

RECAP OF THE SPECIAL REPORT ON IMPLEMENTING THE EU BUDGET THROUGH FINANCIAL INSTRUMENTS – LESSONS LEARNT FROM 2007 – 2013¹

Introduction:

On July 7th 2016, the European Court of Auditors published their Special Report on ‘Implementing the EU budget through financial instruments– lessons to be learnt from the 2007-2013 programme period’

Definition of the European Court of Auditors:

The European Court of Auditors is based in Luxembourg and is a **professional external investigatory audit agency**. It is the 5th of 7 European Institutions, next to the European Parliament, the European Commission, the European Council, the Council of the European Union, the Court of Justice and the European Central Bank. Its primary **role is to externally check if the budget of the European Union has been implemented correctly**, in that EU funds have been spent legally and with sound management. The national equivalents in France, Germany and Italy would be the « Court des Comptes », the ‘Rechnungshof’ and the ‘Corte dei Conti’ respectively.

The ECA’s special reports set out the results of its performance and compliance audits of specific budgetary areas or management topics; in this case ‘Financial Instruments’.

Subjects under study:

The Study was conducted to check whether financial instruments were an efficient mechanism to implement the EU budget during the 2007-2013 programme period and to what extent have main shortcomings identified been addressed in the regulations applicable to the 2014-2020 programme period. In particular, it **assesses whether financial instruments were appropriately sized in view of market needs, succeeded in attracting private capital, provided revolving financial support and were cost-efficient**. The report also sets out a number of significant issues that limited the efficiency of financial instruments for the years under study.

Results:

- ➔ The two main advantages over grants (**mobilising** additional private and public money to complement the initial public funding and **re-using the same funds** over several cycles) were underlined
- ➔ During the 2007-2013 programming period:
 - some €21.5 billion from the total EU budget (which itself accounts for less than 1% of the EU’s GDP (Gross Domestic Product)) were allocated to financial instruments
 - 25 out of 28 Member States made use of Financial Instruments set up under the ERDF (European Regional Development Fund) and the ESF (European Social Fund)
 - €16 bln were paid as contributions by these 2 Operational Programmes to Financial Instruments (972 ERDFs and 53 ESF, so 1025 Financial Instruments in total) compared to €1,3bln between 2000 – 2006.
 - The 21 Financial Instruments managed directly/indirectly by the European Commission received an overall contribution of €5,5 bln. They are centrally managed and operate across all EU Member States. 6 of them were analysed in the study at hand.

¹ The European Court of Auditors published on the 7 July 2016 the special report “Implementing the EU budget through financial instruments – lessons to be learnt from the 2007-2013 programme period”. All 22 language versions <http://www.eca.europa.eu/de/Pages/DocItem.aspx?did=37071>

This recap document was prepared by Marc Basel – Senior Financial Expert of AECM, for the AECM members.

- The audit criticizes several aspects that limited the efficiency of financial instruments as a mechanism to implement the EU budget, namely:
- **ERDF & ESF** FIs (Financial Instruments) **were oversized** (on average only 57% of all capital paid from OPs such as the ERDF or the ESF to the FIs had been used. The oversized capital endowment was due to Member States trying to avoid de-commitments.
 - **Both** shared (ERDF & ESF) and centrally managed (EC) FIs **did not attract private capital**
 - Only **limited success in providing revolving financial support** with regards to ERDF and ESF
 - **ERDF and ESF** FIs seem to have significantly **higher fees and management costs** (compared to actual financial support to recipients) **compared to centrally managed FIs** or private-sector investment funds

Recommendations by the European Court of Auditors:

- With regards to centrally managed FIs by the European Commission:
 1. They should systematically include an **analysis of the 'lessons learnt'**
 2. In addition to that, they should **assess the effect of major socio-economic changes** and the corresponding contribution required from the EU budget for all centrally-managed FIs
 3. Additional guidance should be provided to the Member States on **how to set up FIs within Member States** or at Union Level
 4. In Financial Regulation the EC should provide a definition for the leverage of FIs applicable across all areas of the EU budget **distinguishing** clearly between leverage of **private** and **public contributions** under the OP taking into account the type of instrument
 5. The general **risk-sharing principles** that may have an impact on the EU budget **should be defined in the concerned legislation**
- With regards to ERDF and ESF FIs:
 6. For these FIs, the EC should ensure at closure that Member States provide **complete and reliable data** on private contributions on capital endowments
 7. The EC should further provide additional guidance to Member States on **how to attract more private capital** without allocating excessive risks to public contributors
- Both regarding ERDF/ESF **and** centrally managed FIs:
 8. The EC should ensure that **only structures which are in line with its own recommendations on tax arrangements are implemented** by the Member States, the EC and the EIB.
 9. The EC should do everything to **maintain the revolving nature of the funds** during the required eight-year period after the end of the 2014-2020 programme period
 10. The EC should **allow FIs to be used into the following programme period**, especially where fund managers are selected on the basis of public procurement
 11. The EC should **ask Member States to report comprehensively on fees and management costs** by March 2017
 12. The EC should clarify that **ceilings for these costs need to be applied to the actual capital endowment** used by the financial instrument to final recipients
 13. The EC should **revise the performance-based remuneration for fund managers** in the 2014-2020 programme period
 14. **Member States should make use of the existing performance-based elements** of the remuneration for fund managers when negotiating funding agreements

15. The EC should carry out a comparative analysis of the implementation costs of grants and financial support. This information could be useful for preparing legislative proposals for the post-2020 period.

Reply of the European Commission reply to these 15 recommendations: (answers were copied 1:1 from the 'Reply of the European Commission' Section):

- 1. 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.
- 2. 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.
- 3. 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.
- 4. 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.
- 5. 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.
- 6. 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.
- 7. The Commission partially accepts this recommendation**
insofar as it concerns its legislative proposals for the post-2020 programming period.
- 8. 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.
- 9. 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.

10. The Commission accepts this recommendation.

The guidance notes 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.

11. 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.

12. 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.

13. 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.

14. 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

15. 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.