EN 2016

NO 19

Special Report

Implementing the EU budget through financial instruments — lessons to be learnt from the 2007-2013 programme period



EUROPEAN
COURT
OF AUDITORS

EUROPEAN COURT OF AUDITORS
12, rue Alcide De Gasperi
1615 Luxembourg
LUXEMBOURG

Tel. +352 4398-1
Enquiries: eca.europa.eu/en/Pages/ContactForm.aspx
Website: eca.europa.eu
Twitter: @EUAuditorsECA

More information on the European Union is available on the internet (http://europa.eu).

Luxembourg: Publications Office of the European Union, 2016

Print	ISBN 978-92-872-5417-7	ISSN 1831-0834	doi:10.2865/66662	QJ-AB-16-019-EN-C
PDF	ISBN 978-92-872-5399-6	ISSN 1977-5679	doi:10.2865/98596	QJ-AB-16-019-EN-N
EPUB	ISBN 978-92-872-5414-6	ISSN 1977-5679	doi:10.2865/617611	QJ-AB-16-019-EN-E

EN 2016

NO 19

Special Report

Implementing the EU budget through financial instruments — lessons to be learnt from the 2007-2013 programme period

(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 specialised in structural policies, transport and energy spending areas. The audit was led by the Reporting Member Iliana Ivanova, supported by Tony Murphy, Head of Private Office and Mihail Stefanov, Attaché; Niels-Erik Brokopp, Principal Manager; Rares Rusanescu, Head of Task; and Agathoclis Argyrou, Marcel Bode, Viorel Cirje and Maria Ploumaki, Auditors.

From left to right: M. Stefanov, I. Ivanova, N.-E. Brokopp, R. Rusanescu, T. Murphy, A. Argyrou.

Contents

Abbreviations

05

CEF: Connecting Europe Facility

CF: Cohesion Fund

COCOF: Coordination Committee of the Funds

CPR: common provisions regulation

EAFRD: European Agricultural Fund for Rural Development

EaSI: European Union programme for employment and social innovation

EEEF: European Energy Efficiency Fund

EEPR: programme to aid economic recovery by granting Community financial assistance to projects in the field of energy

EFF: European Fisheries Fund

EFSI: European Fund for Strategic Investments

Egesif: Expert Group on European Structural and Investment Funds

EIB: European Investment Bank

EIF: European Investment Fund

EPMF: European Progress Microfinance Facility for employment and social inclusion

ERDF: European Regional Development Fund

ESF: European Social Fund

ESIF: European Structural and Investment Funds

GBER: general block exemption regulation

Jeremie: Joint European Resources for Micro to Medium Enterprises

LGTT: Loan Guarantee Instrument for Trans-European Transport Network Projects

Marguerite Fund: The 2020 European fund for Energy, Climate Change and Infrastructure

MFF: multiannual financial framework

Abbreviations

06

OP: operational programme

PBI: project bond initiative

PFLP: portfolio first loss piece

SICAV: Société d'investissement à capital variable

SICAR: Société d'investissement en capital à risque

SMEs: small and medium-sized enterprises

SoA: statement of assurance

TEN-E/T: trans-European networks — energy/transport

TFEU: Treaty on the Functioning of the European Union

Glossary

07

Capital endowment refers to the amount of funding paid to a financial instrument (from the EU budget, the national budget or private investors) to support its operations. It should reflect its capacity for investment and be commensurate to the market that the instrument targets.

CEF regulation: Regulation (EU) No 1316/2013 of the European Parliament and of the Council of 11 December 2013 establishing the Connecting Europe Facility, amending Regulation (EU) No 913/2010 and repealing Regulations (EC) No 680/2007 and (EC) No 67/2010[1].

Cohesion policy in the 2007-2013 programme period covered the European Regional Development Fund and the European Social Fund (i.e. the two Structural Funds) and the Cohesion Fund. In the 2014-2020 programme period, the coordination between cohesion policy and the other EU policies contributing to regional development, namely rural development and fisheries and maritime policy, was improved by the establishment of common provisions for the European Structural and Investment Funds.

The **Coordination Committee of the Funds (COCOF)** is a standing monitoring committee of the Commission. Its function is to discuss issues relating to the implementation of the regulations governing the European Regional Development Fund, European Social Fund and Cohesion Fund.

Common provisions regulation (CPR) for the 2014-2020 period: Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006[2].

A **contingent credit line** is a credit line which could be drawn provided that a previously defined event occurred.

Delegated regulation: Commission Delegated Regulation (EU) No 480/2014 of 3 March 2014 supplementing Regulation (EU) No 1303/2013 of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund[3].

The **European Fund for Strategic Investments (EFSI)** aims to mobilise at least 315 billion euro in private and public long-term investment across the EU over the 2015-2017 period, and to guarantee the funding of projects in subsequent years. The EFSI is established within the European Investment Bank (EIB) as a trust fund with unlimited duration to finance riskier parts of projects. A guarantee of up to 16 billion euro, backed by the EU budget, will compensate for the additional risk taken by the EIB. Member States can contribute additional funds to the EFSI.

1 OJ L 348, 20.12.2013, p. 129.

2 OJ L 347, 20.12.2013, p. 320.

3 OJ L 138, 13.5.2014, p. 5.

Glossary

08

The **Expert Group on European Structural and Investment Funds (Egesif)** was created in the Commission with the aim of providing advice to the Commission on issues in relation with the implementation of programmes adopted and implemented in accordance with the European Structural and Investment Funds regulations. It is one of the two groups replacing the Coordination Committee of the Funds (the second one being Coesif — Coordination Committee for European Structural and Investment Funds).

The aim of the **European Regional Development Fund (ERDF)** is to reinforce 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 investments, mainly for businesses.

The aim of the **European Social Fund (ESF)** is to strengthen economic and social cohesion within the European Union by improving employment and job opportunities, mainly through training measures, encouraging a higher level of employment and the creation of more and better jobs.

The **European Structural and Investment Funds (ESIF)** cover five separate funds that aim to reduce regional imbalances across the Union during the 2014-2020 programme period. The funds include: the European Regional Development Fund; the European Social Fund; the Cohesion Fund; the European Agricultural Fund for Rural Development; and the European Maritime and Fisheries Fund.

Equity investment means the provision of capital to a firm, invested directly or indirectly in return for total or partial ownership of that firm and where the equity investor may assume some management control of the firm and may share the firm's profits.

A **financial intermediary** is an entity acting as an intermediary between the managing authority or the holding fund and the final recipients of funds channelled through financial instruments in shared management.

A **final recipient** is any legal or natural person, other than a holding fund or financial intermediary, receiving funding from a financial instrument.

Financial regulation: Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002[4].

General regulation for the 2007-2013 programme period: 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[5].

4 OJ L 298, 26.10.2012, p. 1.

5 OJ L 210, 31.7.2006, p. 25.

Glossary

A **guarantee** is a commitment by a third party, called the guarantor, to pay the debt of a borrower when the latter cannot pay it themselves. The guarantor is liable to cover any shortfall or default on the borrower's debt under the terms and conditions as stipulated in the agreement between the guarantor, the lender and/or the borrower.

A **guarantee cap rate** is a percentage of a total loan portfolio value actually covered by the guarantee.

A **holding fund** is a fund set up to invest in several venture capital funds, guarantee funds, loan funds, urban development funds, funds or other incentive schemes providing loans, guarantees for repayable investments, or equivalent instruments, for energy efficiency and use of renewable energy in buildings, including in existing housing.

The **hurdle rate** is the minimum rate of return on a project or investment required by a manager or investor.

Implementing regulation: Commission Regulation (EC) No 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No 1083/2006 and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund[6].

Joint European Resources for Micro to Medium Enterprises (Jeremie) is an initiative of the Commission developed together with the European Investment Fund. It promotes the use of financial engineering instruments to improve access to finance for SMEs through the Structural Funds.

Legacy funding is the part of the capital endowment which reached the final recipients, was subsequently returned to the financial instrument and it is thus available for a new round of investments.

A **loan** means an agreement which obliges the lender to make available to the borrower a sum of money for the agreed amount and time. The borrower is obliged to repay the loan after a certain period. Usually the borrower is obliged to pay interest on the loan amount.

A **managing authority** is a national, regional or local public authority, or any other public or private body, which has been designated by a Member State to manage an operational programme. Its tasks include selecting projects to be funded, monitoring how projects are implemented and reporting to the Commission on financial aspects and results achieved.

An **operational programme (OP)** sets out a Member State's priorities and specific objectives and how funding will be used during a given period, generally 7 years, to finance projects. These projects must contribute to achieving one or more of a certain number of objectives specified at the level of the OP's priority axis. Programmes have to be in place for each of the funds in the area of cohesion policy, i.e. the European Regional Development Fund, European Social Fund or Cohesion Fund. OPs are prepared by Member States and must be approved by the Commission before any payments from the EU budget can be made. They can only be modified during the period covered if both parties agree.

Portfolio first loss piece (PFLP): when a portfolio of loans is divided in several risk tranches, the PFLP is the tranche which absorbs the first losses of the portfolio (which could be for example the result of loan defaults).

6 OJ L 371, 27.12.2006, p. 1.

Priority axis: one of the priorities of the strategy in an operational programme comprising a group of operations which are related and have specific measurable goals.

A **Société d'investissement en capital à risque** (SICAR) is a structure designed for private equity and venture capital investments with no investment diversification rules, nor lending or leverage restrictions.

A **Société d'investissement à capital variable** (SICAV) is a type of open-ended investment fund for which the value of its capital changes based the number of investors and on the value of its underlying investments. Shares in the fund are bought and sold based on the fund's latest net asset value.

Specific funds are funds which are not holding funds.

State aid is any form of direct or indirect financial support provided by public authorities to private-sector undertakings. The Treaty on the Functioning of the European Union (TFEU) generally prohibits state aid within the common market unless it is duly justified. The EU State aid rules set out when this support does not distort (or does not threaten to distort) competition. The European Commission has the exclusive competence to assess the compatibility of state aid granted by Member States with these rules. Procedural decisions and actions taken by the European Commission are subject to review by the Court of Justice of the European Union and the General Court.

Executive summary

I

The European Union is currently facing serious challenges such as the economic and financial recovery and the management of the refugee crisis. Therefore, the EU's decision-makers are seeking ways to maximise the effectiveness and efficiency of the available EU budget, which accounts for less than 1 % of the EU's gross domestic product (GDP).

II

Financial instruments are a delivery tool to provide financial support from the EU budget. Financial support provided to final recipients through financial instruments may take the form of loans, guarantees and equity investments.

III

If properly implemented, financial instruments provide two specific benefits compared to grants:

— the possibility of leveraging the public funds (i.e. mobilising additional private and public funds to complement the initial public funding); and

— the revolving nature of their capital endowment (i.e. the use of the same funds in several cycles).

The fact that loans have to be paid back and guarantees have to be released or, in the case of equity investments, returned should in principle also have an impact on the behaviour of final recipients, leading to the better use of public funds and reducing the likelihood that the final recipients will become dependent on public support.

IV

During the 2007-2013 programme period financial instruments set up under the European Regional Development Fund (ERDF) and the European Social Fund (ESF) were used by 25 out of 28 EU Member States: in total, 972 ERDF and 53 ESF financial instruments were set up across the EU. By the end of 2014, around 16 billion euro had been paid as contributions from the ERDF and ESF operational programmes (OPs) to these instruments. This represents a significant increase compared to around 1.3 billion in the 2000-2006 programme period and 0.6 billion euro in the 1994-1999 programme period allocated to such instruments. During the same period, 2007-2013, the overall contribution from the EU budget to the 21 financial instruments managed directly or indirectly by the Commission was about 5.5 billion euro. These centrally managed financial instruments operate across all EU Member States.

V

Through this audit, we examined whether financial instruments were an efficient mechanism to implement the EU budget during the 2007-2013 programme period. Our audit was carried out between October 2014 and March 2016 and focused on the areas of regional, social, transport and energy policy. Our analysis covers all 1 025 ERDF and ESF financial instruments set up during the 2007-2013 programme period under shared management, as well as six centrally managed financial instruments in these areas. The data presented in this report are based on the latest available information provided by the Commission in September 2015 reflecting the situation at the end of 2014.

VI

Our audit identified a number of significant issues that limited the efficiency of financial instruments as a mechanism to implement the EU budget during the 2007-2013 programme period.

— A significant number of ERDF and ESF financial instruments were oversized and, by the end of 2014, continued to face significant problems in disbursing their capital endowments (on average, around 57 % of all capital endowment paid from the OPs to the financial instruments had been used). A contributing factor to the excessive initial capital endowments was the Member States' intention to avoid de-commitments throughout the 2007-2013 programme period.

— Overall, financial instruments in both shared and central management were not successful in attracting private capital.

— So far, only a limited number of ERDF and ESF financial instruments have been successful in providing revolving financial support.

— For ERDF and ESF financial instruments, high levels of management costs and fees compared to the actual financial support to final recipients which also appear to be significantly higher than those of centrally managed instruments or private-sector investment funds.

VII

At the same time, we also note that improvements were made in the legal framework for the 2014-2020 programme period as regards financial instruments based on the expertise gained during the 2007-2013 programme period, but certain issues remain.

VIII

In our report, we recommend that

— The Commission's *ex ante* assessment for centrally managed instruments should systematically include an analysis of the 'lessons learnt' to date.

— The Commission, in addition to the 'lessons learnt', should also assess the effect of major socioeconomic changes on the rationale of the instrument and the corresponding contribution required from the EU budget in the context of their respective mid-term reviews for all centrally managed financial instruments.

— The Commission and the Member States should aim at optimising the size of specific ERDF and ESF funds to take, wherever possible, advantage of the significant economies in the cost of operating funds. Additional guidance should be provided to Member States on how to set up such financial instruments within Member States or at Union level (which are managed directly or indirectly by the Commission).

— The Commission should provide in the financial regulation (and subsequently in sectorial regulations) a definition for the leverage of financial instruments applicable across all areas of the EU budget, which clearly distinguishes between the leverage of private and national public contributions under the OP and/or of additional private or public capital contributions, and takes into account the type of instrument involved.

— For ERDF and ESF financial instruments under the 2007-2013 programme period, the Commission should ensure at closure that Member States provide complete and reliable data on private contributions on capital endowments, both through the OPs and in addition to them.

— For ERDF and ESF financial instruments, the Commission should provide additional guidance to Member States on how best to apply the provisions on preferential treatment to attract more private capital without allocating excessive risks to public contributors to the financial instruments' endowments.

— For centrally managed financial instruments, the general risk-sharing principles which may have an impact on the EU budget should be defined in the legislation governing the instrument concerned.

— For all financial instruments funded from the EU budget during the 2014-2020 programme period, the Commission should ensure that only structures which are in line with its own recommendations and actions with regard to tax arrangements are implemented by Member States, the Commission itself and the EIB group.

— The Commission should take appropriate measures to ensure that Member States maintain the revolving nature of the funds during the required 8-year period after the end of the eligibility period for the 2014-2020 programme period.

— The Commission should provide guidance in respect of the provisions allowing financial instruments to continue to be used into the following programme period, in particular for cases where fund managers are selected on the basis of public procurement.

— The Commission should ensure that Member States report comprehensive information on management costs and fees incurred and paid by March 2017 in view of the upcoming closure of the 2007-2013 programme period.

— The Commission should clarify that the ceilings for management costs and fees need to be applied to the actual capital endowment used by the financial instrument, i.e. the contribution from the OP that has been used to provide financial support to final recipients.

— As regards the performance-based remuneration of fund managers in the 2014-2020 programme period the Commission should make a legislative proposal aiming at a revision of the existing provisions in the common provisions regulation (CPR) to strengthen the incentive effect of these arrangements.

— Member States' managing authorities should make extensive use of the existing performance-based elements of the remuneration for fund managers when negotiating funding agreements.

— The Commission should carry out a comparative analysis of the implementation costs of grants and repayable financial support, mainly through financial instruments, for the 2014-2020 programme period with a view to establishing their actual levels. Such information would be particularly relevant for preparing legislative proposals for the post-2020 period and determining an adequate level of technical assistance.

What are financial instruments?

01

The European Union is currently facing serious challenges such as the economic and financial recovery and the management of the refugee crisis. Therefore, the EU's decision-makers are seeking ways to maximise the effectiveness and efficiency of the available EU budget, which accounts for less than 1 % of the EU's gross domestic product (GDP).

Financial instruments[7] are a delivery tool to provide financial support from the EU budget through loans, guarantees and equity (or quasi-equity) investments for the implementation of projects (see ***Table 1***)[8].

Annex I provides an illustration of how the different types of financial instruments operate.

7 During the 2007-2013 programme period, the legislation governing the ERDF and the ESF made reference to 'financial engineering instruments'. In this report, the terms 'financial engineering instrument' and 'financial instrument' are used synonymously.

8 According to International Accounting Standard 32, a financial instrument is '[…] any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Table 1

Main types of financial instruments supported by the EU budget

Loan	Guarantee
'Agreement which obliges the lender to make available to the borrower an agreed sum of money for an agreed period of time and under which the borrower is obliged to repay that amount within the agreed time'. Under a financial instrument, a loan can help where banks are unwilling to lend on terms acceptable to the borrower. They can offer lower interest rates, longer repayment periods or have lower collateral requirements.	'Written commitment to assume responsibility for all or part of a third party's debt or obligation or for the successful performance by that third party of its obligations if an event occurs which triggers such guarantee, such as a loan default*'. Guarantees normally cover financial operations such as loans. * European Commission (2015). Guidance for Member States on Financial Instruments – Glossary.
Equity	**Quasi-equity**
'Provision of capital to a firm, invested directly or indirectly in return for total or partial ownership of that firm and where the equity investor may assume some management control of the firm and may share the firm's profits'. The financial return depends on the growth and profitability of the business. It is earned through dividends and on the sale of the shares to another investor ('exit'), or through an initial public offering (IPO).	'A type of financing that ranks between equity and debt, having a higher risk than senior debt and a lower risk than common equity. Quasi equity investments can be structured as debt, typically unsecured and subordinated and in some cases convertible into equity, or as preferred equity'. The risk return profile typically falls between debt and equity in company's capital structure.

Source: European Commission and EIB, *FI Compass — Financial instrument products: Loans, guarantees, equity and quasi-equity*, p. 3.

02

Compared to grants (which are the traditional way of providing funding from the EU budget), financial instruments, if properly implemented, can provide two specific benefits:

- the possibility of leveraging the public funds (i.e. mobilising additional private and public funds to complement the initial public funding); and
- the revolving nature of their capital endowment (i.e. the use of the same funds in several cycles) allows each euro of funding through financial instruments in principle to be used more than once.

03

The fact that loans have to be paid back and guarantees have to be released or, in the case of equity investments, returned should in principle also have an impact on the behaviour of final recipients, leading to the better use of public funds and reducing the likelihood that the final recipients will become dependent on public support.

04

A common definition for financial instruments was first provided in the revision of the financial regulation in 2012; this definition has since been applied in the sectorial regulations for the 2014-2020 programme period (see ***Annex II***).

Use of financial instruments in implementing the EU budget since 2007

Use of financial instruments funded from the EU budget

05

The EU budget can be implemented through shared management (i.e. in cooperation with Member States such as in cohesion policy), through direct management (i.e. by its departments or through executive agencies) or through indirect management (i.e. by entrusting budget implementation tasks to third countries or to different entities)[9]. The latter two are collectively referred to as centralised management.

9 Article 58 of the financial regulation.

06

Financial instruments are used in different parts of the EU budget:

- Shared management financial instruments in the area of cohesion are set up mainly under the European Regional Development Fund (ERDF), and to a lesser extent under the European Social Fund (ESF). Since the 2014-2020 programme period, financial instruments can also be used for the Cohesion Fund (CF). Each instrument has to be implemented within the framework of an operational programme (OP), which is decided by the managing authorities responsible for that programme, together with its size and design[10]. Financial instruments are also used under the European Agricultural Fund for Rural Development (EAFRD) and the European Fisheries Fund (EFF).

- Centrally managed financial instruments are financed from various budgetary areas such as research, enterprise and industry, education and culture, etc. For these instruments the Commission, together with its partners, is directly involved in their design and in developing their investment strategy and endowment. The decision to set up these instruments is taken by the budgetary authorities (i.e. the European Parliament and the Council) on the basis of a Commission proposal.

Rules for selecting the fund manager of financial instruments

07

In shared management, financial instruments can be set up as standalone funds or as sub-funds of a holding fund, later referred to as specific funds (see ***Figure 1***). A holding fund, sometimes also referred to as a 'fund of funds', is a fund set up with the objective of managing different types of instruments. It also allows making contributions from one or more OPs to one or several financial instruments.

08

Financial instruments are generally managed by private- or public-sector banks or other financial intermediaries rather than public administrations. For ERDF and ESF instruments, the selection of a fund manager has to comply with EU and national public procurement rules if the management of the fund is tendered out. In situations where public procurement rules do not apply (i.e. in case the fund management contract is not a public service contract), the managing authority can designate the fund manager subject to complying with the relevant State aid rules (see paragraphs 10 to 12).

09

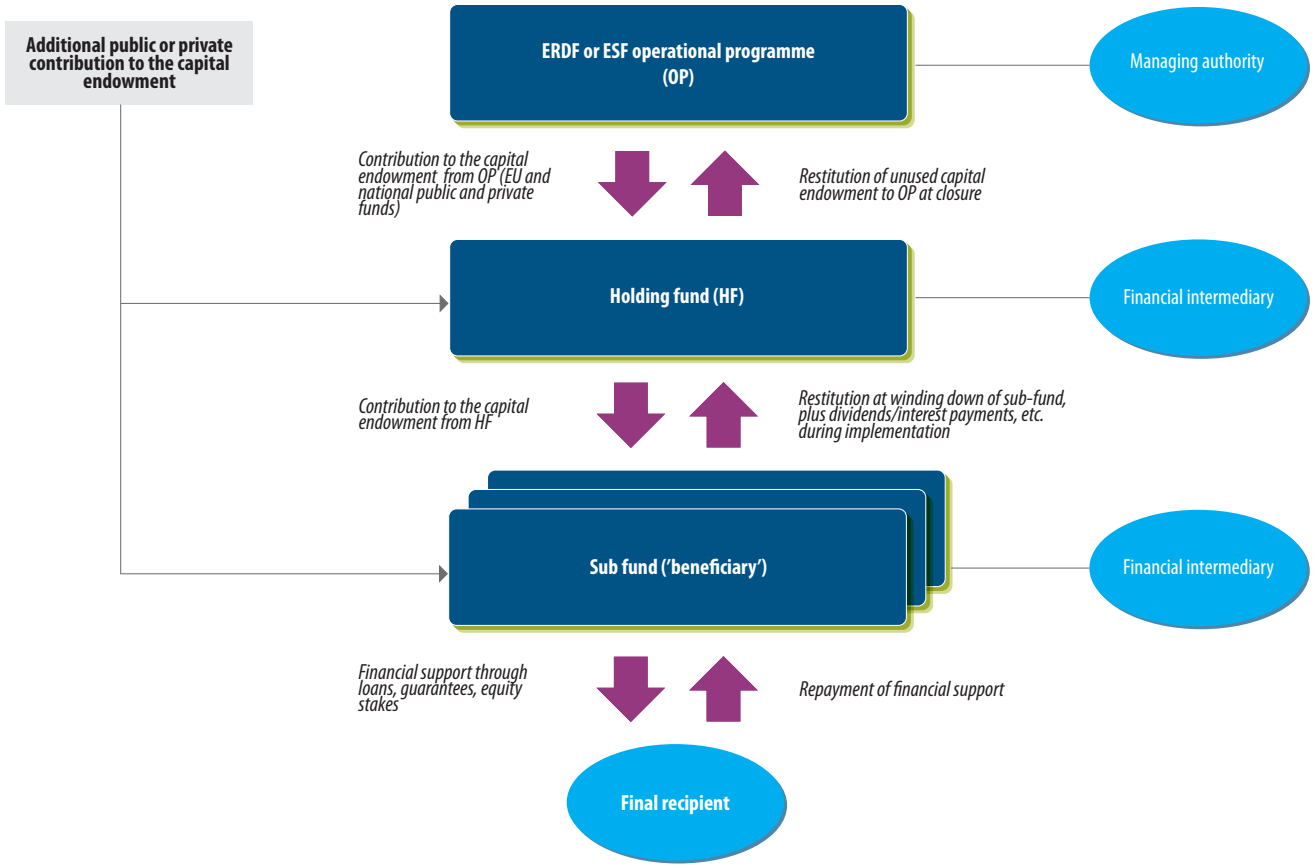
The EIB group (which comprises the European Investment Fund (EIF) and the European Investment Bank (EIB)) benefits from a special status since they can be appointed as fund managers without a public procurement procedure[11]. They also manage most of the centrally managed instruments for which the fund manager is designated in the legislative proposal.

10 European Parliament, Directorate-General for Internal Policies, *Financial engineering instruments in cohesion policy — Study*, 2013, p. 46.

11 Article 44(c) of the general regulation.

Figure 1

Simplified overview of a holding fund structure for ERDF or ESF financial instruments



Source: ECA.

Financial instruments and the EU State aid rules

10

EU funds under shared management are considered part of the national or regional budgets and as such are potentially subject to State aid control. When implementing the financial instrument, managing authorities must therefore ensure compliance with State aid rules[12]. The relevant State aid rules are contained in the new general block exemption regulation (GBER)[13] and the Commission's new guidelines for risk finance[14], which both came into effect in July 2014.

11

For each ERDF and ESF financial instrument, the managing authority has to provide evidence that it is either[15]:

- conforming with normal market practice (which in practice means that the management of the fund has been selected following an open, transparent and non-discriminatory process); or
- covered by the *de minimis* regulation[16]; or
- an exempted aid, because it falls under the GBER or falls under a notified aid scheme in accordance with the Commission's guidelines for risk finance.

12

Centrally managed financial instruments (which do not use national or regional resources, and thus are not part of Member State budgets) fall outside of the scope of the EU's State aid rules, because the main condition of Article 107 TFEU '[…] granted by a Member State or through state resources' is not fulfilled.

Background information on the number of financial instruments and their capital endowment since 2007

2007-2013 programme period

13

During the 2007-2013 programme period financial instruments were used by 25 out of 28 EU Member States. Only Croatia, Ireland and Luxembourg did not use this funding mechanism[17]. ***Annex III and IV*** give an overview of the ERDF and ESF instruments per Member State.

12 Article 37(1) of the common provision regulation (CPR): 'When applying this Title (Title IV, Financial Instruments), the managing authorities, the bodies implementing funds of funds, and the bodies implementing financial instruments shall comply with applicable law, in particular on State aid and public procurement.'

13 Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (OJ L 187, 26.6.2014, p. 1).

14 European Commission, 'Guidelines on State aid to promote risk finance investments' (OJ C19, 22.1.2014, p. 4).

15 Article 37 of the CPR.

16 Council Regulation (EU) 2015/1588 of 13 July 2015 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union (TFEU) to certain categories of horizontal State aid (codification) (OJ L 248, 24.9.2015, p. 1).

17 Nevertheless, centrally managed financial instruments have been set-up in Luxembourg. Moreover they have provided EU financing to projects in Ireland and Croatia.

14

As shown in ***Table 2***, by the end of 2014 around 15.2 billion euro had been paid as ERDF OP contributions and 0.8 billion euro through ESF OP contributions. This represents a significant increase compared to around 1.3 billion in the 2000-2006 programme period and 0.6 billion euro in the 1994-1999 programme period[18].

18 European Commission and EIB, *FI Compass — Financial instruments: A sustainable way of achieving EU economic and social objectives*, p. 3.

15

During the 2007-2013 programme period, the EU contribution paid to financial instruments corresponded to 5 % of the total EU funding for the ERDF and 1 % of the total EU funding for the ESF for the entire period. The EU budget accounted for 69 % and 56 % of the total contribution to the capital endowments of the ERDF and ESF 2007-2013 financial instruments, respectively (see ***Table 2***). In terms of financial support for the final recipient, the EU contribution accounted for 63 % (ERDF) and 65 % (ESF).

Table 2

Implementation of ERDF and ESF financial instruments (2007-2013) as of 31 December 2014

	Amounts committed in funding agreements to financial instruments *(amounts in million euro)*			Amounts paid from OPs to financial instruments *(amounts in million euro)*			Amounts paid from financial instruments to final recipients *(amounts in million euro)*		
	OP[1]	EU	EU/OP %	OP	EU	EU/OP %	OP	EU	EU/OP %
ERDF	17 061	10 946	n.a.	15 189	10 452	69 %	8 871	5 594	63 %
ESF		472		829	462	56 %	318	207	65 %
Total	**17 061**	**11 418**	**67 %**	**16 018**	**10 914**	**68 %**	**9 189**	**5 801**	**63 %**

Source: ECA, based on the most recent Commission data as of September 2015[2].

1 For the OP amounts committed no separation between ERDF and ESF financial instruments is presented in the Commission's implementation report.

2 EGESIF_15-0027-00, '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 — Programme period 2007-2013 — Situation as at 31 December 2014', pp. 21 and 54.

16

According to the latest data reported by the Commission, 972 ERDF financial instruments and 53 ESF instruments had been set up across the EU. Out of these, 903 are specific ERDF funds and 49 are specific ESF funds (see ***Table 3***). 31 of the ERDF instruments are managed by the EIB group (see paragraph 9).

17

In addition, there were 14 instruments funded through the EAFRD and 6 instruments funded by the EFF. For the 2007-2013 programme period, these two funds did not require Member States to report on financial instruments, so there are no official data in this respect[19]. However, based on data compiled by the Court, at the end of 2013 the capital endowment of funds co-financed by the EAFRD can be estimated at around 700 million euro, and around 72 million euro for the EFF (in both cases including the national contributions to the programmes).

19 See Special Report No 5/2015, *Are financial instruments a successful and promising tool in the rural development area?*, paragraph 82 (http://eca.europa.eu).

Table 3

ERDF and ESF financial instruments per type of specific fund (2007-2013) as of 31 December 2014

	ERDF		ESF	
	Number of funds	**Endowment** *(in million euro)*	**Number of funds**	**Endowment** *(in million euro)*
Specific funds, out of which:				
— loan instruments	371	5 637	31	417
— guarantee instruments	171	2 215	7	196
— equity instruments	162	2 006	1	70
— mixed instruments (combination of loans, guarantees, equity or other instruments)	110	2 496	5	59
— other instruments	6	65	0	0
— type not reported	83	770	5	74
Total	**903**	**13 189**	**49**	**816**

Source: ECA, based on the most recent Commission data as of September 2015.

18
For the centrally managed instruments, the EU's overall contribution allocated to 2007-2013 instruments in all budgetary areas was about 5.5 billion euro[20], spread over 21 financial instruments[21]. These instruments operate across all EU Member States.

2014-2020 programme period

19
Within the EU budget, the European Structural and Investment Funds (ESIFs) are the main source of funding for capital investment and infrastructure, with a total budget of around 450 billion euro for the 2014-2020 programme period.

20
Since 2011 the European Parliament and European Council has encouraged an increased use of financial instruments[22]. This political commitment is also reflected in the common provisions regulation (CPR) which provides for an extended use of financial instruments to deliver all five ESIFs (i.e. also the Cohesion Fund) and all thematic objectives for the programmes[23].

21
At the end of 2015 the Commission estimated that, for the 2014-2020 programme period as a whole, approximately 21 billion euro will be allocated to financial instruments from the five ESIFs[24]. Since the average EU contribution to the total endowments of such instruments for the 2007-2013 programme period was around 68 % by the end of 2014[25], we estimate that the 21 billion euro amount coming from the EU budget will probably correspond to approximately 31 billion euro in total allocations (not taking account of additional national and private financing that may be provided to the funds outside the ESIF programmes).

22
In comparison, the European Fund for Strategic Investments (EFSI) aims to mobilise at least 315 billion euro in private and public long-term investment across the EU over the period from 2015 to 2017 and the funding of projects in subsequent years.

20 COM(2015) 565 final of 13 November 2015, 'Report from the Commission to the European Parliament and the Council on financial instruments supported by the general budget according to Article 140.8 of the financial regulation as at 31 December 2014', p. 4.

21 SWD(2015) 206 final of 13 November 2015, 'Activities relating to financial instruments', pp. 6-12.

22 European Parliament, '5th cohesion report and strategy for the post-2013 cohesion policy'; EUCO 169/13, Conclusions of the European Council, 25 October 2013, p. 10.

23 Regulation (EU) No 1303/2013.

24 European Parliament and Commission, 'The 2014 budgetary discharge to the Commission — Answers to the European Parliament's written questions to Commissioner Creţu', hearing on 7 December 2015, p. 34.

25 EGESIF_15-0027-00, '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 — Programme period 2007-2013 — Situation as at 31 December 2014', pp. 21 and 54.

Audit scope and approach

23

Through this audit, the Court examined whether financial instruments were an efficient mechanism to implement the EU budget during the 2007-2013 programme period. In that context our report addresses the following main audit questions:

- were financial instruments appropriately sized in view of market needs?
- did financial instruments succeed in attracting private capital?
- were financial instruments providing revolving financial support?
- did financial instruments prove to be a cost-efficient method to implement the EU budget?

For each of these questions, we examined which lessons could be learnt from the main shortcomings identified. We also assessed to what extent they had been addressed in the regulations applicable to the 2014-2020 programme period.

24

Our audit covers the period from 2009 to 2015. We focused on the areas of regional, social, transport and energy policy. In particular, our review covers all ERDF and ESF financial instruments, as well as six centrally managed financial instruments in the areas of social, transport and energy policy. Several issues identified in this report may, however, also affect other areas of the EU budget where such instruments are used.

25

The audit work consisted of the following elements:

- a review of various Commission, EIB, EIF and third-party analyses and publications.
- the analysis of the most recent annual monitoring report published by the Commission in September 2015, covering all 1 025 ERDF and ESF financial instruments. This analysis, based on data reported by the Commission in November 2015, was also made for six[26] of the 21 instruments under central management (accounting for an EU contribution of 789 million euro, or 14 % of the total amount of all 21 instruments)[27].
- an examination of 10 case studies of financial instruments implemented in the area of the EU budget covered by this report[28], including a field visit to one Member State (Slovakia).

26 One of these six financial instruments, the 2020 European Fund for Energy, Climate Change and Infrastructure (Marguerite Fund), is managed under the direct management mode (see paragraph 6).

27 European Commission, SWD(2015) 206 final, '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 — Programme period 2007-2013 — Situation as at 31 December 2014', Brussels, September 2015.

28 Loan Guarantee Instrument for Trans-European Transport Network Projects (LGTT), Project Bond Initiative (PBI), Marguerite Fund, European Energy Efficiency Fund (EEEF), European Progress Microfinance Facility (EPMF), Jessica Greece, Jeremie Slovakia, Entrepreneurship Fund Greece, Venture Finance Hungary (Jeremie Hungary), Jeremie Sicily.

- a follow-up review of 45 financial instruments audited in compliance audits carried out by the Court since 2009 (whose results were previously reported in our annual reports) and 54 financial instruments examined by our performance audits since 2012.

- a survey of 85 managing authorities and fund managers involved in the implementation of financial instruments. Out of the 85 entities surveyed, 82 relate to ERDF and ESF instruments under shared management and three to centralised management. There were 66 replies for shared management instruments and two for centrally managed ones.

- interviews with more than 40 officials from the Commission, the EIB and the EIF and more than 10 experts from organisations with expertise in the field[29].

26

The Court has already carried out numerous examinations of the use of financial instruments, and has reported since 2011 on the findings in several annual reports[30] and special reports[31]. Moreover, the Commission itself, but also the EIB, the EIF, the European Parliament, national audit bodies and private-sector fund managers, have identified a number of issues in recent years which collectively limited the effectiveness of financial instruments during the 2007-2013 programme period. This report builds also on these assessments.

29 Caisse des Dépôts, Kreditanstalt für Wiederaufbau (KfW) and the OECD.

30 Paragraphs 4.30 to 4.36 of the 2010 annual report (OJ C 326, 10.11.2011); paragraph 5.34 of the 2011 annual report (OJ C 344, 12.11.2012); paragraph 10.31 of the 2012 annual report (OJ C 331, 14.11.2013); paragraphs 5.33 to 5.36 of the 2013 annual report (OJ C 398, 12.11.2014); paragraphs 6.46 to 6.52 of the 2014 annual report (OJ C 373, 10.11.2015).

31 Special Report No 4/2011, *Audit of the SME Guarantee Facility*; Special Report No 2/2012, *Financial instruments for SMEs co-financed by the European Regional Development Fund*; Special Report No 5/2015, *Are financial instruments a successful and promising tool in the rural development area?*; Special Report No 8/2015, *Is EU financial support adequately addressing the needs of micro-entrepreneurs?* (http://eca.europa.eu).

Were financial instruments appropriately sized in view of market needs?

27

Financial instruments are not projects themselves but a delivery tool for funding from the EU budget. In cohesion policy, the decision of a managing authority to deliver OP support through a financial instrument is not so much a decision of whether to invest OP resources or not (this is already predefined in the OP) but rather how to invest: through a one-off grant or support through a financial instrument providing a repayable financial support.

28

We have therefore examined to what extent the 1 025 ERDF and ESF instruments used their capital endowment to provide different forms of financial support to final recipients and analysed several factors contributing to the instruments' low disbursement rates to final recipients during the 2007-2013 programme period: the level of the initial capital endowments of the instruments, whether market needs were properly addressed by the managing authorities and specific difficulties faced by regional financial instruments. We also analysed how similar aspects were dealt with in the case of centrally managed instruments.

Excessive capital endowment led to low disbursement rates, avoidance of de-commitment and potential reimbursement at closure

29

The financial instruments disbursement rates have already been examined in several of the Court's annual and special reports[32]. In this report we analyse the latest available information reported by the Member States to the Commission as at 31 December 2014, published in September 2015. Our analysis of these most recent data shows that a significant number of them continue to face difficulties in using their capital endowments as planned.

30

Table 4 shows the disbursement rates for each of the 25 Member States which implemented financial instruments during the 2007-2013 programme period[33]. The percentages presented are averages for all ERDF and ESF instruments in the Member State concerned. A significant number of financial instruments were established only in 2012 or afterwards.

32 See annual reports concerning the financial years 2013 (paragraph 5.35) and 2014 (paragraph 6.49); Special Report No 8/2015 (paragraph 67).

33 European Commission, '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 — Programme period 2007-2013 — Situation as at 31 December 2014', p. 22.

Table 4

Implementation of ERDF and ESF financial instruments per Member State — as of 31 December 2014

Member State	OP contributions committed *(in million euro)*	Out of which EU contribution	%	OP contributions paid to financial instruments *(in million euro)*		OP contributions paid to final recipients *(in million euro)*		
				Amount	% of commitment	Amount	% of payment	% of commitment
Estonia	200	125	63 %	200	100 %	191	95 %	95 %
Poland	1 196	1 008	84 %	1 190	100 %	1 104	93 %	92 %
Slovenia	124	105	85 %	124	100 %	112	90 %	90 %
Hungary	916	778	85 %	897	98 %	751	84 %	82 %
Germany	1 629	1 025	63 %	1 554	95 %	1 265	81 %	78 %
Malta	12	10	83 %	12	100 %	10	81 %	81 %
Portugal	854	531	62 %	477	56 %	386	81 %	45 %
Czech Republic	278	171	62 %	278	100 %	223	80 %	80 %
Denmark	74	35	47 %	51	68 %	40	80 %	55 %
Romania	150	129	86 %	150	100 %	118	78 %	78 %
Sweden	161	74	46 %	157	97 %	121	77 %	75 %
Lithuania	507	409	81 %	444	87 %	331	75 %	65 %
France	460	240	52 %	419	91 %	310	74 %	67 %
Belgium	396	159	40 %	396	100 %	288	73 %	73 %
Finland	75	35	47 %	75	100 %	51	68 %	68 %
Latvia	216	160	74 %	216	100 %	145	67 %	67 %
United Kingdom	1 632	710	44 %	1 483	91 %	983	66 %	60 %
Cyprus	20	17	85 %	20	100 %	13	63 %	63 %
Bulgaria	388	330	85 %	388	100 %	228	59 %	59 %
Austria	27	10	37 %	27	100 %	13	49 %	49 %
Netherlands	75	20	27 %	67	90 %	32	47 %	42 %
Greece	1 789	1 477	83 %	1 589	89 %	695	44 %	39 %
Italy	4 538	2 809	62 %	4 460	98 %	1 427	32 %	31 %
Spain	1 233	954	77 %	1 234	100 %	330	27 %	27 %
Slovakia	112	95	85 %	112	100 %	23	21 %	21 %
Total	**17 061**	**11 418**	**67 %**	**16 018**	**94 %**	**9 188**	**57 %**	**54 %**

Note: Croatia, Ireland and Luxembourg are not listed, as they had no ERDF and ESF financial instruments during the 2007-2013 programme period.

Source: ECA; based on 2015 Commission data.

31

By the end of 2014, with only 1 year before the end of the initial eligibility period (31 December 2015), only 57 % of ERDF and ESF instruments' endowments had been disbursed to final recipients. Disbursements were low in particular for financial instruments in Slovakia (21 %), Spain (27 %) and Italy (32 %). Moreover, a further three Member States (Greece, Netherlands, Austria) had disbursed less than half of their initial endowments.

32

Overall, 177 of the 972 ERDF financial instruments (18 %) and 16 of the 53 ESF financial instruments (30 %) had disbursed less than a third of their endowment by the end of 2014. For these 177 instruments, their total unused endowment amounted to 4.2 billion euro as at 31 December 2014. For these instruments, we consider it to be unlikely that the available funding will be used once, even though the Commission has extended the eligibility period until March 2017 (see paragraph 43). The final disbursement rate of the financial instruments can, however, only be assessed at the end of their life cycle, especially as regards those set up towards the end of the programme period.

Low disbursement rates due to excessive initial endowment of financial instruments

33

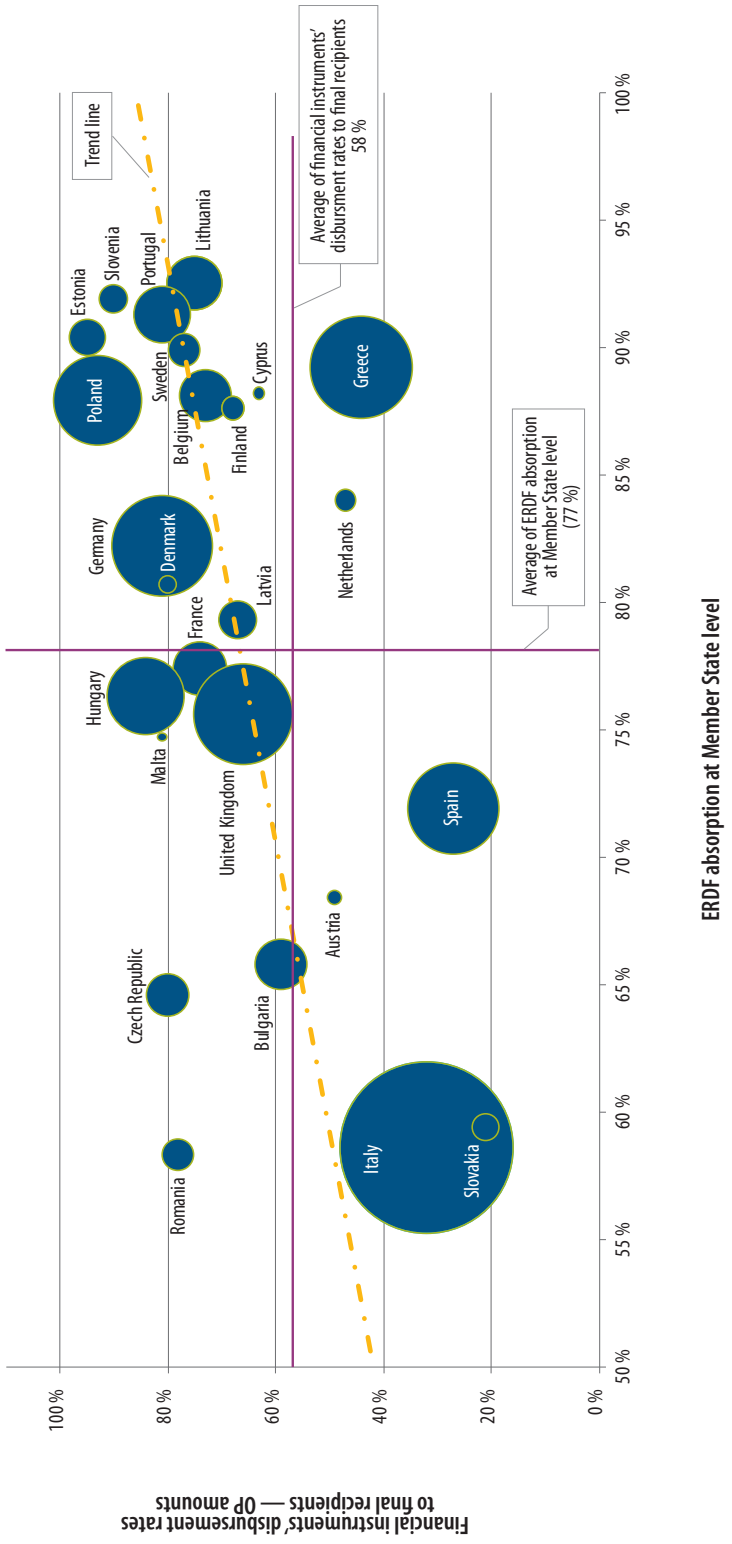
During our interviews, it was often argued that the financial and economic crisis had had a major effect, and had negatively affected disbursement rates to final recipients. However, given the size of the problem, we consider that this is neither the only nor the main factor behind low disbursement rates. In fact, low disbursement rates are primarily due to an excessive endowment of the financial instruments in the first place.

34

Our analysis of the data published by the Commission in 2015 showed that there is a positive correlation between ERDF and ESF absorption rates at Member State level and financial instruments' disbursement rates to final recipients (see ***Figure 2a*** and ***Figure 2b***). This analysis illustrates that those Member States which already face difficulties in absorbing the ERDF and ESF budget often have even more significant problems in disbursing the capital endowment allocated to financial instruments.

Figure 2a

Comparison between the ERDF overall absorption at Member State level and the financial instruments' disbursement rate at the level of final recipients

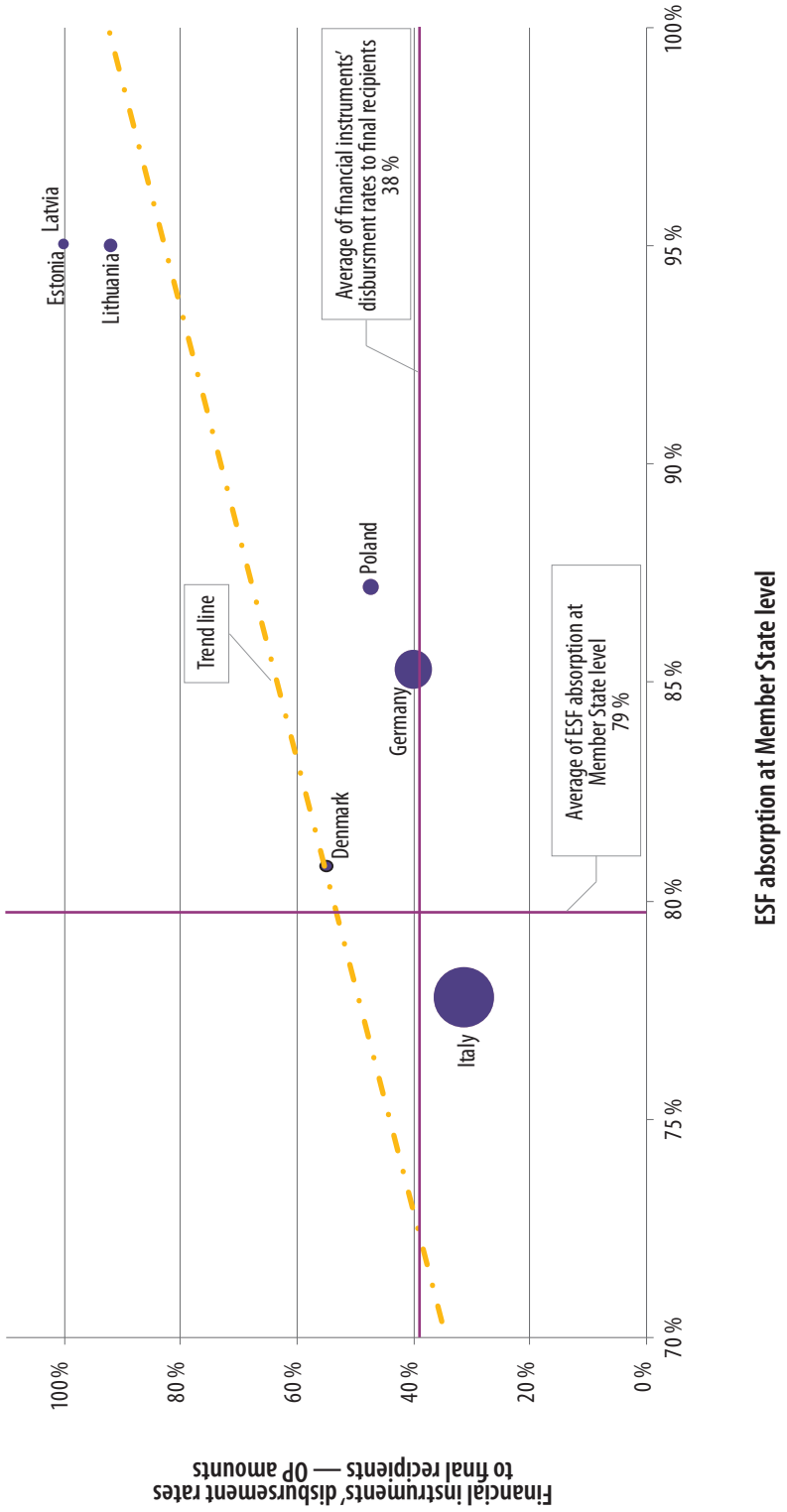


Note: The size of the circles corresponds to the total contribution from the OPs to financial instruments (see ***Table 4***). Correlation coefficient: 0.5.

Source: ECA, based on 2015 Commission data.

Figure 2b

Comparison between the ESF overall absorption at Member State level and the financial instruments' disbursement rate at the level of final recipients



Note: The size of the circles corresponds to the total contribution from the OPs to financial instruments (see ***Table 4***). Correlation coefficient: 0.9.

Source: ECA, based on 2015 Commission data.

Increase in capital endowments of financial instruments in 21 out of 25 Member States

35

In 21 out of 25 Member States, we also found that the initial endowment had been increased since 2011. Overall, around 7.1 billion euro of additional funding from the 2007-2013 ERDF and ESF OPs had been allocated to financial instruments since then.

36

Most of these increases in the instruments' capital endowment were made in Italy (2.5 billion euro), Spain (0.9 billion euro), Greece (0.9 billion euro), the United Kingdom (0.7 billion euro) and Hungary (0.5 billion euro). These five Member States alone account for 77 % of the total increase of capital endowment during the entire period. Four of these five Member States (Italy, Spain, the United Kingdom and Hungary) had a below-average ERDF absorption rate at the end of 2014 (see ***Figure 2a***).

Provisions in the legal base for the 2007-2013 programme period created incentives for Member States to use financial instruments to circumvent the risk of de-commitment of EU funds

37

The legal base for the 2007-2013 programme period made it possible for Member States to absorb the EU contribution to the ERDF and ESF OPs upfront through the use of financial instruments. These upfront contributions could be used by Member States as a mechanism to avoid the risk of de-commitment ('*n* + 2' rule)[34] (see ***Box 1***).

34 The automatic de-commitment rule (*n* + 2 rule) helps to clear outstanding commitments. This rule requires automatic de-commitment of all funds not spent or not covered by a payment request by the end of the second year following the year of allocation.

Box 1

Reimbursement the ERDF and ESF contribution to setting up the financial instruments as eligible cost during the 2007-2013 programme period

According to the general regulation, the only condition for certifying amounts in the 2007-2013 programme period related to financial instruments as eligible expenditure under the OP was that the amounts concerned must have been used to establish or contribute to funds or holding funds. On that basis, ERDF and ESF contributions are reimbursed from the EU budget to Member States and considered as temporarily absorbed. In other words, there was no requirement to link the contribution from the OP to the capital endowment of an instrument to final recipients. Interest generated by the capital also contributes to the instruments' endowment. It is only at the closure of the OP that the Commission will determine the total eligible expenditure on the basis of the actual amounts of loans, guarantees and equity investments provided to final recipients.

38
This arrangement has created an incentive for Member States to 'park' at least part of the EU's contribution to the OPs in the accounts of the banks and financial intermediaries managing the funds, without it being actually used for its intended purposes (see ***Box 2***).

Box 2

Case study — Excessive endowment of a financial instrument in Italy (Fondo regionale di cogaranzia e controgaranzia per le PMI operanti in Sardegna)

In December 2009, the regional government decided to set up a guarantee fund with a capital endowment of 233 million euro. This corresponded to 14 % of the total budget of the OP for the entire programme period.

The total endowment was intended to guarantee loans of around 2.3 billion euro.

Our audit in 2010 of this Italian guarantee fund found that there had been no market needs analysis which justified such an allocation. Moreover, several other mandatory elements (such as the investment strategy and planning, the description of an exit policy and the winding-up provisions) were not in place when the funding agreement was signed by the regional government and the regional agency implementing the fund.

Only in June 2010 was a business plan finally prepared and approved; however, it was based on unrealistic assumptions.

Our audit also showed that a significant part of the OP's funding committed by the managing authorities in 2007 had not been spent by this point. Allocating a high endowment to the financial instrument made it possible to circumvent the $n + 2$ rule in place at the time, according to which unused funds must be de-committed after 2 years.

By the end of 2014, the managing authority reported that 45 million euro out of a total endowment of 233 million euro had been provided as guarantees to final recipients. This gives a disbursement rate of 19 %.

The guarantees made correspond to loans of 460 million euro.

39
On the other hand, we found one case where the endowment of financial instruments had been reduced to take into account market conditions and projected disbursement rates, which is considered good practice. (see ***Box 3***).

Box 3

Case study — Downward adjustment of the Jeremie fund's endowment in line with changing market needs in Lithuania

A Jeremie (Joint European Resources for Micro to Medium Enterprises) instrument was set up in Lithuania in 2008, and its endowment increased progressively to 210 million euro by the end of 2009. The endowment had been based on an assessment of market needs carried out in September 2007.

However, at a later stage, after analysing the effects of the economic crisis on the Lithuanian economy, the managing authority decided to reduce the fund's endowment. By 2012 the fund's endowment was reduced to 170 million euro and the money returned to the OP.

Out of the reduced fund capital of 170 million euro, 121 million euro had been disbursed by the end of 2014, resulting in a disbursement rate for the Jeremie fund of 71 %, instead of 58 % which would have been the disbursement rate in the absence of the capital reduction. Without this change, the overall disbursement rate for all Lithuanian financial instruments would have been 68 % rather than 75 % (see ***Table 4***).

40
Excessive endowments of financial instruments have a negative impact on management costs and fees, where these are determined on the basis of the capital paid into the fund rather than the fund manager's performance. Oversizing the endowment provides a means of generating income for the fund managers without them actually providing the services expected (see paragraphs 116 to 125).

Particularly low disbursement rates for financial instruments managed by the EIB group

41
Our analysis also showed that the average disbursement rate for the 31 ERDF and ESF instruments manged by the EIB and the EIF was particularly low: 43 % as compared to 60 % for the instruments managed by other fund managers.

Extension of eligibility period for financial instruments in shared management until March 2017 through Commission guidance only

42

The EU contribution corresponding to the unused endowments (i.e. funds not paid or guaranteed to final recipients by the end of the eligibility period) must be returned to the EU budget at closure. Given the low average disbursement rates, the Court already stated in its 2014 annual report that financial instruments could not all be expected to have used the available funds in full by the end of 2015[35].

43

In April 2015, the Commission published revised guidelines on closure which extended the eligibility period for financial instrument-related expenditure from 31 December 2015 until 31 March 2017[36]. The general eligibility period is however established by Article 56(1) of the general regulation. In its 2014 annual report, the Court considered that a legal provision can only be modified by legislation of equal or superior legal value so that the hierarchy of norms is duly respected[37]. Thus it was concluded that a Commission guideline could not alter rules adopted by the legislative procedure of the European Parliament and the Council.

44

Based on our analysis, and making a linear projection of the disbursement in previous years, we estimate that more than 5.0 billion euro of funds allocated to ERDF and ESF instruments would remain unused by the end of 2015 without any extension of the eligibility period. Some 3.9 billion euro of these are contributions from the EU budget to the OPs. Actual figures of the amounts used between January 2015 and March 2017 will be available only by the end of 2017, at the earliest.

Addressed in the 2014-2020 programme period?

45

Because the contributions from the OPs are now made through staggered payments, financial instruments should be more appropriately sized, resulting in improved disbursement rates (see ***Box 4***).

35 Paragraph 6.50 of the 2014 annual report.

36 C(2015) 2771 final of 30 April 2015, 'Annex to the Commission decision amending Decision C(2013) 1573 on the approval of the guidelines on the closure of operational programmes adopted for assistance from the European Regional Development Fund, the European Social Fund and the Cohesion Fund (2007-2013)', p. 7.

37 Paragraph 6.52 of the 2014 annual report.

Box 4

Arrangements for reimbursement of the endowment of ERDF and ESF financial instruments from the EU budget (2014-2020 programme period)

According to Article 41(1) of the CPR, each application for interim payment submitted during the eligibility period may not exceed 25 % of the total amount of programme contributions committed to the financial instrument under the relevant funding agreement. Second, third and subsequent payments are made when certain spending thresholds relating to previous payments are reached.

Market needs were not always properly assessed by managing authorities before funds were allocated to ERDF and ESF financial instruments

46

We also examined whether market needs had been properly assessed before the setting up of financial instruments and the allocation of funds to them. The market needs or *ex ante* assessments should make it possible to understand the needs of the market and what type of support (loans, guarantees or equity investment) is most appropriate to address the identified market gaps. They should also determine the funding needs, and ultimately assess whether the intended policy objective can be achieved best by a financial instrument. This has also been highlighted in our previous special reports and in other studies as a precondition for the success of such instruments[38].

Assessment of market needs was not mandatory for financial instruments during the 2007-2013 programme period

47

During the 2007-2013 programme period, the only explicit regulatory reference to market needs assessments (also referred to as a 'gap assessment') relates to holding funds[39].

38 Special Reports No 8/2015 (paragraph 21), No 2/2012 (paragraph 118) and No 5/2015 (paragraph 27); European Commission and EIB, *Financial instruments: a stock-taking exercise in preparation for the 2014-2020 programme period*, study carried out by Mazars/Ecorys/EPRC, pp. 52, 66, 73.

39 For holding funds, the gap analysis is addressed in Article 44(1)(a) of the implementing regulation: '[…] The funding agreement [between Member State or managing authority and holding fund] shall, where appropriate, take account of the following: (a) as regards financial engineering instruments supporting enterprises, primarily SMEs, including micro-enterprises, the conclusions of an evaluation of gaps between supply of such instruments, and demand for such instruments [...]'.

48

For all other specific funds, until 2009, it was possible to infer an indirect obligation to carry out such an assessment from the need to provide a business plan for each instrument[40]. However, the September 2009 amendments to the legal basis introduced lighter requirements concerning these business plans[41]. Since then, while it is still mandatory to submit a business plan, almost all specific requirements have been removed (such as the targeted enterprises or urban projects, the criteria, the terms and conditions for financing them and the justification for, and intended use of, the contribution from the OP). We consider that the added value of a business plan in the absence of such information is limited.

49

The obligation to perform a market needs assessment also did not exist for the centrally managed financial instruments set up in the 2007-2013 programme period. For the six centrally managed instruments covered in this report, we observed different practices. Even though a legal requirement did not exist, we generally saw that some degree of market needs assessment, such as impact assessments, market analysis studies, public consultation, etc., was performed for all of them.

In nearly half of the cases examined, market needs had been assessed too high

50

In previous special reports, we have already identified significant shortcomings in the robustness of market needs assessments[42]. In particular, assessments of market needs should be based on underlying assumptions which are rational and realistic. Otherwise, the instruments may not address actual market needs, resulting in overcapitalisation of the instrument and/or little or no real impact on the ground.

51

Assessing market needs serves a number of purposes, including the identification of a market failure and determination of the market size. In this regard our overall analysis shows that the assessment of market needs was not sufficiently robust during the 2007-2013 programme period. While the majority of respondents to our survey (82 %) indicated that they had carried out a market needs assessment, this did not prevent oversizing: nearly half of the financial instruments (19 out of 41) managed by those of our respondents which had carried out a market needs assessment still exhibited disbursement rates of less than 50 % of the instruments' total endowment by the end of 2014. Only five instruments (12 %) used their initial endowment in full (see ***Figure 3***).

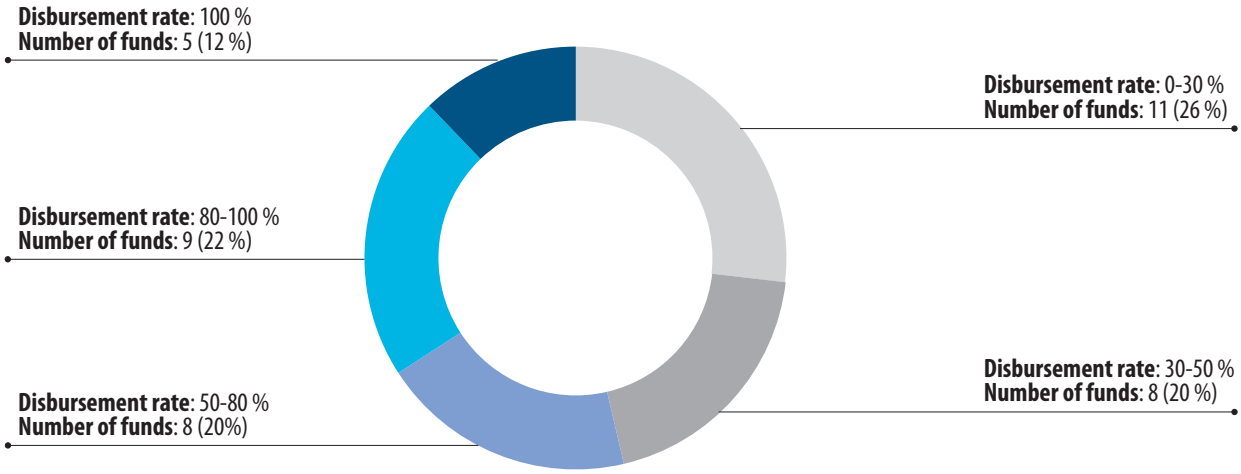
40 Article 43(2) of the implementing regulation, initial version.

41 Article 1 of Commission Regulation (EC) No 846/2009 of 1 September 2009 amending Regulation (EC) No 1828/2006 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 250, 23.9.2009, p. 1).

42 Special Reports No 8/2015 (paragraphs 21 to 22), No 2/2012 (paragraphs 33 to 37 and 116 to 118) and No 5/2015 (paragraphs 27 and 96).

Figure 3

Analysis of disbursement rates for financial instruments indicating in survey that market needs assessment was performed



Note: Survey sent to the managers/managing authorities of the 50 largest ERDF financial instruments; response rate was 80 %.

Source: ECA, based on survey results.

52

In a previous special report we have already pointed out that, during the 2007-2013 programme period, the methodology applied to carry out market needs assessments and the plausibility of the underlying assumptions were not subject to any checks by a body which is independent from the managing authority. This weakness may have contributed to overoptimistic assessments being made by a large number of managing authorities[43].

43 See Special Report No 2/2012, paragraph 118.

Addressed in the 2014-2020 programme period?

53

During the 2014-2020 programme period, a detailed *ex ante* assessment is mandatory for shared management instruments to establish evidence of market failures (or suboptimal investment situations) and to estimate the level and scope of public investment needs. This assessment must also set out the types of financial instrument most suited to the situation. Moreover, the *ex ante* assessment must be submitted to the OP's monitoring committee for information, and its summary findings and conclusions must be published within 3 months of being finalised (see ***Annex V***). However, there is still no requirement to carry out an independent check of the *ex ante* assessment and the plausibility of its underlying assumptions before deciding on the instrument's initial capital endowment.

54

Since the entry into force of the new financial regulation on 1 January 2013, carrying out an *ex ante* evaluation is also mandatory for all new centrally managed instruments (see ***Annex V***). Nevertheless, the *ex ante* assessment includes neither an analysis of the lessons learnt, nor the possibility of review in case of major socioeconomic changes, as is the case for shared management. A mid-term review (which could address such aspects) is undertaken for most, but not all, centrally managed financial instruments.

Regional focus contributed to Member States setting up a large number of small-sized financial instruments in the 2007-2013 programme period

ERDF and ESF financial instruments significantly smaller than centrally managed funds or private investment funds

55

ERDF and ESF OPs are implemented under shared management by national or regional authorities, meaning that financial instruments set up to deliver national or regional programmes are to follow the programmes' demarcations in terms of geography and eligibility. In order to be eligible, projects must be located in a region eligible for the OP from which the financial instrument has received its endowment[44].

44 Article 35 of the general regulation.

56

Within the EU, 952 ERDF and ESF specific funds were set-up during the 2007-2013 programme period (see ***Table 3***). This implies that for most regions several funds were put in place. Our analysis shows that ERDF and, in particular, ESF financial instruments are relatively small. The average EU contribution to an ERDF instrument is 80 million euro for holding funds and 10 million euro for specific funds. The average EU contribution to an ESF instrument is 10 million euro for holding funds and 9 million euro for specific funds. In contrast, by the end of 2014, according to data reported by the Commission, the contribution from the EU budget to the centrally managed funds, which theoretically cover all Member States, was up to 1.2 billion euro. Private equity funds are operating on average with 150-500 million euro.

57

However, implementing funds with a higher capital endowment can result in significant economies of scale and efficiency gains. This is because the overhead costs and the associated risks can be spread over a sufficiently large number of final recipients. In other words, the individual ERDF and ESF specific funds often do not have the size which in the fund industry is considered appropriate to operate them efficiently.

Addressed in the 2014-2020 programme period?

58

During the 2014-2020 programme period Member States enjoy greater flexibility in setting up financial instruments. For instance, OPs may combine one or more complementary investment priorities from the ERDF, the CF and the ESF under a single thematic objective[45].

59

Moreover, the legal prerequisites for establishing instruments with significantly larger capital endowments were introduced[46]. In particular, the possibility of setting up shared management instruments at EU level has been introduced for the 2014-2020 programme period[47] (see ***Box 5***).

45 Article 96(1) of the CPR.

46 Article 38(1) of the CPR.

47 Within this option there is a special case whereby ERDF OPs can contribute to the SME initiative, which is directly managed by the Commission. In this case, specific rules apply, as set in Article 39 of the CPR.

Box 5

Arrangements for setting up financial instruments at EU level (2014-2020 programme period)

Article 38(1)(a) of the CPR makes it possible for a financial contribution to be provided to an instrument set up at Union level, managed directly or indirectly by the Commission, although in principle the '[…] funds [must] be implemented within the framework of shared management between the Member States and the Commission, in accordance with Article 59 of the Financial Regulation […]'.

60

There are also considerable financial incentives for Member States to set up instruments with a larger capital endowment or which extend beyond the regional level. If the entire priority axis of an OP is delivered through a financial instrument, an incentive of a 10 % top-up of the maximum co-financing rate can be applied. If a separate priority axis is set up to be delivered through a financial instrument at EU level and managed directly or indirectly by the Commission, the axis qualifies for a 100 % co-financing rate[48].

61

The Commission and the Member States should use the possibilities provided by the legal basis to set up larger specific ERDF and ESF financial instruments, wherever possible, in order to take advantage of the significant economies in the cost of operating these instruments. However, with more regions and bodies involved, the legal structure may be more complex, which in turn could mean new risks of delay that need to be considered by Member States when designing the most appropriate funding structure. The 2007-2013 regulatory basis already allowed for contributions from more than one programme to the same financial instrument[49]. However, such constructions have not proven popular to date due to their perceived additional complexity. Based on the responses to our survey, additional Commission guidance on how to set up EU-level instruments during the 2014-2020 period is needed.

48 Articles 120(5) and 120(7) of the CPR.

49 Commission, COCOF (10-0014-05), note on financial engineering instruments under Article 44 of the general regulation.

Did financial instruments succeed in attracting private capital?

62

One of the key advantages of financial instruments is the fact that additional funds can be leveraged, i.e. additional private and public funds can contribute to the funds' capital endowment. The leverage effect measures the extent to which public financing mobilises additional funds. It should inform about the ability of an instrument to attract additional funding, depending on its type, location and final recipients, but also on the choices made by the Commission, the managing authority and/or the fund manager when setting up the instrument. For comparable instruments, a higher leverage would then indicate a better-performing instrument in terms of attracting additional funding.

63

We therefore reviewed the way in which the Commission defines and monitors this leverage effect for both shared and centrally managed instruments and assessed whether the instruments were successful in attracting additional private capital. We also analysed the use made of preferential and risk-sharing arrangements with private partners and of tax agreements in this regard.

Commission's measure of leverage for financial instruments does not properly take into account the extent to which public financing mobilises additional funds

Need for more differentiated leverage ratios to obtain meaningful measurements

Difficulties in identifying leverage of additional private and public capital for shared management instruments

64

The 2007-2013 legislation did not specify how leverage should be measured for instruments in shared management. In 2011, the Commission took the first steps towards addressing this issue by suggesting a first definition of the 'leverage effect', and 2 years later in the financial regulation (see ***Box 6***).

Box 6

Definition of 'leverage effect' for financial instruments in shared and central management

In August 2011, in its common audit framework, the Commission provided a definition of the leverage as the '[…] additional resources made available down to the level of final recipients — beyond Structural Funds contribution usually by financial instruments and other private or public investors'[50]. According to this definition (which is however not legally binding), the leverage corresponds to the total financial support provided to final recipients (covering all resources invested in final recipients, irrespective of whether they are part of the OP, or whether they are additional private or public funds) divided by the EU contribution to the instrument (via the OP).

For centrally managed instruments, leverage has been defined in the financial regulation since 2013 as '[…] the amount of finance to eligible final recipients divided by the amount of the Union contribution.'[51]

50 European Commission, Directorate-General for Regional and Urban Policy, 'Common audit framework', July 2011 (Part 2), p. 7.

51 Article 223 of the rules of application of the financial regulation.

65

We consider, however, that counting all public national funding as leveraged amounts, as proposed by the Commission in the case of shared management instruments, is inappropriate: the co-financing rates are already specified at the level of the OP's priority axis, and the national contribution to the financial instruments' endowments generally remains within these rates. In that sense, there is no distinction between the 'normal' national co-financing and an 'additional' national contribution (which goes above the OP rates). However, only the latter could be considered as having been attracted by the EU contribution. We have already noted in a previous report that the Commission's practice of excluding national public funding through the OPs from the denominator leads to an artificial increase in the measured leverage rate[52].

52 Special Report No 2/2012, ***Box 5***.

66

Moreover, the leverage should serve as an indicator for the performance of a financial instrument in terms of attracting additional private or public funds (again, above those already considered for the OP as a whole). Obviously, an assessment of performance needs to take account of the differences in implementing such an instrument. In particular, the risk sharing and preferential arrangements for private-sector partners play a determining role in this (see paragraphs 74 to 78). Moreover, the leverage rate should also vary between different types of financial support (for example, for guarantees the leverage should be higher than for loans), between types of investment (for riskier investments, it should be lower), between the development stages of final recipients supported (for example, start-up companies are more risky) and between geographical markets (for example, lower in less developed regions).

67

In its current form, the Commission's 'leverage effect' calculation cannot provide a reliable indication of actual performance in attracting additional private or public funds. It therefore does not allow a distinction to be made between successful and less-successful financial instruments in attracting additional private or public contributions to the instrument's capital endowment.

Inconsistent measurement of leverage for centrally managed instruments

68

For centrally managed financial instruments, our analysis shows that the Commission uses various ways to calculate the leverage effect for different instruments, as illustrated in ***Table 5***[53].

69

As a result, the leverage ratios reported by the Commission for centrally managed instruments are not comparable between themselves, and also not comparable with those for shared management instruments.

53 SWD(2015) 206 final.

Table 5

Leverage effect for centrally managed financial instruments as reported by the Commission

Instrument	Type of instrument	Method of calculation	Leverage ratio as of 31 December 2014
LGTT	Guarantee	Total amount of finance attracted by the project divided by the EU contribution paid to the facility	57
PBI	Guarantee	Similar to the LGTT	9
EEEF	Equity	Total amount of finance attracted at fund level divided by the EU contribution	2
Marguerite Fund	Equity	Total amount of finance mobilised by the instrument (both equity and debt) at the project level divided by the EU contribution paid	157
EPMF Guarantee Facility	Guarantee	Value of new microloans supported by the guarantee divided by the guarantee cap	7
EPMF FCP-FIS	Loans	Value of new microloans supported by the guarantee divided by the EU contribution paid	2

Source: ECA, based on 2015 Commission data[1].

1 SWD(2015) 206 final.

Not only sources of finances which are the result of the EU and/or national contribution to the financial instrument are taken into account

70

Not all sources of finances attracted by a project are the result of the EU and/or national contribution. However, no attention is paid to this in the Commission's calculation of the 'leverage ratio'. In 2015, the OECD's Development Assistance Committee has proposed an alternative methodology, with calculations depending on the type of instrument (loans, guarantees or equity)[54]. The differences between these two approaches are illustrated in the example in ***Box 7***.

54 OECD, 'Methodologies to measure amounts mobilised from the private sector by official development finance interventions', DCD/DAC/STAT(2015)8, 24 February 2015.

Box 7

Example of a financing structure for a transport project and the differences in the calculation of leverage according to the Commission and OECD methodology

This revenue-generating transport infrastructure project, a high-speed railway line in France, received contributions from multiple funding sources, of which the national grants accounted for 52 % and the commercial debt for 39 %. The EU contribution, in form of a guarantee for up to 200 million euro of the commercial debt, accounts for 2.5 % of the total funding.

In this example, based on the OECD methodology, the leverage effect would however be only 1, as there is only one loan of 200 million euro guaranteed by the EU in the project financing structure.

Types of funding sources	million euro	% of total financing
Commercial debt	3 038	39 %
National grants	4 050	52 %
Equity	758	9 %
Total financing	**7 846**	**100 %**
Maximum EU guarantee on the commercial debt	200	2.5 %

According to the Commission's methodology, the leverage effect is 39 (total financing of 7 846 million euro divided by the EU guarantee of 200 million euro).

We consider that it is unrealistic to assume that the national grants, accounting for the largest part of the project financing, were triggered by the limited EU guarantee. This issue affects the Commission's reporting on financial instruments in both central and shared management, although it is more visible for centrally managed financial instruments, as private co-investment is involved to a lower extent in projects under shared management.

Addressed in the 2014-2020 programme period?

71

For the 2014-2020 programme period, as regards instruments in shared management, the CPR does not explicitly refer to the definition of the leverage effect in the EU's financial regulation. However, the concept defined in Article 37(2)(c) of the CPR is essentially identical: '[…] 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)'. The Commission therefore continues to consider national co-financing as leveraged by the EU's funding of the OP. There are also no changes to the way in which the amounts mobilised from the private sector are to be measured. In our view the Commission should reconsider its methods of calculating the leverage effect of EU and national public funding through financial instruments, taking into account the alternative methodology proposed by the OECD in 2015.

72

We also note that Member States are now required to specify each instrument's 'expected leverage effects' (see ***Box 8***). These elements will provide the Commission with data to monitor how actual leverage compares with the target leverage rate. However, in the absence of a consistent Commission methodology on how to calculate the leverage effect, it is doubtful that this exercise will result in meaningful data which could be used for comparisons.

Box 8

'Expected leverage rates' to be specified for each financial instrument (2014-2020 programme period)

The compulsory *ex ante* assessment for financial instruments must include an estimate of additional public and private resources that may be generated by the financial instruments at all levels down to the final recipient. The funding agreement between a managing authority and a 'fund of funds' (or the strategy document, where the managing authority implements the fund directly) must specify this 'expected leverage effect' of the instrument.

Each year, the managing authority is required to provide an annex to the annual implementation report on operations comprising financial instruments[55].

55 Annex I to Commission Implementing Regulation (EU) No 821/2014 of 28 July 2014 laying down rules for the application of Regulation (EU) No 1303/2013 of the European Parliament and of the Council as regards detailed arrangements for the transfer and management of programme contributions, the reporting on financial instruments, technical characteristics of information and communication measures for operations and the system to record and store data (OJ L 223, 29.7.2014, p. 7) establishes numerous sections to be used as the basis for this reporting, which includes information about the sources of financial instruments' funding.

Difficulties of attracting private-sector investors to financial instruments in both shared and central management

73

One of the stated aims of financial instruments is to attract additional private-sector funding to complement the available public funds since it allows more projects to benefit from the same level of public investment. We have therefore sought to determine for both shared management and centrally managed instruments the extent to which additional private financing has been effectively mobilised by public contributions to the instruments.

Specific arrangements for private investors in financial instruments during the 2007-2013 programme period did not succeed in attracting significant additional financing

74

Our interviews and literature review confirm that during the 2007-2013 programme period the private sector remained reluctant to invest in financial instruments since these instruments were considered to be too strictly regulated (e.g. specific EU and national regulations, State aid, public procurement). It should be recalled that the goals of the two parties differ: while the public sector aims to implement specific policy and investment objectives, the private sector must be oriented towards profitable activities. Moreover, there may be a lack of knowledge on both sides. The public sector is not necessarily equipped with advanced financial background, while the private sector is not necessarily familiar with EU legislation. The Commission considers that one of the ways to attract private capital is to offer preferential treatment and/or 'risk premiums' to private investors. We therefore examined the specific arrangements for private-sector investors to see whether risks were shared between the public and private in a reasonable manner.

Lack of Commission guidance on how to set out arrangements on preferential treatment for ERDF and ESF instruments

75

For the 2007-2013 ERDF and ESF instruments, the legislation provided a possibility for returns on investments to be allocated preferentially to investors operating under the market economy investor principle[56]. Preferential treatment may be exercised, for example, through contracts that do not grant the public funding partner the same repayment rights as private partners, or through an unequal share in profit and loss between private and public partners.

76

Preferential treatment can be justified if it is needed to attract private investment in failing markets, where private funding can contribute to the achievement of public policy objectives. If unjustified, preferential treatment may result in a drain on the initial capital endowment of the financial instrument and thus reduce the legacy funding available for the next investment cycle after the instrument is wound up. However, neither the legal basis for the 2007-2013 programme period nor the Commission's guidance notes provide any indication as to how risk-sharing arrangements should be set out in the funding agreement or how the appropriateness of preferential treatment is to be checked.

Despite Commission assuming higher risks, only limited private contributions to the capital of centrally managed instruments

77

As a general practice, for centrally managed instruments, the governing legislation approved by the European Parliament and the Council includes only general terms in relation to the risk sharing and/or preferential treatment. The detailed arrangements related to the Commission's contribution in these instruments (including the risk-sharing percentages) come only later as part of a separate agreement which does not need to be approved by the budgetary authority (see ***Box 9***).

56 Article 43(5) of the implementing regulation.

Box 9

Risk sharing between the Commission and its partners — case study of the Loan Guarantee Instrument (LGTT) and the Project Bond Initiative (PBI)

The LGTT was jointly established in 2008 by the Commission and the EIB through a cooperation agreement, with each party bearing 50 % of the loan default risk (expected and unexpected losses).

The instrument provides a guarantee in the form of a contingent credit line, which may be drawn upon by the project provider during the first 5 to 7 years of operation, if the revenues generated by a project are not sufficient to ensure repayment of the senior debt (i.e. in case the actual revenues from the project fall below the forecasted level).

As a result of a change in the legal basis, a first loss portfolio approach was introduced in 2013, leading to the risk taken by the Commission of 95 % of the losses on the portfolio first loss piece (PFLP).

In the 2012 amendment to Regulation (EC) No 680/2007, the PBI was introduced as a new instrument. The PBI provides credit enhancement in the form of a subordinated instrument — either a loan or contingent facility — to support senior project bonds issued by a project company. The risk-sharing arrangements between the Commission and the EIB are the same as for LGTT, i.e. the Commission takes 95 % of the losses whereas the EIB bears the risk for the remaining 5 %.

The PFLP for the LGTT/PBI portfolio was set at such a level that it is unlikely that actual losses would go beyond the PFLP. As a consequence, the Commission effectively bears the largest part of the effective risk.

The legal basis provides that the risk sharing will be based 'on a first-loss basis', but it does not provide any details on the way the PFLP should be determined or on the level of risk exposure resulting from this approach. A Commission staff working paper[57] states that the first-loss percentage would 'typically be set at just above the historical average loss'. The EIB however determined the ceiling in such a way that its expected net risk exposure remained within its standard risk (less than 2 % of the expected loss) and not on historic data.

57 SEC(2011) 1237 final of 19 October 2011, 'Commission staff working paper — Impact assessment accompanying the document "Communication from the Commission to the European Parliament, the Council, the European Economic and Social committee and the Committee of the Regions — A pilot for the Europe 2020 Project Bond Initiative"',p. 53.

78

For some centrally managed financial instruments, we found that nearly all effective risks are shifted to the Commission (see ***Box 10***). However, despite the Commission taking more risk than its partners in this type of instrument, our analysis shows that there was no significant private-sector contribution to them.

Box 10

Case study — Risk sharing between the Commission and its partners — EEEF

The EEEF invests in energy efficiency, renewable energy projects and clean urban transport. Its shareholders are the Commission, the EIB and two banks. The EEEF is organised as a public limited liability company and its shares are divided in three classes (A, B and C) depending on the risk taken and the rights to returns, with class A being the most advantageous and class C being the least.

The Commission is the only shareholder of class C shares, the first to bear losses and the last to benefit from gains. Its shares will be redeemed upon maturity. The redemption is subject to the availability of sufficient cash in the fund.

The company's losses are first allocated to the Commission. These losses do not affect the value of class A and B shares, as long as the value of class C shares is still positive. Only after the value of class C shares is reduced to zero will losses be allocated to class A and B shares. Future income and gains do not necessarily lead to write-backs of the class C shares since they would first be used for the target dividends of class A and class B shares.

Moreover, the C class shares cannot be redeemed before the other two classes.

Tax rulings used in some cases to make financial instruments more attractive for private-sector investors

79

A tax ruling is a written decision by a national tax authority on how a particular aspect of an entity's activities is treated under the applicable tax law of that Member State. Such a procedure can be used in several EU Member States to obtain certainty on how activities will be taxed. Generally, individuals or undertakings subject to taxation submit their interpretation of how the tax law applies to them or to a particular transaction or activity, and the tax authority responds with a positive or negative decision. Such tax agreements are also standard practice in the fund industry. While tax rulings can be perfectly legitimate, and they are used in a number of jurisdictions, they have also been used to facilitate aggressive tax planning.

80

Already in 2012 the Commission had issued a recommendation on aggressive tax planning addressed to the Member States[58]. In essence, Member States are encouraged to change their national legislation in order to address '[…] artificial arrangements' and '[…] treat these arrangements for tax purposes by reference to their economic substance'. This has been followed by a series of specific measures in this regard.

- Since 2014, the Commission has opened several investigations to examine whether decisions of tax authorities in the Member States with regard to the corporate income tax to be paid by corporations comply with the EU rules on State aid[59].
- In March 2015, the Commission presented a package of measures to boost tax transparency and to introduce the automatic exchange of information between Member States on their tax rulings[60].
- In June 2015, the Commission adopted an action plan for fair and efficient corporate taxation in the EU[61]. This document discusses, among a number of taxation topics, measures to combat tax avoidance and aggressive tax planning.

81

However, we identified financial instruments for which tax rulings have been obtained (see ***Box 11***).

58 Commission recommendation of 6 December 2012 on aggressive tax planning, C(2012) 8806.

59 See for instance IP/14/663 — Press release of 11 June 2014.

60 COM(2015) 135 final of 18 March 2015, 'Proposal for a Council directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation'.

61 COM(2015) 302 final of 17 June 2015, 'A fair and efficient corporate tax system in the European Union: 5 key areas for action'.

Box 11

Case study — Tax rulings for financial instruments in central management — the Marguerite Fund

In 2013, the Marguerite Fund obtained a Luxembourg advance tax agreement (commonly known as a 'tax ruling') and an advance pricing agreement for Marguerite Holdings and its Luxembourg subsidiaries. The latter is an agreement between a taxpayer and the tax authorities specifying the pricing method that the taxpayer will apply to its related-company transactions.

The specific structure employed by the Marguerite Fund results in a situation whereby withholding tax on dividend payments from holding companies to the fund itself is reduced, by transforming dividend payments into interest payments by using hybrid instruments between the Luxembourg entities[62]. It is also possible that other taxes, such as withholding taxes in the countries of the operating companies or capital gains taxes at the time of divestment, are avoided through the use of this structure.

62 Hybrid instruments are instruments which can be treated differently for tax purposes within and/or across jurisdictions, for example as debt in one country and as equity in another country (see OECD, *Hybrid mismatch arrangements: Tax policy and compliance issues*, March 2012, p. 7).

82

We also note that a number of 2007-2013 ERDF and ESF instruments used SICAV[63] or SICAR[64] entities in their set-up structures. For these structures, tax rulings are common practice. Member States, however, do not report to the Commission whether their instruments made or will make use of advance tax agreements.

Private contributions to the capital endowment of ERDF and ESF financial instruments account for around 2 % of the total

83

In previous reports we noted that the private-sector leverage rate was limited during the 2007-2013 programme period[65]. According to the latest data reported by Member States to the Commission, only 154 out of 1 025 ERDF and ESF financial instruments in 11 Member States attracted private funding in their financing structure as part of the OP contribution.

84

For the private funds contributed through OPs which are reported by the Member States there is also a risk of double counting, since it is possible that the private funding presented at the level of the specific funds is simply a transfer of funds made by the holding fund. If the analysis is restricted to holding funds only, thus eliminating the risk of double counting, only nine out of the 73 existing holding funds in four of the 18 Member States where such funds exist benefited from private contributions. For these nine holding funds the share of private funding in the instrument's endowment varies from 5 % to 50 %. Overall, 325 million euro in private capital was attracted to holding funds through OPs. At the same time we note that, irrespective of the information reported, there is a legal obligation stemming from State aid rules for the equity investments in SMEs to have a minimum level of private co-financing of 30 % or 50 % depending on the region[66].

85

Moreover, based on the information provided by 11 Member States on a voluntary basis, the resources paid to financial instruments in addition to those from the OPs (private or public) amount to 342 million euro[67]. Member States are, however, not required to provide such information, and the data reported on a voluntary basis are also not verified by the Commission.

63 A SICAV is a type of open-ended investment fund for which the value of its capital changes based the number of investors and on the value of its underlying investments. Shares in the fund are bought and sold based on the fund's latest net asset value.

64 A SICAR is a structure designed for private equity and venture capital investments with no investment diversification rules, nor lending or leverage restrictions.

65 See Special Reports No 2/2012 (paragraphs 105 to 115 and 124), No 8/2015 (paragraphs 34 to 35), No 5/2015 (paragraphs 66 to 67 and Box 7).

66 Community guidelines on State aid to promote risk capital investments in small and medium-sized enterprises, paragraph 4.3.4 (OJ C 194, 18.8.2006, p. 2).

67 European Commission, '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 — Programme period 2007-2013— Situation as at 31 December 2014', p. 25.

86

We also note that the legislation for the 2007-2013 programme period did not stipulate that funding agreements between managing authorities and fund managers should specify expected leverage rates for additional private contributions. Moreover, fees were generally not linked to the fund managers' success in attracting private investors (see paragraph 136)[68]. Hence, there was little incentive for the fund manager to get private investors on board.

68 Article 43(4) of the implementing regulation.

87

For centrally managed instruments, and in particular for equity financial instruments, attracting private-sector investments as contributors has proven to be difficult, as illustrated by the case studies in ***Box 12***.

Box 12

Case study — Difficulties of attracting private-sector investors in publicly funded equity instruments — Marguerite Fund and EEEF

Examples of limited private co-financing for two centrally managed instruments are provided below[69].

- In addition to the Commisson, the Marguerite Fund has eight sponsors, all of them publicly controlled banks. These sponsors have committed a total amount of 710 million euro. No money from private investors has yet been attracted to reach the target of 1.5 billion euro in total commitments[70].

- The EEEF has also relied mainly on public funds, the Commission being its largest contributor so far (125 million euro out of total 265 million euro committed). The only private contributor — Deutsche Bank — has made only a limited commitment to the instrument (5 million euro). The total amount committed at this stage is less than half of the instrument's target (700 million euro).

69 SWD(2015) 206 final.

70 Commission Decision of 25 February 2010 on European Union participation in the 2020 European Fund for Energy, Climate Change and Infrastructure (the Marguerite Fund), C(2010) 941.

Addressed in the 2014-2020 programme period?

88

For instruments under shared management, the provisions in the legislation for the 2014-2020 programme period continue to allow preferential treatment, but also ask for risk to be shared appropriately between the public and the private partners (see ***Box 13***).

Box 13

Provisions in relation to preferential treatment and risk sharing (2014-2020 programme period)

Article 44 of the CPR requires an '[…] appropriate sharing of risk and profit' between public and private investors, and the delegated regulation stipulates that the level of preferential treatment should be proportionate to the risks taken by investors, and be limited to the minimum necessary to attract them'[71]. In particular, in the *ex ante* assessment, the Member State must include '[…] 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 […]'[72].

This preferential remuneration may be financed through resources paid back to the instrument, or from gains and other earnings or yields attributable to the support from the EU funds. The concept of preferential treatment also applies to public investors operating under the market economy principle[73].

Moreover, we note that for cases falling under the GBER 'in the case of asymmetric loss-sharing between public and private investors, the first loss assumed by the public investor shall be capped at 25 % of the total investment'[74].

Otherwise it has to be conform with market conditions or undergo a State aid notification process.

71 Article 6(1)(d) of Commission Delegated Regulation (EU) No 480/2014.

72 Article 37(2)(c) of the CPR.

73 Article 44(1) of the CPR.

74 Article 21(13)(c) of Commission Regulation (EU) No 651/2014.

89

The obligation for Member States to assess the need for preferential treatment and the risk-sharing arrangements, and to provide some justification for these arrangements, can clearly be regarded as progress towards the more efficient management of financial instruments. Based on our interviews, we consider however that there is a need for the Commission to provide guidance to Member States on how best to use preferential treatment to attract more private capital while not allocating excessive risk to the public contributors to the instruments' endowments.

90

For some of the centrally managed instruments, the possible extent of risk sharing between the Commission and its partners has also been addressed in the legislation. Here, the regulation specifies that the '[…] risk-sharing pattern [must] be reflected in an appropriate sharing between the Union and the entrusted entity', while '[…] the maximum risk covered by the Union budget [must] not exceed 50 % of the risk of the target debt portfolio under the debt instrument'[75]. It remains to be seen whether these modified provisions will be sufficient to attract more private-sector contributions than in the 2007-2013 programme period. As mentioned already in a previous report, we consider that the main aspects of the risk-sharing arrangements between the Commission and its partners (e.g. the EIB) should be defined in the specific legislation for each centrally managed instrument[76].

91

Finally, as regards tax rulings, the situation remains unchanged from the 2007-2013 programme period. We consider that the continued use of advance tax agreements during the 2014-2020 programme period for centrally managed and/or shared management financial instruments could pose a reputational risk since they may be perceived to go against the Commission's own recommendations and actions concerning tax arrangements.

75 Annex I to the CEF regulation, Part III, Section 6.

76 See Special Report No 2/2013, recommendation 7.

Were financial instruments providing revolving financial support?

92

One of the main reasons for using public funds through financial instruments is the fact that the money can be used multiple times: it can 'revolve'. For instance, if a disbursed loan was repaid after 3 years, the cash could then be used to provide a new loan. We therefore examined whether this revolving effect had actually materialised. The extent to which funds can revolve in practice depends on the type of financial support, but also on the instruments' investment period. We therefore analysed whether the instrument's investment periods correspond to normal market practice and what factors contributed to limiting the instruments' actual investment period.

Delays in the implementation significantly shortened the actual investment period of several ERDF and ESF financial instruments

93

At the start of the 2007-2013 programme period, public authorities in most Member States had only limited experience of structuring and running revolving instruments in partnership with financial intermediaries. Following our audits, we have noted that most delays were caused by the time-consuming internal structuring of financial instruments, lengthy negotiations with financial intermediaries at various levels (often due to negotiations of management costs and fees), complex public procurement procedures, uncertainty about compliance with State aid rules and difficulties in obtaining private-sector contributions.

94

In many cases the various bodies involved experienced a steep learning curve, and it took a good deal of time to reconcile the interests and views of numerous stakeholders in order to reach agreement on the instrument's investment strategies. Several of these issues were also identified by other studies[77]. Our audits over the last years also indicate that more and earlier Commission guidance could have prevented these problems at least in part.

77 European Parliament, Directorate General for Internal Policies, *Financial instruments under cohesion policy 2007-13: How have Member States and selected financial institutions respected and preserved eu financial interests?*, p. 16; Commission and EIB, *Financial instruments: a stock-taking exercise in preparation for the 2014-2020 programme period*, study carried out by Mazars/Ecorys/EPRC, p. 62.

95
The low disbursement rates in many Member States and, as a consequence, the limited capacity of instruments to revolve funds are an obvious result of these difficulties. In some cases, delays in implementation lasted several years, thus significantly reducing the time period during which the financial instrument's endowment could then be disbursed to final recipients (see ***Box 14***).

Box 14

Case study — Delays in setting up the Jeremie holding fund in Slovakia

The memorandum of understanding between the EIF and the Slovak government for the national Jeremie holding fund was signed in 2006, i.e. before the start of the 2007-2013 programme period. After the funds' market needs analysis ('gap analysis') was conducted, a framework agreement was signed in 2008, and the funding agreements between the various ministries and the EIF in 2009.

It then took another year before the two final agreements were signed (holding fund agreement and shareholders' agreement), which are also legal preconditions for starting the actual operation of the fund. The capitalisation of the holding fund itself finally took place in 2011. Overall, it therefore took 5 years (2006 to 2011) until the Jeremie holding fund was operational.

Calls for expression of interest for hiring financial intermediaries were launched in 2011, 2012 and 2013. It then took another 2 to 3 years until the agreements with the financial intermediaries were concluded in 2013 (for the guarantee instrument) and 2014 (for the loan and the equity instruments). Only then did the financial support to final recipients start to flow.

The disbursement rate at the end of 2014 was 12 % at the holding fund level, and even lower as regards the disbursements to final recipients from the sub-funds.

Limited revolving effect of ERDF and ESF financial instruments during implementation and uncertain after closure of the 2007-2013 programmes

Less than a third of all ERDF and ESF financial instruments had used their funds more than once by the end of 2014

96

Overall, our analysis showed that there are 316 ERDF and ESF instruments (in the vast majority specific funds) in 19 Member States which had managed to disburse their full endowment to final recipients by 31 December 2014. However, even for these instruments, the revolving effect came very late in the programme period. As a result, only a limited share of the initial endowment will be used more than once until the end of the extended eligibility period (i.e. March 2017). Moreover, the aggregated disbursement rate did not reach 100 % in any of the 25 Member States' implementing financial instruments (see ***Table 4***).

Time constraints caused particular problems for equity instruments

97

Our analysis also shows that equity instruments experienced particular problems to attain a revolving effect. In Europe the average holding period for equity investments (e.g. the time between the acquisition and the sale of shares) was around six years in 2014[78]. Most of ERDF and ESF equity instruments were however operational for no more than eight years (2009 to 2017). Even if, for instance, operations began at the beginning of 2009 and the exit took place at the end of 2014, there would be only less than three years left before the OP closure to make a new round of equity investments. Therefore, after taking into account the years needed to set up the instrument, it is unlikely that OP contributions to equity instruments will be used again within a programme period.

98

By contrast, centrally managed equity instruments have much longer durations, better reflecting the nature of equity instruments[79] (e.g. Marguerite Fund has a term of 20 years with the possibility of a two years extension).

78 Preqin, *Private Equity Spotlight*, May 2015, p. 8.

79 SWD(2015) 206 final, pp. 51 and 159.

The high degree of discretion in the reutilisation of funds for ERDF and ESF financial instruments may cause the revolving effect to disappear once OPs are closed

99

The 2007-2013 legal framework for the shared management financial instruments stipulates that any resources used at least once by the time of closure can be kept by the Member State, but must be reused for the benefit of the target group[80]. The Commission guidance notes on financial instruments[81] and on the closure of the 2007-2013 OPs[82] suggest that resources from the ERDF and ESF instruments ought to be reinvested indefinitely.

100

We consider however that the 2007-2013 general regulation in relation to indefinite reinvestments cannot be interpreted in this way[83]. For example, the provisions also allow the instrument's capital to be reduced and resources of financial instruments to be used in the form of grants. Moreover, legally speaking, any activity after the closure of the programmes which does not concern the EU budget is the exclusive responsibility of the Member State and no longer subject to Commission supervision, unless provided otherwise in the legal base.

Addressed in the 2014-2020 programme period?

101

For the 2014-2020 programme period, a number of issues regarding the reutilisation of funds for ESIF instruments after the end of the eligibility period in 2023 have been clarified in Articles 44 and 45 of the CPR.

102

Moreover, the legislation governing the 2014-2020 programme period explicitly recognises the intended revolving nature of financial instruments after the eligibility period by including provisions for the reuse of resources paid back during a period of at least 8 years after end of the eligibility period[84]. Through this provision, the CPR sets a minimum period for earmarking the funds allocated to financial instruments, but provides no further details on how this should be done. In our view, the Commission should clarify this aspect.

80 Article 78(7) of the general regulation.

81 European Commission, 'Revised guidance note on financial engineering instruments under Article 44 of Council Regulation (EC) No 1083/2006', COCOF(10-0014-05), 10 February 2012, paragraph 5.2.5.

82 C(2015) 2771 of 30 April 2015, 'Annex to the Commission decision amending Decision C(2013) 1573 on the approval of the guidelines on the closure of operational programmes adopted for assistance from the European Regional Development Fund, the European Social Fund and the Cohesion Fund (2007-2013)', p. 7.

83 Article 108 the general regulation in connection with Articles 152(1) and 153 CPR.

84 Article 45 of the CPR.

103

A critical factor for avoiding the mistakes of the past is standardisation: the option for managing authorities to design financial instruments in accordance with standard terms and conditions laid down by the Commission should significantly streamline and facilitate the set-up process.

104

The legal basis for the 2014-2020 programme period also allows financial instruments to continue to be used during the following programme period, rather than requiring that they be wound up and replaced with new ones[85]. This may save both time and money, since the financial instruments are ready and operational at the start of the programme period and the endowment of the instrument could be increased in accordance with the *ex ante* needs assessment. However, in cases where the fund manager was chosen through an open competitive procedure, time savings may be limited, since a new open procedure would be needed in any case to select the new fund manager. Based on the responses to our survey (see ***Box 15***), additional Commission guidance on how to transfer instruments to the 2014-2020 would be most welcome by fund managers.

85 Article 38(3)(b) of the CPR.

Box 15

Survey responses: issues for which additional Commission guidance is needed (2014-2020 programme period)

Issue	Response rate[1]
Transfer of instruments set up in the previous programme period to the new one (2014-2020)	27 %
Exit policy and winding-up provision	21 %
Rules to be applied in relation to the selection of fund managers	18 %
Reuse of funds returned to the financial instrument after the end of the eligibility period	17 %
Setting up instruments at EU level	9 %
Other	8 %

1 Survey sent to the managers/managing authorities of the 50 largest ERDF instruments, response rate was 80 %.

Source: ECA.

105

Finally, during the 2007-2013 programme period, the Commission started to organise a range of presentations and workshops to spread 'good practices' and to train Member State officials. In January 2015, one year after the start of the 2014-2020 programme period, the Commission also launched a technical advisory platform (https://www.fi-compass.eu) to disseminate expertise about the EU's legal requirements concerning financial instruments.

Did financial instruments prove to be a cost-efficient method to implement the EU budget?

106

Financial instruments, unlike the traditional grants, are managed by fund managers (rather than public administrations). These are generally financial intermediaries, such as private or state owned banks. Managing financial instruments comes at a cost, and fund managers are entitled to be remunerated for their services rendered. The level of management costs (reimbursed against evidence of expenditure) and fees (agreed price or compensation for services rendered) for the fund manager are generally set out in the funding agreement for each of the financial instruments. The remuneration should cover the administration costs of the financial instrument (including expenses for investor relations, legal expenses and expenses for auditors) and, in the case of private-sector fund managers, allow for a profit margin. They should vary between different financial products (i.e. guarantees, loans or equity) and their level should be related to objective criteria (e.g. a large number of small loans usually involve higher administrative costs than a small number of large loans).

107

Based on the most recent data reported by Member States to the Commission, we have analysed the level of actual management costs and fees for both shared management and centrally managed instruments during the 2007-2013 programme period and examined whether they were sufficiently linked to the fund manager's performance. Moreover, as regards the 2014-2020 programme period, we have assessed whether the increased share of funding allocated to financial instruments (and therefore generally not managed by national or regional administrations) has been reflected in setting the level of technical assistance which is paid to Member States for implementing the ESIF.

High level of management costs and fees compared to actual level of disbursement to final recipients

Cumulative management costs exceeding actual disbursements to final recipients for around 2 % of the instruments

108

For some instruments, the management costs and fees even exceeded the actual amounts disbursed to final recipients. Our analysis of the 1 025 ERDF and ESF financial instruments identified 23 such cases (2.2 %) in 8 Member States (Bulgaria, Czech Republic, Germany, Spain, France, Italy, Poland, United Kingdom). Taken together, these instruments charged 28 million euro in management costs and fees in order to disburse 4 million euro to final recipients. At the same time, there are similar instruments where no management costs or fees at all are paid to financial intermediaries (see ***Box 16***).

Box 16

Case study — Fund managers implementing financial instruments free of charge — Entrepreneurship Fund in Greece and Jeremie holding fund in Hungary

(a) Entrepreneurship Fund in Greece

The Entrepreneurship Fund in Greece does not pay management costs and fees to the banks acting as financial intermediaries. Instead the fund and the banks co-finance the loans provided to final recipients. They share the risk of loan default as well. The primary motivation of the banks to take part in the instrument is risk sharing. Therefore they participate in the instrument without charging any management costs and fees.

(b) Jeremie Hungary

Jeremie Hungary does not pay any management cost and fees to financial intermediaries for loan instruments either. Instead loans to financial intermediaries are provided at a very low interest rate compared to the market. The very low interest rate does not represent remuneration of the fund manager as it is counterbalanced by the higher risk the financial intermediaries assume compared to the EU-financed fund. In case the loans default, the financial intermediaries generally assume the highest part of the loss.

Cumulative management costs and fees reach up to 75 % of the financial support disbursed to final recipients

109

We have furthermore carried out our own analysis of the Commission's data whereby we put the management costs and fees in relation to the amounts effectively paid to final recipients. Our results, at Member State level, are presented in ***Table 6***.

110

For 274 of the 1 025 ERDF and ESF instruments in 10 of the 25 Member States (Sweden, Austria, Latvia, Malta, Finland, Lithuania, Romania, Greece, Hungary, Cyprus), we found that the data on management costs and fees reported to the Commission was comprehensive for all financial instruments. For another six Member States (Poland, Portugal, Germany, Slovakia, Bulgaria and the United Kingdom) such information was provided for 392 financial instruments representing 84 % to 98 % of the total capital endowment to financial instruments. For all other Member States plausible information on management costs and fees was reported for instruments representing two thirds or less of the total endowment[86]. For a number of financial instruments data was either not reported at all or was not plausible (such as reported management costs and fees which were 10 times higher than the actual amount disbursed). Moreover, when management costs and fees were reported as 'zero' it could be that this was actually the case, or that the data were not reported. These data were eliminated from our further analysis.

86 Slovenia (66 %), Spain (63 %), France (37 %), Italy (28 %), Denmark (18 %), Czech Republic (16 %), Netherlands (10 %), Belgium (1 %) and Estonia (0 %).

Table 6

Analysis of the cumulative management costs and fees per Member State for ERDF and ESF financial instruments as of 31 December 2014

Member State	Total management costs reported *(in million euro)*	Number of instruments *(incl. sub-funds)*	Management costs and fees			
			% of paid to instrument		% of paid to final recipients	
			Cumulative	Average per annum	Cumulative	Average per annum
Slovakia	9	7	9 %	2 %	75 %	16 %
Czech Republic	4	5	9 %	3 %	47 %	16 %
France	14	120	9 %	2 %	19 %	4 %
Sweden	21	11	13 %	2 %	17 %	3 %
Cyprus	2	5	10 %	2 %	16 %	3 %
United Kingdom	124	74	10 %	2 %	16 %	3 %
Spain	43	16	6 %	1 %	16 %	2 %
Austria	2	2	6 %	1 %	12 %	3 %
Latvia	17	15	8 %	2 %	12 %	2 %
Bulgaria	20	10	6 %	1 %	11 %	3 %
Italy	51	128	4 %	1 %	11 %	2 %
Malta	1	2	8 %	2 %	10 %	2 %
Poland	110	248	9 %	2 %	10 %	2 %
Denmark	1	9	9 %	2 %	10 %	2 %
Lithuania	29	36	7 %	1 %	9 %	2 %
Finland	4	1	6 %	1 %	9 %	1 %
Germany	105	45	7 %	1 %	9 %	1 %
Netherlands	0	11	6 %	1 %	8 %	1 %
Romania	8	4	5 %	1 %	6 %	1 %
Portugal	18	56	4 %	1 %	5 %	1 %
Greece	29	32	2 %	0 %	4 %	1 %
Slovenia	3	3	3 %	1 %	4 %	1 %
Belgium	0	9	4 %	1 %	4 %	1 %
Hungary	17	170	2 %	0 %	2 %	0 %
Estonia	0	6	0 %	0 %	0 %	0 %
Total	**631**	**1 025**				

Source: ECA, based on 2015 Commission data.

No reimbursement from the EU budget of management costs and fees above the regulatory ceilings at closure

Management costs and fees were in principle limited to a maximum of 4 % per annum of the total endowment of the financial instrument

111

In the legal base for the 2007-2013 programme period, the provisions on the remuneration of fund manager were succinct in the main regulation[87], but ceilings for management costs and fees were already specified in the Commission's implementing regulation[88]. In particular, the following annual ceilings were set:

- 2 % p.a. of the capital contributed from the OP to holding funds for guarantee funds;
- 4 % p.a. of the capital contributed from the OP or the holding fund for micro-credit instruments directed at micro-enterprises; and
- 3 % p.a. of the capital contributed from the OP or the holding fund for all other cases.

The Commission established these ceilings in its legislative proposal, taking account of the experience of the 2000-2006 programme period. Then, there was an overall ceiling for management costs and fees of 5 % for equity funds and 2 % for guarantee funds[89].

112

In shared management, when determining the fund manager's remuneration, managing authorities have to comply with both the Structural funds and the State aid legal frameworks. Moreover, managing authorities must take care that the provisions on remuneration are in line with the instrument's investment strategy to ensure that the fund manager has a financial incentive to act in accordance with the stated objectives of the OP. Negotiating the funding agreement therefore is not a trivial task and, during our interviews, many managing authorities stated that they did not have the necessary expertise to do so at the beginning of the 2007-2013 programming period.

87 Article 78(6) of the general regulation.

88 Article 43(4) of the implementing regulation.

89 Commission Regulation (EC) No 448/2004, Rule 8, point 2.7 and Rule 9, point 2.6.

113

Under certain conditions the regulatory ceilings for management costs and fees can be exceeded (e.g. if management costs and fees conform to market terms and do not exceed those payable by private investors or if the fund manager has been selected through a public procurement procedure). Based on the Member States' reporting to the Commission, information on how often the ceilings were exceeded does not exist.

114

Management costs and fees are paid out of the capital endowment of the financial instrument; they are not charged to the final recipient. These costs are considered eligible until the winding-up of the fund, which in most cases is upon the closure of the programme[90]. The eligibility of management costs and fees claimed for the ERDF and ESF funds set up during the 2007-2013 programme period will be checked by the Commission only when analysing the closure documents in 2017 and 2018.

Cumulative management costs likely to exceed the regulatory ceilings in some cases at closure

115

Management costs or fees incurred and paid by 31 March 2017 can be declared as an eligible cost of the ERDF and ESF OP under which the financial instrument has been set up[91]. The regulation specifies that the ceilings for management costs and fees are related to 'the capital contributed from the operational programme'. According to the Commission the ceilings referred to in Article 43 of the implementing regulation are applicable to the total capital contribution to the financial instrument, rather than the actual contribution used to provide financial support to final recipients. The existing guidance for the 2007-2013 programme period on management costs and fees confirms this view[92].

116

In our view, the Commission should have interpreted the provisions on ceilings for management costs and fees set out in the regulation as applying to the actual used capital endowment contributed from the OP to the financial instrument, i.e. the actual endowment that has been used to provide financial support to final recipients. Fund managers should not be remunerated for not making use of the instruments' capital endowment.

90 Article 42 (1)d of Regulation (EU) No 1303/2013.

91 Article 78(6)(d) of the general regulation, within the limits set out in the Article 43(4) of the implementing regulation.

92 COCOF (10-0014-05), 8 February 2012, Section 2.6.

Performance-based remuneration was not a legal requirement during the 2007-2013 programme period

117

During the 2007-2013 programme period, the sound financial management of financial instruments and the actual performance of the fund manager were only referred to in the Commission's guidance notes, but not on any regulatory basis, as a factor for determining management costs and fees[93].

118

Based on our performance and compliance audits of financial instruments, we found that performance-linked remuneration schemes were the exception rather than the rule: only one out of nine instruments examined in the period from 2013 to 2015 had performance-based remuneration of the fund manager in place.

119

Where the remuneration of fund managers is not performance-based, there is little incentive for fund managers to actually transfer the funds to final recipients. This may have adversely affected the performance of financial instruments during the 2007-2013 programme period. Moreover, managing ERDF and ESF instruments becomes then also quite attractive for inexperienced fund managers (see also paragraph 86).

120

In 2012, the Commission recommended to managing authorities that the fund manager's remuneration be linked to the quality of investments actually made, as measured by their contribution to the achievement of the strategic OP objectives and to the value of the resources returned to the operation from investments undertaken by the instrument[94]. However, this recommendation was made in a COCOF guidance note and is not legally binding.

93 During the 2007-2013 programming period, the Commission issued three COCOF guidance notes on financial engineering instruments: COCOF (07/0018/01), COCOF (08/0002/03) and COCOF (10-0014-05).

94 European Commission, 'Revised guidance note on financial engineering instruments under Article 44 of Council Regulation (EC) No 1083/2006', COCOF (10-0014-05), 10 February 2012, paragraph 2.6.12.

Commission's assessment of management costs and fees does not take due account of differences in types of instruments and actual level of support provided to final recipients

Commission's estimate of cumulative management costs of 631 million euro since 2007 likely to be understated

121

In December 2015, based on the data reported by Member States for the year 2014, the Commission estimated cumulative management costs and fees of at least 631 million euro for the ERDF and ESF instruments since the start of the programme period[95].

122

According to the Commission, this represents 4.7 % of the OP contributions paid to the relevant instruments in the 2007-2013 programme period.

123

If the amounts paid between holding funds and the specific funds below are not included in the calculation, having already been included as OP contributions to holding funds, this overall management costs and fees rate increases to 6.2 %. In addition, fund managers can also charge fees to final recipients, but may not have reported these fees to the Commission. Therefore, as the Commission's calculation is based only on partial data, the actual figures (both for the absolute amounts and the share of the OP contributions) are likely to be higher.

Management costs and fees significantly above the levels reported by the Commission if calculated on the basis of the financial support provided to final recipients

124

Overall, based on the 764 ERDF and ESF instruments in ***Table 6***, we found that the cumulative management costs and fees account for up to 75 % of the financial support provided to final recipients, giving an annual average of up to 16 %.

125

For those 10 Member States which have reported robust data for all their 274 ERDF and ESF funds, we found that the cumulative management costs and fees are between 2 % and 17 % of the financial support provided to final recipients. This gives an annual average between 1 % and 3 %.

95 European Commission, '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 — Programme period 2007-2013 — Situation as at 31 December 2014', p. 29.

Significant differences in the management costs and fees between the different types of financial instruments

126

The level of management costs and fees is also related to the type of instrument. Taking into consideration the plausible data reported by the Commission, we found the average values presented in ***Table 7***. On average the guarantee instruments have the lowest percentage of management costs and fees, while the equity instruments have the largest percentage.

Table 7

Average cumulative management costs and fees per type of financial instrument as a percentage of fund endowment

Financial instrument type	Average cumulative percentage of management costs and fees as of 31 December 2014
Loan	4.2 %
Guarantee	2.7 %
Equity	11.0 %

Source: ECA, based on 2015 Commission data[1].

1 European Commission, '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 — Programme period 2007-2013 — Situation as at 31 December 2014'.

127

Moreover, as a general rule, financial instruments implemented with a holding fund are more costly to implement since management costs and fees are payable at both levels (i.e. holding fund and specific fund). We also note that the ceilings for management costs and fees during the 2007-2013 programme period do not depend on the scale of the financial instrument investments because they are paid as a percentage of the OP contribution (see paragraph 108).

Based on the financial support provided, management costs and fees for ERDF and ESF instruments are significantly higher than for centrally managed financial instruments or investment funds in the private sector

128

Our analysis also showed that the average management costs and fees for centrally managed financial instruments or private-sector investment funds were significantly lower than those for ERDF and ESF instruments when compared to the financial support provided to final recipients by the end of 2014.

- The cumulative operating cost charged by the EEEF since it started operating in 2011 are approximately 5 % of the total amounts invested. This results in an annual cost of 1.2 %.
- 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 capital endowment[96]. This corresponds to an annual cost of 0.2 % of the amount of guarantees provided by the EPMF to final recipients.

129

Our analysis also showed that even the EIB's and the EIF's management costs and fees for ERDF instruments were generally higher than those charged by them when they act as fund managers for instruments in 'centralised management'.

130

Our examination of two studies on fund-manager remuneration in private-sector investment funds published in 2015 showed that the average annual management fee across all types of funds (excluding holding funds) was between 0.6 % and 1 %[97]. Both studies also indicated that management fees have been reduced in recent years. Another study published in 2013 describes that annual management fees for venture capital equity funds range between 2.0 % and 2.5 %[98].

131

Our analysis also shows significant differences in the management costs and fees charged between individual ERDF and ESF instruments. Based on information available on the actual implementation costs of individual ERDF and ESF financial instruments, the Commission is not in a position to assess whether such cost differences are justified. We previously made similar observations in another special report[99].

96 See Special Report No 8/2015, paragraph 63.

97 Lane Clark & Peacock, 'Investment management fee survey', 2015 and Morningstar, 'Fee Study: Investors Are Driving Expense Ratios Down', 2015.

98 KfW, *Economic Research*, No 18, 'You get what you pay for — The remuneration structure of VC funds and its consequences', 7 March 2013.

99 See Special Report No 8/2015, paragraphs 62 and 72.

Limitations in reporting of management costs and fees by Member States

Only around 60 % of all ERDF and ESF instruments provide information on their management costs and fees to the Commission

132

In 2011, the Commission introduced an annual reporting obligation for Member States on shared-management instruments[100]. Managing authorities had to report this information for the first time in their reports for the year 2011. The data requested by the Commission included, amongst others, information related to the management costs and fees which was optional for the ERDF and ESF managing authorities. For the year 2014 data on management costs and fees were presented only for instruments representing 63 % of the total amount of payments from the ERDF and ESF OPs to financial instruments (compared to 50 % in 2013)[101].

133

Moreover, we note that only the paid amounts are to be reported as management costs and fees. However, there are also cases of costs and fees accrued but not yet paid. These are de facto excluded from the reporting, affecting its completeness and contributing to an understatement of management costs and fees reported to the Commission.

Addressed in the 2014-2020 programme period?

In relation to the management costs and fees issues a number of measures have been taken for the 2014-2020 programme period.

100 Regulation (EU) No 1310/2011 of the European Parliament and of the Council of 13 December 2011 amending Council Regulation (EC) No 1083/2006 as regards repayable assistance, financial engineering and certain provisions related to the statement of expenditure (OJ L 337, 20.12.2011, p. 1).

101 European Commission, '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 — Programming period 2007-2013 — Situation as at 31 December 2014', p. 27.

Reporting deadlines shortened for Member States and extended for the Commission

134

In the 2014-2020 programme period the Member States are required to submit to the Commission the report on the implementation of financial instruments as part of their annual implementation report. This implies that the reporting takes place 1 month earlier (by 31 May, as compared to 30 June during the previous period, when the reporting was not part of the annual implementation report; for 2017 and 2019 the deadline remains 30 June)[102]. Moreover, the period for the Commission to review the data reported by the Member States was fixed at 6 months. This means that the Commission's deadline to present the consolidated implementation report of financial instruments was changed, except for 2017 and 2019, from 1 October to 30 November. This results in a situation where important information on the implementation of financial instruments will become available to the discharge authorities even later than is currently the case.

Managing authorities are required to report to the Commission on management costs and fees

135

For 2014-2020 financial instruments, managing authorities are required to publish data on management costs and fees as an annex to the annual implementation report[103]. This is an important improvement which will allow the Commission to analyse and supervise the cost of implementing financial instruments much better in the years to come.

Reduced ceilings for management costs and fees, differentiated according to the type of financial instruments

136

As regards the ceilings for management costs and fees, we observe two main differences to the 2007-2013 programme period. First, ceilings for the fund manager's remuneration are differentiated according to the type of financial instruments[104] (see ***Table 8***).

102 Article 46.1 and Article 111 of the CPR.

103 Article 46(2e) of Regulation (EU) No 1303/2013.

104 Article 13 of Commission Delegated Regulation (EU) No 480/2014.

Table 8

Ceilings for management costs and fees of different types of financial instruments under shared management (2014-2020 programme period)

	Ceilings	Base remuneration p.a.	Performance-based remuneration p.a.
Holding fund	7 %	3 % first 12 months	0.5 %
		1 % next 12 months	0.5 %
		0.5 % following years	0.5 %
Loans	8 %	0.5 %	1 %
Guarantees	10 %	0.5 %	1.5 %
Equity	20 %	2.5 % first 24 months[1]	2.5 %
		1 % following years[2]	2.5 %
Micro-credit	10 %	0.5 %	1.5 %
Other	6 %	0.5 %	0.5 %

1 This relates to the period after the signature of the funding agreement; the higher rate can be used only within this period but effectively only for the time from the effective payment of programme contributions to the holding fund.

2 For equity, the base remuneration is linked to amounts committed to the financial instrument.

Source: European Commission, *Guidance for Member States on Article 42(1)(d) CPR — Eligible management costs and fees* (EGESIF_15-0021-01), p. 8.

137

Second, the ceilings (which are now on a cumulative rather than an annual basis) are significantly lower compared to those applicable in the 2007-2013 programme period. Overall we consider the reduced ceilings imposed on the cumulative amount of the fund manager's remuneration to be an improvement, but the Commission did not justify how these ceilings were determined. Our analysis of actual data reported for the 2007-2013 programme period to date shows lower percentages in practice (see paragraph 120).

Performance-based elements of fund managers' remuneration only have limited incentive effect

138

For 2014-2020 the CPR also provides that the performance of the fund manager should serve as a criterion for the determination of management costs and fees. In particular, all management costs and fees to be declared as eligible at closure have to be based on a performance-based calculation methodology (see also ***Table 6***)[105].

139

Further details on the performance-based criteria to determine management costs and fees and the applicable ceilings are set out in a delegated act[106].

140

In addition, according to the Commission's guidelines on risk finance investments[107], this performance-based component of the remuneration must be significant and designed to reward the attainment of the specific policy targets set in advance, as well as the fund manager's financial performance. The latter should be measured not only in terms of the successful disbursement of the initial endowment or the amount of private capital raised, but also on the basis of the actual returns on investments.

141

We observe, however, that these new performance-based elements play a secondary role in determining the fund manager's total remuneration which is to be reimbursed from the EU budget, for the following reasons.

- given the normal duration of a holding or specific fund, the ceilings specified in the Commission's delegated act are generally reached easily without receiving the performance-related part of the remuneration. As a consequence a high-performing fund manager will have reached the maximum remuneration already at an earlier stage than a less-performing one, and will from then on no longer be paid for his services.

- there is no underperformance charge which would ensure that the fund manager bears part of any financial losses that the financial instrument may incur. In fact, based on the current remuneration scheme, even fund managers that achieve negative returns can obtain the maximum remuneration.

105 Consideration 123 and Article 42 of the CPR.

106 Articles 12, 13 and 14 of Commission Delegated Regulation (EU) No 480/2014.

107 European Commission, 'Guidelines on State aid to promote risk finance investments', point 3.6.1.

- the regulatory framework does not require that minimum performance benchmarks (or hurdle rates) which must be attained before the fund manager can receive the performance-related part of the remuneration be specified in advance by the managing authority.

Overall, we therefore consider that the performance-based part of the fund manager's remuneration co-financed from the EU budget currently provides only a very limited incentive effect and needs to be reconsidered.

Management costs and fees are incurred in addition to the administrative cost of implementing ERDF and ESF OPs

142

The management, control, monitoring and evaluation of the ERDF and ESF OPs comes at a cost: this administrative cost for national authorities comprises staff remuneration, operational costs (such as travel and training costs) and costs related to information and communication activities. Member States have the possibility to use technical assistance under the ERDF and ESF OPs to cover these administrative costs[108].

143

During the 2007-2013 programme period, technical assistance could be up to 4 % of the total funding of an ERDF or ESF OP[109]. The same level has been kept for the 2014-2020 programme period. It was established on a basis of a study carried out in 2010 on behalf of the Commission for its impact assessment for the 2014-2020 programme period [110]. On this basis, the Commission estimates that up to 13.6 billion euro can be spent by Member States on technical assistance during the entire period.

144

However, during the 2014-2020 programme period, a significantly larger share of the ERDF and ESF budget will be implemented through financial instruments (see paragraph 21). This implies that comparatively more technical assistance money will be available for the grant-based funding activities of the ERDF and ESF OPs since the main part of the administrative activity for financial instruments is performed by the fund manager. For these activities, management costs and fees are directly charged by fund managers to OPs (or to final recipients). Therefore, the increase in funding through financial instruments also adds indirectly to the total administrative cost to the EU budget, since it raises the amount of technical assistance support given to Member States from the EU budget for the remaining grant-based funding activities.

108 Article 45 of the general regulation.

109 Article 46 of the general regulation.

110 SEC(2011) 1141 final of 6 October 2011 (see also Special Report No 8/2015, paragraph 56; Special Report No 16/2013, paragraphs 74 to 75).

145

We also note that, as for the 2007-2013 programme period, there is no obligation for national administration to report in detail on how technical assistance has been spent[111]. In a previous report we already observed that the Commission does not have any comparative information available on the actual administrative costs for each Member State, for each OP or for each funding mechanism (i.e. grants or financial instruments)[112]. This makes it difficult to assess whether the levels of technical assistance are justified in view of the actual costs incurred by Member States for implementing the ERDF and ESF OPs.

146

We therefore maintain our previous recommendation that the Commission should carry out a comparative analysis of the implementation costs of grants and financial instruments (in central and shared management) for the 2014-2020 programme period with a view to establishing their actual levels[113]. Such information would be particularly relevant in view of preparing the legislative proposals for the post-2020 period.

111 European Commission, 'Co-financing salaries, bonuses, top-ups from Structural Funds during the 2007-2013 programme period', Final Report, 2014.

112 See Special Report 5/2015, paragraphs 58 and 71.

113 See Special Report No 8/2015, paragraphs 57, 63 to 64, 71 to 72 and recommendation 4.

Conclusions and recommendations

147

Overall, we note that financial support provided to final recipients through financial instruments offers significant advantages compared to grants since each euro of funding through financial instruments can in principle be used more than once. Moreover, the fact that loans have to be paid back and guarantees have to be released or, in the case of equity investments, returned should in principle also have an impact on the behaviour of final recipients, leading to the better use of public funds and reducing the likelihood that the final recipients will become dependent on public support.

148

Our audit, however, identified a number of significant issues that limited the efficiency of financial instruments as a mechanism to implement the EU budget during the 2007-2013 programme period.

- a significant number of ERDF and ESF financial instruments were oversized and by the end of 2014 continued to face significant problems to disburse their capital endowments (on average, around 57 % of all capital endowment paid from the OPs to the financial instruments had been used). A contributing factor to the excessive initial capital endowments was the Member States' intention to avoid de-commitments throughout the 2007-2013 programme period.
- overall, financial instruments in both shared and central management were not successful in attracting private capital.
- so far, only a limited number of ERDF and ESF financial instruments have been successful in providing revolving financial support.
- for ERDF and ESF financial instruments, levels of management costs and fees are high compared to the actual financial support to final recipients and also appear to be significantly higher than those of centrally managed instruments or private-sector investment funds.

149

At the same time, we also note that improvements were made in the legal framework for the 2014-2020 programme period as regards financial instruments based on the expertise gained during the 2007-2013 programme period, but certain issues remain. Our main conclusions for the 2007-2013 and 2014-2020 programme periods are presented following the structure of the report, together with our recommendations.

Were financial instruments appropriately sized in view of market needs?

150

We consider that a significant number of financial instruments were oversized. This indicates that market needs have not always been properly assessed by managing authorities before allocating funds from the ERDF and ESF OPs to financial instruments. This led to excessive capital endowments when setting up the financial instruments, which resulted in low disbursement rates. A contributing factor to these excessive capital endowments was the Member State's intention to circumvent the *n* + 2 rule.

The introduction of mandatory *ex ante* assessments during the 2014-2020 programme period for financial instruments in both shared and centralised management will contribute to preventing excessive endowments of financial instruments on a large scale. Nevertheless its success will depend on whether or not it was built on sound assumptions and analysis. For instruments in shared management the phased payments approach (which links the payments from the EU budget to the disbursement of funds to final recipients) is also aimed at addressing the issue of excessive endowment. Moreover, a regular review of the *ex ante* assessment in cases of changes in the economic or market environment is provided for as an option in the CPR, but not for the centrally managed instruments. A mid-term review (which could address such aspects) is undertaken for most, but not all, centrally managed financial instruments. Finally, an independent review of *ex ante* assessments is not provided for in either case.

151

The regional focus of financial instruments contributed to Member States setting up a large number of small-sized financial instruments in the 2007-2013 programme period. Often, these individual ERDF and ESF specific funds did not have the size which in the fund industry is considered appropriate to operate them efficiently (see paragraphs 27 to 61).

Recommendation 1

As regards the *ex ante* assessments for financial instruments:

(a) the Commission's *ex ante* assessment for centrally managed instruments should systematically include an analysis of the 'lessons learnt' to date.

Target implementation date: whenever a new instrument is established.

(b) the Commission, in addition to the 'lessons learnt', should also assess the effect of major socioeconomic changes on the rationale of the instrument and the corresponding contribution required from the EU budget in the context of their respective mid-term reviews for all centrally managed financial instruments.

Target implementation date: as soon as mid-term reviews are carried out.

Recommendation 2

The Commission and the Member States should aim at optimising the size of specific ERDF and ESF funds to take, wherever possible, advantage of the significant economies in the cost of operating funds. The Commission should provide additional guidance to Member States on how to set up such financial instruments within Member States or at Union level (which are managed directly or indirectly by the Commission).

Target implementation date: by the end of 2016 (for the Commission); when establishing the financial instruments (for Member States).

Did financial instruments succeed in attracting private capital?

152

We found that the Commission and Member States faced significant difficulties in attracting private-sector investors to financial instruments in both shared and central management during the 2007-2013 programme period. In particular, the preferential treatment of private investors for financial instruments did not succeed in attracting significant additional financing. In addition, we consider that the Commission's measure of leverage for financial instruments does not properly take into account the extent to which public financing from the EU budget mobilises additional funds. Moreover, Member States are not obliged to report to the Commission information on private contributions to the capital endowment of ERDF and ESF instruments.

153

At this stage it seems unlikely that a significant amount of private funds will be attracted for the 2014-2020 programme period, through the OPs or as additional contributions. The guidance issued by the Commission in April 2014 does not sufficiently draw on the 'good practices' observed during the 2007-2013 programme period on how best to apply the provisions on preferential treatment to attract more private capital without allocating excessive risks to the public sector.

154

The use of advance tax agreements for financial instruments, which under certain conditions may result in tax avoidance, during the 2014-2020 programme period would go against the Commission's own policy in this respect (see paragraphs 62 to 91).

Recommendation 3

The Commission should provide in the financial regulation (and subsequently in sectorial regulations) a definition for the leverage of financial instruments applicable across all areas of the EU budget, which clearly distinguishes between the leverage of private and national public contributions under the OP and/or of additional private or public capital contributions, and takes into account the type of instrument involved. This definition should clearly indicate how the amounts mobilised by the EU and national public contributions are determined, possibly following the OECD's guidelines on the subject.

Target implementation date: at revision of financial regulation and for the sectorial regulation at mid-term review.

Recommendation 4

For ERDF and ESF financial instruments under the 2007-2013 programme period, the Commission should ensure that Member States provide complete and reliable data on private contributions on capital endowments, both through the OPs and in addition to them.

Target implementation date: by the end of 2017.

Recommendation 5

For ERDF and ESF financial instruments, the Commission should provide additional guidance to Member States on how best to apply the provisions on preferential treatment to attract more private capital without allocating excessive risks to public contributors to the financial instruments' endowments.

Target implementation date: by the end of 2016.

Recommendation 6

For centrally managed financial instruments, the general risk-sharing principles which may have an impact on the EU budget should be defined in the legislation governing the instrument concerned.

Target implementation date: when making its proposals for the establishment of new financial instruments or the revision of existing ones.

Recommendation 7

For all financial instruments funded from the EU budget during the 2014-2020 programme period, the Commission should ensure that only structures which are in line with its own recommendations and actions with regard to tax arrangements are implemented by Member States, the Commission itself and the EIB group.

Target implementation date: by the end of 2016.

Were financial instruments providing revolving financial support?

155

For a large majority of ERDF and ESF instruments, no substantial revolving effect of funds had occurred by the end of 2014. This was due to the fact that implementation delays contributed to ERDF and ESF financial instruments' difficulties in disbursing their endowments in full during the 2007-2013 programme period. The eligibility period needed to be extended from December 2015 to March 2017 to increase the likelihood that most financial instruments would spend their initial endowments once. Furthermore, after closure in March 2017, the implementation of the financial instruments is at the discretion of Member States and it remains to be seen to what extent a revolving effect will be realised.

156

For the 2014-2020 programme period, the provisions in the legal basis limit the risk of setting up instruments with excessive capital endowments, and consequently also help to increase the likelihood of achieving a revolving effect. This requires however that lessons have been learnt from the shortcomings observed during the 2007-2013 programme period, and managing authorities are more realistic about the share of the ESIF that can be implemented through financial instruments.

157

Other changes have been made which should help to set up instruments more efficiently, but we found that additional guidance is required on two specific aspects (see paragraphs 92 to 105).

Recommendation 8

The Commission should take appropriate measures to ensure that Member States maintain the revolving nature of the funds during the required 8-year period after the end of the eligibility period for the 2014-2020 programme period. This could be achieved by requiring the use of an explicit clause in the funding agreement to ensure that the funding is used for the intended purposes.

Target implementation date: by the end of 2016.

Recommendation 9

The Commission should provide guidance in respect of the provisions allowing financial instruments to continue to be used into the following programme period, in particular for cases where fund managers are selected on the basis of public procurement.

Target implementation date: by the end of 2016.

Did financial instruments prove to be a cost-efficient method of implementing the EU budget?

158

We found that a significant share of initial endowments of ERDF and ESF financial instruments was spent on management costs and fees. Moreover, the fee level was significantly higher than for centrally managed instruments or private-sector investment funds when compared to the financial support actually provided to final recipients. In view of the high levels observed by the end of 2014, there is a significant risk that a large number of ERDF and ESF instruments will exceed the ceilings for management costs and fees specified in the 2007-2013 legal base. High levels of management costs and fees may point to a fundamental problem with the way in which this funding mechanism has been implemented during the 2007-2013 programme period.

Management costs or fees incurred and paid by 31 March 2017 can be declared as an eligible expenditure of the ERDF and ESF programmes under which the financial instrument has been set up. The regulation specifies that the ceilings for management costs and fees are related to 'the capital contributed from the operational programme' to the instruments.

According to the Commission the ceilings referred to in Article 43 of the implementing regulation are applicable to the total capital contribution to the financial instrument, rather than the actual contribution used to provide financial support to final recipients. In our view, at closure, the ceilings set out in the regulation should however be interpreted as applying to the actual used capital endowment contributed from the OP to the financial instrument, i.e. the one that has been used to provide financial support to final recipients. Fund managers should not be remunerated for not making use of the instruments' capital endowment.

159

The Commission does not have a comprehensive overview of the implementation costs of ERDF and ESF financial instruments, and how management costs and fees are determined and whether they are justified. Similarly, the Commission lacks information on the overall administrative costs for each Member State of implementing the ESIF during the 2014-2020 programme period, depending on how use is made of the alternative funding mechanisms (i.e. grants or repayable financial support, mainly through financial instruments).

160

We also note that these management costs and fees are incurred in addition to the general administrative costs for the ERDF and ESF OPs. Since management costs are paid out of the instruments' initial endowment, they reduce the level of funding from the EU budget which is available for final recipients.

161

For the 2014-2020 programme period, the reporting deadlines for Member States have been reduced since the reporting on financial instruments is now part of the annual implementation report. This report is submitted to the Commission 1 month earlier than the previous reporting on financial instruments, except for the years 2017 and 2019. At the same time the Commission's deadline for presenting its report to the discharge authorities has been fixed at 6 months. In comparison, during the 2007-2013 programme period, the Commission had 3 months to verify the data and present its consolidated implementation report on financial instruments. This means relevant information on the implementation of financial instruments and their related costs is available later than in the previous period.

162

With regard to management costs and fees, the legislation was significantly improved, providing ceilings on cumulative amounts which are below those applicable during the 2007-2013 programme period. However, the performance-based elements are not yet sufficiently strong and the Commission must provide additional clarification on how managing authorities should make use of these provisions when negotiating the funding agreements (see paragraphs 106 to 145).

Recommendation 10

In view of the upcoming closure of the 2007-2013 programme period, the Commission should:

(a) ensure that Member States report comprehensive information on management costs and fees incurred and paid by March 2017.

Target implementation date: by the end of 2017.

(b) clarify that the ceilings for management costs and fees need to be applied to the actual capital endowment used by the financial instrument, i.e. the contribution from the OP that has been used to provide financial support to final recipients.

Target implementation date: by the end of March 2017.

Recommendation 11

As regards the performance-based remuneration of fund managers in the 2014-2020 programme period:

(a) the Commission should make a legislative proposal aiming at a revision of the existing provisions in the CPR to strengthen the incentive effect of these arrangements.

Target implementation date: by the end of 2016.

(b) Member States' managing authorities should make extensive use of the existing performance-based elements of the remuneration for fund managers when negotiating funding agreements. This could be complemented by the use of additional elements on a voluntary basis.

Target implementation date: immediately

Recommendation 12

The Commission should carry out a comparative analysis of the implementation costs of grants and repayable financial support, mainly through financial instruments, for the 2014-2020 programme period with a view to establishing their actual levels. Such information would be particularly relevant for preparing legislative proposals for the post-2020 period and determining an adequate level of technical assistance.

Target implementation date: by the end of 2017.

163

Finally, during the 2014-2020 programme period, it will also be vital for the Commission and the EIB to effectively coordinate the use of financial instruments in shared and centralised management funded from the EU budget with the European Fund for Strategic Investment (EFSI), also known as the 'Juncker plan'. Only then can the financial instruments under the EU budget contribute most effectively to the much needed infrastructure investments in the EU.

This Report was adopted by Chamber II, headed by Mr Henri GRETHEN, Member of the Court of Auditors, in Luxembourg at its meeting of 1 June 2016.

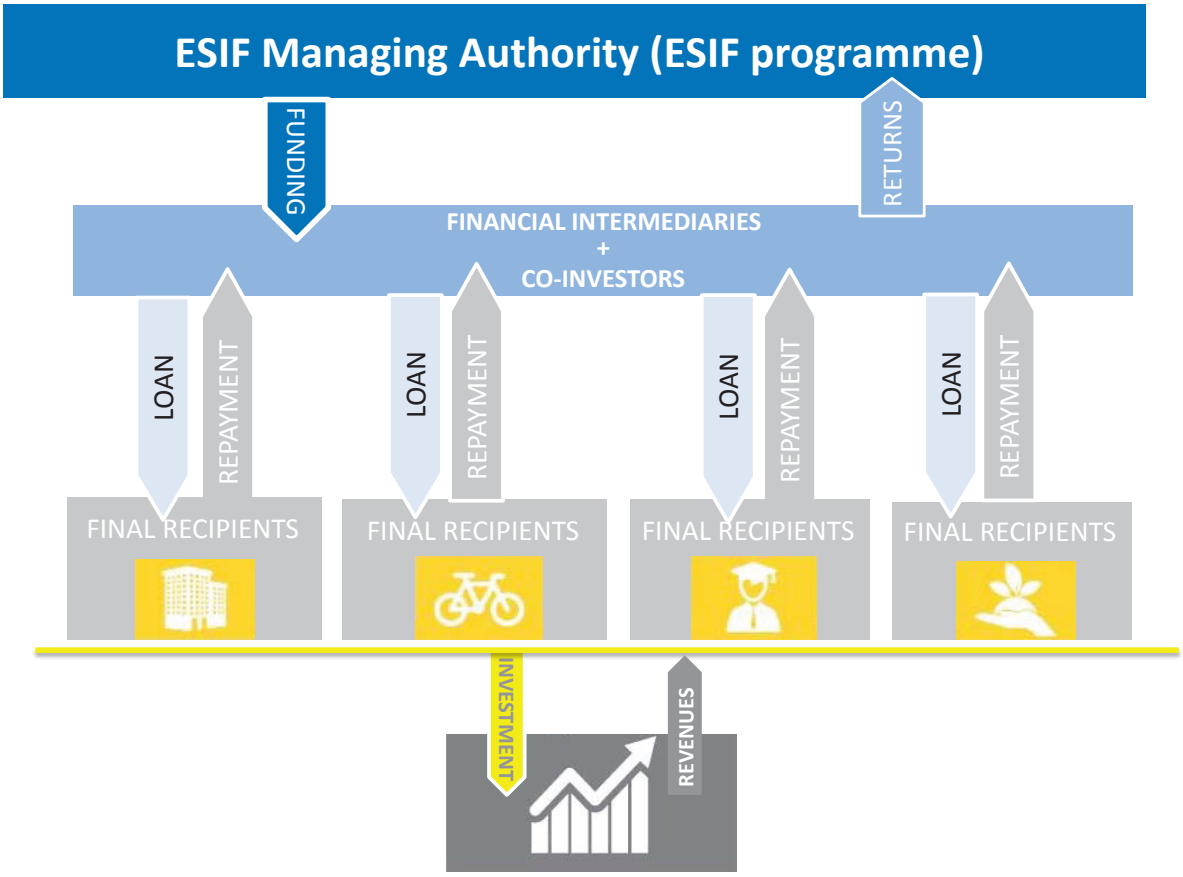
For the Court of Auditors

Vítor Manuel da SILVA CALDEIRA
President

Financial instruments in shared management — how do they work (2014-2020 programme period)

(a) Loan instruments

How does it work?



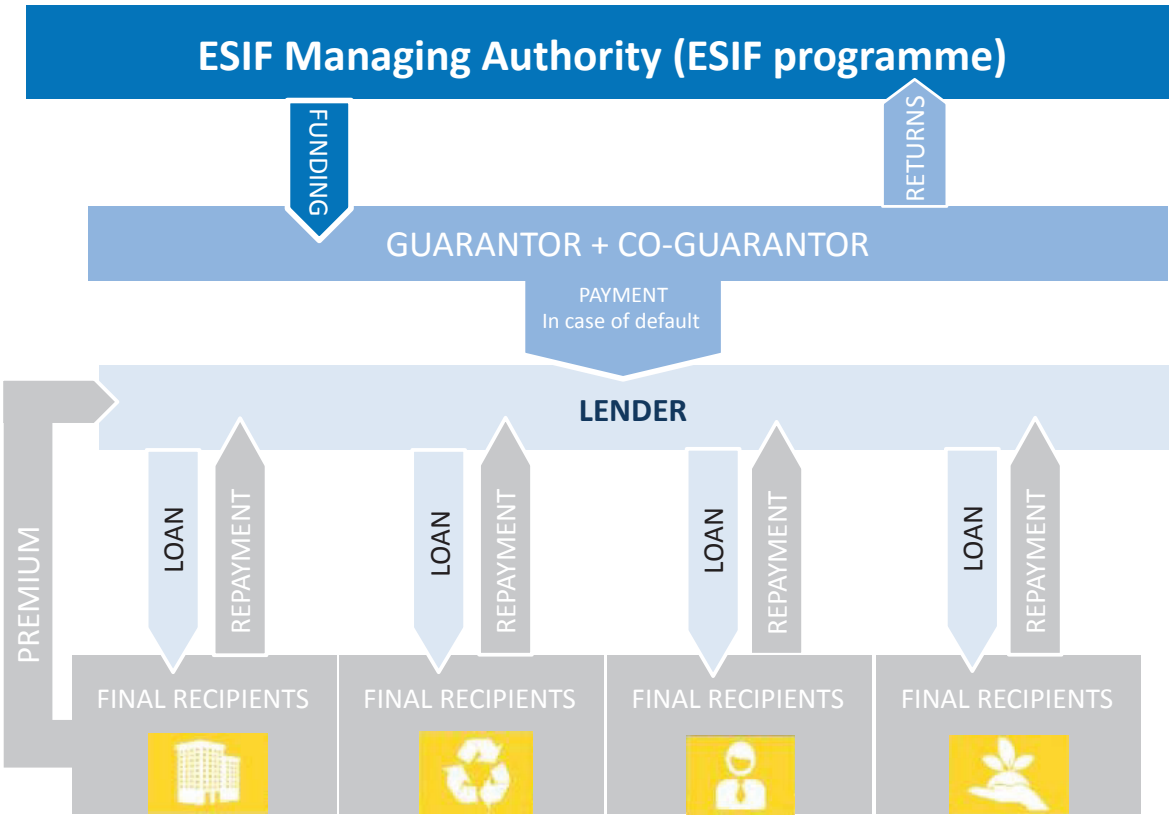
Source: European Commission and EIB, *FI Compass — Financial Instrument products: Loans, guarantees, equity and quasi-equity*, p. 5.

Annex I

Financial instruments in shared management — how do they work (2014-2020 programme period)

(b) Guarantee instruments

How does it work?



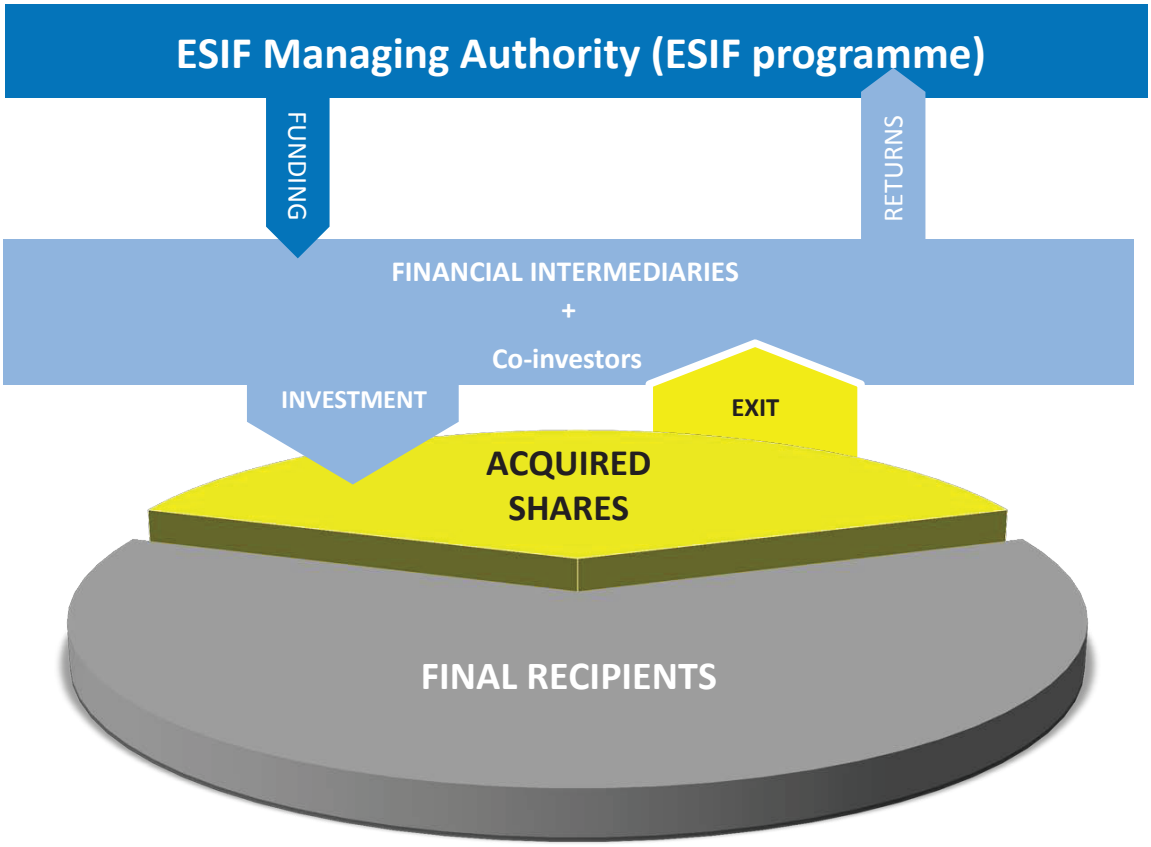
Source: European Commission and EIB, *FI Compass — Financial Instrument products: Loans, guarantees, equity and quasi-equity*, p. 9.

Annex I

Financial instruments in shared management — how do they work (2014-2020 programme period)

(c) Equity (or quasi-equity) instruments

How does it work?



Source: European Commission and EIB, *FI Compass — Financial Instrument products: Loans, guarantees, equity and quasi-equity*, p. 14.

Annex II

Definition of the term 'financial instruments' in the legal basis (2014-2020 and 2007 -2013 programme period)

	Regional policy (ERDF and ESF)	Social policy (EaSI)	Transport and energy policy (CEF)
2014-2020	A definition of financial instruments is provided in the financial regulation, and is therefore applicable to all budgetary areas: Article 2 '(p) "financial instruments" means Union measures of financial support provided on a complementary basis from the budget in order to address one or more specific policy objectives of the Union. Such instruments may take the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments, and may, where appropriate, be combined with grants'.		
	No sector-specific definition. CPR makes direct reference to the definition in the financial regulation.	Despite the common definition in the financial regulation the the EaSI regulation makes reference to 'loans', 'guarantees', 'equity' and 'quasi- equity'.	Despite the common definition in the financial regulation the CEF regulation makes reference to: 'equity instruments', 'loans and/or guarantees', 'risk-sharing instruments for project bonds'.
	Regional Policy (ERDF and ESF)	**Social Policy (EPMF)**	**Transport and Energy Policy (TEN)**
2007-2013	No formal definition exists. Indirect definitions exist in the implementing regulation and in the COCOF note. Article 43 of the implementing regulation: 'Articles 43 to 46 shall apply to financial engineering instruments in the form of actions which make repayable investments, or provide guarantees for repayable investments, or both, in the following: [. . .]' COCOF guidance note: '1.2.12 To qualify as a financial engineering instrument under the SF Regulations, it is necessary therefore that the contributions from the operational programmes [. . .] take the form of repayable investments, namely equity, loans and/or guarantees for such repayable investments in accordance with the specific provisions of Article 44 first paragraph (a), (b) or (c) of the general regulation. 1.2.13 Repayable investments are distinguished from non-repayable assistance or grants, defined for the purpose of this note as "a direct financial contribution by way of donation".'	No formal definition exists. Nevertheless, the EPMF decision makes reference to 'guarantees and risk-sharing instruments', 'equity instruments' and 'debt instruments'.	No formal definition exists. Nevertheless, the TEN regulation makes reference to the 'loan guarantee instrument', the 'risk-sharing instrument for project bonds' and to 'risk capital participation for investment funds'. The EEPR regulation makes reference to a investment 'facility' in which the EU will be a shareholder.

Source: European Commission.

Annex III

Overview of the ERDF financial instruments in the 28 EU Member States: number of funds and endowment (2007-2013 programme period)

Germany	
Total No of funds	41
Holding	-
Loan	21
Guarantee	-
Equity	17
Mixed	3
Other	-
Not reported	-
ERDF contributions*	838
Share of ERDF budget	5 %

Denmark	
Total No of funds	5
Holding	-
Loan	2
Guarantee	-
Equity	-
Mixed	3
Other	-
Not reported	-
ERDF contributions*	13
Share of ERDF budget	5 %

Sweden	
Total No of funds	11
Holding	-
Loan	-
Guarantee	-
Equity	11
Mixed	-
Other	-
Not reported	-
ERDF contributions*	72
Share of ERDF budget	8 %

Finland	
Total No of funds	1
Holding	-
Loan	-
Guarantee	-
Equity	-
Mixed	1
Other	-
Not reported	-
ERDF contributions*	35
Share of ERDF budget	4 %

Estonia	
Total No of funds	5
Holding	-
Loan	3
Guarantee	-
Equity	-
Mixed	1
Other	1
Not reported	-
ERDF contributions*	119
Share of ERDF budget	6 %

Latvia	
Total No of funds	14
Holding	1
Loan	5
Guarantee	1
Equity	6
Mixed	1
Other	-
Not reported	-
ERDF contributions*	146
Share of ERDF budget	6 %

Poland	
Total No of funds	227
Holding	14
Loan	110
Guarantee	92
Equity	11
Mixed	-
Other	-
Not reported	-
ERDF contributions*	973
Share of ERDF budget	3 %

Netherlands	
Total No of funds	11
Holding	1
Loan	2
Guarantee	1
Equity	-
Mixed	7
Other	-
Not reported	-
ERDF contributions*	18
Share of ERDF budget	2 %

United Kingdom	
Total No of funds	74
Holding	10
Loan	32
Guarantee	-
Equity	25
Mixed	7
Other	-
Not reported	-
ERDF contributions*	662
Share of ERDF budget	12 %

Lithuania	
Total No of funds	34
Holding	3
Loan	22
Guarantee	4
Equity	5
Mixed	-
Other	-
Not reported	-
ERDF contributions*	396
Share of ERDF budget	12 %

Czech Republic	
Total No of funds	3
Holding	1
Loan	3
Guarantee	-
Equity	-
Mixed	1
Other	-
Not reported	-
ERDF contributions*	171
Share of ERDF budget	1 %

Slovakia	
Total No of funds	7
Holding	1
Loan	1
Guarantee	-
Equity	-
Mixed	4
Other	-
Not reported	1
ERDF contributions*	95
Share of ERDF budget	2 %

Belgium	
Total No of funds	9
Holding	-
Loan	7
Guarantee	-
Equity	-
Mixed	2
Other	-
Not reported	-
ERDF contributions*	159
Share of ERDF budget	16 %

France	
Total No of funds	120
Holding	2
Loan	34
Guarantee	12
Equity	11
Mixed	5
Other	-
Not reported	56
ERDF contributions*	230
Share of ERDF budget	3 %

Hungary	
Total No of funds	170
Holding	1
Loan	74
Guarantee	20
Equity	28
Mixed	47
Other	-
Not reported	-
ERDF contributions*	762
Share of ERDF budget	6 %

Bulgaria	
Total No of funds	10
Holding	2
Loan	1
Guarantee	1
Equity	3
Mixed	3
Other	-
Not reported	-
ERDF contributions*	330
Share of ERDF budget	10 %

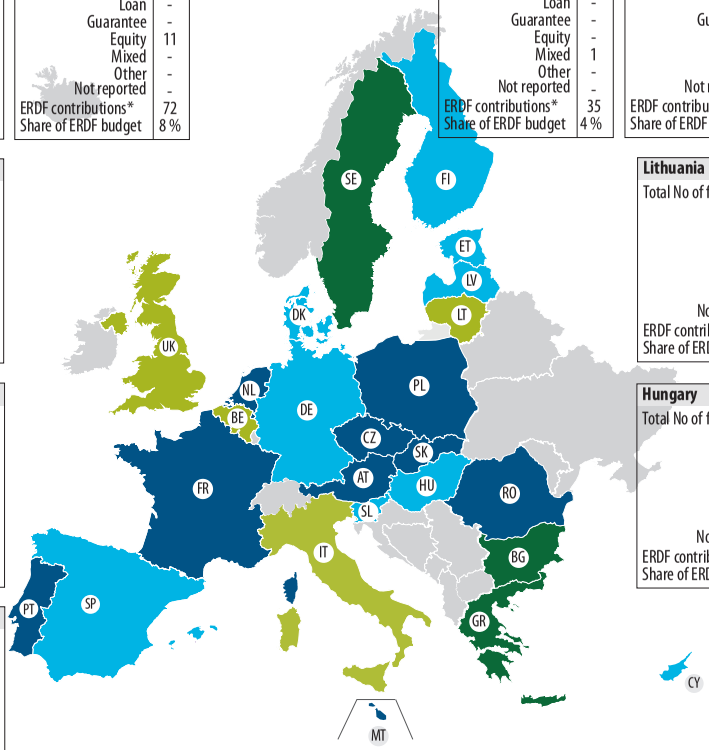
Romania	
Total No of funds	4
Holding	1
Loan	1
Guarantee	1
Equity	1
Mixed	-
Other	-
Not reported	-
ERDF contributions*	129
Share of ERDF budget	1 %

Portugal	
Total No of funds	56
Holding	3
Loan	8
Guarantee	-
Equity	33
Mixed	7
Other	-
Not reported	-
ERDF contributions*	376
Share of ERDF budget	3 %

Spain	
Total No of funds	16
Holding	4
Loan	2
Guarantee	-
Equity	-
Mixed	10
Other	-
Not reported	-
ERDF contributions*	950
Share of ERDF budget	4 %

Austria	
Total No of funds	2
Holding	-
Loan	-
Guarantee	-
Equity	1
Mixed	1
Other	-
Not reported	-
ERDF contributions*	10
Share of ERDF budget	1 %

Slovenia	
Total No of funds	3
Holding	1
Loan	-
Guarantee	1
Equity	-
Mixed	1
Other	-
Not reported	-
ERDF contributions*	105
Share of ERDF budget	5 %



Italy	
Total No of funds	108
Holding	18
Loan	23
Guarantee	33
Equity	6
Mixed	2
Other	-
Not reported	26
ERDF contributions*	2 526
Share of ERDF budget	12 %

Malta	
Total No of funds	2
Holding	1
Loan	-
Guarantee	1
Equity	-
Mixed	-
Other	-
Not reported	-
ERDF contributions*	10
Share of ERDF budget	2 %

Greece	
Total No of funds	32
Holding	4
Loan	17
Guarantee	2
Equity	4
Mixed	5
Other	-
Not reported	-
ERDF contributions*	1 308
Share of ERDF budget	6 %

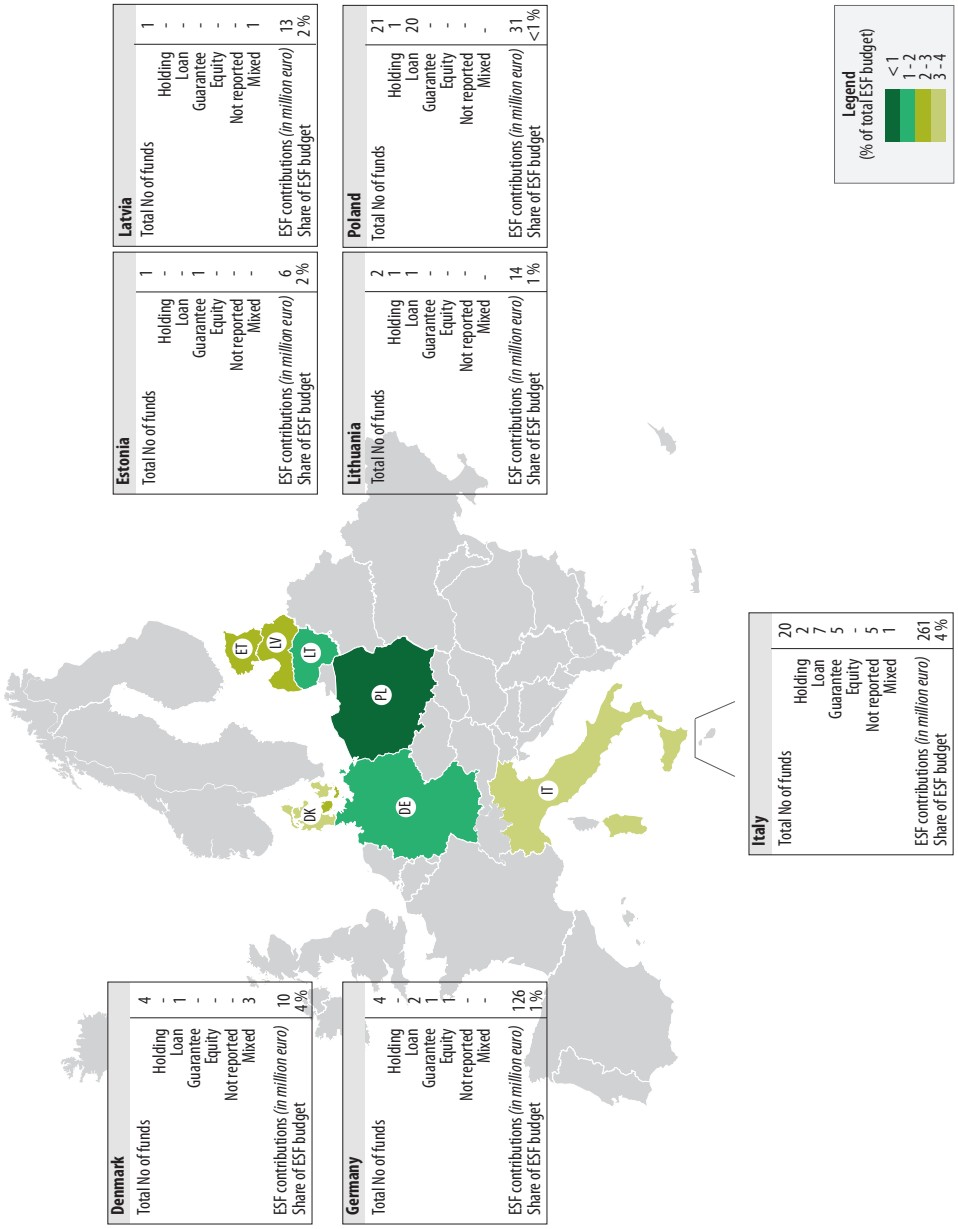
Cyprus	
Total No of funds	5
Holding	1
Loan	2
Guarantee	2
Equity	-
Mixed	-
Other	-
Not reported	-
ERDF contributions*	17
Share of ERDF budget	6 %

Legend
(% of total ERDF budget)
- < 4
- 4 - 8
- 8 - 12
- 12 - 16

Source: ECA, on the basis of the data from the Commission, situation as at 31 December 2014.

Annex IV

Overview of the ESF financial instruments in the 28 EU Member States: number of funds and endowment (2007-2013 programme period)



Source: ECA, on the basis of the data from the Commission, situation as at 31 December 2014.

Annex V

Summary of *ex ante* assessment requirements (2014-2020 programme period)

Element	Shared-managed financial instruments in cohesion policy (2014-2020 programme period)	Centrally managed financial instruments in social energy and transport policy (effective since 1 January 2013)
Legal basis	**Legal basis:** The aspects to be analysed and reported on are set out in Articles 37(2) and 37(3) of the CPR, and include the following aspects.	**Legal basis:** Article 140(f) of the financial regulation provides that financial instruments must be established on the basis of an *ex ante* evaluation. The elements of this evaluation are described in the rules of application of the financial regulation[1] and summarised below.
Market failures	An analysis of market failures, suboptimal investment situations, and investment needs.	Identification of market imperfections or failures or sub-optimal investment situations, and assessment of investment needs in view of policy objectives.
Added value	An assessment of the added value of the financial instruments that are being considered for support from the ESIF; consistency with other forms of public intervention addressing the same market; the proportionality of the planned action; and measures to minimise market distortion.	o Demonstration that identified market needs cannot be addressed appropriately and in a timely manner either through market-led activities or through types of EU intervention other than funding by a financial instrument. o Demonstration that the planned financial instrument is consistent with new and existing financial instrument in order to avoid overlaps.
State aid	Possible State aid implications.	Not applicable.
Leverage	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).	Assessment of the proportionality of the planned action with regard to the size of the funding gap, the expected leverage effect additional qualitative effects.
Investment strategy	The proposed investment strategy, including an examination of options financial products to be offered.	Determination of the most efficient mode for delivering the financial instrument.
Results	A specification of the expected results and of how the financial instrument concerned is expected to contribute to the achievement of the specific objectives set out under the relevant priority, including indicators for that contribution.	Establishment of a set of appropriate performance indicators.
Leasons learnt	An assessment of lessons learnt from similar instruments and *ex ante* assessments carried out by the Member State in the past.	No comparable provision in the legal basis to reflect on the previous experiences.
Posibility for review	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.	No review clause in the legal basis.

1 Commission Delegated Regulation (EU) No 1268/2012 of 29 October 2012 on the rules of application of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union, Article 224 (OJ L 362, 31.12.2012, p. 1).

Reply of the Commission

Executive summary

II
The Commission agrees that there are multiple advantages in delivering financial support from the EU budget through financial instruments, which is why for the 2014-2020 programme period it is actively promoting and encouraging their increased use.

VI
The Commission considers that the effect of the issues identified by the Court varies between Member States and types of financial instruments and that, overall, financial instruments remain an efficient and effective way of delivering EU funds.

VI First indent
The Commission considers that the average disbursement rate of 57% (at end of 2014) represents a very heterogeneous situation. The risk of not achieving full disbursement at closure concerns a limited number of financial instruments in a few Member States.

The low disbursement rate at the end of 2014 is a result of a number of factors including the financial crisis, the limited experience in some Member States and the late start of some instruments.

VI Second indent
For shared management financial instruments, the legal requirements on reporting did not allow the Commission to obtain exhaustive data regarding the participation of private investors from Member States. Nevertheless, the Commission notes that the state aid rules require for certain financial instruments a minimum participation of private investors (e.g. 30% and in some cases even 60%).

The Commission considers that centrally managed financial instruments developed in the period 2007-2013 managed to attract sizeable resources from the private sector at the level of projects, even in those cases where no private contributions were made at the level of the fund (such as the Marguerite fund). We consider that the experience acquired under these instruments helps the Commission to develop instruments capable of attracting even more private investment.

VI Third indent
The Commission considers that the frequency of the recycling of funds during the eligibility period is not an end in itself.

Moreover, the maturity date of the financing provided is/has to be adjusted to the typology of investments being financed, and any conclusion on the limited revolving effect should be drawn by reference to the setup date of the financial instrument, the grace period, the maturity and the default rates of the financing provided to final recipients.

VI Fourth indent

Under the rules established for the programming period 2007-2013, the management costs and fees are linked to the amounts paid in to the financial instruments and not to the amounts disbursed to final recipients. The Commission notes that a comparison with centrally managed instruments will only be possible at closure of the ERDF and ESF instruments.

For 2014-2020 the management costs and fees must be linked to performance, including the amounts disbursed to final recipients.

VIII First recommendation

The Commission accepts the recommendation.

Whenever a new financial instrument is developed, the *ex ante* assessment should include an analysis of lessons learnt with similar instruments in the past.

VIII Second recommendation

The Commission accepts the recommendation.

For centrally managed instruments the relevant legal bases foresee mid-term reviews or evaluations.

For all such future mid-term reviews of financial instruments, the Commission will ensure that they cover the lessons learnt and the effect of any major socio-economic changes on the rationale of the instrument and the corresponding contribution from the EU budget.

VIII Third recommendation

The Commission accepts the recommendation.

Insofar as it is concerned, the Commission considers this recommendation as being implemented through a draft guidance note on the implementation options under Article 38(1)(b) CPR presented for the first time to Member States on 28 April 2016 and now under finalisation, the extensive clarifications provided to Member States on what concerns the SME Initiative and the brochure to guide Member States on ESIF /EFSI complementarities.

VIII Fourth recommendation

The Commission does not accept the recommendation.

It does not see the necessity of amending the financial regulation and/or the underlying sectorial rules (CPR and centrally managed sectorial rules) and considers that the issue can be sufficiently addressed through the provision of guidance.

In this respect, the ESIF DGs started to elaborate a draft guidance note on reporting. That draft was presented to Member States on 28 April 2016 and is envisaged to contain extensive information on the calculation of the leverage as provided for in the financial regulation. For centrally managed instruments, in June 2015, the Commission refined the methodology for leverage calculation for the 2014-2020 financial instruments in order to comply, in a consistent and harmonised way, with the applicable requirements on the leverage effect in the financial regulation and the rules of application.

VIII Fifth recommendation

The Commissions accepts the recommendation.

The Member States will have to report at closure of operational programmes the national private co-financing effectively paid to the financial instrument as well as the identity of national co-financing providers, the type of national co-financing provided and any co-investment funds in addition to programme resources.

VIII Sixth recommendation

The Commission accepts this recommendation.

The Commission started to elaborate a draft guidance note on preferential remuneration which was presented to Member States in October 2015 and the final version is under preparation.

VIII Seventh recommendation

The Commission partially accepts this recommendation insofar as it concerns its legislative proposals for the post-2020 programming period.

VIII Eighth recommendation

The Commissions accepts the recommendation.

For shared management, the Commission will include in the final version of the guidance note on implementation options under Article 38(1)(b) CPR additional recommendations to require alignment of financial instruments structures with the policy set out in the Commission Communication on the anti-tax avoidance package of January 2016.

For centrally managed instruments, the Commission has already written to the EIB and the EIF to stress the importance of the Commission's anti-tax avoidance measures encouraging the further promotion of best practice by EIB/EIF in this field. The Commission engages in an active dialogue with the EIB and EIF on the review of their respective policies in this area.

VIII Ninth recommendation

The Commission accepts this recommendation.

The Commission will in the final version of the guidance note on implementation options under Article 38(1)(b) CPR emphasise the importance of the requirement in the CPR on the use of resources returned in the funding agreement signed by the managing authorities and will indicate that a verification of the adequacy of this provision falls within the scope of regular audit work of the audit authorities.

VIII Tenth recommendation

The Commission accepts this recommendation.

The guidance note on *ex ante* assessment adopted in May 2014 explains the conditions to contribute programme resources 2014-2020 to an existing financial instrument, and the draft guidance note on selection of bodies implementing financial instruments started to be elaborated by the Commission is envisaged to include a section which explains the conditions applicable to contract modifications. The final version of this guidance note is currently under preparation.

VIII Eleventh recommendation
The Commission accepts this recommendation.

The guidelines on the closure of operational programmes (Commission Decision C(2015) 2771) foresee a mandatory reporting on the management costs and fees incurred and paid by March 2017.

VIII Twelfth recommendation
The Commission does not accept the recommendation.

The Commission considers that the rules are clearly set out in the legal basis which has been subject to detailed guidance and that there is no scope at this stage for reinterpretation.

VIII Thirteenth recommendation
The Commission does not accept the recommendation.

The Commission considers the mandatory provisions on performance based remuneration laid down in Article 42(5) CPR, as well as the detailed criteria for performance established in Article 12 of Delegated Act 480/2014 constitute an adequate basis for achieving the desired incentive effect and that at this stage there is no sufficient basis which would justify proposing an amendment.

VIII Fourteenth recommendation
The Commission notes that this recommendation is addressed to Member States.

The Commission agrees that the managing authorities should make the best use of the existing legal requirements.

VIII Fifteenth recommendation
The Commission does not accept the recommendation.

As regards the feasibility and the proportionality of the implementation of this recommendation, the Commission considers that the analysis would require isolating the costs for grants and financial instruments borne by a managing authority, and probably by the same staff working on both tasks. Moreover, the cost structures of grants and financial instruments, as well as of shared management and direct management financial instruments, differ as they are different policy delivery modes and they target different typologies of investments.

Introduction

02
The Commission would like to highlight further advantages such as the better expertise and access to a wider spectrum of financial tools for policy delivery.

08
The Commission highlights that the criteria for selecting fund managers, as defined in Article 7 of Regulation (EU) No 480/2014, are applicable even in the cases where the public procurement rules are not applicable.

The State aid rules require also an open, transparent and non-discriminatory process for the selection of the fund manager.

The Commission considers that these are strong safeguards to ensure a sound selection of fund managers.

09
The Commission notes that not for all centrally-managed instruments is the fund manager designated in the legislative proposal, e.g. the EaSI regulation mentions the EIB Group, but does not exclude other fund managers.

22
The Commission recalls that EFSI aims to mobilise at least 315 billion euros with an EU budget guarantee of 16 billion euros and additional 5 billion euros risk bearing capacity from the EIB resources.

This guarantee is expected to lead to a higher leverage in contrast with the different products delivered under the ESIF financial instruments.

Observations

31
Taking into account the life cycle of the financial instruments, an increase is expected in the last years of implementation and a conclusion on the disbursement rates can be fully drawn at closure.

32
See Commission reply to paragraph 43 and recommendation 5 of the Court's 2014 annual report.

33
The Commission considers that there is no automatic link between the level of disbursement and the level of the initial endowment due to the following factors:

The analysis of the disbursement rates is based on data collected as at the end of 2014. The year-on-year progress made in 2014 (+12% for OP contributions to financial instruments and +38% for payments to final recipients, leading to a 10 percentage point increase in the overall disbursement rates) corresponds to the life cycle of the financial instruments. The Commission expects that the absorption rate in the report for the year 2015 and in the final report on implementation covering 2016 and 2017 will be substantially higher.

The Commission notes that there are also other factors influencing the level of the disbursement rates at the end of 2014 such as new instruments established in 2014 and to the late settlement of financial instruments in some Member States in 2012 and 2013.

See also Commission replies to paragraphs 53 and 54.

34

The Commission believes that an overall absorption rate of 75% and a disbursement rate of around 60% for financial instruments, at the end of 2014, can be considered reasonable. As indicated in Figure 2a, there are also high absorption rates in some of the Member States allocating considerable amounts to financial instruments.

Like in any statistical representation, exceptions exist:

— low overall absorption rate and high disbursement rate for Romania and the Czech Republic;

— high overall absorption rate and a medium disbursement rate like Greece and France.

— Italy, Spain and Slovakia with overall low absorption.

The Commission put in place specific actions to help the low performers to increase their administrative capacity to be able to use the funds in line with their needs.

Common Commission reply to paragraphs 36-38

The Commission has identified the risk indicated by the Court (even if in some cases the increase was justified by the market conditions). The 2014-2020 rules on phased payments address this issue.

The Commission would like to point out that in any event financial intermediaries will not approve starting the implementation of a financial instrument without an appropriate amount of money having been made available to it.

40

Arrangement on management costs and fees are left to the agreement between the managing authority and the fund manager in line with the principle of subsidiarity.

In many cases these arrangements included also a performance based remuneration, and/or set the management costs and fees below the maximum thresholds of the regulation. In some cases, there were no management costs and fees charged to the EU budget.

The regulation defines the maximum level of eligible management costs and fees only, which is capped by the threshold linked to the capital paid in.

41

For the investments in SMEs, the financial instruments managed by EIF started in 2013-2014 and for some instruments, additional allocations were made in 2015. Even if the disbursement rates at end 2014 were below the average, a further significant increase is expected until the end of the eligibility period.

For the investments in urban development funds (UDFs), the EIB and the UDFs have strongly accelerated investment activity since 2014. The slow take-off of investment projects at final recipients' level can be explained by the infrastructure nature and therefore the longer cycle of the Jessica projects which implies more complex permit processes, State-aid and work advancement payments. Number of South-European funds suffered also macro-economic and banking sector crisis.

43
The Commission considers that the modifications introduced in its closure guidelines were within the scope of Article 78(6) of Regulation (EC) No 1083/2006, as amended, and therefore did not require an amendment of the legislative act (see also Commission reply to paragraph 6.52 and to Recommendation 5 of the Court's 2014 annual report).

44
The Commission considers the projection of disbursement rates from previous years not to be the most relevant method to estimate the level of disbursement rate by the end of 2015 as it does not take into account the entire life cycle of the financial instruments and the time elapsed since a particular fund was established.

See also Commission reply to paragraph 43.

48
Experience showed that it was not appropriate to regulate on the details of the content of a business plan. This is also in line with the spirit of shared management and the principles of subsidiarity and proportionality.

The way Article 43(2) of the general regulation was initially drafted raised important questions. For e.g. it was not considered adequate to require the business plan to be submitted by co-financing partners as a business plan (or other appropriate document) should be submitted only by the fund manager. Moreover, Article 43(2) did not make a distinction between the business plan of a holding fund and a business plan of a financial intermediary and thus its content raised confusions.

In the 2014-2020 legal framework which is more comprehensive, the exact content of a business plan is not provided either. The crucial element in terms of setting up a financial instrument is a funding agreement signed between the managing authority and the fund manager. The funding agreement must include the investment strategy and a business plan and several other relevant elements (see Annex IV CPR).

50
The Commission has repeatedly recommended to the Member States to include in the funding agreements the conditions for possible withdrawing of funds from financial instruments and to proceed with phased payments into the instruments (see point 5.3 COCOF Guidance FEI 10-0014-05-EN).

51
The Commission notes that in the same country different funds performed differently.

The Commission considers that there are other factors than just the robustness of the gap assessment which may have contributed to instrument oversizing (e.g. financial crisis or the late setup of the instruments that influence the disbursement of the funds).

Furthermore, the financial instruments are market-led instruments. The gap assessment reveals an existence, or not, of a given market failure. The market conditions can however vary significantly few years after the instruments have been setup. Therefore, assessing the performance of a financial instrument by reference to the link between the gap analyses and the disbursement rates seems not to address these evolving market conditions.

52
The Commission notes that, in 2007-2013, carrying out a gap assessment was only indirectly required by the legal framework. In view of this, the Commission considers the fact that 82% of the respondents to the Court's survey have carried out an assessment as positive.

53
The Commission recalls that the indirect requirement to carry out a gap assessment in the 2007-2013 period did not include any of the mandatory and detailed requirements provided for the *ex ante* assessment in Article 37 CPR for the 2014-2020 period. The Commission believes that the new legal requirement will prevent the associated risk and that a second layer of review would bring no added value.

Performing an *ex ante* assessment is the responsibility of the managing authority and its results are to be submitted to the monitoring committee before any decision to make programme contributions to financial instruments is taken. The *ex ante* assessment is not a decision as such. It helps to avoid overlaps and inconsistencies between instruments implemented by different actors at different levels and to avoid some of the problems identified in the 2007-2013 period.

The experience of the Commission shows that the *ex ante* assessments in 2014-2020 are carried out by entities with market experience and competence, including the EIB group. The *ex ante* assessment requirement was designed with a view to ensure its independence and objectivity. The *ex ante* assessment is undergoing a strong public scrutiny with a much higher added value than an 'independent review' due to the submission to the monitoring committee and the publication within three months of their date of finalisation.

The Commission considers that the new phased payment system will function also as a market test and as a second layer of safeguard. In case the disbursements to final recipients are lower than expected, the Commission will not proceed with any further reimbursements.

54
The Commission notes that 'lessons learnt' and 'major socio-economic changes' are already taken into account in the systematic mid-term reviews of the 2014-2020 centrally managed instruments. This is why the Commission considers that *ex ante* assessments do not need to be updated to cater for these aspects.

55
The Commission recalls that, while financial instruments should be established in line with the rules of the programmes (national/regional), this does not mean that a financial instrument needs to be created in every region. It is possible to make several programme contributions to one financial instrument therefore benefiting from economies of scale and critical mass.

It is also highlighted that the amounts allocated to financial instruments in a region are not arbitrary. They are part of the programme strategy used for the programme negotiations and including the needs analysis of the region which is confirmed by an *ex ante* evaluation of the programme.

57
Under cohesion policy the objective was to provide a sufficient range of options so that the best implementation option is chosen in respect of the market failure identified so to provide the most effective support.

Based on the *ex ante* assessment the instruments should be designed in a way that avoids overlaps and ensures complementarity. It is possible to make several programmes' contributions from different regions to one financial instrument therefore benefiting from economies of scale and critical mass. Depending on the type of instruments (e.g. loans and guarantees), and the specificities of the Member States, some smaller funds perform as well as bigger funds or even better (e.g. Germany, Poland or France).

The Commission believes the *ex ante* assessment, by indicating the adequate size of the financial instrument, will provide reliable and appropriate results with more accuracy than any general information issued by the business fund industry.

59
The Commission recalls that this possibility in the common provisions regulation does not eliminate the geographical restrictions of each contributing programme. The geographical eligibility is one of the main features of cohesion policy.

See Commission replies to paragraphs 55 and 57.

61
With respect to Article 38(1) (a) of the common provisions regulation (CPR), the managing authorities may provide financial contribution to financial instruments set up at Union level, managed directly or indirectly by the Commission.

The Commission has provided extensive clarifications and worked closely with Member States on what concerns the SME Initiative, which is an EU-level financial instrument. Moreover, the Commission has issued a brochure to guide Member States on the complementarities between ESIF and EFSI. In case new EU level instruments are developed, the Commission will provide guidance on the contribution of programme resources to the EU level instruments based on Member States' requests.

64
The definition of leverage derives from Article 223 of the Rules of application of the financial regulation which will allow for consistent reporting by Member State.

The discussion on a common definition of leverage took place between all Commission services. Section 2.3.4 of the Commission Communication COM(2011) 662 of 19.10.2011 introduces an unified concept.

65

Discussions on the definition of leverage between the Court and the Commission have been ongoing since 2010. As mentioned in the Commission reply to paragraph 64, the definition of leverage derives from the financial regulation and ensures a consistent reporting from the Member States.

The Commission considers that the Court's interpretation of the leverage effect is diverging from the definition in Article 223 of the rules of application to the EU financial regulation (RAP) as 'the amount of finance to eligible final recipients divided by the amount of the Union contribution'. This means that the leverage should be seen as the ratio between the Union financial resources allocated to a financial instrument (input) and the (total) amount of finance provided to eligible final recipients (output).

Such an interpretation guarantees in fact a comparable treatment of the leverage effect between financial instruments and grants.

For shared management instruments, the reporting by the Member States will enable the Commission to distinguish between the leverage of private and national public contributions under the OP and/or of additional private or public capital contributions. Co-financing does not necessarily constitute public funding only. Priority axis can be on eligible public expenditure or eligible total expenditure (including public and private expenditure). The majority of the axis created to support SMEs and the private sector in general) are on total expenditure (see Article 120 of the common provisions regulation).

Because the European Structural and Investment (ESI) funds are implemented always through operational programmes which are co-financed with public and/or private resources (whereas financial instruments implemented under other policy areas do not require such co-financing at programme level), it would be inappropriate to consider that such co-financing should not count as leverage resources for financial instruments implemented through ESI funds.

67

The Commission underlines that Member States' reports in the 2014-2020 period will, among others, enable the Commission to provide information on the leverage effect of financial instruments, which takes into account the co-financing requirements, i.e. the fact that the national co-financing can consist of public and/or private expenditure.

68

The Commission has set up a horizontal taskforce providing guidance on the interpretation of the rules of the current financial regulation with regard to the implementation of 2014-2020 financial instruments, including on leverage.

The Commission also refers to its replies to paragraphs 69 and 73.

69
The current financial regulation and its rules of application require an unified approach to reporting on leverage. The Commission took steps to fine tune the methodology for leverage calculation as indicated in the reply to paragraph 68.

As the provisions applying to financial instruments entered into force in January 2014, the revised approach is applied only to 2014-2020 financial instruments.

Moreover, it needs to be noted that the scope of these instruments is far from homogeneous, which explains some differences in the applied methodology. These differences should therefore not be systematically seen as inconsistencies.

70
The Commission agrees that different methodologies adapted to the different instruments should be clarified and notes that efforts have already been made in this respect.

In June 2015, the Commission refined the methodology for leverage calculation in order to comply, in a consistent and harmonised way, with the applicable requirements on the leverage effect in the financial regulation and the rules of application. The methodology covers EU-level financial instruments of the current programming period (2014-2020). According to the aforementioned methodology, the amount of finance to eligible final recipients should correspond to the volume of finance provided to eligible final recipients by a financial instrument through its financing chain, including the part of the Union Contribution.

Moreover, finance provided outside the financing chain of a financial instrument can also be taken into account provided there is a clear link with the financing provided through the financing chain of the financial instrument. In line with the above, in infrastructure financing, all sources of finance — equity investment, loans and grants — are to be taken into account for the calculation of the amount of finance to the project. In this context, the EU budget intervention in the financing of a transaction ensures a high degree of certainty and deliverability of the transaction as a whole, which triggers as an effect a higher volume of finance mobilised.

For the reporting period starting from 2015 the Commission will ensure an improved consistency in the methodology for leverage calculation across instruments and product types.

See also Commission's replies to paragraphs 69 and 73.

Box 7

The Commission notes that the OECD methodology concerns the measurements of amount mobilised from the private sector by official development finance.

The Commission considers that the causality between the EU budget contribution and the amount of finance that was mobilised as a result can be assessed only on a case by case basis.

Even limited EU and EIB contributions to projects can have positive impacts:

— Attracting additional private financing at least for the same amount as EIB senior lending (this is the case for all LGTT guaranteed projects, where the EIB lending has been equal to other banks' lending);

— Providing a stepping-in into the financial close of private financing institutions, or national development banks, due to the recognised role of the EIB as AAA financing institution;

— Public authorities engaging in long term maturities with EIB for projects, which could not otherwise be financed solely in the regional/ even national context due to shorter term return on investment requirements of the private investors.

Given the arguments above, the Commission considers that the joint EC-EIB financial contributions, as well as the EIB's role as institutional bank, do trigger the decisions of the national/ regional authorities in procuring public private partnerships projects, where part of the financing is provided on the long-term basis from the national budgets, along the EU-EIB engagement on the long term basis, which the solely private institutions would be unable to undertake.

The methodology for multiplier calculation was refined in the design of the European Fund for Strategic Investments (EFSI). To this effect, Project Investment Costs have been adjusted to exclude all EU grant financing, EU financial instruments or ESIF grants/financial instruments (including related national public co-financing from Managing Authorities) which are used to co-finance the proposed project.

Common Commission reply to paragraphs 71 and 72

The common provisions regulation provides the framework for the implementation of ESIF. Other legal frameworks such as Procurement Directives or State aid rules apply as well without the need to repeat them in the common provisions regulation. The financial regulation also applies in the same way, in particular its special provisions applicable to shared management.

In April 2016, the Commission issued a guidance note on reporting, which covers leverage calculation in order to give to Member States a consistent methodology. This will ensure robust and comparable data with respect to the expected and achieved leverage effect. For shared management instruments, the reporting by the Member States will also enable the Commission to provide information on the leverage effect of financial instruments, which takes into account the co-financing requirements which may consist of public and/or private expenditure.

73

The Commission considers that the goal of attracting private capital should not be overemphasised in particular for sectors exposed to major market failures.

For both centrally managed and shared management instruments, other goals may be equally important (e.g. establishing investment in a given nascent market with strong EU value added at a time of economic recession; supporting growth, jobs and competitiveness in all Member States and their regions, etc.). Therefore the measurement of the success factor of financial instruments goes beyond the extent of private funds attracted.

The Commission underlines that private funding is an additional legal requirement for shared management stemming from the State aid legal framework.

Common Commission reply to paragraphs 74 to 76

The Commission points out that the fact that the parties may have different goals will reinforce the quality of the projects and will allow for access to a wider spectrum of financial tools for policy delivery and private sector involvement and expertise. It believes that EU support delivered through professional and experienced mechanisms will strengthen the governance and delivery system of ESIF.

For 'shared management' financial instruments, the preferential treatment of the private investors or public investors operating under the market economy principle, as well as any risk-sharing arrangements, have to comply with State aid rules as provided for in the regulations for 2007-13 and is limited to the minimum necessary to attract those investors.

In addition, as provided for in the Article 6 of Delegated Regulation (EU) No 480/2014 the preferential remuneration of private investors or public investors operating under the market economy principle, as referred to in Articles 37(2)(c) and 44(1)(b) CPR, is proportionate to the risks taken by these investors and limited to the minimum necessary to attract such investors, which shall be ensured through contractual terms and conditions and procedural safeguards.

77

The Commission believes that the legal basis should contain general terms in relation to the risk and revenue sharing mechanisms, in order to give sufficient flexibility for the detailed arrangements to be agreed upon in the specific Delegation Agreements between the Commission and the entrusted entities (see Commission reply to Box 9).

Box 9

Fifth alinea: The Commission considers that the level of remuneration that the Commission is entitled to receive for the LGTT/PBI portfolio is commensurate with the risk taken. Moreover following the depletion of the PFLP the remaining risk is fully borne by the EIB.

Sixth alinea: The Staff Working Paper dated 19 October 2011 was an exploratory document, charting the contours of a highly innovative scheme without any precedent.

Under the legislative procedure, the co-legislators were made aware of the evolution of the detailed scheme, which was triggered by further calculations and risk analysis by the Commission and the EIB. In any case, the 95%/5% split of the First Loss Piece was clearly indicated in the Staff Working Paper — this risk-sharing parameter never changed.

Common Commission reply to paragraph 78 and Box 10

The Commission believes that the risk allocation under the examined centrally managed instruments is justified in particular to help overcoming the reluctance of the private sector to invest in certain areas. First loss pieces should be duly justified and certain caveats have to apply taking into account in particular the sector and market in which the instrument operates, which may in turn justify such risk taking.

As regards EEEF, given the difficulties in stimulating investment in the embryonic, fragmented, small scale, capital intensive energy efficiency market, further risk bearing or other measures may be necessary to stimulate investment.

79

The use of tax ruling in the Fund industry in Luxembourg is usual and necessary, in particular for a SICAV, to reduce the uncertainty faced by investors by providing clarity on the cross-borders investment taxations.

Such funds obtain tax rulings only because of the market environment in which they operate and it is not linked to the fact that a financial instrument is implemented through a SICAV structure.

80

The Commission notes that none of the investigations referred to are linked to a SICAV. The Commission emphasizes that only a fraction of tax rulings were used by large multinational companies to gain unfair advantages. The proposal for a Council Directive COM(2015)135 still needs to be adopted by the legislator and subsequently be transposed in the national law of the Member States. The recommendation C(2012)8806 is addressed to Member States.

Common Commission reply to paragraph 81 and Box 11

Marguerite is a Luxembourg based SICAV which operates within the market practices and conditions as well as the national legal environment.

The use of tax rulings is common for financial vehicles established in Luxembourg for confirmatory reasons with a view to limit the uncertainty for investors (especially when the Fund aims to attract private investors).

82

There is no legal requirement from Member States to report to the Commission the details of the set-up of ERDF and ESF financial instruments. Under shared management and in line with the subsidiarity principle, the Member States have the responsibility to ensure that the set-up of the financial instruments is compliant with the applicable EU and national laws so that the related expenditure is legal and regular.

83
The Commission recalls that there is no systematic reporting to identify private funding at the level of the final recipients.

The Court's analysis takes into account only the implementation report on FEIs for which figures were inserted in the column II.10 Amounts of OP contributions paid to FEI — national private co-financing. However, as the Court explains in paragraph 85, private funding can also be provided from sources outside the OP.

85
For the 2014-2020 programming period requirements on reporting on financial instruments are provided in Article 46 CPR, and Annex I of Commission Implementing Regulation (EU) No 821/2014. The latter sets out a model for reporting on financial instruments. In section VIII of the reporting model the Member States have to provide information on the amount of other contributions, outside ESI Funds raised by financial instruments, including public and/or private contributions, both committed in the funding agreements and paid at the level of final recipients. Indeed the regulatory framework envisages that reporting on financial instruments under Article 46 should include information on the private contributions (in the context of assessing the leverage effect).

86
While the legal basis for 2007-2013 did not explicitly require performance oriented management costs and fees, the remuneration is generally determined in the funding agreement between the managing authority and the body implementing the financial instrument. For example, at least Portugal, UK and Poland have put in place a performance based remuneration system in some of the funding agreements for ERDF and ESF instruments during the 2007-2013 programme period.

The Commission underlines also that in many loan funds the private co-investment takes place at the fund level and it is provided by the fund manager itself.

87
The Commission notes that an additional factor regarding the set-up of financial instruments and the leverage result in mobilising additional private funds is the risk and credit profile of targeted final recipients. It is worth mentioning that EPMF targets final recipients with higher risk credit profiles.

See also Commission reply to Box 12.

Box 12 First alinea

According to the ad-hoc audit report prepared by external consultants at the request of the Commission on the Marguerite Fund, a lack of private co-financing at the Fund level was not due to private sector reluctance to invest in publicly-funded instruments but rather to the less common governance structure of Marguerite, the limited pipeline of mature projects and the challenging market conditions in which the Fund has had to operate.

Box 12 Second alinea

The EEEF was created in a short timeframe under the European Energy Recovery programme to support particularly risky and innovative energy efficiency projects, a sector where no previous dedicated funds were established. Therefore, the Commission agreed to be the cornerstone investor of the fund. Nevertheless, there is still room for additional investments as the total amount committed at this stage is less than half of the fund's target of 700 million euro.

89

The Commission started to elaborate a draft guidance note on preferential remuneration which was presented to Member States in October 2015 and the final version is under preparation.

90

The Commission believes that the main aspects of the risk-sharing arrangements between the Commission and its partners are to be assessed in the future legal bases.

However, a balance must be found to allow sufficient flexibility in the legal bases so that the risk and revenue sharing arrangements between the Commission and the entrusted entity can be agreed upon in the specific Delegation Agreement.

91

The Commission recognises the importance of ensuring that financial instruments are not subject to unacceptable tax avoidance schemes. This is reiterated in its recent Communication on the anti-tax avoidance Package of 29/01/2016. However advance tax agreements cannot be considered per se as going against the Commission's own policy.

In respect of both centrally and shared management financial instruments, as provided for respectively in Article 140(4) of the financial regulation and in Article 38(4) of the common provisions regulation, the bodies implementing these instruments shall not be established and shall not maintain business relations with entities incorporated in territories, whose jurisdictions do not cooperate with the Union in relation to the application of internationally agreed tax standards and shall transpose such requirements in their contracts with the selected financial intermediaries. This is a legal requirement for implementation of financial instruments and provides a powerful safeguard for the use of EU funds.

The Commission considers that the reputational risk should not be attached to the existence of advance tax agreements, but to the specific provisions of these agreements.

94
The Commission envisages to provide timely guidance based on Member States identified questions and needs.

Common Commission reply to paragraphs 96 and 97
The Commission considers that the frequency of the recycling of funds during the eligibility period is not an end in itself.

Moreover, the maturity date of the financing provided is/has to be adjusted to the typology of investments being financed, and any conclusion on the limited revolving effect should be drawn by reference to the setup date of the financial instrument, the grace period, the maturity and the default rates of the financing provided to final recipients.

For example, in the off the shelf instrument Energy Efficiency 'Renovation Loan' for 2014-2020 the loan maturity can be defined for a period of up to 20 years.

A full revolving cycle within the programming period goes against such a long -term perspective.

Common Commission reply to paragraphs 99 and 100
The Commission underlines that the managing authorities are obliged to ensure proper measures to comply with Article 78(7) of the general regulation and to present these measures at closure, such as the information on the reuse of legacy resources attributable to the ERDF and ESF specifying the competent authority which is responsible for managing legacy resources, the form of reuse, the purpose, the geographic area concerned and the envisaged duration; (see the closure guidelines point 5.2.5).

The framework not only incentivises Member States to reuse the resources for the same target group but also that these resources are reinvested several times provided that there is a market gap. It is up to the Member States to ensure compliance with these provisions.

102
The Commission highlights that resources returned to the fund after the end of the eligibility period are no longer EU resources, but national resources.

The CPR requires the Member States to adopt the necessary measures to ensure the proper use of resources paid back to the financial instruments during a period of at least eight years after the end of the eligibility period (see Article 45 of the common provisions regulation and the model of funding agreement in Annex IV Article 1(j)).

The Commission envisages verifying the appropriateness of measures put in place in the funding agreements through the regular audit work of the national audit authorities and its own services on financial instruments.

104
The Commission acknowledges the time length necessary to organise an open procedure in order to select a fund manager. Nevertheless, this cannot be avoided as the applicable selection rules, including those on public procurement, have to be complied with.

The Guidance note on *ex ante* assessment which was finalised in February 2015 explains the conditions to contribute programme resources 2014-2020 to an existing financial instrument. In addition, the Commission started to elaborate a draft guidance note on selection of bodies implementing financial instruments which is envisaged to include a section which explains the conditions applicable to contract modifications (e.g. extension of implementation period or increase of amounts of OP contribution to the financial instruments existing under the 2007-2013 period).

110
The Commission recalls that fees reported as 'zero' does in many cases mean that no management costs and fees have been paid out. There are more than 261 funds which have reported 'zero' management costs and fees.

111 Second alinea
In 2007-2013 the regulation referred to national eligibility rules rather than EU eligibility rules (Article 56(4) of 1083/2006). This empowerment to Member States was in line with shared management and the subsidiarity principle.

Eligibility rules on management costs and fees are one of the very few elements in the legislation where a limitation on specific expenditure is imposed by the legal basis. The regulation established different thresholds for management costs and fees depending on the type of financial products provided and these can be lower (but not higher) than 4%, namely 2% for holding and guarantee funds, 3% for loan and equity funds and 4% for micro-credit instruments. The ceilings aim at preserving the EU financial interests.

113
The management costs and fees are eligible and reimbursed by EU only if they are paid. Therefore, the Member State has no obligation to report on management costs and fees which are not paid as they cannot be claimed for reimbursement from the Commission and are therefore not financed by the EU budget.

If the management costs and fees are exceeding the ceilings based on a competitive procedure and are declared to the Commission as eligible expenditure, at closure, the appropriate authorities (managing authorities, certifying authorities and audit authorities) will check the eligibility of this expenditure and are obliged to report to the Commission any irregularities.

Common Commission reply to paragraphs 115 to 117

The Commission considers that the rules are clearly set out in the legal basis which has been subject to detailed guidance and that there is no scope at this stage for reinterpretation.

Article 43 of the implementing regulation states that the ceilings for eligible expenditure are applicable to the capital contributed from the operational programme to the fund, and not to the capital used by the fund to provide support to final recipients.

The ceilings define the maximum amount of eligible expenditure and must be calculated on a yearly average, *pro-rata temporis*. The COCOF guidance note on financial engineering instruments addresses and further explains the legal basis (see paragraphs 2.6.1 to 2.6.17).

For 2014-2020, the legal framework requires that the management costs and fees must be linked to performance, including the amounts disbursed to final recipients.

118

See Commission reply to paragraph 86.

122

On the basis of data reported by Member States, the cumulative management costs and fees for ERDF and ESF financial instruments at the end of 2014 represent 4.7% of the amounts paid to the financial instruments, which is an annual equivalent of less than 1.0%. This is in line with the figures presented by the Court for contributions from the EU budget to centrally managed instruments.

123

The management costs and fees reported to the Commission are those paid by the managing authorities and reimbursed by the Commission to the Member State regardless of the level/layer of implementation where the management costs and fees are incurred. The Commission underlines that a holding fund manager and a financial instrument manager perform different functions and are entitled to fees for performing their functions.

The fees charged to the final recipients have to be deducted from the eligible expenditure declared to the Commission in order to avoid a double financing. The existence of such fees and their correct treatment are part of the management verifications and audit work.

Common Commission reply to paragraphs 124 to 127

The ratio between fees and financial support provided to final recipients reflects the situation in the implementation of financial instruments at the end of 2014 and will be reduced in subsequent years as the financial support provided to final recipients is expected to increase.

128
The Commission refers to its reply to paragraph 124 and notes that a comparison will only be possible at closure of the ERDF and ESF instruments.

131
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, including compliance with the ceilings for reimbursement.

For ERDF and ESF financial instruments the Commission underlines that the management costs and fees are established on the basis of a funding agreement negotiated between the managing authority and the fund manager and the Commission is not a party of that contractual relation. This is different for centrally managed instrument where the Commission is a party in the contractual relation with the fund manager.

133
The management costs and fees are eligible and reimbursed by EU only if they are paid. Therefore, the Member State has no obligation to report on management costs and fees which are not paid as they cannot be claimed for reimbursement from the Commission and are therefore not financed by the EU budget.

The management costs and fees paid by the managing authority can also exceed the thresholds set in the Article 43.4 of Commission Regulation (EC) No 1828/2006, but these are then not eligible for reimbursement from the Structural Funds.

134
For the programming period 2014-2020, the summary of data has to be prepared by the Commission for all of the five ESI funds. The reporting on financial instruments was set up for a time period of six months in order to take into account all fund specific rules (and the respective deadlines of submission of the annual implementation report as required in Articles 50(6) and (7) CPR), the time required for the consolidation and assessment of the data submitted by the Member States/managing authorities as part of the annual implementation report, and the overall presentation of progress on implementation of financial instruments across all 5 ESI Funds.

Where the Commission provides observations on the annual implementation report, including the financial instruments, the report is returned to the managing authorities and the deadline of 2 months is interrupted until the revised information is resubmitted to the Commission and the deadline of two months resumes again.

Therefore, the data can be aggregated once the complete assessment by the Commission has taken place and there is sufficient assurance on the accuracy and plausibility of data provided by the managing authorities.

141 First indent

The Commission considers that the normal duration of a holding fund and specific fund is less than the eligibility period given the necessary time to set up the financial instrument (see also paragraph 93).

The Commission underlines that, according to Article 42(5) CPR, it is mandatory to use a performance based calculation methodology and the criteria for performance are established in Article 12 of Delegated Act 480/2014. The global cap for eligible management cost and fees is established in Article 13(3) of Delegated Act 480/2014 aiming at protecting the EU's financial interest.

In line with the principle of subsidiarity, the payments of management costs and fees are a matter to be established in the funding agreement. The CPR and of Delegated Act 480/2014 only establish ceilings to the maximum eligible expenditure to be co-financed by ESIF, and not to the actual payments of fees to be made. This protects the EU financial interests.

141 Second indent

The Commission clarified in the Guidance Note EGESIF 15-0021-01 on management costs and fees dated 26 November 2015 that a 'bonus/malus scheme' should be used where for instance the full reimbursement of management costs is linked to the fulfilment of agreed targets in relation to the relevant performance criteria (see point 2.2 page 3 of the Guidance Note).

141 Third indent

In line with the principle of subsidiarity, such a condition can be set up at the level of the funding agreement as it is a matter of negotiation between the managing authority and the body implementing the financial instrument. The ceilings for base remuneration and performance based remuneration aim at capping the maximum eligible expenditure.

The Commission emphasizes furthermore that the use of performance based criteria is mandatory.

The performance based remuneration is a mandatory requirement as provided for in Article 42(5) CPR and the criteria for performance are established in Article 12 of Delegated Act 480/2014.

From a regulatory perspective, this was considered sufficient by the co-legislators to ensure a sound implementation of financial instruments.

From a transparency and sound financial management perspective it is also underlined that the managing authority must inform the monitoring committee of the provisions regarding the performance-based calculation of management costs incurred or of the management fees of the financial instrument. The monitoring committee will receive reports on an annual basis on the management costs and fees effectively paid in the preceding calendar year.

144
The Commission does not consider that the increase in funding through financial instruments de facto raises the technical assistance support to Member States as the amounts committed for technical assistance are based on specific projects related to the implementation of the programmes and not to the level of funding delivered through the financial instruments.

In addition, some technical support has to be used in the implementation of the financial instruments (see Commission reply to paragraph 94).

The level of the technical assistance support was planned in each Member State in relation to the expected needs to cover the work linked to the preparation and implementation of the programmes.

The management costs and fees represent the remuneration of the fund manager to manage and to ensure the reporting requirements.

Furthermore, the cost driver of technical assistance is not necessarily the overall amount made available to grant schemes, but other factors such as the complexity of the management and control system and of the legal requirements linked to implementation at national and EU level, the number of OP's, measures and major projects co-financed, the number of IB's etc.

145
The Commission points out that in the Annual Implementation Report submitted by the managing authority the main technical assistance actions undertaken in a particular year are described in a specific section. Furthermore, technical assistance expenses declared to the Commission for reimbursement are verified, based on breakdown of costs and supported by invoices, pay slips or other evidence, by the management authority or another body.

The declaration of expenditure verified by the managing authority, based on a sampling method, could be further verified by the certifying authority, the audit authority and the Commission auditors.

146
The Commission considers that the costs of programme management (TA budget) should not be mixed with the costs of implementation of single operations within a programme (management costs and fees for financial instruments) as it is also not mixed in the implementation of grants operations (e.g. the costs related to the remuneration of the engineer supervisor of the project included in the amounts allocated to the projects and not in the amounts of Technical Assistance).

The Commission receives reports from Member States on the technical assistance budget.

Moreover, the cost structures of grants and financial instruments, as well as of shared management and direct management financial instruments differ.

The Commission published a study in July 2012 with quantitative and qualitative information about the administrative costs and administrative burden of managing EU structural funds (http://ec.europa.eu/regional_policy/sources/docgener/studies/pdf /measuring/measuring_impact_report.pdf).

The update of this study is ongoing and it is planned to be published end 2016. It is planned to be taken into consideration in the simplification exercise.

Conclusions and recommendations

147
The Commission agrees that there are multiple advantages in delivering financial support from the EU budget through financial instruments, which is why for the 2014-2020 programme period it is actively promoting and encouraging their increased use.

148
The Commission considers that the effect of the issues identified by the Court varies between Member States and types of financial instruments and that, overall, financial instruments remain an efficient and effective way of delivering EU funds.

148 First indent
The Commission considers that the average disbursement rate of 57% (at end of 2014) represents a very heterogeneous situation. The risk of not achieving full disbursement at closure concerns a limited number of financial instruments in a few Member States.

The low disbursement rate at the end of 2014 is a result of a number of factors including the financial crisis, the limited experience in some Member States and the late start of some instruments.

148 Second indent
For shared management financial instruments, the legal requirements on reporting did not allow the Commission to obtain exhaustive data regarding the participation of private investors from Member States. Nevertheless, the Commission notes that the state aid rules require for certain financial instruments a minimum participation of private investors (e.g. 30% and in some cases even 60%).

The Commission considers that centrally managed financial instruments developed in the period 2007-2013 managed to attract sizeable resources from the private sector at the level of projects, even in those cases where no private contributions were made at the level of the fund (such as the Marguerite fund). We consider that the experience acquired under these instruments helps the Commission to develop instruments capable of attracting even more private investment.

148 Third indent
The Commission considers that the frequency of the recycling of funds during the eligibility period is not an end in itself.

Moreover, the maturity date of the financing provided is/has to be adjusted to the typology of investments being financed, and any conclusion on the limited revolving effect should be drawn by reference to the setup date of the financial instrument, the grace period, the maturity and the default rates of the financing provided to final recipients.

148 Fourth indent

Under the rules established for the programming period 2007-2013, the management costs and fees are linked to the amounts paid in to the financial instruments and not to the amounts disbursed to final recipients. The Commission notes that a comparison with centrally managed instruments will only be possible at closure of the ERDF and ESF instruments.

For 2014-2020 the management costs and fees must be linked to performance, including the amounts disbursed to final recipients.

150

The Commission considers that the risk of not achieving full disbursement at closure concerns a limited number of financial instruments in a few Member States.

The Commission notes that 82% of the respondents indicated that they performed a gap assessment of the market needs despite the fact that it was only indirectly required by the legal framework. This should be seen as a positive aspect taking into account the non-binding nature of this requirement for 2007-2013.

151

The Commission notes that, depending on the type of instruments, (e.g. loans and guarantees), and the specificities of the Member States, some smaller funds perform as well as or even better than larger-sized funds (e.g. Germany, Poland or France).

Recommendation 1 (a)

The Commission accepts the recommendation.

Whenever a new financial instrument is developed, the *ex ante* assessment should include an analysis of lessons learnt in previous similar instruments.

Recommendation 1 (b)

The Commission accepts the recommendation.

For centrally managed instruments the relevant legal bases foresee mid-term reviews or evaluations.

For all such future mid-term reviews of financial instruments, the Commission will ensure that they cover the lessons learnt and the effect of any major socio-economic changes on the rationale of the instrument and the corresponding contribution from the EU budget.

Recommendation 2

The Commission accepts this recommendation and considers it as being implemented, insofar as it is concerned.

In relation to national/regional level financial instruments the Commission started to elaborate and presented on 28 April 2016 to Member States a draft guidance note on the implementation options under Article 38(1)(b) CPR. The potential for economies of scale has to be also addressed in the context of the *ex ante* assessment when looking at the implementation arrangement within the meaning of Article 38 CPR.

As regards ESIF programme contributions to EU level instruments, the Commission has provided extensive clarifications and worked closely with Member States on what concerns the SME Initiative, which is an EU-level financial instrument.

Moreover, the Commission has issued a brochure to guide Member States on ESIF /EFSI complementarities.

In case new EU level instruments are developed, the Commission will provide guidance on the contribution of programme resources to the EU level instruments based on Member States' requests.

As regards the target implementation date, the Commission underlines that the recommendation is being implemented insofar as it concerns the Commission.

152

The Commission considers that the goal of attracting private capital should not be overemphasised in particular for sectors exposed to major market failures. For both EU level and shared management instruments, other goals were as important (e.g. establishing investment in a given nascent market with strong EU value added at a time of economic recession and supporting growth, jobs and competitiveness in all Member States and their regions.). Therefore the measurement of the success of financial instruments goes beyond the extent of private funds attracted.

For shared management financial instruments, the legal requirements on reporting did not allow the Commission to obtain exhaustive data regarding the participation of private investors from Member States. Nevertheless, the Commission notes that the state aid rules require for certain financial instruments a minimum participation of private investors (e.g. 30% and in some cases even 60%).

The Commission considers that centrally managed financial instruments developed in the period 2007-2013 managed to attract sizeable resources from the private sector at the level of projects, even in those cases where no private contributions were made at the level of the fund (such as the Marguerite fund). We consider that the experience acquired under these instruments helps the Commission to develop instruments capable of attracting even more private investment.

Article 223 of the rules of Application to the EU financial regulation defines leverage as 'the amount of finance to eligible final recipients divided by the amount of the Union contribution'. This means that the leverage should be seen as the ratio between the Union financial resources allocated to a financial instrument (input) and the (total) amount of finance provided to eligible final recipients (output). As such, the Commission considers that this formula fully takes into account the extent to which public financing from the EU budget mobilises additional funds.

153

The Commission considers that it is premature to draw conclusions regarding the level of private funding to be attracted during 2014-2020. The wider scope of financial instruments for the 2014-2020 period should provide additional opportunities, as should the possibility for combination with EFSI. The Commission notes that it did provide models for preferential remuneration schemes in the guidance of 2014.

The implementing regulation No 964/2014 for off the shelf instruments for the 2014-2020 period provides examples on how to best to apply the provisions on preferential treatment to attract more private capital without allocating excessive risks to the public sector.

Moreover, the Commission in its brochure of 22 February 2016 provided examples of combinations of ESIF and EFSI involving preferential remunerations of private investors (see http://ec.europa.eu/regional_policy/sources/thefunds/fin_inst/pdf/efsi_esif_compl_en.pdf).

Finally, the Commission started to elaborate a draft guidance note on preferential remuneration which was presented to Member States in October 2015 and the final version is under preparation.

154

The Commission recognises the importance of ensuring that financial instruments are not subject to unacceptable tax avoidance schemes. This is reiterated in its recent Communication on the anti-tax avoidance Package of 29/01/2016. However advance tax agreements cannot be considered per se as going against the Commission's own policy. As a concept, advance tax agreement aim at diminishing the uncertainty for investors.

Recommendation 3

The Commission does not accept the recommendation.

It does not see the necessity of amending the financial regulation and/or the underlying sectorial rules (CPR and centrally managed sectorial rules) and considers that the issue can be sufficiently addressed through the provision of guidance.

For shared management, the ESIF DGs started to elaborate a draft guidance note on reporting. That draft was presented to Member States on 28 April 2016 and is envisaged to contain extensive information on the calculation of the leverage as provided for in the financial regulation and its rules of application and including how the amounts mobilized are determined. The reporting by the Member States will enable the Commission to distinguish between the leverage of private and national public contributions under the OP and/or of additional private or public capital contributions.

For centrally managed instruments, in June 2015, the Commission refined the methodology for leverage calculation for the 2014-2020 financial instruments in order to comply, in a consistent and harmonised way, with the applicable requirements on the leverage effect in the financial regulation and the rules of application.

Recommendation 4

The Commissions accepts the recommendation.

The guidelines on the closure of operational programmes (Commission Decision C(2015) 2771) foresee in chapter 5.2.5 that the final report as part of the closure package must describe the identity of national co-financing providers, the type of national co-financing provided and any co-investment funds in addition to programme resources. In addition, Annex I, templates 1 and 2, require Member States to report in the mandatory field III.2.2.4 the national private co-financing effectively paid to the financial instrument.

Recommendation 5

The Commission accepts this recommendation.

The way to apply the provisions on preferential treatment to attract more private capital without allocating excessive risks to public contributors to the financial instruments' endowments is covered in the Volume I of the General Methodology to carry out the *ex ante* assessment for financial instruments, issued in April 2014.

Moreover, the implementing regulation No 964/2014 for off the shelf instruments for the 2014-2020 period provides examples on how to best to apply the provisions on preferential treatment to attract more private capital without allocating excessive risks to the public sector. Finally, the Commission started to elaborate a draft guidance note on preferential remuneration which was presented to Member States in October 2015 and the final version is under preparation.

As regards the target implementation date, the Commission underlines that the recommendation is being implemented insofar as it concerns the Commission.

Recommendation 6

The Commission partially accepts this recommendation insofar as it concerns its legislative proposals for the post-2020 programming period.

Recommendation 7

The Commissions accepts the recommendation.

For shared management, the Commission will include in the guidance note on implementation options under Article 38(1)(b) CPR additional recommendations to require alignment of financial instruments structures with the policy set out in the Commission Communication on the anti-tax avoidance package of January 2016.

For centrally managed instruments, the Commission has already written to the EIB and the EIF to stress the importance of the Commission's anti-tax avoidance measures encouraging the further promotion of best practice by EIB/EIF in this field. The Commission engages in an active dialogue with the EIB and EIF on the review of their respective policies in this area.

Moreover, the Commission notes that Article 140(4) of the financial regulation and Article 38(4) 2nd paragraph CPR specifies that the bodies implementing financial instruments should be compliant with the applicable law, including money laundering, fight against terrorism and tax fraud. The bodies implementing financial instruments cannot be established and cannot maintain business relations with entities incorporated in territories, whose jurisdictions do not cooperate with the Union in relation to the application of internationally agreed tax standards. The managing authorities shall transpose such requirements in their contracts with the selected financial intermediaries.

The compliance of the tax treatments with the national law and EU recommendations is part of the system in place to implement the financial instruments and is also covered in the scope of management verifications as provided for in the guidance note EGESIF 14/0012/02.

As regards the target implementation date, the Commission underlines that the recommendation is being implemented, insofar as it concerns the Commission.

Common Commission reply to paragraphs 155 and 156

The Commission considers that the frequency of the recycling of funds during the eligibility period is not an end in itself.

Moreover, the maturity date of the financing provided is/has to be adjusted to the typology of investments being financed, and any conclusion on the limited revolving effect should be drawn by reference to the setup date of the financial instrument, the grace period, the maturity and the default rates of the financing provided to final recipients.

With regard to the end of the implementation period, the Commission considers that the modifications introduced in its closure guidelines were within the scope of Article 78(6) of Regulation (EC) No 1083/2006, as amended, and therefore did not require an amendment of the legislative act (see also Commission reply to paragraph 43 and Commission reply to paragraph 6.52 and Recommendation 5 of the Court's Annual report 2014). The Commission underlines that the managing authorities are obliged to ensure proper measures to comply with Article 78(7) of the general regulation and to present these measures at closure, such as the information on the reuse of legacy resources attributable to the ERDF and ESF, and in particular specifying the competent authority which is responsible for managing legacy resources, the form of reuse, the purpose, the geographic area concerned and the envisaged duration (see the closure guidelines point 5.2.5).

Recommendation 8

The Commission accepts this recommendation.

Article 45 CPR requires Member States to adopt the necessary measures to ensure the proper use of resources paid back to the financial instruments during a period of at least eight years after the end of the eligibility period (see also the model of funding agreement in Annex IV Article 1(j)). Resources returned to the fund after the end of the eligibility period are no longer EU resources, but national resources.

The Commission will in the guidance note on implementation options under Article 38(1)(b) CPR emphasise the importance of this requirement in the funding agreement signed by the managing authorities and will indicate that a verification of the adequacy of this provision falls within the scope of regular audit work of the audit authorities.

As regards the target implementation date, the Commission underlines that the recommendation is being implemented, insofar as it concerns the Commission.

Recommendation 9

The Commission accepts this recommendation.

The Guidance note on *ex ante* assessment adopted in May 2014 explains the conditions to contribute programme resources 2014-2020 to an existing financial instrument.

In addition, the Commission started to elaborate a draft guidance note on selection of bodies implementing financial instruments. That draft was presented to Member States in October 2015 and is envisaged to include a section which explains the conditions applicable to contract modifications (e.g. extension of implementation period or increase of amounts of OP contribution to the financial instruments existing under the 2007-2013 period). The final version of the guidance note is currently under preparation.

As regards the target implementation date, the Commission underlines that the recommendation is being implemented insofar as it concerns the Commission.

158

The cumulated management costs and fees represent 4.7% of the amounts paid to financial instruments as at end December 2014, which is an annual equivalent of less than 1%.

The management costs and fees are eligible and reimbursed by the EU only if they are paid to the fund manager. If the management costs and fees paid exceed the ceilings, the reimbursement will be effected on the basis of those ceilings and not on the actual higher amounts paid. This measure protects the EU financial interest.

The Commission considers that the rules are clearly set out in the legal basis which has been subject to detailed guidance and that there is no scope at this stage for reinterpretation.

Article 43 of the implementing regulation states that the ceilings for eligible expenditure are applicable to the capital contributed from the operational programme to the fund, and not to the capital used by the fund to provide support to final recipients.

The ceilings define the maximum amount of eligible expenditure and must be calculated on a yearly average, *pro-rata temporis*. The COCOF guidance note on financial engineering instruments addresses and further explains the legal basis (see paragraphs 2.6.1 to 2.6.17).

For 2014-2020, the legal framework requires that the management costs and fees must be linked to performance, including the amounts disbursed to final recipients.

Common Commission reply to paragraphs 159 and 160

For 2007-2013, the Commission monitors the management costs and fees through the summary of data for financial instruments based on the reporting from Member States. This requirement was introduced in 2011.

For 2014-2020, the Commission will have more complete and reliable set of data to monitor the whole financial instruments' implementation, including management costs and fees.

For both periods, the national authorities are responsible for ensuring the eligibility of the management costs and fees in line with the applicable rules and the principle of subsidiarity.

The Commission considers that the costs of programme management (TA budget) should not be mixed with the costs of implementation of single operations within a programme (management costs and fees for financial instruments) as it is not mixed in the implementation of grants operations (e.g. the costs related to the remuneration of the engineer supervisor of the project included in the amounts allocated to the projects and not in the amounts of Technical Assistance).

The Commission would like to underline that it reviews reports received from Member States on the technical assistance budget. This was the case for the 2007-2013 period and continues for the 2014-2020 period.

161

For the programming period 2014-2020, the summary of data has to be prepared by the Commission for all of the five ESI funds. The reporting on financial instruments was set up for a time period of six months in order to take into account all fund specific rules (and the respective deadlines of submission of the annual implementation report as required in Articles 50(6) and (7) CPR), the time required for the consolidation and assessment of the data submitted by the Member States/managing authorities as part of the annual implementation report, and the overall presentation of progress on implementation of financial instruments across all 5 ESI Funds.

Where the Commission provides observations on the annual implementation report, including the financial instruments, the report is returned to the managing authorities and the deadline of 2 months is interrupted until the revised information is resubmitted to the Commission and the deadline of two months resumes again.

Therefore, the data can be aggregated once the complete assessment by the Commission has taken place and there is sufficient assurance on the accuracy and plausibility of data provided by the managing authorities.

162

The performance based remuneration is a mandatory requirement as provided for in Article 42(5) CPR and the criteria for performance are established in Article 12 of Delegated Act 480/2014.

In the guidance note on management costs and fees (EGESIF_15-0021-01) issued in November 2015, the Commission provided clarifications on the performance based calculation methodology.

Recommendation 10 (a)

The Commission accepts this recommendation.

The management costs and fees will continue to be reported in the framework of the summary of data and in May 2015 specific instructions on this reporting were sent to Member States.

The guidelines on the closure of operational programmes (Commission Decision C(2015) 2771) Annex I, template 1 (mandatory field III.4, III.6) and template 2 (mandatory field III.4), require Member States to report management costs and fees incurred and paid by March 2017.

Recommendation 10 (b)

The Commission does not accept the recommendation.

The Commission considers that the rules are clearly set out in the legal basis which has been subject to detailed guidance and that there is no scope at this stage for reinterpretation.

Article 43 of the implementing regulation states that the ceilings for eligible expenditure are applicable to the capital contributed from the operational programme to the fund, and not to the capital used by the fund to provide support to final recipients.

The ceilings define the maximum amount of eligible expenditure and must be calculated on a yearly average, *pro-rata temporis*. The COCOF guidance note on financial engineering instruments addresses and further explains the legal basis (see paragraphs 2.6.1 to 2.6.17).

For 2014-2020, the legal framework requires that the management costs and fees must be linked to performance, including the amounts disbursed to final recipients.

Recommendation 11 (a)

The Commission does not accept the recommendation.

The Commission considers the mandatory provisions on performance based remuneration laid down in Article 42(5) CPR, as well as the detailed criteria for performance established in Article 12 of Delegated Act 480/2014 constitute an adequate basis for achieving the desired incentive effect and that at this stage there is no sufficient basis which would justify proposing an amendment.

Moreover, the Commission notes that the managing authority must inform the monitoring committee of the provisions regarding the performance-based calculation of management costs incurred or of the management fees of the financial instrument. The monitoring committee will receive reports on an annual basis on the management costs and fees effectively paid in the preceding calendar year.

Recommendation 11 (b)

The Commission notes that this recommendation is addressed to Member States.

The Commission agrees that the managing authorities should make the best use of the existing legal requirements. These requirements are also explained and interpreted in detail in the Guidance Note on management costs and fees.

The existing legal basis allows for more performance criteria to be used in addition to the ones mentioned in Article 12 of Delegated Act 480/2014.

Recommendation 12

The Commission does not accept the recommendation.

As regards the feasibility and the proportionality of the implementation of this recommendation, the Commission considers that the analysis would require isolating the costs for grants and financial instruments borne by a managing authority, and probably by the same staff working on both tasks. Moreover, the cost structures of grants and financial instruments, as well as of shared management and direct management financial instruments, differ.

Concerning the relevance of such a comparative analysis, the Commission would further like to underline that grants and financial instruments are two different delivery modes of ESIF policy and they target different typologies of investments.

163

The Commission agrees on the principle of optimising the coordination between financial instruments under ESI Funds and EFSI.

The Commission issued on 22 February 2016 a brochure to help local authorities and project promoters to make full use of the opportunities for coordination, synergies and complementarities of the EFSI and ESI Funds. These two instruments have been designed in a different but complementary way in terms of rationale, design and legislative framework. They reinforce each other. The brochure provides an overview of the possible combinations of EFSI and ESI Funds, either at project level or through a financial instrument such as an investment platform (see http://ec.europa.eu/regional_policy/sources/thefunds/fin_inst/pdf/efsi_esif_compl_en.pdf).

Reply of the Marguerite Fund

Replies to paragraph 81 and box 11

The structure employed by the Marguerite Fund to hold the investments that it makes was established primarily to allow the Marguerite Fund to holds its individual investments via individual subsidiary companies for both portfolio risk management reasons (allowing separation of one investment from another), to facilitate disposals of those investments in the future and to facilitate the flow of cash within the structure (down from the Marguerite Fund to make its investments and then the flow of cash back to the Marguerite Fund from those investments). A tax ruling was sought for confirmatory reasons from the Luxembourg authorities.

In relation to your statement "It is possible that other taxes…..are avoided through the use of this structure", we believe that the reference to tax avoidance could be misleading as the term is often used to refer to schemes whose aim is to avoid taxes legitimately due. Marguerite Adviser manages the tax affairs of the Marguerite Fund to ensure it complies with its tax obligations and pays all taxes due.

HOW TO OBTAIN EU PUBLICATIONS

Free publications:

- one copy:
  via EU Bookshop (http://bookshop.europa.eu);
- more than one copy or posters/maps:
  from the European Union's representations (http://ec.europa.eu/represent_en.htm);
  from the delegations in non-EU countries (http://eeas.europa.eu/delegations/index_en.htm);
  by contacting the Europe Direct service (http://europa.eu/europedirect/index_en.htm) or
  calling 00 800 6 7 8 9 10 11 (freephone number from anywhere in the EU) (*).

(*) The information given is free, as are most calls (though some operators, phone boxes or hotels may charge you).

Priced publications:

- via EU Bookshop (http://bookshop.europa.eu).

Event	Date
Adoption of APM / Start of audit	14.1.2015
Official sending of draft report to Commission (or other auditee)	11.4.2016
Adoption of the final report after the adversarial procedure	1.6.2016
Commission's (or other auditee's) official replies received in all languages	5.7.2016

Financial instruments are increasingly used to provide financial support from the EU budget through loans, guarantees and equity investments. During the 2007-2013 programming period, some 21.5 billion euro from the EU budget were allocated to financial instruments. We found that while they may have distinct advantages compared to other forms of EU funding such as grants, their implementation faces significant challenges which could limit their efficiency.

CURIA RATIONUM
EUROPEAN
COURT
OF AUDITORS

Publications Office