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Special Report

Is EU financial support adequately addressing the needs of micro-entrepreneurs?

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(pursuant to Article 287(4), second subparagraph, TFEU)

Audit team

02

The ECA's special reports set out the results of its performance and compliance audits of specific budgetary areas or management topics. The ECA selects and designs these audit tasks to be of maximum impact by considering the risks to performance or compliance, the level of income or spending involved, forthcoming developments and political and public interest.

This performance audit was produced by Audit Chamber II — headed by ECA Member Henri Grethen — which specialises in structural policies, transport and energy spending areas. The audit was led by ECA Member Iliana Ivanova; supported by Tony Murphy, head of private office; Mihail Stefanov, attaché of private office; Emmanuel Rauch, head of unit; Dennis Wernerus, team leader; Romuald Kayibanda, team leader; Piotr Senator, auditor and Christian Wieser, auditor.

From left to right: C. Wieser, R. Kayibanda, E. Rauch, I. Ivanova, T. Murphy, D. Wernerus, P. Senator, M. Stefanov.

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Abbreviations

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CGAP: Consultative Group to Assist the Poor

EaSI: EU Programme for Employment and Social Innovation

EIB: European Investment Bank, or European Investment Bank Group when EIB and EIF are referred to altogether

EIF: European Investment Fund

EPMF: European Progress Microfinance Facility

ERDF: European Regional Development Fund

ESF: European Social Fund

EU: European Union

GNI: Gross national income

OP: Operational programme

SME: Small and medium-sized enterprise

Glossary

Consultative Group to Assist the Poor (CGAP): The Consultative Group to Assist the Poor (CGAP) is a policy and research centre supported by around 30 development agencies and private foundations dedicated to advancing financial access for the world's poor. It is headquartered at the World Bank.

EaSI: The Employment and Social Innovation (EaSI) programme is a financing instrument at EU level to promote a high level of quality and sustainable employment, guaranteeing adequate and decent social protection, combating social exclusion and poverty and improving working conditions.

EaSI is managed directly by the European Commission. It brings together EPMF and two other EU programmes managed separately between 2007 and 2013.

European Code of Good Conduct for Microcredit Provision: A set of 'good practice' guidelines and recommendations for microcredit providers issued by the Commission in December 2011.

European Investment Fund: The EIF is a specialist provider of risk finance to benefit small and medium-sized enterprises (SME) across Europe. It is part of the EIB Group and its shareholders are the European Investment Bank (EIB), the European Commission and a wide range of public and private bank and financial institutions.

European Progress Microfinance Facility (EPMF): The European Progress Microfinance Facility (EPMF) is implemented on behalf of the Commission by the European Investment Fund (EIF) for micro-credit guarantees and for loans to banks and other financial intermediaries.

For the latter, the EIB is a co-investor in the EPMF.

European Regional Development Fund (ERDF): The European Regional Development Fund (ERDF) aims at reinforcing economic and social cohesion within the European Union by redressing the main regional imbalances through financial support for the creation of infrastructure and productive job-creating investment, mainly for businesses.

European Social Fund (ESF): The European Social Fund (ESF) aims at strengthening economic and social cohesion within the European Union by improving employment and job opportunities (mainly through training measures), encouraging a high level of employment and the creation of more and better jobs.

Exit policy: Exit policy means a policy/strategy for the liquidation of holdings by a financial instrument according to a plan to achieve maximum return.

Financial instruments: Financial instruments are a generic term for contracts which provide their holder with a claim on an obligor. The EU provides support for three possible types of financial instruments: equity, loan and guarantee instruments. Equity or loan instruments are contracts between an investor and an investee or between a lender and a borrower. Guarantees are contracts where a guarantor guarantees the rights of an investor or a lender.

Leverage effect: In relation to financial instruments funded from the EU budget and national public funds, leverage is expressed in terms of how many euros of funding (public and private) have been effectively been available to provide financial support to final recipients for each euro of public funding (EU and national public funds) endowed to the instrument.

Managing authority: A national, regional or local public authority (or any other public or private body) which has been designated by the Member State to manage an operational programme. This includes in particular the selection of the projects to be funded, the monitoring of how these projects are implemented and the reporting on both financial aspects and the results achieved to the Commission.

Glossary

06

Micro-entrepreneur: In this report, micro-entrepreneurs should be understood as self-employed persons as well as micro-enterprises (i.e. registered as a corporate body).

Micro-enterprise: As specified in Commission recommendation 2003/361, a micro-enterprise is an enterprise employing less than 10 people and whose annual turnover and/or balance sheet total does not exceed 2 million euros.

Microcredit: The Commission defines microcredit as loans of up to 25 000 euros to micro-entrepreneurs (see Commission Staff Working Paper 'Microcredit for European small businesses', SEC(2004) 1156).

Microfinance: In this report, microfinance is defined as loans to micro-entrepreneurs and guarantees to banks and other financial intermediaries which provide such loans.

Operational programme (OP): An operational programme sets out a Member State's priorities and specific objectives and how the funding (EU and national public and private co-financing) will be used during a given period (generally 7 years) to finance projects. These projects must contribute to achieve a certain number of objectives specified at the level of the OP's priority axis. OPs exist for each of the funds in the Cohesion area (i.e. ERDF and ESF). An OP is prepared by the Member State and has to be approved by the Commission before any payments from the EU budget can be made. OPs can only be modified during the period covered if both parties agree.

Outreach: Outreach is the degree to which projects reach the intended target group (e.g. micro-entrepreneurs).

Oversized financial instrument: A financial instrument is qualified as oversized when its total endowment significantly exceeds the funding necessary to cover the actual needs of the targeted population (i.e. micro-entrepreneurs in the context of this audit).

Portfolio-at-risk: The value of all loans outstanding that have one or more instalments of principal past due more than a certain number of days (usually 30 days).

Revolving effect: The effect of funds endowed to a financial instrument being reused at least once (through the use of loans or guarantees).

Small and medium-sized enterprise: Small and medium-sized enterprises (SMEs) are enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euros, and/or an annual balance sheet total not exceeding 43 million euros. Within the SME category, a small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed 10 million euros.

Survival rate: The survival rate is an indicator for the success of financial support to micro-entrepreneurs. It is calculated by dividing the number of entities having been supported and still in business at the end of a given period (the 'look-back period') through the total number of supported entities.

Winding up: Winding up is a process that entails selling all the assets of a fund, paying off creditors, distributing any remaining assets to the principals, and then dissolving the fund. Essentially, winding up is to be understood as the liquidation of the fund implementing a financial instrument.

Executive summary

I

Micro-entrepreneurs are experiencing problems with accessing the conventional credit market which hampers the creation of new micro enterprises and self-employment. EU support aims to address to some degree the existing funding gap by providing grants to micro-enterprises (under the ESF) or making access to loans easier thanks to financial instruments for microcredit providers namely loans and guarantees.

II

The EU support is provided mainly by two different instruments: the European Social Fund (ESF) and the European Progress Microfinance Facility (EPMF). The ESF includes measures implemented mainly through grants and also through financial instruments (loan or guarantee) which are included in the operational programmes prepared by the Member States and approved by the Commission. On the other hand EPMF is implemented on behalf of the Commission by the European Investment Fund.

III

The Court assessed whether the programming and design of the EU support was addressing the actual needs of micro-entrepreneurs and whether robust performance reporting systems were in place. In addition, the Court examined whether sufficient information is available on implementation costs of the different EU funding mechanisms supporting micro-entrepreneurs.

IV

The Court concludes that for ESF financial support to micro-entrepreneurs there are weaknesses in the programming and the design of the support and a lack of sufficient and reliable monitoring information on performance. In addition, the Commission and the Member States do not have sufficient information available on the administrative cost for each Member State and for each funding mechanism (i.e. grants or financial instruments, such as loans or guarantees).

V

Overall the Court considers that these issues may have a negative impact on the effectiveness of EU financial support addressing the needs of micro-entrepreneurs.

VI

In order to address the issues identified in this report, the Court recommends that:

(a) For the 2014–20 programming period, Member States consistently perform needs assessments when designing funding instruments and preparing operational programmes that include EU financial support for micro-entrepreneurs. This would also help to allocate the appropriate level of funding to the alternative funding mechanisms, i.e. grants or financial instruments (loans or guarantees). The Commission should provide guidance in this regard.

(b) The Commission makes the use of ESF financial instruments by the Member States conditional not only on compliance with regulatory requirements but also on the existence of a robust risk management system to avoid fund oversizing.

(c) In order to improve the outreach, the Commission, together with the Member States, should design ESF financial support measures for micro-entrepreneurs and define eligibility criteria which aim at reaching the unemployed and vulnerable persons who are in a disadvantaged position with regard to access to the conventional credit market.

(d) For the 2014–20 programming period, the Commission carries out a comparative analysis of the implementation costs of ESF grants, ESF financial instruments and EaSI financial instruments with a view to establishing their actual levels. This assessment should allow the identification of 'good practices' on how small amount grants, loans and guarantees can be disbursed at a reasonable cost.

01
Micro-entrepreneurs often suffer from a lack of access to the conventional credit market. Indeed, the total demand for microfinance in the EU Member States, estimated to be above 12 billion euros in 2012[1], exceeds the supply of loans provided by banks and other financial institutions. The EU financial support for micro-entrepreneurs aims to address to some degree this funding gap faced by them.

02
By offering the possibility to launch or develop new businesses, financial support for micro-entrepreneurs is also meant to address exclusion and increase employment, especially among persons previously unemployed. The EU thereby contributes to the achievement of the EU2020 strategy objectives, namely smart, sustainable and inclusive growth through increasing employment, productivity and social cohesion.

03
The Commission's definition of microfinance is financial support of up to 25 000 euro which under EPMF can be given to micro-entrepreneurs. The increase in their accessibility and availability is ensured through financial instruments in the form of loans and guarantees. In the context of this audit, grants provided to launch or develop new businesses respecting this threshold of 25 000 euros are also considered as financial support for micro-entrepreneurs.

EU support to micro-entrepreneurs through the ESF and the EPMF

04
The EU's financial support to micro-entrepreneurs was mainly provided through the European Social Fund (ESF) during the 2007–13 programming period and through the European Progress Microfinance Facility (EPMF) from 2010 to 2013.

05
Other EU instruments provide microfinance to micro-enterprises such as financial instruments for SMEs under ERDF OPs (3 136 million euros in the 2007–13 programming period[2]) and the SME Guarantee Facility under the Competitiveness and Innovation Programme (CIP) managed by the EIF on behalf of the Commission (550 million euros[3] in the 2007–13 programming period). These are not covered by this audit as they are either not part of the EU budget (EIB loans) or they do not specifically target micro-entrepreneurs.

06
Examples of projects examined by the Court are outlined in ***Box 1***.

1 European Commission, Evaluation of the JASMINE Technical Assistance Pilot Phase, ICF GHK on behalf of DG Regional and Urban Policy, 14 November 2013, pp. 20–22.

2 *Source:* Summary of data on the progress made in financing and implementing financial engineering instruments reported by the managing authorities in accordance with Article 67(2)(j) of Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999 (OJ L 210, 31.7.2006, p. 25), Programming period 2007–13, September 2014, European Commission, Situation as at 31 December 2013, p. 26.

3 *Source:* Figures for the 2007–13 financial contribution, EIF, November 2011 (http://www.eif.org/news_centre/publications/corporate_brochure/fei_brochure_new/files/assets/seo/page14.html).

Box 1

Which type of micro-entrepreneurs benefited from EU support?

In a small town in the Voivodeship of Opole (Poland), a micro-entrepreneur received a 40 000 zloty **grant** (around 9 500 euros) from an ESF project to help her start up a children's indoor playground and a clothing store.

In the Land of Bavaria (Germany), a micro-entrepreneur benefited from a 7 000 euro microcredit to finance a new music installation to attract more clients to his lakeside bar. The **loan** was provided by a financial intermediary supported by the ESF.

On the Island of Crete (Greece), a micro-entrepreneur used a 5 000 euro working capital facility to expand his city kiosk. This microcredit was provided by a local bank with an EPMF **guarantee**.

European Social Fund

07

The ESF aims at facilitating the employment of workers (including self-employment), as well as to increase their geographical and occupational mobility, and facilitate their adaptation to industrial changes and to changes in production systems[4]. During the 2007–13 programming period, the Commission advocated that the ESF should support measures that improve the financial and social inclusion of less-favoured persons and give access to employment[5].

08

Support to micro-entrepreneurs financed by the ESF includes measures implemented through grants and financial instruments and is defined in OPs which are prepared by Member States and approved by the Commission.

09

During the 2007–13 programming period, Member States have set up 117 ESF OPs, 96 of which funded measures classified under the code 'support for self-employment and business start-ups'[6], totalling around 2.4 billion euros, mostly through grants. However no information on how much of this grant funding was allocated to micro-entrepreneurs is available. On the other hand, ESF financial instruments providing support to micro-entrepreneurs had an endowment of 680 million euros by the end of 2013[7].

4 Article 162 of the Treaty on the Functioning of the EU.

5 Commission Recommendation 2008/867/EC of 3 October 2008 on the active inclusion of people excluded from the labour market (OJ L 307, 18.11.2008, p. 11); SEC(2010) 1564 final of 16 December 2010 'List of key initiatives'.

6 This estimate is based on an analysis of spending by 86 codes specified by the Commission for Member State reporting according to annex II of Commission Regulation (EC) 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund (OJ L 371, 27.12.2006, p. 1), and in particular expenditure under code 68 'Support for self-employment and business start-up'.

7 The 680 million euros of support provided through microcredit is partly but not exclusively included in the 2.4 billion of ESF spending on supporting self-employment.

European Progress Microfinance Facility

10
The EPMF aims at increasing access to microfinance for people such as the unemployed, as well as to other vulnerable people who are in a disadvantaged position regarding their accessibility to the conventional credit market[8] and to micro-enterprises. It is implemented on behalf of the Commission by the European Investment Fund (EIF), acting as funds manager for funded instruments and as entrusted entity for guarantees.

11
The decision of the European Parliament and of the Council for establishing the EPMF was based on an *ex ante* evaluation carried out by the Commission. This document concludes that, in addition to the already existing EU tools, there was a need to create a microfinance facility within the EU budget[9].

12
In the period 2010–13, the EPMF had an endowment of 203 million euros (103 million euros from the EU budget and 100 million euros from the EIB): 25 million euros (12 % of the total) were intended for guarantees and 178 million euros (88 %) for loan funding. The EPMF financial instruments do not provide direct financial assistance to micro-entrepreneurs but rather provide support to intermediaries through loans and/or guarantees.

13
The EIF selects banks or other financial intermediaries interested in providing support to micro-entrepreneurs at conditions that are as close as possible to market conditions. These intermediaries give loans to eligible final recipients on preferential terms compared to those existing in the market for borrowers of similar credit risk.

14
As of 30 June 2014, 55 banks or other financial intermediaries in 20 Member States had been selected[10] and more than 23 000 micro-loans amounting to 208 million euros had been disbursed to micro-entrepreneurs[11].

15
For the 2014–20 programming period, one of the three strands of the EU Programme for Employment and Social Innovation (EaSI)[12] will progressively replace the EPMF.

16
An illustration of how EU support to micro-entrepreneurs is provided through ESF grants, ESF financial instruments and the EPMF is presented in ***Figure 1***.

8 Decision No 283/2010/EU of the European Parliament and of the Council of 25 March 2010 establishing a European Progress Microfinance Facility for employment and social inclusion (OJ L 87, 7.4.2010, p. 1).

9 SEC(2009) 907 of 2 July 2009.

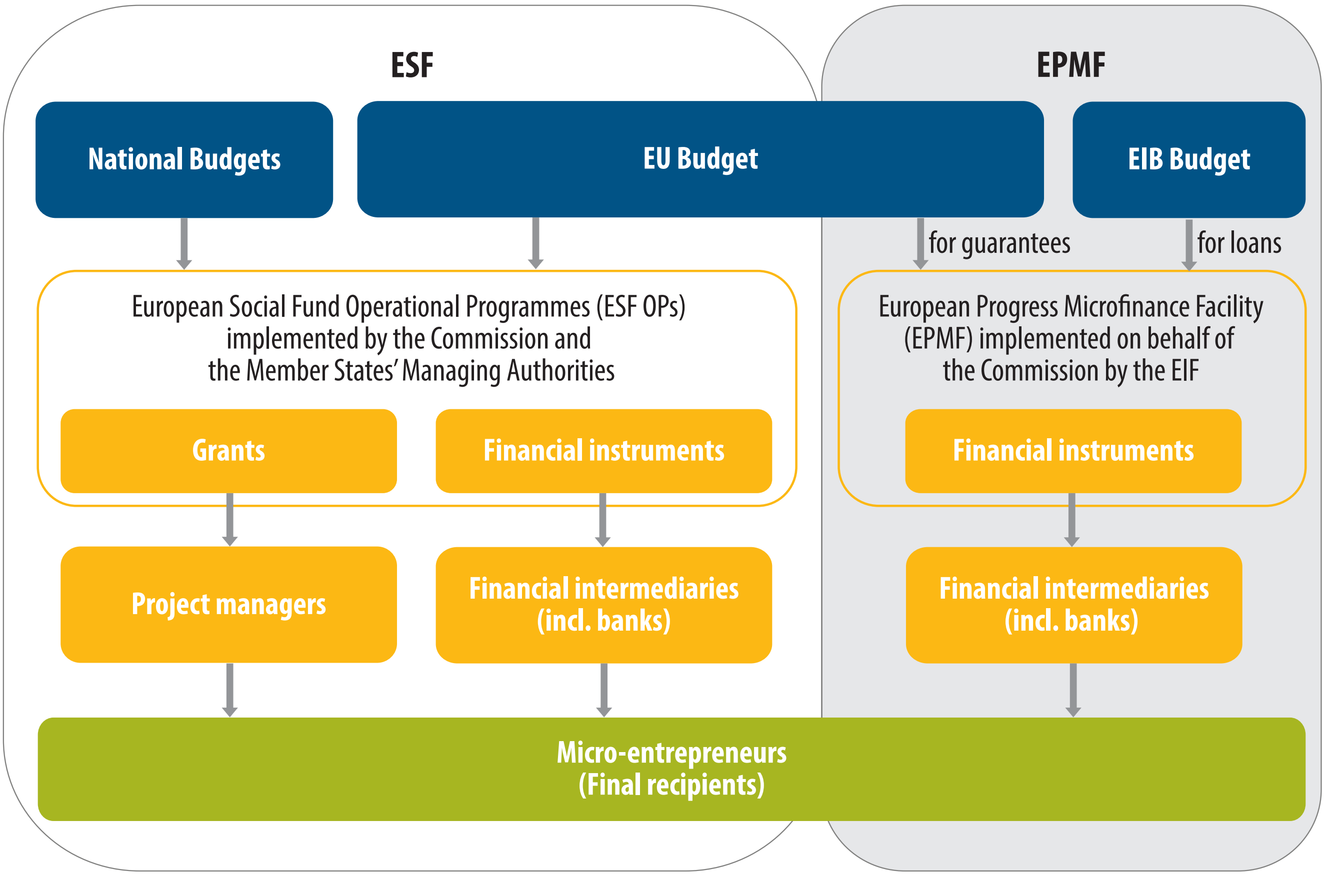
10 Belgium, Bulgaria, Denmark, Ireland, Greece, Spain, France, Croatia, Italy, Cyprus, Lithuania, Netherlands, Austria, Poland, Portugal, Romania, Slovenia, Slovakia, Sweden and the United Kingdom.

11 COM(2014) 639 final of 20 October 2014 'Implementation of the European Progress Microfinance Facility — 2013'.

12 Regulation (EU) No 1296/2013 of the European Parliament and of the Council of 11 December 2013 on a European Union Programme for Employment and Social Innovation (EaSI) and amending Decision No 283/2010/EU establishing a European Progress Microfinance Facility for employment and social inclusion (OJ L 347, 20.12.2013, p. 238).

Figure 1

EU support to micro-entrepreneurs through ESF grants, ESF financial instruments and the EPMF (schematised)



Source: ECA.

Audit scope and approach

17
With this audit the Court assessed whether the needs of micro-entrepreneurs were addressed through the European Social Fund (ESF) and the European Progress Microfinance Facility (EPMF) financial support. The Court examined in particular whether:

— the programming and design of the EU support was addressing the actual needs of micro-entrepreneurs;

— robust performance reporting systems were in place;

— sufficient information is available on the implementation costs of the different EU funding mechanisms supporting micro-entrepreneurs.

18
The audit results are based on:

— the examination of documents at Commission and Member State level (for ESF) and the EIF (for EPMF);

— the examination of a sample of 27 projects[13] providing financial support to micro-entrepreneurs: for six ESF OPs — 14 grants and six financial instruments (three loan and three guarantee funds); and seven EPMF financial instruments (two instruments providing loans and five instruments providing guarantees). These projects, representing approximately 1.6 billion euros committed (1.2 billion euros disbursed), were implemented in five Member States[14] (Germany, Greece, Italy, Poland and Romania), and were either partly or fully completed by the end of 2013 (see ***Table 1***);

— interviews with experts in the field;

— the analysis of client files (grant beneficiaries and borrowers) at the level of banks and other financial intermediaries;

— a survey of 18 additional managing authorities in 14 Member States[15] in charge of 22 ESF OPs with spending on self-employment and business start-ups. The survey's response rate was 89 %[16] and provided feedback on their experience regarding financial support measures to micro-entrepreneurs. The Court analysed the replies of 11 managing authorities in 10 Member States who declared that their OP included measures for micro-entrepreneurs.

13 Projects were examined at the level of the managing authority or intermediate body (in the case of grants) or the financial intermediary (in the case of financial instruments).

14 Germany (five projects), Greece (six projects), Italy (four projects), Poland (eight projects) and Romania (four projects).

15 Belgium, Bulgaria, Czech Republic, Estonia, Spain, France, Latvia, Lithuania, Malta, Portugal, Slovenia, Slovakia, Finland and the United Kingdom.

16 Answers have been received from 16 managing authorities of 14 Member States, concerning 19 OPs.

Table 1

Public funding used (by the end of 2013), to support access to finance to micro-entrepreneurs for projects examined by the Court in million euros

Member State	ESF			EPMF		Total
	Grants	Guarantees	Loans	Guarantees	Loans	
Germany	665.8		100.0			765.8
Greece	368.9			0.8		369.7
Italy	9.1	13.9	9.5			32.5
Poland	21.0		11.6	7.9		40.5
Romania	1.7			6.2	18.9	26.8
Total	1 066.5	13.9	121.1	14.9	18.9	1 235.3

Source: ECA analysis, December 2013.

Programming and design of the EU support to micro-entrepreneurs

19
Designing funding instruments to achieve a certain policy objective is a challenging task. Important factors in this context are ensuring that the nature and type of support (grants or financial instruments) as well as the amounts available are addressing the actual needs of potential beneficiaries.

20
The Court therefore assessed whether:

— needs assessments had been carried out for ESF to determine the overall level and type of support measures proposed to micro-entrepreneurs and, for financial instruments, whether appropriate investment strategies and risk management procedures were in place to avoid the funds being over- or undersized, and an exit policy and/or winding-up provisions had been defined;

— a robust risk management system has been put in place for financial instruments funded under the EPMF and in particular, whether the required portfolio-at-risk assessment has been carried out;

— the financial instruments financed by the ESF or EPMF succeeded in attracting additional private funding by calculating the leverage ratio achieved.

Lack of specific needs assessments and proper risk management systems for ESF support to micro-entrepreneurs

Needs of micro-entrepreneurs not specifically addressed by managing authorities at the design stage of the reviewed ESF operational programmes

21
The Court's audit showed that ESF managing authorities of the examined OPs did not carry out an assessment of the specific needs of micro-entrepreneurs before allocating funds and determining the most appropriate way in which these funds should be used.

22
When responding to the Court's survey, 11 managing authorities in 10 Member States[17] responded that their ESF OPs included support measures for micro-entrepreneurs. The Court's analysis showed however that none of these 11 managing authorities had assessed the specific needs of micro-entrepreneurs prior to the approval of the OP. This was also the case for all OPs in the five Member States where the Court had examined specific projects. The Court notes that there was not a regulatory requirement during the 2007–13 programming period for Member States to conduct needs assessments.

17 Bulgaria, Czech Republic, Estonia, France (Mainland, Martinique), Latvia, Lithuania, Portugal (Madeira), Slovenia, Slovakia and Finland.

23
Box 2 provides an example outside of the audited sample where a robust needs assessment was carried out to establish the need for targeted support measures for micro-entrepreneurs.

Box 2

Example of a study establishing the need for a specific support measure targeted at micro-entrepreneurs

In the German Land of Brandenburg a study was carried out in 2006 to determine the specific needs of business start-ups[18], and in particular on the adequacy of the financial services provided by banks to micro-entrepreneurs.

This study was based on a qualitative and quantitative assessment of the supply and demand for microfinance in this region.

It identified that (i) for traditional banks, the delivery of financial services for micro-entrepreneurs was not attractive, especially for small loans of up to 10 000 euros, and (ii) existing financial support initiatives (e.g. loans subsidised by the state) did not offer suitable alternatives to micro-entrepreneurs.

18 Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ, previously GTZ GmbH), Microfinance in Europe — Regional Case Studies from France, Germany and Greece, pp. 13–15 (a report co-financed by the ESF).

No investment strategies in place for three out of six ESF financial instruments examined

24
In general, ESF financial instruments receive a contribution from the OP to their endowment when their legal structure is set up. They subsequently use this money to support projects that fall within the scope of the OP (i.e. providing loans and guarantees to final recipients). In line with the regulatory requirements for ESF financial instruments, an investment strategy must therefore be developed for each fund. For ESF financial instruments, the investment strategy[19] also includes an analysis of the potential target population to avoid an over- or undersized endowment of the fund.

19 Article 43 of Commission Regulation (EC) No 1828/2006.

25
In three out of the six audited ESF financial instruments, in Poland and Italy (Calabria), the Court found that no investment strategy had been developed (see ***Table 2***).

Table 2 Existence of investment strategy, risk management systems and exit policies/winding up provisions in the ESF financial instruments audited

ESF financial instruments audited (Member State)	Investment strategy	Risk management systems (PAR analysis)	Exit policy/winding up provisions
Financial instrument A (Germany)	yes	no	yes
Financial instrument B (Italy)	no	no	no
Financial instrument C (Italy)	no	no	no
Financial instrument D (Italy)	yes	no	no
Financial instrument E (Poland)	yes	yes	yes
Financial instrument F (Poland)	no	no	yes

Source: ECA analysis (2014).

Inadequate risk management systems for five of the six ESF financial instruments examined

26
In addition to an upfront assessment of needs, fund managers should also put in place appropriate risk management procedures. This includes in particular the analysis of the financial instrument's portfolio-at-risk to assess whether the funds' endowment is adequate, and in particular to establish whether potential losses from loans and guarantees can be covered. Carrying out such an analysis is respecting the principles of sound financial management, according to the Commission's guidance[20] to Member States for the 2007–13 programming period.

20 Guidance Note on Financial Engineering Instruments under Article 44 of Council Regulation (EC) No 1083/2006, COCOF_10-0014-04-EN, 21 February 2011, Article 4.1.6.

27
The Court found that a portfolio-at-risk analysis had been undertaken only for one ESF financial instrument out of the six examined by the Court (see ***Table 2***) and in the case of Italy, the Court considers that the three audited ESF financial instruments are significantly oversized (see ***Box 3***).

28
According to the regulation, unused endowments of financial instruments are to be returned to the EU budget at closure[21].

21 Article 43(2) of Commission Regulation (EC) No 1828/2006.

Box 3

Example of oversized ESF financial instruments

By the end of 2013, disbursement to micro-entrepreneurs was 9.5 % of the total endowment for the loan fund in Campania (set up in in December 2009), while it was 0 % and 26.7 % for the two guarantee funds in Calabria (set up in September and November 2012).

To respect the rule on eligibility of expenditure, the support should be paid by 31 December 2015[22]. It is unlikely that the remaining funds will reach the micro-entrepreneurs by the end of 2015.

22 The end of the eligibility period as defined in Regulation 1083/2006 is currently under discussion.

Weaknesses in relation to exit policy and winding up provisions for ESF financial instruments

29
The Court also assessed whether managing authorities had put in place exit policy and/or winding up provisions in accordance with the applicable rules[23] for ESF financial instruments. The purpose of these policies and provisions is to ensure a sound and orderly liquidation of the fund at the time of closure.

30
The Court found that no exit policy and/or winding up provisions were in place for three out of the six ESF financial instruments examined (two in Campania and one Calabria).

23 Article 43(2) of Commission Regulation (EC) No 1828/2006.

Generally satisfactory EPMF set-up arrangements

31
The set-up of EPMF financial instruments differs from those under ESF. EPMF financial intermediaries (such as banks) have to apply to the EIF to obtain funding for their financial instruments. If financial intermediaries face no demand for loans or guarantees, they simply do not call upon the EIF funding. Therefore a specific regional needs assessment is not necessary.

32
Moreover, in accordance with EPMF rules, each financial intermediary is subject to a standard due diligence process performed by the EIF. This covers an assessment of risk management systems, including the portfolio-at-risk procedures. The portfolio and the respective default rate are subsequently monitored by the financial intermediary and periodically reported to the EIF. Specific rules on these monitoring and reporting arrangements form an integral part of the contract between the EIF and the financial intermediary.

33
The Court found that the required portfolio-at-risk analyses had been carried out for all seven EPMF financial instruments examined. While microfinance activities are by definition high risk, the Court's analysis showed that the portfolio-at-risk for a loan fund in Romania was low when compared to similar funds. The fund which was operational since March 2012 had 0.3 % default risk for its portfolio and no write-offs as of 30 September 2013.

Most ESF financial instruments did not attract private funding

34
One of the advantages of using financial instruments compared to grants is that they potentially attract private funding in addition to the public funding (from EU and national budgets). This is also referred to as leverage effect, which is measured as the ratio of total funding to public funding. A leverage ratio over 1 means that private funding was attracted. The Court examined whether financial instruments used under ESF or EPMF to support micro-entrepreneurs succeeded in attracting private in addition to public funding.

35
The Court's analysis showed that only one of the six audited ESF financial instruments attracted additional private funding with a leverage ratio of 1.2 for a guarantee fund in Italy (Calabria). For four of the six instruments, there was no leverage at all as the leverage ratio was one or less[24]. For the last one, another guarantee fund in Italy (Calabria), the managing authority was not able to provide information on the leverage ratio.

24 A leverage ratio below 1.0 is possible when part of the endowment has been used for management fees.

36
Regarding quantitative objectives, the Court observes that setting a target leverage ratio was not a regulatory requirement during the 2007–13 programming period. It however notes that target leverage ratios above 1.0 were specified at the set-up of the fund only for the two Italian guarantee funds (1.25 to be attained at the closure of the funds in 2015). In all other cases, either no information was available or the target leverage ratio did not envisage that any private funding would be attracted.

EPMF financial instruments attracted some private funding

37
The Court found that all seven EPMF financial instruments implemented at the time of the audit had attracted additional private funding (see ***Table 3***). With regard to guarantees, the target leverage ratios have been exactly matched in one out of seven cases and have not been reached in two cases. For two others, it is unlikely that the initial targets will be reached as the difference between current and target ratio is too significant to be overcome by the mid 2015 target date. For the two microcredit portfolio cases, there were no targets specified. According to the Commission, a final assessment of the achievement of the targeted leverage ratio for the whole EPMF will be carried out after its closure, not earlier than 2020.

Table 3

Leverage of EPMF financial instruments examined

Entity (Member State)	Project description	Leverage ratio		Target date	Private funding *(million euro)*
		Target	Actual (31.12.2013)		
Entity 1 (Greece)	Microcredit portfolio guarantee	7.47	1.33	18.12.2014	0.3
Entity 2 (Romania)	Microcredit portfolio	Not specified	1.25[1]	20.3.2014	2.4
Entity 3 (Romania)	Microcredit portfolio	Not specified	1.18	16.5.2013	1.7
Entity 4 (Romania)	Microcredit portfolio guarantee	8.33	1.38	29.12.2013	2.4
Entity 5 (Poland)	Microcredit portfolio guarantee	9.13	9.13	30.3.2013	55.2
Entity 6 (Poland)	Microcredit portfolio guarantee	6.67	1.33	27.6.2015	0.3
Entity 7 (Poland)	Microcredit portfolio guarantee	7.58	1.33	27.6.2015	0.1

1 Actual leverage date is 30.9.2013.
Source: ECA analysis based on EIF data (2013).

Monitoring and performance reporting systems

38

The Court assessed firstly the relevance of the performance reporting system put in place by the Member States and the EPMF and secondly, for the projects included in the sample, whether they were likely to have provided support to the micro-entrepreneurs, and in particular to those previously unemployed. The Court notes that the monitoring of ESF was done at priority axis level and not at project level for the 2007–13 programming period[25].

39

The ultimate objective of EU financial support to micro-entrepreneurs is to create or further develop sustainable businesses and jobs and to prevent or overcome unemployment. The Court therefore assessed whether the following information was reported by ESF or EPMF, as such performance indicators are also recommended in the Commission's Code of Good Conduct and by expert organisations in the field of micro-finance[26]:

— information on the social profile (e.g. education, age, location or adherence to specifically vulnerable groups such as unemployed, disabled, ethnic minorities or migrants) of recipients of financial support for micro-entrepreneurs; and

— information on the survival rate of the micro-enterprises after a certain period beyond the end of the support (e.g. 2 years).

40

This assessment was done on the basis of the examination of projects on the spot, the responses to the Court's survey, and a review of the annual implementation reports submitted by managing authorities to the Commission for the 17 ESF OPs covered by the audit.

Limited information on outreach and survival rates for ESF OPs

41

The Court's analysis showed that:

— information on whether the recipients of financial support for micro-entrepreneurs were part of a vulnerable group was not available for 11 out of 17 (65 %) ESF operational programmes examined. For the other six programmes, the information is considered to be partly available as it was only provided for the projects specifically targeting the unemployed. In addition, for the audited ESF OPs, when available, the information on the profile of recipients was not systematically monitored;

— information on survival rates was available for three (in Germany, Bulgaria and Finland) out of 17 ESF OPs (18 %). In the absence of reliable and robust performance data on the survival rate, the sustainability of the projects cannot be assessed for the remaining 14 OPs.

25 Article 20(2) of Commission Regulation (EC) No 1828/2006.

26 European Code of Good Conduct for Microcredit Provision; CGAP, The Smart Campaign (Centre for Financial Inclusion), Universal Standards for Social Performance Management (Social Performance Task Force).

42
This analysis is corroborated by the review of the OP's annual implementation reports submitted by the managing authorities to the Commission which also contain very limited or no data in relation to the EU support to micro-entrepreneurs.

43
Due to these limitations on the data provided by Member States, it is not possible for the Commission to aggregate consistent, meaningful and reliable information to monitor the achievements of ESF support to micro-entrepreneurs, in particular in terms of inclusion.

44
The Court, therefore, considers that the lack of sufficient and reliable information on performance makes it impossible to come to an overall conclusion to what extent the ultimate objectives of the ESF financial support to micro-entrepreneurs have been achieved.

More complete information on outreach and survival rates for EPMF projects

45
For the seven EPMF projects covered by the Court's audit, information on whether micro-entrepreneurs were reached was provided in all cases. In most cases, the EPMF reporting also provided information concerning the profile of recipients of financial support for micro-entrepreneurs (such as gender, education, age and region). Data on the previous employment status of final recipients was however only available in one out of seven EPMF financial instruments examined (in Greece).

46
As regards survival rates, three EPMF projects reported a 100 % survival rate and one project an average survival rate of 70 %. As for the other three EPMF projects, the implementation status does not yet allow such a calculation to be made.

47
Overall, the Court found that the reporting was in line with the requirements of the EPMF decision for all seven projects examined[27], and provided better information than that available for financial instruments under shared management.

27 Article 8 of Decision No 283/2010/EU.

Micro-entrepreneurs were reached, around half of whom were previously unemployed

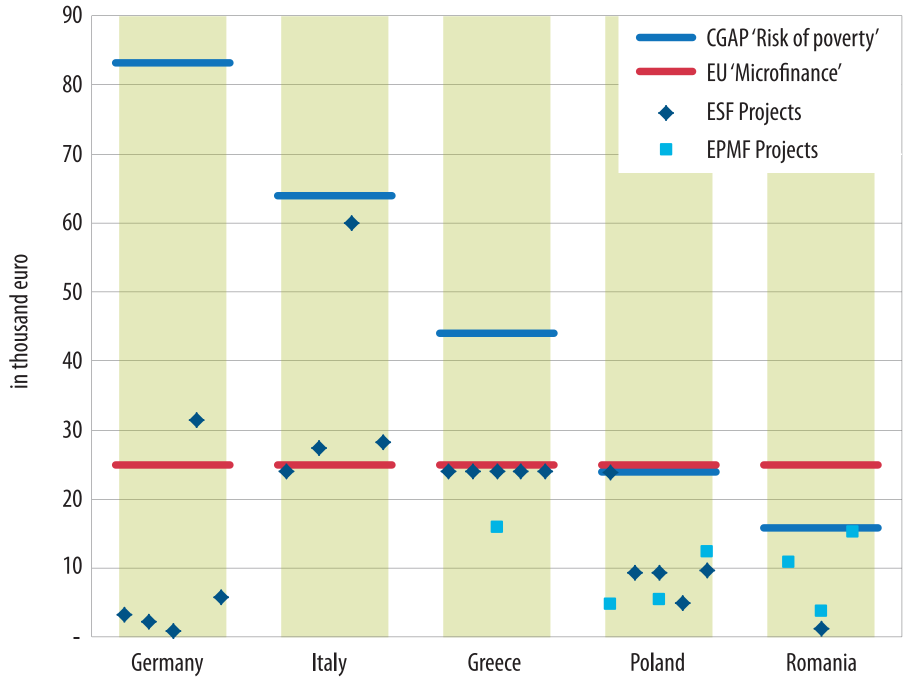
48
The Court assessed whether the projects included in the sample were likely to have supported micro-entrepreneurs and in particular the unemployed. This assessment was carried out firstly by verifying whether the average amount of the support was commensurate with the needs of micro-entrepreneurs and secondly by examining the profiles of grant recipients or beneficiaries of financial instruments.

Average EU financial support commensurate with the needs of micro-entrepreneurs

49
The Court found that the average amount of support was below or just above the EU's 25 000 euro recommended[28] ceiling for all but one of the 20 ESF projects examined. All the seven EPMF projects examined respected the mandatory threshold of 25 000 euros set by the EPMF legal basis (see ***Figure 2***). According to the Commission, as of 30 September 2014, the average size of an EPMF loan was 9 825 euros for guarantees and 6 717 euros for loan instruments.

28 Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.5.2003, p. 36).

Figure 2 **Average EU financial support to micro-entrepreneurs per project against selected thresholds**



Source: ECA analysis (2013), based on data provided by managing authorities (2013) and World Bank (2012).

50
The Court observes that the 25 000 euro ceiling applicable in each of the 28 Member States does not take into account the considerable income and wealth differences between them. Therefore the Court verified whether the support was below a GNI-weighted threshold which takes account of the extent to which the population at risk of poverty is reached had been used (CGAP 'Risk of poverty'[29]). This additional analysis showed that all 27 projects examined were below the CGAP ceiling.

51
This indicates that the individual financial support measures were of a size which can be considered as being commensurate with the needs of a micro-entrepreneur.

Not all projects in the sample targeted the unemployed

52
The Court also reviewed the profiles of grant recipients (at the level of the managing authorities) or profiles of clients having obtained financial support through ESF and EPMF financial instruments (at the level of the fund managers) to assess to what extent micro-entrepreneurs who had previously been unemployed had been targeted.

53
Micro-entrepreneurs who had previously been unemployed were targeted for 11 out of 20 ESF projects (55 %) examined. This includes nine projects (45 %) which exclusively targeted the unemployed (five in Greece, two in Poland, one in Italy (Campania) and one in Germany).

54
Regarding EPMF, the final recipients who had been previously unemployed were specifically targeted in one of the seven projects examined. However, according to the Commission, the overall EPMF aggregate data as of end-September 2014 shows that 58 % of the self-employed financed under EPMF was previously unemployed and more than 60 % of the micro-enterprises supported by the EPMF were start-ups, which implies a high outreach of previously unemployed micro-entrepreneurs.

29 The CGAP threshold consists of the GNI per capita expressed in United States dollars multiplied by 2.5.

Information on the implementation costs of EU support to micro-entrepreneurs

55

Regarding the implementation costs of the EU support for micro-entrepreneurs, there are two elements that have to be considered: the public administrative cost and costs charged for the financial instruments. Hence, the Court assessed whether sufficient information is available to the Commission and to the Member States on these costs.

Incomplete information on the administrative cost of implementing ESF OPs

56

The Commission estimated in 2011 that the administrative cost of implementing OPs amounts to 3.2 % of the total ERDF/CF and ESF funding for the 2007–13 programming period. This includes the cost of control estimated at 0.9 %, which relates to the verification, certification and audit activities carried out by national authorities. This estimate is based on figures reported by some Member States[30] for the early years of the 2007–13 programming period, for both ERDF/CF and ESF OPs.

57

Building on this[31], the Directorate-General for Employment, Social affairs and Inclusion estimated in its 2013 Annual Activity Report, the costs at the level of the Member States to be around 4.8 % of the ESF budget for the 2007–13 programming period (covering managing, certifying and audit authorities). This is based on Member States average costs which varied between 2 and 13 %. In addition, the annual overall Commission administrative costs incurred amounts to approximately 0.2 % of total appropriations. The total overall estimated administration cost for the management and control of the ESF is around 5 % of the total annual budget. The main components of administrative costs are described in ***Box 4***.

58

To conclude, the Court notes that the Commission does not have available any comparative information on the administrative costs for each Member State or for each funding mechanism (i.e. grants or financial instruments, such as loans or guarantees). Moreover the figures available have been updated only for the financial instruments. For the ESF OPs examined by the Court in five Member States, no information on the actual cost of administration was available at the level of the different managing authorities.

30 Belgium, Czech Republic, Italy, Malta, Poland, Finland and the United Kingdom.

31 DG Employment, Social Affairs and Inclusion, *Annual Activity Report 2013*, p. 61 (http://ec.europa.eu/atwork/synthesis/aar/doc/empl_aar_2013.pdf).

Box 4

Main components of public administrative costs for ESF OPs

For the Member States, administrative costs include costs related to management, control, monitoring and evaluation of the operational programmes by national authorities. Such costs could be staff remuneration, operational costs, travel and training costs. To ensure that the country benefits effectively from the provided support, the administrative costs may also cover costs related to information and communication activities on funding possibilities by ESF OPs or costs to reinforce the administrative capacity of beneficiaries (e.g. through training).

In the case of financial instruments, a part of the administrative activity is performed by the fund manager (e.g. selection of the final recipients) resulting in lower administrative costs at Member State level. For these activities management costs are directly charged by the fund managers to the OPs.

At the level of the Commission, administrative costs are linked to costs for drafting the ESF regulatory framework, the financial management, control, audit, the technical coordination with Member States as well as the evaluation and information activities.

These administrative costs do not include the costs borne by the recipients of EU financial support.

Variations in costs charged for ESF financial instruments

59
High costs lead to less funding being eventually available to the micro-entrepreneurs and may put at risk the sustainability of the fund, especially in the case of small microfinance funds. The most common costs charged for financial instruments are the management costs which can include different sub-components (e.g. personnel costs, advertising and marketing costs, travel and consulting costs).

60
The Court's analysis shows that the management costs for five of the six ESF financial instruments examined varied between 2.3 % and 4.2 %[32]. Finally, one guarantee fund in Italy (Calabria) could not provide information on its management costs when requested by the Court.

32 According to Article 43 of Commission Regulation (EC) No 1828/2006, management costs for ESF financial instruments are limited to a maximum of 4 % of the total endowment of the fund on yearly average, unless the fund manager has been selected on the basis of a competitive tendering procedure, which was the case for one fund in Germany.

61
The Court notes that, in its sample, for two ESF financial instruments in Italy (Calabria) an additional cost on top of the management cost has been charged to the OP, namely the interest payment of the guaranteed loans (see ***Box 5***). As a result, this increases the implementation cost for one of the two financial instruments to 7.8 %, representing approximately 4 million euros per year.

62
The structure of the costs being charged for the ESF financial instruments to the EU budget differed based on varying sub-components. While the Court acknowledges that there may be valid reasons for such differences, the Commission does not have a complete overview of the basis for the calculation of ESF financial instruments' management and implementation costs and whether they are justified.

63
On the other hand, for EPMF (loans and guarantee instruments combined), the Commission estimates that the average annual cost payable from the EU budget is a maximum of 0.5 % to 0.7 % of the endowment.

Box 5

High costs charged by a financial instrument in Calabria

In Calabria, the management costs charged by a microcredit guarantee fund were reported to the Commission as 2.23 % of the total endowment meaning that they were formally below the 4 % regulatory ceiling.

However, the managing authorities agreed with the local banks a management cost structure where ESF would pay microcredit interest on behalf of the borrowers. When adding interest payments of 5.6 % of the guaranteed loans to the management costs, the total costs charged to the OP are over 7.8 %. Moreover, at the same time, the same private banks that received the interest payments were also earning interest on the ESF deposited funds serving as guarantees.

Conclusions and recommendations

64
The Court concludes that for ESF financial support to micro-entrepreneurs there are weaknesses in the programming and the design of the support and a lack of sufficient and reliable information on performance. In addition, the Commission and the Member States do not have any comparative information available on the administrative cost for each Member State and for each funding mechanism (i.e. grants or financial instruments, such as loans or guarantees).

65
Overall the Court considers that these issues may have a negative impact on the effectiveness of EU financial support addressing the needs of micro-entrepreneurs.

Weaknesses in programming and design of ESF financial support to micro-entrepreneurs

66
The Member States have generally not adequately assessed the specific needs of micro-entrepreneurs when designing the ESF OPs. There was no regulatory obligation to address the specific needs of micro-entrepreneurs at European level during the 2007–13 programming period. During the period covered by the audit, grants were by far the main ESF support mechanism used for micro-entrepreneurs.

67
EU financial support to micro-entrepreneurs from the ESF was generally provided without any substantiated assessment of needs. For some of the ESF financial instruments examined, the absence of investment strategies, together with inadequate risk management systems, have led to oversized endowments to the funds. The Court also found that half of the ESF financial instruments examined lacked exit policies and winding up provisions, despite this being required by the relevant regulations.

68
The Commission's financial instrument, the EPMF, is considered to have generally satisfactory set-up arrangements regarding risk management systems. The EPMF has succeeded in attracting some additional private funding which was not the case for ESF financial instruments. However, the amounts allocated from the EU budget to the EPMF to date (when compared to ESF financial instruments) have been limited.

Recommendation 1

For the 2014–20 programming period, the Member States should consistently perform needs assessments when designing funding instruments and preparing operational programmes that include EU financial support for micro-entrepreneurs. This would also help to allocate the appropriate level of funding to the alternative funding mechanisms, i.e. grants or financial instruments (loans or guarantees). The Commission should provide guidance in this regard.

Recommendation 2

The Commission should make the use of ESF financial instruments by the Member States conditional not only on compliance with regulatory requirements but also on the existence of a robust risk management system to avoid fund oversizing.

Lack of sufficient and reliable monitoring information on performance

69
The EPMF performance reporting systems provided more complete information than those of the ESF which were considered to be inadequate. On the basis of the data provided by Member States, it is not possible for the Commission to aggregate consistent, meaningful and reliable information (e.g. survival rates of micro-entrepreneurs and outreach) to monitor the achievements of ESF microfinance support to micro-entrepreneurs. The Court considers that this situation makes it impossible to come to an overall conclusion on the effectiveness of the ESF support provided to micro-entrepreneurs.

70
Based on the sample examined, ESF grants, ESF financial instruments and EPMF have provided financial support to micro-entrepreneurs. The outreach towards the micro-entrepreneurs who were previously unemployed was achieved in around half of the projects.

Recommendation 3

In order to improve outreach in the future, the Commission together with the Member States should design ESF financial support measures for micro-entrepreneurs and define eligibility criteria which aim at reaching the unemployed and vulnerable persons who are in a disadvantaged position with regard to access to the conventional credit market.

Insufficient information on the implementation costs of ESF grants and financial instruments

71
For the ESF OPs examined, the managing authorities had no information about the actual cost of administration. The Commission and the Member States do not have available any comparative information on the public administrative cost per Member State or per funding mechanism (i.e. grants or financial instruments, such as loans or guarantees). This situation does not allow them to consider the most cost-efficient way of delivering EU support for micro-entrepreneurs.

72
For the financial instruments examined, the Court observed different cost structures and variations in the percentage rate of management costs charged to the EU budget. The Commission does not have a comprehensive overview of the basis for the calculation of implementation costs of ESF financial instruments and therefore is not in position to assess whether cost differences between instruments are justified.

Recommendation 4

For the 2014–20 programming period, the Commission should carry out a comparative analysis of the implementation costs of ESF grants, ESF financial instruments and EaSI financial instruments with a view to establishing their actual levels. This assessment should allow the identification of 'good practices' on how small amount grants, loans and guarantees can be disbursed at a reasonable cost.

This report was adopted by Chamber II, headed by Mr Henri GRETHEN, Member of the Court of Auditors, in Luxembourg at its meeting of 10 June 2015.

For the Court of Auditors

Vítor Manuel da SILVA CALDEIRA
President

Reply of the Commission

Executive summary

VI(a)
The Commission accepts the recommendation.

For the 2014–20 programming period, the regulatory framework will ensure that each financial instrument is 'based on an *ex ante* assessment' which has identified market failures or suboptimal investment situations, and investment needs. The *ex ante* assessment requirements are also foreseen for the continuation of financial instruments set up in the previous programming period.

When approving the operational programmes, the Commission has ensured alignment with strategic priorities, identification/fulfilment of *ex ante* conditionalities and evaluation of the rationale for the form of support proposed.

The Commission also commits to give advice on the *ex ante* assessment and provide guidance on the implementation of financial instruments.

It has already provided guidance and practical methodology on the preparation of the compulsory *ex ante* assessment for the new programming period.

VI(b)
The Commission accepts this recommendation which is already addressed in the new ESF regulatory framework that requires *ex ante* assessments for financial instruments.

VI(c)
The Commission accepts this recommendation.

The new regulatory framework will allow the identification of the most relevant target groups of microfinance instrument for each considered market. This should be achieved through the *ex ante* assessments.

VI(d)
The Commission does not accept this recommendation.

On the one hand, the Commission considers that the analysis would require isolating the managing costs for a grant or a financial instrument borne by the managing authority. Moreover, the comparison of costs and fees between ESF grants and financial instruments and between ESF and EPMF financial instruments would be difficult (e.g. the costs for ESF financial instruments include the banks' fees but not the costs for the Managing Authorities and the Intermediate Bodies); also the cost structure of the EPMF financial instruments is different from the one of the ESF since the Managing Authorities do not intervene).

On the other hand, the analysis may not achieve the purpose of drawing good practices for the new programming period since the regulatory framework provides new rules on management costs and fees that are performance-based and include thresholds (see delegated regulation 480/2014).

Introduction

09
During the programming period 2007–13, reporting by the Managing Authorities to the Commission at project level on the micro-entrepreneurs target group was not obligatory.

Observations

Common reply to paragraphs 21 and 22
For financial instruments in shared management, the Common Provision Regulation 1303/2013 (CPR) in the 2014–20 programming period introduces a compulsory *ex ante* assessment that should cover inter alia the rationale for the form of support proposed.

Common reply to paragraphs 24 and 25
Under shared management and in line with the subsidiarity principle, it is the responsibility of national authorities to ensure that individual operations are implemented in accordance with the applicable legal provisions.

The Commission acknowledges the fact that the investment strategy was not developed for the set-up of three out of six financial instruments.

This issue arising from the 2007–13 programming period was probably due to the lack of certainty of the General Regulation 1828/2006 which was modified several times in 2010 and 2011 for what concerns financial instruments.

26
During the 2007–13 programming period this requirement derived from the mentioned COCOF note. It goes beyond the competence of the Managing Authorities and lies with the fund manager in line with the sound financial management principles.

For the 2014–20 programming period these requirements are clearly provided for in Article 37(2) of the CPR prescribing the obligation of performing the *ex ante* assessment.

27
See common reply to paragraphs 21 and 22 .

Under the 2014–20 programming period, conducting an *ex ante* assessment is a pre-requirement and the payment rules foresee phased certification of payment. This will contribute to optimising the size of financial instruments.

Box 3
Concerning Campania, as identified by the Court, the oversizing was due to the oversubscription of one axis objective to the detriment of the others that remained unsubscribed. The subsequent call for proposal was modified in order to address this issue. At the end of May 2015, the disbursement to micro-entrepreneurs had reached 37.4 % of the total endowment of the fund.

33
The Commission considers that it is still too early to assess the portfolio-at-risk since the EPMF portfolio is recent and the first cycle of reimbursements has not been achieved yet.

Common reply to paragraphs 35 and 36
Leverage was not a legal requirement for the 2007–13 programming period. However it has been included in the legal framework of the 2014–20 period[1].

However, even without leveraging additional private funds, ESF-funded financial instruments may carry a multiplicative effect thanks to their revolving nature.

1 Recital 34 and Article 37(2)(c) and Article 46(2)(h) of Regulation (EU) No 1303/2013.

37

Regarding the target leverage, the Commission wishes to emphasise that the fact that some of the transactions do not reach the expected leverage is not an issue of performance but an acceptable business reality for the immature microfinance market and for the facility which tries to reach not only the best performing intermediaries but also those that are newly established as well as those targeting vulnerable groups. In order to maximise the use of the available EU budget, in the guarantee agreements that do not reach the target leverage the EIF adjusts accordingly the respective cap amounts and reuses the released cap amounts for new transactions. In addition, the intermediaries are obliged to pay commitment fees for failing to meet the agreed portfolio volumes.

Common reply to paragraphs 41 to 44

The monitoring of ESF is as such done at priority axis level and not at project level. Output and result indicators were formulated at the level of the priority axis in line with its objectives. Improvement will be brought by the 2014–20 programming period since output and result indicators are set at the level of the investment priority, reflecting the specific objectives of that investment priority.

As regards the reporting on survival rate, since it is not a requirement of the regulation, it cannot be expected.

Furthermore, the Commission does not consider the survival rate in itself to be a relevant criterion to assess the success of a microfinance instrument. For example, if an unemployed person tried to set up his or her own business and subsequently failed, he/she would have still acquired a professional experience and management skills, thanks to which the person could find a job at a later stage. The result of the intervention should therefore be considered as positive.

The survival rate of supported micro-entrepreneurs could for example be completed by measurement of the labour market situation of the end recipient sometime after the completion of the action.

45

Under the EPMF rules, the data on previous employment status was collected for natural persons but not for microenterprises. This issue has been taken into account in the design of the EaSI financial instruments.

Common reply to paragraphs 52 to 54

The Commission notes that the audited microfinance instruments are tools to reach the respective objectives of the parts of the ESF Operational Programmes and of the EPMF, under which they are implemented, which may go beyond the integration of unemployed people.

Under the EPMF decision the target groups are defined as both individuals, in particular from vulnerable groups, and micro-enterprises.

By working with non-bank microfinance institutions whenever existing in the respective market, one ensures a good outreach to micro-borrowers which are in a disadvantaged position vis-à-vis the conventional credit market. The business model of non-bank MFIs is based upon the existing situation where vulnerable persons are in a disadvantaged position with regard to access to the conventional credit market because they are perceived by the mainstream banks as more costly and/or riskier.

58

The Commission considers that it would be disproportionately burdensome to provide this information compared to the expected results. In particular, it would require isolating the managing costs for a grant or a financial instrument borne by the managing authority. Moreover, the comparison of costs and fees between ESF grants and financial instruments would be difficult (e.g. the costs for ESF financial instruments include the banks' fees but not the costs for the Managing Authorities and the Intermediate Bodies).

59
The costs for managing microcredit actions are by definition higher than normal lending due to the specific target population, the small amount and high number of loans granted by the microfinance institutions.

62
Under shared management and in line with the subsidiarity principle, it is the responsibility of national authorities to ensure that individual operations are implemented in accordance with the applicable legal provisions.

Since 2011, there is an obligation for the Member States to provide data in the annual implementation report about the management costs and fees related to the implementation of financial instruments.

These data are available for the institutions and the public on the 'Summary of data on the progress made in financing and implementing financial engineering instruments reported by the managing authorities' which is published every year in December.

It should also be stressed that the fund manager is identified through a public procurement procedure while the level of management costs and fees are set by the market.

Regarding the calculation of costs, as was the case for the 2007–13 programming period, the 2014–20 legal framework includes a capping of management costs and fees. In addition, a performance component is now a compulsory element of those fees[2].

The Commission laid down in the Delegated Regulation No 480/2014 the criteria for determining financial instruments' costs and fees on the basis of performance and set the thresholds for management costs and fees based on good market practices.

2 See Article 42(5) of Regulation (EU) 1303/2013.

Conclusions and recommendations

Common reply to paragraphs 64 and 65
The Commission considers that it would be disproportionately burdensome to collect this information. Moreover, the comparison of costs and fees between ESF grants and financial instruments and between Member States would be difficult.

Moreover, the administrative cost as such should not be the main driver to choose the most suitable funding mechanism.

67
See Commission replies to paragraphs 21, 22 and 27.

68
EPMF runs as a pilot initiative since 2010. Further budgetary resources have been allocated to its successor programme under EaSI.

Recommendation 1
The Commission accepts the recommendation.

For the 2014–20 programming period the regulatory framework will ensure that each financial instrument is 'based on an *ex ante* assessment' which has identified market failures or suboptimal investment situations, and investment needs. The *ex ante* assessment requirements are also foreseen for the continuation of financial instruments set up in the previous programming period.

When approving the operational programmes, the Commission has ensured alignment with strategic priorities, identification/fulfilment of *ex ante* conditionalities and evaluation of the rationale for the form of support proposed.

The Commission also commits to give advice on the *ex ante* assessment and provide guidance on the implementation of financial instruments.

It has already provided guidance and practical methodology on the preparation of the compulsory *ex ante* assessment for the new programming period.

Recommendation 2

The Commission accepts this recommendation which is already addressed in the new ESF regulatory framework that requires *ex ante* assessments for financial instruments.

69

The EPMF does not appear to suffer from insufficient and unreliable monitoring information on performance.

For the 2014–20 programming period, the Commission notes that apart from the survival rate ESF specific indicators such as the number of micro-enterprises supported and the employment status of participants upon entry and leaving also help to measure the effectiveness of ESF support to micro-entrepreneurs.

Recommendation 3

The Commission accepts this recommendation.

The new regulatory framework will allow the identification of the most relevant target groups of microfinance instrument for each considered market. This should be achieved through the *ex ante* assessments.

Common reply to paragraphs 71 and 72

Concerning ESF financial instruments, since 2011 there is an obligation for the Member States to provide data in the annual implementation report about the management costs and fees related to the implementation of financial instruments.

For the programming period 2014–20, the Commission laid down in the Delegated Regulation No 480/2014 the criteria for determining financial instruments costs and fees on the basis of the performance and set the thresholds for management costs and fees based on the market good practices.

Recommendation 4

The Commission does not accept this recommendation.

On the one hand, the Commission considers that the analysis would require isolating the managing costs for a grant or a financial instrument borne by the managing authority. Moreover, the comparison of costs and fees between ESF grants and financial instruments and between ESF and EPMF financial instruments would be difficult (e.g. the costs for ESF financial instruments include the banks' fees but not the costs for the Managing Authorities and the Intermediate Bodies); also the cost structure of the EPMF financial instruments is different from the one of the ESF since the Managing Authorities do not intervene).

On the other hand, the analysis may not achieve the purpose of drawing good practices for the new programming period since the regulatory framework provides new rules on management costs and fees that are performance-based and include thresholds (see Delegated Regulation 480/2014).

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Micro-entrepreneurs across the EU are experiencing difficulties in accessing the conventional credit market. With a view to improving this situation the EU provides financial support through grants and financial instruments.

With this report, the Court assessed whether the programming and design of the EU financial support was addressing the actual needs of micro-entrepreneurs and whether robust performance reporting systems were in place. In addition, the Court examined whether sufficient information is available on the implementation costs of the different EU funding mechanisms supporting micro-entrepreneurs.

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