



EUROPEAN COMMISSION

European Structural and Investment Funds

Guidance for Member States on
Article 43 CPR– interest generated by ESIF support
paid to FI

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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
Reg. (EU) N° 480/2014 Commission Delegated Regulation (<i>hereafter CDR</i>)	

2. BACKGROUND

2.1. Scope

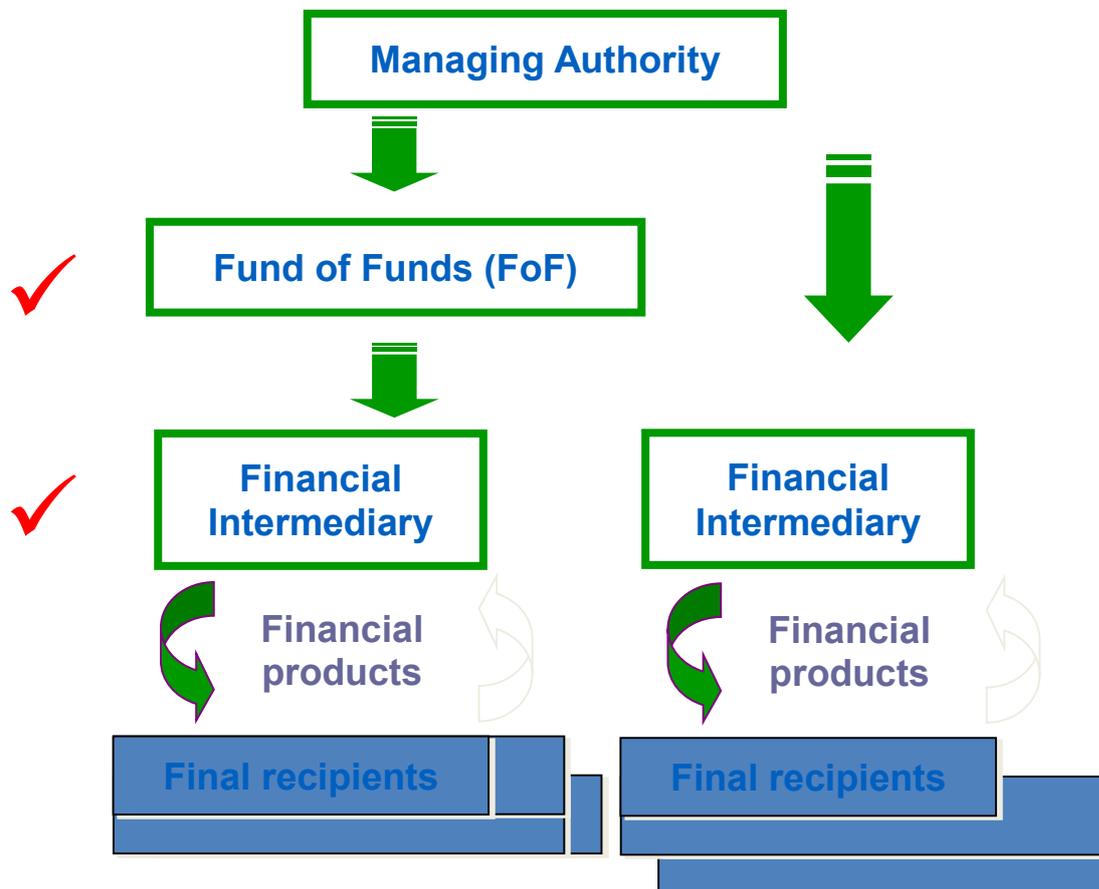
The purpose of the present guidance note is to clarify how Member States should deal with interest or other gains generated from the investment of ESIF contributions to financial instruments (treasury management).

In the context of ESIF, treasury management is used in relation to Article 43 CPR which provides for investing the ESIF contribution to a financial instrument 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 ESIF support paid into the financial instrument, and not to other sources of contribution into the FI;
- they are applicable only at the level of the financial instrument, incl. the Fund of Funds, and at the moment when the ESIF support paid into the FI 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 generated from the resources attributable to the ESI Funds support and generated at subsequent stages of FI implementation are covered by Article 44 and 45 CPR and are not the subject of this guidance note.



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

	2007-2013	2014-2020
Treasury management	Article 78(7) of Regulation 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 in other cases, energy efficiency or use of RES 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 ESIF support paid into the FI when (1) the Managing Authority uses for this purpose the advance paid in relation to the ESIF 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 financial instruments 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 FI should apply the same 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.

As a result of the investment, interest or other gains (such as dividends, capital gains or other profit earned from the investment) could be generated.

The investment and the related risks (including with respect to negative interest and asset management losses – see pt. 3.2.2 below) should correspond to a pre-agreed risk profile and investment strategy. In practice, this means that 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, incl. the Fund of Funds, and included in the relevant Funding Agreements (including between the body implementing a fund of funds and a financial intermediary) (see point 1(g) of Annex IV CPR).

A treasury management fee or reimbursement of costs incurred by the body implementing FI, incl. the Fund of Funds, 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 ESIF support paid into the FI represent a financial advantage, which is additional the programme contribution to the FI. Therefore, the gains generated cannot be considered part of the ESIF contribution into the FI, and should not be treated as programme resources, meaning that the CPR rules outside Article 43, which are applicable to the ESIF programme contribution to the FI, 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), as an underlying principle Article 43(2) CPR requires that the interest and other gains generated by payments from the ESIF to the FI 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 line with the OP/RDP priority objective(s).

In practice, this means that in the case of use within the same FI, such resources should "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, or to the benefit of where applicable, the 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 as the interest and other gains do not represent programme resources, they do not represent eligible management costs and fees that could be claimed for ESIF reimbursement (see also section 'Questions and Answers' in the Guidance for Member States on management costs and fees) and as such do not count towards the maximum thresholds for eligible management costs and fees as stipulated in Article 13 CDR either.

Finally, the interest and other gains used in line with Article 43 cannot be used for eligible expenditure declared at closure. They also cannot be used for the purpose of contributing to the national co-financing to the FI, neither to cover the cost of borrowing money in the financial market for that purpose.

At closure, interest and other gains which in the end of the programme lifecycle have not been used in accordance with the provisions of Article 43(2) CPR should be treated as irregular expenditure.

Example

A guarantee fund (GF) is set up with **40 MEUR programmes resources** (20 MEUR ERDF + 20 MEUR national funding) to guarantee loans for SMEs to facilitate their access to finance and contribute to Thematic Objective 3. The respective ERDF co-financing is 50%.

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

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 100.000 EUR into the GF.

The additional amount of 100.000 EUR 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 mainstream GF, i.e. for providing guarantees to SMEs and/or covering a proportionate share of the management costs/fees.

Until the end of the operational programme lifecycle, 40.000 EUR from the ERDF attributable gained amount has been invested into final recipients. The Managing Authority decided to transfer the remaining 10.000 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 and that the MA decided not to pay a proportionate share of management costs/fees from the gains.

At closure of the OP, the 10.000 EUR attributable to the ERDF (= 50.000 EUR gains – 40.000 EUR used for the same purposes) remains in the national loan fund, but is deducted from the eligible expenditure covered by ERDF.

3.2. Specific cases and situations

3.2.1. FI directly implemented by a Managing Authority

Contrary to entrusting the implementation of a FI to a Fund of Funds manager or financial intermediary, if justified, ESIF Managing Authorities may also decide to implement FIs in the form of loans or guarantees directly (either themselves or by intermediate bodies), 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 paid from ESI Funds to the financial instrument. The MA in this case makes a direct investment from public resources into final recipients and then declares for reimbursement from the Commission the payments effected to final recipients in the case of loans, or resources committed for guarantee contracts. As there is no payment to the FI that could generate interest or other gains, Article 43 is not applicable.

3.2.2. Negative returns

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 ESIF 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 (incl. Fund of Funds), 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, incl. the Fund of Funds, 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 ESIF resources with banks having inappropriate credit rating, or undertaking riskier investments, which will increase the financial risk for the ESIF resources, 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, and/or potentially incurring even further losses if the investments need to be terminated at an earlier period/before maturity.

It will be therefore up to the Managing Authority and the body implementing FI to discuss and agree on an optimum set of investments 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 the max 25% 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/forecast of the cash-flow projections of the FIs to see to what extent they could allow extending maturities of investments and therefore reducing the impact of negative returns;
- in the case of Fund of Funds, asset transfer from another financial instrument within the Fund of Funds' portfolio for short periods, if it is justified, traceable and foreseen in the Funding Agreement, in order to allow for a more integrated/optimised asset management and possibly also increased maturities.

Should, despite all efforts, negative returns still be generated, the body implementing FI, incl. the Fund of Funds, should be able to demonstrate that it has made its best efforts to avoid them by respecting the acceptable treasury operations and investments specified in the Funding Agreement, and that no reasonable alternatives were available.

Otherwise, the Funding Agreement may provide for imposing penalties (such as reduction of management costs and fees) or even activating a provision for winding up and exit of the ESIF contribution from the FI could be considered if losses are above an agreed threshold.

Treatment of the losses

Given the improving economy in the EU, the generation of negative returns (e.g. negative interest rates) is not expected to be an issue in the longer run, but rather a temporary fluctuation resulting from the economic and financial crisis. Therefore, negative returns that could have been accumulated at present and for which it has been demonstrated that no other reasonable alternatives were available, should be covered by other gains generated by the treasury management over the programme lifecycle.

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 e.g. by placing funds into zero interest bearing accounts. Such situations should equally be avoided, as other prudent, but better alternatives could have been available on the market.

3.3. Reporting on treasury management

3.3.1. Between the body implementing FI and the MA

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 be also requested to inform the MA immediately (within a few working days) in the case of (expected) default of an item from the treasury assets.

3.3.2. Between the MA 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 operational programme.

4. RELEVANT PRACTICE AND EXAMPLES FROM 2007-2013 EXPERIENCE

The closure guidance 2007-2013 (paragraph 3.6.4.2) stipulate that interest generated by payments from the programme to the financial engineering instrument, including holding funds, 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.

5. REFERENCE, LINKS

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) - C(2015) 2771 final.

Guidance for Member States on Article 42(1)(d) CPR- eligible management costs and fees – for financial instruments managed in accordance with Article 38(4)(b) CPR.

6. QUESTIONS AND ANSWERS