



EUROPEAN COMMISSION

European Structural and Investment Funds

Guidance for Member States on
Interest and Other Gains Generated by ESI Funds
support paid to FI (Article 43 CPR)

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

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1. REGULATORY REFERENCES AND TEXT

| Regulation | Articles |
|---|--|
| Reg. (EU) N° 1303/2013 Common Provisions Regulation (<i>hereafter CPR</i>) | Article 43 – Interest and other gains generated by support from the ESI Funds to financial instruments Article 46 – Report on implementation of financial instruments Annex IV |
| Reg. (EU) N° 821/2014 Commission Implementing Regulation (<i>hereafter CIR</i>) | Article 1 – Transfer and management of programme contributions Article 2 – Model for reporting on financial instruments Annex I |

2. BACKGROUND

2.1. Scope

The purpose of the present guidance note is to clarify how Member States should deal with interest or other gains generated from the investment of ESI Funds contributions to financial instruments (FI)¹.

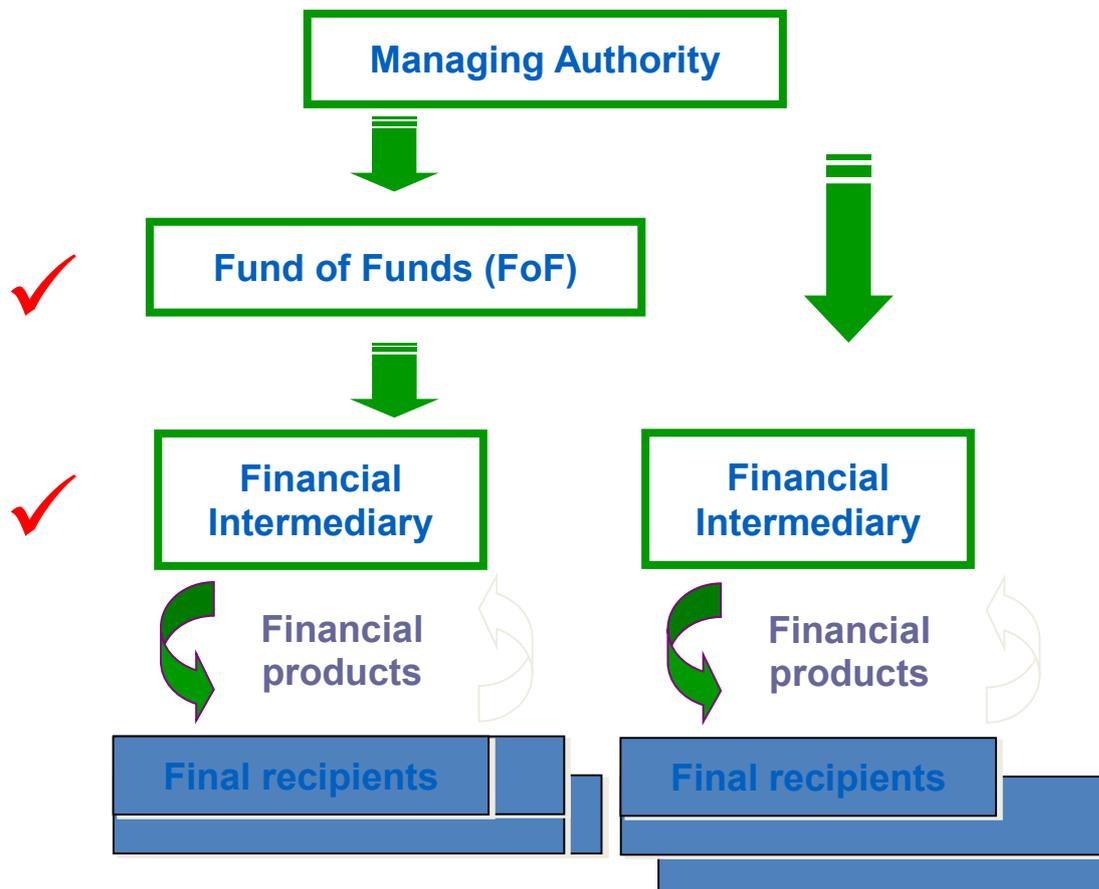
In the context of ESI Funds, the term '*treasury management*' is used in relation to Article 43 CPR which provides for investing the ESI Funds contribution to a FI following the principles of sound financial management, and regulates the use of interest and other gains generated thereto.

It is important to underline that the provisions of Article 43:

- concern only gains that are attributable to the ESI Funds support paid into the financial instrument, and not to other sources of contribution into the FI;
- they are applicable only to the ESI Funds support paid into the FI, at the level of a Fund of Funds or financial intermediary, that is not yet invested in final recipients (i.e. do not apply to the re-use of resources paid back into the FI which are referred to in Article 44 CPR).

Gains and other earnings attributable to support from ESI Funds which are generated from the investments made by the FI into final recipients, or from temporary investments of the resources paid back to the FI pursuant to Articles 44 and 45 CPR, are not the subject of this guidance note.

¹ For the purposes of this guidance the term 'financial instrument' is used in relation to both implementation possibilities - via Fund of Funds or via specific funds.



2.2. Difference in scope compared to the 2007-2013 period

| | 2007-2013 | 2014-2020 |
|----------------------------|--|--|
| Treasury management | Article 78(7) of Regulation (EU) No 1083/2006 provides that interest generated by payments from operational programmes to FEIs shall be used to finance urban development projects in the case of urban development fund, FEIs for SMEs, or energy efficiency or use of renewable energy in buildings. | In line with the extended scope of FIs in the 2014-2020 period, Article 43 CPR provides for a more diverse use of interest and other gains (as in 2014-2020 eligibility is not anymore restricted to urban development, energy efficiency and use of renewable energy in buildings and SMEs), by stipulating that they shall be used for the same purposes as the initial ESIF support into the FI, including for payment of management costs or fees. |

3. CONSIDERATIONS AND SPECIFIC POINTS TO LOOK OUT FOR

It is considered that there is ESI Funds support paid into a FI when (1) the managing authority uses for this purpose the advance paid in relation to the programme, or (2) the managing authority puts national resources in the FI first and declares them to the Commission for reimbursement as part of the eligible public expenditure. Article 43(1) CPR requires that this ESIF support paid into FIs is placed into accounts domiciled within financial institutions in Member States and invested on a temporary basis. Such investments should be in line with the principles of sound financial management and should follow a prudent treasury and investment behaviour, aiming to achieve best value for money. The body implementing FIs should apply the standards of due diligence and care it normally applies when managing its own treasury portfolios, providing at the same time for sufficient liquidity for meeting commitments and execution of payments due in a timely manner. The treasury investment strategy for ESI Funds resources as stipulated in the funding agreement does not need to be exactly the same as the treasury investment strategy followed for own or other non-ESI Funds resources under the management of the body implementing the FI. As a result of the treasury investments, interest or other gains (such as dividends, capital gains or other profit earned from the investment) could be generated.

The treasury investment and the related risks (including with respect to negative interest and asset management losses – see section 3.2.2 below) should correspond to a pre-agreed risk profile and investment strategy. The requirements and procedures for managing the interest and other gains, the acceptable treasury operations and investments, the responsibilities and liabilities of the parties as well as the provisions for record keeping and reporting should be agreed upon in advance between the managing authority and the body implementing the FI and included in the relevant funding agreements (including between the body implementing a Fund of Funds and a financial intermediary) (see point 1(g) Annex IV CPR).

A treasury management fee or reimbursement of costs incurred by the body implementing FI for carrying out the treasury management activities, may be covered as part of the eligible management costs and fees referred to in Article 42(1)(d) CPR.

3.1. Treatment of the gains

The interest and other gains generated from the ESI Funds support paid into the FI represent a financial advantage, which is additional to the programme contribution to the FI. Therefore, the gains generated cannot be considered to be part of the ESI Funds contribution into the FI and should not be treated as programme resources. As a consequence, with the exception of Articles 43 and 46(2)(g) CPR, other, rules laid down in Title IV CPR are not applicable to them.

Nevertheless, since these gains are earned from ESI funding which is not yet used for its main purpose (i.e. investments in final recipients), Article 43(2) CPR requires that these must be used, until the end of the eligibility period, for the same purposes:

- either within the same financial instrument, or

- if the financial instrument is wound up, in other financial instruments or forms of support.

In the case such resources are used within the same FI, it is expected that they mirror the way in which the initial ESI Funds contribution is used in the FI:

- by being added to the capital of the fund and used for investments in final recipients targeted by the FI, and
- being used to cover a share of management costs and fees to bodies implementing FIs which is proportionate to the added capital used for investments as specified above.

However, concerning their use to cover management costs and fees, it should be borne in mind that the interest and other gains do not represent programme resources. Therefore the management costs and fees paid in order to manage gains added to the capital of the fund and to be used for investments in final recipients targeted by the FI, do not represent eligible management costs and fees (see also section 'Questions and Answers' in the Commission's *Guidance note on Eligible Management Costs and Fees for Financial Instruments Managed in Accordance with Article 38(4)(b) CPR- EGESIF_15-0021-02*) and as such do not count towards the maximum thresholds for eligible management costs and fees as stipulated in Article 13 CDR either.

In the case of winding up of the originating FI, the interest and other gains can be used² for investments either (1) within other financial instruments set up under the CPR, or (2) through other forms of support, such as grants, prizes or repayable assistance.

However, in both cases their use has to be in line with the respective priority objectives³ and within the eligibility period.

Finally, the interest and other gains used in line with Article 43 cannot be declared as eligible expenditure at closure. They cannot be used either for the purpose of contributing to the national co-financing to the FI, nor to cover the cost of borrowing money in the financial market for that purpose.

At closure, interest and other gains which by the end of the programming period have not been used in accordance with the provisions of Article 43(2) CPR should be deducted from the eligible expenditure.

² 'Used' here is understood as investments in final recipients for (1), and in analogy to the eligible programme expenditure for (2).

³ Programme priority objectives or measure objectives in the case of EAFRD.

Example

A guarantee fund (GF) is set up with **EUR 40 million programme resources** with ERDF co-financing of 50% (EUR 20 million ERDF + EUR 20 million national funding) to guarantee loans for SMEs to facilitate their access to finance and contribute to thematic objective 3.

A first phased payment (Article 41 CPR) is made to the GF amounting to 25% of the programme contribution, equal to EUR 10 million.

Estimations for immediate payment needs have shown that no guarantees are expected to be called during the first year of implementation, thus money is placed on an interest bearing account with an interest rate of 1% per annum and maturity of 1 year, thus bringing additional EUR 100,000 into the GF.

The additional amount of EUR 100,000 is not considered ERDF resources, but the amount attributable to ERDF support (i.e. 50,000 EUR = 100,000 x 50% ERDF co-financing) has to be used for the same purposes as the originating GF, e.g. for providing guarantees to SMEs, including a proportionate share of the management costs and fees.

Until the end of the programming period:

- 40,000 EUR from the additional amount, i.e. gains attributable to ERDF support, is invested into final recipients;
- 2,500 EUR is used to cover a proportionate share of the management fees (equal to 5% of the additional amount, which corresponds to the remuneration rate agreed with the fund manager for the management of the initial programme allocation);
- the managing authority decided to transfer the remaining 7,500 EUR to a national loan fund (not a FI supported under ESIF programmes), thus not respecting the provisions of Article 43(2).

For the sake of this example, it is assumed that until the end of the programming period no other gains were earned which are attributable to the support from ERDF.

At closure of the programme, the amount of 7,500 EUR (= 50,000 EUR gains – 40,000 EUR used for the same purposes – 2,500 EUR for management fees) remains in the national loan fund, but should be deducted from the eligible expenditure declared for ERDF financing.

3.2. Specific cases and situations

3.2.1. FI directly implemented by a managing authority

Apart from entrusting the implementation of a FI to a Fund of Funds manager or financial intermediary, if justified, managing authorities may also decide to implement

FIs in the form of loans or guarantees directly, without the formal set-up of a fund (Article 38(4)(c) CPR). In this case financial flows do not follow the same pattern as for other FIs, meaning that there is no support prepaid from ESI Funds to the FI. The MA in this case makes a direct investment from public resources into final recipients and then declares expenditure to the Commission corresponding to the payments made to final recipients in the case of loans, or resources committed for guarantee contracts in the case of guarantees. As there is no payment to the FI that could generate interest or other gains, Article 43 is not applicable.

3.2.2. *Negative interest rates*

The economic and financial crisis had a major impact on the economies and financial markets and led, inter alia, to a widespread reduction in interest rates applied to deposits and other assets held for investment purposes. It is possible that as a result of such reduction, negative interest rates or other negative returns are generated, leading to actual losses of nominal investments instead of gains from the ESIF resources invested. The present section deals only with such type of negative returns, i.e. does not cover other possible losses for the FI (e.g. bankruptcy of a financial intermediary).

Although the amount of the negative returns referred to above could be marginal compared to the total ESI Funds contribution to the FI, the possibility of such a situation should be foreseen and addressed in advance by the managing authority and the body implementing FI, in line with the principles of sound financial management referred to in Article 43(1) CPR.

Such an exercise will aim to prevent a scenario according to which, as a way to mitigate the negative returns that suddenly appear during the FI lifecycle, the body implementing the FI, starts undertaking unilateral actions which could not qualify as prudent treasury behaviour in line with the principles of sound financial management, for example:

- placing the ESI Funds resources with banks having inappropriate credit rating, or undertaking riskier investments, which will increase the financial risk or
- opting for longer maturity of the treasury investments in order to reduce the impact of the negative interest, but at the same time creating a risk for the FI not being able to honour its short-term payment obligations in relation to financial intermediaries (in the case of Fund of Funds) or final recipients, or potentially incurring even further losses if the investments need to be terminated before maturity.

It will be therefore up to the managing authority and the body implementing FI to discuss and agree on an appropriate set of measures in order to minimise the risk. Some considerations that may be taken into account include:

- more frequent interim applications for payments for lower amounts than 25% (which is the maximum foreseen in Article 41 CPR) and swift payments to final recipients, in order to avoid holding significant balances on the fiduciary accounts;

- undertaking an accurate assessment of the cash-flow projections of the FIs to see to what extent they could allow prudent extension of maturities of investments which might reduce the impact of negative returns;
- in the case of Fund of Funds – if possible, asset transfer from another FI within the Fund of Funds' portfolio for short periods, in case that such an option is justified, traceable and foreseen in the funding agreement, in order to optimise asset management and possibly also increase maturities. However, accurate accounting and reporting track records need to be ensured, and the provisions of Article 1 CIR respected as regards contributions from more than one programme, priority or measure;
- if possible, negotiating an agreement with the treasury bank that if the interest rate decreases below '0', a '0' rate interest will be used.

Should, despite all efforts, negative returns still be generated, the body implementing FI, should be able to demonstrate that it has respected the acceptable treasury operations and investments specified in the funding agreement. Such negative returns should be offset by any positive gains generated by the treasury management over the programming period.

3.2.3. Overly prudent treasury management

Another extreme situation observed in the past relates to national authorities or bodies implementing FIs undertaking an overly prudent treasury management while better alternatives could have been available on the market. Such situations should equally be avoided when the acceptable treasury operations and investments are decided upon and included in the relevant funding agreement.

3.3. Reporting on treasury management

3.3.1. Between the body implementing FI and the managing authority

According to Article 43(3) CPR, the managing authority has the obligation to ensure that adequate records of the use of interest and other gains are maintained.

The reporting modalities on asset treasury management should form part of the relevant funding agreement. It is recommended that within a pre-agreed time period (e.g. monthly or quarterly), the body implementing the FI is requested to provide information to the managing authority at least on the following:

- the investments made;
- the performance of the treasury assets and any related risks.

In addition, the body implementing FI could also be requested to inform the managing authority immediately (within a few working days) in the case of (expected) default of an item from the treasury assets.

3.3.2. *Between the managing authority and the Commission*

According to Article 46(1)(g) CPR, the managing authority shall send to the Commission on an annual basis information on the interest and other gains generated from the support from the ESI Funds to the FI, as an annex to the Annual Implementation Report for the programme. The model structure for reporting on FI is given in Annex I CIR.

4. RELEVANT PRACTICE AND EXAMPLES FROM 2007-2013 EXPERIENCE

The guidelines on closure of 2007-2013 operational programmes⁴ (paragraph 3.6.4.2) indicates that interest generated by payments from the programme to the financial engineering instrument which are attributable to the Structural Funds' contribution and which at the partial or final closure of the programme have not been used in accordance with the provisions of Article 78(6) and the first subparagraph of Article 78(7) of Regulation 1083/2006, should be deducted from the eligible expenditure.

⁴ Commission Decision C(2013)1573 of 20.3.2013 on the approval of guidelines on the closure of operational programmes adopted for assistance from the European Regional Development Fund, the European Social Fund and the Cohesion Fund (2007-2013)

ANNEX

QUESTIONS AND ANSWERS

- 1) What is the purpose of this guidance note and why is it related to Article 43 CPR only, thus not capturing resources paid back before or after the end of the eligibility period referred to in Articles 44 and 45?**

The guidance note has been drafted following questions from Member States, concerning in particular the risk of negative interest rates and how to avoid such situations. In addition, the note is prepared as, following completion of ex-ante assessments in a number of Member States (1) the specific details and modalities for temporary investing the ESIF contribution have to be included in funding agreements between managing authorities and fund managers, and (2) the treasury management provisions are applicable already to the first tranches of ESIF resources (to be) paid into financial instruments.

- 2) As regards the treatment of the gains, why does the note refer to a limitation that a proportionate share of the gains is used for management costs and fees? Why not use all the gains for paying management costs and fees?**

Article 43(2) CPR requires that the gains are used "for the same purpose" as the initial ESIF contribution to the financial instrument, including for management costs and fees. In view of this requirement and as the core aim of a FI is to make investments in final recipients, the Commission expects that the same approach is applied also vis-à-vis the gains, and only a proportionate share of them is used for management costs and fees.

- 3) If management costs and fees are paid from the gains, what are the consequences regarding the thresholds in Article 13 CDR?**

The interests and other gains attributable to support from the ESI Funds paid to financial instruments and resulting from treasury management do not formally constitute ESIF programme resources, i.e. are not subject to the thresholds in Article 13 CDR either (as these thresholds are applied to programme resources). This gives the possibility for payment of a proportionate share of MCF from the gains, above the Article 13 thresholds, if considered needed and justified.

- 4) What shall be done if negative interest rates are generated which cannot be offset against future gains from treasury management during the programming period? Can the losses be covered from ESIF resources at closure?**

The generation of negative interest rates may not be an issue in the longer run, but rather a temporary fluctuation resulting from the economic and financial crisis. That is why it is expected that any negative returns would be able to be offset against gains during the programming period. However, as it is not possible to predict with certainty at present how the situation could evolve over time, should this still be an issue at closure of ESIF programmes, it will be covered by the closure guidelines 2014-2020.