Sharing Expertise

FINANCIAL INSTRUMENTS IN EUROPEAN TERRITORIAL COOPERATION PROGRAMMES 2014-2020

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Disclaimer and Acknowledgements

This paper was written by Katarzyna Pelc following research undertaken across 15-month period and through cooperation between INTERACT, European Territorial Cooperation programmes, the European Investment Fund and the European Commission. The work on this paper was completed with the support of Mr. Graham Cope, Senior Head of North Europe Region at the European Investment Fund, Mrs. Hanna Dudka from the European Commission and Mr. Martin Dastig from Investionsbank, Berlin. The list of interviewed persons is in Annex 3. All questions and comments should be sent to: katarzyna.pelc@interact-eu.net.

All views expressed in this paper are entirely my own and do not represent any positions or policies in relation to any institution or programme. All errors are my own.

This paper is a draft as the legal framework for Financial Instruments in 2014-2020 has not been finalised yet. Therefore special attention needs to be paid as parts of this paper refer to 2007-2013 regulations and parts to draft 2014-2020 regulations.

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List of Acronyms

CPR	Common Provisions Regulation
CSF	Common Strategic Framework
ECA	European Court of Auditors
EIB	European Investment Bank
EIF	European Investment Fund
ERDF	European Regional Development Fund
ETC	European Territorial Cooperation
EUR	Euro currency
FIs	Financial Instruments
JTS	Joint Technical Secretariat
MA	Managing Authority
MC	Monitoring Committee
OP	Operational Programme
SME	Small and Medium-size Enterprise

Abstract

Since 2010 ETC programmes have called for changes, both conceptual and operational, to facilitate the involvement of private sector partners and capital in delivering programme objectives, producing more tangible and sustainable results and addressing effectively and efficiently state aid, revenues and intellectual property.

The 2014-2020 programming process and preparations for the 5th round of INTERREG have started. Programmes are discussing strategies and tools to deliver Europe 2020 objectives and raising questions whether utilisation of revolving funds would be also possible in multi-country context.

Following this interest, since 2011 INTERACT has been researching about Financial Instruments (FIs), whether and how it can be used in multi-country context of ETC. While research continues, a goal of this paper is to summarise findings in time to inform preparation of 2014-2020 ETC programmes. First lessons learnt include:

- FIs are not new, have been widely used in Cohesion Policy since 1994 and more and more are established. By end of 2011 a total of 592[1] FIs have been set up through 178 operational programmes in almost all Member States with the total value of Operational Programmes' contributions amounting to EUR 10 781m. This implies that knowledge about FIs and good practise examples exist in Member States and regions.

- ETC programmes due to transnational or cross-border scope and nature of cooperation provide suitable structure for FIs to incubate. The governance is stable, mature and in most cases remains unchanged for the entire programme lifetime. ETC programmes operate across borders, which eliminates artificial barriers for investments and helps maximize profits. A multi-country FI implemented through ETC seems most natural and can address weaknesses of FIs operating in limited geographic areas at national and regional levels.

- ETC programmes are not capitalising fully on their unique features: Almost 100% of EUR 8.7b ERDF allocated to ETC in 2007-2013 is spent as grants by nearly 5000[2] projects.

- Thematic Objectives of 2014-2020 Cohesion Policy need to be delivered in broader partnerships formed among public and private sector partners, including financial institutions acting as fund managers and in some cases co-investors. ETC programmes also need to open up for new types of partnerships.

- FIs are flexible mechanisms and can be used alongside grants to support activities with revenue generating potential, especially in richer EU regions. The basic mechanism is that EU funds can be used in a revolving way i.e. funds are invested – repaid – reinvested – repaid – etc. in the programme area, and through risk coverage or risk participation, attract other public and private investors to invest, or invest more alongside EU funds. This multiplier effect (impact or leverage) of FIs can be much greater than grant assistance.

- FIs need to be an integral part of ETC strategy to support SMEs and innovation, not a stand alone project. They can complement programme activities supported with grants, interact with the business community and network and enhance efforts to promote entrepreneurship and innovation.

- FIs can contribute to developing a new culture within the programme area away from grant dependency. Apart from capital injection they can offer advice to entrepreneurs/projects with strategy and business plan development, create incentives for business oriented attitude and more efficient use of funds, pool expertise and know how between public authorities, financial

[1] Summary report on the progress made in financing and implementing financial engineering instruments co-financed by the Structural Funds Programming Period 2007-2013", Situation as at 31 December 2011, December 2012
[2] KEEP website: http://www.territorialcooperation.eu/

institutions and final recipients and facilitate internationalisation of activities with great market potential.

- INTERACT has been actively building capacity in FIs in order to assist the process of blending three worlds: ETC, Europe 2020 and financial institutions. If this process succeeds in setting up a pilot FI in multi-country context, it will be learning for all. The European Commission and the European Investment Fund are ready to support an ETC programme with creating such innovative model, which builds on strengths of existing FIs and avoids replication of their weaknesses.

- FIs seem attractive for ETC programmes which look at it with interest. However, because of the asymmetry of knowledge and expertise between programme stakeholders and financial institutions, ETC programmes are not making any commitments yet.

- This paper is an invitation to join a process of developing a new and innovative FI through streamlining solutions offered by the regulations. It will fit the unique characteristics of ETC, promote the use of revolving funds in a transnational geography and ultimately help move from grant dependency towards more effective ETC programmes, producing tangible and sustainable results.

Financial Instruments: Opportunities and challenges for ETC programmes

Financial instruments and grant-based instruments imply different logic. This table lists potential opportunities and challenges for Managing Authorities when implementing ETC programmes with FI.

Financial Instruments: Opportunities	Financial Instruments: Challenges
Through the multiplier effect (leverage) bigger envelope can be invested in the programme area.	Lower incentives compared to grants as they need to be repaid. Potential beneficiaries generally prefer grants.
Impact can be many times greater than grant assistance: Funds can be reused in the programme area when they are repaid to FI.	Administrative and regulatory complexities due to the need to manoeuvre through Structural Funds regulations, State aid rules, investment principles and national legislation.
FI are flexible mechanisms and can be combined with grants to provide tailored assistance reflecting specific needs of the programme.	The language and objectives of each policy sphere (ETC, investors) can be impenetrable at the start to the non-initiated.
More transparency when involving private partners and addressing State aid.	More complex programme implementation as new stakeholders (financial institutions) are involved (e.g. control, audit)[3].
Can help close existing market gaps with smaller market distortion compared with grants.	The asymmetry of knowledge and expertise: Managing Authorities may not have sufficient knowledge of investment principles and State aid rules; Financial institutions may not have sufficient knowledge and understanding of ETC context.
Create incentives, promote revenue generating activities and force more efficient, business oriented use of funds; Facilitate commercial exploitation of results.	Lengthy start up as it can take two years to set up FI.
Final recipients can get greater capital volume compared with grants at better than market conditions which can help them expand across borders, boost business volumes, employment and tax revenues.	Potential for tension between complex goals of ETC (harmonised development of programme area, innovation and transnational character of activities, N+2, balanced geographical distribution of funds, horizontal objectives) and simple, profit-oriented focus of private sector financial institutions and investors. Investment strategy will need to address this. Investment goals will need to be written for ETC.
Can help shift towards more innovative forms of finance to sustain development of sectors which have traditionally benefited from non-repayable forms of assistance.	Different time-tables for ETC and FIs. ETC programmes run 7 years (+2) while for some FIs the expected time horizon can be longer. A 7-year ETC programme period can increase the risk of making quick (not optimal) investments.
Facilitate internationalisation of business activities with great market potential.	
Offer 'package of support' from financial institutions at different stages, from business plan development to expanding business activities.	
Great non-financial impact for public institutions and enterprises through facilitated access to new skills, expertise and capital from financial institutions.	
Pool expertise and know-how between national and regional authorities, financial institutions, financial intermediaries and final recipients.	
Promote partnership approach and boost cooperation between public and private sector players; Can help establish new cooperation links.	
Innovative type of financial support provided in a proactive way.	
Can facilitate integration of venture capital markets by encouraging transnational or cross-border investments.	

[3] Article 34 draft Common Provisions Regulation, 14.03.2012

1. Introduction

Preface

Investment orientation, innovation and maximising the impact of the EU funds are fundamental for the European Commission to reach the objectives of Europe 2020 Strategy for smart, sustainable and inclusive growth in Member States and regions. Cohesion Policy and all its instruments will need to be deployed to achieve these objectives, among them Financial Instruments.

Financial engineering instruments (FEI), Financial Instruments (FIs), or revolving instruments as they are also called, are not a new concept and have been used by countries for decades. They are not new in Cohesion Policy either and have been offered in addition to the traditional grant-based assistance since 1994. Their volume has been increasing in the successive programming periods, rising from EUR 570 m ERDF in 1994-1999, to EUR 1.2b in 2000-2006. In 2007-2013 the use of different models of FIs has evolved substantially and become more widespread, they have been growing in variety, scope and amounts committed to them. According to the European Commission statistics, over EUR 10[4] billion ERDF was invested in FIs at the end of 2011 and this volume is expected to increase by end of 2007-2013 programming period. In 2014-2020 programmes an even wider application is envisaged in all policy areas, where feasible.

Stakeholders in ETC programmes have started exploring new tools for the future and raised questions whether utilisation of revolving funds would be also possible in territorial cooperation. FI are perceived as a tool which can help address current challenges e.g. involvement of private sector, sustainability of results, revenue generation, innovation and State aid.

There are many arguments why it is worth the effort using revolving funds alongside with grant-based assistance within ETC programmes:

1) because of their revolving character and the possibility to reinvest funds in the programme area
2) leveraging private sector capital invested alongside EU Funds
3) more private partners involved in delivering programme's objectives
4) better tools to address State aid
5) promoting innovation
6) promoting revenue generation, profitability and sustainability of results
7) contributing to developing a new culture amongst actors in the programme area away from grant dependency
8) pooling expertise and know-how between national and regional authorities, financial institutions, intermediaries and final beneficiaries
9) building institutional capacity through partnerships between public and private sectors
10) creating broader partnerships through involvement of financial institutions in the implementation of ETC programmes
11) strengthening the spirit of entrepreneurship through closer cooperation with private sector and financial institutions.

FI seem attractive for ETC programmes and following this interest, since 2011 INTERACT has carried out research to build the knowledge base and share it with programmes at different events. Several workshops took place with ETC finance staff with the assistance of practitioners from financial institutions experienced in designing and implementing FIs with and without EU Funds. The discussions have revealed that current FIs with EU Funds operate primarily at national or regional[5] levels and there are no such instruments operating across borders. The core of ETC is operating across borders and hence ETC programmes seem to be a natural attraction for investors. Operating across borders is what investors wish, as borders often create artificial barriers and reduce the chance of maximising profits. Multi-country FIs implemented through ETC could address weaknesses of FIs implemented in limited geographical territories of national or regional Operational Programmes.

[4] „Summary report on the progress made in financing and implementing financial engineering instruments co-financed in the Structural Funds programming period 2007-2013", Situation as at 31 December 2011, December 2012
[5] Region – in this context is defined as geographical space which is a sub-territory of a Member State.

A dialogue between ETC and the European Investment Fund[6] (EIF) has initiated and the two worlds have started to discuss the possibility for future cooperation. There is interest from both sides to explore the new ideas and establish a pilot FI in 2014-2020. However, because of major differences between these two worlds and the way how they operate, the process of establishing a successful partnership and cooperation structure will require patience and learning from both sides. It is key that all stakeholders (i.e. ETC programme Managing Authorities, Joint Technical Secretariats, Monitoring Committees, European Investment Fund, European Commission) fully comprehend the nuances of this innovative process in order to be in control and feel a share of ownership, which may be the driving force for action, devotion and effort in critical times.

Aims of the paper

This paper aims to:

1) Present the results of research carried out by INTERACT since 2011, i.e. outcomes of discussions with ETC programmes, the EIF and the European Commission.
2) Blend two worlds together: ETC and financial institutions to explore ideas for future cooperation.
3) Propose answers to questions: What FI in ETC could be like? What are the mechanisms and principles governing establishing and operating FI in ETC? What are the conditions to make it work? How to define 'transnationality' of FI in ETC? What is the added value of FI in ETC?
4) Draw conclusions and propose next steps.

Methodology

This paper draws on a mix of desk research, workshops, conferences and talks with staff working in ETC programmes, EIF, European Commission and other market players such as commercial and investment banks, loan funds, etc.[7] The desk-based research has focused on EU-level and programme documents, thematic literature and papers developed by research institutions. In 2011, 2012 and 2013 six workshops were organised where finance staff from ETC programmes discussed the possibility of establishing FI. One of them was hosted by EIF in Luxembourg.

Different terminology is used for discussing the issue including non-grant financial instruments, financial engineering instruments, financial instruments, repayable financial instruments and revolving funds. This paper uses the term financial instruments abbreviated as FIs.

2. Financial Instruments in Europe 2020 Strategy and 2014-2020 regulatory framework

FIs are firmly anchored in the strategic documents and draft regulations shaping the EU funding in 2014-2020. These documents call for a greater use of FIs by Member States and programmes as they can provide an important, new financing stream for innovative and strategic projects and support long-term, sustainable investment at a time of fiscal constraint.

Since 2007 Europe has been struggling with economic and financial crisis which hit severely economies within and outside the Euro zone. To reduce the probability of sovereign default, Member States have used various policy tools such as e.g. reduced government spending, prudent credit policy, raised tax rates, boosting corporate/business activities and bailout.[8]

The European Commission responded accordingly and presented *Europe 2020 Strategy for smart, sustainable and inclusive growth*, aiming to help Member States recover from the crisis through targeted actions coordinated at supranational level. Along with the Europe 2020 Strategy, the European

[6] European Investment Fund is an EU investment institution based in Luxembourg, responsible for the provision of finance to SMEs and promotion of the implementation of EU policies in the field of entrepreneurship, technology, innovation, growth, employment and regional development.
[7] The full list of entities that have been involved in the discussions is shown in Annex 3.
[8] Sovereign Credit Risk in the Euro Zone, Jamal Ibrahim Haidar, World Bank, World Economics, Vol 13, No 1, 2012

Commission proposed Multiannual Financial Framework for 2014-2020, the budget to deliver Europe 2020 Strategy's objectives.

The proposed budget is bigger than in the past which means bigger than before Member States' contributions. On the one hand Europe 2020 represents ambitious political goals which can help EU become more productive and competitive, improve its educational systems and get back on the growth track. On the other hand, it provokes concerns about national contributions to the common EU pot, which may be conflicting with strict budgetary spending policies in Member States. This type of debate has also encouraged arguments such as e.g. Principles of solidarity and redistribution of funds among EU Member States may not be optimal when economic and fiscal crisis hit home; How much longer can EU afford living off grants?; and Shouldn't EU turn to revolving instruments when money is scarce?

"The EU Cohesion Policy is the key delivery mechanism for the Europe 2020 Strategy, however in order to succeed, its role and image must change in 2014-2020. In the past Cohesion Policy focused on supporting Member States lagging behind. The 2014-2020 Cohesion Policy will be different. It has undergone dramatic changes and will propose better designed and targeted delivery mechanisms:

- *Translated into 11 Thematic Objectives and with clear focus on growth and jobs*
- *All Funds will be targeting these objectives*
- *Funds will be concentrated with a large proportion invested in SMEs and renewable energy in all regions: reach and poor.*

Result orientation and optimization of financial resources of 2014-2020 Cohesion Policy will be fundamental. Currently most actions of Cohesion Policy are financed through grants, but in the future more needs to be done through revolving funds. The added value of FIs is more and more recognized across EU, especially their revolving character and leverage effect when finance is a constraint for Member State economies. FIs are getting more and more popular and we all learn along the process. The share of FIs has reached 5% of the Cohesion Policy budget in 2007-2013 and it will increase significantly in 2014-2020 programming period"[9].

Europe 2020 Strategy for smart, sustainable and inclusive growth

The Europe 2020 Strategy envisages an increased mobilisation of innovative FIs as part of a consistent funding strategy pulling together EU and national public and private funding to pursue the Strategy's objectives of smart, sustainable and inclusive growth. Two out of seven Flagship Initiatives outlined in the Europe 2020 Strategy refer directly or indirectly to FIs, especially those supporting SMEs.

In the first one, Flagship Initiative "*Innovation Europe*", the Commission commits to strengthening and further developing the role of EU instruments to support innovation, including through closer work with the EIB and streamlining administrative procedures to facilitate access to funding, particularly for SMEs.

In the second one, Flagship Initiative "*An industrial policy for the globalisation era*", the Commission commits to improving the business environment, especially for SMEs, including through reducing the transaction costs of doing business in Europe, the promotion of clusters, improving affordable access to finance and internationalisation of SMEs.

FIs can help Europe leverage its financial means and pursue new avenues in using a combination of private and public finance. The Europe 2020 Strategy outlines three avenues how the Commission commits to developing innovative financial instruments:[10]

- By improving effectiveness and efficiency of the existing financial instruments;

[9] Rudolf Niessler, Director, Unit B Policy, European Commission, Directorate General for Regional Policy, Financial Engineering Instruments in EU and Poland, Conference speech, 19.12.2012, Warsaw

[10] Europe 2020 A European strategy for smart, sustainable and inclusive growth, Communication from the Commission, Brussels 3.3.2010, p. 20

- By designing new FI, in particular in cooperation with European Investment Bank / European Investment Fund and the private sector. The European Investment Bank and the European Investment Fund can contribute to supporting this goal and be present in a 'virtuous circle' where innovation, entrepreneurship and businesses with growth potential can be funded profitably from early stage investments to listing on stock markets;
- By making an efficient European venture capital a reality, thereby greatly facilitating direct business access to capital markets and exploring incentives for private sector funds that make financing available for start-up companies, and for innovative SMEs.

A Common Strategic Framework 2014–2020

A Common Strategic Framework translates objectives and targets of Europe 2020 Strategy into key actions to be implemented by Common Strategic Framework Funds in Member States and programmes. From the point of view of this analysis (i.e. FIs in ETC programmes), Objective 3 - "Enhancing the competitiveness of SMEs (…)" is crucial, as it outlines key actions for the European Regional Development Fund:
- investment in entrepreneurship, including the provision of start-up capital, guarantees, loans and mezzanine and seed capital through financial instruments and support for the development of business plans;
- investment in the commercial exploitation of new ideas and research results and the creation of more knowledge-intensive businesses through interventions tailored to the needs of SMEs at their various stages of development and along the innovation value chain;
- business advisory services, in particular in the areas of business start-up, business transfer, access to new markets, business strategy and monitoring, technology transfer and foresight as well as user-oriented and design-driven innovation, raising innovation management capacity and encouraging the development and use of such services through innovation voucher programmes;
- support the development of web-tools to provide targeted information and facilitate regulatory procedures for SMEs, particularly in the area of public procurement, employment law, social security, taxation and standardization;
- the development of new business models, including new value chains and marketing organisation, in particular to facilitate internationalisation;
- the development of SMEs in emerging areas linked to European and regional challenges such as creative and cultural industries, new forms of tourism, and innovative services reflecting new societal demands or products and services linked to ageing population, care and health, eco-innovations, the low carbon economy and resource efficiency, including coordination with public procurement to speed up the market take-up of innovative solutions to address these challenges.

The general implementation principles are that the support for SMEs must be more targeted and focus on enhancing the competitiveness and growth performance of SMEs and that Member States need to make a decisive shift from grant-based to financial instruments such as provision of start-up capital, guarantees, loans, mezzanine and seed capital in supporting SMEs.

Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A Budget for Europe 2020

"Financial instruments will form part of EU budget interventions in a variety of policy areas, in particular those pursuing the following objectives:

(1) To foster the capacity of the private sector to deliver growth, job creation and /or innovation: support to start-ups, SMEs, mid-caps, micro-enterprises, knowledge transfer, investment in intellectual property.
(2) To build infrastructures by making use of Public Private Partnerships schemes to reinforce EU competitiveness and sustainability in the transport, energy and ICT sectors.
(3) To support mechanisms that mobilise private investments to deliver public goods, such as climate and environmental protection, in other areas".

Proposal for Council Regulation laying down the Multiannual Financial Framework for the years 2014-2020 (draft 6.7.2012)

In the proposal of the amended Financial Regulation the Commission included a new title dedicated to the budgetary management of FI. This proposal builds on the premise that the Financial Regulation should contain the fundamental principles and the basic rules of budgetary and financial management, leaving the details to be specified in the implementing rules of the delegated act.

Draft Common Provisions Regulation (CPR)

The draft CPR builds on the experience and lessons learnt from the past and aims to improve and simplify provisions for FIs to facilitate the setting up and implementation of such instruments at national, regional, transnational and cross-border levels. The corner stones for greater use of FIs are laid down in the introduction to the CPR:

"(22) Financial instruments are increasingly important due to their leverage effect on CSF Funds, their capacity to combine different forms of public and private resources to support public policy objectives, and because revolving forms of finance make such support more sustainable over the longer term.

(23) Financial instruments supported by the CSF Funds should be used to address specific market needs in a cost effective way, in accordance with the objectives of the programmes, and should not crowd out private financing. The decision to finance support measures through financial instruments should be determined therefore on the basis of an ex ante analysis.

(24) Financial instruments should be designed and implemented so as to promote substantial participation by private sector investors and financial institutions on an appropriate risk sharing basis. To be sufficiently attractive to private sector, financial instruments need to be designed and implemented in a flexible manner. Managing authorities should therefore decide on the most appropriate forms to implement financial instruments, to address the specific needs of the target regions, in accordance with the objectives of the relevant programme."

(25) Managing authorities should have the possibility to contribute resources from programmes to financial instruments set up at Union level, or to instruments set up at regional level. Managing authorities should also have the possibility to implement financial instruments directly, through specific funds or through funds of funds.

(26) The amount of resources paid at any time from the CSF Funds to financial instruments should correspond to the amount necessary to implement planned investments and payments to final beneficiaries, including management costs and fees, determined on the basis of business plans and cash-flow forecasts for a predefined period which should not exceed two years".

Article 9 of draft CPR (version from March 2012): Thematic objectives for CSF Funds:

"Each CSF Fund shall support the following thematic objectives in accordance with its mission in order to contribute to the Union strategy for smart, sustainable and inclusive growth:

1) strengthening research, technological development and innovation;
2) enhancing access to, and use and quality of, information and communication technologies;
3) enhancing the competitiveness of small and medium-sized enterprises, the agricultural sector (for the EAFRD) and the fisheries and aquaculture sector (for the EMFF);
4) supporting the shift towards a low-carbon economy in all sectors;
5) promoting climate change adaptation, risk prevention and management;
6) protecting the environment and promoting resource efficiency;
7) promoting sustainable transport and removing bottlenecks in key network infrastructures;
8) promoting employment and supporting labour mobility;
9) promoting social inclusion and combating poverty;
10) investing in education, skills and lifelong learning;

11) enhancing institutional capacity and an efficient public administration."

Most of thematic objectives, probably with the exception of 9 and 11, can be implemented through FIs.

The legal framework for FIs is outlined in Articles 32 – 40 of the draft Common Provisions Regulations.[11] The current version of Articles 32 and 33 states that FIs can be used alongside grant mechanisms in operational programme and outline options Managing Authorities can chose when setting up FIs:

Article 32

"1. The CSF Funds may be used to support financial instruments under a programme, including when organised through funds of funds, in order to contribute to the achievement of specific objectives set out under a priority, based on an ex ante assessment which has identified market failures or sub-optimal investment situations, and investment needs.

Financial instruments may be combined with grants, interest rate subsidies and guarantee fee subsidies. In this case, separate records must be maintained for each form of financing.

The Commission shall be empowered to adopt delegated acts in accordance with Article 142 laying down detailed rules concerning the ex ante assessment of financial instruments, the combination of support provided to final recipients through grants, interest rate subsidies, guarantee fee subsidies and financial instruments, additional specific rules on eligibility of expenditure and rules specifying the types of activities which shall not be supported through financial instruments.

2. Final recipients supported by financial instruments may also receive grants or other assistance from a programme or from another instrument supported by the budget of the Union. In this case, separate accounts and records must be maintained for each source of financing. (…)"

Article 33

"In implementing Article 32, managing authorities may provide a financial contribution to the following financial instruments:

a) financial instruments set up at Union level, managed directly or indirectly by the Commission;
b) financial instruments set up at national, regional, transnational or cross-border level, managed by or under the responsibility of the managing authority.

2. Title VIII of the Financial Regulation shall apply to financial instruments referred to in paragraph 1(a). Contributions from the CSF Funds to financial instruments under paragraph 1(a) shall be placed in separate accounts and used in accordance with the objectives of the respective CSF Fund, to support actions and final recipients consistent with the programme or programmes from which such contributions are made.

3. For financial instruments under paragraph 1(b), the managing authority may provide a financial contribution to the following financial instruments:
a) financial instruments complying with the standard terms and conditions laid down by the Commission, by means of implementing acts in accordance with the examination procedure referred to in Article 143(3);
b) (b) already existing or newly created financial instruments which are specifically designed to achieve the intended purpose and which respect the applicable Union and national rules.

The Commission shall adopt delegated acts in accordance with Article 142 laying down the specific rules regarding certain types of financial instruments referred to in point (b), as well as the products that may be delivered through such instruments.

[11] These articles will change in the final version so the final version of this paper will be updated accordingly.

4. When supporting financial instruments referred to in paragraph 1(b) the managing authority may:

a) invest in the capital of existing or newly created legal entities, including those financed from other CSF Funds, dedicated to implementing financial instruments consistent with the objectives of this respective CSF Funds, which will undertake implementations tasks; the support to such investments shall be limited to the amounts necessary to implement new financial instruments consistent with the objectives of this Regulation; or

b) entrust implementation tasks to:

   i. the European Investment Bank;

   ii. 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, selected in accordance with applicable Union and national rules;

   iii. a body governed by public or private law selected in accordance with applicable Union and national rules.

c) undertake implementation tasks directly, in the case of financial instruments consisting solely of loans or guarantees.

The Commission shall be empowered to adopt delegated acts in accordance with Article 142 laying down rules concerning funding agreements, the role and responsibility of the entities to which the implementation tasks are entrusted, as well as management costs and fees.

5. The entities referred to in paragraph 4(b)(i) and (ii), when implementing financial instruments through funds of funds, may further entrust part of the implementation to financial intermediaries provided that these entities ensure under their responsibility that the financial intermediaries satisfy the criteria laid down in Articles 57 and 131 (1), (1a) and (3) of the Financial Regulation. Financial intermediaries shall be selected on the basis of open, transparent, proportionate and non-discriminatory procedures, avoiding conflicts of interests.

6. The entities referred to in paragraph 4(b) to which implementation tasks have been entrusted may open fiduciary accounts in their name and on behalf of the managing authority. The assets held on such fiduciary accounts shall be managed in accordance with the principle of sound financial management following appropriate prudential rules and have appropriate liquidity.

7. The Commission shall be empowered to adopt delegated acts in accordance with Article 142 laying down detailed rules concerning specific requirements regarding the transfer and management of assets managed by the entities to which implementation tasks are entrusted, as well as conversion of assets between euro and national currencies."

Delegated and implementing acts will follow with the provisions on e.g. minimum requirements for ex ante assessment of FIs, combination of revolving assistance with grants, eligibility of expenditure, treatment of private investors, multiplier ratios to be ensured, selecting bodies to implement FIs, responsibilities of these bodies and conditions for performance-based remuneration, management and control, payments, etc.

What does it mean for ETC programmes?

2014-2020 EU strategic papers call for greater use of FIs as part of an approach to pull together EU and national public and private funding to pursue the objectives of Europe 2020 Strategy. This applies also to ETC.

Over the years ETC programmes have reported that a change is needed in ETC to deliver Europe 2020:

- conceptual change – a change of ETC mindset and the need to open up for private sector partners, capital, innovation and innovative FIs;
- operational change – a change how ETC programmes address challenges such as state aid, revenues and intellectual property rights;

ETC programmes acknowledge that it is challenging to improve the economic climate for private sector in their respective areas without fully involving private sector in delivering programmes' objectives as well as that future ETC programmes need to be implemented in broader public-private partnerships.

FIs may be a tool which can help make it happen. Almost all thematic objectives of Art 9 of draft CPR can be delivered through FIs. In addition, FIs are flexible mechanisms and can operate alongside grants. Using FIs in ETC will be a steep learning curve however there is a lot to gain, e.g. new partners and partnerships, new type of activities, private capital co-invested in the programme alongside ERDF, new knowledge, etc.

3. Financial Instruments – characteristics and mechanisms

What are Financial Instruments and how does it work?

Definition

Article 2 of Regulation on the financial rules applicable to the general budget of the Union[12] defines FIs:

"Financial instruments are 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, guarantees or other risk-sharing instruments, and may, where appropriate, be combined with grants."

In simple words, FIs are EU funds combined with other public and private sector funds, used in a revolving way in the form of repayable instruments such as e.g. loans, equity, mezzanine and guarantees invested according to profitability criterion[13]. The basic mechanism is that the same funds are used on a commercial basis (e.g. through the fund of funds), venture capital funds, loan funds and guarantee fund mechanisms) several times through various revolving cycles. They are invested and returned after the agreed lending period and reused for at least 10 years[14] after the closure of programme for further investments in the same or another FI, in accordance with the agreed objectives. Ideally, funds invested in FIs become self-sustainable and are utilised eternally (evergreen), which increases their impact as compared with grant-based mechanisms. From a purely budgetary point of view, grants 'are lost' while funds invested through FIs stay in a cycle.

[12] Art 2 of regulation on the financial rules applicable to the general budget of the Union, October 2012. Annex 3 provides definitions of all instruments.
[13] All definitions are provided in Glossary in Annex 1.
[14] Art 39 draft Common Provisions Regulation, 14.03.2012

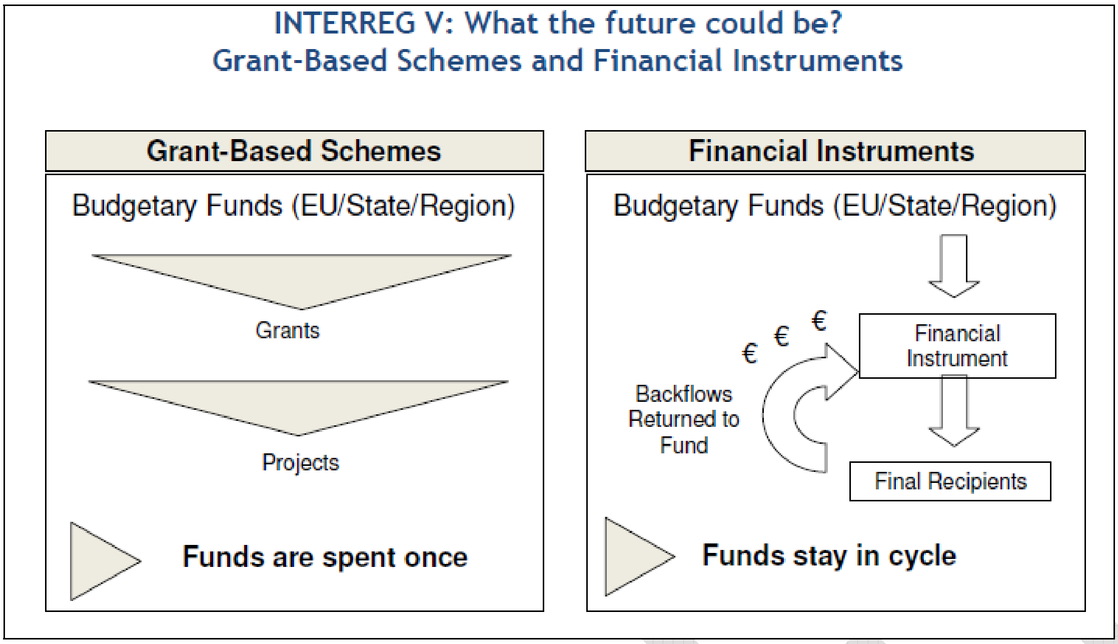


Chart 1. Grant-Based Schemes and Financial Instruments, Source: INTERACT

Main differences between grants and FIs

Grants	Financial Instruments
Gifts: do not need to be repaid.	Loans, guarantees, equity, mezzanine: need to be repayable in nature.
Can only be spent once.	Have revolving character: funds stay in cycle and can be reinvested in the programme area after they have been repaid. Leverage public funds with private sector capital invested in the programme area at much higher rate than grants e.g. 1:4.5, 1:7.5 or more[15]; Can have a greater multiplier effect than grants.
Reimbursements of expenses.	Advanced payments to final recipients.
In many cases driven by market failure.	Market driven instruments promoting entrepreneurship, efficiency and effectiveness. However, FIs with Structural Funds can be used only in the situation of market failure or suboptimal investment situations.
More demanding eligibility criteria and more complex and lengthy procedures: grants can be granted several months after the application / payment request has been submitted.	The process of setting up FIs can be lengthy. However, once set up FIs have simple criteria and short procedures: a loan can be granted to a recipient within one week using the standard procedures operated by financial intermediary.

Source: INTERACT

[15] Financial Engineering Instruments implemented by Member States with ERDF Contributions, European Commission Synthesis Report, 24.01.2012, P. 12

Types of activities and final recipients supported by FIs

Common Strategic Framework Funds' resources can be contributed to FIs which invest in the form of loan funds, guarantee funds, equity (venture capital) funds or other forms of repayable investments in:

- businesses, mainly SMEs
- urban development projects (cities)
- legal or private persons carrying out specific investment activities in energy efficiency and renewable energies (who invest in improving energy efficiency in housing).

Even though most of FIs with EU Funds so far have supported businesses,[16] the assistance is also available to urban development, energy efficiency and renewable energy projects. Funds committed to FIs have direct financing purpose and deliver liquidity, i.e. cash is handed to the debtor. Guarantee funds are an exception as they safeguard somebody, e.g. a creditor, against potential loss in case of default.

Recipients usually carry out financially viable business activities (with potential for revenue generation) in growth generating sectors (i.e. entrepreneurship, innovation, infrastructure and energy) but have difficulties in accessing capital from market sources.

FIs as promotional schemes

FIs are also called promotional schemes, meaning they are instruments which help implement policy objectives e.g. increase employment rates, level of entrepreneurship, administrative capacity, provision of seed capital to micro and SMEs, develop financial market, etc. In contrast to laws and regulations which are compulsory, promotional schemes are voluntary. FIs with EU funds must create an incentive for better performance (e.g. push for better quality, greater financial discipline, access to expertise and know-how supporting the start-up of a business, etc.) and at the same time address market failure or sub-optimal investment situation.

FIs with EU funds will:

- Create incentives which aim at getting the target group to act in a certain way. An example can be a loan scheme for investment purposes offered below market conditions to encourage target companies to invest in growth-generating projects and creating or securing jobs.
- Address market failures such as the lack of offers in risk capital provision due to market imperfections. An example can be risk capital for innovative companies in green technology sectors in poorer regions of the EU. Even though green technology can mean commercially viable activities and contribute to achieving broader policy objectives, there may not be enough offers from private sector banks due to economic and financial crisis or lack of sector knowledge.
- Create long term positive impact even though they may not be cost-covering from a purely business perspective. An example can be micro loans for unemployed people to help them create their own business and employment. Micro loan schemes are unprofitable because of too small unit volume in relation to unit costs. However, due to their impact and medium term positive effects (i.e. creating new jobs, happier society, savings in unemployment benefits budget, etc.), such schemes may have positive credit/debit balance on a larger scale.

Critical mass of Financial Instruments

The critical mass (or size) of FIs is key for the process to succeed. However, the amounts can vary depending on instruments and location. For example, a capital volume of a holding fund of circa EUR 100 million generally makes it possible to set a balanced portfolio, gives flexibility to manoeuvre between transactions, attracts between 30% - 100% of private investors' capital at the level of underlying funds, and helps maximize profits at acceptable levels of risk.

Alternatively, much smaller activities are implementable and the capital volumes invested by programmes to FIs vary between EUR 10 m and EUR 100 m. The amount committed by operational programme to FIs

[16] COCOF 12-0060-00 Summary of data on the progress made in financing and implementing financial engineering instruments, sent by the managing authorities in accordance with Article 67(2)(j) of Council Regulation (EC) No 1083/2006, Programming period 2007-2013, 27.09.2013

should correspond to the amount necessary to address the identified gap in the market and implement planned activities and payments to final recipients, including management costs and fees charged by a professional financial institution responsible for implementation of FI, determined on the basis of a business plan and cash flow forecasts for a pre-defined period. Finding the most optimal scale of support is key: if FI is too small, administrative costs will dominate effects. If FI is too large, much of the support will be deadweight i.e. more than the amount necessary to trigger the change desired.

The rationale for Financial Instruments

The main strategic advantages of FIs are generally recognised and can be summarised as:

FIs pursue EU policy objectives in an innovative way

In the context of Cohesion Policy, FIs are an innovative form of contributing EU funds to Europe 2020's objectives as compared to the traditional grants. They cover a range of cases where EU financial support is provided in other forms than pure grants and where it is blended with loans and other forms of repayable assistance form private financial institutions. FIs can provide concrete financial support in a proactive way even before the potential is recognised by the business community. At the same time they must be vehicles for delivering repayable investments which contribute to the achievement of the goals set out by the operational programme. That is why it is key that FIs are an integral part of the operational programme implementation strategy agreed between the Member States and the European Commission.

FIs can have great multiplier effect (leverage)

FIs supported through EU funds create a multiplier effect for the EU budget by facilitating and attracting other public and private financing throughout the various levels of the implementation chain (i.e. financial institutions, banks, development agencies, private sector investors, final recipients). Through risk coverage or risk participations, the EU funds invested in FIs may attract investors to invest, or invest more, in cases where they would have not invested at all or invested less without the support from the EU budget. This multiplier effect (sometimes also called the impact or leverage) of FIs can be many times greater than grant assistance. However, it differs according to the type of FI, the economic sector it addresses, and the socio-economic conditions in its location/region.

For example, some evaluations have found out that each EUR 1 of Structural Funds committed to a small soft loan fund in 2007-2013 programming period can mobilise (leverage) some EUR 4.5 of private investments.[17] This multiplier effect is even greater in case of guarantee funds, as EUR 1 of public resources put into guarantee funds supports the disbursement of SME loans in the range from EUR 1 to EUR 7.5.[18]

By sharing risks with other investors, FIs unblock private financing and other public sector funding, which when pulled together, can result in a greater envelope for investments in the programme area. This multiplier effect is further strengthened by the accumulation of interests generated and dividends paid to the funds.

FIs are market-based products but when they operate in the area of Cohesion Policy, they may lead to multiplier effects below levels which can be achieved outside Cohesion Policy. This is because when building a fund, a balance needs to be found between specific objectives of the Cohesion Policy (i.e. addressing a market failure, contributing to regional development) and the expectations of private investors. Still, the use of FIs allows the European Commission and programme authorities to multiply the effect of EU funds and/or national or regional contributions to achieve a much larger impact for the final recipients than through grants.

Financial Instruments increase efficiency, effectiveness and sustainability of public resources

[17] Commission staff working document "Financial Instruments in Cohesion Policy", Brussels, 27.2.2012, p. 2

[18] Financial Engineering Instruments implemented by Member States with ERDF Contributions, European Commission Synthesis Report, 24.01.2012, P.12

By pooling resources from various sources, FIs can catalyze investments for identified market gaps, achieve economies of scale and minimize the risk of failure in areas where it would be difficult for individual Member States to achieve the required critical mass. CSF Funds, national/regional public and private resources invested in final recipients through FIs are expected to be paid back by the final recipients and reinvested by the same or other FI or spent (e.g. as grants) for the benefit of the programme area. This way they ensure a long-term recycling of the initially available public resources.

FIs encourage business-minded attitude and offer 'smart money'

FIs can create situations where private sector participation enables public sector stakeholders to make use of private sector skills and expertise in areas such as idea development, management of commercial operations, ability to achieve commercial returns, etc. In case where an ETC programme decides to invest part of OP in FIs, the programme funds will be used in partnership with financial, investment and banking sectors (e.g. EIB, EIF, national or regional financial institutions with a public policy mission, or other financial institutions from public and private sectors). Such cooperation can facilitate a unique blending of expertise and knowledge of these institutions with ETC objectives, and create a greater and deeper skill base across the programme area. Transferring skills and knowledge across the frontiers, partnerships between public and private sectors and broader involvement of financial institutions can help build institutional capacity, reduce the gap between Member States and regions and improve effectiveness of ETC programme implementation.

FIs create incentives and promote enhanced performance and financial discipline

Well designed FIs promote entrepreneurship and enhanced performance by setting appropriate success indicators suited to the achievement of public policy objectives of ETC programme. When compared with grant beneficiaries, final recipients who receive repayable assistance are more disciplined and better incentivised to become efficient and achieve better value for money, since they need to repay the funds.

How does it work in practice?

A person with an innovative business (commercial) idea but without sufficient own capital and credit history at a local bank, will most likely have his/her credit application rejected at a bank, or the conditions (interest) at which a loan is offered are so high, that it becomes impossible (too expensive) to carry on with the idea, especially at the beginning, during the start up phase.

Commercial banks are nowadays cautious with loans, especially for financing innovative (risky) ideas. In normal market conditions many such ideas die unless there is a business angel (business angels exist but are rare cases) willing to support it with money and advice.

This is the 'gap' that can be addressed by FIs with EU Funds. In FIs, EU Funds participate in risk sharing alongside commercial banks, which makes it possible for commercial banks to offer loans and other FIs to innovative enterprises, at lower than market conditions. Also, credit history is not required which makes it possible for young and innovative entrepreneurs to apply for a loan and start up a company.

A loan is still a loan and needs to be repaid, and with interest. That is why entrepreneurs who get a loan, need to work hard and do their best to make sure the business develops, expands and generates profits so there is enough money to repay the loan, and the interest. There is no such incentive effect in case of grants, as grants are gifts and do not need to be repaid.

Benefits from using Financial Instruments in ETC

Benefits for recipients of funds	Benefits for ETC programme	Benefits for financial institutions/intermediaries
Access to start up capital that he/she would not get otherwise	Support for local enterprises planning to grow, expand and internationalise activities	Can offer more capital for final recipients
Access to cheaper capital than in normal market conditions	Boosting entrepreneurship	Can offer bigger envelopes per final recipient
Can turn idea into reality, start a business, expand it, invest and internationalise activities	Boosting innovation	Can develop and expand menu of financial products offered to final recipients
Can start building his/her credit history and credibility	Boosting employment	Can offer cheaper capital than in normal market conditions due to risk sharing with EU funds
Can get 'a business angel' – experienced professional who along with capital can advice, assist and be consulted when developing business plan and strategy	Can try something new and innovative with little risk of failure	
Can get capital up front as an advance payment	Can help establish new cooperation links and public-private partnerships	
Quick administrative procedure before a loan is granted	Can start changing the mind set in the programme area	

Source: INTERACT

4. Governance, funding structure and steps to establish Financial Instruments

Governance of Financial Instruments

Governance of FIs specifies who is involved in the implementation of FIs, following the Managing Authority's decision. Article 33.4 of draft CPR outlines the following options:

a) Managing Authority can invest in the capital of existing or newly created financial institutions which will implement FI
b) Managing Authority can entrust implementation tasks to:
   - European Investment Bank (EIB) or European Investment Fund (EIF) (without public tender)
   - National or international public financial institution where Member States are stakeholders (without public tender)
   - Any other public or private financial institution (following the tender process)
c) Managing Authority can undertake implementation tasks directly ('do it by yourself') in case FI consist solely of loans and guarantees.

EIB and EIF are EU institutions mandated to assume special financial tasks in supporting achieving Europe 2020's objectives. That is why in case b there is no need for a tender and MA can grant EIB or EIF directly a mandate to manage funds and invest it in FIs.

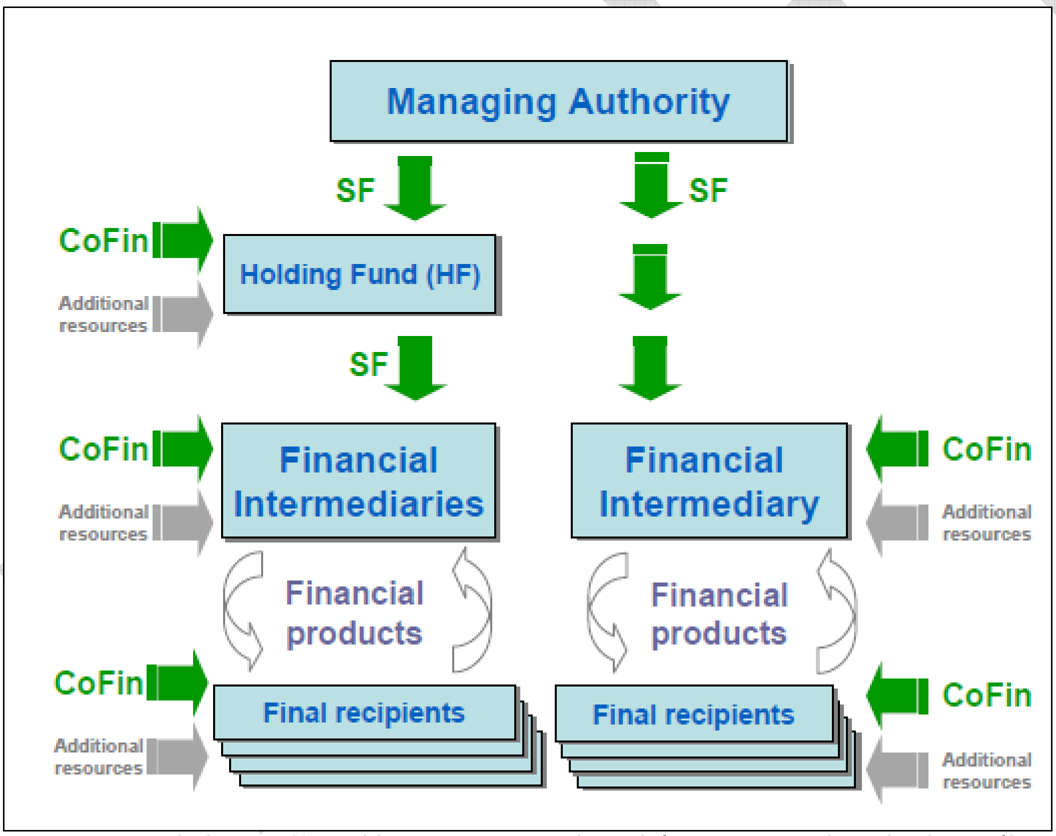
Structuring of Financial Instruments, the source and level where co-funding is raised

Structuring of FIs indicates what sources of capital are used (e.g. EU funds, national public funds, private funds) to build FI, which can generate the optimal financing package. FIs with EU funds are delivered through a cascade of actors e.g. European Commission, Managing Authority, EIB, EIF, national or international financial institutions, commercial, investment or development banks, foundations, insurance companies, investment funds, etc. All of them can provide capital to FI.

In order to set up Financial Instrument with EU funds, Managing Authority transfers some of its Structural Funds allocations to:

- a Fund of Funds, which transfers it to financial intermediaries, or
- directly to a financial intermediary

A Fund of Funds (also known as a holding fund) is an independent legal entity or a separate bank account within an existing financial institution (e.g. EIB, EIF, national financial institutions or other financial market participants). The purpose of the fund of funds is to set up, manage and supervise multiple funds. A fund of funds invests in singular funds, and a fund of funds structure is advisable when more than one singular fund are set up and a Managing Authority has a service provider who can help build, manage and supervise multiple instruments. Capital volume of a fund of funds is greater than that of a singular fund, has the critical mass which makes it possible to diversify portfolio, move between transactions and maximise profits at acceptable level of risk. In case of FI implemented thorough a fund of funds, co-financing and leverage can be provided and obtained at three levels: at the level of a fund of funds, financial intermediary and final recipients. The graph below presents possible structures for financial instruments with EU funds:[19]



Source: Commission Staff Working Document "Financial Instruments in Cohesion Policy", Brussels, 27.02.2012, P.15

[19] Source: Comparative Study of Venture Capital and Loan Funds Supported by the Structural Funds, European Commission, Directorate General Regional Policy, P. 18

Steps in establishing and implementing Financial Instruments

The main steps in establishing and implementing FIs include: ex-ante assessment, strategy planning and design, implementation and evaluation.

Ex-ante assessment

Draft CPR Article 32 (2) states that:

"Support of financial instruments shall be based on an ex-ante assessment which has established evidence of market failures or sub-optimal investment situations, and the estimated level and scope of public investment needs, including types of financial instruments to be supported. Such ex ante assessment shall include:

(a) An analysis of market failures, suboptimal investment situations, and investment needs for policy areas and thematic objectives or investment priorities to be addressed with a view to contribute to the strategy and results of the relevant programmes and to be supported through financial instruments. This analysis shall be based on available good practice methodology.

(b) An assessment of the value added of the financial instruments considered to be supported by the CSF Funds, consistency with other forms of public intervention addressing the same market, possible state aid implications, the proportionality of the envisaged intervention and measures to minimise market distortion.

(c) An estimate of additional public and private resources to be potentially raised by the financial instrument down to the level of the final recipient (expected leverage effect), including as appropriate an assessment of the need for, and level of, preferential remuneration to attract counterpart resources from private investors and/or a description of the mechanisms which will be used to establish the need for, and extent of, such preferential remuneration, such as a competitive or appropriately independent assessment process.

(d) An assessment of lessons learnt from similar instruments and ex ante assessments carried out by the Member State in the past, and how these lessons will be applied going forward.

(e) The proposed investment strategy, including an examination of options for implementation arrangements within the meaning of Article 33, financial products to be offered, final recipients targeted, envisaged combination with grant support as appropriate.

(f) A specification of the expected results and how the financial instrument concerned is expected to contribute to the achievement of the specific objectives and results of the relevant priority or measure including indicators for this contribution.

(g) Provisions allowing for the ex ante assessment to be reviewed and updated as required during the implementation of any financial instrument which has been implemented based upon such assessment, where during the implementation phase, the managing authority considers that the ex ante assessment may no longer accurately represent the market conditions existing at the time of implementation.

2. bis The ex ante assessment may be performed in stages. It shall, in any event, be completed before the managing authority decides to make programme contributions to a financial instrument.

The summary findings and conclusions of ex-ante assessments in relation to financial instruments shall be published within three months from their date of finalisation.

The ex-ante assessment shall be submitted to the monitoring committee for information purposes in accordance with Fund-specific rules".

Strategy planning and design[20]

During the planning and design, strategic decisions are taken about e.g. what type of FI will be set up (loan fund, equity fund, mezzanine fund or guarantee fund), type of activities targeted (enterprises,

[20] The current paper refers to Article 40 EC 1828/2006, however this part will be updated based on finalised 2014-2020 regulations.

urban development projects, energy saving/renewable energy investments), implementation structure (through singular fund or a Holding Fund), how State aid will be addressed.

In 2007-2013 programming period these elements are outlined in the business plan and stipulated in the funding agreement.

Art 43 of 1828/2006 outlines the content of business plan for FIs:

a) the targeted market (enterprises, urban projects or energy saving measurements), criteria, terms and conditions for financing them
b) the operational budget of FI
c) the ownership of FI
d) the co-financing partners or shareholders
e) the by-laws of FI
f) the provisions on professionalism, competence and independence of the management team
g) the justification for, and intended use of, the contribution from the Structural Funds
h) the policy of FI concerning exit from investments in enterprises or urban projects,
i) the winding-up provisions of FI, including the reutilization of resources returned to FI from investments or left over after all guarantees have been honoured, attributable to the contribution from the operational programme

Art 44 of EC 1828/2006 outlines the content of a funding agreement:

a) the investment strategy and planning;
b) monitoring of implementation in accordance with applicable rules;
c) an exit policy for the contribution from the operation programme out of Fi;
d) the winding-up provisions of FI, including the reutilisation of resources returned to FI from investments or left over after all guarantees have been honoured that are attributable to the contribution from the operational programme.

Step 3. Implementation

Every FI is managed and implemented by the management team which organises the investment process in line with the agreed investment strategy. During the implementation phase funds are invested and a mid term evaluation is carried out to review the scheme. Depending on the outcome, the scheme may be changed, additional funds may be contributed or the fund volume may be cut. At the end of the implementation period all capital should have been invested as otherwise it will need to be repaid. During the closure of FI, the settlement of accounts is done and shareholders are paid out their share of the initial investment and a share of profits.

Step 4. Ex-post Evaluation

Ex-post evaluation analyses the impact of FI and identifies points of improvement. The results of ex-post evaluation will determine the further use of the remaining means after the closure of the fund. The means cashed in after the closure of the fund may be used by the operational programme for the same FI, for another FI or as a grant scheme (under the condition that it will be used for the benefit of the programme area).

5. Examples of Financial Instruments

FIs are not new, have been operated for many years all over the world and since 1994 also within EU Cohesion Policy. This section presents examples of four types of FIs. All of them follow the same principles but their capital is from different sources.

1) Financial Engineering Instrument for Europe with the capital from USA

Marshall Fund: The Marshall Fund was part of the European Recovery Programme where the United States gave monetary support to help rebuild European economies after the end of World War II in order to prevent the spread of Soviet Communism.[21] The plan was in operation for four years beginning in April 1948. The goals of the United States were to rebuild a war-devastated region, remove trade barriers, modernize industry, and make Europe prosperous again. In some European countries the Marshall Fund resources were spent as grants while in other as revolving funds to finance e.g. investments in enterprises. In the latter case, the funds have been returned to the financial instrument after the agreed period, reinvested for the same purpose and are still (almost 70 years later) available for financing development of enterprises.

2) Financial Engineering Instruments with EU Structural Funds

JEREMIE stands for Joint Resources for Micro and Medium Enterprises. JEREMIE is technical assistance initiative launched in 2005 by the European Commission Directorate-General for Regional Policy in partnership with the European Investment Bank and the European Investment Fund with the aim of improving SMEs access to finance in the Member States in the framework of 2007-2013 Structural Funds.

The legal basis is Art. 44 1083/2006 which states that Operational Programmes may contribute part of their Structural Funds to financial engineering instruments which invest in enterprises through venture capital funds, guarantee funds and loan funds. Financial engineering instruments in 2007-2013 can be set up at national or regional (sub-national) level and each instrument is individually tailored to the needs of the region where it operates, following the evaluation of the market failures and the appropriate remedies in the Operational Programme. Financial engineering instruments engage other sources of finance outside Structural Funds, including participation of the private sector, and thus can maximise the leverage effect.

JEREMIE initiative offers EU Member States and regions the possibility to invest some of their EU Structural Funds allocations in revolving funds and in this way recycle financial resources in order to enhance and accelerate investment in enterprises. Through JEREMIE initiative Member States can set up market-oriented financial engineering instruments for enterprises with money from Structural Funds, which can be implemented directly or via a holding fund to support the creation and expansion of SMEs by provision of repayable forms of assistance such as equity, loans and/or guarantees. Funding from financial engineering instruments established through JEREMIE may be combined with business support and institution-building measures offered by financial institutions (e.g. banks) invited to help operational programmes manage financial engineering instrument.[22]

By the end of 2010 over EUR 3 billion Structural Funds was invested in nearly 400 financial engineering instruments for enterprises and the resources leveraged at the level of enterprises amounted to over EUR 4 billion.[23]

The shortcomings of financial engineering instruments set up through JEREMIE initiative i.e. regional and national focus of activities carried out by enterprises, can be addressed by FI operating in multi-country context in ETC. FI in ETC can support enterprises which operate across borders and internationalise their activities.

North Denmark Lone Fund (Nordjysk Lånefond)[24] is an example of a JEREMIE type of Financial Engineering Instrument for enterprises, operating as a singular fund (implemented without a holding fund). Nordjysk Lånefond is a corporate foundation in the North Jutland Region of Denmark which is managing the JEREMIE loan fund of DKK 61 million. Nordjysk Lånefond offers attractive loans for

[21] http://en.wikipedia.org/wiki/Marshall_Plan
[22] Handbook on JEREMIE Holding Fund Operational Procedures, European Investment Fund, www.eif.org, P. 4
[23] Source: 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 2010, December 2011
[24] www.nordjysklaanefond.dk

innovative companies with growth-potential and which are based in the North Jutland (one of five regions in Denmark), over the period 2007–2013. It is a successor of Nordjysk Lånefond operating in 2006-2008. The capital of 2007-2013 Nordjysk Lånefond is composed of DKK 30 million from the EU Structural Funds and DKK 31 million from the North Jutland Regional Development Agency. Until now over 100 loan applications were submitted to Nordjysk Lånefond out of which 20 were assessed positively and granted a loan. The maximum loan value is DKK 5 million per enterprise and loans are granted at the annual interest rate of 3%.

Nordjysk Lånefond Board composed of the representatives of the Regional Development Agency, Nordjysk Lånefond, Nord Jyske Bank and a lawyer, meet 6 times per year to take decisions about companies to be supported by the Lånefond. Successful companies need to fulfil the following conditions:

- present a business plan with innovative ideas for products or services
- did not manage to get a commercial loan from their own bank
- were established less than 10 years ago
- are based in North Jutland
- offer new products or services
- have growth potential
- will create new jobs in the region of North Jutland.

Companies which have so far received loans from the Lånefond operate in sectors such as medical biology, military production, green energy production and they have good potential for transnatioalisation of operation. Successful applicants can get a maximum of 50% of a loan from a Lånefond and the remaining 50% from another financial institution. This way the Lånefond leverages private sector capital at the level of beneficiaries. This way a borrower (enterprise) needs to present a business plan at two different financial institutions (Lånefond and a commercial bank). Such 'four-eye scrutiny' makes the process tougher and more selective but also more focused which can increase the chance for success. The core of the Nordjysk Lånefond is its regional focus, i.e. supported enterprises are focused on the North Jutland Region of Denmark and this is where they need to operate, grow and create jobs.

3) Financial Engineering Instruments within European Territorial Cooperation

EUREFI[25] (Europe Regions Funding) – is a project within a cross-border cooperation programme INTERREG IV Greater Region covering Luxembourg and parts of Belgium, France and Germany. It is the first ETC funded cross-border venture capital fund[26] created jointly by EU and a group of private partners in Wallonia (Belgium), Luxembourg and Lorraine (France). According to the information provided under annual implementation report for 2011, the size of the instrument is EUR 4.12 m, with EUR 1.12 m from ERDF. From the latter amount, EUR 0.39 m was paid to final recipients by the end of 2011. The mission of EUREFI is to assist SMEs and industries during their expansion into neighbouring markets, help consolidate their financial structures by boosting own resources and improve integration of investment policies in partner countries/regions. EUREFI project supported by the EU funds is no longer operating and the remaining funds were returned to the ETC programme in 2012.

4) Multi-country Financial Engineering Instruments without Structural Funds capital

Baltic Innovation Fund: The Baltic Innovation Fund (BIF) is an innovative investment initiative dedicated to boosting equity investments made into Baltic enterprises, launched on 26 September 2012 by the European Investment Fund and Lithuania, Latvia and Estonia. It will invest EUR 100 m into private equity and venture capital funds focused on the Baltic States over the next four years (2013-2017) through a 'fund of funds' process to further develop equity investments into SME to boost growth[27]. The capital of the Baltic Innovation Fund is composed of contributions from the EIF and three Baltic States as well as private sector capital levered by the Baltic Innovation Fund at different levels of implementation. National contributions from the Baltic States will originate from utilising revolved Structural Funds from

[25] www.eurefi.eu
[26] Definition of venture capital is provided in glossary
[27] www.eif.org

previously successful SMEs support schemes. The total volume of capital invested by the Baltic Innovation Fund by the end of 2017 is expected to exceed EUR 200m. The Baltic Innovation Fund is unique as it covers three Member States and will operate across the borders investing in growth-oriented enterprises from the region.

FIs presented in this section follow the same principles:

- Initial capital attracts other sources of capital (from public and private investors) and in consequence a bigger envelope is available for investments in growth enterprises from the region (leverage and impact)
- Professional financial institutions are delegated the task of managing FI on behalf of the capital donor/investor (e.g. USA government, Operational Programme, Member States, EU, etc.)
- Initial capital stays in the cycle and once repaid, it can be reinvested over and over again in the region
- 'Smart money' – apart from money, in some cases final recipients may also get advice and consultancy from a financial institution in developing business strategy

The main limitation of Financial Engineering Instruments with Structural Funds in 2007-2013 programming period (e.g. Financial Engineering Instruments for enterprises implemented through JEREMIE initiative) is geographic scope: Financial Engineering Instruments operating on national or regional levels have geographical focus and support enterprises from a predefined geographical area (i.e. Member State or region) and do not operate across borders.

6. Setting up Financial Instruments in ETC: What the process could be like?

Based on my research, observations and discussing the subject with ETC programmes, the European Commission and the European Investment Fund, I see that the process of setting up FI in ETC may have the following steps:

1. Acknowledgement by ETC programme stakeholders that there is a clear and fully understandable EU policy shift towards FIs and the need to anchor it firmly within the Operational Programme strategy during the programming process. FIs with EU Funds are working all over EU at national or regional levels (592 FEI have been set up by end of 2011) and create impact, additionality, leverage and reflows (if set up and managed correctly).

2. There are no successful FIs in ETCs yet and we need to accept that setting it up will be an innovative process along a steep learning curve for all: ETC programmes, the European Commission and financial institutions. The model FI in ETC that will emerge will build on good practise examples from current FIs and avoid replication of their weaknesses.

3. Among 592 FIs operating across EU at national or regional levels there are both successful and less successful instruments. One of the reasons why some FIs have not been successful is that they have not been correctly set up or implemented (no ex ante assessment / gap analysis was carried out in the region prior to setting it up, the instrument was oversized or a wrong type of FI was set up). Still, there are many FIs which are successful, leverage private capital and create positive incentives in the region. They can be used as good practise examples for a pilot FI in ETC.

4. Setting up FI in ETC will imply blending three worlds: ETC, Europe 2020 and financial institutions and finding a common denominator. Because of major differences and the way how ETC and financial institutions operate, establishing a successful partnership and cooperation structure for FI will require patience and openness for trying out new things. It is essential that all stakeholders fully comprehend the principles and nuances of this innovative process in order to be able to drive it, be in control and feel a share of ownership.

5. ETC programme stakeholders (Monitoring Committee, Managing Authority and Joint Technical Secretariat) need to acknowledge that there are real potential benefits from implementing FIs in the Operational Programme. All parties need to confirm readiness to dedicate the needed % of the Operational Programme to such an activity and commit to support the exploration process.

6. ETC Operational Programme needs to be written not only for grants but also for FIs. Even though it is not required by the regulations, if an ETC programme plans to utilise part of the ERDF funds in the form of FI, it is advisable to indicate in the financial tables of the Operational Programme that the co-financing for the programme will be from both public and private sectors.

7. A concept of final recipient rather than project will apply to the part of ERDF invested in FI.

8. Due to multi-country context of ETC it is advisable to involve a professional financial institution, which will dedicate resources to develop a full proposal of FI addressing the needs of an individual ETC programme (Art. 32 draft CPR). The proposed FI (scope, size, type, etc.) will be based on the results of ex ante assessment of ETC programme area, thematic objectives chosen by the programme and investment principles. The proposal and conditions for implementation (e.g. management costs and fees) will be negotiated between an ETC programme and a financial institution, and will be within the limits set out in the regulations.

9. Once the proposal has been agreed on, an investment strategy will be developed by a financial institution and an ETC programme. It will take into account investment principles and parameters set by ETC programme, which however must not be too restrictive as this can strangle the utilisation and success rates of FI.

10. Financial institution will be delegated the implementation task of FI on behalf of the Managing Authority. ETC programme stakeholders will not be involved in selecting enterprises / final recipients which will benefit from FI, however they will set the investment strategy and eligibility criteria to be followed during the selection process of final recipients. Managing Authority will systematically check whether the implementation of FI is in line with the agreed investment strategy and carry out management verification checks.

11. FI will be an integral part of a bigger strategy of ETC programme to support SMEs and innovation, not a stand alone project. Activities supported through FI will complement projects supported with grants, interact with the business community and network and enhance efforts to promote entrepreneurship and innovation.

12. As an example, the investment strategy for FI in ETC may contain the following elements:

- FI will target final recipients operating transnationally according to a set definition and parameters.
- FI will be regarded as a 'single project' and private partner(s) is then selected to implement it: a Bank or Investment Fund operating across an ETC programme area.
- The selected financial institution (Bank or Investment Fund) will provide private co-financing that gives a minimum leverage of 2x. A wide scope of possible final recipients (and investment activities) will be agreed covering thematic objectives and consistent with the rest of the Operational Programme.

13. Examples of possible FIs which can be set up in ETC programme include:

- An instrument that enables a bank to lend to R&D intensive projects within SMEs expanding across ETC programme area. This would enable the bank to lend at beneficial rates to SMEs creating cross-border R&D activities.
- An investment fund that invests in 'spin-out' projects from a network of Universities across ETC programme area targeting certain activities such as 'low carbon economy'. An expansion of a successful model already used in e.g. UK to boost the commercialisation of new technologies developed in Universities into small businesses.
- And many more…

14. If the European Investment Fund is delegated the implementation tasks of FI, the minimum acceptable capital volume invested by ETC programme needs to be approximately EUR 40 m.[28] This amount makes it possible to set up a balanced portfolio and diversify risks. FI will be expected to attract capital at various levels (e.g. Fund of Funds, singular funds, enterprise) located in and outside the programme area, which leverage a total volume of around EUR 40 m to be invested in businesses from the programme area.

15. The main benefits, added value and reasons for setting up FI as an adjunct to grant aid in ETC include:

- FI can be a catalyst for attracting private sector investment to the programme area. It can act as an 'anchor investor' providing e.g. 50% of capital for investments in businesses in ETC programme area in cases where financial support is unlikely to be available or fundraising from other sources has been especially difficult.
- Increased attractiveness of the programme area for regional and international investors.
- Increased number of financing options and investment activities allowing growth oriented businesses expand across the region and beyond hence boosting business volumes, employment, tax revenues and facilitating knowledge-based economy.
- Potential for cooperation with financial institution investors in the programme area.
- Counteracting the problem of 'talent loss' resulting from the withdrawal of private investors in the early stages, by backing experienced and emerging fund management teams.
- Improving the access to finance for businesses from ETC programme area by increasing availability of alternative sources of capital.
- ETC programmes have a long history of cooperation and governance structures that can be utilised to leverage private investors' capital to co-invest in growth enterprises from the region while targeting programme objectives:
  - Contributing to building ecosystem for innovation and entrepreneurship
  - Financing the start up process of new innovative companies
  - Supporting cross-border and transnational investments

16. An ETC programme and a financial institution delegated management and implementation tasks for FI will need to agree on the main characteristics of FI, such as e.g.:

- FI will be designed to suit specific characteristics of ETC programme area and provide a flexible approach to maximise the market opportunity present in the region.
- FI will be managed and invested on a commercial basis with financial institution acting as fund manager and advisor.
- Investments will focus on sectors agreed by ETC programme and financial institution and specified in the investment strategy.
- FI will take full advantage of EIF investment experience, track record as a fund of funds manager and creation of investment infrastructure.
- Objectives and activities of FI will be closely aligned with ETC programme thematic objectives and can be formulated as:
  - Addressing gaps in ETC programme area (supply side oriented FI or demand side oriented FI)
  - Generating positive returns over the lifetime of FI to reward investors
  - Creating a longer term legacy for future investments

[28] Graham Cope, European Investment Fund, 'Financial Instruments in the context of an ETC Programme", Presentation at 2014-2020 NWE Programme Preparation Group Meeting, Brussels, 1.03.2013

7. Conclusions

This paper shows that:

1. EU strategic papers for 2014-2020 call for greater use of FIs by Member States and programmes.
2. Each year there are more and more Structural Funds invested in FIs.
3. There is more and more knowledge and good practise examples about FIs across the EU.
4. There is still little knowledge about FIs in ETC and many concerns how this can be done successfully in multi-country context.
5. The European Commission and the European Investment Fund offered to assist an ETC programme with a pilot.
6. If FI is well designed and implemented, there is nothing to loose as in the worst case EU Funds are invested in enterprises from ETC programme which plan to grow, expand and internationalise activities, but… some of them may not succeed to the extend hoped, will not generate returns as high as expected, and eventually may not be able to repay the loan. In case of grant mechanisms funds are not repaid either, and nobody expects them to be repaid.
7. Well designed and implemented FI can offer gains i.e. more capital to be invested in ETC programme area (leverage and multiplier effect), repaid funds can be reinvested in the programme area (revolving character), smart money for enterprises (consultancy and assistance with strategy and business plan development), access to new knowledge and investment know-how, broader partnerships can be involved in achieving ETC programme objectives, etc. If successfully implemented there will be money repaid to FIs at the end of the programming period on 31.12.2022 (or if agreed otherwise, also later) which can be reinvested in an ETC programme area.
8. FIs are flexible mechanisms and can be implemented alongside grants. This means that ETC programmes can carry on with their traditional activities (i.e. supporting cooperation projects through grants) and at the same time invest part of ERDF in activities which have been previously rejected because of private sector involvement, revenues or too commercial character.
9. FIs can be used smartly in ETC programmes as part of bigger strategy to support business environment and entrepreneurship through both grant and revolving instruments.
10. If a pilot FI in ETC materialises – it will be learning for all.

Next steps: Stakeholders of an ETC programme take a decision to further explore the possibility of investing part of 2014-2020 Operational Programme funds into FIs. Ex ante assessment needs to be carried out for ETC programme area to indicate the market gap and suboptimal investment situation, which will be addressed by FIs, the type and size of FIs to best address this gap and its strategy.

Outcome: At the end of 2022 there will have been several FIs established in ETC programmes. In consequence the capital volume of ETC will have increased (capital returned to FIs with interest) and have been reinvested in respective ETC programme areas.

Annex 1. Glossary[29]

Business angel	A wealthy private individual who invests directly in new and growing businesses from ETC programme area and provides them with advice.
Equity	Equity financing is selling a partial interest in the company to investors to obtain capital. The equity, or ownership position, that investors receive in exchange for their funds usually takes the form of stock in the company. In contrast to debt financing (loan), equity financing does not involve direct obligation to repay the funds. Instead, equity investors become part-owners and partners in the business, and thus are able to exercise some degree of control over how it is run. Since creditors are usually paid before owners in the event of business failure, equity investors accept more risk than debt financiers. As a result, they usually also expect to earn higher return on their investment. But because the only way for equity investors to recover their investment is to sell the stock at a higher value later, they are generally committed to furthering the long-term success and profitability of the company. In fact, many equity investors in start-up companies and very young companies also provide managerial assistance to the entrepreneurs. Equity instruments are usually more appropriate for very high risk start-ups or for SMEs that have reached a stage in their development where substantial additional funding is required but is unavailable in the form of debt.
Final Recipients	Enterprises (SMEs) in ETC programme area benefiting from aid provided by FI.
Financial Engineering Instrument	An instrument such as venture capital fund, guarantee fund or loan fund launched by an operational programme and implemented in 2007-2013 programming period by a professional financial institution according to the investment strategy.
Financial Instrument	An instrument such as venture capital fund, guarantee fund or loan fund launched by an ETC programme and implemented by a professional financial institution in the programming period 2014-2020 according to the investment strategy.
Financial Intermediary	Financial institutions such as e.g. venture capital funds, loan funds, guarantee funds, banks, etc. selected by Managing Authority to implement FEI. The main task of financial intermediary is to channel financial resources to enterprises.
Fund manager	Financial institution which has been delegated by ETC programme the task of implementing the investment strategy of FIs.
Guarantee	The effect of guarantee schemes is to pool risk, thus making the remaining risk more attractive to a lender.
Holding Fund / Fund of Funds	An umbrella fund set up by an ETC programme to invest in more than one FI. The role of a Holding Fund will be to manage ERDF funds on behalf of ETC programme Managing Authority. The Holding Fund together with ETC programme stakeholders (Managing Authority and Monitoring Committee) will develop investment strategy stating the conditions how ERDF funds will be invested in an ETC programme area. Based on its expertise and working closely with ETC programme Managing Authority, a Holding Fund will evaluate, select, accredit financial intermediaries and monitor implementation of ETC FIs. It may also provide technical assistance to financial intermediaries.
Investment Strategy	The strategy developed jointly by an ETC programme and Financial Institution selected for the implementation of FIs. It outlines the mission, objectives and investment policy of FIs and how the funds invested in FIs will be spent in ETC programme following ex ante assessment. It is based on both: ETC programme

[29] Solely for the purpose of this paper.

	objectives and investment principles.
Leverage	An advantage of FI with EU funds is the potential ability to engage private and/or public financial sector with additional capital to increase the potential return of an investment. In case of FI in ETC, Structural Funds will co-investing alongside private investors and participate in sharing the risks. Leverage helps both the investor and the firm to invest or operate. However, it comes with greater risk. If an investor uses leverage to make an investment and the investment moves against the investor, his or her loss is much greater than it would've been if the investment had not been leveraged - leverage magnifies both gains *and* losses.
Liquidity	The amount of capital available for investment and spending.
Loan	Loan as the typical form of debt financing is the purchase of the present use of money with the promise to repay it in the future according to a pre-arranged schedule and at a specified rate of interest. Loan contracts formally spell out the terms and obligations between lender and borrower. Loans can be classified as long-term (with maturity longer than one year), short-term (with maturity shorter than two years), or a credit line (for more immediate borrowing needs). They can be endorsed by co-signers, guaranteed by the government, or secured by collateral - such as real estate, accounts receivable, inventory, savings, life insurance, stocks and bonds, or the item purchased with the loan. The interest rate charged on the borrowed funds reflects the level of risk the lender undertakes by providing the money. For example, a lender may charge a start-up company higher interest rate compared with the interest rate it charges a company with a proven profit record from the past.
Mezzanine	Mezzanine financing consists of a mix between debt financing and equity. It can be distinguished between equity mezzanine – i.e. forms of mezzanine that have many elements of equity – and debt mezzanine – i.e. forms of mezzanine that have many elements of debt financing. Mezzanine financing is usually unsecured and subordinate (so-called „junior“) to normal debt financing (so called “senior loans”). Mezzanine is an extremely flexible form of financing. It is believed that the use of mezzanine financing will continue to grow.
Risk Sharing Instrument	Risk-sharing instrument means a financial engineering instrument which allows for the sharing of a defined risk between two or more entities, where appropriate in exchange for an agreed remuneration.
Small and Medium Enterprise	Micro, small and medium-sized enterprise employing less than 250 persons, with turnover of max. EUR 50 m and a balance sheet with total of max. EUR 43 m.
Structuring capital	Capital structure describes how an organisation finances its assets. It is usually a combination of several sources e.g. debt, guarantee, equity. The right combination of them can help keep the true cost of capital as low as possible. Capital structure can be complex or simple. Complex capital structure can involve dozens of financing sources, drawing on funds from a variety of entities in order to generate the optimal financing package. Simple capital structure draws on one source of capital only.
Venture Capital	Professional equity co-invested with the entrepreneur to fund early stage (seed and start-up) or expansion of an enterprise. The aim of venture capital investors is to support companies with high growth potential, help them grow and create value over several years by providing advice, incentives, networking and knowledge through a range of specific investment structures. Venture Capital is considered as a factor decreasing substantially the required time to introduce an innovation on the market.

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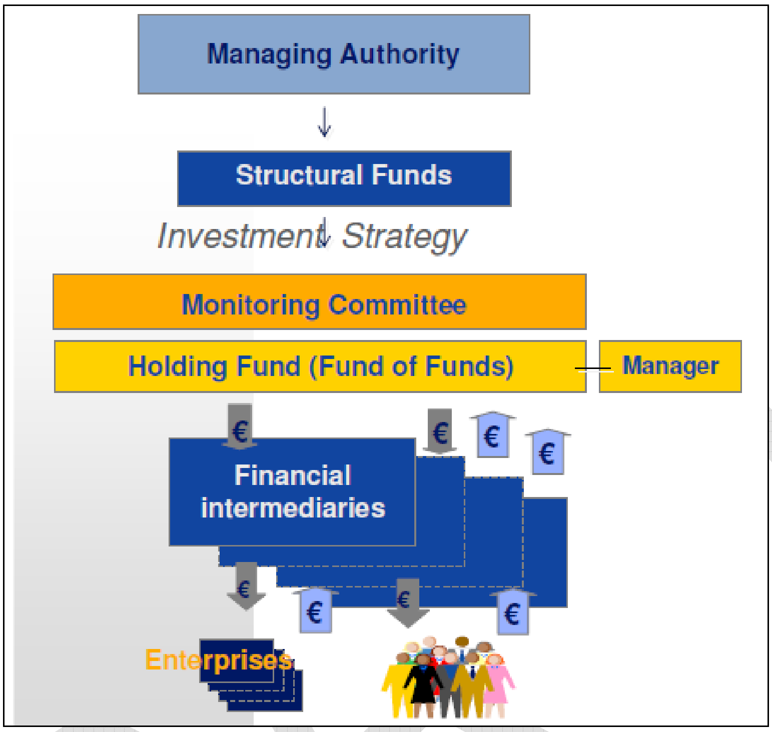
Annex 3. List of Interviewees

The following persons have been interviewed or provided information during this paper development.

Name	Organisation	Country
Hanna Dudka	European Commission	Belgium
Graham Cope	European Investment Fund	Luxembourg
Stephen Langley	European Commission	Belgium
Martin Dastig	Investionsbank Berlin	Germany
Rudolf Niessler	European Commission	Belgium
Vicente Rodriguez-Saez	European Commission	Belgium
Katarzyna Walczak	European Commission	Belgium
Jane Worthington	Department for Communities and Local Government, Worrington	United Kingdom
Poul Kvist Bettina Stiller B. Madsen	Nordjysk Lånefond	Denmark
Veronique Goupy	Vigiacom	Belgium
Tomasz Petrykowski	INTERACT Point Viborg	Denmark
Karolina Bachmann	INTERACT Point Viborg	Denmark
Christophe Wacquez	North West Europe ETC Programme	France
Christian Byrith	North Sea Region ETC Programme	Denmark
Erik Fuglsang	North Sea Region ETC Programme	Denmark
Thomas Weber	Baltic Sea Region ETC Programme	Germany

Annex 4. Financial Instruments with a Holding Fund: Delegation of implementation tasks to a Fund Manager



Source: European Investment Fund

Annex 5. Financial Instruments in ETC: Frequently Asked Questions

1. Are FIs suitable for ETC programmes?

- FIs can be implemented in ETC programmes which due to transnational or cross-border scope and nature of cooperation provide suitable structure for incubating FEI.
- ETC programmes (70 ETCs in 2007-2013 covering EU territory and neighbouring countries on EU external borders, budget for ETC in 2014-2020 over EUR 8b) provide very good environment in which transnational or cross-border FIs can incubate.
- FIs set up by ETC programmes will probably operate in a much stable environment compared to FIs operating at national or regional levels. In most cases ETC programmes governance structures remain unchanged for the whole programming period while national governments may change (in some countries more often than in other), which can slow down or even block the process.
- ETC programmes have multi-country scope, operate across borders and hence create best chances to maximize profits. This is how investors wish to operate i.e. with no national borders, which can create artificial barriers for investments. Financial institutions investing in growth enterprises across EU know no national borders and operate on pan-European and global scales to maximize profits. That is why multi-country FIs implemented through ETC seem natural and could potentially address weaknesses of FIs operating at national or regional levels.
- ETC programmes have a well established network of stakeholders at different governance levels and sectors. This could be an asset when mobilizing involvement of private investors to co-invest in FIs operation alongside the contributions from ERDF.
- The goal of internationalisation of enterprises might be the driving force for FIs in ETC programmes.

2. What is the benefit for ETC programmes from using FIs?

FIs are flexible mechanisms, can operate alongside grant assistance, help address specific needs in the programme area in a cost effective way, can help deliver programme objectives and add value to ETC programme area through:

- Catalysing private sector capital to be co-invested in the programme area (leverage)
- Making it possible to reuse funds (revolving character)
- Supporting innovative ideas
- Promoting revenue generation, profitability, commercialisation and sustainability of results
- Contributing to development and expansion of enterprises: internationalisation of business activities
- Strengthening the spirit of entrepreneurship through closer cooperation with private sector and financial institutions
- Creating broader partnerships through involvement of financial institutions
- Boosting cooperation between public and private sectors and financial institutions (new cooperation links)
- Access to private sector skills and know-how
- Building institutional capacity through partnerships between public and private sectors
- Pooling expertise and know-how between national and regional authorities, financial institutions and final recipients
- Offering 'money with management' or 'smart money' – apart from capital injection offer consultancy services for enterprises (from business plan development to expansion across borders)
- Creating new, high quality jobs

3. What conditions need to be fulfilled to make it possible to implement FIs in ETC?

- The decision if and what FI will be set up in ETC programme needs to be based on ex ante assessment of the programme area

- The right FI needs to be designed to address market failures/imperfections/gaps in ETC programme area and ensure adequate incentives for public and private investors to co-invest alongside ERDF
- Even though it is not required by the regulations, it is advisable that Operational Programme contains provisions which can facilitate investing part of ERDF in FI, in particular:
    a. Financial tables specify that national co-financing will be provided by public and private sectors
    b. Due to multi-country scope, the implementation of FI in ETC will be delegated to a professional financial institution (Art. 32, draft CPR)
    c. The concept of 'final recipient' rather than 'project' will apply to the part of ERDF invested in FI since with revolving instruments it is necessary to state who is liable for repayment of funds
- Interests of all stakeholders must be aligned i.e. ETCs and financial institution entrusted with the implementation of FI, and reflected in the investment strategy
- FI needs to be designed and implemented in such way that it attracts participation of private sector investors and financial institutions on an appropriate risk-sharing basis
- FI needs to target 'bankable' enterprises from ETC programme area, i.e. enterprises with commercial perspective and potential to generate revenue

4. What is the added value of FIs in ETC when such instruments exist on EU, national and regional levels?

- FIs in ETC will not duplicate FIs operating at EU, national or regional levels. They will be tailored and designed for each individual ETC programme based on ex ante assessment of the programme area.
- Internationalisation of activities will be the core of FI in ETC. Such instrument will efficiently engage private sector to maximise the leverage effect when supporting enterprises wanting to internationalise activities. It will not duplicate other FIs but address their weaknesses i.e. 'zoning' and geographical constraints. In particular, FIs at national or regional levels focus on enterprises from a very limited geographical region while FIs in ETC will operate across borders.
- FIs operating on a transnational or cross-border level can create a new dimension of transnational or cross-border cooperation through strengthening cooperation between investors and financial institution and expanding the network of financial stakeholders and investors in ETC programme area.
- Through transnational or cross-border FIs, ETCs can better respond to challenges facing the programme areas (e.g. addressing market gaps in provision of venture capital to SMEs, supporting enterprises planning to expand internationally but did not get external financing at local financial institutions). Even though national or regional programmes have established FIs, the additional value for ETC would be establishing schemes to address specific cases which are not yet addressed by national and regional FIs (e.g. internationalization of venture capital which is in line with the EU goal to create a single market for venture capital).
- Through its leverage effect FI when investing at early stage in companies (especially at seed stage) from ETC programme area, could facilitate integration of the venture capital markets by encouraging transnational investments. This may contribute to further removal of national barriers in ETC programme area and creation of a single market in the risk capital industry.
- Involvement of and cooperation with private sector which until now has been avoided in most ETCs.
- Facilitating investment activities in ETC programme area to enable greater internationalization of growth-oriented companies.
- Enabling ETC programme area to benefit from greater inflows of international investments.
- Strengthening and stimulating exchange of good practices on technology transfer between incubators, universities and technology transfer offices.
- Maximizing the integration and knowledge transfer to and within ETC programme area.
- Utilizing naturally developing incentives: revolving instruments would attract private co-financing and this could ease the pressure on national co-financing institutions.

- Accessing new knowledge and expertise through cooperation with financial institutions (e.g. implementation of innovative instruments, State aid)
- Facilitation of expansions of young and innovative companies into a larger European market to achieve critical mass to compete.

5. At what levels value added can be achieved?

Additionality of FIs in ETC can be achieved at least at three levels[30]:

- Enterprise level: situations where a company's plans could not have gone ahead at all without investments made by FI
- Additionality at financial institution level managing FI: creating and animating a network of financial intermediaries
- Additionality at ETC programme level: trying something the programme has never done before (using ERDF in the revolving way), creating high quality jobs in the region (jobs created through FI are usually in technology and knowledge intensive business activities concentrated in parts of the economy that have good long term prospects.[31]) than those created through Structural Funds interventions, promotion of innovation and regional competitiveness; moving from grant-dependency culture towards more innovative forms of financing.

6. Can ETC operate both grants and FIs or it is better to focus on one type of instrument?

- FIs are flexible mechanisms and can be used alongside grants in ETC programmes. This means that ETCs can carry on with typical types of activities i.e. financing cooperation projects with grants and in parallel invest part of OP in FI supporting activities with growth and revenue generation potential.
- FIs should become part of the overall support strategy of ETC programme for enterprises in the programme area, not as a standalone endeavour. FIs can complement activities supported by grants, interact with the business network, incubators or other business support initiatives and generally enhance programme's efforts to promote entrepreneurship and innovation.

7. Why should ETC programmes support SMEs through FIs?

- Even though most ETCs have avoided private sector participation in 2007-2013 to minimise the risk of State aid and revenue generation, many are considering opening up for private sector in 2014-2020
- FIs in ETC could support start-up companies from the programme area and through private sector investors provide them not only with capital, but also consultancy on business building skills, strategy and business plan development, specialised global networks and experience which can help address challenges of international expansion. Businesses, especially at the start or during expansion need support with building a balanced management team, developing capital-efficient business models, information about foreign markets with their threats and opportunities. There are information gaps due to different administrative, fiscal and regulatory frameworks in different countries that often prevent or slow down the creation of transnational SMEs or the access of national SMEs to foreign markets.
- Through FIs enterprises from an ETC programme could get access to knowledge of foreign markets and international networks to minimize risks and enhance the probability of success. This way FIs can help profiting from opportunities offered by the single market and ultimately contribute to the creation of new companies or expansion of existing ones (SMEs – Small Multinational Enterprises).
- Enterprises which plan internationalisation of activities need to address a number of challenges such as e.g. foreign language, different culture, standards, rules (e.g. legal requirements,

[30] Foe more details see table on page 18
[31] Comparative Study of Venture Capital and Loan Funds Supported by the Structural Funds, European Commission, Directorate General Regional policy, August 2007, p.37

accounting, tax, etc.) International investors pooled together through ETC FEI can help address these challenges.

8. On what basis can ETC programme decide whether it needs FIs?

- ETC programme needs to carry out ex-ante assessment of the area to identify gaps or sub-optimal investment situations. Results of ex ante assessment will be the basis for identification of potential points of intervention to be addressed by FIs. A professional financial institution will then propose the most suitable FIs.
- ETC programme will need to anchor FIs in the programme strategy, secure resources and set a framework to deliver it.

9. What is ex ante assessment and what should be its focus for ETC?

- Ex ante assessment (also called feasibility study or gap analysis) is scientific work carried out by a professional institution to justify why it is necessary to establish FI. It assesses the latest intelligence gap in the region i.e. what type of financial products are offered by financial institutions (supply-side), what type of financial products are needed (demand-side), what is the gap and how to address it.
- Ex ante assessment is a fundamental step in the process of setting up every FI. Terms of reference for ex ante assessment need to be well thought through so that a researcher/consultant can deliver a paper which can help set up a correct FI. Terms of reference for ex ante assessment for an ETC programme would probably need to address the following aspects:

1) Prospective demand and projects

- Present ETC programme in the broader context of Cohesion Policy, including its strategic rationale as well as key threats and opportunities in programme implementation.
- What sectors and project types are most likely to contribute to achieving strategic objectives of the programme and to generate demand for FIs?
- How FIs can complement market driven investments and grant-based public support offered by the programme?
- Are there existing or proposed projects in the programme area which are at a more advanced stage and could be supported with FIs? (projects that can be structured so that they can generate a return to investors and are not only suitable for grants)
  - Provide a clear assessment of the implementation status and estimated timescales of delivery
  - Present the outputs projects would be expected to achieve, focusing also on the socio-economic outputs relevant for ETC programme
  - Identify the key players involved

2) Type and size of FI

- Outline types of projects that could benefit from FIs
- Outline the scale and type of financial products (loan, equity, guarantee) most likely to help project delivery
- Outline the scale of projects/activities that will benefit from FI
- Estimate the ability of FIs to leverage private sector investments, or co-investing additional to the resources from OP or from non-governmental sources (including e.g. EIB investment or loan). This will help understand where (in which parts of an ETC programme area) FIs could most effectively facilitate leverage of other non-government investments.
- Based on estimated demand and nature of potential projects/activities, recommend what FI is needed to maximise impact, critical mass, leverage and contribution to programme objectives
- Estimate the amount which should be invested in FI by ETC programme

3) Market failure

- Provide extent of market failure that is preventing specific projects from taking place in ETC programme area at the desired scale and timescale.

4) What is the link between SMEs development and ETC programme objectives?

- In 2014-2020 11 thematic objectives will be eligible for investment through FIs, with thematic objective 3 "enhancing the competitiveness of SMEs"
- In 2014-2020 multi-fund approach is encouraged as well as combining grant mechanisms with FIs.
- Ex ante assessment should capture potential synergies between grant-financed part of OP and FI-financed part of OP. It should propose smart links between these two parts of OP and ultimately show FI as an integral part of OP strategy.

5) Proposed architecture of FI

- Assess existing national and regional FIs operating in ETC programme area, compare their advantages and disadvantages and outline how FIs in ETC will be different from existing FIs.
- What is the added value of FI in ETC and how to ensure that it will not be crowded out and will not crowd out other FIs in the region?
- Propose a viable architecture of FIs including the number, geographical coverage and investment policy focus.
- Propose the type of co-funding model to be used (match-funding through debt or equity-based instruments – co-funding obtained at the level of the fund or at the level of the individual investments (SMEs). Is it possible to identify a preferred co-funding model? If so, for what reason? (e.g. streamlined setting-up, time/effort from inception to fully operational status, effectiveness as investment vehicle in terms of outputs, cost/benefit ratio, etc.
- Propose management structures for FI and cost implications of such structure; costs of such structure in absolute terms and expressed as a percentage of total investment in FI.
- Propose next steps to progress effectively in setting up FI and incorporating it in ETC OP.
- The ultimate question which needs to be addressed is: Can FI in ETC work or not?

10. Will target sectors be predefined in the investment strategy of FI?

This is an investment decision which needs to be taken jointly by ETC programme and financial institution implementing FI. The following needs to be considered:

- Thematic objectives of ETC programme and results of ex ante assessment of the area can help determine what sectors will be targeted by FI.
- In principle, the wider the range of sectors in which FI can invest, the bigger the chance for greater returns. In contrast, narrow definition of target markets[32] in terms of sectors and geography can 'strangle' utilisation rates of FI (more uncertain and lower overall return).

11. How much money should ETC programme invest in FI?

- The amount committed by ETC to FI should correspond to the amount necessary to address the identified gap in the market and implement planned activities and payments to final recipients, including management costs and fees charged by a financial institution managing implementation of FI, determined on the basis of a business plan and cash flow forecasts for a pre-defined period.
- The critical mass (or size) of FI is key for the process to succeed. However, the amounts can vary depending on instruments and location. For example, a capital volume of a holding fund of circa EUR 100 million generally makes it possible to set a balanced portfolio, gives flexibility to manoeuvre between transactions, attracts between 30% - 100% of private investors' capital at the level of underlying funds, and helps maximize profits at acceptable levels of risk.
- Much smaller activities are implementable and the minimum acceptable capital volume that would need to be invested by ETC programme in FI (in case when it is managed by EIF) would need to be approximately EUR 40 million.[33]

[32] For example, in case of the Baltic Innovation Fund the following sectors were predefined as targets for assistance: Clean technology, ICT/Mobile and Life Science.
[33] Graham Cope, Senior Head of Region, European Investment Fund, INTERACT Newsletter Winter 2013, http://www.interact-eu.net/news/newsletter_interact_winter_2013_territorial_cooperation_2014_part_2/7/13651

12. What can be the source of match-funding / co-financing in FI in ETC?

Similarly to grants, also in case of revolving funds, programme's ERDF invested in FIs needs to be match-funded. It is the responsibility of a managing authority to ensure the required co-financing has been provided. Co-financing can originate from different sources, e.g.:

- Private sector – private sector investors such as banks, investment funds, etc. provide private capital which will be invested in FI alongside ERDF.
- Public sector: public sector institutions provide funds which are invested in FI alongside ERDF.
- International financial institutions: E.g. a loan from EIB can be used as match-funding of FI. Once the funds invested through FI have revolved and returned to FI, they can be used to repay EIB's loan.

13. At what level private capital can be leveraged by FI in ETC?

- Private capital can be leveraged at different levels depending which model of FI is used.
- Private capital can be levered at different levels e.g. at the level of fund of funds, financial intermediary or final recipient.

14. What will be the role of ETC programme bodies in setting up and implementation of FI?

Monitoring Committee will (based on Art 58 Draft GPR and 2007-2013 programming period experience :

- Examine and approve setting up of FI
- Examine and approve the investment strategy of FI
- Examine and approve the methodology and criteria for selection of final recipients of FI
- Examine progress in implementation of FI in line with the agreed investment strategy
- Examine and evaluate the annual and final implementation reports of FI
- Examine and evaluate proposals by the managing authority in relation to implementation of FI
- Can be involved in FI investors' advisory board

Managing Authority:

- Will play the key role in designing and implementation of FI
- Will negotiate a funding agreement with a financial institution implementing FI
- Will approve the investment strategy and business plan of FI
- In its management verification role, MA will monitor implementation and performance of FI. Since FI is an investment operation, the success of its performance will be defined by profitability rather than the absorption level. MA will receive periodic reports from a fund manager with information on progress of implementation according to the investment strategy, profitability, challenges, measures proposed to address them, etc.
- Each year MA will draft a report covering the operations implemented through FI, as annex to the annual implementation report sent to the European Commission. (Art. 40 draft CPR).
- MA will manage information flow and paper work between ETC programme, financial institution implementing FI and the European Commission.

15. Who will be the manager of FI in ETC?

- Due to multi country context of ETC it is advisable to delegate the task of management and implementation of FI to a professional financial institution.

16. What is the management fee? Can ETC programme afford it? From what budget it will be paid?

Management fee is the remuneration an ETC programme will pay to a financial institution managing FI. Different methods are currently used to calculate the management fees:

- Fixed fee linked to the value of FI (e.g. 2% per year)

- Financial performance of investments made and profits earned: the management fee is paid every time a deal has been completed. This method incentivizes managers to bring in good deals to FI.[34]

To avoid situations from 2007-2013 programming period where financial institutions have charged very high management fees for managing FIs, the 2014-2020 will set out thresholds for how high these fees can be.

17. What is 'smart money'?

'Smart money' or 'money with management' is a combination of financial and non-financial support in one package to contribute to greater impact in the region. Financial institutions implementing FIs sometimes provide enterprises not only with the capital but also 'mentor bank' consisting of experienced individuals who offer advice and mentoring on e.g.:

- Business building skills, strategy and business plan development
- Foreign markets and expansion across borders
- FI person or appointed representatives can sit on company's boards. By being directly involved in advising companies, FI can be in a better position to monitor its investments and detect problems at an early stage, when there is still scope to take corrective action.
- Developing business support structures more widely in the programme area and not just for the benefit of final recipients (investees), e.g. pre-investment advisory support, helping to develop business-angels community (supply-side).

Most financial institutions implementing FIs with EU funds accept that 'smart money' or 'money with management' is critical in ensuring successful investments.[35] Research findings indicate that soft support such as business advice, even if just for 12 hours of business consultancy from a pool of professionals in the field of finance, marketing, law, and other practical matters, can make a difference to the long term survival of business start-ups.[36]

18. When FIs in ETC will be successful?

FIs in ETC can be successful, in purely financial terms, when:

- It has invested in a number of innovative enterprises/projects from ETC programme area and certain number of them have survived, grown and expanded across borders increasing turnover.

From a broader regional development perspective, FIs in ETC have been successful when it has contributed to Operational Programme objectives, in particular:

- Supported companies or projects have internationalized business activities, created a number of quality jobs (e.g. in start-ups and SMEs engaged in technology and knowledge-intensive activities, concentrated in parts of the economy that have good long term prospects) and contributed to developing the knowledge base of the programme area
- Supported companies or projects have engaged in developing new products and services
- Financial institutions have provided business advice and mentoring to companies and projects
- Actions supported through FIs have created synergies with actions supported through grants

Positive impacts which FIs achieve are only likely to be possible to assess in the longer term as it usually takes time for successful companies to break even and generate positive returns.

19. How much can ETC programme earn from investing in FI?

[34] This method rewards very active fund managers. According to the data collected by the European Commission, Scottish Co-Investment Fund has one of the lowest levels of management costs of FEI with ERDF: Comparative Study of Venture Capital and Loan Funds Supported by the Structural Funds, European Commission, Directorate General Regional policy, August 2007, p. vi P. 42

[35] Comparative Study of Venture Capital and Loan Funds Supported by the Structural Funds, European Commission, Directorate General Regional policy, August 2007, p.27

[36] What are counterfactual impact evaluations teaching us about enterprise and innovation support?, Daniel Mouque, DG for Regional and Urban Policy, Evaluation and European Semester Unit, December 2012, P. 11

- Based on the available evidence from European Commission[37], projected investment returns from FIs with Structural Funds (i.e. venture capital funds) lie in the range 10 % – 25%. It is however difficult to establish accurate values due to uncertainty over how investments will perform and objectives of different FEI.
- As for ETCs, investment returns from FIs will be even more difficult to estimate as FIs will operate in different environments (every ETC programme covers different Member States and regions where some markets are more developed while some are less). This may also influence the level of returns. Performance of FIs in ETC will also depend on the objectives set and type of financing provided to enterprises, which will depend on the gap analysis of each individual ETC programme.
- All FIs have the objective of ensuring sufficient returns from investments, create legacy funds (new funds), cover investment losses, management fees and management costs.
- In financial terms, at the end of FI lifetime, not only will ETC programme have ERDF repaid, but it will have also earned profit. This does not happen in case of grants.
- In non-financial terms, at the end of FI lifetime, ETC programme will have tried something it has never done before, will have gained new knowledge, will have been exposed to investment principles and will have opened up for new types of activities and partnerships.

20. What will happen with the investment returns from FI? Will ETC programme get a share? Is it still Structural Funds and falls under EU rules?

- Investment returns are distributed among investors according to their share in FI. ETC programme as an investor in FI gets a share of investment returns which should be reinvested in programme area in the same or another FI or spent as grants for the benefit of its Member States and regions.

21. Is ERDF invested in FI outside ETC programme's control?

- When negotiating the investment strategy for FI, ETC programme stakeholders will influence how the money will be invested to ensure the interests of all are aligned.
- The management team entrusted with the implementation of FI will invest the money according to investment principles, profitability criteria and eligibility criteria agreed with ETC programme.
- Conditions under which funds will be paid to final recipients will be stipulated in the investment strategy.
- ETC programmes will be monitoring the implementation of FI to ensure it is in line with the investment strategy.

22. Who carries out first level control of FI and what is checked?

First level control of FI needs to be carried out by first level controllers in Member State where a financial institution responsible for the implementation of FI is based. As in every other project, FLC of FI will focus on checking the existence of the audit trail which can make it possible to verify the legality and regularity of expenditure declared to the Commission and demonstrates that principles of sound financial management have been applied. Based on COCOF guidance, in 2007-2013 the following elements are checked[38]:

- Supporting documents for the establishment of FI e.g. investment strategy, business plan, whether and how State aid rules have been addressed, whether public procurement rules have been observed where applicable, legal agreements between MA and a financial institution, etc.
- Supporting documents of the functioning of FI (e.g. how FI will use interest earned and returns)
- Supporting documents on the management costs and fees (how they are calculated, are they within the limits set by the regulations)

[37] Comparative Study of Venture Capital and Loan Funds Supported by the Structural Funds, European Commission, Directorate General Regional policy, August 2007, p. vi
[38] COCOF Guidance note of Financial Engineering Instruments under article 44 of Council Regulation (EC) No 1083/2006

- Application forms submitted to FI by enterprises who apply for financial support (e.g. business plans, information about previous annual accounts, checklists and reports filled in by financial intermediaries who assess applications from enterprises, etc.)
- Declarations made in connection with the receipt of *de minimis* aid
- Signed agreements in relation to the repayable investments (including equity, loans, guarantees or other forms of repayable investments provided to enterprises, public private partnerships, urban development projects, or to legal or natural persons carrying out specific investment activities in energy efficiency and use of renewable energy in buildings)
- Evidence that the objectives for which the repayable investments were used have been achieved according to the intended purpose (e.g. documents provided by final recipients, reports from on the spot verifications by fund managers, visits and board meetings, annual accounts, and reports by the loan intermediary to the guarantee fund supporting claims).

23. What will be checked during audit of FI?

According to COCOF guidance in 2007-2013 Second Level Control / audit of FI focuses on:[39]

- Transparency of the procedures used by Managing Authority when selecting a fund manager
- Establishment of FEI (whether state aid, public procurement and provisions in legal agreements have been observed), the functioning of FEI (i.e. whether the use of interest and returns is in line with the provisions stipulated in the investment contract and strategy)
- The different levels that can be audited are the managing authority and the FEI. In some cases audit can be also carried out at the level of the final recipients (enterprises)
- Examination that adequate audit trail exists at the appropriate levels of FEI including holding funds
- Examination that financial institution implementing FEI on behalf of ETC programme maintains an adequate accounting code for ERDF contribution from ETC programme
- Existence of a separate accounting system or a separate accounting code within FEI for co-financed expenditure down to the level of individual investments made into final recipients
- Clear identification of the capital contributed from the operational programme and priority axis to FEI
- Examination of the statements of expenditure for FEI – total expenditure paid from OP to FEI
- Examination whether funds are being invested in accordance with the agreed investment strategy, which takes account of ETC programme objectives and investment principles
- Examination that a proof exists of the transfer of the capital from FEI to final recipients (enterprises)
- Examination that the thresholds for management costs are not exceeded
- Examination that State aid rules are respected

24. What is the scope of ETC programme MA's responsibility and liability for funds invested in FEI?

- Allocating part of ERDF into FEI is an investment decision. From now on an ETC programme and its MA act as investors and similarly to other investors are responsible for committing the funds, stipulating the investment strategy and taking the best possible investment decisions. Since ETC programme does not have the skills and know-how to do it on its own, it needs to delegate the task to a professional financial institution. A financial institution will invest ERDF according to the investment strategy taking account of investment principles and ETC programme's objectives.
- Financial institution managing FEI invests capital (ERDF + private sector capital) in a portfolio of enterprises. In venture capital sector it is typical that some enterprises die early, some hardly survive and some do well and sometimes go on the stock. In a typical venture capital scenario investors invest in many companies knowing that only few will succeed and will be sold to generate returns. Probably with the time the successful companies will have also developed a product or service they wanted to develop, improved it and along the process created a number of jobs in the region.

[39] COCOF Guidance note of Financial Engineering Instruments under article 44 of Council Regulation (EC) No 1083/2006

- An ETC programme and its MA will not be responsible or liable for investment decisions taken by a financial institution managing FEI on its behalf. An ETC programme grants ERDF to a financial institution which invests it and in some cases the funds are lost (but they are still eligible) and in other cases funds revolve and generate low, medium or high returns.

25. Are Member State responsible for companies funded in their country?

- There is no direct responsibility chain between the companies in the investment portfolio and Member States in ETC programme. Portfolio companies are legally bounded to FI management company by the investment agreement but have no ties with investors in the fund (i.e. ETC programme, private sector investors, etc.).
- As investors in FI, Member States through Monitoring Committee will receive periodic reports on investees (funded companies in the investment portfolio) and will be able to monitor the status of supported companies but will not be legally tied to them.

26. What happens if a company goes bankrupt? Who repays the loan?

- FIs are investment vehicles and every investment is to some extent risky. Some investments are more risky and some are less. With FIs, ETC programme need to accept that there is a risk that some companies will go bankrupt, some will hardly survive and only some will do very well.

27. How FIs will be managed after closure of ETC programme?

2014-2020 ETC programmes will end in 2022 (2020+ 2 years). The same applies to FIs which hopefully will have fully invested the capital by then. ETC programme and financial institution need to agree when to close FI and what the exit scenario will be for funds committed. The following options exist:

- Limited time-frame of FI: In this case a pre-defined time-horizon for FI is agreed and at the end of it the fund will be closed (e.g. after 10 years from the end of the investment period). On this date, the settlement of accounts is. The funds might be:
  - Reused and invested in another FI in the following programming period
  - Reused in the form of grants which are spent for the benefit of the operational programme
  - Redistributed among partners according to their share in FI
- Evergreen fund structure of FI: MA can decide to set up an evergreen fund, i.e. for an indefinite time frame. In this case there is no deadline and no fixed moment in time when accounts are settled and the fund is closed. In case of such structure a foundation can be set up to manage the funds.

As long as FI funds have been invested, they do not have to be paid back to the European Commission. Only if the investment process has not been smooth and a management team of FI has not invested the whole amount, the share that has not been invested in the agreed period of time will be removed from FI and contributed to another part of the operational programme.