SUMMARY

Unlike pure grants, innovative financial instruments (IFIs) are EU budget tools that trigger equity or debt funding, for example in the form of investments in share capital, loans or guarantees. Financial institutions and intermediaries are often involved in their implementation on behalf of the European Commission (EC).

IFIs are not deemed to fit all kinds of public spending, but have features that make them attractive. Notably, they are expected to increase the impact of the EU budget by leveraging additional funding from other sources. In addition, IFIs generate income through amounts repaid by beneficiaries of funding that can be used for new operations in line with the same policy objectives.

Under the 2007-2013 Multiannual Financial Framework, a number of EU programmes developed different IFIs. Evaluations of some instruments have identified positive outcomes and shortcomings. The complexity, variety and number of IFIs can make it difficult to gain a complete overview of their activities.

The EC has put forward proposals to streamline the relevant tools, suggesting a greater use of IFIs under the 2014-2020 Financial Framework. The European Parliament is supportive of IFIs, but underlines the need to ensure transparency, accountability and democratic scrutiny.

In this briefing:

- Context
- 2007-2013: a short overview
- Beyond 2013: streamlining tools
- European Parliament
- Further reading

Context

The European Union (EU) has been using innovative financial instruments (IFIs) to support its policies for over a decade. The adjective "innovative" is meant to draw a distinction with traditional forms of EU budget spending such as pure grants. Also called "financial engineering instruments" or simply "financial instruments", IFIs include a wide range of interventions, which trigger repayable equity or debt funding, for example through equity and risk-capital investments, risk sharing, loans and guarantees.

The objective of IFIs is to stimulate economically viable investments in line with EU objectives. For example, projects eligible for support under the Project Bond Initiative include grid connections to offshore wind farms and gas-storage facilities. On the other hand, IFIs are not considered to suit projects of great public interest that have little or no capacity to generate revenue.

In principle, IFIs are expected to have a multiplier effect. This means that some form of EU budget backing for funds or projects should attract additional financing from other investors - either public or private. Especially in times of budgetary constraints, this feature is considered of interest, since it may allow the impact of the EU budget to be increased, while addressing shortcomings in the functioning of EU financial markets.
IFIs are usually implemented by financial institutions on behalf of the European Commission (EC). Relevant actors include the European Investment Bank (EIB) Group and its European Investment Fund (EIF), the European Bank for Reconstruction and Development (EBRD) and, in case of IFIs under Structural Funds, Member States' financial institutions with a public-policy mission. Financial intermediaries such as banks, venture capital and equity funds, and microcredit providers often play a role as well. This illustrates the complex and variable structure IFIs can have.

The Your Europe website gives an overview of financing opportunities available in each Member State (MS) through IFIs.

### 2007-2013: a short overview

In an Inter-institutional Agreement (IIA) of 2006, the European Parliament (EP), the Council and the EC stated that IFIs should be developed and act as catalysts for public and private investors.

#### Budget and policy areas

Under the 2007-2013 Multiannual Financial Framework (MFF), a little over 1% of EU budgetary resources (or €13.6 billion) was allocated to IFIs for internal and cohesion policies. IFIs are currently used in several areas such as transport infrastructure, access to finance for small and medium-sized enterprises (SMEs), research and innovation, energy efficiency, urban development and microfinance.

An EP Policy Department study (2012) regroups 25 instruments in three categories: 1) IFIs for internal policies managed by the EC centrally or jointly with financial institutions; 2) IFIs for cohesion policies under "shared management" with a significant role for MS; 3) IFIs for external policies. Development aid is an example for the last category, which includes some IFIs outside the EU budget, such as those under the European Development Fund.

### Results and areas for improvement

According to a second Policy Department study, in general the results of existing IFIs have been positively assessed in audits and evaluations. Looking at the multiplier effect of some IFIs, the authors note that in some cases the initial EU budget backing was accompanied by significant funding from other sources, but relevant figures can differ considerably from one instrument to another. Areas in need of improvement include the coherence between IFIs, as well as their visibility and transparency.

A previous EP study focused on the role played by the EIB and the EBRD, analysing possible concerns that an increasing use of IFIs raise. The design of IFIs does not create additional risks for the EU budget, since financial liability is limited to the amounts initially committed. On the other hand, the EP may encounter difficulties in exerting budgetary control over the implementation of instruments that are run through several intermediaries. The chain of responsibilities reduces transparency, making it complex to assess the effectiveness of spending. The study also highlights a problem of visibility: if IFIs often work through intermediaries, final beneficiaries may be little aware of the fact that they received funding due to an EU scheme. As regards effective policy delivery, the study deems the results to be mixed. Several IFIs produced significant outcomes. But a high variation in results across MS and SMEs could suggest that these instruments better suit relatively developed markets. The authors put forward recommendations that include strengthened auditing, while identifying other aspects of importance for the future of these instruments.

In 2013, a follow-up to the study on the EIB and EBRD’s roles states that information on IFIs, while still somewhat fragmented, is improving. In addition, audit in this field is considered to have increased.
European Court of Auditors

In its 2010 Annual Report, the European Court of Auditors (ECA) noted an accounting issue with regard to pre-financing under IFIs. In several cases, the EC had not initially properly recorded relevant payments as giving rise to an asset, due to a lack of comprehensive information. In 2011, the EC addressed this with data given voluntarily by MS. Subsequently, the legal basis was amended so as to make the provision of the necessary information by MS compulsory.

The ECA has also analysed specific IFIs. According to the special report on the SME Guarantee Facility, the management framework of this internal policy instrument is appropriate. While reporting requirements are satisfactory, performance indicators should be improved so as to monitor not only outputs but also the results and impact of a measure against relevant targets. Other recommendations include increasing transparency in the selection of possible financial intermediaries and maximising EU added value.

A 2012 special report tackles IFIs for SMEs in cohesion policy and notably under the European Regional Development Fund. The ECA says that the regulatory framework of Structural Funds, which was designed for pure grants, hinders the effectiveness of spending in IFIs. The ability to leverage private investment was low. In addition, funding reached beneficiaries with long delays. To address these shortcomings, the ECA recommends, among other things, improving the regulatory framework and setting up an appropriate monitoring and evaluation system specific to IFIs.

Economic crisis

A recent EP Policy Department study (2013) analyses the use of IFIs in cohesion policy, presenting their advantages and challenges and making suggestions to increase their effectiveness under the 2014-2020 MFF. The document identifies sluggish demand due to the economic crisis as one of the causes of the slow implementation registered by some IFIs. But it notes that implementation data differ significantly from one IFI to another, for example with a number of reports on microcredit instruments indicating an increase in demand and good functioning of the relevant funds during the crisis.

As regards IFIs for internal policies, a 2010 evaluation signals a rapid implementation of the Risk-sharing Financial Facility, whose objective is to improve access to debt financing for research, development and innovation (RDI). The analysis notes that, in the context of the financial crisis, this instrument remained one of the few available to innovative firms wishing to invest in high-risk RDI projects.

Project bonds

Indeed, the further development of IFIs has been seen as one possible response to the crisis by way of promoting investments in the real economy. For example, in 2012, Parliament and Council adopted provisions for the pilot phase of the Project Bond Initiative, which aims to attract funding from institutional investors for key EU infrastructure projects in the fields of transport, energy and telecommunications. Project bonds are issued directly by the project company, which can benefit from an enhancement of its credit standing thanks to the EU scheme implemented by the EIB. The EU budget contribution for the pilot phase is limited to €230 million. Yet, according to estimates available on the EIB website, its multiplier effect could trigger total investments of over €4 billion. The concept is expected to be further used under the new MFF, notably in the context of the Connecting Europe Facility.

Beyond 2013: streamlining tools

In its Europe 2020 strategy, the EC said that the potential of IFIs should be developed to support the objectives of smart, sustainable and inclusive growth. Along the same lines, documents accompanying the proposal for the 2014-2020 MFF indicate that...
cooperation on IFIs with the EIB group and other public financial institutions has been positive, and calls for greater use of these instruments.

**Commission communication**

A 2011 communication outlines the EC's vision for a new generation of IFIs, building on the experience gained through current instruments. The aim is to streamline tools in line with market requirements and best practices, simplifying implementation and avoiding overlaps. Reducing the number of schemes could also contribute to enhancing their overall visibility. To this end, *equity and debt platforms* are envisaged. These platforms would consist of a set of common rules and guidance for equity and debt instruments for internal policies (also called "EU-level instruments"), including the development of common operational requirements.

The communication notes the importance for IFIs under Structural Funds to be consistent and avoid overlaps, which can for example occur if they target the same beneficiary groups as EU-level instruments, while offering different conditions. Already put forward in the proposals for the new Structural Funds, the EC confirms its idea of an approach to increase coherence between the two categories of IFIs. In addition to developing their own instruments on the basis of some common principles, MS could invest part of their Structural Funds in EU-level instruments, with their contribution being employed only for relevant regions and policies. Or they could use "off-the-shelf" IFIs that mirror EU-level instruments.

As for the use of IFIs in external policies, this should be supported and streamlined by a platform investigating how to best use the instruments in combination with grants, taking into account the specificities of the EU’s partners in this area. Further to a public consultation, such a platform was launched last year.

**New Financial Regulation**

As a step in the attempts to streamline IFIs, Parliament and Council adopted the new Financial Regulation (FR) in 2012, which is complemented by its rules of application developed by the EC.

The FR introduces a specific legal basis for the use of financial instruments, which have been treated as exceptions to provisions on grants up to now. When examining the EC's initial proposal, the ECA considered this development to be appropriate, while making recommendations on ownership, reporting and the monitoring of IFIs. In addition, the Court suggested strengthening the capacity of the Commission’s staff to deal with instruments that are rather complex.

**Principles and rules applying from 2014**

Title VIII of the FR defines the scope and overall principles of financial instruments centrally or jointly managed by the EC. Unlike most of the FR which is already applicable, these provisions will apply from 1 January 2014 so that they can be aligned with the new financial programming period.

IFIs must promote the attainment of defined EU policy objectives and respect sound financial management. They should address market imperfections such as insufficient funding from the market for financially viable investments. IFIs can be established only on the basis of an *ex ante* evaluation and should not aim at replacing already existing public schemes or private funding. The instruments should not distort markets nor infringe state-aid rules. IFIs may be used in combination with grants, with separate records for each source of financing. The Union's liability is limited to the EU budget contribution, which should aim at mobilising additional funding from other sources.

The FR clarifies the rules for sums paid back to the EU such as loan repayments or guarantees released. In general, these funds will be reused by the same financial
instrument. This feature of revolving funds should also increase the impact of the EU budget.

The EC has the obligation to report to Parliament and Council on activities relating to IFIs on an annual basis, providing information and a number of data sets for each instrument.

The FR is complemented by rules of application, providing details on the management of IFIs, including on selection of entities entrusted with implementation, delegation agreements with those entities, management costs/fees, and a definition of leverage effect for Union funds.

Future instruments

The Commission’s proposals for the 2014-2020 MFF and related programmes called for a greater use of IFIs in a streamlined framework. Parliament and Council are currently examining the legal bases for the next generation of EU programmes.

On the basis of the relevant proposals, internal policy areas that could make use of financial instruments include:

- **Research and innovation.** Both a debt and an equity facility are planned under Horizon 2020.
- **Competitiveness and SMEs.** The COSME programme includes proposals for two facilities devoted to equity and loan instruments.
- **Education and culture.** Erasmus for All foresees a loan guarantee facility for the mobility of masters-level students. A guarantee facility for SMEs engaged in cultural and creative sectors is proposed under Creative Europe.
- **Social change.** To support employment and inclusion, a programme for social change and innovation could promote microfinance schemes for vulnerable groups and micro-companies.
- **Infrastructure.** According to the EC, huge investments in energy, transport and digital infrastructure will be needed in the years to come. To contribute to their funding, the Connecting Europe Facility could have a risk-sharing instrument for loans and bonds (including project bonds). An equity instrument is proposed as well.

As regards cohesion policies, the EC’s 2011 communication says that Structural Funds should deliver an increasing share of their support through IFIs, the use of which would also be encouraged under the European Social Fund.

European Parliament

Over recent years, the EP has shown support for the proper development of IFIs. In a 2011 resolution on the next MFF (rapporteur Salvador Garriga Polledo, EPP, Spain), Parliament stressed that, in order to meet the objectives of the Europe 2020 strategy, the impact of the EU budget should be maximised, leveraging additional funding from private and public sources for EU projects. Accordingly, it called on the Commission to put forward proposals to extend the system of innovative financing. The EP also noted the need to ensure utmost transparency, accountability and democratic scrutiny for IFIs.

In a second resolution (rapporteur Eider Gardiazábal Rubial, S&D, Spain) following the EC’s 2011 communication, the EP underlined that IFIs should not be employed as a strategy to reduce the size of the EU budget, but to optimise its use. Parliament made a series of recommendations, including:

- Each instrument must target one or more EU policy objectives.
- Objective ex ante assessments identifying sub-optimal investment conditions or market failures should be conducted to guarantee the effective running of IFIs.
- The right balance needs to be found between the need for monitoring and the effectiveness of implementation. To this end, the legal framework should be clear and simple. Accordingly, rules on

**Author:** Alessandro D’Alfonso  
**Contact:** alessandro.dalfonso@ep.europa.eu
reporting should be improved so as to guarantee reliability of information, on the one hand, and attractiveness of IFIs for investors, on the other.

- Reducing the number of IFIs could ensure their critical mass.
- As a principle, each IFI should be able to reinvest any income it generates. The adoption of the new FR is welcomed as progress in this sense.

In a 2013 resolution on improving access to finance for SMEs (rapporteur Philippe De Backer, ALDE, Belgium), the EP welcomed the EC’s new funding programmes that take into account the specificities of SMEs but asked for further development of tailor-made EU funding for SMEs. It called for a significant increase of budgetary allocations for IFIs under COSME and Horizon 2020. Parliament also considered that SMEs’ access to these IFIs should be improved.

**Further reading**


**Disclaimer and Copyright**

This briefing is a summary of published information and does not necessarily represent the views of the author or the European Parliament. The document is exclusively addressed to the Members and staff of the European Parliament for their parliamentary work. Links to information sources within this document may be inaccessible from locations outside the European Parliament network. © European Union, 2013. All rights reserved.

[http://libraryeuroparl.wordpress.com](http://libraryeuroparl.wordpress.com)

**Endnotes**

1 Notably those established under Council Regulation (EC) No 1083/2006 in the framework of Structural Funds.
2 See for example European Commission’s memo on Project bonds of 19 October 2011. In its 2011 communication on a new generation of IFIs, the Commission says: “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 [it]...”. The European Parliament also notes the complementary nature of IFIs in its resolution following the Commission communication, saying that these instruments should be aimed at optimising the use of the EU budget.
3 Two indicators measuring fund mobilisation are the leverage effect and the multiplier effect, but different EU documents use these expressions with different meanings. The rules of application of the new Financial Regulation now include a definition of leverage effect for Union funds. See also endnote No 9.
4 Answer by EC Vice-President Olli Rehn to a parliamentary question.
5 EC President José Manuel Barroso proposed the establishment of project bonds in his 2010 State of the Union speech.
6 The concept of Project bonds should not be confused with the contentious idea of having MS jointly issue bonds to cover their financing needs (sometimes referred to as “Eurobonds” or “Stability bonds”).
7 This is a company that is set up to finance, build and operate a specific infrastructure project.
8 Provisions for IFIs under “shared management” have to be laid down separately in the relevant Regulations.
9 Article 223 of the rules of application states: “The leverage effect of Union funds shall be equal to amount of finance to eligible final recipients divided by the amount of the Union contribution.” See also endnote No 3.