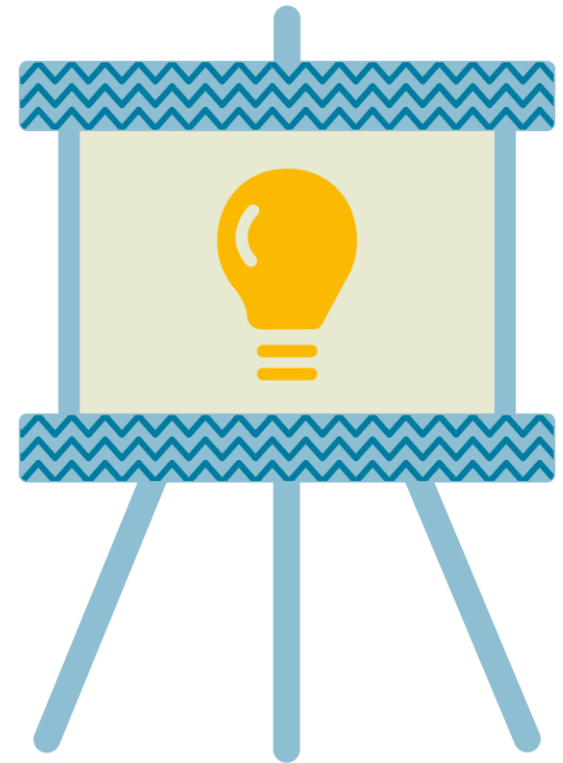


Fls in ESI funds

3rd CBC finance network meeting

15 - 16 October 2019 | Porto, Portugal

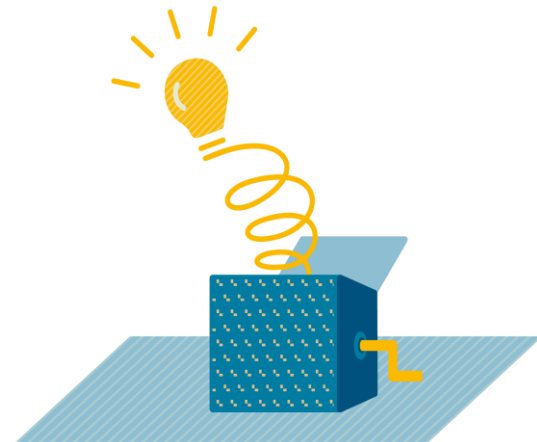
Iuliia Kauk, Interact



THINK
OUTSIDE
THE
BOX

Content

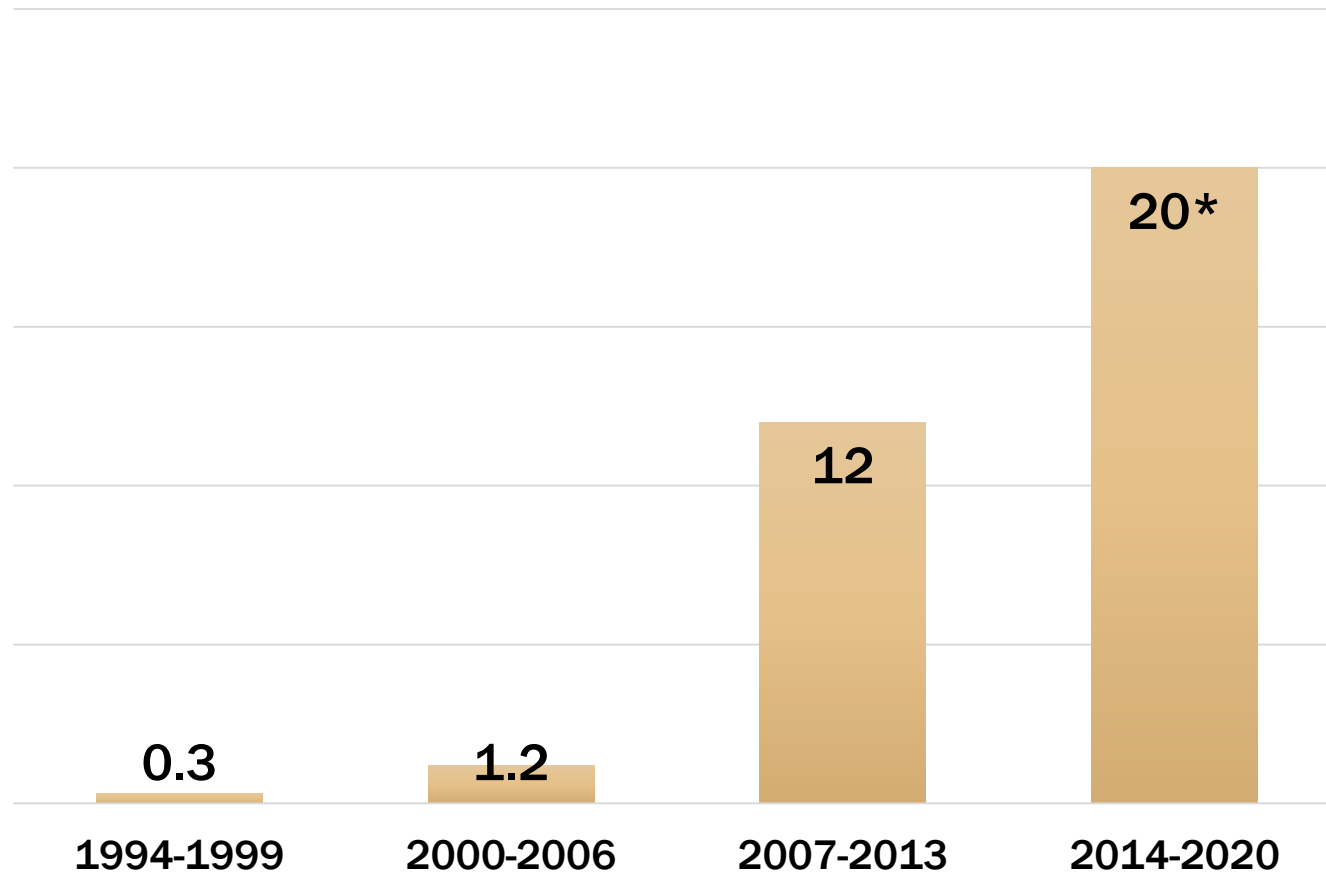
1. WIIFM
2. Financial instruments vs. Grants
3. Types of FIs
4. Ex-ante assessment
5. Implementation options
6. FIs in 2014-2020 and beyond
7. FIs and ETC: is there any future?
8. Case study



Financial instruments is a delivery mechanism!

- FIs are public policy instruments (loans, credit guarantees and equity finance schemes) designed to overcome market failures experienced by small and medium-sized enterprises to promote productive investments in a way that would not result through market interactions alone.
- One of the 4 forms of support (Art. 66 CPR)
- Suitable ONLY for income-generating, financially viable, cost-saving, enabling the initial support to be repaid projects!
- Rooted in the inability of public funds to finance infrastructure projects, economic crisis, gap between the financial requirements and effective budget.

FIs in ERDF spent, bln EUR



*estimated.

20 bln EUR - 6% of the total ESIF commitments.

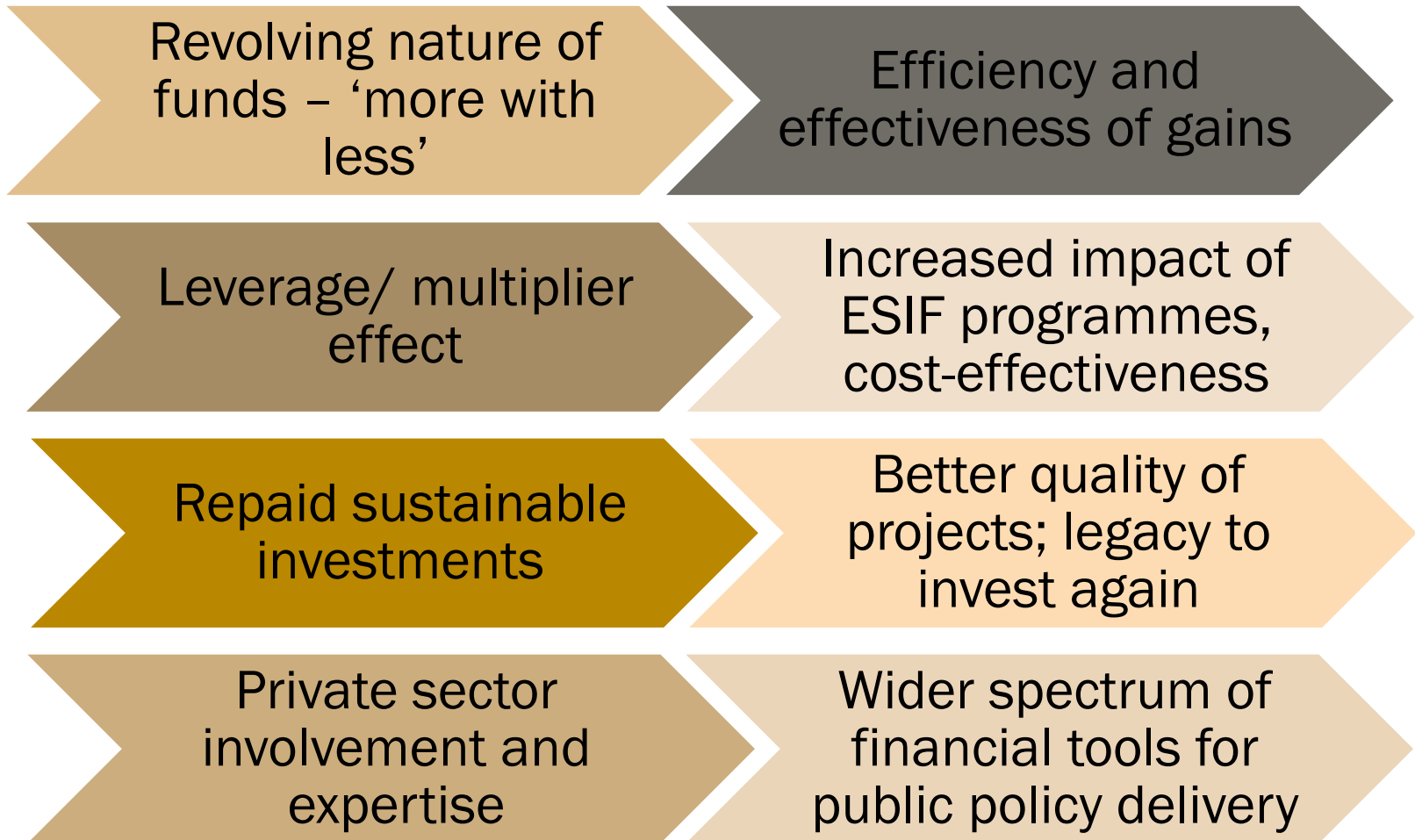
Financial instruments – What's In It For Me?

Why to bother at all?

BENEFITS of FIs



Benefits of FIs

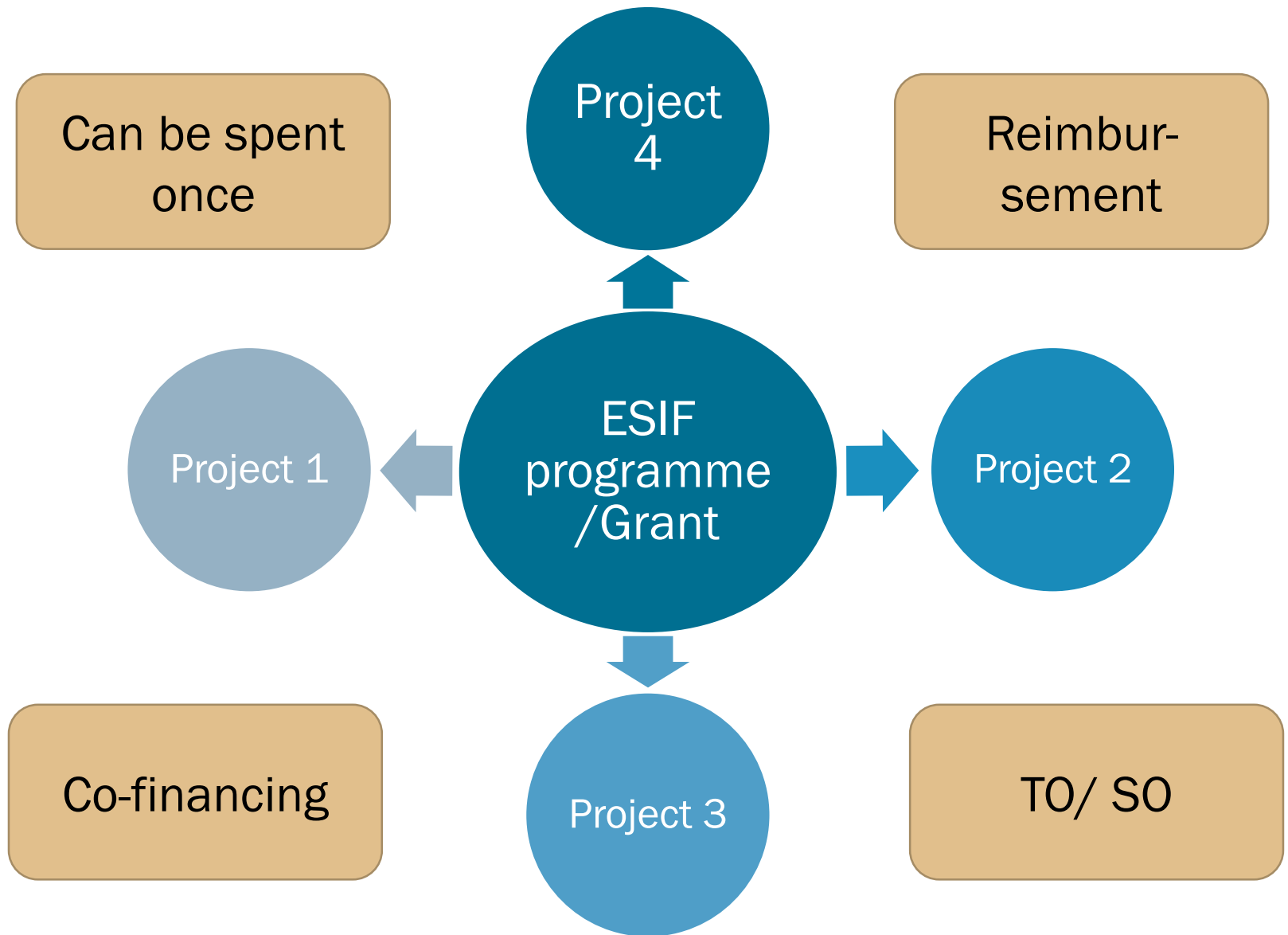


Financial instruments vs. Grants

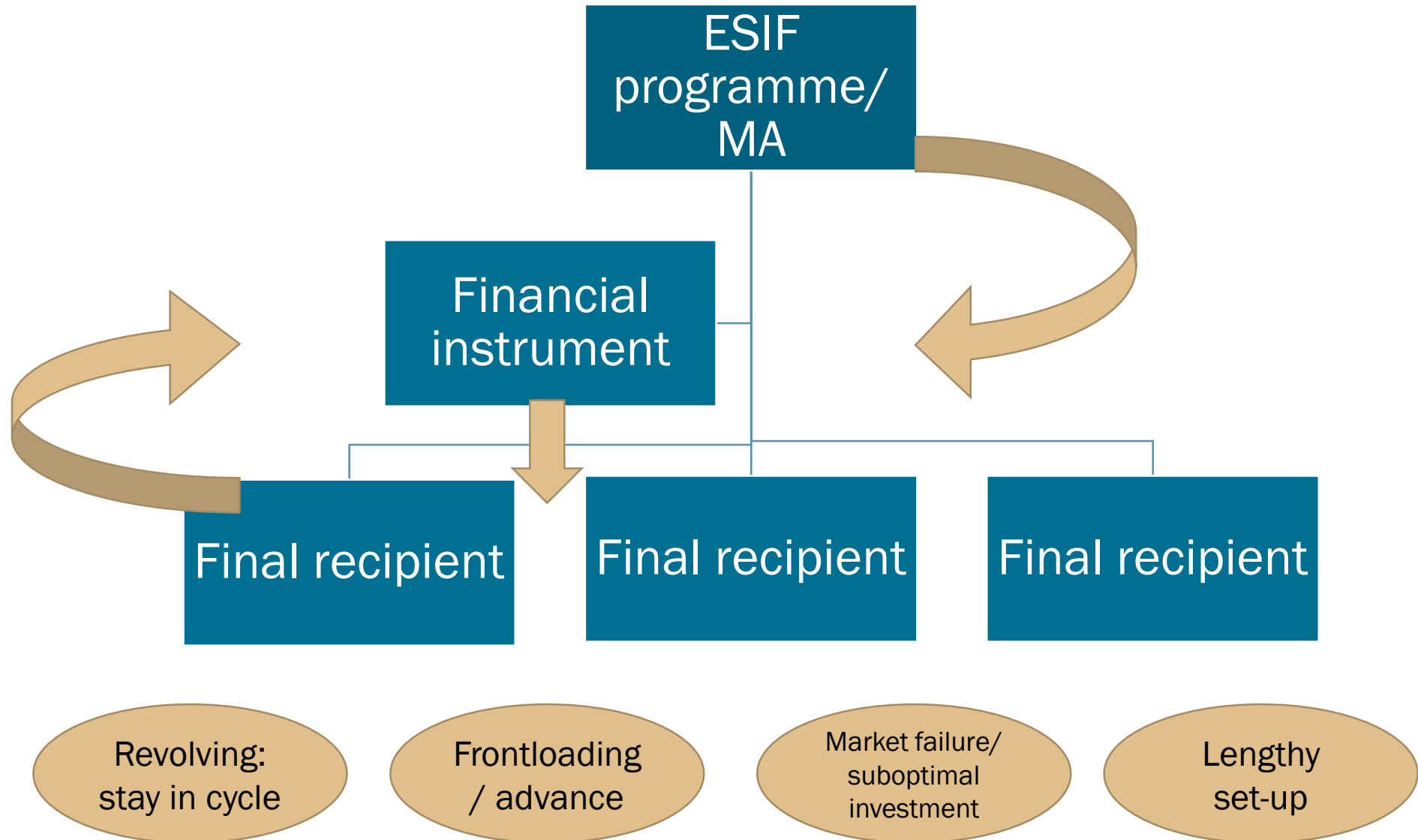
WHAT



Grant

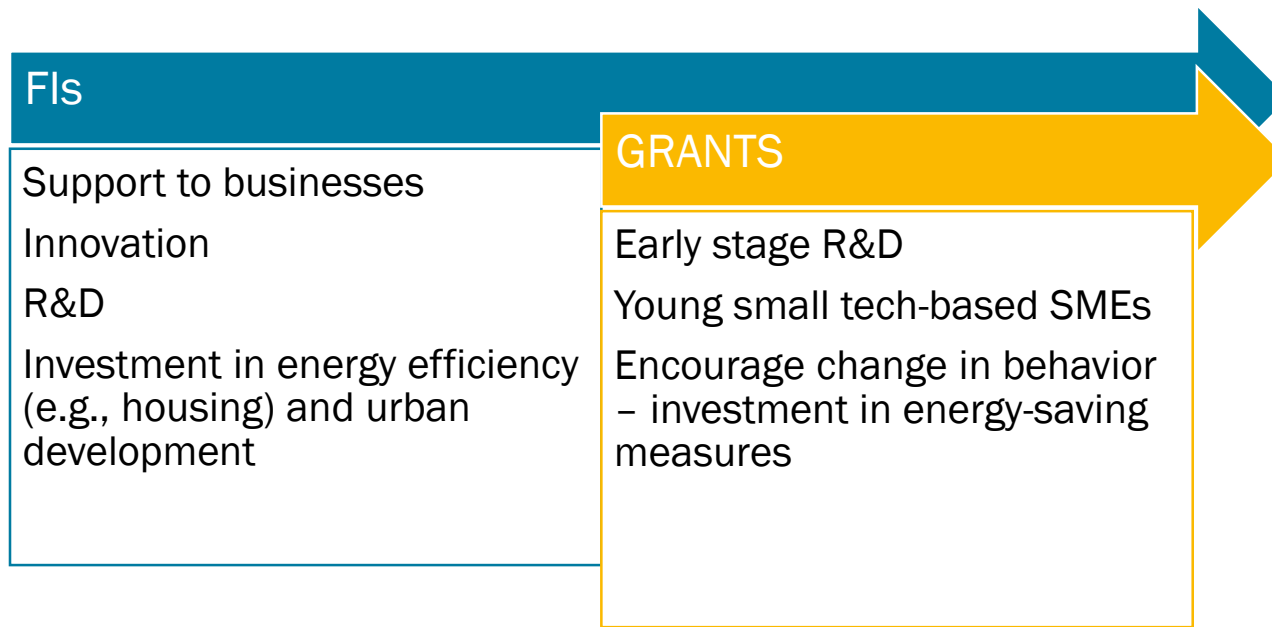


Financial instruments



Financial instruments vs. grants

- In specific areas of intervention FIs might be better suited than grants. On the other hand, in many policy interventions, grants are the only proper tools to use and FI are of complementary nature.



FIs in 2014-2020

Wider scope – all
TOs and IPs

Set-up –
mandatory ex-
ante assessment

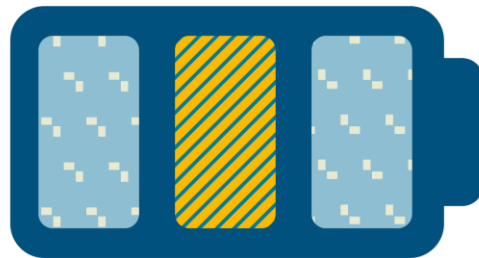
New
implementation
options +
Omnibus Reg.

Legal provisions
set out from
outset

Phasing of
payments

Types of financial instruments

WHAT



Choice of financial products

Type of final recipient

- *Micro-enterprises, start-ups, innovative SMEs, high-risk investments*

Type of project

- *Interest rate, collateral conditions, credit risk protection*

Financial context

- *Market failure, suboptimal investment situation, investment needs*

Financial products in ESIF

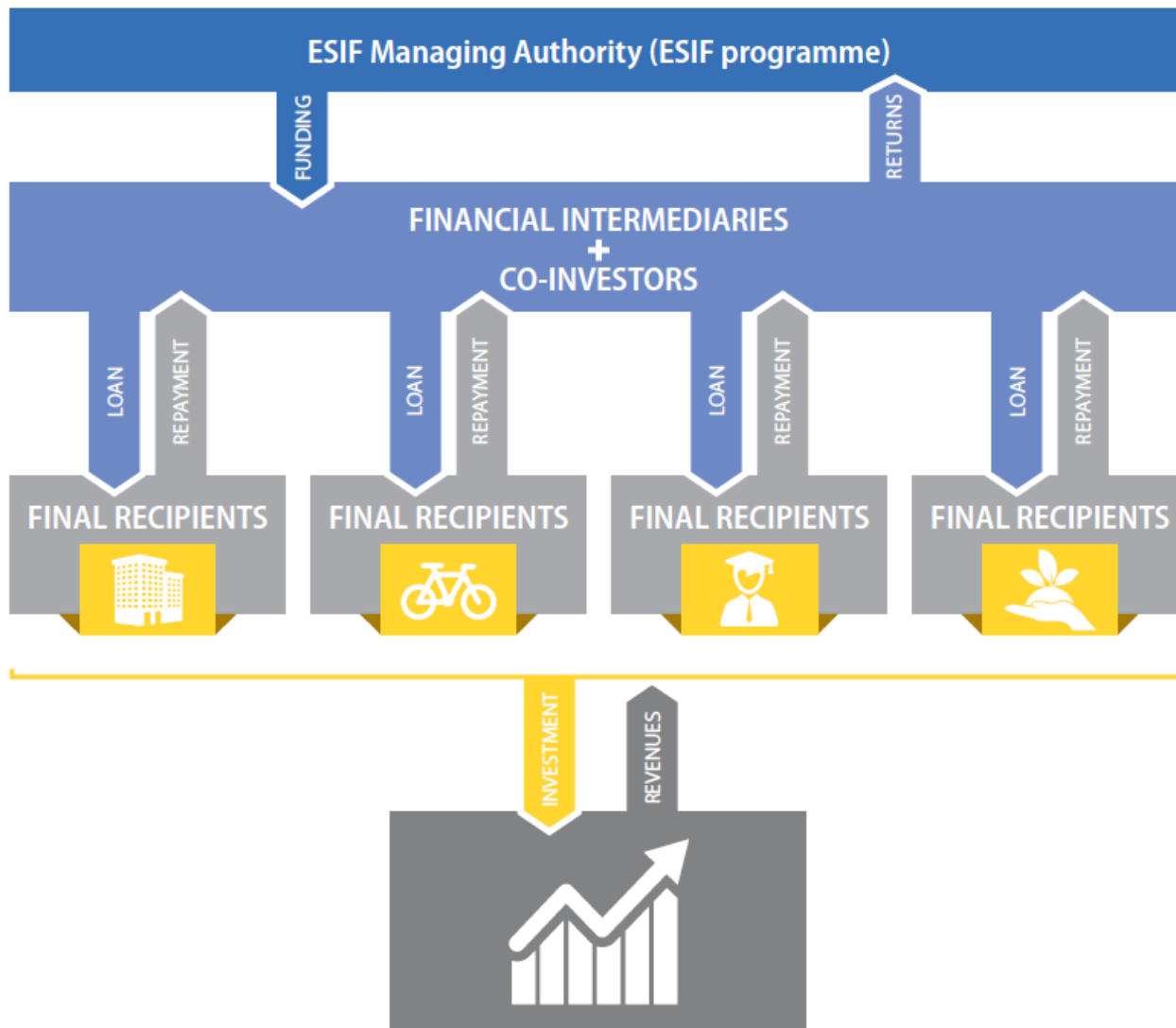
Loans

Guarantees

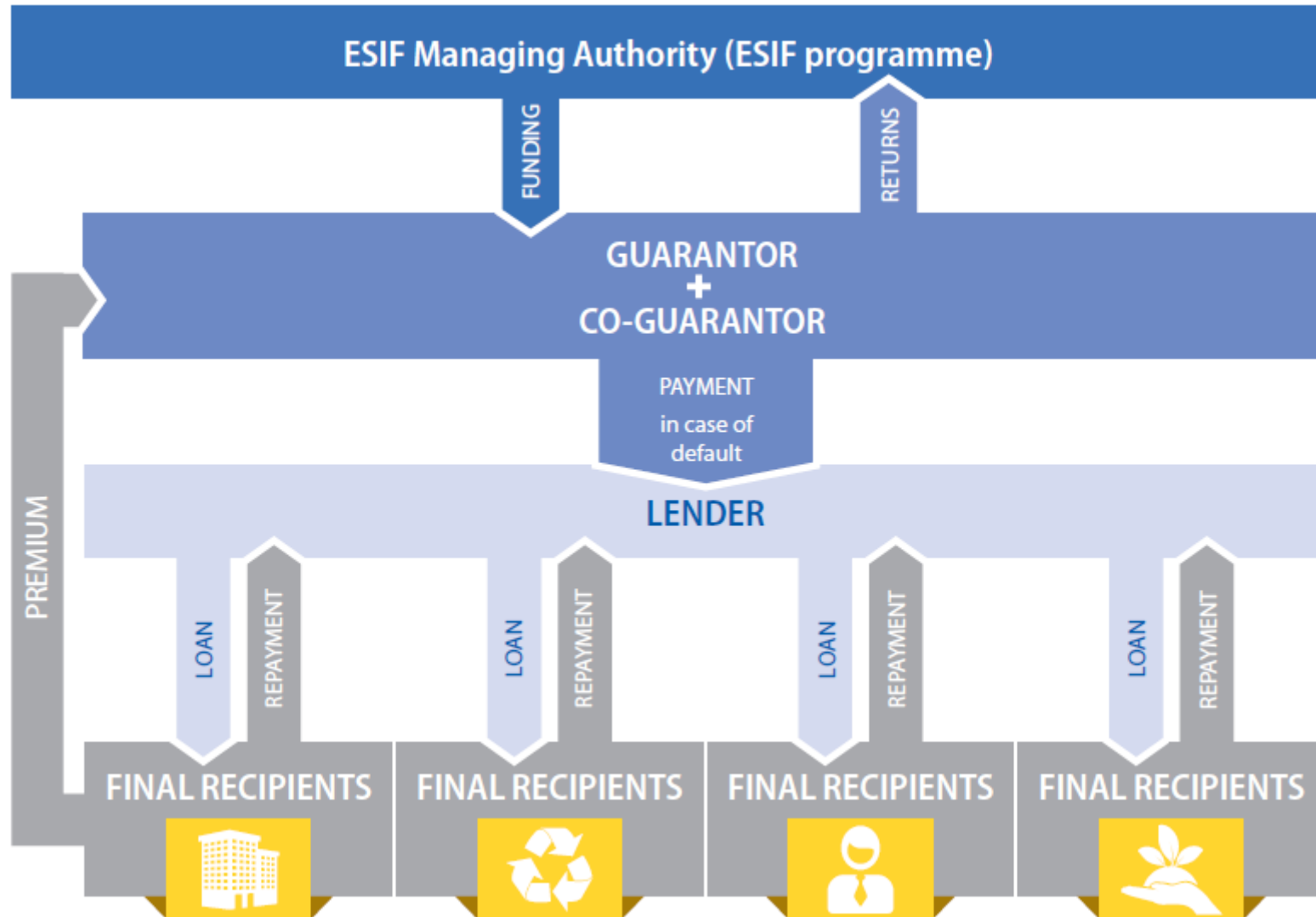
Equity

Quasi-
equity

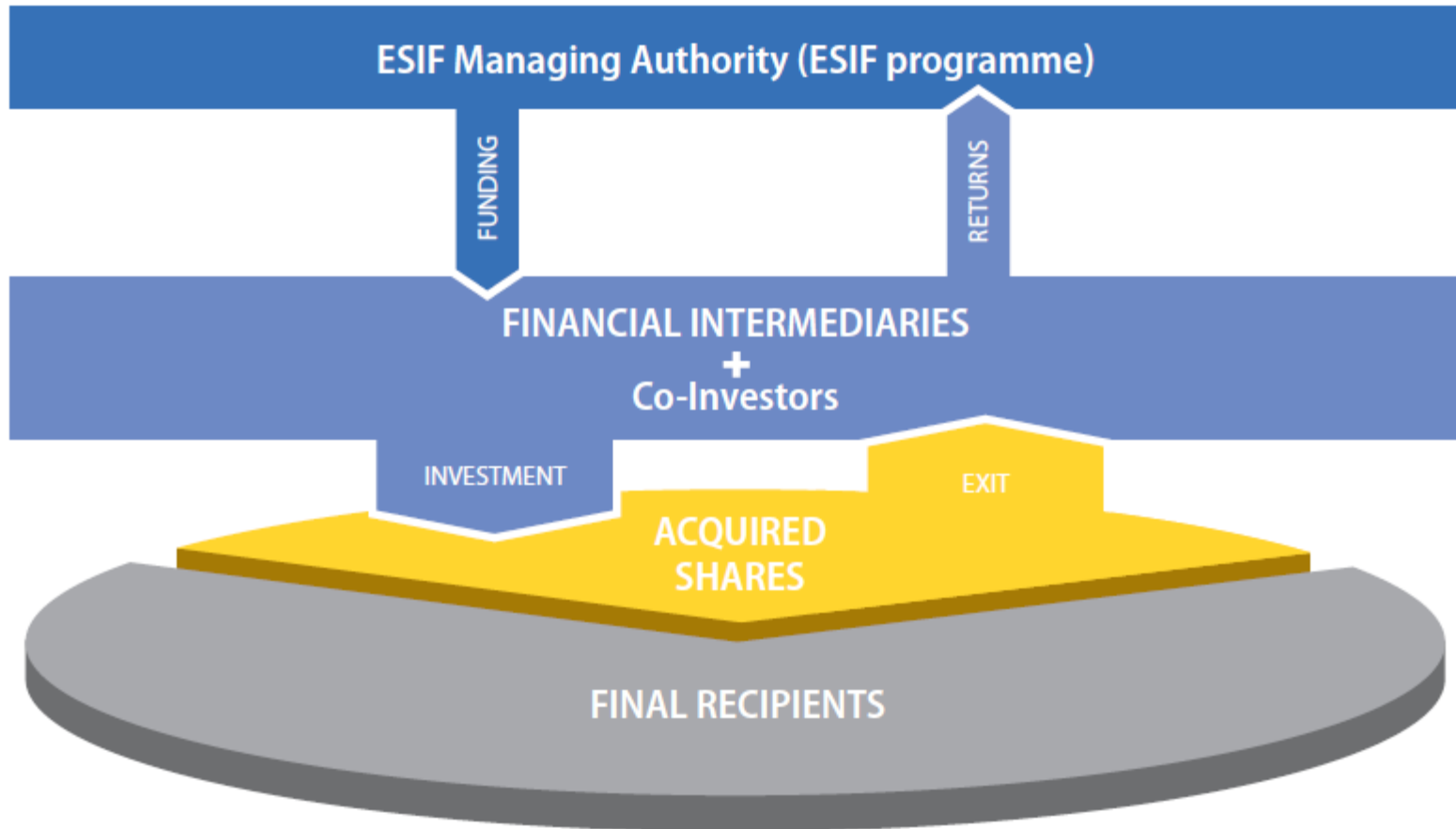
Loans



Guarantees



Equity

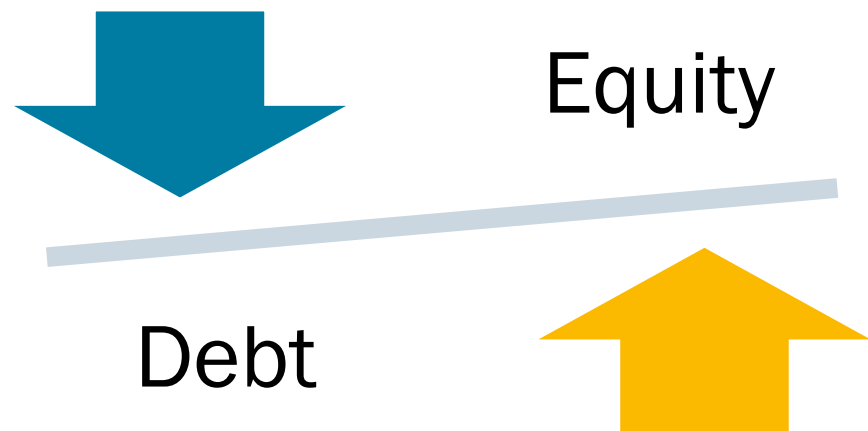


Quasi-equity

Mezzanine capital or mezzanine finance

Closer to equity or debt capital according to the level of ownership acquired and the exposure to loss in the event of insolvency.

For instance, subordinated loan



Pros of financial products for MAs

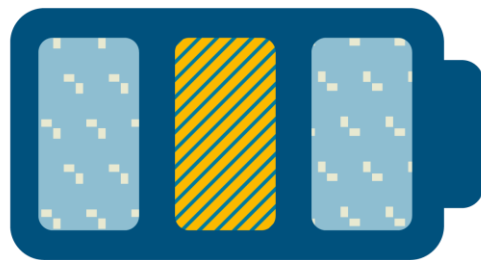
Financial products	Benefits
Loans	<p>Address specific risk capacity constraints in a given segment</p> <p>Large scale investment, high number of FRs</p> <p>Limited management costs</p> <p>Defined repayment scheme</p> <p>Money can quickly be reinvested</p>
Guarantees	<p>High leverage effect</p> <p>Can be part of a broader investment strategy</p> <p>Disbursement only in the event of default</p> <p>Large scale instrument</p>
Equity	<p>High level of returns is possible</p> <p>Stimulates investment by local private equity, external investors</p>
Quasi-equity	<p>Addresses specific liquidity and risk capacity constraints</p> <p>Higher level of returns (compared to normal loans)</p> <p>Stimulates investment by local private equity industry also in riskier areas</p>

Cons of financial products for MAs

Financial products	Benefits
Loans	<p>Expected return is lower than other FIs (equity)</p> <p>Funded products require more initial resources than unfunded (guarantees)</p> <p>Investment risk and management costs are higher (guarantees)</p>
Guarantees	<p>Does not provide liquidity but represents a risk reserve for the lender</p> <p>Revolving effect is slower than for loans (until repayment is ensured)</p> <p>Estimating the appropriate cap (max limit) can be difficult</p>
Equity & Quasi-equity	<p>Time-consuming; cost-intensive investment</p> <p>Short-term financing is not possible</p> <p>Full insolvency risk</p> <p>High set-up and operational costs</p> <p>Typically low number of investors and FRs</p> <p>Addresses only a few selected FRs</p> <p>Fundraising of private resources can be challenging</p>

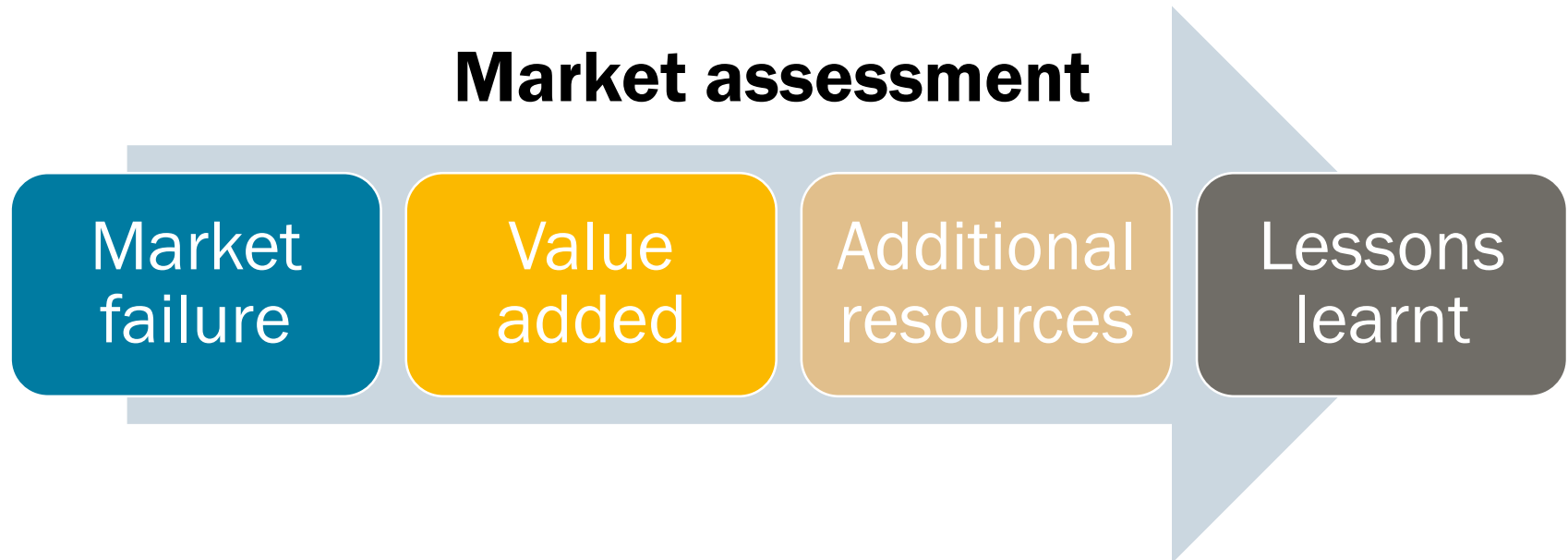
Ex-ante assessment

WHERE



Ex-ante assessment (Article 37(2) CPR)

Market assessment

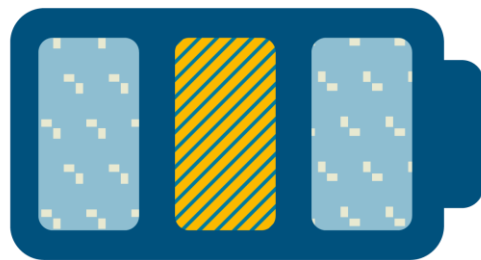


Delivery and Management

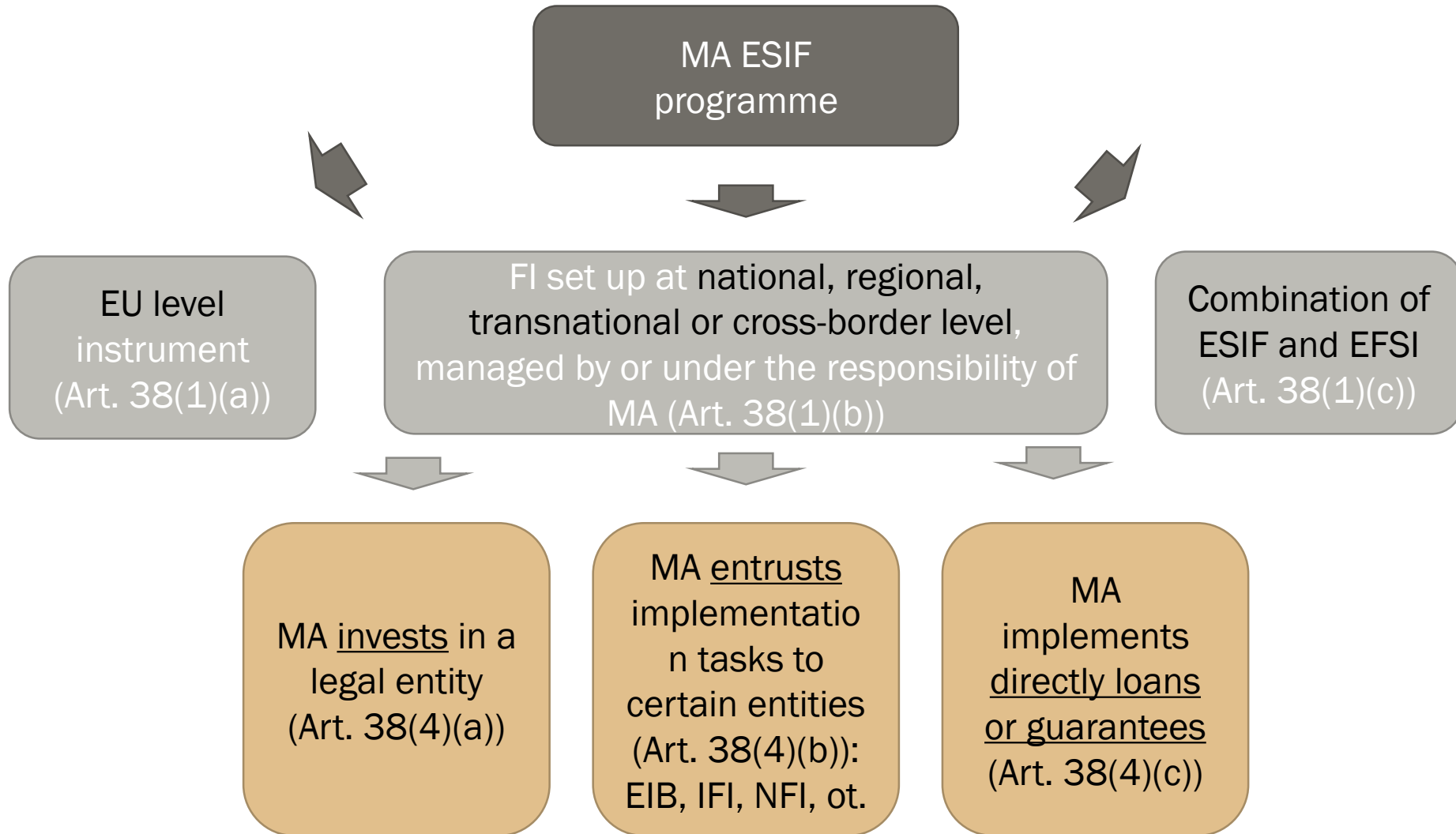


Implementation options for MAs

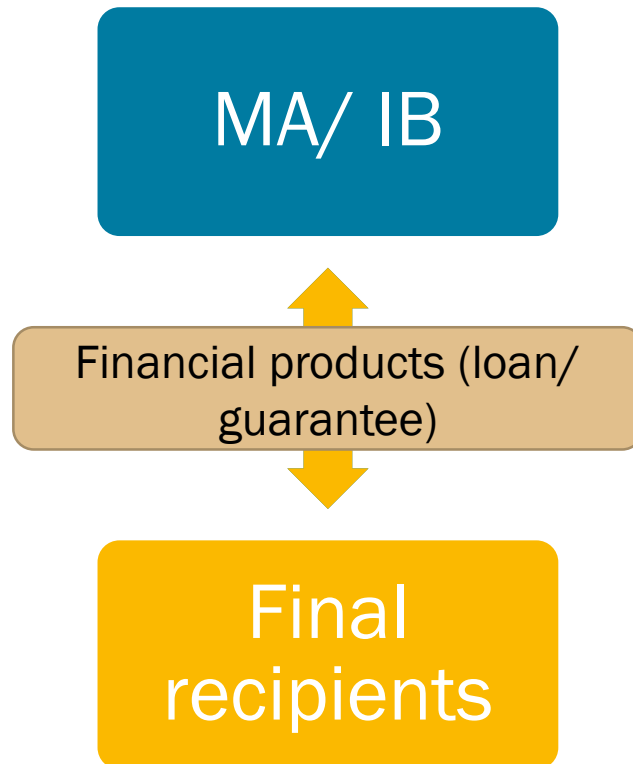
HOW



CPR Article 38(1)



NEW implementation option – FI implemented directly by the MA



MA is a ‘beneficiary’

Selection of final recipients – advantage

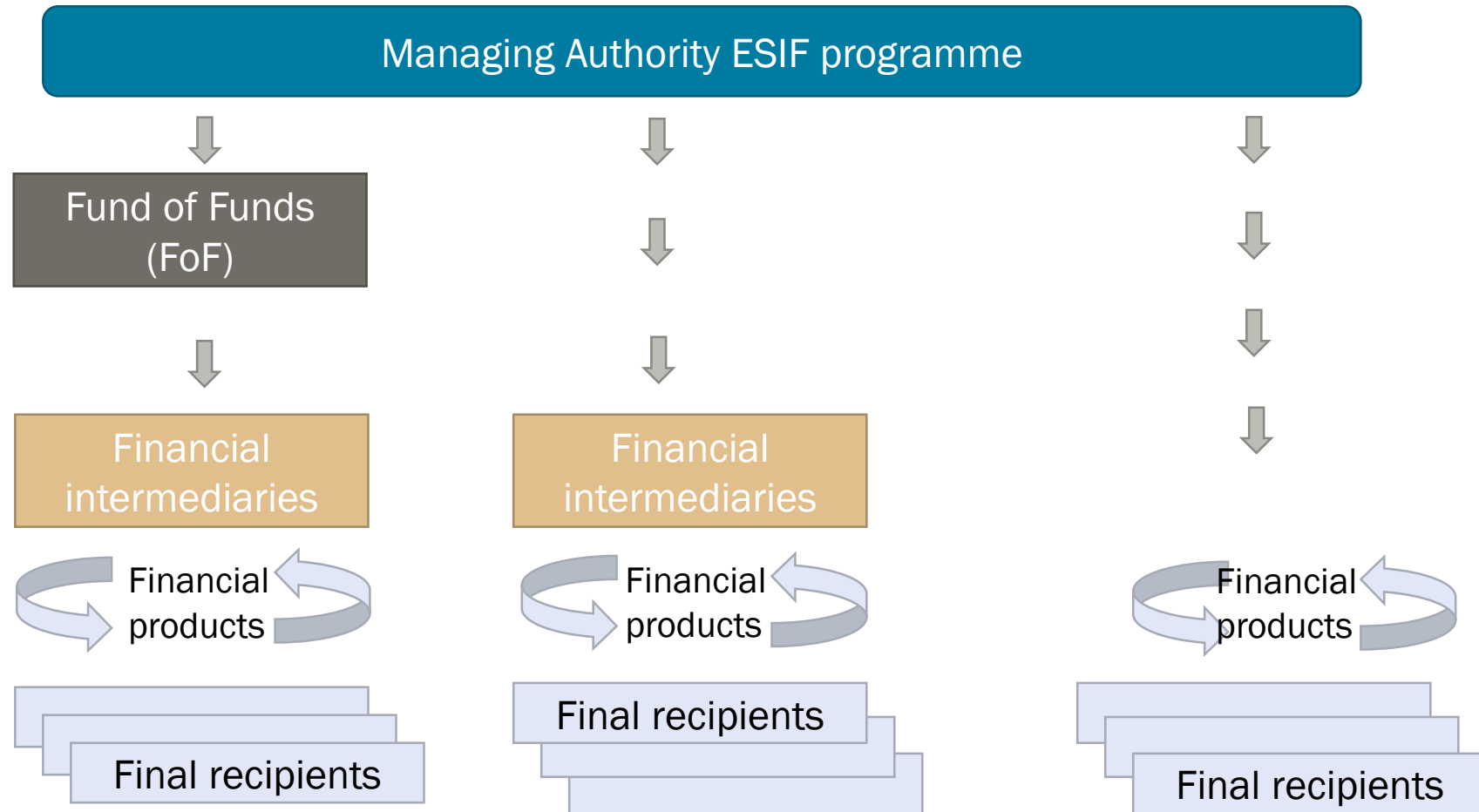
Relatively easy to set up (no establishment of FoF/ no financial intermediaries)

No management costs

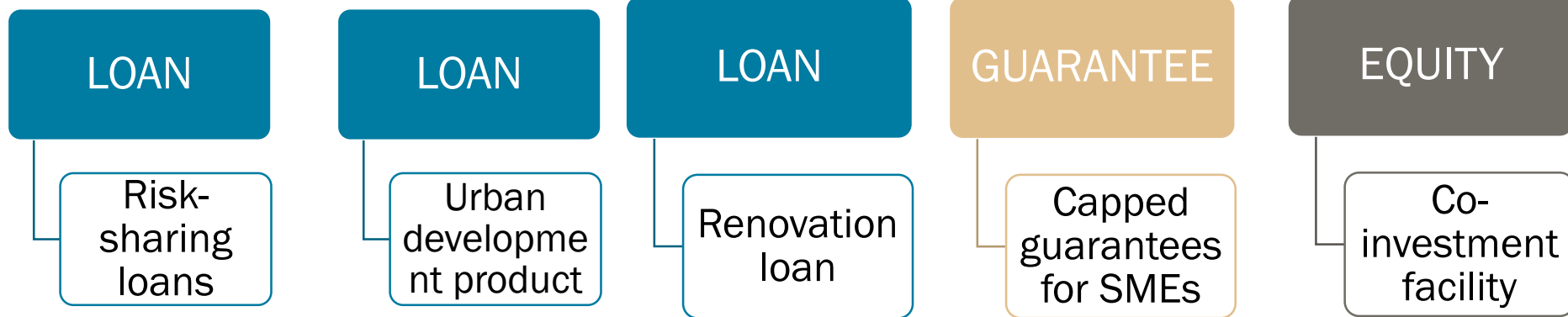
No risk of ‘parking money’ – no frontloading

Capacity of MA – investment decision (ex-ante assessment)


Implementation options



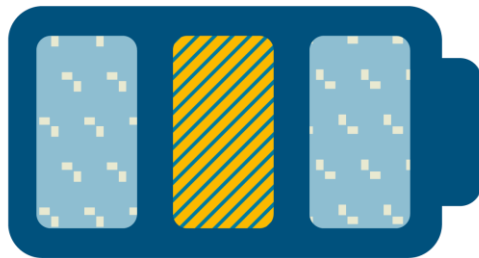
EC off-the-shelf financial instruments



EU level financial instruments

- Set-up phase skipped (selection of FoF/ financial intermediaries, preparation of parameters) as EU level instrument delivery system is used
- MA ultimately responsible for this operation (CPR rules apply) but can rely on structures designated by the EC and EIB
- MA does not carry out on-the-spot management verifications; AA – no system audits/ audits of operations
- WHY?  Reinforcement of EU funds and scale effect, high co-financing rate (100%), easier, no much management, alignment with EU policy objectives
- Examples: Horizon 2020, COSME

Financial instruments in 2014-2020 and beyond



Legal framework

Article 66 (CPR 2014-2020)

Forms of support

The ESI Funds shall be used to provide support in the form of grants, prizes, repayable assistance and financial instruments, or a combination of thereof.

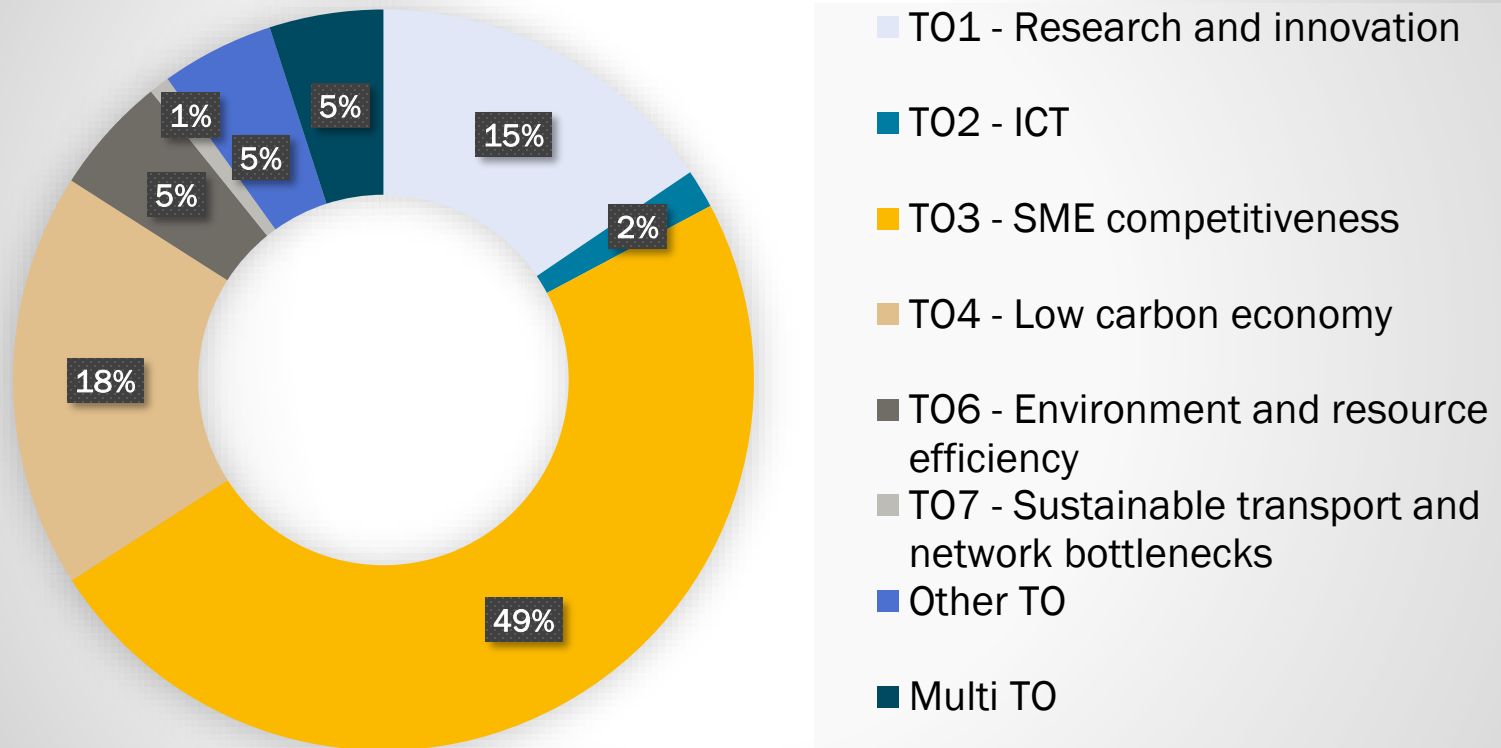
Article 47 (draft CPR 2021-2027)

Forms of support

Member States shall use the contribution from the Funds to provide support to beneficiaries in the form of grants, financial instruments or prizes or a combination thereof

Financial instruments in 2014-2020

EUR 20 billion planned allocations to FI for ERDF, ESF and CF by Thematic Objective – ca 6.4% of ESIF



FIs in draft CPR 2020-2027:



Financial instruments will be a key delivery mechanism for 2021-2027 investments generating revenue or cost savings; the provisions for their use have been streamlined and updated to ensure better and easier implementation as well as quicker set-up.

Simplification in regards to FIs post2020

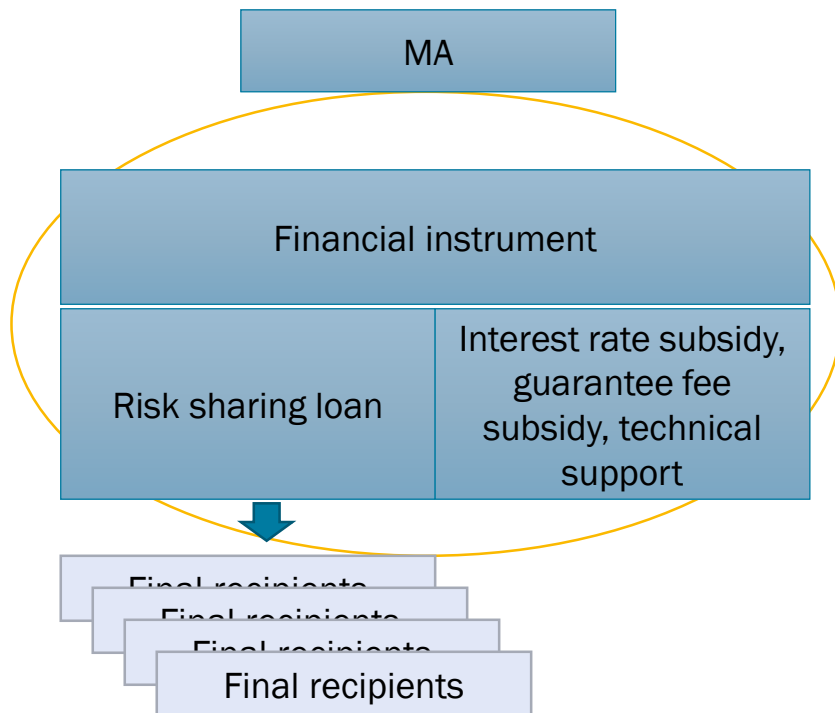
- FIs better integrated into the programming and implementation process;
- Flexible implementation options for MAs (under the responsibility of MA or direct award);
- Combination of EU resources under one set of rules;
- Flexibility on combination of grants and FIs;
- Eligibility rules simplified;
- One reporting system of all forms of finance (no specific reporting on individual FIs, part of programme general reporting and monitoring)



Combination of FIs with other forms of support – Article 37 CPR

Combination of FI and grant within a FI operation (single operation)

Combination of FI and grant at the level of final recipient – 2 operations



4 scenarios:

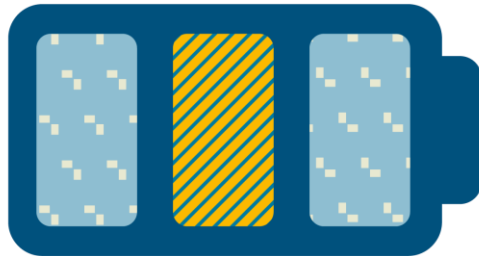
I – FI ESIF + G ESIF (2 separate projects: FI and grant)

II – FI ESIF + FI ESIF (2 separate FI projects)

III – FI ESIF + G non-ESIF (part of a separate project + separate intervention)

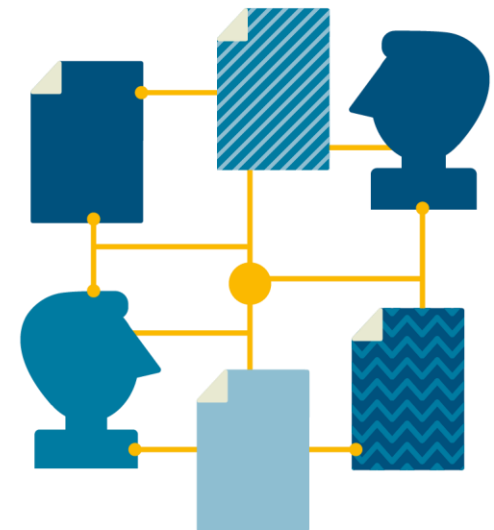
IV – FI ESIF + FI non-ESIF (part of a separate project + separate intervention)

Financial instruments and ETC



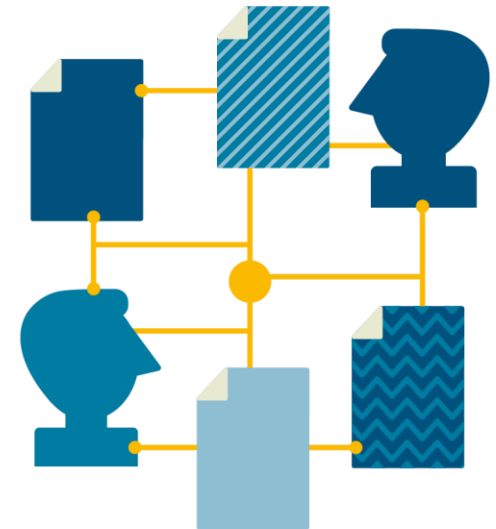
Reflection time

- Q1: Which TOs/PAs/SOs could be suitable for FIs in your programme?
- Q2: What added value could FIs bring to reaching your programme's objectives?



Reflection time

- Q3: Imagine an Interreg programme decided to implement financial instruments (direct awards – loans and guarantees). What could be the potential challenges to implement the FI?



Financial Instruments in ETC? Reality or Wishful thinking?

Favourable conditions:

- Governance structures
- Scope, across borders
- Network of stakeholders at different levels and sectors

To be resolved:

- Demand for FIs in ETC
- Potential to deliver profit
- Governance models
- Audit and control

Financial Instruments and ETC

- Does it fit with the agreed priority axis?
- What about CB/ TN cooperation?
- What is the value added or additionality?
- Who decides on the final beneficiary/ recipient/ project?
- How to deal with reflows/ returns of investment?
- How to monitor financial instruments?
- What about state aid?
- What is the definition of eligibility?

Implementation of FIs in ETC

- Critical mass
- Setting the ‘Investment strategy’
- Ensuring cross-border/ transnational cooperation
- Setting OP indicators
- Governance process and delegation principles
- State aid compliance
- Repayment and reinvestment schemes
- Upward reporting and downward monitoring at all levels

Barriers to implementation of FIs in ETC

- Differentiated state aid rules applied to FIs under shared management and directly managed FIs (de-minimis and GBER)
- Selection of FoF managers and financial intermediaries
- National regulation adds further complexity (e.g. no para-banking)
- Insufficient capacity on the side of MAs
- Competition with grants
- Combination with grants
- others

‘Does your programme consider providing support to financial instrument(s) (i.e. loans, guarantees, equity) in current or the next programming period?’

Repository of Interreg programme management practices

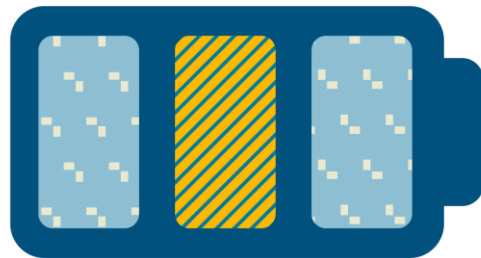


45 Interreg programmes:

- 19 answers – not known yet
 - 2 answers - YES

Programme of FIs for SMEs, Slovenia

Case study by fi-compass.eu



Financial products: Loans, guarantees with interest rate subsidies, equity, quasi-equity

Financial size: Total PFEI – EUR 218.8 mln

Thematic focus: SMEs support

Timing: 2009-2013

Achievements

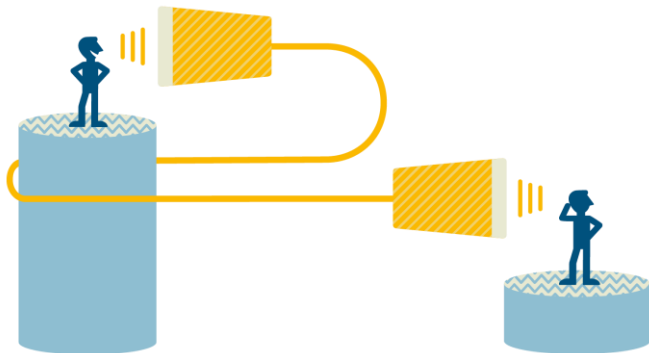
Absorption rate: all absorbed by the end of 2016

EU leverage: 5.8

Leverage of public resources: 3

Re-investment: from 2016 on

Main outputs: **2294 SMEs** supported with **EUR 387 mln** of financial support unlocked **EUR 708 mln** in total SME investment as of end of 2015.



Cooperation works

All materials will be available on:

www.interact-eu.net