AECM reflections on the future of the Cohesion Policy

Context

Since the 2007-2013 programming period, AECM members have been channeling Cohesion Policy funds to benefit final recipients, primarily SMEs. Drawing from their experiences in implementing financial instruments co-funded by the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), and the Just Transition Fund (JTF), we would like to present proposals that could be valuable for shaping future Cohesion Policy.

Comments

I. Allocate a minimum percentage of the Cohesion Policy funds to be delivered through financial instruments

Financial instruments are widely recognised as an effective tool for achieving the sustainable goals of Cohesion Policy. They have consistently proven to be an efficient method for implementing public policies, particularly in the context of constrained budgets. With this in mind, we recommend earmarking a minimum percentage of Cohesion Policy resources within each Investment Programme (IP) for the next programming period to be delivered through financial instruments. Where justified by ex-ante assessments, these could take the form of guarantees. This approach offers several key advantages:

- Higher Leverage Effect: Financial instruments attract additional private sector investments, significantly multiplying the impact of public funds.
- Revolving Effect: Unlike grants, financial instruments are reused, as repayments and returns are reinvested into new projects, ensuring sustained funding availability over time. For the final recipient, receiving repayable support instead of a grant support offers the advantage of quicker access to finance on a more advantageous terms than standard commercial support (e.g. lower collateral/interest rate and longer repayment periods).
- Risk Mitigation: Guarantees help mitigate risks for private investors, encouraging them to support innovative and high-potential projects that might otherwise struggle to secure financing.
- In case of default, guarantees can be easily and quickly used contrary to, for instance, collateral in the form of real estate.

II. Make financial instruments more appealing to businesses seeking support

Regarding financial instruments, it is crucial to make them as business-friendly as possible. The implementation of financial instruments should be entrusted to national and regional financial institutions, as they have the expertise and understanding necessary to effectively communicate with SMEs and address their specific needs.

Additionally, financial instruments should be designed to be readily accessible, streamlined, and cost-effective, ensuring that they are not only easier to use but also more appealing to businesses seeking support and as simple as possible for Managing Authorities to implement.

Romania's approach during the 2021-2027 programming period highlights the need for this. The country established Regional Programs, each of them having allocations to support SMEs through financial instruments. However, the relatively small budgets and the diverse preferences in terms of financial instruments of Regional Development Agencies - serving as the Managing Authorities for these regional programmes - have made it difficult for banks to participate. To overcome this challenge, it was proposed that Managing Authorities in Romania adopt similar, harmonised financial instruments across regions. This would lower administrative costs for banks and ultimately benefit SMEs. We believe these challenges could be avoided if financial instruments were more streamlined or guaranteed at sufficient volumes per each single programme.

Another challenge arises from the increasingly narrow and specific policy objectives. With each Multiannual Financial Framework (MFF), the European Commission limits the objectives for which Member States can allocate Cohesion Policy Funds. In smaller countries, this makes it particularly difficult to implement effective financial instruments when the focus must be very specific (e.g., loans exclusively for the digitalization of industrial companies).

III. Compliance with State aid rules

Compliance with State aid rules is a constraining factor when Managing Authorities provide aid through financial instruments co-financed by Cohesion Policy funds. This challenge arises in part because financial instruments often involve multi-layered structures. Depending on the design of the financial instrument, State aid may be present at the level of investors, the bodies implementing the financial instrument (e. g. Fund of Funds and/or financial intermediaries) as well as final recipients.

From the State aid point of view, Managing Authorities face the challenge of offering low-cost finance to SMEs while simultaneously incentivising private investors participation. Additionally, they must address a third critical issue: ensuring that any aid intended for SMEs does not inadvertently benefit financial intermediaries or private investors.

To achieve State aid rules compliance, Cohesion Policy funds are usually deployed under either the *de minimis* Regulation or the General Block Exemption Regulation (GBER). While the *de minimis* Regulation offers relatively simple rules, its thresholds may be too low for investments like, for instance, new factory building plus machinery equipment of a medium sized enterprise for the production of innovative products, or guarantees for industrial or tech projects. On the other hand, if the GBER is used, the financial institution must firstly identify the relevant articles related to the activity being funded (which is not

always straightforward) and then ensure that the funding complies with the permissible intervention rates specified in those articles.

For Cohesion Policy financial instruments, several provisions of the GBER are particularly relevant i.e. Article 14 (regional investment aid), Article 16 (regional urban development aid), Article 21 (risk finance aid), Article 22 (aid for start-ups), Article 39 (investment aid for energy efficiency projects in buildings) etc. All these articles have different aid intensities/thresholds per undertaking and per project. Moreover, some of these provisions are designed specifically for grant instruments rather than financial instruments (e.g., Articles 14, 25, etc.), which makes them challenging to apply to financial instruments. Therefore, calculating the aid amount embedded in a financial instrument is complex and discouraging for beneficiaries and final recipients.

On this basis, and in order to facilitate the achievement of the Cohesion Policy objectives, we ask the EC for a regulatory simplification, with simpler and clear rules related to the investments under Cohesion Policy Funds.

In the same vein, having separate sets of rules for grants and financial instruments creates a barrier to banks participation. Significant simplification has already been achieved with Article 58(5) of the CPR, however, the Commission should further harmonise these rules, creating a unified framework for both forms of support i.e. grants and financial instruments, when they are implemented independently.

IV. The 'Do No Significant Harm Principle' implications

For the following reasons, the 'Do No Significant Harm principle' (DNSH) represents another challenge to the effective use of EU Funds. Its implementation varies across different programmes and funds, lacking coherence with approaches under the Recovery and Resilience Facility (RRF), the InvestEU Programme, and Cohesion Policy Funds. This inconsistency is particularly concerning given that all these programmes derive the meaning of DNSH from the same legal basis, Article 17 of the Taxonomy Regulation. The differing approaches not only cause confusion regarding the applicable rules but also hinder the seamless combination of various funding instruments. Further, the differing methods of compliance with the DNSH criteria add unnecessary administrative complexity. Each fund manager is required to develop specific expertise in applying DNSH, which not only increases the workload but also demands specialised knowledge that may not be readily available across all Managing Authorities. Finally, the DNSH assessment process is both, time-consuming and costly for funding entities and for final receipients alike.

To address these issues, the EC should **harmonise and simplify the implementation of the DNSH principle**. More specifically, at national level, there is a lack of consistency in how compliance with the DNSH criteria is demonstrated, and whether this requirement applies at the programme level or extends to individual projects. In the case of Cohesion Policy Funds, Member States can create their own methodologies to proof compliance, as

opposed to RRF where the assessment is based on the Commission's pre-defined methodology. Regarding the implementation level, while DNSH compliance under Cohesion Policy is mandatory at the programme level, i.e. for the types of actions defined, the regulatory framework does not impose an obligation for project-level assessments of DNSH compatibility. However, Mananging Authorities have the discretion to voluntarily introduce specific DNSH-related conditions when establishing criteria for the selection of operations. This has created inconsistencies and differences across Managing Authorities and Member States. Furthermore, in many cases, this uneven implementation raises the bar beyond merely complying with existing legislation, creating an increased administrative burden associated with applying the DNSH principle. To ensure this inconsistency is reduced, we advocate for a uniform application at the programme level. If the DNSH principle is to be extended to the project level, we recommend exempting projects below EUR 10 million, similar to the current practice under the InvestEU Programme.

The EC should **minimise the administrative burden for Managing Authorities by developing a single set of simple and practical DNSH guidelines** instead of having 3 separate documents i.e. 'DNSH Technical Guidance for the RRF', 'Explanatory note on the Application of the DNSH principle under Cohesion Policy', as well as the 'InvestEU Sustainability Proofing Guidance' for the repayable support under the InvestEU, that would clearly explain how the measures included in EU funding instruments should comply with the principle. Having a common exclusion list applicable to the different EU funds could be a way to simplify the carrying out of the DNSH assessment, reduce the administrative burden, and facilitate synergies across EU funds to support investments. However, this list should be restricted to activities that cannot make progress in their green transition, ensuring the principle of 'leaving no one behind' is upheld. Additionally, it should include exceptions to these exclusions, laying down clear conditions or criteria that need to be met for these exceptions to apply. This will guarantee that EU funding will not be withheld from companies that are working towards significant investments in green transitions.

Further, the **reporting requirements should be eased for final recipients** as keeping the reporting obligation at minimum will ensure that SMEs, especially micro-enterprises, can access affordable finance in the future. Currently, non-listed SMEs do not have the obligation to report on their ESG data. The reality of the market shows, however, that SMEs' stakeholders (investors, banks, larger suppliers of a supply chain, etc.) are impacted by the ESG reporting requirements and are cascading these requirements to SMEs already today. A recent study by DG GROW[1] reveals that demonstrating taxonomy alignment can cost micro-enterprises approximately EUR 22.500, and up to EUR 125.000 for SMEs, primarily due to the requirements for DNSH proofing. These costs are significant for many small and medium-sized enterprises, which may struggle to meet such reporting demands. Similarly, the EC should make sure that the DNSH does not create any ambiguity for financial intermediaries as in some Member States, EU financing

[1] https://op.europa.eu/en/publication-detail/-/publication/bfc20a54-0b62-11ef-a251-01aa75ed71a1/language-en

programmes could be avoided in favour of less complex and less risky domestic funding opportunities.

Finally, the DNSH principle is still relatively new and can be interpreted differently by Member States creating confusions in its implementation. **Capacity building is needed at national level** to ensure there is uniform understanding of the principle among Managing Authorities and final beneficiaries and that national authorities have the needed knowledge to apply it properly.

V. RRF model versus Cohesion Policy model

Regarding the future of Cohesion Policy, early indications suggest that the RRF could be extended in some form into the next budgetary period. Certain aspects of its governance or delivery model might be integrated into Cohesion Policy. Although it is still too early to draw definitive conclusions on the implementation of the RRF, there are several elements that could be considered for the future development of Cohesion Policy.

First, avoid multiplication of funds and instruments with similar scope and objectives during the same implementation period as this creates risks of overlaps, weakens the administrative capacity of the Managing Authorities which ultimately results in low absorbtion capacity. Moreover, this could discourage municipalities and regions with fewer capacities – hence with the most potential to benefit from Cohesion Policy Funds – from applying for Cohesion Policy funded programmes.

Second, lessons learned from the 2014-2020 period, and the reactions to the COVID crisis and the war in Ukraine showed that more flexibility in implementation, reporting, and monitoring was possible in implementing Cohesion Policy. The RRF showed it was possible to unlock massive levels of investments for green and digital transitions; smart, sustainable, and inclusive growth; social and territorial cohesion; health, social and institutional resilience. All these objectives should be pursued through Cohesion Policy.

Regarding the **geographical scope** of the future of the Cohesion Policy, AECM and its members advocate for a policy that benefits all types of European territory (developed, transition, and less developed) through a place-based approach allowing to address the territorial needs of each territory to the greatest possible extent: urban areas, peripheries, remote and rural areas, etc.

In terms of **governance**, we consider that an European instrument that responds to the principle of subsidiarity is very much needed. There is no doubt that the economic divergence among European regions would have been significantly worse without the establishment of the Cohesion Policy instrument. Therefore, the future Cohesion Policy should remain a regional policy with its core principles, in particular the partnership principle and multi-level governance. Instead, to make this bottom-up approach more successful, more should be done to strengthen the institutional capacity of local authorities.

With reference to **'cost payment'** the use of simplified cost options is further encouraged. Other delivery features imply major simplifications on management and audit, with clear and most important pre-defined rules, as well as flexibility on co-financing rates. One of the key elements of difference between Cohesion policy and the RRF funds, which could significantly improve the absorption capacity of the former, is the non-requirement of national co-financing. For countries that already struggle with their public finances and in finding additional new resources, this surely facilitates the whole process.

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About us

The 47 members of the **European Association of Guarantee Institutions (AECM)** are operating in 32 countries in Europe[2]. They are either private/mutual sector guarantee schemes or public promotional institutions or banks. Their mission is to support SMEs in getting access to finance. They provide guarantees to SMEs that have an economically sound project but do not dispose of sufficient bankable collateral. This so-called SME financing gap is recognised as market failure. By guaranteeing for these enterprises, guarantee institutions help to successfully address this market failure and to facilitate SMEs' access to finance.

European Association of Guarantee Institutions – AECM
Avenue d'Auderghem 22-28, bte. 10, B-1040 Brussels
Interest Representative Register ID number: 67611102869-33

[2] https://aecm.eu/members/our-members/