



CONFERENCE DES REGIONS PERIPHERIQUES MARITIMES D'EUROPE
CONFERENCE OF PERIPHERAL MARITIME REGIONS OF EUROPE

6, rue Saint-Martin, 35700 RENNES - FR
Tel. : + 33 (0)2 99 35 40 50 - Fax : + 33 (0)2 99 35 09 19
email : secretariat@crpm.org - web : www.crpm.org

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BRIEFING NOTE FROM THE SECRETARIAT GENERAL OF THE CPMR

FINANCIAL INSTRUMENTS

1. Introduction

Given the current economic climate and growing disparities within the European Regions, the CPMR is starting to analyse the use of financial instruments (FIs) and their growing importance within the cohesion policy. The viability of FIs to support the development of certain maritime areas (maritime industries, renewable marine energy, blue biotechnology, etc.) is also of interest

This note therefore aims to bring together the main conclusions regarding the use of FIs within the cohesion policy during the 2007-2013 programming period and proposes a consideration of the future investments in the EU with regard to developing FIs.

The second part of this note explains the growth of financial instruments, the third explains the different types of financial instruments, the fourth analyses the use of financial instruments during the period 2007 - 2013 and the fifth summarises the criticism levelled at the instruments. Finally, the sixth and final part of this document proposes a course of action for the CPMR.

This note does not intend to analyse the type of investments supported by the Juncker Plan but such an analysis may be considered in the future.

2. The growth of financial instruments within the scope of the EU budget

2.1. The origins: a targeted use

Although the first use of FIs within the cohesion policy dates back to the 1994-1999 programming period, it was not until the period 2007-2013 that they experienced a real boom. FIs only actually appeared for the first time in the Common Provisions Regulation (CPR) in 2006. Section 4 of Chapter II is entirely devoted to how they are used.

Decided during negotiations about the 2007-2013 Multi-annual Financial Framework (MFF), the development of FIs meets the desire of institutions to increase the multiplier effect of the EU budget by leveraging additional private and public funds, and to boost the real economy by facilitating access to financing for companies and industries producing goods and services.

As foreseen by the CPR for the period 2007-2013 ([EC 1083/2006](#)), FIs could play a part in three areas:

- **support for companies (especially SMEs);**
- **urban development;**
- **energy efficiency and renewable energy in buildings.**

2.2 A political priority for 2014-2020

In relation to the 2014-2020 programming period, the use of FIs has been extended to all sectors covered by the Thematic Objectives (TO) of the cohesion policy. The Commission wants to double the use of financial instruments for 2014 - 2020 with regard to the previous period.

One of the reasons cited for this increased use of FIs by the Commission is that FIs can:

- increase **the scope, effectiveness and efficiency** of policy measures;
- reuse the capital mobilised for **managing public resources more sustainably** and ultimately achieve a self-sustaining system;
- generate **leverage** by mobilising resources from other public and private sector resources and encouraging co-financing and co-investment;
- **encourage private sector participation** and actually benefit from an exchange of knowledge and expertise;
- **improve the quality of investments** (only economically viable investments can attract private capital).

Furthermore, the European Commission states that FIs do not involve more risk than subsidies, since the risk to the EU budget is limited to the budgetary contribution. This argument is supported by the report of March 2012 on the use of FIs during the period 2007-2013¹, commissioned by the European Parliament.

3. The various types of Financial Instruments

Financial instruments can be implemented directly by **Managing Authorities (MAs)** or **via a Holding Fund** in exchange for management fees. The holding fund is controlled by managers who provide their expertise: it may be the European Investment Bank (EIB), the European Investment Fund (EIF) or other financial institutions or agencies.

Holding funds are used to offset the lack of technical expertise of the MAs in the implementation and assessment of FIs. The use of a holding fund also allows MAs to acquire expertise with a view to managing FIs autonomously in the future.

FIs are managed by the managing authority with jurisdiction over the funds for which they are mobilised. They can take the form of loans, guarantees, equity capital or venture capital. The particular kind used depends on the sector concerned and the type of project. Developing an FI in a given area must always be preceded by an ex-ante evaluation to analyse market failures and identify what is needed to compensate for these.

There are many kinds of FI that fit the requirements of MAs and the type of product sought. FIs are divided into three main categories which are themselves subdivided:

1 - FIs established at EU level and managed by the European Commission:

- **JEREMIE**: form of support to Small and Medium Enterprises (SMEs) whose implementation is preceded by a gap analysis in order to assess the lack of adequate funding in a given region.
- **JESSICA**: encourages investment in urban development through public-private partnerships. Implementation preceded by an evaluation study in order to determine whether the creation of an FI in this area is necessary.

2 - FIs implemented at national, regional, transnational or cross-border level under the responsibility of MAs:

- **Tailor-made instruments, whether existing or new**: adapt to certain conditions and certain needs.
- **Off the shelf instruments that are ready for use**: terms and conditions are predefined for a more rapid use. There are three of these²:
 - **Risk-Sharing Loan (RS Loan)**: aimed at SMEs, set up by a financial intermediary. The contribution from the financial intermediary must be at least 25%.
 - **Capped portfolio guarantee**: loan guarantee addressed to SMEs that cannot exceed 80% of the loan.

¹ European Parliament, Directorate-General for Internal Policies, [Overview of Financial Instruments Used in the EU Multi-annual Financial Framework Period 2007-2013 and the Commission's Proposals for 2014-2020](#), March 2012.

² These three instruments are defined in the [Commission Implementing Regulation No. 964/2014](#).

- **Renovation Loan:** aimed at energy efficiency and renewable energy in the buildings sector, set up by a financial intermediary. The contribution from the financial intermediary must be at least 15%. End users can be private or legal persons, owners, independent professionals, administrators or other legal entities acting for the owners.

3 - FIs consisting solely of loans and guarantees: this category may be implemented directly by the MAs. It is impossible to attribute the management fees for these FIs to structural funds and European investment.

4. Evaluation of financial instruments over the period 2007-2013

The existing literature and the various studies conducted to date³ already enable some general conclusions about the 2007-2013 programming period to be drawn.

The provisions of the CPR for the period 2014-2020 relating to FIs should result in several changes, including greater consistency between the different instruments developed, improved visibility and transparency of the FIs, increased monitoring and control - including that which relates to the ex-ante evaluation process - as well as increased opportunities for sharing experiences of creating and managing FIs.

It is also worth mentioning the report of March 2012 concerning the use of FIs during the period 2007-2013⁴, commissioned by the Budgets Committee (BUDG) of the European Parliament, which analyses the use of FIs during the 2007-2013 programming period and makes recommendations for the future MFF (2014-2020). Although this report provides concrete evidence on the use of FIs, it is regrettable that the geographical aspect is not taken into account.

The key statistics for the period 2007-2013 collected by the European Commission and compiled in annual reports (*Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds*⁵) allow for some general lessons to be drawn on the use of FIs.

The analysis of the above mentioned reports can draw the following conclusions:

- **The multiplier effect of FIs varies by sector and market characteristics**

FIs help attract public and private capital and help to promote public-private partnerships. For example, an assessment of the European Commission shows that for loans subject to conditions granted in northern Italy within the scope of the JEREMIE instrument the multiplier is 4.5.

- **The use of FIs is increasing all the time**

Year after year, the number of implemented FIs has increased. Although FIs account for only about 1.2% of the MFF for the period 2007-2013 (excluding the European Development Fund - EDF)⁶, the Commission expects a significant increase in funds dedicated to FIs for the 2014-2020 programming period. Indeed, more than half of the MAs that have implemented FIs during the period 2007-2013 have expressed their willingness to develop new FIs during the period 2014-2020. A memo from the European Commission in 2015 stated that the use of FIs is increasing rapidly over the 2014-2020 programming period compared to the previous period in most Member States (BG, EE, FR, DE, MT, NL, PT, RO, SE, UK)⁷. This data proves that FIs attract a significant proportion of users.

- **The absorption rate of FIs is constantly increasing**

The proportion of OP amounts allocated to FIs paid to final beneficiaries has increased steadily over the period 2007-2013. The absorption rate for amounts dedicated to FIs in 2014 was 57%, representing an increase of 40% in relation to 2013. Absorption rates vary from sector to sector. In 2014, they amounted to 61% for business support, 33% for urban development and 37% for energy efficiency and renewable energy in buildings.

³ [Financial Instruments: A Stock-taking Exercise in Preparation for the 2014-2020 Programming Period; Financial Instruments in Cohesion Policy 2014-2020; Summary report on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds; Permanent revolution in Cohesion policy: restarting the reform debate.](#)

⁴ European Parliament, Directorate-General for Internal Policies, Op. cit.

⁵ See [Annual Reports 2011-2014](#).

⁶ European Parliament, Directorate-General for Internal Policies, Op. cit.

⁷ http://ec.europa.eu/contracts_grants/pdf/esif/invest-progr-investing-job-growth-report_en.pdf.

- **The regional level is the preferred level of implementation for FIs**

Predictions for the period 2014-2020 indicate that a large proportion of users of FIs want the implementation of FIs to take place at regional level⁸.

- **Most FIs are directly implemented by MAs**

In 2011, 67% of the FIs implemented were directly managed by MAs and 33% were managed by a holding fund. The majority of FIs destined for companies were managed by MAs, while the majority of FIs for urban development were managed by a holding fund. This data is indicative of the lack of expertise of a large proportion of the MAs. Forecasts for the period 2014-2020, however, indicate a substantial reduction in the use of holding funds. This proves that the use of holding funds has enabled MAs to gain expertise and become independent.

- **Use of FIs varies by country and sector**

The vast majority of FIs created are dedicated to supporting private companies (90%). The sectors of urban development, and energy efficiency and renewable energy in buildings represent 6% and 4% respectively. Thematic Objective (TO) 3 (enhancing the competitiveness of SMEs) of the cohesion policy is considered in particular as the most relevant TO for the creation of FIs. The new legislative framework and the priorities established by the Juncker Commission should however lead to an increase in the proportion of these two sectors. As such, the Commission is planning for a substantial increase in the number of FIs created within the scope of TOs 4, 5 and 6 of the cohesion policy (reduction of carbon emissions, energy efficiency and climate change).

- All the EU states except Ireland, Luxembourg and Croatia have chosen to devote part of their ESIFs to the implementation of FIs in the area of support to companies.
- 11 Member States have chosen to develop FIs in the urban development sector (BG, CZ, DE, EL, ES, IT, LT, NL, PL, PT, UK).
- 11 Member States have chosen to develop FIs in the area of energy efficiency and renewable energy in buildings (BG, CZ, DE, DK, EE, EL, ES, IT, NL, SK, UK).

- **The use of holding funds varies by country and level of development**

Regarding the FIs devoted to support for companies:

- 9 Member States have implemented all the specific funds without a holding fund (AT, BE, CZ, DE, DK, EE, FI, NL, SE): with the exception of the Czech Republic, all these states are in the central or northern Europe and consist mainly of regions falling under the category of the most developed regions (according to the 2014-2020 cohesion policy). This suggests that the most developed countries are more experienced in FI management.
- 11 Member States combine the two options: direct implementation by the MAs or by a holding fund (EL, ES, FR, HU, IT, LT, LV, PL, PT, SI, UK).
- 3 Member States have chosen not to use FIs at all (Ireland, Luxembourg and Croatia).

- **Financial products vary by sector**

- FIs devoted to supporting SMEs may take the form of loans, guarantees, contributions, equity capital or venture capital.
- FIs devoted to urban development can only take the form of loans or equity capital.
- FIs financed under the terms of European Social Fund (ESF) OPs mainly take the form of micro-credit and target specific groups of people (particularly the self-employed, long-term unemployed and women).

- **The final beneficiaries of FIs are mainly companies**

- Over the period 2007-2014, SMEs account for 67% of the final beneficiaries of FIs. Individuals (one-person businesses, households, associations specialised in housing, public bodies, etc.) represent, in turn, 31% of the final beneficiaries.

⁸ EIB [Financial Instruments: A Stock-taking Exercise in Preparation for the 2014-2020 Programming Period](#).

5. Key lessons for the period 2007-2013 and prospects for the period 2014-2020

The first studies on the use of FIs during the period 2007-2013⁹ highlight the main weaknesses:

- ✓ FIs are complex and time-consuming to implement;
- ✓ The legal framework is better adapted to the subsidy system that has been dominant for a long time.
- ✓ Many delays were experienced in the implementation: this is due to a lack of experience among MAs, unexpected delays in discussions with stakeholders, the risk of conflict with national legislation relating to state aid and the related controls, and the lack of flexibility of the legislation;
- ✓ Eligibility rules are unclear (the Commission needed to intervene several times during the programming period: publication of guidance notes, changes in legislation, changes to terms and indicators, etc.);
- ✓ The support offered to MAs is insufficient;
- ✓ The ex-ante evaluation is not rigorous enough;
- ✓ Indicators are not always appropriate;
- ✓ There are funding gaps (difficulty attracting the private sector).

The March 2012 report commissioned by the European Parliament¹⁰ draws attention to several aspects that need improvement in the future, including transparency of the management of FIs, administration costs, time-scales and a simplification of their implementation.

The same studies welcome the efforts of the European Commission to improve the clarity and precision of legislative provisions relating to FIs (including the CPR for 2014-2020) and to adapt the legal framework of FIs, to strengthen the ex-ante evaluation process and to provide greater flexibility to the implementation. These measures should significantly improve the terms and time-scales for implementing FIs.

6. Next steps

There is no doubt that financial instruments are now anchored in the EU's public policies, and in particular within Cohesion Policy.

As part of the mid-term review of the EU's Multi-Annual Financial Framework which must be done by the 2016-year end, and the preparations for the EU budget for post-2020, a number of questions arise for the CPMR.

The following hypothesis is particularly relevant:

"Financial instruments are unlikely to replace subsidies and contractual payments under the terms of the EU budget to any great extent over the period ahead. When the risk is high and the economic and social benefits are low, EU subsidies are generally preferred. However, when the risk is lower and the economic and social benefits are higher, a mix of subsidies and loans is better" (Report of March 2012 commissioned by the European Parliament's Budget Committee (BUDG)).¹¹

Other questions remain:

- ✓ Are financial instruments intended to replace European subsidies?
- ✓ Could greater use of financial instruments at the heart of European action for growth and employment not exclude certain types of EU territories? Is this already the case for the period 2014 - 2020?
- ✓ Can financial instruments support all the missions of the cohesion policy?
- ✓ To what extent are financial instruments able to support investments in the maritime sector? A large number of maritime sectors are nevertheless risk areas (particularly marine industries, marine renewable energy, blue biotechnology) that do not necessarily offer returns on investment.

⁹ [Financial Instruments: A Stock-taking Exercise in Preparation for the 2014-2020 Programming Period; Financial Instruments in Cohesion Policy 2014-2020; Summary report on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds; Permanent revolution in Cohesion policy: restarting the reform debate.](#)

¹⁰ European Parliament, Directorate-General for Internal Policies, Op. cit.

¹¹ European Parliament, Directorate-General for Internal Policies, Op. cit.

The literature available relating to the results of the use of FIs during the period 2007-2013 is limited for now to providing general data; **the second stage of this work is to analyse the use of FIs in the CPMR Member Regions in more detail by analysing the Operational Programmes of the Regions and through feedback to gauge their effectiveness as well as their impact on the maritime sector.** The aim will be to analyse the European added value of Community FIs and to determine when they are relevant to supporting the EU's cohesion policy.