



EUROPEAN COMMISSION

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Dear President,

The Commission would like to thank the Bundesrat for its Opinion on the Commission proposal for a Regulation of the European Parliament and the Council on the financial rules applicable to the general budget of the Union and amending 15 legislative acts concerning multiannual programmes {COM(2016) 605 final}.

The Commission has proposed in a single act an ambitious revision of the general financial rules accompanied by corresponding changes to the sectorial financial rules set out in 15 legislative acts concerning multiannual programmes. The over-arching themes of the proposal are simplification of financial rules for beneficiaries and creating more flexibility for the EU budget, in line with the "Budget Focused on Results" approach.

The proposals respond to stakeholder requests and problems hampering efficient implementation of EU funds: the need for simpler and more flexible financial rules has been confirmed as the most important concern.

The Commission welcomes the Bundesrat's support for the overall reform objectives of simplification and increased flexibility including the need for sufficient budgetary room to react to extraordinary crises.

The Commission also notes the Bundesrat's concerns regarding the timing of certain proposals. The Commission fully agrees that midway through the 2014-2020 programming period, no major changes in applicable rules should be undertaken which may delay or complicate the implementation of on-going European Structural and Investment Funds programmes. Indeed, any major review of the rules should be looked at in the context of the preparation of the new programming period post 2020. Nevertheless, with the help of the High Level Group on Monitoring Simplification for Beneficiaries, managing authorities and other stakeholders, the Commission has identified a limited number of improvements in terms of simplification and flexibility. These proposals do not question the fundamentals of the way European Structural and Investment Funds are managed and should thus be implementable immediately for the current programmes.

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President of the Bundesrat
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In response to the detailed points in the Opinion, the Commission would like to refer the Bundesrat to the Annex to this letter.

The Commission hopes that the clarifications provided in this reply address the issues raised by the Bundesrat and looks forward to continuing our political dialogue in the future.

We remain available to present the proposal should the Bundesrat request further clarifications.

Yours faithfully,

*Frans Timmermans
First Vice-President*

*Günther H. Oettinger
Member of the Commission*

ANNEX

The Commission has carefully considered each of the issues by the Bundesrat in its Opinion and is pleased to offer the following clarifications.

1. Proposal for a Financial Regulation

On sound financial management

The proposed simplification measures do not weaken sound financial management: on the contrary, a number of provisions strengthen the control framework:

- rules on tax avoidance for financial instruments (see also below);*
- rules on conflicts of interests – also covering Member States when they implement the EU budget;*
- protection of the EU budget against fraud and financial irregularities.*

On the risk of overcompensation of beneficiaries

The Commission welcomes the Bundesrat's support for new payment methods. It should be clarified that there is no risk of overcompensation with the proposed removal of the no profit principle as the rule remains that grants shall not exceed the eligible costs.

On the use of expert judgment in the context of simplified cost options

The Commission welcomes the Bundesrat's support for the proposed possibility to use expert judgment where no statistical/historical data are available. The Commission would use existing transparent selection rules for external experts (as done, for example, for the Connecting Europe Facility). Experts would always be subject to rules on conflict of interest.

On contingent liabilities

The EU budget already bears contingent financial liabilities that have been authorized by the legislator. In times of limited resources using the EU budget as a guarantee buffer to support investments allows for the mobilisation of public and private resources. The rules applicable to these contingent liabilities have been established on an ad-hoc basis in their respective basic acts. Yet, there is no common framework to regulate them. The proposed revision of the Financial Regulation is neutral about the expansion or reduction of contingent liabilities. It simply provides a harmonised and effective framework for the authorization, monitoring, control and reporting of contingent liabilities. The proposal is consistent with the best practices recommended by the International Monetary Fund (IMF) for the management of financial risk¹. Two fundamental elements of the proposal are the requirement to set limits on contingent liabilities in the multiannual framework regulation and the obligation to carry out a sustainability assessment of the contingent liabilities borne by the EU budget in the context

¹ "Government Guarantees and Fiscal Risk", IMF, Fiscal Affairs Department, 2005.

of the annual budgetary procedure. The proposal provides for a robust internal control framework and transparent reporting on the financial exposure of the Union. The rate of provisioning of financial liabilities should be set on the basis of a proper risk assessment of the financial risks stemming from the related intervention. An early warning mechanism should be established to avoid a shortage of provisions to cover financial liabilities.

On the Common Provisioning Fund

The constitution of provisions to cope with the financial liabilities, contingent or non-contingent, generated by the financial instruments and the budgetary guarantees is a safeguard against the uncertainty of payments needs stemming from these liabilities. These provisions are currently held in specific fiduciary accounts and guarantee funds. The fragmented management of these provisions is inefficient: it requires higher provisions, thus imposing a higher financial burden on tax payers, it increases administrative costs, it makes audit and control more complex and it results in a multiplication of monitoring and reporting schemes. The Commission considers that there are clear efficiency gains in using the Common Provisioning Fund for all the risk-sharing instruments established and implemented by the EU. Optimising the amount of provisioning required would deliver leverage while ensuring an adequate level of protection to honour financial liabilities. The Commission will ensure consistent and efficient treasury management and accounting of the Common Provisioning Fund, as well as full transparency towards the budgetary authority. The rules applicable to provisioning and to the Common Provisioning Fund should also provide for appropriate control arrangements. Guidelines for the asset management of the provisions should be established at the level of the Commission after having consulted the accounting officer. The authorising officers should actively monitor the financial liabilities under their responsibility and the authorising officer for the Common Provisioning Fund should manage the cash and the assets in the fund following the rules and procedures set out by the accounting officer.

On tax avoidance rules for financial instruments

Simplification and flexibility cannot be at the expense of sound financial management, which remains of paramount importance. Accordingly, the proposal strengthens rules on tax avoidance to be respected by EU implementing partners. Recent developments at Union level regarding tax avoidance, in particular aggressive tax planning and tax good governance, are duly reflected in the Financial Regulation. In addition, the language of the Common Provisions Regulation is aligned with the general financial rules. The Commission considers that banks managing EU funds through financial instruments should be subject to the same rules on tax avoidance as banks using other funds. EU funds should remain traceable. In addition, the proposed provision does not impose any new requirements for banks managing financial instruments funded by the EU budget, in addition to those currently established by EU law, as transposed by Member States. If appropriate, the Commission could issue formal instructions, which would need to be taken into account by financial actors.

On ex ante evaluation of financial instruments/preferential treatment of private investors

The Commission considers that the ex ante establishment of the acceptable level of preferential treatment of private investors would be more cost-efficient and would provide better protection to the taxpayer than leaving quantification of that level to the market. Ex ante establishment should also strengthen the negotiation position of Managing Authorities (mostly regions). Leaving this to negotiation would not ensure harmonised treatment of partner banks, even at State level. This would also reduce transparency as the ex ante evaluations are public and can be scrutinised by the Court of Auditors. Negotiated agreements may not be public except in an audit context.

On sponsoring

Each EU institution would have to set out guidelines with the purpose of avoiding lobby influence and reputational risk. These guidelines will complement the already strict limits proposed in the new provision: sponsoring would only be authorised in-kind and for an event or an activity for promotional or corporate social responsibility purposes; it cannot generate conflict of interest nor concern exclusively social events; it must comply with the principles of non-discrimination, proportionality, equal treatment, transparency and contribute to the positive image of the Union and be directly linked to the core objective of an event or of an action. A pilot project for EU Delegations will be undertaken in the first half of 2017 to examine practicalities.

2. Simplification proposals in the Common Provisions Regulation

In its general comments, the Bundesrat recognises the efforts to achieve a simpler and more coherent set of general and sectorial rules but expresses concerns that the changes proposed may hinder the implementation of programmes already underway. The Commission would like to point out that most of the proposals in the Common Provisions Regulation² provide either additional options to Member States for simplification or are easily implementable. It should also be noted that a number of the proposals put forward by the Commission are based on recommendations carried out by the High Level Group of independent experts on Monitoring Simplification for Beneficiaries or have been raised by stakeholders in other fora. More detailed elements on the main points made by the Bundesrat in this context are set out below.

² Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006, OJ L 347, 20.12.2013, p. 320–469.

On compulsory use of simplified cost options

The Bundesrat agrees with the Commission that flat rates and lump sums offer a major simplification to beneficiaries of the European Regional Development Fund (ERDF) and the European Social Fund (ESF), but is concerned that the imposition of mandatory flat rates and lump sums for support up to EUR 100,000 may require extensive preparatory work and data analysis. The Commission considers that the application of such mandatory flat rates for both Funds carries a significant potential for simplification on the ground.

The Commission would like to point out that that the administrative burden on managing authorities depends on the type of simplified cost option applied. The legislative proposal widens the possibilities for the use of off-the-shelf flat rates, which is welcomed by the Bundesrat. Their use does not create administrative burden nor require time-consuming procedures, especially given that these off-the-shelf flat rates require no further justification. Furthermore, the additional possibilities for the use of draft budgets should also further facilitate the use of simplified cost options. It should also be noted that many operations receiving public support not exceeding EUR 100,000 are not complex in nature. Therefore, where preparatory work or data analysis for establishing the simplified cost options are required, this would not be expected to be overly complex. Finally, the Commission proposal already provides for a six-month transitional period for the application of these new rules. This should allow sufficient time for managing authorities to adjust to the new requirements, but justified additional time could be considered.

On the provisions for a delegated act in Article 67(5) Common Provisions Regulation

The Bundesrat is concerned that the adoption of further delegated acts would further encumber the regulatory framework already in place. The Commission would like to point out that this provision provides for a delegated act setting out additional financing options Member States could apply if they so wish. It also covers the possibility for establishing a methodology where payments would be connected with the fulfilment of conditions related to progress, a direction also supported by the Bundesrat (in point 20).

On the obligations relating to the amendment of Partnership Agreements in Article 16 Common Provisions Regulation

The Bundesrat is concerned that the proposed changes relating to the amendments and approval of the Partnership Agreement would lead to increased administrative burden. The Commission would like to point out that the proposed changes provide for simplification of the existing rules as opposed to adding additional burdens. Even if the amendments to the Partnership Agreement are already approved by the Commission via the approval of the amendments to the programmes, it is still for the Member State to make the changes in the Partnership Agreement and to submit the amended Partnership Agreement together with the request for amendment to the Commission. The Commission is not in a position to amend the Partnership Agreement of a Member State on its own initiative following the approval of an amendment to the programme as the Partnership Agreement is and remains a document owned by the Member State. Under the new procedure that is proposed, the Member State is only requested to submit one single updated Partnership Agreement in January of the year

following the calendar year in which the amendments to the programmes have been approved by the Commission, as opposed to having to update it after each programme modification. This represents a substantial reduction of administrative burden for Member States.

On the proposed change in the treatment of energy savings in Article 61(1) Common Provisions Regulation

The Commission notes the Bundesrat's proposal set out in point 31 of its Opinion calling for the deletion of the operating costs rule. This is a proposal for an additional change of the Regulation that had not been proposed by the Commission. The Commission wishes to recall that in the last subparagraph of point 2 of its Opinion, the Bundesrat warns that care needs to be taken to ensure that simplification does not jeopardise sound financial management. In addition, in point 20 the Bundesrat states that guarantees need to be in place to avoid overcompensation of actual costs. The Commission has always called for the use of financial instruments in case of operations targeting energy-efficiency since there is indeed already a high risk of overcompensation of actual costs in these investments and the payback period is relatively short. Given the number of derogations provided for in Article 61 of the Regulation large parts of the energy efficiency investments may already currently fall outside of its application.

On the Commission's audits/controls under Article 75 Common Provisions Regulation

Restricting the Commission to carry out plausibility controls is not necessary. In order to gain reasonable assurance that the EU budget has been correctly implemented by the Member States, the depth or intensity of the audits/controls carried out by the Commission should instead depend on the risk related to the specific operational programme. This risk based approach is already included in Article 75, of the current Regulation.

On the de minimis threshold for irrecoverable amounts in Article 122 Common Provisions Regulation

The objective of the Commission was to ensure legal clarity and align the wording of the Regulation with a clearer wording agreed in the delegated act (2016/568/EU) on recoveries which includes a reference to the accounting year. The provisions in force (applying the EUR 250 threshold by accounting year) have not been modified.

On the verification obligations in Article 125(4) Common Provisions Regulation

The Commission has not proposed to add additional requirements. The provisions only clarify the scope of the management verifications when simplified cost options are used. Where this is the case, it is clarified that the managing authority has to verify that the conditions for reimbursement have been met (and not that the expenditure declared by the beneficiary has been paid, as is the case for real costs).