BETWEEN SCYLLA AND CHARYBDIS:
NAVIGATING FINANCIAL ENGINEERING INSTRUMENTS THROUGH
STRUCTURAL FUNDS AND STATE AID REQUIREMENTS

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Structural Funds Programme Management
Through Exchange of Experience

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PREFACE

The research for this paper was undertaken by EPRC in preparation for the 31st IQ-Net meeting held in Aachen, Germany on 7-9 December 2011. The paper was written by Rona Michie and Fiona Wishlade.

The paper is the product of desk research and fieldwork visits during Autumn 2011 to national and regional authorities in EU Member States (notably partners in the IQ-Net Consortium). The field research team comprised:

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**Austria**
- State Government of Niederösterreich (Lower Austria), Economic and Tourism Department
- State Government of Steiermark (Styria), Economic Policy Department

**Belgium**
- Enterprise Flanders Agency

**Czech Republic**
- Ministry for Regional Development
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Denmark
- Danish Enterprise and Construction Authority

Finland
- Alliance of Länsi-Suomi (Western Finland) and the Ministry of Employment and the Economy

France
- Délégation interministérielle à l’aménagement du territoire et à l’attractivité régionale (DATAR, Interministerial Delegation of Territorial Development and Regional Attractiveness)

Germany
- Nordrhein-Westfalen (North Rhine-Westphalia), Ministry of Economy, SMEs and Energy, EU Affairs Unit
- Sachsen-Anhalt (Saxony-Anhalt), Ministry of Finance

Greece
- Management Organisation Unit of Development Programmes S.A.

Hungary
- Hungarian Enterprise Development Centre (MAG), in association with the National Development Agency (NDA)

Italy
- Ministry of Economic Development and Promuovi Italia SpA

Latvia
- Ministry of Environmental Protection & Regional Development, in association with the State Regional Development Agency

Poland
- Śląskie Voivodeship (Marshal’s Office of Silesia)

Portugal
- Financial Institute for Regional Development (IFDR)

Spain
- País Vasco (Basque Country), Provincial Council of Bizkaia, Department of Economy and Finance

Slovenia
- Government Office for Local Self-Government and Regional Policy, EU Cohesion Policy Department

Sweden
- Tillväxtverket, Swedish Agency for Economic and Regional Growth

United Kingdom
- Department of Communities and Local Government
- Scottish Government
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• Welsh European Funding Office

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Disclaimer

It should be noted that the content and conclusions of this paper do not necessarily represent the views of individual members of the IQ-Net Consortium.
EXECUTIVE SUMMARY

The increased use of non-grant financial instruments in Cohesion policy programmes over the last few programme periods, which is predicted to continue into the next period, has been described by Commissioner Johannes Hahn as a ‘profound cultural shift’. Managing authorities have been setting up and implementing complex co-funded financial instruments in an uncertain economic climate, often facing a steep learning curve.

Financial engineering instruments (FEIs) can play an important role in the delivery of policy objectives. Their purpose is to enable public sector capital to be used on a commercial basis (e.g. through holding funds, venture capital funds, loan funds and guarantee fund mechanisms) and, in some cases, to stimulate the participation of private sector capital in order to increase the scale, effectiveness and efficiency of policy measures. They have three important attributes: they increase the sustainability of public investment; they have a leverage effect; and they enable policymakers to make use of private sector skills and expertise.

The use of non-grant financial instruments has risen in prominence under Cohesion policy programmes over successive programme periods, from €570 million under ERDF in 1994-99, to €1.3 billion in 2000-06. There has been heightened interest in the 2007-13 period with the launch of the Jeremie and Jessica initiatives at EU level, and the use of non-grant financial instruments looks to continue to play an important role in programme implementation in future periods.

The IQ-Net partners represent a diverse range of operational programmes in terms of size, and the proportion of OP funds spent on FEIs varies substantially, reflecting factors such as the national/regional context, size of OP, national and regional priorities, and existing domestic provision. The paper takes a case study approach, focusing on one fund in each partner programme.

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1 Johannes Hahn (November 2010) Keynote address to the conference JEREMIE and JESSICA: Towards successful implementation, 29-30 November 2010, Brussels.
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The FEIs covered are of two main kinds - those which support SMEs and those which support urban development.

Support for SMEs

The Jeremie-type funds included in the case studies are located in the IQ-Net partner programmes in France (Languedoc-Roussillon), Greece, Hungary, Latvia (although not in the programme managed by the IQ-Net partner)\(^2\), Spain (although not in País Vasco), Slovenia (where the Slovene Enterprise Fund runs a holding fund similar to Jeremie) and Wales. A wide range of different types of instrument can be provided under the framework of Jeremie (or Jeremie-type) initiatives, including the provision of equity finance (risk capital, seed capital, start-up capital) and debt finance i.e. loans and guarantees. In addition to the Jeremie or Jeremie-type initiatives, a number of ‘own-initiative’ financial instruments providing support for SMEs in IQ-Net partner programmes have been included in the research. These include: loan funds in Denmark, Finland, Germany (Nordrhein-Westfalen and Sachsen-Anhalt), Italy and Śląskie (Poland); a guarantee fund for SMEs in Italy; and regional co-investment/venture capital funds in France (Aquitaine), Sweden and Scotland.

In addition to the existence of an identified gap in the availability of finance for SMEs, IQ-Net partners described a wide range of reasons for supporting SME growth in their programme areas through the use of non-grant instruments. Setting up FEIs has often been found to be a laborious and lengthy process, particularly for the complex Jeremie initiatives. The size of the Cohesion policy programme, the domestic legislative and financial context and existing domestic expertise were all important determinants of how IQ-Net partners chose to set up FEIs to support SMEs under their programmes. Similar factors came into play when choosing a holding fund manager - some partners have already built up considerable domestic experience, and there were mixed feelings about the role the EIF has played. In terms of experience with implementation, the economic crisis is having a serious negative effect on the implementation rate of FEIs in many programmes (although not all).

Urban regeneration

The paper included the experience of five of IQ-Net partners in launching Jessica initiatives - in the Czech Republic (under the ROP Moravia-Silesia), England (London), Śląskie (Poland), Portugal (a joint initiative under the NOP Territorial Enhancement and the ROPs Norte, Centro, Lisbon, Alentejo, Algarve) and Wales. Again, the preparation process from first expression of interest to launch of Urban Development Funds has been lengthy for all the Jessica case study funds. As in the case of Jeremie, different structures are possible. In the

\(^2\) In Latvia, FEIs are supported under the OP for Entrepreneurship and Innovations, while the IQ-Net partner (the MoEPRD) is involved in implementation of the OP for Infrastructure and Services.
case studies, the EIB has been chosen to act as holding fund manager in all except Wales, where there is no holding fund. Most of the case study UDFs funded under Jessica are at an early stage of implementation, so have not yet invested in any projects.\(^3\) Indeed, 2012 is described by the EIF as the Jessica ‘investing phase’.\(^4\)

**Assessment**

The administrative complexities associated with EU co-financed FEIs are a major concern for partners. The set-up and operation of FEIs is administratively very complex, and requires detailed knowledge of Structural Funds regulations, State aid compliance and investment principles. The various parties involved often lack expertise in more than one of the three policy spheres concerned. Through the Jeremie and Jessica Networking Platforms launched in 2009, DG REGIO (in cooperation with the EIF and EIB) has supported the exchange of experience and best practice in implementation of these FEIs. Member States have also organised conferences and seminars to exchange information. While these various initiatives have proved useful, there is widespread frustration that many of the detailed implementation rules were not clearly established before the start of the programme. Moreover, uncertainties persist in many areas: concerns remain about how the recycling of funding will work on a practical level, about the mis-match between the Structural Funds Regulations and FEIs in terms of timing, about measuring impact and about incorporation of the horizontal objectives of sustainable development and equal opportunities.

The goals of the various parties involved in implementing FEIs may not necessarily coincide. There is potential for tension between the complex range of managing authority goals and the profit-oriented focus of private sector fund managers. This may be seen for example in relation to attitudes towards risky or innovative projects, with managing authorities typically seeking to support innovative projects and private fund managers seeing these as potentially undermining profit.

In terms of the regulatory proposals for the 2014-2020 period, the draft proposals build on previous COCOF guidance and provide managing authorities with more legal certainty. However, a number of these proposals also raise issues, especially regarding timely spending and increased reporting requirements.

In addition, State aid compliance remains a major issue. In a past IQ-Net paper, one partner cited the relationship between Jeremie and the State aid rules as being symptomatic of a ‘serious dysfunction’ in the Commission, while another noted that coordination between DG

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\(^3\) The JESSICA initiative in Wielkopolska Vovoidship (Poland) agreed its first urban project in May 2011 and by October 2011 had approved four projects. The other four Polish JESSICA funds are not yet at this stage.

\(^4\) Carbonaro G (2011) Guiding the design and implementation of JESSICA operations, presentation to the 3\(^{rd}\) Annual Conference of JEREMIE and JESSICA, Warsaw 20 October 2011.
REGIO and DG COMP had been particularly poor with respect to financial engineering. The extent to which State aid issues continue to cause concern partly reflects the information asymmetries but also the absence of a single coherent State aid framework for considering FEI, leading to a highly fragmented approach with relevant constraints and parameters spread across a range of documents. It remains to be seen to what extent the landmark decision in Jessica UK (NW England) will prove a useful precedent for other managing authorities. If at the level of the Commission, the current rules are ill-adapted, if can also be argued that many managing authorities have been ill-prepared and may have given insufficient thought to State aid considerations at an early enough stage in the process.

Managing authorities feel under pressure to increase the proportion of their programmes spent on FEIs in future programme periods. However, they may not be suitable for all programmes. In particular, given the administrative burden (and expertise) involved in setting-up such structures, they are likely to be viewed as less useful in small programmes and in sparsely-populated areas where there are both few SMEs and a less well-developed capital market. In addition, the impact of the current economic crisis may mean that the capacity of financial engineering instruments either to leverage in private sector funding or to incentivise SME investment may prove to be limited.
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### GLOSSARY

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<th>Term</th>
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<tr>
<td>Business angel</td>
<td>A wealthy private individual who invests directly in new and growing unquoted businesses and provides them with advice.</td>
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<tr>
<td>Counter guarantees</td>
<td>An instrument that provides cover for third party (financial intermediaries) potential portfolio losses.</td>
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<tr>
<td>Debt</td>
<td>Loans and other funding instruments that provide the investor with mostly fixed minimum return and are at least partly secured.</td>
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<tr>
<td>Early stage capital</td>
<td>Financing to firms before they initiate commercial manufacturing and sales, before they generate a profit. Includes seed and start-up financing.</td>
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<tr>
<td>Equity</td>
<td>Ownership interest in a company, represented by the shares issued to investors.</td>
</tr>
<tr>
<td>Equity gap</td>
<td>When there is a persistent capital market imperfection preventing supply from meeting demand at a price acceptable to both sides.</td>
</tr>
<tr>
<td>Exit strategy</td>
<td>A strategy for the liquidation of holdings by a venture capital or private equity fund according to a plan to achieve maximum return.</td>
</tr>
<tr>
<td>Expansion capital</td>
<td>Financing provided for the growth and expansion of a company for the purposes of increasing production capacity, market or product development or the provision of additional working capital.</td>
</tr>
<tr>
<td>Fund of funds</td>
<td>A fund that invests in other (venture capital or private equity) funds.</td>
</tr>
<tr>
<td>Guarantees</td>
<td>An instrument that covers potential losses on</td>
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<table>
<thead>
<tr>
<th>Financial Engineering Instrument</th>
<th>Description</th>
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<tr>
<td>Mezzanine finance</td>
<td>Type of external loan funding which fits between standard bank lending and equity investment. Generally in the form of repayable debt capital, but with options to convert to equity.</td>
</tr>
<tr>
<td>Micro loans</td>
<td>Unsecured loans in modest amounts targeted at individuals seeking to set-up or expand existing micro businesses</td>
</tr>
<tr>
<td>Pari passu</td>
<td>Relates to both making investments and how returns are attributed to investors. For making investments, where the funds provided in advance by each co-investor and/or lender to the venture capital or loan fund are drawn down in exact proportion to finance individual investments in and/or loans for SMEs. For fund returns, where they are attributed to the co-financing partners without subordination in respect of any particular co-investors and/or lenders.</td>
</tr>
<tr>
<td>Risk capital</td>
<td>Equity financing provided to companies in their start-up and development phases.</td>
</tr>
<tr>
<td>Seed capital</td>
<td>Financing provided to study, assess and develop an initial concept. Precedes that start-up phase.</td>
</tr>
<tr>
<td>Start-up capital</td>
<td>Provided to companies for product development and initial marketing.</td>
</tr>
<tr>
<td>Venture capital</td>
<td>Investment in unquoted companies by venture capital firms.</td>
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1. INTRODUCTION

The increased use of non-grant financial instruments in Cohesion policy programmes over the last few programme periods, also predicted to continue into the next period, has been described by Commissioner Johannes Hahn as a 'profound cultural shift'. Managing authorities have been setting up and implementing complex co-funded financial instruments in an uncertain economic climate, often facing a steep learning curve.

The aim of this paper is to examine how non-grant financial instruments are being used within the Cohesion policy programmes of the IQ-Net partners, including use of the ‘financial engineering instruments’ Jeremie and Jessica. The paper provides a comparative overview of how these non-grant financial instruments are being used in IQ-Net partner programmes, following up on a brief review provided in a previous IQ-Net Paper in June 2011. In doing so, it explores whether partners have encountered challenges, how these were resolved, and whether there have been compatibility issues, such as State aids. A case study approach has been taken, focusing on one fund in each partner programme.

The paper draws on a mix of desk research and interviews with staff working on the implementation of Structural Funds programmes in the 17 Member States where managing authorities and programme secretariats are partners in IQ-Net. The surveyed programmes collectively account for more than a third of Cohesion policy spending and encompass a mix of Convergence, Regional Competitiveness & Employment, and Phasing-In/Out regions. The desk-based research has focused on EU-level and programme documents and the academic and policy literatures. Interviews were conducted with managing authorities, programme secretariats and national coordination bodies and also with officials from the European Commission (DG REGIO and DG COMP).

Policymakers and academics have used differing terminology for discussing this issue, including non-grant financial instruments, financial engineering instruments, and repayable financial instruments. The Commission increasingly refers to ‘financial instruments’. Nevertheless, this paper uses the term ‘financial engineering instruments (abbreviated as FEI)’, primarily to make it clear that the discussion is focusing on non-grant instruments.

Many IQ-Net programmes are experimenting with the use of financial engineering instruments (FEIs) for the first time during this programme period, certainly on a large scale. However, several have used FEIs in one form or another during previous periods, and using ERDF to co-fund FEIs is now an established policy option in the programmes of many IQ-Net partners (Nordrhein-Westfalen and Sachsen-Anhalt (Germany), Slovenia, Śląskie (Poland), Denmark, Spain (although not in País Vasco), France, Scotland, England and Wales). The IQ-Net partner case studies discussed in this report are as follows:

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### Jeremie/Jeremie-type:
- Jeremie France - Languedoc-Rousillon: loans, guarantees, co-investment
- Jeremie Greece
- Jeremie Latvia: Loan instruments (2), risk capital, seed capital, start-up capital
- Slovenia: guarantees and counter guarantees, mezzanine and venture capital
- Jeremie Spain (National OP Technology Fund): venture capital, ‘multi-instrument’
- Jeremie Wales

### Loan Funds:
- Italy - Revolving Fund for SMEs
- Finland - Finnvera loans
- Nordrhein-Westfalen, Germany - NRW/EU Micro Loan Fund
- North Denmark Loan Fund
- Sachsen-Anhalt, Germany - SME Loan Fund
- Śląskie, Poland - Micro-loan fund for unemployed people (ESF)

### Guarantee Funds:
- Italy - Guarantee Fund for SMEs - NOP Reserve

### Co-investment Funds:
- France - Aquitaine Co-Investment Fund
- Scotland - Scottish Co-Investment Fund
- Sweden - regional venture capital funds

### Jessica initiatives:
- Moravia-Silesia, Czech Republic
- London, England
- Portugal
- Śląskie, Poland
- Wales

The programmes in the IQ-Net partner regions of Vlaanderen (Belgium) and in Steiermark and Niederösterreich (Austria) do not currently co-fund FEIs under their Structural Funds programmes.

The remainder of this paper is structured as follows: Section 2 introduces the use of financial instruments as a policy tool; Section 3 then looks in greater detail at the case of Cohesion policy, and the use of FEIs within Structural Funds programmes. It provides an overview of the use of FEIs under ERDF, and then gives a brief overview of the use of FEIs within IQ-Net partner programmes. Sections 4 and 5 examine the experience of IQ-Net partners with setting-up and implementing FEIs under their programmes, to support SME development and urban development respectively. Section 6 then turns to the area of State aids compliance, one of the areas which has been highlighted as being extremely challenging for managing authorities. These initial experiences of the IQ-Net partners are assessed in Section 7, which concludes with a look at the Commission’s draft regulatory proposals for FEIs. The final section, Section 8, highlights issues and conclusions. Further details on all the case study funds are provided in the Annex.
2. THE USE OF FINANCIAL ENGINEERING INSTRUMENTS TO DELIVER POLICY OBJECTIVES

2.1 The use of financial engineering instruments

Financial engineering instruments (FEIs) can play an important role in the delivery of policy objectives. Their purpose is to enable public sector capital to be used on a commercial basis (e.g. through holding funds, venture capital funds, loan funds and guarantee fund mechanisms) and to stimulate the participation of private sector capital in order to increase the scale, effectiveness and efficiency of policy measures.

The attributes of these instruments for policymakers are threefold. First, they increase the sustainability of public investment. FEIs can re-cycle capital for future use, as opposed to the ‘one-off’ nature of non-repayable grants. The ultimate aim is for funds to be ‘evergreen’ (i.e. self-sustaining) which makes them particularly valuable under conditions of economic uncertainty, fiscal deficits and constraints on bank lending.

Second, FEIs have a leverage effect. They have a catalytic function in unlocking other public sector and, importantly, private sector resources, thereby increasing the capital available for policy purposes.

Third, private sector participation enables policymakers to make use of private sector skills and expertise in areas such as project selection, decision-making, management of commercial operations and the ability to achieve commercial returns.

Collectively, these attributes potentially lead to greater value-added for policy interventions, as well as greater effectiveness and efficiency in terms of the use of public sector resources, enabling policymakers to achieve more with fixed or limited resources. Moreover, financial engineering instruments can be tailored to local, regional and national circumstances with inbuilt flexibility, particularly under holding fund structures, and can be altered if these needs change.

As well as satisfying demand-side pressures, policy-related FEIs can make significant long-term contributions to market development through supply-side development and support, particularly in terms of the use of public sector capital and non-capital mechanisms, to stimulate and support commercially-viable propositions and, consequently, to open up new market opportunities to the private sector.

2.2 Structures of financial engineering instruments

Financial engineering instruments are operated through a number of fund structures relative to specific needs and objectives.

- **Holding funds** - also known as fund-of-funds, these achieve their commercial objectives by operating through intermediary funds. Jeremie and Jessica are examples of holding fund operations.
• **Venture Capital Funds** - provide equity capital, both directly and also on a co-investment basis, to companies on a full risk and reward basis, in line with an assessment of the prospects and future enterprise value of the investee companies.

• **Loan Funds** - provide debt capital, typically, securitised lending, to finance businesses or projects over an agreed period and at an agreed rate of return, typically on the basis of the quality of the cashflow and strength of the underlying assets. Loans may be at a subsidised interest rate or interest-free for an initial period.

• **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 European Investment Fund operates a series of credit enhancement and guarantee funds - loan guarantees, micro-credit guarantees, equity guarantees and securitisation guarantees - in order to improve access finance for the start-up and growth of SMEs.

• **Informal Approach** - rather than establishing formal funds, financial engineering instruments can be organised by managing authorities and their agents as informal schemes with capital ring-fenced and operated through separate bank accounts for the purpose of the scheme.

### 2.3 Key components of financial engineering instruments

There are a number of important considerations in the establishment of financial engineering instruments.

• **Regulatory and legislative issues.** At the outset, it is important to note the important role that EU State aids play in the establishment of financial engineering instruments (see Section 6). Moreover, there could be equally important EU and also country-specific regulatory and legislative considerations relative to both the legal status of the instrument to be developed and deployed, as well as the competences of the individuals involved in its operations.

• **Objective-setting.** An ex ante analysis, accurately defining and describing the market failures and market imperfections that the instrument is designed and intended to address, is critical not only to ensure appropriateness of the instrument but also as a means of establishing a benchmark for future performance measurement.

• **Risk capital market interventions.** With regard to FEIs designed to provide risk capital support to growth-oriented and growth-potential SMEs, policy focuses typically on the failures and imperfections of a particular stage of the market.
• **Performance measurement.** Measuring the performance of FEIs poses challenges, particularly with regard to timescale. For example, a typical venture capital fund will operate over an investment and management period of 8-10 years. Performance assessment may also require multiple forms of measurement, at the level of the economy, the level of the market, the level of the firm and the level of the investment may prove helpful.

### 2.4 Future use of financial engineering instruments

Financial engineering instruments and their ability to increase the leverage of additional public and private sector resources are set to play an increasing role in the delivery of key policy objectives, notably, Europe 2020. Operating under conditions of economic uncertainty, fiscal deficit and consequent budgetary pressures, and encouraged by the early performance and leverage effects of FEIs, policymakers see considerable value in supporting the further development of innovative FEIs and for their use in both existing and new policy-related areas of activity. A recent EU Budget Review commented that innovative FEIs could provide an important new financing stream for strategic investments, leveraging investment from other public and private sector sources in order to achieve EU policy goals more efficiently.

In the context of European policy during the 2007-13 period, FEIs are being developed and deployed under:

- the 7th R&D Framework Programme, including the European Investment Bank- operated Risk Sharing Finance Facility;
- the Competitiveness and Innovation Framework Programme (CIP), specifically, the funding initiatives developed by the European Investment Fund, notably, the High Growth and Innovative SME Facility and the SME Guarantee Facility; and
- Cohesion policy, involving Structural Funds support for FEIs in support of growth-oriented SMEs, notably Jeremie and Jasmine, and for urban development through Jessica.

The next section discusses the growing importance of FEIs in the third of these fields, Cohesion policy, and provides an overview of the case study FEIs in IQ-Net partner programmes.
3. THE USE OF FINANCIAL ENGINEERING INSTRUMENTS IN COHESION POLICY PROGRAMMES

‘Financial engineering instruments’ (FEIs) is new terminology, but not a new concept - many countries have operated such instruments for decades (e.g. in Belgium, France, Germany and Netherlands). The term generally refers to non-grant financial instruments such as loans (where the capital is repaid and the terms may or may not be more advantageous than commercial ones); equity (where a holding or share is taken in a firm) or guarantees (where capital is wholly or partially secured in the event of a default).

The use of non-grant financial instruments has risen in prominence under Cohesion policy programmes over successive programme periods, rising from €570 million under ERDF in 1994-99, to €1.3 billion in 2000-06. Member States are not currently required to provide detailed information on the funding of FEIs to the Commission. However, the Commission compiled information on payments made to funds implementing FEIs by the end of 2010 from managing authorities on a voluntary basis, to estimate the progress of FEIs supporting business. This revealed that FEIs with a total endowment of approximately €8.1 billion had been set up, which by the end of 2010 had received payments of €5.2 billion from the 2007-13 operational programmes (OPs) - representing approximately half the envisaged payments from OPs to funds for the current programming period.

There has been heightened interest in the 2007-13 period with the launch of the Jeremie and Jessica initiatives at EU level, and the use of non-grant financial instruments looks to continue to play an important role in programme implementation in future periods. In the research carried out for a previous IQ-Net Paper, partners rated the use of FEI as one of the most effective methods at their disposal to accelerate programme expenditure.

The European Commission, specifically DG REGIO, has been an enthusiastic proponent of the use of financial engineering in Cohesion policy programmes. Professor Danuta Hübner said in November 2010, “[Cohesion policy] should continue its commitment to further developing financial engineering investments to achieve more with the same amounts of available public funding.” The Commission’s main arguments for encouraging the development and deployment of FEIs relate to their appropriateness (effectiveness and sustainability) of grant finance under conditions of financial scarcity; i.e. increasing constraints and budgetary pressures on EU (and domestic public sector) financial resources. This is reflected in the key aim of establishing (over time) evergreen or revolving funding structures using Structural Funds resources. As noted above (Section 2), in addition to the possibility of recycling funding, the main benefits are identified as being sustainability;

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flexibility; leverage and access to European Investment Fund (EIF) and European Investment Bank (EIB) expertise (and potentially capital).

To qualify as a financial engineering instrument under the Structural Funds Regulations, OP contributions must take the form of repayable investments, namely equity, loans and/or guarantees for such repayable investments, and they must target the final recipients or type of investments specified in Article 44 of the General Regulation,\(^\text{10}\) such as enterprises, public private partnerships, urban projects or legal or natural persons implementing actions for energy efficiency and use of renewable energy.\(^\text{11}\)

According to Article 44, “as part of an operational programme, the Structural Funds may finance expenditure in respect of an operation comprising contributions to support any of the following:

a) financial engineering instruments for enterprises, primarily small and medium-sized ones, such as venture capital funds, guarantee funds and loan funds;

b) urban development funds, that is, funds investing in public-private partnerships and other projects included in an integrated plan for sustainable urban development;

c) 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.”

When choosing to set up a financial engineering instrument, managing authorities have four basic options:

a) to make a direct contribution to an instrument (without using a holding fund);

b) to contribute to a holding fund, the management of which is put out to public tender;

c) to contribute to a holding fund and contract the management to EIF/EIB; or

d) to contribute to a holding fund and contract management to a national financial institution without tender under national law (if compatible with the Treaty).

3.1 Jeremie and Jessica instruments

If managing authorities choose one of the options (b)-(d) above, they can choose to put in place Jeremie and Jessica instruments. These two initiatives originated at EU-level, and are


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both FEIs but have quite different purposes. The Jeremie initiative enables Member States to set up market-oriented FEIs with money from the ERDF and the ESF for implementation directly or via a holding fund (optional) to support the creation and expansion of micro- and SMEs by providing repayable forms of assistance such as equity, loans and/or guarantees. Jessica (Joint European Support for Sustainable Investment in City Areas) supports sustainable urban development and regeneration through financial engineering mechanisms. In the case of Jeremie, in particular, there is a great deal of confusion about what constitutes a Jeremie fund. The Commission currently views almost all FEIs for the support of SMEs as ‘Jeremies’, while many Member States continue to see as only those funds which use a holding fund involving the EIF as a ‘Jeremie’ fund.

Funding from instruments established through Jeremie may also be combined with business support and institution-building measures which can be also co-financed by Structural Funds. Importantly, each Jeremie operation is individually tailored to the needs of each Member State or region following the evaluation of market failures and the appropriate remedies in the context of its OPs. Sources of finance outside Structural Funds, including the EIB, the EIF (which can participate in Jeremie at the sub-fund level if they are not managing the holding fund) and the private sector, can also be engaged to maximise the leverage effect. The Commission estimates that, by the end of 2010, approximately €7.5 billion had been allocated to co-funded FEIs used for business support in the EU Member States, of which €5.4 billion was from the Structural Funds. Of this, €4.1 billion was provided via 32 holding funds in at least 16 Member States, with €1.2 billion using the EIF as holding fund manager. FEIs without holding funds were responsible for €3.4 billion.\(^\text{12}\)

As mentioned above, the Jessica initiative supports sustainable urban development and regeneration through financial engineering mechanisms. Jessica promotes sustainable urban development by supporting projects in the following areas:

- urban infrastructure - including transport, water/waste water, energy;
- heritage or cultural sites - for tourism or other sustainable uses;
- redevelopment of brownfield sites - including site clearance and decontamination;
- creation of new commercial floor space for SMEs, IT and/or R&D sectors;
- university buildings - medical, biotech and other specialised facilities;
- energy efficiency improvements.

Contributions from the ERDF are allocated to Urban Development Funds (UDFs) which invest them in public-private partnerships or other projects included in an integrated plan for sustainable urban development. These investments can take the form of equity, loans

\(^{12}\) Zaliwska D (2011) Activities of the JEREMIE Networking Platform and overview of JEREMIE implementation in Member States, presentation to the fifth meeting of the JEREMIE networking platform, Brussels 20 May 2011.
and/or guarantees. Alternatively, managing authorities can decide to channel funds to UDFs using holding funds which are set up to invest in several UDFs.

So far, €1.89 billion has been committed to 22 Jessica operations in 11 Member States. These are made up of 19 holding funds and three Urban Development Funds without a holding fund, and 18 out of 22 funds/agreements are managed by the EIB. A total of 30 UDFs were expected to be operational by the end of 2011, with the first investments in projects being made in Estonia, Brandenburg, Poland and Lithuania.  

3.2 Involvement of the European Investment Fund (EIF) and European Investment Bank (EIB)

The EIF is involved only in Jeremie and its role is limited to providing expertise at pre-set up and set-up phases unless the managing authority wants the EIF to manage the holding fund or manage one of the sub-funds (if the EIF is not managing the holding fund, it can manage and financially participate at the sub-fund level). The EIB can also participate in Jeremie through the provision of loan capital, and only EIB can become involved in Jessica.

3.3 Mixed approaches: financial engineering instruments combined with grants

An approach being used in several IQ-Net partner regions involves combining the use of an FEI with grant aid. This can be seen in the case of the New Széchenyi Combined Micro Loan in Hungary, the Invitalia revolving loan fund for SMEs and the Communities Investment Fund in Wales. The use of such ‘combined’ financial instruments was discussed at the Jeremie networking Platform in Brussels in May 2011, where several participants outlined their rationales for complementing repayable forms of support with grant support:  

- it can be used to tailor support to beneficiaries’ needs, particularly taking into account the effects of the economic crisis;
- the mix of grant and repayable financial instruments could be modulated according to different typologies and recipients e.g. higher aid intensities for more innovative projects in sectors of regional interest with more difficulty accessing traditional finance;
- it enables a ‘smooth shift towards more innovative forms of finance to sustain the development of sectors which have traditionally benefited from ‘non repayable’ forms of finance;


it makes financial engineering mechanisms for attractive to SMEs;

- it allows a balance to be found between meeting beneficiaries’ needs and increasing the financial resources available; and

- it helps ensure that public sector funds are being spent in line with their strategic objectives.

The use of ‘mixed’ approaches can be used to ‘buy’ results in a number of areas. As described in a previous IQ-Net Paper, the Wales Communities Investment Fund uses grants to help build capacity in community/voluntary organisations to enable them to apply for loans. In the Italian Convergence regions, the use of a revolving instrument which combines grant aid with loans enables a higher number of firms to be supported with fewer resources. In Hungary, the New Széchenyi Combined Micro Loan uses the reimbursable loan element of the funding package as a ‘filter’. A positive loan decision is one of the prerequisites to be eligible for the non-reimbursable element (see box).

### A mixed funding approach to financial engineering instruments in Wales and Hungary

The Communities Investment Fund (CIF) run by the WCVA (an umbrella voluntary organisation) in Wales is an investment funding package that can provide flexible loans backed by grant assistance, to social enterprises and community and voluntary organisations seeking to develop their income generating capacity. The CIF was awarded £3 million under the Convergence ERDF programme, with public and private match funding. The Loan Fund has been approved under the remit of Article 44 and been structured in a way that is compliant with it, however, it did not go through the lengthy application process required by Jeremie and Jessica.

The CIF is interesting because it represents a mixed approach, as a small amount is involved in the form of development grants to enable social enterprises or community organisations to build a business case and have the ability to go on and apply for a loan. WEFO considers that this mixed/flexible approach could be key in future if FEIs are to be used much more extensively or broadly. The shift in culture required to move grant-dependent organisations to a position where they have to repay funds is also important, and it requires ‘patient capital’/soft loans, rather than FEIs which operate on a commercial basis. WEFO views the strength of the CIF in being that it is innovative, while still relatively small and willing to give support.

In Hungary, the New Széchenyi Combined Micro Loan programme combines reimbursable and non-reimbursable EU assistance, plus the applicant’s own contribution. The applicant submits both the reimbursable loan application and the non-reimbursable grant application to a financial intermediary. The financial intermediary assesses the loan application, makes a decision about the loan element and forwards the grant application to the IB of the relevant MA. The IB evaluates the grant application by checking all the acceptance criteria and carrying out eligibility and content checks of the application. One of the criteria they check is whether the loan decision is positive or negative.

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The application for the reimbursable EU assistance therefore acts as a filter. It is expected that combining reimbursable and non-reimbursable EU assistance will give rise to a significant leverage effect.

3.4 Scale of financial engineering instruments under ERDF

As mentioned elsewhere in this report, the use of financial engineering instruments has been significantly upgraded in the 2007-13 Structural Fund period. However, it remains relatively difficult to gain precise insights into the volume of funding involved overall and the extent to which this has actually been disbursed to final beneficiaries. This information lacuna largely owes to the absence of any obligation on Member States to provide such information, a position which is likely to change under the post-2013 Regulations.

In the absence of obligatory reporting, the Commission invited Member States, ostensibly on a voluntary basis, to complete a series of templates with a view to monitoring the implementation of financial engineering instruments. This took account of the situation up to end 2010 and the output is currently being debated in the COCOF, which is likely to result in some changes to the data presented here as Member States complete their returns. It is also important to note that these data also only concern FEI co-financed by the ERDF, although ESF co-funded FEI will inevitably be modest by comparison.

Even these preliminary data reveal significant differences between Member States in the use and operation of financial engineering instruments under ERDF. Table 3.1 suggests that most countries operating FEI are doing so using holding funds. As such 17 Member States have established such funds, with several countries having more than one fund - Greece, Spain, France, Italy, Lithuania, the Netherlands, Poland and the United Kingdom all fall into this category so that 41 funds are operated in total. Some countries only operate FEI outside holding funds - Austria, Belgium, Denmark, Germany, Estonia, Finland and Sweden; while others operate both within and outside holding funds - Italy, Lithuania, Latvia, the Netherlands, Poland, Slovenia and the United Kingdom. Ireland and Luxembourg are alone in not operating (or not reporting) any FEI instruments co-financed with the ERDF.

In terms of the volume of contributions provided for in the funding agreements, these total some €4869 million for FEI within holding funds and €3708.6 outside such funds. There are, however, significant variations between countries in terms of the overall allocations of funding. These are partly related to country size, with significant sums allocated in Germany, Italy, Poland and the United Kingdom; on the other hand, there are many smaller countries where significant sums have been allocated, notably Hungary, Latvia, Lithuania and Portugal, while France appears to have very modest sums allocated to FEI in this dataset.

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Table 3.1: ERDF Co-financed business development FEI (€ million)

<table>
<thead>
<tr>
<th></th>
<th>Holding Fund</th>
<th>No holding fund</th>
<th>Total in FA</th>
</tr>
</thead>
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<tr>
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<td>1</td>
</tr>
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<td>260.7</td>
<td>2</td>
</tr>
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<td>199</td>
<td>1</td>
</tr>
<tr>
<td>CY</td>
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</tr>
<tr>
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<td>1</td>
</tr>
<tr>
<td>DE</td>
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<td>1364.7</td>
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</tr>
<tr>
<td>DK</td>
<td>2</td>
<td>21.4</td>
<td>1</td>
</tr>
<tr>
<td>EE</td>
<td>1</td>
<td>156.4</td>
<td>3</td>
</tr>
<tr>
<td>GR</td>
<td>2</td>
<td>710</td>
<td>2</td>
</tr>
<tr>
<td>ES</td>
<td>3</td>
<td>405.7</td>
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<td>10</td>
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</tr>
<tr>
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</tr>
<tr>
<td>SK</td>
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<td>100</td>
<td>1</td>
</tr>
<tr>
<td>UK</td>
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<td>347.9</td>
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<td>41</td>
<td>4869</td>
<td>62</td>
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<tr>
<td></td>
<td></td>
<td>48</td>
<td>33</td>
</tr>
</tbody>
</table>

Key: E= Equity, G= Guarantees, L= Loans


Member States also vary considerably in the types of financial engineering instrument used, as reflected in Figure 3.1. It is important to stress that simply counting schemes is rather a crude indicator of policy choices, and may partly be indicative of the devolution of responsibilities to the subnational level. However, the data are currently inadequate to provide meaningful indicators by instrument type in expenditure terms.
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Figure 3.1: FEI by number and type

![Figure 3.1: FEI by number and type](image)


Regarding Jessica, the uptake to date is more limited. Table 3.2 shows countries where a Jessica holding fund has been established. In addition, there are specific instruments in Germany and the UK which operate without holding funds. Overall, the size of the holding funds totalled some €1.7 billion at end 2010, of which over a quarter was accounted for by Greece, but with substantial funds also in Italy, Lithuania, Poland and the United Kingdom.

Table 3.2: Jessica Holding funds (€ million)

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
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<td>33.0</td>
</tr>
<tr>
<td>CZ</td>
<td>1</td>
<td>20.6</td>
</tr>
<tr>
<td>EE</td>
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<td>GR</td>
<td>2</td>
<td>499.0</td>
</tr>
<tr>
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</tr>
<tr>
<td>IT</td>
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</tr>
<tr>
<td>LT</td>
<td>1</td>
<td>227.0</td>
</tr>
<tr>
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<td>219.1</td>
</tr>
<tr>
<td>PT</td>
<td>1</td>
<td>100.0</td>
</tr>
<tr>
<td>UK</td>
<td>3</td>
<td>288.3</td>
</tr>
<tr>
<td></td>
<td>17</td>
<td>1738.0</td>
</tr>
</tbody>
</table>

3.5 Use of financial engineering instruments in IQ-Net programmes

The IQ-Net partners represent a diverse range of OPs in terms of size, so it could be anticipated that the extent to which they use financial engineering instruments (FEIs) in their OPs and the size of the instruments they operate would also be diverse, reflecting factors such as the national/regional context, size of OP, national and regional priorities, and existing domestic provision. The proportion of OP funds spent on FEIs varies substantially, from, for example, Jeremie in Hungary representing 22 percent of the Economic Development OP (EDOP) resources (and a further six percent of the Central Hungary OP (CHOP) resources) to the Slovene Enterprise Fund holding fund representing only 2.8 percent of OP resources. The Swedish regional venture capital funds display this wide variation also, ranging from one percent of the regional OP resources to 22 percent (Stockholm), but averaging eight percent across the country. The following sections provide brief summaries of the case studies examined as part of the research for this paper. Further details on all the case study funds are provided in the Annex.

3.5.1 Jeremie/Jeremie-like funds

Seven Jeremie or Jeremie-like funds were included as case studies:

- **France - Languedoc-Roussillon**: The Jeremie initiative in Languedoc-Roussillon was set up in October 2008. It has a budget of €30 million, split between guarantees (€14 million), co-investment (€11 million), and loans (€2 million). €3 million have been set aside for management costs. It is managed by the EIF, which is in charge of the Joint holding fund, with support of an Investment Board comprising representatives of regional State representatives and regional authorities.

- **Greece**: The Greek Jeremie initiative was set up in 2007 with a budget of €250 million. The instrument is managed by the EIF, and it is aimed at generic SMEs and technology-oriented SMEs. The products will include funded risk sharing, micro-credits, seed capital, co-investment, early stage venture capital and loan co-financing through the banks. Only the funded risk sharing element is so far operational.

- **Hungary**: Launched in 2008 with a total budget of €836 million, the Hungary Jeremie initiative provides loans (New Széchenyi Loan Programme, New Széchenyi Combined Micro Loan, Small and Medium Enterprise Loan, Working Capital Loan), guarantees (Portfolio Guarantee Programme and New Széchenyi Counter Guarantee Programme) and risk/venture capital (seed and start-up capital through Joint Fund measure; early stage and expansion risk capital through co-investment measure). The holding fund is managed by a national institution, Venture Finance Hungary plc.

- **Latvia**: Launched in 2010 with a total budget of €138.55 million, the Jeremie initiative operates two loan instruments (via the commercial banks AS “SEB banka” and AS “Swedbank”), a risk capital instrument (through Baltcap Management Latvija), a seed capital instrument and a start-up capital instrument (both Imprimatur Capita l Baltics). The initiative aims to support manufacturing SMEs, SMEs operating in industries with high growth potential and enterprise developing
new technologies (IT, telecoms, alternative energy, natural sciences). The Fund was initially managed by the EIF, but is now managed by the Latvian Guarantee Agency.

- **Slovenia**: Launched in 2009, with a budget of €56.66 million, the Slovene Enterprise Fund manages a holding fund which offers guarantees (guarantees for innovative technology projects, classical guarantees (development guarantees, micro guarantees and guarantees for new businesses) and counter-guarantees for regional guarantee schemes) and mezzanine and venture capital guarantees and counter guarantees, mezzanine and venture capital.

- **Spain (National OP Technology Fund)**: A fund of €70 million, set up in 2009, offers guarantees supporting firms engaged in RTDI projects that are eligible for support from the Spanish Technological and Industrial Development Centre (CDTI). The Fund is managed by the Official Credit Institute, and the territorial distribution of the Fund matches that of the NOP: 70 percent to Convergence regions (Andalusia, Castile-La Mancha, Extremadura and Galicia); 30 percent to the remaining 13 regions (including the País Vasco).

- **United Kingdom - Wales**: The €175 million Jeremie initiative in Wales was launched in April 2009. Finance Wales, a wholly owned subsidiary of the Welsh Assembly Government, acts as a holding fund for the EIB loan, which it on-lends to a specially created Jeremie Fund. It provides debt finance and venture capital to new and existing SMEs.

### 3.5.2 Loan funds

Six loan funds were included in the case study selection:

- **Denmark - The North Denmark Loan Fund**: *Den Nordjyske Lånefond* provides low interest loans to SMEs for innovation and development activities in the region of North Denmark. The fund was established in 2009 with a budget of €8 million, and is managed as a corporate foundation.

- **Finland - Finnvera loans**: Finnvera has used ERDF co-funding for its loans since 2001 and for its venture capital investments since the summer 2011. Finnvera provides eight different types of loan funding for different stages of the business cycle: start-up and investments, growth and development. Finnvera channels interest subsidies of the ERDF to investment and working capital loans, loans for women entrepreneurs, microloans, entrepreneur loans and environmental loans. In addition, guarantee fee subsidies of the ERDF are channelled to guarantees of investment and working capital loans. ERDF financing covers the major regions of Eastern Finland and Northern Finland in their entirety. In Southern Finland and Western Finland, ERDF financing is allocated to the most challenging areas.

- **Germany - Nordrhein-Westfalen - NRW/EU Micro Loan Fund (NRW/EU Mikrodarlehen)**: The Fund is managed by NRW.BANK, the Land investment bank and provides loans of €5,000-25,000 to SMEs. Loans are conditional on the firm...
participating in an initial advisory session with the business advice organisation STARTERCENTER NRW, as well as ongoing coaching sessions with other business advisers.

- **Germany - Sachsen-Anhalt - SME Loan Fund**: The €237.9 million loan fund (*KMU-Darlehensfonds*) is managed by the Sachsen-Anhalt Investment Bank, and provides mezzanine or traditional loans for start-ups and existing growing SMEs, especially in the manufacturing sector, for capital investment and other relevant activities (e.g. R&D and patents).

- **Italy - Revolving Fund for SMEs**: a loan scheme managed by Invitalia (the publicly owned agency for the attraction of foreign direct investments and enterprise development (formerly Sviluppo Italia)) was introduced in October 2011, linked to a new ‘omnibus’ aid for business investment scheme. The aid scheme applies in the four Italian Convergence regions and operates on the basis of calls for tenders; the proportion awarded between non-repayable and repayable aid is fixed by the calls for tenders and varies depending on the size of the firm supported.

- **Poland - Śląskie - Micro-loan fund for unemployed people (ESF)**: This new micro-loan fund will target unemployed people who wish to establish micro-enterprises in the region of Śląskie. The region is currently at tendering stage.

### 3.5.3 Guarantee funds

- **Italy - Guarantee Fund for SMEs - NOP Reserve**: a ‘NOP Reserve’ of €100 million has been established as part of the pre-existing Guarantee Fund for SMEs managed by Mediocredito Centrale (MCC). The Central Guarantee Fund is a counter-guarantee fund, a second-level guarantee on guarantees given by first level guarantee providers. The ‘Reserve’ is only available to SMEs operating in the four Italian Convergence regions.

### 3.5.4 Co-investment funds

Three co-investment/venture capital funds are included:

- **France - Aquitaine Co-Investment Fund**: The Aqui-Invest co-investment fund was set up in December 2010. For the first two years of its operation, the budget is €3 million (€1.5 million ERDF and €1.5 million regional funds). It is planned to top up the budget by another €1.5 million of ERDF in 2012 and a further €1.5 million of regional funds in 2013. The fund is managed in a similar way as a limited company (*Société par Actions Simplifiée*) under the tax scheme in place for venture capital societies. It is aimed at contributing to investments in 20 SMEs in the start-up, creation or development phase and active in the fields of innovation and sustainable development. This is done in cooperation with venture capital societies and groupings of business angels.

- **Sweden - regional venture capital funds**: there are 12 regional venture capital funds with a total budget of €264 million, operating under eight Structural Funds
programmes in Sweden. They provide risk capital for investment in SMEs at start-up, creation or development phase and active in the fields of innovation and sustainable development.

- **United Kingdom - Scotland - Scottish Co-Investment Fund**: Managed by Scottish Investment Bank, part of Scottish Enterprise, the €66.7 million SCF operates by co-investing alongside pre-validated private sector co-investment partners, who identify investment opportunities, undertake the necessary due diligence, negotiate the terms and conditions of the investment transaction and decide whether to access SCF capital, through an agreed SCF Partner capital allocation, for equity investments on a *pari passu* basis.

**3.5.5 Jessica initiatives**

Five Jessica initiatives have been included among the case studies:

- **Czech Republic - Moravia Silesia**: The €20 million Moravia-Silesia Jessica initiative launched in 2009 offers loans for urban regeneration projects such as public services infrastructure, tourism, brownfield regeneration (also for entrepreneurial purposes) and regional marketing. The holding fund is managed by the EIB, and there are two UDFs, managed by the Czech-Moravian Guarantee and Development Bank and the private organisation Contera Management.

- **Poland - Śląskie**: The Jessica initiative covers the Śląskie region, and provides equity, loans and/or guarantees for urban development projects. The holding fund is managed by the EIB, and there is one UDF, managed by the Bank of Environmental Protection (*Bank Ochrony Środowiska, BOŚ*).

- **Portugal**: The Jessica initiative in Portugal was launched in 2009 with a budget of €130 million. The holding fund is managed by EIB and contributed to by six OPs (the NOP Territorial Enhancement and the ROPs Norte, Centro, Lisbon, Alentejo, Algarve). There are three UDFs, managed by: a) a consortium of CGD (*Caixa Geral de Depósitos SA*, one of the largest banks in Portugal) and the Institute for Housing and Urban Renewal (*Instituto da Habitação e da Reabilitação Urbana IP, IHRU*, a government agency); the Portuguese Investment Bank (*Banco Português de Investimento*); and the government agency for tourism (*Turismo de Portugal IP*).

- **United Kingdom - London, England**: With a budget of €116 million, the London Green Fund operates two types of instrument throughout London: equity (through a waste fund) and debt finance (energy fund). The holding fund is managed by EIB. One UDF, the Foresight Environmental Fund, is managed by an asset manager, Foresight Group LLP, and supports waste recycling projects. The second UDF, the Energy Efficiency Fund, will support energy efficiency projects mainly carried out by public sector bodies e.g. local authorities.

- **United Kingdom - Wales**: The €64 million Regeneration Investment Fund for Wales provides senior and mezzanine loans, equity and guarantees for senior loans, for urban regeneration projects throughout Wales (although the Convergence area is
the primary target). The initiative operates without a holding fund, and has one UDF (selected in December 2010), managed by Amber Infrastructure.
4. **FINANCIAL ENGINEERING INSTRUMENTS FOR SME SUPPORT IN IQ-NET PROGRAMMES**

The amount of support provided to SMEs via non-grant financial instruments and co-financed through Cohesion policy has increased dramatically over successive programme periods. The estimated amount allocated from Structural Funds to venture capital, loan and guarantee funds to support SME access to finance in 1994-99 was €0.57 billion (0.44 percent of total Structural Funds allocations). This rose to €1.2 billion in 2000-06 (0.8 percent of total allocations). For the 2007-13 period, the total allocation is estimated at €6.2 billion (rising to €8.4 billion when private and national resources are added), allocated to some 386 specific funds in almost all Member States.  

This section examines the experience of IQ-Net partner programmes with the setting-up and implementation of non-grant financial instruments which aim to support SMEs and other businesses. This includes Jeremie initiatives as well as own-initiative funds, including loans, guarantees and equity support.

The Jeremie-type funds encompassed by the fieldwork research carried out for this paper are located in the IQ-Net partner programmes in France (Languedoc-Roussillon), Greece, Hungary, Latvia, Spain (although not in País Vasco), Slovenia (where the Slovene Enterprise Fund runs a holding fund similar to Jeremie) and Wales. A wide range of different types of instrument can be provided under the framework of Jeremie (or Jeremie-type) initiatives, including the provision of equity finance (risk capital, seed capital, start-up capital) and debt finance i.e. loans and guarantees.

In addition to the Jeremie or Jeremie-type initiatives, a number of ‘own-initiative’ financial engineering instruments (FEIs) providing support for SMEs in IQ-Net partner programmes have been included in the research. These include: loan funds in Denmark, Finland, Germany (Nordrhein-Westfalen and Sachsen-Anhalt), Italy and Śląskie (Poland); a guarantee fund for SMEs in Italy; and regional co-investment/venture capital funds in France (Aquitaine), Sweden and Scotland. Brief information on each of the case study funds is provided in the previous section and in case study fiches in the Annex.

4.1 **Experience at the pre-implementation stages**

4.1.1 *Rationale for introducing financial engineering instruments for SMEs*

IQ-Net partners described a wide range of reasons for supporting SME growth in their programme areas through the use of non-grant instruments. The main rationale for the introduction of all the instruments is the existence of an identified gap in the availability of finance for SMEs. In those Member States and regions which decided to go ahead with a Jeremie initiative, the rationale for proceeding was strengthened by the findings of the gap

analyses which were carried out by the EIF. By April 2011, the EIF had conducted 55 gap analyses in 19 different EU Member States, and are managing 12 holding funds, eight as national funds and four at regional level.

Additional reasons for using non-grant instruments to support SME growth include the following.

- Use of FEIs enables additional support to be allocated to SMEs, for example through the leveraging in of additional funding from the private sector. SME support is a high priority in virtually all Cohesion policy programmes.

- They support what is seen by many as a more effective use of public funding than grants, as there is a perception that the availability of grants can encourage ‘rent-seeking’ behaviour, and that the necessity to repay funding may encourage SMEs to be more ‘careful’ with public money.

- Their use can speed up programme implementation, accelerating the absorption of funds and reducing the risks of automatic decommitment.

- They potentially enable the reinvestment of Structural Funds at the level of the region beyond 2014.

- The use of an EU initiative such as Jeremie can provide Member States or regions with the opportunity of benefiting from an EIB loan.

- Their use has been strongly encouraged by the Commission. A key reason behind the adoption of regional venture capital funds in Sweden during the 2000-06 programme period, for example, was the Commission’s observation in 2002 that Sweden was one of the few countries that continued to award only direct aid under its Structural Funds programmes. As a result, three pilot partnership funds inspired by the Scottish Co-Investment Fund were launched in 2005 in the then Objective 2 programmes of Västsverige, Gotland and Mellersta Norrland.

In several cases, the decision on an instrument was also based on experience during the previous programme period (Italy Guarantee Fund for SMEs, North Denmark Loan Fund, Scottish Co-Investment Fund), or on information gathered during the exchange of experience with other Structural Funds programmes. (For example, the idea of establishing a loan fund in North Denmark arose at an IQ-Net meeting in Nordrhein-Westfalen in the spring of 2003.) The underlying reasons were similar to those outlined above - an expected decrease in the future availability of funding that could be allocated for grants, and the possibility of recycling funding.

Setting up FEIs has been often found to be a laborious and lengthy process, particularly for the complex Jeremie initiatives. The set-up time for a Jeremie initiative took approximately 18 months in Latvia. This was considered to be quite a lengthy period, especially given that the fund was set up to provide a rapid response to the economic crisis and to help businesses lacking access to finance. From gap analysis to the granting of the first micro-loan took 15 months in Hungary (October 2006 - January 2008), with the launch
of two further loan products in an additional 11-12 months, and the launch of venture capital activities four years after the gap analysis was carried out. However, it is not just the complex Jeremie funds which take a long time to establish - for example, the North Denmark Loan Fund took two years to set up.

4.1.2 Challenges setting up financial engineering instruments

When setting up an FEI to support SME growth, managing authorities or fund managers (which may be outside the managing authority, e.g. intermediate or implementing bodies such as development agencies or public banks) must go through a process of deciding what type of FEI to implement, and how to best structure the fund. The choice of instrument will be determined by the gap in SME finance which has been identified, demand from the targeted sectors, the input of financial intermediaries and previous experience. When choosing how to structure a fund, managing authorities must decide whether to use the structure of the EU Jeremie initiative, whether to use a holding fund structure and, if such a structure is used, in whom to entrust its management. This section considers some of the factors that IQ-Net partners have taken into account when making these decisions.

The size of the OP is an important factor in determining whether to implement FEIs for SME support, and if so, whether to use the Jeremie model. The managing authority of the ERDF OP in Vlaanderen, for example, has decided against using FEIs, primarily because the programme’s budget of €200 million is considered too small. In addition, loans that are available at a federal Belgian level are thought to provide enough supply of such finance. In Niederösterreich also, the OP is considered too small for the use of FEIs, specifically a Jeremie fund, and in future periods, the managing authority considers that with potentially reduced levels of funding available, such a FEI would probably only be useful if set up at the national level.

In France, smaller regions were discouraged from implementing Jeremie by the minimum threshold imposed by the EIF, and so far only two regions (Auvergne, Languedoc-Roussillon) have set up a Jeremie initiative. Although the EIF had suggested that several regions develop a joint Jeremie in order to reduce management costs and to allow for smaller regional envelopes, the regions were concerned that their funds would be used in neighbouring regions; also, each region was keen to have its own local Jeremie contact, which would have involved considerable management costs. A similar factor was relevant in Denmark, where Danish regions were reluctant to transfer regional funds to a national initiative.

The domestic legislative and financial context has also been an important determinant. In France, for example, accounting procedures at the level of the regional State services (préfets) are not in line with EU requirements, as the préfets are not authorised to make a temporary allocation to Jeremie or similar structures (they can only administer grants). Therefore, the ERDF grant for Jeremie has to be transferred to the regional councils, who allocate the funding to the Jeremie fund together with their own contribution (public match-funding). However, the General Code of Territorial Authorities (legislation governing the roles of subnational authorities) did not allow the regions to get involved in Jeremie-type funds. Therefore, the Finance Law had to be amended in order to make the regions...
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The use of Jeremie has been further inhibited by the fact that the main actors in France in the field of soft loans and guarantees were not prepared to receive ERDF loans (they are used to receiving grants). More generally, many French regions preferred to top up existing funds rather than to set up new instruments.

In Sweden, a pre-study\textsuperscript{18} was carried out in 2008 on whether to adopt the Jeremie initiative. The study, which covered the eight Structural Funds programme regions, indicated that there was a wish to use Structural Funds resources to contribute to new and small businesses capital provision in early pre-seed/seed-phases and in early start-up phases. However, the study also concluded that the Jeremie initiative was not compatible with national laws on public procurement. Furthermore, the involvement of EIB was viewed with certain level of caution, not least given the regulatory requirements. Hence, it was decided that they could work on the basis of existing instruments.

In Finland, use of non-grant financial instruments was considered to already be sufficient, and a decision was made not to adopt EU-level instruments. In addition, due to the fact that the municipal sector in Finland is so strong (in comparison to the European context) and provides financing through its own financing company (Kuntarahoitus Oy), Jeremie would not have added any value (in 2010, Kuntarahoitus awarded loans in the region of €2842 million).

In Nordrhein-Westfalen, it was felt that it made more sense to draw on the existing expertise and structures within the NRW Land-owned public investment bank, NRW.BANK, rather than setting up a parallel institutional framework. It was also hoped that the use of the Land Investment Bank would ensure that the fund was fully neutral and would not favour any particular lending institutions. Similarly, in Sachsen-Anhalt, the Land government decided not to adopt a Jeremie structure because the Sachsen-Anhalt Investment Bank was already in place and is a structure well-used to setting up and operating loan funds. The advantages of the Land Investment Bank are, first, that it is very familiar with financial situation and difficulties of local firms and, second, that it is well used to working closely and constructively with the different Land Ministries and playing a bridging role between the Land government, commercial/cooperative banks and local SMEs. Similarly, in Italy, there was considered to be sufficient know-how and expertise domestically.

4.1.3 Choice of holding fund manager

Of the seven case study funds for SMEs which use a holding fund structure, three chose the EIF to manage the holding fund (France: Languedoc-Roussillon, Greece, Latvia\textsuperscript{19}). In the other cases, where it was decided to appoint a domestic body to act as fund manager, the use of Jeremie has been further inhibited by the fact that the main actors in France in the field of soft loans and guarantees were not prepared to receive ERDF loans (they are used to receiving grants). More generally, many French regions preferred to top up existing funds rather than to set up new instruments.

\textsuperscript{18} SWECO Eurofutures, ‘Strukturfonder för kompletterande kapitalförsörjning i Sverige, En sammanfattning av åtta behovsstudier inför ett JEREMIE-initiativ’, final version, 2 April 2008

\textsuperscript{19} This situation in changing in Latvia, with management of the holding fund moving to the Latvian Guarantee Agency.
there had already been considerable experience built up in developing financial engineering instruments (Hungary, Slovenia, Wales). In Hungary, for example, the team taking part in the development of the Jeremie programme spent two months with lawyers with experience in the banking sector to develop the structure. The national institutional framework was set up as it was considered to give more flexibility in design, and led to faster implementation. In Slovenia, the Slovene Enterprise Fund manages a holding fund offering a range of FEIs supporting SMEs; this domestic management option was chosen as Slovenia had developed FEIs previously and decided that they had enough experience to continue with the management of SME support.

The EIF has played an integral role in implementation of manyJeremie funds - it has carried out 55 gap analyses, is managing 13 holding funds throughout the EU (three in IQ-Net case studies, as mentioned above) and is playing an advisory role for another five holding funds. Those programmes which did choose the EIF as holding fund manager appreciated the fact that no public procurement is needed if the EIF is selected (although this was also not required in Nordrhein-Westfalen and Sachsen-Anhalt, for example, where there was no need for the Land authorities to go through a public procurement process in order to award a contract for managing the fund to the Land investment banks, as these are 100 percent owned by the Land governments).

The role of the EIF, and its parent organisation the EIB, in the implementation of Jeremie funds is not wholly uncontroversial. There has been some conflict over whether the EIB and EIF should act as European institutions or as commercial banks. It has also been noted that human resources within the EIF are limited and not in line with needs. Managing authorities have also been critical of both the EIF and EIB’s understanding of State aid rules. Indeed, one managing authority spoke of having to educate the EIF on this topic over a series of meetings. In France, the approach taken by the EIF during the negotiations was perceived as a banking approach rather than one of a public EU institution. There were different views expressed about EIF management costs across IQ-Net members - some considered that the fees were reasonable (set at cost), while others considered that as a Community institution, its services should not be invoiced. The EIF and EIB’s location in Luxembourg is also perceived as a disadvantage, meaning that it is not familiar with the specificities of regions across the EU or the needs of local firms, thus implying additional bureaucracy and distance from citizens. Specifically relating to EIB loans in the context of FEIs for SMEs, there has been some conflict over the EIB’s risk-averse approach and desire to reduce risk by, for example, taking ‘rights’ over the ERDF element of the package; this leads to detailed, intensive and legally complex negotiation of funding agreements.

An evaluation of the EIF’s role in implementing Jeremie commented on the major learning curve that even the EIF had to undergo. The evaluation noted the major new challenges posed by the Jeremie initiative to the EIF, including dealing with numerous public authorities at national and regional levels, undertaking the gap analysis exercise, becoming

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familiar with Structural Funds regulations, dealing with DG REGIO, and establishing structures which had to be compatible with EU and local legislative frameworks, all under significant time pressure. Although the evaluation reported that most of these challenges were met satisfactorily, a number of recommendations were made, including that to achieve some economies of scale, future initiatives should focus on a small suite of standard products with local adjustments. With respect specifically to countries with small budgets, the evaluation stated:

‘Certain [managing authorities] with a gap analysis but without a holding fund explained that this was not because they did not want a holding fund, but because they were advised their fund would be too small. EIF considered €50-100m to be the minimum practicable size for a holding fund, which in some cases exceeded the [managing authorities’] total budget. In exceptional cases EIF was persuaded to proceed with a very small fund but generally resisted. It is estimated that five countries (and probably many more regions) were keen on having a holding fund, but below €50m. Including these counterparts beyond the Evaluation Phase would have increased relevance and effectiveness. Inversely, if funds below €50m were indeed technically or financially difficult to implement, this should have been announced more clearly, as in many cases performing a gap analysis would have been deemed unnecessary by the simple inspection of the contribution the country or region would be willing to make.”

The evaluation recommended that a ‘more global approach’ with a few standard products and advisory input from the EIF where needed might have allowed more ‘small fund’ managing authorities to participate.

The dual role of the EIF providing a gap analysis and then being in a privileged position to be selected as holding fund manager was sometimes viewed as a conflict of interest — although, in its response included in the evaluation report, the EIF refuted this, stating that any conflict of interest was very marginal and that the EIF was essentially perceived as neutral. It is worth noting here that that, for State aid purposes, under the Risk Capital Guidelines, the EIF (and the EIB) are classed as private investors. The evaluation also found that there was some confusion among managing authorities about the EIF’s role, and that there was an expectation that it should be able to help with interpretation of the regulations or clarifications on the eligibility of various products. The EIF countered, however, that its role was well understood and in any case clearly outlined in the funding agreements.

4.2 Experience with implementation

Although many of the case study funds were established early in the programme period, their negotiation and set-up was often a long process. This delay, plus the effects of the economic crisis, has resulted in slow implementation of many FEIs. Where available, any results so far recorded by the case study funds are provided in the Annex.
4.2.1 Experience with finding suitable projects

The economic crisis is having a serious negative effect on the implementation rate of FEIs in many programmes. This can be due to the lack of demand or the availability of other types of business support.

- **Lack of market demand**: Under the North Denmark Loan Fund, and the Greece, Hungary and Latvia Jeremie initiatives, it has been progressively more difficult to find suitable projects, in part due to firms having problems finding match funding, or behaving more cautiously. In Latvia, for example, contracts concluded by 31 July 2011 represented only 9.45 percent of available funding in the holding fund, although the responsiveness of applicants is now said to be gradually increasing. The loan instrument has recorded particularly low levels of financial absorption, because of delays caused by adjustments required due to changing market conditions. To address this, in March 2011, requirements regarding the limitations in bank risk classes were adjusted, as well as the maximum amounts and time periods of the loans. This seems to have speeded up the rate of spend (from three loans between March 2010 and April 2011, to 13 between April and July 2011).

- **Availability of other types of business support**: In Finland, at the start of the programme period, Finnvera and the T&E centres (now ELY centres) were cooperating with respect to the provision of loan instruments. The ELY centres used lower aid levels, so that Finnvera could provide complementary loan funding. However, as a result of the recession, the ELY Centres’ aid levels have been raised to maximum, which has made Finnvera loans less competitive. This has affected the types of clientele for the two organisations, at least in the region of Keski-Suomi. In the Śląskie Human Capital OP, the level of interest in the (soon to be launched) ESF micro-loan fund targeting unemployed people setting up micro-enterprises has not been high, and a preference for grant aid for start-ups has been noted. Further, the low level of management costs that can be claimed is seen to be a disincentive to potential applicants, as is the pressure resulting from the short time left for projects to be implemented.

In Italy, problems with uptake have been related to the source of the funds, rather than the crisis. Financial intermediaries have been found to prefer the non-ERDF-funded element of the SME Guarantee Fund, preferring to go to the part of the fund financed from domestic resources because this entails a lower bureaucratic burden, less monitoring, and less risk of additional audits. For this reason, there has been a recent modification requested: for the ERDF-funded element of the Guarantee Fund (the NOP Reserve), it has been proposed that firms can directly approach the fund manager to request a pre-eligibility statement. Having obtained this, the firm can then go to the bank or the CONFIDI. This modified procedure is

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21 Centres for business, traffic and environment (ELY) are the state’s regional authorities. The ELY centres cover tasks related to economy, labour force, expertise, culture, traffic and infrastructure, as well as environment and natural resources. However, only nine of the ELY centres perform functions related to the above-mentioned fields; the six other centres are more concentrated in their tasks.
intended to lighten the burden of banks and CONFIDI, i.e. taking away the step of having to check the coherence of the proposed investments with the goals of the NOP, which has proven to be one of the main obstacles. A further factor inhibiting uptake has been that the NOP Reserve cannot fund working capital and operating costs. It is hoped that an increase of the maximum threshold of guaranteed investment, compared to the ordinary fund, plus an increased marketing campaign, will increase take-up.

Other instruments have performed well despite the crisis. In Sweden, experience with the regional venture capital funds varies across programmes, but so far expectations have been exceeded. For instance, in the Norra Mellansverige OP, an initial slow programme start was turned around after strong marketing and communication efforts, which has resulted in a large flow of projects. The Scottish Co-Investment Fund has also experienced a strong flow of projects, although performance is now slowing down because of the financial climate. Fund managers are also providing second or third rounds of financing for some clients, i.e. they are keeping businesses in their portfolio for longer because the businesses are finding it difficult to get funding elsewhere. Nevertheless, all funds are expected to be fully exhausted by December 2015.

Both the NRW/EU Micro Loan Fund and the Sachsen-Anhalt SME Loan Fund are perceived to have been very successful in attracting sufficient high-quality projects. Indeed, in Nordrhein-Westfalen, the crisis is seen to have increased demand for micro-loans, and success has been such that there has been a television series based on the fund, with the story of a different start-up firm being presented each week. In Slovenia, there have been no problems with finding suitable projects for the instruments managed under the Slovene Enterprise Fund holding fund (although it has taken two years to get to this stage); indeed, the managing authority would like to channel further resources (e.g. Cohesion Fund) into the instruments. In Wales, under the Jeremie initiative, the managing authority has found that the loan instrument has performed very well because of the economic climate, and that the quality of business coming to them is better (i.e. businesses that would normally have gone to a bank).

The importance of the case-study FEIs in helping the programmes to reach n+2/3 varies across programmes, from being fundamental to less crucial. In Sweden, for example, the regional venture capital funds have been very important for the smaller Structural Funds programmes, such as Stockholm. In larger programmes, they contribute to reaching the n+2 rule, but have not been an essential element. Several managing authorities are allocating funds in stages (Aquitaine Co-Investment Fund; Scottish Co-Investment Fund) to ensure that funding will be absorbed successfully.

4.3 Monitoring and control

4.3.1 Monitoring

All instruments are subject to EU and domestic monitoring systems. The IQ-Net partner case study funds use similar types of indicators (e.g. number of projects/investments, amount of funding, jobs created) and standard monitoring procedures (e.g. with fund managers
reporting quarterly to managing authorities along with annual reports) with different levels of analysis.

4.3.2 Use of sanctions or conditionalities

Few sanctions and conditionalities were mentioned by IQ-Net partners in the use of FEIs to support SMEs. One exception, which presents an interesting example, is where a condition forms an integral part of the operation of the NRW/EU Micro Loan Fund in Nordrhein-Westfalen. These loans are conditional on the firm obtaining business advice/coaching, which is seen as a means of increasing firm survival rates and addressing any difficulties early on. First, before obtaining a loan, applicants must attend a session with a recognised business adviser, based in the ‘STARTERCENTER NRW’, a network of local business advisers located in chambers of industry and commerce, craft chambers and local economic development agencies. The STARTERCENTER NRW advisers provide applicants with advice on their business plan (including market and financial aspects) and application form. Second, applicants must participate in coaching sessions during the first two years of the loan period, either from a private business adviser or from consultants participating in the ‘Senior coaches’ programme (i.e. business managers who have taken early retirement and provide advice to other firms on a voluntary basis). Initially, the fund was set up as a pilot project covering around one third of the local STARTERCENTERS in the Land, with these centres deciding whether or not to opt into the scheme. Almost all local STARTERCENTERS have now decided to participate in the fund.

4.3.3 Financial control

Several technical implementation issues concerning FEIs have previously been raised by IQ-Net partners.22 These included confusion about who should be designated the ‘final beneficiary’ for monitoring and control purposes. While this has been clarified by the COCOF 3 guidelines and the regulatory proposals, a variety of approaches remain, due to differences in national management and control systems. Under the Latvian system for management and control, for example, the current legislative framework requires that the firms are designated as the final beneficiaries. The Italian managing authority note that although financial control is at the level of instrument, given the continuous requests by the external control/audit bodies - i.e. ECA, European Commission and National Audit Authority - it is clear that there is now a trend to control up to the level of the single firm; thus what is happening is that this type of control is also placed upon the manager of the fund (i.e. an expectation that the fund manager monitors and checks the projects).

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5. FINANCIAL ENGINEERING INSTRUMENTS FOR URBAN DEVELOPMENT IN IQ-NET PROGRAMMES

The Jessica initiative supports sustainable urban development and regeneration through financial engineering mechanisms. Contributions from the ERDF are allocated to Urban Development Funds (UDFs) which invest them in public-private partnerships or other projects included in an integrated plan for sustainable urban development. These investments can take the form of equity, loans and/or guarantees. Alternatively, MAs can decide to channel funds to UDFs using holding funds which are set up to invest in several UDFs. The reduced budgets available for Cohesion policy programmes in 2007-13 and the strong Lisbon orientation led to a lower focus on urban regeneration-type activities in some OPs, for example in the UK, although some level of support for investment in deprived areas continued. Where regeneration activity was co-funded by ERDF, it tended to take place within a ‘sustainable development context’. In this context, the launch of Jessica could be viewed as re-targeting Structural Funds support towards urban areas.

This section examines the experience of IQ-Net partners in launching five Jessica initiatives - in the Czech Republic (under the ROP Moravia-Silesia), England (London), Śląskie (Poland), Portugal (a joint initiative under the NOP Territorial Enhancement and the ROPs Norte, Centro, Lisbon, Alentejo, Algarve) and Wales.

Jessica Fund prototypes

A recent study developed a typology of Jessica funds, describing five UDF prototypes. The first three are what the study calls ‘first generation’ prototypes, which have a low level of complexity so that they can be developed in a fairly short period of time, and the concept and innovative character of the instrument can be disseminated as quickly as possible:
- Energy efficiency funds, focusing on renovating existing assets to save future energy costs, and upgrading in buildings to generate alternative energy;
- Infrastructure Funds, e.g. for waste management;
- Environment funds: financing projects relating to renewable energy and other environmental objectives.

The two ‘second generation’ prototypes will require more expertise and time to be established:
- ‘Smart city’ Investment Funds, supporting sustainable urban investments to improve the quality of the location; and
- Area-based brownfield funds, combining multiple sectoral components in areas designated for regeneration.

The study goes on to makes recommendations on governance structures for each prototype.


Among the IQ-Net case-study Jessica funds, four are general urban development/regeneration funds, while one focuses on waste and energy efficiency (London). They are still at a very early stage of implementation, with no investments yet made.
5.1 Preparation phase

The preparation process from first expression of interest to launch of Urban Development Funds has been lengthy for all the Jessica case study funds - taking from approximately 2.5 years in Śląskie, Poland (May 2009 - December 2011/January 2012) and Wales, UK (2008-2010) to around three years in Portugal, London and the Czech Republic (all about autumn 2008 - autumn/winter 2011). This is in spite of the intention to operate a Jessica instrument having been foreseen at an early stage in both Portugal and London, and having been written into the operational programmes.

The first stage in all the case studies was a feasibility study funded by the EIB. In a number of IQ-Net programmes, the feasibility studies carried out resulted in a negative decision (Finland) or no further progress due to lack of match funding (some regions in the Czech Republic). Steiermark (Austria) also considered using Jessica, but decided against it as funding would have needed to be earmarked very early, and no problem with absorption under the measure for urban development was foreseen in any case.

### Feasibility study - Jessica in Länsi-Suomi (Western Finland)

An assessment of the feasibility of implementing Jessica in the context of the Länsi-Suomi OP was carried out in 2009 by Ernst and Young. The assessment was based on a pilot evaluation study in the city region of Jyväskylä. The study found that while there is a need for new forms of financing for urban development, and several potential projects that could benefit from the instrument, any grant allocations from the Structural Funds for the Jessica Urban Development Fund would be significantly smaller than needed to obtain an efficient fund structure. While the size of the potential projects ranged from €10-€50 million, the total Structural Funds allocations and public match-funding available for urban development in the city region of Jyväskylä would be approximately €2-€6 million. Additional public funding or private funding was seen to be unlikely.

The study emphasised that it would be beneficial for the city region as well for the OP as a whole if new forms of funding could be mobilised to accelerate the development of premises and other types of infrastructure to support the creation of new businesses. However, the Structural Funds available for Jessica were too small to have a real impact on development in Jyväskylä. The study neither recommended the implementation of Jessica in Jyväskylä during the current programme period, nor recommended it for other city regions in the programme area for similar reasons. The study recommends exploring whether Jessica could be used in the future programme period, as well as looking into other possibilities of realising urban development, most notably through various forms of public-private partnerships.

In addition to the results of the feasibility studies, the main arguments cited for using a Jessica instrument were that it would mobilise additional support for entrepreneurs beyond grants, provide new opportunities for private sector participation in urban development projects, and leverage additional funding through public-private partnerships. This provision of new institutional instruments/solutions for urban development was viewed as particularly important, given that there are few financial or other vehicles on the market that play a similar role to the Urban Development Funds. This importance has been highlighted by the economic crisis. In addition, the use of Jessica is seen as aligning
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strongly with the current and future direction of EU (and national) policy objectives. A further reason was a lack of certainty about the implications of Article 55 rules around revenue-generating projects, as only revenue-generating projects can be supported under Jessica initiatives.

Managing authorities viewed the introduction of the initiative as a possible way to encourage public and private bodies to undertake urban regeneration projects. In Moravia-Silesia, (Czech Republic), for example, the introduction of a Jessica financial engineering instrument was seen as a way of increasing interest in brownfield regeneration projects, which had previously been restricted to publicly-owned sites and those with a non-commercial future use.

Pro-active external encouragement by the EIB and Commission also seems to have played a major part in the decision-making process, for example at the OP-writing stage (London, Portugal), enhanced by the offer of an EIB-financed evaluation to test feasibility.

As in the case of Jeremie, different structures are possible. In the case studies, the EIB has been chosen to act as holding fund manager in all except Wales, where there is no holding fund. Four of the case study examples fund general regeneration/urban development projects, while London (England) supports waste and energy efficiency projects. Different approaches can be taken to the number of Urban Development Funds (UDFs) set up under the holding fund, if applicable, whether the UDFs are managed by public or private institutions, and whether UDFs operate on different themes or levels of risk (see box).

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<th>Urban Development Funds in the Jessica case studies</th>
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<td>In the case study examples, between one and three Urban Development Funds (UDFs) sit below the level of holding fund (if applicable):</td>
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<tr>
<td>- In Moravia-Silesia (Czech Republic), two UDFs have been selected: the Czech-Moravian Guarantee and Development Bank, which is expected to support more conservative and less risky projects; and the private development company Contera Management, which is expected to focus on riskier but potentially more profitable projects.</td>
</tr>
<tr>
<td>- In London (England), there are two UDFs investing into waste and energy efficiency projects; the Foresight Environmental Fund (waste) and the Energy Efficiency Fund, both managed by private asset managers.</td>
</tr>
<tr>
<td>- In Portugal, the Jessica fund has three UDFs: a consortium of CGD (Caixa Geral de Depósitos SA, one of the largest banks in Portugal) and the Institute for Housing and Urban Renewal (Instituto da Habitação e da Reabilitação Urbana IP, IHRU, a government agency); the Portuguese Investment Bank (Banco Português de Investimento); and the government agency for tourism (Turismo de Portugal IP). A notable aspect of the structure in Portugal is that the holding fund is constituted by six OPs. There are organisational advantages to this set-up: a single holding fund manager, investment strategy, communication plan etc. However, there are also inherent challenges in that it takes longer to achieve consensus on decisions as all parties have to be consulted.</td>
</tr>
</tbody>
</table>
Between Scylla and Charybdis:
Navigating financial engineering instruments through Structural Fund and State aid requirements

- In Śląskie (Poland), one UDF has been selected, managed by the Bank of Environmental Protection (Bank Ochrony Środowiska, BOŚ).

- In Wales, one UDF - the Regeneration Investment Fund for Wales - has been set up without a holding fund. The Fund is managed by a private company/manager of social and economic infrastructure projects, alongside an investment manager (property consultant).

As can be seen from the box above describing the governance of UDFs in the case study Jessica funds involves a range of choices of management arrangements. These include consortia of government agencies and banks, banks alone, finance companies, and property developers/asset managers.

Difficulties noted at the stage of preparation of the holding funds and UDFs include: the time-scale of the process, which in one case necessitated additional market testing being done to gauge the on-going impact of the recession; uncertainty about how the initiative would work in practice and a learning process to be gone through; the difficulties in using land as match funding; convincing private sector UDF managers to engage with contracts involving ERDF funding; and State aid (see Section 6).

One activity which was considered to have smoothed the process was mentioned in Moravia-Silesia (Czech Republic), where a secondee from Moravian-Silesian Regional Council (managing authority of the Moravia-Silesia ROP) will work as a long-term expert with the EIB, building the knowledge and experience basis within the Regional Council. This is considered to have been an important initiative to facilitate communication, ensure the transfer of know-how, and also provide feedback to the EIB.

5.2 Implementation phase

Most of the case study UDFs funded under Jessica are at an early stage of implementation, so have not yet invested in any projects. Indeed, 2012 is described by the EIF as the Jessica ‘investing phase’. Most UDFs, however, report a healthy ‘pipeline’, with earlier evaluations and surveys having revealed latent demand, and, in some cases (Moravia-Silesia, Śląskie), the UDFs proposing potential projects ready for implementation or under preparation in their business plans. However, there are concerns emerging in some Member States/regions about the ability of the Funds to spend the total allocation before the end of the allotted period. This is particularly so given that the type of project funded (infrastructure) takes longer to develop than other types of project, and given the experience of Jessica in Wales, where it has taken a year (for marketing, expressions of interest and project assessment) after the launch of the UDF to get to the stage of being about to invest in projects.

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23 The JESSICA initiative in Wielkopolska Voivodship (Poland) agreed its first urban project in May 2011 and by October 2011 had approved four projects. The other four Polish JESSICA funds are not yet at this stage.

24 Carbonaro G (2011) Guiding the design and implementation of JESSICA operations, presentation to the 3rd Annual Conference of JEREMIE and JESSICA, Warsaw 20 October 2011.
Although as noted above, the case study Jessica initiatives are all at an early stage in implementation, a number of areas of concern have been identified, including the following.

- The nature of the projects funded under the Jessica instruments and more traditional grant funding is expected to be similar, with the main difference being the requirement of profitability under Jessica. The social component of projects is expected to be much more important in Jessica projects in Śląskie (Poland).
- A lot of urban regeneration activity is activity that will not generate a return, and there are challenges around putting together packages of urban regeneration activity that do generate enough of a return, so there will continue to be a need for grants alongside FEIs.
- There is a general aim of encouraging more private sector investors to get involved.
- There is lack of clarity over exit policies, including winding-up provisions for UDFs and re-use of resources returned to the UDFs. The Financing Agreement for the Portuguese Jessica has identified two potential (although not exhaustive) options: reinstalling a Jessica holding fund, with the EIB or another entity; and transferring funds available to the managing authorities, or another designated public body or institution dealing with the UDFs.

5.3 Monitoring

The level of monitoring undertaken so far has been limited by the fact that there have not yet been any investments made. However, monitoring plans have been set out, generally involving quarterly reporting by the UDF managers to the holding fund manager (EIB), and either quarterly or bi-annual reporting by the EIB to the Investment Board/managing authority.

5.4 Use of sanctions or conditionalities

Several case study funds use sanctions or conditionalities beyond monitoring the attainment of indicators, and general provisions for the recovery/clawback of funding (i.e. for legal compliance breaches etc.). In London, there are targets included in both UDF contracts which must be reached by a certain time or the managing authority can remove itself from its contract with them. For example, the waste fund is tied to invest c.€11m in the first year, and there is a further target for 2013/14. The managing authority will review progress along with the EIB. In Moravia-Silesia, the managing authority (the Regional Council) decided that a part of the allocation will be kept as a performance reserve that will be paid to the more successful one of the two UDFs.
6. FINANCIAL ENGINEERING INSTRUMENTS AND STATE AID COMPLIANCE

6.1 Introduction

A recent EPRC report to IQ-Net partners identified the use of financial engineering instruments (FEI) as a key source of frustration and anxiety in the context of the rules on State aid: almost every Commission document dealing with financial engineering under the Structural Funds stresses the need for the State aid rules to be respected, and yet the State aid rules have seemed to be relatively ill-equipped readily to deal with the emphasis on such instruments in the current period.

As described below, the Treaty provides for a general ban on State aids. In practice, however, this is tempered by a number of derogations which set out the circumstances in which State aid is, or may be, compatible with the Treaty. These provisions have been extensively interpreted by the European Commission, giving rise to a large body of guidelines, communications and regulations specifying policy across a number of areas. Moreover, although in principle proposed aid must be approved by the Commission in advance of implementation, in practice, the General Block Exemption Regulation (GBER) enables measures that meet its terms simply to be reported, rather than requiring ex ante notification. In consequence, the prohibition set down in Article 107(1) is far less draconian than initially appears. Nevertheless, the complexities of the various provisions should not be underestimated. This is particularly so in the case of FEI because the focus of the various guidelines tends to be on the policy objective (regional development, R&D&I, SME development) rather than on the form of aid. As a result, there may be several different texts to take into consideration in designing a particular measure. The complexities are arguably multiplied in the case of Jessica since there is no overarching framework for the assessment of urban development measures.

There are three principal options available to Member States (and by extension managing authorities) to ensure State aid compliance of FEI measures. These are outlined in Box 6.1.

Box 6.1: Ensuring State aid compliance of FEI

- to design measures so that no aid is involved
- to design measures that fit within the parameters of the GBER so that measures can be implemented without prior Commission approval
- to notify measures to the Commission and await approval prior to implementation.

26 The framework and implementation regulations and successive COCOF notes.
27 This section does not discuss the special provisions on State aid relating to the impact of the crisis on the ‘real’ economy, see Communication of the Commission — Temporary Union framework for State aid measures to support access to finance in the current financial and economic crisis, OJ C6/5 11 January 2011.
As noted in the earlier report to partners, however, each of these options has certain disadvantages: the ‘no aid’ option requires some confidence that the measure does not indeed involve aid, not least since the consequences of failing to notify, then finding the measure to constitute incompatible aid are that the beneficiary may have to repay amounts received, possibly with interest; the ‘GER compliant’ option dictates the form, amount and focus of measures to an extent that may be too inflexible to deliver on the policy objectives sought; and the notification option often involves long delays and has an uncertain outcome.

Against this background, this chapter is divided into four parts. The first considers the opportunities for designing financial engineering instruments such that they contain no aid; the second looks at the so-called GBER compliant option; and the third reviews the State aid notifications of financial engineering instruments made by IQ-Net partners. The last section considers issues arising from Jessica in more depth, focusing on the recent landmark decision in Jessica UK(NW England), which seems set to be a precedent case on which other regions, encouraged by the Commission, are considering modeling their own notifications.

6.2 The ‘no aid’ option

The prerequisite for designing a measure that does not involve aid is to know what an aid is. This section begins by addressing that question before considering how a measure might be designed in order to avoid aid.

6.2.1 What is an ‘aid’?

Article 107(1) of the TFEU sets out a basic prohibition of State aid, but does not define what a State aid actually is:

Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

Nevertheless, this provision gives rise to five criteria which are summarised in Box 6.2.

Box 6.2: Criteria for measures to involve State aid

- The measure must confer a benefit or advantage on the recipient which it would not otherwise have received;
- it must be granted by the State or through State resources;
- it must favour certain undertakings or the production of certain goods;
- it must distort or threaten to distort competition;
- it must affect trade between the Member States.

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28 Wishlade and Michie op cit.
These criteria are cumulative - all must be met for a measure to involve aid - and each has given rise to a vast body of case law and legal literature. It is fair to argue, however, that a clear and consistent definition of what constitutes a State aid has yet to emerge. A detailed discussion of each of these is well beyond the scope of this paper, but it is evident that financial engineering instruments *de facto* fulfil some of these criteria. More specifically: it is established that the deployment of the Structural Funds constitutes an action of the State and/or involves State resources for the purposes of the State aid rules; and, on the basis of existing Commission practice, a potential threat to competition or impact on trade can generally be presumed. In short, it can largely be assumed that three of the five criteria are fulfilled. However, it does not necessarily follow that financial engineering measures benefit *undertakings* or that they involve an *advantage*.

The notion of *undertaking* is neutral as to ownership or legal status. The term is not defined in EU law, but it is established that it may be public or private, voluntary, charitable or not-for-profit, involve a group of organisations or a public-private partnership or indeed a self-employed individual; the key is not the status of the organisation, but rather that it must be engaged in an *economic activity* in order for Article 107(1) to apply. Economic activity is broadly defined as ‘any activity consisting in offering goods or services on a given market’.

Some activities are ‘non-economic’ owing to the exclusive competence of the State - the issuing of passports is an example. Similarly, the social nature of the activity may render it non-economic - the provision of national health, social security or education systems are regarded as non-economic activities. On the other hand, the status of an activity as economic or not also depends on the terms on which the goods or services are supplied - healthcare and pensions are obvious examples. Even if an entity provides services totally free-of-charge to users or customers and is financed entirely by the State, it may still qualify as an undertaking - museums, libraries and other public leisure facilities, for example, which could be important components of urban development plans under Jessica, cannot be excluded from the scope of ‘undertaking’ on this basis. On the other hand, where such beneficiaries do not qualify as undertakings (because of the nature of the activity), then the financing involved is a transfer of funds within the State, which does not constitute State aid.

Equally, where the beneficiary is an *individual* who is not engaged in an economic activity, there is no State aid. In this context, a Jessica programme for energy efficiency in Lithuania did not involve aid since the beneficiaries of the measure were individual home-owners who were able to access low interest long-term loans for the upgrading of their properties through a housing association.

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31 It follows that an entity can be regarded as an undertaking for some of its activities and not for others. For example, a museum organising an exhibition on a commercial basis would be regarded as an undertaking, but in its involvement in the provision of educational activities for primary school children would not.

32 For an overview of the programme which aims to improve energy efficiency in apartment blocks see:
Another open question is whether the measure *confers a benefit or advantage* under ‘normal’ market conditions. An additional complication in the context of financial engineering is identifying the recipient(s) of such benefits or advantages. However, it is important to note that the simple fact that a measure is provided through the State or with State resources does not condemn a measure as State aid. The market economy investor principle is key to determining whether there is an advantage.

*The market economy investor principle (MEIP)*

Reflecting the neutrality of the Treaty with regard to the system of property ownership in the EU,33 public bodies can participate in market activities without infringing State aid rules, provided that they operate on market terms. Accordingly, the so-called *market economy investor principle*34 has become an important criterion in assessing whether particular transactions – notably, but not exclusively, loans, guarantees and equity – involve State aid; according to this, if a public authority acts in the same way as a private investor would conceivably have done in the same circumstances, then no benefit is conferred. This can include accepting short-term losses in anticipation of longer-term gains, but would exclude wider public policy objectives such as regional development or job maintenance, which would not be relevant considerations for a private investor.

In the context of land sales by public authorities the Commission has issued guidance35 which sets out the procedures for ensuring that a normal market price is paid, and no aid is therefore involved; this guidance also forms the basis for valuations of land where match funding is provided ‘in kind’ in the form of land in Jessica initiatives. Essentially, such sales must either be the subject of an open and unconditional bidding process or follow an independent valuation of the assets in order for there not to be a benefit to the purchaser.

For financial engineering instruments, the key questions about whether a benefit is involved relate to the terms for public sector involvement and whether they are consistent with what a private investor would have accepted in relation, for example, to interest rates, anticipated returns, guarantees, and so on. The application of the MEIP is discussed in more detail below in relation to these various instruments.

*Compensation for Services of General Economic Interest*

A further issue which has given rise to a growing body of case law concerns whether there is an ‘advantage’ inherent in the compensation paid by public authorities for the execution of services of general economic interest (SGEI).36

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33 Article 345 TFEU.
34 This has been elaborated through a series of cases dating back to the 1980s – see Bacon *op cit*, pp. 41-50 for a detailed consideration of the relevant case law.
35 Commission communication concerning aid elements in land sales by public authorities, OJEC No C 209/3 of 10 July 1997.
36 SGEI are not defined in EU law but generally concern services that either the market does not provide or not to the extent and or quality desired by the public authorities, and which are in the
The precise contours of the ‘advantage’ continue to evolve, but in a landmark decision (the *Altmark* case)\(^{37}\), the Court concluded that compensation for the fulfilment of public service obligations does not constitute an advantage provided that the following four conditions are met:

- the public service obligations are clearly defined;
- the compensation is calculated in an objective and transparent manner;
- the compensation does not exceed the cost of discharging the relevant public service obligations, plus a reasonable profit;
- the level of compensation is based on an analysis of the costs which a typical, well-run undertaking would have incurred, unless the undertaking is chosen following a public procurement procedure.

Again in the context of Jessica, it is possible that some projects in the housing sector (in the EU12) could be classified as SGEI enabling State aid issues to be circumvented. However, the SGEI provisions are likely to be of limited general application, certainly beyond Jessica.

*De minimis*

Distinct from the Treaty provisions themselves in terms of aid definition and derogation from the general ban on State aid, the Commission has defined a level of aid below which Article 107(1) can be said not to apply - so-called *de minimis* aid. This arguably sits rather uneasily with the view of the Court of Justice,\(^{38}\) which historically has taken the view that even very small amounts of aid can have an impact on competition, but was driven by the need to reduce the administrative burden on the Commission and to focus resources on larger cases of aid.

The *de minimis* principle is enshrined in a Commission Regulation.\(^{39}\) This applies to aid to all sectors except agriculture and fisheries,\(^{40}\) coal, aid for the acquisition of vehicles by road transport undertakings, aid for export and aid for firms in difficulty. The essence of the *de minimis* rule is that aid of up to €200,000 per undertaking\(^{41}\) in any three-year period can be considered to fall outside Article 107(1), provided that the criteria of the Regulation are met. Of particular importance, *de minimis* support must be *transparent*. This means

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\(^{37}\) C-280/00 Altmark Trans GmbH, Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, ECR I-7747.


\(^{40}\) Separate *de minimis* rules apply to these sectors.

\(^{41}\) The ceiling is €100,000 in the transport sector; some activities are excluded altogether, notably agriculture and fisheries, export aid, rescue and restructuring aid and the acquisition of road freight transport vehicles.
that it must be possible to calculate *ex ante* the gross grant-equivalent of the measure without needing to undertake a risk assessment: loans may be regarded as transparent if the grant-equivalent is calculated on the basis of prevailing market interest rates; capital injections and risk capital measures are not considered transparent unless the capital provided is less than the *de minimis* ceiling. Aid provided under a guarantee scheme may be considered *de minimis* if the underlying loan does not exceed €1.5 million per undertaking. Also important, *de minimis* aid cannot be cumulated with other State aid in respect of the same eligible costs. Nevertheless, the absence of restrictions on how *de minimis* support is spent makes it a very flexible instrument, albeit of restricted value.

**6.2.2 The ‘no aid’ option in practice**

For financial engineering instruments, the main options to remove measures from the scope of Article 107(1) are either to ensure that transactions take place on market terms and there is accordingly no ‘advantage’ beyond that which the market would deliver or to ensure the intervention remains below *de minimis* levels, as described above. There may also be scope for an intervention to be structured as a Service of General Economic Interest, but none of the IQ-Net partners appears to have gone this route. A major complication in assessing the State aid compliance of some ‘non-grant’ measures is that aid may exist at one or more different levels - for example, in relation to the ultimate target (e.g. the firm in receipt of a loan), holding fund managers who are remunerated for investment management services and investors or lenders where loans are guaranteed or where the private and public contributions are asymmetric. For some types of instrument, the Commission has defined what can be regarded as ‘market terms’ enabling the design of measures that fall outside the scope of Article 107(1). These concern guarantees, loans and risk capital.

**Guarantees**

The Commission has set down various criteria\(^2\) which enable both individual guarantees and guarantee schemes not to involve State aid; in both cases a slightly simplified approach applies to SMEs. In the case of guarantee schemes, the key criteria are that:

- borrowers should not be in difficulty
- the guarantee should be linked to a specific transaction, for a maximum amount and limited in time; it should generally not cover more than 80 percent of the loan
- premia should be such as to make the scheme self-financing, including normal risk, administrative costs and yearly remuneration of an adequate capital; premia should be reviewed annually
- the eligibility criteria and terms for guarantees should be transparent for applicants

\(^2\) Commission notice on the application of Article 87 and 88 of the EC Treaty to State aid in the form of guarantees, OJEU No C155/10 of 20 June 2008.
• for SMEs, there is scope for either ‘safe-harbour’ premia\textsuperscript{43} or the use of a single yearly guarantee premium for all SMEs for amounts up to €2.5 million.

**Loans**

Loans which are offered at market rates and terms - the so-called reference rate - do not involve State aid. The reference rate is based on one-year inter-bank offered rate (IBOR) increased by margins ranging from 60 to 1000 basis points (i.e. 0.6 percentage points to 10 percentage points), depending on the creditworthiness of the company and the level of collateral offered. This approach is in line with the revised international capital framework introduced under the Basel II Accords. The base rates are published online\textsuperscript{44} and the margins to be added are set out in a Commission communication.\textsuperscript{45}

**Risk capital**

The situation for risk capital is more complex since, as noted in the risk capital guidelines,\textsuperscript{46} aid may be present at several levels - notably: investors, investment fund/vehicle and/or its managers and the firm in which the investment is made. Moreover, it does not follow that because aid is absent at one level, that it is also absent at others. Indeed, eight possible ‘constellations’ have been identified in Commission decisions concerning State aid and risk capital.\textsuperscript{47}

At the level of the investor, there is no State aid if the investment is effected on a pari passu basis such that the public and private investors share exactly the same upside and downside risk and rewards and hold the same level of subordination, and normally where at least 50 percent of the funding is provided by private investors which are independent from the firms in which they invest.

The Commission normally considers that an investment fund or vehicle is an intermediary vehicle for the transfers of funds to a firm, rather than a beneficiary of aid itself. However, it does not exclude that possibility. As far as fund managers are concerned, there is a presumption of no aid if the management company is chosen through an open a transparent public tender procedure and if they do not receive any other advantages.

Regarding target firms, if intervention is made on terms that would be acceptable to a private investor in a market economy, then no State aid is involved. Alternatively, if the measure provides public capital only up to the de minimis threshold (€200,000), then this falls outside the scope of Article 107(1).

\textsuperscript{43} Corrigenda to Commission notice on the application of Article 87 and 88 of the EC Treaty to State aid in the form of guarantees, OJEU No C244/32 of 25 September 2009.
\textsuperscript{44} See: \texttt{http://ec.europa.eu/competition/state_aid/legislation/reference_rates.html}
\textsuperscript{45} Communication from the Commission on the revision of the method for setting the reference and discount rates, OJEU No C14/6 of 19 January 2008.
\textsuperscript{46} Community guidelines on State aid to promote risk capital investments in small and medium-sized enterprises, OJEU No C194/2 of 18 August 2006.
**Box 6.3: Summary of ‘no aid’ criteria for financial engineering instruments**

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>De minimis</strong></td>
<td></td>
</tr>
<tr>
<td>transparent support</td>
<td></td>
</tr>
<tr>
<td>&lt;€200,000 cash grant equivalent over 3 years or guarantees relating to loans &lt;€1.5 million</td>
<td></td>
</tr>
<tr>
<td><strong>Service of general economic interest</strong></td>
<td></td>
</tr>
<tr>
<td>clearly-defined public service mandate</td>
<td></td>
</tr>
<tr>
<td>no over-compensation</td>
<td></td>
</tr>
<tr>
<td>compensation &lt;€30m pa per undertaking; and annual turnover &lt;€100m pa per undertaking</td>
<td></td>
</tr>
<tr>
<td>no limit on compensation amount for social housing, hospitals (and some small scale transport)</td>
<td></td>
</tr>
<tr>
<td><strong>Guarantees</strong></td>
<td></td>
</tr>
<tr>
<td>maximum 80% of loan</td>
<td></td>
</tr>
<tr>
<td>premia cover normal risks, costs and adequate capital</td>
<td></td>
</tr>
<tr>
<td>premia within safe harbour limit or single SME premium rate for guaranteed amounts up to €2.5m</td>
<td></td>
</tr>
<tr>
<td><strong>Loans</strong></td>
<td></td>
</tr>
<tr>
<td>interest at or over reference rates</td>
<td></td>
</tr>
<tr>
<td><strong>Equity / risk capital</strong></td>
<td></td>
</tr>
<tr>
<td>investors: public sector invests on pari passu basis</td>
<td></td>
</tr>
<tr>
<td>funds/fund managers: no specific transfers or benefits; manager selected by open tender</td>
<td></td>
</tr>
<tr>
<td>target firm: investment on ‘market economy investor principle’ or public capital &lt;€200,000</td>
<td></td>
</tr>
</tbody>
</table>

Overall, it is clear that financial engineering instruments must be carefully structured and designed if State aid is to be avoided altogether. Setting aside *de minimis* (the most straightforward route) and SGEI (arguably the most complex), the options for operating financial engineering instruments on a ‘no aid’ basis are summarised (in simplified form) in Figure 6.1.
Among the IQ-Net partner case studies, quite extensive use is made of the ‘no aid’ option, as summarised in Figure 6.2. Setting guarantees aside (which are only used in Hungary on a ‘no aid’ basis), it can be seen that, in general, State aid issues are avoided by offering loans on a de minimis basis and equity tends to be structured such that private and public contributions are pari passu. Exceptions to this are the loans under Jessica in Wales and London, which are offered at market rates, and the seed capital scheme in Latvia, which is provided on a de minimis basis. The main justification given for using the de minimis facility is, quite simply, ease of use. However, there are two main disadvantages to de minimis. The first is that the sums available are quite small, reflected in the fact that, with the exception of Portugal, de minimis is only used under business development schemes; it is unlikely systematically to provide adequate funds in the context of urban development programmes under Jessica. The second disadvantage is that the monitoring requirements for ensuring that the threshold is not exceeded in the three year period are onerous. In practice, few countries have very rigorous systems for ensuring this - Portugal is one of the
f ew that does. Many countries rely on declarations from beneficiaries and some partners have viewed this as a risk, for example in the context of audit or checks by DG COMP.\textsuperscript{48}

**Figure 6.2:** ‘No aid’ Instruments in Partner Case Study Measures

<table>
<thead>
<tr>
<th>MS</th>
<th>Measure</th>
<th>Instrument</th>
<th>State aid status</th>
</tr>
</thead>
<tbody>
<tr>
<td>DE</td>
<td>NRW/EU. Mikrodarlehen</td>
<td>Loan</td>
<td>De minimis</td>
</tr>
<tr>
<td>DK</td>
<td>Den Nordjyske Lånefond</td>
<td>Loan</td>
<td>De minimis</td>
</tr>
<tr>
<td>GR</td>
<td>Jeremy</td>
<td>Loan</td>
<td>De minimis</td>
</tr>
<tr>
<td>HU</td>
<td>Jeremy</td>
<td>Loan, guarantee</td>
<td>De minimis</td>
</tr>
<tr>
<td>LV</td>
<td>Jeremy</td>
<td>Seed capital</td>
<td>De minimis</td>
</tr>
<tr>
<td>PL</td>
<td>ESF loan fund</td>
<td>Loan</td>
<td>De minimis\textsuperscript{a}</td>
</tr>
<tr>
<td>PT</td>
<td>Jessica</td>
<td>Loan, equity</td>
<td>De minimis\textsuperscript{b}</td>
</tr>
<tr>
<td>SE</td>
<td>Regional venture capital funds</td>
<td>Equity</td>
<td>No aid - pari passu public/private contributions</td>
</tr>
<tr>
<td>SI</td>
<td>Slovenski Podjetniški Sklad</td>
<td>Debt financing</td>
<td>De minimis</td>
</tr>
<tr>
<td>UK</td>
<td>Jessica Wales</td>
<td>Loan</td>
<td>No aid - market interest rate</td>
</tr>
<tr>
<td>UK</td>
<td>Jessica London Green fund</td>
<td>Equity</td>
<td>No aid - pari passu public/private contributions</td>
</tr>
<tr>
<td>UK</td>
<td>Jessica London Green fund</td>
<td>Loan</td>
<td>No aid - market interest rate</td>
</tr>
<tr>
<td>UK</td>
<td>Scottish co-investment fund</td>
<td>Equity</td>
<td>No aid - pari passu public/private contributions</td>
</tr>
</tbody>
</table>

**Notes:** a). It is not entirely clear how \textit{de minimis} is applied in this case. b). The Portuguese authorities plan to notify Jessica, but in the interim \textit{de minimis} support is offered.

### 6.3 The GBER compliant option

As part of the rationalisation and simplification of the State aid rules, the Commission adopted a General Block Exemption Regulation (GBER) in July 2008;\textsuperscript{49} the GBER entered into force on 29 August 2008. The main purpose of the block exemption approach is to obviate the need for prior notification and approval of aid schemes in areas where the Commission has defined the circumstances in which it will find aid to be compatible with the common market. In other words, provided that a given measure meets the conditions set out in the Regulation, there is a \textit{presumption} that the measure is compatible with the Treaty.\textsuperscript{50}

The principal rationale for this approach is to reduce the administrative burden on the Commission which, in the past, had committed considerable resources to ‘rubber stamping’ aid schemes that national administrators had already taken care to ensure were in line with the Commission’s published guidelines. There is a considerable incentive for administrators to design measures that comply with the GBER, since measures that do not meet the precise criteria have to be notified; a potentially lengthy process with an uncertain outcome. Importantly, however, the GBER applies only to transparent aid with incentive effect. The downside, as noted earlier, is that the GBER may not enable the policy choices of managing authorities to be addressed adequately or appropriately.

\textsuperscript{48} For a discussion of the arrangements in IQ-Net partners for using the \textit{de minimis} facility see Section 2.2 in Wishlade and Michie, \textit{op cit.}

\textsuperscript{49} Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Article 87 and 88 of the Treaty (General block exemption Regulation), OJEU No L 214/3 of 9 August 2008

\textsuperscript{50} See Wishlade and Michie \textit{op cit} for an overview of the GBER as it relates to measures most relevant to the Structural Funds or Bacon \textit{op cit} for a more detailed analysis.
In the context of the Regulation, transparency means investment aid schemes under which it is possible to calculate ex ante the gross grant equivalent (GGE) as a percentage of eligible expenditure. Such schemes include grants, interest rate subsidies and capped fiscal measures.

Loans financed under Structural Funds programmes can be rendered GBER compliant by ensuring that the interest rates payable respect the grant-equivalent thresholds, taking account of the relevant reference rate, as described earlier.

Schemes which comprise a guarantee element may be considered transparent if the Commission has accepted the methodology used to calculate the intensity of the guarantee. Several countries (Austria, Denmark, France, Germany, Hungary, Italy) have notified methodologies for calculating the grant-equivalent of measures.51 These methodologies have been endorsed by the Commission, which effectively renders aid calculated according to these methods transparent.52 This enables the Member State concerned to report schemes under the GBER that use the methodology to calculate aid values and increases the scope of the GBER to include measures that would otherwise lack the transparency for exemption.

Repayable advances are transparent if the total advance does not exceed the aid ceiling expressed as a percentage of eligible expenditure. The following are not considered transparent:53 aid comprised in capital injections (without prejudice to the specific provisions on risk capital); and aid comprised in risk capital measures (except for risk capital aid schemes for SMEs that comply with the GBER).

The maximum value of loans and guarantees under the GBER will depend on the policy objective. The standard gross grant-equivalent rates for general investment are 10 percent for medium-sized firms and 15 percent for small firms. Where firms are located in assisted areas, these amounts are applied on top of the relevant regional aid ceiling. In countries with extensive assisted areas such as Poland, Czech Republic, Latvia, the flexibility under Jessica is considerably enhanced. By contrast, where assisted areas are limited or fragmented, as in France and the UK, the opportunities for Jessica-based funding are much more restricted at the project level since, outside the assisted areas, only SMEs can be supported in respect of general investment aid. Of course, loans and guarantees need not relate only to general investment, but could concern, for example, environmental


52 GBER, Article 5(1).

53 GBER, Article 5(2).
Between Scylla and Charybdis: Navigating financial engineering instruments through Structural Fund and State aid requirements

protection or research, development and innovation, for example, in which case the aid ceilings relating to those policy areas would apply.

Under the GBER, risk capital measures in the form of participation in a private equity investment fund are compatible with the Treaty if the following conditions are met: 54

- the tranches of investment made by the fund in any target SME do not exceed €1.5 million in any 12 month period
- at least 70 percent of the fund is invested in SMEs in the form of equity or quasi equity
- for SMEs in assisted areas and small firms, risk capital is restricted to providing seed capital, start-up and/or expansion capital; for medium-firms in non-assisted areas expansion capital is excluded
- at least 50 percent of the financing of the fund is provided by private investors (except where the fund exclusively targets SMEs in assisted areas, in which case the threshold is 30 percent)
- the risk capital measure must be profit driven (there must be a business plan for each investment and a clear and realistic exit strategy)
- the investment fund must be managed on a commercial basis.

As can be seen from the above, unlike loans, advances and guarantees, the aid element in risk capital cannot readily be calculated as a grant-equivalent sum. The provisions of Article 29 of the GBER largely mirror those of Section 4 of the Guidelines on State aid to promote risk capital, which are discussed in Section 6.4. It is worth noting in passing that, in many circumstances, it may be questionable whether there is any aid at all involved in measures that comply with Article 29 of the GBER. For example, where the public and private sectors invest on a 50/50 basis, investments are profit-driven and fund manager remuneration is performance-related, it is difficult to see how either the investor, the fund manager or the target SME would be in receipt of any advantage in the sense discussed in 6.2.1 above.

54 GBER, Article 29.
Box 6.4: Summary of GBER compliant criteria for financial engineering instruments

<table>
<thead>
<tr>
<th>Guarantees</th>
<th>Loans</th>
<th>Equity / risk capital (for SMEs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ approved valuation methodology</td>
<td>▪ interest rate reduction expressed in gross grant-equivalent does not exceed SME aid, regional aid, environment aid etc. ceilings as appropriate</td>
<td>▪ investment in profit-driven private equity investment fund, commercially managed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ investors: public sector invests on 50/50 basis, or 70/30 in assisted areas; private investors represented in decision-making</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ fund/fund managers: performance-related remuneration; &gt;70% of fund invested in SMEs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ target firm: investment tranches up to €1.5m pa; start-up and expansion capital for small firms and in assisted areas; seed capital/start-up capital only for medium firms in non-assisted areas</td>
</tr>
</tbody>
</table>

Among the IQ-Net partner case studies, some use is made of the GBER option, as shown in Figure 6.3. However, the scope is rather limited. In the main, the GBER is used for the compliance of business development (as opposed to urban development) measures. This largely reflects the fact that GBER compliance is restricted to SMEs or tightly-defined investments or is only available to large firms if they are located in assisted areas. In the Śląskie region loans and guarantees are, in principle, available under Jessica. However, in practice, guarantees will not be granted at all owing to the difficulty in using the instrument, the lack of demand and the fact that guarantees are limited to SMEs. In consequence, loans are the only instrument currently used (but a risk capital measure may be notified in the coming year).

Figure 6.3: ‘GBER-compliant’ Instruments in Partner Case Study Measures

<table>
<thead>
<tr>
<th>MS</th>
<th>Measure</th>
<th>Instrument</th>
<th>State aid status</th>
<th>Ref</th>
</tr>
</thead>
<tbody>
<tr>
<td>CZ</td>
<td>Jessica Moravia-Silesia</td>
<td>Loan</td>
<td>GBER objectives not specified</td>
<td>SA. 32229</td>
</tr>
<tr>
<td>GR</td>
<td>Jeremie</td>
<td>Equity</td>
<td>GBER Art 29</td>
<td>Not yet published</td>
</tr>
<tr>
<td>IT</td>
<td>Invitalia</td>
<td>Loan</td>
<td>GBER Art 15, 26</td>
<td>SA. 31665</td>
</tr>
<tr>
<td>IT</td>
<td>SME NOP Reserve</td>
<td>Guarantee</td>
<td>GBER Art 14, 15, 16, 21, 22, 23, 24, 31.2(a)-(c), 32,</td>
<td>SA. 32747</td>
</tr>
<tr>
<td>LV</td>
<td>Jeremie</td>
<td>Various</td>
<td>To be clarified</td>
<td>To be confirmed</td>
</tr>
<tr>
<td>PL</td>
<td>Jessica-Śląskie</td>
<td>Loan, guarantee</td>
<td>GBER Art 15</td>
<td>SA. 32805</td>
</tr>
</tbody>
</table>

6.4 The notification option

The third option open to managing authorities is to notify the measures proposed. This may be necessary where it is uncertain whether a measure involves aid or when the GBER is not

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55 This could, presumably, be resolved by notifying a guarantee calculation methodology which would render guarantees transparent and therefore potentially GBER-compliant.
considered to offer sufficient scope to support a project in the way envisaged or at the level of intervention desired. As mentioned earlier, the key benefit of notification is legal certainty; the main disadvantage tends to be the time taken for a decision.

Where a measure may constitute aid and does not fit within the GBER parameters, Member States are duty bound to gain authorisation from the Commission before the measure is implemented. A notified measure may fall to be assessed under one or more of a number of sets of guidelines or, it may be assessed directly against the Treaty provisions. In practice, most financial engineering instruments notified to date have been assessed in relation to the Guidelines on risk capital for SMEs, but at least two Jessica measures (UK-North West England and Andalucia) have been assessed against Article 107(3) of the Treaty, in the absence of a relevant framework for analysis; it seems probable that, using this experience more will follow.

For risk capital schemes aimed at SMEs there are, in effect, four ‘tiers’ of State aid compliance. As noted above (see 6.2.2), it is possible for such schemes not to entail any aid. Second, risk capital schemes may be designed to fit with the GBER (see 6.3). Third, there is essentially a presumption of compatibility under Chapter 4 of the State aid guidelines on risk capital (SARC) where certain criteria are met. These criteria are very similar to the GBER provisions, but the ‘safe harbour’ threshold of the SARC is more generous in terms of the tranche of capital that may be invested. Schemes falling within Chapter 4 must be notified, but are subject to a simplified (and swifter) approval procedure. Last, measures which do not comply with Chapter 4, are subject to a detailed assessment under Chapter 5. Under this assessment, the Commission seeks to balance the potential benefits of aid:

- existence and evidence of market failure
- appropriateness of the instrument
- incentive effect and the necessity for aid
- proportionality of the measures

against the possible negative effects:

- crowding out
- other distortions.

There are a number of notified measures among the IQ-Net partner case studies - these are set out in Figure 6.4. All concern risk capital measures targeted at SMEs.
The Finnish risk capital aid scheme provided through Aloitusrahasto Vera Oy (AVERA) was initially provided on a de minimis basis but it was concluded that these parameters were too constraining and the measure was notified in order that larger tranches of funding could be invested. However, the measure did not fulfil all the Chapter 4 criteria whereby compatibility could be presumed. In particular: (i) investments in the form of equity and quasi-equity were less than the 70 percent threshold; (ii) less than 7 percent of investment capital came from the private sector (compared to the general requirement of 50 percent); and (iii) investments included the expansion of target firms. In consequence the measure was assessed under Chapter 5. However, the Commission accepted: (i) the commitment of Finnvera to reach the 70 percent equity threshold in 12 months, (ii) that evidence of market failure in the early risk capital market justified the low participation of the private sector and that there were adequate safeguards to prevent crowding out; and (iii) that follow-on investments could be justified because the tranches were limited and the same commercial criteria applied to their assessment.

The framework scheme notified by France is particularly interesting insofar as it is not a measure per se but rather sets the parameters for compatibility of measures to be introduced under Jeremie in France. Reaching agreement with the Commission on this issue has been an extremely long process. The initial notification was made in October 2007, and a Commission Decision reached in July 2009; changes and an extension to the framework measure were notified in September 2010, and approved by the Commission in March 2011. A so-called circulaire was published at the end of 2009; this essentially provides instructions for subnational authorities on how to construct financial engineering measures that are State aid compliant. A revised version of the circulaire, taking account of the latest Commission decision, is currently under preparation. The notified framework comprises three elements: a co-investment fund; a risk capital fund; and a contribution to prospecting costs, covering half of those costs where an investment does not result. Regarding the co-investment fund, the Commission considered there to be aid at the level of the investor (because risk capital funding in a given firm could involve up to 75 percent of public funding) and, by extension, at the level of the firm. A similar conclusion was reached for the risk capital fund, because no minimum private sector investment was specified, the French authorities arguing that no such contribution could be guaranteed given the high-risk sector of the market. Moreover, the compatibility criteria under Chapter 4 of the SARC could not be satisfied, so that the Commission proceeded to an in-depth analysis under Chapter 5. The French authorities presented studies illustrating two...
dimensions to market failure: information asymmetries leading to credit and risk capital shortages for SMEs, especially those undertaking risky projects; and a lack of supply of credit and underdevelopment of the ‘business angels’ sector in France. On the basis of this, the Commission concluded that the measures proposed responded to the market failure identified and that the measure could be considered compatible. The later modifications to the scheme involved an extension of the timescale, an increase in the maximum tranches of investment (in line with the increase in the SARC), and a change in the management structure to merge the roles of the fund manager and the co-investment fund manager.

Overall, the main problem in the negotiations of the French Jeremie concerned the *pari passu*, because of the high level of public participation (50 percent) already present in French risk capital associations, which meant that adding ERDF automatically took proposed measures beyond the *pari passu* threshold; the Commission did not accept French proposals to exceed this, so that all the co-investment funds under the regime involve State aid. Although agreement was ultimately reached, the French authorities were surprised at how rigorous DG COMP scrutiny was, especially given the pressure from DG REGIO to implement financial engineering measures and the impact of the financial crisis on credit availability, especially for high risk investments. Moreover, the French authorities considered that inability of the market to supply the capital required by SMEs was clearly demonstrable, and yet there were apparently persistent concerns in DG COMP about crowding out and distortions in the credit market, even though the Basle agreements had led to a significant tightening of private investment.

The Hungarian Jeremie risk capital measure comprises loans (at market rates, so no aid) and risk capital investment in SMEs. In examining the measure, the Commission found aid at the level of the investor and the target SMEs. However, in both cases aid was found to be compatible with Chapter 4 of the SARC so that no in-depth analysis was required and the measure approved.

The Finance Wales Jeremie Fund was also subject to notification. This provides loans under market conditions (therefore no aid) and three types of risk capital intervention: a co-investment scheme; a technology transfer scheme; and a risk capital investment scheme. The Commission concluded that the risk capital measures involved aid at the level of the target enterprises. However, all but the risk capital investment scheme were found to be compatible with Chapter 4, which then stipulated that the investment tranches must not exceed €1.5 million, whereas Finance Wales had proposed tranches of €2.5 million, based on a study that suggested the need to be able to finance mezzanine/equity deals of up to £2-2.5 million; in addition, Finance Wales sought to fund expansion projects with risk capital outside the assisted areas, whereas Chapter 4 only allows for such investment within assisted areas. The Commission considered the scheme under Chapter 5, and

56 This threshold has since been raised to €2.5 million following the experience with the so-called Temporary Framework – see Communication from the Commission amending the Community guidelines on State aid to risk capital investments in small and medium-sized enterprises, OJ C329/4 of 7 December 2010.
accepted the study as evidence for the need for a higher threshold and for follow-on investments.

The Slovene National risk capital scheme was notified in 2008 and approved some eight months later. The measure involved a proposal by the Slovenian Enterprise Fund (SEF) to set up a venture capital fund in order to make risk capital investments into SMEs with leveraged private funding. There will be a Europe-wide call for tender to private investors inviting investment or co-investment in the fund. In considering the measure, the Commission concluded that: there was no aid to (potential) private investors; no aid to the fund itself; there was aid to the Fund manager, since it could not be shown that the fee payable reflected market rates; and that there was also State aid at the level of the target enterprises. However, the measure was assessed and found to comply with Chapter 4 of the SARC.

Published positive decisions tend to present a rather sanitised perspective on the overall process, in some instances, at least. In a number of cases a lengthy informal pre-notification process may have eliminated controversial elements from the ultimate notification; in addition, changes to the notification may be made in the course of negotiations in response to issues on which DG COMP proves to be intransigent. For example, in Finance Wales, an earlier proposal had included the eligibility of management buy-outs and buy-ins, but this was viewed as incompatible by the Commission and not included in the notification. More generally, it is worth noting that national authorities have a very powerful incentive to bring measures into line with DG COMP demands in the course of the negotiation process: if the Commission has doubts as to the compatibility of the measure, it must open the investigative procedure, a lengthy process involving comments from third parties, and which is unlikely to yield a decision in much under two years. Crucially, a measure cannot be implemented until the Commission has reached a final (positive) decision. Given \( n+2/3 \) and other time constraints for disbursing the Structural Funds, there are compelling reasons for reaching agreement with DG COMP without recourse to a full investigative procedure.

6.5 State aid and Jessica

To date, none of the IQ-Net partners have notified measures under Jessica, though several envisaged this as a possibility. In Portugal for example, there are plans to notify a measure similar to the recent approved Jessica scheme in the UK (North West England) and the Śląskie region also plans to notify some elements, reflecting the constraints of the GBER, especially in relation to large enterprises.

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58 Under Article 108 of the Treaty.
6.5.1 Urban regeneration and State aid issues

In a State aid context, Jessica presents particular challenges - more so than for business development measures targeted at SMEs. While the Commission has a well-developed basis for dealing with business development measures for SMEs, as outlined above, this is not the case for urban development measures where there is no overarching framework setting out eligible expenditure types or projects. Instead, there is a ‘Staff working document’ which argues that “a formal regeneration framework based upon limited experience can quickly turn out to restrict choices and options.” Instead, it sets out aspects of the State aid rules of relevance to urban regeneration with respect to definitional issues, the role of services of general economic interest and the scope for urban regeneration measures to be handled under the derogations related to other policy areas, such as training, culture and heritage, SMEs and regional aid, it also lists a number of regeneration schemes which it has approved. However, the guidance is insufficiently precise for domestic policymakers to conclude with certainty that no State aid issues arise, or, if they do, how to frame policy to ensure compatibility. This is particularly so in the context of private public partnerships - likely to be a key structure for Jessica implementation - where the document states inter alia that:

“In assessing state aid implications in PPPs, the Commission generally considers the following to be essential:

- The arrangements for financing the PPP may or may not result in a transfer of state aid to one or more of the private partners. State aid could be involved if there is over-compensation of the costs of the private partners.

- For all types of PPPs, private partners must be chosen in accordance with EC rules on public procurement, where these rules apply. A properly conducted tender procedure will provide reasonable assurance that private partners will be remunerated in line with market conditions. In the absence of a tender procedure, the Commission will look at the detailed arrangements of the PPP and the safeguards put in place to avoid overcompensation in order to determine if state aid is involved.”

For a number of years the United Kingdom government argued for a more formal and predictable framework for dealing with land and property market failures. This position was partly the legacy of the Commission’s 1999 decision on the United Kingdom’s English Partnerships PIP scheme, the loss of which was widely viewed as a ‘disaster’ at the time since the replacement schemes which the Commission would allow were viewed as inadequate. In this context, the United Kingdom authorities identified a number of

60 Many of these have been revised since the Vademecum was published.
61 State aid support for land and property development in sustainable communities - UK proposals for reform, URN 06/1661.
projects perceived to be ‘put at risk’ by the State aid rules. These included projects in pockets of deprivation or derelict land outside the assisted areas map (which means that regional aid ceilings do not apply) or projects comprising multiple elements - e.g. land remediation, historic buildings, new build and development - where the lack of clarity in the rules and the complexity in applying different rules to different elements of the project makes administration costly and complicated. More generally, the fact that ‘direct development’ by public authorities falls outside the State aid rules even where it arguably impinges on private sector markets, but that support payments for private sector led regeneration falls within them may be viewed as anomalous given the higher public cost of the former and the principle of equal treatment of public and private undertakings enshrined in the Treaty. This position was reiterated in a United Kingdom response to a Commission consultation where it was claimed that:

“In areas like this the Commission ‘winks at’ non-notification from most Member States on a massive scale despite the strong possibility that many such grants would be found to be State aid if the cases ever came to Court.”

Be that as it may, EPRC’s earlier report to IQ-Net partners on State aid argued that levels of State aid compliance under Structural Fund programmes may well be higher than under domestic policy, owing to the potential for greater Commission scrutiny and audit of almost all operations. Moreover, while it may be more straightforward from a State aid perspective for the private sector not to play a direct role, the very purpose of financial engineering instruments is to leverage in that contribution. In this context, it may be argued that the options for State aid compliant schemes within Jessica are limited, as discussed below.

### 6.5.2 The limitations of existing State aid rules for Jessica initiatives

Figure 6.5 shows two dimensions which affect the scope for State aid compliant instruments to be used within Jessica.

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66 Wishlade and Michie, op cit.
First, it is evident, as shown earlier this section, that the Commission has a distinctly more relaxed approach to the use of State aids in SMEs, with relatively wide scope for their use under the GBER or, following approval, under the SARC. Second, the corollary of this is that the conditions in which State aid for large firms can be compliant are much tighter, with some flexibility only in assisted areas, and then only in the context of soft loans or guarantees under an approved methodology; there is no explicit provision for equity investments in large firms to be compatible, though of course investments undertaken on purely market terms (the MEIP) fall outside the definition of State aid. As noted elsewhere, however, proving that an investment is undertaken on a MEIP basis is not always straightforward.

These two dimensions have significant implications for ensuring the State aid compliance of Jessica initiatives. First, in practice, it seems likely that the ultimate targets for investment will mainly be large undertakings (whether public or private) and that private sector investments are often likely to be made by property developers, unlikely to fall into the SME category. Second, outside the EU12, assisted area coverage is limited and does not typically coincide with the areas targeted by urban regeneration programmes, though there may be overlap. This means that, for regeneration projects located within assisted areas the regional aid ceilings would apply, but for non-assisted areas there would be no scope to provide aid unless the project were to fit within other guidelines, such as those relating to environmental protection. This situation arose in the English cities fund scheme, which essentially operated as a PPP but where support differentiated between projects according

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to where they were located. In practice, therefore, outside the assisted areas, the compliance options are largely limited to ‘no aid’ or notification.

**Figure 6.6: State aid issues and options in Jessica initiatives**

Figure 6.6 is a (simplified!) illustration of where State aid issues can arise under Jessica. One important theme to arise from the earlier discussion is that where the Commission finds aid to exist at the level of the investor or the fund manager, it tends, by extension to conclude that it also exists at the level of the target enterprise or investment. There is some evidence to suggest that managing authorities are factoring State aid issues into the process only at a late stage in the design of the system - with some even attempting to delegate State aid compliance to fund managers by including this as a task in calls for expressions of interest. A potential problem in failing to consider State aid issues from the outset is that the final structure may fall foul of the State aid rules and some elements of the arrangement may need to be re-negotiated at a late stage in the process, with the risk of further delays. In this context, Figure 6.6 also highlights the possibility of addressing State aid compatibility on a ‘systemic’ basis, reflecting the outcome of the Jessica (UK

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69 Formally, of course, responsibility for State aid compliance rests with the Member State.
North West England) decision. This decision, along with Jessica (Andalucía) - which has yet to be published, can be considered a landmark or ‘precedent’ case.

6.5.3 A ‘systemic’ approach to compliance: Jessica UK North West England

Provision for Jessica was made in the North West England operational programme and is considered to have had two main benefits: first, the creation of £100 million fund for urban development; and second, it enabled the programme to meet the first (‘challenging’) n+2 target of the programme.

Under the measure notified to the Commission, there is provision for sub-commercial public investments in order to provide incentives to private investors where the market by itself would not deliver urban generation projects. The investments are undertaken by the UDF in line with investment strategy of the North West Urban Investment Fund (NWUIF). The basic structure deployed is outlined in Figure 6.7.

The aim of the NWUIF strategy is to bring back into commercial use land or buildings which are derelict, contaminated, under-used or vacant and are suitable for business purposes. As such, eligible projects include site clearance and remediation; development of site specific infrastructure and site servicing; and construction of new buildings or renovation of existing ones.

UDF investments are made on a demand-led basis whereby project developers come forward requesting funding from the UDF. This process is intended to ensure competition between developers and between investors for UDF sub-commercial investments, not least since it is expected that there will be more projects seeking resources than the funding available. The UDF appraisal process seeks to ensure that proposals are selected on the basis of policy fit and the minimum profit margin sought by developers and investors, thus minimising the advantage gained.

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Of key importance in the present context, projects must meet specific financial requirements which are verified by the UDF manager. In particular, projects must be based on a sound business plan but show a financial viability gap that justifies the need for sub-commercial funding. This gap is said to exist if the gross development cost exceeds the gross development value. This means that the estimated rate of the return for the project promoter is below market benchmarks and a ‘fair rate of return’ (FRR). One of the tasks of the UDF manager is to establish what would be a fair rate of return. Having established the viability gap and the FRR, UDF managers determine the form, amount and conditions of the UDF funding required. These can include senior debt and subordinated loans at below market rates. Also, funding could take the form of equity investments in cash or kind on a non-pari passu basis, for example through preferential returns or different investment timing. In any event, there must be private investment in each urban project either through the UDF or directly and private investors must cover at least 50 percent total eligible project costs. In addition, the maximum UDF exposure in any form is limited to £6 million.
Box 5: Jessica UK North West England: Basic Structure and Tasks

**Holding Fund**: Northwest Urban Investment Fund (NWUIF).

- managed by the EIB
- comprises £50 million ERDF; £50 million from North West Development Agency, of which £12 million cash and £38 million land assets, the value of which was established in line with the guidance on land sales

- NWUIF provides a contingent loan of £30 million each to the urban development funds (UDF)
- *the main tasks of the NWUIF manager are*: procuring UDFs and negotiating operational agreements with them; evaluating UDF business plans and monitoring their investment activities; and treasury management of ‘idle funds’
- *the remuneration of the NWUIF manager is less 2 percent of annual average capital contributions* (so below the ceiling set in Article 43(4a) of the Implementing Regulation).

**Two UDFs**: Merseyside UDF and Evergreen (rest of the northwest) UDF

- EIB appointed Igloo Regeneration Limited as the Merseyside UDF manager and CB Richard Ellis as the Evergreen UDF manager following a competitive selection process
- UDFs do not carry out urban projects directly, but are investment vehicles which make repayable investments in line with the NWUIF Investment Strategy
- the NWUIF loan must be invested by the UDFs alongside an additional £30 million in public/private match funding (which may include land); private investments in the UDF may be made on a non pari passu basis in relation to sub-commercial UDF investments
- UDF are invested in the form of equity or loans on a sub-commercial basis, following calls for proposals which are appraised by the UDF manager
- the UDFs must seek to repay the loan from NWUIF. Any interest arising from the loan is paid directly to NWUIF (and used mainly to cover management costs). Repayments of capital (but not interest) may be reinvested by the UDF if they arise before 2021
- *the main tasks of the UDF manager are*: identifying, appraising and structuring investments in viable urban projects which fit with the UDF business plan and the NWUIF strategy; securing private/public match funding and the required level of private funding to ensure that UDF funds are appropriately leveraged; monitoring financial performance of urban projects and managing investment exits
- The *remuneration* of the UDF manager is partly performance-related and, after 2015, the UDF manager will only receive fees from returns in investment projects.

In examining the Jessica proposal notified by the UK authorities, the Commission, as outlined earlier in this section, considered at what levels aid might be present. It concluded that:

1. There is *no* aid at the level of the NWUIF (the holding fund), which was simply considered an intermediary vehicle for the transfer of resources.
2. There is *no* aid at the level of the holding fund manager (the EIB), which, the Commission noted, was ‘entitled’ to a fee up to the 2 percent cap set down in the Structural Funds regulations.

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73 *Commission communication concerning aid elements in land sales by public authorities, OJEC No C 209/3 of 10 July 1997.*
3. There is no aid at the level of the UDF, which was, again, simply considered an intermediary vehicle.

4. There is no aid at the level of the UDF managers since these were selected by competitive tendering and their remuneration therefore reflected market rates.

5. There is aid at the level of the private investor in the UDF to the extent that investments take place on non-pari passu terms with public funds.

6. There is aid at the level of the urban development project since, in some cases at least, the UDF will provide sub-commercial investments to cover a viability gap and make projects commercially viable.

As mentioned earlier, a key issue with urban development funding is that no single set of existing rules and guidelines is applicable, and the SARC are only concerned with investment in SMEs. In consequence (and in line with the UK authorities’ proposal, it appears) the Commission assessed the notification directly under Article 107(3)(c) TFEU, (though in practice, many of the principles applicable under the SARC are extended to this case). This is a comparatively rare process since the key trend in State aid discipline in the last two decades or so has been for the Commission to set out ex ante how it proposes to deal with certain types of aid, such as SME support, R&D aid, and so on.

In assessing measures directly against the Treaty the Commission undertakes an assessment to determine the negative and positive effects of the measure in question. Specifically, it considers whether the aid measure is aimed at a well-defined objective of common interest, whether it is an appropriate instrument and well-targeted and proportionate to the objective pursued, and seeks to establish whether it adversely affects trading conditions to an extent contrary to the common interest.

In undertaking the assessment the Commission readily found that the measure addressed an objective of common interest, this being urban regeneration pursuant to Articles 4, 14 and 174 TFEU.

Regarding the design of the measure, the Commission considered two dimensions: the improvement of market efficiency by tackling market failures; and the pursuit of equity objectives by tackling socio-economic deprivation. Regarding the former, the Commission took account of evidence provided by the UK authorities on market failures affecting urban regeneration in the region (such as undersupply of property due to perceived lack of demand; low returns) and noted that aid would only be provided to projects affected by those market failures (reflected in the ‘viability gap’). It concluded that the measure had the potential to improve market efficiency in the region. Regarding the latter, the spatial focus of the measure (on deprived urban areas) was sufficient for the Commission to view the measure as well-targeted.

As to the appropriateness of the measure, the Commission normally considers whether Member States have contemplated alternative (less distorting) measures than State aid. In this context, the UK authorities provided a number of studies suggesting that existing measures were inadequate to address the viability gap or were not suited to achieving the objectives of Jessica. The Commission concluded that the measures proposed were appropriate because:
Public funds are contributed as repayable investments to the UDF and then lent on in the form of equity or loans to urban projects. Grant funding combined with repayable investments will be subject to the same conditions and limitations. Each UDF must attract at least 50 percent of private funding to each project, of which private equity must account for a significant share. The NWUIF will be managed by the EIB and the UDFs by professional and independent fund managers.

The Commission takes the view that State aid must have an *incentive effect* to be compatible with the internal market, otherwise it gives rise to windfall gains that may result in various market distortions. The Commission therefore considered whether the measure would change the behaviour of private investors such that they would undertake the proposed urban regeneration project. In this context, it took account of the following:

- That projects must not start prior to an application for assistance being made
- That the NWUIF/UDF investments are based on a business plan and exit strategies defined *ex ante* to ensure that the funds are repaid
- That projects must have a realistic business plan, that is assessed by the UDF manager, itself a financial institution regulated by the Financial Services Authority
- That the UDF managers remuneration was based on the overall investment value, incentivising investment in efficient projects
- That there was an effective mechanism to establish financial ‘viability gap’ and thus the need for aid
- That the nature of the incentives was such as to encourage private developers to engage in regeneration activities and private investors to provide the necessary funding

With respect to *proportionality*, the Commission considers that this is achieved only if the same result could not be reached with less aid and less distortion. It is probably in this area that the Commission decision represents the most significant departure from existing practice, at least in authorising an aid *scheme*, as opposed to an individual award. This is because the Commission emphasis is on the existence of *criteria and processes* to ensure that the amount of aid is the minimum necessary to enable private developers to undertake urban regeneration projects; this is in contrast to the general approach which involves setting aid ceilings as a proportion of eligible investment. Nevertheless, the fact that the exposure of the UDF is limited to a maximum of £6 million was also seen as mitigating underlying project risks to the UDF. Other factors taken into account regarding proportionality concern the fact that there is a maximum public investment of 50 percent of eligible costs and that, having put sub-commercial investments out to tender, the UDF will select projects on the basis of their compliance with policy objectives and overall profitability involving the least amount of aid. In this context, the Commission considered that the FRR provides sufficient assurance that each transaction will be assess objectively, while the performance-based management remuneration of the UDF will provide a disincentive for UDFs to overestimate the FRR. More generally, the Commission considered that *sound investment management* - including the selection procedure for the UDF managers, issues of professionalism and independence (such as the requirement for an FSA
regulated body to manage the UDF), performance-based management remuneration and the monitoring and control mechanisms in place contributed to ensuring that the amount of aid would be at the minimum required, without having recourse to setting explicit aid ceilings.

As to the negative effects of the measures, only brief consideration is given to these in the decision (largely reflecting the fact that any such concerns would have been dealt with in the negotiations). However, the Commission concludes that because the aid is related to the viability gap, it does not provide developers with resources that can be deployed elsewhere. Moreover, because the scheme is aimed at those projects which the market would not undertake alone, there is no ‘crowding out’ effect. Last, since the process of offering sub-commercial investment is transparent and non-discriminatory - effectively projects competing among themselves - the minimum aid necessary is in effect determined through an open tender procedure.

Overall the Commission concludes that, on balance, the measure does not distort the proper functioning of internal market but provides an incentive at the minimum necessary to undertake projects which would not otherwise have gone ahead.

The key points to note about this analysis is that, as mentioned, it relies on processes and criteria to determine compatibility. While approval was given at the level of the operation of the fund, there is no need to calculate or justify the amount of State aid. Instead, this is deemed to be the minimum necessary since project developers effectively bid for sub-commercial investment, but projects must be viable and ultimately generate minimum returns to repay the UDF. Investors may participate in projects on a non-pari passu basis (for example, through asymmetric risk-sharing), but the return to co-investors is capped in relation to the FRR, while that to the UDF cannot fall below zero. In any event, public co-financing is limited to 50 percent of eligible project costs (70 percent in the assisted areas). For its part, the UDF manager must ensure that the contingent loans are ultimately repaid to the NWUIF and its remuneration arrangements are set to create an incentive for profit-oriented investments. More generally, there is a strong emphasis on the existence of credible structures and organisations operating according to externally determined professional norms, with an important role for independent experts in, for example, in determining the FRR.

At the time of writing, only one other decision on what might be termed ‘systemic’ approach to approving Jessica has been taken (in Andalucía), which as noted is currently unpublished. There is, however, apparently considerable interest in the model adopted in the UK, though given the long UK tradition of private sector involvement in regeneration it is unclear to what extent this model will prove to be ‘exportable’.
7. **ASSESSMENT AND FUTURE PERSPECTIVES**

The IQ-Net case studies of financial engineering instruments (FEIs) co-funded under Cohesion policy programmes and used to support SME development and urban regeneration are drawn from a wide range of programme type and size, and cover several different types of instrument. Some are well established while others have only just started their implementation phase. As a 2007 evaluation noted “Different funds are appropriate for different regions...[and]... there is no ‘ideal model’”.  

This section assesses the experience of IQ-Net partner managing authorities in preparing and implementing FEIs for SME support and urban development under their Structural Funds programmes, in terms of the administrative burden, the roles of public and private sectors, and their experiences with measuring impact. The section then turns to the regulatory proposals for the remainder of this period and for the next, and the extent to which the proposals address the issues identified by the IQ-Net partners.

7.1 **Administrative burden**

The administrative complexities associated with EU co-financed FEIs are a major concern of partners. This is due to the regulatory complexity and the need to manoeuvre through the often seemingly incompatible provisions of Structural Funds regulations, State aid principles, market investment principles and national legislative contexts.

One of the main issues is the asymmetry of knowledge and expertise. Managing authorities have knowledge and expertise of implementing Structural Funds programmes in their Member State/region, although the parameters set by the Structural Funds regulations are regularly changing, and are set to change again at the end of this period. Managing authorities often have limited State aid expertise, and the design and implementation of FEIs is particularly demanding in terms of State aid compliance. DG COMP case handlers have noted that those designing FEIs are prone to considering State aid issues late rather than early in the process. Neither DG COMP or DG REGIO, or the managing authorities, have expertise about investment principles or financial markets, which implementation of the more complex instruments requires. The equity-based instruments, in particular, may require managing authorities to act commercially, or at the very least, agree non-disadvantageous deals with private sector investors such as venture capitalists and business angels. There is a widespread perception among managing authorities that financial intermediaries (including the EIB and EIF, which many expect to act as Community institutions rather than as financial intermediaries), lack experience in dealing with Structural Funds regulations, State aid rules and the regional and national regulatory contexts within which Structural Funds programmes are implemented. To add to the

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74 CSES (2007) p. ix, p.x

information asymmetry, the language used in each policy sphere can be impenetrable to the non-initiated.

The administrative complexity can lead to compliance errors. In 2010, the European Court of Auditors found compliance errors in seven of the 13 ERDF and ESF payments they audited which were made to funds implementing FEIs. Most errors were due to non-respect of the regulatory requirements for making the contribution from the OP to the fund.

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**ECA report on compliance errors in relation to financial engineering instruments**

The 2010 European Court of Auditors report highlights a number of errors found in relation to FEIs. These included:

- **Excessive endowment of a guarantee fund managed by a regional financial body**: In the case of an ERDF project, the Court found that several required elements (such as the investment strategy and planning, the description of an exit policy and the winding-up provisions) were not in place when the funding agreement was signed by the regional government and the regional agency implementing the fund. Following the signature of this funding agreement, in the last week of December 2009, the endowment of the fund was increased from €17m to €233m (corresponding to 14 percent of the total budget of the OP for the entire programming period). Only in June 2010 was a business plan finally prepared and approved, albeit based on unrealistic assumptions. A significant part of the OP’s funding committed by the MA in 2007 had not been spent at the end of 2009. Increasing the amount allocated to the guarantee fund made it possible to circumvent the n+2 rule in place at the time by which unused funds must be de-committed after two years. By mid-2011, €1.5m out of a total endowment of €233m million euro had been pledged against this fund.

- **Delays in establishing a Jeremie holding fund managed by the European Investment Fund (EIF)**: for this ERDF project, a Jeremie holding fund had been set up through a complex structure involving three OPs and four different Ministries contributing to a Special Purpose Vehicle (SPV) to be managed by the EIF. After the signature of initial funding agreements with the EIF in October 2009, the MAs concerned declared expenditure which was certified to the Commission in December 2009. This expenditure was related to the contribution to the holding fund from two of the three OPs to a transitional account managed by the EIF. Negotiations regarding the SPV were, however, still ongoing with one of the Ministries in charge of managing the third OP. The final holding fund agreement between the EIF and the SPV was therefore signed only in late December 2010. As a consequence, the structure set up to implement the FEI was not operational during 2010 and the transfer of funds from the transitional account to the SPV took place only in 2011.

- **Irregular winding-up provision**: In the case of an ERDF project, the agreement signed by the national ministry and the regional agency implementing the Jeremie fund specified that, in the case of the winding-up of the fund, the remaining capital would be at the disposal of the regional government and should be transferred to the regional treasury. This provision is in breach of the regulatory requirement that resources returned can only be used for the benefit of SMEs.

Financial engineering instruments and Structural Funds regulations run to different timetables. Experience has shown that there is a mis-match between the Structural Funds regulations and FEIs in terms of timing, and that the regulatory requirements for the start and end of projects does not fit well with FEIs, as some estimate that the expected time horizon for FEIs is around 15-20 years, and the six-year programme period increases the risk of making bad investments. Also, the end of a programme period does not necessarily coincide with the point when a fund would stop making investments in a firm. The exit period required operating within a set time frame is not the way commercial funds would operate, and the size of the fund should be sustainable and therefore large enough to transcend/extend beyond programme periods.

Last, the administrative burden of ensuring compliance with State aid regulations has been considerable (see Section 6).

### 7.2 Public / private sector involvement in funding and managing funds

Some programmes have seen using FEIs as a means of increasing resources for development by leveraging in private sector funding for investment and also by drawing on private sector skills and expertise in managing funds. However, there is some variation between programmes, with some fund managers acting fully on a commercial basis (e.g. Scottish Enterprise) and others operating as private sector bodies but with a public vocation (e.g. the EIB and EIF but also e.g. Germany's Land banks). Tension between the managing authority's goals and those of the fund manager may be more evident if the private fund manager is strongly profit-oriented.

While private sector fund managers are primarily profit-oriented, managing authorities and other public bodies involved in Structural Funds programmes are likely to have layers of objectives. First, they may have relatively pragmatic goals, relating to financial absorption, the potential to set up 'revolving' funds as future resources, and a concern to balance FEI with other forms of economic development intervention, possibly including grant aid. Second, they are concerned with goals relating to regional or national development, which in turn may be complex and relate not only to the creation of new firms and jobs or an increase in private investment, but also to take into account the longer-term effects of public investment, as well as its impact on the geographical distribution of economic activity, social and gender inequality, and environmental sustainability.

There is potential for tension between this complex range of goals and the simpler, profit-oriented focus of private sector fund managers. This may be seen for example in relation to attitudes towards risky or innovative projects, with managing authorities typically wanting to support innovative projects and private fund managers seeing these as potentially undermining profit.

Some suggest that some of the problems associated with new instruments (particularly instruments) during this period could have been avoided by more consultation when the models were being developed. The mis-match between the EIB’s approach (described as ‘ultra-conservative’) and the types of projects which need ERDF support in integrated urban development plans can create major problems – leading to the situation (in Scotland, for
example) where the fund has to pick and choose parts of development projects, because of ERDF and EIB requirements. Similarly, it has been suggested (Hungary) that the role of the gap analysis and the design and preparatory procedure should be strengthened at Member State level to improve efficient implementation.

An evaluation of ERDF-funded venture capital and loan funds carried out for the Commission in 2007 points out that the extent of public or private involvement in venture capital and loan funds can have implications for risk management and the relative emphasis on regional development objectives versus purely financial objectives. Evidence from the evaluation suggests that public sector involvement leads to a greater focus on purely regional development objectives. Also, because the public sector shareholders perceive the impact on regional development as one of the most important aims of venture capital and loan fund interventions, they are often willing to assume greater risks and accept lower financial returns. This can increase deal flow and widen the impact on jobs. In contrast, private shareholders are likely to be more concerned with financial returns and see regional development impacts more in terms of the ‘demonstration effect’ arising from a professionally managed venture capital operation.

A second area where tensions may arise concerns Structural Fund horizontal objectives of sustainable development and equal opportunities. Several managing authorities/bodies operating funds feel strongly that if funds are to operate on a commercial basis, then there can be no conditions imposed on those managing the instruments, including with regard to the horizontal themes. For these instruments, the primary purpose (in terms of regional development) is development of the SME base. In Hungary, for example, it is considered difficult to incorporate the horizontal themes into FEIs, and that grants are the best vehicle for promoting these.

7.3 The impact of financial engineering instruments from a managing authority perspective

7.3.1 Methods

An evaluation for the Commission in 1998 noted that more emphasis was being placed on financial absorption than on outputs and impacts. This gave rise to concern that appropriate information on impacts was not being collected to allow the contribution of FEIs to regional development to be assessed. In November 2010, Professor Danuta Hübner

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said that ‘more work is needed to better understand the impact [of financial instruments] on the grounds and barriers to overcome’.  

An evaluation of co-financed FEIs in 2007 raised questions over monitoring, and the usefulness/appropriateness of the indicators being used for FEIs. For example, the evaluation pointed out the potential mismatch between funds investing in technology-based businesses designed to provide long-term returns and high-quality jobs, and ERDF measures on job creation during the programme period. Partner feedback on the use of indicators noted the difficulty of reconciling FEIs with the targets and indicators set out in the OPs. For Jessica funds in particular, output-based indicators such as ‘land developed’ are considered appropriate, but indicators relating to ‘number of jobs created’ do not work as well for infrastructure/regeneration investment. In Wales, the managing authority WEFO are investigating more suitable indicators to use with FEIs in the 2014-20 period.

It is too early for some of the case study funds to show evidence of impact. In France, for example, it is considered that an evaluation of the JEREMIE initiative can only be launched at the end of the programming period in order to measure its impact on the economic development of the concerned regions. A mid-term evaluation of the regional venture capital funds in Sweden has revealed some positive findings (see box).

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<th>Mid-term evaluation of the 12 regional venture capital funds in Sweden</th>
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At the time when the mid-term evaluation for the 12 regional venture capital funds was launched (mid-2010), most funds were still in start-up phases. Several had experienced a slow start, largely due to delays in the disbursement of regional co-financing, the need to develop procedures for the assessment and implementation of investments and lengthy recruitment processes. Also, the economic situation was uncertain, so many companies were cautious about investing in expansion and there appeared to be little capital in the market for new investment. It was challenging for many venture capital funds to ensure a sufficient flow of good deals and suitable investment partners, particularly in those regions dominated by large companies and industrial environments which had not historically had a culture of venture capital financing. In addition, regulations governing the activities of the ERDF-financed venture capital funds were perceived to be creating ambiguities, taking up time and leading to frustration and long investment processes.

However, according to the mid-term evaluation, the venture capital funds appear to have made good progress in the course of last year, and most are in line with, or close to, planned investment rates. The composition of the venture capital funds’ portfolio is generally regarded as good, i.e. investments

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78 Prof Danuta Hübner (November 2010) EU Perspective on today’s regional policy and the relevance of financial engineering instruments, Speech at Conference on JEREMIE and JESSICA: Towards successful implementation, 29-30 November 2010, Brussels.


have largely focused on small enterprises in early development stages. This is in line with the overall objective to address the gap in the supply of capital to SMEs.

The evaluation concluded that there is a risk that the rate of investment (particularly for Almi Invest Småland & Öarna, Almi Invest Västsvverige Värmland, Partnerinvest i Norr, Mittkapital Jämtland/Västernorrland and SEF II-III) may be below the projected rate of investment at the end of 2011. The evaluation also noted a long-term risk that Almi Invest Östra Mellansverige, Almi Invest Småland & Öarna, Almi Invest Västsvverige Värmland and Almi Invest Norra Mellansverige will not manage to invest the entire capital base made up of EU funds before the end of the project period. However, if the assessment takes into account whether these funds have entered into legal agreement to pay out additional EU funds, this risk is eliminated or at least significantly reduced. On the basis of the venture capital funds' total investment decisions, the funds are all expected to be able to use the entire capital base made up of EU funds before the end of the project period.

Those companies receiving funding under the initiative are generally satisfied with their relationship with both the venture capital fund and the private co-investors. The companies have used the capital primarily for market development, product development and skills acquisition, and most are experiencing a high investment value. Investment has generally contributed to faster expansion, more opportunities for other external financing, a higher ambition level, increased production capacity and professionalisation of board work. Further, many companies believe that the investment will ultimately lead to increased expertise and better profitability.

The overall question of whether the capital supply situation for businesses and the capital market has improved as a result of the initiative is difficult to answer, although there are indications that the initiative has helped to address the equity gap and has also attracted private capital. Just over one-fifth of the companies that participated in the evaluation decided to go ahead with the venture capital fund investment as no other source of investment was considered possible. A further quarter of the companies said that other investment sources were available but that they did not offer equivalent conditions. These figures indicate that the initiative has filled a market need and there is evidence of additionality. Almost half of the private co-investors who participated in the evaluation said they would probably not have made the investment at all without the venture capital fund's co-investment; for a further the amount would have been lower, indicating that the initiative has resulted in an increased volume of private capital investment. Consequently, there is at present no evidence that the investment has crowded out private capital.

There is an ongoing debate about methodologies for measuring the impact of FEIs. Scottish Enterprise, which manages the Scottish Co-Investment Fund, argue that market analysis (rather than fund-level evaluation) is the best way to measure impact (see box).
development in terms of transparency and performance. The report can be used to assess the impact of FEIs at industry level, and therefore whether FEIs are doing what they were intended to do at macro-economic level. Whilst fund evaluations provide information about what is happening at the level of the fund, the Market Report provides information on what is happening at the level of the economy, and builds up a store of longitudinal data.

The first report was published in 2003 and subsequent reports have been published providing annual market data and commentary up until 2008. The latest report for 2009-2011 will be published early in 2012.

7.3.2 Practical issues

A major public sector reason for using FEIs is the possibility of establishing a revolving fund that will make available funds after the programme period has ended. There was little feedback from IQ-Net partners on how the revolving aspect of funds is working - for most instruments, it is too early in the period for any funding to have been returned. Indeed, the managing authority in Latvia noted that more than a half of the programme period has been required to shape fund structures, select intermediaries, set up the funds and launch the calls for proposals, so use of funds as ‘revolving’ instruments will be quite limited (in this programme period) due to the time constraints. In France, the operation of revolving funds is incompatible with French law (the accounting system cannot register amounts that come back from a beneficiary).

There is some concern that, in the move towards increasing the use of FEIs under Cohesion policy programmes, grant aid is being portrayed as variously old-fashioned, bureaucratic or inefficient, and that there must be recognition of how important the contribution of grant-based instruments is to regional development. Others express the view that the real issue is not whether support is in the forms of grants or other FEIs, rather the issue is whether the aid (in whatever form) is well-focused and related to the programme strategy. Hence, the development of new financing forms should include an analysis of the regional development challenges to see what instruments are most suited to these needs.

7.3.3 Impact on economic development and the type of economic development

Some instruments which were launched relatively early in the programme period (or continued from the previous period) can be seen to be performing well. For example, because the NRW/EU Micro Loan Fund was initially set up on a pilot basis, the NRW managing authority decided to undertake an evaluation relatively quickly (in 2010, after launching the fund in 2008), in order to see whether the fund should be extended and made permanent, or whether any of its key features needed to be amended.\(^{81}\) The NRW/EU Micro Loan Fund is seen to have supported a relatively high number of firms and thus reduced funding constraints for start-ups and increased their chance of survival. It is thus considered

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to have been successful in filling a financing gap and to have addressed a market segment with genuine demand.

Some instruments have struggled with low levels of demand due to the financial crisis, and have had to scale-up marketing efforts. This echoes a 2007 report on ERDF-funded FEIs in England and Wales which found that all the funds examined needed to expend considerable effort on marketing to produce an acceptable level of interest, and hence deal flow, and not all were successful.\(^2\)

An example of an evaluation revealing that the use of a FEI is contributing to the goals of the OP can be found in Sachsen-Anhalt, where the mid-term evaluation of the SME Loan Fund revealed that the fund makes an important contribution to extending and modernising business capital stock and thus to the goal of economic growth. The fund also contributes to the programme goal of ‘improving employment opportunities’ by stimulating productivity growth, which in turn leads to wage growth and thus employment effects.

FEIs may not be equally useful to all programmes - smaller programmes may lack sufficient budget of capacity (for example, as in Vlaanderen, Niederösterreich and Steiermark (Austria)). In addition, FEIs may be unsuitable in some rural and sparsely populated regions, where the critical mass of businesses required to generate sufficient demand may be lacking (for example, in the Scotland Highlands and Islands).

There are a number of approaches to the horizontal objectives evident among the IQ-Net case studies using FEIs for SME support. Several case study instruments actively try to address horizontal themes. For example, the NRW/EU Micro Loan Fund is seen to contribute to horizontal goals relating to gender equality. Ex ante assessments during the design phase suggested that relatively small-scale, non-secured loans could be particularly attractive to women wishing to start their own businesses and, indeed, this has proved to be the case. Around 40 percent of loans (in terms of both number of loans and amount of funding lent) have been awarded to women, which, according to the 2010 evaluation of the fund, is considerably higher than the average percentage of start-ups which are run by women in Germany (26 percent). In Finland, horizontal criteria have been incorporated into Finnvera’s loan instruments, particularly in the context of environmental loans or loans for women. Finnvera financing is considered to have been particularly supportive of new businesses owned and run by women in the Länsi-Suomi programme area.

### 7.4 Future perspectives

For the period 2014-20, many IQ-Net partners are expecting to increase the role of FEIs in their programmes, while at the same time potentially receiving less under Cohesion policy. Experience gained during the current period is expected to provide lessons feeding in to the

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next period, particularly around the main areas which have caused uncertainty for a large part of the 2007-13 period.

- **The definition of the final beneficiary.** In Nordrhein-Westfalen, for example, current EU rules have been interpreted so that the NRW.BANK as intermediate body has had to undertake financial control tasks at the level of the individual firms and so the administrative burden has been very high. This has meant that the cost of administration relative to loans is very high in the case of the NRW/EU Micro Loan Fund, and this has been the subject of criticism by the Land Court of Auditors. This issue has also become a problem in relation to the other ERDF co-financed loan fund (NRW/EU Investitionskapital) where commercial/cooperative banks are involved as co-lenders. The banks end up having to take on some of the financial control tasks of an intermediate body. The NRW managing authority therefore supports EU-related financial control tasks being undertaken only down to the fund-level in future.

- **The use of interest and capital gains.** In Nordrhein-Westfalen again, this is not only affected by EU rules but also by Land rules. Discussion in Germany has centred on whether interest payments could be used to pay the fund’s administrative costs. In Nordrhein-Westfalen, this has not been done to date; instead, the interest has simply been recycled into new loans. A further question is whether funding could in future be used for a completely different purpose (i.e. after the end of the programme period). In Sweden, income accrued from interest on advance funds is currently deducted from the project budget. This practice is viewed to be odd given that it is not used in any other instance of advance funding in Sweden. From a management perspective, it is very complex to keep track of the interest income that is derived from those resources that have not been invested and the interest income that is based on revolving funds, and it is considered that it would be more reasonable to give this income to the projects from the start.

Areas where further clarification is felt necessary include the closure of revolving instruments. In Sweden, there are not yet sufficient programme resources to finance the management of a portfolio of businesses after the end of the programme period. The current closure procedures are viewed to be complex and unclear. For the future period, it would be important to decide who is responsible for what, decide on the tools for monitoring, and who should finance this.

In France, there has been a strong interest at national level to identify potential difficulties with the implementation of FEIs and to determine their contribution to strategic objectives. A working group has been set up by DATAR and the Caisse des Dépôts group, a long-term public investor, with the aim of preparing the negotiations on the future regulatory framework, to identify the needs of managing authorities and to discuss the challenges and the good use of FEIs (e.g. advantages compared to grants, support for small businesses, projects without immediate return). To that end, a survey was carried out among regional managing authorities to identify technical and legal difficulties as well as needs for the post-2013 period (see box).
A survey carried out in spring 2011 reveals interesting insights regarding concerns about the introduction of FEIs across France. At the start of the programme period, there was considerable uncertainty associated with understanding the regulations and intervention arrangements of FEI and uncertainty over the scheme to be applied, as well as on a number of specific issues, including the legal basis, timing and the time and cost of management. Reasons why plans for the set-up of instruments/sub-funds were abandoned include: a lack of private investors coming forward; heavy administrative and financial monitoring requirements; and legal, financial and technical complexity in the context of the ERDF OP.

Programme managers are keen on receiving support in the framework of technical assistance, notably for the post-2013 phase, and particularly with the selection of operators and the phase of concluding agreements (i.e. entry and exit of ERDF). More specifically, support is required regarding:

- the undertaking of calls for Expressions of Interest, the set-up of the management structure, and the conclusion of agreements (between the region, the financial intermediary and the fund manager, as well as between the financial intermediary and the firms);
- exit arrangements for ERDF; recovering and reutilisation of funds; closure;
- the application of aid schemes; eligibility of expenditure (cumulation and intensity);
- the parameters of a guarantee fund.

7.4.1 Regulatory changes for the remainder of the 2007-13 period

There has been considerable uncertainty on certain regulatory issues among managing authorities during the current period and a demand for clarification. A key difficulty has been ambiguity in some of the content of the regulations, leaving them open to interpretation, and problems emerging during audits. Successive COCOF notes have attempted to provide clarification, but without the legal certainty that managing authorities/legal teams/beneficiaries felt they needed. The Commission is proposing a regulatory amendment for the remainder of the period 2007-13. It is intended to incorporate into the Regulations the successive clarifications that have been elaborated in

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83 DOC COCOF/07/0018/01 (2007) provided definitions of ‘operation’ and ‘beneficiary’, guidance on selection of holding funds, financial engineering instruments and operations, and on management costs and major projects, advice on state aids and the retention of supporting documents for expenditure under financial engineering instruments. COCOF 08/0002/03 (2008) provided guidance on selection of holding funds, contributions to instruments other than holding funds, recycling of funds, interest subsidies, integrated urban development plans, audit trails, rules on revenue-generating projects. COCOF.10-0014-04 (2011) is a 34-page document with nine pages of annexes, with guidance on setting up operations, investment-specific issues, product-specific issues, interest and returns from investments, audit and control, management control by the managing authority, and issues such as State aid, public procurement, major projects and closure of programmes.

the COCOF notes. The proposal would modify Regulation 1083/2006 to cover repayable assistance that falls outside the scope of Article 44, and provide legal certainty that the rules on major projects, revenue-generating projects and on durability of operations do not apply for FEIs (i.e. instruments under Article 44). It also proposes a new obligation on timely spending (within two years of payment into the fund) and on increased reporting on financial engineering instruments by managing authorities. The vote on the proposal was scheduled for 1 December 2011.

The response of IQ-Net partners to the proposal has been mixed. There was a positive perception that the amendments (plus the latest revised COCOF guidelines) go some way towards clarifying several areas of uncertainty, for example, the definition of the final beneficiary. However, a number of reservations remain, as follows.

1. The regulatory amendment may not resolve the outstanding issues for the 2007-13 period.

   a) The Sachsen-Anhalt managing authority has been waiting for an extended period (18 months) for official Commission confirmation that interest payments and other yields on the domestic co-financing of initial contributions to a fund may be treated as domestic co-financing for subsequent contributions to the fund. The authority notes that the ongoing uncertainty is hindering the creation of a number of further funds within the Structural Funds programmes.

   b) There is still a need for further clarification about projects in the ‘grey zone’ between Article 44 and 55 (Sweden) and whether or not firms in difficulties and cases of transfer of firm ownership can receive support (France). There is concern under some English programmes that if reimbursable grants are categorised as financial engineering instruments, all the other rules relating to FEIs might not have been followed.

   c) An issue that has arisen in audit is that there is no precise and unanimous definition of “firms in difficulty” at EU level, and DGs have different views about at what level this should be defined (Latvia).

2. It creates new problems of substance.

   a) The proposed revision concerning the new obligation to ensure timely spending has been very unpopular, viewed variously as ‘rewriting the rules within the programme period’, ‘unrealistic’, ‘excessive’ and ‘incompatible with national legislation’, along with concern that the new rules would be applied retrospectively to existing funds. There was concern that enforcing this could conflict with the terms and conditions of the contractual agreements already drawn up with the EIB and UDFs for Jessica, putting them at risk. One managing authority argued that this would imply a shift away from the principle that loan/equity funds are assumed to support projects that are relevant from a
Structural Funds perspective, would restrict the flexibility of loan/equity funds and would generate an additional significant administrative burden.

b) There was a varied reaction to increased reporting requirements: while a couple of managing authorities did not foresee any problems with the proposed increase in reporting requirements, several viewed this as a negative development which would discourage rather than encourage the use of FEIs. There is a preference to [continue to] report on FEIs only in the Annual Implementation Report (the latest version of the proposal requires only annual reporting).

c) The proposals (also for the next period) are perceived by some managing authorities to have a negative impact (and be a disincentive for) directly managed funds.

3. **Process.** Although the clarifications are welcomed, the time-consuming nature of the legislative process raised doubts as to whether managing authorities would be able to benefit from the changes before the end of the period.

### 7.4.2 Regulatory proposals for 2014-20

The draft legislative package for Cohesion policy 2014-20 was presented on 6 October 2011. Articles 32-40 of the proposed new general regulation concern FEIs. The main provisions relate to:

- enabling the use of FEIs set up at EU level and models based on standard terms and conditions;
- addressing ambiguities and increasing legal certainty (e.g. around interest and other gains, re-use of resources and use of legacy resources);
- extending use to all types of investment and beneficiary.

In the next period, four main possible routes to using co-funding FEIs with Structural Funds are envisaged by the Commission:

a) a centralised debt and equity platform set up at EU level, for which there would be national discretion about participation;

b) off-the-shelf standardised instruments, with a very simple design. These could potentially be for loan, loan guarantee and co-investment models, with terms and conditions established such that the model could be ready-to-use, with, for example, state aids pre-cleared. This could reduce complexity and provide a ‘quick start’ model.

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c) tailor-made solutions; and

d) use of existing structures.

Many partners had not yet had time to prepare detailed responses to the draft regulations at the time fieldwork for this paper was carried out. Nevertheless, responses on the regulatory proposals were quite positive in general terms from several IQ-Net partners (Finland, Slovenia, Latvia, Italy).

There is wide-spread support for extending the support available from FEIs to cover a much broader group of final recipients (Śląskie ERDF, Latvia, Wales, Hungary), although this would only be true if these institutions (beneficiaries) are interested and motivated to apply for the instruments, and available evidence is not very convincing in this regard (Latvia).

There is a more mixed response to the remaining detail of the proposals, and whether they are expected to have a positive or negative impact on the implementation of FEIs. Aspects of the proposals regarded as beneficial include: abolition of the limited duration of projects; extension of the range of the final recipients; the clarification (and therefore legal certainty) they provide is seen as fundamental, particularly relating to control and audit activities; and clarification that there will be no audit below UDF level for Jessica instruments.

There were more reservations about several aspects of the draft proposals.

- The ‘off the shelf’ models i.e. FEIs set up at EU level and models based on standard terms and conditions, would even further extend the certainty and clarity of rules, but it is also possible that they may conflict with local needs, preference and regulations at the level of Member States.

- The ‘off the shelf’ type models would be welcomed by many so long as the ability for Member States and regions to develop their own instruments is maintained.

- There is a perception of imbalance between the treatment of instruments, based on whether the instrument is managed by Community institutions or whether the instrument is managed by domestic authorities, and that the use of FEIs is not as welcome when managing authorities choose not to involve the EIF or EIB.

- Any increased administrative burden related to increased reporting opportunities would not be welcomed.
8. ISSUES AND CONCLUSIONS

The aim of this paper has been to examine the experience of the IQ-Net partners with preparing and implementing non-grant financial instruments within their Cohesion policy programmes. It has focused on the challenges partners have encountered, how (and whether) these have been resolved, and compatibility issues such as State aids. The aim of this final section is to draw out some of the key issues which have emerged.

(i) There is an asymmetry of information and expertise

The set-up and operation on FEIs is administratively very complex, and requires detailed knowledge of Structural Funds regulations, State aid compliance and investment principles. The various parties involved often lack expertise in more than one of the three policy spheres concerned. Through the Jeremie and Jessica Networking Platforms launched in 2009, DG REGIO (in cooperation with the EIF and EIB) has supported the exchange of experience and best practice in implementation of these FEIs. Member States have also organised conferences and seminars to exchange information. While these various initiatives have proved useful, there is widespread frustration that many of the detailed implementation rules were not clearly established before the start of the programme. Moreover, uncertainties persist in many areas: concerns remain about how the recycling of funding will work on a practical level, about the mis-match between the Structural Funds Regulations and FEIs in terms of timing, about measuring impact and about incorporation of the horizontal objectives of sustainable development and equal opportunities.

In terms of the regulatory proposals for the 2014-2020 period, the draft proposals build on previous COCOF guidance and provide managing authorities with more legal certainty. However, a number of these proposals also raise issues, especially regarding timely spending and increased reporting requirements.

(ii) Public and private sectors objectives are not always easy to reconcile

The goals of the various parties involved in implementing FEIs may not necessarily coincide. There is potential for tension between the complex range of managing authority goals and the profit-oriented focus of private sector fund managers. This may be seen for example in relation to attitudes towards risky or innovative projects, with managing authorities typically seeking to support innovative projects and private fund managers seeing these as potentially undermining profit. While the development of a regional SME base is a core objective for the managing authority, it is merely an incidental by-product to a profit-driven private investor.

(iii) There are tensions around the role of the EIB and EIF

The roles of the EIF and EIB are not without controversy. Several managing authorities commented negatively on the capacity of the EIF to deal with the early phases of Jeremie implementation, a perception that was backed up by the EIB’s own evaluation report. In addition, some were scathing about both the EIB and EIF understanding of the intricacies of the Structural Fund Regulations and the State aid rules. Moreover, at best, the role of the
EIB is ambiguous. For State aid purposes the EIB (and the EIF) is viewed as a private investor, and yet it is explicitly not profit making and has among its tasks the financing of projects aimed at regional development (Article 309 TFEU). It is hard to reconcile this with the general requirement that the public sector must operate on a market investor principle basis if State aid is to be avoided. It would appear, however, that no Commission State aid decisions have seriously considered whether the EIB is a recipient of State aid or whether its role risks crowding out other participants in the capital market. At the same time, many managing authorities have been surprised at the strictly commercial approach taken by the EIB and EIF (albeit with their privileged status) having assumed that, as ‘Community institutions’ they would be dealing with supportive bodies rather than bankers.

(iv) **State aid compliance remains a major concern**

Several years into the current programming period, State aid compliance remains a major issue. In a past IQ-Net paper, one partner cited the relationship between Jeremie and the State aid rules as being symptomatic of a ‘serious dysfunction’ in the Commission, while another noted that coordination between DG REGIO and DG COMP had been particularly poor with respect to financial engineering. The extent to which State aid issues continue to cause concern partly reflects the information asymmetries outlined earlier but also the absence of a single coherent State aid framework for considering FEIs, leading to a highly fragmented approach with relevant constraints and parameters spread across a range of documents. It remains to be seen to what extent the landmark decision in Jessica UK(NW England) will prove a useful precedent for other managing authorities. If at the level of the Commission, the current rules are ill-adapted, if can also be argued than many managing authorities have been ill-prepared and may have given insufficient thought to State aid considerations at an early enough stage in the process.

(v) **Financial engineering instruments are not always the optimal approach**

Managing authorities feel under pressure to increase the proportion of their programmes spent on FEIs in future programme periods. However, they may not be suitable for all programmes. In particular, given the administrative burden (and expertise) involved in setting-up such structures, they are likely to be viewed as less useful in small programmes and in sparsely-populated areas where there are both few SMEs and a less well-developed capital market. In addition, the impact of the current economic crisis may mean that the capacity of financial engineering instruments either to leverage in private sector funding or to incentivise SME investment may prove to be limited.
9. REFERENCES


Government.  

http://publikationer.tillvaxtverket.se/ProductView.aspx?ID=1680

http://www.eprc.strath.ac.uk/iqnet/downloads/IQ-Net_Reports%28Public%29/ThematicPaper24%282%29Final.pdf
ANNEX: CASE STUDY FICHES
1. JEREMIE LANGUEDOC-ROUSSILLON (FRANCE)

KEY FEATURES

- EIF as Holding Fund manager
- Types of instrument: guarantees, co-investment, loans
- Key objectives: support for SMEs
- Spatial coverage: Languedoc-Roussillon region
- Date of implementation: 2008

STATE AID COMPLIANCE

- Venture capital instrument notified

BUDGET

- €30m
- Of which, €15m regional, €15m ERDF

RESULTS AND EVALUATION

- By September 2011, commitments were at €27m (90 percent), transfers to financial intermediaries in the form of investment capital and loans for start-ups was at €1.4m (10.8 percent) and investments at the level of firms was at €1.2m (7.7 percent) for operations launched before June 2011.

USEFUL LINKS

Regional webpage:

http://www.languedoc-roussillon.eu/nouveaux_dispositifs/jeremie.php#jeremie_lr
2. JEREMIE - GREECE

KEY FEATURES

- Holding Fund managed by EIF

- Types of instrument: loans, seed capital, co-investment, early stage venture capital, co-finance loans (only one instrument, for loans, is so far operational). Products will include:
  - Funded Risk Sharing (€60 million public expenditure) - Intermediaries (banks) will contribute the equivalent amount of public expenditure to share the risk and reduce the required collateral for the loans. Two financial institutions have been selected (National Bank of Greece, ALPHA Bank).
  - Micro credits (€30 million public expenditure and €30 million from private funding (banks)) - The contract with ALPHA Bank is in progress. The product is addressed to enterprises in all sectors of economic activity.
  - Seed capital - €10 million for aid in start-ups and investments at a very early stage, to be allocated to 3-4 fund managers.
  - Co-investment for "advanced" operations - €30 million will be available for private equity investments, to be implemented through a call from the EIF to a network of potential investors.
  - Early stage Venture Capital - €30 million to be allocated to firms in the form of risk capital, by creating an ICT venture capital fund.
  - Co-finance loans - co-financing business loans by Greek banks by 50 percent, sharing the risk for IT operations.

- Spatial coverage: nationwide

- Date of implementation: 2007

STATE AID COMPLIANCE

- de minimis (loans), GBER (equity)

BUDGET

- €250m (total)

RESULTS AND EVALUATION

- By 30 September 2011, 197 SME loans had been disbursed, worth €6.3m.

USEFUL LINKS

3. HUNGARY JEREMIE

KEY FEATURES

- National Holding Fund manager - Venture Finance Hungary plc
- Types of instrument: loans (New Szechenyi Loan Programme, New Szechenyi Combined Micro Loan, Small and Medium Enterprise Loan, Working Capital Loan), guarantees (Portfolio Guarantee Programme and New Szechenyi Counter Guarantee Programme), risk/venture capital (seed and start-up capital through Joint Fund measure; early stage and expansion risk capital through co-investment measure)
- Key objectives: support for micro-, small and medium sized enterprises
- Spatial coverage: nationwide. Under the risk/venture capital instrument, almost 90 percent of funds available will be for regions covered by the Convergence objective.
- Date of implementation: 2008

STATE AID COMPLIANCE

- Risk capital instrument notified, de minimis for everything else

BUDGET

- €836m
- Of which, €125m national/regional, €711m ERDF. ERDF contribution from two OPs - the Economic Development Operational Programme (EDOP) and the Central Hungary Operational Programme (CHOP)

RESULTS AND EVALUATION

- As at 18 October 2011, 240 contracts had been signed with financial intermediaries and 4939 contracts signed with SMEs, worth c. €211m

USEFUL LINKS

Synthesis of the Mid-term Review of the Operational Programmes
http://www.nfu.hu/a_felidei_ertekelesek_szintezise_2007_2013 (Hungarian version)

Presentations
www.eib.org/attachments/general/events/holding-fund-on-the-jeremie-implementation.pdf/
4. **LATVIA JEREMIE**

**KEY FEATURES**

- ELF initially Holding Fund manager, now replaced by Latvian Guarantee Agency.
- Types of instrument: two loan instruments (through the commercial banks AS “SEB banka” and AS “Swedbank”), a risk capital instrument (through Baltcap Management Latvija), a seed capital instrument and a start-up capital instrument (both Imprimatur Capital Baltics)
- Key objectives: manufacturing SMEs, SMEs operating in industries with high growth potential and enterprise developing new technologies (IT, telecoms, alternative energy, natural sciences)
- Spatial coverage: nationwide
- Date of implementation: 2010

**STATE AID COMPLIANCE**

- GBER, de minimis for seed capital (tbc)

**BUDGET**

- €154.5m
- Of which, €91m from joint ERDF and national co-financing, and €63.5m in private co-financing (from the banks)

**RESULTS AND EVALUATION**

- Low but gradually increasing up-take of instruments due to time-consuming evaluation of investment applications (risk capital) and changes needed to loan conditions due to economic crisis.
- 16 contracts for loans concluded, 10 contracts for risk capital, worth €14.6m (9 percent of total available financing)

**USEFUL LINKS**

- [http://www.esfondi.lv](http://www.esfondi.lv)
- [http://www.seb.lv/](http://www.seb.lv/)
5. SLOVENE ENTERPRISE FUND (SLOVENIA)

KEY FEATURES

- Slovene Enterprise Fund is Holding Fund manager
- Types of instrument: the holding fund offers guarantees (guarantees for innovative technology projects, classical guarantees (development guarantees, micro guarantees and guarantees for new businesses) and counter-guarantees for regional guarantee schemes) and mezzanine and venture capital
- Key objectives: support for SMEs
- Spatial coverage: nationwide
- Date of implementation: Holding fund created 2009

STATE AID COMPLIANCE

- De minimis (debt financing), risk capital notified

BUDGET

- €56.55m
- Of which, €48.07 from ERDF, €8.48m in national co-financing (plus €50 million from the Ministry of Education, Science and Technology for debt financing)

RESULTS AND EVALUATION

- Between 2003 and 2011, the SEF supported 3,762 SME projects. The guarantee credit line is running particularly well, and almost all the funds are spent.

USEFUL LINKS

http://www.podjetniskisklad.si/index.php?option=com_content&view=article&id=81&Itemi d=104
6. JEREMIE - SPAIN TECHNOLOGY FUND OP

KEY FEATURES

- Managed by Official Credit Institute
- Types of instrument: guarantees
- Key objectives: support for firms engaged in RTDI projects that are eligible for support from the Spanish Technological and Industrial Development Centre (CDTI)
- Spatial coverage: The territorial distribution of the Fund will match that of the NOP: 70 percent to Convergence regions (Andalusia, Castile-La Mancha, Extremadura and Galicia); 30 percent to the remaining 13 regions (including the Pais Vasco)
- Several regional governments in Spain have also set up JEREMIE Funds: Andalucia, Canarias, Catalonia
- Date of implementation: 2007

STATE AID COMPLIANCE

- N/A

BUDGET

- €70m
- Of which, €47.1m ERDF; the rest is co-financed by the Official Credit Institute (a public agency)

RESULTS AND EVALUATION

- N/A

USEFUL LINKS

Official Credit Institute

7. JEREMIE - WALES

KEY FEATURES

- Managed by Finance Wales
- Types of instrument: guarantees
- Key objectives: support for SMEs
- Spatial coverage: Wales
- Date of implementation: 2009

STATE AID COMPLIANCE

- Notification

BUDGET

- €175m
- Of which, €76m ERDF, €88m EIB loan, €18m Welsh Assembly Government

RESULTS AND EVALUATION

- The cumulative level of investment to end September 2011 was €87m invested in 362 SMEs. This level of investment represents approximately 49 percent of the value of the Fund. The geographic and sectoral spread of the investments is also considered to be good. The Fund has leveraged €139m of private sector investments and created 902 jobs so far. Loans are going particularly well.

USEFUL LINKS

Presentation on Wales Jeremie


Finance Wales

http://www.financewales.com/default.aspx
8. ITALY - REVOLVING LOAN FUND

KEY FEATURES

- Fund managed by Invitalia, the publicly owned agency for the attraction of foreign direct investment and enterprise development (formerly Sviluppo Italia)
  - Types of instrument: soft loans, linked to a grant scheme
  - The scheme operates through calls for tender; the proportion awarded between non-repayable and repayable aid is fixed by the calls for tenders and varies depending on the size of the firm supported.
  - Key objectives: innovation-oriented productive investments, linked to specific innovative sectors
  - Spatial coverage: Italian Convergence regions (Sicily, Campania, Puglia and Calabria)
  - Date of implementation: October 2011

STATE AID COMPLIANCE

- GBER

BUDGET

- €80m
  - Of which, €40m from national co-financing.

RESULTS AND EVALUATION

- So far, only first tranche of projects has been appraised.

USEFUL LINKS

www.invitalia.it
9. FINNVERA LOANS (FINLAND)

KEY FEATURES

- Financial instruments provided by Finnvera, a State-owned financing company
- Types of instrument: loans, including: investments and working capital loans; loans for women entrepreneurs; microloans; environmental loans; entrepreneur loans; guarantees and venture capital
- Key objectives: loans provide support for SMEs at different stages of the business cycle. Venture capital targets early-stage technology enterprises and technology-intensive or innovative service enterprises with international growth potential
- Spatial coverage: nationwide, ERDF co-financing in Eastern and Northern Finland, and the most challenging areas of Southern and Western Finland. Higher rates of award in regional aid areas, particularly the northern parts of the country.
- Date of implementation: 1998, loans ERDF co-funded since 2001 and venture capital co-funded since 2011

STATE AID COMPLIANCE

- Venture capital funds underwent notification

BUDGET

- In the partner OP of Länsi-Suomi, €16.37m has been channelled to environmental loans, entrepreneur loans, guarantee fee support, microloans, loans for women entrepreneurs, and investment and working capital loans. The proportion of ERDF co-funding is relatively small; of this total, €2.79 came from ERDF.

RESULTS AND EVALUATION

- In the partner OP of Länsi-Suomi, 1492 projects have received support in the form of investment and working capital loan (223), loan for women entrepreneurs (378), microloan (490), guarantee fee support (44), environmental loan (3) and entrepreneur loan (354).

USEFUL LINKS

FINNVERA

http://www.finnvera.fi/eng
10. NRW/EU MICRO LOAN FUND (NRW/EU.MIKRODARLEHEN)

 KEY FEATURES

- Fund managed by NRW.BANK, the Land investment bank

- Types of instrument: loans of €5,000-25,000, covering up to 100 percent of eligible expenditure, generally for a period of six years, with a fixed interest rate. Firms not required to provide security but must pay interest on the loans from the beginning of the loan period and must start to repay the loan after six months. Loans are conditional on the firm participating in an initial advisory session with STARTERCENTER NRW and in ongoing coaching sessions with an independent business adviser.

- Key objectives: support for start-ups and new SMEs

- Spatial coverage: Land of Nordrhein-Westfalen

- Date of implementation: initially set up on a pilot basis in 2008-10 but, following a positive evaluation report in 2010, has since been extended throughout NRW.

 STATE AID COMPLIANCE

- de minimis

 BUDGET

- N/A

 RESULTS AND EVALUATION

- Between 2008 and 30 September 2011, the fund had provided loans to around 430 projects, amounting to €8.7m

- Evaluated in 2010; Fund seen to have succeeded in filling a financing gap and to have addressed a market segment with genuine demand. Recommendations included reducing repayment-free period to increase awareness among the firm-owners of the need to repay the loan and to plan accordingly. This recommendation has since been adopted and the repayment-free period has been reduced from one year to six months. Found that integration of advisory services with loans had worked well.

 USEFUL LINKS

[www.nrwbank.de/de/foerderlotse-produkte/NRWEUMikrodarlehen/15262/nrwbankproduktdetail.html](http://www.nrwbank.de/de/foerderlotse-produkte/NRWEUMikrodarlehen/15262/nrwbankproduktdetail.html)
11. NORTH DENMARK LOAN FUND

KEY FEATURES

- Den Nordjyske Lånefond (DNL) is managed as a corporate foundation.
- Types of instrument: low interest loans for innovation and development activities
- Key objectives: SMEs primarily in the areas of production, tourism and services
- Spatial coverage: North Denmark region
- Date of implementation: 2009

STATE AID COMPLIANCE

- de minimis

BUDGET

- €8.06 m
- Of this, €4.03 is from ERDF.

RESULTS AND EVALUATION

- Loans worth approximately €2.7m had been awarded by October 2011. In 2010, 11 SMEs benefitted from the loan fund. The original loan fund from 2004 had a budget of €15.6, and €4.2m has “revolved” so far. A total of 49 SMEs benefitted from the original loan fund.

USEFUL LINKS

www.nordjysklaaneufond.dk
12. SACHSEN-ANHALT SME LOAN FUND (KMU-DARLEHENSFONDS)

KEY FEATURES

- Fund managed by Sachsen-Anhalt Investment Bank
- Types of instrument: mezzanine or traditional loans of between €25,000 and €1.5m for up to 15 years (with up to two years’ interest free)
- Key objectives: support for start-ups and existing growing SMEs, especially in the manufacturing sector, for capital investment and other relevant activities (e.g. R&D and patents). Can also finance innovative technology-oriented firms who wish to commercialise an idea.
- Spatial coverage: Land of Sachsen-Anhalt
- Date of implementation: 2007 (similar fund in place 2000-06)

STATE AID COMPLIANCE

- N/A

BUDGET

- €237.9m
  - Of which, €179.4m ERDF and the rest from the Land government

RESULTS AND EVALUATION

- Between 2007 and April 2009, the fund had provided loans to around 248 projects, amounting to €50.8m committed funding.
- Evaluated in 2009 and 2010, found to be contributing to the goals of the OP and that it is of continued relevance.

USEFUL LINKS

http://www.ib-sachsen-anhalt.de/firmenkunden/investieren.html
13. ITALY CENTRAL GUARANTEE FUND FOR SMES: NOP RESERVE

KEY FEATURES

- Fund managed by Medio Credito Centrale
- Types of instrument: counter guarantees i.e. second level guarantees on guarantees given by first level guarantee providers
- Key objectives: SME investment projects
- Spatial coverage: Italian Convergence regions (Sicily, Campania, Puglia and Calabria)
- Date of implementation: The Central Guarantee Fund already existed, the sub-fund from the National Operational Programme for Research and Competitiveness (NOP Reserve) for the Convergence regions was set up in 2009.

STATE AID COMPLIANCE

- GBER

BUDGET

- €100m
- Of which, €50m from national co-financing

RESULTS AND EVALUATION

- Implementation slow; first operation has just been approved. It is hoped that procedural changes, increase in guarantee threshold and promotional campaign will boost uptake.

USEFUL LINKS

http://www.mcc.it/
14. AQUITAINE CO-INVESTMENT FUND ‘AQUI-INVEST’

KEY FEATURES

- The co-investment fund is 100 percent owned by the region, which invests alongside the private sector and Business Angels on a pari-passu basis

- Types of instrument:

- Key objectives: investment in 20 SMEs at start-up, creation or development phase and active in the fields of innovation and sustainable development

- Spatial coverage and discrimination: Aquitaine region

- Date of implementation: December 2010

STATE AID COMPLIANCE

- No aid

BUDGET

- €3m (there are plans to top this up by another €1.5m ERDF in 2012, and another €1.5m from regional funds in 2013)

- Of which, €1.5m regional, €1.5m ERDF

RESULTS AND EVALUATION

- So far, five investments have been carried out involving €875,000 and further investments are lined up. This has levered in private funding of €2.8 million. Over the coming months, a further €475,000 will be invested, leveraging an expected €3.2 million of private funding (i.e. with a much higher leverage effect compared to earlier investments).

USEFUL LINKS

Regional presentation on Aqui -Invest

http://www.europe-en-aquitaine.eu/system/files/u1/Presentation-Aqui-invest_2-12-10_presse.pdf
15. SCOTTISH CO-INVESTMENT FUND

KEY FEATURES

- Managed by Scottish Investment Bank, part of Scottish Enterprise, a public-sector economic development agency
- Types of instrument: equity; the Fund forms contractual partnerships with venture fund managers, businesses and syndicates of business angels
- Key objectives: support for SMEs. Forms part of broader package of support available through Scottish Investment Bank
- Spatial coverage and discrimination: Scotland-wide
- Date of implementation: 2003

STATE AID COMPLIANCE

- No aid

BUDGET

- SCF II: €78m
- Of which, €31m from ERDF, €47m regional

RESULTS AND EVALUATION

- Overall to date (April 2008-September 2010), SCIF II has invested a total of £32 million in 110 companies. The overall largest recipient sector by value is software and computer services. Life sciences is also a significant emerging sector. The fund currently has 39 approved investment partners.
- A lot of the success of the SCF model can be seen in the growth of angel syndicates. From an initial two main groups involved in Scotland, this has grown to 20 syndicates within ten years.

USEFUL LINKS

Scottish Co-Investment Fund page at Scottish Investment Bank (Scottish Enterprise)

16. REGIONAL VENTURE CAPITAL FUNDS IN SWEDEN

KEY FEATURES

- 12 regional venture capital funds, operating under 8 Structural Funds programmes
- Managed by public sector agencies
- Types of instrument: risk capital
- Key objectives: investment in SMEs at start-up, creation or development phase and active in the fields of innovation and sustainable development
- Spatial coverage and discrimination: nationwide
- Date of implementation: Pilot projects introduced in 2005; 12 regional funds launched in 2009. In practice, there are only nine funds, since the Sydsvensk Entreprenorsskapsfond (SEF) II and III are delivered as one fund, as is the ALMI Invest Västsverige and ALMI Invest Värmland.

STATE AID COMPLIANCE

- No aid

BUDGET

- €264m in 12 regional venture capital funds.
- Of which, €73m from ERDF, the rest equally from public and private sectors.

RESULTS AND EVALUATION

- Mid-term evaluation completed September 2011 found that interest from firms has exceeded expectations. Most are in line with or close to the planned investment rates, and their portfolio composition is good. A total of 124 investment decisions have been made, involving total investment of 786 SEKm (328 SEKm from ERDF and public sources, and 458 SEKm in private co-financing).
- Most investments taken place in firms operating in the IT/Telecommunications and Industry/Transport sectors. In terms of size of firm supported, an overwhelming majority have fewer than nine employees.

USEFUL LINKS

Tillväxtverket, ‘Mid-term evaluation of regional venture capital funds, Implementation and lessons learnt’, September 2011 (not yet available online)

http://publikationer.tillvaxtverket.se/ProductView.aspx?ID=1680
17. JESSICA MORAVIA-SILESIA (CZECH REPUBLIC)

KEY FEATURES

- Holding Fund managed by EIB
- Two UDFs, managed by: a) the Czech-Moravian Guarantee and Development Bank; b) the private society Contera Management.
- Types of instrument: loans
- Key objectives: urban regeneration, i.e. public services infrastructure, tourism, brownfield regeneration (also for entrepreneurial purposes), regional marketing
- Spatial coverage and discrimination: Moravia-Silesia region
- Date of implementation: UDFs launched October 2011

STATE AID COMPLIANCE

- GBER, notification will be considered for projects which do not fit this framework

BUDGET

- €20.6m
- Of which, €3.1 national, €17.5m ERDF

RESULTS AND EVALUATION

- Too early: UDFs set up in October 2011; project selection has just begun.

USEFUL LINKS

Implementation of the JESSICA financial instrument in Moravia-Silesia


Implementation of the JESSICA financial instrument in Moravia-Silesia - Supplementary Study

18. THE LONDON GREEN FUND (JESSICA)

KEY FEATURES

- Holding Fund managed by EIB
- Two UDFs, managed by: a) Foresight Group LLP and b) second fund manager to be appointed
- Types of instrument: equity (waste fund) and debt finance (energy fund)
- Key objectives: The first UDF, the Foresight Environmental Fund, supports waste recycling projects. The second UDF, the Energy Efficiency Fund, will support energy efficiency projects mainly carried out by public sector bodies e.g. local authorities.
- Spatial coverage and discrimination: London, England (UK)
- Date of implementation: Foresight Environmental Fund launched December 2010;

STATE AID COMPLIANCE

- No aid.

BUDGET

- €116m
- Of which, €58m ERDF, €37m regional, €21m public sector (London Waste and Recycling Board)

RESULTS AND EVALUATION

- No projects yet.

USEFUL LINKS

JESSICA scoping study London


Greater London Authority webpage

http://www.london.gov.uk/erdf/jessica-london-green-fund

London Waste and Recycling Board webpage

http://www.lwarb.gov.uk/page/?identity=green-fund-%28lgbtq%29
19. **JESSICA PORTUGAL**

**KEY FEATURES**

- Holding Fund managed by EIB and contributed to by six OPs (the NOP Territorial Enhancement and the ROPs Norte, Centro, Lisbon, Alentejo, Algarve)

- Three UDFs, managed by: a) a consortium of ‘Caixa Geral de Depósitos SA’ (CGD, one of the largest banks in Portugal) and the government agency ‘Instituto da Habitação e da Reabilitação Urbana IP’ (IHRU, Institute for Housing and Urban Renewal); b) the bank ‘Banco Português de Investimento’ (BPI); and c) the government tourism agency ‘Turismo de Portugal IP’ (TdP)

- Types of instrument: loans and equity

- Key objectives: urban projects for sustainable development

- Spatial coverage and discrimination: nationwide

- Date of implementation: UDFs launched October 2011

**STATE AID COMPLIANCE**

- Notification being prepared, expected to follow design of North West England JESSICA notification. Until then, de minimis is being used.

**BUDGET**

- €130 million from ERDF.

- A further €60m leverage at UDF level (public) and €144m at urban project level (public and private capital) is anticipated.

**RESULTS AND EVALUATION**

- Too early: UDFs set up in October 2011; project selection has just begun.

**USEFUL LINKS**


20. JESSICA ŚLĄSKIE (POLAND)

KEY FEATURES

- JESSICA Fund
- Holding Fund managed by EIB
  - One UDF, managed by Bank of Environmental Protection
  - Types of instrument: equity, loans and/or guarantees
  - Key objectives: urban regeneration projects aimed at the revitalisation of degraded areas in big and small cities
  - Spatial coverage and discrimination: Śląskie region
  - Date of implementation: UDF signed in October 2011, with the Bnk of Environmental Protection (Bank Ochrony Środowiska, BOŚ)

STATE AID COMPLIANCE

- GBER

BUDGET

- €60m
  - Of which, €51m from ERDF, €9m from

RESULTS AND EVALUATION

- No projects yet.

USEFUL LINKS

JESSICA evaluation study for Silesia

21. **REGENERATION INVESTMENT FUND FOR WALES (JESSICA)**

**KEY FEATURES**

- JESSICA Fund
- No Holding Fund
- One UDF, managed by Amber Infrastructure (private sector, infrastructure project manager)
- Types of instrument: senior and mezzanine loans, equity and guarantees for senior loans
- Key objectives: urban regeneration projects
- Spatial coverage and discrimination: Wales. The Fund targets the Convergence region of West Wales and the Valleys although it is possible to invest outside that area.
- Date of implementation: December 2010

**STATE AID COMPLIANCE**

- No aid (loans)

**BUDGET**

- €64 million
- Of which, €29m ERDF, €35m Welsh Assembly Government

**RESULTS AND EVALUATION**

- No projects yet.

**USEFUL LINKS**

JESSICA preliminary study Wales


[http://www.rifw.co.uk/eng/index.html](http://www.rifw.co.uk/eng/index.html)
Improving the Quality of Structural Funds Programme Management through Exchange of Experience

IQ-Net is a network of Convergence and Regional Competitiveness programmes actively exchanging experience on practical programming issues. It involves a programme of research and debate on topical themes relating to Structural Funds programme design, management and delivery, culminating in twice-yearly meetings of members. IQ-Net was established in 1996 and has successfully completed four periods of operation: 1996-99, 1999-2002, 2002-07 and 2007-10. The fifth phase was launched on 1 January 2011 (Phase V, 2011-13).

IQ-Net Meetings

30 partners’ meetings and a special 10th anniversary conference have been held in 13 European countries during 15 years of operation of the network. Meetings are held at approximately six-month intervals and are open to IQ-Net partners and to observers interested in joining the network. The meetings are designed to facilitate direct exchange of experience on selected issues, through the presentation of briefing papers, plenary discussions, workshop sessions and study visits in the hosting regions.

IQ-Net Website

The IQ-Net Website is the network’s main vehicle of communication for partners and the public. The launch of Phase V has been accompanied by an extensive redesign of the site which comprises two sections:

- Partner Intranet Pages available exclusively to IQ-Net members.
- Public Pages which provide information on the Network’s activities and meetings, allow the download of IQ-Net Reports and Bulletins, and provide a news section on issues relevant to the Network.

The Partners’ section of the website provides exclusive services to members of the network, including access to all materials prepared for the IQ-Net meetings, a list of EU27 links (programmes, institutions etc.), partners’ contact details, a partners’ blog and other items of interest.

IQ-Net Reports

The IQ-Net Reports form the basis for the discussions at each IQ-Net meeting. They present applied and practical information in a style accessible to policy-makers, programme executives and administrators. The reports can be downloaded, at no charge, from the IQ-
Net website. To date, 29 thematic papers have been produced on both ‘functional issues’ (e.g. management arrangements, partnership, information and communication, monitoring systems) and ‘thematic issues’ (e.g. innovation, enterprise development, tourism). A similar number of papers have also been produced to review developments in the implementation of the Network’s partner programmes.

### IQ-Net Thematic Papers

- Financial engineering instruments and State aids in Cohesion policy
- Taking stock of programme progress: implementation of the Lisbon Agenda and lessons for Europe 2020
- The Reform of Cohesion Policy after 2013: More Concentration, Greater Performance and Better Governance?
- New Partnership Dynamics in a Changing Cohesion Policy Context
- Pandora’s Box and the Delphic Oracle: EU Cohesion Policy and State Aid Compliance
- The Financial Management, Control and Audit of EU Cohesion Policy: Contrasting Views on Challenges, Idiosyncrasies and the Way Ahead
- From Environmental Sustainability to Sustainable Development? Making Concepts Tangible in Structural Funds Programmes
- Making sense of European Cohesion Policy: 2007-13 on-going evaluation and monitoring
- Turning ideas into action: the implementation of 2007-13 programmes
- National Strategic Reference Frameworks and OPs, 2007-13
- Preparations for the Programme Period 2007-13
- Territorial Cohesion and Structural Funds
- Cohesion Policy Funding for Innovation and the Knowledge Economy
- The Added Value of Structural Funds
- Information, Publicity and Communication
- Mid-term Evaluation of the 2000-06 Programmes
- Mainstreaming Horizontal Themes into Structural Fund Programming
- The Structural Funds: Facilitating the Information Society
- Information into Intelligence: Monitoring for Effective Structural Fund Programming
- At the Starting Block: Review of the New Programmes
- Tourism and Structural Funds
- Preparations for the New Programmes
- The New Regulations and Programming
- Strategic Approaches to Regional Innovation
- Effective Responses to Job Creation
- The Evolution of Programmes and Future Prospects
- Equal Opportunities in Structural Fund Programmes
- The Contribution of Meso-Partnerships to Structural Fund Implementation
- Regional Environmental Integration: Changing Perceptions and Practice
- Structural Fund Synergies: ERDF and ESF
- The Interim Evaluation of Programmes
- Monitoring and Evaluation: Principles and Practice
- Generating Good Projects
- RTD and Innovation in Programmes
- Managing the Structural Funds - Institutionalising Good Practice
- Synthesis of Strategies 1994-96
IQ-Net Bulletin

The IQ-Net Bulletin promotes the dissemination of the Network’s activities and results. Fifteen issues have been published to date, over the period from 1996 to 2011. Bulletins are published using a standard format, with each providing summaries of the research undertaken and reports on the discussions which take place at IQ-Net meetings. The Bulletins can be downloaded from the IQ-Net website.

Admission to the IQ-Net Network is open to national and regional Structural Funds managing authorities and programme secretariats. For further information or to express an interest, contact Professor John Bachtler (john.bachtler@strath.ac.uk) or Dr Laura Polverari (laura.polverari@strath.ac.uk).