FIN-EN

Sharing Methodologies
on Financial Engineering
for Enterprises

GUIDELINES FOR THE IMPLEMENTATION OF FINANCIAL INSTRUMENTS

Building on FIN-EN – sharing methodologies on FINancial ENgineering for enterprises

Executive Summary

INTERREG IVC
INNOVATION & ENVIRONMENT
REGIONS OF EUROPE SHARING SOLUTIONS

A project co-funded by
European Union
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Imprint

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Scientific Coordination:
Finlombarda S.p.A. (Paolo Zaggia, Antonella Pisano, Federica Rosi)
With the contribution of the European Policies Research Centre, School of Government & Public Policy, University of Strathclyde, UK (Fiona Wishlade, Rona Michie, Claudia Gloazzo)

Authors: Finlombarda SpA. (Italy) - Lead Partner with endorsement of Lombardy Region
European Association of Public Banks A.I.S.B.L. (Belgium)
Agency for Innovation and Development of Andalucía, IDEA (Spain)
Ministry for National Economy, Deputy State Secretariat Responsible for Implementing Economic Development Programs, Managing Authority (previously the National Development Agency, Operational Programme for Economic Development Managing Authority) (Hungary)
Regional Council of Auvergne (France)
SID Bank (Slovenia)
Latvian Development Finance Institution (Latvia)
Investment and Business Guarantees Ltd.- INVEGA (Lithuania)
Central Denmark Region (Denmark)
Wirtschafts- und Infrastrukturbank Hessen - WIBank (Germany)
Hellenic Fund for Entrepreneurship and Development SA - ETEAN SA (Greece)
Managing Authority of COMPETE/POFC (Portugal)
North West Competitiveness Operational Programme, Department for Communities and Local Government (England, UK)

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PREFACE

The FIN-EN project has supported the exchange of experience on a cross-section of 2007-13 financial instruments in both Convergence and Competitiveness regions, providing a comprehensive picture of the strengths and weaknesses of their implementation. The FIN-EN partners' experiences have been brought together in these Guidelines, along with an overview of the changes expected in the 2014-20 programme period. In considering the evidence and results presented in the Guidelines, it is important to stress the need for capacity building, continuity and flexibility, as well as caution concerning leverage, timing and certification:

- **Capacity building**

In terms of the ability of public institutions to evaluate and address crucial questions related to policy choices and implementation methods, the 2007-13 experience of setting up and managing financial instruments was the first such attempt for most of the project partners, as only a few had previous experience in this field. It is clear that all the partners recognise that the 2007-13 programme period has entailed the development of expertise through 'learning by doing'. Public sector staff had to incorporate a new perspective, working to support territorial development over the seven-year period, while also guaranteeing revenues for the future, and moving away from a 'grant' culture.
Even if mistakes were made, they resulted in useful experience for the future.

At the same time, the global economic crisis affected economic development in Europe, and influenced the performance of financial instruments. In consequence, and looking towards 2014-20, there is a need to move away from an 'aggregating approach' (viewing programmes as simply the sum of different actions) to a 'matrix approach', where each action is required to generate added value not only directly (to final recipients) but also indirectly (i.e. 'horizontally'). This can create positive externalities. In the context of financial instruments, this is reflected in the support for final recipients provided by Managing Authorities (as public bodies) which, through fund managers and financial intermediaries, also produces indirect positive effects. Structural Funds can provide a strong incentive to public bodies to combine spillover effects and efficiency with the proactive involvement of local and regional stakeholders.
This is fundamental to exploiting the benefits of financial instruments, especially in the case of tailor-made instruments.

- **Continuity**

This refers to continued use of existing tailor-made instruments, renewed on the basis of an ex ante assessment for 2014-20, but exploiting the know-how and experience gained in 2007-13; building on this experience may be the most appropriate solution for partners. The Commission's off-the-shelf models are perceived as helpful for organisations without experience of managing financial instruments. However, where instruments have performed well, it is better for stakeholders and final recipients alike, who are already accustomed to the various products and procedures, if the same measures are continued. Of course, in the interests of simplification, continuity must not be confused with 'inflexibility'

as here is an ongoing requirement to reduce the administrative burden on recipients.
Continuity also offers other benefits in terms of reducing 'Time to Market', i.e. the period of time between a financial instrument being designed and resources committed and it becoming available to final recipients.
The experience gained through procedures which have already been tested (even if they need refining) should reduce the incidence of bottlenecks. The value of continuity is also evident in terms of effects, since policy stability can result in greater overall impact.

- **Flexibility**

This concept has been discussed frequently at FIN-EN project meetings and in FIN-EN reports. In 2007-13, the concept was not clearly explained in the regulatory framework and has been interpreted differently. There are two main types of flexibility in financial instruments – flexibility in composition and flexibility referring to adaptability to change.

Flexibility in composition – as financial instruments are intended to address a gap identified by an ex ante assessment of demand and supply in the relevant territory, the nature and scale of a financial instrument is the result of a complex evaluation. Thus, the opportunity to combine instruments, (e.g. grants and revolving instruments) was appreciated and found suitable by the majority of FIN-EN project partners.

The need to adapt general instruments to local specificities is important to bear in mind in the context of tailor-made instruments. Fortunately, in 2014-20, the Financial Regulation (art.139) and General Regulation (art.37.7) support the option of combining financial instruments as follows: *'Financial instruments may be combined with grants, interest rate subsidies and guarantee fee subsidies. Where support from ESI Funds is provided by means of financial instruments and combined in a single operation, with other forms of support directly related to financial instruments targeting the same final recipients, including technical support, interest rate subsidies and guarantee fee subsidies, the provisions applicable to financial nstruments shall apply to all forms of support within that operation'.*

What is not expressly described, but is valuable evidence from the FIN-EN analysis, is the added value that can be generated by financial instruments that combine funding and training. Final recipients can benefit not only from financial support but also from management and administrative assistance; this is often needed by start-up companies which may have strong technical know-how but lack business experience.

Flexibility in changes – the use of financial instruments must already be indicated in Operational Programmes and an ex ante assessment must be carried out prior to funds being committed. Experience in 2007-13 suggests that both 'need' and 'economic context' could change in the framework of a seven-year period and so, consequently, should the financial instrument. It is therefore advisable not to be too specific in the Operational Programme on the financial instruments to be used, indicating that further detail will be developed in the ex-ante assessment. This will help prevent the need for modification of the OP, which requires the approval of the EC.

Concerning the compulsory ex ante assessment, minimum requirements are specified in the General Regulation and guidelines, but, if the context or territorial needs change, it can be updated and modified. A potentially critical issue is that, even if the ex ante assessment is a compulsory document and must be submitted to the monitoring committee, it is not formally approved. This means that the document could be always called into question by the EC.

- **Leverage**

During the 2007-13 period, the concept of leverage was strongly used to push for the use of financial instruments instead of traditional grants. The idea of 'multiplying' the amount available to final recipients thanks to co-financing with private stakeholders was one of the key innovative elements, together with the revolving effect introduced by financial instruments.

As the period progressed, it became evident that 'leverage' should not be an overriding priority. The analysis suggests that in some cases (e.g. innovation, start-up companies, etc.) the design of a financial instrument need not envisage significant leverage, but should focus on achieving the policy objective. In this regard, the 'Ex ante assessment methodology for financial instrument in the 2014-2020 programming period' – Volume I', which provides a guide to how to develop ex ante assessment and how to quantify the value added of a financial instrument, describes leverage as the non-EU financial contribution by third parties to the financial instrument; in other words, the national contribution is included in the contribution by third parties. This means that all financial instruments have a leverage effect, even if there is no other co-financing. This interpretation of leverage means that leverage does not need to be artificially high, but can be evaluated from time to time and the priority of a financial instrument can be stated differently.

- **Timing**

The evaluation of time taken to set up and run financial instruments was one of the critical issues emerging in the FIN-EN analysis. The 2007-13 period was focused on setting up new instruments and there were a number of new issues related to implementation to be addressed. In consequence, although many instruments were set up, the length of the process affected their effectiveness.
In 2014-20, public bodies must control the phasing of FI implementation more tightly than in 2007-13, since the certification of OP spending depends on effective expenditure of the FI. It is therefore crucial that each phase of the instrument life cycle reflects the most appropriate solution, including speed of disbursement. This can be ensured in the design phase, for example, by renewing an already existent financial instrument, and in the implementation phase, for example, by using a quick method to select financial intermediaries. Managing Authorities should introduce 'time' as an evaluation criterion to select managing bodies and financial intermediaries, in order to manage the overall 'time to market' of the instrument.
Another consideration is that the timetable of financial instruments does not sit easily with that of the Structural Funds. Given that it is already possible to set up an OP priority axis entirely dedicated to FIs, could it also be possible to consider a 'dedicated' management approach to FIs which would also take account of their different schedules?

- **Certification**

The new 2014-20 regulations present a completely different method of certification of expenses for financial instruments. In 2007-13, the entire amount devoted to the instrument could be considered as certified from the start, with a cross check at the end of the programme period, providing considerable management freedom. In contrast, under the new rules the programme contribution paid to the financial instrument included in applications for interim payments cannot exceed 25 percent; moreover, this is dependent on reaching a minimum expenditure threshold. This means that, whereas in 2007-13 the performance trend of the instrument was not relevant until the end of the programme period, for example where a financial instrument could not spend very much in the first years but gained ground in later years, this is not feasible in 2014-20. If finance does not reach the final recipient, the expenditure cannot be certified and, in any case, certification cannot exceed 25 percent of the total amount of the instrument. In consequence, the ex ante assessment must also consider whether the forecast expenditure trend is compatible and appropriate for EU co-funding.

Finlombarda S.p.A., FIN-EN Lead Partner

GLOSSARY AND LIST OF ABBREVIATIONS

FIN-EN GLOSSARY		REFERENCES 2007-2013
Beneficiary	if there is a holding fund, it is the holding fund itself; if not it will be the financial instrument	COCOF_10-0014-05-EN REVISED VERSION 08/02/2012
Co-funder	a private subject co-funding the financial instrument	
Default	failure of an SME to repay its credit under contractual conditions	European Court of Auditors, Special report n.2
ERDF	European Regional Development Fund	Regulation 1080/2006
ESF	European Social Fund	Regulation 1081/2006
Evergreen	a financial instrument without a fixed end	European Court of Auditors, Special report n.2
FEI Manager	is the subject entitled to manage the financial instrument, it does not coincide with Managing Authority or financial intermediary	COCOF_10-0014-05-EN REVISED VERSION 08/02/2012; FINAL VERSION 21/02/2011 COCOF_10-0014-04-EN
Final recipient	enterprises, public-private partnerships, projects and any legal or natural person receiving repayable investments (namely through equity participations, loans, guarantees and other forms of repayable investments implemented through similar transactions, with the exception of grants) from an operation	COCOF_10-0014-05-EN REVISED VERSION 08/02/2012
Financial Engineering Instrument	is an action which makes repayable investments or provide guarantees for repayable investments in enterprises, public private partnerships or other urban projects included in integrated plans for sustainable urban development, and funds or other incentive schemes for energy efficiency and use of renewable energy in buildings, including in existing housing	Regulation 1083/2006 art.44, COCOF_10-0014-05-EN REVISED VERSION 08/02/2012, COCOF Note COCOF_10-0014-04-EN point 2.1.3 decisional process
Financial Intermediary	the entity acting as intermediary between sources of capital supply and demand	European Court of Auditors, Special report n.2
Grant	non-reimbursable budgetary contribution from the EU or any Member State public institution	European Court of Auditors, Special report n.2

FIN-EN GLOSSARY		REFERENCES 2007-2013
Holding Fund	fund set up to invest in several venture capital funds, guarantee funds, loan funds, urban development funds, funds or other incentive schemes providing loans, guarantees for repayable investments, or equivalent instruments, for energy efficiency and use of renewable energy in buildings, including in existing housing	COCOF_10-0014-05-EN REVISED VERSION 08/02/2012
Holding Fund Manager/Fund Holder	is the subject entitled to manage the fund set up to invest in several venture capital funds, guarantee funds, loan funds, urban development funds, funds or other incentive schemes providing loans, guarantees for repayable investments, or equivalent instruments, for energy efficiency and use of renewable energy in buildings, including in existing housing.	
Intermediate Body	any public or private body or service which acts under the responsibility of a managing or certifying authority, or which carries out duties on behalf of such an authority vis-à-vis beneficiaries implementing operations;	Regulation 1083/2006 art.2
Jeremie	Joint European Resources for Micro to Medium Enterprises is an initiative of the European Commission developed together with the European Investment Fund. It promotes the use of financial engineering instruments to improve access to finance for SMEs via Structural Funds interventions.	http://ec.europa.eu/regional_policy/thefunds/instruments/jeremie_en.cfm#1
Leverage effect	how many euro of funding (public and private) have been paid for each euro of public funding paid	COCOF_10-0014-05-EN REVISED VERSION 08/02/2012
Managing Authority	national, regional or local public authority or a public or private body designated by the Member State to manage the operational programme	Regulation 1083/2006 art.59
NACE Rev.2	Statistical classification of economic activities	http://epp.eurostat.ec.europa.eu/portal/page/portal/nace_rev2/introduction

FIN-EN GLOSSARY		**REFERENCES 2007-2013**
NUTS II	The NUTS classification (Nomenclature of territorial units for statistics) is a hierarchical system for dividing up the economic territory of the EU: - NUTS 1: major socio-economic regions - NUTS 2: basic regions for the application of regional policies - NUTS 3: small regions for specific diagnoses	Regulation 1059/2003
Operation	the operation is constituted by the financial contributions from an operational programme to financial engineering instruments (including holding funds) and the subsequent investments made by the financial engineering instruments	http://epp.eurostat.ec.europa.eu/portal/page/portal/nuts_nomenclature/introduction
Operational Programme	document submitted by a Member State and adopted by the Commission setting out a development strategy with a coherent set of priorities to be carried out with the aid of a Fund	COCOF_10-0014-05-EN REVISED VERSION 08/02/2012
Priority Axis	one of the priorities of the strategy in an operational programme comprising a group of operations which are related and have specific measurable goals;	Regulation 1083/2006 art.2
Public co-funding	National or regional co-funding	Regulation 1083/2006 art.2
Revolving	when a contribution to financial instruments, after a first utilization or cycle, get recycled/reutilized	
SMEs	Small, medium size enterprises	COCOF_10-0014-05-EN REVISED VERSION 08/02/2012
Winding up	liquidation: process entailing selling all the assets, paying off creditors, distributing any remaining assets to the owners and dissolving the fund	COMMISSION RECOMMENDATION of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises
Working capital	enterprises' current assets (short term inventory, receivables, cash equivalents, cash) minus current liabilities (short term liabilities, prepayments)	COCOF_10-0014-05-EN REVISED VERSION 08/02/2012

List of abbreviations	
EAPB	European Association of Public Banks
EIB	European Investment Bank
EIF	European Investment Fund
FEI	Financial engineering instrument
FI	Financial instrument
GBER	General Block Exemption Regulation – Regulation (EC) No. 800/2008
HF	Holding Fund
HFM	Holding Fund manager
JEREMIE	Joint European Resources for Micro to Medium Enterprises
TAC	Technical Advisory Committee
TWG	Thematic Working Group
TWG1 report	The report of Thematic Working Group 1 on Programming coordinated by the project partner Auvergne Region (France)
TWG2 report	The report of Thematic Working Group 2 on Implementation coordinated by project partner Agencia IDEA (Spain)
TWG3 report	The report of Thematic Working Group 3 on Monitoring and Reporting coordinated by project partner Hungarian Ministry for National Economy (Hungary)

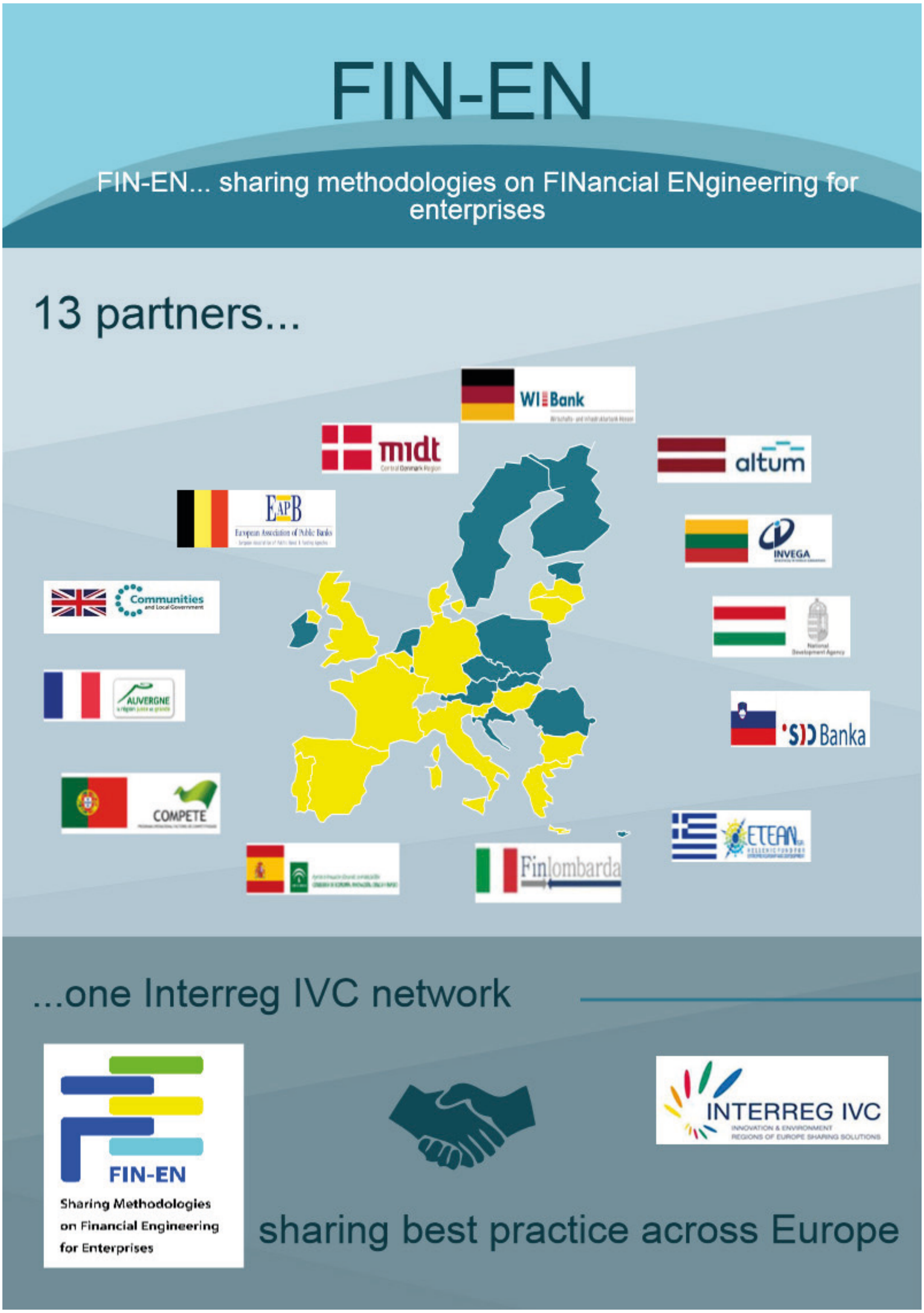
INTRODUCTION

The FIN-EN project - sharing methodologies on FINancial ENgineering for enterprises- is financed by the European Regional Development Fund (ERDF) under INTERREG IVC. The aim of the project is to enhance cooperation between regional and national authorities across Europe on the methodologies and instruments used for implementing financial instruments in the framework of EU Structural Funds, in order to find concrete solutions to common problems and promote a more efficient and effective use of financial instruments in the future. FIN-EN is a wide and stable network of 13 regional and national institutions coming from 13 different EU Member States, managing 45 financial instruments under 2007-2013 Structural Funds programmes, worth a total budget of circa 3,5 billion euro, without the support of the European Investment Fund (EIF).
FIN-EN comprises partners from across the EU, including both Convergence and Competitiveness regions, which have accrued substantial experience with the use of financial instruments in 2007-13:

- Finlombarda SpA. (Italy) – Lead Partner with endorsement of Lombardy Region
- European Association of Public Banks A.I.S.B.L. (Belgium)
- Agencia IDEA - Agencia de Innovación y Desarrollo de Andalucia - Agency for Innovation and Development of Andalucía, IDEA (Spain)
- Nemzetgazdasági Minisztérium - Ministry for National Economy, Deputy State Secretariat Responsible for Implementing Economic Development Programs, Managing Authority (previously the National Development Agency, Operational Programme for Economic Development Managing Authority) (Hungary)
- Conseil Régional d'Auvergne - Regional Council of Auvergne (France)
- SID – Slovenska izvozna in razvojna banka, d.d. -SID Bank (Slovenia)
- VAS Latvijas Attīstības finanšu institūcija Altum - Latvian Development Finance Institution (Latvia)
- UAB Investiciju ir verslo garantijos – Investment and Business Guarantees Ltd.- INVEGA (Lithuania)
- Region Midtjylland - Central Denmark Region (Denmark)
- Wirtschafts- und Infrastrukturbank Hessen - WIBank (Germany)
- Hellenic Fund for Entrepreneurship and Development SA - ETEAN SA (Greece) (until July 2013)
- Autoridade de Gestão do COMPETE, Programa Operacional Factores de Competitividade – Managing Authority of COMPETE/POFC (Portugal)
- North West Competitiveness Operational Programme, Department for Communities and Local Government (England, UK)

The following institutions were involved as Observers:

- Bulgarian Development Bank (BDB) (Bulgaria)
- Investitionsbank Berlin (IBB) (Germany)
- Bank of Valletta p.l.c (Malta)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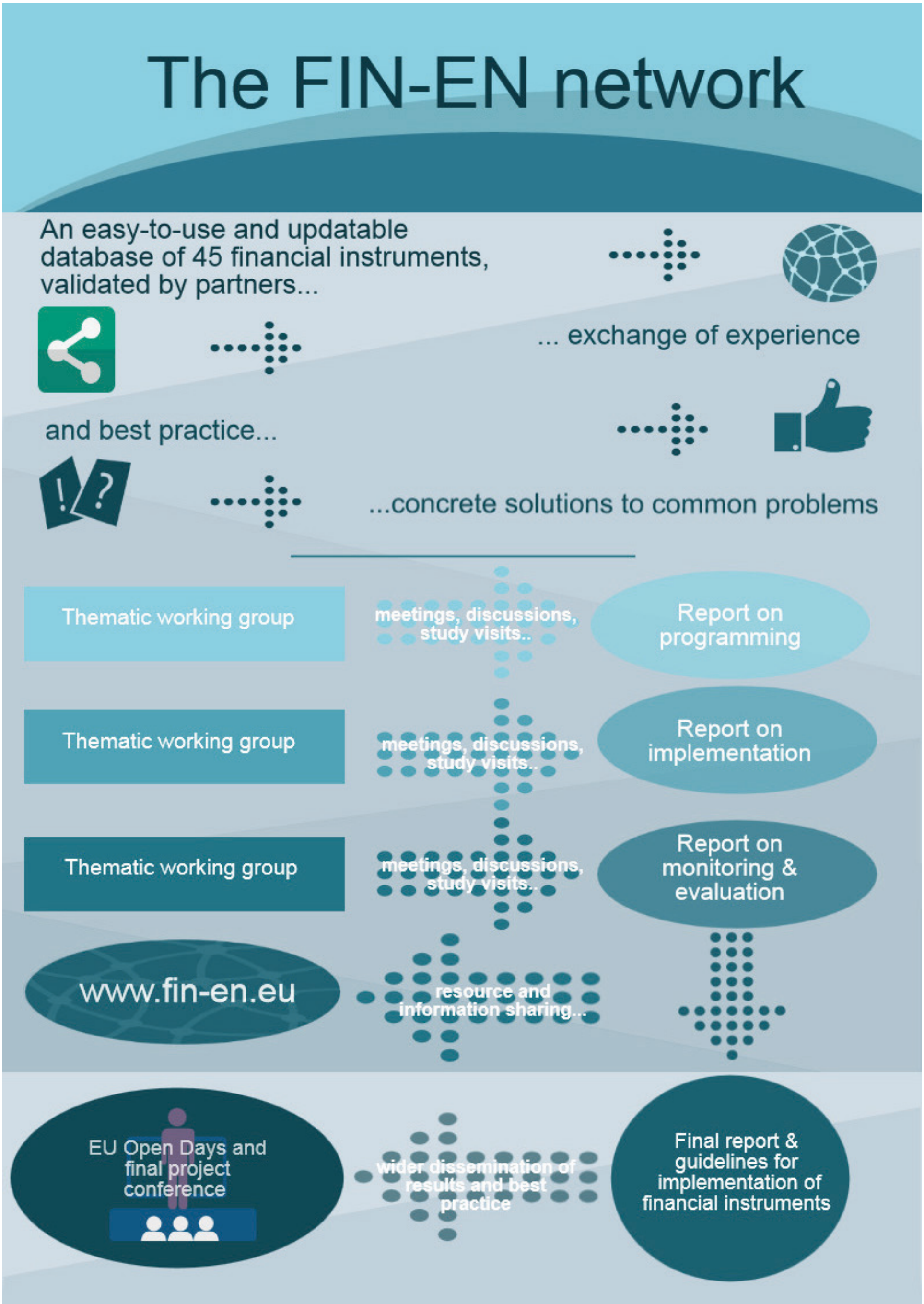
FIN-EN
Sharing Methodologies on Financial Engineering for Enterprises
INTERREG IVC
INNOVATION & ENVIRONMENT
REGIONS OF EUROPE SHARING SOLUTIONS
sharing best practice across Europe

Since the launch of the network in 2012, a series of networking and exchange of information activities have taken place. As a first step, a **comprehensive database of information on the 45 financial instruments** operated by the partners was developed. The updatable database describes the main quantitative and qualitative characteristics of the instruments which represent the basis for the exchange of experience between partners.
Three **Thematic Working Groups** were set up to examine and report on the programming, implementation and monitoring phases of operating FIs, identifying main critical problems and related good practices. In addition, **study visits** have been held in Lisbon, Auvergne and North-West England, and the mid-term conference took place in Auvergne (December 2013). The final conference is planned for November 2014. More information are available on the project website, at http://www.fin-en.eu/.

The 'Guidelines for the Implementation of Financial Instruments: Building on FIN-EN – sharing methodologies on FINancial ENgineering for enterprises', are the final project output, and are intended to be a useful tool for regional and national authorities planning to implement financial instruments in 2014-2020 programming period. The Guidelines illustrate the main findings of FIN-EN networking activity: the first part considers the 'lifecycle' of financial instruments and deals with aspects of programming, implementation and monitoring which are essentially common to all financial instruments; the second part reviews each type of financial instrument in turn, considering issues that are specific to that form of intervention. Each section has been structured to consider: 2007-2013 context, the experience of FIN-EN partners, with particular reference to good practices identified; and new rules and regulations for 2014-20.

The aim of this Executive Summary is to provide a synthetic overview of the Guidelines[1].

1. The complete text of the Guidelines together with an Annex on Financial instruments and State Aid, is available in the CDROM attached to this summary.


The FIN-EN network
An easy-to-use and updatable database of 45 financial instruments, validated by partners...
... exchange of experience
and best practice...
...concrete solutions to common problems
Thematic working group
meetings, discussions, study visits..
Report on programming
Thematic working group
meetings, discussions, study visits..
Report on implementation
Thematic working group
meetings, discussions, study visits..
Report on monitoring & evaluation
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Final report & guidelines for implementation of financial instruments

FINANCIAL INSTRUMENTS LIFECYCLE

Programming Financial Instruments

The first section of the report focuses on the preparatory phase of designing and incorporating financial instruments into Cohesion policy programmes. The topics developed include: the analysis of the need for financial instruments, the investment strategy, the incorporation of financial instruments in the operational programmes and the management of financial flows.

• Analysis of the need for financial instruments

A crucial issue in considering the role for financial instruments (FI) in economic development is whether there is a need for public policy intervention or whether the market is already providing the necessary finance of an appropriate type and scale. For the 2007-13 programme period it was not compulsory to carry out an ex ante evaluation or assessment specific to financial instruments. Nevertheless, the usefulness of such an analysis was recognised by the Commission, which co-financed so-called 'gap assessments' with the European Investment Fund (EIF) at the request of Member States, free-of-charge.

FIN-EN partners took different approaches to determining the 'need' for financial instruments in 2007-13. In many cases a gap assessment/analysis was undertaken by the EIF and was used by the partners to justify the setting up of the financial instrument.
Among those who opted to undertake the analysis themselves, **WIbank in Hessen** found that carrying out the task internally facilitated a swift turnaround. Lessons identified included the need for: a thorough understanding of the locality; specialist analysis of the SME financing market; involvement of both public and private stakeholders; taking account of stakeholder capacity; inclusion of a forward-looking element; and the case for a mid-term re-evaluation of the market.

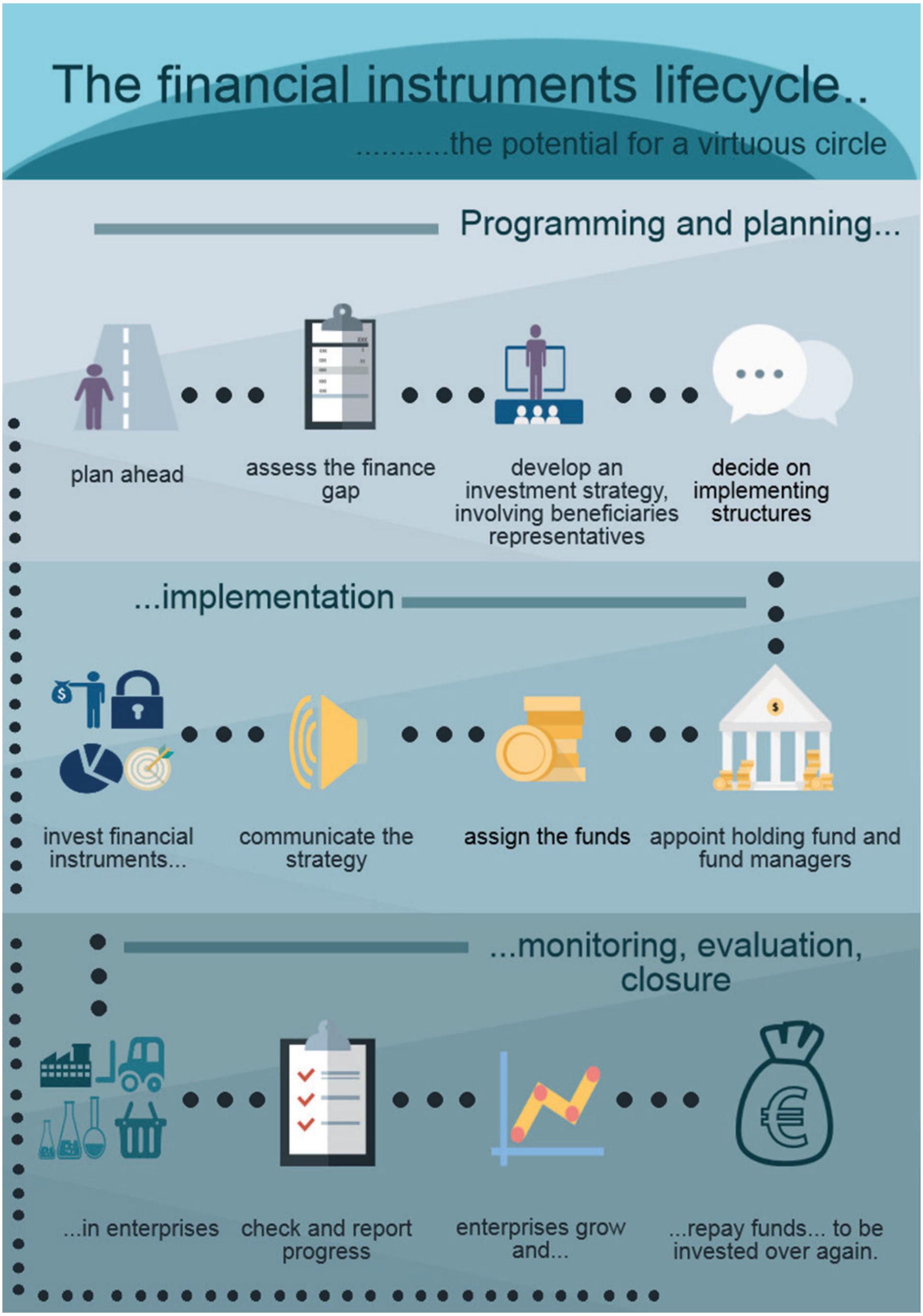
For 2014-20 the Commission requires support for financial instruments to be based on an ex ante assessment establishing evidence of market failure. This ex ante ***assessment,*** specifically dedicated to FI, is distinct from the ex ante ***evaluation*** which must be undertaken for the operational programme. It is extremely detailed and requires precise information on the financial instrument.

• Investment strategy

The investment strategy links the market gap assessment and the financial instruments put in place to address that gap. The 2007-13 regulations said little about what an investment strategy should contain. A COCOF note in 2011 provided additional information on the need for an 'underlying' and 'coherent' investment strategy.

A number of key lessons emerge from the experience of FIN-EN partners: the investment strategy should be flexible and adaptable to the changing economic context and local needs; it should be kept up to date as a consequence of updating the ex ante assessment, and a follow-up with final recipients to ensure the quality of investments made must be secured by managing authority and fund manager. Two good practices were identified among partners: **JEREMIE Fondo Multiinstrumento (Andalucia) and Midtjysk Iværksætterfond (Denmark)** (more detail is provided in the full report).
The partners suggested that the following elements be included in the investment strategy: type of FIs to be set up; implementation structure; governance and management arrangements; degree of private sector participation to be sought and at what stage; type of company and sector targeted; company development stage targeted; amounts needed; investment period and timetable; performance indicators and objectives.
Two additional points could be added to this list for 2014-20: the level of legacy funds expected to be created, and plans for their future use, and a discussion of any envisaged combination with grant support, as required in the regulatory provisions.

For the 2014-20 programming period, the now mandatory ex ante assessment must include an examination of the proposed investment strategy, including the options for implementation arrangements, characteristics of the financial products to be offered and the financial recipients targeted, as well as the envisaged combination with grant support, if appropriate.


The financial instruments lifecycle..
...........the potential for a virtuous circle
Programming and planning...
plan ahead
assess the finance gap
develop an investment strategy, involving beneficiaries representatives
decide on implementing structures
...implementation
invest financial instruments...
communicate the strategy
assign the funds
appoint holding fund and fund managers
...monitoring, evaluation, closure
...in enterprises
check and report progress
enterprises grow and...
...repay funds... to be invested over again.

• Incorporation in the operational programmes

In 2007-13, Member States or managing authorities had to indicate in their operational programmes plans to use FIs to contribute to the achievement of programme goals. The use of FIs had to form part of the implementation strategy for the OP, and be agreed between the Member State and the Commission. However, the decision on specific instruments to be used fell entirely within the competences of the Member State/managing authority concerned. Member States/managing authorities could also decide whether to devote an entire priority to FI, or whether to deploy FI as measures under one or more priorities. FIN-EN partners were divided fairly evenly between these two approaches.

Among the key lessons cited by FIN-EN partners are: the need to think ahead about any regulatory changes that will be required at national and regional level to facilitate implementation of FIs (as in Slovenia, under the programme for financing of technological projects 2011–13); to gain expertise in the relevant regulations and to resolve regulatory problems as soon as possible; to aim at clarity and simplicity when incorporating FIs into the OP as this helps prevent problems arising over interpretation (as done by Land Berlin); and, in general, to look for opportunities to use FIs beyond ERDF (as, for example, the **ENALIO Fund Greece,** co-financed by the Fisheries Fund and **JEREMIE in Lombardia,** co-financed through ESF. Further information is provided in the full report).

The CPR for 2014-20 specifies that consideration of FIs (even in the form of 'broad text'), should be indicated at priority axis level on the basis of the ex ante evaluation of the OP. At a minimum, the managing authority should mention that it envisages the use of FIs. The specific FIs to be used can only be decided after the ex ante assessment is carried out, and this can take place after the programme is adopted. However, where managing authorities decide to devote an entire OP priority to FIs, and benefit from the incentive of a 10 percent increase in the EU co-financing rate for the priority, or where they decide to dedicate a whole priority to support an EU-level FI, and apply a 100 percent co-financing rate to that priority, the European Commission would seek more detailed information in the OP (or a later programme modification).

The scope for FI use is being expanded and enlarged in 2014-20 to cover all ESI Funds (including the Cohesion Fund) and all thematic objectives and priorities in the OPs. The new regulations are non-prescriptive with regard to sectors, beneficiaries, types of projects and activities to be supported.

• Managing financial flows from the OP

In the 2007-13 period, funds were slow to reach final recipients from many FIs set up under Structural Funds. There have been no major lessons emerging from FIN-EN partners, largely owing to the lack of precedent in terms of managing financial flows from operational programmes to holding funds and FIs, and then ensuring onward progression to final recipients. Important changes are taking place in 2014-20, with the introduction of staged payments linked to disbursements to final recipients and new restrictions on 'parking' funds to avoid decommitment.

Implementing Financial Instruments

This section focuses on the implementation phase of FIs in Cohesion policy, including decisions about implementation structures, selecting fund managers and financial intermediaries, issues related to management fees, co-financing and leverage, communication strategies and closure.

• Implementation structures and options

In 2007-13, when choosing to set up a financial instrument, managing authorities had four basic options:

- to make a direct contribution to an instrument (without using a holding fund);
- to contribute to a holding fund, the management of which is put out to public tender;
- to contribute to a holding fund and contract the management to EIF/EIB; or
- to contribute to a holding fund and contract management to a national financial institution without tender under national law (if compatible with the Treaty).

Managing authorities also had to decide whether to establish a distinct legal entity for the instrument (including the holding fund) or whether to set up a separate block of finance within an existing institution. By the end of 2012, most Member States using financial instruments to support enterprises were using both organisational approaches.[2] In terms of the overall pattern of management, the majority of holding funds were managed by either national financial institutions or were put out to public tender, rather than being managed by the EIF or EIB.

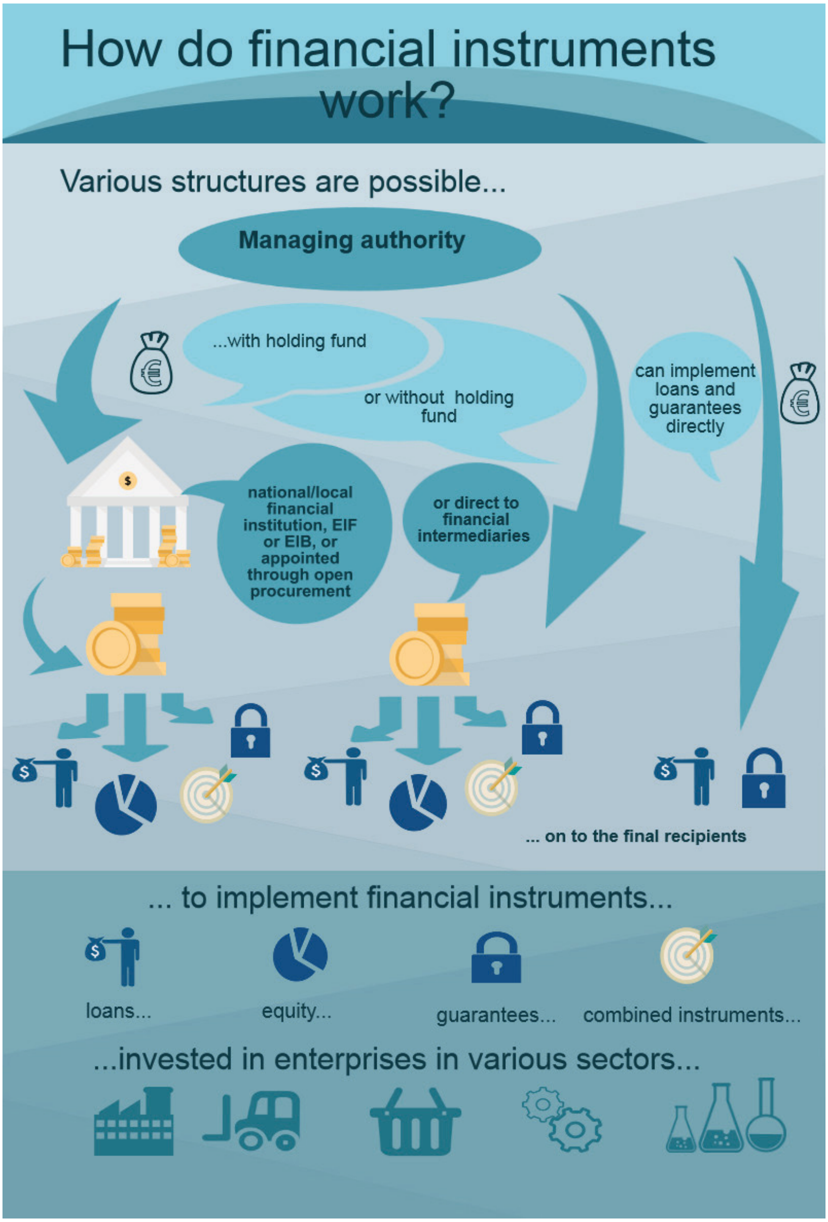
Among the FIN-EN partners, the use of holding funds predominates with nine partners having established 11 holding funds between them; these holding funds account for 35 of the 45 FIs operated by the partners. Seven of the holding funds are operated as separate blocks of finance while the remaining four are established as independent legal entities. Among the 10 FIs that operate without a holding fund, three are established as separate legal entities and seven as separate blocks of finance within a financial institution.

The choices made by the FIN-EN partners are largely context driven, so that the scope for lesson-drawing from this aspect of FI implementation may be limited.
Nevertheless, the FIN-EN experience suggests that using a separate block of finance within an existing institution may facilitate rapid implementation and that holding fund structures increase flexibility, since funds may be switched between instruments, depending on their performance.

2. European Commission (2013) Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds, September 2013, see: http://ec.europa.eu/regional_policy/thefunds/instruments/doc/summary_data_fei_2012.pdf .

In 2007-13 managing authorities could only set up tailor-made FIs at national or regional level. By contrast, for 2014-20, the options include tailor-made FIs at national, regional, transnational or cross-border level: with or without holding funds (termed 'fund of funds' in 2014-20), and two new options. First, contributions can be made to EU-level instruments which are managed directly or indirectly by the European Commission. Second, while remaining under the responsibility of the managing authority, FI can use pre-determined terms and conditions or templates for implementation; these have become known as 'off-the-shelf' (OTS) instruments.

Managing authorities also have the option of designing their own FIs from scratch or using existing instruments independently of EU-level instruments or templates, as is the case under domestic policy.


How do financial instruments work?
Various structures are possible...
Managing authority
...with holding fund
or without holding fund
can implement loans and guarantees directly
national/local financial institution, EIF or EIB, or appointed through open procurement
or direct to financial intermediaries
... on to the final recipients
... to implement financial instruments...
loans...
equity...
guarantees...
combined instruments...
...invested in enterprises in various sectors...

● Selecting fund managers and financial intermediaries

In 2007-13, fund managers could be public or private institutions.
There were several possibilities for selecting holding fund managers, either:

- the award of a public contract through public procurement; or
- the award of a direct financial contribution to the EIB or to the EIF, or to a financial institution without a public procurement process, subject to national law compatible with the Treaty.

For financial instruments themselves, financial intermediaries can be appointed with or without a procurement process, depending on national legislation.

Within the FIN-EN network, FIN-EN partners note that there is no predominant or most suitable method to appoint fund managers or financial intermediaries. Lessons learned include the need to devote sufficient time and effort to the selection of financial intermediaries and fund managers, because a sound process is crucial; ensuring funding agreements are attractive to intermediaries, easy to enforce and flexible (and provide exit/closure options); and adopting standardized selection criteria (especially for equity funds, selection criteria should be adjusted for loans and guarantees).
Examples of good practice include the procedures for **FRIM (Fondo di Rotazione per l'Imprenditorialità) ERDF in Lombardia**, where a document fully describing the role, activities, remuneration and deadlines to be respected by the financial intermediary was produced, reducing the time needed in the selection process of financial intermediaries. FIN-EN partners suggested that selection criteria for holding fund managers should include: track record; expertise and skills of the team, especially on the technical aspects of financial instruments co-financed by Structural Funds; local presence, with a strong understanding of regional, national and European financial and banking networks and knowledge of local financial needs; flexibility and creative approaches; understanding of the policy challenges and the capacity to develop ad hoc solutions; administrative capacity, and ability to add value.
The **Auvergne** FIN-EN partner took an innovative approach using a public/private partnership: whereby SOFIMAC PARTNERS manages the holding fund and oversees follow-up of the venture capital investment portfolio and mezzanine debt portfolio and Auvergne Region Chamber of Commerce and Industry (CCIA) manages the loan fund portfolio.

When fund managers/ financial intermediaries have been selected, a funding agreement is drawn up which sets out the terms and conditions for contributions from the OP to the FI. FIN-EN partners recommend public law expertise being available at this stage, the importance of creating a working team which combines legal and operational specialists, and the need to foster dialogue with the relevant authorities to adapt regulations and settle differences in interpretation.

Under the CPR for 2014-20, managing authorities again have a number of options regarding implementation:

- to invest in the capital of existing or newly created legal entities, including those financed from other ESI Funds, dedicated to implementing financial instruments consistent with the objectives of the respective ESI Funds, which will undertake implementation tasks;
- to entrust implementation tasks to: the EIB; international financial institutions in which a Member State is a shareholder, or financial institutions established in a Member State aiming at the achievement of public interest under the control of a public authority; a body governed by public or private law;
- or undertake implementation tasks directly (loans and guarantees only).

Where part of the implementation is entrusted to entities other than the EIB, certain minimum requirements must be met.

● Management costs and fees

The Implementing Regulation for 2007-13 included some guidance on management costs and fees but concerns were raised about transparency and the lack of clarity over whether management costs were based on fund size, investment size or tied to financial performance of the investments.

FIN-EN partners' recommendations include designing a flexible and adjustable scheme for management fees, ensuring that the design of the remuneration schemes is consistent with the investment strategy; and balancing the different components of a remuneration scheme to deliver the desired behaviour.

For 2014-20 the regulatory provisions set out more detailed rules on management costs and fees. Management costs comprise direct or indirect cost items reimbursed against evidence of expenditure, while management fees refer to an agreed price for services rendered established through a competitive market process, where applicable. Management costs and fees are to be based on a performance-based calculation methodology.

● Co-financing and leverage

Co-financing refers to the public contribution to a financial instrument from the Member State/regional level, and also any private sector contribution (at the level of the OP).
All Structural Fund resources are required to be co-financed by other public or private resources for managing authorities to be able to spend Structural Funds.

One of the perceived benefits of FIs is their capacity to attract private contributions, thereby increasing the sums available for investment in SMEs. This contribution may take place at the level of the holding fund (if there is one), the individual fund or the deal/final recipients. This mobilisation of private resources is known as leverage, and this leverage effect has been one of the main elements of added value reported by managing authorities using FIs in 2007-13.[3]

While attracting private sector participation is one of the main areas where added value can be identified, it has been difficult to do, particularly during the economic crisis. FIN-EN partners have generally found it challenging to attract private co-financing at all levels. One cautious conclusion from the FIN-EN partners is that co-funding at the fund level has been easier to achieve than co-investment at the level of each deal. They have found that this avoids having to secure private leverage on every deal, making it easier and quicker to invest the funds in businesses.

A number of lessons have been learned on maximising leverage at fund and investment levels. In general, forming partnerships with Community institutions such as the EIB / EIF is found to be very advantageous in terms of maximizing leverage (as in the **North West England JEREMIE Fund**), as these are public entities but their funds are considered 'private money'. In addition, the regulatory constraints for them are low in comparison with government and arms-length bodies (e.g. relating to procurement). In general, to optimise co-financing, it is recommended ensuring that strategy, fund and portfolio design is attractive for a private investor (as in the New Hungary Venture Capital Programme), potentially by involving co-funders in the design and implementation of funds and instruments (as in the **Midtjysk Iværksætterfond, Denmark**).

For 2014-20, significant additional flexibility has been introduced whereby national public and private co-financing contributions may be provided at the level of the FI (fund of funds or financial intermediary) or at the level of the final recipient (including in-kind contributions where relevant, except for the EAFRD). National co-financing does not have to be paid to the financial instrument upfront but may be provided at later stages of financial instrument implementation. It has to be provided before the end of the eligibility period. However, the provisions on payments allow for the full reimbursement of ESI Fund contributions even when material co-financing is provided at a later stage. The expected leverage effect should be assessed by the ex ante appraisal.

- **Communicating the strategy and publicising instruments**

Among FIN-EN partners, communication and marketing activity has been carried out mostly by managing authorities and holding fund managers, through the use of advertising, events and networking. There has been some uncertainty over communication obligations where there is a potential conflict between the obligations deriving from the use of Structural Funds and, for example, the preference for confidentiality on the part of the final recipient.

3. Van Ginkel et al (2013) Op cit.

FIN-EN partners suggest that activities such as seminars, events and networking seem to be the most effective approach for improving deal flow, in particular for equity and combined instruments. A good practice example is provided by the **INVEGA fund, Guarantee fund and Entrepreneurship Promotion Fund, Lithuania,** where innovative promotion and communication techniques were used successfully (more information is available in the full report).
For 2014-20, to encourage information dissemination and communication over the use of financial instruments over a wider range of funds and sectors, the Commission has asked the EIB to set up, implement and manage the Financial Instruments Technical Advisory Platform for ESI Funds (FI-TAP), which will play a role in preparing methodological guidance, developing and delivering capacity building services, designing and delivering awareness raising campaigns and disseminating information through a variety of delivery channels.

• Closure and exit

Closure of a financial instrument takes place at the end of its lifetime, or before, if it is underperforming. FIN-EN partners have identified a number of required processes including the tasks necessary to stop the operation, liquidation of assets, ownership transfer, transferring of funds, ensuring eligibility of expenditure, etc. Exits, on the other hand, refer to the termination of specific deals (e.g. when a loan is repaid in full (or is defaulted on), or when the stock in an equity investment is sold). In 2012, a report by the European Parliament identified room for improvement in the areas of setting up clear exit strategies and winding-up provisions.[4]

Several recommendations from FIN-EN partners related to closure and exit can be identified. First, it is important to consider the whole life-cycle of each FI and each transaction at planning stage, and to incorporate information on processes and rules for exit and closure policy in funding agreements. Related to this is the need to specify clear rules/criteria in case of underperformance and defaults of the FI and extraordinary exits out of the FI, in the instrument design.

The new regulations for 2014-20 provide more detailed guidance on closure, eligible expenditure at closure, notably in relation to eligible expenditure and management costs and fees.

4. European Parliament (2012) Overview of Financial instruments used in the EU Multiannual Financial Framework period 2007-2013 and the Commission's proposals for 2014-2020. Analytical Study. DG for Internal Policies, Policy Department D: Budgetary Affairs, Brussels, see: http://www.europarl.europa.eu/committees/en/studiesdownload.html?languageDocument=EN&file=73151 (accessed July 2014).

Monitoring and Reporting Financial Instruments

This section focuses on the monitoring and reporting phase of FI in Cohesion policy. It deals in particular with internal issues for tracking progress as well as the verifications and checks required by the Commission.

• Internal monitoring and reporting

Effective monitoring of the implementation of FIs is required both for the internal assurance of probity and effectiveness, as well as to ensure that the required reporting to national government and the European Commission is accurate and based on the best possible data.

All FIN-EN partners had to establish monitoring and reporting systems in order to meet the administrative requirements of the funding, although the nature of these systems varies according to the institutional context and the reporting requirements of partners.
Good practices therefore have to be placed within these contexts, and relate more to the design and management of monitoring procedures rather than the specific contents of data collected. At the outset, managing authorities should identify all actors in the reporting system and map which forms of data need to be collected and reported to each of the actors. The data collected should make it possible for Member States/managing authorities to carry out in-depth analyses and provide a global assessment on the performance of FIs. In addition, monitoring data and information (including results of evaluations, surveys, etc.) on FIs could be made public to a larger extent.

Good practice examples were provided in **JEREMIE North West England** where the CRM software tool for monitoring investment processes and reporting provides the managing authority with reliable and up to date information, and the web-based data management system developed for the **FRIM (Fondo di Rotazione per l'Imprenditorialità) ERDF in Lombardia**, through which data is collected from the first application throughout the project (more information provided in the full report).

The timing of reporting is also diverse with reporting periods varying from annual to monthly or even daily in some situations, in addition to ad hoc reports. This demands that effective monitoring and reporting systems are established that gather data on a timely and regular basis, and hold that data in a flexible format that permits reporting at different points in time and for different periods.

Standard templates should be used to collect data on a consistent basis, ideally through a web-based data entry system. Templates may be revised over time in response to new needs, but changes should be minimized and implemented in major revisions rather than incrementally.

An ideal approach to developing a monitoring system is to develop it in conjunction with a web-based data input and management system, so that all those involved in the project have to enter data in real time and only need to enter data once. In this way monitoring data is always available on a real-time basis.

For 2014-20, the Commission stresses the importance of reporting in order to assess FI performance. Monitoring committees are charged with a specific responsibility to examine FIs, and should be supplied with specific information. The information to be provided has been expanded in 2014-20 to include elements such as leverage and performance, and also now includes the Cohesion Fund, EAFRD and EMFF, where appropriate.

● Reporting to the Commission

The first reporting exercise on FIs set-up in 2007-13 was carried out on a voluntary basis by managing authorities in 2011. The data provided by the Member States in various formats was collected and aggregated by the European Commission in a synthesis report published in December 2011. At the end of 2011, the General Regulation was amended to introduce an obligation for Member States to formally report on FIs within the Annual Implementation Reports by 30 June. The Commission published a summary of the data; however, this had many omissions and inaccuracies, so the Commission invited managing authorities to verify the information they had submitted. The second formal reporting exercise took place in 2013, when the Commission prepared and presented to the Member States updated guidance on FI reporting.5 While improved, the data is still problematic.

FIs use a range of indicators, with great variation in the number produced. FIN-EN partners recommend that the indicators measuring FI performance should be clearly identified, and that a broad range of indicators should be provided for the Annual Implementation Report to the Commission to encompass operational indicators, output indicators and results indicators.

The identification of suitable indicators for FIs has been problematic. The majority of FIs within the FIN-EN group have been audited by the Commission. There appears to be no common problem as a wide variety of issues was identified, including missing data and information, weaknesses in verification procedures, weaknesses in the evaluation plans, and changes to the approach of the funds from that which was agreed. In order to reduce these issues, the lessons from FIN-EN are that those operating FIs should invest in better monitoring data, verification processes and evaluation plans.
Linked to the internalreporting requirements, monitoring systems should be able to collect data in a form which is convenient for a swift elaboration of annual reports.

Building on the reporting requirements in 2007-13, the new framework requires managing authorities to send to the Commission a specific report on operations comprising FIs as an Annex to the Annual Implementation Report. Based on the reports submitted, the Commission will provide summaries of data collected. Templates for reporting are provided on the Commission's SFC system.[6]

5. http://ec.europa.eu/employment_social/sfc2007/quick-guides/sfc2007_reporting%20instruction_fei_air_updated_version.pdf.6 http://ec.europa.eu/employment_social/sfc2007/quick-guides/index_en.htm
6. http://ec.europa.eu/employment_social/sfc2007/quick-guides/index_en.htm

• Checks and verification

Verification is the internal system of checks to ensure that projects selected for funding by the FI are in accordance with the criteria applied by the fund, the operational programme and national and EU regulations.

Two models of verification checks were used by FIN-EN partners:

- the 'cascade model', in which typically only the level directly below the MA is checked, but not the levels lower in the hierarchy; and
- the 'ladder model', in which typically the entity checks all lower levels in the hierarchy.

General recommendations from FIN-EN partners include ensuring that the verification process is a regular, planned element as part of wider administrative procedures, creating procedures for verification at all levels that play a role in FI implementation, investigating the relevance of risk analysis instead of random sampling, and developing central (national/regional) databases of State aids to limit the risks of exceeding the de minimis thresholds or cumulation ceilings.

Adequate management verification is a key requirement of the management and control system in 2014-20. Several implementing acts are envisaged to deal with different aspects of monitoring, verification and control, but at the time of writing, these have not been published.[7]
MAs must submit a proposed methodology for carrying out on-the-spot checks if the Commission does not do so.

• Evaluation

Evaluation of FIs is usually a part of the overall evaluation of operational programmes, given the scale of the FIs within such programmes. Whilst such evaluations vary in format and objectives, the scale and nature of FIs suggests that evaluations should be undertaken within the FI to ensure effective and efficient implementation and to ensure that the FIs are correctly targeted.

Among FIN-EN partners, the majority have plans for qualitative and quantitative interim and ex-post evaluations of FIs. Planned evaluation activity varies in frequency, for example:

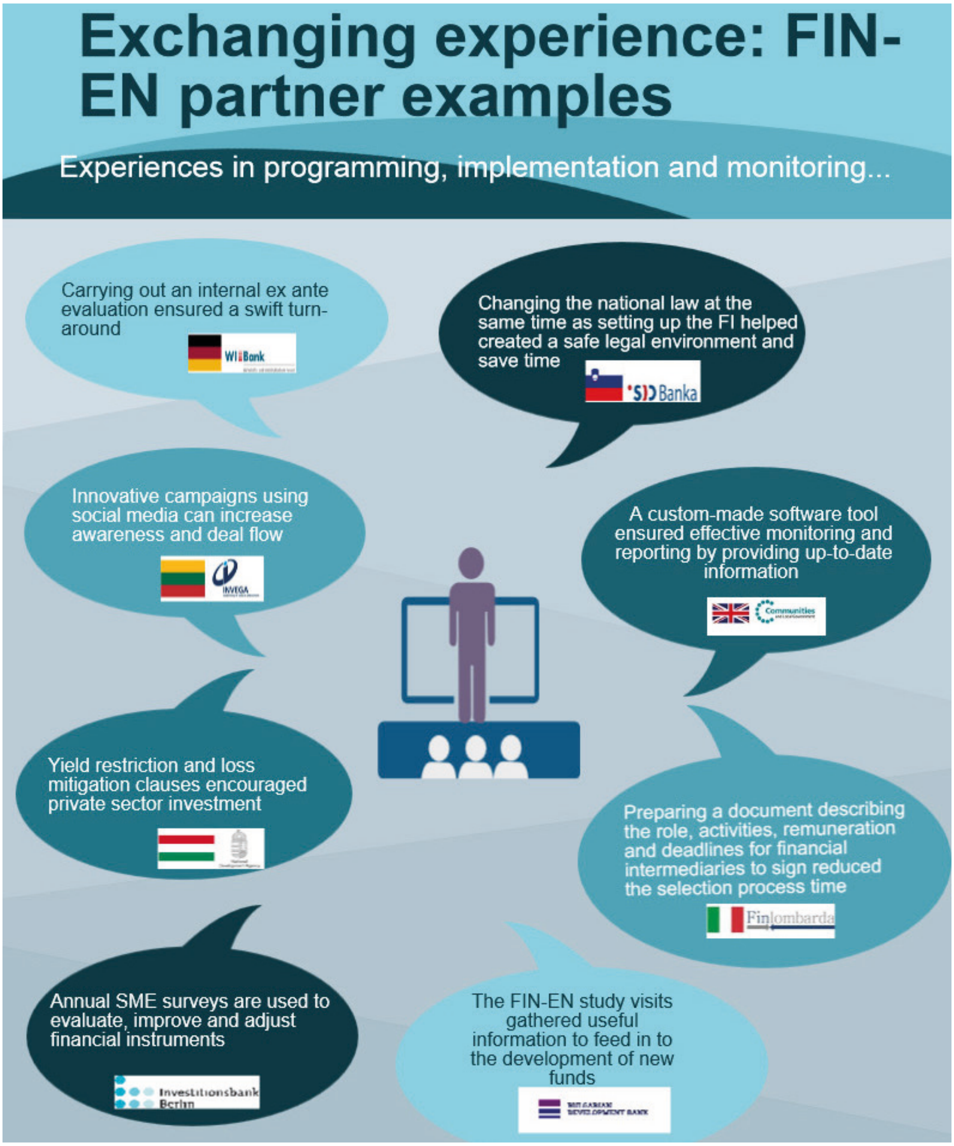
- In the case of the Spanish FIs there are evaluations on a monthly and an annual basis.
- In France, the MA evaluates the FI once a year.
- In Hungary, typically one interim and one ex post evaluation is planned for FIs.

In some cases the evaluation is not specific to the FI but is part of a complex evaluation project. For example, in the case of the **Portuguese FIs,** the evaluation is planned and included in a broader performance evaluation of the OP, while in the case of **Hessen Kapital I GmbH** and **Mittelhessenfonds GmbH** the evaluation is part of the regular report to the relevant Ministry.

Evaluation plans should be drawn up at the outset as part of the effective management of FIs, both to ensure that the effective use of public funds can be accounted for and also to help with the management and targeting of the funds on an ongoing basis, as well as to provide guidance on future needs and funding strategies. FIs should be assessed through, as a minimum, ex ante, interim and ex post evaluations with these evaluations feeding into programme-wide evaluations where applicable (for example, in the case of the North-West Fund in England, an internal review of the fund was undertaken in 2012 to determine if the strategic rationale was still relevant and whether the outputs and targets could be met). Regular updates of needs or gap analysis should be undertaken alongside evaluation to ensure that the FI continues to be targeted on needs (as, for example, the annual SME survey carried out by the IBB, Berlin).

In 2014-20, regulatory provisions have been strengthened in terms of the monitoring of FIs. The managing authority must report annually to the Commission on the operations comprising FIs as an annex to the Annual Implementation Report. Provisions are also made in the regulations for the ex ante evaluation and evaluation of Cohesion policy programmes during the programme period. Specifically, an evaluation should be carried out for each priority at least once during the period to assess how support from the ESI Funds has contributed to its objectives.

7. See: http://ec.europa.eu/regional_policy/what/future/pdf/preparation/implementing_acts_summary_inforegio_180614.pdf.



REF. P. 31

8. Guidance Note on Financial Engineering Instruments under Article 44 of Council Regulation (EC) No 1083/2006 COCOF_10-0014-04-EN, 21/02/2011.
9. Ward T (2012) Expert evaluation network 2012. The use of the ERDF to support Financial Engineering Instruments. A report to the European Commission Directorate-General for Regional Policy. See: http://ec.europa.eu/regional_policy/sources/docgener/evaluation/pdf/eval2007/expert_innovation/2012_evalnet_fei_synthesis_final.pdf.
10. Tykvová T, Borell M and Kroencke TA (2012) Potential of Venture Capital in the European Union, European Parliament, Directorate-General for Internal Policies, Policy Department A, Economic and Scientific Policy.

SPECIFIC FINANCIAL INSTRUMENTS

Financial instruments under Cohesion policy can take three principal forms:

- **Equity** (sometimes referred to as debt) – where the capital is loaned to the borrower and must be repaid.
- **Loans** – where capital is wholly or partially secured in the case of a default.
- **Guarantees** – where a holding or share is taken in the capital of a firm.

FIs may also be offered in **combination,** for example, different programme contributions and different funds in one financial instrument, as well as a combination of financial instruments and grants and other forms of assistance. This section highlights lessons from the FIN-EN partners which relate specifically to certain types of financial instrument, although most lessons are horizontal in nature and were described in the earlier sections of this report.

Equity

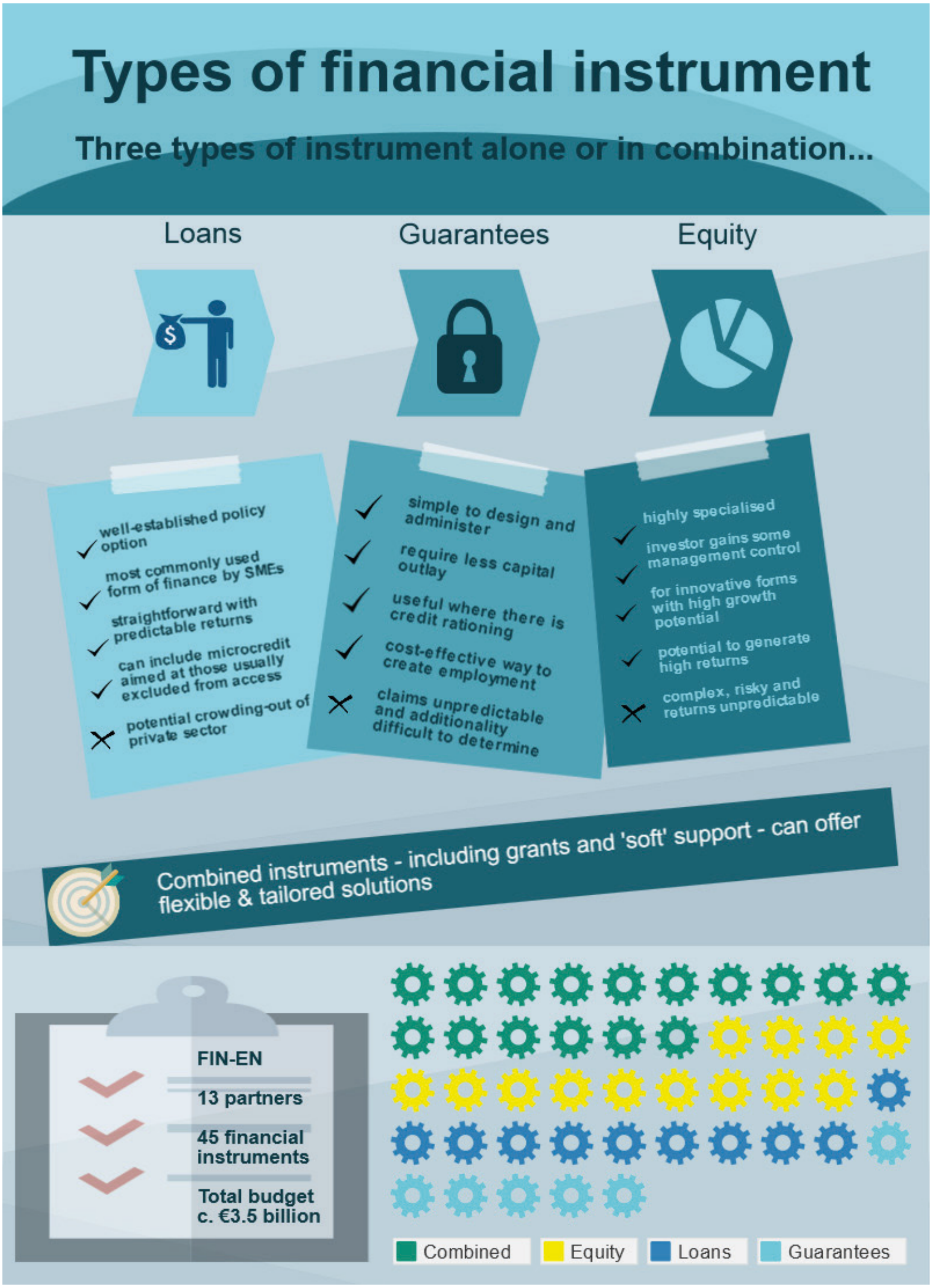
A comprehensive set of definitions and guidance on the implementation of FIs was not available until 2011, four years after the start of the 2007-13 programme period and approval of the General Regulations. The guidance states that:

> *"Equity is the (ordinary) share capital of an enterprise. Typical features of equity capital include an entitlement to the profits of the enterprise, a proportionate share of the proceeds upon liquidation and subordination to creditors."*
>
> *while equity investment: "refers to the acquisition of an equity participation (ownership) in an enterprise (or a start-up enterprise)".*[8]

Although the co-funding of equity instruments by the public sector has gained a higher profile in recent years, equity instruments have been less widely used than other forms of FI under Structural Funds programmes. Equity investment represented a comparatively small proportion of co-financed FIs in 2007-13.

In general, equity financing tends to be used to support innovative firms and business start-ups with high growth potential, but which are subject to a relatively high degree of uncertainty, and therefore risk, in respect of the return on investment and how long it will take to come through.[9]

The frequently regional character and relatively small size of the co-funded equity instruments set up in 2007-13 has been criticised.[10] Also problematic have been issues related to follow-on investments and exits. State aid rules have constrained the capacity for follow-on investments, while, at the same time, the economic climate has reduced the scope for exits from investment. A more general concern has been the difficulty of reconciling the lifespan of equity funds with the programme period duration, especially in the context of often lengthy delays in the setting-up process.


Types of financial instrument
Three types of instrument alone or in combination...
Loans
Guarantees
Equity
$
well-established policy option
most commonly used form of finance by SMEs
straightforward with predictable returns
can include microcredit aimed at those usually excluded from access
potential crowding-out of private sector
simple to design and administer
require less capital outlay
useful where there is credit rationing
cost-effective way to create employment
claims unpredictable and additionality difficult to determine
highly specialised
investor gains some management control
for innovative forms with high growth potential
potential to generate high returns
complex, risky and returns unpredictable
Combined instruments - including grants and 'soft' support - can offer flexible & tailored solutions
FIN-EN
13 partners
45 financial instruments
Total budget c. €3.5 billion
Combined
Equity
Loans
Guarantees

In total, 7 FIN-EN partners operate equity FIs.

MS/REGION	PARTNER	TITLE	HF	BUDGET (M€)	
			Y/N	EU	TOTAL
DE (Hessen)	WIBank	Hessen Kapital I GmbH	N	19.0	38.0
		Mittelhessenfonds GmbH	N	5.0	10.0
ES (Andalusia)	Agency for Innovation & Development of Andalusia	JEREMIE Andalucia Fondo de Capital Riesgo	Y	40.0	75.0
FR (Auvergne)	Regional Council of Auvergne	FCPR Jeremie Innovation 1	Y	10.3	14.4
		FCPR Jeremie Mezzanine 1	Y	2.6	3.7
HU	Ministry for National Economy (formerly National Development Agency)	New Hungary Venture Capital Programmes	Y	147.6	233.4
HU (excluding Central-Hungarian region)	Ministry for National Economy (formerly National Development Agency)	New Szechenyi Venture Capital Programmes - Joint Seed Fund sub-programme	Y	54.6	83.2
		New Szechenyi Venture Capital Programmes - Joint Growth Fund Sub-programme	Y	0	0
UK (North West England)	Department for Communities & Local Government (DCLG)	Biomedical Fund	Y	13.7	27.5
		Development Capital Fund	Y	24.7	49.5
		Energy & Environmental Fund	Y	11.0	22.0
		Digital & Creative Fund		8.2	16.5
		Venture Capital Fund		16.5	33.0
TOTAL				**298.6**	**523**

FIN-EN partners have identified a number of lessons specific to equity instruments:

- Equity instruments have been characterised in an analysis by the network partners as being of low efficiency and high efficacy (where efficiency describes the extent to which time, effort or cost are well used for the intended task or purpose, and efficacy is the capacity to produce an effect).
- Equity can be more appropriate than debt instruments where there is a risk of substitution for bank lending.
- The lowest levels of leverage have been achieved in equity instruments. This is found to be the case especially for seed and early stage instruments. In general, everage maximization in equity is found to be difficult to achieve, especially because when ERDF funding is included, the entire fund must comply with ERDF regulations, whether the ERDF share is 10 percent or 90 percent of the fund total.
- Equity instruments have involved a relatively standard pattern of remuneration, based on the established market standard for private equity (combination of fixed management fee plus carried interest).

- Investment in projects where equity is a suitable instrument, but where the private sector is unwilling to invest alone, will involve an element of risk.

- It is recommended that standardised selection criteria be used for the selection of financial intermediaries for equity instruments. Selection criteria should include:

  - Investment strategy
  - Track record
  - Minimum experience
  - Ability to attract private capital
  - Distribution cascade – determination of timing of returns
  - Management fees.

For 2014-20, the main definitions applying to FIs can be found in different legal bases: the Financial Regulation and its Implementing Rules, the CPR, the ESI Fund-specific regulations, and the applicable State aid framework. In the Financial Regulation setting the rules applicable to the EU budget for 2014-20, two different definitions are set, one for "equity investment" and the other for "quasi-equity investment", the former meaning:

> *“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”; whereas the lat ter concerns “a type of financing that ranks between equity and debt, having a higher risk than senior debt and a lower risk than common equity. Quasi-equity investments can be structured as debt, typically unsecured and subordinated and in some cases convertible into equity, or as preferred equity”.* [11]

The role of equity instruments in different OPs will be determined by the outcomes of the ex ante assessment, which will assess to what extent they can be designed to fill a gap in the market.
The ESIF 2014-20 regulations imply some specific changes for equity-based instruments, including special provisions with regard to eligible expenditure, while maximum thresholds for fees and costs are set out in the Delegated Act. A further key area of change concerns State aid compliance, where there are more changes in respect of equity than for other types of instrument.

Loans

Loans are the most widely used form of finance by SMEs. The provision of loans (and the accompanying loan guarantees) by the public sector to fill an identified market gap is a well-established policy option in a number of Member States and loans have been used for several decades in, for example, Austria, Germany, Finland and Sweden.
The use of micro-finance is also widespread, often with a social inclusion aspect, with a focus on the long-term unemployed and on disadvantaged areas.

According to the Commission's summary report for 2013, the number of co-financed loans offered up to the end of 2012 was 38,501, accounting for 47 percent of the value of OP funds committed.[12] In total, 7 FIN-EN partners operate loan-type FIs. In an analysis carried out by the FIN-EN network, loan instruments were characterised by high efficiency and low efficacy (where efficiency describes the extent to which time, effort or cost are well used for the intended task or purpose and efficacy is the capacity to produce an effect). The main reported burdens for beneficiaries are red tape and the collateral required.

MS/REGION	PARTNER	TITLE	HF	BUDGET (M€)	
			Y/N	EU	TOTAL
FR (Auvergne)	Bulgarian Development Bank	First Loss Portfolio Guarantee Financial Instrument	Y	66.6	78.4
HU	Ministry for National Economy (formerly National Development Agency)	New Széchenyi Loan Programme	Y	181.2	229.4
		New Hungary SME Loan Programme	Y	15.2	35.8
		New Hungary Working Capital Loan Programme	Y	12.6	28.6
LT	Invega	Small credits	Y	27.5	27.5
		Open Credit Fund	Y	43.4	57.9
IT (Lombardia)	Finlombarda SpA	Fondo di Rotazione per l'Imprenditorialità FESR	N	13.9	35.0
LV	(Hipoteku banka) Altum banka	ERDF Promotional Programme for improvement of Competitiveness of Entrepreneurs (Nr.X399/2009)	N	54.6	83.2
SI	SID Bank, Slovenia	The development-promotional programme for financing of technological projects 2011 - 2013	N	N/A	150.0
UK (North West England)	Department for Communities and Local Government (DCLG)	Business Loans Fund	Y	19.2	38.5
TOTAL				**371.5**	**691.3**

As noted elsewhere, the role for loans in the implementation of the various OPs will be decided on the basis of the ex ante assessment. The European Commission proposals for 'off-the-shelf' instruments include a risk-sharing loan with subsidised rates for SMEs. This falls within the de minimis ceilings for beneficiaries and provides no aid for intermediaries, provided certain conditions are met (including market rate remuneration and pari passu risk sharing). Notwithstanding the availability of off-the-shelf instruments, the ESIF 2014-20 regulations imply some limited changes for loan instruments, with specific management fees and cost maxima outlined in the Delegated Regulation.

11. Regulation (EU, EURATOM) no 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 in EUJ L298/1 issued 26.10.2012.
12. European Commission (2013) Op cit.

Guarantees

Guarantee funds provide support to companies unable to obtain finance, typically debt finance, due to a lack of collateral. Guarantee funds (and cross or counter-guarantee funds that provide support to intermediaries providing guarantee funds) are an important source of support for new businesses.
The guarantee is the most common form of co-financed FI, with 96,989 having been committed for disbursed loans and other risk-bearing instruments by the end of 2012. The average commitment per guarantee for one loan disbursed to the final recipient is €20,000. Note that guarantees funds are only disbursed when there is a default on the associated loan. By the end of 2012, there were 128 Structural Funds-supported funds offering guarantees.[13]

Only four FIN-EN partners reported using guarantee instruments in 2007-13.

MS/REGION	PARTNER	TITLE	HF	BUDGET (M€)	
			Y/N	EU	TOTAL
BG (through EAPB)	Bulgarian Development Bank	First Loss Portfolio Guarantee Financial Instrument	Y	66.6	78.4
HU	Ministry for National Economy (formerly National Development Agency)	New Széchenyi Credit Guarantee	Y	40.0	47.1
		New Széchenyi Counter-Guarantee Programme	Y	161.2	189.6
IT (Lombardy)	Finlombarda SpA	Joint European Resources for Micro to Medium Enterprises	Y	7.9	24.0
		Made in Lombardy	N	13.1	33.0
LT	Invega	Guarantee Fund	N	37.4	37.4
TOTAL				**326.2**	**409.5**

In an analysis by the FIN-EN network partners, guarantee instruments were characterised by high efficiency and low efficacy (where efficiency describes the extent to which time, effort or cost are well used for the intended task or purpose and efficacy is the capacity to produce an effect). There were some doubts expressed about the effectiveness of guarantees, and it was not considered to be clear that guarantees alter the investment decision, rather than simply lowering the risk to the lender. Also, in the context of the economic crisis, guarantees have been found to be of limited use because of the lack of liquidity. However, the highest levels of leverage have been achieved in guarantee instruments.[14]

13. European Commission (2013) Op cit.
14. FIN-EN Thematic Working Group Report 2 notes some concerns that this data may be misleading, due to the above-mentioned questions of whether guarantees just lower the risk to the lender rather than alter the investment decision.

The ex ante assessment guidelines provide more detailed recommendations with regard to guarantees. These relate to the need to estimate in advance expected and unexpected losses, the need to put a cap on liability of the funds and the likely premium that will be required by a financial intermediary to accept such a cap on liabilities. Additional costs to financial intermediaries of operating unfunded instruments can include (possibly substantial) administration costs and the amount of capital underpinning required by the relevant regulations. Several further suggestions are made:

- financial intermediaries should retain at least 20 percent of the risk to align their interest with those of the managing authority; and
- a specific risk assessment for guarantees in addition to the general ex-ante assessment should be carried out to assess the leverage of the funded products.

The ex ante assessment guidelines suggest that a prudent approach to risk assessment will result in unfunded instruments such as guarantees not showing advantages over funded instruments such as loans, and a careful check of whether a funded product could deliver the same objective instead is recommended. If not, the managing authority should set a maximum amount of the guarantees significantly smaller than the total volume of the FI, and identify possible partners such as financial institutions with relevant own risk-bearing capacities such as commercial or promotional banks or private mezzanine and loan funds.

The European Commission proposals for off-the-shelf instruments include a guarantee fund for SMEs (capped portfolio guarantee). From a State aid perspective, this falls within ***the de minimis ceiling*** for beneficiaries and offers no aid to financial intermediaries, provided certain conditions are met.

The off-the-shelf instrument aside, the new regulations imply some specific changes in respect of guarantees. In particular, the Delegated Act 480/2014 includes specific requirements with regard to guarantees.

Combined Financial Instruments

Combined FIs are the most popular type of financial instrument among FIN-EN partners. Altogether 16 combined instruments were reported by 10 partners. This covers a wide range of combinations, not only of FIs with grants, but more commonly different types of FIs together (equity and quasi equity, loans and guarantees, as well as guarantee fee and interest rate subsidies, equity and loans and FIs with 'soft support' such as training and consultancy). Among FIN-EN partners, combined instruments are found to be very attractive, but complex to implement due to regulatory and operational issues, and their State aid status is often unclear. Loan and grant procedures can be difficult to coordinate.

MS/REGION	PARTNER	TITLE	HF	BUDGET (M€)	
			Y/N	EU	TOTAL
BG (through EAPB)	Bulgarian Development Bank	Risk Capital Fund(s) Financial Instrument	Y	17.8	30.0
		Bulgarian Development Bank	Y	0	0
		Mezzanine Fund(s) Financial Instrument	Y	0	0
		Entrepreneurship, Acceleration and Seed Financing Instrument	Y	0	0
		JEREMIE funded financial instrument with an embedded risk sharing	Y	0	0
DE (Berlin through EAPB)	Investitionsbank (IBB), Berlin	KMU-Fonds Berlin (SME-Fund Berlin) / Berlin Kapital	N	50.0	100.0
DK (Central Denmark Region)	Central Denmark Region	Midtjysk Iværksætterfond	N	6.7	13.42
ES (Andalusia)	Agency for Innovation & Development of Andalusia	JEREMIE Fondo Multiinstrumento	Y	148.0	185.0
GR	ETEAN SA	Fund for entrepreneurship - loan fund, fund for entrepreneurship - guarantee fund	Y	386.5	1,060.0
HU	Ministry for National Economy (formerly National Development Agency)	Combined micro-credit	Y	60.7	78.5
IT (Lombardy)	Finlombarda SpA	Joint European Resources for Micro to Medium Enterprises	Y	8.5	37.5
LT	Invega	Entrepreneurship Promotion Fund	Y	14.5	15.8
LV	(Hipoteku banka) Altum banka	ESF programme "Support to Self-employment and Business Start-ups"	N	17.3	32.8
PT (North, Center, Alentejo)	MA Compete	Venture Capital Funds	Y	118.0	211.0
		Credit lines combined with Guarantees	Y	107.9	154.2
		Business Angels Program	Y	27.0	44.0
TOTAL				**962.9**	**1962.22**

Combined instruments can be one way of trying to introduce flexibility to FI implementation. The need for flexibility during the programme period has been a key issue among FIN-EN partners and this is expected to continue to be the case in 2014-20.
The EIB stocktaking report identified that in the majority (66 percent) of reported cases where market conditions changed, this led to different products being introduced as part of the portfolio of FIs, for example, through the introduction of an equity scheme in addition to loan funds, or increases in the provision of both.[15]

State aid approaches used for combined instruments among FIN-EN partners include: no aid (three out of 16); use of de minimis (nine out of 16); and use of GBER (four out of 16, two of which were not only exempted but also notified).

The new regulations contain clear rules to enable better combination of financial instruments with other forms of support, in particular with grants. The Commission's view is that combining funds from different sources in one FI can help achieve critical mass and economies of scale as well as cover a wider spectrum of policy objectives.
For the combination of FIs with grants or other assistance from ESI Funds, there are two possibilities:

- certain types of grants (interest rate subsidy, guarantee fee subsidy or technical support as specified in the Delegated Act) and financial products can be combined within the same operation and can be treated as a financial instrument.
- the grant operation and financial instrument operation support can be combined to finance the same investment at the level of final recipient as separate operations.

The same expenditure cannot be declared twice to the Commission, grants must not be used to reimburse support received from FIs, and FIs must not be used to pre-finance grants. Separate records must be maintained for each source of assistance.

15. Van Ginkel et al (2013) Op cit.

Shared experience of financial instruments ......

Financial instruments are not only for ERDF...

Micro-credits are used to support cooperatives under European Social Fund (ESF)

Finlombarda

Enalio Guarantee Fund financed through the European Fisheries Fund (EFF)

ETEAN

Combining financial instruments can improve impact...

A combined ESF FI offers loans/equity plus a business coaching programme (the Accelerator programme). Companies completing the programme apply for investment capital

midt

The New Szechenyi Combined Micro Loan programme combines loans and grants: approved borrowers can qualify for non-reimbursable support.

ESF Start Programme combines loans and grants with consultancy and training in management, accounting and marketing.

altum

Innovative financial instrument design...

The IN2:BA – Business Angels Co-investment schemes aim to address market failure and sub-optimal investment situations for early stage businesses. The selection of investors on a deal-by-deal basis and the asymmetric distribution of earnings is popular within the Business Angel community.

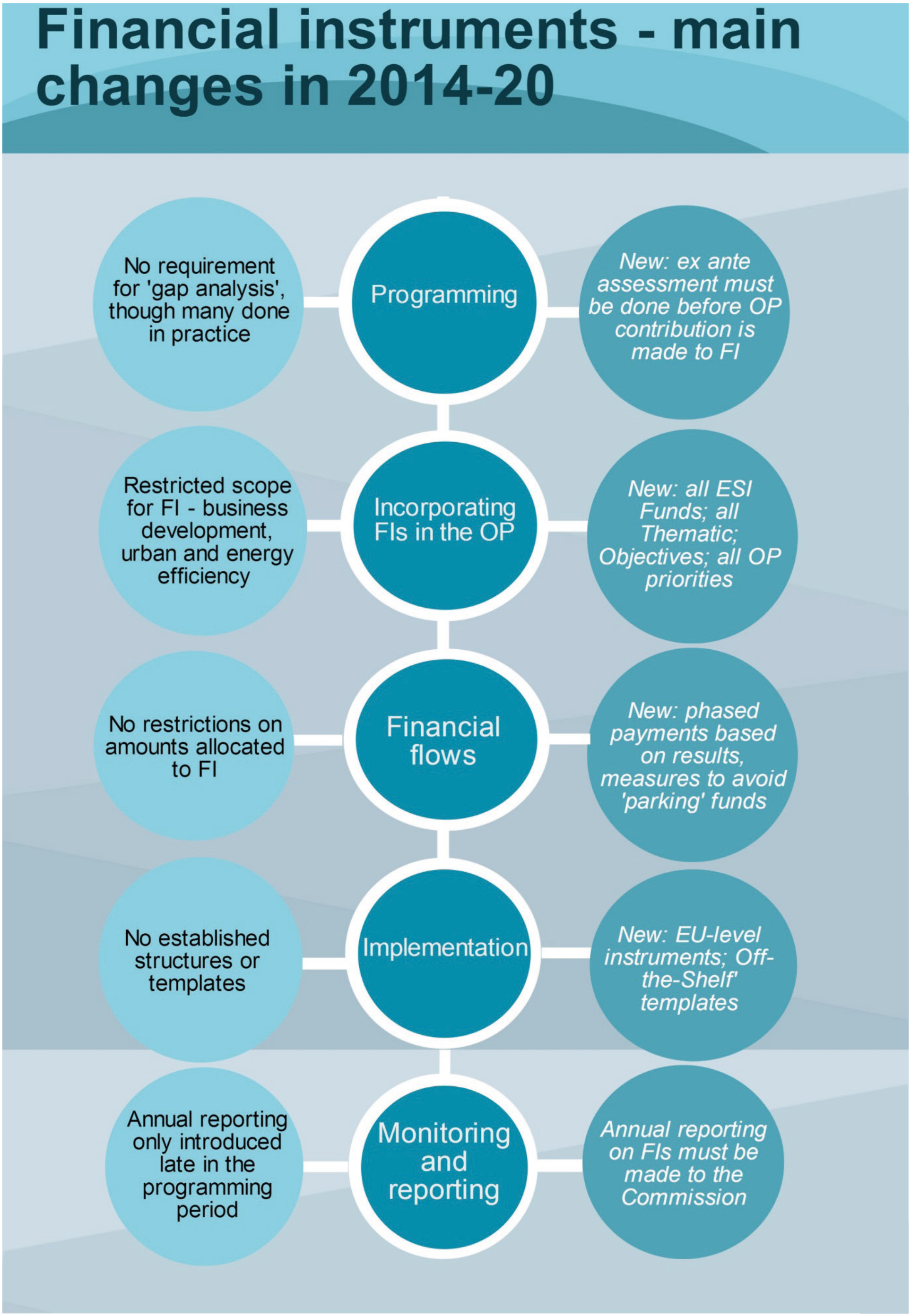
COMPETE

JEREMIE Fondo Multiinstrumento offers flexibility by using a variety of financial instruments (equity capital, mezzanine funding, loans, convertible loans, guarantees) to offer a tailor-made solutions for expanding early stage companies.

PERSPECTIVES FOR THE FUTURE

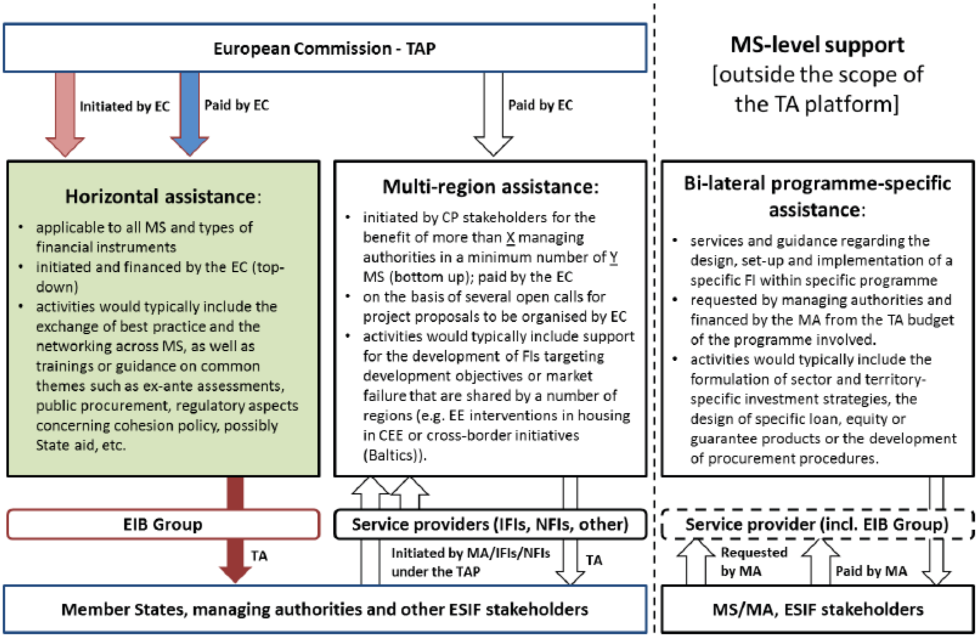
The new regulations introduce greater clarity and certainty on the use of FIs under Structural Funds programmes in 2014-20. Managing authorities, financial intermediaries and fund managers have built up considerable expertise over the last few years. However, challenges and areas of uncertainty remain. There are new provisions that must be adhered to in the regulations, particularly relating to monitoring and reporting, FIs must be adapted to the new State aid requirements, and there is increased pressure on all projects and instruments funded under ESI Funds to be able to demonstrate the impact they have achieved.
FIN-EN partners have discussed many of these issues and shared possible solutions, such as how to ensure flexibility and the ability to adapt FIs to changing market conditions, how to combine different instruments to produce successful levels of outputs while still being able to address niche markets, combining instruments to ensure sustainability of the FI portfolio, effective means of monitoring, and how to communicate FI achievements to a wider audience.

Further challenges have been identified by partners - finding effective ways to incentivise fund managers while ensuring value for money, ensuring effective leverage and involving the private sector to a greater degree, and calculating the leverage effect.
In this regard, the FIN-EN partners would welcome common provisions at EU level to calculate leverage effect, providing a common standard allowing reliable benchmarking and comparisons between regions. A further question, which may only be addressed towards the end of the 2014-20 period, is how the new off-the-shelf proposals will compare to the tailor-made instruments which have been in operation in 2007-13.


Financial instruments - main changes in 2014-20
No requirement for 'gap analysis', though many done in practice
Programming
New: ex ante assessment must be done before OP contribution is made to FI
Restricted scope for FI - business development, urban and energy efficiency
Incorporating FIs in the OP
New: all ESI Funds; all Thematic; Objectives; all OP priorities
No restrictions on amounts allocated to FI
Financial flows
New: phased payments based on results, measures to avoid 'parking' funds
No established structures or templates
Implementation
New: EU-level instruments; Off-the-Shelf' templates
Annual reporting only introduced late in the programming period
Monitoring and reporting
Annual reporting on FIs must be made to the Commission

The continued need for support and Technical Assistance in the area of FI is clear. In recognition of this, the Commission has launched a new technical assistance platform (TAP) to provide common and fund-specific support related to FIs.
Alongside this support, managing authorities may wish to allocate dedicated Technical Assistance to supporting FI design and implementation. As a capacity-building network, FIN-EN has been greatly valued by its partners since its inception in 2012, and discussions amongst peers has allowed learning, capacity building and exchange of ideas to take place. The TAP seems set to provide a useful mechanism for addressing many of the issues facing those implementing and managing FI. FIN-EN is a powerful and qualitative complement to this EU-wide initiative. Based on a comparatively small number of diverse partners who have come to know one another well, FIN-EN provides the basis for more fine-grained analysis and learning and the transfer of best practice between partners and beyond.

Horizontal, multi-region and bilateral assistance under the Technical Assistance Platform



Source: Horizontal Advisory Services for the use of ESIF FIs in the 2014-20 Programming Period Terms of Reference

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FIN-EN PARTNERS

BELGIUM
European Association of Public Banks A.I.S.B.L.
Avenue de la Joyeuse Entrée/Blijde Inkomstlaan 1-5
1040 Brussels
Belgium
Tel : +32 (0)2 286 90 65
Fax : +32 (0)2 231 03 47
E-mail : info@eapb.eu
Website : www.eapb.eu
Contact Person : Elke Nass Tønnessen

LATVIA
VAS "Latvijas Attīstības finanšu institūcija Altum"
Doma laukums 4
LV 1977 Riga
Latvia
Tel : +371 6777 4332
E-mail : Andrejs.Buharins@altum.lv
Website : www.hipo.lv/en
Contact Person: Andrejs Buharins

DENMARK
Central Denmark Region
Skottenborg 26
DK-8800 Viborg
Denmark
Tel : +45 7841 1532
Fax : +45 7841 0001
E-mail: jens.kjersgaard@ru.rm.dk
Website : www.rm.dk
Contact Person: Jens Kastrup Kjersgaard

LITHUANIA
UAB "Investicijų ir verslo garantijos" (INVEGA)
Konstitucijos av. 7
09308 Vilnius
Lithuania
Tel : +370 5 210 0601
Fax : +370 5 210 7511
E-mail : Fin_en@invega.lt
Website : www.invega.lt
Contact Person: Viktorija Vaitkevičienė

FRANCE
Regional Council of Auvergne
13-15 avenue de Fontmaure BP60,
63402 Chamalières Cedex
France
Tel : +33 (0) 473 31 81 40
Fax : +33 (0) 473 36 86 02
E-mail : c.legrand@cr-auvergne.fr
Websites : www.auvergne.org
: www.auvergnecentrelimousin.eu
: www.jeremie-auvergne.eu
Contact Person: Charlotte Legrand

PORTUGAL
Autoridade de Gestão do COMPETE
Programa Operacional Factores de Competitividade
Edifício Expo 98, Av. D.João II, Lote 1.07.2.1 - 3° Piso
1998-014 Lisboa
Portugal
Tel : +351 211 548 700
Fax : + 351 211 548 799
E-mail : info@compete-pofc.org
Website : www.pofc.qren.pt
Contact Person: Francisco Nunes

ITALY
Finlombarda S.P.A.
Via Taramelli 12
20124 Milan, Italy
Tel : +39 02 76 04 41
Fax : +39 02 78 08 19
E-mail : fin-en@finlombarda.it
Website : www.finlombarda.it
Contact Person: Antonella Pisano

GERMANY
Wirtschafts- und Infrastrukturbank Hessen
rechtlich unselbstständige Anstalt in der Landesbank
Hessen-Thüringen Girozentrale
Strahlenbergerstraße 11
63067 Offenbach am Main
Germany
Tel : +49 69 9132-03
Fax : +49 69 9132-4636
E-mail : info@wibank.de
Website : www.wibank.de
Contact Person: Cornelia Gester/Patrick Schlupp

SPAIN
Agencia de Innovacion Y Desarrollo de Andalucia
C/ Torneo, n° 26,
41002 Sevilla
Spain
Tel : + 34 955 039 842
Fax : + 34 955 039 846
E-mail : csillero@agenciaidea.es
Website : www.agenciaidea.es
Contact Person: Carmen Sillero Illanes
International Programmes Head of Unit

GREECE
Hellenic Fund for Entrepreneurship and Development SA
(ETEAN SA)
24 Xenias,
11528 Athens
Greece
Tel : +30 210 7450400
Fax : +30 210 7450500
E-mail : info@etean.com.gr
Website : www.etean.com.gr
Contact Person: Evangelia Stavrinaki

SLOVENIA
SID – Slovenska izvozna in razvojna banka,d.d., Ljubljana.
(SID Bank)
Josipine Turnograjske 6
SI - 1000, Ljubljana
Slovania
Tel : +386 1 2007 500
Fax : +386 1 2007 575
E-mail : nejc.dvoracek@sid.si
Website : www.sid.si
Contact Person: Nejc Dvoraček

HUNGARY
Ministry for National Economy
Wesselényi U. 20-22,
H-1077 Budapest
Tel : +36 1 474 9498
Fax : +36 1 474 9441
E-mail : koranyi.daniella@ngm.gov.hu
Website : www.szechenyi2020.hu
Contact Person: Daniella KorÁnyi

UNITED KINGDOM
North West Competitiveness
Operational Programme NWOP, DCLG
2007-13, Department for
Communities and Local Government
Arpley House, 110 Birchwood Boulevard
Warrington, WA3 7QH
United Kingdom
Tel : +44 (0)303 444 6520
E-mail : nw.erdfenquiries@communities.gsi.gov.uk
Website : www.communities.gov.uk/erdf
Contact Person: David Read