




## EU requirements on financial engineering in rural development


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Workshop „Establishment of the Credit Fund using opportunities offered by EAFRD“, Latvia, 19/01/2010



### Financial engineering in RD: Policy issues


- Policy issues:
  - Better access to capital for farmers and SMEs
  - Efficient use of funds
  - Economic & financial crisis response
- Setting issues:
  - Legal framework similar to the one under the SF
  - Less legal complexity on certain elements
  - Much smaller experience in establishing financial engineering actions (funds) compared to the SF
  - Support to all proposals received until now – Romania and Lithuania most recent best experiences



## Financial engineering in RD: Legal framework




- **Legal provisions:**
  - Art. 71(5) of R1698/2005 (EC)
    - general permission for support “in a form other than a non-repayable direct assistance”
  - Art. 49 of R1974/2006 (EC)
    - interest rate subsidies
  - Art. 50-52 of R1974/2006 (EC)
    - Guarantee funds
    - Credit (Loan) funds
    - Venture (capital) funds



## Financial engineering in RD: Setting-up of a Fund



- **The Fund:**
  - should be an independent legal entity, and
  - (i) newly established under an agreement between the shareholders, or (ii) separate block of finance within an existing financial institution
  - should keep separate accounts in case (ii)
- **The EC remains outside the scheme**
  - it cannot be a partner or shareholder in the fund
- **Funding agreement between the Fund and the Managing authority (MA)**



## Financial engineering in RD: Setting-up of a Fund



- Funding agreement (Fund – MA) to cover the terms and conditions for contributions to funds from RDP:
  - deliverables
  - investment strategy and planning
  - monitoring implementation
  - investment exist policy
  - winding up provisions
  - duration of the Fund's existence (in years)

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## Financial engineering in RD: Setting-up of a Fund




- Major pillar of the Funds' setting-up is the business plan to be submitted to the MA, which should appraise it:
  - Targeted market (or guarantee portfolio)
  - Criteria, terms and conditions of financing
  - The operational budget of the fund
  - The ownership and part-financing partners
  - Requirements as to the professionalism, competence and independence of the management
  - Fund's by-law
  - Justification and utilisation of the EAFRD contribution
  - Investment exit policy
  - Winding-up provisions, including the re-utilisation of returns attributable to the EAFRD contyribution

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## Financial engineering in RD: Setting-up of a Fund




- EAFRD contribution:
  - Paid either as a single “tranche” or as instalments
    - has to be declared as expenditure in that year only
  - Expenditure declared to the Commission: “total expenditure paid in establishing or contributing to funds”
- National contribution:
  - To be executed at the same time as the EAFERD contribution
  - EAFRD co-financing rate for the axis concerned to be accepted implicitly

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## Financial engineering in RD: Usage of Funds




- The Fund invests in or provide guarantees to enterprises:
  - on their establishment, or
  - during their early stages, or
  - during their expansionand
  - only in activities considered potentially viable
- Firms in difficulty are not eligible for support
- Community rules on state aid should be respected
- Interest generated by payments from RDPs to Funds are to be used to finance financial engineering actions
- Returned capital to be re-used for granting new credits/guarantees

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## Financial engineering in RD: Usage of Funds



- **Management costs:**
  - 3% of the paid-up capital
  - 2% of the paid-up capital in case of a guarantee fund
  - to be estimated on a yearly average for the duration of the programme
  - In specific cases if higher rate proves necessary, it should be set after a competitive tender
- **Capital reduction**
  - If MS/MA decides to take capital out of the Fund during the programming period, it should re-use it for the programme concerned
    - it is considered as positive expenditure
  - This must be specified in the funding agreement (e.g., winding-up provisions)



## Financial engineering in RD: Implementation linked to operation of Funds




- The Fund manager normally should present to the MA, for the first time when starting the operation, and then at the end of each financial year, among others, an activity plan which describes:
  - The credit/guarantee portfolio for the coming year
  - Exposure rate for the current year
  - Target indicator estimate for the annual default rate
  - Modifications concerning the credit/guarantee criteria, terms and conditions
  - Annual management costs covered from the total amount of the Fund (taking into account the ceilings in the funding agreement)
  - Other information foreseen in the funding agreement



## Financial engineering in RD: Closure of Funds



- Eligible costs
  - Any payment for investment in enterprises out of the Fund, or guarantees provided, including those that are still committed, qualify for being eligible at closure
  - Expire date on outstanding credits normally is not taken into account
  - Management costs are also eligible
- The difference between the EAFRD contribution actually paid under the financial engineering and the eligible expenditure shall be cleared in the context of the annual accounts of the last year of RDP's implementation
- The Fund can continue to operate after the closure of the RDP, but the duration of its existence set in the funding agreement has to be respected



## Financial engineering in RD: Other points for consideration



- MS have to explain their arrangements for the financial engineering in the RDP
- Any extension/contraction of the support under the Fund should be notified to the Commission and introduced in the RDP
- Normally, beneficiaries eligible for support under the RDP should be eligible for support under the Fund
- Paying agency to control the investments of beneficiaries
- Demarcation lines (e.g., on beneficiaries and/or type of activities) with similar funds (i.e. under SF) to be established
- Implementation of financial engineering actions remain a MS issue, such as the RDP



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Thank you