Innovative financial instruments in the context of the next multiannual financial framework

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PURPOSE: to define a framework for the next generation of innovative financial instruments with a view to meeting effectively the objectives set by the Europe 2020 strategy.

BACKGROUND: the Commission and its financing partners have undertaken considerable work on innovative financial instruments since the launch of the Europe 2020 strategy and the preparation for the next multiannual financial framework (MFF), in particular in the context of discussions on the future of specific financial instruments such as the **Competitiveness and Innovation Framework Programme** (CIP) or **Risk Sharing Finance Facility** (RSFF). Discussion has also begun with Council and Parliament in the context of the revision of the Financial Regulation. Strong focus has been put on the importance and **relevance of financial instruments** for the attainment of EU policy objectives.

The term "**innovative financial instrument**" covers a broad range of cases where financial support from the budget is provided **in other forms than pure grants**, including cases where EU grants are blended with loans from financial institutions. The intention behind an increased use of innovative financial instruments is however not to replace grant funding with financial instruments, as grants will still be necessary in a range of areas, but to **complement the grant funding** by supporting projects pursuing EU policy objectives through other forms of intervention.

- Some of the effects of the economic and financial crisis are likely to spill over into the first years of the next MFF and impact the functioning of financial markets in the years to come. There will be a need to mitigate the prevailing risk aversion to ensure access to capital for growth generating activity such as infrastructure, SMEs and innovation throughout the MFF period (2014-2020), and innovative financial instruments can play an important role in this respect.
- Innovative financial instruments combined with appropriate regulatory measures can also contribute to the development and consolidation of financial (capital and equity) markets as well as higher EU financial market integration, opening up alternative sources of finance for the growth generating sectors.

The **Europe 2020 Strategy** envisages an increased mobilisation of innovative financial instruments as part of a consistent funding strategy pulling together EU and national public and private funding. In its proposal for amendment of the Financial Regulation in the context of the triennial review, the Commission included a new Title dedicated to the budgetary management of financial instruments.

In the Commission's communication on the next MFF and the Budget Review, it is noted that innovative financial instruments could provide an important new financing stream for strategic investments, supporting long-term, sustainable investment at a time of fiscal constraint.

CONTENT: this Communication presents the Commission's view on **the design and management of innovative financial instruments** which should play an increasingly more important role in the EU budget spending of the 2014-2020 MFF. The Communication takes stock of the analysis work on a new framework for innovative financial instruments which has been carried out by the Commission's throughout the phase of preparation of the next MFF. It looks at the design and management of innovative financial instruments across policy sectors and sets out the next steps in achieving the Commission's ambition of a more streamlined, comprehensive and highly efficient and effective toolbox of innovative financial instruments to support the Europe 2020 Strategy objectives.

1) Lessons learnt from experience acquired between 2007 and 2013: for some of the currently existing innovative financial instruments (mainly those under the CIP), assessments in the form of audits, interim and *ex post* evaluations and studies have been carried out. A key conclusion at this juncture is that, due to the individual manner in which the existing innovative financial instruments have been developed, some instruments overlap in terms of areas and beneficiaries targeted and their design and management models vary, which could create confusion among stakeholders and beneficiaries.

In the design of the new generation of financial instruments for the 2014-2020 MFF, if instruments are to be rolled out at larger scale, focus should be on exploiting the experience with the existing financial instruments in order to **establish appropriate rules, guidance and standardisation for the design and management of innovative financial instruments in accordance with market requirements and best practices**, to avoid overlaps and simplify implementation modalities.

This – together with an appropriate cross-policy grouping of the innovative financial instruments proposed at EU level and enhanced consistency with such instruments implemented at national, regional, transnational or cross border level under structural funds programmes – will ensure an optimisation of their **impact and EU value added** in the next MFF.

2) Scope and sectors concerned: financial instruments are particularly suited to addressing sub-optimal investment situations in a broad range of policy areas, e.g. for business activities or infrastructures that are capable of being financially viable (in terms, for example, of revenue generating capacity), but do not (yet) attract sufficient funding from market sources. They are in particular relevant:

- **to foster the capacity of the private sector to deliver growth,** job creation, social inclusion and/or innovation, notably through support to start-ups, SMEs, microenterprises, social enterprises, investment in human capital, research institutions, business/science parks, knowledge/technology transfer, or investment in intellectual property rights.
- **to build infrastructures** with an earmarked revenue stream, making use of adequate funding structures, such as PPPs, to reinforce EU competitiveness and sustainability in areas such as transport, environment, energy and digital infrastructures.
- **to support mechanisms that mobilise private investments** to deliver public goods, such as climate and environment protection.

3) Innovative financial instruments for the 2014-2020 MFF: the innovative financial instruments dealt with in the Communication include instruments which **provide equity/risk capital**, or **debt instruments** (such as loans or guarantees to intermediaries that provide financing to a large number of final recipients who have difficulties in accessing finance, or risk sharing with financial institutions in order to increase the volume of finance and hence the impact resulting from the EU budget intervention).

The communication on the MFF presents **several of the Commission's sector-specific proposals** for innovative financial instruments in the next MFF:

- to support **investments in research and innovation** (RDI) under Horizon 2020, two financial instruments are planned: a debt instrument providing loans to single beneficiaries for investment in RDI, guarantees to financial intermediaries making loans to beneficiaries and an equity instrument;
- to support **competitiveness and SMEs**, two financial instruments are proposed: an equity facility for growth-phase investment and a loan facility providing direct or other risk sharing arrangements with financial intermediaries to cover loans for SMEs and provide cross-border lending or multi-country lending with a high leverage effect;

- to promote self-employment, micro-enterprises and social enterprises, the European Union Programme for Social Change and Innovation proposed by the Commission includes a Microfinance and Social Entrepreneurship axis which builds upon and continues the existing Progress Microfinance Facility;
- financial instruments under the Connecting Europe Facility for **infrastructure** are likely to include: a risk-sharing instrument covering loans and bonds (incl. the Europe 2020 Project Bond Initiative) and an equity instrument;
- in the area of **education and culture,** guarantee facilities are developed to contribute to the EU2020 objectives: a student loan guarantee facility to enable master level students to undertake studies in another country and a guarantee facility to incentivise financial intermediaries to extend loans to SMEs in the cultural and creative sectors;
- lastly, an increasing share of **support under the structural funds** will be delivered by means of financial instruments, in particular support to enterprises and other projects or investment activities that generate revenues, notably in the areas of climate change, environment, innovation, ICT and infrastructure.

4) Common rules for streamlining and rationalising instruments: the envisaged new framework for streamlining and rationalising the design and management of the new generation of financial instruments is based on what has been dubbed the **EU equity and debt platforms**. The platforms are a **set of common rules** and guidance for equity and debt instruments (including guarantees and risk sharing) for internal policies, ensuring a consistent approach to such instruments where they are supported by the EU budget. The common rules and guidance also aim to streamline relations with financing partners, in particular the international financial institutions and provide transparency vis-à-vis the markets on how the EU intervenes by means of equity and debt instruments, ensuring **higher visibility** of the EU's intervention. The EU equity and debt platforms would form part of a coherent body of horizontally applicable principles, rules and guidance.

As far as the **Structural Funds** are concerned, the highest possible consistency should be achieved between the instruments in shared and direct management and overlaps be avoided, in order to prevent that several instruments target the same beneficiary groups at EU and national/regional level while offering different terms. It should be made attractive to Member States to contribute to EU level instruments with their structural funds. A **3-options approach has been proposed** within the framework of the Structural Funds Regulations:

Member States continue creating tailor-made instruments under shared management principles, aligned with some common rules inspired by the EU equity and debt platforms under development for the EU instruments;

creation of "off-the-shelf instruments" under shared management principles which would facilitate the set-up of instruments for Member States as well as ensure compatibility with the EU-level instruments;

Member States would be encouraged to invest part of their structural funds in compartments of EU level instruments "ring-fenced" for investments in regions and policy areas covered by operational programmes from which structural funds resources are contributed (“joint instruments”).

The MFF Communication proposed further use of innovative financing in all **external policy instruments** (where appropriate through regional investment facilities) so as to mobilise additional funding – including from the private sector – in support of EU priorities and cover the investment needs of partner countries.

The use of innovative financial instruments in external policies should be supported under the EU platform for external cooperation and development combining the respective strengths of the Commission, Member States and European bilateral and multilateral financial institutions (notably the EIB) active in the external development and cooperation field. The platform will contribute to fostering EU coherence,

effectiveness, efficiency and visibility in external financing, while taking account of the specificities of the EU's external partners.

The Commission will continue its **discussions with Council and Parliament** in the coming months, both on the general framework to be created by the Financial Regulation and the Delegated Act replacing its Implementing Rules, and on the specific legislative proposals for the next MFF which will be successively adopted by the Commission in 4th Quarter 2011.