fi-compass Knowledge Hub

Implementation of financial instruments across consecutive programming periods

Notes of workshop

The Knowledge Hub has been developed to meet the growing need amongst experienced practitioners for events and materials that provide a more in-depth look into topics affecting financial instruments. Its format utilises email exchanges to promote a longer term engagement between participants together with traditional face to face workshops to allow experienced practitioners to work together to explore the subject matter through peer to peer exchange and expert-led sessions.

In order to encourage openness between the parties the discussions are undertaken under the Chatham House Rule which states: 'When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.'

In particular, the representatives of the European Commission, namely DG REGIO have participated in the Knowledge Hub to receive feedback from the Member States concerning the implementation of financial instruments across consecutive programming periods. The participation of the representatives of DG REGIO and the European Investment Bank should not be interpreted as an official endorsement of any of the suggestions that may be discussed and/or described during the Knowledge Hub.

DISCLAIMER

1. Introduction

The fi-compass Knowledge Hub – Implementation of financial instruments across consecutive programming periods took place between October 2021 and September 2022. Expert fi-compass practitioners came together with specialists from the European Commission, DG REGIO and fi-compass to consider the new flexibility under the CPR 2021/1060 (the CPR) to use programme resources to implement financial instruments across consecutive programming periods.

The discussions considered Article 68(2) CPR, which introduces a major change to the rules governing this topic by providing:

> *"Where a financial instrument is implemented across consecutive programming periods, support may be provided to, or for the benefit of, final recipients, including management costs and fees, based on agreements made under the previous programming period, provided that such support complies with the eligibility rules of the subsequent programming period. In such cases, the eligibility of expenditure submitted in payment applications shall be determined in accordance with the rules of the respective programming period."*

Participants considered the practical application of these rules in an online session on 16 November 2021. Key topics were further explored in email exchanges within the group before and after the event.

2. Key notes

Some of the key points that were discussed during the Knowledge Hub were as follows.

The new rules relate to all types of financial instruments (loans, guarantees and equity). They are intended to enable financial instruments implemented with EU shared management funds to be aligned with market practice.

This includes allowing for provision to be made for follow-on investments in equity funds and to ensure resources for interest rate subsidies can be provided throughout the duration of long term loans. More generally, however, managing authorities are able to apply the rules to allow financial instruments of all types to be implemented across more than one programming period where necessary to meet the local market needs.

Subject to compliance with relevant procurement rules, managing authorities may contribute resources from the current programme to financial instruments created in the 2014-2020 period.

Where Holding Fund (Fund of Fund) managers or financial intermediaries were entrusted through direct award according to the applicable public procurement Directives, the contract/agreement can be extended and additional funds committed in a straightforward way, as long as the conditions for this direct award are still fulfilled.

It was acknowledged that in many cases, where implementing bodies were selected through a competitive process, compliance with procurement rules will be a constraint and the scope to use this flexibility will be limited by the terms under which the financial instruments were originally established. Where the selection process and funding agreements did not anticipate the continuation of the financial instrument into the new programming period the managing authority may not be able to take advantage of the new rules to the fullest extent in the short term.

The Public Procurement Directive[1] (PPD) provides at Article 72(1)(a) a mechanism enabling authorities to include options to commit additional resources and extend the duration of financial instruments as envisaged by Article 68 CPR.

Article 72(1)(a) of the PPD allows modifications to be made to funding agreements, irrespective of their monetary value, as long as they have been provided for in the initial procurement documents in clear, precise and unequivocal review clauses, which may include price revision clauses, or options, taking also into account the use of this provision cannot alter the overall nature of the contract. The flexibility available under Article 72(1)(a) PPD can be viewed as being complementary to the approach envisaged under Article 68.

The design and implementation of financial instruments in the 2021-2027 period, should consider whether to provide for the commitment of additional resources in future programme periods.

It is possible to 'future-proof' financial instruments being established in the 2021-2027 period by including in the design and implementation procedures mechanisms to extend the operation into the next period, taking advantage of flexibilities including Article 72(1)(a) PPD. Where the potential for such an extension is foreseen in the initial selection procedure and funding agreement, the managing authority has greater scope to commit further resources to the financial instrument in the future.

Support provided by the financial instrument can be declared as eligible expenditure only on the basis of the eligibility rules applicable to the programming of the period under which the expenditure is declared.

This means that before resources are committed to an existing financial instrument from a new programme period, the managing authority must be satisfied that the eligibility rules applicable to the financial instrument established in the previous period continue to apply into the new period.

1 Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC

3. Implementation of financial instruments across consecutive programming periods

3.1. Overview

Article 68(2) CPR provides the legal basis for managing authorities to create financial instruments that may be implemented across consecutive programming periods. This new flexibility permits EU shared management resources from consecutive programming periods to be contributed to financial instruments, to be passed on to the final recipients in the form of investments (through loan, equity or guarantees), grants (including technical support, interest rate subsidy and capital payments) and management costs and fees.

The new flexibility applies to all types of financial instruments offering investments through the full range of financial products (loans, guarantees and (quasi)-equity) and the related management costs and fees.

Thus, financial instruments which commenced implementation in the 2014-2020 programming period that would be suitable to continue in the 2021-2027 programming period may, subject to compliance with public procurement rules, take advantage of the new rules. Further, financial instruments which are set up in the 2021-2027 programming period that would be suitable to continue in the following programming period, may be set up in a way that allows the extension of the operation into the post 2027 period.

The introduction of this new flexibility does not affect the ability for managing authorities to use escrow accounts with financial instruments set up in the 2014-2020 period, under the conditions defined in Articles 42(1)(c), 42(2) and 42(3) of Regulation 1303/2013.

3.2. Practical considerations

Managing authorities may use the new rules to better align financial instruments (including those combined with grant) with market practice. This supports the use of financial instruments for those investment types with an implementation period longer than the eligibility period of the cohesion policy, such as:

- follow-on investments for equity instruments: investment period for equity investments lasts in general around 10-12 years; and
- interest rate subsidies or guarantee fee subsidies which are going along with the underlying loans. The other types of grants accompanying the financial products under the 2021-2027 CPR may follow the same logic depending on the structure of the support (e.g. investment grants or capital rebates).

There are several practical considerations for managing authorities seeking to take advantage of the new rules including:

- Importantly, there is no derogation from the requirements of the Public Procurement Directive (PPD)[2]. Thus, any entrustment of the management of additional resources to financial intermediaries must be made in accordance with applicable EU and national procurement rules.
- The programme resources from the subsequent/new programming period will be committed through the existing framework of legal agreements between the managing authority and bodies implementing the financial instrument(s). The agreements may already provide a mechanism for achieving this, alternatively a new agreement may be needed to either amend the existing agreement or set up a new framework.

2 Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC

- The eligibility rules applying to the financial instrument will need to reflect the requirements of the relevant programming period. Thus, eligible expenditure will need to be reported separately for the different programming periods. Equally, the different thresholds applicable to determine eligible management costs and fees (where there is no competitive procurement) must also be observed. Separate records of programme resources of the programming period from which they come from should be kept.

3.3. Selection – use of existing financial instruments in consecutive programming periods

Article 68(2) CPR does not create any derogation from the applicable public procurement rules. As a result managing authorities must take advantage of the new flexibility within the scope of the PPD and local implementing acts.

Selection Knowledge Hub

The scope to amend existing contracts under Art 72 of the PPD was considered in an earlier fi-compass Knowledge Hub on Selection fi-compass Knowledge Hub - Selection of financial intermediaries | fi-compass.

The importance of Art 72(1)(a) was highlighted as being applicable. It allows modification of contracts (without financial limit) to the extent it is envisaged at the outset. By specifying clearly at the time of setting up a financial instrument when and under what conditions the financial instrument may receive additional funding, the managing authority can ensure compliance with the Directive.

The position is relatively straightforward, in case of direct award. Additional funds may be directly entrusted to the existing implementing bodies on the basis of updated agreements, as long as the conditions for this direct award are still fulfilled. If the entrusted entity is a holding fund, it may have to apply public procurement rules to further entrust the implementation of the additional funds to specific funds.

Where the bodies implementing the financial instrument were selected on the basis of public procurement rules, the contracting authority must ensure that the rules are respected for the modification of the contracts or launch a new procedure. In particular Article 72 of the PPD and its equivalent in the local implementing acts will be an important consideration for managing authorities when determining the scope to extend funding agreements to allow the extension of existing financial instruments using resources from the new programming period.

For financial instruments being set-up in the future, whether under the 2014-2020 or 2021-2027 period, managing authorities have the opportunity to structure the selection procedure to enable the continuation of the financial instrument into subsequent programming periods. In particular managing authorities should seek to take advantage of Article 72(1)(a) which provides:

> *Contracts and framework agreements may be modified without a new procurement procedure in accordance with this Directive in any of the following cases:*
>
> *(a) where the modifications, irrespective of their monetary value, have been provided for in the initial procurement documents in clear, precise and unequivocal review clauses, which may include price revision clauses, or options. Such clauses shall state the scope and nature of possible modifications or options as well as the conditions under which they may be used. They shall not provide for modifications or options that would alter the overall nature of the contract or the framework agreement*

Participants discussed how a new procurement procedure can be structured to take advantage of Article 72(1)(a) of the PPD (and its equivalent in local implementing acts) to support flexibility in relation to both the volume of resources under management and the duration of the underlying financial instrument. Thus the commitment of resources from a new programming period without financial limit can be made without a further procurement as long as the option to do so is defined in a clear, precise and unequivocal way in the initial tender documentation.

Similarly, the duration of the funding agreement may also be extended through the exercise of an option if the criteria of Article 72(1)(a) are fulfilled. It was acknowledged that the flexibility to extend the duration of a contract is subject to the general principle that public contracts should not have an unduly long duration that would restrict access for third parties to the market. It is, nevertheless, considered likely that the extension of a financial instrument into a successive programme period would be within the scope of the PPD. This would need to be considered on a case by case basis, in consultation with specialist advisers.

In view of the flexibility to extend the financial size and duration of funding agreements within the scope of the PPD, the use of the Article 72 (1)(a) flexibility to modify contracts was recognised as being complementary to the new provision under Article 68 CPR. Managing authorities and other implementing bodies seeking to future-proof their financial instruments to include the scope to contribute resources from a future programming period are strongly encouraged to explore this approach when designing their financial instruments in the 2021-2027 period.

An alternative option considered by participants was the use of framework agreements. This allows for flexibility in terms of volume, but not in terms of duration. Although framework agreements may be helpful in some circumstances it was considered a less flexible option than the use of contract options under Article 72(1)(a) of the PPD.

3.4. Eligible expenditure

Participants discussed during the Knowledge Hub the importance of ensuring alignment of eligible expenditure across different programming periods. Where a financial instrument benefits from resources from consecutive periods, the managing authority must ensure that the support provided by the financial instrument can be declared as eligible expenditure on the basis of the eligibility rules applicable to the programming of the period under which the expenditure is declared.

This means that before resources are committed from a new programme period, the managing authority must be satisfied that the eligibility rules applicable to the financial instrument established in the previous period will continue to apply into the new period.

As financial instruments are mainly used to support SME, RDI and energy efficiency, the general eligibility rules are not expected to change significantly from one programming period to another, even for post-2027. Nevertheless, managing authorities must ensure that the policy objectives supported by the financial instruments continue to be supported from one programming period to the next when considering whether to commit additional resources from the new period.

Eligible expenditure in successive programming periods

If a financial instrument started in period N-1 continues the implementation in period N, the support provided by the financial instrument and the related management costs and fees in period N can be declared as eligible expenditure in period N, provided that the eligibility rules of the programming period N are respected.

When preparing the programmes for the period N, this implies that the managing authorities have to take into account the eligibility rules applicable to the financial instrument in period N-1 and to ensure that they are also applicable within the period N (e.g. priorities and eligibility in the programmes).

Similarly, managing authorities must put in place plans to enable funding commitments to be met in the event that eligibility rules change to exclude certain types of investment in the future. This is particularly relevant for equity/venture capital operations where ensuring resources are in place to finance follow on investments is often an essential requirement of the design of the financial instrument. Under Article 42 of the CPR 1303/2013 escrow accounts can be set up to hold 2014-2020 programme resources to be used for follow-on investments after the end of the programme period. However, this approach creates only a partial solution as it can be difficult to estimate the scale of the resources required for future follow-on investments.

The new approach for the 2021-2027 period, under Article 68 CPR is more flexible as it allows resources from the next period to be committed to the financial instrument to meet follow-on investment needs at a later date when the scale of the requirement can be better assessed. This should ensure the amount of resource committed better reflects the scale of the need. However, when setting up the financial instruments, managing authorities must, in addition to ensuring sufficient flexibility under the selection/contract, provide financial intermediaries with a commitment to provide funds for follow-on investments in the future. This may not be straightforward for some managing authorities where the eligibility (and availability) of Cohesion policy resources in future programming periods will not be certain.

It will be interesting to see how market practices develop to address this issue. Managing authorities may for example rely on reflows from its previous or current portfolios of financial instruments to act as a backstop for financing follow-on investments in the event that future EU shared management funds are unable or insufficient to cover the commitments made. Alternatively managing authorities may identify own resources from which they could meet the commitments if EU shared management funds are not available in the future.

3.5. Payment applications

The payment applications by managing authorities in respect of funds committed to financial instruments should be determined in accordance with the rules of the respective programming period under which the expenditure is declared. This implies that:

- payment applications are submitted to the Commission on the basis of the rules for payment applications of the period of submission. For example, for investments supported by shared management funds from 2021-2027, the rules for payment applications under 2021-2027 period apply.
- there is a separation of the financial flows/audit trail as the expenditure included in a payment application for the first programming period in which the financial instrument operates is not included under any payment applications for the subsequent programming period. Thus for the years when two programming periods overlap (e.g. 2021 to 2023 and 2028 to 2029), expenditure in relation to a single financial instrument will be reported separately based on the rules of each programming period as it is possible to use in parallel, resources from both programming periods.

4. Application of the Art. 68 CPR - Specific scenarios

Participants discussed a number of likely scenarios where Article 68 CPR may be considered in the future to identify the scope for and key considerations for application of the rules.

4.1. Extending existing financial instruments to utilise 2021-2027 resources

With over EUR 22 billion of ESIF resources committed to financial instruments in the 2014-2020 programming period, many Member States are benefitting from well-established successful guarantee, loan and equity instruments. As programmes are being prepared for the use of EU shared management funds in the 2021-2027 period, it is expected that many managing authorities will consider using the new resources to maintain and scale-up existing financial instruments in their Member State or region.

Article 68 CPR provides scope within the Cohesion policy legislative framework for resources in the 2021-2027 period to be used to extend existing financial instruments. However, the new flexibility remains subject to the public procurement rules both under the PPD and local implementing acts. This will, therefore, mean that managing authorities will need to satisfy themselves that any additional contribution under funding agreements entered into in the 2014-2020 programming period will fall within the relevant procurement rules.

In some cases, the potential to extend the financial instrument into the new programming period will have been foreseen by the implementing bodies and options included in the contract to allow additional resources to be committed from the 2021-2027 programming period. However, in many cases, the extension of financial instruments into subsequent programming periods will not have been foreseen and, as a result, the scope within the public procurement rules to utilise Article 68 CPR to extend the operation with 2021-2027 resources will be limited. Nevertheless participants identified the following potential activities that may be worth further consideration:

- Extension of Holding Funds entrusted to EIB Group or National Promotional Banks and Institutions under the direct award procedure.

  It is straightforward to extend Holding Fund arrangements where the entrustment is made through direct award according to the applicable public procurement Directives (for example to National Promotional Banks, in-house entities and the EIB/EIF). As long as the conditions for this direct award are still fulfilled, additional funds may be directly entrusted to the existing implementing bodies on the basis of updated agreements. Participants identified, however, that the entrusted Holding Fund, it may have to apply public procurement rules to further entrust the implementation of the additional funds to specific funds.

- The scope to extend the existing funding agreement by up to 10% under Article 72(2) of the PPD may be available for existing agreements without modifying the overall nature of the contract.

  Article 72(2) PPD permits extensions to existing contracts where the value of the extension is below both the procurement thresholds and 10% of the existing contract value and the modification does not alter the nature of the contract. This flexibility may be helpful to allow existing financial instruments to utilize 2021-2027 resources for a short period of time, for example to allow continued investment during the transition to new financial instruments being set up under the new programme. However, the constraint in terms of size of the modification means this approach will not provide scope for a long term extension of existing financial instruments.

Participants also considered whether managing authorities and other implementing bodies may place reliance on Art 72(1)(c) PPD to extend existing contracts up to 50%. This would allow for a more significant extension of existing financial instrument operations although would still not provide a sustainable long term solution.

Responding to the crisis in Ukraine

Following the Workshop and before the publication of this note, the Russian invasion of Ukraine has caused significant social and economic hardship both in Ukraine, its neighbours and other parts of the EU. In particular more than 3.5 million people have sought refuge in the EU, triggering the need for an urgent humanitarian response and longer term measures to support the integration of migrants into host countries.

Existing financial instruments (for example microfinance, SME and housing loans) may be effective tools for authorities to use to mobilise finance to support the integration of migrants. In such a case, given that the war in Ukraine would not have been foreseen by managing authorities at the time the financial instruments were set up, the criteria under Art 72 (1)(c) PPD may be met allowing additional resources to be committed to existing financial instruments. (Please see the Communication from the Commission from 01/04/20 Guidance on using the public procurement framework in the emergency situation related to the COVID-19 crisis.pdf (europa.eu) which can apply mutatis mutandis to the consequences of the Russian invasion of Ukraine.)

Managing authorities seeking to rely on this provision should make their own judgement on whether it is available based on their specific circumstances with the support of their legal advisers. It is recommended that the decision to employ the flexibility under Art 72(1)(c) PPD is recorded as part of the decision making process.

Article 72(1)(c) PPD allows for modifications to be made to contracts of up to 50% of the original contract value where such modifications are 'brought about by circumstances which a diligent contracting authority could not foresee'. Managing authorities would have to seek their own advice on a case by case basis as to whether their particular circumstances are such that 'a diligent contracting authority could not foresee'. In many cases, however, this may be difficult to establish and, thus, whilst not ruling it out completely, it is unlikely that this approach will be relevant to managing authorities and other implementing bodies.

4.2. Designing 2021-2027 financial instruments to enable commitment of resources in future programme periods

The importance of embedding the flexibility to use Article 68 CPR in the design of financial instruments in the 2021-2027 period was highlighted by participants during the Knowledge Hub. The alignment of selection and contract processes with Article 72(1)(a) of the PPD (and equivalent local implementing acts) was seen as a critical consideration.

Measures to be considered to 'future-proof' financial instruments to enable them to benefit from additional resources committed under Article 68 CPR (or successor articles in future regulations) might include:

- Ensure that the fact that the potential for future commitments are foreseen in the initial Terms of Reference (ToR) used for the selection of implementing bodies. Article 72 (1)(a) of the PPD requires that such statements are 'clear and precise' and may take the form of options (for example to contribute additional resources) that can be exercised in the future.
- The funding agreement should describe clearly the options and the circumstances in which the options to commit additional resources may be exercised.
- The mechanism for exercising of options may include price adjustment mechanisms if needed to meet revised eligibility rules regarding management costs and fees.
- In estimating the contract value for the purposes of the selection procedure, the managing authority or other implementing body should ensure sufficient headroom is retained to allow flexibility to extend the financial instrument into the following programming period. The ToR may explain how this figure has been calculated in order to manage the expectations of the tenderers, for example in relation to the initial value of the funding agreement.

- In the case of equity financial instruments, where the future commitment of resources for follow-on investments is often an essential feature of the managing authority's commitment, it may be necessary to identify alternative source of funds in the event that EU shared management funds are not available in subsequent programming periods.

Application of Article 68 CPR to ERDF equity funds in 2021-2027 period

A managing authority or its implementing partner seeking to set up an equity financial instrument will need to consider how it will resource follow-on investments that will, in many cases fall outside the initial ERDF programme period.

Further, as follow-on investments are often significantly greater than initial investments, the public contribution needs to be flexible enough to scale -up to meet demand in subsequent programming periods.

Using Article 72(1)(a) of the PPD and equivalent local implementing regulations, the managing authority can select financial intermediaries so that:

- additional resources (that could be more than double the initial contribution) can be contributed to the equity fund and
- the duration of the operation can be extended to align with the local requirements and market norms.

The potential to include the scope to apply the Article 68 CPR flexibility in the design of new financial instruments should be considered by managing authorities at the time of the ex-ante assessment. As discussed above in the case of equity funds, such flexibility might be an essential component in the design of the instrument. Likewise guarantee instruments underpinning long term loans which include an interest rate subsidy would require the resources to finance the ongoing interest rate subsidy to be committed in consecutive programming periods.

In many other cases it may nevertheless be desirable to include in the design of a financial instrument the scope to extend the operation into subsequent programming periods, for example by adding of options of prolongation, if duly justified by financial reasons, as, for example, amortization. The inclusion of this flexibility would allow managing authorities to keep their options open to commit additional resources to successful financial instruments that can continue to meet the local financing needs in the following programming period.

4.3. Structuring Holding Funds implementing financial instruments across consecutive programming periods

During the Knowledge Hub, several participants described how they propose to structure the Holding Fund and underlying funding agreements to reflect the need to account and report separately for expenditure from the different programmes and the possibility for changes in Investment Strategies.

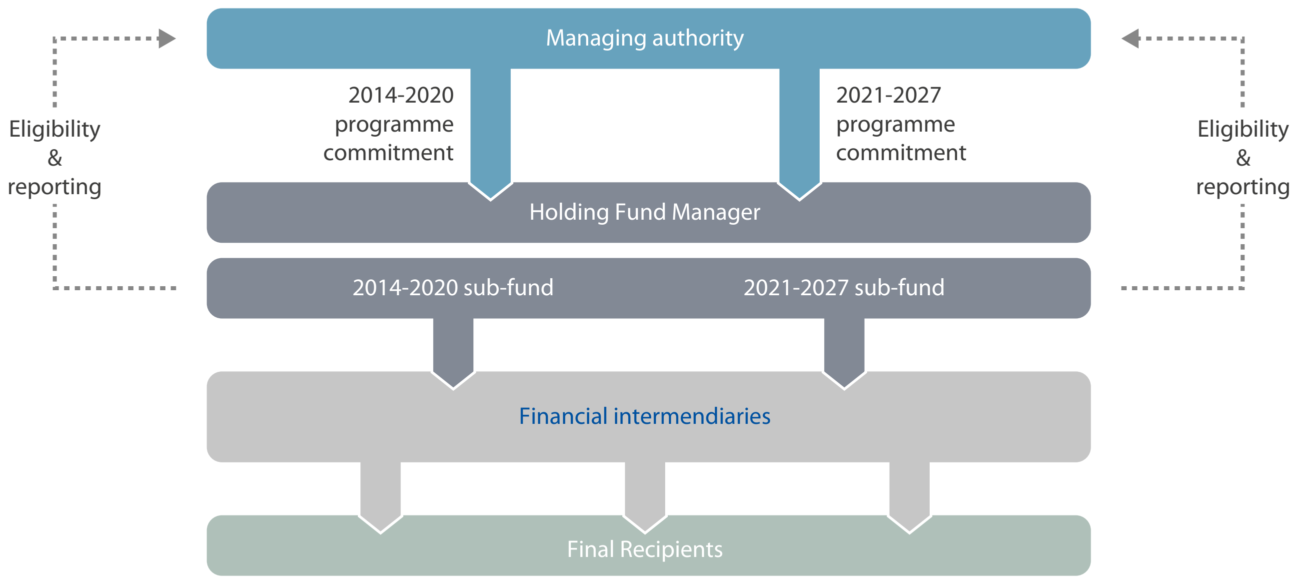
A number of different mechanisms were proposed for structuring the agreement to achieve separation between the two programme contributions. These included:

- using separate blocks of finance within the holding fund (including by creating separate bank accounts/ sub-accounts);
- creating separate sub-funds set up by the holding fund; and
- using different companies to act as HF (which may be both subsidiaries of the same overall body).

The proposed structures all provide for the separate management of the resources from different programming periods which would facilitate the reporting and audit of the operations. At the same time by maintaining the separate structures within a single holding fund structure, economies of scale and continuity of implementation can be achieved by the managing authority in relation to the implementation of the financial instruments.

Figure 1 below shows how a separate sub-fund type structure within a Holding Fund may facilitate the management of the parallel eligibility and reporting requirements for Holding Funds which receive resources from consecutive programming periods.

Figure 1: Holding Fund structure with sub-funds for resources from consecutive programming periods



5. Final comments - taking the long term view

The new framework introduced under Article 68 CPR to allow financial instruments to be implemented across consecutive periods needs to be seen as a long term measure to enable managing authorities to plan financial instruments aligned with market practice. This new flexibility will be vital for future equity financial instruments, where it will allow additional resources to be contributed to meet follow-on investment requirements.

However, the application of the new rules may be adopted in relation to all types of financial instruments to allow sustainable, long term loan, guarantee and (quasi-) equity operations to be established with the potential to be extended to take advantage of additional resources from future programming periods.

The implementation of the new measures must take into account the requirements of the public procurement rules both under the PPD and national implementing acts. This may be a constraint in the short term for many managing authorities seeking to apply Article 68 to financial instruments established in the 2014-2020 period (or before). However, when seen in the context of financial instruments to be set up in the 2021-2027 period, in many cases there will be sufficient flexibility in the procurement rules to allow new financial instruments to be implemented in a way which does allow their future extension to take advantage of Article 68 CPR, to allow the financial instruments to be implemented across consecutive periods.

The introduction of Article 68 CPR at the beginning of the 2021-2027 period allows managing authorities the time to design, with support from specialist advisers, selection processes and contractual clauses that allow Article 68 to be used in the future. As managing authorities update or carry out new ex-ante assessments for their shared management financial instruments in the 2021-2027 programming period, they are encouraged to ensure the flexibility under Article 68 CPR is considered and where approach included in their design and implementation procedures in the future.

Notes

Notes

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