



EUROPEAN COMMISSION

European Structural and Investment Funds

Guidance for Member States on
CPR eligibility rules for ESI Funds Financial Instruments

DISCLAIMER

“This is a working document prepared by the Commission services. On the basis of applicable EU law, it provides technical guidance for colleagues and bodies involved in the monitoring, control or implementation of the European Structural and Investment Funds on how to interpret and apply the EU rules in this area. The aim of this document is to provide Commission services' explanations and interpretations of the said rules in order to facilitate the programme implementation and to encourage good practice(s). This guidance is without prejudice to the interpretation of the Court of Justice and the General Court, the applicable State aid rules or decisions of the Commission.”

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1. REGULATORY REFERENCES

| Regulation | Articles |
|---|--|
| Regulation (EU) N° 1303/2013 of 17 December 2013 Common Provisions Regulation <i>(hereafter CPR)</i> | Articles 2, 37, 38, 39, 40, 41, 42, 44, 45, 46, 65, 69, 70, 71 and 120 |
| Regulation (EU) N° 480/2014 of 3 March 2014 Commission Delegated Regulation <i>(hereafter CDR)</i> | Articles 4, 5, 6, 8, 9, 11, 12, 13, 14, 25 |
| Commission Implementing Regulation (EU) No 821/2014 of 28 July 2014 <i>(hereafter CIR)</i> | Articles 1, 3, 4 and 5 |
| Regulation (EU) No 1301/2013 of 17 December 2013 on the European Regional Development Fund <i>(hereafter ERDF)</i> | Article 3 |
| Regulation (EU) No 1300/2013 of 17 December 2013 on the Cohesion Fund <i>(hereafter CF)</i> | Article 2 |
| Regulation (EU) No 1305/2013 of 17 December 2013 on support for rural development by the European Agricultural Fund for Rural Development <i>(hereafter EAFRD)</i> | Articles 59(2) and 60 |
| Regulation (EU) No 508/2014 of 15 May 2014 on the European Maritime and Fisheries Fund <i>(hereafter EMFF)</i> | Articles 69(2) and 94(2) |

2. BACKGROUND AND PURPOSE OF THE GUIDANCE

In contrast to the 2007-2013 period, where different Funds followed different rules, for 2014-2020 financial instruments can be used across all ESI Funds with a common legal framework as the CPR lays down common provisions for the five ESI Funds (ERDF, CF, ESF, EAFRD and EMFF) therefore allowing Member States and managing authorities to use financial instruments in relation to all thematic objectives covered by their programmes, and for all Funds, where it is efficient and effective to do so.

In summary, the 2014-2020 legal framework for financial instruments aims at:

- (i) promoting sound financial management in implementing financial instruments (e.g. ex-ante assessment, phased payments);
- (ii) providing the necessary flexibility for the national/regional actors implementing ESI Funds policy (e.g. possibility to use financial instruments in all thematic objectives and all ESI funds, national co-financing can be provided at a later stage and at all levels of implementation, incentives on co-financing rates, clear implementation options, in-kind contributions in the form of land and real estate for urban or rural development investments);
- (iii) ensuring alignment of the legal framework with market practices e.g. allowing to declare as eligible expenditure capitalised interest rate subsidies and guarantee fee subsidies to be paid after the end of eligibility period, capitalised management costs and fees to be paid after the end of the eligibility period (for equity and microcredit financial instruments), unconditional VAT eligibility, as well as expenditure for follow-on investments after the end of the eligibility period.

The eligibility of expenditure has to comply with the CPR rules, Fund specific rules and with the national rules. The purpose of this note is not to cover in an exhaustive manner all the eligibility rules that can be established especially at national level, but to provide details on the rules established at EU level.

In this context, this guidance note covers the most important of the legal framework's key provisions mentioned above and which are not yet be covered by other guidance notes. This guidance note is without any prejudice to the applicable State aid rules.

3. WHAT HAS CHANGED IN 2014-2020?

Table 1: Changes relating to the ERDF, ESF and EAFRD

| | 2007-2013 ERDF/ESF | 2007-2013 EAFRD | 2014-2020 ESI Funds |
|-------------------------------|---|--|--|
| Source of financing | Financial instruments can provide support from Structural Funds only (ERDF and ESF) under a common legal framework for ERDF and ESF only. | Financial instruments can provide support from EAFRD only under separate legal framework). | Financial instruments may provide support from all ESI Funds through financial instruments under a common legal framework – <i>Art 37(1) CPR</i> . |
| Scope of support | Support for enterprises, urban development, energy efficiency and renewable energies in the building sector. | Support only for enterprises as defined by Article 51(3) of Regulation No 1974/2006. | Support for all thematic objectives. Any investment which is financially viable and does not give rise to sufficient funding from market sources can be supported through financial instruments – <i>Art 37(1) CPR</i> . |
| Set-up | Indirect requirement for an evaluation of gaps between supply and demand for financial instruments for enterprises and at the level of Holding fund. | Requirement for ex-ante risk assessment of expected losses only for guarantee funds, introduced within the programming period. (i.e. no requirement in the beginning of the programming period). | Compulsory ex-ante assessment for any FI – <i>Art 37(2)(3) CPR</i> . |
| Implementation options | Financial instruments at national or regional level with or without holding fund – tailor made only The investment in credit lines directly by MA [covered by Article 43a(1)(b) of the General Regulation] was not possible under financial instruments rules (only under repayable assistance). | Financial instruments at national or regional level – tailor made only | Contribution to EU level financial instruments. Financial instruments at national, regional level, transnational or cross-border level: - Off-the-shelf; - Tailor-made. In addition to implementation through Funds of funds or entrusted entities: - Direct implementation by managing authority (loans/guarantees only) - <i>Article 38 CPR</i> |
| Payments | Possibility to pay to the financial instruments and declare to the Commission 100% of the amount committed to the financial instrument – not linked to disbursements to final recipients. | | Phased payments declared to the Commission linked to disbursements to final recipients. National co-financing which is expected to be paid can be included in the |

| | 2007-2013 ERDF/ESF | 2007-2013 EAFRD | 2014-2020 ESI Funds |
|--|--|--|---|
| | | | request for the interim payment – <i>Article 41 CPR</i> |
| Co-financing rates | No distinction between grants and financial instruments. | | Where the whole priority axis is delivered through financial instruments the co-financing rate is increased by 10 percentage points and in case of contributions to an EU level financial instrument the co-financing rate can go up to 100% – <i>Art 120(5) and (7) CPR</i> . |
| Management costs and fees | Management cost and fees eligible under Article 43(4) of Implementing Regulation No 1828/2006 (link to performance recommended by EC in COCOF note) | Management costs and fees eligible under Article 52(1)(b) and limited by Article 51(5) of Regulation No 1974/2006 (link to performance recommended) | Performance-oriented methodology of calculating management cost and fees as well as their thresholds – <i>Articles 42(1)(d) CPR and Articles 12, 13 and 14 CDR</i> |
| Capitalised management costs and fees for equity-based instruments and micro-credit | Not eligible. | | The period for eligibility of capitalised management costs and fees in case of equity-based instruments and micro-credit is set at 6 years after the end of the eligibility period if investments in final recipients occurred within the regular eligibility period and an escrow account has been set up for that purpose – <i>Art 42(2) CPR and Article 14 CDR</i> |
| Interest (treasury management), resources returned, legacy resources | Legal basis set out in successive amendments of the Regulations and recommendations set out in COCOF note | Interest generated from payments from RDPs to financial instruments to be used for the purpose of the fund. | Full provisions set out from outset – <i>Articles 43, 44 and 45 CPR</i> |
| Reporting | Compulsory reporting only from 2011 onwards and on a limited range of indicators. | No compulsory reporting – part of the general annual reporting on the programme's implementation. | Compulsory reporting from the outset, on a range of indicators linked to the Financial Regulation – <i>Article 46 CPR</i> |
| Combination of grant and financial instrument | Article 43(6) of the Implementing Regulation provided for combination of grant and financial instrument, for a specific area, at the level of final recipients as two separate operations. Combination of grant | No specific rules. General principles apply. Interest rate subsidies seen as a separate form of support from FEI under Article 49 of R 1974/2006. | The CPR contains provisions on combination of financial instruments and grants within FI operation (e.g. interest rate subsidy or guarantee fee subsidy) and as two distinct operations – <i>Article 37(7)(8)(9) CPR</i> |

| | 2007-2013 ERDF/ESF | 2007-2013 EAFRD | 2014-2020 ESI Funds |
|---|--|-----------------|---|
| | and financial instruments in one operation clarified in COCOF note (paragraph 4.3.1) | | |
| Capitalised interest rates subsidies and guarantee fee subsidies | The eligibility of this type of expenditure was clarified in the guidelines on the closure of programmes 2007-2013 (ERDF, CF and ESF). | Not eligible. | Capitalised interest rates subsidies and guarantee fee subsidies, due to be paid for a period not exceeding 10 years after the end of the eligibility period are considered eligible expenditure under certain conditions – <i>Article 42(1)(c) CPR</i> |
| Follow-on investments, after the end of the eligibility period, in case of equity and equity-based instruments | Not eligible. | | Follow-on investments into final recipients within 4 years after the end of the eligibility period are eligible, under certain conditions – <i>Article 42(3) CPR</i> |

Additional EAFRD specific eligibility requirements are also set out in the EAFRD Regulation and in its Delegated Regulation No 807/2014 as general investment related or final recipient related eligibility requirements (e.g. no purchase of animals and annual plants, working capital thresholds for agriculture and forestry, thresholds for maximum proportions of certain inputs for bioenergy production, specific targeted groups as final recipients, etc.)

On what concerns the EMFF, in addition to the applicability of the CPR provisions concerning financial instruments, and in contrast to the situation under the European Fisheries Fund for 2007-2013, the EMFF includes an obligation that support provided to enterprises in the processing sector other than SMEs must be through financial instruments (Article 69(2) EMFF).

4. ELIGIBLE EXPENDITURE FOR FINANCIAL INSTRUMENTS

The general rule for the eligibility of expenditure for a contribution from ESI Funds is provided for in Article 65(2) CPR. Under this provision expenditure is eligible for a contribution from the ESI Funds if it has been incurred by a beneficiary and paid between the date of submission of the programme to the Commission or from 1 January 2014, whichever is earlier, and 31 December 2023. In addition, the eligibility of expenditure has to comply with the CPR rules, Fund specific rules and with the national rules as provided for in Article 65(1) CPR and be in line with requirements set out under the relevant programme and priority (in this regard please refer to the additional explanations under point 5.5).

Programme contributions are paid to financial instruments during the eligibility period and reimbursed by the Commission (through interim payments) in line with the provisions of Article 41 CPR¹.

¹ Please refer to the additional explanations available in the guidance note on Article 41 CPR - Request for payments: <https://www.fi-compass.eu/publication/ec-regulatory-guidance/ec-regulatory-guidance-guidance-member-states-article-41-cpr%E2%80%9393>

According to Article 42(1)(2) and (3) CPR, the eligible expenditure of the financial instrument at closure is the total amount of programme contributions effectively paid or committed in the case of guarantees, by the financial instrument by the end of eligibility period corresponding to:

1) Payments to final recipients (in the form of loans, equity and quasi-equity) and in the cases referred to under Article 37(7) CPR, i.e. the types of grants there mentioned, payments to the benefit of final recipients (for the eligibility of contributions in kind and support paid to the benefit of the final recipient please refer to the explanations under points 5.2 and 5.12);

2) Resources committed for guarantee contracts, whether outstanding or already come to maturity, in order to honour possible guarantee calls for losses, calculated according to a prudent ex ante risk assessment, covering a multiple amount of underlying new loans or other risk-bearing instruments for new investments in final recipients (for the establishment of the eligible expenditure for guarantees and the notion of multiplier please refer to the explanations under point 5.7);

3) Capitalised interest rate subsidies or guarantee fee subsidies, due to be paid for a period not exceeding 10 years after the eligibility period, used in combination with financial instruments, paid into an escrow account specifically set up for that purpose, for effective disbursement after the eligibility period laid, but in respect of loans or other risk-bearing instruments disbursed for investments in final recipients within the eligibility period laid down in Article 65(2) CPR (please refer to the explanations under point 5.13);

4) Reimbursement of management costs incurred or payment of management fees of the financial instrument;

5) For equity-based instruments and micro-credit, capitalised management costs or fees due to be paid for a period not exceeding 6 years after the eligibility period in respect of investments in final recipients which occurred within that eligibility period and which cannot be covered by Articles 44 and 45 CPR, paid into an escrow account specifically set up for that purpose²;

6) For equity-based instruments for enterprises, a limited amount of payments for follow-on investments in final recipients having received initial equity investments from the financial instrument within the eligibility period can be eligible if the conditions under Article 42(3) CPR are met (please refer to the explanations under point 5.14).

As set out in Article 42(4) CPR, the eligible expenditure cannot exceed the sum of the total amount of support from ESI Funds paid for the purposes above mentioned from 1) to 6) plus the corresponding national co-financing.

5. SPECIFIC ELIGIBILITY RULES FOR FINANCIAL INSTRUMENTS

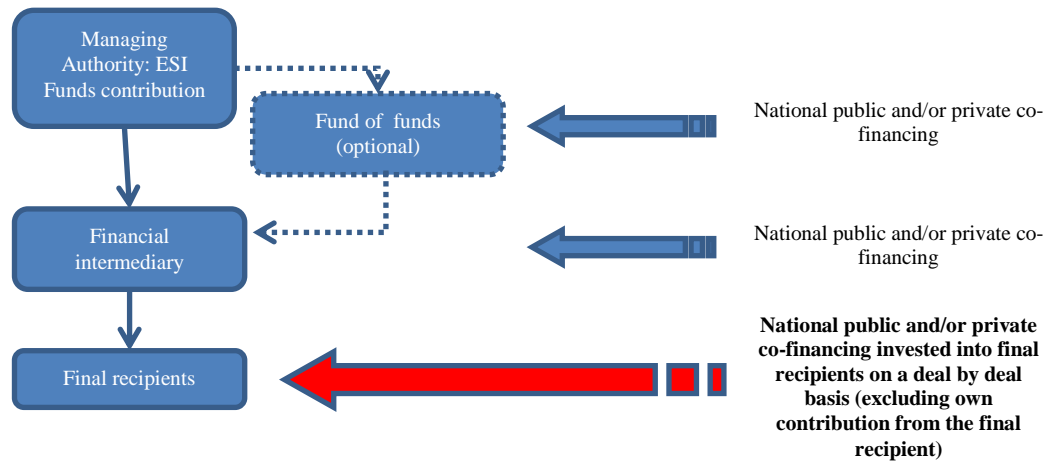
5.1. NATIONAL PUBLIC/PRIVATE CONTRIBUTIONS CONSTITUTING NATIONAL CO-FINANCING AT THE LEVEL OF FINAL RECIPIENT VS OWN CONTRIBUTION OF FINAL RECIPIENT

With the objective of increasing the flexibility in mobilising support from different sources to financial instruments, Article 38(9) CPR provides that the national public and

² Please refer to the additional explanations available in the guidance note on management costs and fees <https://www.fi-compass.eu/publication/ec-regulatory-guidance/ec-regulatory-guidance-guidance-member-states>

private contributions from programmes to financial instruments may be provided at the level of the fund of funds, at the level of the financial instrument or at the level of final recipients.

The following schematic representation illustrates the different levels at which national co-financing can be provided.



Contrary to what happens in grant operations where programme support is provided in the form of reimbursement of expenditure already incurred and paid (by a beneficiary), in the case of financial instruments the programme support precedes the investment (by the final recipient) by providing the means of financing for the investment.

In line with Article 42 CPR eligible expenditure for financial instruments is the total amount of programme contributions paid to final recipients (or committed in the case of guarantees), meaning third party financing and not own resources already available at the level of the final recipient. This conclusion is reinforced by the fact that under Article 37(2)(b) and (c) CPR national public and private contributions from programmes to financial instruments should represent additional financing, i.e. should be triggered by the presence of the ESI Funds contribution, as compared to the resources already or otherwise available to the final recipient.

Therefore, own resources/contribution of the final recipient allocated to its planned investment, cannot be considered as national co-financing of the operation/programme³ and therefore are not part of the eligible expenditure, as the purpose of financial instruments is to provide means of financing.

However, in the case of legal entities (in particular SMEs), a distinction should be made however between resources already forming part of the legal entity's assets, and new assets transferred to the legal entity by its shareholders – e.g. a capital increase through the incorporation of reserves should not be eligible national co-financing, but a capital increase through the issue of new shares with corresponding paid-in capital should be considered as additional private funding counting as national co-financing, provided that this capital increase is directly related to the investment being supported also by the financial instrument.

³ Even if State aid rules sometimes require own resources of the final recipient.

Where the national public and private contributions to financial instruments are made at the level of final recipients, the body implementing the financial instrument should monitor the effective payment of the national public or private contributions constituting national co-financing of the programme while ensuring that the requirements of Article 1(2) to (6) CIR on the definition of the rules for transfer and management of programme contributions are complied with, as follows:

- The bodies implementing financial instruments have to retain overall responsibility for the investments in final recipients including subsequent monitoring of the contributions from programmes in accordance with funding agreements.
- The bodies implementing financial instruments have to ensure that expenditure covered by the national public or private contributions constituting national co-financing is eligible before declaring it to the managing authority. In other words, the bodies implementing financial instruments are responsible for verifying the reality and the eligibility of the expenditure claimed before declaring it to the managing authority.
- The bodies implementing financial instruments have to keep documentary evidence of:
 - The legal agreements concluded with the public and/or private entities that provide the national public or private contributions constituting national co-financing at the level of final recipients and which were triggered by the presence of the ESI Fund contribution.

The contributions provided by the private entities may also include contributions provided by natural persons, such as business angels (when investing directly and not through their personal holding company).

In addition, the legal agreements may be signed between the public and/or private entities referred to above and the final recipients and/or such entities and the body implementing the financial instrument.

However, to reach this end and to allow the body implementing the financial instrument to keep record of the public and private contributions, it must be ensured that the legal agreements clearly state its purpose and objective, which amount is concerned and demonstrate that the amount made available to the final recipient was triggered by the presence of the ESI Fund contribution, i.e. was conditional on the presence of the ESI Fund support received.

- The effective transfer/payment of resources constituting national co-financing by private and/or public entities to the final recipients.
- The national public or private contributions constituting national co-financing and made by private and/or public entities reported to the body implementing the financial instrument.
- The bodies implementing financial instruments have to maintain the audit trail for the national public or private contributions constituting national co-financing down to the level of the final recipient. Articles 9 and 25 CDR set out the elements which should be part of the audit trail for financial instruments.

The flexibility provided for in Article 38(9) CPR of providing the national public and private contributions from programmes to financial instruments at the level of final recipients implies that these contributions are done on a deal by deal basis.

To that end, it is expected that the same type of product (e.g. equity) is provided by both the body implementing the financial instrument and the public and/or private entities that provide the national public or private contributions constituting national co-financing at the level of final recipients. This allows the financial instrument to provide a consistent support with a view to follow the State aid legal framework and facilitate its assessment⁴ and facilitates the calculation of the eligible management costs and fees and the reporting to the Commission as provided for in Article 46 CPR.

The recognition of private contributions as national co-financing is only possible for priority axes which are based on total expenditure, as follows from Article 120(2) CPR. However, the EAFRD and EMFF contribution has to be calculated on the basis of the amount of eligible public expenditure only, as follows from Article 59(2) EAFRD and Article 94(2) EMFF. To be noted that this does not prevent EAFRD and EMFF financial instruments to receive private contributions on top of the programme contribution leveraging more resources to the financial instrument.

Further details are also available in the Guidance for Member States on Article 41 CPR - Requests for payment⁵.

5.2. CONTRIBUTIONS IN KIND

As provided for in Article 37(10) CPR, **contributions in kind are not eligible in respect of financial instruments, except for contributions of land or real estate in respect of investments with the objective of supporting rural development, urban development or urban regeneration**, where the land or real estate forms part of the investment. Such contributions of land or real estate, if eligible under national eligibility rules and under the programme, must comply with the conditions under Article 69(1) and the thresholds under 69(3)(b) CPR.

Contributions in kind in the form of land and real estate, for which no cash payment has been made⁶, may be eligible in respect of financial instruments making investments in rural development, urban development or urban regeneration on condition that the eligibility rules of the ESI Funds and of the programme so allow for it and that all the following criteria are fulfilled:

- the share of ESI Funds support (via the financial instrument) to an investment (that includes the contribution in kind) by a final recipient should be less or equal to the total eligible expenditure excluding the contribution in kind;
- the value of the land or real estate must be certified by an independent qualified expert or duly authorised official body and must not exceed the costs generally accepted on the market in question;
- the value of the land or real estate should be less or equal to 10 % of the total eligible expenditure of the investment by the final recipient, where the land or real estate forms part of the same investment. For derelict sites and for those

⁴ For State aid purposes, the products do not have to be of the same type. However, if a financial instrument is developed as aid free because it is *pari passu* with private investors, the instruments must have the same terms and conditions.

⁵ <https://www.fi-compass.eu/publication/ec-regulatory-guidance/ec-regulatory-guidance-guidance-member-states-article-41-cpr%E2%80%93>

⁶ In the case of provision of land or real estate, a cash payment, for the purposes of a lease agreement of a nominal amount per annum not exceeding a single unit of the currency of the Member State (for e.g. EUR 1), may be made as provided for in Article 69(1)(d) CPR.

formerly in industrial use which comprise buildings, that limit can be increased to 15 %. In exceptional and duly justified cases, the limit may be raised above the respective aforementioned percentages for operations concerning environmental conservation.

As explained in point 5.1 above, own resources/contribution (including any in-kind contributions) of the final recipient, cannot be considered as national co-financing of the programme and consequently is not part of the eligible expenditure. However, if the in-kind contribution is provided by a third party (public or private), including independent shareholders of final recipients as legal entities, then this contribution can also count as national co-financing of the programme at any of the levels referred to in Article 38(9) CPR and provided that the conditions above mentioned are complied with.

Finally, the contribution in kind provided to the final recipient and calculated following Article 69(1) CPR can be eligible as follows from Article 42(1)(a) CPR.

Example on the requirements of Articles 37(10), 69(1)(a) and 69(3)(b) CPR

A final recipient plans to carry out an urban development investment and there is an investor willing to contribute with land so to make the investment possible.

The table below shows different possibilities and the corresponding conclusions (each column represents a different case/scenario):

| First step | | | | | |
|--|------------|-------------|------------|--------------|------------|
| | Case 1 | Case 2 | Case 3 | Case 4 | Case 5 |
| (a) Support provided by FI (e.g. loan) | 90 | 80 | 90 | 90 | 95 |
| (b) Full amount of contribution in kind | 10 | 20 | 10 | 10 | 5 |
| (c) Estimated total eligible expenditure (a)+(b) | 100 | 100 | 100 | 100 | 100 |
| (d) Co-financing rate | 50% | 90% | 90% | 95% | 95% |
| (e) Estimated ESIF support (c)*(d) | 50 | 90 | 90 | 95 | 95 |
| Conditions fulfilled? | | | | | |
| ESIF support is less or equal to the the estimated total eligible expenditure minus contributions in-kind ? (e) <= (c)-(b) | Yes | Yes | Yes | NO | Yes |
| Value of in kind contribution is less or equal to 10 % of the estimated total eligible expenditure? (b) <= (c)*10% | Yes | NO | Yes | Yes | Yes |
| Second step (only relevant for the "NO" above) | | | | | |
| (f) Correct amount of eligible contribution in kind | 10 | 8,8 | 10 | 4,7 | 5 |
| (g) Final total eligible expenditure (f)+(a) | 100 | 88,8 | 100 | 94,7 | 100 |
| (h) Final ESIF support (g)*(d) | 50 | 79,9 | 90 | 89,97 | 95 |
| Conditions fulfilled? | | | | | |
| ESIF support is less or equal to the the final total eligible expenditure minus the contributions in-kind? (h) <= (g)-(f) | Yes | Yes | Yes | Yes | Yes |
| Value of contribution in kind less than 10% of final total eligible expenditure? (f) <= (g)*10% | Yes | Yes | Yes | Yes | Yes |

The results of the calculations above show that:

- Cases 1, 3 and 5 are, from the onset, compliant with Article 69(1)(a) and 69(3) CPR.
- In case 2, the value of the land is more than 10% of the total eligible expenditure, therefore not in line with Article 69(3)(b) CPR.
- In case 4, the ESI Funds support provided via the financial instrument is higher than the total eligible expenditure minus the contribution in-kind, therefore not in line with Article 69(1)(a) CPR.

Conclusion:

In order to ensure compliance with the provisions above mentioned, the eligible amount of the contribution in-kind, for cases 2 and 4 (please see second step) should be reduced proportionally up to the point of ensuring compliance with the Article 69(1)(a) and 69(3)(b) CPR (as shown in rows (f) and g).

It also results from this table that if the contribution in kind is provided with an amount representing 10% of the total eligible expenditure than the only limitation stemming from Article 69(1) CPR is only applicable in case the co-financing rate exceeds 90%.

5.3. PURCHASE OF LAND

Article 4 CDR allows financial instruments financed by the ERDF, the Cohesion Fund and the EAFRD to support investments that include the purchase of land not built on and land built on for an amount not exceeding 10% of the programme contribution paid to the final recipient. In the case of guarantees, this percentage applies to the amount of the underlying loan that the final recipients will obtain from a commercial bank.

Where financial instruments provide support to final recipients in respect of infrastructure investments with the objective of supporting urban development or urban regeneration activities, this limit is 20%. In exceptional and duly justified cases, the managing authority may derogate from the above limits for operations concerning environmental conservation.

The limits above mentioned applies to land (built on or not), but not to real estate or buildings. If support via financial instruments is provided for the purchase of a building or real estate, this should be done only if these assets are directly linked to a productive activity of the final recipient concerned.

However, from a policy point of view and as a matter of ensuring the best use of ESI Funds, financing the purchase of real estate or buildings (including when such assets are directly linked to the productive activity of the business concerned), should be treated as an exception rather than as a general rule. Real estate and buildings are by definition widely acceptable collateral and consequently the need to cover such investments should be carefully assessed and demonstrated in the context of the ex-ante assessment, in relation to the planned financial product and subsequently in the assessment of the application forms and business plan for the prospective investment of the final recipient.

The rules for the purchase of land, as set out in Article 4 CDR, should not be confused with the possibility of providing contributions in kind in the form of land or real estate in respect of investments with the objective of supporting rural development, urban development or urban regeneration, as follows from Article 37(10) CPR and explained in point 5.2 above.

Whereas the first (subject to programme rules and national eligibility rules) is applicable to any type of investment and allows for the purchase of land by the final recipient with the payments made by the financial instrument to the final recipient, the second is limited to investments with the objective of supporting rural development, urban development or urban regeneration and allows for the contribution in kind to be considered as a payment to the final recipients by the financial instrument, as set out in Article 42(1)(a) CPR.

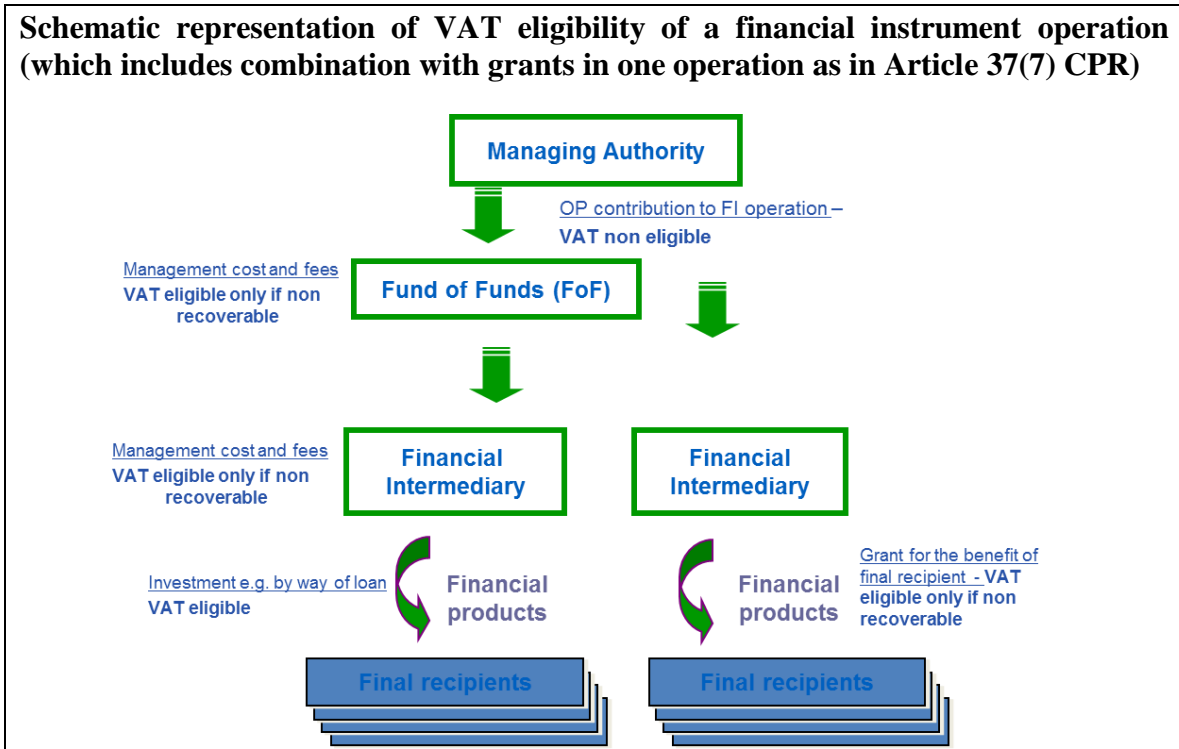
5.4. VAT ELIGIBILITY

The general rule for VAT eligibility provided for in Article 69(3)(c) CPR and recalled in Article 37(11) CPR is that the VAT amount is eligible only if it is not recoverable under national VAT legislation.

However, in order to take account of the repayable character of the support provided through financial instruments and to align it with market practices with a view to facilitate the investments by final recipients, the ESI Fund programme support provided through financial instruments to final recipients may cover the totality of the investments made by final recipients, without distinction of VAT-related costs. This means that the treatment of VAT at this level is not be considered for determining the eligibility of expenditure under the financial instrument (unless otherwise provided for in the national eligibility rules). This applies regardless of the final recipients being a legal or natural person and regardless of its VAT status under national VAT legislation.

Where financial instruments are combined with grants in one or more than one operation (as provided for in Article 37(7) and (8) CPR), the rule for VAT eligibility, for the grant part, is that VAT is not eligible expenditure of an operation, except in the case of non-recoverable VAT under national VAT legislation, as follows from Article 69(3) CPR. Please refer to the example below.

Schematic representation of VAT eligibility of a financial instrument operation (which includes combination with grants in one operation as in Article 37(7) CPR)



In addition, for the combination of financial instrument and grant in two operations, the allocation of VAT for each of the two operations should follow the base amount of the expenditure allocated to each of operation and the respective VAT rules (including its rate).

As explained in the Guidance Note on combination of support from a financial instrument with other forms of support⁷, an expenditure item means the amount declared as eligible for Union funding under a budget category. Usually where the combination of a grant and a financial instrument covers the same expenditure item there will still be a possibility to distinguish separate sub-items and the Commission recommends assigning each of them either to the grant operation or to the financial instrument operation. Where support from ESIF programme financial instrument and a grant cover the same expenditure item not dividable in sub-items the support from a financial instrument and grant should be established proportionally (in percentage). In both cases, the allocation of VAT to the 2 operations should follow the agreed allocation/split of expenditure.

⁷ <https://www.fi-compass.eu/publication/ec-regulatory-guidance/european-structural-and-investment-funds-guidance-member-states>

It is the responsibility of the managing authority to put in place an effective management and control system functioning well so that the expenditure declared to the Commission is legal and regular. In this respect, the managing authority can decide on the necessary allocation of the expenditure item between financial instruments and grants as long as the applicable rules for each form of support are respected and an adequate audit trail is kept. Please refer to the example below.

Example of VAT eligibility at the level of the final recipient (which includes combination with a grant in two distinct operations as in Article 37(8) CPR):

An SME plans to invest in the purchase of a fixed asset (e.g. a piece of equipment to increase its production activity, i.e., an expenditure item not dividable in sub-items) which costs $100 + \text{VAT} (20\%) = 120$. The VAT status under national VAT legislation of the SME indicates that VAT is recoverable.

This investment can be supported by a loan (delivered via a financial instrument) and a grant operation (delivered by the managing authority) with a 50/50 split between the two operations, as follows:

- Maximum eligible expenditure loan FI= $50\% * 100 + \text{VAT} (50 * 0.2) = 60$ (VAT eligible)
- Maximum eligible expenditure grant operation = $50\% * 100 = 50$ (VAT not eligible)
- Maximum total eligible expenditure for the two operations = Maximum eligible expenditure loan + maximum eligible expenditure grant = 110

(N.B. the maximum total eligible expenditure for the two operations would be of 120 if the VAT status under national VAT legislation of the SME indicates that VAT is non-recoverable)

In this respect, an adequate and clear audit trail should be ensured.

5.5. EXPENDITURE PAID TO FINAL RECIPIENTS BEFORE THE SETUP OF THE FINANCIAL INSTRUMENT

The general rule for the eligibility of expenditure for a contribution from the ESI Funds is provided for in Article 65(2) CPR. Under this provision, expenditure is eligible for a contribution from the ESI Funds if it has been incurred by a beneficiary and paid between the date of submission of the programme to the Commission or from 1 January 2014, whichever is earlier, and 31 December 2023. In addition, the eligibility of expenditure has to comply with the other CPR rules, Fund specific rules (e.g. Article 60 of EAFRD Regulation) and with national rules as provided for in Article 65(1) CPR and be in line with requirements set out under the relevant programme and priority.

However, with respect to financial instruments, the following additional provisions need also to be considered and are also applicable.

In accordance with Article 2(9) CPR, a financial instrument operation is defined as the financial contribution from a programme to a financial instrument and the subsequent financial support provided by this financial instrument. These two elements, namely: 1) a programme contribution to the financial instrument and 2) support from the financial instrument to final recipients, constitute sequentially an operation.

As provided for in Article 2(10) CPR, the beneficiary is the body that implements the financial instrument or the fund of funds, as appropriate. Such body becomes the

beneficiary on the basis of a funding agreement or a strategy document, depending on the implementation option chosen. The negotiation and signature of a funding agreement should be preceded by the obligatory ex-ante assessment, by the submission of the ex-ante assessment to the monitoring committee, by the managing authority's decision to contribute programme resources to the financial instrument and finally the selection of the body implementing the financial instrument. In financial instruments implemented in accordance with Article 38(4)(c) CPR, following the ex-ante assessment, a strategy document is developed and submitted to the monitoring committee and in this case the beneficiary is the managing authority (or the intermediate body).

A financial instrument should be established following the legal and chronological sequence above, meaning that support to final recipients or for the benefit of final recipients granted by financial instruments can be eligible as of the date of the programme contribution to the financial instrument (which occurs only after the signature of the funding agreement⁸). In financial instruments implemented in accordance with Article 38(4)(c) expenditure can be eligible as of the date of presentation of a strategy document for examination by the monitoring committee.

The contribution of the programme to the financial instrument should, therefore, precede the support provided by the financial instrument to the final recipients. Contrary to what happens in grant operations where programme support is provided in the form of reimbursement of expenditure already incurred and paid by a beneficiary, in the case of financial instruments the programme support precedes the investment by the final recipient by providing the means of financing for the investment.

Therefore, payments to final recipients that have been made before the date of the programme contribution to the financial instrument established in accordance with the provisions of Title IV CPR are not eligible.

It is also highlighted that as set out in Article 42(5) CPR, management costs and fees are eligible as of the date of the signature of the relevant funding agreement, provided that all other eligibility criteria are fulfilled. However, management costs and fees incurred for the preparatory work in relation to the FI before the signature of the relevant funding agreement, and which according to the general rule above become eligible after the signature, may only be included in the eligible expenditure if incurred after the date when the formal decision selecting the body concerned was taken.

5.6. REFINANCING OF EXISTING LOANS

The CPR does not envisage the possibility of supporting the refinancing of existing loans but sets requirements which de facto exclude that loan agreements signed and paid out to the final recipient are used for the purpose of refinancing existing loans.

As follows from Article 37(1) CPR, financial instruments should be implemented to support investments which are expected to be financially viable and do not give rise to sufficient funding from market sources, therefore justifying the need for public intervention. The existence of an initial loan proves the existence of sufficient funding from market sources for carrying out the investment. Therefore, an ESI Fund programme loan which is refinancing an existing loan (or an ESI Fund programme guarantee for an existing loan) is not justified.

Only in the situation set out in Article 37(6) CPR, the reorganisation of a debt portfolio in certain infrastructure investments is considered possible. Article 37(6) CPR is further explained in point 5.9 of this document. In addition, please refer also to point 5.8 on the

⁸ For EAFRD: also following a programme modification to include the financial instrument if not yet done.

eligibility of expenditure (payment to final recipient) vs completion of underlying investment by the final recipient.

Furthermore, from the State aid legal framework point of view, the refinancing of existing loans proves that there is no incentive effect in addition to the explicit provisions that make this type of support incompatible with State aid rules. For example, the GBER⁹ defines a guarantee as a written commitment to assume responsibility for all or part of a third party's newly originated loan transactions and provides for that the refinancing of existing loans is not an eligible loan in the context of this legal framework.

Moreover, the Guidelines on State aid to promote risk finance investments¹⁰ explicitly states that "if funded debt instruments are used to refinance existing loans, they are not considered to generate an incentive effect and any aid element in such instruments cannot be regarded as compatible with the internal market under Article 107(3)(c) of the Treaty". In addition to the lack of incentive effect, refinancing/guaranteeing an existing loan may also constitute State aid at the level of the financial intermediary and consequently may require a State aid notification.

5.7. GUARANTEES

There are several financial products that can be delivered through financial instruments such as equity or quasi-equity, loans and guarantees¹¹.

Guarantees are a written commitment to assume responsibility for all or part of a third party's debt or obligation if an event occurs which triggers such guarantee, such as a loan default. In other words, guarantees allow a commercial lender to seek reimbursement in case a loan or part of it default.

ESI Funds Financial instruments operate under market failures (as identified in the ex-ante assessment) meaning that without an ESI Fund programme guarantee the loan would not have been disbursed. Consequently an ESI Fund programme guarantee is the trigger of a commercial loan. In case of ESI Fund programme guarantees, the eligibility rules should be applied to the entire loan (portfolio) supported with the guarantee. Such a requirement is linked to the nature of the guarantee and universality of the loan (portfolio). Indeed, at the moment of committing the guarantee, it is not possible to predict which (and if any at all) part of the loan (portfolio) will default and be written off and eventually covered by the ESI Fund programme guarantee.

As provided for in Article 42(1)(b) CPR, the eligible expenditure for ESI Fund programme guarantees is the total of the amounts committed as guarantees (whether outstanding or already come to maturity), i.e. the amount of the programme contribution set aside to cover expected and unexpected losses, calculated on the basis of a prudent ex-ante risk assessment and covering a multiple amount of underlying new loans or other risk-bearing instruments for new investments in final recipients and covered by those guarantees.

The resources committed for guarantees are eligible once the underlying loan is disbursed and the corresponding guarantee is issued, regardless of the guarantee being still outstanding (at closure) or having come to maturity and regardless of the guarantee having been called or not, meaning regardless of default or not of the underlying loans.

⁹ Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

¹⁰ Communication from the Commission "Guidelines on State aid to promote risk finance investments" (2014/C 19/04)

¹¹ Please refer to factsheet <https://www.fi-compass.eu/publication/brochures-factsheets/financial-instrument-products> for further details

This means that even if there is no default of the underlying loans the resources committed to guarantee them are still eligible. Once the guarantees come to maturity, the amounts can be reused for more guarantees ensuring the revolving effect of the financial instrument.

The ratio between 1) the value of disbursed new loans or other risk sharing instruments and 2) the amount of the corresponding programme contribution set aside/committed to cover expected and unexpected losses from new loans or other risk sharing instruments is defined as multiplier (Article 8(a) CDR). Depending on the underlying funding structure of a financial instrument, a guarantee can be more effective than a loan as it may provide greater value-added and requires lower capital charges, due to its multiplier effect. The multiplier allows measuring the impact of programme resources in the financing provided to final recipients.

| |
|---|
| The value of the disbursed new loans/other risk-sharing instruments |
| Multiplier ratio = ----- |
| The programme contribution set aside to cover expected and unexpected losses from new loans/other risk-sharing instruments to be covered by the guarantees |

As provided for in Article 8 CDR, the multiplier ratio should be established through a prudent ex-ante risk assessment for the specific guarantee product to be offered, in order to ensure sound financial management of resources. The establishment of an adequate multiplier is indeed inherent in the nature and objectives of guarantee products.

The ex-ante risk assessment should reflect in particular the specific market conditions (for example, the statistics on the rate of defaulted loans in the MS for the sector concerned), the investment strategy of the financial instrument, the characteristics of the guarantee operations and of the underlying new loans and their inherent target investments and the principles of sound financial management (economy, efficiency and effectiveness (e.g. in terms of correctly determining the size of the ESI Fund programme contribution compared to the amount of new loans expected and their forecasted default rate).

In order to achieve an optimal use of the EU scarce financial resources and in line with the principle of sound financial management, the value of the "guarantees provided" is eligible for co-financing if it reflects that the principles of sound financial management and (market) good practices have been taken into account in order to avoid over-guaranteeing (i.e. setting aside more EU financial resources for guarantees or guarantee funds than necessary to cover expected and unexpected losses from loans).

The ex-ante risk assessment may be reviewed where it is justified by subsequent changes in market conditions. This means that whenever during the period of implementation of the financial instrument the market conditions become more or less favourable than initially foreseen, the multiplier ratio should be revised. However, the new multiplier will not apply retroactively to already guaranteed loans which have come to their maturity date but only to those which are outstanding, i.e. the part of the loan still to be repaid by the final recipients but only if justified in the revised ex-ante risk assessment. Thus, the guarantees that have already come to maturity cannot be affected by the recalculation of the multiplier and therefore do not affect retroactively the calculation of the eligible expenditure. The new multiplier will also apply to the new guaranteed loans disbursed after the revision of the ex-ante risk assessment.

Example: Calculation of multiplier for the off-the-shelf financial instrument "Capped Portfolio Guarantee"

The off-the-shelf financial instrument "Capped Portfolio Guarantee" set out in Regulation No 964/2014¹² provides credit risk coverage on a loan by loan basis up to a guarantee rate of maximum 80%, for the creation of a portfolio of new loans to the small and medium-sized enterprises, up to a maximum loss amount fixed by the guarantee cap rate which must not exceed 25% of the risk exposure at portfolio level. The terms and conditions of this financial instrument provide for that, consequently, the multiplier ratio should be no less than 5.

In an example scenario¹³ where the managing authority has decided to contribute EUR 15 million for a guarantee financial instrument in the maximum conditions describe above and as a result of the ex-ante risk assessment (guarantee rate of 80% and guarantee cap rate of 25%) what is the multiplier and the eligible expenditure?

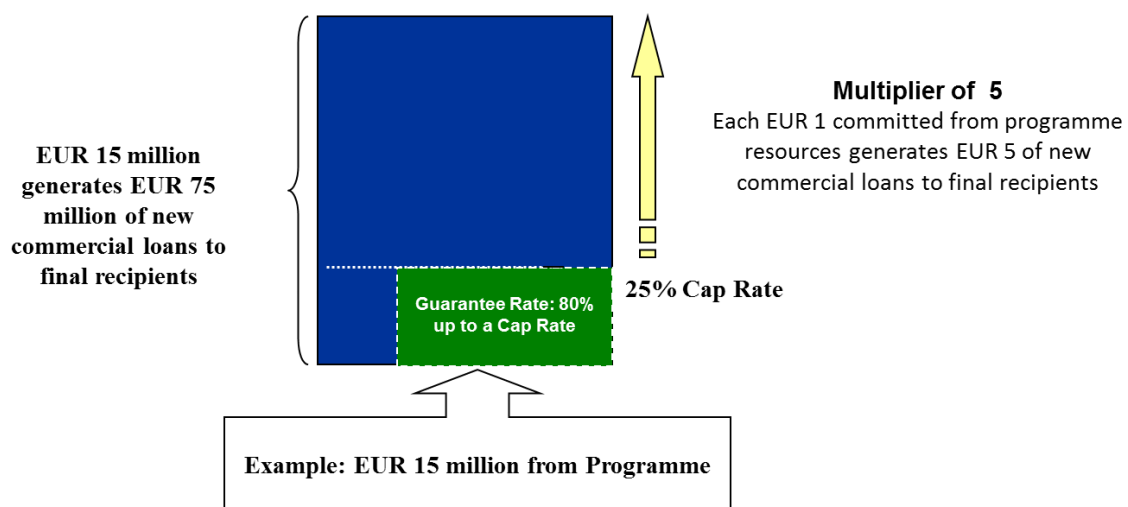
Multiplier = $1/\text{Guarantee rate} * 1/\text{Guarantee cap rate}$

Multiplier = $1/80\% * 1/25\% = 1.25 * 4 = 5$

Portfolio of new loans = EUR 15 Million * 5 = EUR 75 Million

Multiplier = $75/15 = 5$ (each EUR 1 committed from programme resources generates EUR 5 of new commercial loans to final recipients)

Assuming that all loans were disbursed, EUR 15 million of programme resources committed would constitute the eligible expenditure of this financial instrument.



Please note also that any modification of the rates above mentioned has an impact on the multiplier: The lower the guarantee rate on a loan by loan basis and/or the cap rate at the portfolio level, the higher the multiplier ratio. For example in a case where the guarantee rate is of 60%, keeping all remaining conditions above, the portfolio of new loans could be extended up to EUR 100 million (multiplier of 6.66).

The example above is made on the assumption that the financial intermediary has disbursed all the planned new loans. If the financial intermediary has not disbursed the

¹² Commission Implementing Regulation (EU) No 964/2014 of 11 September 2014 laying down rules for the application of Regulation (EU) No 1303/2013 of the European Parliament and of the Council as regards standard terms and conditions for financial instruments

¹³ This is presented as a mere illustration for the calculation method of the multiplier.

planned amount of new loans, the eligible expenditure must be reduced proportionally. This is explained in the following example.

Example of proportional reduction of eligible expenditure due to not reaching the target for loans:

For the scenario above the initial total estimated portfolio of newly guaranteed commercial loans was of EUR 75 million and this would require EUR 15 million to guarantee the entire portfolio. However, by closure only EUR 50 million has been disbursed as new commercial loans.

Consequently, the eligible expenditure at closure will be of EUR 10 million as follows from the following formula:

Total amount of new loans disbursed/multiplier = EUR 50 million/5 = EUR 10 million (eligible expenditure at closure)

5.8. EXPENDITURE (PAYMENT TO FINAL RECIPIENT) VS COMPLETION OF UNDERLYING INVESTMENT BY FINAL RECIPIENT

As provided for in Article 37(5) CPR, the investments by final recipients to be supported through financial instruments must not be physically completed or fully implemented at the date of the investment decision for such support through the financial instruments.

The date of the investment decision refers to the moment when the loan/guarantee or equity investment is approved by the body implementing the financial instrument. In the loan origination process which includes all the steps from taking a loan application up to disbursement of funds (or declining the application), the date of the investment decision precedes the actual signature for e.g. of the loan agreement and the disbursement of funds. Please refer to the example below.

Example of eligibility of expenditure in relation to the date of the investment decision by the body implementing the financial instrument:

A final recipient planned an investment for a total of 1000. The investment was partly financed from other market sources for the amount of 500 and this part is already fully implemented or completed (for ease of reference this will be referred to as the 1st phase). The final recipient wants to continue the investment but does not find any market sources willing to finance it.

There is an ESI Fund financial instrument that could provide the means of financing the final recipient needs and consequently the final recipient applies for a loan of 500 (for ease of reference this will be referred to as the 2nd phase) and this is the first step of the loan origination process. In case the body implementing the financial instrument approves the loan application, the final recipient can start the implementation of the 2nd phase of its project even if the 1st phase has already been fully implemented or completed.

In other words, this also means that if the final recipient had asked for a loan of 1000 from the ESI Fund financial instrument, 50% of it would not be eligible, because the 1st phase has already been fully implemented or completed and received funding from market sources.

The State aid legal framework plays an important (and possibly a more restrictive) role as it requires that there is an incentive effect to the aid granted. According to Article 6 of

the GBER¹⁴, aid is considered to have an incentive effect if the final recipient has submitted a written application for the aid to the Member State concerned before work on the project or activity starts. Start of works means the earlier of either the start of construction works relating to the investment, or the first legally binding commitment to order equipment or any other commitment that makes the investment irreversible. Preparatory works such as obtaining permits and conducting feasibility studies are not considered start of works.

The same line is also followed in the Guidelines on State aid to promote risk finance investments¹⁵, whereby State aid can only be found compatible with the internal market if it has an incentive effect that induces the aid beneficiary to change its behaviour by undertaking activities which it would not carry out without the aid or would carry out in a more restrictive manner due to the existence of a market failure. At the level of the eligible undertakings, an incentive effect is present when the final beneficiary can raise finance that would not be available otherwise in terms of form, amount or timing.

In addition, since the payment from financial instruments to the final recipient can be made until the end of the eligibility period, it is not reasonable to expect that the final recipient's investment activity pre-financed by the financial instrument is completed by the same date. Therefore, it is possible that the implementation of the investment activity by the final recipient may continue beyond the end of the eligibility period.

However, even if the CPR does not set deadlines for completion of investment activity financed through financial instruments, Article 9(1)(e)(xi) CDR requires evidence that the support from the financial instrument to final recipients was used for its intended purpose by closure of the programme. Expenditure for which the national authorities do not have assurance that the contribution paid to the final recipient has been used for its intended purpose is not eligible and hence cannot be declared at closure.

5.9. EXPENDITURE LINKED TO THE REORGANISATION OF A DEBT PORTFOLIO IN CERTAIN INFRASTRUCTURE INVESTMENTS

As provided for in Article 37(5) CPR and as explained above in point 5.8, the investments to be supported through financial instruments must not be physically completed or fully implemented at the date of the investment decision.

However, as provided for in Article 37(6) CPR there is an exception to this general rule, since support to final recipients provided through financial instruments may include the amount necessary for the reorganisation of a debt portfolio up to a maximum of 20% of the total programme support from the financial instrument to the investment under the following conditions:

- The investment must be an infrastructure investment with the objective of supporting urban development or urban regeneration or similar infrastructure investments with the objectives of diversifying non-agricultural activities in rural areas;
- The amount necessary for the reorganisation of the debt portfolio concerns infrastructure which forms part of the new investment.

¹⁴ Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

¹⁵ Communication from the Commission "Guidelines on State aid to promote risk finance investments" (2014/C 19/04)

There could be several reasons for the reorganisation of a debt portfolio such as (1) to consolidate other debt(s) into one loan, (2) to benefit from better interest rates or switch from a variable-rate to a fixed-rate loan or vice versa or (3) to reduce the monthly repayment amount by having longer maturities. These examples in the end would allow the final recipient to increase its ability to meet the obligations and to free up resources to support the continuation of its investment.

It should however be highlighted that the purpose of this provision is not to allow that an ESI Fund financial instrument provides a loan with a view to reorganise other ESI Fund financial instrument loan(s), i.e. this flexibility is open to previously disbursed commercial loans, as an ESI Fund programme loan is usually provided at much better conditions which would not, in principle, require its reorganisation and could also mean non-compliance with the CPR rules on combination of support from the budget of the Union..

In addition, the State aid legal framework plays an important role in this regard and the national authorities should verify the compliance with State aid rules before making use of this provision. Only new investments are allowed under State aid rules as re-financing of financed and completed activities has no incentive effect. There is also a significant risk of crowding out private investors if ESI Funds are used to refinance commercial loans and refinancing/guaranteeing an existing loan may also constitute State aid at the level of the financial intermediary and consequently may require a State aid notification. Please refer also to point 5.6 on the eligibility refinancing of existing loans.

Example of eligibility of expenditure for the reorganisation of a debt portfolio:

In the context of an integrated infrastructure investment with the objective of supporting urban development, part of the investment (e.g. part of the infrastructure) was financed from market sources and is already constructed. Thus, this part of infrastructure, which must be linked and essential for the overall investment can be considered as fully completed and as a general rule would not be able to receive any support from an ESI Fund financial instrument.

However, with the flexibility provided by Article 37(6) CPR, the loan from the ESI Fund programme financial instrument can cover the amount necessary (up to a maximum of 20% of the total loan(s) provided by the financial instrument) with a view to reorganise the current debt portfolio of the final recipient linked to the overall investment at stake.

The entire loan disbursed by the financial instrument could thus be considered as eligible expenditure as provided for in Article 42 CPR, provided that State Aid rules and national eligibility rules are complied with.

5.10. FACTORING

Article 37(1) CPR requires that financial instruments should support investments which are expected to be financially viable and do not give rise to sufficient funding from market sources. This provision refers to the viability of the investment and is backed by recital 38 CPR which refers to "direct financial returns" of the investment. It should also be noted also that Article 2 of CF and Article 3 of ERDF exclude the provision of aid to undertakings in difficulty as defined under Union State aid rules and in general these rules does not allow this type of support.

Article 6 CDR requires that the final recipients receiving support from financial instruments are selected with due account taken of the nature of the financial instrument and the potential economic viability of investment projects to be financed.

Article 9 CDR requires the submission of a business plan and other supporting documents at the moment a final recipient applies for support from a financial instrument.

As a consequence of the above, the economic and financial viability of the underlying investment by a final recipient to be supported by the financial instrument must be documented in a business plan to be assessed by the body implementing the financial instrument at the moment of application for support. This is one of the core principles for the provision of financial instrument support.

For the purposes of this guidance, factoring is understood as the sale of all kinds of receivables (usually with a discount) to a third party called factor.

As a rule, factoring does neither imply an assessment of the repayment capacity of the final recipient nor an assessment of the economic and financial viability of the prospective investment to be carried out by the final recipient (which is not even be the underlying reason for the application for such factoring services). On the contrary, the factor assesses the repayment capacity of the third party responsible for paying the invoice (e.g. the client of the final recipient) and this is the self-liquidating feature of the factoring advance.

It is within this context that the provision of factoring services under an ESI Funds financial instrument is not eligible under CPR rules, because the provision of factoring services is not aligned with the purpose and objectives of ESI Funds financial instruments support as explained above.

Other relevant information can be found in the guidance note on support to enterprises/working capital¹⁶.

5.11. BUSINESS TRANSFERS

Article 37(4) CPR provides for that financing to enterprises, including SMEs, “*shall target the establishment of new enterprises, early stage capital, i.e. seed capital and start-up capital, expansion capital, capital for the strengthening of the general activities of an enterprise, or the realisation of new projects, penetration of new markets or new developments by existing enterprises, without prejudice to applicable Union State aid rules, and in accordance with the fund-specific rules. Such support may include investment in both tangible and intangible assets as well as working capital within the limits of applicable Union State aid rules and with a view to stimulate the private sector as a supplier of funding to enterprises. It may also include the cost of transfer of proprietary rights in enterprises provided that such transfers take place between independent investors.*” (Bold added)

The support above mentioned should be also in accordance with the Fund-specific and State aid rules. The last indent of paragraph 4 specifies that the support through financial instruments may include the costs of transfer of proprietary rights in enterprises provided that such transfers take place between independent investors.

There is no legal definition of an "independent investor" in the CPR. For ESI Funds, "independent" in this context means an investor who holds no shareholding or voting rights in, or has any family ties to the proprietor(s) of the enterprise which is the object of transaction.

¹⁶ <https://www.fi-compass.eu/publication/ec-regulatory-guidance-guidance-member-states-article-374-cpr-support-enterprisesworking>

This means that even if State aid rules do not require the existence of an "independent investor" or that there is no State aid at all, the CPR restricts the support via financial instruments to costs of transfer to proprietary rights only if taking place between independent investors.

In conclusion, when supporting an enterprise through financial instruments the ESI Fund programme may include the costs of transfer of proprietary rights in enterprises provided that the following cumulative conditions are fulfilled:

- The final recipient is an eligible enterprise in accordance with CPR rules, Fund specific rules and with the national eligibility rules;
- The transfer of proprietary rights is part of a viable investment focusing on at least one eligible activity under Article 37(4) CPR, and presented in the business plan. Financing of costs of transfers which is not associated to an investment plan in the form of seed capital, start-up capital, establishment of a new enterprise, or, for existing enterprises for their expansion, strengthening, implementation of new developments, realisation of new projects or penetration of new markets, should not be supported through financial instruments;
- The transfer takes place between independent investors as defined above;
- The transfer is allowed under State aid rules.

Further details in relation to Article 37(4) CPR are available in the guidance note on support to enterprises/working capital¹⁷.

5.12. INTEREST RATE SUBSIDIES, GUARANTEE FEE SUBSIDIES AND TECHNICAL SUPPORT WHEN COMBINED WITH A FINANCIAL INSTRUMENT IN A SINGLE OPERATION PURSUANT TO ARTICLE 37(7) CPR

Article 37(7) CPR provides for the possibility of combining financial instruments and other forms of support (interest rate subsidies, guarantee fee subsidies and technical support for the preparation of a prospective investment) in a single financial instrument operation.

Interest rate subsidies, guarantee fee subsidies and technical support¹⁸ for the preparation of a prospective investment when provided alone are considered support in the form of grants. However, in order to facilitate and enhance the implementation of a specific financial instrument, interest rate subsidies, guarantee fee subsidies and technical support for the preparation of the prospective investment can be considered to be a part and directly linked to the financial instrument operation when associated and combined with support provided from the financial instrument targeting the same final recipients in a single financing package.

This type of combination should be provided through financial instruments operating with 2014-2020 programme resources (both for the grant part and the financial instrument part). This means that the provisions under Article 37(7) CPR are not applicable if the grant component is provided from 2014-2020 programme resources but the financial instrument component is delivered from resources other than 2014-2020

¹⁷ <https://www.fi-compass.eu/publication/ec-regulatory-guidance-guidance-member-states-article-374-cpr-support-enterprisesworking>

¹⁸ Technical assistance and technical support are two distinct terms used in the CPR. Whereas, the notion of technical support is explained in Article 5 CDR, the notion of technical assistance is explained in title VI of CPR.

programme resources and vice versa. If this was the case it would be considered a mere grant operation or a financial instrument operation but not a combination of grant and financial instrument within a single financial instrument operation as provided for in the referred article.

As financial instruments operate in changing market conditions, Article 37(7) CPR does not provide for an exhaustive list of grants and enumerated only the three types of grants which are commonly used. In any case, this type of grants or any other type will have to be compliant with the conditions set in the CPR. Thus, even if there is any other type of grant in addition to the ones mentioned in Article 37(7), any other type of grant to be combined with the financial instrument must be directly related to the financial instrument with the purpose of facilitating and enhancing its implementation and must target the same final recipients.

In addition, in accordance with Article 5 CDR, grants for technical support may only be provided for the purpose of technical preparation of the prospective investment to be supported by the financial instrument and for the benefit of the final recipient.

Consequently, if the final recipient eventually does not receive the financial instrument support then the related technical support should also be not eligible. However, this does not prevent the managing authority, if seeing the need for general support for example in the form of training to potential final recipients, to consider setting up a separate grant operation (falling under grant rules), whose aim would be to assist a specific target group (potential final recipients). In such case of grant support its eligibility follows the grant rules and does not need to be conditional on the prospective support from the financial instrument.

Article 42(1) CPR explicitly makes a distinction between:

- 1) The payments to final recipients (which take the form of financial instruments products: loans, guarantees, equity and quasi-equity) and
- 2) The payments to the benefit of final recipients, i.e. without an effective payment to the final recipient for the cases referred to in Article 37(7) CPR, i.e. the types of grants there mentioned. In practice the money is paid to the body implementing the financial instrument which will subsequently, for e.g., pay the provider of the technical support services or pay the interest rate subsidy to the bank that provides a commercial loan which is also guaranteed by an ESI Fund financial instrument.

This distinction is also corroborated in Article 13(2)(b)(v) CDR on the management costs and fees thresholds applicable to grants managed under Article 37(7) CPR which refers exclusively to amounts paid for the benefit of final recipients.

The above also means that the type of grants referred to in Article 37(7) CPR, cannot be provided for the actual investment to be carried out by the final recipients but for their benefit and that the body implementing the financial instrument should manage the grant component for which it will also be remunerated.

For the grant expenditure within the financial instrument operation please refer also to point 5.4 of this document on VAT eligibility rules.

Finally, it is highlighted that, as provided for in Article 37(2)(e) CPR, the ex-ante assessment needs to consider the "envisaged combination with grant support as appropriate". This implies that for the combination of a financial instrument and grants within one operation the ex-ante assessment should not only assess the need but also estimate the contribution needed for such grants. The amounts needed for the grant

together with contribution to the financial instrument would constitute the programme contribution from the managing authority to the financial instrument.

Further details are also available in the guidance note on combination of support from a financial instrument with other forms of support¹⁹.

5.13. CAPITALISED INTEREST RATE SUBSIDIES AND GUARANTEE FEE SUBSIDIES USED IN COMBINATION WITH FINANCIAL INSTRUMENTS (TO BE PAID AFTER THE ELIGIBILITY PERIOD)

As explained above in point 5.12, interest rate subsidies and guarantee fee subsidies can be considered to be a part of the financial instrument, only when associated and combined with support provided from the financial instrument in a single financial instrument operation.

With a view of ensuring that the legal framework is applied in a way so that market practices are taken into due consideration and since the decisions on the maturity of the loans or even its grace period do not need to be necessarily linked to the eligibility period foreseen in Article 65 CPR and in order to allow the continuation of the payments to the benefit of final recipient, the CPR allows for capitalised interest rate subsidies or guarantee fee subsidies due to be paid for a period not exceeding 10 years after the end of the eligibility period to be declared as eligible expenditure under Article 42(1)(c) CPR in relation to loans or other risk-bearing instruments disbursed for investments in final recipients within eligibility period, whose maturity extends beyond the end of the eligibility period.

As set out in Article 42(1)(c) CPR, the total amount of capitalised interest rate subsidies or guarantee fee subsidies must be transferred to an escrow account²⁰. The payment of this amount to the escrow account at the end of eligibility period is considered eligible expenditure.

As provided for in Article 11 CDR, capitalised interest rate subsidies and guarantee fee subsidies are calculated at the end of the eligibility period as the total of discounted payment obligations for the purposes and periods referred to above and in accordance with the relevant funding agreements. Any resources left in the escrow account after the period for which there is an obligation to make this type of payments for the benefit of the final recipient (maximum 10 years but can be less if such an obligation is shorter in time), or as a result of an unexpected winding-up of the financial instrument before the end of that period, must be used in accordance with Article 45 CPR.

Finally, the CPR and the CDR do not stipulate which discount rates should be used to calculate the amount of capitalised interest rate subsidies and guarantee fee subsidies which may be considered eligible at closure. Nevertheless, the economic reasoning would be that this capitalised value paid to the escrow account should just allow paying the interest rate subsidies and guarantee fee subsidies which will be due within the 10 years after the eligibility period. In this case the discount rate to be used would correspond to the internal rate of return on the amount paid to the escrow account, i.e. the

¹⁹ <https://www.fi-compass.eu/publication/ec-regulatory-guidance/european-structural-and-investment-funds-guidance-member-states>

²⁰ As provided for in Article 2(26) CPR an escrow account means a bank account covered by a written agreement between a managing authority or an intermediate body and the body implementing a financial instrument (...), set up specifically to hold funds to be paid out after the eligibility period, exclusively for the purposes provided for in point (c) of Article 42(1), Article 42(2), Article 42(3) (...), or a bank account set up on terms providing equivalent guarantees on the payments out of the funds.

agreed (expected if there is no fixed interest rate for the whole duration) interest rate of the account if no other returns or expenses are expected.

5.14. FOLLOW-ON INVESTMENTS IN ENTERPRISES IN THE CASE OF EQUITY INSTRUMENTS (TO BE PAID AFTER THE ELIGIBILITY PERIOD)

An equity investment is the provision of capital to a firm, invested directly or indirectly in return for total or partial ownership of that firm and where the equity investor may assume some management control of the firm and may share the firm's profits.

Equity investments are very often made in several rounds. The first round financing/investment can be followed by the so called follow-on investments which are subsequent investments made by an investor who has made a previous investment in the enterprise (the final recipient), generally a later stage investment in comparison to the initial investment²¹.

With the objective of ensuring alignment of the legal framework with market practices, of ensuring that final recipients are able to benefit from continued support from the ESI Funds even after the end of the eligibility period and also to protect the initial investment by the financial instrument so that it is not diluted by a subsequent capital increase taking place before exit, to which the financial instrument investment would have not participated, in the case of equity-based instruments for enterprises a limited amount of payments for follow-on investments in final recipients can be eligible.

This amount is eligible even if not paid/invested in final recipients until the end of the eligibility period, if the following conditions, in line with Article 42(3) CPR, are cumulatively met:

- the planned support to enterprises has to comply with Article 37(4) CPR;
- the funding agreement between the duly mandated representatives of the managing authority, or where applicable, the body that implements the fund of funds, and the body that implements equity-based financial instrument is signed before 31 December 2017;
- by the end of eligibility date at least 55% of the programme resources committed in the relevant funding agreement is invested in final recipients;
- the amount of payments for investments in final recipients:
 - cover the period not exceeding 4 years after the end of eligibility period;
 - is paid into an escrow account²² specifically set up for that purpose;
- the amount paid into the escrow account:

²¹ For ease of reference the GBER also provides definitions: Article 2 (74) GBER 'equity investment' means the provision of capital to an undertaking, invested directly or indirectly in return for the ownership of a corresponding share of that undertaking; Article 2(77) GBER "follow-on investment" means additional risk finance investment in a company subsequent to one or more previous risk finance investment rounds.

²² As provided for in Article 2(26) CPR an escrow account means a bank account covered by a written agreement between a managing authority or an intermediate body and the body implementing a financial instrument (...), set up specifically to hold funds to be paid out after the eligibility period, exclusively for the purposes provided for in point (c) of Article 42(1), Article 42(2), Article 42(3) (...), or a bank account set up on terms providing equivalent guarantees on the payments out of the funds.

- is used solely for follow-on investments in final recipients having received equity investments from the financial instrument within the eligibility period for 2014-2020, which are still outstanding wholly or partially;
 - is used solely for follow-on investments to be made in accordance with market standards and market standard contractual arrangements and limited to the minimum necessary to stimulate private sector co-investment, while ensuring continuity of financing for the target enterprises so that both public and private investors can benefit from investments;
 - does not exceed 20% of the eligible expenditure at closure of the equity-based instrument in the form of payments to final recipients and payments to the benefit of final recipients. From this ceiling (i.e. 20% of eligible expenditure in final recipients) capital resources and gains returned during the eligibility period to this equity-based financial instrument should be deducted;
- State aid rules have to be complied with.

The amount of payments for investments in final recipients paid into escrow account will constitute eligible expenditure which can be declared at closure. Any amount of payments for investments in final recipients paid into an escrow account but not used for related follow-on investments in final recipients within the four years after the end of eligibility period will be used in accordance with Article 45 CPR.

Example of eligible expenditure to be paid/invested after the end of the eligibility period:

- 1) Funding agreement signed on 1 June 2016 with a committed amount to an Equity-based instrument: EUR 100 million
- 2) Total amount invested in SMEs by 31/12/2023 (excluding management costs and fees): EUR 80 million (i.e. more than 55%)
- 3) Resources & gains returned to the instrument by 31/12/2023: EUR 10 million
- 4) Maximum amount of payments for follow-on investments in final recipients within 4 years after 31/12/2023:
EUR 80 million*20%= EUR 16 million
EUR 16 million – EUR 10 million (resources & gains returned) = EUR 6 million should be paid into an escrow account in order to allow its declaration as eligible expenditure.
- 5) Total amount of management costs and fees for the whole implementation of the equity instrument: EUR 2 million
- 6) The amount of EUR 88 million (80+6+2) can be declared as eligible expenditure at closure.

5.15. ELIGIBILITY DEPENDING ON LOCATION, RELOCATION AND DURABILITY

Location

In the context of financial instrument operations, the general rule of Article 70(1) CPR is that operations supported by the ESI Funds should be located in the programme area.

In the context of financial instruments, the general rule above as well as the exception presented in Article 70(2) CPR should apply only in relation to the location of the operation at the level of the final recipient receiving support from a financial instrument, i.e., these provisions cannot be understood as a limitation in relation to the place of establishment of a body implementing financial instrument (including a fund of funds) which should, nevertheless, be established in a Member State and which must be legally authorised to provide financial instrument's support to final recipients.

This means that the investment by the final recipient for which the ESI Fund programme contribution was disbursed (or committed in the case of guarantees) should be located in the geographical area of the corresponding ESI Fund programme.

Where assistance is granted from the Funds to a large enterprise²³, the managing authority should assure itself that the financial contribution from the ESI Funds does not result in a substantial loss of jobs in existing locations within the Union. It is therefore recommended that the funding agreement includes provisions allowing the avoidance of such cases.

Relocation/Durability

Article 71(4) CPR states that the provisions on durability of operations do not apply to contributions to or by financial instruments.

The non-applicability of durability provisions under Article 71 CPR to financial instruments is intrinsically linked to the different notion of operation and beneficiary in financial instruments as compared to traditional grant operations. However, financial instruments providing ESI Fund support to different thematic objectives and through different delivery modes very likely fall under different State aid rules²⁴ which may include special provisions on durability that have to be complied with.

In order to ensure the effectiveness of the support delivered through financial instrument it is necessary that investments in final recipients contribute to the attainment of the specific objectives set out under the relevant priority of the programme and contribute to the achievement of its intended results. It is not enough to require that investments by the final recipient contribute to priority objectives only at the moment of disbursing the support from the financial instrument to the final recipient, as such narrow interpretation could lead to misuse of programme resources, as in the end, it is important to obtain assurance that the support channelled through the financial instrument has indeed been used for its intended purpose.

To exclude situations where a final recipient relocates the investment that received support from the financial instrument once the payment to the final recipient is executed, it is recommended that the link between the priority axis objectives and the investment

²³ It should be noted that there are significant limitations on the possibility of using ESI Funds to provide support to large enterprises stemming from Fund-specific rules and from State aid rules. For example, support to large enterprises is limited in the ERDF Regulation (articles 3(1)(b) and 5) to thematic objectives 1 (RDI) and 4 (low carbon economy).

²⁴ *de minimis*, different categories of aid under GBER (depending on the objective of the financial instrument), Guidelines on State aid to promote risk finance investments. For example, if the financial instrument is setup under the Regional investment aid measure foreseen in the GBER, then, in accordance with the provisions of GBER (Article 14(5) of GBER) the investment supported through a financial instrument is maintained in the recipient area for at least five years, or three years in the case of SMEs, after the completion of investment.

by the final recipient is maintained until the actual investment by the final recipient is completed²⁵.

Therefore, at the time of implementing the investment with the support received from the financial instrument, the investment by the final recipient for which the support (e.g. loan) was provided should be located in the relevant Member State and in the geographical area of the ESI Fund programme. However, in order to ensure the effectiveness of the support delivered under a programme it is recommended that the same principle applies during the period for reimbursement of the support received from the financial instrument as follows from the provisions for the off the shelf instruments described in Regulation (EU) No 964/2014 2014 (see Annex II, III and IV – section *Final recipients eligibility*).

5.16. TECHNICAL CHARACTERISTICS OF INFORMATION AND COMMUNICATION MEASURES FOR FINANCIAL INSTRUMENTS

The detailed technical characteristics for displaying the Union emblem and reference to Fund(s) supporting any operation are provided for in Articles 3, 4 and 5 CIR. In this regard, it is highlighted that Article 4(4) CIR requires the name of a financial instrument to include a reference to the fact that it is supported by the ESI Funds.

²⁵ Please note that usually the completion of the investment takes place in a shorter time frame than the actual maturity of the loan.