with an integrated plan. This integrated plan or the envisaged group of projects as a whole is the object of the State aid compatibility assessment.

Figure 17 presents an overview of the process followed by the Commission when performing the compatibility assessment for an FI according to Article 107 (3) (c) TFEU.

Figure 17: Overview of the process to be followed for the compatibility assessment of aid granted through FIs under Article 107 (3) (c) TFEU

Steps of State aid test	Specific questions/Steps for FI's
1. Contribution to a well-defined objective of common interest	
2. Need for State intervention	Analysis of market failure (e.g. Externalities, Imperfect information, coordination problems, insufficient access to finance)
	Equity objectives of welfare
3. Appropriateness of the aid measure	Choice of the least distortive policy option
4. Incentive effect	Check whether suboptimal situation is not due to poorly structured investments
	Necessity of a subsidy element to attract private investors
	If no private investors are there, necessity of a subsidy element to achieve repayment capacity (albeit below commercial terms)
5. Proportionality of the aid	Crowding-in of private investments (no crowding out)
6. Avoidance of undue negative effects on competition and trade between Member States	Minimum required aid only (see above)
7. Transparency of aid	Ensure that Member States, the Commission, economic operators and the public have easy access to all pertinent information about the aid

5. Additional public and private resources to be potentially raised by the financial instrument

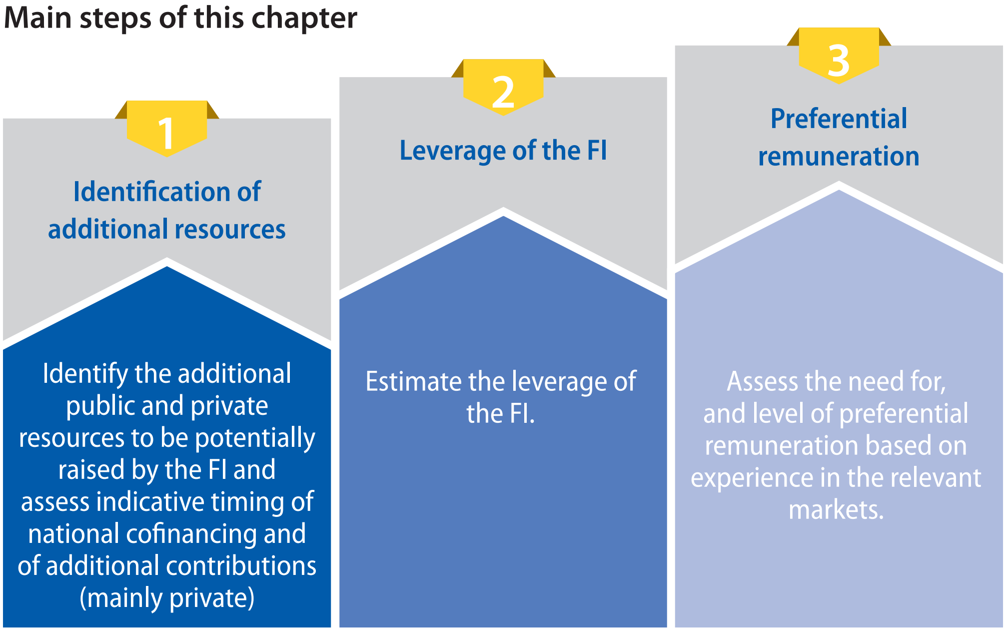
As detailed in chapter 1, one of the expected benefits of FIs is to **attract private investment and other public funding**, notably thanks to risk-sharing provisions. This is particularly relevant in the context of budgetary constraints or when private investors show restrictions on their risk appetite, their risk bearing capacity or are not fully confident in the market and would like to share risks.

Thus Article 37 (2) (c) of the CPR specifies that the ex-ante assessment shall include:

- An estimate of additional public and private resources to be potentially raised by the FI down to the level of the final recipient (expected leverage effect);
- An assessment of the need for, and level of, preferential remuneration to attract counterpart resources of private investors; and
- A description of the mechanisms to be used to establish the need for, and the extent of, preferential remuneration, such as a competitive or appropriately independent assessment process.

As already noted in the previous chapter, the analysis of additional resources to be potentially raised by the FI and, more specifically, the conditions at which private investors would be willing to invest in the FI, constitute key elements of the State aid assessment, which is presented in section 4.3 of this methodology.

Main steps of this chapter



5.1 Estimating additional public and private resources

In order to obtain a clear picture of additional public and private resources that could be potentially raised by the FI, MAs have to take into account that such resources:

- Can come from different stakeholders;
- Can be raised at all levels of the FI down to the final recipients' level;
- Can be considered as national co-financing of the Programme under certain conditions;
- Can be financial as well as in-kind contributions[59].

It should be noted that additional resources which constitute national co-financing of ESIF programme can be provided until the end of the eligibility period (31 December 2023[60]). Pursuant to Article 41 CPR, the ESIF contribution and the additional resources follow a concept of phased interim payments to FIs starting with an amount up to 25% of the total amount.

If additional resources do not constitute national co-financing of ESIF programme, i.e. they are contributed in addition to the ESIF programme resources (ESIF + national co-financing), then the ESIF rules do not apply.

The assessment may therefore take into account that the mobilisation of private (and public) contributions may be carried out over the lifetime of the envisaged FI.

5.1.1 Identification of the different potential sources

Combining different ESI Funds (CF, ESF, ERDF, EARDF and EMFF) may increase the volume of the FI but this is not considered as providing additional resources. Combining several ESIF resources may take place deliberately to exploit the synergies of different funds, Programmes or priority axis/measures within the same Programme to address several objectives in an integrated manner, for instance to support measures related to employment, education, social inclusion and institutional capacity. Combining resources may be necessary for multi-purpose FIs, which aim for territorial/spatial objectives such as regeneration of villages or city districts. These combinations can foster cooperation among different levels of government, but could also create additional difficulties in the implementation and management. The ex-ante assessment should provide arguments to justify the choice of combining resources coming from different Funds and Programmes.

The **national co-financing** to the EU programme contribution, coming from a public budget or from a private source is considered as additional resources.

59 In kind contributions in the form of land and real estate are possible only for rural development, urban development or urban regeneration where the land or real estate is part of the investment as provided for in Article 37 (10) of the CPR.

60 Article 65 (2) of the CPR.

The other component of additional resources, and in some cases the largest one, are further contributions coming from **outside the Programme**, be they public or private, but beyond the co-financing requirement. Such public financing could come from public sources other than the ESIF and include local semi-public companies or public financial institutions. The private financing could come from financial institutions interested by the scope of the FI, its investment strategy or by some specific project financed by the envisaged FI.

As already noted in section 4.1.1, the contribution by the final recipient is not considered as additional resource. According to the Rules of Application Article 223 of the Financial Regulation the leverage is equal to "amount of finance to eligible final recipients divided by the amount of the Union contribution". As this discussion concerns the contribution to final recipients, not the contribution by final recipients, the financial structure of the support scheme matters (please refer to 5.1.3 below).

5.1.2 Consideration of budget-saving options (contribution in kind and total investment costs approach)

The assessment of the sources may also address **national or regional budget-saving** options. This could be done in different ways:

- The first option is to consider an increase in the co-financing from the ESIF. The overall amount of public resources does not change, but the proportion of contribution can be more favourable for national public finance;

Box 5: Increase of maximum co-financing rate

MAs could consider in the ex-ante assessment that the maximum co-financing rate at the level of a priority axis shall be increased by 10%, where the whole axis is delivered through FIs. If implementation of a whole axis is envisaged by a FI set up at Union level managed directly or indirectly by the Commission, the co-financing rate can be set as high as 100%.[61] For FIs receiving EAFRD contributions additional co-financing rates are the same, however there is no need to dedicate a whole measure to the FI to benefit from the 100% co-financing. From the perspective of the Commission, such increase of ESIF contribution would not be counted as 'additional' support,[62] because it is integrated in the envisaged support scheme.[63]

61 According to Article 59 (4) of the RDR the EAFRD increases the contribution rate to the 'measures' referred to in Article 38 (1) (b) CPR (increase by 10%) and in Article 38 (1) (a) CPR (EU-level FI).

62 All other things being equal the leverage of the EU contribution will be lower.

63 Priority axis co-financing is not necessarily systematically applied to an FI, since MAs are free to decide on the co-financing rate. A single operation such as an FI can have even 100% co-financing by ERDF provided that co-financing at the level of priority axis is maintained.

- The second option is to consider the total investment cost approach, referring to total eligible expenditure including public and private expenditure instead of applying eligible public expenditure only. If the envisaged FI is set up with the total investment cost approach, all contributions beyond the ESIF support contribute to the co-financing, provided that they comply with ESIF rules. However, this is only possible if for the entire priority axis the co-financing rates are applied to total eligible expenditure (Article 120 (2) CPR);
- The third option is to consider contributions in kind, instead of financial resources, in the form of land and real estate for rural development, urban development and urban regeneration where the land or real estate is part of the investment and where the value of the in-kind contribution is certified by an independent qualified expert. Additional conditions for the use of in-kind contributions are set in Article 69 (3) (b) CPR. [64]

5.1.3 Identification of the level at which national co-financing of ESIF programme intervenes

According to Article 38 (9) CPR, national public or private contributions can be made at all levels, including at the level of final recipients, unless excluded in fund-specific rules, as shown in the Figure 18 below. The only fund Regulation that limits co-financing to the level of the fund of funds or to the level of the FI is EAFRD.[65]

In the case of EAFRD, co-financing cannot be done at the level of the final recipient, contrary to the rest of the Funds. The Public Expenditure principle used to determine the level of co-financing obligations for the Managing Authorities (contrary to the Total Expenditure principle which may be used in other ESI Funds) makes this option not possible. Nonetheless, aid intensities applying under the measures imply a level of private contributions by final recipients.

64 *The transmission of public assets to the FI reduces the stock of assets owned by the region yet, in most of the budgetary systems, such a transfer of assets is not calculated as a budget expenditure.*

65 *Financial Instruments in ESIF programmes 2014-2020. A preliminary guide for Managing Authorities. (version February 2014).*

Box 6: Clarification on co-financing

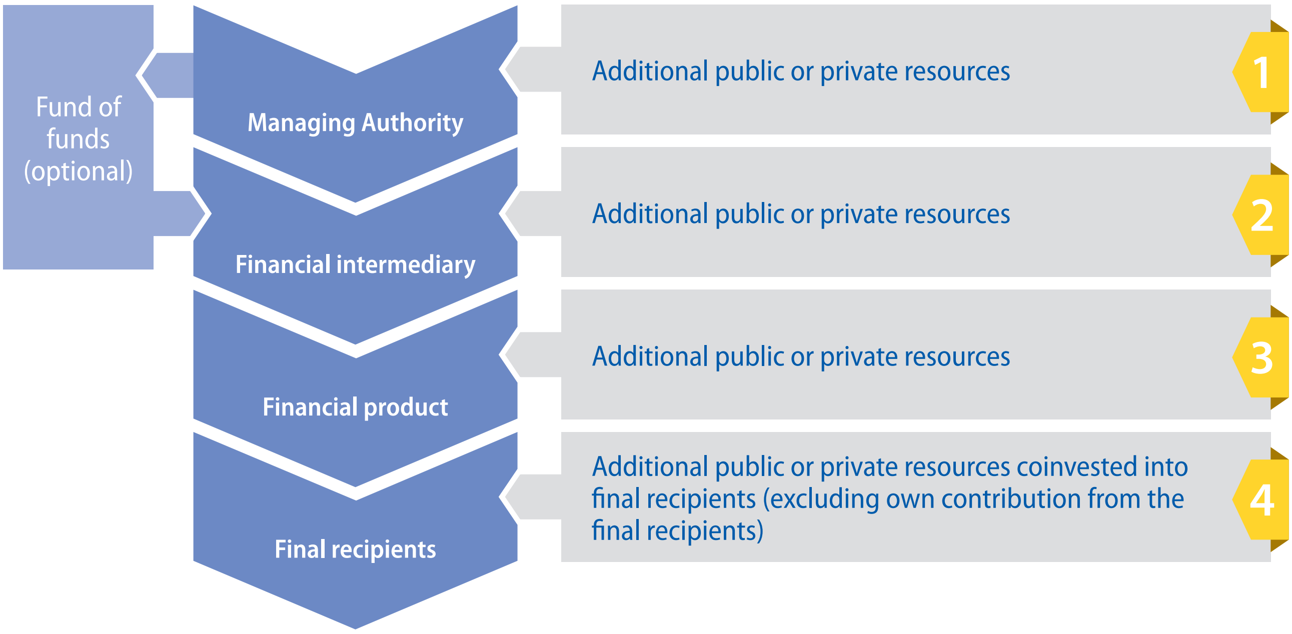
Extract from the Reference Guide for Managing Authorities on Financial Instruments in ESIF programmes 2014-2020 (section 7.4)

"Significant additional flexibility is introduced whereby national public and private co-financing contributions under Programmes may be provided at the level of the FI (fund of fund or financial intermediary) or at the level of the final recipient (including in-kind contributions where relevant, except for the EAFRD). National co-financing does not have to be paid to the FI upfront but may be provided at later stages of FI implementation. It has to be provided before the end of the eligibility period. However, the Article on payments contains provisions to allow for the full reimbursement of ESIF contributions even when material co-financing is provided at a later stage.

In many FIs a private contribution will be present and is encouraged to increase leverage (also may be required by State aid rules). For ESIF policy, Programmes based on total eligible expenditure may facilitate co-financing and implementation (MA to decide upfront).

In kind contributions in the form of land and real estate are possible only for rural development, urban development or urban regeneration where the land or real estate is part of the investment and where the conditions under the relevant Article of the CPR are met (the value is certified by an independent qualified expert)".

Figure 18: Different levels at which additional resources can intervene[66]



66 *Please note that for EAFRD resources, additional resources do not include the final recipient level. In addition, the grant given to the final recipient from another source cannot be declared as eligible expenditure under an FI.*

MAs need to define at which level of the FI's value chain the contributions from the previously identified different sources can intervene. The ex-ante assessment has to **confirm** that the envisaged mobilisation of resources at the different levels is realistic and where appropriate give **ranges** showing the order of magnitude of the different contributions.[67] In case of a two-stage approach where the second stage includes a competitive tender process and different partners are involved, these ranges may also consider a partial replacement of one partner by another. If the tendering process results in a private contribution at the higher end of the range, the additional public contribution might be reduced accordingly.

5.2 Estimating the leverage of the envisaged financial instrument

As already noted in chapter 4, the calculation of the leverage does not necessarily coincide with the consideration of the quantitative value added.

The concept of leverage is broader that the concept of national co-financing of the ESIF Programme. According to Article 140 of the Financial Regulation and Article 223 of its Rules of Application, the leverage effect of Union funds shall be equal to the amount of finance to eligible final recipients divided by the amount of the Union contribution

The calculation of leverage follows the rules of the Regulation and as shown above (i) own contributions from the final recipient are not taken into account, (ii) the face value of the expenditure is counted irrespective of the financial nature (e.g. repayable or non-repayable)[68] and (iii) future investment cycles are not considered if there are any (e.g. revolving instruments).

Different financial support schemes show different levels of leverage. Examples of support schemes allowing achieving high leverage are:

- Fixed risk contributions for credit enhancement;
- Guarantee instruments, where a fixed contribution covering the expected and the unexpected loss is given to an intermediary[69]; and

67 *The ex-ante assessment will provide (see chapter 7) an indicative business plan for the proposed investment strategy. The commitment on one hand of private partners in respect to resources and timelines has to met by commitments from the budgetary side for each budget involved on the other hand, each including the EU level following certain rules.*

68 *If the leveraged resources are to be considered national co-financing of ESIF Programme the eligbility rules for these resources have to be complied with. Moreover, only the repayble form of invesmtent in final recipient (e.g. loan, equity) with eligibile expendiure distinct from other sources of assistance can be presented as ellgible expenditure under FI operation -see Article 37(8).*

69 *Guarantee covers risk (e.g. reduces the risk taken by a bank with respect to a final recipient) without changing the risk profile of the other partners involved. On the other hand, credit enhancement changes the risk of the other partners involved (e.g. purchasing the issued project bonds). Credit enhancement could be done with guarantees as well with a specific financial engineering involving funded structures like mezzanine finance.*

- Guarantee instrument, where a contribution is given to an intermediary with a ceiling. If after the expiry of the guarantee, the volume of losses occurred is lower than calculated ex-ante, an upside takes place. The remaining resources, which are not needed to to cover the losses) constitute resources paid back to the FI (Article 44 and 45 CPR).[70]

Generally speaking, the higher the leverage the higher the impact of the FI[71]. However, maximising leverage is not the main objective of ESIF policies:

- Leverage may be lower in less developed regions than in more developed ones;
- A lower leverage is expected to be achievable in times of crisis by comparison of times of boom; and
- A too high leverage could reduce the incentive effect and in fact attract more windfall gain projects.

Experience showed wide range of leverages across financial products, sectors and countries. A range of 4 - 5 as found in a study mentioned in chapter 1 for soft-loans could be considered as average, with a broad spread in both directions.

The ex-ante assessment has to consider the different sources of additional public and private resources, the different options to structuring the envisaged FI. It has to conclude on the expected leverage effect. Such a target may be conditional to the economic environment.

5.3 Attracting additional private resources

A certain level of participation of independent private investors co-investing together with ESIF Programme through the same FI might be required by the State aid legal framework (e.g. risk finance under GBER). In some cases it may be necessary for the MA to offer preferential treatment to the private investor in order to attract its participation in the FIs pursuing ESIF Programme objectives.

Even if participation of private investors can result in higher leverage, the MA should be aware that at the same time it is lowering the revolving character of the FI, if part of the resources attributed to the ESIF Programme is used to preferentially remunerate the co-investor.

70 *This is not an exhaustive list and other examples may include loans with the participation of financial intermediary and the RSSF scheme of the Commission with the EIB to provide loans to industrial innovation projects.*

71 *It must be underlined that the FI may leverage other resources than Programme resources which do not have to comply with eligibility rules under the Programme or the CPR. This may result in leveraged resources financing parts of the project which fall outside the scope of Programme.*

To effectively attract and monitor the additional private resources, MA should define the following elements:

- Expected leverage level and targeted private investors *(please refer also to chapter 7)*;
- Financial techniques to attract private investors, and, if justified, preferential remuneration for private investors including possible incentives given to them;
- Mechanisms to align private interests with the policy goals.

According to the CPR and the State aid schemes under preparation alignment of interest with private partners follows two concepts. Firstly, the *pari passu* approach, meaning that a private investor contributes with own funds in the same risk position as the EU contribution. A good alignment of interest will be achieved in case the private share is significant. According to the different co-financing rates, the definition of significance may vary. Secondly, the mechanism of preferential remuneration should be accompanied by measures aiming at the alignment of interests, for instance performance-based remuneration of the management, a commercial orientation of the management decisions and, where appropriate, the managers' direct participation to the FI. The alignment of interest is further part of the assessment of the remuneration for the private co-investor.

5.3.1 Analysing the need for and extent of preferential remuneration for private investors

The possibility to adopt a preferential remuneration scheme for private investors already existed in the 2007-2013 programming period, although it was exclusively foreseen for profit sharing. The standard approach is *pari passu* remuneration where public and private investors share exactly the same risks and rewards, due to the State aid considerations. Such an approach was mirrored in the previous State aid rules on risk capital investments in SMEs. The future GBER will include some schemes for preferential remuneration. For ESIF support schemes, a specific justification and assessment is foreseen as part of the ex-ante assessment.

Box 7: Funds with preferential remuneration for private investors

In recent years preferential remuneration schemes have increasingly been used. Several funds, in many cases encompassing EU support, were set up in the recent decade with different classes of shares reflecting different risk appetite from core-equity down to quasi senior loans. The funds are structured as follows:

- Class A shares with equity risk is injected by the budget,
- Class B shares with mezzanine risk by development/promotional banks,
- Class C shares with junior loan risk by public or private impact investors, and
- Class D shares with quasi senior loans with some conditionality on the payment of the interest rate by patient commercial investors.

The fund manager brings in a small participation to class A and, if it were a bank, a broader participation to one of the other classes. There are many variants of this basis concept. A few examples are EFSE (mainly microfinance), Green for Growth (mainly renewable energy production), EEEF (mainly energy efficiency investments with a contracting approach) and Marguerite (mainly equity piece for large infrastructure investments).

The scope for preferential remuneration was already used in the 2007 - 2013 framework however it was limited only to returns. In the 2014-2020 period preferential remuneration is extended also to repaid capital[72]. MAs could, therefore, consider:

1. Asymmetric profit-sharing (e.g. the hurdle rate is not *pari passu* to the investors in infrastructure[73] funds, but gives preference to the private partners)

2. Asymmetric loss-sharing (e.g. guarantee schemes, covering a first loss piece of the downside risk for innovation loans)

3. Preferential fee payment to the managers to the extent they are also co-investors[74] within the limits established by the envisaged Delegated Act to the CPR (e.g. microfinance)

4. Preferential exit regime (e.g. risk taking on the not sold engagements in energy efficiency funds)

In line with this increased consideration of preferential remuneration schemes at the EU level, the scope of the envisaged General Block Exemption Regulation[75] is broader than in the past and covers risk finance for SMEs.

- Asymmetrical loss-sharing, which could be considered under the GBER, occurs if the first loss of the public investor is capped at 20% of its total investment or 20% of a guaranteed portfolio;
- Asymmetric profit sharing shall be given preference over downside protection; and

72 *Please refer in addition to Article 37 (2) to Article 44 (1). "The preferential remuneration shall not exceed what is necessary to create the incentives for attracting private counterpart resources and shall not over-compensate private investors, or public investors operating under the market economy principle. The alignment or interest shall be ensured through an appropriate sharing of risk and profit…" Such remuneration schemes have to be compatible with State aid rules.*

73 *It is important to note that this is only one illustrative example, similar schemes are found in other sectors as well.*

74 *Co-investment of professional or commercial managers is often required to achieve some alignment of interest.*

75 *DG COMP consultation May/June 2013, the 20% cap is still under discussion, some MS request a higher cap, expected entry into force of new GBER is 1 July 2014. - Beyond SMEs the GBER cover several further topics of the Thematic Objectives or investment priorities, e.g. district heating and cooling, production and distribution of energy from renewable sources, cogeneration of heat and electricity, energy saving, research and research infrastructures, broadband infrastructure and generally regional aid.*

- The intermediaries shall be selected through an open, transparent and non-discriminatory call.

The framework of GBER may help the MA to facilitate State aid procedures in case a preferential remuneration scheme is considered and could be covered by the GBER for SME risk finance aid.

The first approach to assess the need and the extent of preferential remuneration necessary to attract private investors is looking at the experience collected so far and the evaluations of such experience if available.[76] As a matter of fact most experiences with FIs involving private investors did not encompass ESIF resources. As a result, it is recommended to consider also experiences outside the ESIF as a good starting point for the assessment of the envisaged FI. Such an approach driven by experience could be considered, for instance, for urban development funds. In this regard it is however necessary to pay special attention to the State aid rules which are fully applicable to ESIF Programmes financing.

The second approach to assess the need and extent of preferential remuneration is to conduct a comprehensive study which:

- Defines the main investment criteria for potential private investors, particularly in terms of profit expectation and risk appetite;
- Establishes a hierarchy of preferential schemes according to their impact on competition (e.g. asymmetric profit sharing schemes tend to be less distortive than asymmetric loss sharing[77]); and
- Foresees the preferential remuneration scheme as part of the governance of the FI mitigating the downside risks involved for the EU contribution.

The main indicators to assess the need for preferential remuneration are related to the risk, in particular to the overstretching of the risk-appetite of the private partners or a new financial product, where no, or insufficient, experience and track-record can be found. The analysis, therefore, includes:

- The targeted sector itself, since different sectors show different risk profiles;
- The diversification of the fund by sectors and regions;[78]
- The diversification of the fund portfolio by granularity, since the level of risk is closely related to the composition of the portfolio (i.e. Number and size of loans). As such the risk tends to be higher if a portfolio of loans is composed by a small number of large loans rather than if

76 The experience will be accessible only to the extent evaluation or other reports are published. The assessment will consider mainly the relevant sectoral experience and the preferential components linked to the investors and the management team.

77 It is expected that the new GBER will establish a concept for preferential remuneration, where asymmetric profit sharing will be given preference over downside protection. At least the schemes covered by the GBER have to fulfill the condition.

78 Often a regional diversification is not deemed possible for a regional instrument. However, there are cases where a national or even EU-wide product could be considered.

it comprises a large number of small loans. It should be noted, however, that for most of the thematic objectives or investment priorities with the exception of SME competitiveness, it may be difficult to achieve a good portfolio diversification in this regard;

- Position in the life cycle of the products or the companies (e.g. SME since inception until the moment the growth phase starts); and
- Maturity of the target market as regards the implementation of FIs, since financial partners tend to be more reluctant and request preferential remuneration in regions or sectors where past experience with FIs is limited.

As preferential remuneration needs a specific assessment, the mismatch between the expected profits of the FI and the risk of the private partners has to be clearly communicated. The main steps to be undertaken to assess the need for preferential remuneration can be summarised as follows:

- A statement on the expected profit (or loss) rate and the risk of the FI;
- A statement on the expectations of the private partners is needed, taking into account the volume of their contribution and the distribution of profit and risk. As a matter of fact, although it is true that a higher risk can be compensated by higher expected profit, this compensation works only in a rather limited range in order to respect the principles of sound financial management;
- Based on these considerations, it is possible to estimate the amount of support needed to attract private investors. Two components could be identified:
  - The difference between the revenue-rate of the envisaged FI and the fair rate of return (FRR) of the private investors[79]; and
  - The rate of return to compensate the risk difference in case of high risks.

If the compensation is deemed possible, because the risk difference falls in the limited area mentioned above, in a fourth step, it is possible to sum the rate of returns. In such a case, an **asymmetric profit sharing** could serve the purpose. The ex-ante assessment will then be able to provide a reasonable range for the value. Such a range could serve as a starting point for a competitive assessment (e.g. call for expression of interest) to select private investors.

If the envisaged sector is considered by the banks or other financiers as too risky, compensation via an asymmetric profit sharing will not be possible or will be too expensive. The perceived risk may be temporary (economic downturn or new product without track record), but may be also systemic (sector risk) or portfolio-related (low granularity i.e. a few large investments). In such cases, a **risk re-**

79 *The FRR is applied in several decisions of DG Competition. It is understood as a risk adjusted rate of return that is comparable with other opportunities in the relevant market segment for the envisaged type of investment. It is determined by the risk profile of the envisaged investment. The MA has to assess what could be considered as FRR according to market data. Where no market data are available or the market is very limited, the FRR could be determined by an independent expert by analysis of industrial benchmarks and market risk.*

duction (asymmetric loss protection) for the private investors has to be assessed. State-of-the-art instruments for risk reduction are the so called first-loss buffers, which imply that, up to a pre-defined ceiling, the losses are borne by the EU contribution. If the losses occurring during the implementation of the FI are lower than this threshold, they are covered by the public budget.[80] If the losses during the implementation are higher, the part above the ceiling is either shared *pari passu* between the private and the public investor or following another pre-agreed rule.

The ex-ante assessment will give a reasonable range for these values. Such asymmetric first loss pieces may not be covered all by the GBER. As already discussed, a 20% first loss piece is foreseen in the GBER for SME risk-instruments, however, for instance, UK authorities report the need for up to 50% first loss piece for their VC regional markets,which are among the most developed in Europe.[81]

The experience with preferential remuneration is rather broad for FIs targeting SMEs, although the majority of past experiences did not encompass ESIF resources. In other sectors, the experience is scarcer. PPP transport projects that were undertaken in the past showed a considerable protection for the downside risk, sometimes engineered the other way round so that the private investors took the first hits with a first loss piece, but if costs increased or low traffic levels caused further deteriorations, the risk beyond a pre-defined threshold was again taken by the public budget. Such financial engineering could be used for FIs provided that the present and future liabilities of the EU contribution are limited by a pre-defined ceiling. Such ceilings apply in the financial engineering of the Connecting Europe Facility (CEF), with the mezzanine element supported by the EU budget and in contracting projects for energy savings and energy efficiency as provided with the European Energy Efficiency Fund (EEEF).

Against this background, the key parameter for an independent assessment of preferential remuneration schemes would be a combination of the foreseen rate of return for private investors and the share of risk they take.

As the data sources are very limited, an independent assessment will likely require a survey based on a representative sample, which will nonetheless require significant assumptions, proxy considerations and models. Despite the evident difficulties, an estimate should be provided by the ex-ante assessment. A review of the ex-ante assessment during the implementation stage, based on the performance of the FI might be useful given the limited data base available for the ex-ante estimate.

80 *A variant of this would be a first loss piece where, however, a certain portion is borne by the private investors, be it 20% or 10%.*

81 *Response of the UK to the public consultation of the draft EU guidelines on State aid to promote risk finance investments, September 2013.*

6. Lessons learnt

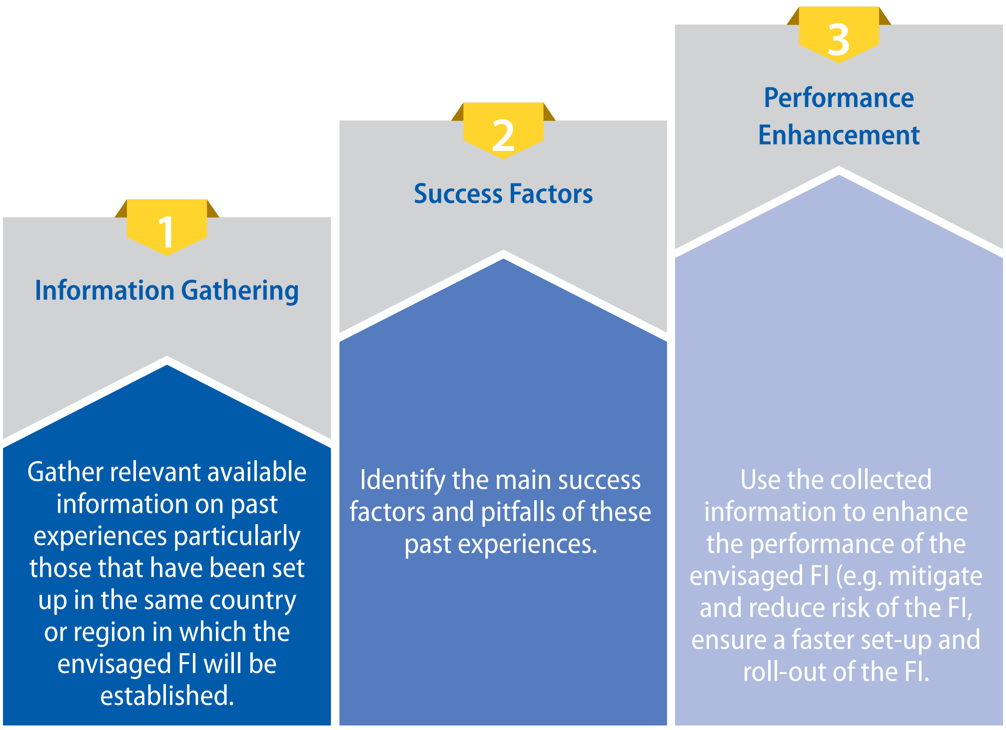
The purpose of conducting lessons learnt is to capture the knowledge learnt in the course of activities as part of a continuous improvement principle. Therefore, Article 37 (2) (d) of the CPR states that the ex-ante assessment shall include an assessment of the following:

- Lessons learnt from similar instruments and ex-ante assessments carried out in the past;
- How these lessons will be applied in the future.

The main questions the MA needs to address to comply with this requirement are as follows:

- Which past experiences in carrying out ex-ante assessments and in setting up and implementing FIs are relevant and should be taken into account when setting up an FI?
- What are the main success factors and pitfalls when analysing these past experiences?
- How could these lessons learnt be taken into account in the setting up of the envisaged FI to maximise its chance of success?

Main steps of this chapter



6.1 Gathering relevant information

The first necessary step would be to identify and select the past experiences through a thorough desk research on the following:

- Any FI using structural funds or involving public intervention implemented in the region/country in the past;
- Any evaluation (ex-ante, interim or ex post) of an FI carried out in the past covering similar region(s);
- FIs implemented in any other region/country, focusing on similar sector, target market and/or financial product.

The information may be gathered from a wide range of documentary sources, notably the experience documented on the different EU institutions' websites about the use of FIs in the former MFF (e.g. JESSICA and JEREMIE websites).

The following reports should be part of this data collection:

- The European Court of Auditors Special report 2/2012 deals with FIs and lessons learnt, including the recommendation to develop off-the-shelf instruments[82];
- Audit reports by audit authorities and by Commission services;
- The annual reports of DG REGIO on the progress of the FIs[83] provide statistical data and they are a rather unique source to observe the flow of the investment contributions over time. It draws conclusions, including the need for due attention to achieve scale and critical mass for FIs;
- Specific reports, such as 'Financial Instruments: A Stock-taking Exercise in Preparation for the 2014-2020 Programming Period'[84].

This desk research should be complemented by consultation of key stakeholders who participated in past FI experiences, such as MA staff members, FI-implementing bodies, final recipients/project managers who received funding from the FI, independent consultants who performed midterm and ex post evaluations. Relevant tools for these consultations are surveys, questionnaires, focus groups and workshops.

82 *See http://www.europarl.europa.eu/document/activities/cont/201203/20120329ATT42186/20120329 ATT42186EN.pdf.*

83 *See DG Regio: Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds.*

84 *http://www.eib.org/attachments/documents/jessica_stocktaking_final_report_en.pdf*

The main information or data to be collected about past FI experiences, if available, are the following ones:

- Economic and political context of the region/country of implementation;
- Objectives of the FI, target market, type of financial product;
- Eligible final recipients, implementing bodies;
- Organisational structure of the FI;
- Preferential remuneration to private investors;
- Performance against expected results:
  - Successful disbursement;
  - Quality of support provided to final recipient (successful returns on investments: income receipts, capital receipts);
  - Contribution of the FI to the objectives of the Programme/priority.
- Key success factors and main obstacles encountered (resource constraints, administrative issues, availability of project pipeline, etc.).

6.2 Identifying success factors and pitfalls of past experiences

The ex-ante assessment should analyse the information and/or data of past experiences collected and clearly assess the key success factors and the main pitfalls of these selected past experiences at each step of the FI life cycle: design, set-up, implementation, running and winding-up. The analyses should focus on former MFF and SF schemes, but are not limited to it. Experiences from comparable instruments may provide useful information about success factors and pitfalls. The data could cover, for instance but not limited to, the following domains:

- **Assumptions made during the design phase of the FI**, with regard to the identification of market failure, potential project pipeline, expected added value, private sector participation; etc.;
- **Use of EU Programmes and instruments set up at EU level:** preconditions and other considerations upon which the decision was made. Commercial or promotional banks (participated e.g. in CIP) or corporates (final recipients e.g. of RSFF) which participated in such instruments in the past could be consulted. Possible overlapping with existing instruments co-financed by SFs should also be considered;
- **Governance and structure:** commitment of the stakeholders, governance rules, experience with the governance in case of contributions from more than one OP, experience with the governance in case of CLLD predecessors like LEADER, implementing bodies and final recipients, legal structure, etc.;
- **Administrative and human resource capacity:** relevance of the applicable administrative

procedures, experience and competences of the main actors, provision of technical support to final recipient (in the phases of preparation, implementation and reporting[85]), reporting tools, IT system (if any), etc.;

- **Fees and life cycle costs of the FI:** relevant for the efficiency of the FI and its value added;
- **Investment strategy:** size of the target market, adequacy with the country/region specificities, selected financial products; etc.
- **Monitoring and control:** indicators (realisation indicators, result indicators, performance indicators in terms of disbursement, in terms of returns and in terms of contribution to OP objectives), any other monitoring tools; etc.

It should be noted that, since success factors and pitfalls encountered in past experiences are most likely to be sector and country-specific, additional information on this subject can be found in the sector-specific methodologies, e.g. Volume III on Enhancing the competitiveness of SME, Volume IV on Low Carbon economy and Volume V on Territorial Development.

6.3 Applying lessons learnt to enhance the performance of the financial instrument

Implementing specific tools might be useful for applying lessons learnt in a structured and systematic way. The proposed tools or approaches are listed in this paragraph.

Risk analysis

One possible tool for a MA to apply lessons learnt would be to perform a risk analysis on the implementation of the FI. Lessons learnt should facilitate the identification and the assessment of risks as well as the definition of the countermeasures. The main steps of the risk analysis are listed below:

- Risk identification: comprises listing the different risks and dependencies associated with the implementation of the FI, i.e. any uncertain event or condition the realisation or occurrence of which may have a negative impact on the FI, such as time, cost, scope or quality. Table 8 below gives an example of risk category that could also facilitate the identification of risks;
- This identification should take into account lessons learnt from the past and could cover the domains listed in the previous paragraph. It is likely that lessons learnt from the previous FI don't cover the whole FI life cycle (e.g. urban development with a cycle of up to 20 years);
- Risk assessment: the systematic and regular evaluation of the probability and potential impact of the identified risk occurring. Lessons learnt could facilitate the estimation of the

85 *The provision of technical support to final recipient was not part of 2007-2013 FEI and for 2014-2020 FEI it is limited to the preparation of the investment.*

probability as well as the impact of the risks. This step is essential to raise awareness among all stakeholders of the possible risks;

- Risk response: the definition of the appropriate required response to the risk. This could be a preventive action to avoid risk occurrence or a corrective action to reduce its impact. Three main types of risks responses can be considered:
  - Avoidance (change the initial plan);
  - Mitigation (reduce the probability or impact);
  - Acceptance (no change to the initial plans).
- Risk monitoring and control: comprises tracking and reviewing identified risks and associated risk response, and identifying and assessing new ones. This is an ongoing process.

Table 8: Example of risk category

Risk category	Examples of types of risk that would fall in this category
Executive and governance risk	Lack of commitment, support or sponsorship; insufficient alignment with other initiatives
Management risk	Insufficient project/programme management; unsatisfactory planning, monitoring or controls; inadequate scope; or inappropriate decision-making process
Financial risk	Credit risk (defaulting loans or mezzanine loans, defaulting underlying loans covered by guarantees), counterpart risk (final recipient or financial intermediary), treasury risk, or operational risk Costs of the FI
Organisational risk	Inadequate organisational alignment; change management; insufficient communication; lack of competences; insufficient staffing; lack of training; ineffective business continuity plan; or IT risks (related to hardware, software, security, availability, disaster recovery, etc.)

Promotional schemes may be designed to take risks the market is not willing to accept. So the objective is not to minimise the risks. But it is important to assess the risks ex-ante and to avoid risk-taking where it is not intended. In a case where the FIs have similarities to financial products available in the relevant regional markets, a comparison to data of the financial supervisors may help to apply lessons learnt. Financial supervisors collect data on non-performing loans (NPL), guarantees and other financial products. Many of these data are published and could support the risk analysis.

SWOT analysis

Another way to take into account these lessons, to improve the setting up of the envisaged FI and to enhance its performance is to perform a SWOT[86] analysis of the envisaged FI, as shown in the Figure 19 below.

86 *SWOT: Strength – Weaknesses - Opportunities – Threats.*

Figure 19: Example of a SWOT analysis for an FI

	INTERNAL	EXTERNAL
POSITIVE	**Strengths** Success factors identified in past experiences that exist and can be exploited in the country, region or target market for the envisaged FI (e.g. sufficient market depth, absorption capacity or project pipeline, well-developed financial intermediaries, familiarity with FIs, etc.). The MA will have to make sure that these factors are maintained.	**Opportunities** These are factors that may exert a positive influence on the success of the envisaged FI but are not placed under the exclusive control of the MA (e.g. potential synergies with other forms of public interventions on the same market managed by other entities or MAs). The MA shall be pro-active in promoting those opportunities and in fostering cooperation with key stakeholders.
NEGATIVE	**Weaknesses** Conditions and factors that determined a pitfall or represented an obstacle in past experiences and that can be found in the country, region or target market for the envisaged FI. The MA will need to take corrective actions to limit the risk of facing the same issues in the implementation of the FI.	**Threats** These are factors that could potentially reduce the performance of the FI but are not placed under the exclusive control of the MA (e.g. the financial crisis puts public budgets under particular stress). The MA shall bear these threats in mind when designing and implementing the FI, even though the room for manoeuvre may be very limited.

The SWOT analysis will enable the MA to distinguish factors placed under their control from external factors, to easily identify key success factors and main risks for the envisaged FI. Based on this analysis and on the lessons learnt, the MAs shall decide actions to enhance the implementation of FI.

It is important to remember that some of the elements of the SWOT analysis refer to lessons learnt relating to the market assessment (building block 1), while other elements are more related to the delivery and management of the FI (building block 2).

The ex-ante assessment will then assess how these lessons are/will be applied going forward.

7. Proposed investment strategy

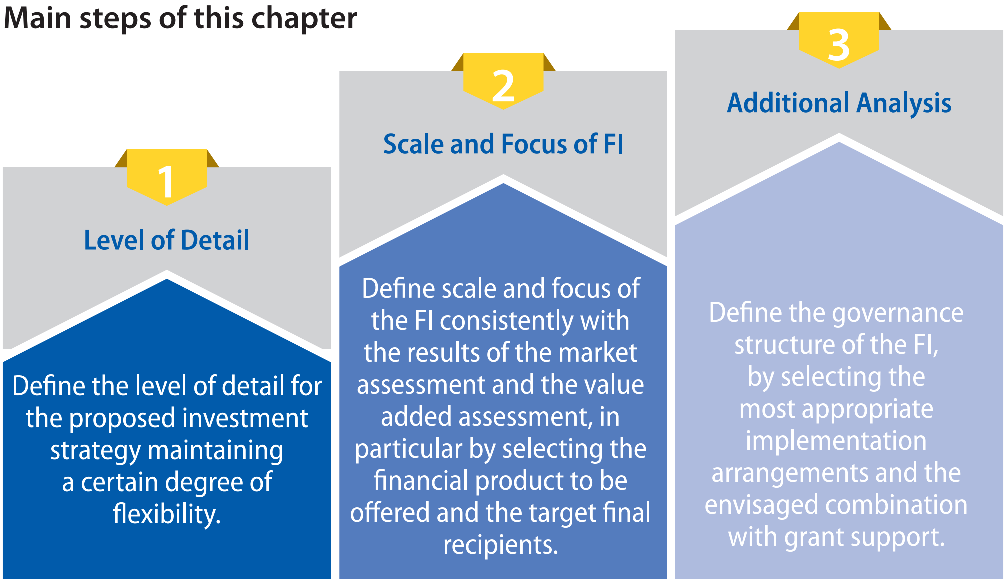
While a formal approach is needed to properly set up the FI, the content and procedure of the proposed investment strategy should comply with Article 37 CPR and at the same time should remain flexible. This and following chapters belong to the building block 'implementation and delivery' following the first building block 'market assessment'.

Article 37 (2) (e) CPR states that the ex-ante assessment for the proposed investment strategy of the FI should include the following four requirements:

- An examination of the options for implementation arrangements within the meaning of Article 38;
- Offered financial products;
- Targeted final recipients;
- Envisaged combination with grant support where appropriate.

As discussed in previous sections, MAs should take the State aid implications of the planned FI into account upfront, starting from the very beginning of the design phase. As a matter of fact, the applicable State aid compatibility legal base, presented in section 4.3 of this methodology, is relevant for the main parameters of the design of the FI, in particular as regards eligible undertakings, maximum amounts per beneficiary, the financial conditions attached to them, as well as rules on governance.

Main steps of this chapter



As explained in chapter 1.2.3, the flow of the investment should be structured in different levels. If an intermediary level is foreseen (i.e. FoF), this could be considered as a **two-stage FI**, where the MA firstly negotiates a funding agreement with the FoF and then the FoF negotiates one or more funding agreements with financial intermediaries[87]. In the two-stage FI a so-called 'call for expression of interest' (CEI) should include the proposed investment strategy which should constitute the basis for negotiations with potential intermediaries. The ex-ante assessment should not aim to foreclose the CEI. The published ex-ante assessment should include for example a range for a forecasted leverage effect[88]. On the one hand, the flexibility needs to be within reasonable limits, since forecasting a too ambitious range could result in a failed round of offers and a significant loss of time to start the support scheme. On the other hand, the minimum ranges proposed should ensure that public funds are used efficiently and that the public intervention in the market is limited to the minimum required.

If a **one-stage FI** is envisaged in the business plan, the financial parameters and the description of the governance are much closer to a **'term sheet'** of the envisaged product. The better the investment strategy can define such a term sheet the easier it will be to continue with the further implementation steps. However, it is also important to note, if a term sheet was set-up, the MA should define ranges where appropriate to reflect potential on trends and volatilities until the end of the FI implementation period.

In this section, we present the different steps that have to be taken to develop a sound investment strategy for the FI. We have identified two main components of the proposed investment strategy that will be addressed in detail in the following paragraphs, as shown in Table 9 below.

Table 9: Main components of the investment strategy

	Aim	Correspondence with the requirements of Article 37 (2) (e) CPR
Scale and focus of the FI	How is the FI going to address the identified market needs?	• Financial products to be offered; • Final recipients targeted.
Governance structure	What is the most efficient structure to reach the objectives of the FI?	• Examination of the options for implementation arrangements within the meaning of Article 38; • Envisaged combination with grant support as appropriate.

87 *In the previous programming period the MA had the option to organise financial engineering instruments for sustainable urban development through the intermediary of a Holding Fund (HF). Holding Funds then invested the resources of Programmes in one or more Urban Development Funds (UDF), under a revolving scheme, generally providing them with equity, loans or guarantees. UDFs were financial engineering instruments investing directly in urban projects.*

88 *Analysis of already existing support schemes shows a leverage of 4, one could give a range of 3 to 6 to grater flexibility.*

7.1 Process to develop a proposed investment strategy

As already discussed in section 2.2, the Programme has already provided an indicative definition of the strategic priority axis/ focus areas, the share of ESI Funds to be allocated to each axis/ focus area and provided an indicative definition of the percentage of the amount to be delivered through FIs. Furthermore, the market assessment part from the ex-ante assessment should have already been carried out, meaning that the MA has a clear view on the market failures or the sub-optimal investment situations that exist in the target market for the envisaged FI.

Phase 1: Define the scale and focus of the FI

The ex-ante assessment needs to do the following:

- Ensure consistency with the outcome of the market assessment and the value added assessment (insofar not finalised earlier, *please refer to chapter 3 and chapter 4*);
- If a group of FIs has been identified in chapter 4, select the most appropriate financial product to address the market needs. However this is not always the case, as the assessment of the value added of potential FIs has possibly already shown a clear preference for one option;
- With the selected FI, check the product and adapt or work out more in detail to address the market segments (including the forecasted range of interest rate, guarantee fees, collateral, tenor/duration, grace period, premiums for voluntary repayment, waiver of availability fees);
- Select targeted final recipients, in line with the eligibility of the Programme.

Phase 2: Define the governance structure of the FI

After ensuring that the envisaged FI is suited to the identified market needs, the ex-ante assessment has to define the governance structure that will allow the FI to meet its objectives in the most efficient way.

As a result, the following steps need to be taken:

- Analyse the pros and cons of the different options for implementation arrangements as foreseen by Article 38 of the CPR;
- Determine the envisaged co-financing structure of the FI and the possible combination with grants.

Figure 20 below presents the different steps to be completed to develop the proposed investment strategy of the FI.

Figure 20: Process to develop the proposed investment strategy of the FI

Phase 1

Phase 1: Defining the scale and focus of the FI

Where do we stand?

The Programme has provided an indication of the amount of ESIF resources to be delivered through FIs under a specific priority. The market assessment has identified market failures or suboptimal investment situations. The first phase of preparing the proposed investment strategy involves defining the **scale and focus of the FI**, in order to ensure that the envisaged FI will effectively address the market needs.

- Ensure consistency with the outcome of the market assessment and of the value added assessment
- Select the most appropriate financial product
- Select targeted final recipients

Phase 2

Defining the governance structure of the FI

Where do we stand?

The Managing Authority is confident that the envisaged FI will effectively address the market needs. What needs to be done in a second phase is to ensure that the most efficient **governance structure** is selected, taking into account the specificities of the situation in the country or region.

- Analyse the pros and cons of the different options for implementation arrangements
- Define the co-financing structure, in particular the possible combination of the FI with grants

It is important to recognise that there may be links between the two phases. For example, if in phase 2, an off-the-shelf instrument is deemed appropriate and the detailed parameters already selected in phase 1 show small deviations from the scope of off-the-shelf, one might consider adapting the parameters of phase 1. If this adaptation subsequently might not be acceptable, the preference for off-the-shelf has to be reconsidered.

The following sections will present in more detail the content of the different steps of the elaboration of the proposed investment strategy.

7.2 Defining the scale and focus of the financial instrument

7.2.1 Ensure consistency with the market assessment and value added assessment

The proposed investment strategy for the FI needs to be aligned with the outcome of the analysis of market failures and suboptimal investment situations carried out in the market assessment (*please refer to chapter 3*). This phase will lead to the identification of investment needs and, as such, the potential final recipients of the envisaged FI.

When performing the market assessment, the MA will have already ensured that the target market for the FI fits into the priorities defined in the ex-ante evaluation of the Programme, both in terms of geographical and thematic scope. Where contributions from different Programmes in one FI are envisaged, the fit to multiple Programmes has to be ensured.

In addition, the value added assessment, described in Chapter 4, should have already demonstrated whether or not the FI in quantitative terms is a good and efficient approach in addressing the market failure. Furthermore, the qualitative added value of the FI should have been established.

7.2.2 Characteristics of the financial product

The investment strategy should provide an indication of the rationale behind the choice of the financial product to be provided by the FI. FIs can support projects by providing different financial products, namely[89]: Guarantees; Loans; Quasi-equity or mezzanine capital; and Equity and venture capital.

However, each product has specific characteristics, responds to different needs and its suitability also depends on each particular case being considered. An analysis of these characteristics will allow the MA a better tailoring of the FI to the identified market demand. Table 10 below presents a synthetic analysis of the different financial products.

Table 10: Analysis of the advantages and disadvantages of different financial products

Financial product	Example	Advantages	Disadvantages	Key considerations
Guarantee	SMEs lacking of collaterals to gain access to debt finance on reasonable terms	Addresses specific risk capacity constraints in a given market segment Actual disbursement takes place only in case of default Allows consolidating the financing structure of a large number of projects with relatively little resources Allows reducing the risk premium for the request of further financing	The main problem of all unfunded instruments is the control of the liabilities in case the guarantees become striking.[90] This can be mitigated by a prudent analysis of the risk and measures to limit potential liabilities Proving the incentive effect of FIs using this type of financial product might be more complex than that of others Assessing the value added needs more efforts	It is crucial to define an appropriate and prudent multiplier ratio between the Programme contributions set aside to cover expected and unexpected losses and the corresponding loans or other risk-sharing instruments covered by the guarantees

89 JESSICA – UDF Typologies and Governance Structures in the context of JESSICA implementation.

90 If the MA decided to use a (fixed) subsidy for guarantee fee subsidy, such a product would be classified as grant. In such a case the risk mentioned here is rather with the intermediary. Another situation is addressed here. If the risk is as such that an intermediary would not take it with a fixed subsidy, a higher level of market failure is found. Perhaps no investment at all would be financed without a high percentage of the investment covered by a guarantee.

Financial product	Example	Advantages	Disadvantages	Key considerations
Loan	Purchases (plant, equipment, raw materials, semi-manufactures…)	Addresses specific liquidity and risk capacity constraints in a given market segment Limited management cost (yet higher than guarantees in case the due diligence of the financial intermediary receiving the guarantee can be accepted as a delegated process – so no own diligence is necessary)	Funded products such as loans require more initial support than unfunded products such as guarantees. On the other hand as loans assume part of the risk and provide liquidity at the same time, there are no uncovered liabilities When a grant scheme is transformed into a loan scheme, particular efforts are needed to establish a realistic PD and LGD ratio. Once assessed, these values of should be monitored carefully during the implementation phase	Key issues are the definition of the terms of the loan (e.g. soft loan in a revolving fund) and its eligibility, the required interest rates and potential losses from insolvency risk of final recipients.
Mezzanine (quasi-equity)	Infrastructure projects Growing SMEs or Mid-Caps	Allows bridging the equity gap needed for leveraging additional loans Reduced exposure to loss in case of insolvency (compared to equity)	High risk borne by the financial intermediary (yet reduced compared to equity) No active role in the project management or the management of the target companies High transaction costs related to the complexity of these products	Silent participations and other forms of mezzanine loans require a very detailed due diligence, an ad hoc contract and a very specific scheme for the exit phase One of the opportunities lies in an upside ('equity kicker') participation, which could be agreed upon by the fund

Financial product	Example	Advantages	Disadvantages	Key considerations
Equity and venture capital	Development phase of SMEs (start-ups, seed, early stage) Higher-risk projects	Active role in project management and access to shareholder's information Allows high impact per EUR invested (projects with sufficient level of equity are able to gather other types of finance)	High risk borne by the financial intermediary (full insolvency risk for the invested capital in the target companies) Venture capital (early stage) investments are time-consuming and cost intensive (due diligence is carried out for several potential business plans before investment)	High involvement of the fund in the project management or the management of the target companies. The due diligence already includes considerations on it.

Box 8: Controlling liabilities of guarantee schemes

One key instrument to control the liabilities of guarantee Programmes is a guarantee cap. One example for this is provided in the First Loss Portfolio Guarantee (for up to 80% of the first 20% of the portfolio bridging the event clauses for default). This capped portfolio guarantee (CPG) for SME portfolios works on a loan by loan basis. If the portfolio was up to €100m, the maximum payment of the ESIF was €18m. In a prudent approach, this amount could be brought into a revolving fund. If during the life cycle of the fund, a part only of this amount was used to cover called guarantees, the remainder could be reinvested in new alike schemes. If the guarantee agreement with the intermediary included a payment of guarantee fees (likely to be lower than market fees for promotional purposes), the payments could compensate (partly, fully or overcompensate) the payments of ESIF and insofar strengthen the revolving function of the scheme.

One way to deal in a prudent way with public money with respect to unfunded instruments like guarantees could be the following:

- In a first step, the **expected losses** of the envisaged individual investments of the envisaged portfolio are estimated by computing the difference between payments on first demand (if such a scheme is chosen) and the recovery rate achieved later;
- In a second step, the **unexpected loss** is estimated covering risks driven by more macroeconomic developments, asymmetric crisis shocks, but also disaster risks; etc.

- In a third step, estimate a '**premium**' for the intermediary to accept a cap, as it is prudent to design an FI with a cap on the liability of the funds. This premium would be a range for negotiations with the potential intermediary.

If the expected loss is 15% of a portfolio and the unexpected loss is 7%, than the total risk is 22%. In theory, the body implementing the project has no further risks to cover. Only to the extent administration is needed (which might be substantial) and to the extent regulation requires capital underpin for the uncovered part (which is driven by regulation), cost occurs for the intermediary.

Experience also suggests the need to take into account two further steps:

1. To align the interest of the intermediary with the MA, the intermediary should retain at least 20% of the risk. This could be compensated by lifting the cap if appropriate[91];

2. To bring in the element of the 'cap'. If a cap of 25% was finally agreed, the maximum liability of the FI would be 20% of the whole portfolio.[92] It might be needed in a negotiation process to offer a premium beyond the calculated value of expected and unexpected loss to achieve an agreement. The risk perception from the side of the intermediary may be different and the perception of the future as well. In the example, one could imagine a 'premium' in the range of 1 to 3%. The main decision with such an approach is to implement the **cap**. A cap should be acceptable to partners in all cases of rather granular portfolios and where an experience from the past is collected in the relevant market.

A specific risk assessment for guarantees in addition to the general ex-ante assessment should assess the leverage of the funded products (the potential payment of the funds equals the expected loss). Using a prudent approach, the multiplier (for guarantees) will then be reduced by taking into account the unexpected loss and further prudential factors, where appropriate.

In theory, such a prudent approach should result in unfunded FIs (such as guarantees) not showing advantages in respect to funded FIs (such as loans). Therefore, it is recommended to **check** at this stage again whether the funded product could deliver the same objective. If not, then an unfunded product remains the only way to deliver the objective. The MA should set up a new component for a broader FI and a maximum amount of the guarantees significantly smaller than the total volume of the FI. Possible partners for such an approach could be financial institutions

91 *Without lifting the calculated maximum liability of the ESIF support scheme would go down to 17.6% of the portfolio. In the extreme case, where each single loan in the portfolio will become a loss, the final liability would sum up to 80% of the portfolio.*

92 *As 20% of the defaults up to the cap are borne by the intermediary. Losses are accepted up to 25%, since the intermediary has to contribute with 20% to the 25% (as 20% of 25% = 5.0% and 25% - 5%= 20%). Any further loss beyond the cap will be fully borne by the intermediary.*

with relevant own risk-bearing capacities such as commercial or promotional banks or private mezzanine and loan funds.

Managing Authorities can decide to provide only one type of financial product through the FI or several types. However, it is recommended to limit the product offering of the FI to those that better address the market failure identified with the goal to maximise the strategic fit of the FI set-up.

Since the choice of the most appropriate financial products is closely related to sector and country-specific considerations, additional information on this subject can be found in the sector-specific methodologies.

7.2.3 Identify targeted final recipients

At this stage, on the basis of the demand for the FI identified in chapter 3, the ex-ante assessment has to decide who the potential final recipients for the targeted FI are.

MAs should have a good view on the existing project pipeline to take an informed decision on the investment strategy of their FI. Nevertheless, this exercise can be particularly challenging on a time horizon of up to ten years (i.e. the duration of the eligibility period, running until 31 December 2023), especially in some sectors such as microcredit.

Therefore, the proposed investment strategy should set a target for the final recipients, leaving room for changes (e.g. sectors of industry classified as innovative may develop over time) and be sufficiently prudent when selecting the financial product. Indeed, during the implementation phase, a reasonable level of flexibility can be beneficial to the effective disbursement of the funds.

Box 9: Example on eligibility

If an FI is envisaged to support an enterprise in research, development and innovation (RDI), the eligibility criteria should comprised the following:

- The sector and the size of the company;
- R&D and/or innovation should be targeted;
- The specificity of the investment.

The eligibility criteria should also include the definition of an innovative enterprise e.g. research and development costs represent at least 15% of its total operating costs in at least one of the three years preceding the granting of the aid or, in the case of a start-up enterprise without any financial history, in the audit of its current fiscal period, as certified by an external auditor (applied by the draft General Block Exemption Regulation GBER of DG Competition[93]), or the indicators on innovation followed by Innovation Union Scoreboard (IUS)[94] or other indicators developed in the literature.

Experience shows that detailed eligibility criteria achieve better results and reach effective implementation, nevertheless it should be measurable and 'easy to identify' eligibility parameters to deliver good results.

93 http://ec.europa.eu/competition/consultations/2013_gber/gber_draft_regulation_en.pdf

94 5% of the turnover, see http://ec.europa.eu/enterprise/policies/innovation/files/ius-2013_en.pdf

7.3 Defining the governance structure of the financial instrument

7.3.1 Analysing the pros and cons of the different options for implementation arrangements

Article 37 (2) (e) CPR specifies that the proposed investment strategy shall include an examination of options for implementation as foreseen by Article 38. An overview of the different available implementation options is provided in chapter 1.2 of this guidance. As discussed, the MA has to choose among the following:

- **Four implementation options**, namely contributing with ESIF resources to EU-level FIs, investing in the capital of an existing or newly created legal entity, entrusting implementation tasks to another entity or undertaking implementation tasks directly;
- **Two FI typologies**, namely off-the-shelf or tailor-made FIs.

7.3.1.1 Implementation options

The issues the MA has to consider when making a decision concerning the implementation option are linked to the need to:

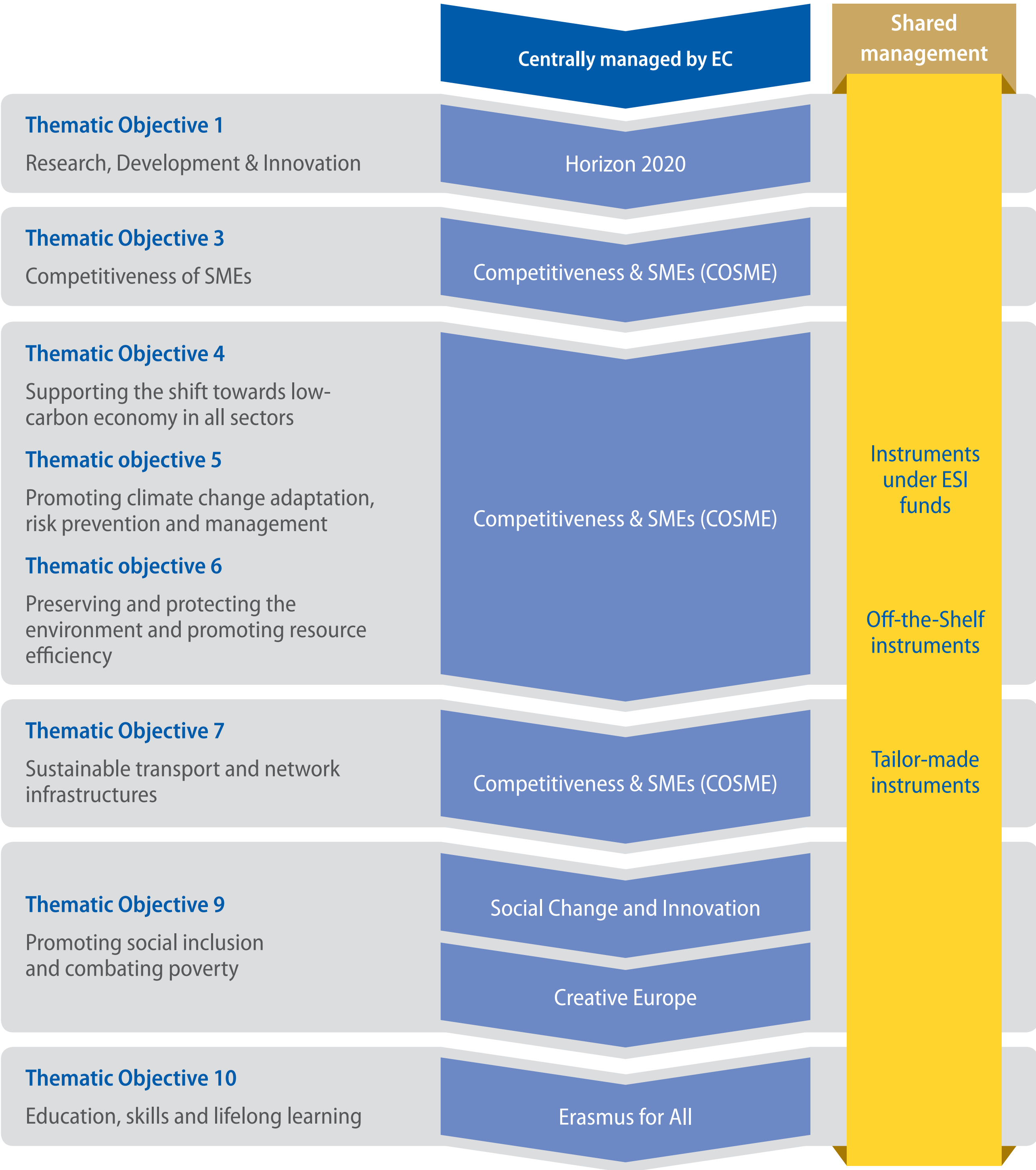
- Contribute to the achievement of strategic priorities of the Programmes;
- Achieve the highest possible efficiency in addressing the target market, taking into account the administrative and technical capacity of the actors involved;
- Avoid duplication and redundancy with already established FIs.

In order to facilitate the choice for MAs, we provide a few examples in which each implementation option can be found most appropriate as well as the main advantages of each option for the MA.

7.3.1.1.1 Contribution from ESIF to EU-level FIs

MAs could decide to allocate the amount dedicated to FIs to EU-level FIs such as Horizon 2020, COSME, Connecting Europe Facility, Social Change & Innovation, Creative Europe, LIFE, or Erasmus for All.[95]

Figure 21: EU instruments and TOs



95 *EU-level FI might not be available in all regions. A final decision may depend on the shaping of the EU- level FI by the EC or by calls/tenders of entrusted implementation bodies.*

This contribution will then be ring-fenced to make sure that it is used to finance projects in the territories and investments covered by the scope of the relevant Programme.

This option is appropriate when:

- The EU-level FI set-up can ensure that the ESIF resources are used consistently with the strategic priorities and objectives of the Programmes;
- The instruments set up at the EU-level address the same market needs and targeted final recipients identified during the market assessment phase;
- The target market is not sufficient to justify the creation of a specific FI, as the critical mass would not be reached;
- The technical and administrative capacity of ESIF stakeholders is considered insufficient to ensure efficient and effective FI implementation at regional or national levels.

The main elements to consider for the MA to find the best possible FI are:

- Avoiding duplication and increasing efficiency by taking advantage of an already existing FI, instead of creating a new one;
- Reaching a sufficient critical mass is essential for the success and the effectiveness of the envisaged FI. This may prove challenging due to insufficient market in the region or country under consideration. Contributing ESIF resources to EU-level FIs may be a way to overcome this issue and reach the desired economies of scale;
- Reducing the risk taken when setting up FIs, by relying on a tested vehicle, a proven set of procedures and implementation structure established by the Commission;
- Capitalise on EU-wide experience to develop regional and national capacities over time to possibly set up, e.g. a tailor-made FI in the future;
- The possibility to increase the co-financing rate up to 100%;
- The MA shall not carry out on-the-spot verifications of operations (it shall receive regular control reports from the bodies entrusted with the implementation of these FIs);
- The Audit authority (AA) shall not carry out audits of such FIs and of management and control systems relating to these instruments. They shall receive regular control reports from the auditors designated in the agreements setting up such FIs.[96] On the other hand, it is important to remind that this does not imply a relaxation of the CPR rules on audit trail.

96 *The latter two points aim to sort out difficulties in the audit and control trail of the past. If the audit is concentrated at one level and the other level receives regular reports, a significant reduction of complexity can be achieved.*

7.3.1.1.2 Option a: Investment in the capital of an existing or newly created legal entity dedicated to implement FIs consistently with the objectives of the ESI Funds

When choosing among options available under the FIs set up at national, regional, transnational or cross-border levels, MAs can decide to invest in the capital of existing or newly created legal entities dedicated to the implementation of FIs.

This option is appropriate when:

- The FI is conceived to be implemented by a body where an injection to the own funds of the body is necessary or supportive to achieve the objectives (e.g. a quasi-equity fund, where a trustee account without injection to the own funds will restrict the lending capacity of the fund too much and therefore its capability to contribute with own investments);
- The FI is conceived to be implemented by one clearly identified body, with well-defined objectives and structure[97]. This does not prevent the body implementing the fund of funds from delegating part of the implementation tasks to other financial intermediaries as per Article 38 (5) CPR;
- A fund of funds structure is chosen as a body dedicated to implement FIs consistent with the ESI Funds only. According to Article 2 (27) the fund of funds is the beneficiary of the ESIF resources and it contributes support from one or more Programmes to several FIs. The rationale of the fund of funds structure is strong, when the financial intermediaries (e.g. urban development funds, e.g. banks for SME lending, e.g. Microfinance credit institutions) (i) are multiple or form a competing group or (ii) will be identified at a later stage or (iii) the implementation volumes will be defined later.

As the entity will be a vehicle, dedicated to implement FIs consistently with the objectives of the ESI Funds most forms of conflict of interest can be avoided, such as interests of the entity in other potentially conflicting activities and profit accumulation for other activities supported by the activities related to the ESIF;

7.3.1.1.3 Option b: Entrust implementation tasks to another entity

MAs can appoint a **financial institution for public interest under public control** (which is normally a national or regional development bank or promotional bank or promotional agency) or an IFI or the EIB[98]:

- As a manager of FoF (body implementing a fund of funds); or
- As a manager of a specific FIs/products (financial intermediary).

97 Institutions mentioned under Article 38 (4) (b) normally are not dedicated to implementing FIs of the EU only, they endeavour to have a broad other business as well.

98 The Delegated Act, according to Article 38 (5). CPR lays down,inter alia, the related selection criteria.

This option provides the MA with a robust structure, which is well equipped and used to manage funds and investments according to recognised standards of independence and professional management. Therefore the option could be used where a long-term partner for entrustment is sought.

In cases where MAs lack a sufficient level of in-house knowledge and expertise and looks for a short term partner this could provide an opportunity to build it up and possibly take a more direct management role in future FIs.

The implementation of the FI can also be entrusted to **other bodies subject to public or private law** such as agencies, PPP funds, commercial banks and other bodies. The entity has to be selected through a selection process in accordance with applicable EU and national rules. Specific rules for entrustment apply depending on the nature of the public body.[99]

The elements to consider for the MA are as follows:

- Builds on know-how and expertise that public and private bodies have of the local financial and legal environment;
- Benefits from the added value of the bodies already active in the market and ready to be mobilised by the MA. This option also includes the possibility under certain conditions to refinance existing instruments that proved to be successful. In certain cases open selection procedures may be appropriate to scale-up existing instruments with additional refinancing.

It is important to note that the proposed investment strategy represents a starting point for negotiations with (e.g. private) intermediaries. However, in the case of a direct entrustment of financial intermediaries, such strategy may need to be adapted to facilitate implementation negotiations.

The MA has to select the financial intermediary taking into account, at least, the following criteria:

- Prior experience with the implementation of similar FIs, including, where applicable, the expertise and experience of proposed team members;[100]
- The body's operational and financial capacity;
- Robustness and credibility of the methodology for identifying and appraising financial intermediaries or final recipients as applicable;
- The level of management costs and fees for the implementation of the FI and the methodology proposed for their calculation;
- Terms and conditions applied in relation to support provided to final recipients, including pricing;

99 Inhouse procurement may apply.

100 Under public procurement rules experience can be one selection criteria in the selection phase only.

- The ability to raise resources for investments in final recipients additional to Programme contributions;
- The ability to demonstrate additional activity through the FI in comparison with the present activity and overall strategy in the sector; and
- In cases where the financial intermediary allocates its own financial resources to the FI or shares the risk, proposed measures to align interests and to mitigate possible conflicts of interest.[101]

7.3.1.1.4 Option c: Direct implementation of the FI by the MA

This option can be used exclusively when the financial product to be provided by the FI is a loan or a guarantee. The MA or the intermediate body may have a significant experience and good knowledge on FIs. In addition to the in-house expertise, also resources in the MA or an intermediate body are needed, since it will have to ensure the full scope of activities involved in the FI implementation, including due diligence, treasury management, risk management, monitoring and reporting.

The advantages of this option are as follows:

- The possibility to draw non-grant finance from ESI Funds without establishing a dedicated FI, which could be complex and potentially time-consuming;
- Avoids introducing additional layers of reporting and monitoring;
- Leverage the competences when the MA already holds in-house expertise.

Article 90 states that FIs are not considered major projects; therefore, even though a direct loan or guarantee is provided to a major project, the prescription of Articles 90 and 91[102] should not apply. However, some questions addressed in the CBA analysis have to be addressed in the ex-ante assessment anyhow.

7.3.1.2 Choice of FI type

Once the choice of implementation option is made and the establishment of an FI at the national, regional, transnational or cross-border levels is decided, MAs face the choice of the most appropriate FI typology, i.e. between off-the-shelf instruments and tailor-made instruments. The following paragraphs describe the main advantages of these two typologies.

101 *List foreseen in the Delegated Act according to Article 38 (5).*

102 *Article 91 of CPR describes the information necessary for the approval of major projects, including an analysis of the environmental impact and a cost-benefit analysis, including an economic and financial analysis, and a risk assessment.*

7.3.1.2.1 Off-the-shelf instruments

To facilitate the timely launch and sound functioning of FIs, the CPR allows making Programme contributions to FIs complying with standardised terms and conditions ('off-the-shelf').

These terms and conditions include (non-exhaustive list): Aim of the instrument; State aid implications; Lending policy; Eligibility criteria for final recipients and financial intermediaries; Pricing policy; Characteristics of the financial product for final recipients; Liabilities of the MA.

The off-the-shelf instruments developed so far focus on models which were implemented in the 2007 - 2013 programming period and those that have proved successful in terms of the implementing methods pursued by MAs and their stakeholders.[103] In a second phase, and depending on the different Programmes and results of ex-ante assessments, additional off-the-shelf instruments may be developed by the Commission during the programming period 2014-2020.

The predefined standard terms and conditions are understood as minimum requirements. So tightening in a regional adaptation would be possible. Deviations in the other direction make the instrument to be treated as a tailor-made instrument.

This option is appropriate when:

- The available instruments fit the market needs and the targeted final recipients identified during the ex-ante assessment phase;
- A proven model is important for all stakeholders involved;
- The MA has limited resources to commit for the development of a specifically designed FI;
- A fast roll-out of the FI is crucial, for instance where anti-crisis interventions are envisaged, e.g. access to finance for SMEs.

The main advantages for the MA are:

- Foster a safer and better managed process, since these instruments are based on the implementation experiences and know-how capitalised during the current programming period;
- State aid compliance is already embedded in the terms and conditions, therefore a notification to the Commission is not necessary;
- If there is no predecessor FI for the envisaged area of intervention, faster delivery of the financial means to the final recipients (early start). Given the slow start of new tailor-made FIs the financial perspective 2007 – 2013, a fast ramp-up of Programmes may significantly increase the absorption capacity of a region;

103 See Chapter 1 and Table 1 for the reported FIs. Those running FIs not covered by de minimis or (the old) GBER have passed the notification process for state-aid.

- Flexibility of the proposed terms and provisions to fit into the reality of each OP. Off-the shelf instruments may evolve into tailor-made instruments in the future if the MA feels the need to provide a more targeted FI, better suited to the market demand or if market conditions evolve.[104]

7.3.1.2.2 Tailor-made instruments

Tailor-made instruments are FIs implemented on the basis of CPR provisions from Articles 37 to 46 CPR (for example, in terms of eligibility and reporting) but the specific set-up is designed to address particular needs not covered by off-the-shelf or to use already running FIs with or without EU support (perhaps with smaller adaptations) as delivery mechanisms for ESIF 2014-2020.

Box 10: Example on Energy Efficiency

Energy efficiency (EE) support schemes were set up by several Member States. However, only after the financial perspective 2007 - 2013 had already started, the availability of structural fund for EE was developed. So some Member States have schemes in place with national funding and could consider combining and enlarging it with EU support as of 2014. Another consideration could transform grant schemes with EU support into a grant-FI combination.

This option is appropriate when:

- The market needs and the targeted final recipients are very specific and cannot be covered by either EU-level or Off-the shelf FIs;
- MAs are already familiar with and have the resources for the setting up and use of FIs;
- The MA wants to address a field where on one hand a broader experience is already built up in the regions (e.g. UD Funds, Innovation finance), but on the other hand no off-the-shelf is defined yet;
- An 'advanced' model of risk-sharing with private and public partners is envisaged. Schemes including existing loan portfolios for collateral, larger companies as partners for housing renovation, lower own-funds participation of the management of equity funds in exchange against lower earnings or where the first loss piece taken by the promotional scheme exceeds 20% of the portfolio[105] require a tailor-made approach;
- A grant-loan combination (or broader a combination of grants with 'bankable instruments') is envisaged, where tailor-made is the only way forward.

104 It is possible to add conditions to the minimum set of requirements for the off-the-shelf optional.

105 20% is the threshold as defined in the envisaged GBER (The 20% threshold for SME risk schemes in the GBER still discussed and might be different in the final GBER.). A higher intensity of support for specific sectors like innovation for Mid Caps or specific phases for SMEs might be found as a part of the viability analysis in a region – beyond the thresholds of five years' lifetime and 20% first loss piece.

The main advantages for MAs are:

- Ensure that the FI is perfectly adapted to country or region-specific market conditions and to the needs of the targeted final recipients;
- Exploit standardisation in the sectors where other regions have already collected experience, but adapt it to the region to the extent possible (for those sectors without off-the-shelf instruments);
- Gives the opportunity to align an existing activity to an envisaged EU support scheme without creating two Programmes (one EU-supported, the other one not EU-supported) with potential overlap, despite the fact that there needs to be a clear separation of the different budget lines;
- Allow exploiting solutions envisaged by the CPR such as ITI and CLLD through FIs, where the governance structure needs to be tailor-made, but the bottom-up approach or the decentralised management may allow for specific adaptation to local needs.[106]

7.3.2 Envisaged combination with grant support

Article 37 (7) of the CPR states that FIs may be combined with grants. Grants as technical support for the benefit of the final recipient and for the purpose of technical preparation of the prospective investment to be supported, interest rate subsidies and guarantee fees subsidies, can be combined with a FI in a single operation if they are directly related to this FI, if they target the same final recipients and if separate records are maintained for each form of support[107]. Grants, interest rate subsidies and guarantee fees subsidies may be used to deliver an additional service in combination with the FI and to engineer the respective FI according to the minimum intensity of subsidy required to achieve the objective according to the ex-ante assessment.

Final recipients supported by an ESI Fund FI may also receive assistance from another ESI Funds priority or Programme or from another instrument supported by the budget of the Union in accordance with applicable Union State aid rules, as provided for in Article 37 (8) of the CPR. In that case, separate records shall be maintained for each source of assistance and the ESI Funds FI support shall be part of an operation with eligible expenditure distinct from the other sources of assistance. This means that the two types of support form part of two separate operations with distinct eligible expenditures.

For all cases (the same operation or separate operations) the CPR allows the combination of grants and FIs to be used on the **same** expenditure item provided that the sum of all forms of support combined does not exceed the total amount of the expenditure item concerned and all the con-

106 E.g. the decision-making process in CLLDs might be not always in line with the management on a commercial basis as required by the off-the-shelf for equity. On the other hand, most of the support schemes envisaged by CLLDs could be covered by de minimis – and as such free of notification also in a tailor-made case.

107 Article 37 (7) of CPR.

ditions under Article 37 (7) (8) and (9) CPR are met and explicitly provides for that (1) grants shall not be used to reimburse support received from FIs and (2) FIs shall not be used to pre-finance grants.[108]

The main advantages of combining FIs with grant support include the following:

- Facilitating the **transition** from a former grant regime towards revolving FIs, thereby gradually moving away from grant dependency;
- Flexibility in the choice of the appropriate mix of grant and FIs, depending on the specific needs of the targeted final recipients and their **access to finance**, where the FI may be more supportive than a grant irrespective of a lower intensity of subsidy;
- Effectiveness of EU public spending by promoting and achieving to the extent possible a **lower intensity of subsidy** than with grants.

If the grant, as technical support for the benefit of the final recipients, for instance in case 0f Energy Efficiency project management for multiple apartment owners, to audit the existing situation or to identify the right investments, there might be good reasons to integrate it in a combined FI.

On the other hand, there could be good arguments for a separate support operation. This could help to mobilise specialists and in addition provide checks and balances in the project preparation as the financing interest might be less dominant. If the grant constitutes a separate operation, the MA may choose a specialised company or institution as beneficiary for this. The separated grant instrument falls under the rules for grants including ex-post reimbursement. Double counting has to be avoided in both cases, the expenditure declared under the grant has to be excluded from the expenditure declared under the FI. Moreover, State aid rules on combination of aid should be adhered to. Double funding of the same measure by management costs and technical support budget has to be excluded.

108 Article 37 (9) of CPR.

Box 11: Illustrative example of the combination of a guarantee fee subsidy with a loan

Let us consider the case of an incumbent grant support scheme of 2007-2013. The MA faces the question whether to continue with it or due to changing conditions explore the possibility to transform it into a loan support scheme. Since the market conditions of the loan (e.g. high cost of borrowing) are unlikely to be accepted by SMEs, the MA has two options: i) the interest rate to be paid by the final recipient could be lowered or ii) the loan could be combined with a grant element.

The possibility to combine a loan with a grant within financial instrument operation draws from the possibility offered by Article 37 (7) of the CPR which states that support from ESI Funds delivered through FIs can be combined into a single operation with other forms of support directly related to the FI and addressing the same final recipients, provided that State aid rules are respected and that separate accounts are maintained for each form of support.

Therefore a possible solution would be to set up a loan scheme where 50% of the loan is financed by ESIF programme resources and 50% by the financial intermediary's own resources. For the part of the loan coming from the financial intermediary's own resources to the final recipient at market rates a guarantee is usually required. The final recipient charged with a guarantee fee could benefit from a guarantee fee subsidy and this way would benefit of more favourable conditions than the market offers.

8. Specification of expected results consistent with the relevant Programme

The result orientation of the ESI Funds for the 2014-2020 programming period is based on three pillars:

- A clear articulation of the objectives of Programmes with a strong intervention logic (the result orientation of Programmes);
- The definition of ex-ante conditionalities to ensure that the necessary prerequisites are in place for the effective and efficient use of Union support;
- The establishment of clear and measurable milestones and targets to ensure progress is made as planned (performance framework).

In this context it is essential for MAs to setup target results and a practical monitoring system dedicated to FI to monitor their performance and contribution to the corresponding investment priority(ies) (ESI Funds) or focus area (EAFRD) and to the overall objective(s) of the related Programme(s).

Therefore, Article 37 (2) (f) CPR specifies that the ex-ante assessment shall include:

- A specification of the expected results;
- How the FI is expected to contribute to the achievement of the specific objectives and results of the relevant priority or measure including indicators for this contribution.

In order to meet these requirements, MAs could refer to other useful relevant guidance documentations published by the Commission, such as (non-exhaustive list):

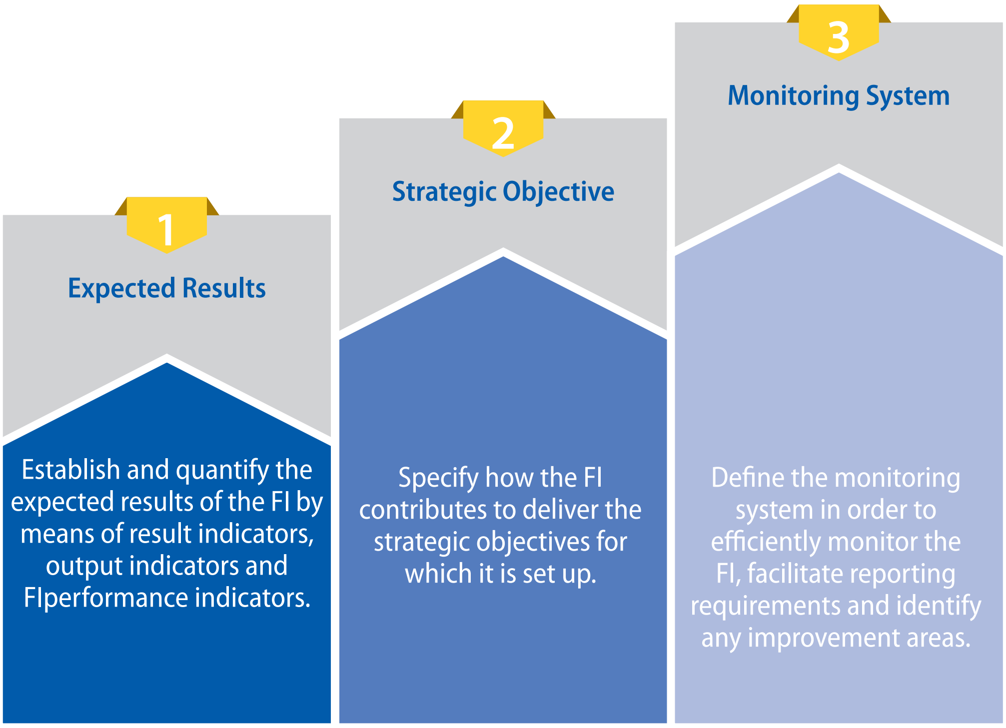
- Guidance document on monitoring and evaluation – European regional development fund and cohesion fund – Concepts and recommendations[109];
- Monitoring and Evaluation of European Cohesion – European Social Fund – Concepts and recommendations – Guidance document - Draft, 9 January 2013[110];
- Elements of strategic programming for the period 2014-2020 (EAFRD).[111]

109 http://ec.europa.eu/regional_policy/sources/docoffic/2014/working/wd_2014_en.pdf.

110 http://ec.europa.eu/social/BlobServlet?docId=7884&langId=en.

111 http://ec.europa.eu/regional_policy/conferences/sfc2014/doc/wp_prog.pdf.

Main steps of this chapter



8.1 Establishing and quantifying the expected results of the financial instrument

The expected results of the FI shall be derived from the previous parts of the ex-ante assessment, notably the market assessment, the expected value added and the investment strategy. The MA should then define corresponding indicators to quantify the expected results and, at the same time, to comply with the Commission requirements.

In addition, indicators are useful to possibly refine the FI during the implementation phase.

Depending on the needs of the MA and the applicable requirements result/output/FI performance indicators should be defined:

- **Output indicator:** MA should use the set of common indicators already predetermined in the fund-specific Regulations or complementary documents provided by the Commission. In case of EAFRD and the EMFF, the Commission provided a detailed set of measure and focus area-specific indicators, also mandatory for FIs. Indicators could cover the different forms of support to beneficiaries (including technical support) through FIs;
- Additional FI performance indicators could be defined with regard to measuring the operational efficiency of FI implementation (e.g. management costs, expected credit loss);

- **Result indicator:** Following the new results-oriented approach, there should be special attention paid to the definition of clear and measurable result indicators. The result indicators must be clearly interpretable, statistically validated, truly responsive and directly linked to the specific objectives of the investment priority or focus area the FI is contributing to. For that, the implementation of the FI should affect the value of the selected result indicator under the corresponding investment priority or focus area. Examples of result indicators can be found in the different thematic guidance fiches provided by the Commission. In case of EAFRD and the EMFF, target and complementary result indicators are part of the common monitoring and evaluation system for RDPs, as defined in Art. 67 of Regulation (EU) No 1305/2013 [EAFRD].

The following figures give examples of possible indicators of FIs, the first for SMEs and the second on energy efficiency. Please refer to the specific volumes on Energy Efficiency (Volume II) and SMEs (Volume III) for further information.

Figure 22: Example of indicators for a loan fund for SMEs

Type of FI	Loan funds to SME
Source of financing	ERDF
Funds budget	10M EUR
Specific objective of corresponding investment priority/ focus area	Supporting investments of SME with a focus to manufacturing

Result indicator of the corresponding investment priority/ focus area

indicator	unit	baseline	target	source
gross fixed capital formation in manufacturing	M EUR / national currency	800 (2011)	1.000 (2022)	National / regional accounts

Output indicators (as stated in the Annex of ERDF Regulation)

indicator	unit	baseline	target	source
enterprises receiving loans	number	-	100	monitoring
new enterprises supported	number	-	50	monitoring
Private investment matching public support to SMEs	M EUR / national currency	-	40	monitoring
jobs created in assist-ed SMEs	number	-	600	monitoring

Performance indicators

indicator	unit	target	source
credit loss	Volume of defaulted loans / volume of total loans outstanding	4 %	monitoring
Management costs	% on volume of total loans outstanding	4 %	monitoring
Leverage	Private investment matching public support to SMEs / public support to SMEs	5	monitoring

Figure 23: Example of indicators for a loan fund for energy efficiency

Type of FI	Loan fund to support energy efficiency investments in public housing
Source of financing	ERDF
Funds budget	20M EUR
Specific objective of corresponding investment priority/ focus area	Supporting investments in energy efficiency investments in public housings

Result indicator of the corresponding investment priority/ focus area

indicator	unit	baseline	target	source
CO_2 emissions from public sector	1.000 tonnes of oil equivalent	240 (2009)	180 (2022)	National / regional energy statistics

Output indicators (as stated in the Annex of ERDF Regulation, supplemented with FI specific indicators)

indicator	unit	baseline	target	source
Decrease of primary energy consumption of public buildings	kWh/year	-	240.000	monitoring
Estimated decrease of GHG	tonnes of CO_2eq / year	-	140	monitoring
renovated public buildings	1.000 square metres	-	40	monitoring

Performance indicators

indicator	unit	target	source
Management costs	% on volume of total loans outstanding	4 %	monitoring
Saved GHG per 1.000 € invested	Kg of CO_2eq per year	350	monitoring

An FI may contribute to deliver objectives related to different investment priorities or focus areas under one or more Programmes. In such cases, the MA has to consider that the set of indicators to be established needs to cover the monitoring requirements of all corresponding investment priorities or focus areas.

8.2 Specification of how the financial instrument will contribute to the strategic objectives

As previously specified, one of the three pillars of the result orientation of the ESI Funds is a clear articulation of the objectives of Programmes with a strong intervention logic (the result orientation of Programmes). This articulation should be reflected in the definition of the FI (market gap assessment, investment strategy) but also in the expected results, thus in the indicators.

As the FI is embedded into the architecture of the corresponding Programme, the MA should describe how the FI is expected to contribute to the achievement of the specific objectives at the level of the corresponding investment priority or focus area. If the FI is just one of a batch of different measures programmed under the corresponding investment priority or focus area, the MA should also describe the interaction of those measures and the specific role of the FI for achieving the specific objectives.

For making clear the expected quantitative contribution, MA should refer to the targeted indicators of the FI.

Box 12: Energy efficiency in Poland

A study was performed in Poland for NFOS, the National Fund for Environmental Protection and Water Management, which is the main promotional agency for energy efficiency support schemes and other promotional Programmes with environmental impact. National targets in Poland were derived from the EU Directives into the Second National Action Plan (NAP) for energy efficiency. The breakdown into the different sectors and the estimation of the investment needs for the sectors was an objective of the study. The main sectors identified were (i) energy efficiency (EE) and renewable energy sources (RES) in buildings, (ii) EE and RES in companies, (iii) EE and RES in other projects including urban projects like city lighting, low-emission transport and revitalisation, (iv) generating energy from municipal solid waste and (v) generating energy from sludge. The investment needs until 2020 were determined to deliver the objectives of the NAP. The investment needs were estimated at PLN170bn (around €41bn). The intensity of State aid to make the investments happen was estimated in the different sectors between 30% and 45%, which results across all sectors in a public support scheme of €15bn.

Based on this ex-ante screening, FIs will be developed and designed. The contribution to each of the sectors and to the overall target of the NAP may be quantified, as well as the share of the NAP objectives foreseen to be addressed under the Programme. In addition, the contribution to the achievement of the specific objective at the level of the investment priority can be calculated.

8.3 Monitoring and reporting

Due to the specific procedures and delivery structures of the FIs, the provision of information on the use of budgetary resources from ESIF is crucial for all stakeholders of the ESIF Policies 2014-2020, as it allows them to draw conclusions about the actual performance of supported instruments and the necessary adjustments to ensure their effectiveness. Therefore, Article 46 of the CPR requires the MAs to forward to the Commission a 'special report on the activities related to FIs in the form of an annex to the annual implementation report.

The MA has firstly to ensure that the reporting requirements are met. Monitoring and reporting requirements from the implementing body (dedicated entity, entrusted intermediary or MA) to the MA should be clearly defined in the funding agreement. The exceptional case is the implementation of an FI according to Article 38 (4) (c) where the MA implements directly without classical intermediary. In such a case, the MA should define the reporting needs in an internal document.

A dedicated monitoring process should be defined at FI level. The key elements of the monitoring process are illustrated in Figure 24 below. This monitoring process should take into account the governance structure of the FI.

Figure 24: Monitoring process of the FI

Secondly, the MA may also consider the content of the required specific report is listed in Article 46 (2). Fiche No. 4B 'Reporting on financial instruments to the Commission under the annual and final implementation reports' provides-on a provisional basis-much more detailed information concerning the reporting obligations of the MA.[112] This information will be part of the Implementing Act under preparation. However, the requirements for reporting to the Commission do not limit the reporting requirements that the MA may consider necessary to get from the fund of funds or the financial intermediary.

In order to be able to respond to its obligations towards the Commission, MAs have to make sure that all the necessary information is available. For that, the overall data set should be part of the

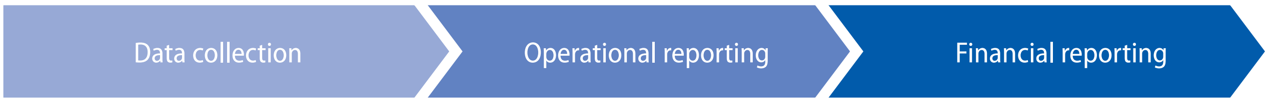
112 *Version 4 - 23 September 2013; http://ec.europa.eu/regional_policy/what/future/pdf/preparation/262709_ia_2_implementing_act_reporting_template.pdf.*

funding agreement between the MA and the financial intermediary. In this context, also the requirements regarding the monitoring system allowing for IT-based data collection and reporting might be specified.

Annex IV of the CPR provides **secondly** another element of the reporting for the MA (via funding agreement). This second element is about the steering of the FI. The MA may pilot the FI to some extent through conditions in the funding agreement about targeted results, leverage, reutilisation of resources and responses of the FI, when things develop differently and deviations occur.

The MA could, therefore, decide to set up a monitoring and reporting system that provides them with information on the performance of the FIs in shorter intervals, e.g. with **quarterly** monitoring reports. A closer monitoring would allow the MA to identify possible hinders and issues in FI implementation and to facilitate its management. As an example, the MA should include the amount of eligible expenditures incurred (in line with Article 42(1) (a)(b)(d) in payment requests. A bottom-up reporting approach could be implemented as defined in Figure 25 below:

Figure 25: Steps of the reporting process



For ensuring **data collection** and availability, the overall data set should be part of the funding agreement between the MA and the financial intermediary. In this context, it is advisable to define a standard reporting format, for instance an IT-based system or a common template. This will make data aggregation more efficient.

For the **operational information** reports on items such as like deal flow, addressed target groups, uptake of the FI (to phase inter alia the payments of the contribution) and/or risk profile of the implemented investments might be necessary. More generally, such a reporting is to document the progress made in implementing the FI over the preceding period. Progress reports should include elements such as analyses of progress made in comparison with the established investment strategy as well as the provisions of the funding agreement.

For the **financial reporting** element, the information with respect to **accountability** is important. Annex IV states that minimum requirements of such documentation are included in the funding agreement. As there are different regimes to implement FIs, the minimum requirements are expected to be different and adapted to the situation. If the MA has entrusted the implementation of the FI to a financial intermediary, the documentation and the audit of the escrow account (normally a part of the audit of the whole entity where the escrow account is located) will be important. A system to document the current payments for the management and liabilities for present and future fees will be needed as well. If the FI is implemented by a dedicated entity such as a fund with its own legal personality and defined governance for different groups of investors (who may have different non-pari passu arrangements) then a complete set of financial statements will be needed, including:

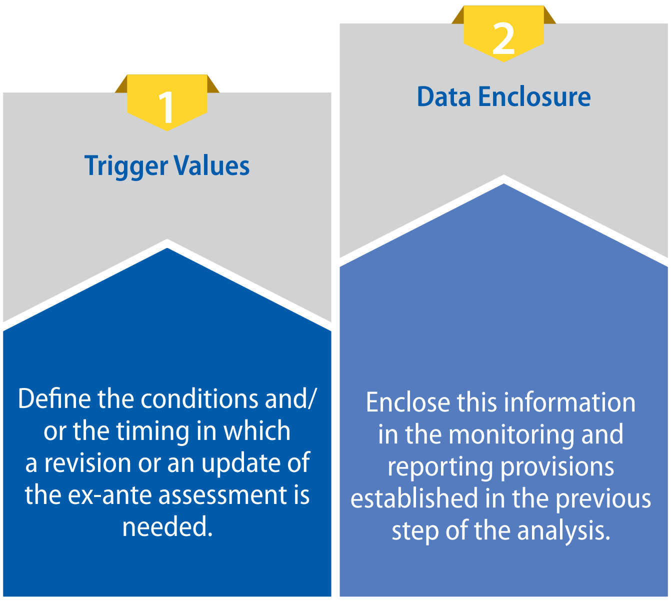
- Economic out-turn account;
- Balance sheet and P&L;
- Management costs statement;
- Various notes to financial statements.

The funding agreement has to fix appropriate documentation requirements.

9. Provisions for the update and review of the ex-ante assessment methodology

Market conditions and investment trends may evolve before and during the implementation phase of the FI. As a result, Article 37 (2) (g) CPR requires that the ex-ante assessment includes provisions for its revision and update, in case the MA considers that the conclusions of the ex-ante assessment do no longer represent the actual market conditions.

Main steps of this chapter



This component of the ex-ante assessment creates the freedom for the MA the change the ex-ante assessment when it is deemed necessary.

As the envisaged FI is built on support from the EU budget for well-defined objectives, one can address the update building on the **results** of the FI during implementation. If the expected results of the FI are not achieved, an update could be considered.[113] The main drivers to trigger an update could be:

113 *One could also look at a sample of the parameters considered during the ex-ante assessment. If the parameters change, an update could be initiated in case the change was deemed relevant. Many parameters for the ex-ante assessment are not automatically at hand of the MAs. So additional time and effort would be needed. The approach lined out here is based on the results. The data volume for this is smaller and most or all of it is part of the monitoring.*

- **Poor accuracy** of the proposed targets compared to observed results. A strong divergence between the two may jeopardise the delivery of the FI's objectives and a review may be needed to adapt the targets. The consistency with the Programme strategy (chapter 2) and the value added (chapter 4) are the main elements to be updated;
- **Inadequate volume** of the support scheme compared to observed demand. For example, a situation where the volume is too low to meet observed demand may undermine the ability of the FI to achieve envisaged objectives. Furthermore, if the phased payment process of the EU contribution pursuant to Article 41 shows a **significant faster** or **significant slower take-up** of the support scheme than originally envisaged, there may be a good case for a review resulting in an update. The review may show that:
  - i. The market situation is more or less unchanged, but the absorption speed has been underestimated or overestimated; or
  - ii. That the implementation is in line with the expectations, but a change in the market segments itself created a significant higher or lower demand for the support scheme than envisaged.

Volumes could be increased or lowered; technical support could be added to improve the absorption capacity. If the result of the review shows the alternative (i) the original ex-ante assessment was not right in respect to the estimated volume, the needs for public investment were underestimated or overestimated (chapter 3). If the review finds alternative (ii), the original ex-ante assessment was right, but the environment had changed, the level of market failure might be higher or lower (chapter 3).

- **Miscalculation of the risk** taken by the FI: A situation may occur where the risk profile of the FI is significantly higher than expected, leading the FI to incur significant losses and thereby compromising its revolving nature. A review could readjust the risk profile to ensure the appropriate level of revolving money and thus maintain the leverage effect[114];

Alternatively, the review may also find evidence that the original risk profile was overestimated. In this case of a better risk profile, additional target volume with the same financial support contribution (e.g. via higher leverage, chapters 4 and 5) might be envisaged.

The need for update and review of the assessment could be signalled through:

- Regular reporting/monitoring of the FI (at least annually);
- The regular reporting data send the signal for an update probably more rapidly than external statistical data;
- Predefined trigger values (which are compared with the reporting figures); or

114 *Revolving funds envisaged for reinvestment constitute additional resources for investment in the future.*

- Through ad hoc or planned evaluations (e.g. ongoing evaluations).

The **volume of work** for the update is difficult to predict. A drastic change to the economic environment such as a major financial crisis might cause a comprehensive update. A more gradual change should result in a smaller update, reviewing perhaps one step of the ex-ante assessment only. It seems reasonable to update the summary findings and conclusions (Article 37 (2) (g) CPR) accordingly and to explain what triggered the update and what was changed by comparison to the original assessment.

Following the conclusions of the updated ex-ante assessment, the MA should take action, if necessary, to improve the strategic fit of the FIs.

As it is always difficult to anticipate economic environments for the whole financial perspective, this update clause allows for more **flexibility** in the programming of the ESIF with a procedure triggered and performed in the sole capacity of the MA.

10. Ex-ante assessment completeness checklist

The following checklist shall help the MA to get an **overview of the essential requirements** carrying out the ex-ante assessment of the FI:

- Reference to Article 37 (2) (a) - (g) CPR;
- Reference to the chapters of the general methodology;
- Recommended main methodological steps detailed as the beginning of each chapter;
- Expected outputs of these steps.

It is represented as a linear approach, even if the ex-ante assessment should be an iterative approach (please refer to Introduction).

The checklist could be used for defining the scope of the ex-ante assessment, planning it, monitoring it and/or checking its completeness

Monitoring requirements

The main documents of the ex-ante assessment are provided to the **Monitoring Committee (MC)** by the MA for information purposes (Article 37 (3) of the CPR). The Monitoring Committee includes pursuant to Article 48 and Article 5 CPR representatives of the intermediate bodies (which may play an important role for FIs) and of the partners of the Partnership Contract (e.g. urban authorities, which may play a role for FIs on urban development and urban regeneration).

In accordance with Article 37 (3) of the CPR, the MA should submit the ex-ante assessment to the Monitoring Committee. This should enhance the procedural reliability in implementing the FIs by the MAs. In addition, the summary findings and conclusions of ex ante assessments in relation to FIs shall be published within three months of their date of finalisation.

Figure 26: Ex-ante assessment completeness checklist (Article 37 (2))

Preliminary considerations
Chapters 1 and 2

1. Understand the rationale for an increased use of FIs and consider the experience gained with FIs in the 2007 - 2013 period.
2. Understand the different types of FIs available, the possible implementation arrangements and the different possible flows of investment contributions
3. Define the scope and the time frame of the ex-ante assessment
4. Check the consistency with the Partnership Agreement and the Programme Strategy

Article 37 (2) a
Chapter 3

1. Identify the market problems existing in the country or region in which the FI has to be established
2. Analyse the gap between supply and demand of financing and by identifying sub-optimal investment situations
3. Quantify the investment gap to the extent possible

Article 37 (2) b
Chapter 4

1. Identify the quantitative and the qualitative dimensions of the value added of the envisaged FI and compare it with the added value of alternative approaches
2. Assess the consistency of the envisaged FI with other forms of public intervention
3. Consider the State aid implications of the envisaged FI

Article 37 (2) c
Chapter 5

1. Identify additional public and private resources to be potentially raised by the FI and assess indicative timing of national co-financing and of additional contributions (mainly private)
2. Estimate the leverage of the envisaged FI
3. Assess the need for, and level of, preferential remuneration based on experience in the relevant markets
4. Choose an approach for alignment of interest with private co-financing

Article 37 (2) d
Chapter 6

1. Gather relevant available information on past experiences, particularly on those that have been set up in the same country or region in which the envisaged FI will be established;
2. Identify the main success factors and the main pitfalls of these past experiences;
3. Use the collected information to enhance the performance of the envisaged FI (e.g. mitigate and reduce risk, ensure a faster set-up and roll-out of the FI).

Article 37 (2) e
Chapter 7

1. Define the level of detail for the proposed investment strategy maintaining a certain degree of flexibility
2. Define scale and focus of the FI consistently with the results of the market assessment and the value added assessment, in particular by selecting the financial product to be offered and the target final recipients
3. Define the governance structure of the FI, by selecting the most appropriate implementation arrangement and the envisaged combination with grant support

Article 37 (2) f
Chapter 8

1. Establish and quantify the expected results of the FI by means of result indicators, output indicators and FI-performance indicators as appropriate
2. Specify how the envisaged FI wil contribute to deliver the strategic objectives for which it is set up
3. Define the monitoring system in order to efficiently monitor the FI, facilitate reporting requirements and identify any improvement areas

Article 37 (2) g
Chapter 9

1. Define the conditions and/or the timing in which a revision or an update of the ex-ante assessment is needed
2. Enclose this information in the monitoring and reporting provisions established in the previous step of the analysis

Table 11: Ex-ante assessment completeness checklist (Article 37(2) and Article 37 (3))

Have you considered?		
Key checklist points	**CPR Reference**	**(Yes/No)**
Identification of market problems existing in the country or region in which the FI is to be established.	Art. 37 (2) (a)	☐
Analysis of the gap between supply and demand of financing and the identification of suboptimal investment situation.	Art. 37 (2) (a)	☐
Quantification of the investment (to the extent possible).	Art. 37 (2) (a)	☐
Identification of the quantitative and qualitative dimensions of the value added of the envisaged FI.	Art. 37 (2) (b)	☐
Comparison to the added value of alternative approaches.	Art. 37 (2) (b)	☐
Consistency of the envisaged FI with other forms of public intervention.	Art. 37 (2) (b)	☐
State aid implications of the envisaged FI.	Art. 37 (2) (b)	☐
Identification of additional public and private resources to be potentially raised by the envisaged FI and assessment of indicative timing of national co-financing and of additionality contributions (mainly private).	Art. 37 (2) (c)	☐
Estimation of the leverage of the envisaged FI.	Art. 37 (2) (c)	☐
Assessment of the need for, and level of, preferential remuneration based on experience in relevant markets.	Art. 37 (2) (c)	☐
Collation of relevant available information on past experiences, particularly those that have been set up in the same country or region as the envisaged FI.	Art. 37 (2) (d)	☐
Identification of main success factors and/or pitfalls of these past experiences.	Art. 37 (2) (d)	☐
Using the collected information to enhance the performance of the envisaged FI (e.g. risk mitigation).	Art. 37 (2) (d)	☐
Definition of the level of detail for the proposed investment strategy (maintaining a certain degree of flexibility).	Art. 37 (2) (e)	☐
Definition of the scale and focus of the FI in line with the results of the market assessments and value added assessment.	Art. 37 (2) (e)	☐
Selection of the financial product to be offered and the target final recipients.	Art. 37 (2) (e)	☐
Definition of the governance structure of the FI.	Art. 37 (2) (e)	☐
Selection of the most appropriate implementation arrangement and the envisaged combination of grant support.	Art. 37 (2) (e)	☐
Set up and quantification of the expected results of the envisaged FI by means of output indicators, result indicators and FI-performance indicators as appropriate.	Art. 37 (2) (f)	☐

Have you considered?		
Key checklist points	**CPR Reference**	**(Yes/No)**
Specification of how the envisaged FI will contribute to deliver the desired strategic objectives.	Art. 37 (2) (f)	☐
Definition of the monitoring system in order to efficiently monitor the FI, facilitate reporting requirements and identify any improvement areas.	Art. 37 (2) (f)	☐
Definition of the conditions and/or the timing in which a revision or an update of the ex-ante assessment is needed.	Art. 37 (2) (g)	☐
Ensure that this flexibility, and trigger points, is reflected in the monitoring and reporting provisions.	Art. 37 (2) (g)	☐
The ex-ante assessment is submitted to the monitoring committee for information purposes and in accordance with Fund-specific rules.	Art. 37 (3)	☐
Publication of summary findings and conclusion of the ex-ante assessment within three months of their date of finalisation.	Art. 37 (3)	☐

Appendices

Appendix A
List of useful documents

- Commission staff working document, Elements for a Common Strategic Framework 2014 to 2020 - the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund, Part II, Annexes, 14.3.2012;
  http://ec.europa.eu/regional_policy/what/future/index_en.cfm#12
- Commission staff working document, financial instruments in Cohesion Policy, SWD (2012) 36 final, Brussels, 27.2.2012;
  http://ec.europa.eu/regional_policy/sources/docoffic/official/communic/financial/financial_instruments_2012_en.pdf
- Commission staff working paper SEC (2011) 867: 'The added value of the EU budget', 29.6.2011;
  http://ec.europa.eu/budget/library/biblio/documents/fin_fwk1420/working_paper_added_value_EU_budget_SEC-867_en.pdf
- Communication from the Commission, Europe 2020 A strategy for smart, sustainable and inclusive growth, COM (2010) 2020 final, Brussels, 3.3.2010;
  http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:EN:PDF
- Consultation on the second draft of the new de minimis Regulation replacing Regulation No 1998/2006;
  http://ec.europa.eu/competition/consultations/2013_second_de_minimis/index_en.html
- Consultation on a draft General Block Exemption Regulation (the GBER) on State aid measures;
  http://ec.europa.eu/competition/consultations/2013_gber/
- Elements of strategic programming for the period 2014-2020 (EAFRD);
  http://ec.europa.eu/regional_policy/conferences/sfc2014/doc/wp_prog.pdf

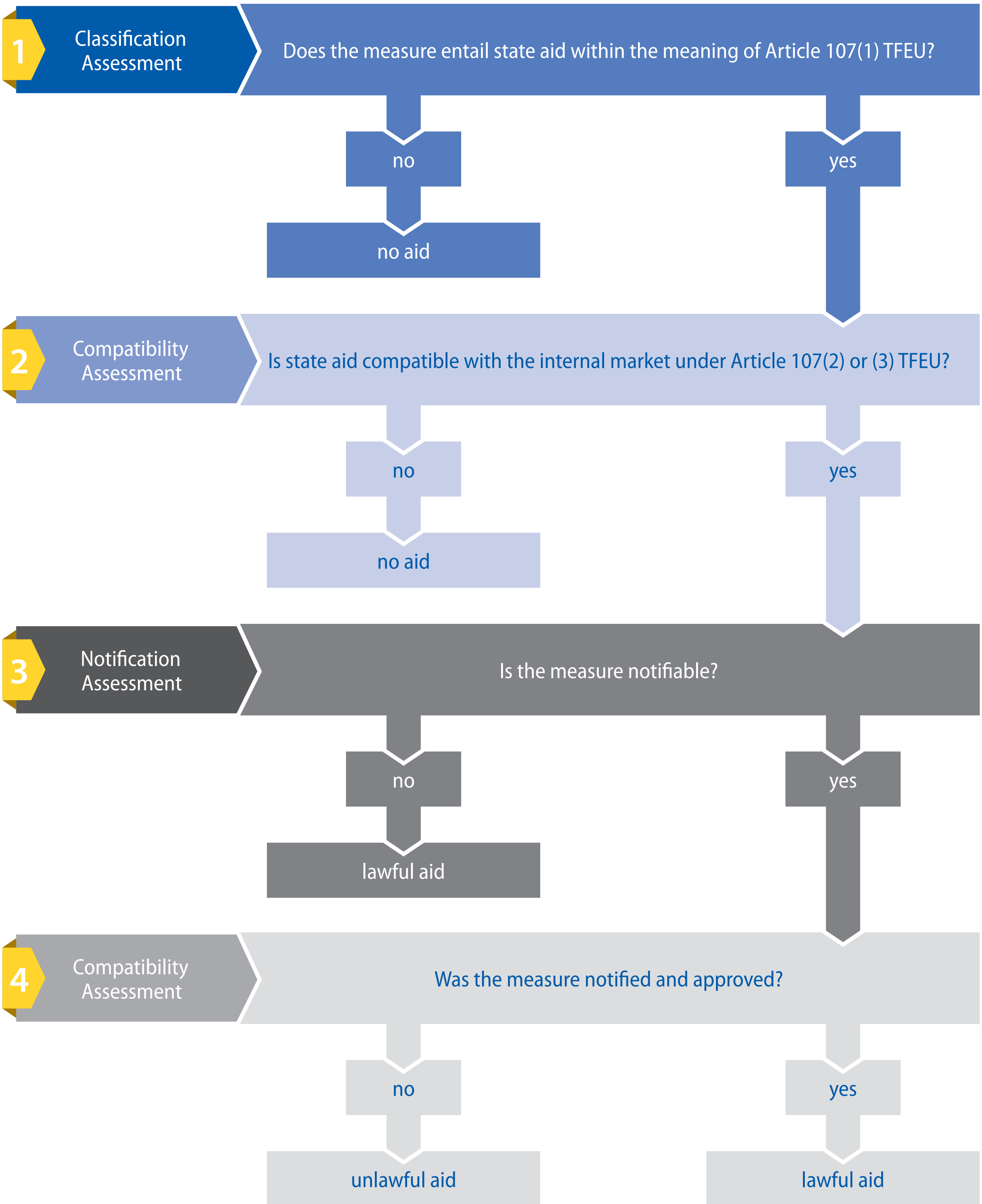
- Fiche No 9 - Financial Instruments - Implementing Acts, Version 3, 23.09.2013;
  http://ec.europa.eu/regional_policy/what/future/pdf/preparation/262709_ia_1_financial_instruments_implementig_act.pdf
- Fiche No 10 - Financial Instruments - Delegated Act, Version 1, 3.6.2013;
  http://ec.europa.eu/regional_policy/what/future/pdf/preparation/fiche_10_da_financial_instruments_03062013.pdf
- Fiche No 24 a - Implementing act on the arrangements to ensure consistency in determining milestones and targets in the performance framework for each priority and for assessing the attainment of the milestones and targets, Version 2, 5.11.2013;
- Financial Instruments in Cohesion Policy 2014-2020, Factsheet, DG Regio, 2012;
  http://ec.europa.eu/regional_policy/sources/docgener/informat/2014/financial_instruments_en.pdf
- Financial Framework 2014-2020;
  http://ec.europa.eu/budget/biblio/documents/fin_fwk1420/fin_fwk1420_en.cfm
- Getting the most from your RDP: Guidelines for the ex-ante evaluation of 2014-2020 RDPs – Draft August 2012;
  http://ec.europa.eu/agriculture/evaluation/guidelines/2014-2020-ex-ante-draft-08-2012_en.pdf
- Guidance document on monitoring and evaluation – European Regional Development Fund and Cohesion Fund – Concepts and recommendations;
  http://ec.europa.eu/regional_policy/sources/docoffic/2014/working/wd_2014_en.pdf
- Guidance Fiche – Performance Framework Review and Reserve in 2014-2020 – Version 3, 19 July 2013;
  http://ec.europa.eu/fisheries/reform/emff/guidance-performance-framework-review_en.pdf
- Guidelines for the ex-ante evaluation of 2014 - 2020, Draft August 2012;
  http://ec.europa.eu/agriculture/evaluation/guidelines/2014-2020-ex-ante-draft-08-2012_en.pdf
- Monitoring and Evaluation of European Cohesion – European Social Fund – Concepts and recommendations – Guidance document- Draft, 9 January 2013;
  http://ec.europa.eu/social/BlobServlet?docId=7884&langId=en
- Preparation of Delegated Acts, Implementing Acts and Guidance for the European Structural and Investment Funds 2014 - 2020;
  http://ec.europa.eu/regional_policy/what/future/experts_documents_en.cfm#1

- Regulation of the European Parliament and of the Council laying down common provisions on European Regional Development Fund, European Social Fund, Cohesion Fund, European Agricultural Fund for Rural Development and European Maritime and Fisheries Fund covered by Common Strategic Framework and laying down general provisions on European Regional Development Fund, European Social Fund and Cohesion Fund and repealing Council Regulation (EC) No 1083/2006, 11.9.2012;
  http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0496:FIN:EN:PDF
- Programming Period 2014 - 2020 - Guidance document on Monitoring and Evaluation - European Regional Development Fund and Cohesion Fund, October 2013;
  http://ec.europa.eu/regional_policy/sources/docoffic/2014/working/wd_2014_en.pdf
- Working Paper: Elements of strategic programming for the period 2014 - 2020; 6./7.12.2012;
  http://ec.europa.eu/regional_policy/conferences/sfc2014/doc/wp_prog.pdf

Appendix B
Notification and pre-notification procedure

Notification and pre-notification procedure

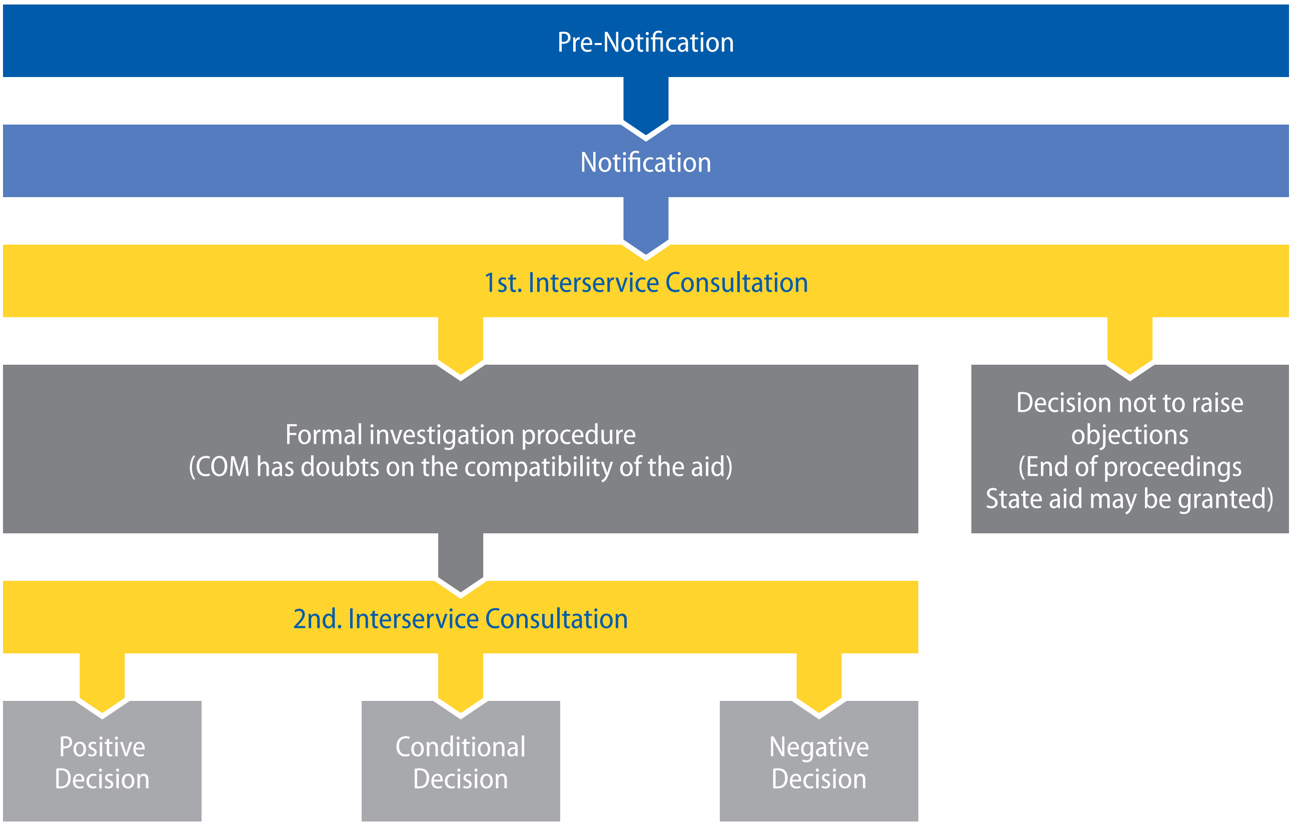
Figure 27: Assessment of whether the measure constitutes State aid, compatibility and notification of State aid



Pre-Notification and Notification Process

All measures which entail State aid within the meaning of Article 107 (1) TFEU and, being potentially compatible with the common market under Article 107 (2) or (3) TFEU are not expressly exempted from notification, must be notified to the Commission.

Figure 28: Procedural overview of the notification process



Appendix C
Example of an access to finance survey for the Euro zone with a breakdown at national level

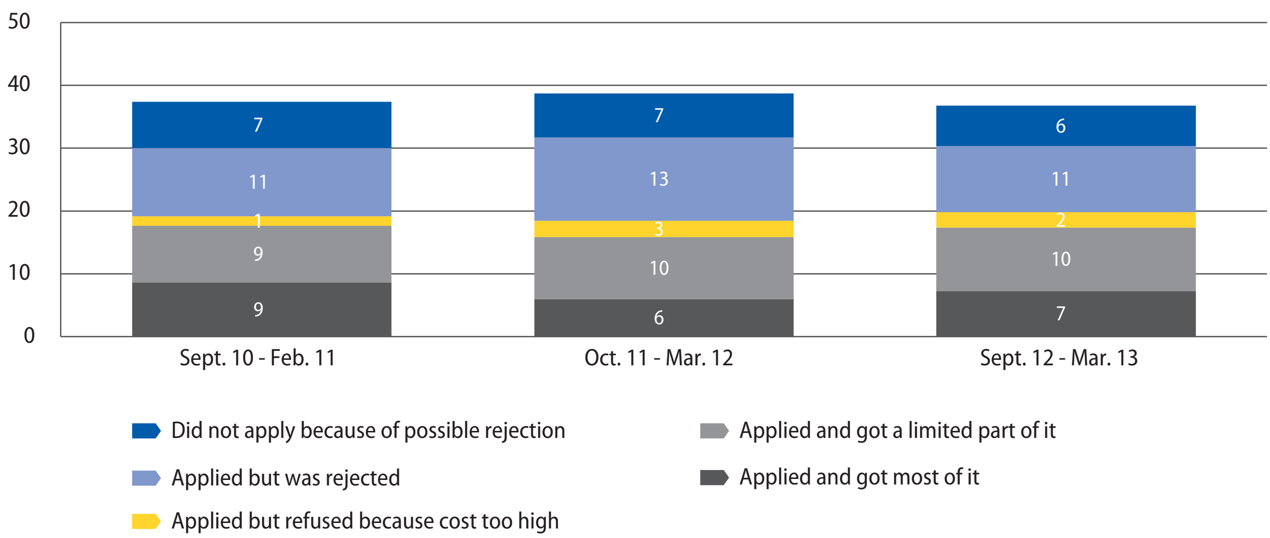
Example of an access to finance survey of the Euro zone with a breakdown at the national level

As discussed in chapter 3.2, it may often be difficult to accurately capture unsatisfied demand which is important when considering access to finance issues. However, the quality of surveys today is much better than in the past. For a growing group of sectors, surveys are now established at the EU or EURO-area level (e.g. SME survey on the access to finance in the EURO area SAFE). Some surveys (e.g. kfw Mittelstandpanel) already estimate the overall financing gap. In many EU countries, the chambers of commerce provide additional data.

Important quality elements of the SAFE survey published by the ECB are:

- A forward looking element (measured by the change of expectations compared to the previous survey); and
- A quantification of the rejections (measured in two categories, (i) the formal rejections and (ii) where the costs of the envisaged loans were too high for the recipients to sign the offer). Approvals are shown as full approvals, where most of the loan was agreed to and approvals, where only a part was finally signed.

Figure 29: Charts from the SAFE survey EURO-area (October 2012-March 2013)



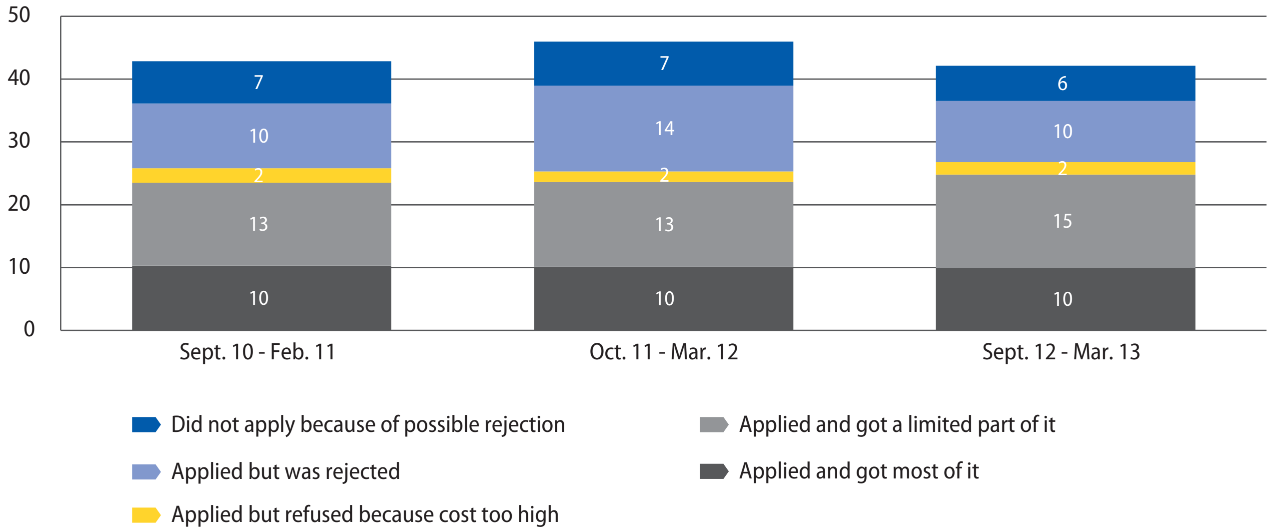


Figure 30 below show the difference between answers 'will improve' and "will deteriorate" in percentage points is shown.

Figure 30: Expected change in access to finance in the following six months - Bank overdraft, credit line or credit cards.

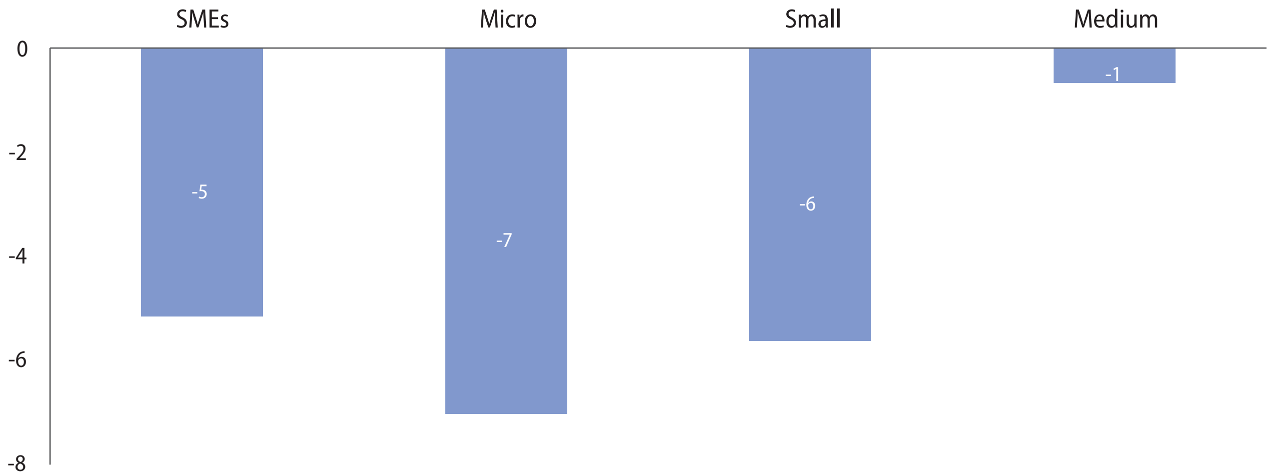
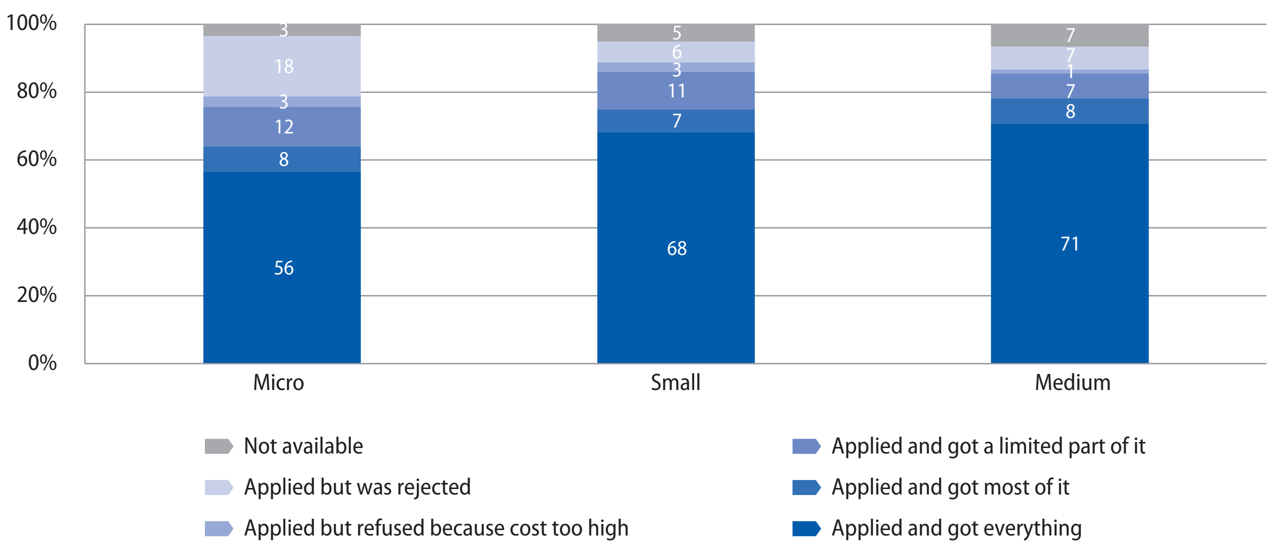


Figure 31: Application success in the past six months - bank loans in percentage



Appendix D
Breakdown of calculations for the quantitative value added example

Assumptions of example shown in Figure 10

Investment costs: 2.000.000,00
ESIF part of the loan: 960.000,00
Interest rate: 5%
Proportional repayment rate: 10%

	Debt value (Debt value$_t$ - Repayment$_{t-1}$)	**Interest payment** (Debt value$_t$ * Interest rate$_{fix}$)	**Repayment** (Debt * Repayment rate)	**Annual payment** (Interest payment$_t$ + Repayment$_t$)	**Subsidy element** (Annual payment$_t$ - Repayment$_t$)	**Present value of the subsidy elements** (Subsidy element$_t$) / (1 + Interest Rate)^year$_t$
Value date	**960.000,00**					
Year 1	864.000,00	48.000,00	96.000,00	144.000,00	48.000,00	48.000,00
Year 2	768.000,00	43.200,00	96.000,00	139.200,00	43.200,00	41.142,86
Year 3	672.000,00	38.400,00	96.000,00	134.400,00	38.400,00	34.829,93
Year 4	576.000,00	33.600,00	96.000,00	129.600,00	33.600,00	29.024,94
Year 5	480.000,00	28.800,00	96.000,00	124.800,00	28.800,00	23.693,83
Year 6	384.000,00	24.000,00	96.000,00	120.000,00	24.000,00	18.804,63
Year 7	288.000,00	19.200,00	96.000,00	115.200,00	19.200,00	14.327,34
Year 8	192.000,00	14.400,00	96.000,00	110.400,00	14.400,00	10.233,81
Year 9	96.000,00	9.600,00	96.000,00	105.600,00	9.600,00	6.497,66
Year 10	0,00	4.800,00	96.000,00	100.800,00	4.800,00	3.094,12
					264.000,00	**229.649,12**
Quantitative value added (Inv estment costs / Total of present v alue):						8,7

A lumpsum payment of € 229.649,12 at the day of approval of the loan to the financial intermediary from ESI Funds will be sufficient to cover for the interest rate subsidy over the lifetime of the loan.

In case of annual expenditures the nominal value of the budget expenditure will be in this illustrative example € 264.000,00, but as the budget is agreed on in real terms due to the inflation the result will be closer to the lumpsum payment. As a matter of fact when inflation is 5% the result is exactly the same.

www.fi-compass.eu
contact@fi-compass.eu

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

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