Study on
Financial Interests of European Scale
FIES

FINAL REPORT

Hercule III Programme
Hercule III 2020 Legal Training and Studies
HERCULE-2020-LT-AG (Proposal Number: 101015488)

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List of Abbreviations

AFCOS: Anti-Fraud Coordination Service

COCOLAF: Advisory Committee for the Coordination of Fraud Prevention

CPR: Common Provisions Regulation

EC: European Commission

ECA: European Court of Auditors

EDES: Early Detection and Exclusion System

EPPO: European Public Prosecutor Office

ESI Funds: European Structural and Investment Funds

EU: European Union

FIES: Financial Interests of European Scale

FRA: Fraud Risk Assessment

MA: Managing Authority

MS: Member State

PPP: Public-Private Partnership

TFEU: Treaty on the Functioning of the European Union

1. Introduction to the study

The present report aims to spotlight opportunities and drawbacks related to the current administrative approach toward the prevention of fraud, corruption, and other illegal activities (and consequently even mere irregularities) regarding peculiar forms of support established by the ESI funds regulatory framework under shared management when private financial resources are involved.

In recent years, ESI funds legal framework has shown a growing relevance of new ways of financing where financial actors are entailed. At the core of this new interest toward alternative sources of financing, it could be recalled at first the innovative set of rules established by regulation EU 1303/2013 supporting private finance initiative (PPP operations, article 64) or the increasing weight given to financial instruments because of their leverage effect on the ESI funds and their capacity to combine different forms of public and private resources (Recital 34).

The same favourable conditions for an increasing impact of those alternative sources have been confirmed by regulation EU 1060/2021 for the current programming period, where the regulatory approach of the previous common provision regulation has been substantially replicated.

Besides, it should be mentioned that in 2020, during the time between the end of the previous programming period 2014-2020 and the beginning of the current programming period 2021-2027, ESI funds legal framework has been characterised by an unprecedented mutability, mainly because of the COVID-19 pandemic and its macro-economic consequences.

In particular, before regulation EU 1060/2021 was issued, the previous regulation EU 1303/2013 was twice amended by regulation EU 2020/460 and regulation EU 2020/558, providing exceptional and additional flexibility to ESI funds allocation under shared management.

Therefore, regulation EU 2020/2221 (the so-called REACT-EU regulation) provided additional resources and implementing arrangements to the 2014-2020 common provision regulation to be used for specific actions, such as health services or in

social infrastructure related to the European Regional Development Fund management or even to supporting access to the labour market by maintaining jobs of employees and of the self-employed related to European Social Fund.

Almost at the same time, Regulation (EU) 2020/2094 established a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis. In principle, the mentioned regulation falls outside the scope of the present study since those funds are implemented under direct management.

Nonetheless, according to article 92a of regulation EU 1303/2013, as inserted by regulation EU 2020/2221, the measures related to the scope of the Recovery Instrument must be partially implemented under the Structural Funds for an appreciable amount. Under this circumstance, thus rules on ESI funds entirely apply.

In short, all those exceptional acts of primary legislation issued in 2020 had as objective to widen the scope of the cohesion policy and subject matters to be supported by ESI funds co-financing as well as to allocate some extraordinary and additional resources to the ESI fund budget. Conversely, the latter regulations did not interfere with the fundamental rules on ESI funds management and proceedings.

For this reason, in analysing the relevant legal framework, the present study will refer exclusively to past and current common provision regulations, given that the origin of the financial resources available does not imply any modifications to proceedings, legal instruments or rules applicable to ESI funds allocation. In other words, it is neutral for the conclusions reached by this study if the financial resources to be combined with private finance initiative belong either to the European recovery instrument, to extraordinary ESI funds budget, or ordinary ESI funds budget.

In our view, it is essential to highlight that regulation EU 2020/2094 seems to have the same favourable position toward private financial resources we described before about the current legal framework regulating ESI funds. Recital (4) expressly states that the path towards a sustainable and resilient recovery requires "substantial amounts of public and private investment".

In consequence of those additional resources, the span of applications of private finance initiative legal instruments - which will be examined later - seems to have widened considerably.

Along with opportunities, compared to more traditional co-financed operations, those instruments imply peculiar irregularities, fraud or corruption risks related to complex financial services provided most of the time by transnational financial actors.

Prevention here appears even more inadequate than already assessed by EU Institutions if left to uncoordinated member States' initiative, since single National or Regional managing authorities may not properly evaluate and identify irregularities, fraud or corruption risks given the high technicality of those services as well as the capacity of transnational financial operators to bypass national legal requirements or limitations easily.

In the cases described below, the preventive protection of EU financial interests should diverge from the traditional approach.

Up to date, the protection of EU financial interests related to ESI funds should lay on three pillars: effectiveness, coordination, and cooperation between competent authorities (art. 325 TFEU).

Regarding effectiveness, contrasting irregularities, fraud, and corruption requires a balanced set of preventive and remedying legal measures capable of acting as a deterrent and affording adequate protection. Nowadays, the most recent evolution of the EU legal framework shows valuable progress in remedying and sanctioning mechanisms.

The EU legal framework is based on a large array of remedying and sanctioning (*ex-post*) mechanisms, safeguarding the financial interests of the EU. Not by chance, the EU Public Prosecutor's Office (EPPO) aims to improve criminal law enforcement, in line with the proposal to enhance OLAF cooperation with EPPO to support the investigation's effectiveness. Coherently, the European Commission established the EDES system to reinforce the protection of such interests by ensuring sound

financial management and keen administrative sanction procedures and exclusion processes against fraudsters.

However, preventive legal protection is not yet sufficient under EU law, as partly recognized by the 2019 Commission Anti-fraud strategy.

Of course, EU authorities may carry out *on-the-spot* controls and reviews on the Member States' managing authorities during external inspections. Moreover, for each programming period, common provision regulations lay down that Managing Authorities should set up an efficient management and control system, requiring *inter alia* effective and proportionate anti-fraud (and other illegal activities) measures considering the risks to be identified.

In this field, the European Commission and OLAF have made considerable efforts to give (not legally binding) guidelines and directions to the Member States to promote anti-fraud strategies concerning ESI funds. However, as demonstrated later, a single State approach appears inadequate to foster preventive action and reduce risks related to those specific forms of support the present study focuses on.

Regarding coordination and cooperation between authorities, it is true that regulation EU 883/2013 required Member States to designate an Anti-fraud coordination service (AFCOS) to facilitate effective cooperation and exchange of information with OLAF. The European coordination mechanism is still mainly focused on *ex-post* measures and procedures, that is, investigation, whilst prevention mechanisms are left at a mere advisory level, according to the role played by COCOLAF.

It follows from such a complex framework the need to investigate more robust coordination mechanisms between European and National managing authorities owing to boost cooperation in establishing preventive administrative measures as a homogeneous system of guidelines sharing a common risk assessment and risk management methodologies. The point is to assess anti-fraud (and other illegal activities) preventive measures as efficiency patterns capable of general application and then identify a set of preventive measures and risk-assessment methods,

establishing a common anti-fraud administrative frame for EU Institutions and National Authorities vested with the power to protect financial interests.

In the view of the present research, all rests on a new concept: the "financial interests of European scale" (FIES).

Preliminarily and in general terms, it could be said that the study aims to support an extension of the traditional budgetary meaning of "EU financial interest", so to include the concept of "financial interests of European scale". The new concept aims to give an adequate theoretical background to those interests often related to financing sources where financial actors are involved. The purpose here is to clearly distinguish the legal features of those interests potentially affected by irregularities or illegal activities (fraud, corruption) whose adequate preventive protection necessarily requires a common response, that is, a joint action of Member States under the coordination of EU Institutions.

Once those features have been identified, it will be possible to propose a harmonised legal protection of those financial interests. In other words, that theoretical framework is essential to distinguish "financial interests of European scale" from those EU financial interests that could still be adequately protected under the traditional programme-based scheme, where the single managing authority has the burden to establish effective preventive measures along with the Commission powers and responsibilities (including OLAF's) provided by ESI funds regulations.

The essential point is to make plain the legal features of EU financial interest when private financing sources are involved in ESI funds operations. The assumption is that a high level of preventive protection may only be based on accurate knowledge of the specific characteristics of those interests and the factual circumstances related to them. In other words, adequate protection of EU financial interests could be achieved only if it is clear what different problems and needs ESI funds operations bring when private financing sources are involved.

In consequence thereof, the study aims to reach two main results.

The first and immediate result is to point out a set of macro-indicators (i.e., bias, fair proceeding, impartiality, project financial sustainability, etc.) to assess fraud risks

related to what will be defined as Financial Interests of European Scale (FIES) and, therefore, to select a harmonised scheme of preventive administrative measures. In sum, to elaborate specifically on designed macro indicators and select appropriate preventive administrative measures to assess irregularity, fraud and corruption risks.

The second and foreseeable result is to explore the theoretical background of a specific set of financial interests of the European Union, defined below as Financial Interests of European Scale (FIES). Their peculiarities require additional coordination effort by EU Institutions in accordance with the principles laid down by article 325 TFEU. So that in the future, European Authorities may evaluate the opportunity to adopt a sharper approach toward coordination regarding preventive measures, as it happens today about *ex-post* measures.

Having said that, the present study is composed of five more chapters.

The second chapter regards the definition and legal frame of the new concept of Financial Interests of European Scale, as briefly described before.

The third chapter gives an overview of current issues related to preventing fraud and irregularities in shared management. In particular, it examines the role of EU Institutions and National authorities under European law. It also extends the analysis to the additional rules the selected national legal systems (namely the Italian and French legal systems) may have adopted to compensate eventual lack of preventive protection.

The fourth chapter aims to tackle the main critical issues related to prevention regarding those forms of support when private sources of financing are involved. This perspective focuses on financial instruments and those special grant schemes defined as PPP operations.

The fifth chapter regards the national survey the research team has conducted among managing authorities of the selected national legal systems. Given the lack of orientation concerning an administrative preventive approach toward fraud and other illegal activities, the purpose of the survey is to collect valuable data from managing authorities on possible measures they have autonomously implemented.

The sixth chapter contains some proposals on administrative preventive measures deriving from the study results so that a possible new frame to protect the financial interest of European scale could be suggested.

Eventually, as an appendix, the study tries to draft a scheme of administrative preventive measures designed to protect FIES. The intention is to make the draft available for EU Institutions as support regarding future policies in the specific field of preventive protection of EU financial interests at stake.

2. Financial Interests of the Union and Financial Interests of European Scale.

The conception of *financial interest* enshrined in art. 310, paragraph 6, TFEU ("*The Union and the Member States, in accordance with Article 325, shall counter fraud and any other illegal activities affecting the financial interests of the Union*") is a due starting point in the analysis of the structure of the European Union budget. Of course, the structure of the European Union's budget does not only determine its financial size as, through the analysis of its resources, it also highlights the subjects considered to play a redistributive function.

Indeed, the Union's financial resources are directly functional to purposes – as options assessed by EU policy-makers – that are disclosed through the budgeting system. Thus, the budget is a legal tool to perform the fundamental redistributive function under the Union's institutional frame. Consequently, European funds lead to an extensive array of administrative entities audited by EU and national bodies holding different competencies and jurisdictions.

Anyway, it is possible to point out a clear *general interest* held by the Union pursued through its financial sources. Consequently, any infringement in managing Union's financial sources may cause a breach of the EU law and, in the meantime, may (more or less deeply) prevent accomplishing the general interest related to each financial source if they are lost or misused.

It is crucial, under this perspective, to stress the legal value of the general interests held by the Union (managing its financial sources) and that held by the Member States, also through their Managing Authorities.

Therefore, the art. 325 TFEU states other fundamental legal principles on the same conception, pointing out a common interest and competence between the Union and the Member States to counter fraud and any other illegal activities affecting the financial interests of the Union. Such a norm refers to measures taken as a *deterrent* and afford *effective protection* in the Member States and all the Union's

institutions, bodies, offices, and agencies. Moreover, the art. 325 TFEU obliges the Member States to counter illegal activities affecting the financial interests of the European Union through effective deterrent measures. More in particular, it binds them to take the same measures to counter fraud affecting the financial interests of the European Union as they take to counter fraud affecting their own interests (see, to this effect, Case C-367/09 SGS Belgium and Others [2010] ECR I-10761, and more precisely, paragraphs 40 to 42).

Nowadays, the leading EU (derivate) legislative source providing for a *definition of financial interest* must be pointed out as the **Directive (Eu) 2017/1371** of the European Parliament and of the Council (5 July 2017) *on the fight against fraud to the Union's financial interests by means of criminal law* (the so-called "PIF Directive"). Even if the perspective considered by such a norm is that of one of the criminal laws, it is possible to refer to a reasonably comprehensive normative definition.

The Directive clearly states in art. 2 paragraph 1 that "*financial interests of the Union means all revenue, expenditure, and property which are covered or acquired or due under: (i) the Union budget; (ii) the budgets of the institutions, bodies, offices, and agencies of the Union established under the Treaties or the budgets directly or indirectly managed and controlled by them*". The Union budget consists of revenue and expenditure.

To a large extent, however, it is, to date, dependent on the States' resources because the most significant share of revenue is represented by a payment that they make in proportion to the GDP of each of them. In addition, the EU budget also has a small share of the value-added tax (VAT) that States collect on taxable transactions. Budget expenditure is the Union's financial commitment to pursue its policies.

This report commonly deduced that the European Union and the Member States have a shared responsibility for safeguarding financial interests and, in this sense, for the fight against fraud. **However, in our opinion, this assertion should be integrated mainly by a conception of public interest/public benefit exclusively held by the Union because of their scale as supported and pursued through EU financial sources.**

Another definition of the Union's financial interests may also be found in another Union source of law – namely, the Regulation n. 883/2013 – and, as such, directly applicable in national legal orders. Indeed, governing investigations by the European Anti-Fraud Office (OLAF), as the Union body responsible for conducting administrative investigation/inquiry into facts – essentially irregularities – affecting the Union's budget. According to Article 2, the Union's financial interests refer to all the "*revenue, expenditure and assets covered by the budget of the European Union, as well as those covered by the budgets of the institutions, bodies, offices and agencies and the budgets managed and controlled by them*".

As seen in a straightforward literal comparison, the two norms substantially coincide, and the second, as mentioned, is already part of the system. It follows that financial interests relate to the *revenue and expenditure* of the Union budget.

To complete this framework, it is possible to claim the article 2, paragraph 1, of Council Decision 2007/436/EC, Euratom of 7 June 2007 (*on the European Communities' resources* system, OJ 2007 L 163, p. 17). According to it, the European Union's resources include "*revenue from application of a uniform rate to the harmonized VAT assessment bases determined according to the European Union rules*", thus with a direct link between the collection of VAT revenue in compliance with the law applicable and the availability to the European Union budget of the corresponding VAT resources, since any lacuna in the collection of the first potentially causes a reduction in the second (see, to this effect, Case C-539/09 Commission v Germany [2011] ECR I-11235, paragraph 72). Finally, the decision to integrate VAT into the rules governing the adopted PIF Directive depended on the position of the Court of Justice. Indeed, on the grounds of the judgments of the European Court of Justice (i.e., CJEU, 8 September 2015, so-called Taricco I; and CJEU, Grand Chamber, 5 December 2017, so-called Taricco II), this solution is supported, noting that "*since the Union's resources include, in particular, within the meaning of Article 2(1)(b) of Decision 2007/436, revenue from the application of a uniform rate to harmonized VAT assessment persons determined under EU rules, there is ... a direct link between the collection of VAT revenue in compliance with applicable EU law and the making available to the Union budget of the corresponding VAT*

resources, since any gap in the collection of the former potentially leads to a reduction in the latter".

Thus, nowadays, the concept of ***financial interests of the Union*** includes all *revenues, expenditures, and financial assets* covered by, acquired through, or due to the Union budget and the budgets of the institutions, bodies, offices, and agencies established under the Treaties and budgets managed and monitored by them. The definition from art. 2, par. 1(a), Directive (EU) 2017/1371 is substantially the same as in art. 2, par. 3, Council Regulation (EU) 2017/1939 of 12 October 2017, implementing enhanced cooperation on establishing the European Public Prosecutor's Office (EPPO).

This concept appears significantly improved comparing it to the previous one under the Convention (26 May 1997, 97/C 191/01, "*on the protection of the European Communities' financial interests*") that encompassed only the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities.

The inclusion of financial operations such as borrowing and lending activities as objects to protect resulted from the Position of the European Parliament adopted at the first reading on 16 April 2014. Namely, the position of the European Parliament was that the protection of the Union's financial interests calls for a common definition of *fraud* covering *fraudulent* conduct concerning expenditure and revenues, assets, and liabilities at the expense of the Union budget, including borrowing and lending activities. Considering EU financial interests includes two crucial issues: multiannual financial framework and EU budget. The multiannual financial framework (MFF) lays down the maximum annual amounts or ceilings the EU may spend in different political fields or headings over at least five years. Nowadays, the financial interests of the Union point out its proper legal position and, more precisely, the quality of **EU Institutions as *general interest holders***, which is a crucial point in the reasoning of this study.

The protection of the European funds and, therefore, the financial interests of the Union means referring both to the EU and Member States' public interests and stakes. However, the Union's interest is peculiar due to its exclusive position as an

institutional holder of a supranational interest. This approach might shape a new legal conception.

Due to the European size of the public benefit pursued through its financial expenditures, the Union holds an exclusive interest, not merely limited to the regular expenditure of its financial resources. Such an interest is also related to the **sound performance and the effectiveness of national or local projects as assets directly (co)financed by the Union.** Thus, the Union may claim a legal status not merely limited to the accountable regularity of the financial expenditure of Member States' managing authorities, as it may also encompass a direct interest in the assets, projects, and other activities directly performed by the above-mentioned national authorities (i.e., Managing Authorities). This approach allows the Union as the sole (stake)holder of interests *per se* representing the European scale (and size) of the positive or negative consequences of any outcome related to assets and/or projects, fully or partially financed by the Union through ESI funds.

A lack of performance caused by a national authority (i.e., due to fraud, yet also to maladministration) in managing ESI Funds is not an issue limited to the lack of pursuing a national (or even local) interest, nor only to that one held by the Union acting as granting entity which, indeed, implies the need to protect the financial interest of the Union.

Such an adverse condition (lack of performance) causes damage to the other concurring national interests (namely, to other *peer-ordinated* public benefits) that did not benefit, indeed, from the quota of ESI funds granted to the mentioned Member State (i.e.) managing authority.

The subject is very sensitive, and a threshold should be settled somehow. However, beyond that threshold, the Union holds a general interest which also must consider those affected as potentially held by (all) the Member States.

Under this view, proposing a more robust (thus, harmonized) legal protection of the financial interests at stake would be possible. In other words, it is essential to distinguish the "financial interests of European scale" from "EU financial interests" as there is a different perspective of the public benefit at stake. Their

protection requires a preventive approach matching EU and Managing Authorities' roles. The former, by setting the frame and consequent homogenous common standards; the latter, by tangibly implementing preventive measures fitting their specific administrative environment.

This new frame could be possible only under the Commission's powers (along with OLAF's essential technical support).

For this reason, it is essential to make plain the legal properties of the financial interest on a European scale when private financing sources are involved in ESI funds operations, such as in PPP Contracts. Reliable preventive protection may only be based on an accurate assessment of legal tools and funding systems and the consequences related to in term of risks.

3. Contrasting fraud and irregularities in shared management: an overview on current issues related to prevention

In the most recent years, the EU regulatory framework on ESI funds has seen significant changes for the purpose of improving competent European and National authorities' powers to prevent, detect and contrast fraud and other illegal activities, on the one hand and the capacity of ESI fund to increase their leverage by attracting private financial resources.

EU Institutions are aware that "*in addition to known risks, new challenges are emerging. They are linked to new ways of managing and spending EU funds, linked to performance and achieving specific targets, areas of reinforced spending… Coping effectively with* ***these risks will require new approaches and tools and a renewed and joint European vision for fighting fraud, corruption and other illegal activities affecting the EU's financial interests.*** *This vision will build on the achievements of recent years and include a more efficient collection and use of data, improved transparency, better coordinated, coherent anti-fraud efforts by Member States through national anti-fraud strategies,* ***reinforced cooperation*** *within national authorities, between EU Member States and with the EU*" (PIF Report 2020).

In line with the overall objectives of the present study, the analysis will now focus on the role of those public authorities in the prevention of illegal activities and cooperation mechanisms in force, taking into account peculiarities of the most recent legal tools involving private financial initiative such as financial instruments and public-private partnerships.

Eventually, it should be stressed that the following analysis will not cover instead preventive measures adopted by the Commission against a Member State (*rectius* the authority responsible for the implementation of an operational programme) that may result in a deferral of payments from the EU budget when the EU Institution claims evidence of severe deficiencies in the management and control system.

3.1 The role of the European Commission and OLAF

Exploring the extent of the mission carried on by the European Commission and OLAF about the prevention of fraud and other illegal activities (including irregularities) related to the allocation of ESI funds under shared management requires focusing primarily on cooperation. Cooperation may play a decisive role in boosting an effective preventive approach, as we will describe later.

For that purpose, the analysis should start from the principle of loyal cooperation established by article 235 TFEU and the relevant European legislation.

Having regard to the earlier – as it is well known – the European Commission and the Member States should "*coordinate their action aimed at protecting the financial interests of the Union against fraud*" by setting up adequate cooperation mechanisms.

Regarding the latter, it should be said that the relevant legal framework is characterised by a combination of powers directly entrusted to the Commission through OLAF, on the one hand, and a set of tasks provided for the Member States, on the other.

So, among the general powers OLAF is vested with, Article 1(2) of Regulation (EU, EURATOM) no. 883/2013 concerning investigations conducted by OLAF expressly states that "*the Office shall provide the Member States with assistance from the Commission in organising* ***close and regular cooperation*** *between their competent authorities in order to coordinate their action aimed at protecting the financial interests of the Union against fraud. The Office shall contribute to the design and development of methods of* ***preventing and combating fraud, corruption and any other illegal activity*** *affecting the financial interests of the Union*".

This provision is consistent with the mission entrusted initially to OLAF by the decision 1999/352/EC, ECSC, Euratom establishing the Office. Article 2 gives OLAF the task not only to carry out administrative investigations to strengthen the fight against fraud, corruption and any other illegal activity adversely affecting the Union's financial interests but also to provide the Commission's support in cooperating with the Member States in the area of the fight against fraud. In

addition, OLAF is responsible for the preparation of the legislative and regulatory initiatives of the Commission with the objective of fraud prevention.

Similarly, the current Regulation (EU, Euratom) no. 2018/1046 on the financial rules applicable to the general budget of the Union provides at article 63 on shared management that when executing tasks relating to budget implementation, Member States shall take all the necessary measures, including legislative, regulatory and administrative measures, to protect the financial interests of the Union. In particular, those measures should have as an object: preventing, detecting and correcting irregularities and fraud; and cooperating with the Commission and OLAF, in accordance with that Regulation and other sector-specific rules.

Having said that, how this cooperation should be implemented is the result of a delicate balance between the need for effective vertical coordination of activities and the institutional autonomy of Member States.

In general terms, the problem of finding an adequate balance between the aforementioned principle of loyal cooperation and the institutional autonomy of Member States cuts across all relationships between European Institutions and National administrations (Le Barbier Le Gris, 2006). Nonetheless, when the Union has exclusive competences, Member States have an actual duty to cooperate. That is the case of the financial interest of the European Union at issue, whose protection requires the establishment of clear duties of administrative coordination.

Yet, how far European Institutions may go in setting up cooperation mechanisms is still critical since it may imply a breach in the institutional autonomy of the Member States (La Farge, 2010). No specific orientations may be found in the Court of Justice case law, which has never directly coped with the problem, so general or predetermined solutions may not be found.

Notwithstanding, regarding ESI funds shared management, some specific orientations are given by recital 22 of Regulation no. 2018/1046. Under that recital, for information purposes, the Commission only should be able to make available to national or local authorities responsible for management and control activities "*a* ***non-binding methodological guide*** *setting out its* ***control strategy and approach,***

including checklists and examples of best practice" in order to promote best practices in the implementation of the ESI Funds.

The Regulation thus seems to confirm the approach EU Institutions have followed so far to adopt soft law tools aiming to progressively standardise proceedings adopted by National and local managing authorities by stimulating more efficient management of those funds (Macchia 2012).

However, that recital could be considered a stepping stone for analysing how cooperation mechanisms should be put into practice in the subject at issue, as long as the two main points are clear.

Firstly, the mentioned recital does not cover all the powers OLAF – as representative of the Commission for the matter – may exercise to protect the financial interests of the Union. The orientation toward a non-binding approach set by that Recital seems to be limited to *ex-post* measures, that is, to "*control strategy and approach*". On the contrary, no references are made to prevention, even if we saw that it is the primary duty of managing authorities in the light of the broader duty to cooperate set by article 63 of the current financial regulation.

Secondly, it should be noted that non-binding legal tools are not the only solution theoretically applicable to the cooperation problem above. Based on the interpretation of Article 197 TFEU, some studies have broadened the capability of European Institutions to set forth binding legal tools since "*the future 'binding measures' will represent the European parameter to direct administrative action in the Member States, and consequently evaluate their effectiveness, even without providing a full and uniform discipline*" (Chiti 2010). In other words, given the lack of legal provisions explicitly prohibiting the European Commission from adopting binding measures concerning prevention in the field of ESI Funds management and allocation, **there are no theoretical constraints in speculating the adoption of binding cooperation schemes** under article 197 TFEU to enhance a coordinated approach towards prevention of risks related to fraud and other illegal activities (including irregularities).

Therefore, vesting the EU Commission with this mission, supported by OLAF for all technical aspects, should prevent any criticism even in the light of a rigorous interpretation of the Treaties also consistent with limits stated in "*Meroni case*" and the subsequent well-known "*Meroni doctrine*" on delegation of regulatory powers to 2nd level EU agencies[1].

Focusing now on the preventive perspective, the EU Commission has fulfilled its mission of organising a "*close and regular cooperation*" conformingly to the non-binding approach described before. More precisely, OLAF has attempted to stimulate Member States and managing authorities to adopt more coordinated or homogeneous measures concerning both prevention and contrast of illegal activities related to ESI Funds following three directions: a. improving coordination among managing authorities, stimulating strategies adopted at the National level; b. guiding managing authorities in building up an efficient set of anti-fraud measures; c. providing managing authorities with some operational tools to support their preventive approach.

a. Having regard to anti-fraud strategies, OLAF attempted to encourage the adoption of National anti-fraud strategies (or NAFS) by issuing specific guidelines in 2014[2].

The reasons behind those guidelines mainly rested on the radically changed approach provided at article 125(4)(c) by regulation EU no. 1303/2013 and now article 74(1)(c) of Regulation EU no. 1060/2022. Under that provision, for the first time, managing authorities must put in place "*effective and proportionate anti-fraud measures taking into account the risks identified*".

In OLAF's view, that change in the legal requirements would have allowed the Member States to adopt National anti-fraud strategies to "*ensure homogenous and effective practices, especially where their organisational structures are decentralised*" (Guidelines on national anti-fraud strategies, 2014).

[1] CJEU cases C-9/56 and C-10/56 *Meroni v High Authority* [1957/1958] ECR 133. On the theoretical implications of the so-called Meroni Doctrine see Schneider 2008 and Simoncini 2018.
[2] OLAF, Guidelines for national anti-fraud strategies for European Structural and Investment Funds (ESIF), Ref. Ares (2014)4344594 - 23/12/2014.

The idea was, in sum, to replicate for each Member State the same scheme proved quite successful for the European Commission, which already adopted its own Commission Anti-fraud Strategies (CAFS) in 2011, as updated and modified in 2019[3]. NAFS would have been crucial for identifying vulnerabilities to fraud within the managing systems and assessing the main fraud risks. For that purpose, OLAF suggested designing the Anti-Fraud Coordination Service (AFCOS) as the national service responsible for elaborating the strategy and adopting it with a legal act to make it binding.

According to the Guidelines, prevention should have played a crucial role in the fight against fraud since it was considered easier and more cost-effective to prevent fraud than to make repairs. So the Member States should have been fully committed to developing and implementing fraud prevention (Guidelines on national anti-fraud strategies, 2014). That is why those guidelines gave great attention to fraud risk assessment and methodology, to the point that a possible structure is proposed in Annex 3. In this perspective, National Strategies would have coordinated the efforts made by AFCOS, managing authorities and certifying authorities.

Unfortunately, experience so far has demonstrated that the attempt to give impulse to National strategies has been scarcely effective for at least two main reasons.

Firstly, not all Member States have responded to the orientation given by OLAF. As emerged by the last PIF report available, barely half of the Member States have adopted a NAFS (PIF Report 2020)[4]. Plus, among those who reported having drafted a NAFS, none seems to have followed the scheme provided by the mentioned guidelines (PWC, 2019).

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[3] EUROPEAN COMMISSION, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions and the court of Auditors on the Commission Anti-fraud Strategy*, COM(2011) 376 final and *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions and the court of Auditors* Commission Anti-Fraud Strategy: enhanced action to protect the EU budget, COM(2019) 196 final.

[4] COMMISSION STAFF WORKING DOCUMENT Measures adopted by the Member States to protect the EU's financial interests in 2020 Implementation of Article 325 TFEU Accompanying the document REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL 32nd Annual Report on the protection of the European Union's financial interests - Fight against fraud – 2020 SWD(2021) 264 final

Secondly, as emerged by the PIF reports issued after those guidelines, measures adopted by the Member States are far from those "*better coordinated, holistic anti-fraud efforts at EU Member State level, based on developing and implementing national anti-fraud strategies*" EU Institutions have tried to promote (PIF Report 2020). Up-to-date NAFS could be relevant from an institutional perspective rather than a legal one. In essence, **the elaboration of a NAFS today is a chance for inter-institutional dialogues** on the topic of fraud deterrence and contrast in the view of sharing policies among competent authorities, **rather than a proper legal tool providing binding legal rules** in such details that it may effectively coordinate the performance of tasks vested on managing authorities. That is even more true in the case of prevention strategies since all recommendations made in the 2014 guidelines about risk assessment and risk assessment methodology have been scarcely followed.

b. Having regard to the role played by EU Institutions in guiding managing authorities during the process of building up an efficient set of anti-fraud preventive measures, we should move from a fundamental soft law tool issued in 2014 by the European Commission: the Guidance for the Member States and Programme Authorities concerning Fraud Risk Assessment and Effective and Proportionate Anti-Fraud Measures[5].

The Guidance provides fundamental orientations to managing authorities, whose overall objective is to address the main fraud risks in a targeted manner. The Guidance stimulates those authorities to evaluate the impact and likelihood of specific fraud scenarios during their self-assessment process. So that in adopting the consequent measures managing authorities may balance the overall benefit of any additional anti-fraud measures and their overall costs, e.g. the high reputational cost linked to fraud and corruption, under the principle of proportionality.

To better orientate managing authorities in this complex evaluation, the Guidance also provides in Annex 1 a fraud risk assessment tool, covering the likelihood and

[5] EUROPEAN COMMISSION, European Structural and Investment Funds Guidance for Member States and Programme Authorities Fraud Risk Assessment and Effective and Proportionate Anti-Fraud Measures, EGESIF_14-0021-00

impact of specific and commonly recognised fraud risks particularly relevant to the key processes. Plus, it gives a list of recommended mitigating controls in Annex 2.

Moreover, OLAF itself issued three important documents giving those authorities practical orientations on specific topics related to fraud (and other illegal activities) prevention, namely: a practical guide on detection of forged documents in the field of structural actions; a practical guide on identifying conflicts of interests in public procurement procedures for structural actions; and, a compendium of anonymised cases. It should be underlined that those further documents pay special attention to prevention and risk-based analysis. In particular, in OLAF's view, the effectiveness and intensity of *ex-post* measures implemented by managing authorities, such as on-the-spot checks, are grandly determined by the accuracy of the risks identified (OLAF, Practical guide on detection of forged documents).

Unlike with NAFS, these practical orientations had a considerable impact, especially the guidance above. Most managing authorities have largely accepted the perspective of improving their preventive approach toward frauds and irregularities (PWC 2019).

The importance of those orientations provided by the Commission and OLAF derives primarily from **the complexity of the assessment vested on managing authorities to establish an effective management and control system**. The overall success of the guidance underlines the need for orientation managing authorities still have.

Nonetheless, the current **lack of financial instruments' support should be stressed**. As noted by the European Court of Auditors, those orientations do not cover financial instruments or risks about state aid (ECA, special report no. 6/2019).

It could be said that preventive measures templates available today do not consider specific risks related to financial instruments. For this reason, the same Court warns that "*the Commission should provide guidance in respect of the provisions allowing financial instruments to continue to be used into the following programme period, in particular for cases where fund managers are selected on the basis of public procurement*" (ECA, Special report no. 19/2016).

More generally, the same conclusions may apply to other alternative private financing sources, such as PPPs. Although those guidelines focus primarily on public procurement, they do not consider the peculiarities of those public contracts as analysed below.

c. Eventually, to stimulate the competent National authorities toward a more effective preventive approach, the EU institutions created two important operational tools: **ARACHNE and EDES**.

In essence, ARACHNE is an integrated IT tool for data mining and data enrichment that the EU Commission has developed since 2009. ARACHNE may thus give managing authorities precious information on risk levels associated with a specific operation to be co-financed by elaborating data coming from two external databases (Orbis and World Compliance) on public reputational, financial and person-related information as well as from an internal database, which is constantly fed by managing authorities with data on projects and contracts already awarded.

More precisely, ARACHNE provides managing authorities with historical data on a particular beneficiary since it keeps a log of the risk evolution, including all the details used to calculate the risk scores and the data deliveries related to the beneficiary. Plus, it provides *ex-ante* risk calculations so that managing authorities can identify potential risks associated with the likely beneficiary in the pre-selection process.

In the light of the ongoing analysis, three key factors should be remarked about ARACHNE. Firstly, the IT tool has been developed, **focusing on the beneficiary situation**. Hence, ARACHNE may give competent authorities valuable information on the beneficiary's financial capacity, involvement in criminal sanctions or convictions, tax evasion, etc. We will see *infra* what implications this circumstance has in cases of financial instruments, especially when fund managers are selected following a public procurement procedure and of PPPs.

Secondly, being a mere IT risk scoring tool, **ARACHNE does not solve *per se* the prevention problem, nor is it the only instrument authorities under share management are requested to use to lower fraud** (and other illegal activities or

irregularities) **risk levels**. It is instead considered by the EU Institutions "*as a good tool amongst anti-fraud measures*".

Besides, as recognised by the same EU Commission, "*it is the responsibility of Member States' authorities to define the sample or the population of projects which will be further investigated, based on the risk indicators and risk scores calculated by the Arachne tool. Member States are, however, strongly recommended to define upfront their risk score analysis strategy which will lead to the identification of projects selected for investigation*" (EUROPEAN COMMISSION, 2016)

Thirdly, once again, it should be recalled that applying **ARACHNE is not a legal requirement** for the management and control system built up by managing authorities since that service is provided voluntarily. However, "*it is recommended that it becomes a part of effective and proportionate anti-fraud measures*" (*Ibidem*). The initiative taken by competent Directorates of the EU Commission about creating ARACHNE falls outside the scope of the regulation package concerning ESI Funds.

On the opposite, the Early Detection and Exclusion System (EDES) – *id est* the second IT tool described above – is regulated in detail by Chapter 2, section 2 of the current financial regulation.

Preliminarily, it should be said that **EDES is a horizontal measure capable of being applied in all cases related to the implementation of the EU budget**. Under article 135 of the current financial regulation, EDES applies to participants or recipients of European funds regardless of the kind of management, being direct, indirect or shared.

The mentioned legal framework establishes thus two primary duties. On the one hand, the European Commission has the duty to set up and operate an early detection and exclusion system to protect the financial interests of the Union. In sum, the Commission has the duty to keep a constantly updated and centralised database of economic operators and entities that have infringed one of the rules set by article 136. Those subjects are in an exclusion situation compared to the exclusion grounds set by article 57 of Directive 2014/24/EU on public procurement.

On the other, all the authorities involved in implementing the EU budget have the duty to exchange information with the Commission so that the latter may determine the inclusion or not of those recipients of EU funds within the EDES database.

A critical point here is to determine how early the detection of those situations potentially hazardous to the EU budget should be because of the legal effects registration on the EDES database may have. Under article 136, competent authorities must report the exclusion situation despite the lack of a final judgment or a final administrative decision on the point. When it occurs, in principle, the decision should be taken "*on the basis of a preliminary classification in law of a conduct as referred to in those points*", as article 136(2) states.

According to the General Court, the case's referral does not presuppose a final judgment or a final administrative decision already exists. The authority is then to refer the case "*in the absence of a judgment or a decision of that kind, where it finds that a possible financial irregularity… is likely to create 'risks threatening the Union's financial interests*". The contracting authority must nevertheless assess "*whether such a risk exists and, if so, if it is likely to threaten the financial interests of the European Union*" (Case T-228/18 *Transtec*).

As to the legal effects, the inclusion of an economic operator into the 'black list' may determine its exclusion of it from further comparative selection procedures for at least three years unless the duration is set by the final judgment in case of an exclusion situation ascertained by a National or European Court. Besides, the inclusion may follow a financial penalty.

On this point, the same Court has stated that "*the registration of an early detection case in the EDES database enables the competent authorising officers merely to carry out the necessary verification in respect of ongoing procurement procedures and existing contracts. It follows that such registration merely makes it possible for authorising officers to satisfy themselves that the rules of sound financial management have been observed and that the agreements have been properly performed, but does not result in an automatic measure or penalty. It does not therefore in itself produce any binding legal effects*" since the binding effect of the inclusion takes place only

after a verification made according to the centralised assessment provided by article 135(4) of the current financial regulation (T-477/16, *Epsilon International SA*).

From the perspective of the ongoing analysis, we should make two remarks. Firstly, **it is doubtful that EDES may be qualified as a proper preventive measure**. In this case, prevention seems to be an indirect consequence of the sanctioning effect (exclusion). That is to say, applying EDES may prevent fraud and irregularities in general just because, according to the already mentioned provisions set by the financial regulation, registered economic operators are excluded from future selection procedures, as we saw before. From our perspective, sharing information among managing authorities prevents other authorities from making the same mistake in the future. However, even though the EDES tool may be helpful to prevent further managing authorities from awarding ESI Funds to economic operators already sanctioned, it may not be appropriately seen as an administrative measure to lowering risk levels. Secondly, it should be remarked that being a fully horizontal measure, as we described before, the application of EDES to financial instruments or PPPs does not differ from its general application.

3.2 The role of National Authorities

To better describe the role played by National Authorities in prevention, we should focus separately on National Governments (Member States) and managing authorities.

a. Having regard to the first, we have already seen that in the view of EU Institutions, **National Governments are recommended to coordinate and uniform the missions vested on managing authorities**. In this perspective, the primary tool to reach those objectives should be the definition of an accurate National anti-fraud strategy. However, we have already described the problems related to the application of those recommendations.

An example of it may be found in the selected national legal systems since they are included in the Member States that have adopted a NAFS.

In Italy, the Italian AFCOS, namely *Comitato per la lotta contro le frodi nei confronti dell'Unione europea* (Committee for the fight against frauds affecting the European Union), is headed by the Minister for European Affairs, and it is composed of other members designated by the same Minister and the Regions. It is vested with the mission to elaborate the National Anti-fraud strategy, being the strategy part of the annual report the Committee is obliged to present to the Parliament. Although this is a legal requirement provided by article 1(54) of law no. 234/2012, the National strategy implemented by the Italian AFCOS varies utterly from the scheme elaborated by OLAF in the 2014 guidelines. Besides, it does not provide a proper "action plan": it establishes no detailed rules or measures managing authorities must comply with. As we said before, it could be classified as a policy-setting document. Among those policies, it should be remarked the objective of "*consolidat*[ing] *the analysis and assessment of the risk of fraud, corruption, conflict of interest and double funding (regarding the protection of the EU's financial interests)*" even though no specific orientations may be found for managing authorities other than the quoted reference (Committee annual report 2020).

Plus, France has a more complex organisation involving central and local authorities. First of all, it should be noted that in France, there is no specific legislation regarding fraud (and other illegal activities) affecting the financial interests of the European Union since the same authorities are in charge of the fight against fraud harming the National interest. That is undoubtedly compatible with article 325 TFEU when it states that the Member States shall take the same measures to counter fraud affecting the financial interests of the Union as they take to counter fraud involving their financial interests. On the opposite, it seems less consistent with the approach followed by EU Institutions in the 2014 guidelines, as described before.

Recently designed by decree no. 2020-872[6], the *Comité interministériel anti-fraude* (Anti-fraud Inter-ministerial Committee) is entitled to define 'common operational

[6] Décret n° 2020-872 du 15 juillet 2020 relatif à la coordination interministérielle en matière de lutte contre la fraude et à la création d'une mission interministérielle de coordination anti-fraude. The new act of primary legislation extinguishes the previous one created by Décret n° 2008-371 du 18 avril

strategies' by coordinating the action of the National anti-fraud working group, that is, groups of experts organised within the same Committee to address frauds in specialised fields. The presence of different groups may be easily explained by the broad scope of the mission carried out by the Committee. Besides, the Committee's mission is to coordinate the activities of *Comités opérationnels départementaux anti-fraude* (Departmental Operational Anti-fraud Committee). Those regional committees are in charge of coordination measures adopted by the relevant public authorities.

So far, the mission of the National Committee has been primarily focused on raising awareness of the importance of contrasting frauds and on training addressed to managing authorities officers and personnel (Yoli, 2019).

b. Regarding the second, **preventing irregularities, including fraud and other illegal activities, rests today entirely on managing authorities**.

Article 72(h) of Regulation EU no. 1303/2013 includes prevention among the general principles concerning management and control systems. Besides, the already mentioned article 125(4)(c) of the same regulation establishes prevention as one of the primary missions of managing authorities since they are called to elaborate effective and proportionate anti-fraud measures. The same approach may be found in the new Regulation EU no. 1060/2021 at article 74, where those authorities are again charged with setting up not only effective and proportionate anti-fraud measures but also specific procedures to apply those measures (**table 1**).

It follows that **managing authorities have broad discretion in determining the extent of the self-assessment** since the fraud risk assessment tool provided by the 2014 Guidelines described earlier has as its primary objective to facilitate managing authorities in that task, whilst "*any other known risks for the specific programme/region under assessment should be added by the self-assessment team*". In fact, according to those guidelines, any managing authorities should build up a self-assessment team, whose composition should be proportionate to the

2008 relatif à la coordination de la lutte contre les fraudes et créant une délégation nationale à la lutte contre la fraude.

complexity and size of each programme, according to §3.2 of the same guidelines. That team should be composed of members internal to the authority since "*the self-assessment should not be outsourced as it requires a good knowledge of the operating management and control system and the programme's beneficiaries*". Moreover, managing authorities have the same discretion in determining the frequency of the self-assessment, although the Guidelines recommend that it should be proportionate and adequate to the risk levels assessed.

Besides, Audit authorities must control the completed risk assessment. They could participate in the assessment process in an advisory role or as an observer. Audit authorities should pursue fulfilling their mission as long as they avoid taking direct decisions on the level of risk exposure because that could be seen as an infringement of independence.

To sum up, in the lack of specific orientations given by NAFS or other equivalent legal acts issued by central governments, managing authorities are fully autonomous in selecting the most appropriate preventive approach to implement their management and control system.

Such autonomy inevitably brings a wide variety of solutions adopted. The success of the 2014 guidelines and the wide application of those operational IT tools described in paragraph 3.1 stress how favourably those authorities receive orientations because of the complexity **of setting up an efficient preventive approach towards irregularities, fraud and other illegal activities**.

As we saw above, the lack of orientation is even more severe concerning financial instruments and PPPs. No specific directions or guidelines at all address the topic. Consequently, up-to-date coordination among managing authorities to share experiences or common solutions is left again to the autonomous initiative of single authorities.

Programme management	
Regulation EU no. 1303/2013	**Regulation EU no. 1060/2021**
Article 72 **General principles of management and control systems** Management and control systems shall, in accordance with Article 4(8), provide for: […] (h) the prevention, detection and correction of irregularities, including fraud, and the recovery of amounts unduly paid, together with any interest on late payments.	*Article 74* **Programme management by the managing authority** 1. The managing authority shall […] (c) have effective and proportionate anti-fraud measures and procedures in place, taking into account the risks identified; (d) prevent, detect and correct irregularities; […] (f) draw up the management declaration in accordance with the template set out in Annex XVIII.
Article 125 **Functions of the managing authority** […] 4. As regards the financial management and control of the operational programme, the managing authority shall: […] (c) put in place effective and proportionate anti-fraud measures taking into account the risks identified; […]	

Table 1

4. Preventing fraud or other illegal activities when private sources of financing are involved

Having addressed the main functions entrusted to European and National authorities regarding the prevention of fraudulent and other illegal activities (i.e., corruption) related to ESI funds allocation, it is now possible to concentrate on those special legal instruments provided by the past and current common provisions regulations where both public and private financing resources are concerned.

The following analysis will focus on financial instruments and public-private partnerships (PPPs). For each of those legal tools, the present study will provide a general description of their most peculiar features and the main issues related to preventing fraud and other illegal activities (including irregularities).

Preliminarily, it should be said that both instruments share two common features.

Firstly, both instruments have shown a **growing relevance in the ESI funds context, given their leverage effect** on the ESI funds and their capacity to combine different public and private resources.

That is true for financial instruments. In recent years, European Institutions have constantly encouraged more extensive use of financial instruments[7] since these have been considered "*a smart way to finance the real economy and boost growth and employment*"[8]. Hence, it is expected that the overall importance of financial instruments will increase further in the 2021-2027 programming period (ECA, special report no. 6/2021).

Moreover, financial instruments may play a decisive role in supporting public policy objectives due to "*their capacity to combine different forms of public and private resources to support, and because revolving forms of finance make such support more sustainable over the longer term*", as recital (34) of Regulation UE no. 1303/2013

[7] Since 2011, as stated in the '5th cohesion report and strategy for the post-2013 cohesion policy'; EUCO 169/13, Conclusions of the European Council, 25 October 2013.

[8] EC, *Report from the Commission to the European Parliament and the Council on financial instruments supported by the general budget according to Art. 140.8 of the Financial Regulation as at 31 December 2013*, COM(2014) 686 final.

puts it so that they may multiply the effect of ESI funds on the real economy without increasing risk levels for the EU budget (Russo, 2021).

That is also true for PPPs, at least when they combine ESI funds with private financing resources, an operation often referred to as blending, as will be described later on (EPEC, 2016).
Secondly, both instruments have been the object of an **evolution of the recent ESI funds legal framework** that confirms the mentioned growing relevance for the European Legislature of those alternative ways of allocating ESI funds where financial actors are entailed. The change in the legal framework mainly aims to enhance the capability of managing authorities to use those instruments.

4.1 Financial instruments

Financial instruments as we know them today made a relatively recent appearance within the ESI funds regulations, given that their legal definition was provided for the first time in 2012 after the revision process of the financial regulation previously in force. Consequently, that definition has since been included in the ESI funds legal framework starting from the 2014-2020 programme.

In essence, financial instruments provided by ESI funds regulation may be split into three separate categories: (a) investments in equity, (b) loans, and (c) guarantees.

They may be implemented by creating a specific fund that can be managed: (a) directly by the managing authority; (b) indirectly by awarding it to a public or private body consistently with the European rules on public procurement.

In particular, regarding the latter, the implementation may be directly awarded to supranational financial institutions, such as the European Investments Bank (EIB) or international financial institutions in which a Member State is a shareholder. It may also be directly awarded to financial intermediates controlled by the managing authority according to the European in-house providing rules. As an alternative, managing authorities may award the implementation of a financial instrument to a

private financial intermediate, selected after a comparative tendering in the light of the principle of competition and the general rules on public procurement[9].

Regarding the first implementation mode, that is, the direct implementation by the same managing authority, it should be said that it has no particular relevance in the light of the ongoing study since no financial intermediates are involved. On the contrary, each of the three alternatives to direct management implies different risk levels related to fraud and other illegal activities depending on the characteristics of the intermediate, as we will see later on.

The reason for the increasing attention EU Institutions have been paid to financial instruments, as described before, rests essentially on the **additional benefits those instruments can provide compared to grants**, which represent the most traditional and still the most frequent mechanism of allocating funding from the EU budget in shared management.

As keenly synthesised by the European Court of Auditors, financial instruments may provide two specific benefits: "*the possibility of leveraging the public funds (i.e. mobilising additional private and public funds to complement the initial public funding); and the revolving nature of their capital endowment (i.e. the use of the same funds in several cycles) allows each euro of funding through financial instruments in principle to be used more than once*" (ECA Special Report n. 19/2016). Moreover, those instruments may positively impact the behaviour of final recipients since they may lead to better use of public funds and may help reduce the likelihood that the final recipients will become dependent on public support. It should be recalled that, differently from traditional grants, financial instruments should, in principle, be returned by final recipients to the managing authority, as in the case of equity investments, as well as they should be paid back or released, as in the case of loans or guarantees (*ibidem*).

[9] "*Financial instruments are generally managed by private- or public sector banks or other financial intermediaries rather than public administrations. For ERDF and ESF instruments, the selection of a fund manager has to comply with EU and National public procurement rules if the management of the fund is tendered out*" (ECA 2016).

Nonetheless**, using ESI Funds to support financial instruments is a much more complex task for managing authorities than using more classical grant schemes**. The reasons for such complexity rest on two key factors.

The first factor regards the **organisation required to implement those instruments**, including the number of subjects involved.

Regarding the relevant subjects, it should be stressed that financial instruments differ from the traditional grant scheme based on the bilateral legal relationship managing authority – the beneficiary. Conversely, the financial instrument scheme is based on the trilateral legal relationship managing authority – the beneficiary – final recipient.

More precisely, according to the definition set by article 2(10) of Regulation EU no. 1303/2013, as confirmed by article 2(9)(e) of Regulation EU no. 1060/2021, in the context of financial instruments, the 'beneficiary' is the body implementing the fund[10]. Plus, under article 2(12), as confirmed by article 2(18) of Regulation EU no. 1060/2021, the 'final recipient' is a legal or natural person receiving support from a financial instrument.

Furthermore, such complexity is revealed by various models managing authorities may choose to implement those instruments.

Having analysed the previous and current European legal framework, for the purpose of the present study, models no. 1, 2, 3 and 4 have been considered utterly relevant, as synthesised in **figures 1 and 2** below.

The number of players involved characterises those models. Differently from the classical scheme provided for grants, the beneficiary here is not the final recipient of public co-financing but a financial intermediate vested with two fundamental tasks: (i) creating and managing a fund, (ii) selecting final recipients by primarily (if not exclusively) managing the selection procedure.

[10] Curiously, in the case in which the managing authority implements directly financial instruments, for the same mentioned legal provision the managing authority is considered at the same time the managing authority and the beneficiary.

In its most straightforward configuration (model 1), implementing financial instruments requires three different actors (MA, beneficiary, final recipient).

According to the financial instruments' legal framework, even more complexity may be added. On the one hand, as an exemption to the general prohibition, in the case of financial instruments, beneficiaries may be co-financed by several ESI funds (model 2, model 4). On the other hand, the beneficiary may be allowed to manage a holding fund (a "fund of funds") and to award the management of specific sub-funds to other financial intermediates along with the selection of final recipients (model 3, model 4).

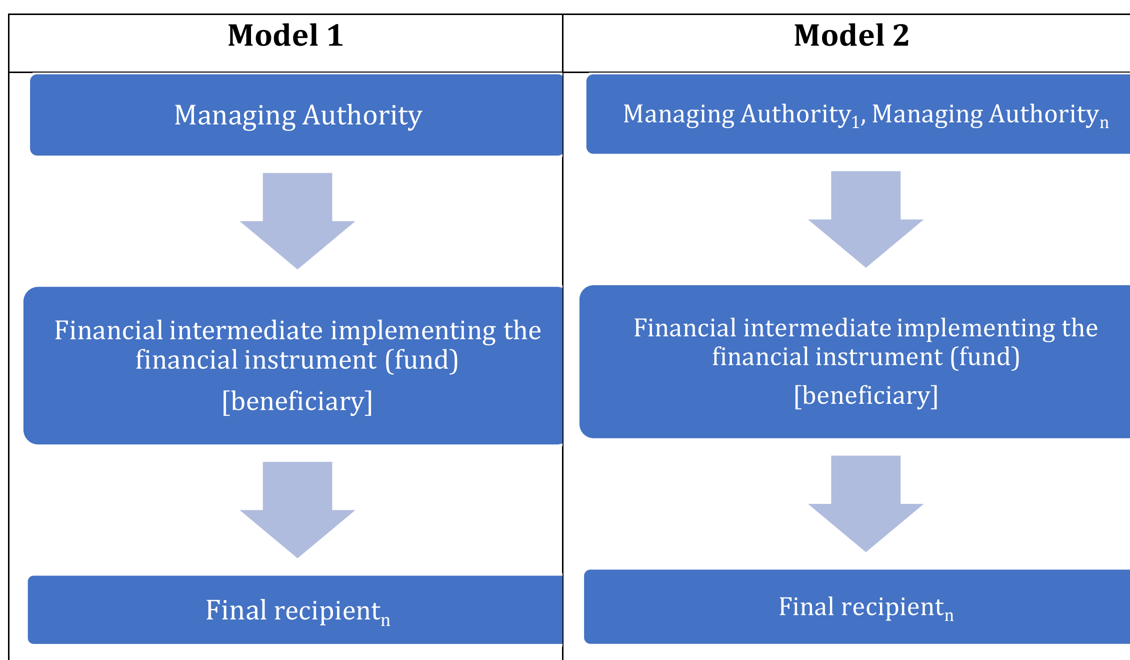

Figure 1

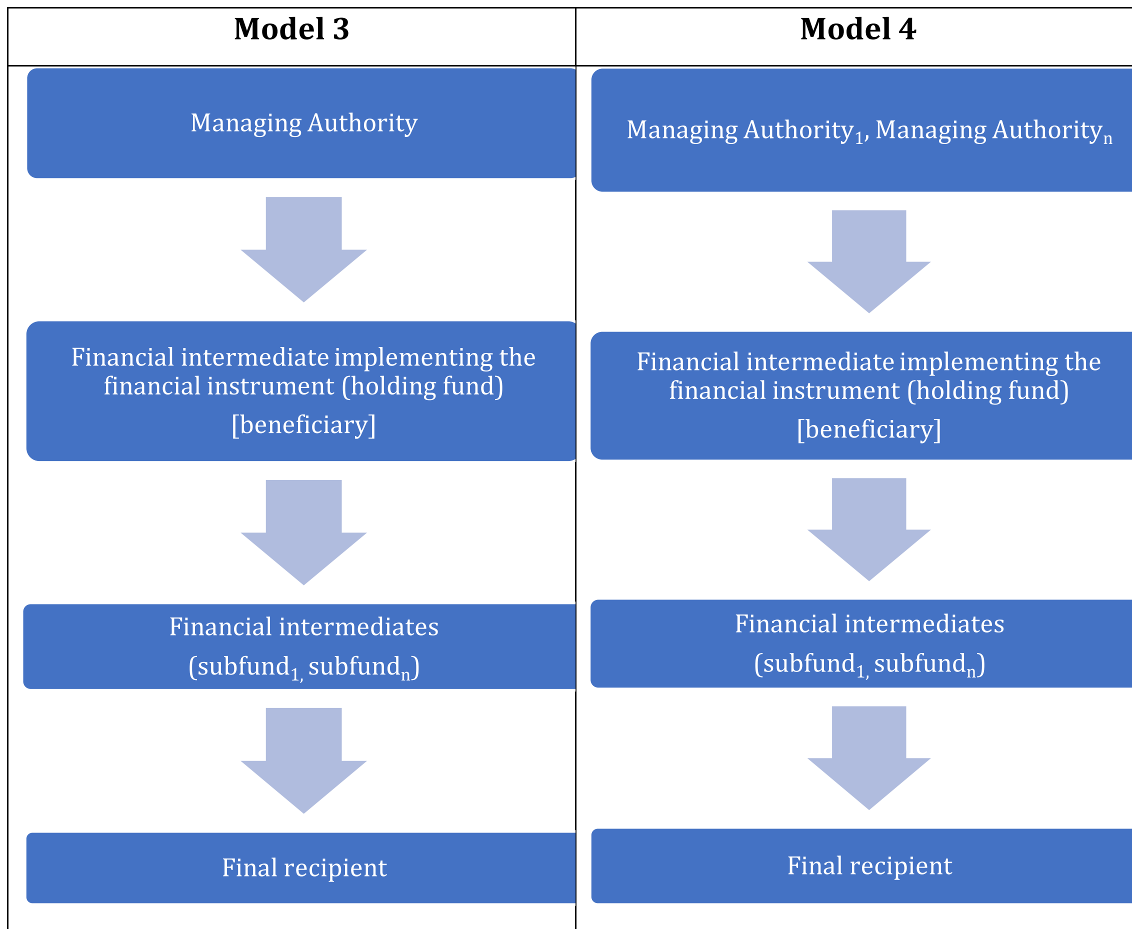

Figure 2

It is essential to underline that this scheme brings on two critical points. Firstly, regardless of its public or private nature, **the financial intermediate is considered the beneficiary** of the co-financing in the light of the mentioned legal provisions, instead of the final user of the ESI funds as in a traditional grant scheme.

In particular, according to specific guidelines issued by the European Commission on the selection of bodies implementing financial instruments under Article 7 of Regulation EU no. 480/2014, managing authorities should focus on the organisational capacity of the financial intermediate, considering:

— **an adequate capacity to implement the financial instrument**. More precisely "*the managing authority must evaluate how well the system put in place in the body to which implementation tasks are to be entrusted, is directed and controlled. The system put in place should cover the aspects like: planning, setting-*

*up, communication, monitoring of the progress against the objectives****, risk management*** *and business controls*";

- **an effective and efficient internal control system**. On the assumption that "*an effective and efficient internal control system should ensure that the body entrusted with implementation of financial instrument(s) has in place an adequate control environment and respects the procedures in place for the execution, measurement, follow up and* ***mitigation of risks***" (Commission 2016 III).

Secondly, the peculiar scheme provided for financial instruments' implementation elongates the chain of control. Managing authorities have no direct control over the exact allocation of ESI funds since that task is vested in the intermediate managing the fund. As we saw, it is up to the financial intermediate to select the final recipients of a specific fund.

As confirmed by the approach followed by the 2014 guidelines mentioned above issued by OLAF, the duty to put in place an adequate internal control environment, including an effective risk management set on managing authorities by article 124 of regulation EU no. 1303/2013 and now article 72 of regulation EU no. 1060/2021 in the light of the principle of sound financial management, is fulfilled in this specific circumstance by transferring it to the internal control system of the fund manager.

The potential lack of effective control powers over final recipients may grow worse in case a holding fund is created (model 3 and 4), where the exact allocation of ESI funds goes through the sub-fund manager, based on orientations given by the holding fund manager and going back on the control chain up to the same managing authority.

As a consequence, differently from the traditional grant scheme, a preventive approach against fraud and other illegal activities should, in principle, consider different and more complex aspects, among those the relationships and conducts involving holding fund or fund managers and final recipients.

In the light of the above, this peculiar mechanism may have two main implications on the effectiveness of the existing prevention tools provided today by the EU

Commission, such as ARACHNE or EDES described in §3, owing that their all calibrate on the beneficiary situation. In principle, managing authorities should use those tools to assess potential risks related to the financial intermediate (beneficiary), whilst a risk analysis on the allocation of ESI funds to a determined final recipient should be carried out exclusively by the fund manager.

The first implication regards the information related to the financial intermediate. The basic data set provided by those risk scoring tools may appear not fully exhaustive for those peculiar economic operators.

As discussed below, financial intermediates are subject to a highly complex legal framework, including prudential supervision regulation. Regulatory powers regarding economic operators providing financial services generate precious information of prudential nature related, among other things, to the fitness and properness of internal control mechanisms set by supervisees.

This is a fundamental issue in the perspective of the present study since, as illustrated before, a proper internal control mechanism set by the fund manager is a crucial element for the selection of the financial intermediate and for the implementation itself of the financial instrument. The point here is that in practice, it is **utterly difficult for managing authorities to ascertain how proper those mechanisms are and what risks are associated with potential deficiencies of those** without having access to essential information gathered by regulators on the topic. The likely result is that in awarding a contract having the management of a determined financial instrument as an object, managing authorities comply with the selection criteria set by article 7 of delegated regulation no. 480/2014 simply verifying (possibly by a mere participant declaration) that the financial intermediate has formally fulfilled the relevant legal requirements.

A solution to this problem could be integrating the existing tools with relevant information of prudential nature according to the cooperation efforts already carried on by those regulatory authorities to share on (*infra*).

A further implication concerns the possibility for financial intermediates operating as fund managers to use those same tools to evaluate risks related

to a specific final recipient. As mentioned above, this task is entrusted exclusively to fund managers whose activity is eventually controlled *ex-post* by managing authorities. Up to date, in the lack of specific orientations given by EU Institutions and specific tools accessible for fund managers, the preventive approach concerning risks of fraud and other illegal activities could hardly be implemented. As an alternative, managing authorities could establish a prior approval of the selected recipients so that those authorities may themselves evaluate risks, although some doubts may raise on the compatibility of this cumbersome mechanism with the principles of efficiency, effectiveness and economy; in other words of with the principle of sound financial management.

The second factor regards **the technical complexity of activities entrusted to those financial intermediates** and the complexity of legal rules applicable to those same activities.

Having regard to the technical complexity, the actual implementation of a specific financial instrument should have as primary objectives not to alter competition levels by giving unduly competitive advantages to final recipients in comparison to other firms operating in the relevant market and, consequently, to comply with the rules on State aid.

For this reason, article 37(2) of Regulation EU no. 1303/2013 and now article 58(3) of Regulation EU no. 1060/2021 impose managing authorities to draw up an ***ex-ante* assessment** beforehand to identify market failures or sub-optimal investment situations, respective investment needs, possible private sector participation and resulting value added of the financial instrument in question (Commission 2015).

Having entrusted managing authorities with such a complex task, European Institutions have tried to coordinate and support that effort, following an approach we have already seen each time cooperation or coordination needs have been detected by those same Institutions.

A first attempt to boost coordination in this field dates back to the programming period 2007-2013 when financial instruments were not those we are analysing

today, and the only possibility for managing authorities was to seek the support of EIB.

Under the so-called JEREMIE and JESSICA initiative, EIB and EIF carried out evaluation studies whose main goal was to address the potential implementation of financial instruments. Those studies were financed mainly by the Commission, so they could be offered free of charge to interested Member States and regions. As the same Commission recognised, those attempts were not particularly successful, mainly because the EIB and EIF's role as advisors and privileged position as holding found managers was perceived as a conflict of interest (Commission 2016 II).

Later, the Commission issued specific guidelines[11] to orientate managing authorities in such a difficult task. Then from the 2014-2020 programming period onward, by a joint initiative of the Commission and the European Investments Bank, all advisory services related to financial instruments involving ESI Funds have been transferred to a single technical assistance platform named FI-COMPASS.

Once again, EU Institutions, through FI-COMPASS, have produced an important series of documents all aimed at assisting and coordinating managing authorities' approach toward ex-ante assessment. However, no specific indications have been issued so far about another crucial ex-ante assessment related to financial instruments: fraud and other illegal activities risk assessment.

Regarding the legal complexity, this circumstance was addressed by regulation EU no. 1303/2013 regarding common provisions for ESI Funds during the 2014-2020 programming period. At article 38(4) it established that "*when implementing the financial instrument,* [financial intermediaries] *shall ensure compliance with applicable law, including rules covering the ESI Funds, State aid, public procurement and relevant standards and applicable legislation on the prevention of money laundering, the fight against terrorism and tax fraud*". This provision has not been replicated in Regulation EU no. 1060/2021 (**table 2**).

[11] EUROPEAN COMMISSION (2015), Directorate-General for Regional and Urban policy Guidance for Member States on Article 37(2) CPR– Ex-ante assessment, Luxembourg, Publications Office of the European Union.

Implementation of Financial Instruments	
Regulation EU no. 1303/2013	**Regulation EU no. 1060/2021**
Article 38 **Implementation of financial instruments** […] 4. When supporting financial instruments referred to in point (b) of paragraph 1, the managing authority may: (a) invest in the capital of existing or newly created legal entities, including those financed from other ESI Funds, dedicated to implementing financial instruments consistent with the objectives of the respective ESI Funds, which will undertake implementation tasks; the support to such entities shall be limited to the amounts necessary to implement new investments in accordance with Article 37 and in a manner that is consistent with the objectives of this Regulation; (b) entrust implementation tasks to: (i) the EIB; (ii) international financial institutions in which a Member State is a shareholder, or financial institutions established in a Member State aiming at the achievement of public interest under the control of a public authority; (iii) a body governed by public or private law; or (c) undertake implementation tasks directly, in the case of financial instruments consisting solely of loans or guarantees. In that case the managing authority shall be considered to be the beneficiary as defined in point (10) of Article 2. **When implementing the financial instrument, the bodies** referred to in points (a), (b) and (c) of the first subparagraph **shall ensure compliance with applicable law, including rules covering the ESI Funds, State aid, public procurement and relevant standards and applicable legislation on the prevention of money laundering, the fight against terrorism and tax fraud.** Those bodies shall not be established and shall not maintain business relations with entities incorporated in territories, whose jurisdictions	*Article 59* **Implementation of financial instruments** 1. Financial instruments implemented directly by the managing authority may only provide loans or guarantees. The managing authority shall set out the terms and conditions of the programme contribution to the financial instrument in a strategy document which shall include the elements set out in Annex X. 2. Financial instruments implemented under the responsibility of the managing authority may be either of the following: (a) an investment of programme resources into the capital of a legal entity; (b) separate blocks of finance or fiduciary accounts. **The managing authority shall select the body implementing a financial instrument**. 3. The managing authority may directly award a contract for the implementation of a financial instrument to: (a) the EIB; (b)international financial institutions in which a Member State is a shareholder; (c) a publicly-owned bank or institution, established as a legal entity carrying out financial activities on a professional basis, which fulfils all of the following conditions: […] 4. When the body selected by the managing authority implements a holding fund, that body may further select other bodies to implement specific funds. […]

do not cooperate with the Union in relation to the application of the internationally agreed tax standards and shall transpose such requirements in their contracts with the selected financial intermediaries.	
5. The bodies referred to in points (a) and (b) of the first subparagraph of paragraph 4, when implementing funds of funds may further entrust part of the implementation to financial intermediaries provided that such entities ensure under their responsibility that the financial intermediaries satisfy the criteria laid down in Article 140(1), (2) and (4) of the Financial Regulation. **Financial intermediaries shall be selected on the basis of open, transparent, proportionate and non-discriminatory procedures, avoiding conflicts of interest.**	7. The bodies implementing the financial instruments concerned, or in the context of guarantees, the body providing the underlying loans, shall support final recipients, taking due account of the programme objectives and the potential for the financial viability of the investment as justified in the business plan or an equivalent document. **The selection of final recipients shall be transparent and shall not give rise to a conflict of interest.**

Table 2

In that regard, it should be noted that financial instruments are nothing but peculiar **financial services provided by financial intermediates**. Consequently, they should be subject not only to ESI Funds regulations but also to other relevant legal frameworks, depending on the specific object of the instrument, that is, on the activity co-financed, as well as on the legal nature of the beneficiary.

It is thus possible to focus on those specific legal frameworks recalled by the mentioned article 38 to underline those aspects closely related to the object of the present study.

So, during the selection proceeding, managing authorities should, in principle, verify that none of the exclusion grounds set by article 57 of directive 2014/24/EU is met by the financial intermediate. It does not matter if the selection comes after a direct award or a comparative procedure. Among those, some seem to overlap the provision of article 38.

In particular, managing authorities during the selection procedures must automatically exclude financial intermediates having been the subject of a conviction by final judgment for (a) corruption, (b) fraud, and (c) money laundering or terrorist financing. In addition, managing authorities should evaluate if a

potential conflict of interest may occur between that intermediate and their staff members (**table 3**).

Plus, similar conclusions may be reached regarding the duty of compliance to the prevention of tax fraud set by article 38(4) on fund managers. However, preventing tax fraud is a task left to Member States National legislations and competent authorities identified by those legislations.

The approach followed by public procurement directives cannot be appropriately considered preventive. However, it could generate some preventive effects, provided that it prevents a subject already condemned for one of those crimes could put in place similar conducts in the future, following the same logic we saw concerning EDES.

Directive 2014/24/EU
Article 57 - Exclusion grounds 1. Contracting authorities shall exclude an economic operator from participation in a procurement procedure where they have established, by verifying in accordance with Articles 59, 60 and 61, or are otherwise aware that that economic operator has been the subject of a conviction by final judgment for one of the following reasons: […] (b) **corruption**, as defined in Article 3 of the Convention on the fight against corruption involving officials of the European Communities or officials of Member States of the European Union and Article 2(1) of Council Framework Decision 2003/568/JHA as well as corruption as defined in the national law of the contracting authority or the economic operator; (c) **fraud** within the meaning of Article 1 of the Convention on the protection of the European Communities' financial interests; […] (e) **money laundering or terrorist financing**, as defined in Article 1 of Directive 2005/60/EC of the European Parliament and of the Council; […] 4. Contracting authorities may exclude or may be required by Member States to exclude from participation in a procurement procedure any economic operator in any of the following situations: […] (e) where a **conflict of interest** within the meaning of Article 24 cannot be effectively remedied by other less intrusive measures; […] 2. An economic operator shall be excluded from participation in a procurement procedure where the contracting authority is aware that the economic operator is in breach of its obligations relating to the **payment of taxes or social security contributions** and where this has been established by a judicial or administrative decision having final and binding effect in accordance with the legal provisions of the country in which it is established or with those of the Member State of the contracting authority.

Table 3

The only exception is the provision on **conflict of interests,** where the evaluation is left uniquely to managing authorities. In fact, under article 24 of directive

2014/24/EU, acting as contracting authorities, managing authorities must "*take appropriate measures to effectively prevent, identify and remedy conflicts of interest arising in the conduct of procurement procedures so as to avoid any distortion of competition and to ensure equal treatment of all economic operators*".

Avoiding conflicts of interest is a crucial point in a preventive perspective since taking adequate measures to prevent may "effectively", as in the wording of article 24, reduce the risk of fraud, corruption or other illegal activities.

In that regard, it should be noted that the new common provisions regulation follows a different approach in comparison to the 2014-2020 programming period legal framework.

Specifically, Article 38(5) of Regulation EU 1303/2013 states that "*financial intermediaries shall be selected on the basis of open, transparent, proportionate and non-discriminatory procedures, avoiding conflicts of interest*" (**table 2**). This provision has two drawbacks.

On the one hand, it could be seen as a simple recall of the directives above on public procurement. It is clear that **in selecting the fund manager, managing authorities must comply with the rules on public procurement**. Avoiding conflicts of interest is a legal requirement, as we have seen, irrespectively whether the financial intermediate is selected by direct award or comparative procedure (open procedure, restricted procedure and so on). On the other, the application of article 38(4) is limited to potential conflicts of interest between staff members of the managing authorities and the financial intermediate to be selected. It does not cover potential conflicts concerning ESI funds' latter and final recipients.

This key point has been regulated by delegated regulation EU no. 480/2014. According to article 6, those bodies implementing financial instruments have the responsibility to ensure that selection of final recipients should not give rise to a conflict of interest. The delegated regulation adopts no definitive solution to make this provision effective. The only exception may be found at article 7(2)(f) in cases where the body implementing the financial instrument allocates its financial resources to the financial instrument or shares the risk. Here the article imposes

managing authorities to select the fund manager based on a selection criterion having as an object "*proposed measures to align interests and to mitigate possible conflicts of interest*".

Following this reasoning, **the responsibility to avoid potential conflicts of interest with final recipients rests entirely on fund managers** (beneficiaries). What kind of role managing authorities should play to prevent those situations is not specified in cases where the financial intermediate is called to participate in the financing effort. Managing authorities may not play an active role in mitigating potential conflicts. Still, they evaluate how theoretically effective the possible mitigating actions offered by economic operators conform to the general rules of selection criteria in a comparative selection procedure.

Coherently, the new common provisions regulation follows a different approach by establishing at article 59 that "*the selection of final recipients shall be transparent and shall not give rise to a conflict of interest*" (**table 2**). The new provision switches the focus on the legal relationship bounding the fund manager and those subjects whose activities are co-financed by ESI funds.

For the avoidance of doubt, under the new provision, the application of public procurement rules on conflicts of interests is implicit since there is no need to duplicate the reference to those provisions as in the previous regulation. In addition, the new provision highlights in an act of primary legislation the problem of guaranteeing that in selecting final recipients of the fund, financial intermediates orientate their conduct exactly as managing authorities, especially when they are private economic operators. This problem is a consequence of the elongated control chain we discussed.

Moreover, according to article 38(4), the body implementing the fund should ensure compliance with applicable legislation on the **prevention of money laundering and the fight against terrorism**.

It should be borne in mind that financial intermediates are already subject to **(prudential) supervision** of the competent European and National Authorities and control power vested on special public authorities, the so-called Financial

Intelligence Units. It falls outside the scope of the present study to deeply analyse the utterly complex legal framework concerning financial supervision and the set of powers entrusted to competent regulatory authorities.

In essence, under the anti-money laundering/countering the financing of terrorism European legal framework, financial institutions must comply with three fundamental requirements: (a) to put in place policies, controls and procedures to mitigate and manage risks of money laundering and terrorism financing; (b) to carry out adequate customer due diligence, and (c) to inform without any delay the so-called Financial Intelligence Unit of any suspicions of money laundering/terrorist financing circumstance.

Financial Intelligence Units are highly technical public authorities vested with analysing suspicious transaction reports and informing law enforcement apparatus, financial supervisors and other competent authorities if the illegal activity is confirmed.

In this field, having adequate information and sharing that information is essential for preventing those illegal activities. On the one hand, an important role in contrasting those phenomena is played by prudential supervision, as recognised by recital (19) of Directive 2018/843/EU, which is the fifth directive on the prevention of the use of the financial system for money laundering or terrorist financing, when it recognised that "*information of a prudential nature relating to credit and financial institutions, such as information relating to the fitness and properness of directors and shareholders, to the internal control mechanisms, to governance or compliance and risk management, is often indispensable for the adequate AML/CFT supervision of such institutions*".

On the other, as recognised by recital (1) of directive 2019/1153/EU laying down rules facilitating the use of financial and other information for the prevention, detection, investigation or prosecution of certain criminal offences, "*facilitating the use of financial information is necessary to prevent, detect, investigate or prosecute serious crime*". In particular, this directive has potentially improved the sharing of relevant information by granting direct access to national centralised bank account

registries or data retrieval systems by competent authorities, including tax and anti-corruption authorities (Commission 2019).

For the purpose of the ongoing study, the described scheme has some deficiencies because it does not explicitly regulate what functions managing authorities should exercise to prevent those illegal activities. The point here is how managing authorities may efficaciously verify that compliance and, most of all, how they could put in place an effective prevention system in the light of art. 125(4) to prevent those illegal activities related to financial instruments.

Lastly, the current common provision regulation does not replicate the content of article 38(4), probably because each of the duties set by article 38(4) on financial intermediates already has a more detailed regulation in the Directives mentioned above. Nonetheless, in the light of the ongoing study, the problems for managing authorities remain the same.

4.2 Grants

As an alternative to financial instruments described before, common provision regulations EU 1303/2013 and 1060/2021 allow ESI funds to provide support to beneficiaries in the form of grants or a combination of both[12]. When financial instruments and grants are combined, the principle of non-cumulative award and prohibition of double funding set by article 191 of regulation EU no. 1046/2018 apply, so specific conditions preventing double financing should be set out.

Grants represent the most traditional and common form of support established by ESI funds' legal framework. A more straightforward allocation proceeding characterises them since they are generally managed by the same managing authority or, in a slightly more complex organisational framework, by an intermediate body[13]. Besides, unlike financial instruments, grants aim to reimburse

[12] Respectively article 66 of regulation EU no. 1303/2013 and article 52 of regulation EU no. 1060/2021. Both articles include prizes as a form of support, which are not relevant for the primary purposes of the present study.
[13] Intermediate bodies are defined by article 2(18) of Regulation EU no. 1303/2013 and article 2(8) of Regulation EU no. 1060/2021 as any public or private body which acts under the responsibility of

ex-post expenditures incurred by the beneficiaries according to one of the methods provided by the common provision regulation itself.

In the perspective of the ongoing study, no particular fraud and other illegal activities risk levels related to an injection of private financing resources stem from using a grant scheme unless the following conditions are met.

On the one hand, grants may be combined with financial instruments, as just said. In this hypothesis, the combination of grants and financial instruments has no practical effects on risk levels already associated with financial instruments. In other words, in the case of co-financing according to a financial instrument scheme, it makes no difference that the operation is financed for the remaining part by the beneficiary's resources or, instead, by a grant. In this case, preventive measures related to financial instruments should be applied in addition to those already implemented for grants.

On the other hand, grants may impinge upon other sources of private finance in the case of public-private partnership operations (PPPs), as analysed in the following paragraph. It should be borne in mind, though, that co-financing of PPP operations by ESI belongs to the grant scheme. Consequently, private financing in PPP operations could benefit from the award of a financial instrument to better cope with the financial balance of the investments required. Under this specific circumstance, risk assessments should be separately focused again on the specificity of each form of support.

4.2.1 PPP operations

As an alternative to financial instruments, EU regulations on ESI Fund promote the use of private finance through special provisions concerning public-private partnership operations.

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managing or certifying authority, or which carries out duties on behalf of such an authority, about beneficiaries implementing operations.

Article 2(15) of Regulation EU 1060/2021 defines a PPP operation as "*an operation which is implemented under a partnership between public bodies and the private sector in line with a PPP agreement, and which aims to provide public services through risk sharing by the pooling of either private sector expertise or additional sources of capital or both*". This definition is consistent with that provided by articles 2(24) and (25) of previous regulation EU 1303/2013, as well as the most internationally accepted definitions, such as the OECD definition of PPP as "*long-term contractual arrangements between the government and a private partner whereby the latter delivers and funds public services using a capital asset, sharing the associated risks*" (OECD 2012).

In essence, PPPs are peculiar public contracts that differ from the most common public contracts normally co-financed by ESI funds grants because of the following features:

a) **Duration**. Unlike other public contracts, in a PPP operation, the private partner is expected to share the burden of capital expenditures with the contracting authority. For this reason, **PPPs are typically long-term contracts**, so the private partner may be allowed to recoup its investment adequately. As a consequence, PPP contracts may last longer than the eligibility period for expenditures established by the common provision regulation for each programming period;
b) **Private financing**. Due to the investment required from the private partner, a PPP operation may involve a certain degree of private financing: the so-called **blending**. That may require the participation of financial intermediates (lenders), as in the case of project finance loans, to underpin the risks transferred to the private partner (EPEC 2021). More precisely, except for the rare case where the private partner bears the capital costs with its resources, a PPP operation reaches financial close due to additional resources made available by a financial intermediate. That could be both due to a loan agreement third to the PPP agreement signed between the economic operator and a financial intermediate, as in the case of a corporate finance PPP operation, or due to the acquisition of shares of a newco (a so-called special purpose vehicle)

by the same financial intermediate, as in the case of a project finance PPP operation;

c) **Risks allocation**. A fundamental feature of PPP contracts is allocating risks related to the operation between the public and private partners.

d) **Payments for outputs**. Under a PPP operation, **payments are performance-based.** That is, they are based on the level and quality of the services provided by the private partner. Conversely, in line with a more traditional public procurement approach, ESI funds grants are generally designed to pay for project inputs.

The use of PPPs has been encouraged by EU Institutions since the Europe 2020 Strategy[14], although in practice, so far, EU funds have been little used for those contracts, as recognised by the European Court of Auditors (ECA SR 9/2018).

This peculiar contract scheme has been scarcely applied mainly because of the need for a special legal framework to remove potential barriers for contracting authorities[15]. In that regard, the turning point has been regulation EU 1303/2013 for the programming period 2014-2020. This regulation has thus provided an **innovative set of rules to boost the use of blending operations** by beneficiaries of ESI funds.

In particular, before the mentioned change in the legal framework, the experience revealed three main constraints: a) public sector capacity and National legislations; b) duration of PPP contracts and expenditures; c) appointment of beneficiaries.

a) **Public sector capacity and National legislation**. Regarding the first constraint, a significant obstacle to blending operations has been found in limited public sector capacity to manage the combination of grant funding and PPP preparation and procurement processes because of the inner complexity of PPP operations

[14] "*To accomplish its objectives for Europe 2020... Europe must also do all it can to leverage its financial means, pursue new avenues in using a combination of private and public finance, and create innovative instruments to finance the needed investments, including public-private partnerships (PPPs)*".

[15] The need for special provisions concerning PPPs is confirmed by Recital (59) of regulation EU 1303/2013: "*Public Private Partnerships ("PPPs") can be an effective means of delivering operations which ensure the achievement of public policy objectives by bringing together different forms of public and private resources. In order to facilitate the use of ESI Funds to support operations structured as PPPs this Regulation should take account of certain characteristics specific to PPPs by adapting some of the common provisions on the ESI Funds*".

compared to more traditional grant schemes (EPEC 2016). Besides, that limited capacity is often caused by the insufficiently **developed institutional and legal framework** (ECA SR 9/2018). From this perspective, it should be noted that the previous common provision regulation could not solve this critical point. On the one hand, institutional deficiencies in projecting and managing PPPs are a question of the technical expertise of the staff involved that an act of primary legislation cannot simply overcome. On the other, European directives on public procurement have not directly addressed public-private partnerships. Directive 2014/23/EU has only provided a special regime for concession contracts, a specific model of PPP (Arrowsmith 2019)[16]. As a consequence, apart from the case of a PPP having the legal shape of a concession contract, beneficiaries should apply **national legislation on PPP procurement**. In the light of the ongoing study, it should be recalled that both the selected National legal systems have established specific legal provisions regarding PPP. In particular, in France, articles L2211-1 to L2236-1 Public Procurement Code (*Code de la Commande Publique*. At the same time, in Italy, PPPs are regulated explicitly by articles 179 to 191 Public Procurement Code (*Codice dei Contratti Pubblici*). This point remains critical in the lack of a European legislation on PPP **Duration of PPP contracts and expenditures**. Another essential issue concerned a **potential misalignment between the long-term PPP agreement and the relatively short-term period provided for eligibility of expenditures** by each programming period. In the past, this circumstance imposed blended projects to use ESI funds to partially pay up-front capital costs, the only costs that could be born in an early stage of the relevant operation. Nonetheless, such a limitation could, in principle, decrease the full benefits of such an operation, inter alia in spreading the investment recovery throughout the long-term service performance. To prevent this constraint, articles 2(26) and 64(2) of Regulation EU 1303/2013 have introduced for the first time a peculiar payment mechanism

[16] This approach is thus coherent with the 2004 Green paper on public-private partnerships and community law on public Contracts and concessions COM(2004) 327 final. It identifies three main categories of PPP: a) purely contractual partnership designated as a "public contract", b) purely contractual partnership designated as a "concession", and c) institutionalised PPPs (or IPPs).

consisting of an escrow account set up expressly to hold funds to be paid out after the eligibility period. The described mechanisms are confirmed by the new common provision regulation as well, alt. However, article 63 seems to include expenditures in a PPP operation within the strict time limits set for the eligibility period in the 2021-2027 programming period, in contrast to the exact definition of escrow account explicitly referred to as PPP operations (**table 4**). Moreover, to give impulse to PPP operations by derogating ordinary rules on eligibility, article 64 of previous regulation 1303 allows managing authorities to consider expenditures incurred by the private partner as incurred and paid by a beneficiary. The same provision is now set by article 53(a) of the new common provisions regulation.

b) **Appointment of beneficiaries**. Lastly, under article 63 of the previous regulation, three special provisions have been introduced to facilitate funding for PPP agreements.

   1. Differently from other public contract operations, under article 63 of regulation EU 1303/2013, the general partner initiating the PPP operation may ask the managing authority to **appoint the private partner as the beneficiary**. The importance of this derogation may be fully appreciated in the light of the **amplified leverage effect** that it may bring. It should be borne in mind that, generally, allocation of ESI funds by managing authorities implies to "*determine a co-financing rate from the Funds to priority axes, in particular, to increase the multiplier effect of Union resources*"[17]. Given the opportunity for contracting authorities to propose the private partner as the beneficiary, the effect is to substitute public resources (those the contracting authority should set aside depending on the rate of co-financing) with private financial resources (those made available by the private partner). As a result, this mechanism allows receiving ESI Funds to those public authorities who could not afford to co-finance an operation according to traditional public contract schemes (Novaro 2018).

[17] Recital (105), Regulation EU 1303/2013.

2. A further constraint in the past was the unacceptable risks for contracting authorities caused by the need to select the private partner before the grant application. So that those authorities could find themselves having to guarantee the availability of funding if the grant from the ESI Fund was not approved or reduced (EPEC 2016). This inconvenience has been considered as solved based on the possibility given by article 63(1)(b) of regulation 1303/2013 to propose as a beneficiary "*a body governed by private law of a Member State (the "private partner") selected or to be selected for the implementation of the operation*" (**table 4**). The fact that the private partner may still be "*to be selected*" has been interpreted as an opportunity for contracting authorities **to participate to grant application in an early stage of the procurement procedure or even before the procedure has started**. The new regulation EU 1060/2021 has not replicated this provision exposing contracting authorities to the risk mentioned above.
3. At article 63(3), the 2013 common provision regulation allowed the private partner selected to implement the PPP operation to be **replaced as beneficiary during implementation**, on the condition that substitution is required under the terms and conditions of the PPP agreement or under the financing agreement between the private partner and the financial institution co-financing the operation. This innovation has been considered "*particularly relevant for the financing of PPPs as they preserve lenders' step-in and substitution rights without the risk of loss of the grant*" (EPEC 2016). To become effective, the replacement requires prior approval by the same managing authority based on the condition that the new subject fulfils and assumes all the corresponding obligations of a beneficiary under the common provision regulation. Again, regulation EU 1016/2021 has not replicated this provision.

To sum up, consistently with the object of the present study, a grant scheme concerning a PPP operation has **two significant peculiarities**. On the one hand, it may combine public finance (ESI funds and contracting authority's resources) and private finance, a circumstance referred to as blending above. On the other,

differently from grant schemes, co-financing investments made by public authorities through public contracts, the number of subjects may include at the same time **a private economic operator and a financial intermediate**, the interests of whom are in principle aligned with those of the contracting authority since private partners have an expected return on their investments on condition that the project performs in line with what contractually agreed.

The combination of those key factors may vary risk levels associated with fraud, corruption and other illegal activities compared to traditional grant schemes.

PPP special provisions comparison	
Regulation EU 1303/2013	**Regulation EU 1060/2021**
Article 2 **Definitions** (24) 'Public private partnerships' (PPPs) means forms of cooperation between public bodies and the private sector, which aim to improve the delivery of investments in infrastructure projects or other types of operations, delivering public services through risk sharing, pooling of private sector expertise or additional sources of capital; (25) 'PPP operation' means an operation which is implemented or intended to be implemented under a public-private- partnership structure; (26) 'escrow account' means a bank account covered by a written agreement between a managing authority or an intermediate body and the body implementing a financial instrument, or, in the case of a PPP operation, a written agreement between a public body beneficiary and the private partner approved by the managing authority or an intermediate body, set up specifically to hold funds to be paid out after the eligibility period, exclusively for the purposes provided for in point (c) of Article 42(1), Article 42(2), Article 42(3) and Article 64, or a bank account set up on terms providing equivalent guarantees on the payments out of the funds;	Article 2 **Definitions** (15) 'PPP operation' means an operation which is implemented under a partnership between public bodies and the private sector in line with a PPP agreement, and which aims to provide public services through risk sharing by the pooling of either private sector expertise or additional sources of capital or both; (39) 'escrow account' means, in the case of a PPP operation, a bank account covered by a written agreement between a public body beneficiary and the private partner approved by the managing authority or an intermediate body used for payments during or after the eligibility period;
Article 63 **Beneficiary under PPP operations**	Article 2 **Definitions**

1. In relation to a PPP operation, and by way of derogation from point (10) of Article 2, a beneficiary may be either: (a) the public law body initiating the operation; or (b) a body governed by private law of a Member State (the "private partner") selected or to be selected for the implementation of the operation. 2. The public law body initiating the PPP operation may propose that the private partner, to be selected after approval of the operation, be the beneficiary for the purposes of support from the ESI Funds. […] 3. The private partner selected to implement the operation may be replaced as beneficiary during implementation where this is required under the terms and conditions of the PPP or the financing agreement between the private partner and the financial institution co-financing the operation. […]	(9) 'beneficiary' means: (b) in the context of public-private partnerships ('PPPs'), the public body initiating a PPP operation or the private partner selected for its implementation;
Article 64 **Support for PPP operations** 1. In the case of a PPP operation where the beneficiary is a public law body, expenditure under a PPP operation which has been incurred and paid by the private partner may, by way of derogation from Article 65(2), be considered as incurred and paid by a beneficiary and included in a request for payment to the Commission provided that the following conditions are met: (a) the beneficiary has entered into a PPP agreement with a private partner; (b) the managing authority has verified that the expenditure declared by the beneficiary has been paid by the private partner and that the operation complies with applicable Union and national law, the programme and the conditions for support of the operation. 2. Payments to beneficiaries made in respect of expenditure included in a request for payment in accordance with paragraph 1 shall be paid into an escrow account set up for that purpose in the name of the beneficiary.	Article 53 **Forms of grants** Grants provided by Member States to beneficiaries may take any of the following forms: (a) reimbursement of eligible costs actually incurred by a beneficiary or the private partner of PPP operations and paid in implementing operations, contributions in kind and depreciation; Article 63 **Eligibility** 2. Expenditure shall be eligible for a contribution from the Funds if it has been incurred by a beneficiary or the private partner of a PPP operation and paid in implementing operations, between the date of submission of the programme to the Commission or from 1 January 2021, whichever date is earlier, and 31 December 2029. Article 74 **Programme management by the managing authority** For PPP operations, the managing authority shall make payments to an escrow account set up for that purpose in the name of the

3. The funds paid into the escrow account referred to in paragraph 2 shall be used for payments in accordance with the PPP agreement, including any payments to be made in the event of termination of the PPP agreement.	beneficiary for use in accordance with the PPP agreement.

Table 4

5. National survey findings

As emerged during the previous analysis about the role of National authorities, prevention of irregularities, fraud, and other illegal activities related to ESI funds still rests entirely on managing authorities. Not only do those authorities have broad discretion in determining which administrative preventive measures are the most appropriate concerning their ESI funds allocation operations, but they have the same degree of discretion in determining the extent of the self-assessment related to the application and efficacy of those measures.

The study has also shown so far that efforts made by EU Institutions to give managing authorities specific orientations on the topic, as well as IT tools provided to those authorities (e.g. ARACHNE), do not fully solve problems related to particular forms of support involving private finance sources as described above. In essence, those mentioned orientations do not provide specific measures for financial instruments or PPP contracts. Likewise, IT tools do not fit well for beneficiaries under a financial instrument scheme, nor do they apply immediately to private or financing partners under a PPP scheme.

For those reasons, the study intended to explore if and how, on their initiative, ESI Funds managing authorities would have implemented an efficient system of preventive administrative measures initially designed for those forms of support involving private financing, being that one of its main objectives.

The goal here was to support the effort of drafting a scheme of administrative preventive measures aimed to protect FIES compared with measures previously experienced in managing operational programs. Consistently with the original project, the research has focused on the selected national legal systems. Plus, the preliminary results of the analysis described in the previous chapters of the present study suggested furtherly concentrating the attention on managing authorities designed as such during the 2014-2020 programming period.

For this reason, the analysis of the role of competent authorities and the legal framework concerning financial instruments and PPPs has shown that reliable data could only come from managing authorities since National Authorities have not fully

implemented specific prevention strategies. Plus, no other organisations (neither institutional nor civil society ones) would have already participated in creating those measures before, since under past and current CPRs, the self-assessment mentioned above does not fall under the principle of partnership for reasons explained earlier.

To do so, the team designed and launched a survey to collect valuable data provided by the same managing authorities.

In summary, the survey aimed to ascertain whether and what kind of preventive measures MAs have implemented for financial instruments or, more generally, private finance initiatives in the lack of specific orientations EU Institutions gave during the 2014-2020 programming period.

5.1 Design of the survey

From the preliminary findings of the project, it emerged that the information that needed to be gathered was highly complex; thus, the team opted for designing and implementing a written questionnaire. Semi-structured interviews were not carried out in the first phase as respondents needed enough time to ponder and adequately reflect on the specific dynamics and details related to the forms of support and the implemented measures. For this reason, the team considered a written survey the most appropriate methodological tool to provide the required information. Furthermore, the delays in the survey responses were more extended than what was initially foreseen. Hence, it was impossible to conduct follow-up interviews with some key respondents within the project's timeframe. Again, this speaks of the complexity of the matter and the need to plan accordingly, leaving enough time for the respondents to gather the required information.

The focus was on the French and Italian legal systems in line with the project's overall aims.

The survey was composed of three parts: 1) Financial Instruments, 2) Public-private Partnership, and 3) Suggestions. The first part included ten questions: seven were

closed-ended and three open-ended. The second part had six questions, four closed-ended and two open-ended. The third part included only an extended open-ended question. The survey was developed between 01/09/2021 and 31/03/2022 and administered between 26/04/2022 and 15/06/2022.

The survey was split into three parts.

The first part regarded financial instruments. MAs were required to indicate what kind of financial instruments they had implemented according to the definition given by article 37 of regulation EU 1303/2013 and, essentially, if they had awarded their implementation directly to a public financial intermediate, to a private financial intermediate or, as an alternative, if they managed them directly. The goal was to understand better what financial instruments MAs used.

Plus, more importantly, how often they are supported by public or private intermediates, since the risk level related to the management of a fund implementing financial instruments may utterly vary depending on the public or private nature of the fund manager.

Afterwards, MAs were required to indicate which kind of preventive measures they were used to apply by allowing them to choose among measures already used for grants (as established in 2014 orientations issued by OLAF) or other measures. In the latter case, MAs were given the possibility to explain the main characteristics of those further measures in an open question.

The second part of the questionnaire was focused on PPP operations instead. It followed the same approach as part one. Eventually, the third part was left to suggestions to improve the efficacy of anti-fraud (or irregularities) preventive measures based on the experience of each MA.

A total of 50 Italian Mas/AAs and 40 French Mas/AAs were contacted, and six surveys were returned: one from the "Regione Emilia-Romagna"; one from "Région Centre Val de Loire"; one from the "Regione Sardegna"; one from the "Regione Sicilia"; one from "Région Bourgogne Franche Comté" and one from the "Autonomous Province of Bolzano". The limited number of feedbacks has been balanced by the relevance and size of the Mas/AAs actively answering the survey.

5.2 Key findings

Preliminarily, it should be said that the survey has confirmed two main features of the topic at issue, which have already emerged during the previous steps of the ongoing research and were actually at the base of the approach adopted for the survey as explained above.

On the one hand, the complexity of ESI funds' legal framework concerning financial instruments and PPP operations reflects the utter complexity of implementing those instruments and the related form of support. That may partially explain the low response rate to the survey and, in particular, to open questions.

On the other hand, the great variety of measures adopted by those authorities who have responded reflects the lack of orientation by EU Institutions on the topic and the struggle of each MA to find an efficient and effective approach toward prevention. We are in the presence of a complex scenario, ranging from the non-use of financial instruments to the adoption of one or more of these instruments. Most have implemented one or more financial instruments such as loans, investments in the capital of existing or newly created entities, or guarantees.

It is interesting to note that MAs have sometimes implemented specific preventive measures about one or more financial instruments, such as the following: "drafting and compilation of a specific control check-list"; "on-site audits to verify the real and correct implementation of the intervention"; and procedures "aimed to verify that the Implementing body has adopted and properly implements its policy regarding the reduction of conflicts of interest risks (especially in the "selection of applicants" process), as stated in formal agreements and official documents".

With regards to measures to align interests and mitigate possible conflicts of interest, MAs have introduced different measures such as the "Consultation of the "self-assessment tool-matrix" of fraud risk": "periodical checks to verify that the Implementing body has selected final recipients in line with the requirements established by the ROP/other operational guidelines" and "direct participation of MA staff -attached to the Financial Instrument unit-in the Evaluation Committee

meetings (organised by the implementing body) in charge of the selection of final recipients". In the case of PPP operations, other specific preventive anti-fraud measures put in place by the Managing Authority have emerged, such as tailor-made checks on the expenses declared by beneficiaries. These checks (implemented before the payment is made to beneficiaries) cover the regularity of procurement procedures for the totality of operations (from contract awards to contract complete execution, and in the case of PPP, the correctness of financing agreements between the private partner and financial institutions co-financing the operation), and on the sample basis the regular implementation and the correct accounting of planned interventions. The elements acquired during these checks also aim to prevent irregularities and fraud, particularly before certification of expenditures to the EC.

Another critical issue was to ascertain how effective current digital measures in supporting preventive action could be. More precisely, one of the ancillary aims of the survey was to collect data on the use of ARACHNE by MAs, a tool that we saw is not fully calibrated for the peculiarities of financial instruments and public-private partnerships when private financial intermediates are involved.

Despite the limitations of ARACHNE that we just mentioned, the results show that ARACHNE is primarily used among our respondents. MAs considered the use of IT tools insufficient to prevent those illegal activities the study focuses on if that is not supported by training activities and raising awareness among staff. Strengthening training activities has been seen as one of the critical points to correctly addressing fraud and other illegal activities risks.

In one case, a MA is reported to have developed a targeted and differentiated analysis tool for each financial instrument established in accordance with the Operational Programme. This tool has been based on the 2014 "Fraud Risk Assessment and Effective and Proportionate Anti-Fraud Measures" orientations. According to the information given by the MA, this analysis tool has followed the same approach suggested by the Orientations for other target areas/processes (that is: quantification of gross risk in terms of impact and likelihood, assessment of the effectiveness of the current controls to mitigate the gross risk, assessment of the net/residual risk). Fraud-risk evaluation applied to financial instruments has taken

into account two different levels of analysis: relations between MA and the Implementing body (selected key process: “implementation and verifications of the operations”) and relations between the Implementing body and the final recipients (selected key processes: “selection of applicants”; “implementation and verification of the operations”).

Furthermore, in building up this new tool, the MA has considered other key processes identified by the EGESIF document based on broad compatibility criteria. However, those were not specifically addressed with regard to financial instruments.

Moreover, given the high technicality of operations related to financial instruments, the MA has created a special Working Group. While implementing the fraud-risk assessment on financial instruments, MA Working Group members are also demanded to coordinate it with relevant anti-corruption prevention measures provided by a specific plan concerning corruption prevention and transparency adopted by the Authority designed as MA because of its general activity as public administration of the Member State, consistently with national legislation. For that purpose, the plan has been implemented on purpose, so to include specific risk areas associated with ESI funds management.

Additionally, the final “suggestions section” has yielded interesting results, for instance, the need for the Implementation body to commit to establishing and developing a managing information system (where all kinds of supporting documentation should be uploaded) to be shared with the MA. This would enable full access to relevant information. The information to be uploaded should be formally agreed upon. The participation of MA staff in Committees responsible for the selection of operations should be agreed upon with the Implementation body. As part of the Manual of procedures of each financial instrument, procedures related to the reduction of conflicts of interests (from the side of the Implementing body) should be clearly defined, including the evidence (traceability) of their effective implementation.

5.3 Reflections and future developments

Overall, the results of the surveys are in line with the expectations as well as the partial conclusions reached during the previous part of the present study. Forms of support involving private finance sources require an extra effort to prevent and detect fraud and other illegal activities risks because of the number of actors involved and due to what we have called an elongated chain of control.

It seems of utmost importance for future research stemming from the results of the present study to set up a stronger collaboration with the MA, who has created that original analysis tool to assess risk levels related to both the relationship between the MA and the Implementation body as well as those relationships between the Implementation body and final recipients.

More profound knowledge of that instrument may give fundamental clues on the possibility of extending its application to MAs in general and may provide an understanding of the possibilities of furtherly developing that tool to cover PPP operations.

Moreover, this survey has demonstrated that the followed approach may bring interesting results if extended to Managing authorities based throughout the European Union. In a future perspective, to overcome the actual lack of specific orientations at the European level, a fundamental stepping stone may be a confrontation with those - very few, might we say - managing authorities that tried to implement their original tool.

Even if the number of surveys received was relatively low, the findings have proven to be promising and illuminating, especially the open-ended questions that enrich our understanding of the topic shedding light on the measures adopted in different contexts by various actors. There is a need to develop a more robust follow-up with the respondents, given the specificity and complexity of the topic and the nature of the research participants. Indeed, the survey was vital to identify and better foreground the issues we would like to focus on, that is, prevented measures, in our future research endeavours. Furthermore, the findings from the survey strongly

suggest that a future research design should contemplate a deeper involvement of the MAs who have been proactive and responsive.

6. A possible new frame to protect the Financial Interest of European Scale. Some proposals on administrative preventive measures.

The outcome of such a complex framework makes clear the need for more robust coordination between European Institutions and National Managing Authorities and for establishing **a homogeneous anti-fraud preventive system based on (EU) guidelines or standards** leveraging on risk assessment and risk management methodologies.

The attempt is to draft anti-fraud (and other relevant illegal activities) preventive measures that could be generally implemented and applied by Managing Authorities. Such a purpose, which could be achieved in the future, lays in the idea of progressively building up a common anti-fraud administrative frame under guidelines issued by EU Institutions vested with the power to protect EU financial interests: namely, the Commission along with OLAF's fundamental technical support.

For those reasons, paragraphs of this chapter focus on some issues and proposals related to a preventive system deriving from outcomes of the present FIES study. Indeed, it may suggest a possible new administrative frame to protect the Financial Interest of European Scale. Moreover, the appendix to this Report reports a list of feasible risk indicators to protect FIES in the case of PPP.

6.1 Oversight frauds: integrating the *ex-post* controls (sanctions) with a preventive approach laying on fraud risks assessment.

The FIES analysis outlined so far points out some criticalities in the **current administrative approach to preventing fraud, corruption, and other illegal activities in managing ESI funds**, mainly when private financial resources are

involved, such as in the case of PPP or financial instruments managed by private financial intermediates as described above.

The most recent evolution of the EU legal framework shows clear progress in remedying and sanctioning systems safeguarding the financial interests of the EU, yet ruled as ***ex-post* tools**. Amongst the others (see previous chapters), it would be enough to mention here the Public Prosecutor's Office (EPPO), a cornerstone aiming to improve criminal law enforcement, along with the proposal to enhance OLAF cooperation with EPPO to support the investigation and the effectiveness of action against frauds. Therefore, EU authorities may always carry out *on-the-spot* controls and reviews on the Member States' managing authorities during external inspections. Consistently, the European Commission established the EDES system to reinforce the protection of financial interests by ensuring sound financial management of administrative sanction procedures and exclusion of fraudsters from public auctions and tenders. Moreover, for each programming period, Managing Authorities are expected to set up efficient management and control systems, requiring *inter alia* effective and proportionate anti-fraud measures.

In sum, the European coordination mechanism is still mainly focused on *ex-post* measures and procedures that are based on multilevel inquiry-investigation patterns, while prevention mechanisms are substantially left at a mere advisory level.

However, as said above, the European Commission and OLAF have issued guidelines addressing Member States' anti-fraud strategies concerning ESI funds, trying to enhance a different approach to the issue. Indeed, *Guidelines on national anti-fraud strategie*s (2014) moved some attention to the preventive side of the issue. Indeed, amongst the reason grounding such guidelines, ultimately, was the quite relatively low capacity of many Member States to implement effective systems contrasting frauds. Furthermore, OLAF supported the adoption of National anti-fraud strategies (NAFS) by the Member States and national Managing Authorities to adopt more coordinated and homogeneous measures concerning both the prevention and contrast of illegal activities related to ESI Funds.

The strategy was based on improving coordination between EU and national levels, guiding Managing authorities in building up a set of anti-fraud measures, and providing them with some operational tools to support a possible common preventive system. Such a (new) approach proposed by the guidelines should have played a crucial role since it was considered more straightforward and cost-effective than sanctions and repairs or restoring remedies. Thus, guidelines pay great attention to risk assessment and its methodology so far that a possible structure is proposed in (guidelines) Annex 3.

Yet, National States' answer has been found not entirely appropriate in fostering preventive actions, as they were not homogeneous (standardized) enough, thus not comparable, nor oversight by anyone but national authorities in assessing their efficacy.

Moreover, such a system was expected to be implemented by the Member States through *ad hoc* measures, but the empirical evidence shows that the national side has been scarcely adequate in building an appropriate preventive system. Indeed, not all Member States have responded to the suggestions given by OLAF. The last PIF report shows that barely half of the Member States have adopted a NAFS (PIF Report 2020). Moreover, among those who reported having drafted a NAFS, none seems to have followed the scheme provided by the mentioned guidelines (PWC, 2019). Indeed, measures adopted by the Member States are far quite from being "*better coordinated, holistic anti-fraud efforts at EU Member State level, based on developing and implementing national anti-fraud strategies*" EU Institutions have tried to promote (PIF Report 2020).

These brief considerations seem sufficient to clarify how the systematic adoption of a common preventive approach to fighting fraud on ESI funds is still far from being implemented in all EU Member States. Conversely, a balanced set of preventive *ex-ante* and *ex-post* legal tools would enhance the efficacy in contrasting frauds, affording higher protection of financial interests related to ESI funds.

Similarly, adopting (supplementary) preventive measures would also optimize the (scarce) resources of agencies and bodies entrusted with control tasks by

addressing their action according to warning signals that may be preventively disclosed when managing ESI funds.

6.2 A possible EU preventive system based on common standards and risk-driven approach.

The overall purpose is to support future policies in the specific field of preventive protection of EU financial interests at stake. Of course, the present proposal is a starting point for following more insights and technical development.

The essential point is to clarify the legal properties of a system protecting EU financial interest when private financing sources are involved in ESI funds through financial instruments or PPP Contracts (see *infra*). The assumption is that a high level of preventive protection may only be based on accurate knowledge of the specific properties of interests at stake and related legal framework.

In other words, adequate protection of EU financial interests could be achieved only if it is clear what problems and needs ESI funds operations bring when private financing sources are involved.

For this reason, the framework should be based on:

1) an EU level (Commission/OLAF) establishing common European standards and risk methodology settled on systematic (*not episodic*) preventive measures consistent with the potential risk of fraud managing ESI funds in PPP. Such a risk should be progressively considered as higher as symptoms of maladministration, illicit or illegitimate practices performed by any of the relevant players take place (first off: Managing Authorities and Awarding Authorities; yet also Contractors and Private Partners as far as needed);
2) a National level (National Authorities) under which Managing Authorities and Awarding Authorities implement their own preventive systems according to the common frame and methodology established by EU standards, as above;

3) a reporting and alerting system based on website/digital communication shared through different institutional levels (EU/Commission/OLAF – National Authorities/Managing and Awarding Authorities).

To be more open, an **EU preventive system based on common standards** should be issued as compulsory for national authorities whenever ESI funds are applied and, to focus on our subject, mainly if the vehicle to public benefit is a financial instrument or a PPP Contract. The meaning is that adopting a preventive alerting system is (merely) due as a requirement to apply for. Of course, this legal frame would imply a different legal vest adopted by the Commission issuing it.

This is, of course, a pretty sensitive subject. Yet, it has been shown above (chapter 3, par. 3.1) that non-binding legal tools are not the one and only solution theoretically applicable to the issues related to the lack of cooperation mentioned earlier. It is clear that from the preventive side, the national authorities do not always cooperate as expected in establishing an appropriate *ex-ante* system.

Indeed, it could be possible to support an interpretation of Art. 197 TFEU broadening the legal ability of European Institutions to set forth binding legal tools representing standards "*to direct administrative action in the Member States, assessing their effectiveness, even without providing a full and uniform discipline*". In other words, given the lack of legal provisions explicitly prohibiting the European Commission (in this case, OLAF) from adopting binding measures concerning prevention in the field of ESI Funds management and allocation, there are no theoretical constraints in speculating the adoption of binding cooperation schemes under article 197 TFEU to enhance a more coordinated approach towards prevention of risks related to fraud and other illegal activities managing ESI funds (and, in our case, those associated with financial instruments or PPP contracts). Therefore, vesting the EU Commission with this task, supported by OLAF for all technical aspects, should prevent any criticism even in the light of a rigorous interpretation of the Treaties also consistent with principles stated in "*Meroni case*" and the subsequent "*doctrine*" stating limits on delegation of regulatory powers to 2nd level EU agencies, as said above.

The purpose of this task would be to set forth a preventive system based on common binding principles and standards to establish a more **integrated and homogeneous administrative action** in the Member States and evaluate their effectiveness in preventing damages to the public (financial) interests held by the Union.

Furthermore, other properties should be added to the previous ones describing a system based on common EU standards. Of course, they cannot entirely pre-empt Managing and Awarding Authorities' discretion in establishing the implementation of those standards: this ability must be preserved by leaving room for adapting them to their organizational frameworks.

This aspect is not under discussion, here, and the reasons are many, and amongst them, it is essential to keep in mind the large array of peculiarities affecting each administration while acting for the public benefit. Those specificities can be appreciated and assessed by each administration playing an **active role** in managing ESI funds or awarding PPP contracts.

Besides that, EU common standards should also point out a set of macro-indicators (i.e., bias, fair proceeding, impartiality, project or asset economic and financial sustainability, contract awarding criteria, contract modifications, etc.) to assess fraud risks related to what will be defined as Financial Interests of European Scale (FIES) and, therefore, to select a harmonized scheme of preventive administrative measures. In sum, to elaborate specifically designed macro indicators and appropriate preventive administrative measures to assess risks as mentioned earlier. Those macro-indicators could be applied along with those provided by the Guidelines 2014, *sub* Annex 3 (i.e., that could be transferred in the common standards system here described) and, more relevant, should follow the administrative chain moving from the ESI funds supplier to the Managing and Awarding Authorities.

To this extent, **EU common standards** must require Managing and Awarding Authorities to **map the different areas having jurisdiction on decisions** concerning subjects related to the use of specific ESI funds (in our case, with

reference to or intended for financial instruments or PPP contracts) and focus on that, making clear their duty to **point out**:

(a) (*ex-ante*) the list of **discretionary decisions related to the administration of ESI funds until the awarded financial instrument management or PPP Contract (i) is going on in its performance or (ii) the relevant target declared in applying for a quota of ESI funds has been reached**; it must be noted that the list regards both the decision-making process and boards/offices entrusted with that decision-making power;

(b) (*ex-ante*) tangible measures have been implemented to mitigate the risk of anomalies (fraud, corruption, or maladministration), **along with each discretionary decision/step**;

c) (*ex-ante*) measures that will play, later, the role of **administrative benchmarks** to compare to the corresponding effective decisions, facts, and evidences taking place while ESI funds are managed, as long as the ultimate step of the PPP Contract has been reached having regard to the oversight of the ESI funds involved;

(d) to feed the **reporting/alerting system** on due time, to point out all the relevant outbreaking gaps, i.e., by comparing expected and factual or tangible measures/circumstances/data/etc. In the case of significant gaps, it would be possible to drive and focus oversight actions on that specific procedure on time, to overview whether managing the ESI fund is consistent with the due standard or deserves a more insightful analysis. The threshold of alert could be set as a common standard and/or (partially) agreed upon along with the ESI funds application procedure.

Examples of indexes of potential anomalies will follow in the next paragraphs and Annex, as the proposal focuses on PPP contracts.

6.3 Managing and Awarding Authorities' preventive measures. Legal properties and Suggestions Implementing EU Common Standards.

The system set out here requires some change of perspective, if compared to the sanctioning and restoring systems fighting frauds related to ESI funds.

One of the core concepts is that of **symptomatic figures of anomalies managing ESI funds in financial instruments or PPP contracts**, that are to be intended as **risks of fraud, corruption or maladministration**, thus, something potential. Of course, some of the legal standards sanctioning frauds or other figures – as soon as they are ascertained according to the rules, procedures and safeguard established under the rule of law – would acquire an autonomous proper legal (criminal/sanctioning) relevance. However, it could also be possible to look at certain decisions and/or behaviors as **"signal" of risks** taking place along with the ongoing administrative action awarding and performing PPP contracts financed by ESI funds as well as awarding and management of financial instruments.

The fact that ESI funds go through a quite long and complex administrative chain that, in the end, roots its actual implementation in a PPP project or other related asset or services. This is one of the most critical issue, as different institutional levels are involved: from the EU bodies until the Managing Authority and/or the Awarding Authority – namely, the legal entity managing the project, asset, service, etc., entirely or partially fund by ESI, through a PPP contract which is *ex-se* usually submitted to the EU Directive 2014/23. Similarly, the same complexity is found when Managing authorities, acting as Awarding authorities, award the management of a financial instrument to a financial intermediate as in the models described in paragraph 4.1.

The introduction of preventive measures to mitigate such a risk requires a change in the methods of carrying out administrative action since it takes place across multiple institutional and management levels. That is why in this meaning of fighting against fraud/etc., the definition of common standards, homogeneous and consistent with the public benefits to be protected (first off, the financial interests of the Union) is essential.

Having regard to Managing and Awarding Authorities, adopting or implementing a preventive system makes necessary to set specific *ex-ante* methods of action, especially regarding **how to exercise discretion** along with the relevant decision-making power in managing financial instruments/PPP contracts.

In this way, a specific administrative practice could be *ex-ante* established, under the above-mentioned EU common standards. In the meantime, it is also true that preventive measures should be tangible and systematic, being settled consistently with the administrative procedures and proceedings held by Managing and Awarding Authorities.

Various consequences may follow from that: application of (*ex-ante*) measures to prevent fraud must play mainly where the risk of fraud appears (*ex-ante*) being most significant. Here rises the issue related to how setting criteria supporting a transparency and impartiality in discretionary decision performed by Authorities managing/receiving ESI funds - and, in particular, where there is a legal nexus with third parties (i.e., PPP), meaning with the related interests at stake.

Of course, this approach does not mean that preventive measures should introduce a sort of self-annihilation of discretion but, rather, **pre-define methods of its exercise/performance**, so to mitigate risks of bias and/or externally driven decisions that otherwise, could be easily covered by discretionary decisions issued by the acting Authorities.

In this view, Authorities' fraud prevention systems can be legally qualified either as a **self-codification** or methods on how exercise discretion in managing ESI funds by awarding public contracts (PPP) or financial instruments management, consistently with the EU common standards and a sound administrative praxis.

From this, it follows that the **legal nature** of a system of preventive measures, particularly where self-measures qualify as (self-)binding, affects decision-making and, moreover, discretion. Under this way, it is possible to underline two different legal effects: a vertical one, given by ability of preventive measures to affect methods of carrying out each proceeding or relevant decision; a horizontal one, caused by the standardization of authorities' **administrative praxis** that will affect a plurality of

(different) procedures related to (different) financial instruments and PPP contracts.

It is interesting to note, here, as, in that way, preventive systems could also be comparable to each other in terms of object and/or purpose.

A further consequence of this approach shows how the prevention of fraud, corruption or maladministration can vary in nature, according, in turn, to the legal ability of affect also third parties. More precisely, Managing and/or Awarding Authorities could settle their own preventive system as **(a) a mere internal guidance** for officers (clearly less effective in our perspective), or **(b) as a prescriptive system (self-restraint)**, *ex-ante* declaring how discretion is to be performed, through the adoption of standards and criteria that, consequently, will be **legally relevant also for third parties** (i.e., contractors, private partners, stakeholders, etc.).

Therefore, unlike in the case (a), a more effective system is likely to be legally relevant also for third parties, particularly those interested in the administrative proceeding at stake. It is clear that the legal properties of such measures may vary, depending on the content. Ultimately, measures to prevent may be defined as a self-codification of administrative practice/praxis, self-restraining next, future, decisions, which could be easily turned in parameters of legality. In other words, an authority's decisions will be expected to be consistent not only with the statutory provisions governing it (i.e., to discretionary decide), but also with the standards (self-)established as preventive measures.

From this, a further consequence immediately comes after: the adoption of preventive measures may also enhance the possibility for the third parties (stakeholders, etc.) to safeguard their stakes (legitimate expectations, etc.) if harmed, as a consequence of the breach of those standards codified as administrative practice or praxis.

Besides that, as EU common standards would require to focus on transparency of the procedures, Managing and Awarding Authorities could not avoid to map steps most exposed to the risk of fraud, corruption, maladministration as any other

behavior not compliant with the principles of legality, impartiality (i.e., bias, etc.), and sound administration. This would be a deep change in the overall system.

In sum, to award and manage financial instruments or PPP contracts co-financed by ESI funds, each Authority should identify the risk areas from the internal perspective and declare them (i.e., see par. 6.2) along with a list of tangible preventive measures to implement as an **administrative self-restraint**, to prevent the risk potentially symptomatic of frauds, corruption or maladministration.

Once more, this pattern highlights how it is necessary to define common standards, on the administrative side, based on a plurality of coherent and concurrent measures, sharing the same methodology (i.e., identification of relevant administrative areas; risk assessment; risk management; definition of organizational and procedural measures, vertical and horizontal side effects; etc.).

Under that umbrella, authorities, will implement measures more in keeping with their administrative and organizational structure, so to fine-tuning the exposure to risks assessment and the consequent measures. Finally, all the preventive measures implemented will require a clear **procedural timing** and bodies/offices entrusted with the legal ability to perform it. It must keep in mind that a system of such complexity would be applied by a very heterogeneous corpus of public administrations acting as Managing and/or Awarding Authorities, so it is clear that the implementing level would be decisive to reach the purposes to protect FIES.

6.4 PPP contracts and financial instruments as tools to steer ESI funds and private funds: positive financial leverages and risk-driven contracts.

A previous chapter already focused on financial instruments and public-private partnership contracts (PPP). As said above, financial instruments provided by ESI funds are spread into different categories: (a) investments in equity, (b) loans, and (c) guarantees. They may be implemented by creating a specific fund that can be

hold: (a) directly by the managing authority; (b) indirectly by awarding it to a public or private body consistently with the European rules on public procurement.

In particular, regarding the latter, the implementation may be directly awarded to supranational financial institutions, such as the European Investments Bank (EIB) or international financial institutions in which a Member State is a shareholder. It may also be directly awarded to financial intermediates controlled by the managing authority according to the European in-house providing rules.

As an alternative, managing authorities may award the implementation of a financial instrument to a private financial intermediate, selected after a comparative tendering in the light of the principle of competition and the general rules on public procurement. Regarding the direct implementation by the same managing authority, it should be said that it has no particular relevance in the light of the ongoing study since no financial intermediates are involved. On the contrary, each of the three alternatives to direct management implies specific risks related to fraud and other illegal activities depending on the characteristics of the intermediate.

Regarding the relevant subjects, it should be stressed that financial instruments differ from the traditional grant scheme based on the bilateral legal relationship managing authority – the beneficiary. Conversely, the financial instrument scheme is (substantially) based on the trilateral legal relationship between the managing authority, beneficiary, and final recipient. More precisely, according to the definition set by article 2(10) of Regulation EU no. 1303/2013, as confirmed by article 2(9)(e) of Regulation EU no. 1060/2021, in the context of financial instruments, the **'beneficiary' is the body implementing the fund**. Plus, under article 2(12), as confirmed by article 2(18) of Regulation EU no. 1060/2021, the **'final recipient' is a legal or natural person receiving support from a financial instrument.**

However, as an alternative to financial instruments, EU regulations on ESI Fund promote the use of **private finance** through special provisions concerning public-private partnership contracts. Here, Article 2(15) of Regulation EU 1060/2021 defines "PPP" as "*an operation which is implemented under a partnership between public bodies and the private sector in line with a PPP agreement, and which aims to provide public services through **risk sharing** by the pooling of either private sector*

expertise or additional sources of capital or both". This definition is consistent with that provided by articles 2(24) and (25) of previous regulation EU 1303/2013, as well as the most internationally accepted definitions, such as the OECD definition of PPP as "*long-term contractual arrangements between the government and a private partner whereby the latter delivers and funds public services using a capital asset, sharing the associated risks*" (OECD 2012).

It looks interesting to consider that legally, PPP contracts may refer to a vast array of arrangements, including joint ventures or companies-corporation-based agreements, yet also contracts awarded by authorities under the EU Directives related to "concessions" (Directive 2014/23), etc.

In essence, PPPs are peculiar public contracts that differ from the most common public procurement contracts usually because of the following legal properties:

- Term/Duration (contract lifespan). Unlike other public contracts, in PPP contracts, the private partner is expected to share the burden of capital expenditures with the contracting authority. For this reason, PPPs are usually **long-term contracts**, so the private partner may be allowed to recoup its investment adequately, according to a precise economic-financial plan/sheet corresponding to the contract's lifespan. Consequently, PPP contracts may last longer than the eligibility period for expenditures established by the common provision regulation for each programming period. For this reason, it should be *ex-ante* assessed by European common standards and, mostly, by Managing and Awarding Authorities, as it concurs to the risk-allocation between contracting parties.

- Private financing. Due to the investment required from the private partner, PPP contracts may involve a certain degree of private funding: the so-called **blending** or **pooling.** Pooling may require the participation of financial intermediates (lenders), as in the case of project finance loans, to underpin the risks transferred to the private partner (EPEC 2021). More precisely, excepting cases where the private partner bears the capital costs with its own equity/cash sources, PPP contracts may reach the financial closing thanks to resources made available by a financial intermediate. It could be both due to a loan agreement (third to the PPP agreement) between the private partner (an economic operator) and a financial intermediate, as in the case

of a corporate finance PPP operation, or due to the acquisition of shares of a newco (a so-called special purpose vehicle - SPV) by the same financial intermediate, as in the case of a project finance PPP operation.

- **Risks allocation**. A fundamental legal property of PPP contracts refers to allocating risks related to the operation between the public and private partners (so-called "inherent risks").

- **Payments for outputs (*value-for-money*)**. Under a PPP operation, **payments are performance-based**. That is, payments are based on the level and quality of services provided by the private partner (also via SPV). Conversely, in line with a more traditional public procurement approach, ESI funds grants are generally designed to pay for project inputs under the value-for-money standards.

In short, PPP contracts differ from other public (procurement) contracts because the interests of private capital are aligned with those of the public sector. In other words, the economic operator here is not a mere contractor of the public body selected as the beneficiary of co-financing, having opposite interests to those of the contracting authority. Instead, the private partner could be seen as an 'indirect' beneficiary because it participates in the financial effort required for the operation. Consequently, having the private partner a direct interest in the investment return, there could be specific risks associated with its activity that are hardly assessed by managing authorities in the lack of particular orientations on the matter.

The same conclusion can be reached concerning financial intermediates that may play a fundamental role in co-financing the PPP operation. Specific risks related to unlawful activities, bias, conflicts of interest, etc. involving the private partner and the lender are, nowadays, out of the scope of Managing Authorities' prevention powers.

In the case of PPP contracts, some specific preventive anti-fraud measures put in place by the Managing Authority have emerged, such as tailor-made controls on expenses declared by beneficiaries. These controls (implemented before the payment is made to beneficiaries) cover the regularity of procurement procedures for the totality of operations (from contract awards to contract complete execution,

and in the case of PPP, the correctness of financing agreements between the private partner and financial institutions co-financing the operation), and on the sample basis the regular implementation and the correct accounting of planned interventions. The elements acquired during these checks also aim to prevent irregularities and fraud, particularly before certification of expenditures.

However, this system looks barely formal and mainly does not match a large number of potential fraud, corruption, or maladministration risks. The suggestion here is to apply the preventive system based on the properties outlined in the previous paragraph of this chapter.

Indeed, PPP contracts have specific legal properties deeply characterized by the allocation of ***inherent risks*** **directly** related to the performance the contracting parties agreed upon. Such risks are (or should be) quite far from other public contract patterns where the performance is fully price-settled through direct payment by the awarding authority, which relies on the traditional methodology.

To be more precise, PPP contracts are (or should be, as elusive practices are not so rare) affected by ***inherent risks*** such as those due to:

(a) the appropriate technical execution or performance of the contract;

(b) the supply of available assets for the (public) benefit envisaged by the contract;

(c) pay back the entire investment through the market demand of the services, utilities or other asset supplied (in the case).

However, point (c) may be more or less mitigated by the Awarding Authority by paying a price or granting other contributions. In these last cases, the ESI fund may come to evidence. In short, PPP contractors should run a market-driven activity (market risks), yet this status may be (more or less largely) mitigated by payments of the Awarding Authority, as agreed under the PPP contract.

The above shows that PPPs are contracts in which different (contractual) risk components may coexist. This situation can determine a very variable distribution of risk between the contracting parties (Awarding Authority and PPP Contractor) and, consequently, affect the legal relationship between the two. These parameters

are so relevant that Eurostat bases its assessment on whether PPP assets are on-balance or off-balance (regarding the public budget) upon such risk indicators. Besides that, the distribution of inherent risks between contracting parties affects the behavior of those players.

In short, what legally qualifies a PPP contract is a transfer on the PPP (private) contractor of the "operating risks" held in exploiting assets or services, thus encompassing demand or supply risk or both.

In other words, risks held by the PPP contractor must involve a tangible exposure to the market uncertainty so that any potential estimated loss incurred by the concessionaire cannot be purely nominal.

Managing and Awarding Authorities must consider these properties by assessing risks related to PPP.

Of course, risks related to fraud are conceptually utterly different from risks associated with the performance of a contract. This is something that must be stated very clearly. However, the latter may affect the former. Risks related to ESI fraud, indeed, may vary due to many reasons (conflict of interests, bias, etc.), considering either the awarding procedure (usually a public tender) or the material performance of the PPP contract.

Along with the contract performance, for example, higher exposure to market risk is proportional to a lower risk of fraud in performing contracts. This, mainly, when the quality of the service provided by the PPP contractor is entirely (or far primarily) paid back through the market demand. The presence of ESI funds involves a public contribution; yet, if the asset management is entirely market-driven, the risk of ESI fraud would be reasonably limited in building up the asset.

In short, what is relevant is the peculiar concept of operational risk. The main properties of a PPP contract imply the right to exploit asset or services and always requires the Contractor to bear the operative risk of economic nature (involving the possibility that it will not recoup the investments made, etc.) even if a part of the risk may remain with the contracting authority or contracting entity.

Consequently, it should be made clear that specific arrangements which are exclusively remunerated by a contracting authority or a contracting entity should qualify as concessions where the recoupment of the investments and costs incurred by the operator for executing the work or providing the service depends on the actual demand for or the supply of the service or asset.

Once we try to cope with this very variable array of PPP contracts with an EU common standard-based preventive system fighting ESI fraud, there is a minimum set of information about the fundamental drivers of the Managing/Awarding Authority – PPP Contractor that must be acquired. Otherwise, it won't be possible to establish any affordable, preventive system.

To do this, the risk mapping methodology is essential. Indeed, as a proposal, the suggestion is to, first off, set aside the administrative decision-making process related to the awarding proceeding (i.e., a public tender, with or without a possible dialogue between awarding authority and bidder(s)), from the decision-making process related to the concrete performance of the PPP contract.

As a consequence, under the awarding process, it would be requested, at least, to map three main areas of activity of Managing and/or Awarding Authorities related to ESI (co) funded PPP contracts. This refers to activities summarized as follows.

1) Internal phase: assessment of the public benefit (need) to be pursued through a PPP contract; settlement of feasibility analysis; budgeting; design; coordination with other procedures and public authorities (i.e., urban planning; eminent domains; etc.); definition of the project and technical standards; economic-financial balancing sheet. This phase ends with a specific decision-making step: the provision to contract (i.e., establishing bidders' requirements; awarding criteria; etc.).

2) Public Auction/Public Tender phase: call starts an open-to-the-market procedure (unless exceptions), it goes up to awarding PPP contract: selection of bidders; functional assessment of technical bids and, subsequently economic-financial bids; assessment of not sustainable offers; final award provision (identifying the best bidders/value for money/etc.).

3) Contract execution/performance phase (the overall contract performance goes through different steps): PPP Contractor implements the (executive) technical project; builds assets, operates assets; supplies services, utilities, or facilities; transfers it/does not to the Awarding Authority. The latter, along with the Managing Authority, controls/audits the proper performance of the PPP contract and the fulfillment of the obligation assumed (final testing, etc.).

Concerning the PPP contract execution, other discretionary decisions pertain to amendments or modifications stated in progress (regardless of the cause/reasons), mainly where the contract provides for a price/pricing paid to the Contractor and, always, in case of a contribution of ESI funds. A further aspect concerns the changes to the economic-financial plan affecting or altering the balance and/or the original economic or financial sustainability requirements of the PPP contract.

Moreover, it is due to map decisions related to sub-contractors in the presence of a price component paid to the PPP Contractor.

Then, it is possible (1) to map the discretionary decision-making (steps) and decision-makers and, consequently, (2) to settle preventive measures considered to be relevant in mitigating fraud, corruption, or maladministration risks, to protect the financial interests of European scale.

The same approach concerning PPP operations may be substantially applied also to financial instruments. When competent authorities award the management of financial instruments to private or public financial intermediates, they may be qualified as financial services falling within the scope of public procurement regulations.

In addition, an adequate set of preventive measures regarding financial instruments should necessarily consider the organizational capacity of the financial intermediate, as described in paragraph 4.1. More precisely:

- its capacity to implement the financial instrument, and
- its effective and efficient internal control system.

About the former, it is sufficient to recall preventive measures concerning the award of a public contract and precisely the technical and economic. While about the latter, financial service providers have to set up, anyway, an internal control system under the general rules on corporate liability and financial supervision.

Nonetheless, financial operators adopt internal control systems based on ordinary financial activities under those rules. As a result, they may lack mitigating risk measures specially designed for the peculiarities of financial instruments co-financed by ESI funds.

For this reason, it is essential that managing authorities expand their risk assessment to the adequacy of those internal systems to risks related explicitly to ESI funds management. In other words, managing authorities need to properly assess risks associated with fraud and other illegal activities arising from the implementation of financial instruments managed by intermediates to ascertain better if those internal systems are effectively adequate for the task.

Conversely, prevention of those risks may not be left to a merely formal check on whether the financial intermediate has complied or not with the general rules on internal control it is subject to due the legal regime who it is subjected to. This circumstance may also be directly related to the capacity of the fund manager to prevent or avoid conflict of interests with final recipients.

Moreover, consistently with directive EU 2019/1937, another set of preventive measures may regard whistleblowing. In particular, depending on risk levels associated with a determined financial instrument, the effective implementation of internal reporting and follow-up procedures may act as an adequate indicator.

It follows that a proper risk assessment having as an object internal control system, conflict of interests, and whistleblowing may thus induce managing authorities to impose specific contractual obligations. For example, high levels of risk may suggest managing authorities to establish duties to put in place dedicated communication channels with the fund manager. That could guarantee the sharing of information on the financial instruments allocated in real-time or direct access to the IT tool used

by the financial operator to fulfill its obligations so that the managing authority may exercise continuous or random control at any time.

The Annex to this Report shows a list of feasible risk indicators to protect FIES in the case of PPP and financial instruments.

7. Final overview and conclusions

The analysis carried on so far on the prevention of fraud and other illegal activities regarding financial instruments and PPPs has shown some critical issues that can be summarized as follows.

Having regard to financial instruments:

1. The main patterns provided by ESI funds regulations for the indirect implementation of financial instruments may present critical issues related to the elongated chain of control described above. In other words, control mechanisms set by managing authorities over financial intermediates' activity and final recipients are not calibrated on a proper risk assessment to balance the effectiveness of fund managers' activity, on the one hand, and the legality of ESI funds allocation proceeding, on the other. The point here is that according to the ESI funds regulatory framework, beneficiaries are financial intermediates selected to manage the fund (or holding fund and sub-funds). In line with the preventive approach for grant schemes, preventive measures should, in principle, focus on risk levels related to the beneficiary's activity. Conversely, final recipients – the actual beneficiaries of the ESI funds – fall outside the reach of managing authorities' preventive approach. This circumstance may lead to a lack of effective preventive measures regarding the selection of final recipients since mitigating those risks is a task entrusted solely to financial intermediates depending on the efficacy of their internal control mechanisms required by financial services regulatory rules.

2. As a consequence of the previous point, specifically regarding conflicts of interest, common provision regulations focus mainly on the relationship linking managing authorities and fund managers. Potential conflicts of interest between fund managers and final recipients fall outside the reach of managing authorities, too, since prevention of those risks is left again on financial intermediates.

3. Differently from the *ex-ante* assessment imposed by the past and current provision regulations, every time a managing authority implements financial instruments, the (fraud, etc.) risk assessment related has never been the object of coordination efforts by EU Institutions, nor has it been the object of cooperation initiatives of some sort. These

coordination efforts include sharing of information with financial supervision regulators and financial intelligence units on risks related to financial intermediates in general or, specifically, to anti-money laundering and terrorist financing.

Having regard to PPP Contracts:

1. PPPs differ from other public (procurement) contracts because the interests of private capital are aligned with those of the public sector. In other words, the economic operator here is not a mere contractor of the public body selected as the beneficiary of co-financing, having opposite interests to those of the contracting authority. Instead, the private partner could be seen as an 'indirect' beneficiary because it participates in the financial effort required for the operation. Consequently, having the private partner a direct interest in the investment return, there could be specific risks associated with its activity that are hardly assessed by managing authorities in the lack of particular drivers/guidelines on the matter. The same conclusion can be reached concerning financial intermediates that may play a fundamental role in co-financing the PPP operation. The risks of illegal activities or conflicts of interest involving the private partner and the lender are quite out of the scope of managing authorities' prevention powers.

Therefore, the same criticisms have been substantially confirmed by the survey outcomes.

In conclusion, it is clear that these are subjects of great complexity and sensitivity; however, the ESI system as a whole seems ready for a further step forward in improving the mechanisms for protecting the financial interests of the Union and, more generally, for European scale. Perhaps the time has come to evaluate the adoption of uniform common standards aimed at the adoption by the Managing and Awarding Authorities of prevention and early detection systems based on the ex-ante assessment of the risks of fraud and other harmful conduct. In our opinion, these new approaches could be seen, maybe in the next future, as binding or conditioning elements to access ESI funds management.

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