Joint AECM/EAPB/NEFI Position Paper on the Future of EU Finances

(Programming period post 2020)

23. November 2017

Executive summary of joint position

As the main intermediaries for EU Structural Funds and other EU financial Instruments (COSME, InnovFin etc.) the member institutions of AECM, EAPB and NEFI are key players in addressing economic and social challenges in the Member States and their regions. By providing amongst others greater leverage, geographical coverage, as well as specific market knowledge, Promotional Financial Intermediaries bring crucial added value to the success of the EU economic policies. Based on the comprehensive experience of our member institutions at national, regional and local level, we are pleased to share our thoughts in the debate on the future of EU finances and on how Promotional Financial Intermediaries can be further encouraged to participate in EU programmes.

Systemic approach and level playing field: We call for a systematic consideration of regional and national Promotional Financial Intermediaries in the distribution of EU financial instruments, Cohesion Policy programmes and infrastructure investments. Promotional Financial Intermediaries should benefit from a level playing field with regard to the treatment of the EU-level financial instruments under State aid rules as well as from the advantages provided by guarantee mechanisms.

Financial Instruments and Cohesion Policy: We support a greater use of financial instruments where appropriate. Complementary to grants, they allow leveraging both scarce public resources and economic and social impact.

We do not believe that regrouping all EU-level instruments into a single fund or a single instrument would be the right way forward. The current policy objectives would be better served via a flexible design and an adequate mix of the future financial instruments. Thus the allocation of EU financial instruments and grants through Promotional Financial Intermediaries should be made easier by:

a) aligning administrative procedures (e.g. application, reporting, audit) between different programmes to offer synergies for financial intermediaries participating in more than just one programme or instrument.

b) simplifying administrative and regulatory requirements, especially those concerning State aid or audits.

c) harmonization or merging of similar instruments under a wider scope and reviewing the objectives of minor Financial Instruments that lack critical budget.

The EU Cohesion Policy after 2020 should further work for the benefit of all EU regions. A more simple and transparent legislation would certainly improve the results of the Cohesion Policy in the next Multiannual Financial Framework. The European Structural and Investment Funds (ESIF) should remain a separate chapter of the EU budget due to their unique nature and the need to foster the convergence across the European regions.

We call for smooth transitions between financing periods by providing Promotional Financial Intermediaries and national authorities with all the necessary secondary legislation in a timely manner.

Finally, we believe joint investment platforms of Promotional Financial Intermediaries should be encouraged in order to promote smaller projects.

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I. Introduction

AECM, EAPB and NEFI (detailed description of the organizations in end-note) welcome the "Reflection paper on the future of EU finances"[1]. We are pleased to provide our contribution to this debate with regard to EU promotional finance, based on our experience in this field.

The members of AECM, EAPB and NEFI comprise regional and national promotional institutions[2] (banks, agencies or other legal status) as well as mutual, private or mixed guarantee institutions, all pursuing development and long-term investment objectives building a long-standing experience as Promotional Financial Intermediaries. Our member institutions are able to combine grant-based instruments with market-based instruments to leverage both scarce public resources and a positive economic and social impact.

II. EU financial instruments and grants: improving access to finance to deliver economic growth and social cohesion

The Reflection paper rightly recognizes EU financial instruments and grants as an *efficient tool to stimulate economic growth and social cohesion* throughout the European Union and as having gained importance over the last years. We would like to stress the reasons that explain their successful use:

1. First, EU financial instruments and grants are designed to *address financing needs of projects pursuing the public interest, which are not properly served by commercial financial institutions*. They are part of a necessary corrective mechanism to information asymmetry, commercial players' focus on cost considerations, lack of knowledge of the market etc. This is for example the case in the financing of social or green infrastructures or the promotion of innovative start-ups.

2. Moreover, *EU financial instruments are also an efficient way to address the challenges faced by many regions and Members States in terms of scarcity of public resources*. Thanks to their revolving nature (at the level of the intermediary) a larger number of beneficiaries can be served with the same amount of money, leading to greater investment, job creation and economic growth.

3. In addition they are a flexible tool to promote diverse investment needs. In this context we would also like to stress that *grants are a prerequisite for a balanced finance mix*,. Grants are among others useful for specific purposes where projects serve EU objectives and support the development of EU regions but do not generate returns and are hence non-bankable (e.g. research & development & innovation, education, social objectives). As on the other hand grants are still a prerequisite for non-bankable projects a mix of instruments consisting of grants, loans, guarantees and equity complementing each other is a must. This is also true for SME financing. Only the proper mix of these instruments allows addressing e.g. the different needs of start-ups and SMEs along their life cycle. In terms of local implementation, a clear legal framework should therefore allow for enough room to choose the most appropriate instrument or mix of instruments.

4. Last but not least, loans and guarantees backed by financial instruments, whether issued by the EU, the Member States or the Regions, are awarded based on a thorough credit risk assessment, as customary in banking. Given this formalized process, the *project quality may be improved and default rates reduced*. The thoroughness of these procedures also creates trust in the market which helps *crowding-in co-lenders or co-investors, hence increasing the leverage of the initial investment*.

For the reasons mentioned above a particular attention should be paid to the design and endowment of EU financial instruments and grants in the discussion on the reform of the EU finances. We call for a decisive continuation and improved use of EU financial instruments, in combination or blended with grants, in the upcoming programming period and beyond.

[1] https://ec.europa.eu/commission/publications/reflection-paper-future-eu-finances_en
[2] national promotional banks or institutions' means legal entities carrying out financial activities on a professional basis which are given a mandate by a Member State or a Member State's entity at central, regional or local level, to carry out development or promotional activities (EFSI-REGULATION (EU) 2015/1017)

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III. Promotional Financial Intermediaries: key partners for the implementation of EU funding

Financial instruments are typically distributed via financial intermediaries to the final beneficiaries in form of loans, risk capital, venture capital, mezzanine finance and/or diverse guarantee types – all instruments being repayable by the final beneficiary as a rule. A great number of the Promotional Financial Intermediaries also have many years of experience in managing grant programs. *The cooperation with Promotional Financial Intermediaries for the distribution of EU financial instruments and grants is therefore crucial for the success of the EU support policies to economic development and social cohesion*. During the current programming period, the Promotional Financial Intermediaries continue to be key distribution and funding partners to the EU and the Members States for Cohesion funding as well as for centrally managed EU financial instruments such as for the ones under InnovFin or the COSME programmes. Promotional Financial Intermediaries are a very important group of intermediaries involved in the co-financing of infrastructure projects under EFSI. In the case of retail/SME products, the Promotional Financial Intermediaries in turn provide the funding to the final beneficiaries in cooperation with the commercial banking sector.

Their long tradition in cooperation with the European institutions enables them to play an important role in the implementation of the EU support policies to economic development and social cohesion. The EU-added value of cooperating with Promotional Financial Institutions results from the following features:

1. First, our member institutions participate in the *implementation of a wide range of economic and social policies of the European, national, regional and local authorities*. They are indispensable and responsible partners for the support of the SME sector, research, innovation and development, infrastructure, digitalisation, energy sector, social housing and urban development, etc.

2. In addition, due to their longstanding experience with beneficiaries in all 28 EU Member States and beyond, Promotional Financial Intermediaries *have the expertise in developing appropriate instruments to address specific market deficiencies in their domestic markets*. *By designing customised financing solutions at all levels and for diverse kinds of beneficiaries* they contribute to transform EU and national policy decisions endowed with public budget into target-oriented action in very different environments in the EU Member States and regions.

3. Moreover, these Promotional Financial Intermediaries are ideally placed to ensure the most adequate and cost-efficient distribution of EU financial instruments. Given that they usually cooperate with all commercial banking groups, they can ensure a *full coverage of the banking sector in their respective territories*, resulting in fair, transparent and *equal access* to public promotional funding for all partner banks and consequently to all potential final beneficiaries.

4. With their long-standing and in-depth market knowledge, along with proper risk assessment and credit/guarantee processing procedures, they can also provide a *sound assessment of the effective default risk*. This allows them to support projects, which would otherwise not be financed by commercial banks, while keeping the default levels as low as possible.

5. Finally, by providing their co-funding or co-/counter-guaranteeing, Promotional Financial Intermediaries contribute by an *additional leverage, which allows achieving even more final investment*. A co-funding or co-guarantee allows increasing the final investment or the number of recipients. It is generally recognized that financial instruments, be it in the form of guarantees or passed-through loans, do not distort competition and result in a high economic additionality in terms of innovation, employment and growth. To boost the results of the cooperation with Promotional Financial Intermediaries, State Aid rules must be reviewed as elaborated in the section IV. (c) of this paper.

This considerable added value provided by Promotional Financial Intermediaries has been confirmed in the long-standing cooperation with the national and regional governments as well as the EIB group over previous programming periods.

While the reflection paper has not emphasized this particular subsidiary role of Promotional Financial Intermediaries, the European Commission *has underlined the need for strong and efficient regional and national promotional institutions to support EU funding strategies* in its Communication on *Long-Term-Financing of the European Economy*[3]and in the *EFSI Regulation*[4].

The cooperation between the EU, Promotional Financial Intermediaries, and commercial banks, brings about economic synergies to the benefit of the European economy. It is therefore of *utmost importance that Promotional Financial Intermediaries are systematically taken into consideration* in the distribution of EU centrally managed and Cohesion policy programmes. It is essential to conduct EU economic policies in the spirit of subsidiarity. The implementation of the EU funding, whether via EFSI or stand alone programmes should always avoid crowding-out financial entities at Member State or regional level, no matter if private or public.

In addition, Promotional Financial Intermediaries strive to further develop their technical expertise. The exchange between Promotional Financial Intermediaries and notably technical assistance among and for Promotional Financial Intermediaries as well as for national governments for the creation of new national and regional Promotional Banks and Institutions helped to improve the services or even create new players in Member States where no National Promotional Bank existed before. Lessons should be drawn in a systemic manner from the experiences in the exchange of best practices, technical assistance and support as has already been initiated in this programming period e.g. with Enterprise Europe Network EEN (under COSME) when designing future support mechanisms. This exercise should include proper consultation of our associations which possess the experience in the creation of new promotional institutions and sharing best practices. EFSI has also brought about the possibility to set up *joint investment platforms* of multiple Promotional Financial Intermediaries. However, this opportunity foreseen already in the first EFSI Regulation has never been fully exploited due to the lack of clear rules, flexibility and projects eligible under existing rules. Our members are persuaded that such platforms, which would benefit from the EU Guarantee awarded by the EIB Group, could efficiently finance small projects all across the Union. In our view this would contribute to a better geographical balance of EFSI investments, also in favor of smaller and less developed markets, while not discriminating the larger ones. The EU is aspiring to finance more small-scale projects. Bundling such projects is an essential step to reach this objective.

IV. General Suggestions for The Multiannual Financial Framework post 2020

The Reflection Paper investigates different ways to further improve the performance and increase the impact of EU funding that are either centrally or locally managed. Among these are proposals to integrate all EU-level financial instruments into one single fund, which could provide loans, guarantees and risk sharing instruments, blending and combining them with grants where appropriate. This single fund would cater for the different policies depending on the projects or windows, to cater for different objectives.

A single rule book is proposed, governing all processes and instruments or applications of the same rules and conditions for the same type of project, with a view of simplifying implementation and reduce administrative burden for the beneficiaries.

a) Single fund or instrument vs. specific financial instruments with critical mass

The current budget of the European Union is composed of four spending blocks which serve different purposes, and have specific investment needs and governance structures. Since there are significant differences between these spending blocks we *do not see a justification for compressing all EU-level financial instruments* and grants from distinct policy fields *into one overall single instrument or fund*.

We see this solution as unwieldy and counterproductive; a one–size-fits-all approach is in contradiction with the flexibility individual financial instruments have to retain in their respective design and terms (guarantee coverage rate, duration, etc.) to be able to fulfil their assigned purpose.

[3] http://ec.europa.eu/internal_market/finances/docs/financing-growth/long-term/140327-communication_en.pdf
[4] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2015.169.01.0001.01.ENG

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From the perspective of implementing entities, a *smaller set of flexible financial instruments,* which can be employed for broadly defined purposes in distinct policy areas, would be the most desirable setting the EU should pursue. Instruments with larger scope would allow Promotional Financial Institutions to adapt them to their specific national or local needs, taking better account of already existing national or local promotional instruments. This would significantly contribute to avoiding overlaps, while maximizing synergies and making the most out of European funding. *A wider scope of existing instruments would allow subsuming very small instruments that do not dispose of sufficient budgetary volumes*. All instruments to be implemented shall keep a specific policy focus.

The EU added value is an important guiding principle for the design of new financial instruments and EU spending in general. As such it should be demonstrated taking into account respective market needs and demand, which might vary between Member States. We thus encourage the EU Commission to adopt a flexible approach towards EU added value tests.

As regards budgetary flexibility, this could be achieved via an *annual review process* by the Commission and an ordinary *legislative procedure*.

b) Single rule book vs. targeted alignment of rules and "slim" approach

We welcome in principle the approach of the Reflection Paper of pursuing simplification and reduction of administrative burden. In our view, a more efficient solution than a single fund or instrument to improve the roll-out and intermediation of the EU financial instruments would be the *alignment of specific rules governing for similar programmes and adopting a "slim" approach to administrative requirements for Promotional Financial Intermediaries*.

However, when the Reflection Paper raises the prospect of a "Single Rule Book", we are concerned that this may go too far in terms of harmonization. It should be clarified that such an alignment should be *focused only on administrative procedures* (e.g. application, reporting, audit) of different programmes *to offer synergies for Promotional Financial Intermediaries participating in more than just one programme.*

A "slim" approach would aim at a reduction of administrative burden for the Promotional Financial Intermediary by *reducing unnecessary requirements*, all the while aiming at maintaining high levels of certainty. In particular, the *audit requirements should be streamlined*, aiming at subsidiarity whenever possible and avoiding a succession of a number of different audits from different national and EU institutions, which pose a challenge to Promotional Financial Intermediaries in terms of cost and time. Furthermore, *record keeping and verification obligations should be reduced*. Similarly, evidencing of the proper use of financial instruments funding to beneficiaries and reporting principles should also be simplified. Given the revolving nature of financial instruments, the reporting process should be focused on examining the impact of financing provided instead of following detailed and burdensome procedures.

Grants distributed from EU Funding should always be available as stand-alone ones, or in combination with central EU Financial Instruments, or blended with other Financial Instruments.

These synergies would also have direct benefits for the final beneficiaries in terms of simplification and reduction of red tape.

c) State aid and level playing field

As mentioned above, *Promotional Financial Intermediaries at national and regional level should be systematically crowded in* in the implementation of the distribution of EU-Level funding. The current *lack of level playing field in terms of State aid rules* poses an obstacle to the cooperation with Promotional Financial Intermediaries.

Under the current rules, an investment undertaken by commercial banks or the EIB Group is never considered as State aid (as long as the EIB Group invests own resources at own risk and as long as national authorities do not decide about the use of the resources), while State aid rules apply in case of an investment with identical features undertaken by a national Promotional Financial Intermediary. This *uneven position* significantly complicates the participation of Promotional Financial Intermediaries in the distribution of EU financial instruments and grants, and should certainly be addressed by the European institutions. In order to maximize the EU added value, the legal framework governing

State aid should be significantly simplified for implementation of all EU programmes – within both centrally managed instruments and the Cohesion funding.

d) Legal certainty in transition and implementation

Laws governing EU financial instruments and grants for different programming periods should *ensure a smooth transition* from one framework to another. Delays resulting from e.g. the absence of legal certainty or lack of framework agreements, as was the case in the transition towards the current and preceding programming periods, have hampered the timely roll-out of EU funding.

Such delays can lead to the interruption in the provision of certain promotional instruments and thus lead to visibility problems towards the beneficiary, both from the perspective of the Promotional Financial Intermediary as well as of the EU institutions. In the same vein, *the general framework* of the EU financial instruments and grants should ideally *remain as stable as possible* from one programming period to the next.

The European Commission should table amending laws only after it has received and analyzed *independent evaluations* of the original programmes. This could actually speed up the legislative process, as fewer corrections would be necessary throughout the legislative process.

As far as the discussion about the duration of Multiannual Financial Framework MFF is concerned, the Promotional Financial Intermediaries *do not support the idea of shortening the period from seven to five years.* Such a scenario would certainly not improve the implementation of EU Financial Instruments and the ESIF instruments because their legal framework would change even more often. In contrast, we support the idea of a "5+5 period", which would create a flexible 10-year framework with a scrutiny based on an independent evaluation in the mid-term.

e) Specificity of Cohesion Policy

The Reflection Paper raises the idea of complementarity between centrally managed financial instruments and instruments managed by the Member States under the Cohesion Policy. We would like to emphasize that due to its unique nature and the need to foster the convergence among the European regions, the *Cohesion Policy should remain a separate chapter*. Furthermore, it would be desirable to simplify the combination of Cohesion Policy funding with the centrally managed EU financial instruments.

The EU Cohesion Policy is one of the key activities of the European Union, which aims to address the differences in development levels of the European regions. In the wake of the financial crisis economic convergence in the EU has considerably slowed down. The continuation and, ideally, the improvement of the functioning of Cohesion Policy in the context of the next MFF are thus indispensable in the view of Promotional Financial Institutions. It is however equally important to *preserve funding opportunities for all regions*, including the more developed ones, as they are the drivers of growth and innovation in individual Member States, hence promoting the development of all regions.

In general, our members stress that the complexity of ESIF rules has significantly increased in the course of the current funding period. There are totally 8 main regulations, 10 delegated regulations, 8 implementing regulations and 6 decisions. In addition, innumerable guidance documents as well as the so-called EGESIF documents drawn up in expert groups with the assistance of the European Commission explain how the provisions are to be interpreted. Moreover, guidelines often significantly differ among Directorates-General. More simple and transparent legislation, adopted in the prior to the programming period, would certainly improve the results of the Cohesion Policy. Guidelines under ESIF should also not make it more difficult for financial intermediaries to implement financial instrument in comparison to grants, which are subject to easier rules on e.g. Ex-Ante assessments.

The 42 members of the ***European Association of Guarantee Institutions (AECM)*** *are operating in 26 countries in- and outside the European Union. They are mutual, private, public or mixed institutions all having in common the mission to support SMEs during their whole business cycle in getting access to finance, thus, to foster economic growth, innovation, digitization, job creation, and social integration. More precisely, they promote SMEs by providing guarantees to them as well as to entrepreneurs and freelance professions who have an economically sound project but do not dispose of sufficient bankable collateral. At the end of 2016 AECM's members had over 85 billion of guarantee volume in portfolio, thereby granting guarantees to more than 3.1 million SMEs.*

The ***European Association of Public Banks (EAPB)*** *gathers member organizations (financial institutions, funding agencies, public banks, associations of public banks and banks with similar interests) from 15 European Member States and countries, representing directly and indirectly the interests of over 90 financial institutions towards the EU and other European stakeholders. With a combined balance sheet total of about EUR 3,500 billion and a market share of around 15%, EAPB members constitute an essential part of the European financial sector, providing financial services and funding for projects that support sustainable economic and social development with, amongst others, activities ranging from the funding of companies/SMEs and the promotion of a greener economy to the financing of social housing, health care, education and public infrastructure at national, regional and local level.*

The ***Network of European Financial Institutions for Small and Medium Sized Enterprises (NEFI)****, which was founded in 1999, consists currently of 19 financial institutions from 19 European Union member states. In 2016 NEFI members actively supported and financed approximately 350 000 SMEs all over Europe with more than EUR 51 billion of financing mainly in the form of loans and guarantees.*

NEFI pursues the objective of following the financial, political and legal developments in the fields of European economic and financial policies and all measures adopted by the EU institutions which are relevant for promotional financial institutions focusing on the facilitation of SMEs' access to finance. NEFI serves as a contact for the European Institutions providing know-how and information on all matters concerning promotional banking.

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